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Research Update:

Dutch Energy Distributor Alliander Downgraded To ‘A/A-1’ On Higher Transition Investments and Costs; Outlook Stable

March 5, 2025

Rating Action Overview

- On March 5, 2025, Alliander N.V. announced a material step-up in capital expenditure (capex) to an extent that was not anticipated in our previous base case. We now expect gross capex of €12.8 billion over 2025-2029, a steep increase of about 30% on the previous five-year plan.
- Higher capex to speed up electrification and address serious national grid congestion issues will lead the group to post significant negative discretionary cash flow, leading to higher leverage, especially as work in progress is not part of remuneration for energy distributors in the Netherlands. At the same time, higher operating costs not immediately recovered in the allowed remuneration will put pressure on EBITDA and funds from operations (FFO).
- Because of this, Alliander's credit metrics will deteriorate, even accounting for remedy measures to be implemented from 2025, and we expect the group will now sustain FFO to debt at above 11% compared to 15% before, as per the company's updated financial policy.
- We therefore lowered our issuer credit rating on Alliander to 'A' from 'A+' and our ratings on senior unsecured and junior subordinated debt to 'A' and 'BBB' from 'A+' and 'BBB+', respectively.
- The stable outlook reflects our expectation that Alliander's FFO to debt will remain above 11% in the next two to three years. We also factor in management's commitment to this rating level, including timely implementation of credit remedy measures over the next few months, and our view of extraordinary support from the central government as moderately likely, which translates to one notch of uplift to the rating.

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Rating Action Rationale

Alliander's increased investments exceed by far our previous base case. Its new capital deployment estimates reflect, on the one hand, the national need to speed up the energy transition, which is advancing rapidly, and to cut heavy domestic congestion by increasing power

grid capacity. On the other hand, higher investments also stem from significant price inflation across the entire value chain. Combined, these factors translate to a more than 30% increase in gross capex to €12.8 billion from €9.6 billion over the previous 2024-2028 five-year period, marking another consecutive year of sustained investment increases.

We have revised down our earnings estimates due to higher operating costs. The cost base is expanding by about €150 million-200 million per year above what we had anticipated last year. This is mainly driven by higher labor costs, fueled both by an expanding employee base (+1,000 full-time equivalents over the plan, mostly added in 2025), overall inflation on procurement materials and services, and a growing electricity network. These additional costs will be reflected in tariffs with a two-year lag as per the current regulation. The additional costs offset most of the extra allowed revenues from an administrative court ruling of about €560 million over 2025-2026. Allowed revenues are also reduced by a lack of adequate remuneration for work in progress. All in all, these elements raise some questions as to the effectiveness of the regulation in allowing for a full and timely recovery of total expenditure, at least in the current regulatory period. This is because regulated asset base growth does not keep pace with such large operating and work-in-progress capex increases, in our view.

Consistent negative annual discretionary cash flows will lead to higher leverage, making remedy measures necessary to keep the 'A' rating. We project FFO to debt of 12%-13% on average over the next two years, which is much lower than our previous expectation of 15%-18%. From 2027 onwards, much will depend on how regulation evolves, adding uncertainty to our base case. That said, because of ever-increasing investments in the electricity grid, we anticipate that sustaining this level of metrics will entail putting in place timely remedy measures, which we understand the management is committed to doing from as early as this year. These measures include further hybrid bond issuance--a development we will monitor closely--as well as the conversion to equity of the existing €600 million convertible shareholder loan. We regard capital contributions from the central government as less likely at this stage. To accompany a growing investment pipeline, Alliander is also proactively managing its liquidity sources, which we consider essential to maintain an adequate liquidity profile in the long-term.

Alliander has amended its financial policy, relaxing its maximum leverage target, which is consistent with a lower rating. The company has announced it will now maintain minimum FFO to debt of 11% versus 15% previously. This level is in line with an 'a-' stand-alone credit profile (SACP), one notch lower than before. While the 45% payout is being maintained, which compares well compared with the utility sector in Europe, shareholders have agreed to a dividend cap of €100 million per year. We see this development as credit supportive, though we note it will only marginally improve the company's financials given the significant balance sheet pressure from investments.

The next regulatory period starting in 2027 should evolve into a cost-plus model, which would be more supportive of the company's financials. We understand a new cost-plus model might be implemented for the next regulatory period starting Jan. 1, 2027. Compared with the current sector costs benchmarking, this should allow for a better recovery of operational costs and capex and sustain the company's cash flow generation at a time of peak investments as we approach the next decade. We understand the regulator has already started engaging with stakeholders through public consultation processes, and we expect to have a better understanding of the next regulatory reset over the next 12 months or so. This will be critical to assess whether the company can sustain the current rating level beyond the current regulatory period.

We continue to view extraordinary support from the central government as moderately likely, which translates to one notch of uplift for our SACP. This is in line with the framework agreement that Alliander, together with the other two domestic distribution system operators 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 above 11% over the coming two to three years. It also factors in management's willingness to enact remedial measures from as early as this year to sustain the metrics embedded in our base case, including maintaining an adequate liquidity profile.

Downside scenario

The rating could come under pressure if we forecast a decline in FFO to debt below 11% with no immediate likelihood of recovery. This could result from:

- Adverse regulatory decisions;
- A 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 15%, 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 of 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 95% of Alliander's EBITDA, the company provides electricity and gas to about 3.4 million consumers and businesses through its 5.9 million connection points.

Alliander is 100% owned by 74 Dutch provinces and municipalities. Gelderland owns 45%,

Friesland 13%, Noord-Holland 9%, and Amsterdam 9%. The remainder is owned by other smaller Dutch municipalities.

Our Base-Case Scenario

Assumptions

- Real GDP growth in the Netherlands of 1.6% in 2025, 1.3% in 2026, and 1.4% in 2027. We expect limited impact from the economic situation on Alliander's activities, due to its majority-regulated nature.
- The Dutch regulatory framework allows for yearly indexation of the tariffs to inflation, though we anticipate the cost of labor, materials and supply to grow at a faster pace than inflation.
- Over the 2022-2026 regulatory period, nominal pretax weighted average cost of capital (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.
- Net capex increasing to above €2.3 billion in 2027 from €1.9 billion expected this year, driven by the energy transition target in the Netherlands and the requirement to expand Alliander's electricity grid as well as grid replacement and digitalization.
- A dividend payout ratio of 45% of the previous year's net income, according to Alliander's policy, with a €100 million cap.
- Sustained hybrid issuance from 2025 onwards to accompany capex acceleration.
- Conversion of the €600 million shareholder loan by next year.

Key metrics

Table 1

Alliander Key Metrics

(Mil. €)	2022a	2023a	2024e	2025f	2026f
EBITDA	773	877	~ 837	800-850	1,000-1,050
FFO/debt (%)	19.7	20.5	~ 17.5-18	12.0-13.0	11.5-12.5
Debt	3,314	3,896	~ 4,035	~ 5,100	~ 6,200
Capex	1,229	1,411	1,645	~ 1,900	~ 2,300
Debt/EBITDA (x)	4.3	4.4	~ 4.8	~ 6.2	~ 6.2
DCF	-766	-777	< (1,000)	< (1,200)	< (1,400)
DCF/Debt (%)	-23.1	-19.9	~ (26)	~ (25)	~ (25)

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 2025. We also expect Alliander to maintain an adequate liquidity profile beyond 2025, despite negative discretionary cash flow, via proactive refinancing and recalibration of committed bank lines to better match increasing investments.

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

Principal liquidity sources for 2025 include:

- Cash and near-term investments of close to €500 million;
- Committed undrawn credit facilities of €1.9 billion maturing in more than one year; and
- Cash FFO of about €750 million.
- Principal liquidity uses over the same period include:
- Debt maturities of €500 million;
- Capex of more than €1.9 billion; and
- Dividends of about €80 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 fossil fuels by 2050 and embrace renewable gases.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2024, our estimate of Alliander's gross debt (including IFRS16 obligations and the 2018 hybrid bond that has lost its equity content following refinancing) totaled about €4.5 billion.

Our calculations of adjusted debt consider only 50% of both the company's 4.5% €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 '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 there is no structural subordination.

We rate the perpetual notes '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 rate it by notching down from the SACP.

Ratings Score Snapshot

Table 2

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:	Significant
Cash flow/leverage	Significant (low volatility table)
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	Neutral (no impact)
Stand-alone credit profile:	a-
Related government rating	AAA/Stable/A-1+
Likelihood of government support	Moderate (+1 notch)

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, Feb. 10, 2025
- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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 2025: EMEA Utilities, Jan. 14, 2025
- Alliander's Proposed Hybrid Instrument Rated 'BBB+'; Equity Content Intermediate, June 20, 2024

Ratings List

Downgraded; Ratings Affirmed

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

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