Research Update:

Eneco N.V. 'A-/A-2' Ratings Affirmed; Outlook Stable

October 29, 2024

Rating Action Overview

- Eneco posted solid results for fiscal 2023 (year ended March 31, 2024), while it continued to expand installed capacity, reaching almost 2.4 gigawatts (GW) supported by long-term contracts.
- We, however, view a higher discrepancy in Eneco's credit metrics between March 31 and Dec. 31 due to the seasonality of operational working capital.
- We will continue benchmarking credit metrics to the end-December level because we think they adequately reflect the group's credit quality.
- We affirmed our 'A-/A-2' long-term and short-term ratings on Eneco, reflecting the 'bbb+' stand-alone credit profile and a one-notch uplift from its main shareholder, Mitsubishi Corp. (A/Stable/A-1).
- The stable outlook on Eneco reflects that on Mitsubishi and our forecast of adjusted funds from operations (FFO) to debt to staying higher than 50% at Dec. 31 while expanding its renewable fleet, due to a supportive financial policy. We will monitor whether the difference in FFO to debt at the end of March and the end of December deviates substantially above 10% due to working capital seasonality.

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Rating Action Rationale

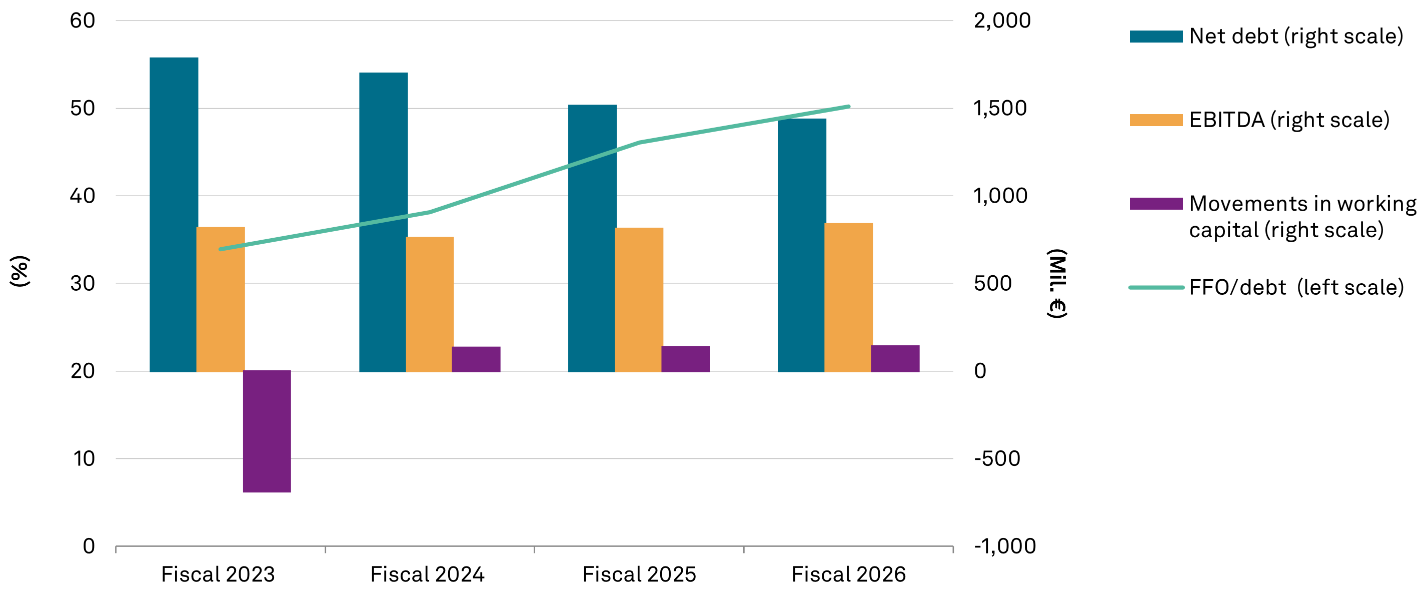
We view Eneco's fiscal 2023 operational performance as solid, fueled by renewable generation and retail activities. The solar and wind segment performed well, contributing to 38% of total EBITDA for fiscal 2023 with new assets becoming operational (increasing consolidated capacity by 273 MW to 2,394 MW) and favorable weather conditions. However, Eneco's heating and cooling business posted a loss in 2023 due to one-off items related to a fire at one of its heat suppliers and lower-than-expected demand. EBITDA from energy trading (about 27% of the total for 2023) remains strong despite prices stabilizing since 2022's energy crunch. Supply activities in Germany, Belgium, and the Netherlands performed exceptionally well, contributing about 28% of total EBITDA supported by fixed-price contracts with customers and relatively stable volumes.

Eneco continues delivering on its strategic path, with a focus on expanding its renewable capacity. The company is vertically integrated, with about 77% of the electricity it supplies coming from its own or long-term contracted renewable assets. By March 31, 2026, Eneco targets an increase of its green energy capacity, by about 1 gigawatt (GW) to 3.1 GW at March 31, 2025. To achieve this, the company is investing about €800 million in capital expenditure (capex) over fiscal years 2024-2026 dedicated to wind and solar. Eneco's asset base remains primarily covered by subsidy schemes and fixed-price offtake agreements. As of March 31, 2024, about 77% of Eneco's renewable capacity benefits from subsidy schemes, 12% has expired subsidies, and 11% are no subsidies. We expect subsidized capacity will decline gradually to 55%-60% by March 31, 2028, as subsidies expire at some plants and new subsidy-free capacity starts operations. At the same time, the company expects additional subsidies, increasing subsidized capacity 20% until fiscal 2028; therefore, merchant exposure is only increasing moderately. Moreover, assets without subsidies benefit from long-term corporate power purchase agreements, which have an average residual tenor of 10 -15 years and mitigate investment recovery risk by providing some visibility on cash flows with creditworthy offtakers.

We view a higher discrepancy in Eneco's credit metrics between March 31 and Dec. 31 due to the seasonality of operational working capital. However, this does not impair credit quality, in our view. Eneco changed its fiscal year to March from December starting from April 1, 2023, which was prompted by shareholder Mitsubishi, to synchronize both companies' reporting cycle. Eneco's net debt is structurally higher in March because the company's net working capital is more negative at the end of December than at the end of March. This is mainly due to payments by Eneco's retail and small and midsize enterprise customers being spread evenly over the year, while it sources and pays in the wholesale market based on actual offtake, which is much higher in the winter. The company's business to business portfolio also affects this seasonal net working capital swing because these customers consume more gas during the winter months on average. Working capital swings can be influenced by absolute price levels for power and gas, and weather conditions. We think differences in ratios between March and December end can affect FFO to debt by about 10%.

We will benchmark Eneco's credit metrics at their Dec. 31 levels. We would need a track record to assess the financial performance of the group at end of March, to capture the seasonality of the working capital and any potential extra volatility. We expect credit metrics to remain above the downside 50% trigger at Dec. 31. We also expect EBITDA will increase to €830 million-€850 million by March 2027 from €750 million-€770 million at March 2025. The increase comes from renewable capacity coming online and efficiency savings through digitalization. Because of expected collateral margin positions and flow of working capital compared with fiscal year-end 2023, free operating cash flow (FOCF) will be €280 million-€300 million in March 2025. Over fiscal years 2025-2026, we forecast strong FOCF of €210 million-€320 million, based on good cash conversion, and contained shareholder distributions of €120 million-€130 million per year over fiscal years 2025-2026 after peaking in fiscal 2024 due to high profit in the previous year. Eneco's net debt position incorporates €412 million of nonrecourse project finance debt, which is not the common accounting practice in the sector. All in all, per March-end, we forecast that the company's FFO to debt will remain at 35%-40% in fiscal 2024, although remaining at 45%-50% over fiscal years 2025-2026.

Working capital swings affect the FFO-to-debt metric



Note: Fiscal year ends March 31 of the following year. Source: S&P Global Ratings.

FFO to debt dropped to about 35% for fiscal year-end 2023 despite Eneco's solid financial results. We expected a drop in FFO to debt for March 2024 due to the company's working capital seasonality, but net debt was higher than expected. Despite the fact that Eneco posted EBITDA in line with our forecast (€771 million compared with €725 million expected), net debt was materially higher than expected driven by working capital fluctuations (€1.78 billion actual versus €1.6 billion expected). S&P Global Ratings-adjusted net debt for 2023 was also temporary higher than our previous forecast due to the substantially higher margining position and delay in selling its Ecowende stake to Chubu Electric Power. EBITDA in the heating and cooling business fell in part because of one-off items related to a fire at one of Eneco's heat suppliers (AVR) and due to Eneco's decision not to further develop a heating concession (WAD kwartier). Moreover, less customer demand also had a negative impact on the heating and cooling business. We do not view these one-offs as recurring, so they do not affect Eneco's credit quality.

We expect shareholders will continue supporting Eneco's credit quality. Our rating on the company benefits from a one-notch uplift for support from our expectation that its 80% shareholder, Mitsubishi, is willing and able to provide extraordinary financial support. In addition, the rating reflects our expectation that Eneco's shareholders will uphold its historically prudent financial policy.

Outlook

The stable outlook on Eneco reflects that on Mitsubishi. In addition, we expect Eneco's subsidized or long-term contracted renewable capacity and district heating operations will continue to deliver stable cash flow, underpinning the group's credit quality. We further think Eneco can sustain FFO to debt of above 50% at Dec. 31 while expanding its renewable fleet, due to a supportive financial policy. We will monitor the difference in FFO to debt at the end of March and the end of December not deviating substantially above 10% due to working capital seasonality. As such, we expect the company's metrics to remain within the range for the 'bbb+' stand-alone credit profile (SACP).

Downside scenario

We could downgrade Eneco if the credit quality of its main shareholder deteriorates.

A downgrade would also result from a deterioration of Eneco's SACP that could stem from a more aggressive capex program or unexpected M&A activity translating into FFO to debt dropping below 50% at Dec. 31. This could also occur, for example, if the wind fleet's output was much lower than currently anticipated; the company lost significant market share in its retail activities; or the group experienced significant negative margin call requirements on its trading portfolio. We could see pressure on Eneco's metrics if FFO to debt at March 31 was substantially lower from 10% at Dec. 31 and not explained by working capital seasonality.

Upside scenario

Rating upside is limited. An improvement of the company SACP to 'a-' would not result in an upgrade, since we cap group support at one notch below the long-term rating on Mitsubishi, given Eneco's strategic relevance to its new majority shareholder.

We could revise our assessment of Eneco's SACP upward over the next 12-24 months if the company posts FFO to debt consistently above 60% as of Dec. 31 and trending to this level as of March 31; and maintains a financial policy that supports the metric at these levels.

Company Description

Eneco N.V. (formerly N.V. Eneco Beheer) is headquartered in Rotterdam, The Netherlands. It generates electricity from onshore and offshore wind and solar parks in the Netherlands, Belgium, and the U.K. The renewable operations accounted for 38% of total EBITDA in 2023. Eneco also provides heating and cooling services in the Netherlands. However, there was no EBITDA contribution from the heat and cold business due to one-off items and less demand than anticipated. The rest of the company's EBITDA comes from commercial activities, which include energy retail, trading, and other energy services.

Eneco is the Netherlands' third-largest energy supplier with 3.3 million customer contracts, including No. 3 in the Flanders region with 1 million contracts. Since 2017, it has also been a niche participant in Germany's renewable energy supply market through its acquisition of Lichtblick SE and E.ON Heizstrom, together accounting for about 900,000 customer contracts.

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

Our Base-Case Scenario

Assumptions

- EBITDA from subsidized renewable generation and district heating increasing to about 49% in fiscal 2026 (year ending March 31, 2027) from 41% in fiscal 2023.
- Continued long-term hedging approach to manage commodity price risk, leading to protection against power prices movements until 2028.
- Focus on digitalization and synergies resulting in increasing margins, supporting EBITDA and FFO.
- Ongoing market leadership as an integrated player in Belgium, the Netherlands, and Germany, despite competitive pressures on retail business.
- Investment focus on increasing owned renewable capacity to about 3.5 GW by fiscal 2026 from 2.4 GW currently, which translates into €1.8 billion of capex over 2024-2026.
- Working capital inflow of €130 million-€150 million related mainly to margin variations on existing positions that flow back to the exchange for fiscal year-end 2024.
- Dividend distributions of about 50% of the previous year's net income.

Key metrics

Eneco N.V.--Key metrics

Period ending	Mar-31-2024	Mar-31-2025	Mar-31-2026	Mar-31-2027
(Mil. €)	**2023a**	**2024e**	**2025f**	**2026f**
EBITDA	817	750-770	800-820	830-850
Funds from operations (FFO)	605	640-660	690-710	710-730
Capital expenditure (capex)	642	290-310	510-530	530-550
Free operating cash flow (FOCF)	(568)	290-310	310-330	200-220
Debt	1,785.9	1,650-1,750	1,500-1,600	1,400-1,500
Adjusted ratios				
Debt/EBITDA (x)	2.2	2.0-2.5	1.8-2.3	1.5-2.0
FFO/debt (%)	33.9	35-40	43-48	47-52
FOCF/debt (%)	-31.8	15-20	18-23	12-17

Liquidity

The short-term rating on Eneco is 'A-2', reflecting our 'A-' long-term issuer credit rating and our assessment of liquidity as adequate, supported by the company's cash position as of June 30, 2024. We expect Eneco to maintain a sources-over-uses ratio well above 1.2x over the next 12 months.

The company's liquidity is enhanced by its access to a revolving credit facility of €2.50 billion, of which €1.25 billion expires in June 2026 and €1.25 billion expires in September 2027.

Although Eneco's quantitative characteristics that align with a strong liquidity assessment, our view of qualitative factors prevents us from assessing it as such. We believe the very high liquidity sources are only temporary since the company may cancel or lower some of its unused liquidity lines.

Principal liquidity sources over the next 12 months include:

- Cash and liquid investments of about €233 million;
- Undrawn committed credit lines of €2.5 billion;
- Projected cash FFO of about €550 million; and
- Working capital inflows of about €130 million.

Principal liquidity uses over the same period include:

- Debt maturities of €715 million;
- Capex of about €410 million; and
- Dividend distributions of about €160 million.

Covenants

Eneco has no covenants under its bank facilities.

Environmental, Social, And Governance

Environmental factors are a positive consideration in our credit rating analysis of Eneco. The company was one of the first to use renewable energy in the Netherlands (7.9 GW of owned and controlled renewable capacity as of 2023), which provided the company with a large, subsidized portfolio, resulting in stable and predictable cash flows. Moreover, Eneco is one of the largest district heating providers in the Netherlands, a business that is poised for growth given that the central government intends to decarbonize its heating base (currently above 90% from gas). This will provide Eneco with a stable and increasing source of cash flow, which we see as an advantage from a credit perspective. As part of its strategy, the company aims to be carbon neutral by 2035. This entails Eneco's own activities and the energy supplied to its customers, meaning that the strategy's reach covers scope 1, 2, and 3 emissions. As of 2023, the company emits about 1.2 million tons of scope 1 and scope 2 carbon dioxide (CO_2)-equivalent emissions (9.7 million tons of CO_2 scopes 1, 2, and 3 emissions).

Ratings Score Snapshot

Rating component scores

Component	
Foreign currency issuer credit rating	A-/Stable/A-2
Local currency issuer credit rating	A-/Stable/A-2

Rating component scores (cont.)

Component	
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	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb+
Group credit profile	a-
Entity status within group	Core (+1 notch)

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- What Europe's Energy Redesign Might Mean For Its Power And Gas Markets, Sept. 13, 2022

Ratings List

Ratings Affirmed	
Eneco N.V.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	A-2