

**Credit Opinion: [Fingrid Oyj](#)**

**Fingrid Oyj**

*Helsinki, Finland*

**Ratings**

| Category              | Moody's Rating |
|-----------------------|----------------|
| Outlook               | Stable         |
| Senior Unsecured      | Aa3            |
| Subordinate -Dom Curr | A1             |
| Commercial Paper      | P-1            |
| Other Short Term      | P-1            |

**Contacts**

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**Key Indicators**

[1]  
**Fingrid Oyj**

|                                      | 31/12/2004 | 31/12/2005 |
|--------------------------------------|------------|------------|
| Adjusted FFO Interest Coverage [2]   | 3.3x       | 3.8x       |
| Adjusted FFO / Net Adjusted Debt [3] | 12.3%      | 13.1%      |
| Adjusted RCF / Net Adjusted Debt [4] | 11.5%      | 12.3%      |
| Adjusted RCF / Capex [5]             | 232.3%     | 180.2%     |

[1] Based on "As Adjusted" financial statements. Details in "Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations - Part II, Rating Methodology, Feb-06 (#96729). [2] (Cash flow from operations (CFO) pre-Working Capital + Interest Expense) / Interest Expense [3] CFO pre-Working Capital / Net Debt Adjusted [4] (CFO pre-Working Capital - Dividends Paid) / Net Debt Adjusted [5] (CFO pre-Working Capital - Dividends Paid) / Capex

*Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).*

**Opinion**

**Credit Strengths**

Fingrid's credit strengths are:

- Low business risk given focus on monopoly transmission business
- Predictable and steady operating cash flows
- Flexibility to raise tariffs if need be under current regulation and grid user agreements.

**Credit Challenges**

Fingrid's credit challenges are:

- Increased investment programme and higher operating costs 2006-11

- low debt protection measures, although mitigated by low business risk and strong liquidity.

## Company Profile

Fingrid (Aa3/P-1) is the transmission system operator and owner of Finland's high voltage electricity assets and interconnectors. It also owns a 20% stake in Nord Pool Spot AS, the Nordic electricity exchange. Fingrid has a low business risk profile as it benefits from its position as a natural monopoly. Virtually all its operating profits come from regulated activities under a framework which currently affords Fingrid the flexibility to raise tariffs if need be, given Fingrid's high level of efficiency.

Fingrid was established in 1997 out of the transmission assets of the electric utilities IVO, now the 50% state-owned Fortum, Finland's largest utility, and PVO (each with 33.44% of voting rights). These entities, together with the State (16.44% of voting rights) are the company's main shareholders. The balance is held by institutional investors. Fingrid was incorporated with high leverage in order to reduce its cost of capital and hence offer the lowest possible tariffs to its customers.

## Rating Rationale

Fingrid is considered a Government Related Issuer (GRI) because of its direct and indirect ownership by the Finnish state.

In accordance with Moody's GRI rating methodology, the Aa3 ratings of Fingrid reflect the combination of the following inputs:

- Baseline credit assessment (BCA) of 5 (on a scale of 1-21 where 1 is the highest and a 5 maps to an "A1".)
- Aaa local currency rating of the Finnish government;
- Medium dependence;
- Low support.

Hence Fingrid's rating benefits from a one notch uplift as a result of the application of Moody's GRI methodology.

When assessing Fingrid's BCA, Moody's applies its Rating Methodology for Global Regulated Electric Utilities. The following factors represent key drivers in determining the rating:

### ASSESSMENT OF BUSINESS RISK PROFILE (INCLUDING REGULATED V UNREGULATED ACTIVITIES)

The baseline credit assessment of 5 is underpinned by the very low business risk of Fingrid as owner and operator of Finland's national electricity transmission system - virtually all Fingrid's operating profits derive from regulated grid user tariffs. Fingrid has significant flexibility under the current regulatory environment and has maintained a solid and conservative track record since its establishment.

The current regulatory framework in Finland has shifted over time from a very "light-handed" cost-plus regime based on an ex-post methodology to an ex-ante regulatory regime as from January 2005. Under the new regulatory regime (2005-7), Fingrid is allowed a post-tax return on its Regulatory Asset Base.

Moody's assigns an SRE of a "1" to the Finnish regulatory framework under its methodology within a framework of 1-4, where 1 is considered the most predictable. This recognises that despite its recent move from an ex-post to an ex-ante regime it remains a rather "light-handed" and flexible regulatory regime. The realized returns can be more or less than the allowed returns, on an annual as well as a cumulative basis during the 2005-7 regulatory period. Any cumulative difference, either positive or negative, between the realized and allowed returns should be adjusted during the next regulatory period (2008-11).

In particular Fingrid is well placed within this framework compared with other network companies in Finland. Its high level of efficiency (measured in benchmarking studies with other grids in Europe and globally) and policy of keeping tariffs as low as possible for its users means that it maintains a high degree of financial flexibility under this regulatory regime; its allowable return is much higher than its expected realized return for 2006. Moody's expects that less efficient network companies in Finland may be impacted more by the change in regulatory regime.

Within the regulatory framework, Fingrid is also party to the Main Grid Agreement (2005-7) with its users which allows for annual increases in tariffs. In line, however, with Fingrid's aim to keep tariffs as low as possible for its end-users, Fingrid cut tariffs by 5% at the beginning of 2006. This cut, together with the 3% it would be allowed to apply both this year and next, (cumulatively 11%) means that Fingrid still retains significant flexibility under this Agreement.

## ASSESSMENT OF FINANCIAL PROFILE

A highly efficient structure and good turnover growth have allowed Fingrid to keep tariffs low, although the company has gradually improved its financial profile since its inception in 1997. RCF/Net adjusted debt has improved over the years from 7-8% to around 11-12% in 2004 and 2005.

Fingrid is expected to be affected by higher operating costs in the forthcoming period as a result of (i) higher losses driven by expected volume growth and the higher price of electricity (ii) increased depreciation costs (iii) slightly higher staff costs; although the impact of these costs is expected to be somewhat mitigated by higher ETSO compensation fees. Going forward, Fingrid is also expected to increase capex from around Eur40-50 million per annum to around Eur 80-100million per annum over the 2006-11 period to fund reinforcements of the grid network and interconnectors. Overall this means that debt levels are expected to rise from 2005 levels of Eur 985million. Fingrid should nonetheless be able to maintain similar debt protection measures as noted above over this period assuming turnover grows through volume increases, and costs and investments remain as planned, however changes in these parameters may put pressure on the company's financial profile should tariffs not be increased.

Moody's note that in addition to the flexibility provided by the tariff framework, Fingrid also has a conservative risk management and hedging strategy and benefits from strong liquidity (please see separate LRA).

In comparison with a number of peer transmission grids in Europe, FFO/gross interest coverage(>3.5x) and RCF/adjusted debt (11/12%) is low at the current fundamental rating level (equivalent to A1). Net interest coverage is however stronger at >4x given the company's commitment to maintain a large liquid portfolio. Moody's also notes that whilst Fingrid still looks very leveraged on a debt/book capitalization basis (around 70%), it is significantly less leveraged on a net debt/RAV basis (around 50%). On this basis it compares favourably with other network companies and is in line with the guidelines for a high A network company. In addition Moody's factors (i) the flexibility of the regulatory framework (SRE 1) which would allow Fingrid to significantly increase tariffs should it so desire. (ii) flexibility under their current Main Grid Agreement (MGA - 2005-7) . This allows for a year-on-year increase in tariffs, although applied tariffs in 2006 reflect this year's 5% cut. Additionally clause 9.4 of the MGA allows Fingrid to raise tariffs (with one month's notice) in special circumstances, such as a severe economic downturn, that could affect Fingrid adversely. Should however Fingrid give up its flexibility to increase tariffs on an annual basis under its MGA then this could have a negative impact on the rating (iii) Fingrid's strong liquidity (iv) long and conservative track record.

The National Grid Electricity Transmission PLC is rated A2, and is Fingrid's closest comparator in Europe with a similar, very low, business risk profile. The parameters for its rating are RCF/debt >9%, FFO/interest >3.5 x and net debt/RAV not to be above 60%.

As Fingrid's key shareholders are also customers, this is a prime incentive to keep tariffs, and hence costs, low. As a mitigant to the pressure on Fingrid's profitability that low tariffs create, dividends are also expected to be maintained at low levels (around 6%). As a result, FFO/adjusted debt levels are expected to remain low, but stable in relation to RCF/adjusted debt parameters.

## OTHER GRI FACTORS

Dependence is medium given the fact that Fingrid's revenues are derived primarily from domestic sources; it also reflects the high degree of energy intensive industry in Finland.

Support is low. This reflects the fact that the State directly holds and indirectly holds 33% of voting rights and through its ownership is involved in the supervision of Fingrid. Nonetheless the Finnish State is strongly non-interventionist. Moody's believes that it would hesitate to support state-owned companies except in the most extreme circumstances unless they were strategically important, as is the case with Fingrid, controlling key infrastructure. The government would expect Fingrid in the first instance to raise user tariffs to meet emergency requirements.

## Rating Outlook

Stable. The company maintains a strong commitment to a conservative strategy and stability of cash flow to service its debt commitments and in addition maintains healthy liquidity.

The following rating range is expected for this rating category: RCF/debt of 11-14% and FFO/ net interest expense of more than 3.5x. This range is predicated on the fact that the company continues to enjoy financial flexibility both under the regulatory regime and its Main Grid Agreement to raise tariffs in the normal course of events, as well as retaining the ability to raise tariffs on a short term basis if special circumstances arise. Should this flexibility be reduced then negative pressure could arise if financial metrics were not improved.

## What Could Change the Rating - Up

As the current ratios are somewhat tightly positioned for the current rating category, positive rating pressure is not imminent; in any event we would expect to see significant improvement in current debt protection measures in

order for this to occur.

### **What Could Change the Rating - Down**

RCF/adjusted debt dropping below 11-12% or FFO/interest below 3.5x (assuming regulatory flexibility noted above). This could be as a result of continued low tariffs or higher investments or costs. A prolonged downturn (not currently anticipated) in the Finnish economy which could weaken Fingrid's earnings and customer creditworthiness could also be a negative factor.

A one-notch reduction in the sovereign rating would not impact the final rating. A reduction in the level of support within the "low" category could however have a negative impact on the rating.

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