STANDARD & POOR'S

Standard & Poor's Research

Alliander N.V.

Primary Credit Analyst:
Mark J Davidson, London (44) 20-7176-6306; mark_j_davidson@standardandpoors.com

Secondary Contact:
Karin Erlander, London (44) 20-7176-3584; karin_erlander@standardandpoors.com

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Major Rating Factors

Corporate Credit Rating
A+/Positive/A-1

Strengths:

- Low-risk, monopoly electricity and gas distribution networks in the company's license areas.
- Stable and predictable cash flows resulting from transparent regulatory framework.
- Strong financial profile in current regulatory period owing to tariff increases and a sizable cash position.

Weaknesses:

- Regulatory reset risk and exposure to incentive-based regulation.
- Remaining risks related to cross-border leases.

Rationale

The rating on Dutch electricity and gas distribution network company Alliander N.V. reflects 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 strengthened financial profile due to tariff increases for the 2011-2013 regulatory period.

The rating is constrained by regulatory reset risk in 2014, exposure to incentive-based regulation that can impose challenging efficiency requirements, the potential for further consolidation in the Dutch energy network sector in the medium term (in which we would anticipate Alliander to take a leading role), and counterparty and liquidity risks related to remaining cross-border lease agreements amounting to $390 million.

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. Nonregulated businesses, comprising infrastructure installation and maintenance activities, accounted for less than 10% of revenues in the first half of 2012 and were slightly loss-making. Alliander has about three million electricity customers and 2.6 million gas customers in its service area, which is concentrated in the provinces of Gelderland and Noord-Holland, and covers about one-third of The Netherlands. Alliander's combined domestic market share in electricity and gas is 37%.

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, given the dispersed ownership structure. Despite this, 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.

S&P base-case operating scenario

In our base-case operating scenario, we anticipate that Alliander will continue to report rising revenues and profits to the end of the 2011-2013 regulatory period, as a result of healthy tariff increases approved by the regulator to cover increased costs in the previous period. For the next regulatory period in 2014-2016, tariffs will be based on the cost development in the current 2011-2013 period. The tariffs for 2014-2016 have not yet been announced, and may not be as favorable for the network companies as they have been in the current period.

At the beginning of 2012, Alliander began the statutory roll-out of smart gas and electricity meters required by the Dutch government. The initial phase of the roll-out program will be relatively small in scale, and the Dutch energy regulator has confirmed that the costs will be covered by the regulated tariff. That said, Alliander anticipates that roll-out costs will amount to €60 million-€100 million a year until 2020, which is significant in terms of the company's total capital expenditure (capex).

S&P base-case cash flow and capital-structure scenario

We assess Alliander's current debt cover ratios to be strong for the rating, with S&P-adjusted funds from operations (FFO)-to-debt of more than 30% during the 2011-2013 regulatory period. Alliander's operating cash flows are benefiting from the healthy tariff increases, while debt is staying relatively flat due to moderately positive discretionary cash flows (after capex and dividends), and significant cash balances.

We cannot predict what Alliander's debt cover ratios will be in 2014-2016 until the new tariffs are announced. To achieve a higher rating, we have stated that Alliander would need to maintain an adjusted FFO-to-debt ratio of about 25% on a sustainable basis. The actual ratio will depend on the outcome of the tariff setting process, and the evolution of costs, capex, dividends, and external factors such as inflation.

Our base-case scenario excludes the effect of any potential acquisitions, adverse regulatory interventions, or extraordinary returns to shareholders. In this respect, we note that Alliander's financial policy includes a number of minimum financial ratio requirements. These include FFO to debt of more than 20%, which is lower than the company's projections and our base case. However, we understand from Alliander that no mergers or acquisitions are imminent.

Liquidity

The short-term rating on the entity is 'A-1'. We view Alliander's liquidity as "strong" under our criteria, and calculate that liquidity sources should exceed liquidity needs by about 2.3x over the next 12 months.

As of Sept. 30, 2012, we estimate liquidity sources in the next 12 months of about €1.67 billion. These include:

- Unrestricted cash and equivalents of €455 million;
- €600 million available under the undrawn committed bank facility maturing on July 15, 2016; and
- FFO of about €610 million.

On the same date, we estimate Alliander's liquidity needs over the subsequent 12 months to be about €740 million, comprising:

- Short-term debt maturities of €95 million;
- Net capital expenditures of about €540 million, including smart meters; and
- Dividends of about €105 million.

Outlook

The positive outlook reflects our view that Alliander will continue to report robust cash flow-based debt coverage ratios over the medium term, supported by healthy tariff increases in the 2011-2013 regulatory period. We would consider a one-notch upgrade to 'AA-' if we believe that the company is able to sustainably report adjusted FFO to debt of about 25%, while maintaining an unchanged business risk profile. We anticipate increasing clarity on future credit metrics as details are confirmed regarding tariffs in the 2014-2016 regulatory period.

If we believe that the company is likely to recapitalize its balance sheet to be in line with its publicly stated FFO to debt minimum ratio requirement of 20%--either through an extraordinary dividend distribution, negative regulatory intervention, or further sector consolidation in The Netherlands--we would likely revise the outlook back to stable.

Business Description

Alliander is the largest electricity and gas distribution network operator in the State of The Netherlands (AAA/Stable/A-1+), with 3.0 million electricity and 2.6 million gas customers and a combined market share of about 37%. The vast majority of its customers are residential, while the number of business customers is about 33,000.

More than 90% of revenues come from regulated power and gas distribution, with the remainder mainly services relating to infrastructure installation and maintenance. These activities were approximately break-even in 2011.

Government Support And GRE Methodology Impact

In accordance with our criteria for GREs, the 'A+' rating on Alliander is based on the company's 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.

We view Alliander's role as "important" for the provinces and municipality owners because it provides essential public services to the population of its service areas. However, we see Alliander's link to the owners as "limited" because of the dispersed ownership structure, although historically most of the smaller shareholders, primarily municipalities, have been connected to the provinces in terms of geography and administration. As stipulated by the Dutch Independent Network Operation Act, electricity and gas distribution network operators in The Netherlands must be publicly owned. Alliander's shareholders are the provinces of Gelderland (45%), Friesland (13%), and Noord-Holland (9%), and the municipality of Amsterdam (9%), as well as 27 municipalities and provinces--each holding less than 3%.

Business Risk Profile: Excellent, Due To Stable Earnings From Regulated Distribution Network

Alliander's excellent business risk profile is supported by:

- Predictable and stable cash flows from its electricity and gas distribution networks that account for more than 90% of revenues and 100% of operating profits. The majority of the company's customers are households, which results in fairly stable demand from year to year. We consider the regulatory framework to be transparent and credit supportive, with the sector as a whole being able to cover its costs over time.
- A solid market position and monopoly position in its service areas. Alliander's market share is 36% in electricity distribution and 31% in gas, respectively. Its overall market share increased to 37% from 34% following the acquisition of Endinet in 2010.
- A strong operating performance. Alliander is well positioned among its Dutch peers in the incentive-based regulatory framework. The regulator sets tariffs every three years, based on sector broad cost levels in the previous regulatory period.
- High asset quality. Alliander's network operation benefits from low interruption rates, with 99.99% reliability in distribution, and low technical losses.

These supports are partly offset by:

- Regulatory reset risk, with the next regulatory period starting on Jan. 1, 2014. Tariffs for the 2014-2016 period will be set based on the evolution of costs in the current regulatory period.
- Potential sector consolidation. The Dutch government's stated position is that it wishes to see further consolidation in the energy distribution network sector in the Netherlands. In the medium term, Alliander, as the largest distributor, might play a leading role in such a process which will depend to a large extent on the outcome of the European Court decision on the Dutch Unbundling Act. In the near term, it is possible that consolidation will take the form of asset swaps or bolt-on acquisitions, with potentially no financial outlay on behalf of Alliander.

Financial Risk Profile: Intermediate, Reflecting Stable Operating Cash Flows And Robust Debt Cover Ratios

The main strengths of Alliander's intermediate financial risk profile are:

- Stable and predictable cash flows from operations within regulatory periods. Between 2011-2013, revenues are strongly supported by healthy tariff increases approved by the regulator for the current regulatory period.
- A conservative financial policy. Alliander has set itself a requirement to maintain a solid 'A' rating profile and it has set minimum ratios to ensure it complies with this target. The ratios include FFO to debt of more than 20%, FFO interest cover of more than 3.5x, and net debt to capitalization of not more than 60%.
- A strong liquidity position. We estimate that Alliander's ratio of sources to uses of funds will exceed 2x in the next 12 months, supported by high cash balances, sizeable undrawn committed facilities, and moderate dividends.

These strengths are moderated by:

- Our view of the company's exposure to risks related to remaining cross-border leases, including liquidity and counterparty risks. Such risks have gradually declined, however, with the voluntary early termination of some leases. Furthermore, the early termination risk that remains is covered by required LOCs. A portion of the committed credit lines also acts as a backup.

Financial Statistics/Adjustments

Alliander reports under International Financial Reporting Standards. Our main adjustment consists of surplus cash (see table 1), which has been credited to the 2011 gross debt figure. We net the cash because we understand it is unrestricted and readily available. We also understand that Alliander has not earmarked the cash for any specific investment or acquisition in the near term.

Table 1.

Reconciliation Of Alliander N.V. Reported Amounts With Standard & Poor's Adjusted Amounts

	--Fiscal year ended Dec. 31, 2011--									
Alliander N.V. reported amounts										
(Mil. €)	**Debt**	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	2064.0	3079.0	1586.0	710.0	398.0	205.0	527.0	527.0	80.0	394.0
Standard & Poor's adjustments										
Operating leases	49.8	--	--	3.0	3.0	3.0	16.0	16.0	--	16.0
Intermediate hybrids reported as equity	247.0	(247.0)	--	--	--	--	--	--	--	--
Surplus cash and near cash investments	(531.0)	--	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	24.0	--	--	--	--	--
Reverse changes in working-capital	--	--	--	--	--	--	--	72.0	--	--
Debt - Net investments applied to cross-border leases	(149.0)	--	--	--	--	--	--	--	--	--
EBITDA - Amortization of construction contributions	--	--	--	(57.0)	(57.0)	--	--	--	--	--
EBIT - Other	--	--	--	--	12.0	--	--	--	--	--
Interest expense - Other	--	--	--	--	--	(75.0)	--	--	--	--
FFO - Amortization of construction contributions	--	--	--	--	--	--	(57.0)	(57.0)	--	--
Total adjustments	(383.2)	(247.0)	0.0	(54.0)	(18.0)	(72.0)	(41.0)	31.0	0.0	16.0

Table 1.

Reconciliation Of Alliander N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (cont.)										
Standard & Poor's adjusted amounts										
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**	**Dividends paid**	**Capital expenditures**
Adjusted	1680.8	2832.0	1586.0	656.0	380.0	133.0	486.0	558.0	80.0	410.0

FFO--Funds from operations

Related Criteria And Research

All articles listed below are available on Ratings Direct the Global Credit Portal, unless otherwise stated.

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

Ratings Detail (As Of November 2, 2012)	
Alliander N.V.	
Corporate Credit Rating	A+/Positive/A-1
Junior Subordinated	A-
Senior Unsecured	A+
Short-Term Debt	A-1
Corporate Credit Ratings History	
30-Aug-2011	A+/Positive/A-1
27-Mar-2009	A/Stable/A-1
18-Jul-2008	A+/Watch Neg/A-1
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate
Debt Maturities	
As of Sept. 30, 2012: 2012: €95 million 2013: €5 million 2014: €441 million 2015: €5 million Thereafter: €1.37 billion	

*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.

Additional Contact:
Infrastructure Finance Ratings Europe; InfrastructureEurope@standardandpoors.com