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Enexis Holding N.V.

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Enexis Holding N.V.

Major Rating Factors

Corporate Credit Rating
A+/Positive/--

Strengths:

- Low-risk, monopoly electricity and gas distribution networks in the company's license areas.
- Stable and predictable cash flows from regulated revenues under transparent regulatory framework.
- Strengthened financial risk profile owing to recent tariff increases and the postponement of its investment program.

Weaknesses:

- Regulatory reset risk and exposure to incentive-based regulation.
- Potential for further consolidation in the Dutch energy distribution sector.

Rationale

The ratings on Dutch electricity and gas distribution network company Enexis Holding N.V. and its subsidiary Enexis B.V. (jointly Enexis) reflect Standard & Poor's Ratings Services' view of the company's excellent business risk profile and intermediate financial risk profile.

Our assessment of Enexis' business risk profile reflects its natural monopoly status in its license areas, its low-risk regulated electricity and gas distribution network businesses, and its high quality network assets. The majority of Enexis' activities, including its electricity and gas tariffs, are regulated by the Dutch Ministry of Economic Affairs and the Dutch regulator, Energiekamer. These strengths are partly offset by the regulatory tariff reset risk every third year, exposure to incentive-based regulation that can impose challenging efficiency requirements, and the potential for further consolidation in the Dutch energy network sector, in which we anticipate Enexis would take an active part.

The intermediate financial risk profile continues to reflect Enexis' stable and predictable operating cash flow, our view that Enexis' credit metrics have strengthened due to tariff increases for the 2011-2013 regulatory period, and the company's well-spread maturity profile. It also takes into account a sizable capital expenditure (capex) program of about €1.2 billion through 2013, and the risk that investments could increase above our base-case projections due to acquisitions or higher-than-anticipated investments in smart meters.

The 'A+' rating on Enexis is based on the company's stand-alone credit profile (SACP), which we assess at 'a+', and on our opinion that there is a "moderate" likelihood that its owners would provide timely and sufficient extraordinary support in the event of financial distress.

In accordance with our criteria for government-related entities (GREs), our view of a "moderate" likelihood of extraordinary support is based on our assessment of Enexis':

- "Important" role, given its strategic importance to the province and municipality owners, as the monopoly provider of gas and electricity distribution services in its license areas; and

- "Limited" link to the owners, given the dispersed ownership structure. Enexis' owners are the provinces of Noord Brabant (31%), Overijssel (19%), Limburg (16%), Groningen (6%), and Drenthe (2%), as well as other provinces and 116 municipalities in the region.

Key business and profitability developments

Enexis' reported operating profit increased by 40% to €213 million in the first half of 2011, compared with the same period in 2010. We believe that Enexis will be able to sustain this level of earnings given the approved regulated tariffs through 2013 and the company's ongoing cost-saving program. Revenues are also likely to increase as a result of the consolidation of the Dutch gas distribution network operator Intergas that Enexis acquired in May 2011. At the same time, cost savings reduced operating costs by over €22 million in the first half of 2011, and our view is that the cost savings will continue in the near term. We project that Enexis' revenues, excluding further consolidation, will increase by an annual average of 5% through 2013, from €1.2 billion reported in 2010, and that the company's EBITDA margin will reach about 51% by 2013, which compares with less than 47% in 2009 and 50% in 2010.

Key cash flow and capital-structure developments

We believe that Enexis' regulated electricity and gas networks will continue to generate relatively stable and predictable operating cash flows, comfortably covering average annual capex of about €415 million through 2013.

Enexis' free operating cash flow increased by 8% in 2010, to €217 million, and by 39% to €218 million in the first six months of 2011, compared with the same period in 2010, which amply covered the €193 million acquisition of Intergas.

We understand that the consolidation of the distribution network sector in The Netherlands is unlikely to be implemented as quickly as we initially thought. We believe that Enexis will continue to participate in the consolidation of the sector, but that investment will be more spread out over time, thereby limiting the near-term effect on the company's credit metrics. Our view is that, as a result of these developments, Enexis' will be able to sustain Standard & Poor's-adjusted funds from operations (FFO) to debt of more than 20% over the next few years.

Liquidity

We view Enexis's liquidity as adequate under our criteria. Projected sources of liquidity exceed projected uses by about 1.2x in the next 12 months. Liquidity sources mainly comprise operating cash flow and available bank lines. Projected uses mainly comprise capex, debt maturities, and dividends. Enexis' ability to absorb high-impact, low-probability events, with limited need for refinancing; its sound bank relationships; its satisfactory standing in the credit markets; and its generally prudent risk management further support our opinion of its liquidity as adequate. We believe that Enexis will maintain substantial headroom under the financial covenants in its credit facility documentation.

Our assessment of Enexis' adequate liquidity is underpinned by its unrestricted cash and short-term marketable securities of about €276 million as of Sept. 30, 2011, and access to an undrawn €450 million committed credit facility expiring in 2015. We forecast that Enexis will generate gradually higher FFO over the next 12 months, compared with last year (FFO was €480 million for the full-year 2010, and €294 million in the first half of 2011). We further forecast that generated FFO will cover capex of close to €400 million and €106 million in dividend payments, while the accumulated cash balance will largely cover the €450 million loan that expires in September 2012.

Outlook

The positive outlook reflects our view that Enexis will continue to report solid cash flow coverage of debt metrics over the medium term. We believe that an increase in earnings and operating cash flows is likely through 2013, due to pre-approved regulatory tariffs, ongoing cost savings, and the consolidation of Intergas. We also believe it likely that the company's debt-financed capex and investment plans will be lower than we had previously anticipated.

We would consider a one-notch upgrade to 'AA-' if we assess that the company's financial risk profile is likely to have strengthened on a sustainable basis, particularly if the company is able to sustain an adjusted FFO-to-debt ratio of about 25%, while maintaining an unchanged business risk profile.

However, if we believe that the company is likely to recapitalize its balance sheet to be in line with its publicly stated minimum FFO-to-debt ratio requirement of 20%--either through further sector consolidation in The Netherlands, an extraordinary dividend distribution, or negative regulatory intervention--we would likely revise the outlook to stable.

Business Description

Enexis is the second-largest distribution network company in State of The Netherlands (AAA/Stable/A-1+) with a market share of about 31%, including Intergas. The gas distribution network operator Intergas, which Enexis acquired in May 2011, manages the gas network in 21 municipalities in the West Brabant region, adding 3,200 kilometers (km) of gas pipelines and 150,000 customer connections to Enexis' portfolio. Enexis' networks now span 130,000 km of electricity cables and 44,000 km of gas pipelines, delivering electricity to about 2.6 million customers and gas to 2.0 million customers in its license areas. The vast majority of the company's customers are residential.

Government Support And GRE Methodology Impact

In accordance with our criteria for GREs, the 'A+' rating on Enexis is based on the company's SACP, which we assess at 'a+', and on our opinion that there is a "moderate" likelihood that its owners would provide timely and sufficient extraordinary support in the event of financial distress.

We view Enexis' role as "important" for the province and municipality owners because it provides essential public services to the population of its service areas. Enexis owns the electricity and gas meters of every household in the operating region and is the monopoly provider of gas and electricity distribution services.

We assess Enexis' link to the owners as "limited" because of the dispersed ownership structure. As stipulated by the Dutch Independent Network Operation Act, electricity and gas distribution network operators in The Netherlands must be publicly owned. Enexis' owners are the provinces of Noord Brabant (31%), Overijssel (19%), Limburg (16%), Groningen (6%), and Drenthe (2%), as well as other provinces and 116 municipalities in the region.

Business Risk Profile: Excellent; Due To Natural Monopoly And Regulated Revenues

The major supports for Enexis' excellent business risk profile are:

- Monopoly electricity and gas distribution networks in its license areas in the north east and south east of The Netherlands. Following Enexis' acquisition of Intergas in May 2011, and Alliander's acquisition of Endinet in July 2010, there are seven regional network companies in The Netherlands. The three largest, Alliander N.V. (A+/Positive/A-1), Enexis, and Stedin (part of Eneco Holding N.V. [A-/Stable/A-2]) account for 90% of the market. Enexis is the second-largest with a market share of about 31%.
- Regulated revenues under a transparent regulatory framework and limited nonregulated activities. Enexis' electricity and gas tariffs are regulated by Energiekamer. Nonregulated businesses comprise infrastructure installation and maintenance activities, which accounted for less than 10% of revenues in 2010. The Dutch energy regulator has confirmed regulatory tariff increases for all Netherlands-based distribution companies for the 2011-2013 regulatory period, enabling them to cover an increase in costs in the previous period.
- High asset quality and strong operating performance. Measured by the average number of minutes or seconds per year and per customer for which the energy supply is interrupted, Enexis' electricity grid scored 25.1 minutes. This implies a higher reliability than the national average of 33.7 minutes in 2010. The gas networks, however, scored an outage time of 44 seconds per connection in 2010, which was worse than the national average of 29 seconds. Customer satisfaction--as assessed by Enexis' customers in terms of overall service level on a scale of 1-10--continued to strengthen to an average score of 7.6 in 2010, up from 7.5 and 6.7 in 2009 and 2008, respectively.

These supports are partially offset by:

- Regulatory reset risk and exposure to incentive-based regulation. While we consider the current regulatory period, which runs through 2013, to be generally positive for all the Dutch distribution network operators, Enexis is nevertheless exposed to the risk that the regulator makes adverse changes to the regulatory framework or imposes higher efficiency requirements in the next regulatory period from Jan. 1, 2014. In our opinion, a revision of the regulatory framework with a harsher-than-anticipated outcome for 2014-onward--more stringent efficiency measures than are currently anticipated, for instance--would have a detrimental effect on Enexis' revenues, EBITDA, and FFO from 2014.
- Uncertainties remaining about the introduction of the smart meter model, whereby households in The Netherlands would be fitted with a gas or electricity meter. While the mandatory implementation of smart meters has been postponed, and we understand the bulk of investment is likely to be spent from 2015, voluntary installation of smart meters could eventually result in a fairly significant increase in capex beyond our projections. This could adversely affect Enexis' credit metrics, in our view. That said, we understand that capex related to smart meters would be covered by increases in tariffs.

Financial Risk Profile: Intermediate; Improving Cash Flow And Stable Credit Metrics

The main strengths of Enexis' intermediate financial risk profile are:

- Improving and predictable free cash flows from regulated businesses. We anticipate that Enexis' earnings and cash flows will continue to improve through 2013, due to the healthy tariff increases approved by the regulator through the period. The regulator has confirmed negative efficiency requirements, or "x-factors," for Enexis, which result in tariff increases of 6.2% in electricity and 3.4% in gas--plus an adjustment for inflation--through 2011-2013. Last year we assumed very low or slightly negative x-factors for the current regulatory period and forecast revenues to increase by about 2% annually. We have now revised our projections to include an annual 5% revenue increase on average through 2013, excluding acquisitions.

- A moderate and prudent financial policy. Enexis' policy is to maintain leverage below 55% and FFO to debt at about 20%, and we consider that the company's prudent approach will also maintain comfortable headroom on these minimum credit metrics. Also, the dividend policy is relatively moderate, with a dividend payment of 30% of net income in 2010, and 50% thereafter.
- A well-spread maturity profile. The €1,800 million shareholder loan is divided into four tranches due between 2012 and 2019. The 10-year bond contains an equity conversion element, triggered if Enexis breaches regulatory minimum credit metrics or covenants in its loan agreements. However, we understand that interest is nondeferrable, that the trigger levels are substantially below Enexis' expected credit metrics, and that Enexis intends to refinance the shareholder loan tranches on the debt capital market when they fall due. We view the loans as debt in our analysis.

These strengths are moderated by:

- Enexis' investment program, including potential acquisitions or asset swaps linked to further consolidation of the sector and, longer-term, potentially significant investments in smart meters. We project that Enexis' capex plan through 2013 amounts to about €1.2 billion. Maintenance capex accounts for about one-quarter of this plan, and the extension of the network accounts for about one-half of investments. The remainder comprises investments in information technology, installation of smart meters, and other infrastructure-related products.

Financial Statistics/Adjustments

Enexis reports under International Financial Reporting Standards. We make limited adjustments to Enexis' reported figures (see table 1).

Table 1

Reconciliation Of Enexis Holding N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2010--									
Enexis Holding N.V. reported amounts										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	1,926.4	2,963.9	1,204.2	598.2	349.7	98.8	629.1	629.1	78.9	411.8
Standard & Poor's adjustments										
Reclassification of nonoperating income (expenses)	--	--	--	--	9.9	--	--	--	--	--
Reclassification of working capital cash flow changes	--	--	--	--	--	--	--	(70.3)	--	--
Working capital - Other	--	--	--	--	--	--	78.9	--	--	--
FFO - Other	--	--	--	--	--	--	(78.9)	(78.9)	--	--
Total adjustments	0.0	0.0	0.0	0.0	9.9	0.0	0.0	(149.2)	0.0	0.0

Table 1

Reconciliation Of Enexis Holding N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €) (cont.)

Standard & Poor's adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	1,926.4	2,963.9	1,204.2	598.2	359.6	98.8	629.1	479.9	78.9	411.8

Table 2

Enexis Holding N.V. Peer Comparison

	Enexis Holding N.V.	Alliander N.V.	N.V. Nederlandse Gasunie	Enagas S.A.
Ratings as of Nov. 7, 2011	A+/Positive/--	A+/Positive/A-1	AA-/Negative/A-1+	AA-/Negative/A-1+
(Mil. €)	**--Fiscal year ended Dec. 31, 2010--**			
Revenues	1,204.2	1,432.0	1,523.0	1,000.6
EBITDA	598.2	567.1	941.6	780.8
Net income from continuing operations	193.7	222.0	453.7	333.5
Funds from operations (FFO)	479.9	512.9	837.8	654.1
Capital expenditures	411.8	292.8	1,113.2	629.5
Free operating cash flow	217.3	231.1	(202.8)	(0.6)
Dividends paid	78.9	54.0	415.9	185.7
Discretionary cash flow	138.4	177.1	(618.7)	(186.3)
Cash and short-term investments	330.2	0.0	158.5	0.0
Debt	1,926.4	1,721.8	4,981.2	3,203.1
Equity	2,963.9	2,659.0	5,260.8	1,736.2
Debt and equity	4,890.3	4,380.8	10,242.0	4,939.4
Adjusted ratios				
EBITDA margin (%)	49.7	39.6	61.8	78.0
EBITDA interest coverage (x)	6.1	4.8	4.0	7.5
EBIT interest coverage (x)	3.6	2.8	3.3	5.3
Return on capital (%)	7.4	7.5	7.6	11.2
FFO interest coverage (x)	5.9	5.4	4.3	7.3
FFO/debt (%)	24.9	29.8	16.8	20.4
Free operating cash flow/debt (%)	11.3	13.4	(4.1)	(0.0)
Discretionary cash flow/debt (%)	7.2	10.3	(12.4)	(5.8)
Net cash flow/capex (%)	97.4	156.7	37.9	74.4
Debt/EBITDA (x)	3.2	3.0	5.3	4.1
Total debt/debt plus equity (%)	39.4	39.3	48.6	64.8
Return on capital (%)	7.4	7.5	7.6	11.2
Return on common equity (%)	6.7	8.6	7.5	20.1
Common dividend payout ratio (unadjusted; %)	30.0	36.2	40.0	55.7

Table 3

Enexis Holding N.V. Financial Summary

	--Fiscal year ended Dec. 31--			
(Mil. €)	**2010**	**2009**	**2008**	**2007**
Rating history	A/Stable/--	A/Stable/--	--/--/--	--/--/--
Revenues	1,204.2	1,358.1	1,341.9	1,108.0
EBITDA	598.2	632.4	580.2	261.0
Operating income	349.7	399.1	365.5	236.0
Net income from continuing operations	193.7	263.1	147.5	204.0
Funds from operations (FFO)	479.9	453.7	276.4	203.6
Capital expenditures	411.8	414.5	302.3	151.2
Free operating cash flow	217.3	201.4	183.8	(30.9)
Dividends paid	78.9	0.0	0.0	0.0
Discretionary cash flow	138.4	201.4	183.8	(30.9)
Cash and short-term investments	330.2	192.2	2.0	19.0
Debt	1,926.4	1,926.5	2,613.0	3,394.0
Equity	2,963.9	2,849.1	2,236.0	1,512.0
Debt and equity	4,890.3	4,775.6	4,849.0	4,906.0
Adjusted ratios				
EBITDA margin (%)	49.7	46.6	43.2	23.6
EBITDA interest coverage (x)	6.1	7.2	3.0	N.M.
EBIT interest coverage (x)	3.6	4.8	2.0	N.M.
FFO interest coverage (x)	5.9	5.9	2.4	N.M.
FFO/debt (%)	24.9	23.6	10.6	6.0
Free operating cash flow/debt (%)	11.3	10.5	7.0	(0.9)
Discretionary cash flow/debt (%)	7.2	10.5	7.0	(0.9)
Net cash flow/capex (%)	97.4	109.5	91.4	134.7
Debt/EBITDA (x)	3.2	3.0	4.5	13.0
Debt/debt and equity (%)	39.4	40.3	53.9	69.2
Return on capital (%)	7.4	8.8	8.0	5.5
Return on common equity (%)	6.7	10.3	7.9	13.5
Common dividend payout ratio (unadjusted; %)	30.0	30.0	0.0	0.0

N.M.--Not Meaningful.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

Ratings Detail (As Of November 7, 2011)	
Enexis Holding N.V.	
Corporate Credit Rating	A+/Positive/--
Corporate Credit Ratings History	
01-Nov-2011	A+/Positive/--
30-Aug-2011	A/Watch Pos/--
09-Dec-2009	A/Stable/--
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate
Debt Maturities	
On Dec. 31, 2010: 2011: Nil. 2012: €450 mil. 2013: Nil. 2014: €500 mil. Thereafter: €850 mil.	
Related Entities	
Enexis B.V.	
Issuer Credit Rating	A+/Positive/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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