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Alliander N.V.

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Table Of Contents

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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.
- Strengthened financial profile owing to recent tariff increases and a sizable cash position.

Weaknesses:

- Regulatory reset risk and exposure to incentive-based regulation.
- Potential for further consolidation in the Dutch energy distribution sector.
- 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 which we would anticipate Alliander to take a leading role; and counterparty and liquidity risks related to remaining cross-border lease agreements amounting to $592 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, that accounted for 10% of revenues in 2010 but were moderately loss-making, comprise infrastructure installation and maintenance activities. Alliander has about 3 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 38%.

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

In the first six months ending June 30, 2011, Alliander reported an 11.8% year-on-year increase in revenues, to €816 million. The increase resulted from higher tariffs allowed by the regulator for the 2011-2013 regulatory period, and the consolidation of Dutch energy distributor Endinet N.V., that Alliander acquired in July 2010. Reported operating profit increased by 54% to €199 million, supported by a €28 million positive movement in the result from cross-border-related investments (that we reverse to determine our adjusted measure of operating profit).

For the 2011-2013 regulatory period, all distribution network operators in the Netherlands have been allowed healthy tariff increases to cover higher costs in the previous period. In addition, the regulator has confirmed that the large-scale rollout of smart meters will not begin until after a two-year trial period. From January 2012, all meters (including smart meters) will be covered by the regulated tariff, reducing the risk of large-scale, non-remunerated investments by Alliander.

The integration of Endinet, which Alliander acquired for €712 million (including €576 million of Endinet debt), is now complete. All of Endinet's debt has been repaid from Alliander's existing cash balances, and the board of Endinet has been replaced with Alliander representatives.

Key cash flow and capital-structure developments

Alliander maintains strong debt cover ratios for its rating. On June 30, 2011, Standard & Poor's-adjusted funds from operations (FFO) to debt was 32% (annualized), while FFO interest coverage was 5.9x and debt to capital was 39%. These robust ratios are supported by the healthy tariff increases approved by the regulator for 2011-2013. In addition, in November 2010, Alliander issued €500 million in hybrid securities that we treat as surplus cash in our calculation of adjusted debt. Alliander issued the securities to increase its financial flexibility, in part due to the ongoing consolidation of the distribution network sector in the Netherlands. We understand from Alliander that no transaction is imminent, however.

Looking ahead, our base case anticipates that adjusted FFO to debt will stay above 30% in 2012 and 2013, but might fall back to about 25% in 2014, when the next regulatory review begins. The ratios are supported by Alliander's moderate capital investments over the period, which we believe can be funded with internal resources. The ratios exclude 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 financial ratios that act as minimum ratio requirements for the company. These include FFO to debt of more than 20%, which is lower than the company's, and our, base case.

Liquidity

We assess Alliander's liquidity as strong under our criteria. On June 30, 2011, the proportion of sources to uses of cash exceeded 1.5x for the subsequent 24 months, according to our estimates.

On June 30, 2011, Alliander had unrestricted cash and marketable securities of €707 million, comprising in part the proceeds from the issuance of hybrid securities in November 2010. In addition, the company had a €600 million committed bank facility expiring in July 2016 that it expects will remain undrawn. There is ample room under the financial covenants, which are slightly stricter than the regulator's minimum ratio requirements for network operators in The Netherlands. These requirements are in turn lower than the minimum ratio requirements set out in

Alliander's financial policy.

Against total sources of liquidity of €1,307 million (including €600 million under the committed bank facility) on June 30, 2011, Alliander had short-term debt maturities in the next 12 months of €504 million. The latter includes a €500 million debt maturity in April 2012, which we understand the company should refinance in a timely manner.

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.

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 38%. The vast majority of its customers are residential, while the number of business customers is about 25,000.

About 90% of revenues come from regulated power and gas distribution, with the remainder mainly services relating to infrastructure installation and maintenance. These activities were moderately loss-making in 2010.

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 that account for about 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.
- 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% 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. Based on the evolution of costs in the current regulatory period, the company's, and our, base case, assumes that the regulator will lower tariffs moderately for the 2014-2016 period. This would correspondingly weaken ratios, although we anticipate that they should remain solid.
- 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. Alliander, as the largest distributor, anticipates that it would play a leading role in such a process. However, we understand that no transaction is imminent. In addition, it is possible that consolidation will take the form of asset swaps or bolt-on acquisitions, with limited 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. In 2011-2014, revenues will be strongly supported by healthy tariff increases approved by the regulator for the current regulatory period.
- A conservative financial policy. Alliander aims to maintain a rating at least in the 'A' category, 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 1.5x in the next 24 months. Our assessment assumes that the company will refinance its €500 million debt maturity in April 2012 in a timely manner.

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 2010 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 (Mil. €)

	--Financial year ended Dec. 31, 2010--									
Alliander N.V. reported amounts										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	2,312.0	2,906.0	1,432.0	571.0	330.0	114.0	508.0	508.0	54.0	281.0
Standard & Poor's adjustments										
Operating leases	49.8	--	--	3.1	3.1	3.1	15.9	15.9	--	11.8
Intermediate hybrids reported as equity	247.0	(247.0)	--	--	--	--	--	--	--	--
Surplus cash and near cash investments	(749.0)	--	--	--	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	12.0	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(11.0)	--	--
Debt--other	(138.0)	--	--	--	--	--	--	--	--	--
EBITDA--reversal of incidental items	--	--	--	(7.0)	(7.0)	--	--	--	--	--
EBIT--reversal of incidental items	--	--	--	--	(7.0)	--	--	--	--	--
Total adjustments	(590.2)	(247.0)	0.0	(3.9)	1.1	3.1	15.9	4.9	0.0	11.8
Standard & Poor's adjusted amounts										
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**	**Dividends paid**	**Capital expenditures**
Adjusted	1,721.8	2,659.0	1,432.0	567.1	331.1	117.1	523.9	512.9	54.0	292.8

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 as of Oct. 18, 2011	A+/Positive/A-1	A/Watch Pos/--	BBB+/Stable/--	BBB+/Stable/A-2
	--Financial year ended Dec. 31, 2010--			
(Mil. €)				
Revenues	1,432.0	1,204.2	397.9	706.8
EBITDA	567.1	598.2	202.9	496.3
Net income from continuing operations	222.0	193.7	16.0	246.2
Funds from operations (FFO)	512.9	479.9	133.6	281.9
Capital expenditures	292.8	411.8	98.0	265.0
Free operating cash flow	231.1	217.3	16.0	(5.4)
Discretionary cash flow	177.1	138.4	(59.9)	(5.4)
Cash and short-term investments	0.0	330.2	0.2	6.6
Debt	1,721.8	1,926.4	1,303.2	1,860.8
Equity	2,659.0	2,963.9	312.1	1,073.9
Adjusted ratios				
EBITDA margin (%)	39.6	49.7	51.0	70.2
EBITDA interest coverage (x)	4.8	6.1	2.8	4.3
EBIT interest coverage (x)	2.8	3.6	2.1	3.0
Return on capital (%)	7.5	7.4	9.4	10.3
FFO/debt (%)	29.8	24.9	10.2	15.1
Free operating cash flow/debt (%)	13.4	11.3	1.2	(0.3)
Debt/EBITDA (x)	3.0	3.2	6.4	3.7
Total debt/debt plus equity (%)	39.3	39.4	80.7	63.4

Table 3

Alliander N.V. Financial Summary			
	--Financial year ended Dec. 31--		
	2010	**2009**	**2008**
Rating history	A/Stable/A-1	A/Stable/A-1	A+/Watch Neg/A-1
(Mil. €)			
Revenues	1,432.0	1,446.0	1,497.0
EBITDA	567.1	553.2	702.5
Net income from continuing operations	222.0	312.0	270.0
Funds from operations (FFO)	512.9	680.8	477.0
Capital expenditures	292.8	530.0	258.0
Dividends paid	54.0	350.0	459.0
Debt	1,721.8	2,152.9	2,290.8
Preferred stock	(247.0)	0.0	0.0
Equity	2,659.0	2,245.0	1,661.0
Debt and equity	4,380.8	4,397.9	3,951.8

Table 3

Alliander N.V. Financial Summary (cont.)			
Adjusted ratios			
EBITDA margin (%)	39.6	38.3	46.9
EBIT interest coverage (x)	2.8	2.7	2.5
FFO interest coverage (x)	5.4	6.4	1.9
FFO/debt (%)	29.8	31.6	20.8
Discretionary cash flow/debt (%)	10.3	(26.5)	(10.2)
Net cash flow/capex (%)	156.7	62.4	7.0
Debt/debt and equity (%)	39.3	49.0	58.0
Return on capital (%)	7.5	8.5	16.6
Return on common equity (%)	8.6	16.0	16.3
Common dividend payout ratio (un-adjusted) (%)	36.2	17.3	129.6

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 October 18, 2011)	
Alliander N.V.	
Corporate Credit Rating	A+/Positive/A-1
Junior Subordinated (1 Issue)	A-
Senior Unsecured (5 Issues)	A+
Short-Term Debt (1 Issue)	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
14-Sep-2007	A+/Negative/A-1
02-Feb-2007	A+/Watch Neg/A-1
04-Dec-2006	A+/Negative/A-1
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate
Debt Maturities	
As of June 30, 2011: 2011: €1 mil. 2012: €504 mil. 2013: €4 mil. 2014: €506 mil. Thereafter: €1.26 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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