Dutch utilities: Addressing the capex and opex challenges

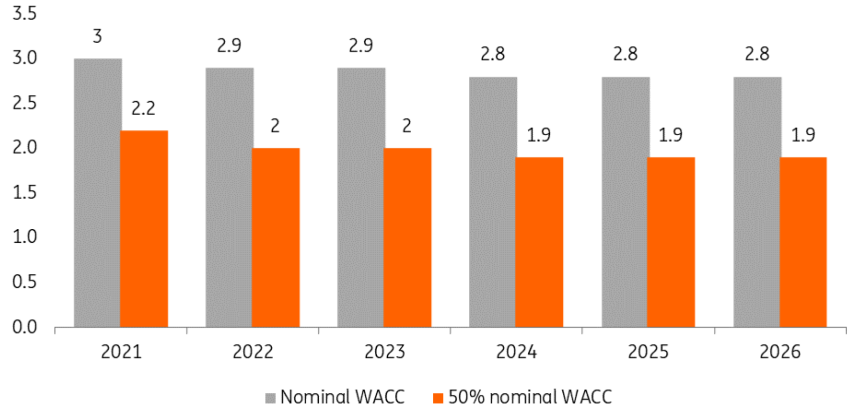
Dutch grid utilities have had regulatory frameworks that in the past offered the lowest return on capital and debt. The current regulatory period is no different and the network companies have struggled to generate the necessary cash to fully fund their investments. Adding to this challenge, the energy crisis has added much higher operating costs

Source: Shutterstock

The 2021-2026 regulatory period for the Dutch grid companies

Across Europe, energy distribution and transmission activities are regulated. The network companies are monopolies whose allowed tariffs and revenues are defined by regulators. With formulas taking into account the cost of equity, the cost of debt, inflation and other market elements, the Dutch regulated utilities have evolved within the least generous remunerative frameworks in the last ten years. One of the causes is the decreasing cost of debt, reflecting the sharp decline of government bond yields. If regulated utilities can save money on servicing their debt, the lower financial expenses do not compensate at all for the additional hundreds of millions of euros electricity and gas network companies have to find for their surging capital expenditure.

Dutch network utilities: Further reduction in the WACC (weighted average cost of debt and capital) in %



Source: ACM, ING

The initial remuneration determination was improved but remains low

The determination of the weighted average cost of capital has been set following a similar approach to the former regulatory period. The declining (and even negative) sovereign rates as well as the very low cost of debt led to another reduction in the allowed remuneration. The formula led to a progressive decline of the nominal WACC to 2.77% in 2026 compared with c.3% in 2021. The formula included an average annual inflation of 1.77%, leading to a real WACC around 1% at the end of the regulatory period. Dutch gas and electricity distribution companies (DSOs) appealed against the decision of the ACM, the Dutch regulator.

The DSOs obtained some improvements:

- Gas network activities to be remunerated at a nominal WACC level and grids subjected to a limited degressive depreciation
- Electricity activities to benefit from a 50% nominal WACC (including half of the inflation indicator) instead of real WACC
- The yearly revision of inflation and market elements forming the WACC formula

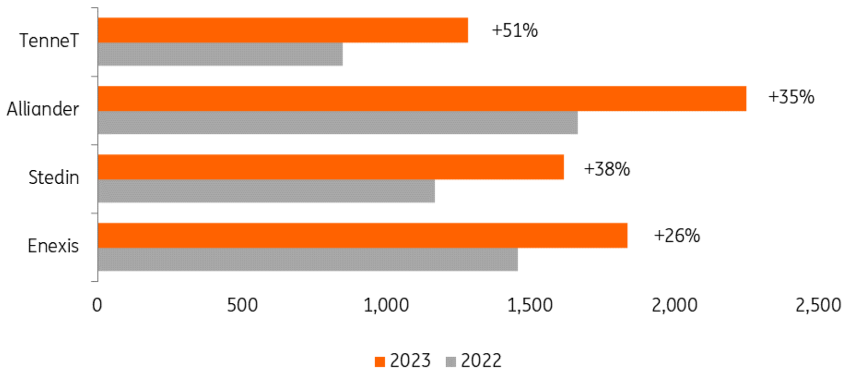
Tariffs to sharply rise in 2023

At the end of November 2022, the Dutch regulatory body ACM published the 2023 tariffs for the transmission and distribution network companies. 2023 will mark an important surge in tariffs due to the need to (re)cover operating costs that have significantly increased. The costs reflect higher energy bills for grid companies as they themselves are important users of power to operate their networks. Although more marginal, the lack of skilled staff leads to increasing salary costs in a tight employment market environment.

TenneT, Alliander, Enexis and Stedin will charge customers much higher in 2023 vs. 2022, except for Nederlandse Gasunie, which was not given a positive conclusion by the regulatory body (ACM). The gas transportation company has appealed the decision.

TenneT's 2023 allowed tariffs for transmitting electricity will increase by 51% compared with 2022. In 2022, TenneT was able to charge an aggregate of €850m in the Netherlands for its transmission services. In 2023, the transmission system operator will be able to charge €1,254m. The sharp rise should compensate for the surging costs that have occurred since 2021. For instance, TenneT's purchasing costs for energy and capacity reached €850m in 2021 when the company would disburse a yearly average of €280m in the period 2018-2021. Note that this increase comes from higher costs only. It is not a policy measure to make funding of the large energy transition capex easier, a policy option that has been discussed in the past.

TenneT sees strongest increase in allowed revenues



Source: ACM, ING

+31% in tariff increase for gas and electricity transmission services for the Dutch final customer

With the ACM's decision, Stedin's 2023 charges will grow by 38% for a total allowed revenue (electricity and gas distribution services) of €1,618m. Alliander's regulated activities will be able to generate €2,251m, representing a 35% rise compared with 2022 and Enexis €1,837m (+26% vs. 2022).

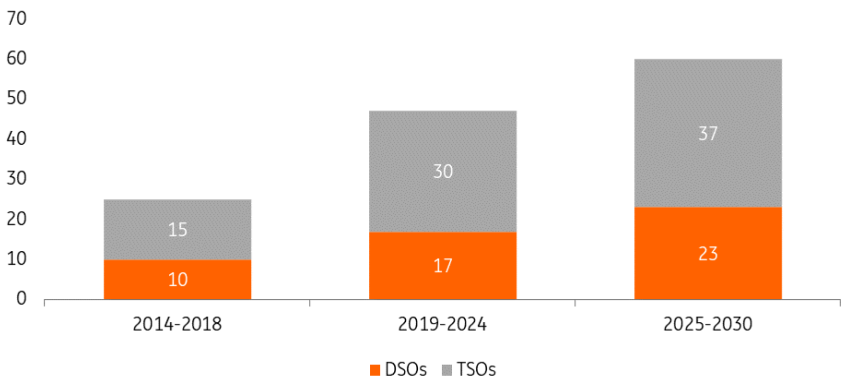
According to the regulator, a household with an average energy usage paid €392 for the year for electricity and gas network services. In 2023, the average bill for these services will surge to €513 – a 31% increase for the Dutch final consumers.

Spiraling investment needs on the back of the energy transition

The tariffs increase should restore the balance between revenues and operating costs, but the financing of capital expenditure plans remains a challenge. The energy transition and the strong development of renewables in the country impose higher investments to upgrade and develop the grids.

Taking into consideration Germany, the transmission network companies (TSOs), TenneT and Nederlandse Gasunie will invest a total of c.36bn between 2025 and 2030. The three gas and electricity distribution network companies (DSOs) will invest €23bn in the same period. These amounts are respectively 20% and 40% higher than in the period 2019-2024.

Energy transition leads to strong increase in investment for network operators



Source: Company data, ING

Past capital injections have not been enough

TenneT is 100% owned by the Dutch state. The electricity transmission network company already received capital injections in the last ten years (€600m in 2011/2012 and €1.2bn between 2017 and 2019). TenneT and the Dutch government agreed on a €4.25bn capital injection to be able to maintain current ratings. The Dutch State has budgeted €2.57bn that it will distribute to TenneT between 2023 and 2025. Another €1.68bn remains to be found. TenneT and the Dutch State are still exploring alternatives. A preferred solution is a capital stake by the German government, as TenneT has many operations in Germany, but parties disagree on the conditions of an equity stake.

Enexis obtained a €500m convertible hybrid shareholder loan paid in two tranches. The first tranche of €421m came in July 2020 while a second tranche of €79m was added in November 2020.

In December 2021, 70 out of the 76 shareholders of Alliander agreed on a capital injection of €600m in the form of a reverse convertible hybrid shareholder loan.

Stedin is the DSO in the most challenging position with capital expenditure already surpassing cash flow generation for a few years. In June 2021, Stedin Group's shareholders strengthened the grid operator's equity by €200m in the form of cumulative preference shares. Recently, the network company estimated it will need an additional funding of €1.8bn between now and 2030 to finance its investments in full and maintain an appropriate credit profile.

Securing the financial help of the Dutch State

These recent capital injections are more than welcomed but the shareholders of Enexis, Alliander and Stedin (Dutch provinces and municipalities) do not have the financial facilities to accentuate the financial help to their respective regional grid companies. In 2022, the Dutch gas and electricity network companies started to look for other solutions, including the introduction of a new shareholder into their capital: the Dutch State. Alliander, Enexis and Stedin have reached a "framework of agreements" with the Dutch Ministry of Finance and the Ministry for Climate and

Energy Policy. The Dutch government will reinforce the DSOs' capital in exchange of a stake. With urgent financial needs, Stedin is the first DSO to secure €500m of reserves from the Dutch State. Alliander and Enexis should be able to communicate on capital injections when agreements are finalised. The agreements also stipulate that the regional shareholders could be asked to participate again to further capital increases.

Large investments, changes in remuneration as well as new shareholder structures put the sector in a turbulent environment. Luckily the Dutch government is working on capital injections that should limit the negative impact of higher indebtedness. The consequences of the Russian-Ukraine war reinforce the need to accelerate the energy transition and to guarantee the required investments.

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