

Eneco Holding N.V.

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Major Rating Factors

Strengths:

- Monopoly owner and operator of regional electricity and gas networks in The Netherlands.
- Strong, stable, and predictable cash flows from low-risk businesses.
- Established and transparent regulatory regime.

Corporate Credit Rating

A-/Negative/A-2

Weaknesses:

- Enforced unbundling of generation and supply businesses by Jan. 1, 2011, leading to some uncertainty.
- Temporary exposure in the meantime to potentially volatile wholesale prices as a result of a short position in the supply business.
- Sizeable capex program likely to result in higher leverage.

Rationale

The ratings on Dutch utilities Eneco Holding N.V. and N.V. Eneco (collectively known as Eneco) factor in Standard & Poor's Ratings Services view of the upcoming enforced unbundling of Eneco's regulated electricity and gas distribution business (the network company; 64% of 2008 EBITDA) from its commercial generation, trading, and supply businesses (the energy company; 36%). The enforced unbundling, imposed by the Dutch Ministry of Economic Affairs, must occur by Jan. 1, 2011. We understand from Eneco that it intends to unbundle the group by spinning off the unregulated energy company and that after the unbundling, Eneco will comprise the network business, Stedin, the infrastructure business, Joulz, and the metering business, MDDS.

The ratings on Eneco reflect the credit quality of its regulated network business, which we understand will generate about 90% of its earnings after the unbundling. At present, the strengths of the network business are offset by the competitive energy business, which we consider to be much weaker. The ratings also reflect our understanding that the network company will carry the majority of all external rated debt after the unbundling, and our view that this, in combination with the network company's sizable capital expenditure (capex) program, would likely result in an increase of its leverage toward 50%.

The ratings are constrained by Eneco's medium-term capex of about €300 million per year, which we understand may not be fully recovered by tariffs. That said, Eneco has substantially reduced its planned investments in smart meters because the regulatory framework relating to the smart meter model has been delayed beyond 2013. The ratings are further constrained by Eneco's exposure to incentive-based regulation and higher efficiency requirements imposed by the regulator in the current regulatory period through 2010.

We understand that Eneco is likely to target a ratio of 60% debt to 40% equity, given its sizable capex program. We consider these ratios to be significantly more aggressive than the group's current credit metrics. On Dec. 31, 2008, Eneco's adjusted debt to capital was 36%.

Key business and profitability developments

Eneco's operating profit fell by 9% to €205 million in the first half of 2009, as a result of a drop in profit at the network business, Stedin, partly as a consequence of efficiency requirements stipulated by the regulator. Operating costs also increased due to costs associated with the early termination of lease and lease-back facilities and the upcoming unbundling. We believe that this trend will continue throughout 2010.

Key cash flow and capital-structure developments

Eneco purchases energy during the winter, while invoices are evenly spread. This results in fluctuating free operating cash flows (FOCF) across the year. Eneco has reduced its capex program, and a number of projects have been postponed due to unfavorable economic conditions, but also due to delays to permits. Overall, therefore, we anticipate that Eneco will recover its negative FOCF of about €400 million as of the end of June 2009.

Short-term credit factors

Eneco's short-term credit rating is 'A-2'. This reflects what we perceive to be an adequate liquidity profile, underpinned by available cash and securities of €176 million at end-September 2009, and an undrawn €1.5 billion credit facility expiring in 2013. The facility is a backup for Eneco's €750 million commercial paper program, and it also provides collateral support for letters of credit (LOCs) issued in connection with the group's cross-border leases (CBLs).

Having repaid the €400 million drawdown under the credit facility using about €390 million from a number of private placements in May and April 2009, Eneco's short-term debt amounts to about €300 million, including outstanding commercial paper.

Following the unbundling, only €250 million of the €1.5 billion revolving credit facility, which matures in 2013, will be available for the network company. Given the likely increase in its leverage, we believe that the network company will have put significant additional credit facilities and funding in place by the time of the unbundling.

The network company's net exposure to the costs of the early termination of CBLs charged to its network assets--\$495 million (€354 million) in 2009--is a negative credit factor, in our view. However, the company reduced the obligation for the CBLs by \$189 million in the first half of 2009 and the remainder is effectively covered by LOCs totaling \$670 million (€479 million). About 20% of the LOCs expire by Aug. 30, 2010, but we understand from management that they will be extended comfortably ahead of maturity.

Outlook

The negative outlook reflects our view that the network company may further increase its leverage after unbundling, given that the regulator would allow a ratio of total debt to equity of 70% if this were to result from investments in the network. It also reflects general uncertainties surrounding Eneco's unbundling process.

We would likely lower the rating on the network company if its leverage looked likely to rise above 60% and its cash flow coverage of debt to deteriorate as a result.

Conversely, we could revise the outlook to stable if we believed that the network company would maintain its leverage at about 50%, resulting in cash flow coverage of debt ratios commensurate with an 'A-' rating. This is based on our understanding that Eneco intends to implement the unbundling by spinning off the energy company.

Business Description

Eneco is the third-largest energy utility in The Netherlands. Its operations include regulated gas and power distribution (network company; 64% of 2008 reported EBITDA). It also currently has supply and trading operations (energy company; 36%). Eneco serves about two million customers and its share of the Dutch retail market is 21% in electricity and 22% in gas. The Dutch government has enforced the unbundling of the network businesses from the competitive areas of the group, and this unbundling must be implemented by Jan. 1, 2011, at the latest.

Eneco's shareholders are public authorities, and include the municipalities of Rotterdam (31.3%), The Hague (16.6%), Dordrecht (9.1%) and 58 smaller local municipalities, each holding less than 3.5%.

Rating Methodology

The current ratings anticipate the forthcoming unbundling of the group's networks and energy business, which must be completed by the end of 2010. We understand that the majority of the external debt will reside with the network company and that the energy company, incorporating generation, trading and supply, will be spun off to existing shareholders of Eneco.

Business Risk Profile: Excellent, Due To Regulated Activities

The major supports for Eneco's excellent business risk profile are:

- A monopoly position in the regulated supply of electricity and gas.
- Low risk distribution network activities, which provide relatively stable and predictable cash flows.
- A well-established and generally supportive regulatory framework.

These supports are partially offset by:

- Uncertainty over the enforced unbundling. Eneco has to transfer the management of its high-voltage grid to the Dutch transmission system operator TenneT (not rated) as part of the unbundling, although this has been delayed due to the CBLs tied to the grid.
- Challenging targets set by the regulator for the current regulatory period, which runs from 2008 to 2010, in order to increase the efficiency of Eneco's electricity and gas grids relative to other Dutch network companies. Efficiency factors for the power and gas networks are set at 6.3% and 4.8%, respectively, compared with 1.1% and 3.1% in the previous regulatory period; this has resulted in a decline in Eneco's revenues. The rise in efficiency targets represents a significant increase from previous regulatory periods, but the levels are similar to those set for the company's Dutch peers.
- The short supply position of the energy business until the unbundling of the group takes place. This is because the energy business has to purchase power on the volatile wholesale market. Furthermore, this business operates in a competitive market.

Financial Risk Profile: Intermediate, Due To Relatively High Debt Levels

The main strengths of Eneco's intermediate financial risk profile are:

- A forecast 90% of future earnings after unbundling to come from the very low-risk electricity and gas distribution businesses.
- Highly predictable and regulated cash flows from the network business. The remainder will come from the unregulated infrastructure business, Joulz, which provides a service to Stedin and third parties.

These strengths are moderated by:

- Higher leverage, likely due to a sizable capex program. We understand that the network company's leverage will likely increase over the near to medium term, given planned capex of about €300 million per year.
- The network company's retention of debt. We understand that the network company will retain all external debt apart from that related to sustainable production facilities in The Netherlands and nonrecourse project financing, which will follow the generation and supply business.
- CBLs that Eneco entered between 1997 and 2003. These essentially arbitrage tax benefits between the U.S. and The Netherlands, and use the group's distribution assets as the underlying collateral. Eneco's net exposure (after investments) of about €350 million is a negative credit factor. That said, we do not believe that the unbundling will trigger the early termination of these CBLs. Eneco has to provide collateral cover for the net exposure by way of LOCs of about €480 million. About 20% of these LOCs are due for renewal in 2010.

Financial Statistics/Adjustments

Eneco's accounts are prepared in compliance with the International Financial Reporting Standards (IFRS).

We adjust the group's debt in respect of operating leases and unfunded pension obligations. We also adjust debt for the annual capacity payments relating to two long-term power purchase agreements as we view such long-term obligations as debt-like. We also adjust Eneco's debt for surplus cash, excluding such amounts that are not freely available or restricted.

Table 1

Reconciliation Of Eneco Reported Amounts With Standard & Poor's Adjusted Amounts*									
--Fiscal year ended Dec. 31, 2008--									
Eneco Holding N.V. reported amounts									
(Mil. €)	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	1,863.0	3,799.0	695.0	695.0	404.0	64.0	532.0	532.0	337.0
Standard & Poor's adjustments									
Operating leases	114.5	--	37.0	6.4	6.4	6.4	30.6	30.6	45.3
Postretirement benefit obligations	23.1	--	--	--	--	--	--	--	--

Table 1

Reconciliation Of Eneco Reported Amounts With Standard & Poor's Adjusted Amounts* (cont.)									
Surplus cash and near cash investments	(260.0)	--	--	--	--	--	--	--	--
Power purchase agreements	400.6	--	63.7	63.7	28.0	28.0	35.7	35.7	--
Reclassification of nonoperating income (expenses)	--	--	--	--	21.0	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	52.0	--
Minority interests	--	10.0	--	--	--	--	--	--	--
Total adjustments	278.2	10.0	100.7	70.2	55.5	34.5	66.3	118.3	45.3

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	2,141.2	3,809.0	795.7	765.2	459.5	98.5	598.3	650.3	382.3

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Table 2

Eneco Peer Comparison*						
	Eneco [¶]	N.V. Nuon Energy [¶]	N.V. Nederlandse Gasunie	Northern Gas Networks Holdings Ltd.	CE Electric U.K. Funding Co. [¶]	
Rating as of Dec. 10, 2009	A-/Negative/A-2	NRS	AA-/Stable/A-1+	BBB+/Stable/--	BBB+/Stable/A-2	
(Mil. €)	--Average of past three fiscal years--					
Revenues	4,673.0	5,798.3		1,358.5	378.1	721.3
Net income from continuing operations	336.3	697.0		404.0	6.5	182.5
Funds from operations (FFO)	652.7	1,019.5		700.0	112.0	292.7
Capital expenditures	388.1	593.5		448.5	96.8	284.3
Debt	1,966.1	591.4		2,028.1	1,276.1	1,992.0
Equity	3,195.7	5,699.0		5,446.8	524.7	705.9
Adjusted ratios						
Operating income (before D&A)/revenues (%)	17.3	22.6		62.1	46.9	67.1
EBIT interest coverage (x)	5.3	9.5		9.2	1.9	2.6
EBITDA interest coverage (x)	7.8	12.1		11.8	2.7	3.5
Return on capital (%)	10.9	16.2		9.2	6.9	11.1
FFO/debt (%)	33.2	172.4		34.5	8.9	14.7
Debt/EBITDA (x)	2.5	0.5		2.4	7.2	4.2

Table 2

Eneco Peer Comparison* (cont.)

*Fully adjusted (including postretirement obligations). †Excess cash and investments netted against debt. \$N.V. Nuon changed its name to Alliander N.V. (A/Stable/A-1) on Aug. 7, 2009. Note: Eneco Holding N.V. and N.V. Nuon comprise integrated generation, supply, and distribution activities. NR--Not rated.

Table 3

Eneco Financial Summary*

(Mil. €)	--Fiscal year ended Dec. 31--				
	2008	2007	2006	2005	2004
Rating history	A/Watch Neg/A-1	A/Negative/A-1	A/Negative/A-1	A/Negative/A-1	A+/Watch Neg/A-1
Revenues	4,943.0	4,789.0	4,287.0	3,692.0	3,544.4
Net income from continuing operations	272.0	426.0	311.0	302.0	218.2
Funds from operations (FFO)	650.3	595.5	712.4	556.7	450.3
Capital expenditures (capex)	382.3	428.2	353.9	321.1	196.7
Cash and short-term investments	0.0	0.0	0.0	0.0	0.0
Debt	2,141.2	1,943.4	1,813.5	1,514.8	1,377.9
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	3,809.0	3,040.0	2,738.0	2,601.9	2,396.8
Debt and equity	5,950.2	4,983.4	4,551.5	4,116.7	3,774.7
Adjusted ratios					
EBIT interest coverage (x)	4.7	4.8	6.0	6.1	3.7
FFO interest coverage (x)	7.3	5.9	8.0	6.8	4.2
FFO/debt (%)	30.4	30.6	39.3	36.8	32.7
Discretionary cash flow/debt (%)	0.2	14.6	(8.5)	8.4	23.3
Net cash flow/capex (%)	114.7	99.1	154.4	142.0	228.9
Debt/debt and equity (%)	36.0	39.0	39.8	36.8	36.5
Return on common equity (%)	8.0	14.7	11.6	12.1	9.1
Common dividend payout ratio (unadjusted) (%)	77.9	40.1	0.0	0.0	0.0

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Ratings Detail (As Of December 10, 2009)***Eneco Holding N.V.**

Corporate Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Senior Unsecured (2 Issues)	A-

Corporate Credit Ratings History

27-Apr-2009	A-/Negative/A-2
18-Jul-2008	A/Watch Neg/A-1
04-Dec-2006	A/Negative/A-1
28-Apr-2006	A/Watch Neg/A-1
13-Jul-2005	A/Negative/A-1

Business Risk Profile

Excellent

Financial Risk Profile

Intermediate

Ratings Detail (As Of December 10, 2009)***(cont.)****Debt Maturities**

On Sept. 30, 2009:
 2010: €158 mil.
 2011: €15 mil.
 2012: €94 mil.
 2013: €29 mil.
 2014: €161 mil.
 Thereafter: €1 bil.

Related Entities**N.V. Eneco**

Issuer Credit Rating

A-/Negative/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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