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Research Update:

Dutch Energy Provider Stedin 'A-' Ratings Affirmed On Announced Deal For PZEM's Networks; Outlook Stable

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Overview

- On March 31, 2017, Dutch energy providers Stedin N.V. and PZEM announced that Stedin will buy Zeeuwse Netwerkholding N.V. and its subsidiaries from PZEM for a total consideration of €610 million.
- The transaction is moderately positive for Stedin's business. It will increase the scale of Stedin's operations by about 10% and the acquired networks neighbor Stedin's existing ones, creating some potential for synergies.
- It represents a material debt increase but given Stedin's size, we believe that the company will maintain its current financial profile, albeit with much less headroom.
- We are therefore affirming the 'A-' rating on Stedin.
- The stable outlook reflects our forecast that Stedin will be able to maintain a 12%-13% ratio of funds from operations to debt over the next three years.

Rating Action

On April 6, 2017, S&P Global Ratings affirmed its 'A-' long-term corporate credit ratings on Dutch multi-utility Stedin Netbeheer B.V. and its holding company Stedin Holding N.V. (together, Stedin). The outlook remains stable.

We also affirmed our 'A-2' short-term rating on Stedin Holding.

At the same time, we affirmed our issue ratings on Stedin Holding's unsecured debt at 'A-' and hybrid security at 'BBB'.

Rationale

The rating affirmations follow the announcement by PZEM N.V. (formally Delta N.V.) that it has agreed to sell Zeeuwse Netwerkholding N.V. and its subsidiaries (together, ZNH) to Stedin for a consideration of €450 million of equity and €160 million of debt (€610 million). The transaction is still subject to approval by PZEM's shareholders in June 2017, The Netherlands Authority for Consumers and Markets (ACM), and PZEM's works council.

Stedin remains an almost entirely regulated company. We view the Dutch regulatory framework for distribution networks as strong as we believe it provides for visible, stable cash flows. We consider that the proposed transaction is moderately positive for Stedin's business as it will increase the scale of its operations by about 10%, offering the company a wider served area. Although we do not factor any synergies into our base case, we recognize there are potential gains that could emerge as both networks are operating in neighboring areas with the same regulator overseeing network performance. We also understand that both networks have a relatively similar operating performance track record.

However, we believe that there are currently some risks from potential operational issues due to Stedin's recent unbundling of its network and non-network businesses. We also consider that integrating the new network could weigh on the company's profitability if it creates additional costs, for example from integrating IT systems. We also note that Stedin has little track record as a stand-alone entity since its inception in February 2017 and that it will remain a relatively small utility even after the acquisition. Stedin will still be smaller than its Dutch peers Alliander and Enexis, but a similar size to U.K. peers like Wessex Water. Although the rating does not incorporate a negative adjustment to reflect these weaknesses, we are cautious to an extent about the group's ability to effectively operate as a newly created, stand-alone, fully fledged company and to integrate ZNH at the same time.

Given the overall price Stedin paid for ZNH (valued at approximately 11x EBITDA) and the largely debt-funded nature of the transaction, the acquisition will weaken Stedin's financial profile. As ZNH is relatively small compared to Stedin, and given the relatively low cost of debt, the impact is not material enough to lead us to change our overall financial risk assessment. The transaction reduces Stedin's financial headroom, however. We also believe that pressure on the rating might arise from 2020 when profitability reduces and in 2021 when the new regulatory period starts.

We base our 'A-' long-term rating on Stedin Holding on our view of the company's stand-alone credit profile, which we assess as 'a-', and our opinion that there is a moderate likelihood that its owners would provide timely and sufficient extraordinary support to the company in the event of financial distress. The rating on Stedin Netbeheer is equalized with that on Stedin Holding, reflecting our view of Stedin Netbeheer as a core subsidiary of Stedin Holding.

In our base case, we assume:

- €610 million acquisition price for the ZNH;
- Dividends in line with Stedin's policy of a 50% net profit payout;
- An EBITDA margin of roughly 40%;
- Post transaction, Stedin's total regulated asset base will be about €5.7 billion, roughly 8% of which will be from its newly acquired regulated network;
- EBITDA between €450 million and €550 million over the next three years; and
- Roughly 10% of EBITDA and capital expenditures (capex) contributions to come from the newly acquired regulated business.

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

- Funds from operations (FFO) to debt remaining at 12%-13% on an ongoing basis; and
- Negative free operating cash flow post dividends and capex.

Liquidity

The short-term corporate credit rating is 'A-2'. We assess Stedin Holding's liquidity position as adequate.

We anticipate that the company's liquidity sources will exceed uses by more than 1.1x over the next 12 months. We also assume that sources would cover uses even if forecast EBITDA were to drop by 10%. We understand that Stedin Holding has access to an undrawn facility of €750 million maturing in October 2018 and a €500 million bridge maturing in August 2018. It also has access to short-term facilities (not considered in our liquidity calculations) consisting of a €300 million bridge maturing in November 2017 and a €200 million bridge maturing in February 2018.

We anticipate the following principal liquidity sources over the 12 months from March 31, 2017:

- Access to cash and cash equivalents of approximately €45 million;
- Access to €1.25 billion of undrawn committed credit facilities expiring between August and October 2018; and
- FFO of about €450 million-€500 million according to our base-case scenario.

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

- Short-term debt maturities of approximately €360 million in 2017;
- €610 million acquisition of ZNH;
- Capex of about €450 million annually; and
- Shareholder distributions of 50% of net income.

Outlook

The stable outlook on Stedin Holding and Stedin Netbeheer reflects the group's excellent business risk profile and our expectation that Stedin Holding will maintain credit metrics in line with the rating, namely FFO to debt consistently above 11% (we forecast 12%-13% over the medium term under our base case). Robust earnings from the stable distribution networks support the current rating, even though we expect profitability to be affected by additional costs from the unbundling process. We also expect the contribution from unregulated ancillary activities to remain below 10% of the group's total EBITDA.

Downside scenario

We could lower the ratings on Stedin if the group's adjusted FFO to debt fell below 11%, combined with declining profitability. In our view, the main risk factor in this respect is possible adverse regulatory impacts on profitability in 2020 when some of the profit on smart meters may have to be returned to consumers, or from the new regulatory review in 2021. Secondarily, we believe rating pressure could materialize from potential integration risk or additional costs following the acquisition of ZNH.

Upside scenario

We consider an upgrade unlikely in the near term given the company's current leverage and the possible profitability pressure from 2020. This said, we would consider an upgrade if Stedin Holding maintained FFO to debt sustainably above 15%.

Ratings Score Snapshot

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

Business risk: Excellent
- Country risk: Very Low
- Industry risk: Very Low
- Competitive position: Excellent

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: a-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a-
- Sovereign rating: NR (local municipalities)
- Likelihood of government support: Moderate

NR--Not rated.

Related Criteria

- 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: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And

Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, 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: Methodology: Industry Risk, Nov. 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 And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 01, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 01, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Stedin Holding N.V.	
Corporate Credit Rating	A-/Stable/A-2
Junior Subordinated	BBB
Commercial Paper	A-2
Stedin Netbeheer B.V.	
Corporate Credit Rating	A-/Stable/--

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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.