MOODY'S
INVESTORS SERVICE

Credit Opinion: Enexis Holding N.V.

Global Credit Research - 31 Jul 2015

Rosmalen, Netherlands

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Aa3
Senior Unsecured -Dom Curr	Aa3
Enexis B.V.	
Outlook	Stable
Issuer Rating -Dom Curr	Aa3

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Key Indicators

[1]**Enexis Holding N.V.**

	12/31/2014	12/31/2013	12/31/2012	12/31/2011
FFO Interest Coverage	7.7x	5.8x	6.8x	6.5x
Net Debt / Fixed Assets	28.7%	30.6%	32.6%	31.2%
FFO / Net Debt	33.7%	31.9%	31.8%	33.5%
RCF / Net Debt	26.8%	25.5%	25.6%	30.0%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Low business risk underpinned by stable regulated cash flows; limited contribution from unregulated businesses

- Established regulatory framework, but allowed returns will reduce

- Moderate capital expenditure requirements, but proposed asset swap with Alliander will result in additional payment from Enexis to Alliander

- Modest leverage compared with wider peer group supports strong stand-alone credit quality

- Two notches of rating uplift for potential support from government shareholders

Corporate Profile

Enexis Holding N.V. is a holding company of Enexis B.V., which owns and manages the gas and electricity distribution networks in several Dutch regions. Enexis B.V. generates more than 95% of the group's revenue and represents 99% of group assets and liabilities. Moody's rates both Enexis Holding N.V. and Enexis B.V. (together "Enexis") at Aa3 stable. Enexis is one of the three largest electricity and gas network operators in the Netherlands responsible for the maintenance, management and development of the medium-voltage electricity and gas distribution grids. It operates around 136,000 km of electricity cable and 45,000 km of gas pipelines, delivering electricity to approximately 2.6 million customers and gas to 2.1 million customers. Enexis is fully owned by Dutch provinces and municipalities, with the largest owners being the provinces of Noord Brabant (31%), Overijssel (19%), Limburg (16%), Groningen (6%) and Drenthe (2%). The remaining 26% stake is owned by one other small province and approximately 113 municipalities where Enexis provides its network services.

SUMMARY RATING RATIONALE

Enexis's Aa3 rating reflects the low business risk of its domestic electricity and gas distribution operations, which generate more than 90% of its earnings and cash flows, supported by a well-defined and transparent Dutch regulatory framework. The company has historically maintained a conservative financial position relative to European peers. However, we anticipate some decline in Enexis's financial metrics over the current regulatory period, as allowed returns will reduce and the company will have to make an additional payment of around EUR365 million to its peer network operator Alliander N.V. (Aa2 stable) under an asset swap transaction that will become effective on 1 January 2016. Nevertheless, overall leverage will remain modest in the wider European context.

The Aa3 rating incorporates a two-notch uplift from Enexis's stand-alone credit quality, reflecting the likelihood of extraordinary financial support being provided by its owners, and ultimately the Dutch government, if this were ever required.

At Aa3, Enexis's rating is materially higher than those of many of its European peers, whose ratings are generally in the low single-A/high Baa categories, primarily as a result of Enexis's significantly lower financial leverage.

DETAILED RATING CONSIDERATIONS

LOW BUSINESS RISK UNDERPINNED BY REGULATED CASHFLOWS

Enexis's core business activities relate to low risk regulated network operation and management. These activities generate predictable cash flows over the medium term, providing useful visibility on funding requirements.

Enexis's business is focused on the core regulated network activities, with a few exceptions that contribute less than 10% of revenues in aggregate and relate to its Fudura energy services brand as well as public lighting and traffic management services as a joint venture with neighbouring network owner Alliander. We note that these non-regulated business are complementary to the core activities.

ESTABLISHED REGULATORY FRAMEWORK BUT ALLOWED RETURNS WILL REDUCE

The Dutch framework applied since 2000 and 2001 for electricity and gas networks, respectively, allows the country's distribution companies to earn a return on their regulated asset base, adjusted for a consumer price index (CPI) and an efficiency incentive X factor. The regulation incorporates incentives based on a "yardstick" mechanism, which defines the efficiency X and quality Q factors based on industry averages and encourages network companies to improve profitability by outperforming the sector through improved efficiency and increased quality. This approach is typical of peer regulatory regimes in Europe and we consider that the application of the Dutch regulatory methodologies by the regulator, the Authority for Consumers and Markets (ACM), has been transparent and consistent to date.

The current price control period runs from January 2014 to December 2016 and allowed revenues have generally been tightened from those applied during the previous period. Most notably, the weighted average cost of capital (WACC) for network companies will be gradually reduced to 3.6% (pre-tax) in real terms over the three years 2014-2016, from a level of 6.2% previously.

While this new settlement will drive a material decline in allowed returns, Enexis has demonstrated its ability to operate within the bounds of the regulatory return allowance, and to fund comfortably within the cost of debt implied by the return calculation. For the three years 2011-13, Enexis has implemented tariff increases below the maximum revenue allowance; the associated decline in returns under the new allowance will therefore impact Enexis to a lesser extent than its peers. We estimate Enexis's cost of external debt (historically raised at nominal rates ranging between 1.875%-3.375% under the company's EMTN programme) to be lower than the ACM's cost of debt assumption (also gradually reducing to 3.85%) within the allowed return calculations, illustrating Enexis's ability to fund itself within the current regulatory allowances.

The regulator also imposed a series of cost efficiency targets on the networks (the `X-factor'), of around 5% for electricity and 7% for gas annually for Enexis, which will result in an incremental decline in the element of revenue funding of operating costs. Although the base costs have been reset on the basis of average costs in the period 2010-2012, we expect this to be a challenging target to outperform over the price control period.

MODERATE CAPITAL EXPENDITURE REQUIREMENTS, BUT PAYOUT EXPECTED ON ASSET SWAP WITH PEER NETWORK ALLIANDER

Enexis's internal investment plan does not present a challenge in terms of scale or growth ambitions. We expect capital expenditure to gradually increase over the current regulatory period, reflecting the roll out of smart meters, with overall investments (gross of customer contributions) around EUR600-700 million p.a., up from around EUR 500 million p.a. over the past few years.

Furthermore, we expect additional expenditure during 2016 in relation to an asset swap with Alliander, as agreed between the parties by the signing of a sale and purchase agreement in July 2015. The transaction will see Enexis transfer its networks in the Friesland province and the Noordoostpolder area, in exchange for Alliander's network in the Eindhoven and southeast Brabant region (operated Endinet). This is part of the Dutch government's wider policy to arrange network operations along provincial borders.

Alliander's Endinet business serves a larger number of customers (108,000 electricity and 398,000 gas connections) than the Enexis assets to be transferred (combined 79,000 electricity and 223,000 gas connections). Therefore, Enexis will have to compensate Alliander for the larger revenue generation capability of the latter's assets to be transferred by paying an amount of EUR365 million. Depending on the funding of this payment, Enexis's financial metrics may weaken moderately. However, due to the relatively small size of the assets to be swapped when compared with the companies' existing businesses we expect any direct financial implications stemming from the agreement to be modest, and thus unlikely to materially alter either companies' overall credit quality.

MODEST LEVERAGE COMPARED WITH WIDER PEER GROUP SUPPORT STRONG STAND-ALONE CREDIT QUALITY

Similar to its closest peer Alliander, Enexis exhibits a strong financial profile with modest financial leverage when compared with the wider European peer group of energy network companies. Over the medium term, we expect that Enexis's metrics will weaken with the reduction in allowed return, which is itself a reflection of the lower interest rate environment as well as the slightly increased investment requirements from the roll out of smart meters. In addition, the payment to Alliander in relation to the asset swap may also increase indebtedness. Nevertheless, overall leverage will remain modest in the wider European context.

We forecast Enexis to maintain funds from operations (FFO)/net debt in the low to mid-twenties in percentage and net debt/fixed assets below 40% over the medium term. The conservative financial profile is also supported by a comparably modest dividend policy, with a payout ratio of 50%, with an implicit commitment to shareholders to maintain a absolute dividend levels around EUR100 million on a best efforts basis.

TWO NOTCHES OF RATING UPLIFT FOR POTENTIAL SUPPORT FROM GOVERNMENT SHAREHOLDERS

Enexis is fully owned by Dutch regional and local governments, with public ownership of the networks required by current legislation. Therefore, in assessing Enexis's credit quality, we apply our rating methodology for Government-Related Issuers published in October 2014. Our assumption of strong systemic support in the event of need reflects Enexis's strategic importance as a pure network company, and the high reputation risk to its owners. Although ownership of Enexis is relatively fragmented among 119 provinces and municipalities, we perceive the shareholders to be capable and willing to act in conjunction with one another. In determining the probability of systemic support as "strong", we have also taken into account the 72% ownership share of the four largest provinces and their historically proven ability to reach consensus in event of need. Furthermore, in our view, the legal and political mechanisms established in the Netherlands, including the legal requirement for public ownership of distribution network assets, increase the probability of systemic support by the Dutch Government being provided to a strategically important network operator in the event of extraordinary need.

Our assessment of a very high level of dependence (i.e. the degree of exposure to common drivers of credit quality) between Enexis and the Government of the Netherlands reflects our expectation that Enexis, like its owners, will continue to derive all of its revenues from domestic sources.

The above factors result in two notches of rating uplift from Enexis's stand-alone credit quality, expressed as a baseline credit assessment (BCA) of a2.

Liquidity Profile

Enexis's liquidity position is supported by strong cash flow generation from its regulated monopoly network activities and solid cash reserves (EUR206 million at December 2014, including deposits and marketable securities). The company's liquidity position is further underpinned by an undrawn EUR600 million back-up revolving credit facility (RCF) maturing in June 2020 (with the option to extend to 2021). The repayment profile is manageable with EUR850 million of outstanding shareholder loans maturing in 2016 and 2019 and the first bond (EUR500 million) maturing in 2020.

Rating Outlook

The stable outlook reflects our expectation that Enexis will remain a pure electricity and gas distribution network operator that derives most of its revenues and cash flow from regulated activities. This further assumes that the proposed asset swap with Alliander would be transacted at a rate that does not materially impair financial ratios.

What Could Change the Rating - Up

An upgrade of the final rating is considered unlikely at this point in time. Taking into account (1) the latest regulatory settlement with lower allowed return, (2) the ongoing capital requirements with additional smart metering investments; and (3) the payout required in the context of the asset swap with Alliander, we expect Enexis's financial profile to weaken from currently very strong level, albeit remaining in line with our guidance for the current ratings.

What Could Change the Rating - Down

For Enexis to remain safely positioned within its current BCA of a2, we would expect the company to exhibit on a sustainable basis the following minimum credit metrics: an FFO/net debt ratio in the mid to high teens, and leverage on the basis of net debt/fixed assets no higher than the low fifties in percentage terms.

The final rating could also be subject to downward pressure if our assessment of the credit quality of the government of the Netherlands and the associated credit risk of the municipalities and provinces owning Enexis changes or our view of extraordinary support weakens.

Other Considerations

The principal methodologies used in rating Enexis were Moody's "Regulated Electric and Gas networks" rating methodology, published in November 2014 and "Government Related Issuers", published in October 2014. Over the next 12-18 months, we expect Enexis to continue to exhibit a very strong financial profile, but to modestly weaken beyond 2016.

The indicated rating from the regulated networks methodology grid is A1, one notch higher than the assigned a2 BCA.

Rating Factors

Enexis Holding N.V.

Regulated Electric and Gas Networks Industry Grid [1][2]	**Current FY 12/31/2014**			[3]**Moody's 12-18 Month Forward ViewAs of July 2015**	
Factor 1 : Regulatory Environment and Asset Ownership Model (40%)	**Measure**	**Score**		**Measure**	**Score**
a) Stability and Predictability of Regulatory Regime	Aa	Aa		Aa	Aa
b) Asset Ownership Model	Aa	Aa		Aa	Aa

c) Cost and Investment Recovery (Ability and Timeliness)	A	A	A	A
d) Revenue Risk	Aa	Aa	Aa	Aa
Factor 2 : Scale and Complexity of Capital Program (10%)				
a) Scale and Complexity of Capital Program	Baa	Baa	Baa	Baa
Factor 3 : Financial Policy (10%)				
a) Financial Policy	A	A	A	A
Factor 4 : Leverage and Coverage (40%)				
a) FFO Interest Coverage (3 Year Avg)	6.6x	Aa	6x - 8x	Aa
b) Net Debt / Fixed Assets (3 Year Avg)	30.6%	Aa	28% - 33%	Aa
c) FFO / Net Debt (3 Year Avg)	32.4%	Aa	25% - 30%	Aa
d) RCF / Net Debt (3 Year Avg)	25.9%	Aa	18% - 22%	A
Rating:				
Indicated Rating from Grid Factors 1-4		Aa3		A1
Rating Lift	0	0	0	0
a) Indicated Rating from Grid		Aa3		A1
b) Actual Rating/BCA Assigned				Aa3/a2

Government-Related Issuer	Factor
a) Baseline Credit Assessment	a2
b) Government Local Currency Rating	Aaa
c) Default Dependence	Very High
d) Support	Strong
e) Final Rating Outcome	Aa3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures