S&P Global
Ratings

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Summary:
PZEM N.V.

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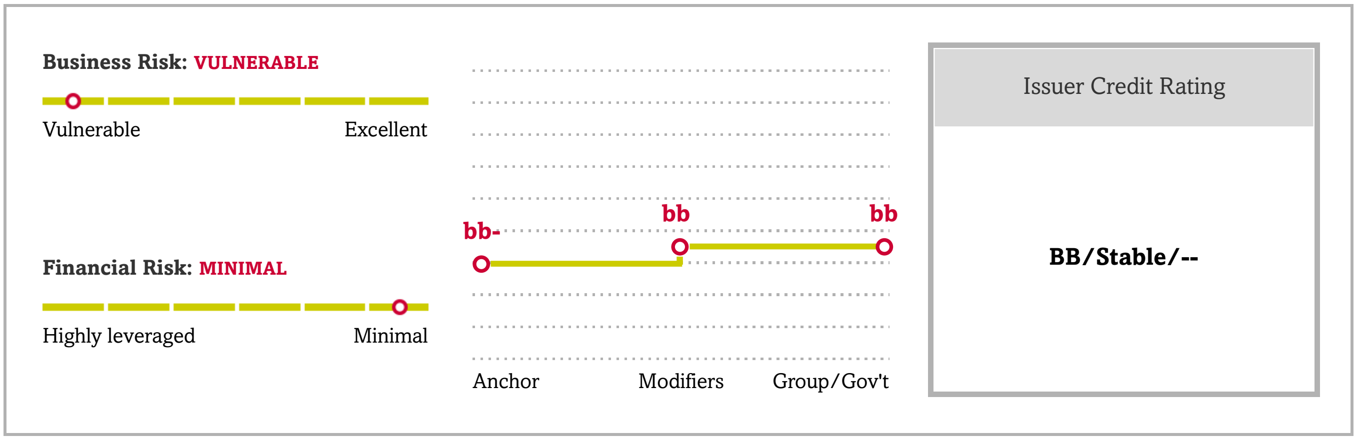

Rationale

Business Risk: Vulnerable	Financial Risk: Minimal
• PZEM's concentration on nuclear and gas power generation, which are currently loss-making and dependent on improving market conditions to return to profitability. • PZEM's only partial ownership of its assets, which prevents the company from fully controlling them. • Support for PZEM's overall creditworthiness from water utility Evides, in which PZEM holds a 50% stake, and which continues to represent a stable and predictable source of cash for PZEM.	• Essentially no net financial debt. PZEM has retained all the proceeds of the sale of its regulated and retail businesses in 2017. • Substantial cash amounts, which enable the company to meet its financial obligations and cope with unprofitable operations at its nuclear and gas plants. Due to locked prices at the nuclear operations and unprofitable gas generation, PZEM will continue to generate negative free operating cash flow (FOCF), at least over the next two years. • Our anticipation of no dividend payments until generation activities return to profitability.

Outlook: Stable

The stable outlook on PZEM captures our view that the cash on the company's balance sheet will help it cope with its unprofitable gas and nuclear power plants, as well as related obligations. The outlook also reflects our view that the company will keep this cash until market conditions improve.

In addition, our stable outlook mirrors our expectation that Evides--which accounts for most of PZEM's participation dividends--will continue to pay stable dividend amounts to PZEM on a yearly basis, as such proceeds will alleviate negative cash flow generation at the PZEM level to a certain extent.

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.

Given the relevance of Evides' dividends for PZEM's cash position under the current circumstances, we could lower our ratings on PZEM by one notch in the event of an unexpected drop in such contributions.

Upside scenario

We do not see any ratings upside potential for PZEM because of the sensitivity of its business performance to current market conditions. Over the long term, we could upgrade PZEM if the company diversifies its generation mix, thereby reducing its exposure to commodity price swings and asset concentration, as this would likely improve its business risk profile.

Our Base-Case Scenario

Assumptions

- Growth of the Netherlands' economy of about 2.7% in 2018 and 2.3% in 2019, with an inflation rate of about 1.6% in 2018 and 1.7% in 2019. Population growth of about 0.3% per year in 2018 and 2019. In our opinion, the continued economic resiliency of the Netherlands' economy should correlate positively with future energy demand and prices, thus partly improving business conditions for PZEM.
- Average prices in the German power market, and by reference the Dutch power market, of €40 per megawatt hour (MWh) in 2018 and €41.5 per MWh in 2019. We expect that the positive trend in energy prices in the region will reduce losses for PZEM's unprofitable gas and nuclear operations.
- Our expectation that PZEM's nuclear and gas plants will remain unprofitable, at least over the next one-to-two years, mainly due to locked prices. In our opinion, PZEM's future business sustainability depends heavily on market conditions improving. We believe that the company will be able to cope with unfavorable market conditions by using the cash held on its balance sheet. This amounts to around €580 million of unrestricted cash, in addition to €204 million of deposits maturing beyond 12 months, as of June 2018.
- The end of the 25% participation agreement in gas power plant Elsta in September 2018, which should partially help cash flow generation in 2019.
- Dividend contributions of €34 million in 2018, which mostly account for Evides, but also for Elsta and biomass power plant BMC Moerdijk. Once the Elsta agreement expires in 2018, we expect the dividend stream from participations to remain around €20 million on a consistent basis, with Evides accounting for most of this amount.
- Adjusted EBITDA margins of around 6.4% in 2018 and 10.3% in 2019.
- Negative FOCF over the next two years, although improving in 2019.
- Capital expenditures (capex) of about €47 million in 2018, declining to €22 million in 2019.
- No dividend distributions over 2018-2019.

Key Metrics

(Mil. €)	2017A	2018E	2019E	2020E
EBITDA	31.2	38.0	50.8	59.3
Capex	74.4	57.0	32.0	33.0
FOCF	(133.1)	(63.3)	(4.0)	1.1
Dividends	0.0	0.0	0.0	0.0
FFO to debt (%)	N.M.	N.M.	N.M.	N.M.
Debt to EBITDA	0.0x	0.0x	0.0x	0.0x

A--Actual. E--Estimated. FOCF--Free operating cash flow. FFO--Funds from operations. N.M.--Not meaningful.

- No financial debt needs over 2018-2019, due to PZEM's continued sound cash balance.

Company Description

PZEM (formerly known as Delta) is a multi-utility based in Zeeland, a small Dutch province in the Netherlands. Following the Dutch Authority for Consumer and Markets' 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 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 485 MW. PZEM also has a 50% share of the 32 MW 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 interest in the wind farms. Lastly, PZEM has a 50% share in Evides, a regulated water supplier operating in the Netherlands.

Business Risk: Vulnerable

PZEM's vulnerable business risk profile reflects our concern that the company is very sensitive to pricing conditions in power markets and is subject to competitive pressures. The business risk profile also captures our view that PZEM's business sustainability is highly dependent on market conditions improving. We understand that PZEM's major assets--the EPZ nuclear power plant and Sloecentrale--will remain unprofitable over the next two years. In addition, PZEM only partially owns its remaining assets after unbundling, which we view as a disadvantage because it does not fully control the assets.

This said, PZEM's overall portfolio is supported by Evides' regulated activities. Although PZEM also receives dividends from BMC Moerdijk and Elsta, most of its dividends come from Evides. In our opinion, this provides a stable and predictable source of cash, and we believe this enhances the company's creditworthiness.

Financial Risk: Minimal

PZEM has retained all the proceeds from the disposal of its regulated and retail activities on its balance sheet to support its financial obligations related to its unprofitable operations. This amounts to around €580 million of unrestricted cash, in addition to €204 million of deposits maturing beyond 12 months, as of June 2018. In our opinion, this provides the company with comfortable headroom to cope with market adversity, at least over the next few years. This essentially results in no net financial debt.

Energy prices are on a positive trend, with average prices in the German power market, and by reference the Dutch power market, of €40 per megawatt hour (MWh) in 2018 and €41.5 per MWh in 2019. This should support future cash generation and reduce losses for PZEM's unprofitable gas and nuclear operations. This said, we understand that PZEM's nuclear and gas plants will remain unprofitable, at least over the next one-to-two years, mainly due to locked prices under previous market conditions.

We also expect PZEM to have only moderate capex over the next few years, because of both the completion of a major capex project at EPZ and the company's policy of cash preservation. Moreover, we do not anticipate any dividend distributions until the merchant operations return to profitability. That said, we expect PZEM to generate negative FOCF over the next two years, although the expiration of the Elsta 25% participation agreement in September 2018 should help reduce operating losses.

Financial summary

Table 1

PZEM N.V. -- Financial Summary	
	--Fiscal year ended Dec. 31--
(Mil. €)	**2017**
Revenues	600.8
EBITDA	31.2
Funds from operations (FFO)	8.2
Net income from continuing operations	(248.1)
Cash flow from operations	(58.7)
Capital expenditures	74.4
Free operating cash flow	(133.1)
Discretionary cash flow	(133.1)
Cash and short-term investments	643.9
Debt	0
Equity	1,374.30
Adjusted ratios	
EBITDA margin (%)	5.2
Return on capital (%)	(14.8)
EBITDA interest coverage (x)	1.5
FFO cash interest coverage (x)	2.3
Debt/EBITDA (x)	0
FFO/debt (%)	N.M.
Cash flow from operations/debt (%)	N.M.
Free operating cash flow/debt (%)	N.M.
Discretionary cash flow/debt (%)	N.M.

N.M.--Not meaningful.

Liquidity: Adequate

We continue to assess PZEM's liquidity as adequate as we expect that its sources will exceed its uses by well over 1.2x over the next 12 months. Despite its cash position, the company's liquidity assessment is constrained by its limited banking relationships and standing in the credit markets, since the company does not have any financing needs for the time being, and therefore no public debt.

Principal Liquidity Sources	Principal Liquidity Uses
• A cash balance of €580 million as of June 2018; and • Projected working capital inflows of about €16 million.	• Negative cash funds from operations of about €50 million; • Average capex of about €47 million; • No dividend payments; and • Short-term debt maturities of €12 million.

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)

Reconciliation

Table 2

Reconciliation Of PZEM N.V. Reported Amounts With S&P Global Ratings Adjusted Amounts

	--Fiscal year ended Dec. 31, 2017--						
PZEM N.V. reported amounts							
(Mil. €)	**Debt**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Capital expenditures**
Reported	159.4	18.0	(238.8)	9.5	18.0	(85.6)	64.4
S&P Global Ratings adjustments							
Interest expense (reported)	--	--	--	--	(9.5)	--	--
Interest income (reported)	--	--	--	--	1.1	--	--
Current tax expense (reported)	--	--	--	--	(2.9)	--	--
Surplus cash	(643.9)	--	--	--	--	--	--
Dividends received from equity investments	--	31.9	--	--	31.9	--	--
Power purchase agreements	19.0	11.3	1.3	1.3	10.0	10.0	10.0
Asset retirement obligations	204.3	--	--	9.4	(10.3)	16.9	--
Non-operating income (expense)	--	--	1.1	--	--	--	--
EBITDA--income (expense) of unconsolidated companies	--	(30.0)	(30.0)	--	(30.0)	--	--
EBIT--income (expense) of unconsolidated companies	--	--	30.0	--	--	--	--
Total adjustments	(420.5)	13.2	2.4	10.7	(9.8)	26.9	10.0
S&P Global Ratings adjusted amounts							
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditures**
Adjusted	--	31.2	(236.4)	20.3	8.2	(58.7)	74.4

Related Criteria

- 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, 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

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-

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