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Summary:
Alliander N.V.

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Summary:

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Credit Rating: A/Stable/A-1

Rationale

The ratings on Dutch electricity and gas network company Alliander N.V. (Alliander) reflect the credit quality of its regulated electricity and gas distribution network business, including its stable and predictable operating cash flow, its high quality network assets, and adequate operating performance. The ratings are constrained by an expected near- to medium-term increase in capital spending, a significant part of which may not be fully recovered through tariffs; exposure to incentive-based regulation; and counterparty and liquidity risks related to remaining cross-border lease agreements on 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, including construction of complex energy infrastructure and municipal lighting, are unregulated. Alliander has about 2.9 million customers and its service area, concentrated in the provinces of Gelderland and Noord-Holland, covers about one-third of The Netherlands.

Alliander is owned by a number of Dutch provinces and municipalities, of which the largest is the Province of Gelderland (not rated), which holds 44.68% of the shares. The 'A' rating on Alliander is based on the company's stand-alone credit profile, which we assess at 'A', as well as 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, this view is based on Alliander's:

- "important" role as the monopoly provider of gas and electricity distribution services in its license areas; and
- "limited" link to its ownersas a result of its dispersed ownership structure.

Key business and profitability developments

Alliander reported a decrease in revenues for the first six months in 2009 resulting from a tariff reduction in 2008 and the introduction in 2009 of new capacity-based tariffs which reduced seasonal effects on tariff income. Operating profit was positively affected by a €168 million book value gain from the divestment of the company's high-voltage grid to Dutch electricity transmission operator TenneT (not rated). This effect was, however, partly offset by lower tariff revenue and higher operating expenditures.

Alliander has signed a non-binding agreement to acquire Netherlands-based grid operator Endinet B.V. (not rated), a Dutch network company operating three separate electricity and gas networks in The Netherlands. The acquisition requires approval from both companies' shareholders and the Dutch Ministry of Economic Affairs. Furthermore, the final terms of the transaction will be subject to a due diligence process expected to be conducted in early 2010. We expect the proposed acquisition – with potential for operating and investment synergies - to be moderately positive for Alliander's business risk profile, which we assess as "excellent".

Key cash flow and capital-structure developments

According to pro-forma accounts for the six-month period ended June 30, 2009, Alliander reported strong free operating cash flow following receipt of €368 million in cash for the sale of the company's high-voltage network, which more than offset the effect of lower operating profit and higher capital spending in the period. In addition, a €400 million equity contribution received in preparation for the unbundling further strengthened Alliander's balance sheet.

We view the proposed acquisition of Endinet as marginally dilutive to Alliander's financial risk profile, which we currently assess as "intermediate". We expect Alliander to finance the proposed acquisition by using a large part of its existing on-balance sheet cash. Due to timing effects in the consolidation of Endinet (expected as of mid-2010) and an increase in operating expenditures, we expect Alliander to post funds from operations to debt of below 20% in 2010. Over the following two years, however, this ratio should again reach above 20%, which is in line with our expectations for the current 'A' rating.

Short-term credit factors

The short term rating is 'A-1'. As at June 30, 2009, Alliander reported adequate liquidity with available cash and equivalents of €337 million. In addition, Alliander had access to an undrawn €875 million committed credit facility, maturing in November 2011, with significant covenant headroom as of June 30, 2009. This compares with €130 million in maturing short-term debt at the same date. Alliander's liquidity position has strengthened since, following the sale of the company's high-voltage grid, generating cash receipts of €368 million. On a stand-alone basis, Alliander is expected to post positive free operating cash flow in 2010. However, the level will ultimately depend on development in discretionary capital spending related to investments in smart metering.

We expect Alliander to finance the proposed acquisition by using existing on-balance sheet cash without the need to draw on its €875 million credit facility, which mainly serves as a back-up to the company's €1.5 billion euro commercial paper program (unused as of Nov. 30, 2009).

Outlook

The stable outlook reflects our expectations that Alliander will continue to post stable and predictable cash flows from its regulated business, while performing adequately within the incentive-based Dutch regulatory framework.

The acquisition of Endinet would effectively exploit all headroom within the current rating. A negative rating action could follow should Alliander not sufficiently offset the negative impact from the proposed acquisition of Endinet on its financial profile. The ratings could come under pressure following adverse regulatory actions, higher-than-expected operating expenditures, or an increase in capital expenditure. An upgrade is unlikely over the near to medium term.

Related Research

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

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