MOODY'S INVESTORS SERVICE

Credit Opinion: Alliander N.V.

Global Credit Research - 09 Feb 2012

Arnhem, Netherlands

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aa3
Pref. Stock -Dom Curr	A3
ST Issuer Rating	P-1

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Key Indicators

Alliander N.V.

	Jun-2011	Dec-2010	Dec-2009
EBIT Margin	**27.1%**	**25.4%**	**23.2%**
FFO Interest Coverage	**5.6x**	**5.2x**	**5.8x**
Net Debt / Fixed Assets	**36.1%**	**36.8%**	**35.0%**
FFO / Net Debt	**34.0%**	**28.4%**	**38.0%**
RCF / Capex	**1.0x**	**1.4x**	**0.9x**
RCF / Net Debt	**30.1%**	**25.8%**	**16.4%**

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

Opinion

Corporate Profile

Alliander N.V. (Alliander) owns and manages, through its fully owned subsidiaries of Liander, Liandon 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 million electricity and 2.6 million gas customers, Alliander has a combined market position of 37% in the Netherlands.

Rating Rationale

Alliander's Aa3 issuer rating is underpinned by a combination of: (i) the low-risk business profile of Alliander's domestic electricity and gas regulated distribution network operations; (ii) the well-defined, transparent and cost-efficient, Dutch regulatory framework; and (iii) 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 for potential support from its owners.

Rating Drivers

Given its 100% ownership by Dutch provinces and municipalities, Alliander falls within the scope of our rating methodology for government-related issuers (GRIs). In accordance with the methodology, Alliander's rating incorporates uplift for potential support from its owners to its standalone credit quality, which is expressed as a baseline credit assessment (BCA) of 6 (on a scale of 1 to 21, where 1 represents the lowest risk and 6 is equivalent to an A2 rating).

Although the ownership of Alliander is relatively fragmented among approximately 58 provinces and municipalities, we perceive the shareholders to be 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 a distressed situation.

This assessment considers Alliander's strategic importance 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 level of correlation to common drivers of credit quality.

When assessing Alliander's BCA, we apply our Rating Methodology for Regulated Electric and Gas Networks, which identifies key areas of focus for assessing the relative fundamental credit quality of regulated electric and gas network companies. The methodology focuses on the assessment of the regulatory environment, ownership model, operational performance, stability of business model, financial policy and key credit metrics. Based on historical financial performance, the methodology grid indicates a BCA of 5 for Alliander. Any positive pressure on Alliander's BCA, narrowing the difference between the methodology grid outcome and the actual BCA of 6 would depend on the company's ability and willingness to adjust the increasing investments and acquisition activity, in order not to constrain Alliander's financial performance in the medium term.

Alliander's rating is supported by low business risk, strong financial profile and prudent financial policies, encouraged by its local government owners. The rating also benefits from uplift because of the potential for systemic support given their ownership model and the clear policy choice made in the Netherlands to maintain network utilities in public ownership. At Aa3, Alliander's rating, is materially higher than those of many of its European peers, which have private shareholders and exhibit higher leverage and whose ratings are generally in the low single-A/high Baa categories.

RATING FACTOR 1 - Regulatory Environment and Asset Ownership Model

Currently in its fifth regulatory period, the Dutch regulatory 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. The solid score (Aa) for the "Stability and Predictability of Regulatory Regime" sub-factor reflects the consistent application of transparent regulatory methodologies by the Dutch regulator.

We view positively that the negative X-factor, set by the Dutch regulator for the fifth regulatory period (2011-13), allows a gradual increase of tariffs and positively impacts the financial profile of the distribution network operators through strengthened cash flow generation, as already evidenced by Alliander's financial results for the first half of 2011. However, we keep the score for the "Cost and Investment Recovery" sub-factor at A, as the mechanism of setting the X-factor has not changed and the negative X-factor reflects the regulator's recognition of network operators' needs to cover growing costs incurred in the previous regulatory period.

The regulatory mechanism based on a revenue cap model and the introduction of capacity-based payments reduces the exposure of network companies to volume volatility risk, resulting in Alliander scoring Aa for the "Revenue Risk" sub-factor. We have assigned the same score to Alliander for the "Asset Ownership Model" sub-factor, given the company's full ownership of the network assets under a licence.

RATING FACTOR 2 - Efficiency and Execution Risk

Our overall score of Alliander within Factor 2 is supported by the high technical operating performance of Dutch networks, which is generally very solid in the context of their European peers. The company's very low average annual outage time reflects the extremely high reliability of its network assets. Alliander's score of A for the sub-factor "Cost Efficiency" further reflects its historically consistent outperformance of the regulatory targets and its Dutch peers.

Although Alliander does not plan significantly large single projects as part of its capital investment programme, its Baa score for the "Scale and complexity of Capital Programme" sub-factor reflects our expectation that Alliander's annual investment plan, currently at EUR 475 million, including the rollout of smart meters, is set to increase over the next five years.

RATING FACTOR 3 - Stability of Business Model and Financial Structure

With the exception of the construction and maintenance of complex infrastructures and some small scale German operations, which do not exceed 10% of its revenues, Alliander strategically focuses on its core business of regulated activities based on its distribution network assets, which justifies its solid A score within the sub-factor "Proportion of Activities outside the Core Network Segment".

Although Alliander's strategy is fully focused on its core business of regulated network activities, the company's acquisition of Endinet in July 2010 demonstrates a greater willingness on behalf of management to pursue acquisition activity, as well as an appetite to increase leverage, although within Alliander's financial policy framework. Although the acquisition is in line with the government's and owners' view of long-term consolidation of the Dutch distribution network sector in the Netherlands, we have assigned a rating of Baa to Alliander for the sub-factors "Ability and Willingness to Pursue Opportunistic Corporate Activity" and "Ability and Willingness to Increase Leverage" reflecting the company's plans to play a role in the long-term strategy for consolidation of the Dutch distribution network sector.

RATING FACTOR 4 - Key Credit Metrics

Historically solid financial performance enabled Alliander to absorb the EUR 712 million acquisition of Endinet B.V. without materially threatening its position within its rating category. Furthermore, the strong liquidity position supported by high cash reserve enabled the company to partially pre-pay EUR 250 million of its bonds due in 2014 and 2016. Furthermore, we expect Alliander's financial profile to stabilize over the next years as the negative X-factor, set by the Dutch regulator for the current regulatory period (2011-

13), enables a gradual increase of tariffs resulting in growing revenues and strengthening cash flow generation as already evidenced by strengthened 2011 half-year results.

However, we point out that the positive impact depends upon the continuing successful execution of the cost efficiency measures and might be constrained by a need to finance potential future acquisitions of smaller network operators, as envisaged within the overall strategy for consolidation of the Dutch distribution network segment. Furthermore, the need to fund the growing investment programme might restrict the future strengthening of Alliander's financial profile, especially if the smart metering project gets expedited compared with the company's expectations.

Liquidity Profile

Alliander's strong liquidity position is supported by solid cash flow generation, the favourable maturity profile of its EUR 2 billion of notes issued under the EUR 3 billion euro medium-term note (EMTN) programme, a currently undrawn ECP programme of EUR 1.5 billion and an undrawn committed facility of EUR 600 million the maturity of which has been recently extended to 2016. The EUR 500 million bonds maturing in 2012 are well covered by the undrawn committed back-up bank facility of EUR 600 million in case own cash flow generation is not sufficient to cover the repayment. Although it has been largely consumed by the acquisition of Endinet and used for partial repayment of outstanding bonds, we perceive Alliander's cash reserve at the EUR 400 million level as at the end of 2011 as sufficient and supportive to the company's liquidity position. Alliander's solid liquidity position is further supported by a reasonable dividend policy, of 45% of net income. Alliander's future liquidity position also depends on its ability to adjust its investment plans, according to its financial performance and debt repayment requirements.

CROSS-BORDER LEASE AGREEMENTS (CBL)

We note that Alliander has exposure to contingent liabilities represented by seven CBLs. In the unlikely case of an unscheduled early termination of all of these CBLs at the same time this could give rise to a total exposure of $268 million. In addition, market-to-market changes in valuations of underlying investments could lead to a higher strip risk and increase Alliander's total exposure to $450 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 $74 million of letters of credit. In this context, we note that the company currently has solid liquidity within its EUR 600 million credit facility to cover potential financing needs stemming from the CBLs, including a sufficient limit for issuing related letters of credit. The documentation of the credit facility includes certain financial covenants that the company is required to maintain. Alliander is in compliance with all the covenants with comfortable headroom.

Rating Outlook

The stable outlook for Alliander reflects our expectation that the company will remain a pure electricity and gas distribution network operator that derives most of its revenues and cash flow from regulated activities. Furthermore, we would 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 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 6, we would expect Alliander's credit metrics not to materially deteriorate below the minimum levels set within the company's financial policy: 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	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Regulatory Environment and Asset Ownership Model (40%)							
a) Stability and Predictability of Regulatory Regime (15%)		x					
b) Asset Ownership Model (10%)		x					
c) Cost and Investment Recovery (Ability and Timeliness) (10%)			x				
d) Revenue Risk (5%)		x					
Factor 2: Efficiency and Execution Risk (10%)							
a) Cost Efficiency (6%)			x				
b) Scale and Complexity of Capital Programme (4%)				x			
Factor 3: Stability of Business Model and Financial Struct (10%)							
a) Ability & Willingness to Pursue Opportunistic Corp Activ (3%)				x			
b) Ability and Willingness to Increase Leverage (3%)				x			
c) Proportion of Oper. Profit outside Core Reg. Activities (3%)			x				
Factor 4: Key Credit Metrics (40%)							
a) FFO Interest Cover (15%)			x				
b) Net Debt / Fixed Assets (15%)		x					
c) FFO / Net Debt (5%)	x						
d) RCF / Capex (5%)					x		
Rating:							
a) Indicated BCA from Methodology Grid			**5 (A1)**				
b) Actual BCA			**6 (A2)**				