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Research Update:

Dutch Electricity And Gas Utility Alliander Upgraded To 'AA-/A-1+' On Stronger Credit Metrics; Outlook Stable

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Overview

- Dutch electricity and gas distribution network operator Alliander N.V. continues to report solid earnings and cash flow coverage of debt measures.
- We believe that Alliander's Standard & Poor's-adjusted credit metrics will remain commensurate with a "modest" financial risk profile, despite the regulator's relatively challenging draft method decision for the tariff set applicable from Jan. 1, 2014.
- We are therefore raising our long- and short-term corporate credit ratings on Alliander to 'AA-/A-1+' from 'A+/A-1'.
- The stable outlook reflects our opinion that Alliander will be able to sustain adjusted funds from operations to debt at about 25%.

Rating Action

On Aug. 15, 2013, Standard & Poor's Ratings Services raised its long- and short-term corporate credit ratings on Dutch electricity and gas distribution network operator Alliander N.V. to 'AA-/A-1+' from 'A+/A-1'. At the same time, we raised the ratings on Alliander's unsecured debt to 'AA-' from 'A+' and the ratings on the subordinated debt to 'A' from 'A-'. The outlook is stable.

Rationale

The rating actions reflect our view that Alliander's Standard & Poor's-adjusted credit metrics will remain at around 25% on a sustainable basis, which is in line with our guidance for a rating of 'AA-', given our assessment of Alliander's business risk profile as "excellent."

Our business risk profile assessment continues to reflect Alliander's natural monopoly status in its license areas, its low-risk regulated electricity and gas distribution network businesses, and its high-quality network assets. These strengths are partly offset by regulatory tariff reset risk every three years and the company's exposure to incentive-based regulation that can impose challenging efficiency requirements.

We consider that the draft method decision for the next regulatory period starting on Jan. 1, 2014, published by the regulatory Authority for Consumers and Markets (ACM) on May 1, 2013, could be challenging for the Dutch distribution network operators. The draft method decision indicates that the

ACM could lower the tariffs, mainly through a reduction of the real pretax weighted-average cost of capital to 3.6% from 6.2%, which we calculate would reduce Alliander's revenues by about 13% in 2014. However, we believe that Alliander's efforts to reduce costs and its prudent prefunding of upcoming debt maturities at a lower cost, as well as the fact that dividends are likely to reduce with lower net profit, could mitigate a challenging tariff set.

The "modest" financial risk profile reflects Alliander's stable and predictable operating cash flow during a regulatory period, but also its sizable capital expenditure (capex) program of about €550 million over 2013 and close to €1.4 billion during the next regulatory period 2014-2016.

Under our base-case scenario, we anticipate that Alliander's Standard & Poor's-adjusted FFO-to-debt ratio will increase to about 34% in 2013 from about 31% in 2012. We expect credit metrics to decline from 2014, but that the FFO-to-debt ratio will be close to 25% in 2014 and 2015.

Alliander's €500 million subordinated perpetual capital securities include a 100-basis-point step-up in November 2020. In our view, the replacement capital covenant (RCC) will not adequately mitigate the step-up because of the implications of an upgrade clause in the RCC. Under our base case, however, we assume that we will continue to assess the equity content in these securities as "intermediate" based on our understanding that Alliander is considering an amendment to the RCC. We believe that if we were to reassess the equity content as "minimal," Alliander's credit metrics would still be commensurate with our assessment of the financial risk profile as modest, but the headroom would tighten significantly.

The 'AA-' rating on Alliander is based on the company's stand-alone credit profile, which Standard & Poor's assesses at 'aa-', and on our opinion that there is a "moderate" likelihood that Alliander's owners would provide timely and sufficient extraordinary support in the event of financial distress. In accordance with our criteria for government-related entities, our view of a "moderate" likelihood of extraordinary support is based on our assessment of Alliander's:

- "Important" role, given Alliander's strategic importance to its province and municipality owners as the monopoly provider of gas and electricity distribution services in its license areas; and
- "Limited" link to its owners, given the dispersed ownership structure. Alliander's shareholders are the provinces of Gelderland (45%), Friesland (13%), and Noord-Holland (9%), and the municipality of Amsterdam (9%), as well as 27 other municipalities and provinces--each holding less than 3%.

Liquidity

The short-term rating is 'A-1+'. We assess Alliander's liquidity position as "strong" as defined in our criteria, supported by our view that Alliander's liquidity sources will exceed its funding needs by well over 1.5x over the next 12 months. Alliander's well-established and solid relationships with banks, generally high standing in the credit markets, and typically very prudent risk management further support our opinion of liquidity as strong.

As of June 30, 2013, we estimate that Alliander's liquidity sources over the next 12 months will be close to €1.4 billion under our base-case scenario. These include:

- Unrestricted cash and short-term marketable securities of about €225 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 €570 million.

We estimate that Alliander's liquidity needs will be about €700 million in the 12 months to June 30, 2014, including:

- Working capital of about €5 million.
- Capex of about €540 million.
- Debt repayments of less than €10 million.
- Dividend payments of about €140 million.

Outlook

The stable outlook reflects our opinion that Alliander will be able to sustain adjusted FFO to debt of about 25%. Underpinning this opinion are our assumptions that we will continue to assess Alliander's business risk profile as excellent and that the final determination for the 2014-2016 tariff will not be materially different from the draft determination that ACM published on May 1, 2013.

We could lower the ratings if we believe that the company is likely to recapitalize its balance sheet to maintain its publicly stated minimum requirement of FFO to debt of 20%. In our view, this could occur either through further sector consolidation in The Netherlands or an extraordinary dividend distribution. If the ACM's final tariff decision for the next regulatory period is worse for Alliander than that indicated in the draft method decision, that could also weaken the company's credit metrics.

Although we consider it unlikely, given the regulated tariffs through 2016 and the company's capex program and dividend policy, we could upgrade the ratings if we deemed it likely that Alliander would be able to sustain adjusted FFO to debt of about 35%, all else being equal.

Related Criteria And Research

- 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: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 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: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

Ratings List

Upgraded; CreditWatch/Outlook Action

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

Upgraded

	To	From
Alliander N.V.		
Senior Unsecured	AA-	A+
Junior Subordinated	A	A-

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