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**Research Update:**

## Netherlands-Based Gas Company Gasunie Ratings Affirmed On Stabilized Relationship With Regulator; SACP Raised To 'a'

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## Research Update:

# Netherlands-Based Gas Company Gasunie Ratings Affirmed On Stabilized Relationship With Regulator; SACP Raised To 'a'

## Overview

- We now have more clarity regarding the new regulatory determinations for Dutch gas transmission system operator Gasunie.
- As expected, the new regulatory determination will erode Gasunie's profitability, but in our view, this is compensated for by Gasunie's improved relationship with its regulator.
- We are also more certain that Gasunie will sustainably maintain funds from operations to debt above 15% in the medium term.
- Although we have revised upward Gasunie's stand-alone credit profile (SACP) to 'a' from 'a-', the 'AA-' rating is unaffected because it factors in our expectation of government support.
- The stable outlook reflects that on the Netherlands, because in our view the government has a high likelihood of providing exceptional support to Gasunie in case of need.

## Rating Action

On May 24, 2017, S&P Global Ratings affirmed its 'AA-/A-1+' long- and short-term corporate credit ratings on N.V. Nederlandse Gasunie. The outlook is stable.

## Rationale

Gasunie's regulator--the Authority for Consumers & Markets (ACM)--has finalized the method and parameters for tariff determination during the 2017-2021 period. We anticipate that Gasunie will be able to maintain funds from operations (FFO) to debt sustainably above 15% during this period. This is lower than in previous years because Gasunie's profitability will be lower under the new regulatory determination. That said, we consider the increased predictability of Gasunie's future financial performance to be positive to the rating.

In addition, Gasunie's relationship with ACM has stabilized. Previously, negative interactions in 2012-2013 with ACM had caused us to adjust down the SACP by one notch, but there has been no sign of such negative regulatory intervention since. As a result, we have raised Gasunie's SACP to 'a' from 'a-', although this does not affect the final rating of 'AA-'.

The ratings on Gasunie include two notches of uplift from the SACP, based on

our view that there is a high likelihood of extraordinary support from the 100% owner, the government of the Netherlands, in case of financial stress. We base our view on Gasunie's:

- Very important role for the Dutch government, given the group's strategic importance as the sole owner and operator of the regulated high-pressure gas transmission network in The Netherlands. Gasunie plays an important role in implementing the Dutch government's policy of enhancing the gas infrastructure networks in the country and in securing the country's supply of gas; and
- Strong link with the state, based on our opinion that the state will likely retain majority ownership of Gasunie. This also reflects that the state is involved in Gasunie's strategic decisions, although management is generally independent and makes autonomous business decisions.

Gasunie's excellent business risk profile is underpinned by very stable and regulated gas transmission in the Netherlands and in Northern Germany. About 70% of Gasunie's EBIT is derived in the Netherlands and 15% in Germany; the remaining 15% is derived from other unregulated midstream activities. The new regulatory period in the Netherlands starts in 2017 and that in Germany starts in 2018. These will lead to a decline in profitability over the medium term. Lower regulated revenue is linked to increased efficiency requirements and lower overall cost of debt. Gasunie's capital expenditure (capex) requirements are limited, in contrast to electricity transmission system operators, especially since we understand that the company will likely not need to build a new conversion gas facility at Groningen, although this will be confirmed in the second half of 2017. The final regulatory determination for Germany will only be known at the end of the year.

As a result of the new regulatory decisions in the Netherlands and Germany, we expect Gasunie's credit measures to weaken compared with previous years. Its FFO to debt will fall to about 16%. That said, the reduction in planned capex, combined with moderate dividend payments, should result in positive discretionary cash flow generation, causing Gasunie's level of debt to decline over the regulatory period.

Under our base-case scenario, we assume:

- Revenues will decrease following implementation of the new regulatory determinations in the Netherlands and in Germany.
- Capex of €750 million over 2017-2019, much lower than the historical average because Gasunie is currently focusing on its maintenance and replacement program.
- Regulatory weighted-average cost of capital declining to 3% in 2021 in the Netherlands.
- Regulated return on equity of 6.9% for new assets, and 5.1% for existing assets in Germany from 2018.
- Dividends payout of 60% over 2017-2019.
- Average cost of debt falling to about 2.2% over 2017-2020 as maturing debt is refinanced at lower rate.
- Gradual decrease in debt due to positive cash flows.
- FFO to debt comfortably above 15%.

## **Liquidity**

We assess Gasunie's liquidity position as adequate, supported by our view that its liquidity resources will exceed its funding needs by more than 1.2x in the 12 months from March 31, 2017. We consider that Gasunie has a good credit standing and very good access to the credit market. Management is committed to maintaining an adequate liquidity.

We anticipate the company will have the following principal liquidity sources over the 12 months from March 31, 2017:

- A cash balance of close to €40 million as of March 31, 2017;
- Access to €775 million undrawn committed credit maturing in 2020-2021; and
- Our expectation that Gasunie will generate FFO of above €600 million.

We anticipate the company will have the following principal liquidity uses over the same period:

- Debt maturity of €371 million in the next 12 months;
- Expected capital spending of close to €250 million-€300 million on average; and
- Expected shareholder distributions of €100 million-€200 million.

## **Covenant analysis**

The credit facility contains covenants that require Gasunie to comply with the Financial Management Grid Operator Decree (Besluit financieel beheer netbeheerder; published July 26, 2008, by the Dutch Ministry of Economic Affairs). The decree includes financial criteria applicable to Dutch network operators--including minimum credit ratings of at least 'BBB' (or equivalent). Gasunie has a comfortable amount of headroom under the covenant, given that we rate it 'AA-', five notches above the minimum threshold of 'BBB'.

## **Outlook**

Our stable outlook on Gasunie reflects that on the sovereign, and our opinion that a rating action or outlook revision on Gasunie's 100% owner, the Netherlands, would likely result in a similar action on Gasunie.

## **Downside scenario**

We could lower the ratings on Gasunie if we downgraded the sovereign or if we significantly revised down Gasunie's SACP to 'bbb+' from 'a'. We do not currently consider this likely, given the regulated nature of the company's business and the moderate dividend payout ratio of 60%. This said, it could happen if Gasunie's FFO to debt declined sustainably below 11%.

We could also lower our rating on Gasunie if we revised our view of the likelihood of government support, for example, if we thought the role of gas in the Netherlands had declined such that the likelihood of extraordinary support from the government was reduced.

## Upside scenario

The potential for a positive rating action is limited, as it would require a two-notch increase in Gasunie's SACP to 'aa-'. This could happen if Gasunie's adjusted FFO to debt sustainably stabilized to above 23%.

## Ratings Score Snapshot

Corporate Credit Rating: AA-/Stable/A-1+

Business risk: Excellent

- Country risk: Very low risk
- Industry risk: Very low risk
- Competitive position: Excellent

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a

- Group credit profile: a
- Sovereign rating: AAA
- Likelihood of government support: high

## Related Criteria

- 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And

Adjustments, Nov. 19, 2013

- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Related Research

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

## Ratings List

Ratings Affirmed

N.V. Nederlandse Gasunie  
Corporate Credit Rating  
Senior Unsecured

AA-/Stable/A-1+  
AA-

### Additional Contact:

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