



Moody's Investors Service

Credit Opinion: [Fingrid Oyj](#)

Global Credit Research - 14 Oct 2009

Helsinki, Finland

Ratings

| Category | Moody's Rating |
|----------------------------|----------------|
| Outlook | Negative |
| Senior Unsecured | A1 |
| Subordinate -Dom Curr | A2 |
| Commercial Paper | P-1 |
| Other Short Term -Dom Curr | P-1 |

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Key Indicators

Fingrid Oyj

| | 2008 | 2007 | 2006 |
|---|---------------|---------------|---------------|
| (FFO + Interest Expense) / Interest Expense | 3.8x | 3.5x | 4.1x |
| FFO / Net Debt | 15.1% | 13.5% | 14.9% |
| RCF / Net Debt | 14.2% | 12.6% | 14.0% |
| RCF / Capex | 120.1% | 113.1% | 160.4% |
| Debt/Book Capitalisation | 64.2% | 64.6% | 67.3% |

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

Opinion

Corporate Profile

Fingrid Oyj ("Fingrid", rated A1/P-1, negative outlook) 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 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 Finnish state (16.44% of voting rights), are the company's main shareholders. The balance is held by institutional investors.

Recent Developments

On 9 October 2009, Moody's downgraded to A1 from Aa3 the long-term senior unsecured debt rating of Fingrid. The downgrade reflected Moody's view that the continuation of the company's ambitious investment programme will weigh on the company's projected financial profile, thus resulting in credit metrics inconsistent with the previous rating (see below for further details).

Rating Rationale

Given Fingrid's direct and indirect ownership by the Finnish state, the company falls within the scope of Moody's rating methodology for Government-Related Issuers ("GRIs"). Hence, the company's A1 rating reflects the combination of the following components:

- Baseline Credit Assessment ("BCA") of 6, based on a scale of 1-21 where 1 indicates the highest credit quality and 6 maps to the "A2" rating category. The BCA is a representation of the company's credit quality before taking into account any support.
- Aaa local currency rating of the Finnish government.
- Medium dependence, reflecting the domestic nature of Fingrid's activities and its revenue sources.
- Low support, reflecting Fingrid's strategic importance as owner and operator of key infrastructure. The state holds (directly and

indirectly) 33% of voting rights through its ownership and is involved in the supervision of Fingrid. However, Moody's believes that the strongly non-interventionist Finnish government would hesitate to support state-owned companies except in the most extreme of circumstances. In Moody's view, the government would expect Fingrid in the first instance to raise user tariffs to meet emergency requirements.

As a result of these parameters, Fingrid's A1 rating incorporates a one-notch uplift from its stand-alone credit quality for potential government support under Moody's GRI methodology.

When assessing Fingrid's BCA, Moody's applies its Rating Methodology for Regulated Electric and Gas Networks, published in August 2009. The methodology examines the core factors that Moody's considers most relevant to electric and gas network operators, sets out the range of possible outcomes by factor and maps these to a rating range. Each factor is appropriately weighted and in combination contributes to the rating output by the methodology grid. Measurements are quantitative where an appropriate metric is defined. However, for some sub-factors, qualitative judgment is necessary to determine the appropriate category. The qualitative factors mostly reflect the benefits associated with Fingrid's status as Finland's sole transmission system operator operating in a well established regulatory framework. For illustrative purposes, the methodology relies upon historical financial results, while ratings incorporate Moody's expectations for future performance. The suggested rating under the methodology grid for Fingrid is A2, as summarised in the table below and based on the 2006-08 average key credit metrics. The suggested rating is in line with the company's BCA.

FACTOR 1: REGULATORY ENVIRONMENT AND ASSET OWNERSHIP MODEL

(a) Stability and Predictability of Regulatory Regime: Aa

Fingrid was established in 1997 as owner and operator of Finland's national electricity transmission system. The company operates in a stable, transparent and well established framework. Prior to 2005, the regulatory regime was based on a very "light-handed" cost-plus system with an ex-post methodology. In January 2005, the regulator Energy Market Authority ("EMA") introduced a new regime which, despite being ex-ante, remains relatively flexible, which underpins the stability of Fingrid's credit profile, supporting the positioning in the Aa category under this methodology factor.

(b) Asset Ownership Model: Aa

In its role as Finnish Transmission System Operator ("TSO"), Fingrid owns its transmission grid assets, with operations subject to a licence granted by the regulator EMA. Moody's understands that such licence, and the associated right to operate the network, could potentially be terminated under specific circumstances, namely: (i) if Fingrid ceases its grid operations, (ii) if Fingrid does no longer fulfil the obligations related to the licence and (iii) if Fingrid repeatedly and substantially breaks the Electricity Market Act or rules and regulations which it governs. In this context, Moody's notes Fingrid's excellent operational track record on this front, as further discussed below.

(c) Cost and Investment Recovery: Aa

Under the flexible Finnish regulatory framework, Fingrid is allowed to cover its costs and realise a reasonable post-tax return on its Regulatory Asset Base ("RAB"), with annual tariff increases implemented by the company, without the requirement for formal approval by the regulator.

Moody's notes that, under the current tariff formula, only approximately 20% of Fingrid's costs are subject to efficiency requirements, while capex remain outside the scope of regulatory efficiency standards, with any potential overruns in comparison with the capex plan agreed with EMA fully included in the company's RAB at the subsequent revision.

Actual realised returns generated through tariff increases implemented by the company can be higher or lower than allowed regulatory returns on an annual as well as a cumulative basis during the relevant period. However, any cumulative difference, either positive or negative, between the realised and allowed returns should be adjusted during the next regulatory period. For the current regulatory period (ie 2008-11), Fingrid is allowed a nominal post-tax return of, on average, approximately 5% on its RAB.

Within the regulatory framework, Fingrid is also party to the Main Grid Agreement (known as "MGA"), under which tariff policy for the relevant period is agreed with the grid users. Despite the potential for tariff increases permitted under the regulatory framework, Fingrid has significantly cut overall tariffs since its inception. Nevertheless, Moody's notes that under the MGA for the period 2008-11 Fingrid's tariffs will increase annually by 4.5%, to help accommodate the company's significant investment programme. However, despite these increases, Fingrid's expected returns for 2008-11 remain well below the levels permitted by the regulation, leaving the company with additional flexibility to raise tariffs further if required. Importantly, the MGA also provides for exceptional increases (with one month notice) under special circumstances that could affect Fingrid adversely. Moody's notes that the company has publicly indicated the intention to further raise tariffs after the current regulatory period, in order to support its sizeable capex plan.

(d) Revenue Risk: Aa

Moody's scores Fingrid in the Aa category under this factor, in light of the company's limited exposure to volume risk associated with the current regulatory regime. Under the current system, should volumes be lower or higher than expected, tariffs charged to customers are amended in the subsequent regulatory period.

FACTOR 2: EFFICIENCY AND EXECUTION RISK

(a) Cost Efficiency: Aa

Fingrid's tariffs management has been historically supported by its very efficient profile. The company has an excellent operational track record and has come out in the top tier in several international benchmark studies of maintenance and grid operation in recent years. As indicated by a benchmarking study concluded by ETSO (the former association of TSOs in Europe, now replaced by ENTSO-E), Fingrid maintains the lowest network tariff in Europe at EUR2.69/MWh, compared, for example, with the UK (EUR7.12/MWh), Spain (EUR7.55/MWh) and Italy (EUR10.59/MWh). In 2007, Fingrid also received a high ranking in operational

efficiency and service quality in an international benchmarking finalised by ITOMS (International Transmission Operations and Maintenance Study) concerning transmission grid maintenance. In addition, a study finalised by the Council of European Energy Regulators ("CEER") in 2009, including 22 TSOs from 19 countries, concluded that Fingrid was "exceptionally efficient", together with two other TSOs. The comparison was based on costs in grid construction, maintenance, planning and administration.

(b) Scale and Complexity of Capital Programme: Ba

As part of its ongoing capex programme, Fingrid has identified investments for the period 2009-19 totalling more than EUR1.6 billion (ie approximately EUR150 million per annum), mainly related to grid reinforcements, international interconnections and increase in reserve capacity. The sizeable plan represents a material increase compared with the recent history of the company, with capex over 2005-08 amounting to approximately EUR70 million on average per annum. With the objective of assessing the complexity of such investment plans, Moody's compares the size of Fingrid's annual capex with its asset base. In Fingrid's case, whilst a RAB is considered by the regulator, this is not publicly available and disclosed. Therefore, Moody's refers to net tangible fixed assets as a proxy for this measure (EUR1.1 billion as of YE 2008), with projected annual capex over 2009-19 representing approximately 13.5% of the company's asset base. This ratio and, more importantly, the general complexity and execution risk associated with such a large investment plan, result in the Ba positioning under this rating category.

FACTOR 3: STABILITY OF BUSINESS MODEL AND FINANCIAL STRUCTURE

(a) Ability and willingness to Pursue Opportunistic Corporate Activity: A

Fingrid has a strong track record of no material corporate activity (ie M&A, disposals and investments) which supports the company's positioning in the A category under this factor. Nevertheless, Moody's notes that there are no specific restrictions limiting management's discretion to potentially pursue significant corporate activity included either in the licence, the company's by-laws, financing and debt documentation, or any other binding agreement.

(b) Ability and Willingness to Increase Leverage: Baa

With this factor, Moody's aims at addressing the likelihood that a company may potentially alter its capital structure, based on the degree of discretion left to management and shareholders. In Fingrid's case, its financing and debt documentation does not include restrictive financial covenants aimed at limiting a potential material increase in leverage and specifically protecting creditors. Nevertheless, Moody's notes that Fingrid has maintained a stable financial policy. These considerations support Fingrid positioning in the Baa category under this factor.

(c) Targeted Proportion of Operating Profit Outside of the Core Regulated Business: Aa

Fingrid is not specifically subject to contractual, statutory or regulatory restrictions prohibiting investments outside the electricity transmission business. Currently, Fingrid retains very limited unregulated operations, mainly consisting of the company's 20% stake in Nord Pool AS, the Nordic Power Exchange for trade in physical and financial power contracts. Moody's notes that these businesses are somewhat complementary to the core regulated electricity transmission activity, which generates virtually all Fingrid's operating profit, thus supporting the positioning in the Aa rating category for this input

FACTOR 4: KEY CREDIT METRICS

A highly efficient structure and good turnover growth have allowed Fingrid to keep tariffs low, while at the same time strengthening its financial profile since its inception in 1997, with RCF/Net Debt ratios improving over the years from 7-8% to 14.2% in 2008.

Going forward, Fingrid is expected to significantly increase capex, in conjunction with the implementation of its ambitious EUR1.6 billion investment plan over 2009-19, mainly aimed at reinforcing the grid network, increasing reserve power capacity and building international interconnectors including the Fenno-Skan 2 cross-border link between Finland and Sweden and Estlink 2 between Finland and Estonia. Whilst the committed tariff increases of 4.5% annually until 2011 would somewhat mitigate the negative impact on Fingrid's financial profile, the debt requirements associated with Fingrid's investment plan are expected to weigh on the company's debt protection measures, which prompted the recent downgrade of the company's rating to A1.

Going forward, Moody's would expect Fingrid to exhibit ratios of FFO Interest Coverage of at least 3x, FFO/Net Debt at least in the low double digit and RCF/Net Debt of at least 9%-10% to support the current ratings. Moody's highlights that, in light of its sizeable capex requirements, Fingrid's financial profile is expected to be weakly positioned in the near term in the current rating category, thus potentially leaving limited headroom to absorb large adverse variances in operational performance and/or further increase in the scale of planned capex.

In comparison with a number of peer transmission grids in Europe, ratios guidance for Fingrid are relatively low in the context of the company's rating positioning. Nevertheless, in its assessment, Moody's factors in that, whilst Fingrid is expected to remain fairly leveraged on a Debt/Book Capitalisation basis (around 70%), it is significantly less leveraged on a Net Debt/RAB basis (currently approximately 37% and estimated at, on average, approximately 45% over the longer term). On this measure, it compares favourably with other network companies and is in line with the guidelines for a high-mid "A" rated network company. In addition, Moody's factors (i) the artificially low level of tariffs applied by Fingrid, negatively impacting key credit ratios, and the flexibility of the regulatory framework which would allow Fingrid to significantly increase tariffs should it so desire; (ii) the flexibility under the MGA 2008-11, providing for annual tariff increases of 4.5% and additional increases under exceptional circumstances that could affect Fingrid adversely, and (iii) the company's long and conservative track record.

Moody's also notes the fact that Fingrid's key shareholders are also its main customers, which constitutes 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. As a result, FFO/Net Debt levels are expected to remain low, but stable in relation to RCF/Net Debt parameters.

Other Considerations

Moody's notes that the Finnish government has recently indicated its intention to potentially increase its ownership in Fingrid and acquire a majority stake, in conjunction with the implementation of full ownership unbundling, under which the shareholders Fortum (rated A2/stable outlook) and PVO (each holding a 25% stake) are required to sell their stakes by 2012. Moody's rating assessment for Fingrid reflects the current ownership structure and does not take into account such potential development. Should such a scenario materialise, Moody's cautions that it may revise ratings guidance expected for the current rating in order to reflect any potential change in the company's financial strategy. In addition, Moody's notes that, while confirming the strong link between the State and Fingrid, were the Finnish government to acquire a majority stake, this may not have an impact on the company's rating, which already incorporates the assumption of potential government support under Moody's GRI methodology.

Liquidity

Fingrid's exhibits a healthy liquidity profile. Primary sources of liquidity include the company's predictable operating cash flow generation and cash and liquid securities balances which were EUR207 million at 30 June 2009. Secondary sources of liquidity include a EUR250 million multicurrency credit facility expiring in 2012 (currently undrawn and maintained solely for back-up purposes). The facility benefits from limited conditionality (no financial covenants and no repeating MAC clause). Together, these sources provide sufficient funds to cover the payments for capex (approximately EUR150 million), debt maturities (approximately EUR345 million) and moderate dividends expected over the period to June 2010. In light of the company's significant investment programme, Moody's expects Fingrid to generate negative free cash flow over the medium term, financed through increasing recourse to debt.

Fingrid has clear financial policies requiring that it should not have more than the equivalent of 45% of long-term debt in short-term or maturing debt over a 12-month period and that the refinancing requirement in any year should not exceed 30% of total debt. Fingrid's policies also require that the next 12 months' refinancing needs can be fully covered by liquid assets (cash and marketable securities) and undrawn credit facilities.

Rating Outlook

The outlook associated with Fingrid's rating is negative, reflecting the company's expected weak positioning within the current rating category, in light of the material debt-funded investment requirements incorporated in the company's plan.

What Could Change the Rating - Up

In view of the significant investment programme ahead, Moody's does not expect any positive pressure on Fingrid's rating in the near term.

What Could Change the Rating - Down

Negative pressure on Fingrid's rating could arise as a result of the group failing to sustainably meet its credit metrics in line with Moody's guidance outlined above.

Rating Factors

Fingrid Oyj

| Regulated Electric and Gas Networks | Aaa | Aa | A | Baa | Ba | B |
|--|-----|----|-------|------|-----|---|
| Factor 1: Regulatory Environment and Asset Ownership Model (40%) | | | | | | |
| a) Stability and Predictability of Regulatory Regime | | X | | | | |
| b) Asset Ownership Model | | X | | | | |
| c) Cost and Investment Recovery | | X | | | | |
| d) Revenue Risk | | X | | | | |
| Factor 2: Efficiency and Execution Risk (10%) | | | | | | |
| a) Cost Efficiency | | X | | | | |
| b) Scale and Complexity of Capital Programme | | | | | 14% | |
| Factor 3: Stability of Business Model & Financial Structure (10%) | | | | | | |
| a) Ability & Willingness to Pursue Opportunistic Corp. Activity | | | X | | | |
| b) Ability & Willingness to Increase Leverage | | | | X | | |
| c) Targeted Proportion of Op. Profit outside Core Reg. Activities | | X | | | | |
| Factor 4: Key Credit Metrics* (40%) | | | | | | |
| a) FFO Interest Coverage | | | 3.8x | | | |
| b) Net Debt / Net Fixed Assets | | | | 69% | | |
| c) FFO / Net Debt | | | 14.7% | | | |
| d) RCF / Capex | | | | 1.3x | | |
| Rating: | | | | | | |
| a) Indicated Rating from Methodology | | | A2 | | | |
| b) Actual BCA Assigned | | | A2 | | | |

* 3-year average



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