

Netherlands-Based Alliander Proposed Subordinated Securities Assigned 'BBB+' Rating

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- The Netherlands-based distribution network operator Alliander N.V. is proposing to issue perpetual capital securities to bolster its capital structure.
- We assess the proposed securities as having intermediate equity content.
- We are assigning an issue rating of 'BBB+' to the proposed securities to reflect their subordination and optional deferability.

LONDON (Standard & Poor's) Oct. 28, 2010--Standard & Poor's Ratings Services said today that it assigned its 'BBB+' long-term rating to the proposed perpetual, optionally deferrable, and subordinated capital securities to be issued by the Netherlands-based distribution network operator Alliander N.V. (A/Stable/A-1). The completion and size of the transaction remain subject to market conditions.

Alliander plans to use the proceeds of the proposed securities to strengthen the capital structure of the company, enhance its credit metrics, and diversify its funding sources.

We consider the proposed securities to have intermediate equity content because they adequately meet our relevant criteria in terms of: subordination; permanence; and optional deferability of interest at the company's discretion if certain conditions are met for an indefinite period of time.

The two-notch differential between the 'BBB+' rating on the proposed securities and the 'A' long-term corporate credit rating on Alliander reflects the application of our notching criteria, which calls for:

- A one-notch differential for subordination, as the corporate credit

rating on Alliander is investment grade; and

- An additional one-notch differential for payment flexibility, reflecting that the deferability of interest is at the company's discretion.

The notching of the proposed securities is linked to our perception of the currently low likelihood of the deferral being implemented. Should our perception change, the notching may increase significantly and, in relative terms, much more quickly than any revision of the corporate credit rating on Alliander.

Although the proposed securities have no stipulated maturity, they can be called at any time for tax, rating, and accounting events. In addition, the issuer can redeem them for cash on the fifth (first call date) and 10th (step-up date) anniversaries of the issuance, and on each annual interest payment date thereafter.

The combination of a 100 basis-point margin step-up on the proposed securities and an issuer cash call on the second call date in November 2020 would strongly reduce the permanence of the proposed securities, in our view, by providing an embedded incentive to call the securities at that time. This would consequently reduce the proposed securities' equity content, unless it were mitigated by the replacement capital covenant that Alliander entered into separately, and which becomes effective from the business day following the first call date.

Under the replacement capital covenant, drawn for the benefit of specified covered debtholders, Alliander commits to replace the proposed securities with an equivalent amount of equity content arising either from new common shares, or from a similar instrument, in the 12 months prior to redeeming the proposed securities. We understand that the replacement securities will rank *pari passu* with, or junior to, the proposed securities.

We consider that Alliander's option to defer payment on the proposed securities is somewhat restricted. Its exercise is conditional on the absence, in the preceding six months, of any common dividend or buyback of Alliander's common shares. We see this as a negative factor, based on our assessment of hybrids whereby instruments are deferrable at any time and without precondition. However, this condition remains acceptable under our methodology, as only the dividend cycle would constrain deferral.

The option to defer interest on the proposed securities is unlimited in time, which supports the equity content of the proposed instrument. Deferred interest is, however, cash cumulative, and will ultimately be settled in cash. Given our view of the intermediate equity content of the proposed securities, we will allocate 50% of the related payments as a fixed charge and 50% as an equivalent of a common dividend, in line with our hybrid criteria. The 50% treatment (of principal and accrued interest) also applies to the adjustment of debt.

RELATED CRITERIA AND RESEARCH

Netherlands-Based Alliander Proposed Subordinated Securities Assigned 'BBB+' Rating

- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

RATINGS LIST

New Rating

Alliander N.V.

Perpetual subordinated callable hybrid (proposed) BBB+

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