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Research Update:

Eneco Beheer Downgraded To 'BBB+' After Unbundling Requirements Confirmed; Outlook Stable

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Overview

- On Nov. 1, 2016, the Court of Amsterdam confirmed the requirement for Dutch multi-utility Eneco Holding N.V. (Eneco) to unbundle by January 2017.
- Eneco has announced that it plans to implement unbundling by spinning-off its non-network activities to N.V. Eneco Beheer (Beheer), while leaving Stedin Netbeheer B.V. in charge of regulated networks.
- We are therefore resolving the CreditWatch negative and assessing Beheer as if the unbundling had already happened, as we cannot see a scenario where it would not.
- We understand that the new group will be significantly less leveraged than Eneco pre unbundling, however, Beheer's business risk will be weaker as it will not benefit from any regulated activities. As a result, we are lowering the rating on Beheer to 'BBB+' from 'A-'.
- The stable outlook reflects the financial headroom and liquidity we expect the company to have post unbundling.

Rating Action

On Nov. 24, 2016, S&P Global Ratings lowered its long-term corporate credit rating on Eneco Beheer N.V. (Beheer) to 'BBB+' from 'A-'. At the same time, we affirmed our 'A-2' short-term rating. The outlook is stable.

Rationale

The downgrade follows the confirmation by the Court of Amsterdam that the company must unbundle its regulated network from the rest of its activities by Jan. 31, 2017. As previously disclosed by the company, Eneco Holding (Eneco) and Stedin Netbeheer B.V. will hold the network activities and Beheer will operate the non-network businesses, including mainly power generation and supply and energy services.

Beheer's activities will consist of renewable energy (about 47% contribution to its approximately €400 million EBITDA); supply (around 22%) district heating business (approximately 16%); and gas fired generation (around 12%). We currently view the European power market conditions as very challenging. We believe, however, that Beheer's business risk will be supported by its strong portfolio of renewable energy in supportive jurisdictions, as well as district heating and cooling activities that together contribute to a majority of the EBITDA contribution. We also understand that the company's hedging strategy in its generation activity prevents excessive cash flow volatility. In addition, we have seen a relatively low churn rate in Eneco's retail activity and we expect the company to maintain its market share. This compensates, to some extent, for the continuous competitive pressure in its supply and energy service activities and the group's limited size compared with European peers.

We anticipate that Beheer should be able to maintain a modest financial risk profile based on a funds from operations (FFO)-to-debt ratio of above 50%, which would be commensurate with a 'BBB+' rating.

We have also revised our assessment of the likelihood of government support for Beheer to low from moderate, although the ownership structure will remain unchanged.

In accordance with our criteria for government-related entities, our view of a low likelihood of timely and sufficient extraordinary support is based on our assessment of Beheer's:

- Limited importance, given that its activities could be performed by a private company; and
- Limited link with the owners given the dispersed ownership structure. Eneco's owners are the municipalities of Rotterdam (31.7%), The Hague (16.5%), Dordrecht (9.1%), and 52 other small local authorities, each with less than 4% ownership.

In our base case, we assume:

- Sustainable EBITDA contribution from wind and heating and cooling divisions.
- Increased wind capacity supports cash flow generation, subject to their respective regulatory regimes.
- Sustained contribution from the heating and cooling division.
- Reduced contribution from gas-fired generation.
- Sustained contribution from supply activities.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt above 50% on a sustainable basis.
- Strongly negative operating cash flow after capex.

Liquidity

The short-term corporate credit rating is 'A-2'. We assess Beheer's liquidity position as adequate, reflecting our view that the company will put in place an adequate financing arrangement post unbundling, in particular ample credit facilities.

Post unbundling, we understand that Beheer will have access to at least a €500 million facility maturing in October 2018 and a €300 million bridge facility maturing in August 2017, which, together with FFO of about €320 million-€360 million, should finance capex of about €440 million-€450 million annually and limited short-term debt maturities.

Pre unbundling, on a consolidated basis, we anticipate the following principal liquidity sources over the next 12 months:

- Access to cash and cash equivalents of approximately €239 million as of June 30, 2016;
- Access to €1.25 billion in an undrawn committed credit facility expiring in October 2018; and
- FFO of about €700 million according to our base-case scenario.

We anticipate the following principal liquidity uses over the same period:

- Capex of about €700 million annually;
- Repayment of short-term debt of approximately €225 million until the second quarter of 2018; and
- Shareholder distributions of 50% of net income.

Outlook

The stable outlook on Beheer reflects the financial headroom we expect the company to have post unbundling. We understand that the company will embark on a significant capex program to increase the size of its renewable fleet and maintain its heating networks while generating stable cash flow from other existing activities. The current rating assumes that Beheer will maintain FFO to debt above 50%, on average, while generating significantly negative free operating cash flows but maintaining prudent hedging strategy, therefore reducing cash flow volatility.

Downside scenario

The rating could come under pressure if the company struggled to maintain FFO to debt above 50% on a sustainable basis. We could also lower the rating if our assessment of Beheer's business risk profile became more unfavorable, for example if the heating and cooling networks failed to deliver stable cash flows; if the output of the wind fleet was much lower than currently anticipated, for example due to operational issues; or if the company lost significant market share in its retail activities.

Upside scenario

Upside is currently limited for Beheer as it will depend on the execution of the current strategy, which will not be delivered before 2019. We could consider an upgrade if ratios improved clearly such that we expected FFO to debt to rise well above 60% on a sustained basis and the company was still able to invest in its asset base.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Stable/A-2

Business risk: Satisfactory
- Country risk: Very Low
- Industry risk: Moderately High risk
- Competitive position: Satisfactory

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers
- Diversification/Portfolio effect: Neutral
- Capital structure: Neutral
- Liquidity: Adequate
- Financial policy: Neutral
- Management and governance: Satisfactory
- Comparable rating analysis: Neutral

Stand-alone credit profile: bbb+
- Sovereign rating: NR (local municipalities)
- Likelihood of government support: Low

NR--Not rated.

Related Criteria And Research

Related Criteria

- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry - March 28, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010

Related Research

- Research Update: Eneco Beheer Rating On Watch Negative; Eneco Holding Rating Affirmed After Further Disclosure On Likely Unbundling Plans, Sept. 20, 2016
- Research Update: Netherlands-Based Delta And Eneco Ratings Affirmed After Dutch Regulator's Announcement About Potential Unbundling Dates, Dec. 17, 2015

Ratings List

Downgraded; Removed From CreditWatch

	To	From
N.V. Eneco Beheer		
Corporate Credit Rating	BBB+/Stable/A-2	A-/Watch Neg/A-2

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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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.