

Research Update:

Dutch Integrated Utility Company Eneco N.V. Affirmed At 'A-/A-2'; Outlook Stable

October 26, 2023

Rating Action Overview

- For its financial year ending March 31, 2024, Eneco N.V.'s credit metrics will go below our threshold for the rating as net debt peaks, but we expect S&P Global Ratings-adjusted funds from operations (FFO) to debt to remain consistently higher than 45% in 2024-2026.
- The company will invest €1.8 billion in its renewable assets over 2024-2026 and retains a strong position in its core markets while focusing on its strategy to remain a leading player in targeting climate neutrality by 2035.
- We have affirmed our 'A-/A-2' long- and short-term ratings on Eneco N.V. (Eneco).
- The stable outlook on Eneco reflects that on its main shareholder, Mitsubishi Corp., and our forecast of adjusted FFO to debt to staying higher than 45% except for the 2023 fiscal year.

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Rating Action Rationale

The temporary dip in FFO to net debt for financial year ending March 31, 2024, reflects conservative reverse flow collateral or variation margins. We forecast net debt to increase substantially to €1.5 billion –€1.6 billion, from €893 million as of March 31, 2023, and then remain at €1.4 billion–€1.5 billion in fiscal years 2024-2025. The increase reflects the reversal of collateral margins received in the 2022 calendar year on the back of extraordinarily high gas TTF (Title Transfer Facility) prices and favorable variation margins received on the group's large, contracted gas hedges. We expect that, as energy prices stabilize and existing positions go into delivery, Eneco will suffer negative working capital flows from reverse margins of €600 million–€700 million in fiscal year 2023. Consequently, FFO to debt will drop to 40%-45% from 99% in 2022 (15-month results). From 2024 onward, we expect debt to stabilize and FFO to net debt to be supported by EBITDA growth, assuming no significant margin requirement affects the group's cash flows. We forecast that FFO to debt will increase gradually and exceed 45% over 2024 and 2025.

Eneco's change in fiscal year to March from December increases its net debt due to the seasonality of operational working capital but has no impact on overall credit quality. We understand this change was prompted by Eneco's shareholder Mitsubishi's move to synchronize

both companies' reporting cycle. From fiscal year 2023 (ending March 31, 2024) net debt will therefore be structurally higher, since Eneco's net working capital is more negative at the end of December than at the end of March. This is mainly due to payments by Eneco's retail and small and midsize enterprise customers being spread evenly over the year, while it sources and pays in the wholesale market based on actual offtake, which is much higher in the winter. Eneco's B2B (business to business) portfolio also affects this seasonal net working capital swing because B2B customers on average consume more gas during the winter months. We note that working capital swings can be influenced by absolute price levels for power and gas as well as by weather conditions. These swings are part of Eneco's business cycle and, in our view, the change in fiscal year end does not affect Eneco's credit quality because it doesn't change the group's economic reality. We now expect Eneco to post adjusted FFO to debt higher than 45%, after 50% previously, which is our threshold for a 'bbb+' stand-alone credit profile and a rating of 'A-'. We understand that seasonality in Eneco's working capital swing between December and March could be bigger than 5% FFO to net debt and we will monitor the drivers behind this if that is the case.

Eneco's fiscal-year 2022 earnings were affected by a few one-off items but we expect low-risk activities to contribute 45%-55% of the total over fiscal years 2023-2025. In a normal year, Eneco's low-risk segments contribute about 50% of Eneco's EBITDA. The group's earnings quality benefits from subsidized renewable power generation in the Netherlands, Belgium, and U.K., which provide a floor price, guaranteed return, or a feed-in tariff, respectively, depending on the location, for a period of 12 to 19 years, from the start of operations. In addition, the company's district heating activities provide further earnings visibility, since this business has some characteristics of a regulated business, such as steady tariff structures and monopoly-like regional operations (around 12% of EBITDA). We estimate these segments will account for 45%-55% of Eneco's EBITDA over the next two-to-three years and add visibility and stability to the company's cash flows. In 2022, EBITDA from low-risk segments accounted for only 31% of the total, due to exceptional performance of Eneco's trading business, low wind yields; the inframarginal revenue cap reducing the renewable EBITDA contribution; higher performance of the retail activities; and part of the capital expenditure (capex) of the offshore Maasvlakte 2 wind farm that was not capitalized but expensed.

Eneco continues its strategic path with a focus on expanding its renewable capacity. Eneco is vertically integrated, with about 68% of the electricity it supplies coming from its own or long-term contracted renewable assets. By March 31, 2026, Eneco targets an increase of its green energy capacity, by about 1 gigawatts (GW) to 3.1GW from 2.1GW as of March 31, 2023. To achieve this, the company is investing over €1.8 billion in capex over FY2024-FY2026 with about 50% to be invested in wind and solar. Notable offshore wind projects include Hollandse Kust Nord and West (both joint ventures with Shell). Maasvlakte 2, which is now fully operational, is Eneco's first subsidy-free wind park. We expect Eneco to continue focusing on the Netherlands, Belgium, and Germany for new wind capacity, since a customer base can help mitigate merchant risk, thereby reducing portfolio risk. In addition, the company is targeting one million additional customer contracts and targeting a 6% return on average capital employed. Eneco is aiming to increase its renewable asset base significantly in Germany in the coming years through 100%-owned Lichtblick, mainly focusing on investments in solar and wind assets; this project, and all other renewable asset investments in Germany, are excluded from the solar and wind capex figures. Eneco's growth ambition in Germany in renewables will also result in an increase in the contribution of low-risk activities to EBITDA in the future. Eneco is also installing a 50 megawatt hour (MWh) battery with 4 hours of withdrawal capacity, resulting in total energy storage capacity

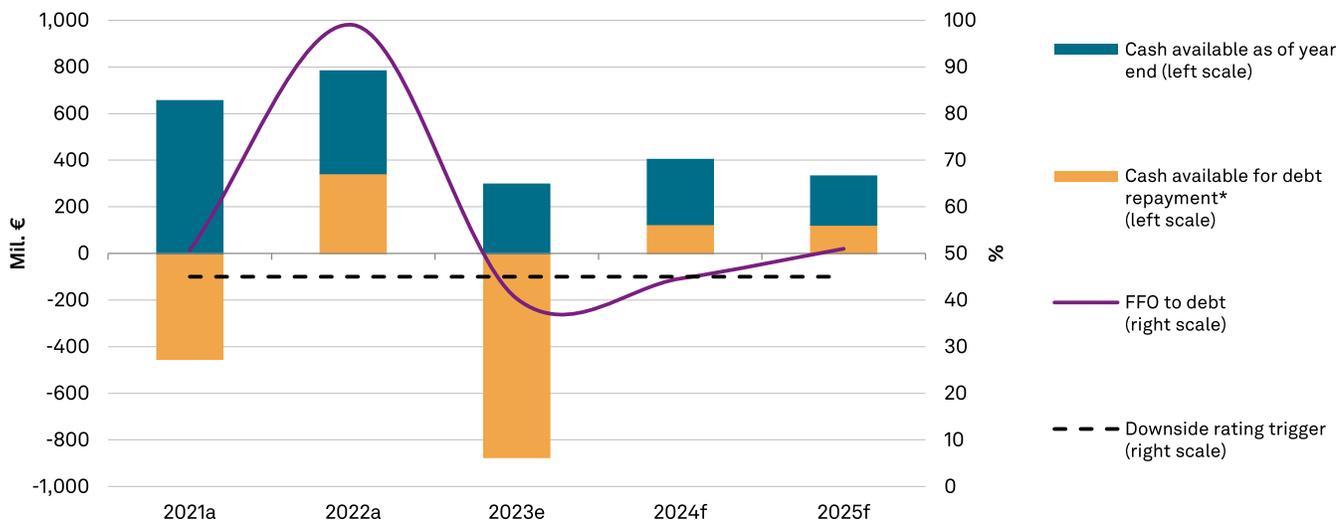
of 200 MWh in Wallonia, Belgium, with the aim of commissioning the project by the end of 2024.

We see merchant exposure in Eneco's renewable fleet moderately increasing over the medium term, but believe risk-management policies will mitigate this risk. As of March 31, 2023, close to 80% of Eneco's renewable capacity benefits from subsidy schemes, 10% has expired subsidies, and the remaining 10% no subsidies. We expect subsidized capacity will decline gradually to 55%-60% by fiscal year ending March 31, 2028, as subsidies expire at some plants and new subsidy-free capacity starts operations. At the same time, Eneco expects additional subsidies to be granted, adding 20% of subsidized capacity until fiscal year 2028; therefore, only moderately adding merchant exposure. Also, in our opinion, a stronger political commitment to the energy transition in Europe, which aims to double renewable capacity by 2050, is creating conditions for increased investments in renewables and therefore competition. This trend could potentially pressure the price of corporate purchase power agreement (CPPAs) and represent a medium- to long-term risk, particularly because we expect Eneco's new capacity will come increasingly from subsidy-free tenders. We believe both trends will increase Eneco's exposure to power prices over the medium term.

However, we perceive Eneco's risk-management policies as prudent since the company hedges all of its price exposure over a period of at least three years, currently until fiscal year ended March 31, 2026. This compares with what we believe is the industry's common practice of hedging about 100% in the current year, about 75% the second year, and about 50% the third year. In addition, the company's long-term CPPAs, which have an average residual tenor of 10 years-15 years, in its subsidy-free capacity portfolio mitigate investment recovery risk by providing contractual certainty with creditworthy offtakers. For example, Eneco closed a 25-year CPPA with the Dutch government for capacity at Maasvlakte 2, which is now fully operational. Also, Eneco reached a long-term agreement with Amazon.com Inc. for 130 MW of the 150 MW capacity to be operational by 2023 at the still to be built Hollandse Kust Noord, and a 50 MW 15-year CPPA with KPN at Hollandse Kust West. Moreover, we believe Eneco has accumulated significant expertise over the past decade developing offshore wind capacity, which we expect will provide it with a competitive edge when managing cost and development risks.

We forecast FFO to debt to remain above the downside rating trigger except in 2023, thanks to moderate EBITDA growth and positive FOCF. We expect EBITDA will increase to €800 million-€820 million by 2025 by a compound annual growth rate of 9% over 2023-2025 compared to €740 million in 2022. This will be mainly due to better-than-expected performance of Eneco's trading arm Eneco Energy Trade on the back of spark-spread development and a reserve capacity contract with the network regulator. The increase also comes from new renewable capacity coming online and efficiency savings through digitalization. As a result of expected collateral margin positions and flow of working capital compared to year-end March 31, 2023, annual free operating cash flow (FOCF) will be negative €650 million-€700 million and credit metrics will deteriorate towards the fiscal year ending in 2024. However, over fiscal years 2024-2025, we forecast strong FOCF of €300 million-€320 million, based on good cash conversion, nonrecurrence of government measures implemented in 2022 to cover the consumer price cap, and contained shareholder distributions of €120 million-€180 million per year over 2024-2025 after peaking in in 2023 due to high profit in the same fiscal year. We also note that Eneco's net debt position incorporates €412 million of nonrecourse project finance debt, which is not the common accounting practice in the sector. All in all, we forecast that Eneco can keep FFO to debt at 45%-50% over fiscal years 2024-2025 while expanding its renewable fleet, due to a supportive financial policy.

Eneco N.V.--Tight headroom under FFO-to-debt threshold in forecast years due to seasonal working capital swings



Source: All figures adjusted by S&P Global Ratings. FFO--Funds from operations. a--Actual. e--Estimate. f--Forecast. Year-end is Dec. 31 for 2021. For 2022, the year runs from Jan. 1 to March 31, 2023. 2023e runs from April 1, 2023 to March 31, 2024, and so on. Cash available for debt repayment = operating cash flow less capital expenditure, acquisitions, dividends, and other minor cash adjustments. Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

Eneco's financial policy remains aligned with a stand-alone credit profile (SACP) assessment of at least 'bbb'. considering the financial policy agreed when Mitsubishi acquired Eneco in 2020.

This policy includes a dividend payout ratio of 50% of the previous year's net income, which we expect will continue. Moreover, we expect shareholders will remain supportive of Eneco's credit quality. Our rating on Eneco benefits from a one-notch uplift for support, since we anticipate that Eneco's main shareholder, Mitsubishi (A/Stable/A-1) has the willingness and ability to provide extraordinary financial support. In addition, we expect Eneco's shareholders will uphold its historically prudent financial policy.

Outlook

The stable outlook on Eneco reflects that on its main shareholder, Mitsubishi. In addition, we expect Eneco's subsidized or long-term contracted renewable capacity and district heating operations will continue to deliver stable cash flows, underpinning the group's credit quality. We also believe Eneco can sustain FFO to debt of 45%-60% while expanding its renewable fleet, due to a supportive financial policy. "As such, we expect Eneco's metrics to remain within the range for the 'bbb+' SACP.

Downside scenario

We could downgrade Eneco if the credit quality of its main shareholder deteriorates.

A downgrade would also result from a more aggressive capex program or unexpected M&A activity that results in FFO to debt dropping below 45%. This could also occur, for example, if the output of the wind fleet was much lower than currently anticipated; if the company lost significant market share in its retail activities; or if the group experienced significant negative margin call requirements on its trading portfolio.

Upside scenario

Rating upside is limited, given that improvement of Eneco's SACP to 'a-' would not result in an upgrade, since we cap group support at one notch below the long-term rating on Mitsubishi, given Eneco's strategic relevance to its new majority shareholder.

We could revise our assessment of Eneco's SACP upward over the next 12-24 months if Eneco posts FFO to debt consistently above 60% and maintains a financial policy that supports the metric at such levels.

Company Description

Eneco (formerly N.V. Eneco Beheer) is headquartered in Rotterdam, The Netherlands. Eneco generates electricity from onshore and offshore wind and solar parks in the Netherlands, Belgium, Germany, and the U.K. It also provides heating and cooling services in the Netherlands. Together, these activities accounted for close to 30% of EBITDA, as of fiscal year 2022.

About 8%-13% of the group's EBITDA comes from gas-fired generation and storage, which Eneco uses to balance generation from renewable assets. The rest of the company's EBITDA comes from commercial activities, which include energy retail (about 20% of EBITDA for fiscal year ending March 31, 2023), trading (about 40%), and other energy services.

Eneco is the Netherlands' third-largest energy supplier with 3.3 million customer contract, No. 3 in the Flanders region with 1 million contracts, and, since 2017, has also been a niche participant in Germany's renewable energy supply market through its acquisition of Lichtblick SE and E.ON Heizstrom, together accounting for about 0.9 million customer contracts.

Since March 25, 2020, the group is fully owned by a consortium in which Mitsubishi owns 80%, and Chubu Electric the remaining 20%.

Our Base-Case Scenario

Assumptions

- EBITDA from subsidized renewable generation and district heating increasing to 55% in fiscal year 2025 (ending March 31, 2026) from 44% in fiscal year 2023.
- Continued long-term hedging approach to manage commodity price risk, with no exposure (100% hedged) to power prices until fiscal year 2026.
- Focus on digitalization and synergies resulting in increasing margins, supporting EBITDA and

FFO.

- Ongoing market leadership as an integrated player in Belgium, Netherlands, and Germany, despite competitive pressures on retail business.
- Investment focus on increasing owned renewable capacity to about 3.1GW by fiscal year 2025 from 2.1GW currently, which translates into capex of about €550 million-€600 million in fiscal year 2023, €550 million-€600 million in fiscal year 2024, and €600 million each year thereafter.
- Initial margin to remain at €200 million.
- Working capital outflow of €650 million-€700 million related mainly to variation margins received on existing positions that flow back to the exchange in the fiscal year ended March 31, 2024.
- Dividend distributions of about 50% of the previous year's net income.

Key metrics

Eneco N.V.--Forecast summary

Industry sector: Electric utility

Mil. €	2021a	2022a	2023e	2024f	2025f
EBITDA	588	989	730-750	770-790	820-840
Funds from operations (FFO)	513	884	620-640	650-670	700-720
Capital expenditure (capex)	380	617	550-600	550-600	550-600
Free operating cash flow (FOCF)	(338)	477	(660)-(680)	310-330	290-310
Debt	1,013	893	1,500-1,600	1,400-1,500	1,400-1,500
Adjusted ratios					
Debt/EBITDA (x)	1.7	0.9	2.0-2.5	1.5-2.0	1.5-2.0
FFO/debt (%)	50.7	99.0	40-45	44-49	48-53
FOCF/debt (%)	(33.4)	53.4	(40)-(45)	20-25	20-25

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. 2021a--1 Jan 2021 to 31 Dec 2021. 2022a--1 Jan 2022 to 31 Mar 2023. 2023e--1 Apr 2023 to 31 Mar 2024. 2024f--1 Apr 2024 to 31 Mar 2025. 2025f--1 Apr 2025 to 31 Mar 2025.

Liquidity

The short-term rating on Eneco is 'A-2', reflecting our 'A-' long-term issuer credit rating and our assessment of liquidity as adequate, supported by its cash position as of June 30, 2023. The company's access to four committed revolving credit facilities (RCFs) also enhance liquidity. We believe these sources will support Eneco's expansion phase, which we believe will intensify up to 2024 to achieve strategic goals. We expect Eneco to maintain a sources-over-uses ratio well above 1.2x over the next 12 months.

Although Eneco's quantitative characteristics that align with a stronger liquidity assessment, our view of qualitative factors prevents us from assessing it as such. We believe the currently very high liquidity sources are only temporary since the company will cancel some of its unused liquidity

lines after the winter of 2023-2024.

In September 2022, Eneco signed a €2.5 billion committed working capital facility with its main shareholder, Mitsubishi. Even though, we do not include it in our calculation, it will boost Eneco's liquidity sources for the next 12 months. We understand this facility has a five-year tenor and will be used for regular working capital needs. We also exclude from our calculation the €750 million working capital facility maturing in December 2024.

Principal liquidity uses

- Cash and liquid investments of about €418 million as of June 30, 2023.
- Undrawn committed credit lines of €1.25 billion maturing in June 2026.
- Projected cash FFO of about €590 million over the next 12 months.

Principal liquidity uses

- €50 million of maturities related to nonrecourse project finance debt in the next 12 months.
- Working capital outflows of about €245 million.
- Capex of about €565 million.
- Acquisitions of about €28 million.
- Dividend distributions of about €156 million.

Covenants

Eneco has no covenants under its bank facilities.

Environmental, Social, And Governance

Environmental factors are a positive consideration in our credit rating analysis of Eneco. The company was one of the first to use renewable energy in the Netherlands (6.3GW of owned and controlled renewable capacity as of 2022), which has provided the company with a large, subsidized portfolio, resulting in stable and predictable cash flows. Moreover, Eneco is one of the largest district heating providers in the Netherlands, a business that is poised for growth given that the central government intends to decarbonize its heating base from currently more than 90% gas use. This will provide Eneco with a stable and increasing source of cash flows, which we see as an advantage from a credit perspective. As part of its strategy, Eneco aims to be carbon neutral by 2035. This entails Eneco's own activities, and the energy supplied to its customers, meaning that the strategy's reach covers scope 1, 2, and 3 emissions. As of 2022, Eneco emits about 1.4 million tons of scope 1 and scope 2 CO₂-equivalent emissions (10 million tons of CO₂ scopes 1, 2, and 3 emissions).

Ratings Score Snapshot

Issuer Credit Rating	A-/Stable/A-2
Business risk:	Satisfactory
Country risk	Very low
Industry risk	Moderately high
Competitive position	Satisfactory
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	bbb+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb+
Group credit profile	a
Entity status within group	Moderately strategic (+1 notch from SACP)
Related government rating	--
Likelihood of government support	--
Rating above the sovereign	--

Related Criteria

- 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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

Research Update: Dutch Integrated Utility Company Eneco N.V. Affirmed At 'A-/A-2'; Outlook Stable

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- 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

- Industry Top Trends Update Europe: Utilities, July 18, 2023
- Industry Top Trends 2023: EMEA Utilities, Jan. 23, 2023

Ratings List

Ratings Affirmed

Eneco N.V.

Issuer Credit Rating	A-/Stable/A-2
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Commercial Paper	A-2
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