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

	2006	2005	2004
EBITA Margin	25.7%	36.2%	35.2%
(FFO + Interest) / Interest Expense	4.1x	4.0x	3.4x
FFO / Net Adjusted Debt	14.9%	14.0%	12.8%
RCF / Net Adjusted Debt	14.0%	13.2%	12.0%
RCF / (Capex + Acquisitions - Divestitures)	160.4%	194.0%	242.0%
Adjusted Debt / Book Capitalisation	68.0%	69.7%	73.2%

[1] Based on "Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations - Part II, Rating Methodology, Feb-06 (#96729).

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

Opinion

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 derive from regulated activities under a framework which currently affords Fingrid the flexibility to raise tariffs if need be, given the company'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 Finnish 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

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 Aa3 ratings reflect the combination of the following components:

- Baseline Credit Assessment (BCA) of 5, based on a scale of 1-21 where 1 indicates the highest credit quality and 5 maps to an "A1". The BCA is a representation of the company's credit quality before taking into account any support. Fingrid's BCA reflects the very low business risk of its operations, the significant flexibility enjoyed under the current regulatory environment and a solid and conservative track record, all of which help mitigate the relatively weak financial profile. The profile is expected to be weakly positioned in the medium term in light of the company's significant investment programme.

- Aaa local currency rating of the Finnish government;

- Medium dependence, reflecting (1) the fact that Fingrid's revenues are derived primarily from domestic sources and (2) the high degree of energy-intensive industry in Finland.

- Low support. Fingrid is strategically important as it controls 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 our 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 BCA receives a one-notch uplift under 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 (INCLUDING REGULATED VS. 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 of 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 (2008-11), Fingrid is allowed a post-tax return of around 5% p.a. on its Regulatory Asset Base.

As regards supportiveness of the regulatory environment, Moody's classifies the Finnish regulatory framework into the SRE 1 category. Of the four categories available, SRE 1 represents frameworks that are considered most predictable. This assessment recognises that the regulatory regime, despite being ex-ante, is relatively "light-handed" and flexible. The realised returns can be higher or lower than the allowed returns on an annual as well as a cumulative basis during the new four-year regulatory period for 2008-11. Any cumulative difference, either positive or negative, between the realised and allowed returns should be adjusted during the next regulatory period (2012-15).

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 mean that it maintains a high degree of financial flexibility under this regulatory regime; its permitted return is much higher than its expected realised return for 2007.

Within the regulatory framework, Fingrid is also party to the Main Grid Agreement for 2008-11 (known as MGA 2008-2011) with its users under which tariffs will increase by 4.5% per annum over the 2008-11 period to help accommodate the company's significant investment programme. Moody's notes that, despite these increases, the company's expected returns remain below the levels permitted by the regulation, leaving Fingrid with additional flexibility to raise tariffs further if required. Importantly, the new agreement continues to provide for exceptional increases (with one month's notice) under special circumstances that could affect Fingrid adversely.

ASSESSMENT OF QUANTITATIVE RISK FACTORS

A highly efficient structure and good turnover growth have allowed Fingrid to keep tariffs low, although the company has gradually strengthened its financial profile since its inception in 1997. Retained Cash Flow (RCF) / Net Debt has improved over the years from 7-8% to around 13-14% in 2005 and 2006.

Going forward, Fingrid is expected to significantly increase capex from around EUR 50-70 million per annum to around EUR 100-200 million per annum over the 2007-12 period to fund reinforcements of the grid network and interconnectors including the Fenno-Skan 2 cross-border link between Finland and Sweden, although Moody's understands that the company has some flexibility regarding the timing of certain investments. The committed tariff increases of 4.5% annually until 2011 and the recent announcement of the unexpected delay to the completion of the Fenno-Skan 2 project are likely to somewhat mitigate the pressure on Fingrid's debt protection measures over the 2008-11 period. Nevertheless, Moody's expects RCF/Net Debt to be at the lower end of our guidance set for the current rating category, leaving the rating vulnerable to any deterioration of the economic environment in the company's domestic market.

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

In comparison with a number of peer transmission grids in Europe, FFO/gross interest coverage (>3.5x) and RCF/Debt (13/14%) are 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 portfolio of liquid assets. Moody's also notes that, whilst Fingrid still looks fairly leveraged on a Debt/Book Capitalisation basis (around 70%), it is significantly less leveraged on a Net Debt/RAV basis (approximately 50%). On this measure, 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 the MGA 2008-11, providing for annual tariff increases of 4.5% and additional increases under exceptional circumstances that could affect Fingrid adversely. However, should Fingrid choose not to raise tariffs annually as planned under its MGA or give up its flexibility to increase tariffs altogether, this could have a negative impact on the rating; (iii) Fingrid's strong liquidity; and (iv) the company's long and conservative track record.

The National Grid Electricity Transmission PLC (rated A3/stable) is Fingrid's closest comparator in Europe with a similar, very low, business risk profile. The parameters for its rating are RCF/Net Debt 9-10% and FFO/Interest cover of around 3.0x.

That Fingrid's key shareholders are also customers 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/Debt levels are expected to remain low, but stable in relation to RCF/Debt parameters.

Liquidity

Fingrid's liquidity profile is healthy. Primary sources of liquidity include the company's predictable operating cash-flow generation and healthy cash and liquid securities balances which were expected to be around EUR 200 million at 31 December 2007. Secondary sources of liquidity include a EUR 250 million multicurrency credit facility expiring in 2012; this was undrawn at 31 December 2007 and is maintained solely for back-up purposes. The facility benefits from limited conditionality (no financial covenants and no repeating MAC clause). Together, these sources provide ample funds to cover the payments for capex (approximately EUR 100 million), moderate dividends and debt maturities expected over the next twelve months. In light of the company's significant investment programme, Moody's expects the company to generate slightly negative free cash flow in 2008.

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 rating outlook is stable, reflecting the company's strong commitment to a conservative strategy and stability of cash flow to service its debt commitments as well as its healthy liquidity profile. Nevertheless, Moody's expects that, given the company's substantial investment programme until 2011, its RCF/Net Debt metric is likely to be at the lower end of our expectation (please see below) - leaving Fingrid with very limited room to accommodate any deterioration of the economic environment in its domestic market, overspend on capex and/or lower than anticipated tariffs at the current rating level.

The following ranges are expected for this rating category: RCF/Net Debt of 11-14% and FFO/Net Interest Expense of more than 3.5x. These ranges are predicated on the company continuing to enjoy and, if necessary, make use of the 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 occur. Should this flexibility be reduced, negative pressure could arise if financial metrics were not improved adequately.

What Could Change the Rating - Up

In view of our expectation of relatively weak financial metrics for the current rating category, positive rating pressure is not imminent; in any event, we would expect to see a significant improvement in current debt protection measures in order for this to occur.

What Could Change the Rating - Down

RCF/Net Debt falling below 11-12% and/or FFO/Net Interest Expense below 3.5x (assuming maintenance of regulatory flexibility noted above) would exert negative pressure on the rating. Such falls could be as a result of lower than anticipated tariffs or higher investments or costs. Although not currently expected, a prolonged downturn in the Finnish economy that weakened Fingrid's earnings and customer creditworthiness could also be a negative factor.

A one-notch downgrade of the sovereign rating would not impact Fingrid's rating. However, a reduction in the level of support within the "low" category could have a negative impact on the rating.