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Research Update:

Dutch Energy Company Alliander 'AA-' Ratings Affirmed As Liquidity Score Revised To Adequate From Strong; Outlook Stable

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Overview

- Dutch energy company Alliander N.V. is performing in line with our base-case expectations, with lower regulated returns compensated by cost cutting and a lower cost of debt.
- Alliander has a large amount of debt due for refinancing in the next 12 months. This has led us to revise our assessment of its liquidity to adequate from strong.
- The revised liquidity assessment still reflects our view of Alliander's good access to financial markets and prudent liquidity management.
- We are affirming our 'AA-' ratings on Alliander.
- The stable outlook reflects our expectation that Alliander will be able to sustain Standard & Poor's-adjusted funds from operations at about 25% of debt over the next three years.

Rating Action

On Nov. 26, 2015, Standard & Poor's Ratings Services affirmed its 'AA-' corporate credit rating on Dutch regulated electricity distribution network operator Alliander N.V. The outlook remains stable.

We also affirmed the 'AA-' issue credit rating on the senior debt and 'A' issue credit rating on the hybrid capital issued by Alliander.

Rationale

The affirmation reflects Alliander's good operating performance and credit metrics that we expect to remain within the ranges commensurate with its financial risk profile.

Our assessment of Alliander's excellent business risk profile primarily reflects the very low risk associated with its regulated electricity and gas distribution network businesses, the company's natural monopoly status in its license areas, and the high quality of its network assets. We see Alliander's competitive position as excellent, supported by a strong regulatory advantage.

The majority of Alliander's activities, including its electricity and gas tariffs, are regulated by the Dutch Ministry of Economic Affairs and ACM. The regulatory framework, which has existed since 2001, is well-established,

supportive, mature, and has been relatively stable through each three-year regulatory period. We consider that the tariff decision for the current regulatory period, which started on Jan. 1, 2014, is challenging for the Dutch distribution network operators since it will result in substantial tariff reductions over 2014-2016. However, we believe that Alliander's efforts to reduce costs, its prudent prefunding of upcoming debt maturities at a lower cost, and the fact that dividends are likely to reduce with lower net profit, mitigate the lower tariffs.

The above strengths are partly offset by regulatory tariff reset risk every third year and the company's exposure to incentive-based regulation that can impose challenging efficiency requirements.

Alliander's modest financial risk profile assessment is based on our view of its continued ability to report solid earnings and cash flow coverage of debt measures. Standard & Poor's-adjusted ratios of funds from operations (FFO) to debt and debt to EBITDA stood at about 31.5% and 2.4x, respectively, when the last regulatory period ended in December 2014. We anticipate a weakening in these ratios from 2015-2016, due to lower tariffs in the current regulatory period, and we also note that rising capital expenditure (capex) will result in moderately negative discretionary cash flows. We expect that ratios will remain at the lower end of the modest financial risk profile. We reflect this in a one-notch downward adjustment to the SACP under our comparable rating analysis .

Our base case assumes:

- Revenues and FFO to decrease in 2015 due to the reduction in tariffs in the current regulatory period. We expect the dip to continue to the end of the current regulatory period in 2016.
- Lower capex than we previously anticipated in light of the company's efficiency plan.
- Moderately negative discretionary cash flows after capex and dividends to result in gradually rising debt levels.
- Dividend payout of 45% of income with no minimum payment, in line with Alliander's policy.

Based on these assumptions, we arrive at the following credit measures for 2015-2016:

- FFO to debt above 25%.
- Neutral free operating cash flow.
- Ongoing dividend payments of around €100 million-€120 million (excluding the exceptional dividend linked the cash receipts from the asset sale).

Liquidity

The short-term rating is 'A-1+'. We assess Alliander's liquidity position as adequate, supported by our view that Alliander's liquidity sources will exceed its funding needs by more than 1.1x over the next 12 months.

Alliander's well-established and solid relationships with banks, its generally high standing in the credit markets, and typically very prudent risk

management further support our opinion of its liquidity.

We estimate that Alliander's liquidity sources over the next 12 months will be close to €1.4 billion, comprising:

- Unrestricted cash and short-term marketable securities of about €73 million.
- Access to an undrawn €600 million committed credit facility expiring in July 2018. The credit facility contains no financial covenants.
- Annual FFO of about €400 million-€450 million.
- Proceeds from the asset sale of about €350 million.

The company's principal liquidity uses over the same period will be about €1.1 billion, comprising:

- Capex of about €600 million.
- Debt repayments of €425 million.
- Dividend payments of about €100 million-€120 million.

Outlook

The stable outlook reflects our opinion that Alliander will be able to sustain adjusted FFO to debt of about 25% over the medium term. Underpinning this view is our assumption that Alliander will partially offset the impact of lower tariffs in the current regulatory period by reducing its operating costs and dividend distributions. Alliander has a publicly stated minimum FFO-to-debt requirement of 20%, but we understand that the company operates at a lower level of leverage.

Downside scenario

We could lower the ratings if the company's FFO-to-debt ratio were to weaken below 23%, for example as a result of operational issues, negative regulatory intervention, or a balance sheet recapitalization.

Upside scenario

We consider an upgrade unlikely in light of the relatively predictable tariffs set by the regulator to end-2016, and the company's capex plan and dividend policy. This said, we would consider an upgrade if Alliander were able to sustain an adjusted FFO-to-debt ratio of more than 30%, assuming an unchanged business risk profile and no negative impact from Alliander's public sector shareholder ownership.

Ratings Score Snapshot

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Excellent

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: aa

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: aa-

- Related government rating: AA+
- Likelihood of government support: Moderate (no impact from SACP)

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Group Rating Methodology, Nov. 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Ratings On Four Dutch Issuers Affirmed; UCO Identifier Removed, Sept. 23, 2015

Ratings List

Ratings Affirmed

Alliander N.V.
Corporate Credit Rating AA-/Stable/A-1+

Alliander N.V.
Senior Unsecured AA-
Junior Subordinated A

Additional Contact:

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