

Research Update:

# Dutch DSO Enexis Holding Upgraded To 'AA-/A-1+' On Strong Credit Metrics And Supportive Financial Policy; Outlook Stable

February 7, 2024

## Rating Action Overview

- Enexis Holding will receive about €700 million additional revenue over 2024-2026 after the Dutch competition regulator adjusted the allowed remuneration for this current regulatory period. In addition to the €1.3 billion asset disposal proceeds Enexis received in 2022, this supports deleveraging.
- We anticipate a steep increase in capital expenditure (capex) for 2024-2026 (to €1.3 billion-€1.6 billion of annual net capex for 2024-2026 versus €900 million-€960 million for 2022-2023) given the necessary grid upgrades to address the country's congestion issues.
- We expect Enexis to retain some balance-sheet headroom until the next regulatory period, with adjusted funds from operations (FFO) to debt at 18.5%-19.5% in 2026, only slightly down from 19%-21% on average over 2024-2025. Compared with its closest peers, Stedin and Allander, we perceive Enexis' track record in financial policy and a more prudent risk management as supportive of a higher level rating.
- We are therefore raising our long- and short-term ratings on Enexis to 'AA-/A-1+' from 'A+/A-1'.
- The stable outlook reflects that we expect Enexis' FFO to debt to remain above 18% on average in the next two to three years. We also factor in our view of extraordinary support from the central government as moderately likely.

## Rating Action Rationale

**The positive developments around allowed remuneration underpin our view that the regulatory framework for electricity and gas distribution networks in the Netherlands supports our ratings on Enexis.** On Dec. 21, 2023, The Netherlands Authority for Consumers and Markets (ACM) published its final decision on changes in the allowed remuneration, as instructed by a court ruling by the Netherlands' Trade and Industry Appeals Tribunal (CBb) earlier in the year. The CBb ruling prompted ACM to use the average from 2021, instead of from 2018-2020, as a reference to

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determine distribution system operators' (DSOs)' efficient costs and to recalculate the productivity change based on the 2017-2021 period instead of the 2004-2020 period. This translates into more financial flexibility for Enexis and the other two DSOs, Alliander and Stedin. This results in higher revenue of €169 million in 2024, and our estimate of €235 million in 2025 and €295 million in 2026. The change in method decision may also support revenue in the next regulatory period starting 2027 adding to the boost from the update in the base weighted-average cost of capital (WACC) parameters.

**Enexis' likely increase in capex to address congestion issues over 2024-2026 will absorb part of the balance sheet headroom stemming from the regulatory decision.** We forecast Enexis will accelerate its investments at a similar pace to its Dutch peers, to accommodate for a faster energy transition in the Netherlands and address congestion by increasing grid capacity. This translates into a 15%-20% increase in gross capex to €4.6 billion-€4.8 billion over 2024-2026 from €4.0 billion in Enexis' previous capex plan for 2023-2025. We expect Enexis' gradual increase in capex (net of customer contributions) will reach close to €1.3 billion already this year and close to €1.5 billion in 2025-2026, from €950 million in 2023. We also anticipate that the increase will drive consistently negative annual discretionary cash flows of €700 million-€750 million on 2024-2026. Although we think that price inflation is behind a small part of this increase (about 10% of additional capex), we acknowledge that the electricity grid's heightening congestion, as electrification across the country intensifies, is pushing a countrywide need to invest more, and at a quicker pace, into the electricity grid. We believe material hurdles to achieve this high capex plan have eased compared to the beginning of last year, with slower inflation pace, and higher availability of workforce and materials.

**We expect Enexis' credit metrics will remain in line with a 'AA-' rating based on the company's track record of supportive and prudent financial policy.** Under our updated base case, we project funds from operations (FFO) to debt of 18%- 20% over the next two to three years. This is slightly lower than our October 2023 expectation of 20%-21%, on average, and is due to a reduced EBITDA forecast in 2025-2026. Enexis has reiterated its financial policy of maintaining a solid 'A' rating from S&P Global Ratings with a five-year horizon. We recognize Enexis' track record of prudent financial policy and shareholder support, with high anticipation of finding new funding needs to contain leverage. This has been demonstrated with the 2022 disposal of its unregulated Fudura activities, with all but €100 million of the €1.3 billion proceeds being applied to debt reduction. We also view the 50% dividend payout as relatively contained compared with the rest of the sector, and in line with that of Alliander (45%), for instance, while Stedin has a more flexible dividend policy. Finally, we believe Enexis' risk management is more cautious than peers'; for example, it fully hedges energy prices at least a year in advance.

**We continue to view extraordinary support from the central government as moderately likely.** This is in line with the framework agreement that Enexis, together with the other two domestic DSOs Alliander and Stedin, signed with their shareholders and the Dutch government. This legally binding agreement set out the conditions and requirements under which the Dutch state would provide common equity to the companies. We continue to believe that Enexis could benefit from extraordinary government support to enhance its capacity and willingness to meet its financial commitments as they come due, although this is not part of our base case for now. We incorporate our view of government support by applying a one-notch uplift over the 'a+' stand-alone credit profile (SACP) into the 'AA-' rating on Enexis. For more information, see "Dutch Networks Stedin, Alliander And Enexis Ratings Affirmed On Government Support; Enexis Outlook Revised To Positive," published on Feb. 14, 2023.

## Outlook

The stable outlook on Enexis reflects that we expect the company to post average FFO to debt of above 18% in 2024 and 2025, after spiking to about 30% in 2022 due to the exceptional cash-in of the Fudura sale.

Although Enexis has incremental debt needs due to an intensive capex program as part of the Dutch government's energy transition plan, we expect the company to maintain an FFO-to-debt ratio sustainably above the 18% threshold for the current rating. We expect that the effects of volatile energy costs and higher inflation will be manageable for Enexis, thanks to the hedging in place and cost recovery throughout the regulatory framework, which we perceive as very supportive.

## Downside scenario

We could downgrade Enexis if the company's FFO to debt were to decline and remain below 18%, which could stem from:

- A higher-than-expected increase in debt from additional capex versus our expectations; or
- Higher shareholder distributions.

Coupled with:

- No timely and sufficient implementation of remedial measures from its shareholders or the Dutch state.

We would downgrade the company if we considered the likelihood of support from the state had weakened.

## Upside scenario

All else equal, an upgrade of Enexis long-term issuer credit rating would require a two-notch upgrade of Enexis SACP to 'aa' from 'a+', which we deem unlikely.

## Company Description

Enexis installs, maintains, operates, and develops distribution grids for electricity and gas in the Netherlands. Through its main subsidiary, Enexis Netbeheer B.V., the company's electricity grid covers 144,200 kilometers (km) with 2.9 million connection points (cps), while its gas grid covers 46,200 km with 2.3 million cps, making it the second largest Dutch DSO after Alliander (as of year-end 2022).

Through its network, the company provides electricity and gas in the Dutch provinces of Groningen, Drenthe, Overijssel, Noord-Brabant, and Limburg. After the Fudura sale, less than 5% of Enexis' revenue is derived from other utility services. These nonregulated businesses are complementary to the core activities. Enexis is owned by the Provinces of Noord-Brabant (30.8%), Overijssel (19.7%), Limburg (16.1%), and Groningen and Drenthe (9%), and the rest is owned by 86 smaller municipalities.

## Our Base-Case Scenario

### Assumptions

- Real GDP growth in the Netherlands of 0.9% in 2024, 1.4% in 2025, and 1.4% in 2026, after a slowdown at 0.4% in 2023. We expect limited impact from the economic situation on Enexis' activities, due to its majority-regulated nature.
- Easing inflation levels, with consumer price index growth at 4.5% in 2023, 3.3% in 2024, and 2.4% in 2025. The Dutch regulatory framework allows for yearly indexation of the tariffs to inflation.
- Over the 2022-2026 regulatory period, nominal pretax WACC for the gas grid increasing to 3.7% from 3.3%, and inflation-adjusted pretax real WACC for the electricity grid increasing to 2.75 % from 2.22% in 2022.
- We forecast revenue growth of around 15% in 2023, 29% in 2024, 15% in 2025, and 6% in 2026 mainly due to cash settlements for change in allowed revenue calculation, regulated asset base growth, subsequent adjustment for inflation and grid losses, that result in electricity and gas tariff increases.
- The rise in energy prices for grid losses completely hedged for current year and partially hedged thereafter.
- Adjusted EBITDA margin of about 32%.
- Net average capex of about €1.3 billion-€1.5 billion annually over 2024-2026, driven by the energy transition target in the Netherlands and the requirement to expand Enexis' electric grid (connecting new renewable projects to the grid) as well as grid replacement and digitalization.
- Customer contributions netting capex of around €135 million per year.
- A dividend payout ratio of 50% of recurring net income. Extraordinary dividend of €100 million in 2023 following the Fudura sale.

### Key metrics

#### Enexis Holding N.V.--Key Metrics\*

(Mil. €)	--Fiscal year ends Dec. 31--					
	2021a	2022a	2023e	2024f	2025f	2026f
EBITDA	732	712	500-530	780-820	1,050-1,100	1,060-1,110
Capital expenditure	763	898	950-970	1,100-1,300	1,400-1,700	1,400-1,700
Free operating cash flow	(148)	(223)	(530)-(580)	(570)-(620)	(500)-(550)	(680)-(730)
Dividends	80	105	170-200	30-40	100-150	150-200
Discretionary cash flow	(229)	(328)	(730)-(780)	(600)-(650)	(600)-(650)	(880)-(930)
Debt	3,037	1,965	2,600-2,800	3,200-3,500	3,800-4,200	4,800-5,200
Debt to EBITDA (x)	4.1	2.8	5.2-5.4	4.0-4.4	3.6-4.0	4.4-4.8

## Enexis Holding N.V.--Key Metrics\* (cont.)

(Mil. €)	--Fiscal year ends Dec. 31--					
	2021a	2022a	2023e	2024f	2025f	2026f
FFO to debt (%)	20.7	31.4	16.0-18.0	18.0-20.0	20.0-23.0	16.0-20.0

\*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

## Liquidity

We continue to assess Enexis' liquidity as adequate, based on our expectation that the company's sources will exceed its uses by about 1.1x over the 12 months started Dec. 31, 2023, despite increasing capex needs and debt maturities. We believe that the company could withstand a 10% drop in EBITDA. Our assessment captures qualitative factors such as Enexis' prudent risk management (including a swift refinancing or extension of the revolving credit facility maturing in December 2025), reflected in its hedging strategy, and its diverse sources of funding. We expect the metric to be met beyond 2024, despite negative discounted cash flow, via proactive refinancing.

We also believe that Enexis has a high standing in the credit markets. For instance, in June 2023, the company issued a 3.625% €500 million green bond.

Principal liquidity sources for the 12 months started Dec. 31, 2023:

- Unrestricted cash and short-term marketable securities of €127 million as of Dec. 31, 2023.
- New €500 million loan agreement with the European Investment Bank with a three-year drawdown period up to December 2026.
- Projected cash FFO of about €665 million.
- Principal liquidity uses over the same 12-month period:
  - Capex of about €1.1 billion-€1.2 billion.
  - Dividend distributions of about €30 million-€40 million.

## Environmental, Social, And Governance (ESG)

ESG factors have an overall neutral influence on our credit rating analysis of Enexis. The company is one of the most relevant stakeholders for the Dutch government to deliver on its energy transition objectives. Its pivotal role entails collaborating with Dutch local governments, industries, and communities to integrate new renewable capacity into its grid while managing congestion. We believe this will stimulate Enexis' electricity grid deployment by expanding its regulatory asset base over the next decade. In our opinion, the critical role of its electricity infrastructure more than compensates for the more uncertain long-term prospects of its gas grid, as the country strives to phase out gas by 2050 and embrace renewable gases.

Given the sharp rise in power and gas prices, political scrutiny on affordability remains high in Europe. Although we consider that there could be negative government intervention in the sector, we believe any potential negative impact is amply covered by a supportive regulatory framework.

## Issue Ratings--Subordination Risk Analysis

### Capital structure

As of Dec. 31, 2022, Enexis reported total interest-bearing liabilities of €3.1 billion, of which €2.5 billion corresponded to euro medium-term notes and €500 million to a convertible shareholder loan. The remainder comprised a private loan and lease liabilities.

### Analytical conclusions

We rate Enexis' senior unsecured debt at the same level as the issuer credit rating, at 'AA-', since we perceive no subordination risk that could result in a material credit disadvantage for bondholders. Enexis is the holding company of the key operating company Enexis Netbeheer. Most of debt is placed at the holding company level.

### Ratings Score Snapshot

Issuer Credit Rating	AA-/Stable/A-1+
Business risk:	Excellent
Country risk	Very low
Industry risk	Very low
Competitive position	Excellent
Financial risk:	Intermediate
Cash flow/leverage	Intermediate (Low volatility table)
Anchor	a+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	a+
Related government rating	AAA/Stable/A-1+
Likelihood of government support	Moderate (+1 notch)

### Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

**Related Research**

- Dutch DSO Alliander 'A+/A-1' Ratings Affirmed; Outlook Stable; Off CreditWatch Positive On Capex Increase, Feb. 2, 2024
- Industry Credit Outlook 2024: EMEA Utilities, Jan. 9, 2024
- Benelux, France, Italy, Iberia: Energy Transition Shapes Credit Quality, Jan. 8, 2024
- ACM's Positive 2024 Tariff Decision Will Test Dutch DSOs' Financial Policies, Dec. 6, 2023
- Enexis Holding N.V., Nov. 3, 2023
- Utilities Handbook 2023: Western Europe Regulated Power, Oct. 18, 2023
- Dutch Electricity And Gas Transmission And Distribution Framework: Supportive, March 7, 2023
- Dutch Networks Stedin, Alliander And Enexis Ratings Affirmed On Government Support; Enexis Outlook Revised To Positive, Feb. 14, 2023

**Ratings List**

**Upgraded;**

	To	From
<b>Enexis Holding N.V.</b>		
Issuer Credit Rating	AA-/Stable/A-1+	A+/Positive/A-1

**Enexis Netbeheer B.V.**

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Issuer Credit Rating	AA-/Stable/--	A+/Positive/--
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**Upgraded**

**Enexis Holding N.V.**

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Senior Unsecured	AA-	A+
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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