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Summary:
Alliander N.V.

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Summary:
Alliander N.V.

Credit Rating: A/Stable/A-1

Rationale

The ratings on Dutch electricity and gas distribution network company Alliander N.V. reflect Standard & Poor's Ratings Services' view of the company's low-risk regulated electricity and gas distribution network businesses, stable and predictable operating cash flow, high quality network assets, and stable operating performance.

The ratings are constrained by a sizable capital expenditures (capex) program in the medium term; regulatory reset risks and exposure to incentive-based regulation; and counterparty and liquidity risks related to remaining cross-border lease agreements on about 10% of the company's assets.

Alliander has a natural monopoly status in its license areas and a majority of its activities, including its electricity and gas tariffs, are regulated by the Dutch Ministry of Economic Affairs and the regulator, Energiekamer. Other business activities (including infrastructure installation and maintenance activities), accounting for less than 10% of Alliander's revenues, are unregulated. Alliander has about 3 million electricity customers and 2.6 million gas customers; its service area, concentrated in the provinces of Gelderland and Noord-Holland, covers about 40% of The Netherlands.

The 'A' long-term rating on Alliander is based on the company's stand-alone credit profile (SACP), which we assess at 'a', and on our opinion that there is a "moderate" likelihood that its owners would provide timely and sufficient extraordinary support in the event of financial distress.

In accordance with our criteria for government-related entities (GREs), our view of a "moderate" likelihood of extraordinary ownership support is based on our assessment of Alliander's:

- "Important" role, given its strategic importance to the provinces and municipality owners, as the monopoly provider of gas and electricity distribution services in its license areas; and
- "Limited" link to the owners, owing to the dispersed ownership structure.

Key business and profitability developments

Alliander reported stable results for the year ending Dec. 31, 2010. Revenues decreased by 1%, resulting from the tariff reduction in the final year of the 2008-2010 regulatory period. Operating profit (EBIT)--excluding exceptional items such as a gain on the sale of the high-voltage grid to Dutch electricity transmission operator TenneT Holding B.V. (A-/Stable/A-2) in 2009, and an adjustment in deferred tax assets in 2010--increased by 1%, to €337 million.

At the beginning of July 2010, Alliander completed the acquisition of Endinet B.V. (not rated), a Dutch network company operating three electricity and gas networks. We understand that the acquisition has the potential for some synergies, which could result in improved operating margins. In our opinion, the acquisition is largely neutral for Alliander's excellent business risk profile.

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Key cash flow and capital-structure developments

In 2010, Alliander reported positive free cash flow (after capex, but before dividends) of €168 million, up slightly from €152 million in 2009. Reported net debt increased by €290 million to €1,672 million, which includes the effect of consolidating 50% of the €500 million perpetual hybrid securities that Alliander issued in October 2010. While we are unable to calculate Standard & Poor's-adjusted ratios from the preliminary 2010 accounts, we anticipate that the company will remain comfortably above the 20% adjusted FFO to debt threshold for the 'A' rating. Alliander has been allowed an increase in tariffs for the 2011-2013 regulatory period, which we think should support compliance with this ratio threshold over the medium term.

Liquidity

Alliander's liquidity position is adequate, in our view, and the company is fully funded through the next two years.

Freely available cash and equivalents totaled about €751 million on Dec. 30, 2010. Debt maturities through 2011 are modest at only €5 million, and the company has access to a fully undrawn, €600 million committed credit facility expiring in March 2015. A €500 million bond falls due in April 2012. Alliander generates stable cash flows from operations that we believe are sufficient to cover its capex requirements. Dividend payments are reasonable and its policy of paying out 45% of net income is flexible to accommodate potential investment needs.

According to management information, Alliander has sufficient liquidity to cover a potential payment related to the early termination of cross-border leases on the company's networks. Alliander is required to maintain letters of credit (LOCs) covering part of the early termination value. As of January 2011, the company issued LOCs totaling $160 million, compared with a total exposure of about $637 million. This exposure includes equity strip risk (the portion of the termination value that would be payable by Alliander in the event of early termination) of $492 million, and a mark-to-market impairment risk of $145 million. Furthermore, Alliander has earmarked €200 million of the €600 million credit facility in the form of LOCs.

Outlook

The stable outlook reflects our opinion that Alliander will continue to focus on its regulated network business and continue to post stable and predictable cash flows that cover its investment requirements. We assume that Alliander will maintain credit metrics commensurate with the ratings over the medium term, with adjusted FFO to debt above 20%. The outlook also takes into account our assumption that Alliander will abstain from any credit-dilutive acquisitions in the near term.

Downward rating pressure could occur if there were to be adverse regulatory actions, higher-than-we-anticipate operating expenditures, or an increase in capex. Conversely, upward rating pressure could develop if Alliander were able to achieve credit measures significantly and sustainably above current guidance, while maintaining an unchanged business risk profile.

Related Criteria And Research

- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- Principles Of Corporate And Government Ratings, June 26, 2007

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