

RESEARCH

Research Update:

ENECO Energie 'A/A-1' Rating Affirmed, Off Watch On Suspension Of Unbundling; Outlook Negative

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Primary Credit Analyst: Hugues De La Presle, Paris (33) 1-4420-6666;
hugues_delapresle@standardandpoors.com
Secondary Credit Analyst: William Ferara, London (44) 20-7176-3519;
bill_ferara@standardandpoors.com

Rationale

On Dec. 4, 2006, Standard & Poor's Ratings Services affirmed its 'A/A-1' long- and short-term corporate credit ratings on Dutch utility entities ENECO Holding N.V. and N.V. ENECO (collectively known as ENECO Energie). The outlook is negative.

At the same time, all ratings were removed from CreditWatch, where they had been placed with negative implications on April 28, 2006.

The rating actions follow a Dutch parliament vote to accept a motion of amendments, which suspends the law in favor of splitting Dutch utilities between competitive generation and supply operations on the one hand and regulated network activities on the other.

The motion of amendments removed the immediate threat of ownership unbundling, which could only be introduced if the EU forces all energy companies under its jurisdiction to split their regulated and unregulated activities, and if the financial risks related to the Dutch utilities' cross-border leases are mitigated.

Some uncertainties remain, however, as the unbundling legislation could nevertheless be implemented, upon consultation of both the Dutch upper and lower houses, if the integrated utilities take actions that jeopardize the independence of distribution networks. Although only broadly defined at present, such actions include a lack of transparency in the management of the networks or not maintaining equal access to them, but also the conduct of overseas operations or the utilities' participation in cross-border alliances.

It remains uncertain how ENECO Energie or ENECO Energie's public shareholders, some of whom may wish to exit in the future, will adjust to this new and untested regulatory landscape. The privatization of distribution networks is not allowed for the time being, but strategic options could include domestic consolidation or the sale of generation and supply operations to foreign parties.

The ratings on ENECO Energie continue to be underpinned by the stable and substantial earnings contribution of the group's monopoly energy-distribution businesses (68% of consolidated EBIT in 2005), and its conservative financial policy. These strengths are offset, however, by exposure to volatile wholesale power prices: The group has a significant short power supply position, despite its power purchase agreement with the Rijnmond power station, which supplies up to one-third of its electricity needs.

Short-term credit factors

ENECO Energie's 'A-1' short-term rating reflects a sound liquidity profile, with very limited long-term debt maturities, limited recourse to short-term debt, and an undrawn €1 billion revolving facility maturing in 2009. In anticipation of the possible ownership unbundling, ENECO Energie recently bought back 82% of its €700 million bond due 2010 using a bridge loan, which will be refinanced with longer term debt.

ENECO Energie's letter of credit (LOC) bank commitments relating to its cross-border leases for €921 million, although manageable, remain a negative credit factor. The group would need to increase the amount of these LOC bank commitments in the event of a downgrade. In case of a one-notch downgrade, the group would need to increase LOCs by €63 million.

Outlook

The negative outlook reflects our uncertainties about the new regulatory landscape in the Netherlands, and the risks entailed by a possible increase in sector consolidation. It also reflects the potential for increased regulatory transparency and scrutiny owing to stricter requirements for the separation of network and commercial operations--and, in the case of the high voltage grid, transfer of management responsibility to the national transmission company--as well as the ongoing development of competitive wholesale and retail markets in the Netherlands and neighboring countries.

Ratings List

	To	From
N.V. ENECO		
Corporate credit rating		
	A/Negative/A-1	A/Watch Neg/A-1
CP*	A-1	A-1/Watch Neg
ENECO Holding N.V.		
Corporate credit rating		
	A/Negative/A-1	A/Watch Neg/A-1

*Guarantor: ENECO Holding N.V.

NB: This list does not include all ratings affected.

Additional Contact: [Infrastructure Finance Ratings Europe;
InfrastructureEurope@standardandpoors.com](mailto:InfrastructureFinanceRatingsEurope@standardandpoors.com)

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