

Research Update:

Dutch DSO Alliander 'A+/A-1' Ratings Affirmed; Outlook Stable; Off CreditWatch Positive On Capex Increase

February 2, 2024

Rating Action Overview

- Dutch energy distribution system operator (DSO) Alliander will receive €750 million in additional revenue over 2024-2026 as part of the regulator's formal amendment to the allowed remuneration for the current regulatory period (2022-2026).
- At the same time, Alliander updated its 2024-2028 business plan, including a step-up in capital expenditure (capex) to meet the country's ambitious climate targets and remedy the increasing congestion of the grid. We now expect gross capex of €9.6 billion over 2024-2028, versus €7.7 billion in the previous plan for 2023-2027.
- We anticipate these higher investments will absorb most of the balance sheet headroom gained from the positive regulatory decision and the sale of unregulated subsidiary Kenter, leading us to think that Alliander's credit metrics will not support a higher rating level, at least over the remainder of this regulatory period.
- We therefore affirmed our issuer credit ratings on Alliander at 'A+/A-1' and removed them from CreditWatch positive, where we had placed them on Oct. 13, 2023. We also affirmed our 'A+' and 'BBB+' ratings on the company's senior unsecured and junior subordinated debt, respectively.
- The stable outlook reflects our expectation that Alliander's funds from operations to debt will remain above 15% in the next two to three years, as per the company's financial policy. We also factor in our view of extraordinary support from the central government as moderately likely.

Rating Action Rationale

The recent developments around allowed remuneration underpin our view that the regulatory framework for electricity and gas distribution networks in the Netherlands is supportive of our ratings on Alliander. On Dec. 21, 2023, The Netherlands Authority for Consumers and Markets (ACM) published its final decision on changes in the allowed remuneration for the current

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2022-2026 regulatory period, as instructed by a court ruling by the Netherlands's Trade and Industry Appeals Tribunal (CBB) earlier in the year. The CBB ruling prompted ACM to use the average from 2021, instead of from 2018-2020, as a reference to determine DSOs' efficient costs and to recalculate the productivity change based on the 2017-2021 period instead of 2004-2020. This translates into more financial flexibility for Alliander and the other two DSOs, specifically via higher revenue of €187 million in 2024, €280 million in 2025, and €283 million in 2026, totaling €750 million over the coming three years.

Alliander's planned increase in investments from this year already will absorb most of the balance sheet headroom stemming from the regulatory decision. The significant step-up in investments is part of Alliander's recently updated business plan, to accommodate for a faster energy transition in the Netherlands. The plan also looks to cut currently heavy domestic congestion by increasing grid capacity. This translates into a 25% increase in gross capital expenditure (capex) to €9.6 billion over 2024-2028 from €7.7 billion in the previous 2023-2027 business plan. We also anticipate that the increase will drive consistent negative annual discretionary cash flows for several years to come. Although we think that price inflation is behind a small part of this increase, we acknowledge that the electricity grid's heightening congestion, as electrification across the country intensifies, is pushing a country-wide need to invest more, and at a quicker pace, into the electricity grid. In our opinion, Alliander is now in a better position to step-up its capital deployment capacity--thanks to long-term agreements with contractors signed over the past few months, alleviating some operational constraints--and enact a plan to address technical skilled workforce penury. Alliander will increase its net capex to close to €1.7 billion already this year and €1.8 billion in 2025, from €1.2 billion in 2023, and we expect the pace of investments to gradually increase through the coming years.

Alliander's higher investments and financial policy are consistent with our 'A+' rating. Under our updated base case, we project funds from operations (FFO) to debt of 15%-18% over the next two to three years. This is much lower than our previous expectation of more than 20% on average, which had prompted us to place our ratings on Alliander on CreditWatch positive on Oct. 13, 2023. In addition, Alliander has reiterated its financial policy of maintaining a minimum FFO to debt of 15%. This level is in line with an 'a' stand-alone credit profile (SACP). Sustaining this metric is likely to hinge on further hybrid issuance--a development we would monitor closely--while we see capital contributions from existing shareholders or the government as less likely at this stage. That said, we recognize Alliander's track record of prudent financial policy and shareholder support. We also view the 45% dividend payout as relatively contained compared to the rest of the sector, and it is in line with that of Enexis (50%), for instance.

Our base case includes the one-off boost to Alliander's credit metrics in 2024 from the sale of its unregulated subsidiary Kenter. Alliander agreed with ABP and Omers Infrastructure to sell energy metering services provider Kenter in a transaction that closed over the past few days. Proceeds will yield an uptick of about 400 basis points to Alliander's FFO to debt in 2024. This estimate also factors in an exceptional dividend payment of €53 million on the book profit stemming from the transaction.

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 domestic DSOs Enexis Netbeheer B.V. and Stedin Netbeheer B.V., signed with their shareholders and the Dutch government. 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. We incorporate our view of government support by applying a one-notch uplift to the 'a' SACP, leading to the 'A+' rating on Alliander.

Outlook

The stable outlook reflects our expectation that Alliander will post an FFO-to-debt ratio sustainably above 15% over the coming two to three years. It also factors in management's willingness to enact additional remedial measures if necessary to counter downward trending metrics in case of capex acceleration.

Downside scenario

The rating could come under pressure if we forecast a decline in FFO to debt below 15% with no immediate likelihood of recovery. This could result from:

- Adverse regulatory decisions;
- Further material increase in investments; coupled with
- No timely and sufficient implementation of remedial measures.

Excluding a change in our view of extraordinary government support, deducting one notch from the SACP would result in a one-notch downgrade of Alliander. A one-notch downgrade of the Netherlands would not result in a downgrade of Alliander, all things remaining equal.

Upside scenario

We would consider an upgrade if Alliander were to achieve and sustain FFO to debt above 18%, backed by the company's financial policy, barring any change in our views on extraordinary government support. However, we regard this as a remote scenario at this time because of the constraints from the sizable capex plan.

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 76 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.

Our Base-Case Scenario

Assumptions

- Real GDP growth in the Netherlands of 0.9% in 2024, 1.4% in 2025, and 1.4% in 2026, after a slowdown at 0.4% in 2023. We expect limited impact from the economic situation on Alliander's activities, due to its majority-regulated nature.
- Easing inflation levels, with consumer price index growth at 4.5% in 2023, 3.3% in 2024 and 2.4% in 2025. The Dutch regulatory framework allows for yearly indexation of the tariffs to inflation.
- Over the 2022-2026 regulatory period, nominal pretax WACC for the gas grid increasing to 3.7% from 3.3%, and inflation-adjusted pretax real WACC for the electricity grid increasing to 2.75 % from 2.22% in 2022.
- Adjusted EBITDA margin of about 30%.
- Net average capex of about €1.7 billion annually over 2024-2026, driven by the energy transition target in the Netherlands and the requirement to expand Alliander's electric grid (connecting new renewable projects to the grid) as well as grid replacement and digitalization. We expect about 10% of the capex will be deployed in gas networks, reflecting the business' maturity.
- Dividend payout ratio of 45% of the previous year's net income, according to Alliander's policy. We include a €53 million extraordinary dividend linked to the Kenter transaction.
- Hybrid issuance to accompany capex acceleration.

Key metrics

Alliander Key Metrics

(Mil. €)	2021a	2022a	2023e	2024f	2025f	2026f
EBITDA	776	773	867	774	1,116	1,093
FFO/debt (%)	25.9	19.9	19.6	16.9	18.4	15.0
Debt	2,590	3,314	3,851	3,800	4,799	5,635
Capex (net)	865	1,087	1,228	1,676	1,769	1,793
Debt/EBITDA (x)	3.3	4.3	4.4	4.9	4.3	5.2
DCF	(303.0)	(766)	(536)	(1,157)	(918)	(1,071)

FFO—Funds from operations. Capex—Capital expenditure. DCF—Discretionary cash flow. A—Actual. E—Estimate. F—Forecast.

Liquidity

We assess Alliander's liquidity as adequate, based on our view that the company's liquidity sources will exceed its funding by more than 1.1x in 2024 thanks to the sale of Kenter. We also expect the metric to be met beyond 2024, despite negative DCF, via proactive refinancing.

Furthermore, our liquidity assessment factors in Alliander's high standing in the credit markets.

Principal liquidity sources for 2024 include:

- Cash and near-term investments of €244 million;
- Committed undrawn credit facilities of €1.3 billion maturing in more than one year; and
- Cash FFO of about €750 million; and
- Our estimate of proceeds from the sale of Kenter.

Principal liquidity uses over the same period include:

- Debt maturities of €900 million;
- Capex of close to €1.7 billion; and
- Dividends of about €160 million.

Environmental, Social, And Governance

ESG factors have an overall neutral influence on our credit rating analysis of Alliander. The company is one of the most relevant stakeholders for the Dutch government to deliver on its energy transition objectives. Its pivotal role entails collaborating with Dutch local governments, industries, and communities to integrate new renewable capacity into its grid while managing congestion. We believe this will stimulate Alliander's electricity grid deployment by expanding its regulatory asset base over the next decade. In our opinion, the critical role of its electricity infrastructure more than compensates for the more uncertain long-term prospects of its gas grid, as the country strives to phase out gas by 2050 and embrace renewable gases.

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 €600 million optionally 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 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. Because of this, we continue rating it from the SACP.

Ratings Score Snapshot

Issuer Credit Rating	A+/Stable/A-1
Business risk:	Excellent
Country risk	Very low
Industry risk	Very low
Competitive position	Excellent
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
Anchor	a+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	a
Related government rating	AAA/Stable/A-1+
Likelihood of government support	Moderate (+1 notch)

Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Industry Credit Outlook 2024: EMEA Utilities, Jan. 9, 2024
- Benelux, France, Italy, Iberia: Energy Transition Shapes Credit Quality, Jan. 8, 2024
- ACM's Positive 2024 Tariff Decision Will Test Dutch DSOs' Financial Policies, Dec. 6, 2023
- Enexis Holding N.V., Nov. 3, 2023
- Alliander N.V. Placed On CreditWatch Positive On Upcoming Regulatory Decision, Oct. 13, 2023
- Utilities Handbook 2023: Western Europe Regulated Power, Oct. 18, 2023
- Dutch Electricity And Gas Transmission And Distribution Framework: Supportive, March 7, 2023
- Dutch Networks Stedin, Alliander And Enexis Ratings Affirmed On Government Support; Enexis Outlook Revised To Positive, Feb. 14, 2023

Ratings List

CreditWatch/Outlook Action; Ratings Affirmed

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

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