MOODY'S
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Credit Opinion: Fingrid Oyj

Global Credit Research - 19 Dec 2013

Helsinki, Finland

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	A1
Senior Unsecured	A1
Commercial Paper	P-1
Other Short Term -Dom Curr	(P)P-1

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Key Indicators

[1]**Fingrid Oyj**

	12/31/2012	12/31/2011	12/31/2010	12/31/2009
(FFO + Interest) / Interest Expense	**4.6x**	**4.3x**	**6.0x**	**4.5x**
Net Debt / Fixed Assets	**70.8%**	**73.4%**	**70.2%**	**67.5%**
FFO / Net Debt	**13.1%**	**9.7%**	**13.4%**	**11.1%**
RCF / CAPEX	**0.9x**	**0.4x**	**0.8x**	**0.6x**

[1] All ratios are calculated using Moody's Standard Adjustments. Source: Moody's Financial Metrics TM

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Stable and predictable regulatory regime supports good visibility of cash flows

- Financial profile expected to improve reflecting tariff increases and decrease in capex

- Access to potential government support provides rating uplift

- Step-up in dividends to shareholders factored into the rating

Corporate Profile

Fingrid Oyj ("Fingrid", rated A1/P-1, stable outlook) is the transmission system operator and owner of Finland's high voltage electricity assets and interconnectors. It also owns a 19.18% stake in Nord Pool Spot AS, the Nordic electricity exchange.

The Government of Finland (Aaa stable) owns 53.1% of Fingrid, and has 70.9% of the voting rights, giving it overall control. Fingrid was established in 1997 out of the transmission assets of the electric utilities IVO, (now 50.76% state-owned Fortum Power and Heat Oy (Fortum; A2 stable), Finland's largest utility), and Pohjolan Voima Oy (PVO).

SUMMARY RATING RATIONALE

Fingrid's A1 issuer rating is underpinned by (1) the low business risk profile of its regulated electricity transmission network operations; (2) the well-established, stable and transparent regulatory framework, which supports good visibility of cash flows; and (3) the support of the majority owner, the Finnish government. The rating is constrained by Fingrid's sizeable investment programme, which is expected to total approximately EUR800 million over the next seven years (2014-20), with annual capital expenditure (capex) ranging between EUR100 million and EUR150 million.

We expect Fingrid's long-term financial profile to improve, moving towards funds from operations (FFO) interest coverage of over 4.0x, FFO/net debt of about 14% and retained cash flow (RCF)/net debt of at least 9%-10%, reflecting both the ongoing increases in tariff in line with regulatory allowed profit, and the expected significant step-up in the company's dividend payments.

Fingrid's A1 rating incorporates a one-notch uplift as a result of the credit quality of the company's majority shareholder. It also factors in our assessment that there is a moderate probability of government support in the event of financial distress, as well as a very high level of default dependence.

DETAILED RATING CONSIDERATIONS

STRATEGY UPDATE RESULTING IN HIGHER CASH FLOW AT OPERATIONAL LEVEL

Fingrid is transitioning its tariff levels up to the levels allowed by the Finnish regulator, Energiamarkkinavirasto (EMV), and the company will charge the full regulatory allowed tariff from January 2014. Fingrid increased the average tariff during the first two years of the current (third) regulatory period (2012-15) by 30% and 15%, respectively, supporting the company's operating cash flows. This is a positive credit factor given the high levels of investment that Fingrid is undertaking.

The change in tariff strategy followed the sale by Fortum Oyj (A2 negative) and Pohjolan Voima Oy of their shareholdings in Fingrid in April 2011, in order to comply with the EU's directive requiring transmission system companies to unbundle from companies that generate and sell electricity. The shareholdings were acquired by the Government of Finland and Mutual Pension Insurance Company Ilmarinen. As a result the government's direct ownership in the company is 53.1%, Ilmarinen's share is 19.9%, with the remaining 27% ownership distributed among other shareholders, mainly Finnish pension funds.

RATING UPLIFT FROM GOVERNMENT SHAREHOLDING

Fingrid's A1 ratings incorporate one notch of uplift from the company's a2 baseline credit assessment (BCA) - a measure of standalone financial strength. This uplift takes into account the government ownership of the company, the credit quality of the majority owner and our expectation of ongoing support.

The government maintains control of Fingrid through its holding of 70.9% of voting rights, and is involved in the supervision of the company. Although the increase in ownership confirmed the strong link between the state and the company, we have not revised our view of the expected levels of support from the government, which remains moderate. It reflects Fingrid's strategic importance as owner and operator of key infrastructure.

We believe that the strongly non-interventionist Finnish government would hesitate to support state-owned companies except in the most extreme of circumstances. In our view, the government would expect Fingrid in the first instance to seek to raise user tariffs to meet emergency requirements.

STABLE REGULATORY FRAMEWORK IS SUPPORTIVE

We view the regulatory framework in Finland as stable, transparent and supportive of credit quality. Under the flexible Finnish regulatory framework, Fingrid is allowed to cover its costs over time and realise a reasonable post-tax return on its Regulatory Capital ("RC"), with annual tariff increases implemented by the company, without the requirement for formal approval by the regulator. Fingrid increased tariffs to bring its return in line with the regulatory allowed profit during the current regulatory period (2012-15).

Under the current tariff formula, only around 20% of Fingrid's costs are subject to efficiency requirements. Operating and investment costs are estimated in advance, based on the preceding period, but including an annual efficiency target, which incorporates a +/-5% margin of error to take into account modest cost fluctuations.

Cumulative over- or under-recovery of allowed profits during the 2012-15 period will be adjusted in the 2016-19 period. The allowed profit also includes an incentive to improve quality and a small premium for research and development. However, Fingrid will not pursue historical under-recoveries relating to the previous low-tariff policy.

For the current regulatory period 2012-15, Fingrid is allowed a nominal post-tax return of, on average, approximately 3.1% on its RC, reflecting the government of Finland's low cost of borrowing. Fingrid's allowed return is modelled on leveraging of 60% debt/total capital, lower than the company's actual leverage of about 68% as at September 2013.

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 recent tariff increases, Fingrid's tariffs remain very low when compared with other European electricity grid companies.

HISTORICALLY HIGH LEVELS OF CAPEX DECREASING

We expect Fingrid's capex commitments to be substantially lower for the period 2014-20, as major investments in reserve plants, new interconnectors (Estlink 2) and grid upgrades are completed. We expect capex for the seven-year forecast period to be approximately EUR800 million (EUR100-150 million per annum), mainly relating to grid reinforcements and international interconnections. This compares with the period of substantial investments for the company between 2011 and 2013, with average annual capex of more than EUR200 million. Given the growth in Fingrid's asset base and expected drop in annual investments, projected annual capex over the next three years will be below 10% of the company's net tangible fixed assets (EUR1.5 billion as of 30 September 2013).

CASH FLOW MEASURES EXPECTED TO IMPROVE

The combination of substantial tariff increases and the significant growth in Fingrid's regulatory asset base (RAB) due to the company's large investment programme is resulting in increased operating cash flow. Compared with a number of peer transmission grids in Europe, the ratio guidance for Fingrid is relatively low in the context of its rating positioning, factoring in the company's long and conservative track record.

Fingrid's higher revenues and lower cash outflow for capex will be offset by our expectation of significantly higher dividend payments over time, which are likely to result in negative free cash flow and absorb the company's increased operating cash flows resulting from tariff rises. Whilst the company's dividend policy is not defined, Fingrid's ratings take into account the expected step-up in return to shareholders. In order to fund its investment programme and expected increases in dividend payments, we expect that Fingrid will continue to raise additional debt.

Liquidity Profile

Fingrid's liquidity profile is adequate, underpinned by (1) the company's predictable operating cash flow; (2) its significant cash liquidity balances of EUR197 million as of 30 September 2013; and (2) its undrawn committed back-up revolving credit facility amounting EUR250 million (expires in 2016 with two extensions possible). For the nine months to September 2013, Fingrid reported operating cash flow of EUR159 million and gross debt of EUR1.3 billion. We expect the company's principal cash calls during the period Q4 2013-Q3 2014 to include approximately EUR100 million of maturing debt, and capex of around EUR160 million.

Despite the expected improvement in company's cash flow generation, we anticipate that Fingrid will experience negative free cash flow for at least three years as a result of its ongoing capex programme and increasing dividend payments.

Fingrid has a clear financial policy requiring the company to fully cover its funding needs for the upcoming 12 months by means of liquid assets and available long-term committed credit lines. At the same time, Fingrid's refinancing needs each year may not account for more than 45% of the total amount of the company's debt financing. Fingrid traditionally funds requirements through its debt issuance programmes.

Rating Outlook

The stable rating outlook reflects our expectation that Fingrid's financial profile will improve from its current level, helped by increased levels of cash flow resulting from higher tariffs and returns that the company will claim. We expect Fingrid's key credit metrics to improve during the current regulatory period. Specifically, we expect the company's FFO interest coverage to rise to over 4.0x, its FFO/net debt to about 14% and its RCF/net debt to move to at least 9%-10% to support the current ratings.

What Could Change the Rating - Up

Positive pressure on Fingrid's rating could develop if the company's FFO/interest coverage and FFO/debt ratios were to exceed our expectations on a sustainable basis.

What Could Change the Rating - Down

We could downgrade the rating in the event that Fingrid's FFO/interest coverage and FFO/debt ratios were to fail to meet our expectations, falling below 4.0x and not reaching the mid-teens in percentage terms, respectively, during the upcoming regulatory period. We note that the single notch of uplift to the BCA under our methodology for government-related issuers (Government Related Issuers: Methodology Update, published 22 July 2010) would be unlikely to be reduced in the event of a limited fall in the ratings of the Finnish government.

Other Considerations

The BCA of a2 is based on the application of Rating Methodology for Regulated Electric and Gas Networks, published in August 2009. Based on the company's three-year (2010-2012) average historical financial metrics, the grid-indicated BCA is a3.

The one-notch uplift to the ratings for government support reflects the application of our GRI methodology. We view Fingrid as having very high dependence on the Government of Finland, and consider that there is a moderate likelihood of the company receiving support.

Rating Factors

Fingrid Oyj

Regulated Electric and Gas Networks [1][2]	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**
Factor 1: Regulatory Environment & 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 & Execution Risk (10%)						
a) Cost Efficiency			X			
b) Scale and Complexity of Capital Programme					X	
Factor 3: Stability of Business Model & Financial Structure (10%)						
a) Ability and Willingness to Pursue Opportunistic Corporate Activity			X			
b) Ability and Willingness to Increase Leverage				X		
c) Targeted Proportion of Operating Profit Outside Core Regulated Activities		X				
Factor 4: Key Credit Metrics (40%)						
a) (FFO + Interest) / Interest Expense (3-Year Average)			4.9x			
b) Net Debt / Fixed Assets (3 Year Avg)				71.5%		
c) FFO / Net Debt (3 Year Avg)			12.0%			
d) RCF / CAPEX (3 Year Avg)					0.6x	
Rating:						
a) Indicated BCA from Grid factors 1-4			a3			
b) Impact from Rating Uplift	0					
c) Indicated BCA from Grid			a3			
d) Actual BCA Assigned			a2			

Government-Related Issuer	Factor
a) Baseline Credit Assessment	a2
b) Government Local Currency Rating	Aaa
c) Default Dependence	very high
d) Support	moderate

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2012. Source: Moody's Financial Metrics

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