

Research:

[Return to Regular Format](#)

Fingrid Oyj

Publication date: 06-Jul-2005
Primary Credit Analyst(s): Magnus Pettersson, Stockholm (46) 8-440-5929;
magnus_pettersson@standardandpoors.com
Secondary Credit Analyst(s): Andreas Zsiga, Stockholm (46) 8-440-5936; andreas_zsiga@standardandpoors.com

Corporate Credit Rating

AA-/Stable/A-1+

Outstanding Rating(s)

Fingrid Oyj

Sr unsecd debt	AA-
CP	
<i>Foreign currency</i>	A-1+
Pfd stk	
<i>Local currency</i>	A-

Corporate Credit Rating History

Nov. 19, 1998	AA-
Jan. 14, 2003	--

Major Rating Factors

Strengths:

- Monopoly transmission operator in the stable macroeconomic environment of Finland, characterized by steady growth in electricity demand.
- Favorable cost-plus regulation allowing significant freedom in tariff setting, capital expenditure, and quality settings.
- The ability to increase tariffs at very short notice.

Weaknesses:

- Weak financial profile, with high leverage and low debt-service coverage ratios.

Rationale

The ratings on Fingrid Oyj are based on the utility's strong business position as the monopoly electrical transmission grid company and system operator in the politically and economically stable Republic of Finland. The ratings also reflect Fingrid's stable revenue base, a favorable cost-plus regulatory regime, and a focused and prudent strategy. These factors balance a weak financial profile attributable to high leverage and weak debt-service ratios.

Fingrid is responsible for national power-balance management and settlement. Counterparty risk in this business is limited through the continual monitoring of positions and the requirement of guarantees or deposits from the participants. Fingrid benefits from Finland's cost-of-service electricity grid regulation, which allows cost cover, a reasonable ROE, and a high degree of flexibility in tariff setting and capital expenditures. Tariffs are mainly charged to consumption, thereby enhancing revenue stability.

Compared with its peers, Fingrid's track record on network efficiency is excellent; it has highly efficient operations, with virtually no bottlenecks or disturbances. The transmission system has accommodated the strong demand growth and substantial import/export volumes of recent years. Demand grew by 2% in the first quarter of 2005, in line with the medium-term expectations of Standard & Poor's Ratings Services, of 1%-2%.

Capital expenditure needs in infrastructure are expected to be moderate in the medium term, and will mainly focus on grid refurbishment. In early 2005, Fingrid decided on a joint investment with Svenska Kraftnät, the Swedish transmission system operator, in a new cable connection to be built alongside the existing Fenno-Skan cable between Finland and Sweden. Fingrid's share in this investment is estimated at about €120 million (\$160 million), spread over 2007-2010. The project is not expected to have any material credit impact on Fingrid because costs can be covered by increased tariffs.

Fingrid's debt leverage is high, amounting to 76.4% at the end of the first quarter of 2005, including capital notes (63.8% excluding capital notes). This is expected to fall to about 70% over the next five years, thanks to relatively moderate investment needs and the early redemption of €137 million of capital notes, expected in 2007. Funds from operations (FFO) interest coverage is expected to stay above 4.0x over the medium term.

Liquidity

Fingrid's liquidity position is sound. At the end of the first quarter of 2005, Fingrid had €196 million in cash and marketable short-term securities. The €400 million multicurrency revolving credit facility expiring December 2007, together with cash and liquid assets, serves as backup for short-term debt. There are no material financial covenants or material adverse change clauses in the existing credit agreements.

■ Outlook

The stable outlook reflects Fingrid's stable monopoly position and revenue base, and its flexible regulatory regime, both of which are expected to remain unchanged for the foreseeable future. This should enable the utility to avoid financial difficulties despite its highly leveraged balance sheet. No further tariff reductions or leverage increases are expected. Regardless of higher investment needs in the medium term, a reduction in debt is likely, as is a gradual improvement in FFO interest coverage ratios. To maintain the current ratings, Standard & Poor's assumes FFO interest cover to be at least 4.0x.

■ Business Description

Fingrid, established in 1997, is owned by the Finnish state, which has 12.3% of shares and 16.4% of votes, private sector electric consortium Pohjolan Voima Oy (PVO), and Fortum Oyj (BBB+/Stable/A-2), each holding 25.0%, and each representing 33.4% of votes. Finnish institutional investors own the remainder.

Fingrid's operations are divided into three main business areas: grid service (customer service); grid asset management (grid planning and development); and power system operations (power system operations, balance management, and grid operation). Fingrid is also 20% owner of the Nordic physical electricity exchange, Nord Pool Spot AS.

Fingrid's business strategy is highly focused, and Standard & Poor's does not expect the utility to venture outside its core business in Finland.

■ Business Profile

Excellent operational track record

The strong business profile primarily reflects Fingrid's monopoly position as electricity transmission service operator in Finland, and the existing flexible cost-plus regulation. In addition, Fingrid has an excellent operational track record compared with its peers. The company has come out in the top tier in several international benchmark studies of maintenance and grid operation in recent years.

In a normal year in the Nordic power system Finland is a net importer of electricity, with import primarily from Russia and export to Sweden. When hydro levels are low in the Nordic system the transit between Russia and Sweden and the rest of the Nordic countries becomes even higher. Fingrid has managed such situations well without disturbances in the domestic grid, although cross-border capacity has at times experienced some minor disruptions due to technical failures.

Fingrid and Svenska Kraftnät, the Swedish transmission system operator, have decided to invest in a cable connection to be constructed alongside the existing Fenno-Skan cable. Fingrid's share of the investment is estimated at €120 million. The investment, if needed, can be financed by higher tariffs, already approved by the customers in grid agreements.

Table 1 Fingrid Oyj Operating Statistics					
	--Year ended Dec. 31--				
	2004	2003	2002	2001	2000
Number of employees	220	218	210	204	270
Number of customers	98	100	100	100	100
Operations and maintenance excluding depreciations (mil. €)	151.3	155.6	129.7	105.7	96.8
Transmission operations					
Units transmitted (TWh)	67.3	66.6	62.0	59.9	64.7
System peak demand (GW)	13.6	14.0	13.5	13.3	13.2
Total transmission lines (kilometers)	13,980	13,879	13,841	13,843	13,843
Transmission energy losses (%)	1.7	1.9	1.5	1.2	1.5
Average transmission revenues (€ cents/kWh)	0.3	0.3	0.3	0.3	0.3
Average operations and maintenance costs excluding depreciations (€ cents/kWh)	0.2	0.2	0.2	0.2	0.2

TWh--terrawatt-hours. GW--Gigawatts. kWh--Kilowatt-hours.

Stable growth market environment and increased transmission capacity

Electricity consumption growth in Finland has historically been steady at about 2% per year, and the macroeconomic environment is favorable, with 1%-2% growth expected in the medium term. The 1,300 MW of interconnection transmission lines with Russia, owned by Fingrid, are fully reserved and used by electricity importers, and they provide additional supply to the transmission market.

A new tariff agreement for the period, 2005-2007, has been concluded. The customers have agreed to increase tariffs by about 3% in 2006 and another 3% in 2007 to cover for the Fenno-Skan cable investments. Over the last six years, including 2005, the price level has been unchanged.

Fingrid's operations are stable and operating profits are expected to be steady over the next couple of years. The financial impact of the Fenno-Skan investment is expected to be relatively limited.

Fingrid's grid networks are well scaled for domestic transmission needs, and represent a significant strategic and economic asset. The level of import compared with export generally depends on the supply of hydropower in the Nordic market.

Light-handed regulation of Fingrid's natural monopoly operations

Finland's regulatory regime is flexible and underpins the ratings on Fingrid. Electricity transmission is regulated and monitored by the Energy Market Authority (EMA), an independent government agency. Although a methodology for tariff evaluation has been established, the material rules of the Electricity Act regarding reasonable pricing will remain unchanged. The impact on Fingrid is limited.

EMA has already tested the reasonableness of Fingrid's tariffs under the new methodology and came to the conclusion that historical tariffs had complied with Electricity Market Act's requirements. The basic rule allows network companies to cover their costs and make reasonable ROE, and tariff increases do not need to be sanctioned. Within the current regulatory framework, transmission tariffs are decided by the board of directors following discussions with customers. Fingrid is also allowed to cover the costs of operating its emergency reserve gas turbines through revenues from power system operations, because the maintenance of emergency reserve capacity is considered part of the utility's system responsibility.

According to the tariff agreement, exceptional adjustments could take place at Fingrid's discretion in the event of force majeure or other significant events beyond Fingrid's control (such as increased financial costs). Cross-border transmission tariffs within European Transmission System Operators (ETSO) have been abolished, but cross-border tariffs to Russia are expected to remain in the medium term. The net cost of this regime is expected to be €5 million-€20 million annually.

■ Financial Policy: Moderately Aggressive

Setting aside the flexible regulation and stable revenue base, Fingrid's financial profile could be considered weak. Although the company's capital structure is bordering on aggressive, its financial policy is characterized by prudent risk management. In addition, the company has diversified funding

sources and a well-spread maturity profile, and has adequate back-up lines for liquidity purposes. Derivatives are used for hedging purposes only.

Fingrid's shares are not listed, and institutional investors have made their investment in Fingrid with the aim of a safe and stable dividend. A fixed margin is determined at the end of year. The dividend is 1.5% over the five-year Finnish government bond. Over the next five years, the payout ratio is projected to average about 30% (treating the interest on capital notes as dividend).

Accounting

Fingrid will introduce International Financial Reporting Standards for financial 2005. The most notable changes compared to the current accounting method, Finnish Accounting Standards, will be the end of depreciation of intangible assets and the recognition of the fair values of electricity and financial derivatives. An impairment test will now be carried out annually in relation to intangible assets. Fingrid will not apply hedge accounting to its derivative instruments. The instruments will be treated as assets and liabilities held for trading and changes in fair value will appear in the profit and loss account. Under normal circumstances, adjustment for derivatives value and depreciation of intangible assets would only have a minor impact (less than 5% of turnover) on the profit and loss account.

Financial Profile

Profitability and cash flow

Fingrid's profitability is weak but stable, reflecting the voluntary tariff policy adopted by the utility. Although the EMA has established a new methodology for tariff evaluation, the material rules of the Electricity Act regarding reasonable pricing will remain unchanged and the impact on Fingrid is expected to be limited. Tariff increases starting in 2006 have already been approved in principle by consumers. The cost of power transmission losses remains subject to variations in the volatile and highly competitive Nordic electricity market. Fingrid has, however, hedged a major portion of its expected energy losses for 2005.

Operating profit is expected to remain about €90 million per year and profit before tax at about €55 million-€60 million, trending slightly down from the €68 million in 2004. This assumes unchanged tariffs in nominal terms, increasing depreciation charges, and an annual 1%-2% increase in transmission volumes. Of the €168 million of capital loans outstanding, €138 million will be redeemed in 2007 and €30 million in 2009.

Interest payments on capital notes, averaging about 16% of expected total interest expenses over the next five years, are deferrable.

In the medium term, FFO to debt is expected to average a weak 11%, its 2004 level, and FFO coverage of interest expenses is expected to average more than 4.0x (4.7x in 2004), due to reduced interest expenses. The planned redemption of €137 million in capital loan debentures in 2007 could improve the ratio in the longer term. Cash flow is expected to more than cover capital expenditure (including the €120 million Fenno-Skan investment), at an average of about 140% over the next five years. Total investments over the next five years are expected to amount to €420 million and grid maintenance expenditure is forecast to rise to about €60 million per year in the coming years, which is €10 million-€20 million higher than in the past, with depreciation averaging about €55 million-€65 million.

Income statement (mil. €)	--Year ended Dec. 31--				
	2004	2003	2002	2001	2000
Gross revenues	304	299	274	242	236
Operating expenses (excluding DD&A)	151	156	130	105	99
Depreciations and amortizations	54	53	53	52	49
EBITDA	156	146	147	138	140
Interest incurred	34	44	44	41	44
Net interest incurred	31	41	41	41	41
Net income	59	38	39	34	37

Earnings protection					
Pretax interest coverage (x)	3.0	2.1	2.1	2.1	2.1
Net pretax interest coverage (x)	3.2	2.2	2.2	2.1	2.1
EBITDA interest coverage (x)	4.6	3.3	3.4	3.4	3.2
Total debt/EBITDA (%)	5.8	7.0	7.3	7.5	7.4
Return on average equity (%)	19.1	13.9	15.3	14.9	17.4
Annual expenditure growth (excluding DD&A)	53.1	48.4	23.7	6.1	7.9
Total operating expenditures/revenues (%)	41.9	43.3	47.3	43.3	41.9

*Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend.

Table 3 Fingrid Oyj Cash Flow*					
	--Year ended Dec. 31--				
Cash flow (mil. €)	2004	2003	2002	2001	2000
Net income	59	38	39	34	37
Depreciation	54	53	53	52	49
Funds from operations (FFO)	113	92	100	94	96
Preferred dividends	11	11	11	11	11
Common dividends	7	7	7	7	7
Net cash flow (NCF)	95	74	82	75	78
Net capital expenditures (capex)	39	42	48	47	35
Discretionary cash flow	56	30	76	(5)	62
Cash flow adequacy					
Capex/average total capital (%)	3	3	4	4	3
NCF/capex (%)	244	176	171	159	224
NCF/capex and net acquisitions (%)	239	180	171	159	224
FFO/average total debt (%)	12	9	9	9	9
FFO/average net debt (%)	13	10	10	9	9
FFO interest coverage (x)	4.3	3.1	3.3	3.3	3.2
FFO net interest coverage (x)	4.7	3.2	3.5	3.3	3.3

*Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend.

Capital structure and financial flexibility

Fingrid's leverage is very high, at about 76.4% in the first quarter of 2005, including capital notes. This is, however, expected to fall to about 70.0% over the next five years due to manageable investment needs and the early redemption of €137 million of capital notes. If all the capital notes were treated as equity, Fingrid's leverage would decrease to about 63.8% at the end of the first quarter 2005.

Although Fingrid's financial flexibility is restricted by its high leverage and dividend payout policy, this is offset by a flexible regulatory regime--even under the new model--that allows for tariff increases. Fingrid's policy is to cover short-term debt with a cash balance and backup facilities. The utility is tapping the domestic and international money and capital markets, and has established domestic and international CP and MTN programs. Fingrid uses its syndicated revolving credit facility as a backup for short-term debt. Fingrid has a €750 million MTN program, which is used as a long-term funding source.

Fingrid's liquidity position is sound. At the end of the first quarter of 2005, the company had €196 million in cash and marketable short-term securities. The €400 million multicurrency revolving credit facility expiring December 2007, together with cash and liquid assets, serves as backup for short-term use. Cash flow generation in 2005 is expected to be sufficient to cover planned capital expenditure for the year. There are no material financial covenants or material adverse change clauses in the existing credit agreements.

Table 4 Fingrid Oyj Capital Structure*

Balance sheet (mil. €)	--Year ended Dec. 31--				
	2004	2003	2002	2001	2000
Cash and short-term financial investments	143	105	101	64	52
Net plant	1,034	1,036	1,032	1,033	1,038
Total assets	1,400	1,369	1,379	1,338	1,337
Short-term debt	182	209	178	250	336
Long-term debt	715	820	893	785	697
Common equity	339	275	269	242	221
Total capitalization	1,236	1,304	1,339	1,277	1,254
Balance sheet ratios (%)					
Short-term debt/total capital (%)	15	16	13	20	27
Long-term debt/capital (%)	58	63	67	61	56
Common equity/total capitalization (%)	28	21	20	19	18
Total debt/total capitalization (%)	73	79	80	81	82
Net debt/total capitalization (%)	69	77	80	81	82
*Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend.					

Rated Peer Comparison

Table 5 Fingrid Oyj Peer Comparison					
	Fingrid Oyj	Statnett SF	Eltra amba	Elkraft System amba	Elkraft Transmission amba
Corporate credit rating	AA-/Stable/A-1+	AA/Stable/A-1+	AA/Watch Pos/A-1+	AA/Watch Pos/A-1+	AA-/Watch Pos/A-1+
Year of data	2004	2004	2004	2004	2004
Country	Finland	Norway	Denmark	Denmark	Denmark
Type of operations	Transmission and system operator	Transmission and system operator	Transmission and system operator	System operator	Transmission operator
Financial policy	Moderately aggressive	Moderate	Moderate	Moderate	Moderate
Transmission volume (TWh)	67.0	N.A.	21.0	13.7	13.7
Grid network length (kilometers)	13,980	10,300	763	N.A.	565
Financial statistics (mil. €)					
Gross revenue	304.0	663.0	876.1	497.9	36.9
EBITDA	156.0	224.0	36.5	11.4	31.2
Funds from operations (FFO)	113.0	131.0	21.0	36.8	25.2
Total assets	1400.0	1531.0	701.5	300.4	350.5
Total debt	897.0	760.0	279.2	169.2	128.7
Net debt	754.0	622.0	267.4	166.6	128.3
FFO interest coverage (x)	4.3	4.4	2.6	7.6	4.6
FFO/net debt (%)	13.0	22.0	7.9	22.1	19.6
Total debt/total capital (%)	73.0	57.0	50.1	98.0	42.2
TWh--Terrawatt-hours. N.A.--Not available.					

Group E-Mail Address

InfrastructureEurope@standardandpoors.com

