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Research Update:

German And Dutch Power TSO TenneT 'A-' Rating Affirmed On Expectation That Ratio Dip Is Temporary; Outlook Stable

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Rating Action Overview

- German and Dutch transmission system operator (TSO) TenneT Holding B.V. posted strong operating performance in 2021, and benefits from almost 100% of its earnings being generated from regulated activities in the Netherlands and in Germany.
- TenneT's 2021 financial performance suffered due to higher energy prices and transmission restrictions that led to S&P Global Ratings-adjusted EBITDA of below €900 million in 2021 (based on International Financial Reporting Standards [IFRS]), instead of about €2.0 billion (based on regulatory accounting standards), and S&P Global Ratings-adjusted funds from operations (FFO) to debt of 2.7%. S&P Global Ratings expects those increased costs will be mostly recovered by 2023/2024, thanks to the cost recovery mechanisms embedded in the regulatory frameworks in the Netherlands and Germany. As a result, on average over the next few years, we expect FFO to debt to remain above 6%, which is our threshold for the current rating.
- We affirmed our 'A-' long-term rating on TenneT.
- The stable outlook reflects our expectation that TenneT will recover the extra costs incurred in 2021 through tariff adjustments. This should mean that adjusted FFO to debt for 2022 will remain well below the 6% threshold for the 'A-' rating on an IFRS basis, and is expected to be in the high single teens, based on regulatory figures, which is in line with the company's financial target. Our stable outlook also takes into account the Dutch government's commitment, made in September 2021, to support TenneT, via a €4.25 billion equity contribution.

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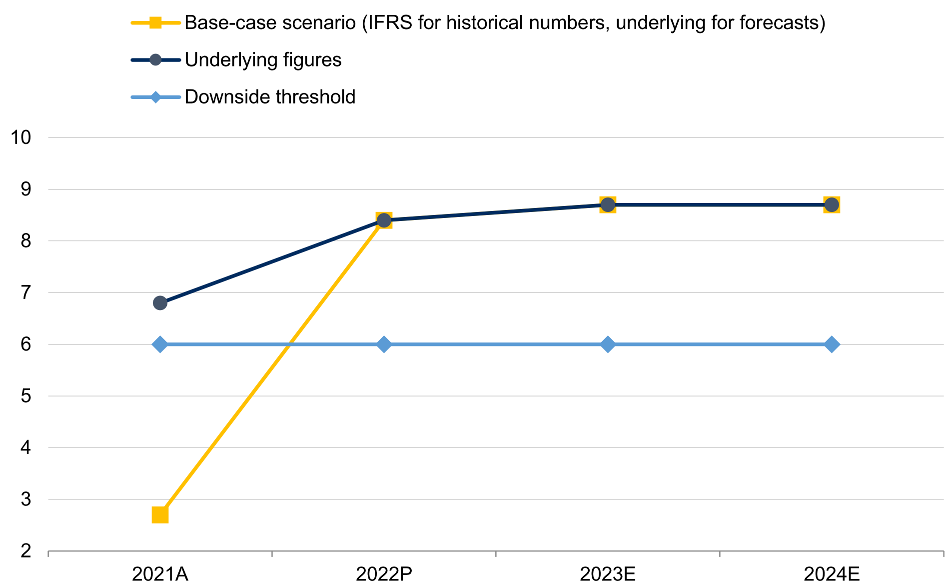
Rating Action Rationale

Despite strong operating performance in 2021, IFRS adj. FFO to debt was well below the threshold for the current rating. TenneT posted strong operating performance in 2021 with no material delays in the commissioning of new lines and onshore grid availability close to 100%. Despite this, higher energy prices and transmission restrictions weighed on the group's adjusted

EBITDA, which fell to €890 million on an IFRS basis, from €2.4 billion in 2020, while adjusted funds from operations (FFO) to debt declined to 2.7%, well below the 6% threshold for the current rating. This is because IFRS records revenues for a given year based on tariff charges derived from historical rates. Based on regulatory accounting, which considers revenues and charges approved by the regulator, TenneT's reported EBITDA would have been about €2.0 billion and the adjusted FFO to debt would have been above our 6% threshold for the current rating. TenneT will effectively recover those extra costs via its tariffs, but only after a delay of a couple of years. The effects of that delay on results in 2021 and 2022 will be particularly strong given the current energy market conditions.

Chart 1

Expected Evolution Of TenneT's Adjusted FFO To Debt Based On Underlying And IFRS Numbers



FFO--Funds from operations. IFRS--International Financial Reporting Standards. A--Actual. P--Projected. E--Estimated. Source: S&P Global Ratings

While we expect 2022 adjusted FFO to debt will remain well below the 6% threshold for the current rating based on IFRS numbers, we note from 2023 it should materially improve as:

- TenneT will start to recover the extra costs incurred in the Netherlands, and the higher costs in Germany two years after the current regulatory period ends in 2023;
- The costs incurred in 2022 will be reflected in the tariffs for future periods and thus recovered.

On an IFRS basis, this should result in a weighted average adjusted FFO to debt of above 6%, which is the threshold for the current rating. Based on regulatory figures, we expect TenneT's adjusted FFO to debt to remain well above the 6% threshold during 2022-2024.

TenneT will continue to benefit from high regulatory visibility in the Netherlands and Germany. About 95% of TenneT's profits are generated from fully regulated power transmission activities in Germany (which accounted for 70% of the group's EBITDA in 2021) and the Netherlands (30% of EBITDA in 2021).

In the Netherlands, the current five-year regulatory period runs until 2026. Despite the significant reduction in the pre-tax weighted average cost of capital (WACC), which fell to below 2.5% for both new and old assets, compared with 3.0% at the end of the previous regulatory period, we do not expect TenneT's operating performance to dip as efficiency rates are expected to remain well above 80% at the end of the regulatory period (for which TenneT has appealed the regulatory proposal).TenneT will also benefit from increases in the risk free rate due to the ex-post settlement of that rate.

In Germany, the current five-year regulatory period will end in 2023. The regulator, BNetzA, has already published the pre-tax return on equity (ROE) for the new regulatory period, which will start in 2024. The new regime will reduce remuneration for assets built before 2006 by about 160 basis points (bps), from the previous level of 5.12%, and by about 180 bps for new assets, from 6.91%. We note that the cost recovery in Germany takes longer compared with other European regulatory frameworks that we assess as "strong."

TenneT's capital expenditure (capex) will increase to support the energy transition in Germany and the Netherlands, leading to an expected increase in debt of about €10 billion by 2024 versus 2021. TenneT will invest more than €14.5 billion over 2022-2024. This translates into annual capex of more than €5.0 billion, up from about €3.7 billion in 2021. Negative free cash flow after capex and dividends will be close to €3.0 billion per year over 2022-2024, while adjusted debt will likely increase to about €25 billion by the end of 2024, from about €16.5 billion in 2021. The evolution of adjusted debt will depend on timing and the amount of the capital increase.

Government support continues be necessary to maintain credit metrics in line with the current rating. TenneT's sole shareholder, the Dutch Ministry of Finance, has a strong track-record of supporting the company, including €600 million of capital injections over 2011-2012, and €1.2 billion over 2017-2019.

In September 2021, the Dutch government approved €4.25 billion of additional support for TenneT, which we expect will support the company's growth plans and mitigate the effect of increased capex on credit metrics. In particular, the capital increase will have a positive impact of about 150 bps on adjusted FFO to debt in the year when it is implemented, which is 2024 in our base case scenario.

Our rating on TenneT stands two notches above the stand-alone credit profile (SACP) of 'bbb', based on our view of a moderately high likelihood of extraordinary support, thanks to the groups "important" role for the Dutch government and its "strong" link with the Netherlands.

Outlook

The stable outlook on TenneT factors in our expectation that operating conditions for power transmission in the Netherlands and Germany will not change in the coming years. This reflects regulation in the Netherlands that is set until 2026, and in Germany where a new regulatory period starting in 2024 is expected to provide continuity with the current period which expires at the end of 2023. Moreover, it also factors in the full recovery of extra costs incurred in 2021. We expect that recovery will occur during 2023 in the Netherlands, and over 2024-2026 in Germany, such that adjusted FFO to debt based on IFRS will be on average above 6%.

Our base case assumes that TenneT's direct owner, the Dutch Ministry of Finance, would consent to lower dividends to mitigate an unexpected increase in the company's already high leverage. Overall, we see a moderately high likelihood that TenneT would receive extraordinary support from the Dutch government in the event of financial distress. The government has already committed, in September 2021, to provide €4.25 billion to support TenneT. Our assessment of TenneT's SACP also takes into account the government's ongoing support through measures such as capital contributions.

We assume that TenneT's plans for significant investment and its lower regulated returns will weaken its credit metrics in the coming years. That said, we expect adjusted FFO to debt to remain above our 6% threshold for the 'A-' rating during 2022-2024, based on underlying numbers. We also anticipate that, on an IFRS basis, adjusted FFO to debt could remain well below this threshold in 2022 before rebounding in 2023, due to recovery of higher 2021 operating costs, and recognition of higher energy costs.

Downside scenario

A downgrade of TenneT would stem from one or a combination of the following factors:

- Should the SACP deteriorate to 'bbb-' or lower. This could occur if changes to either the German or Dutch regulatory framework materially weakened the stability of TenneT's cash flows or profitability, with a less-timely-than-expected recovery of extra costs incurred in 2021.
- Should its adjusted ratio of FFO to debt decline and stay below 6% for a prolonged period of time. This could occur if, for example, TenneT's capex increases further, without offsetting measures, or if there are unexpected delays or cost overruns on existing projects and these are not covered in a timely manner by regulated tariffs.
- If the Dutch government seems less likely to support TenneT, we could lower our rating on TenneT. That said, a one-notch downgrade of the Netherlands would not trigger a downgrade of TenneT, if TenneT's stand-alone credit quality did not weaken.

Upside scenario

The likelihood of an upgrade is currently remote given TenneT's extensive investment program, which will lead to a material increase in debt and weaken debt-coverage ratios over the medium term. That said, we would consider revising the SACP upward if TenneT demonstrates that it can sustain adjusted FFO to debt of more than 10%.

We would also consider upgrading TenneT, assuming an unchanged SACP, if we considered that the likelihood of extraordinary support from the Dutch government had materially strengthened, although we consider this unlikely in the near term because of the high proportion of TenneT's capex in Germany.

Company Description

TenneT is a leading European electricity TSO serving 42 million end-users in the Netherlands and Germany and operating 16 cross-border interconnectors through about 25 thousand kilometers (km) of high voltage transmission lines. The company's activities are under the oversight of the regulatory authorities in each jurisdiction, the Autoriteit Consument & Markt (ACM) in the Netherlands and Bundesnetzagentur (BNetzA) in Germany. The company generated annual turnover of about €5.5 billion and IFRS EBITDA of about €920 million in 2021 (€1,966 million based on underlying figures); its asset book value totals €32 billion. TenneT is involved in limited nonregulated activities (less than 5% of EBITDA) through its 50% stake in BritNed, a merchant cable operator (Anglo-Dutch interconnector), and the regulated activities of NOKA. The company also has a 25% indirect equity stake in OTC., a 17% stake in EPEX, which is a North West European electricity exchange, and 100% of Relined and NOVEC, two telecommunication infrastructure companies.

Germany accounts for about 70% of TenneT's EBITDA and Netherlands 30%. TenneT is wholly owned by the Dutch Ministry of Finance.

Our Base-Case Scenario

Assumptions

German regulated:

- Pre-tax ROE of 5.12% (on assets commissioned before January 2006) and 6.91% (on new assets). For the new regulatory period starting in 2024 we expect ROE of 3.51% for old assets and 5.07% for new assets.
- Sectoral efficiency factor (xgen; productivity target) of 0.9% for the five-year regulatory period over 2019-2023.
- Individual efficiency factor (xind) of 99.92% for the five-year regulatory period over 2019-2023.

Dutch regulated:

- Current regulatory period from 2022 to 2026.
- Regulated expected capital cost allowance (real pre-tax WACC) gradually decreasing to 1.9% in 2026 from 2.0% in 2022 for existing capital; and 1.9% over the same period for new investments.
- Pre-tax real WACC of 2.4% for offshore cables.
- Xind decreasing from 97.28% in 2022 to 89.1% in 2025/2026
- Xgen productivity factor: 0.5% onshore and 0.2% offshore for 2022-2026.

Combined operations:

- A steady rise in revenue as investments in the Netherlands and Germany increase the regulated asset base (RAB). We assume around €14.5 billion of capex over 2022-2024, with about two-thirds of invested in Germany, and about 35% in offshore connections.
- A dividend payout ratio of 35% of the underlying distributable profit, after income allocated to project investors and distributions to hybrid capital holders.
- Further, we do not consider in our base case the recovery of 2021 IFRS (High opex) since we are already considering the underlying figures for the forecast that are based on regulatory accounting.
- We continue to assume restricted cash of €3.2 billion related to the Renewable Energy Sources Act, or EEG, over 2022-2026, which would be in line with 2021.

- A €4.25 billion capital increase in 2024.

TenneT Holding B.V.--Key Metrics*

(Mil. €)	2021a	2022f	2023f	2024f
EBITDA	896	1,800-2,000	2,100-2,300	2,100-2,300
Capital expenditure	3,711	3,800-4,300	4,800-5,300	5,300-5,800
FFO to debt (%)	2.7	7.0-8.5	7.0-8.5	6.5-8.0
Debt to EBITDA (x)	18.5	9.0-10.0	9.0-10.0	9.0-12.0

*All figures adjusted by S&P Global Ratings. Note: 2021 numbers are based on IFRS and forecasts are based on underlying numbers. a--Actual. e--Estimate. f--Forecast.

Liquidity

We consider TenneT's liquidity to be adequate for the next 12 months. As of March 31, 2022, we expect that the company's sources of liquidity will exceed uses by more than 1.2x over this period.

We understand that there are no restrictive covenants in the documentation for the group's debt.

Principal liquidity sources:

- Unrestricted cash of about €389 million;
- Available undrawn committed bank facilities of €4.4 billion with maturity beyond 12 months, with notably a €3.3 billion syndicated loan with maturity in November 2026;
- Cash FFO of about €1.73 billion in the next 12 months; and
- Working capital inflow of about €545 million in the next 12 months.

Principal liquidity uses:

- €2.20 billion in debt maturing over the next 12 months;
- Capex of about €4.3 billion; and
- Dividend payments based on a 35% payout ratio of more than €200 million.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors have an overall neutral influence on our credit rating analysis of TenneT. To support the European energy transition, TenneT is accelerating its regulated capital expenditure plan to connect offshore and onshore renewable generation capacities to the high and extra-high voltage grid and to enforce the backbone and extend long-distance transport capabilities domestically and across balancing zones. The company is also providing security of supply while operating highly critical infrastructure and seeks to balance network expansion needs against affordability implications for customers. Governance is also an overall neutral consideration. TenneT's regulated asset base is part of two countries' critical infrastructure, reinforcing the need for strong governance. Management decisions are under increased regulatory and political scrutiny, which could create tensions for TenneT to satisfy both Dutch and German requirements. However, we consider interests between TenneT's regulatory stakeholders aligned and view its governance as supportive.

Issue Ratings - Subordination Risk Analysis

Capital structure

TenneT is the biggest corporate issuer of green senior unsecured debt in the Netherlands , with about €13.0 billion outstanding as of Dec. 31, 2021. In 2021, TenneT successfully issued two green bonds, €1.8 billion in May 2021 and €1.0 billion in November 2021.

TenneT is using hybrid capital to support its large investment program in Germany. We consider the rated €2.1 billion outstanding hybrids to have intermediate equity content.

Analytical conclusions

TenneT's debt structure is within our guidelines for aligning the rating on senior unsecured debt with the 'A-' issuer credit rating (ICR). This is because all outstanding debt is at the parent company level and there is no secured debt.

We arrive at our 'BB+' issue rating on the hybrid instruments by notching down from our 'bbb' SACP on TenneT. The two-notch difference stems from deducting:

- One notch for subordination because our long-term ICR and SACP are investment grade (higher than 'BB+'); and
- An additional notch for payment flexibility, to reflect that the deferral of interest is optional.

Ratings Score Snapshot

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

Business risk: Excellent

- Country risk: Very Low Risk
- Industry risk: Very Low Risk
- Competitive position: Strong

Financial risk: Aggressive

- Cash flow/leverage:Aggressive (low volatility table)

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: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

Related government rating: AAA/Stable/A-1+

Likelihood of government support: Moderately High (+2 notches)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- 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 | General: Corporate Methodology, 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- TenneT Holding B.V., May 17, 2021

Ratings List

Ratings Affirmed

TenneT Holding B.V.	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Junior Subordinated	BB+
Commercial Paper	A-2

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 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/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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; or Stockholm (46) 8-440-5914