MOODY'S INVESTORS SERVICE

Credit Opinion: Alliander N.V.

Global Credit Research - 22 Dec 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.**

	12/31/2013	12/31/2012	12/31/2011	12/31/2010
(FFO + Interest) / Interest Expense	6.8x	5.9x	6.1x	5.1x
Net Debt / Fixed Assets	34.7%	36.8%	35.0%	38.9%
FFO / Net Debt	28.8%	26.8%	34.9%	26.8%
RCF / Net Debt	24.4%	21.2%	30.6%	24.4%
RCF / CAPEX	0.9x	0.8x	1.2x	1.3x

[1] All ratios are calculated using Moody's Standard Adjustments. Source: Moody's Financial Metrics TM

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

Opinion

Rating Drivers

- Low business risk profile supported by predictable cash flows due to predominantly regulated activities

- Stable and transparent regulatory regime, though allowed returns are decreasing

- Moderate investment requirements and conservative distribution policy underpin strong financial profile going forward

- Two notches of rating uplift reflecting potential support from government shareholders

Corporate Profile

Alliander N.V. (Alliander) owns and manages low and medium voltage electricity and gas distribution networks in the Dutch provinces of Gelderland, Noord-Holland and large parts of Flevoland, Friesland, Zuid-Holland and Noord-Brabant. Alliander is fully owned by Dutch provinces and municipalities, with the largest owners being the provinces of Gelderland (45%), Friesland (13%), Noord-Holland (9%), and the City of Amsterdam (9%). The remaining 24% share is owned by 54 small municipalities where Alliander provides its network services. Alliander is the largest electricity and gas network operator in the Netherlands with approximately 3.1 million electricity and 2.6 million gas connections and it has a combined market share 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 and transparent Dutch regulatory framework; and (3) the company's conservative financial profile with relatively modest leverage for the sector and solid liquidity position.

During the current regulatory period 2014-2016, returns will gradually reduce from previously 6.2% to 3.6% (real, pre-tax) by the end of the three-year period. In addition, revenue allowances will decrease to reflect cost efficiency savings being passed through to the end consumers. Despite the lower allowed returns, we expect Alliander to maintain a strong financial profile over the medium term, supported by limited investment requirements and a conservative distribution policy.

The Aa3 rating also incorporates a two-notch rating uplift under our ratign methodology for Government-Related Issuers (GRI), published October 2014, reflecting the potential support from Alliander's owners.

At Aa3, Alliander's rating is materially higher than those of many of its European peers, whose ratings are generally in the low single-A/high Baa categories, reflecting lower financial leverage.

DETAILED RATING CONSIDERATIONS

LOW BUSINESS RISK PROFILE SUPPORTED BY PREDICTABLE CASH FLOWS DUE TO PREDOMINANTLY REGULATED ACTIVITIES

Regulated activities (i.e., the operation of energy distribution networks) contribute more than 90% of Alliander's revenues, providing relatively stable and predictable cash flows under a transparent regulatory regime, and medium term visibility over investment requirements.

We note that Alliander and Enexis Holding N.V. (Aa3, stable) are contemplating an asset swap that would allow the two businesses to better align some of their regional operations between both electricity and gas networks - where currently they each operate one network type in the same region. The negotiations have not yet been concluded, but we expect any conclusion to not materially alter the business or financial risk profile of either company.

Alliander's unregulated activities represent less than 10% of revenues and the company strategy does not envisage material growth of such activities in the medium term. Alliander disposed of the non-core unregulated KEMA business in H1 2014 and is adopting an asset-light strategy with respect to its entry in the German market where strategic partnerships would be preferred to outright asset acquisitions.

STABLE AND TRANSPARENT REGULATORY REGIME THOUGH ALLOWED RETURNS ARE DECLINING

The Dutch framework has been applied since 2001 and 2004 for electricity and gas respectively and allows the country's energy distribution companies to earn a return on their regulated asset base adjusted for a consumer price index (CPI). 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 CPI-X 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 to date been transparent and consistent.

The current price control period, from January 2014 to December 2016, allows for lower returns than in the previous periods. Most notably, the weighted average cost of capital (WACC) for network companies is being reduced to 3.6% in real terms by the end of 2016 , from a level of 6.2% previously. This translates into an overall reduction in regulated revenue of about EUR50 million per year on a cumulative basis during the current regulatory period.

While this represents a decline in allowed returns, Alliander has demonstrated its ability to fund comfortably around the cost of debt of 3.85% incorporated in the new WACC allowance. The company's most recent debt issuance was the EUR500 million 3.25% perpetual hybrid bond in November 2013. Alliander's average cost of debt, including the hybrid, is around 3.85% (nominal), broadly in line with the regulatory cost of debt assumptions.

LIMITED INVESTMENT REQUIREMENT AND CONSERVATIVE FINANCIAL POLICY SUPPORT STRONG FINANCIAL PROFILE

The technical operating performance of the Dutch networks is excellent when compared to other European peers, demonstrated by the networks' high reliability and lower unplanned interruptions time. The generally good condition of the Dutch energy network assets reduces necessary maintenance requirements. Total capital expenditure was stable around EUR500 million in the past few years (EUR474 million in 2013, net of customer contributions) and is expected to broaldy remain around this mark over the medium term. The biggest single investment project for Alliander is the smart-meter roll-out which is expected to slightly increase investment needs after its estimated start in 2015. Investment implications from decentralised energy generation as well as integration of renewable generation is mitigated by ongoing technology updates to the existing network.

The modest investment requirements, particularly when compared with transmission networks operators, underpin our expectation of a continuously strong financial profile. In addition, the management maintains a conservative dividend policy, with distributions around 45% of net income.

Over the medium term, we expect Alliander to continue to exhibit strong financial metrics, albeit lower than historically due to the reduction in allowed returns, with Funds from Operations (FFO)/Net Debt around the low to mid twenties in percentage terms, and RCF/net debt in around the 20% mark. Such metrics continues to position the company with some headroom against our guidance for the current rating. However, the company may decide to use some of this headroom for any potential future acquisition on neighbouring networks.

TWO NOTCHES OF UPLIFT REFLECTING POTENTIAL SUPPORT FROM GOVERNMENT SHAREHOLDERS

Given its 100% ownership by Dutch provinces and municipalities, Alliander falls within the scope of our rating methodology for government-related issuers (GRIs), published in October 2014. Alliander's Aa3 rating incorporates two notches of uplift on its standalone credit quality, which is expressed as a baseline credit assessment (BCA) of a2, reflecting our assessment of a strong probability of potential extraordinary support from its owners should this be needed.

Our assessment of strong level of expected systemic support to Alliander reflects the strategic importance of the company and its assets to the regions in which it operates. Although the ownership of Alliander is relatively fragmented among 58 provinces and municipalities, we believe the shareholders would be capable and motivated to act in conjunction with one another in case of need. Furthermore, 76% of Alliander's shares is concentrated in relatively small number of provinces and is owned by the 4 largest shareholders.

Our assessment of very high level of default dependence 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.

Liquidity Profile

Alliander continues to maintain a strong liquidity position. This is supported by large committed liquidity facilities and solid cash flow generation, although we expect cash generation to decline over the current regulatory period. As of 30 June 2014 the company had EUR190 million of cash and a EUR600 million revolving credit facility - fully undrawn and available until July 2018. In addition, the company is an active issuer of commercial papers (CP) under its established EUR1.5 billion ECP programme.

Alliander has a EUR276 million bond Maturity in December 2014 and this has been fully pre-funded. The next significant bond maturity is EUR400 million due in April 2016. Liquidity in place is sufficient to cover in excess of 12 months' scheduled cash requirements.

Alliander has exposure to contingent liabilities represented by four cross-border leasing (CBL) arrangements. 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 $234 million as of September 2014. 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 $5 million of letters of credit. We note that the company currently has availability under its EUR600 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 maintain focus on its regulated business and continue to follow its conservative financial policy.

What Could Change the Rating - Up

FFO/net debt sustainably above the mid-twenties and RCF permanently above 20% may put upward pressure on the ratings, provided that such metrics are combined with a still conservative approach to the business, with continuing focus on the core regulated activities, and a prudent financial and dividend policy.

Before considering any upgrade, we would also need to have clarity on the proposed asset swap with Enexis and its implication on the business and financial profile of the group.

What Could Change the Rating - Down

To be safely positioned within its current BCA of a2, we would expect Alliander to maintain the following minimum credit metrics: FFO interest coverage at or above 3.5x and FFO/net debt above 20% on a sustainable basis. A downward rating pressure could also arise if the potential support from Alliander's government shareholders were to be seen less likely to be obtained.

Other Considerations

The principal methodologies used in rating Alliander were Moody's "Regulated Electric and Gas networks" rating methodology, published in November 2014 and "Government Related Issuers", published in October 2014. Over the next 12-18 months, we expect Alliander to exhibit a financial profile broadly in line with historical metrics, albeit reducing slowly as the allowed return continues to be adjusted over the regulatory period.

The indicated rating from the regulated networks methodology grid is Aa3/A1 (forward-looking), higher than the assigned a2 BCA, reflecting the current headroom within the rating.

Rating Factors

Alliander N.V.

Regulated Electric and Gas Networks Industry Grid [1][2]	**Current 12/31/2013**		[3]**Moody's 12-18 Month Forward View as of 12/10/2014**	
Factor 1 : Regulatory Environment and Asset Ownership Model (40%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability and Predictability of Regulatory Regime		Aa		Aa
b) Asset Ownership Model		Aa		Aa
c) Cost and Investment Recovery (Ability and Timeliness)		A		A
d) Revenue Risk		Aa		Aa
Factor 2 : Scale and Complexity of Capital Program (10%)				
a) Scale and Complexity of Capital Program		Baa		Baa
Factor 3 : Financial Policy (10%)				
a) Financial Policy		A		A
Factor 4 : Leverage and Coverage (40%)				
a) FFO interest cover (3 Year Avg)	6.3x	Aa	6.5x-7.0x	Aa
b) Net Debt / Fixed Assets (3 Year Avg)	35.5%	Aa	31%-34%	Aa

c) FFO / Net Debt (3 Year Avg)	30.0%	Aa	25%-28%	A/Aa
d) RCF / Net Debt (3 Year Avg)	25.4%	Aa	20%-22%	A/Aa
Rating:				
a) Indicated Rating from Grid Factors 1-4		Aa3		A1/Aa3
b) Rating Uplift		0		0
c) Indicated Rating from Grid		Aa3		A1/Aa3
d) Actual BCA Assigned		a2		

Government-Related Issuer	**Factor**
a) Baseline Credit Assessment	a2
b) Government Local Currency Rating	Aaa/Stable
c) Default Dependence	Very High
d) Support	Strong
e) Final Rating Outcome	Aa3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2013; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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