S&P Global
Ratings

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PZEM N.V.

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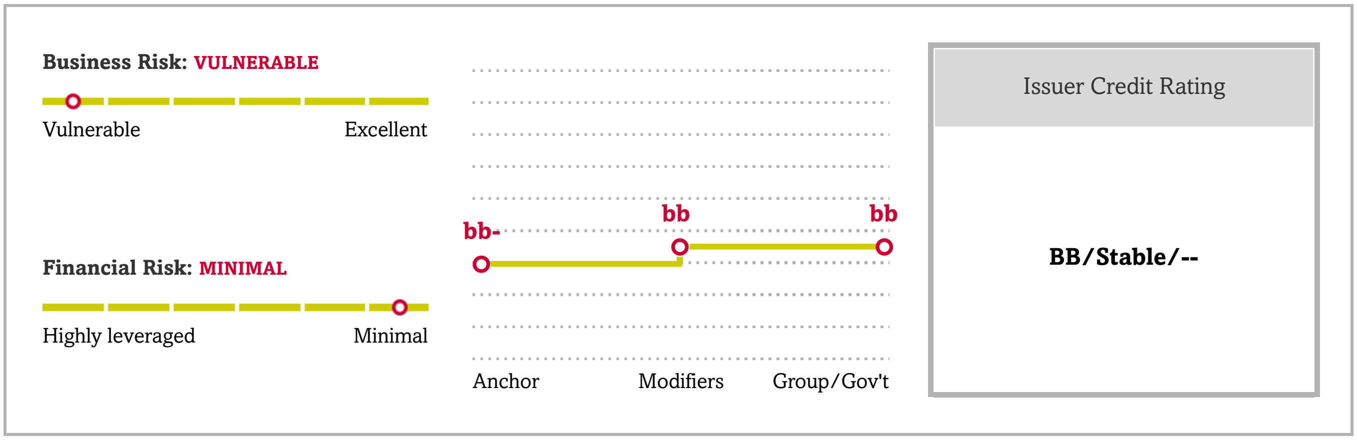


Credit Highlights

Overview

Key strengths	Key risks
Accessible cash and liquid investments result in zero net debt.	High dependence on market electricity prices to generate profits.
PZEM's 50% participation in Evides Waterbedrif (Evides), a regulated water utility, provides a stable and predictable source of cash flows.	PZEM's smaller scale and concentration in its nuclear and combined cycle gas turbines (CCGT) power plants, which the company doesn't fully control.
Regional conventional capacity decommissioning over the next few years could slightly support business.	PZEM requires significant cash flexibility to cope with volatile power generation activities.

We believe that the impact from lower power prices and volume will be manageable in 2020, but could increase in 2021 if prices remain low. We expect lower power prices caused by declining demand amid the ongoing pandemic, among other things, will have an effect on PZEM's earnings. This is because, while volumes in its nuclear power plant (BS30) for 2020 are 85% contracted, open volumes, and therefore price exposure, increase in 2021 and thereafter because only about 60% of the volumes are closed for 2021 and 35% for 2022. This means that PZEM's short-term price exposure at BS30 is lower than that in the medium term. On the other hand, this exposure is partially mitigated by the fact that PZEM's contract profile is improving over the next two years. Although we continue to expect unprofitable tolling agreements to make PZEM's CCGT plant unprofitable over 2020 and 2021, a significant share of these agreements at its nuclear power plant expires in 2020, leaving some room for EBITDA improvement in the consolidated picture.

We believe PZEM's cash position provides substantial cushion to withstand the pandemic. PZEM should be able to weather the effects of the ongoing pandemic on its earnings thanks to its significant cash resources, boosted by the liberation of a €93 bank guarantee upon the resolution of the S'Energy litigation process in May 2020, which increased the total to about €700 million. Since unbundling its regulated operations, PZEM has kept its cash to protect the company's financial position against unprofitable operations, which has been a key rating component ever since. We expect this policy to continue as long as the economic crisis lasts, and therefore foresee no use of cash other than to cope with liquidity needs triggered by ongoing operations. However, although manageable, we see some potential liquidity needs that could arise as a consequence of the ongoing pandemic. For example, a protracted economic crisis would take a higher economic toll on PZEM's customers, and would increase the risk of bad debt provisions and working capital fluctuation, but we see this contained at about 3% of PZEM's sales for now. In addition, PZEM typically provides guarantees as collateral to its counterparties on its trading activities. In the past, these guarantees have increased in the event of sharp increases in power prices, and we would expect a similar pattern if that occurs in the current context. Nevertheless, we see that risk as contained within €20 million-€30 million in 2020-2021.

The pandemic highlights PZEM's business vulnerabilities, but we already capture these in our rating. Because PZEM's business is largely concentrated in two assets, BS30 nuclear power plant and Sloecentrale CCGT plant, and because of its smaller scale, we see that the impact of market conditions could be higher than for larger, more diversified groups. However, we believe these factors are already captured in PZEM's business risk profile and credit rating.

PZEM's interest in Evides will provide a stable source of cash over the next two years. Although not part of PZEM's ongoing operations, Evides, the company's partially owned (50%) water utility, enjoys fully regulated income under the Dutch regulatory framework. This provides a source of highly predictable cash flows of about €22 million per year over 2020 and 2021. We believe the stable source of cash is beneficial for PZEM's credit quality, as it adds visibility amid challenging macroeconomic conditions. We incorporate this in a one-notch uplift to PZEM's rating.

Outlook: Stable

Our stable outlook on PZEM reflects our expectation that the company will be able to cope with a declining power price scenario amid difficult macroeconomic conditions thanks to its solid cash position and predictable source of cash flows from its 50%-owned water utility, Evides. Our base case also contemplates that the company will not engage in any form of aggressive growth, including mergers and acquisitions (M&A) or expansive investments, or dividend payments, until it returns to positive free cash flow generation. In our view, this will not be before 2022.

Downside scenario

We could downgrade PZEM if the company pursues acquisitions or dividend payments that would compromise its cash position before the power generation division returns to profit. We see such a scenario as remote over the next 12 months.

Upside scenario

We see rating upside potential as limited over the next 12 months because of the sensitivity of PZEM's business performance to market prices.

Over the long term, we could upgrade PZEM if the company is successful in diversifying its generation mix toward a long-term contracted and profitable mix, thereby strengthening its business risk profile, while at the same time retaining a solid balance sheet.

Our Base-Case Scenario

Assumptions

- Baseload power prices averaging €35 per megawatt hour (MWh) for the rest of the year in the Netherlands, increasing to €38 in 2021.
- We assume about 85% of PZEM's volumes at BS30 are locked at €43.5 per MWh (/MWh) for 2020, and 62% at €45.6/MWh in 2021.

- Tolling agreements expiring at BS30, leaving room for gradual increase in profits in this asset. We still assume unprofitable operations at Sloecentrale throughout 2020.
- Capital expenditure (capex) of about €24 million in both 2020 and 2021, almost exclusively destined for maintenance purposes.
- Potential contingent liquidity uses for guarantees stemming from increasing prices in 2021 of about €20 million-€30 million. We assume that the potential fine by the Authority for Consumers and Markets (ACM) related to the open investigation could be €1 million-€5 million.
- A 25% drop in the value of the equity share of PZEM's nuclear dedicated fund assets under a stress scenario.
- Bad debt provisions representing at most about €2 million during 2020.
- Ongoing dividend contributions of about €22 million stemming from Evides' participation.
- No dividend distributions over 2020 and 2021.
- No inorganic growth over 2020 and 2021.
- No debt needs.

Key Metrics

PZEM N.V.--Key Metrics

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
EBITDA	29.7	54.3	39.0	61.0	68.0
Capex	22.2	11.1	24.0	24.0	29.0
FOCF	(135.7)	66.5	3.1	(1.7)	4.5
Accessible cash	572.0	590.0	673.6	655.6	645.7

a--Actual. e--Estimate. F--Forecast. FOCF--Free operating cash flows.

PZEM enjoyed a positive 2019, which provides a good starting point against the challenges ahead. Because of a favorable trend in power prices, and gradual improvement of tolling contract conditions at the BS30 plant, PZEM was able to generate free operating cash flows of about €66.5 million in 2019, which boosted the company's accessible cash and liquid investments to €590 million by the end of 2019 from €572 million in 2018. In addition, the company freed €93 million of a bank guarantee in May 2020. While we believe lower electricity demand and power prices could hurt PZEM's financial performance over 2020 and 2021, the starting cash position provides the company with some headroom to retain an overall robust financial profile.

We anticipate neither dividend distributions nor M&A activity over our base case forecast period. We believe that PZEM will retain its cash to cope with the risks of uncertain power demand and price developments throughout the ongoing economic crisis. The company's financial policy entails making neither dividend distributions nor engaging in M&A activity until the company is able to remain profitable in the foreseeable future. We don't see PZEM generating consistently positive cash flows until after 2022. This is mostly because of the expiration of unprofitable tolling agreements at the nuclear power plant and more profitable operations in its CCGT plant Sloecentrale by 2022.

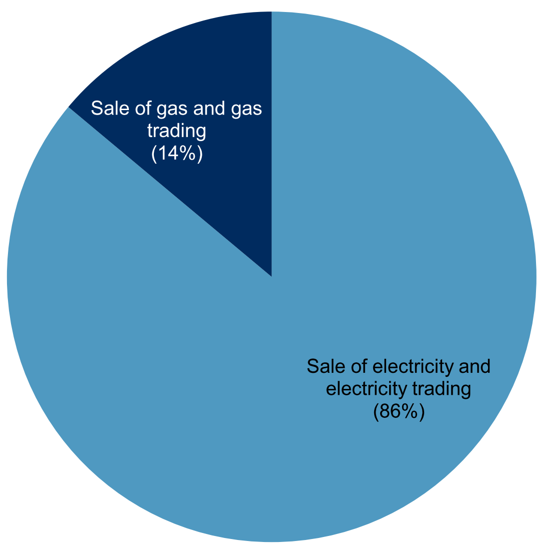
Company Description

PZEM (formerly known as Delta) is a multi-utility based in Zeeland, a small Dutch province in the Netherlands. Following the Dutch ACM's decision that PZEM had to unbundle its network operations from its other operations, the company sold its regulated power networks and its retail business. Following these disposals, PZEM's activities now focus on power generation and trading, and the company operates with no net financial debt.

PZEM owns 50% of Sloecentrale, a 870 megawatt (MW) natural gas power plant, and has a 70% share in EPZ, the Netherland's only nuclear power plant for the production of electricity, with capacity of 485MW. PZEM also has a 50% share of the 32MW BMC Moerdijk biomass power plant, although this asset only marginally contributes to the whole business. PZEM has access to wind generation through purchase power agreements across the Netherlands, but has no ownership in the wind farms. The group's operations comprise the sale of gas and gas trading, which currently do not contribute to EBITDA generation. Lastly, PZEM has a 50% share in Evides, a regulated water supplier operating in the Netherlands.

Chart 1

PZEM Revenue Split 2019



Source: S&P Global Ratings.

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Peer Comparison

Table 1

PZEM N.V.--Peer Comparison

Industry sector: Energy

	PZEM N.V.	N.V. Eneco Beheer	Vattenfall AB	Uniper SE	Hrvatska Elektroprivreda d.d.
Ratings as of July 7, 2020	BB/Stable/--	A-/Stable/A-2	BBB+/Stable/A-2	BBB/Negative/--	BB+/Stable/--
	--Fiscal year ended Dec. 31--				
	2019	2019	2019	2019	2018
(Mil. €)					
Revenue	574.2	4,330.0	15,868.9	65,804.0	1,921.4
EBITDA	54.3	472.3	3,828.7	1,658.0	497.4
Funds from operations (FFO)	43.5	394.9	3,420.7	1,446.0	413.5
Interest expense	15.9	22.4	381.8	326.0	27.1
Cash interest paid	9.6	21.4	262.3	165.0	24.5
Cash flow from operations	77.6	461.9	1,591.0	843.0	521.0
Capital expenditure	11.1	350.9	2,474.3	566.0	320.7
Free operating cash flow (FOCF)	66.5	111.0	(883.3)	277.0	200.4
Discretionary cash flow (DCF)	66.5	43.0	(1,380.1)	(84.0)	170.9
Cash and short-term investments	394.2	479.0	3,162.6	871.0	394.1
Debt	0.0	461.8	12,002.6	2,079.4	239.6
Equity	1,346.6	2,937.0	11,313.5	11,942.0	3,288.8
Adjusted ratios					
EBITDA margin (%)	9.5	10.9	24.1	2.5	25.9
Return on capital (%)	3.5	5.5	8.8	6.6	6.1
EBITDA interest coverage (x)	3.4	21.1	10.0	5.1	18.4
FFO cash interest coverage (x)	5.6	19.4	14.0	9.8	17.9
Debt/EBITDA (x)	0.0	1.0	3.1	1.3	0.5
FFO/debt (%)	N.M.	85.5	28.5	69.5	172.5
Cash flow from operations/debt (%)	N.M.	100.0	13.3	40.5	217.4
FOCF/debt (%)	N.M.	24.0	(7.4)	13.3	83.6
DCF/debt (%)	N.M.	9.3	(11.5)	(4.0)	71.3

N.M.--Not meaningful

Because of its asset concentration in mainly two power plants, we see PZEM as more exposed to electricity market fluctuations and unexpected operational disruptions than other larger and more diversified groups, such as N.V. Eneco Beheer or Vattenfall AB. This is because such groups are able to mitigate drops in power prices through other business segments, such as district heating or regulated networks. In addition, we believe these companies also have cost advantages because of their renewable generation, which benefits either from subsidies or low-cost hydropower generation.

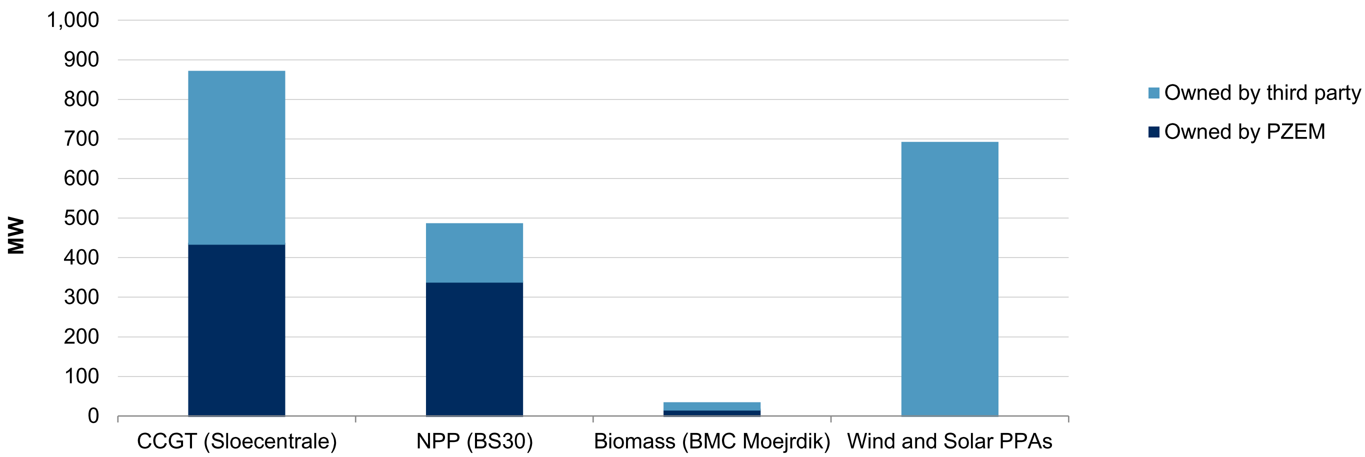
On the other hand, PZEM bears no net financial debt, thanks to its robust cash position and therefore compares favorably with its peers in terms of leverage.

Business Risk: Vulnerable

We believe that PZEM's business risk profile is largely constrained by its dependence on external factors to ensure its business sustainability. The company's nuclear and CCGT power plants are heavily dependent on market conditions to generate profits, and we also believe that PZEM is subject to competitive pressures because of regional oversupply. An additional rating constraint is that PZEM only partially owns its assets, which we see as a disadvantage because it doesn't fully control them.

Chart 2

PZEM Generation Fleet
Including stake owned by third parties



Source: S&P Global Ratings.
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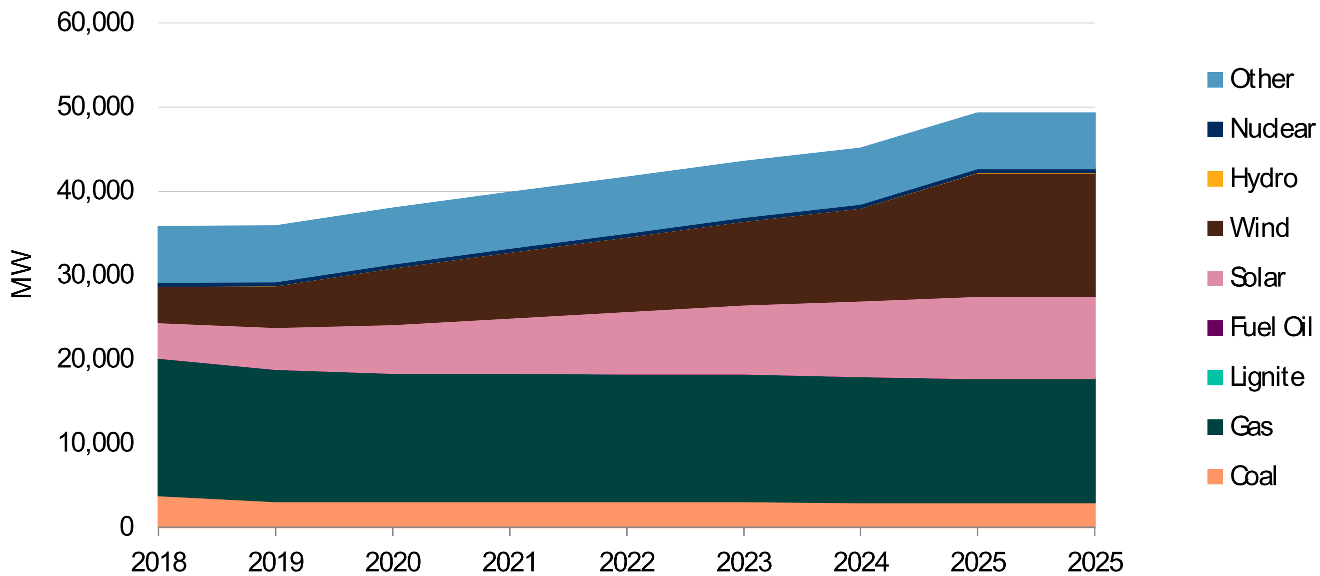
PZEM's nuclear power plant runs at baseload capacity in the Netherlands, which means that the plant is continuously generating power regardless of power demand fluctuations. PZEM's nuclear power plant operates with low variable costs (comprised mostly from fuel costs) but high fixed costs (mostly including the capital costs for construction, decommissioning, and waste disposal). We believe that BS30's inflexible cost structure, coupled with inflexibility to adjust to short-term demand fluctuations, could expose PZEM to short-term power price fluctuations, but the company accounts for this by locking its volumes and prices, in average, over a period of 18 months. On the other hand, it makes the company more dependent on long-term power price trends, as the nuclear power plant's costs depend much more on long-term costs. Therefore, we believe that the longer the depressed price environment lasts, the harsher the impact for BS30's profitability.

PZEM complements its baseload nuclear power generation with its more flexible CCGT plant, Sloecentrale, and its contracted renewable PPAs, mostly from the Dutch largest offshore wind farm Gemini (600MW capacity). Although smaller in scale, this mix allows PZEM to adjust to power demand fluctuations and different customer's needs. This said, the CCGT power plant has mostly been loss-making in the past (although achieving a positive result in 2019) due to the company's tolling agreements, clean spark spreads, a key profitability driver, and overall pressure on power prices due to regional oversupply. We believe that this could change over the medium-to-long term due to the gradual planned closing of 8 gigawatts (GW) of nuclear capacity in Germany from 2020 until 2022 and 5.9GW in Belgium by 2025, respectively, coupled with planned lignite and coal phase-out in Germany of 14GW by the end of 2022, which, in hand with an increase of intermittent renewable generation in the capacity mix, will create more need for flexible power generation, improving the fundamentals for CCGT power generation.

Chart 3

Dutch Power Generation Capacity

Wind and sollar will increase in relevance while thermal declines



Source: S&P Global Ratings.

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In fact, PZEM's strategy entails expanding its gas generation capacity, provided that existing operations are structurally profitable. We don't account for any additional capacity over our forecast period; however, the impact on the company's business risk profile would depend on new capacity improving cash flow visibility and operational stability, which we now don't see in PZEM's generation activities.

Our business risk profile on PZEM includes the contribution of Evides, a water utility supplying drinking and industrial water in the Southwestern part of the Netherlands. We see Evides' contributions to PZEM as a stable source of cash flows that enhance the group's overall credit quality.

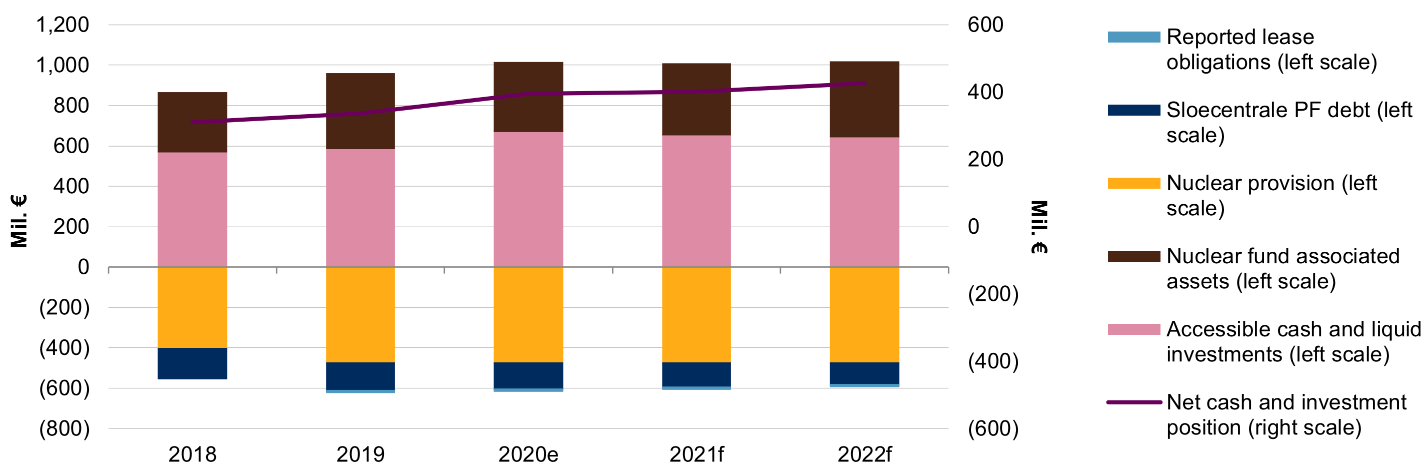
Financial Risk: Minimal

Our financial risk profile on PZEM reflects our expectation that the company will keep its resources to meet its financial obligations, and support its working capital needs arising from an evolving and challenging macroeconomic environment. We believe such cash sources are necessary, because PZEM could face sudden and meaningful cash needs, for instance in the form of margin calls for its commercial operations.

As of May 2020, PZEM's cash and liquid investments totaled €1.03 billion, including €334 million in assets dedicated for its nuclear fund. This amount is boosted by a recent release of a €93 million bank guarantee related to the favorable settlement of a litigation process which had been ongoing since 2010. In our opinion, these resources will be largely sufficient to cope with any contingent liquidity needs for PZEM resulting from the evolving COVID-19 crisis and sustain its operations, which is a key rating consideration. We therefore foresee no debt needs for PZEM over the next 12-24 months.

Chart 4

PZEM Cash And Investments Trajectory
PZEM has enough resources to cover its obligations



e--Estimate. F--Forecast. Source: S&P Global Ratings.

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We believe that, over the medium-to-long term, if PZEM's operations turn sustainably profitable, the company's strategy could drive it to pursue inorganic growth. We believe that the erosion of existing cash levels by more than €300 million could be to the detriment of the existing rating, if that doesn't translate in an enhanced earnings profile that reduces the company's needs for cash flexibility (i.e., if this is not compensated by an enhanced business risk profile). We do not consider such a development over our base case forecast period.

Financial summary

Table 2

PZEM N.V.--Financial Summary

Industry sector: Energy

	--Fiscal year ended Dec. 31--		
	2019	**2018**	**2017**
(Mil. €)			
Revenue	574.2	601.8	600.8
EBITDA	54.3	29.7	31.2
Funds from operations (FFO)	43.5	20.9	10.1
Interest expense	15.9	18.7	20.3
Cash interest paid	9.6	11.1	13.9
Cash flow from operations	77.6	(113.4)	(75.6)
Capital expenditure	11.1	22.2	74.4
Free operating cash flow (FOCF)	66.5	(135.7)	(150.0)
Discretionary cash flow (DCF)	66.5	(135.7)	(150.0)
Cash and short-term investments	394.2	396.7	643.9
Gross available cash	590.0	572.0	643.9
Debt	0.0	0.0	0.0
Equity	1,346.6	1,280.7	1,374.3
Adjusted ratios			
EBITDA margin (%)	9.5	4.9	5.2
Return on capital (%)	3.5	(2.1)	(14.9)
EBITDA interest coverage (x)	3.4	1.6	1.5
FFO cash interest coverage (x)	5.6	2.9	1.7
Debt/EBITDA (x)	0.0	0.0	0.0
FFO/debt (%)	N.M.	N.M.	N.M.
Cash flow from operations/debt (%)	N.M.	N.M.	N.M.
FOCF/debt (%)	N.M.	N.M.	N.M.
DCF/debt (%)	N.M.	N.M.	N.M.

N.M.--Not meaningful

Reconciliation

Table 3

PZEM N.V.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2019--				
PZEM N.V. reported amounts					
	Debt	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**
Reported	134.7	63.6	15.3	8.8	54.3
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	--	--	(1.2)
Cash interest paid	--	--	--	--	(9.6)

Table 3

PZEM N.V.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)

Reported lease liabilities	6.7	--	--	--	--
Accessible cash and liquid investments	(590.0)	--	--	--	--
Dividends received from equity investments	--	18.1	--	--	--
Asset-retirement obligations	112.6	--	--	7.1	--
Income (expense) of unconsolidated companies	--	(27.3)	--	--	--
Nonoperating income (expense)	--	--	31.2	--	--
Total adjustments	(470.7)	(9.3)	31.2	7.1	(10.8)
S&P Global Ratings' adjusted amounts					
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**
Adjusted	--	54.3	46.5	15.9	43.5

Liquidity: Adequate

We assess PZEM's liquidity as adequate, reflecting our expectation that its sources will exceed its uses by well over 1.2x over the next 12 months.

PZEM reached an agreement to settle a pending litigation with S'Energy, a case open since 2010. The favorable outcome for PZEM resulted in the release of €93 million from bank guarantees, which adds to the company's liquidity. The proceeds will be invested in short-term deposits maturing by the end of 2020 with the intention of covering guarantees in case power prices suddenly increase.

PZEM's liquidity assessment is constrained by its limited banking relationships and standing in the credit markets, since the company does not currently have any financing needs, and therefore no public debt.

Principal Liquidity Sources	Principal Liquidity Uses
• A cash balance of about €745 million as of March 31, 2020; • Projected working capital inflows of about €15 million, resulting from released trading collateral from previous years; and • Cash FFO of about €10 million.	• Debt maturities of about €28 million over the next 12 months and €30 million over the subsequent 24 months; • Average capex of about €24 million; and • No dividend payment.

Debt maturities

PZEM's only debt maturities are amortizations to its Sloecentrale project finance loan, which will be €28 million-€30 million per year over the next few years.

Ratings Score Snapshot

Issuer Credit Rating

BB/Stable/--

Business risk: Vulnerable

- **Country risk:** Very low
- **Industry risk:** Moderately high
- **Competitive position:** Vulnerable

Financial risk: Minimal

- **Cash flow/leverage:** Minimal

Anchor: bb-

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:** Positive (+1 notch)

Stand-alone credit profile : bb

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- The Energy Transition And What It Means For European Power Prices And Producers: Midyear 2020 Update. Jun 08, 2020.
- Energy Transition: The Outlook For Power Markets In The Age Of COVID-19. June 25, 2020.

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	**Minimal**	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	**bb-**	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of July 14, 2020)*

PZEM N.V.	
Issuer Credit Rating	BB/Stable/--
Issuer Credit Ratings History	
13-Jul-2017	BB/Stable/--
27-Oct-2016	BBB-/Watch Neg/--
03-Oct-2014	BBB/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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