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ISSUER COMMENT
8 January 2016

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RATINGS

Fingrid Oyj

Issuer Rating - Domestic Currency	A1
Senior Unsecured	A1
Commerical Paper	P-1
Other Short Term	(P)P-1
Outlook	Stable

KEY METRICS:

	31/12/2014	31/12/2013	31/12/2012
FFO Interest Coverage	6.2x	5.6x	4.8x
Net Debt / Fixed Assets	64.4%	67.0%	70.4%
FFO / Net Debt	16.5%	14.0%	13.5%
RCF / Net Debt	8.8%	12.8%	12.5%

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Fingrid Oyj

Change in cost of capital calculation will boost earnings following regulatory methods for 2016-23 entering into effect

On 5 January 2016, Fingrid Oyj (Fingrid) announced that it had not appealed the Finnish Energy Authority's decision on the regulatory methods for electricity transmission system operations for both the 2016-19 (RP4) and 2020-23 (RP5) regulatory periods. The company will now benefit from increased visibility over its cash flows for the next 8 years and, at least in the near-term, higher earnings as a result of a change in the way allowed returns are calculated – a credit positive.

After the Energy Authority published its Final Determination on 4 December 2015, which governs the methods used to set Fingrid's allowed revenues until 2023, parties had until 4 January 2016 to appeal. Now that the appeal period has passed, the regulatory methods that came into effect on 1 January 2016 are legally binding.

We view the Final Determination, which is largely in line with the October 2015 Draft Determination, as credit positive. We expect a material improvement in Fingrid's operating cash flows during RP4, primarily resulting from changes to the weighted average cost of capital (WACC) calculation for the 2016-23 period compared to the previous regulatory period (RP3, which ran from 2012-15).

In Finland the WACC is mainly driven by the 10-year Finnish government bond yield, used as the risk-free rate in both the cost of debt and cost of equity calculations. The regulator's move from taking spot values, affected by the sustained low interest rate environment, to the greater of the spot and the 10-year trailing average, both updated annually, to set the risk-free rate should result in a more than two percentage point increase in the 2016 WACC alone. We estimate this change equates to over a €60 million increase in regulatory allowed profit in 2016, (which was €90m in 2015). Moreover, whilst we expect the trailing average to be higher than the spot rate in the short-to-medium term, if this situation reverses in RP4 or RP5, Fingrid is protected from any sharp uptick in rates as a result of the risk-free rate being calculated as the higher of the spot rate and the trailing average. This is important given the significant portion of short-term commercial paper debt in Fingrid's capital structure.

Exhibit 1

Comparison of WACC calculation in regulatory period 2012-15 and 2016-23

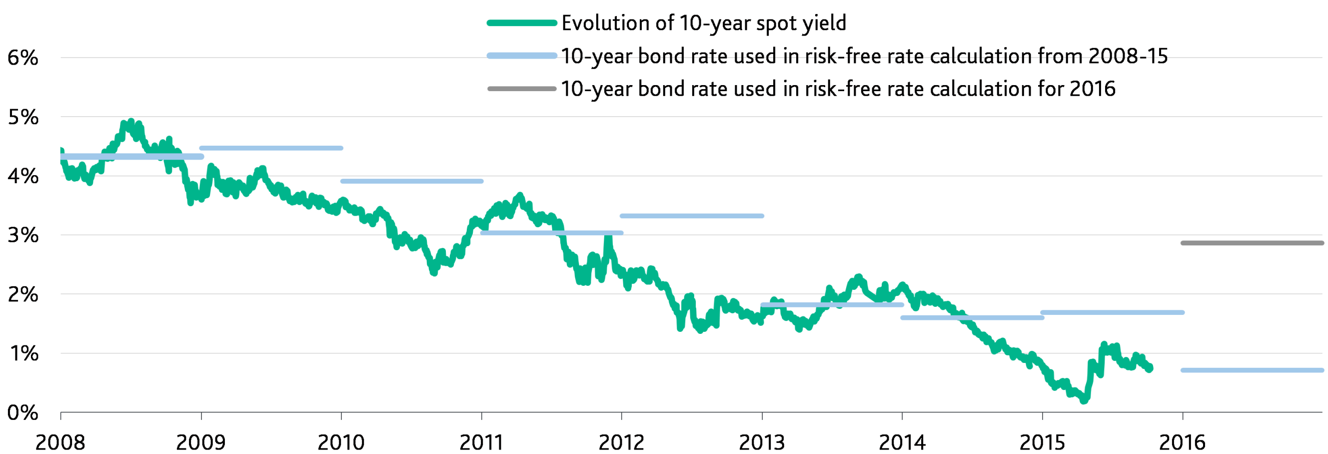
Reference period for Finnish 10-year bond rate the main change

	2014-15 (real parameters)	2016-23 (nominal parameters)
Calculation of Finnish 10-year bond	Average previous year (May)	Greater of: 10-year average (Oct-Sep)[1] and average previous year (Apr-Sep)
Cost of equity	Finnish 10 yr bond + 3.9%	Finnish 10 yr bond + 4.2%
Cost of debt	Finnish 10 yr bond	Finnish 10 yr bond + 1.4%[2]
Notional gearing	60%	50%
WACC (post-tax)	Finnish 10 yr bond * 0.88 + 1.56%	Finnish 10 yr bond * 0.9 + 2.7%[3]
WACC (pre-tax)	n/a - post-tax values set	Finnish 10 yr bond * 1.125 + 3.4%[3]
Inflation assumption	1%	n/a - nominal parameters set

1 For example, the reference period for 2016 is the average daily rate for October 2005 - September 2015.
2 1.4% is the risk premium on the cost of debt - this value will be updated in 2019 for 2020-23 (RP5).
3 If the cost of debt premium value changes for RP5 this formula will also change.
Source: Fingrid; Moody's Investors Service

Exhibit 2

Evolution of Republic of Finland's 10-year bond rate



Source: Bank of Finland; Moody's Investors Service

Higher returns will boost operating cash flows, with Funds From Operations (FFO) to Net Debt anticipated to be in the high teens to low twenties in percentage terms during RP4 (as compared to 16.5% in 2015). However, since 2014, Fingrid has adopted a policy of distributing substantially all parent company profit as dividend. If the company maintains this policy then it will constrain the benefits of improved cash flow on the company's debt metrics, in particular Retained Cash Flow (RCF) to debt (8.8% in 2014).

Overall, the modest changes between the Draft and Final Determination, and the increased consultation and transparency around the changes for RP4 and RP5, 2016-23, underpins our view that the regulatory framework is stable, transparent and largely supportive of credit quality.

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