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Alliander N.V.

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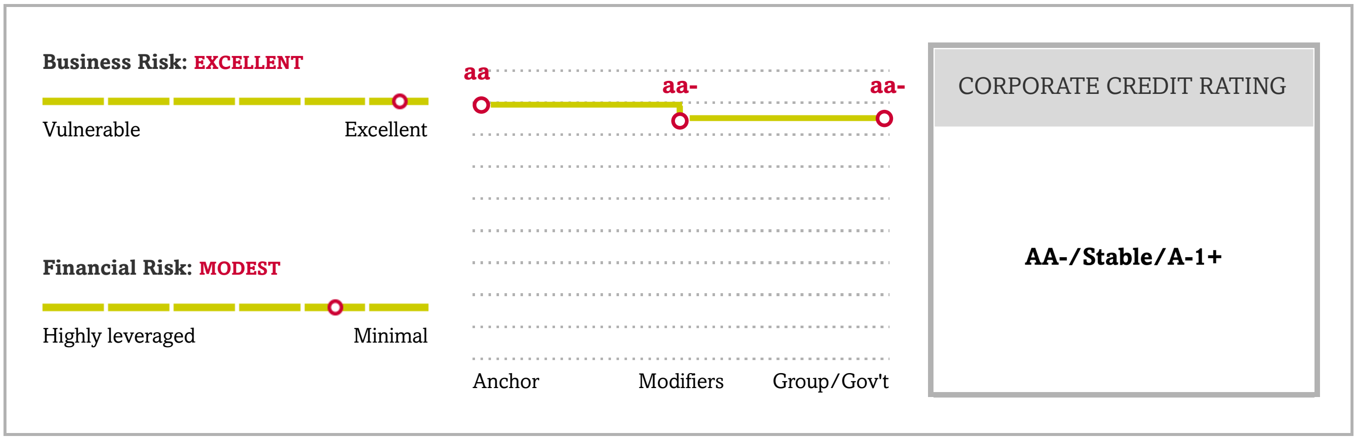

Rationale

Business Risk: Excellent	Financial Risk: Modest
• More than 95% of operating profit derived from stable, regulated revenues. • Natural monopoly position in service areas. • Strong operational performance of networks. • Regulatory reset risk every three years.	• Stable and predictable operating cash flows within regulatory periods. • Conservative financial policy and strong debt coverage ratios. • Strong liquidity.

Outlook: Stable

The stable outlook reflects our opinion that Dutch electricity and gas distribution network operator, Alliander N.V., will be able to sustain adjusted funds from operations (FFO) to debt of about 25% over the medium term. Underpinning our opinion is our assumption that Alliander will partially offset the impact of lower tariffs in the current regulatory period by reducing its operating costs and dividend distributions.

Downside scenario

We could lower the ratings if we believe that Alliander is likely to recapitalize its balance sheet to maintain its publicly stated minimum requirement of FFO to debt of 20%. In our view, this could occur either through further sector consolidation in The Netherlands or an extraordinary dividend distribution. We could also lower the ratings if the company's credit ratios were to weaken sustainably below our guidance of 25% FFO-to-debt, for example as a result of operational issues or negative regulatory intervention.

Upside scenario

We consider an upgrade unlikely in light of the relatively predictable tariffs set by the regulator to end-2016, and the company's capital expenditure (capex) plan and dividend policy. This said, we would consider an upgrade if Alliander were able to sustain an adjusted FFO-to-debt ratio of more than 35%, assuming an unchanged business risk profile.

Standard & Poor's Base-Case Scenario

We anticipate a weakening in Alliander's credit metrics from 2014, due to lower tariffs in the current regulatory period, and rising capex that will result in moderately negative discretionary cash flows. However, we expect that ratios will remain commensurate with the modest financial risk profile. In our opinion, Alliander has a conservative financial policy with specific minimum ratio thresholds that also support the company's strong liquidity position.

Assumptions

- Revenues and FFO decrease in 2014 due to the reduction in tariffs in the current regulatory period starting January 2014. We expect the dip to continue to the end of the current regulatory period, December 2016, and to recover from 2017 mainly as a result of a delayed compensation for sufferance tax (municipal tax for use of public land) that has risen in the current period.
- Moderately negative discretionary cash flows after capex and dividends result in gradually rising debt levels.
- Alliander has affirmed its dividend policy, of 45% pay-out with no minimum.

Key Metrics

	2013A	2014F	2015F	2016F
EBITDA Margin (%)*	44.3	40-50	35-45	35-45
Debt/EBITDA (x)*	2.4	2.0-3.0	2.5-3.5	2.5-3.5
FFO/Debt (%)*	33.4	25-35	20-30	20-30
DCF/debt (%)*	4.6	0-(5)	0-(5)	0-(5)
Debt/(debt+equity)(%)*	37.3	35-45	35-45	35-45

*S&P adjusted figures. A--Actual. F--Forecast. FFO--Funds from operations. DCF--Discretionary cash flow.

Company Description

Alliander is the largest electricity and gas distribution network operator in The Netherlands, with 3.1 million electricity and 2.6 million gas customers, and a combined market share of 37%.

Alliander's operations are regulated by the Ministry of Economic Affairs (energy policy) and the regulator, Authority for Consumers and Market, ACM (implementation). Allowed tariffs are set based on recovery of an average cost base, a reasonable return on a regulated asset value, inflation adjustments, and pre-set efficiency targets. Unregulated activities account for about 7% of Alliander's revenues and EBITDA, and comprise infrastructure services and a small subsidiary in Germany (Alliander AG), which provides public lighting services and network operations.

Business Risk: Excellent

Alliander's "excellent" business risk profile primarily reflects the very low risk associated with its regulated electricity and gas distribution network businesses, the company's natural monopoly status in its license areas, and the high quality of its network assets.

Additionally, our assessment is underpinned by Alliander's "strong" competitive position, which we see as supported by a "strong" regulatory advantage.

The majority of Alliander's activities, including its electricity and gas tariffs, are regulated by the Dutch Ministry of Economic Affairs and ACM. The regulatory framework is well established, supportive, mature, and relatively stable through a regulatory period, having started in 2001. It allows companies to recover their costs and earn a return on their regulated asset base (RAB), adjusted for CPI and an efficiency incentive, the x-factor (CPI-X adjustment of revenues). We consider that the tariff decision for the current three-year regulatory period, which started on Jan. 1, 2014, will be challenging for the Dutch distribution network operators since it will result in substantial tariff reductions over 2014-2016. The decision indicates that ACM will lower the tariffs, mainly through a step-by-step reduction of the real pretax weighted-average cost of capital to 3.6% from 6.2%, which we calculate will reduce Alliander's regulated revenues by about €50 million in 2014.

However, we believe that Alliander's efforts to reduce costs, its prudent prefunding of upcoming debt maturities at a lower cost, and the fact that dividends are likely to reduce with lower net profit, will mitigate the lower tariffs.

These strengths are partly offset by regulatory tariff reset risk every third year; exposure to incentive-based regulation that can impose challenging efficiency requirements; and the potential for further consolidation in the Dutch energy network sector, in which we anticipate Alliander will take an active part. However, it is possible that consolidation will take the form of asset swaps or bolt-on acquisitions, with limited financial outlay on behalf of Alliander.

S&P Base-Case Operating Scenario

Current regulatory period: Jan. 1, 2014 to Dec. 31, 2016

- Positive x factors (efficiency factors) have been set that require a decrease of allowed revenue.
- The lower weighted average cost of capital (WACC) reflects lower risk free rates and risk premiums.

Next regulatory period: Jan. 1, 2017 to Dec. 31, 2019

- We expect WACC to decrease further, to 3.1%, if low interest rates and moderate economic growth persist.
- Nevertheless, we expect revenues to increase due to the delayed recovery in sufferance tax, which has been rising in the current regulatory period.

Regulatory framework to continue to evolve

We anticipate that the regulatory framework in The Netherlands will continue to evolve. In 2013, a simplified energy market model in was introduced. This includes the introduction of a "one-stop shopping" model for energy retail customers, allowing for simplified administrative processes and lower network costs for the network companies.

Volume risk has been phased out because of the gradual introduction of capacity-based payments.

Peer comparison

Table 1

Alliander N.V. -- Peer Comparison

Industry Sector: Electric

	Alliander N.V.	Enexis Holding N.V.	N.V. Nederlandse Gasunie	TenneT Holding B.V.	Eneco Holding N.V.
Rating as of Nov. 25, 2014	AA-/Stable/A-1+	A+/Stable/--	A+/Stable/A-1	A-/Stable/A-2	A-/Stable/A-2
	--Average of past three fiscal years--				
(Mil. €)					
Revenues	1,668.0	1,355.8	1,586.3	1,872.3	5,171.3
EBITDA	717.2	702.0	1,055.3	637.0	893.5
Funds from operations (FFO)	616.5	575.4	784.3	429.8	760.5

Table 1

Alliander N.V. -- Peer Comparison (cont.)					
Net income from cont. oper.	254.3	232.5	73.7	267.1	246.7
Cash flow from operations	585.3	556.7	791.8	844.6	926.2
Capital expenditures	458.3	391.2	589.4	1,421.5	769.2
Free operating cash flow	127.0	165.5	202.4	(576.9)	157.0
Discretionary cash flow	22.7	69.7	70.2	(619.5)	60.3
Cash and short-term investments	120.3	36.6	18.1	71.1	0.0
Debt	1,942.6	1,739.9	4,690.8	3,345.4	2,306.6
Equity	2,932.3	3,248.4	4,833.2	2,497.3	4,464.3
Adjusted ratios					
EBITDA margin (%)	43.0	51.8	66.5	34.0	17.3
Return on capital (%)	8.7	8.2	8.0	7.6	6.4
EBITDA interest coverage (x)	6.4	6.8	4.4	4.4	6.2
FFO cash int. cov. (X)	6.7	7.0	4.0	4.7	9.0
Debt/EBITDA (x)	2.7	2.5	4.4	5.3	2.6
FFO/debt (%)	31.7	33.1	16.7	12.8	33.0
Cash flow from operations/debt (%)	30.1	32.0	16.9	25.2	40.2
Free operating cash flow/debt (%)	6.5	9.5	4.3	(17.2)	6.8
Discretionary cash flow/debt (%)	1.2	4.0	1.5	(18.5)	2.6

Financial Risk: Modest

Alliander's "modest" financial risk profile is based on its continued ability to report solid earnings and cash flow coverage of debt measures. Adjusted FFO-to-debt and debt-to-EBITDA stood at about 33% and 2.4x, respectively, at the end of the last regulatory period ended December 2013. We anticipate a weakening in these ratios from 2014, due to lower tariffs in the current regulatory period, and we also note that rising capex will result in moderately negative discretionary cash flows. However, we expect that ratios will remain commensurate with the modest financial risk profile. In our opinion, Alliander has a conservative financial policy with specific minimum ratio thresholds that also support the company's strong liquidity position.

S&P Base-Case Cash Flow And Capital Structure Scenario

Our base-case cash flow and capital structure scenario includes:

- Our expectation that the issuer will post negative discretionary cash flow caused by increased capex and dividends, although the dividends are declining in the current period in support of credit metrics.
- Our assumption that the smart meter rollout will be about €200 million less than our previous estimate of €1 billion, as joint procurement of smart meters with other network operators generates substantial cumulative savings over the period.
- A focus on benefits through cooperation rather than through acquisitions.
- Adoption of an asset-light strategy in Germany.

Financial summary

Table 2

Alliander N.V. -- Financial Summary

Industry Sector: Electric

	--Fiscal year ended Dec. 31--				
	2013	**2012**	**2011**	**2010**	**2009**
Rating history	AA-/Stable/A-1+	A+/Positive/A-1	A+/Positive/A-1	A/Stable/A-1	A/Stable/A-1
(Mil. €)					
Revenues	1,744.0	1,674.0	1,586.0	1,432.0	1,446.0
EBITDA	772.5	706.0	673.0	554.0	603.0
Funds from operations (FFO)	610.4	599.5	639.6	538.5	457.3
Net income from continuing operations	288.0	224.0	251.0	222.0	312.0
Cash flow from operations	672.4	548.5	535.1	523.5	308.3
Capital expenditures	488.0	493.0	394.0	281.0	530.0
Free operating cash flow	184.4	55.5	141.1	242.5	(221.7)
Dividends paid	100.5	125.0	87.5	54.0	350.0
Discretionary cash flow	83.9	(69.5)	53.6	188.5	(571.7)
Debt	1,824.9	1,898.3	2,104.6	1,968.6	1,855.6
Preferred stock	(248.0)	(247.0)	(247.0)	(247.0)	0.0
Equity	3,069.6	2,895.3	2,832.0	2,659.0	2,245.0
Debt and equity	4,894.6	4,793.6	4,936.6	4,627.6	4,100.6
Adjusted ratios					
EBITDA margin (%)	44.3	42.2	42.4	38.7	41.7
EBITDA interest coverage (x)	7.1	6.4	5.8	4.7	4.6
FFO cash int. cov. (x)	9.3	7.1	5.1	5.0	3.4
Debt/EBITDA (x)	2.4	2.7	3.1	3.6	3.1
FFO/debt (%)	33.4	31.6	30.4	27.4	24.6
Cash flow from operations/debt (%)	36.8	28.9	25.4	26.6	16.6
Free operating cash flow/debt (%)	10.1	2.9	6.7	12.3	(11.9)
Discretionary cash flow/debt (%)	4.6	(3.7)	2.5	9.6	(30.8)
Net Cash Flow / Capex (%)	104.5	96.2	140.1	172.4	20.2

Table 2

Alliander N.V. -- Financial Summary (cont.)					
Return on capital (%)	9.6	7.9	8.7	7.9	8.7
Return on common equity (%)	8.8	7.1	8.4	8.6	16.0
Common dividend payout ratio (un-adj.) (%)	43.4	33.2	45.0	36.2	17.3

N.M. - Not Meaningful.

Liquidity: Strong

The short-term rating is 'A-1+'. We assess Alliander's liquidity position as "strong" as defined in our criteria, supported by our view that Alliander's liquidity sources will exceed its funding needs by more than 1.5x over the next 12 months.

Alliander's well-established and solid relationships with banks, its generally high standing in the credit markets, and typically very prudent risk management further support our opinion of liquidity as strong. We estimate that Alliander's liquidity sources over the next 12 months will be close to €1.6 billion, while uses will be around €1 billion under our base-case scenario.

Principal Liquidity Sources	Principal Liquidity Uses
• Unrestricted cash and short-term marketable securities of about €460 million. • Access to an undrawn €600 million committed credit facility expiring in July 2018. The credit facility contains no financial covenants. • Annual FFO of about €570 million.	• Capex of about €470 million. • Debt repayments of €280 million. • Maturing commercial paper of €150 million. • Dividend payments of about €120 million.

Debt maturities

As of Nov. 13, 2014

- 2014: €284 million
- 2015: €156 million
- 2016: €424 million
- After 2017: €1,181 million

Other Modifiers

We modify the stand-alone credit profile (SACP) for Alliander down by one notch based on our "comparable rating analysis," to reflect our opinion that Alliander's ratios will be at the low end of the "modest" financial risk profile during the current regulatory period. In addition to our forecast that adjusted FFO-to-debt will be about 25%, we anticipate that Alliander will post negative discretionary cash flows, and that the supplementary payback ratios of free operating cash flow/debt and discretionary cash flow/debt will be in the "significant" range.

Group Influence

Alliander N.V. is the holding company for the group's operating companies, which include the regional network operators Liander and Endinet, and subsidiaries. Liandon is Alliander's knowledge center and is largely responsible for the technical innovations for the transportation and distribution of electricity and gas. In Germany, Alliander AG is responsible for network operation as well as for the construction and maintenance of public lighting and traffic control installations.

The shareholders of Alliander are Dutch provinces and municipalities. The largest shareholders are the provinces of Gelderland, Friesland and Noord-Holland and the municipality of Amsterdam.

Government Influence

The 'AA-' long-term rating on Alliander is based on the company's SACP, which we assess at 'aa-', 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, given the dispersed ownership structure. Nevertheless, most of the smaller shareholders, primarily municipalities, have historically been connected to the provinces, which are the larger shareholders, in terms of geography and administration.

Ratings Score Snapshot

Corporate Credit Rating

AA-/Stable/A-1+

Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Excellent

Financial risk: Modest

- **Cash flow/Leverage:** Modest

Anchor: aa

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)

- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Stand-alone credit profile : aa-

- **Related government rating:** AA+
- **Likelihood of government support:** Moderate

Reconciliation

Alliander reports under International Financial Reporting Standards. The main adjustments we make to the 2013 accounts are as follows:

- We add the present value of operating leases of about €50 million to debt.
- We assign 50% equity credit to the hybrid, due to our assessment of "intermediate" equity content. Alliander reports the hybrid as equity under IFRS, therefore we add 50% (€248 million) to debt, and interest expense (€26.5 million). We also deduct €26.5 million from dividends.
- We add to cash, €100 million of time deposits and a €136 million covered bond (Depfa), as both are tradeable. We then net the total cash balance, amounting to €391 million, from debt as we assume it to be unrestricted. We understand that all cash is in euro deposits with highly rated EU banks.
- We also deduct from debt, investments that are held to offset cross-border lease obligations of €161 million.
- We consider €61 million attributed to amortization of construction contributions as an operating expense, and accordingly deduct it from reported EBITDA.

Table 3

Reconciliation Of Alliander N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2013--									
Alliander N.V. reported amounts										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	2,022.0	3,375.0	1,744.0	814.0	457.0	79.0	814.0	683.0	127.0	488.0
Standard & Poor's adjustments										
Interest expense (reported)	--	--	--	--	--	--	(79.0)	--	--	--
Interest income (reported)	--	--	--	--	--	--	1.0	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(54.0)	--	--	--
Operating leases	49.6	--	--	19.5	3.6	3.6	15.9	15.9	--	--
Intermediate hybrids reported as equity	248.0	(248.0)	--	--	--	26.5	(26.5)	(26.5)	(26.5)	--

Table 3

Reconciliation Of Alliander N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €) (cont.)										
Postretirement benefit obligations/deferred compensation	57.4	(57.4)	--	--	--	--	--	--	--	--
Surplus cash	(391.0)	--	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	3.0	--	--	--	--	--
Debt - Investments held for Cross Border Lease liabilities	(161.0)	--	--	--	--	--	--	--	--	--
EBITDA - Amortization of construction contributions	--	--	--	(61.0)	(61.0)	--	(61.0)	--	--	--
D&A - Amortization of construction contributions	--	--	--	--	61.0	--	--	--	--	--
Total adjustments	(197.1)	(305.4)	0.0	(41.5)	6.6	30.1	(203.6)	(10.6)	(26.5)	0.0
Standard & Poor's adjusted amounts										
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Adjusted	1,824.9	3,069.6	1,744.0	772.5	463.6	109.1	610.4	672.4	100.5	488.0

Related Criteria And Research

Related Criteria

- Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	**Modest**	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	**aa**	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of December 10, 2014)

Alliander N.V.	
Corporate Credit Rating	AA-/Stable/A-1+
Junior Subordinated	A
Senior Unsecured	AA-
Short-Term Debt	A-1+
Corporate Credit Ratings History	
15-Aug-2013	AA-/Stable/A-1+
30-Aug-2011	A+/Positive/A-1
27-Mar-2009	A/Stable/A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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