Moody's
INVESTORS SERVICE

Rating Action: Moody's upgrades Gasunie to A1 from A2; stable outlook

08 Aug 2018

London, 08 August 2018 -- Moody's Investors Service, (Moody's) has today upgraded to A1 from A2 the long-term issuer and senior unsecured debt ratings of N.V. Nederlandse Gasunie (Gasunie). Concurrently, Moody's has upgraded to (P)A1 from (P)A2 the ratings of the group's EUR7.5 billion senior unsecured EMTN programme. Finally, Moody's has affirmed the short term issuer rating of Gasunie at P-1. The outlook on all ratings has changed to stable from positive.

The rating action reflects Moody's view that Gasunie will maintain a solid financial profile over the period to 2020 under the regulatory determinations for its monopoly gas transmission activities in northern Germany and the Netherlands, which together account for the vast majority of the group's earnings, despite the incremental capex associated with facilitating the reduction and minimisation of gas extraction from the Groningen field in the Netherlands.

RATINGS RATIONALE

The A1/P-1 ratings factor in Moody's expectation that Gasunie will continue to maintain a solid financial profile, with Funds From Operations (FFO) / Net Debt in the high teens in percentage terms over the period to 2020.

Gasunie has good cash flow visibility until at least the end of 2021 for all its monopoly gas transmission operations (until end 2022 in Germany) following regulatory determinations in the Netherlands and Germany in the last 18 months. We expect Gasunie to outperform regulatory cost allowances in aggregate with the slight underperformance in the Netherlands offset by significant incremental revenue from regulatory settlements in Germany, although less than in the prior regulatory period. We expect these regulated gas transmission operations to account for almost 90% of reported group EBITDA over the period to 2020, given the decline in unregulated earnings since end 2016 from the majority of long-term contracts expiring on the BBL interconnector and recontracted capacity being significantly less profitable in the current market environment.

Regulatory allowed returns are materially lower than in the prior regulatory periods in both jurisdictions (2013-17 in Germany and 2014-16 in the Netherlands), weakening cash flow based metrics. However, we note that (1) Gasunie's FY2017 metrics already reflected the further cut in allowed returns for its Dutch operations (carried out by Gasunie Transport Services, GTS), which accounts for c. 80% of the group's regulated EBITDA; and (2) Gasunie has received favourable interim court/appeal body rulings in 2018 in both jurisdictions on this subject. The relevant bodies concluded that the allowed return (equity return in Germany) may have been set too low with the Dutch energy regulator required to re-determine the WACC by January 2019 and a final outcome expected in Germany in 2019/20 (the regulator is challenging the court's decision). Moody's expects the incremental revenues from the final re-determination, which include higher cost allowances for GTS (the court also ruled that the frontier shift, which is the scope for improving productivity resulting from technology progress and lower purchasing prices, may have been set too high) for the entire regulatory period, to be reflected in tariffs from 2020.

Moody's believes that GTS will play an increasingly important role in delivering Dutch national energy policy objectives, including both decarbonisation and the further material lowering of the Groningen gas production cap. The output cap has been reduced several times in recent years due to seismic activity in the region which has caused significant damage to thousands of homes and buildings and been attributed to decades of extraction at Groningen. Following the largest earthquake in recent years in January 2018, amendments to the Gas Act and Mining Act were proposed. Subject to these being passed into law, GTS's legal responsibilities will be made more explicit to ensure security of supply, while facilitating the reduction of the extraction from the Groningen field over time.

Irrespective of the final outcome of the amended Gas Act and Mining Act, GTS is able to recover in tariffs the costs for the most material incremental capex over the period to 2022 to facilitate these objectives, including an additional nitrogen facility which the company has guided will cost c. EUR0.5 billion. In addition, the Dutch regulator has given comfort to GTS that the related efficient costs (of blending gas) will not be taken into account in future efficiency benchmarks. This is important because since other gas network operators would not be required to undertake this activity, GTS's cost efficiency and, in-turn, cost allowances would otherwise be lower increasing the risk of underperforming the regulatory settlement. This, coupled with modest other capex requirements (mainly replacement and maintenance), means that Moody's does not expect a material deterioration in Gasunie's financial profile from the required investments to facilitate government national energy policy objectives over the period to 2020. Finally, Gasunie's A1 rating incorporates a two-notch uplift from its standalone credit quality or Baseline Credit Assessment (BCA) of a3, taking into account its ownership by the Dutch government (Aaa stable) and the aforementioned strategic importance to national energy policy. Moody's assumes strong support and high dependence under the rating agency's methodology for Government-Related Issuers published in June 2018.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Gasunie will continue to maintain a solid financial profile, with FFO / Net Debt at least in the high teens in percentage terms and Net Debt / Fixed Assets below 55%, despite the incremental capex associated with maintaining security of supply in the Netherlands given the further reduction in the Groningen gas production cap.

WHAT COULD CHANGE THE RATING UP/DOWN

Although not currently anticipated over the period to 2021, upward rating pressure would arise if Gasunie were to exhibit a sustainably stronger financial profile, expressed as FFO / Net Debt at least in the low twenties in percentage terms and Net Debt / Fixed Assets below 45%, and no material change in business risk profile.

Downward rating pressure would arise if (1) Gasunie was unable to meet our ratio guidance for the current baseline credit assessment (BCA) of a3, which includes FFO / Net Debt at least in the high teens in percentage terms and Net Debt / Fixed Assets below 55%, or (2) there was a substantial increase in Gasunie's business risk profile, e.g. the absence of a regulatory framework that provides for timely cost recovery for the incremental investments required to ensure security of supply in the Netherlands. Finally, the rating could be downgraded if there was a reduction in the likelihood of extraordinary support by the Dutch government in a financial distress scenario.

The methodologies used in these ratings were Regulated Electric and Gas Networks published in March 2017 and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

N.V. Nederlandse Gasunie (Gasunie) is the 100% Dutch state-owned owner and operator of the Dutch and north German high pressure gas transmission systems. Over the 2015-17 period, Gasunie generated around 85% of its operating profit from these activities, with the majority of these regulated earnings coming from its Dutch operations. Gasunie's residual earnings relate to its participations in non-regulated businesses, which generate most of their revenues from long-term contracts. Gasunie reported revenues of EUR1,241 million and EBITDA of EUR753 million in FY2017.

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For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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