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Alliander N.V.

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Alliander N.V.

Major Rating Factors

Corporate Credit Rating
A/Stable/A-1

Strengths:

- Monopoly electricity and gas distribution networks in the company's license areas.
- Regulated revenues under transparent regulatory framework; limited nonregulated activities.
- Stable and predictable cash flows from regulated businesses.

Weaknesses:

- Regulatory reset risk and exposure to incentive-based regulation.
- Sizable capital expenditures program; potentially significant investments in smart meters over the longer term.
- 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 stable operating performance.

The rating is constrained by a sizable capital expenditures (capex) program in the medium term; regulatory reset risk arising from a new regulatory period that starts in 2011 and exposure to incentive-based regulation; as well as counterparty and liquidity risks related to remaining cross-border lease agreements on about 10% of the company's network assets.

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. Other business activities, accounting for less than 10% of Alliander's revenues, including infrastructure installation and maintenance activities, are unregulated. Alliander has about 2.8 million customers, and its service area, concentrated in the provinces of Gelderland and Noord-Holland, covers about one-third of The Netherlands.

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.

Key business and profitability developments

Alliander reported a 3% decrease in revenues in 2009, resulting from the tariff reduction in the current regulatory period. The lower revenues also reflect the introduction in 2009 of new capacity-based tariffs for small-scale users, which we nonetheless view positively as they limit Alliander's volume risk. However, over 2009 and 2010 Alliander has to compensate consumers that were negatively affected by the change. Operating profit (EBIT), excluding a gain from the sale of the high-voltage grid to Dutch electricity transmission operator TenneT Holding B.V. (A-/Stable/A-2) and other one-off items, declined by 17% in 2009.

At the beginning of July 2010, Alliander completed the acquisition of Endinet B.V. (not rated), a Dutch network company operating three electricity and gas networks. We understand that the acquisition will increase Alliander's revenues, and that the potential for synergies could result in improved operating margins. In our opinion, the acquisition is largely neutral for Alliander's excellent business risk profile.

Key cash flow and capital-structure developments

Alliander's free operating cash flow decreased by 13% in 2009 due to lower revenues and higher capex. Alliander issued €1.25 billion of bonds under its €3 billion Euro Medium Term Note program, which largely financed the repayment of an overdraft facility that Alliander had with Nuon Energy, thereby eliminating its short-term debt. The company also received a €400 million equity contribution from the previous owners to strengthen its balance sheet in preparation for the unbundling, and €368 million from the sale of its high-voltage network to TenneT.

We view the acquisition of Endinet as marginally dilutive to Alliander's financial risk profile, which we already assess as intermediate, based on our opinion that Alliander's available cash surplus would decline in the near term in light of the acquisition. In our view, the acquisition effectively exploits the financial headroom available within the current rating. We believe that Alliander's FFO-to-net debt ratio is likely to fall in 2010, from 34% in 2009, but remain above 20% through the forecast period.

Short-term credit factors

Alliander's liquidity position is adequate, in our view, and the company is fully funded through the next two years.

Freely available cash and equivalents totaled about €800 million on June 30, 2010, but fell by €712 million the following month due to the completion of the Endinet acquisition. Debt maturities through 2011 are limited at about €70 million, and the company has access to a recently signed, fully undrawn five-year €600 million committed credit facility. A €500 million bond falls due in April 2012. Alliander generates stable cash flows from operations that we believe are sufficient to cover its capex requirements. Dividend payments are reasonable and its policy of paying out 45% of net income is flexible to accommodate potential investment needs.

According to management information, Alliander has sufficient liquidity to cover a potential payment related to early termination of cross-border leases on the company's networks. Alliander is required to maintain letters of credit (LOCs) covering part of the early termination value. As of January 2010, the company issued LOCs totaling $213 million, compared with a total exposure of about $641 million. This exposure includes equity strip risk (the portion of the termination value that would be payable by Alliander in the event of early termination) of $468 million, and a mark-to-market impairment risk of $173 million. Furthermore, Alliander has earmarked €200 million of the €600 million credit facility in the form of LOCs.

Outlook

The stable outlook reflects our opinion that Alliander will continue to focus on its regulated network business and continue to post stable and predictable cash flows that cover its investment requirements. We assume that Alliander will maintain credit metrics commensurate with the ratings over the medium term, with adjusted FFO to debt above 20%. The outlook also takes into account our assumption that Alliander will abstain from any credit-dilutive acquisitions in the near term. The acquisition of Endinet effectively exploited all headroom within the current rating.

The ratings could come under pressure following adverse regulatory actions, higher-than-we-anticipate operating expenditures, or an increase in capex. An upgrade is unlikely over the near to medium term given Alliander's investments through 2014, which we believe will result in largely neutral discretionary cash flows and only gradual repayment of debt.

Business Description

Alliander is the largest electricity and gas distribution network operator in the State of The Netherlands (AAA/Stable/A-1+), with 2.8 million electricity and 2.1 million gas customers and a market share of about 36% in electricity and 31% in gas. The acquisition of Endinet increased Alliander's total market share to about 38%. The vast majority of customers are residential, while the number of business customers is about 25,000.

About 90% of revenues and 95% of EBIT come from regulated power and gas distribution, with the remainder mainly services relating to infrastructure installation and maintenance. Alliander also holds 53% in a joint venture with Enexis Holding N.V. (A/Stable/--), which operates public lighting, traffic management, and parking systems.

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. 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, accounting for about 90% of revenues and 95% of EBIT. The majority of the company's customers are households, resulting in fairly stable demand from year to year.

- 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 38% from 34% with the acquisition of Endinet.
- A strong operating performance. Alliander is well positioned among its Dutch peers in the incentive-based regulatory framework. The regulator sets tariffs every three or five 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 new regulatory period starting on Jan. 1, 2011. In our view, there is a risk that the regulator does not lower the efficiency targets as much as generally expected by the industry.

Financial Risk Profile: Intermediate, Reflecting Stable Cash Flows And Sizable Capex Program

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

- Stable and predictable cash flows from operations, generated from regulated businesses. We anticipate that Alliander's earnings and cash flows will decline slightly in 2010 due to high efficiency requirements, but that generated cash flows will be sufficient to cover capex. We believe that the efficiency targets imposed by the regulator will ease from 2011. We base this view on the incentive-based formula for revenue collection and that the benchmark in the next regulatory period will be based on a higher industrywide cost base in 2009.
- A target debt-to-total capital ratio of less than 60%, and our view that leverage will average 45% over the medium term. We also believe that Alliander's FFO-to-net debt ratio will decline in 2010, from 34% in 2009, but that it will remain stable at more than 20% through the forecast period--a level we view as commensurate with the 'A' rating.
- Adequate liquidity positions. The company is fully funded through the next two years. Alliander has limited short-term debt maturities and a well-spread maturity profile, with the first bond maturing in April 2012.

These strengths are moderated by:

- Potentially significant investments in smart meters over the medium term. Although the Dutch Senate has decided that smart meters must be installed on a voluntary basis, there is a risk that consumers opt to have them installed such that Alliander's investments increase more than it currently anticipates. This would likely result in negative free operating cash flow and higher debt levels.
- 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 2009 gross debt figure.

Table 1

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

	--Fiscal year ended Dec. 31, 2009--						
Alliander N.V. reported amounts							
(Mil. €)	**Debt**	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**
Reported	2,345.0	705.0	705.0	491.0	151.0	659.0	659.0
Standard & Poor's adjustments							
Operating leases	53.9	28.0	4.2	4.2	4.2	23.8	23.8
Surplus cash and near cash investments	(958.0)	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	43.0	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	(43.0)
One-off items, including a gain on the sale of the high-voltage grid	--	(156.0)	(156.0)	(173.0)	4.0	(152.0)	(152.0)
Total adjustments	(904.1)	(128.0)	(151.8)	(125.8)	8.2	(128.2)	(171.2)
Standard & Poor's adjusted amounts							
	Debt	**Operating income (before D&A)**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**
Adjusted	1,440.9	577.0	553.2	365.2	159.2	530.8	487.8

*Alliander N.V. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Table 2

Alliander N.V. Peer Comparison*

	Alliander N.V.§	**Enexis Holding N.V.**	**Northern Gas Networks Holdings Ltd.¶**	**CE Electric U.K. Funding Co.¶§**
Corporate credit rating**	A/Stable/A-1	A/Stable/--	BBB+/Negative/--	BBB+/Stable/A-2
(Mil. €)	--Fiscal year ended Dec. 31, 2009--			
Revenues	1,446.0	1,358.1	386.6	637.5
Net income from continuing operations	312.0	263.1	11.3	119.2
Funds from operations (FFO)	487.8	437.9	124.2	281.0
Capital expenditures (capex)	296.0	299.6	109.8	289.6
Cash and short-term investments	0.0	192.2	1.7	6.8

Table 2

Alliander N.V. Peer Comparison* (cont.)				
Debt	1,440.9	1,926.5	1,193.2	1,944.9
Preferred stock	0.0	0.0	0.0	0.0
Equity	2,245.0	2,849.1	346.2	773.2
Debt and equity	3,685.9	4,775.6	1,539.4	2,718.1
Adjusted ratios				
EBIT interest coverage (x)	2.3	4.6	2.1	2.5
FFO interest coverage (x)	3.9	5.7	2.6	3.3
FFO/debt (%)	33.9	22.7	10.4	14.5
Discretionary cash flow/debt (%)	(8.0)	9.6	(2.3)	(0.8)
Net cash flow/capex (%)	46.6	146.2	82.5	97.6
Total debt/debt plus equity (%)	39.1	40.3	77.5	71.6
Return on common equity (%)	16.0	10.3	2.6	13.4
Common dividend payout ratio (unadjusted; %)	17.3	30.0	298.7	0.0

*Fully adjusted. ¶Fully adjusted (including postretirement obligations). §Excess cash and investments netted against debt. **On Aug. 6, 2010.

Table 3

Alliander N.V. Financial Summary*		
	--Fiscal year ended Dec. 31--	
	2009	**2008**
Rating history	A/Stable/A-1	A+/Watch Neg/A-1
(Mil. €)		
Revenues	1,446.0	1,497.0
Net income from continuing operations	312.0	270.0
Funds from operations (FFO)	487.8	509.0
Capital expenditures (capex)	296.0	274.0
Cash and short-term investments	0.0	0.0
Debt	1,440.9	2,290.8
Preferred stock	0.0	0.0
Equity	2,245.0	1,661.0
Debt and equity	3,685.9	3,951.8
Adjusted ratios		
EBIT interest coverage (x)	2.3	2.5
FFO interest coverage (x)	3.9	2.2
FFO/debt (%)	33.9	22.2
Discretionary cash flow/debt (%)	(8.0)	(9.5)
Net cash flow /capex (%)	46.6	18.2
Debt/debt and equity (%)	39.1	58.0
Return on common equity (%)	16.0	16.3
Common dividend payout ratio (unadjusted; %)	17.3	129.6

*Fully adjusted. Excess cash and investments netted against debt.

Related Criteria And Research

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 August 6, 2010)*	
Alliander N.V.	
Corporate Credit Rating	A/Stable/A-1
Senior Unsecured (6 Issues)	A
Short-Term Debt (1 Issue)	A-1
Corporate Credit Ratings History	
27-Mar-2009	A/Stable/A-1
18-Jul-2008	A+/Watch Neg/A-1
14-Sep-2007	A+/Negative/A-1
02-Feb-2007	A+/Watch Neg/A-1
04-Dec-2006	A+/Negative/A-1
28-Apr-2006	A+/Watch Neg/A-1
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate
Debt Maturities	
As of Dec. 31, 2010: 2011: €9 mil. 2012: €500 mil. 2014: €500 mil. Thereafter: €1.05 bil.	

*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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