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Research Update:

Dutch DSO Stedin Holding Affirmed At 'A-/A-2' On Restored Financial Headroom Despite High Capex Plan; Outlook Stable

February 8, 2024

Rating Action Overview

- Stedin Holding will receive €500 million additional revenue over 2024-2026 following the regulator's change to the allowed remuneration of this current regulatory period.
- It adds to the €500 million state equity support received in December 2023, supporting deleveraging and confirming our assessment of a moderate likelihood of support from the state to Dutch distribution system operators (DSOs).
- We anticipate a steep increase in net capital expenditure (capex) on 2024-2026 (to €900 million-€1.4 billion, versus €600 million-€700 million in 2022-2023) given the necessary grid upgrades to address the country's congestion issues.
- We expect Stedin will use the additional revenue to finance capex, leading to adjusted funds from operations (FFO) to debt at about 10% as of the end of the 2022-2026 regulatory period from 12% on average in 2024-2026. We understand the company's financial policy aims to maintain an 'A-' rating.
- We affirmed our 'A-/A-2' long- and short-term ratings on Stedin.
- The stable outlook reflects our expectation that Stedin's FFO to debt will remain well above 9% in the next two to three years, in line with the company's financial policy targeting a minimum of 10%, as well as our view of a moderate likelihood of extraordinary support from the central government.

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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 is supportive of our ratings on Stedin. On Dec. 21, 2023, The Netherlands Authority for Consumers and Markets (ACM) published its final decision on changes to the allowed remuneration, as instructed in a ruling by the Netherlands's 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 determine 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 Stedin and the other two Dutch DSOs, Alliander and Enexis. This is because the ruling raises Stedin's revenue by €129 million in 2024, and our estimate of €200 million-€250 million in 2025, and by €130 million-€170 million in 2026. The change in method may well also support revenue in the next regulatory period starting 2027, adding to an increase in base weighted average cost of capital (WACC) parameters.

Stedin's likely increase in capex to address congestion issues over 2024-2026 will absorb most of the balance sheet headroom stemming from the regulatory decision. We forecast Stedin will accelerate its investments, in line with its Dutch peers, to support the Netherlands' energy transition by increasing grid capacity to reduce currently heavy congestion. This translates into a 30%-40% increase in gross capex to €3.7 billion-€4.1 billion over 2024-2026 from €2.9 billion in our previous base case for 2023-2025. We expect Stedin's gradual increase in capex (net of customer contributions) will approach €900 million already this year and close to €1.3 billion-€1.4 billion in 2025-2026, from €675 million-€700 million in 2023. We also anticipate that the increase will drive consistently negative annual discretionary cash flows (DCF) of €390 million-€890 million through 2026.

The recent €500 million equity injection from the state confirms our view of moderately likely extraordinary support from the government. This is in line with the framework agreement that Stedin, together with the other two main domestic DSOs, Alliander and Enexis, signed with their shareholders and the Dutch government. This legally binding agreement sets out the conditions and requirements under which the Dutch state would provide common equity to the companies. The state became a 11.9% owner in Stedin in December 2023 after injecting €500 million common equity, which we now factor in the stand-alone credit profile (SACP). We continue to believe that Stedin could benefit from further extraordinary government support to enhance its capacity to meet its financial commitments as they come due, although additional equity support is not currently part of our base case. We incorporate our view of government support by applying a one-notch uplift to the 'bbb+' SACP, leading to the 'A-' rating on Stedin. For more information, see "Dutch Networks Stedin, Alliander And Enexis Ratings Affirmed On Government Support; Enexis Outlook Revised To Positive," published Feb. 14, 2023, on RatingsDirect.

Stedin is committed to maintaining an 'A-' rating. Under our updated base case, we project FFO to debt of 13% on average over 2024-2025. However, from 2026 we expect FFO to debt to return below 11% with no further remedial measures from Stedin's shareholders. This is because Stedin's financial policy is to preserve at least an 'A-' rating and sustain FFO to debt above 10%. That said, we recognize Stedin has some headroom at the current rating level until 2026. We also view the new dividend policy of as relatively more flexible than peers with a payout scale of 90% for €0-€20 million of net income, 30% for €20 million-€100 million of net income, and below 18% from €100 million net income, which currently would imply a payout ratio within 40%-45% for Stedin, compared with a 45% dividend payout ratio for Alliander and 50% for Enexis.

Outlook

Our stable outlook on Stedin captures the company's financial policy of retaining at least an 'A-' rating, and our view of shareholders' supportiveness of this goal. We believe Stedin will maintain

FFO to debt sustainably above 9% over the regulatory period through 2026. It also reflects our expectation that Stedin's cash flow generation will remain stable and predictable on the back of solid operational performance in the supportive Dutch regulatory framework, and despite increasing pressure from increasing capex needs.

Downside scenario

The rating could come under pressure if our forecast FFO to debt approached or fell below 9% with no immediate likelihood of recovery. This could result from:

- Adverse regulatory decisions;
- Further material increases in investments; and
- No timely and sufficient implementation of remedial measures from Stedin's shareholders, including the Dutch state.

If we revised down the SACP by one notch, it would lead us to lower the issuer credit rating by one notch, all else remaining equal. In contrast, a one-notch downgrade of the Netherlands would not result in a downgrade of Stedin, all other things remaining equal.

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

Upside scenario

We would consider an upgrade if, all else remaining equal, Stedin were to achieve and sustain FFO to debt comfortably above 11% backed by the company's financial policy.

Company Description

Stedin Group was formed on Feb. 1, 2017, from the unbundling of Eneco Holding N.V. into an energy company of the same name and a network company, Stedin Holding N.V.

Stedin Group, through its Stedin and Enduris subsidiaries, is the third-largest electricity and gas distribution grid operator in the Netherlands. It operates as a monopoly in a large part of the provinces of South Holland, Utrecht, and Zeeland, and in parts of North Holland and Friesland. As a grid operator, Stedin provides energy to more than 2 million customers.

In addition, Stedin offers electricity and gas infrastructure services under the name DNWG Infra. It also offers the realization and maintenance of energy infrastructure, other than gas and electricity, through its subsidiary NetVerder. We expect the company's unregulated business, DNWG Infra and NetVerder, to only represent a minimal part of consolidated EBITDA over the next few years.

Stedin is owned by the Dutch State (11.9%) and by 44 Dutch municipalities, the largest of which is the City of Rotterdam, followed by The Hague. By law, Stedin must be owned by a public entity.

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 Stedin's 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.
- Standardized output to increase +5.1% on average for electricity and decrease 6.9% for gas over 2023-2026.
- Adjusted EBITDA margin of about 30%.
- Net average capex of about €1.2 billion annually on average over 2024-2026, driven by the energy transition target in the Netherlands and the requirement to expand Stedin's electric grid (connecting new renewable projects to the grid) as well as grid replacement and digitalization.
- Customer contributions netting capex of around €110 million per year.
- €500 million of equity injection from the state received in 2023. We assume no further equity injection from potential new municipalities.
- Dividend pay-out as follows: for net income of €0 million-20 million (90%); €20 million-€100 million (30%); above €100 million (18%), resulting in effective payout ratio on previous year net income of 40%-45% on the period.

Key metrics

Stedin Holding N.V.—Key metrics

	--Fiscal year ended Dec. 31--					
(Mil. €)	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**	**2026f**
EBITDA*	466	415	550-570	530-550	890-910	730-750
Capital expenditure	570	593	650-700	850-900	1250-1350	1300-1400
Free operating cash flow	(311)	(421)	(270)-(300)	(370)-(400)	(600)-(650)	(800-850)
Dividends	33	11	20-30	50-80	40-70	70-100
Discretionary cash flow	(855)	(432)	(300)-(330)	(440)-(470)	(670)-(720)	(890-940)
Debt	3,408	3,678	3,400-3,600	3,700-4,200	4,400-4,800	5,300-5,700
Debt to EBITDA (x)	7.3	8.9	6.2-6.4	7.1-7.5	4.9-5.3	7.3-7.7
Funds from operations to debt (%)	10.8	9.5	12.0-14.0	10.0-12.0	13.0-15.0	9.0-10.0

*EBITDA is adjusted for about €25 million of customer contributions. All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Stedin's liquidity position as adequate, reflecting our expectation that its liquidity sources will exceed uses by 1.1x over the 12 months from Dec. 31, 2023. We also assume that sources would cover uses even if forecast EBITDA dropped by 10%. Stedin has access to an undrawn committed credit facility of €800 million maturing in June 2028, which supports the group's liquidity position. We also expect the metric to be met beyond 2024, despite negative DCF, via proactive refinancing.

Moreover, our assessment also considers Stedin's satisfactory standing in the credit markets, prudent risk management, and proven access to diverse sources of funding.

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

- Cash and short-term investments of €185 million;
- Unused committed credit line of €800 million maturing 2028;
- Working capital inflow of €60 million; and
- Cash FFO of about €430 million-€440 million.

Principal liquidity uses over the same period are:

- Debt maturities of €265 million;
- Capex, net of customer contributions, of €850 million-€950 million; and
- Dividends of about €60 million.

Covenants

A part of Stedin's loans are subject to various financial covenants, including a ratio of net debt to total equity lower than 70%, and an interest-coverage ratio greater than 3.0x. Stedin complied with both tests as of year-end 2023.

Compliance expectations

We forecast that Stedin's net debt to total equity ratio be at 45%-50% and interest coverage ratio will remain consistently above 5x over our forecast scenario, implying significant headroom.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2023, our estimate of Stedin's reported interest-bearing debt is €3.4 billion. Out of this debt, €1.8 billion corresponds to Eurobond financing, around €590 million corresponds to private placements, €81 million to lease liabilities, and the rest to other type of senior debt.

We add €250 million to this debt, corresponding to 50% of the company's perpetual subordinated bond loan, because we view this instrument as having intermediate equity content.

Analytical conclusions

Except for Stedin's hybrid capital securities, we rate its public debt at the same level as the issuer credit rating, since we perceive no subordination risk that could result in a material credit disadvantage for bondholders.

We rate the company's senior unsecured debt at 'A-', the same as the long-term issuer credit rating.

Stedin is the holding company of the key operating company Stedin Netbeheer. Most of debt is placed at the holding company level. We rate Stedin's debt in line with the issuer credit rating as we conclude there is no subordination risk.

We rate the perpetual notes at 'BBB-', two notches below the 'bbb+' SACP on Stedin, reflecting:

- A one-notch deduction because of contractual subordination; and
- An additional one-notch deduction for payment flexibility to reflect that the deferral of interest is optional.

We do not consider that the Dutch state would provide support to the company's hybrid. Because of this, we continue rating it from the SACP.

Ratings Score Snapshot

Issuer 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 (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	Negative (-1 notch)
Stand-alone credit profile:	bbb+
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: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Ratings Affirmed	
Stedin Holding N.V.	
Issuer Credit Rating	A-/Stable/A-2
Stedin Netbeheer B.V.	
Issuer Credit Rating	A-/Stable/--
Stedin Holding N.V.	
Senior Unsecured	A-
Junior Subordinated	BBB-
Commercial Paper	A-2

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 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/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at 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. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.