

Research Update:

Alliander N.V. Placed On CreditWatch Positive On Upcoming Regulatory Decision

October 13, 2023

Rating Action Overview

- Earlier this year, the Netherlands' Trade and Industry Appeals Tribunal (CBb) ruled against the decision of the Dutch regulator, the Authority for Consumers and Markets (ACM), and instructed it to make some material changes to the remuneration in the current 2022-2026 regulatory period. This should lead to higher recognized revenue of about €750 million for Dutch energy distributor Alliander N.V., according to our estimates.
- The upcoming positive regulatory decision, coupled with higher proceeds from the sale of Alliander's subsidiary Kenter, should improve credit metrics and translate into funds from operations (FFO) to debt of at least 20% on average for the next few years.
- Depending on Alliander's financial policy and its use of the higher balance sheet headroom, we could raise the rating on the company. Consequently, we placed our 'A+/A-1' ratings on Alliander on CreditWatch with positive implications.
- The CreditWatch placement indicates the possibility of a one-notch upgrade. We intend to solve it over the next three to six months, following the ACM's decision on the tariff update.

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Rating Action Rationale

The CreditWatch placement follows the CBb's ruling, which instructs the regulator ACM to amend the current regulatory period decision on allowed remuneration. The CBb ruled on appeals filed by several grid operators against the ACM's decision on the current 2022-2026 regulatory period. The CBb's decision from July 4, 2023, gives ACM six months to adjust its initial remuneration method on several points. Notably, the CBb instructed the ACM to use 2021 instead of the 2018-2020 average as a reference to determine the company's efficient costs and to recalculate the productivity change based on the 2017-2021 period instead of 2004-2020. This translates into more financial flexibility in the allowed revenue for Alliander and the other energy distribution system operators (DSOs). We understand the court ruling is final and legally binding. Operators are currently discussing tariff proposals with the ACM, which will issue a final decision toward the end of the year.

The upcoming sale of Alliander's unregulated subsidiary Kenter will generate more proceeds than we initially anticipated. Alliander has reached an agreement with ABP and Omers Infrastructure to sell Kenter, which offers smart meter services. We expect the transaction will close by the end of the year. While the sale of Kenter was already part of our base case, we understand the sale price will be higher than we initially assumed, leading to higher cash proceeds and greater net debt reduction.

The CBB's decision and the sale of Kenter will likely translate into a substantial improvement in Alliander's S&P Global Ratings-adjusted FFO to debt. The upcoming positive regulatory update will likely translate into higher revenue of about €750 million on an aggregate basis, though the final settlement is also subject to the ACM's decision. The timing of the integration of the additional allowed remuneration into the tariffs over the next few years is still under discussion. Based on the CBB's ruling, we understand that the ACM will publish the tariff settlement in the coming three months. This decision represents a material upside to our previous base case. Combined with higher proceeds from the Kenter sale, FFO to debt could average more than 20% over the rest of the current regulatory period, according to our preliminary estimates. This would be commensurate with a higher stand-alone credit profile (SACP) and, therefore, a higher rating when factoring in the likelihood of government support.

We expect to resolve the CreditWatch listing after we have gained clarity on Alliander's financial policy following the regulator's public tariff settlement update. We expect to gain more clarity on Alliander's financial trajectory once ACM has published its final regulatory decision. Specifically, we will monitor potential changes to the investments plan to accommodate for the energy transition in light of supply chain and labor market constraints. Our base case is €5.4 billion over 2023-2026. Furthermore, we will reassess the company's financial policy and the extent to which it will use the extra headroom in the balance sheet, especially when it comes to shareholders' remuneration. For the time being, Alliander aims to maintain adjusted FFO to debt of at least 15%, which is consistent with the 'a' SACP. Finally, we will monitor if the company secures enough treasury sources to ensure adequate and comfortable liquidity at all times, given its structural negative discretionary cash flow over the coming years.

We continue to view extraordinary support from the central government as moderately likely. This is in line with the framework agreement that Alliander, together with the other two main domestic DSOs Enexis Netbeheer B.V. and Stedin Netbeheer B.V., have signed with their shareholders and the Dutch government last year. This legally binding agreement set out the conditions and requirements under which the Dutch state would provide common equity to the companies. We continue to believe that Alliander could benefit from extraordinary government support to enhance its capacity and willingness to meet its financial commitments as they come due, although this is not part of our base case for now.

CreditWatch

The CreditWatch placement signals the likelihood that Alliander's FFO to debt could increase and remain well above 18% on a sustainable basis until the end of the current regulatory period. This would be commensurate with a SACP of 'a+', one notch higher than the current SACP. Barring a change in our views on extraordinary government support, a one-notch upward revision of the SACP would lead to the same action on the long-term issuer credit rating.

We expect to resolve the CreditWatch placement once we have more clarity on the final regulatory

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decision and the related effect on credit metrics. We will also consider any update to the company's business plan over the next few years and how the financial policy will adapt to the higher balance sheet flexibility. We will also monitor if Alliander posts an adequate liquidity profile at all times.

At this stage, rating upside potential is limited to one notch. We will monitor further developments over the coming three to six months.

Company Description

Netherlands-based Alliander mainly focuses on electricity and gas distribution in the regions of Gelderland, Noord-Holland, Amsterdam, Zuid-Holland, Friesland, and Flevoland.

Through its main subsidiary, Liander--which accounts for about 90% of Alliander's EBITDA--the company provides electricity and gas to about 3.3 million consumers and businesses through its more than 5.7 million connection points.

Alliander is 100% owned by 74 Dutch provinces and municipalities. Gelderland owns 44.7%, Friesland 12.7%, Noord-Holland 9.2%, and Amsterdam 9.2%. The remainder is owned by other smaller Dutch municipalities. In 2022, Alliander reported EBITDA of €849 million.

Liquidity

We assess Alliander's liquidity as adequate, based on our view that the company's liquidity sources will exceed its funding in the 12 months from June 30, 2023, by more than 1.1x. Furthermore, our liquidity assessment factors in Alliander's high standing in the credit markets.

Principal liquidity sources over the 12 months from June 30, 2023, include:

- Cash and near-term investments of €196 million, which already factor in the proceeds from the green bond issued in June 2023;
- A committed credit facility of €900 million maturing in 2027; and
- Cash FFO of about €1.4 billion, including our estimate of proceeds from the Kenter sale.

Principal liquidity uses over the same period include:

- Debt maturities of €725 million;
- Capital expenditure (capex) of €1.3 billion; and
- Dividends of about €90 million-€100 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2022, Alliander's gross debt (including financial lease obligations) totaled about €3.5 billion.

In our calculations of adjusted debt, we consider only 50% of both the company's 1.625% €500 million perpetual subordinated notes and the nonmandatory €600 million convertible shareholder

loan maturing in 2081, because we evaluate these instruments as having intermediate equity content.

Analytical conclusions

We rate the company's senior unsecured debt at 'A+', the same as the long-term issuer credit rating.

Alliander is the holding company of a key operating company and other smaller subsidiaries. All new debt is placed at the Alliander level. Debt at the Liander level is small, compared with the company's total debt.

We rate Alliander's debt in line with the issuer credit rating because we consider the company's leverage low enough to limit the possibility of any noteholders being significantly disadvantaged relative to other lenders.

We rate the perpetual notes at 'BBB+', two notches below the 'a' stand-alone credit profile on Alliander, reflecting:

- A one-notch deduction because of contractual subordination; and
- An additional one-notch deduction for payment flexibility to reflect that the deferral of interest is optional.

We do not consider that the Dutch state would provide support to the company's hybrid layer. Because of this, we continue rating it two notches lower than the SACP.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

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- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Industry Top Trends Update Europe: Utilities, July 18, 2023
- Dutch Networks Stedin, Alliander And Enxsis Ratings Affirmed On Government Support; Enxsis Outlook Revised To Positive, Feb. 14, 2023
- Alliander N.V., Oct. 19, 2022

Ratings List

CreditWatch Action

	To	From
Alliander N.V.		
Issuer Credit Rating	A+/Watch Pos/A-1	A+/Stable/A-1
Alliander N.V.		
Senior Unsecured	A+/Watch Pos	A+
Junior Subordinated	BBB+/Watch Pos	BBB+

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