MOODY'S
INVESTORS SERVICE

Credit Opinion: Alliander N.V.

Global Credit Research - 07 Feb 2014

Arnhem, Netherlands

Ratings

Category	**Moody's Rating**
Outlook	Stable
Issuer Rating	Aa3
Senior Unsecured -Dom Curr	Aa3
Jr Subordinate -Dom Curr	(P)A3
ST Issuer Rating	P-1
Alliander Finance B.V.	
Outlook	Stable
Bkd Senior Unsecured -Dom Curr	Aa3

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Key Indicators

[1]**Alliander N.V.**

	12/31/2012	**12/31/2011**	**12/31/2010**	**12/31/2009**
(FFO + Interest) / Interest Expense	**5.3x**	**5.8x**	**5.1x**	**5.1x**
Net Debt / Fixed Assets	**40.2%**	**42.3%**	**41.2%**	**46.5%**
FFO / Net Debt	**24.0%**	**28.5%**	**25.3%**	**29.6%**
RCF / CAPEX	**0.8x**	**1.2x**	**1.3x**	**0.5x**

[1] All ratios are calculated using Moody's Standard Adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Low business risk, with operations primarily in distribution networks that are price regulated under a stable and transparent system of regulation

Low financial risk relative to European peers evident in stable and modest leverage

Reducing regulatory revenues, reflecting lower cost of capital set by the regulator over the period 2014-2016, which we consider challenging but achievable given the lower market cost of debt

Fully owned by Dutch provinces and municipalities - we assign two notches of uplift to reflect our expectation of the likelihood of extraordinary support, if necessary

Corporate Profile

Alliander N.V. (Alliander) owns and manages, through its fully owned subsidiaries of Liander and Endinet, electricity and gas distribution networks in the Dutch provinces of Gelderland, Noord-Holland and large parts of Flevoland, Friesland and Zuid-Holland. Alliander is fully owned by Dutch provinces and municipalities, with the largest owners being the provinces of Gelderland (45%), Noord-Holland (9%), Friesland (13%) and the Municipality of Amsterdam (9%). The remaining 24% share is owned by approximately 54 small municipalities where Alliander provides its network services. Alliander is one of the three largest electricity and gas network operators in the Netherlands, responsible for the maintenance, management and development of the medium and low-voltage electricity and gas distribution grids. With approximately 3.1 million electricity and 2.6 million gas customers, Alliander has a combined market position of 37% in the Netherlands.

SUMMARY RATING RATIONALE

Alliander's Aa3 issuer rating is underpinned by a combination of (1) the low-risk business profile of Alliander's domestic electricity and gas regulated distribution network operations; (2) the well-defined, transparent and cost-efficient, Dutch regulatory framework; and (3) the company's conservative financial profile, reflected by its strengthened capital structure and solid liquidity position. The Aa3 rating also incorporates a two-notch uplift under our government-related issuer (GRI) methodology, reflecting the potential for support from its owners.

At Aa3, Alliander's rating is materially higher than those of many of its European peers, which have private shareholders, exhibit higher leverage and whose ratings are generally in the low single-A/high Baa categories.

DETAILED RATING CONSIDERATIONS

REGULATED NETWORKS REPRESENT A LOW BUSINESS RISK, LIMITED IMPACT FROM UNREGULATED BUSINESSES

We consider regulated energy distribution networks to be amongst the lowest risk assets within the utility sector and these are capable of some of the strongest credit ratings. These typically exhibit stable operating costs, afford medium term visibility of capital and maintenance programmes, and have limited scope for significant single-event risk to the asset operations. Combined with a stable regulatory framework, the revenue source should represent a highly predictable income stream which provides useful visibility on medium term funding requirements.

Alliander's business is focused on the core regulated network activities, with the exception of some construction and maintenance of complex infrastructures and small scale German operations, which account for around 6% of its revenues. The company's acquisition of Endinet in July 2010 did demonstrate a willingness on behalf of management to pursue acquisition activity and increase leverage in the process, although within Alliander's financial policy framework.

The high technical operating performance of Dutch networks is generally good relative to their European peers. Alliander's very low average annual outage time reflects the extremely high reliability of its network assets, and this performance compares favourably relative to the regulatory targets and its Dutch peers. This reduces the cost and complexity of maintaining the existing network. Alliander does not plan particularly large single development projects, and the company's aggregate investment plan, of which EUR 245 million was spent in 1H 2013, including the rollout of smart meters, is set to remain stable over the next five years.

REGULATORY FRAMEWORK IS STABLE BUT ENTERING A PERIOD OF REDUCING ALLOWANCES

Now in the sixth regulatory period, the Dutch framework applied since 2001, allows the country's electricity and gas distribution companies to earn a return on their regulated asset base, adjusted for a consumer price index (CPI) and an efficiency incentive X factor. The regulation incorporates incentives based on a "yardstick" mechanism, which defines the efficiency X and quality Q factors based on industry averages and encourages network companies to improve profitability by outperforming the sector through improved efficiency and increased quality. This approach is typical of peer regulatory regimes in Europe and we consider that the application of the Dutch regulatory methodologies by the regulator, the Authority for Consumers and Markets (ACM), has been transparent and consistent.

The current price control period runs from January 2014 to December 2016 and allowances have generally been tightened from those applied during the previous period. Most notably, the weighted average cost of capital (WACC) for network companies will be reduced to 3.6% in real terms by the end of 2016, from a level of 6.2% currently. While this represents a material decline in allowed returns, Alliander has demonstrated its ability to fund comfortably within the cost of debt implied by this. In November 2012 the company issued a EUR 400 million 10-year bond at a coupon of 2.25%; and in November 2013 it placed a EUR 500 million perpetual hybrid - which we consider has equity-like characteristics - at a coupon of 3.25%. Given this, we expect Alliander will continue to improve its achieved cost of debt as it refinances and should outperform the regulator's embedded assumption for the same of 3.85%.

Furthermore, the regulator has imposed a series of cost efficiency targets on the networks of around 5% - 7% annually (the `X-factor'), this is in contrast to the fifth period which allowed a negative X-factor that provided an incremental increase in the element of revenue funding operating costs. In order to meet this target Alliander will need to continue its existing cost efficiency programme. We expect this will be a challenging target to outperform over the price control period.

BROAD MUNICIPAL OWNERSHIP GIVES RISE TO A STONG EXPECTATION OF SUPPORT IF NEEDED

Given its 100% ownership by Dutch provinces and municipalities, Alliander falls within the scope of our rating methodology for GRIs. In accordance with the methodology, Alliander's rating incorporates uplift to its standalone credit quality, which is expressed as a baseline credit assessment (BCA) of a2, for potential support from its owners.

Although the ownership of Alliander is relatively fragmented among approximately 58 provinces and municipalities, we believe the shareholders are capable and willing to act in conjunction with one another. Furthermore, the 76% ownership share of the four largest provinces and their historically proven ability to reach consensus provides us with comfort for the assignment of a strong level of expected systemic support to Alliander in case of need.

This assessment considers Alliander's strategic importance to the regions and our view that extraordinary support from its governmental owners is more likely for a pure electricity and gas distribution network company compared with a vertically integrated utility. In addition, the two-notch uplift to Alliander's BCA incorporates the credit quality of the company's shareholders and our assessment of a very high level of default dependence. This assessment reflects Alliander's significant exposure to the Dutch economy, as almost all of the company's revenues and cash flows are generated from domestic activities and have a high number of common drivers of credit quality.

KEY CREDIT METRICS

Alliander has historically reported stable financial metrics on the back of its regulated revenues, suitable cost control and modest financial leverage in comparison to its European peers outside of the Netherlands. Ratios have historically exceeded our guidance for the current rating level, and this leaves Alliander some headroom as the company enters the sixth regulatory framework, but we anticipate this may be consumed over the current regulatory period. While less likely given the new revenue allowances, finances could be further constrained by any decision to debt-finance potential future acquisitions of smaller network operators.

Liquidity Profile

Alliander's strong liquidity position is supported by solid cash flow generation and large committed liquidity facilities. At end-June 2013 the company had EUR 80 million of cash on balance sheet, and its EUR 600 million revolving credit facility was fully undrawn - the availability of which expires in 2017. In addition, the company has an established ECP programme of EUR 1.5 billion that has no outstanding liabilities, although this is an uncommitted resource. Alliander's next significant bond maturities are now EUR 276 million and EUR 400 million due in December 2014 and April 2016 respectively. Liquidity in place is sufficient to cover in excess of 12 months' scheduled cash requirements.

CROSS-BORDER LEASE AGREEMENTS (CBL)

Alliander has exposure to contingent liabilities represented by four CBLs. In the case of an unscheduled early termination of all of these CBLs at the same time this could give rise to a total exposure (maximum strip risk) of $307 million. According to the conditions of some of the CBLs, the company would need to post additional letters of credit if its ratings were to drop below certain minimum levels. Currently, Alliander posts $6 million of letters of credit. We note that the company currently has availability under its EUR 600 million revolving credit facility to cover potential financing needs stemming from the CBLs, including a sufficient limit for issuing related letters of credit.

Rating Outlook

The stable outlook for Alliander reflects our expectation that the company will primarily remain an electricity and gas distribution network operator that derives its revenues and cash flow from regulated activities. Furthermore, we expect Alliander to continue to follow its conservative financial policy.

What Could Change the Rating - Up

For any upward pressure on the rating to occur, Alliander would need to consistently achieve ratios well above the minimum credit metrics set by the company within its financial policy and incorporated in its business plan (funds from operations (FFO) interest coverage at or above 3.5x and FFO/net debt above 20%) on a sustainable basis.

What Could Change the Rating - Down

To be safely positioned within its current BCA of a2, we would expect Alliander's credit metrics not to materially deteriorate below the minimum levels set within the company's financial policy, namely: FFO interest coverage at or above 3.5x and FFO/net debt above 20% on a sustainable basis. If the debt protection metrics decline substantially below these levels, perhaps due to a significant increase in indebtedness above the forecast levels or weakening of cash flow generation, the BCA and rating would come under downward pressure.

Rating Factors

Alliander N.V.

Regulated Electric and Gas Networks [1][2]	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**
Factor 1: Regulatory Environment & Asset Ownership Model (40%)						
a) Stability and Predictability of Regulatory Regime		X				
b) Asset Ownership Model		X				
c) Cost and Investment Recovery			X			
d) Revenue Risk		X				
Factor 2: Efficiency & Execution Risk (10%)						
a) Cost Efficiency			X			
b) Scale and Complexity of Capital Programme				X		
Factor 3: Stability of Business Model & Financial Structure (10%)						
a) Ability and Willingness to Pursue Opportunistic Corporate Activity				X		
b) Ability and Willingness to Increase Leverage				X		
c) Targeted Proportion of Operating Profit Outside Core Regulated Activities			X			
Factor 4: Key Credit Metrics (40%)						
a) (FFO + Interest) / Interest Expense (3-Year Average)		5.4x				
b) Net Debt / Fixed Assets (3 Year Avg)		41.2%				
c) FFO / Net Debt (3 Year Avg)		25.9%				
d) RCF / CAPEX (3 Year Avg)				1.1x		
Rating:						
a) Indicated Rating from Grid factors 1-4			A1			
b) Impact from Rating Uplift	0					
c) Indicated Rating from Grid			A1			
d) Actual BCA Assigned				a2		

Government-Related Issuer	**Factor**
a) Baseline Credit Assessment	a2
b) Government Local Currency Rating	Aaa negative
c) Default Dependence	Very High
d) Support	Strong

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2012