S&P Global
Ratings

RatingsDirect®

Summary:

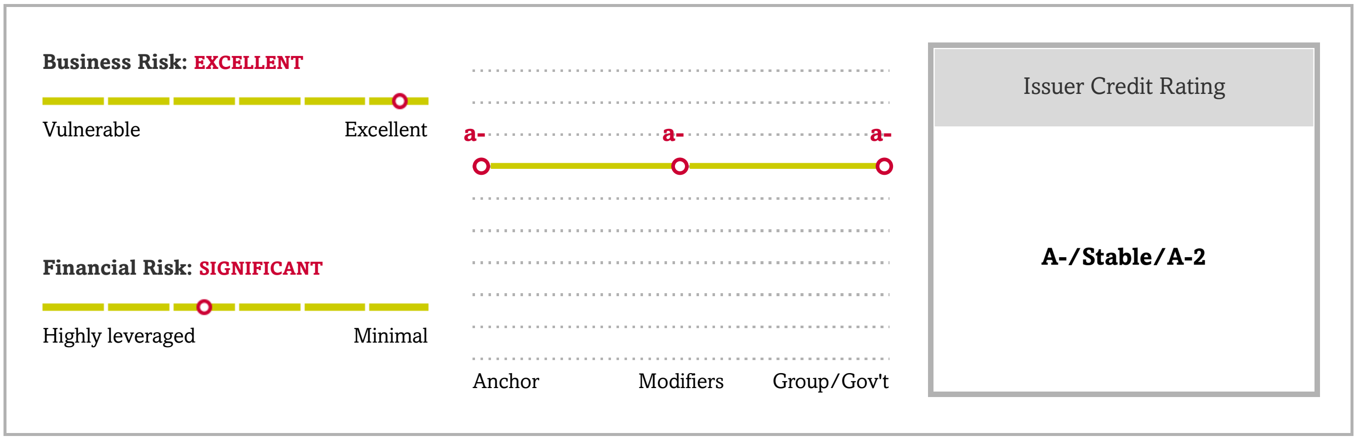
Stedin Holding N.V.

Primary Credit Analyst:
Gerardo Leal, Frankfurt +49 (0) 69 33 999 1; gerardo.leal@spglobal.com

Secondary Contact:
Beatrice de Taisne, CFA, London (44) 20-7176-3938; beatrice.de.taisne@spglobal.com

Table Of Contents

Summary:
Stedin Holding N.V.



Credit Highlights

Overview

Key Strengths	Key Risks
Third largest electricity and gas distributor in the Netherlands, with a monopoly in South Holland, Utrecht, Zeeland, and parts of North Holland and Friesland.	Likely pressure on revenues from lower regulatory returns in 2017-2021.
A relevant role in Netherlands' commitment to transition to sustainable energy.	Negative free operating cash flows (FOCF) over the next two years, owing to capital expenditure (capex) for the Netherlands' energy transition.
Stable and predictable EBITDA and cash flow from regulated activities.	Higher financial risk than Dutch peers', due to higher leverage and weaker credit metrics.
Competitive position supported by the transparent and highly stable regulatory framework.	

Stedin continues to prioritize regulated business as part of its strategy.

Stedin sold its Joulz Energy Solutions commercial activities in September 2018 and we expect other nonregulated divestments in 2019. The rationale behind these divestments is that the assets are no longer in line with the group's strategy, which prioritizes regulated over non-regulated business.

The Netherlands' energy goals provide expansion opportunities.

We believe Stedin will play an important role in helping the Dutch government achieve its target of 16% renewable energy sources by 2023 and that the company will emerge with a larger regulatory asset base (RAB) to support its competitive position, as a result.

The scheduled decrease in regulatory WACC will be manageable.

In our view, operating efficiencies and a larger RAB resulting from continued grid deployment will help Stedin cope with lower regulatory returns stemming from the declining weighted average cost of capital (WACC) in the current regulatory period.

Outlook: Stable

The stable outlook on Netherlands-based electricity and gas grid operator Stedin Holding N.V. stems from S&P Global Ratings' view that, despite the regulatory WACC declining to 3% in 2021 from 4.0% in 2017, which will likely weigh on revenues and EBITDA generation, the company will continue to post funds from operations (FFO) to debt consistently above 11% over the next 12-24 months.

In our opinion, the company will continue to benefit from its excellent position as the third largest regional electricity and gas distributor in the Netherlands, adding predictability and stability to its business. In addition, we contemplate the incorporation of DNWG's distribution activities to its business will compensate to some extent for the divestment of Joulz's commercial activities in 2018 and other nonregulated asset divestments in 2019.

Downside scenario

We could lower our ratings on Stedin if the group's adjusted FFO to debt stayed below 11%. In our view, potential risk factors are a possible adverse regulatory impact on profitability, due to potential interest costs for excess smart-meter profits to be returned to consumers, or from the next regulatory review in 2021.

Upside scenario

An upgrade in the short term is unlikely, given that the declining WACC will reduce EBITDA and FFO over the next few years. In addition, we believe that the company's financial policy will remain in line with achieving FFO to debt within the 11%-13% range. That said, we could upgrade Stedin if it posted FFO to debt sustainably above 15%.

Our Base-Case Scenario

Assumptions

- Regulatory WACC of 3.8% in 2018 decreasing to 3.5% in 2019 and to 3.0% by the end of the regulatory period, due to reduced cost of debt.
- Our forecast of an average inflation rate in the Netherlands of 1.7% in 2018 and 2.0% in 2019.
- Overall lower electricity and gas x-factors for Stedin compared with the previous regulatory period.
- Given that allowed regulatory revenues are adjusted by adding the consumer price index (CPI) minus the x-factor, a higher inflation rate with a lower x-factor, on average, should compensate somewhat for a lower regulatory WACC.
- Recently acquired DNWG will increase Stedin Group's scale by 10%-13% after full-year consolidation in 2018.
- Joulz Energy Solutions' commercial activities were sold in September 2018, and we expect other nonregulated operations to be divested in the first half of 2019.
- Gradually increasing like-for-like profitability, due to synergies resulting from DNWG's integration and other operating efficiencies.
- Capex net of customer contributions of €360 million-€370 million in 2018, 40% of which is network driven, 38% customer driven, and 13% destined for smart-meter deployment. Investments increasing to €510 million-€520 million in 2019 due to additional investments for Netherlands' energy transition.
- Dividend payments of 50% of the previous year's net income.
- Refinancing as debt falls due.

Key Metrics

	2017a	2018e	2019e
Debt/EBITDA (x)*	6.10	5.5-6.0	6.0-6.3
FFO to debt (%)*	12.20	13.0-13.5	12.0-12.5
FFO interest cover (x)*	5.50	5.5-6.0	5.0-5.5
DCF to debt (%)*	0.40	(0-0.5)	(5.0-6.0)
Debt/debt plus equity (%)*	56.60	55-57	55-57

*Adjusted by S&P Global Ratings.

a--Actual. e--Estimate. DCF--Discretionary cash flow.

Base-Case Projections

Divestments and investments will have mixed effects on revenue growth and margins.

We forecast an 8.8% revenue expansion in 2018, mostly supported by DNWG; and a 6.2% contraction in 2019, mainly resulting from the disposal of Joulz's commercial activities and other assets. In addition, we forecast an adjusted

EBITDA margin of 42.5% in 2018 due to DNWG's contribution and improved cost management. For 2019, we anticipate that divestments of Joulz's commercial and other nonregulated activities will result in an 11% drop in EBITDA generation, consistent with an EBITDA margin of 40%-41%.

Negative discretionary cash flow is likely over the next few years.

Due to higher capex and dividend payments, we expect Stedin will continue to generate negative discretionary cash flow, more so in 2019 than in 2018. We expect this to improve after 2020 once the smart-meters rollout program is completed.

Company Description

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

Stedin Group, through its Stedin and Enduris subsidiaries, is the third largest electricity and gas grid operator in the Netherlands. It operates as a monopoly in a large part of the province 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. Additionally, although it represents a minor part of the company's business, Stedin also offers electricity and gas infrastructure services under the name of Joulz and DNWG Infra.

Business Risk: Excellent

Acquisition, divestments, and strategy are leading to a greater share of regulated business

The incorporation of DNWG (formerly Zeeuwse Netwerkholding N.V.) into Stedin's operations has resulted in a larger contiguous network, which in our opinion will allow for economies of scale through higher responsiveness rates and operating efficiencies. We expect one-off integrating costs observed in 2018 to dissipate over the next few years, leaving room for margin improvement on a like-to-like basis. Stedin's strategy is to improve its grid management while facilitating the energy transition in the Netherlands and maintaining sustainable business operations.

Stedin sold its Joulz's commercial activities to Koninklijke VolkerWessels in September 2018. Additionally, we expect the company to dispose of other nonregulated assets by the first half of 2019. Although we estimate that this will result in lower diversification, these disposals demonstrate the company's strategy of focusing on purely regulated activities in the future, which we view as credit positive given the stable and predictable nature of regulated activities. We expect regulated distribution activities to represent almost 100% of total EBITDA in the coming years.

Stedin is a key player in the Netherlands' energy transition phase

The Dutch government aims to increase the share of renewables to 16% of total energy sources in 2023 from 6% in 2017. To achieve this, several wind and solar projects are currently underway. We believe that Stedin is an important component of the country's energy transition and that investments related to these projects will enhance Stedin's competitive position through a larger RAB.

Financial Risk: Significant

We continue to see Stedin as more leveraged than its Dutch distribution system operator (DSO) peers. Under our base-case scenario, we forecast that the company's FFO to debt will remain in the 12.0%-13.5% range, which is above our 11% threshold for the current rating. We benchmark Stedin's ratios against the low volatility table, since the company derives most of its revenues from regulated activities with a strong regulatory advantage.

In our opinion, the full-year consolidation of DNWG in 2018 will increase Stedin's EBITDA and FFO generation by 10%-13% compared with 2017 figures. This will temporarily lead to FFO to debt slightly above 13%. Nonetheless, we estimate the disposal of Joulz's commercial activities and other operations will lead to a decrease in EBITDA by about the same amount by year-end 2019. Therefore, we expect the company's FFO-to-debt ratio to stabilize at 12.0%-12.5% thereafter.

We forecast capex net of customer contributions at €360 million-€370 million in 2018, increasing over 2019 to €510 million-€520 million. Stedin will dedicate most of this capex to network deployment for the Dutch energy transition, in our opinion. We expect these expenditures to result in negative FOCF for the upcoming two years.

Lower allowed returns on capital weigh on revenues

In the Netherlands, the regulatory WACC provides DSOs a return on their RAB. Over the current regulatory period, the WACC (real pre-tax) is set to decline to 3.0% by the end of 2021 from 4.04% in 2017, due to reduced cost of debt.

The regulatory WACC multiplies the RAB, and is then added to depreciation and operating expenses to set average efficient costs, which constitute the basis for future allowed revenues. Therefore, all other things equal, we expect a lower WACC to weigh on the company's revenues in future periods. We believe, however, that the company has various options to cope with a declining regulatory return, including cost efficiencies, and the larger RAB resulting from its expanding network during the energy transition phase.

We also forecast an average domestic inflation rate of 1.7% in 2018 and 2.0% in 2019 and, for Stedin, lower electricity and gas x-factors on average in the 2017-2021 regulatory period compared with 2014-2016. Given that the allowed regulatory allowed revenues are adjusted by adding the CPI minus the x-factor, a higher inflation rate minus a lower x-factor on average, should compensate to some extent for a lower regulatory WACC in terms of allowed revenues.

For further details on tariff-setting procedures, see "Why Do We View The Dutch Electricity And Gas Networks Regulatory Framework As Supportive?," published March 2, 2016, on RatingsDirect.

Potential interest costs on outstanding excess profits will likely accelerate returns to customers

Stedin finances smart-meter deployment through its own resources and customer contributions. This means that Stedin must pay the excess profits generated by these assets to customers. Since the regulator is expected to force interest to be paid on amounts not returned to customers from 2022, we believe the company will accelerate the payment schedule over the next few years to minimize costs, since the interest payable could affect its FFO.

Financial summary

Table 1

Stedin Holding N.V.--Financial Summary	
(Mil. €)	**At year-end Dec. 31, 2017**
Revenues	1,194.0
EBITDA	495.5
Funds from operations (FFO)	371.9
Net income from continuing operations	89.0
Cash flow from operations	579.9
Capital expenditures	499.0
Free operating cash flow	80.9
Discretionary cash flow	(12.1)
Cash and short-term investments	72.7
Debt	3,046.3
Equity	2,332.5
Adjusted ratios	
EBITDA margin (%)	41.5
Return on capital (%)	3.2
EBITDA interest coverage (x)	5.2
FFO cash int. cov. (x)	5.5
Debt/EBITDA (x)	6.1
FFO/debt (%)	12.2
Cash flow from operations/debt (%)	19.0
Free operating cash flow/debt (%)	2.7
Discretionary cash flow/debt (%)	(0.4)

Liquidity: Adequate

We assess Stedin's liquidity position as adequate because we believe its sources will exceed its uses by more than 1.1x over the next 12 months and that its net sources minus uses ratio will remain positive even if forecast EBITDA dropped by 10%.

We also consider the company's prudent risk management, generally satisfactory standing in credit markets, and demonstrated access to diverse sources of funding.

Principal Liquidity Sources(for the 12 months started June 30, 2018)

- Cash and equivalents of €58 million.
- Access to a €600 million committed credit facility maturing in July 2023.
- Projected cash FFO of about €390 million over the next 12 months.
- €500 million resulting from a 10-year Eurobond issued in September 2018.

Principal Liquidity Uses(over the next 12 moths)

- Short-term debt maturities of approximately €630 million.
- Capex net of customer contributions of about €440 million.
- Working capital outflows of about €15 million.
- Dividend payments of about €55 million.

Covenant Analysis

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 2017.

Compliance Expectations

We forecast that Stedin's interest coverage will remain consistently above 5.0x, and net debt to total equity at 55%-57%, over our forecast scenario, implying significant headroom under both ratios.

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

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:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a-

Issue Ratings--Subordination Risk Analysis

Capital structure

Stedin's reported debt as of June 30, 2018, totaled €2.86 billion, of which €2.2 billion was long term and €640 million short term. Stedin also issued a €500 million Eurobond in September 2018 to prerefinance debt maturing in 2019. We add €250 million, corresponding to 50% of the company's perpetual subordinated bond loan, to reported debt, since 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 to bondholders.

We rate Stedin's subordinated capital securities two notches below the issuer credit rating: one notch for contractual subordination to other senior debt within the group and an additional notch due to the optional deferability of interest.

Reconciliation

Table 2

Reconciliation Of Stedin Holding N.V. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €)

--Fiscal year ended Dec. 31, 2017--

Stedin Holding N.V. reported amounts	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
Reported	2,753	2,583	471	198	80	471	571	99	502
S&P Global Ratings adjustments									
Interest expense (reported)	--	--	--	--	--	(80)	--	--	--
Interest income (reported)	--	--	--	--	--	1	--	--	--
Current tax expense (reported)	--	--	--	--	--	(29)	--	--	--
Operating leases	98	--	25	7	7	18	18	--	--
Intermediate hybrids reported as equity	251	(251)	--	--	6	(6)	(6)	(6)	--
Postretirement benefit obligations/deferred compensation	17	--	--	--	--	--	--	--	--
Surplus cash	(73)	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	3	(3)	(3)	--	(3)
Non-operating income (expense)	--	--	--	1	--	--	--	--	--
Total adjustments	293	(251)	25	8	16	(99)	9	(6)	(3)

Table 2

Reconciliation Of Stedin Holding N.V. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €) (cont.)

S&P Global Ratings adjusted amounts

	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	3,046	2,333	496	206	96	372	580	93	499

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued By Corporate Entities And Other Issuers Not Subject To Prudential Regulation, Jan. 16, 2018
- 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 - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 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. 1, 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

Related Research

- Why Do We View The Dutch Electricity And Gas Networks Regulatory Framework As Supportive?, March 2, 2016

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	**a-**	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Additional Contact:
Infrastructure Finance Ratings Europe; InfrastructureEurope@spglobal.com