

Research Update:

# Eneco Beheer Upgraded To 'A-' On Potential Support From New Majority Shareholder Mitsubishi Corp; Outlook Stable

March 31, 2020

## Rating Action Overview

- On March 25, 2020, Eneco Groep, the parent of N.V. Eneco Beheer, announced that the consortium led by Mitsubishi Corp had completed its acquisition of a 100% of the Dutch integrated utility company.
- We believe the group will benefit from extraordinary financial support from Mitsubishi, if needed, given the company's relevance for the wider group's long-term strategy.
- We are therefore raising our long-term issuer credit rating on N.V. Eneco Beheer to 'A-' from 'BBB+', and affirming the short-term rating at 'A-2'. We are removing the long- and short-term ratings from CreditWatch positive, where we had placed them on Dec. 4, 2019.
- The stable outlook mirrors that of Mitsubishi, and captures our expectation that the group's new shareholders will adopt a conservative financial policy, solidifying our assumption of continued funds from operations (FFO) to debt above 50% over the next two years.

## Rating Action Rationale

**We believe Eneco's creditworthiness has been boosted by potential extraordinary support from Mitsubishi, the main shareholder following the completed acquisition.** As of March 25, 2020, Eneco is fully owned by a consortium in which Mitsubishi Corp. (A/Stable/A-1) owns 80% of the total shares and Chubu Electric (not rated) owns the remaining 20%. We assume Mitsubishi has the capability and willingness to provide financial support to Eneco, given the integrated utility company's relevance for the group's long-term strategy. Such extraordinary support is beyond what we capture in Eneco's stand-alone credit profile (SACP), supported by its existing business operations. As such, we apply a one-notch positive adjustment to our 'bbb+' assessment of Eneco's SACP, resulting in the 'A-' issuer credit rating.

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**We understand Eneco will be key in Mitsubishi's aim to develop a European renewable platform.** Mitsubishi intends to use Eneco's expertise and well-balanced portfolio from generation to retail as a platform to expand its footprint across Europe and Asia, among other regions. For example, Eneco's expertise in wind power generation would support Mitsubishi in its offshore wind business in Japan. Furthermore, some of Eneco's business solutions could be rolled out to Mitsubishi's retail operations in the Japanese market. We also note that benefits will run in both directions. Eneco will be able to expand its customer solutions offerings by benefitting from Mitsubishi's experience in the automobile industry, artificial intelligence, living essentials, and internet of things.

**Mitsubishi and Eneco have been close business partners for some time.** The cooperation between the two companies has intensified over the years since their joint investment in Luchterduinen wind farm in 2012. In 2019, Eneco, together with Mitsubishi and other stakeholders, finalized the construction of Norther wind farm (with a capacity of 370MW) in Belgium. The two companies are also collaborating on the 730MW Blauwwind (Borssele III/IV) offshore wind park, in which Mitsubishi and Eneco own together 25%; it will be operational by 2022. In addition, the two groups collaborated to develop an energy storage project in Germany.

**We consider Eneco to be moderately strategic for Mitsubishi.** Because of Eneco's strategic relevance within Mitsubishi's extended growth plans, we believe that Mitsubishi will remain a long-term investor in Eneco. However, we expect Eneco to continue operating mostly independent from the rest of Mitsubishi Group. Eneco's management and supervisory boards will change because of the acquisition, but we expect Eneco's business management practices to remain in line with the current model and enjoy some autonomy. Moreover, even though we believe Mitsubishi has incentives to provide extraordinary support to Eneco under some foreseeable circumstances, there are currently no stipulations enforcing such aid, such as cross-default clauses. This supports our assessment of Eneco's moderately strategic group status.

**We believe Eneco's financial policy will remain prudent, at least over the next three years.** In our view, a crucial element of Eneco's stronger credit profile following the transaction is our understanding that the company's financial policy will remain unchanged under the new ownership, at least for the next three years. We understand that the new owners support this through a shareholder agreement in place. It includes a dividend payout ratio of 50% of the previous year's net income and maintaining Eneco's stand-alone credit quality at least in line with a 'bbb' SACP assessment. We don't see this stand-alone credit level as a target, but rather as a level of protection on the downside for Eneco. In our view, these financial measures are credit supportive.

**We see Mitsubishi as a long-term investor with no short-term return pressures.** We understand Mitsubishi will focus on expanding Eneco's business sustainably rather than seeking short-term returns. In our opinion, this will allow Eneco to remain a financially robust company on a stand-alone basis and support its long-term credit quality.

**The COVID-19 impact on Eneco's electricity sales segments should be manageable.** Workforce confinement measures prompted by the COVID-19 pandemic are causing an increase in domestic electricity demand. Conversely, commercial and industrial demand is declining, likely by 5%-7% in 2020 in Europe, as per our estimates. Eneco's B2C business represents close to 15% of EBITDA, while B2B accounts for nearly 5%. Because profitability is higher in the B2C segment, the changing patterns in electricity consumption are mitigating the reduction in industrial and

commercial electricity demand on Eneco for now.

**Although we see a risk of increasing bad-debt provisions across the sector, government support may ward off the challenges.** We acknowledge a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. The longer the situation lasts, the deeper its impact, and the greater possibility of hindrances on working capital and financial performance because of bad-debt provisions. However, we believe government support will partially mitigate this risk by, for instance, covering 90% of the salary of people not able to work due to the virus, providing allowances for people unable to cover their bills, and delaying tax payments. These programs should increase the paying capability of the average customer affected by the ongoing situation.

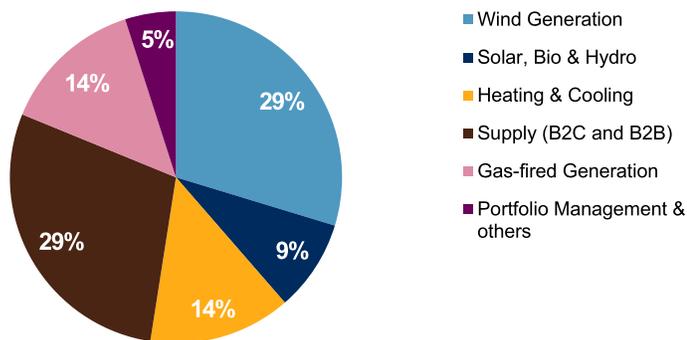
**Potential delayed capex would be executed in 2021.** Complications due to the COVID-19 pandemic could cause some delay in the completion of Eneco's 2020 projects. However, capex otherwise destined to such projects would remain in balance--thereby reducing net debt--only to be executed next year.

**Eneco posted financial results in line with our expectations in financial year 2019.** This was on the back of good commercial and positive trading results that yielded revenue growth of 4.2%. Furthermore, the group's ongoing efforts to cut expenses saved about €70 million, supporting an S&P Global adjusted EBITDA margin expansion of 60 basis points. This resulted in an S&P Global Ratings-adjusted debt to EBITDA of 1.0x and FFO to debt of 86% for 2019, well above our 50% trigger for an intrinsic credit quality of 'bbb+'.

**We expect Eneco financial performance to remain resilient over 2020 and 2021.** Eneco's high cash flow quality benefits from subsidized renewable power generation in The Netherlands, Belgium, and the U.K., which provide a floor price, guaranteed return, or a feed-in tariff, respectively, depending on the location. In addition, the company's district heating activities grant further earnings visibility, since this business has some characteristics of a regulated business, such as steady tariff structures and monopoly-like regional operations. We estimate these segments will account for close to 55% of Eneco's EBITDA over the next two years, and that they'll add visibility and stability to the company's cash flows. This will be further enhanced by Eneco's long-term hedging strategy, which translates in its customer and renewable generation segments price exposure to be fully hedged over 2020-2021. Prudent financial policies provide protection, particularly amid declining European power prices. Eneco's CCGT generation earnings are slightly more exposed, but we see this contained within €10 million if spark spreads sharply decline and without a material impact on Eneco's credit metrics.

Chart 1

### Eneco's EBITDA Split By 2019



Source: S&P Global Ratings.

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### Greater capex on the back of more approved projects over the coming years will remain

**manageable.** We assume that capex may rise to €300 million–€400 million, which is well within Eneco's operating cash flow boundaries of about €450 million–€500 million in 2020 and 2021. In addition, we view as unlikely that all investments will be implemented given the current economic situation. This further cushions Eneco's credit metrics for 2020, and coupled with a continued dividend policy of about 50% of previous year's net income, translates into neutral to positive cash flows after dividends in our base-case scenario over the next two years. We expect these factors to result in a ratio of funds from operations (FFO) to debt consistently above 50% over the next two years, in line with our assessment of Eneco's SACP.

**We expect Eneco to remain focused on expanding its renewable capacity.** We don't think the new business plan from Eneco's new ownership—who, together with Eneco, are still defining the strategy—will derail Eneco's strategy to remain centered around developing new renewable generation. Eneco aims to expand its own renewable capacity to 2.2GW by 2022 from 1.3GW in 2019, and Mitsubishi's transfer of 400MW of wind capacity to Eneco, alongside around 300MW renewable capacity already under development, will complement these efforts. We expect the new business plan will further Eneco's existing strategy, potentially beyond the Dutch borders.

Other growth vectors will come from additional functions to Eneco's trading department, and further developing its supply business by broadening customers solutions offerings, and expanding customer base while keeping the deployment of digital-oriented cost optimization programs.

## Outlook

The stable outlook on Eneco mirrors that of its main shareholder, Mitsubishi.

The outlook also captures our expectation that the new shareholders will uphold Eneco's historically prudent financial policy, with a supportive dividend policy at least over the next three years. Furthermore, we expect Eneco to continue posting a relatively stable EBITDA and FFO, underpinned by subsidized renewable generation and district heating.

These factors result in our expectation that the group will continue posting an FFO to debt above 50% over the next two years.

## **Downside scenario**

We could lower the ratings if Mitsubishi's credit quality deteriorates, thereby reducing its capability to provide extraordinary support to Eneco.

A downgrade over the next two years would also result from a more aggressive capex acceleration or unexpected mergers and acquisitions that result in its FFO to debt dropping below 50%. This could also occur, for example, if the output of the wind fleet was much lower than currently anticipated; or if the company lost significant market share in its power retail segments.

## **Upside scenario**

An upgrade is unlikely over the next two years. Since we cap the group support that Eneco receives at one notch below the 'A' rating on Mitsubishi, any upside to its 'bbb+' SACP to 'a-' would not yield a higher issuer credit rating.

That said, we could positively reassess Eneco's SACP to 'a-' over the next two years if the company posts an FFO to debt consistently above 60%, and this is backed by a financial policy that support the metric at such levels.

## **Company Description**

N.V. Eneco Beheer is a subsidiary of Eneco Groep N.V., headquartered in Rotterdam, The Netherlands.

Eneco generates electricity from onshore and offshore wind and solar parks in The Netherlands, Belgium, and the U.K. Eneco also provides heating and cooling services in The Netherlands. Together, these activities account for close to 55% of EBITDA. About 13% of the group's EBITDA comes from gas-fired generation, which Eneco uses to balance generation from renewable assets.

The rest of the company's EBITDA comes from commercial activities, which include energy retail, trading, and other energy services. Eneco is The Netherlands' second-largest energy supplier, the No. 3 in the Flanders region, and, since 2017, a niche participant in the German renewable energy supply market through its acquisition of Lichtblick SE.

As of March 25, 2020, the group is fully owned by a consortium in which Mitsubishi Corp. owns 80%, while Chubu Electric holds the remaining 20%.

## **Ratings Score Snapshot**

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

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Modest

- Cash flow/leverage: Modest

Anchor: bbb+

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: bbb+

- Group credit profile: a
- Group status: Moderately strategic (+1 notch)

## **Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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 | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## **Related Research**

- Research Update: N.V. Eneco Beheer 'BBB+' Rating Placed On CreditWatch Positive On Announced Acquisition By Mitsubishi Corp. And Chubu, Dec. 4, 2019

## Ratings List

### Upgraded; Ratings Affirmed; CreditWatch Action

|                          | To            | From               |
|--------------------------|---------------|--------------------|
| <b>N.V. Eneco Beheer</b> |               |                    |
| Issuer Credit Rating     | A-/Stable/A-2 | BBB+/Watch Pos/A-2 |
| Commercial Paper         | A-2           | A-2/Watch Pos      |

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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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.

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