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Fingrid Oyj

Corporate Profile

LOW BUSINESS RISK MITIGATES HIGHLY LEVERAGED STRUCTURE

Fingrid Oyj (Aa3) is Finland's transmission grid owner and operator. It is also the country's system owner and operator. Its business is low-risk given its monopoly position and strategic importance; this is reinforced by its predictable cash flow and capex needs, light-handed regulatory framework, strong ownership structure and highly efficient operations. These benefits mitigate its highly leveraged profile which is gradually improving.

Fingrid was founded in 1997 and it acquired the transmission networks of IVO (former power activities of Fortum) and PVO, with the aim of separating the company from the generators to achieve scale and efficiency.

| Eur million | 1999 | 2000 | 2001 | 2002 |
|---------------------|-------------|-------------|-------------|-------------|
| Turnover of which | 235 | 236 | 242 | 273 |
| Grid business | 212 | 203 | 200 | 210 |
| Balance management | 21 | 23 | 38 | 49 |
| Bottleneck revenues | 2 | 10 | 4 | 14 |
| EBIT | 96 | 88 | 85 | 91 |
| EBIT margin | 41% | 37% | 35% | 33% |

Corporate Structure

(See appendix 1) Fingrid has a simple corporate structure. All debt is at the parent level, Fingrid Oyj. On 31 December 2002 Fingrid System Oy, which was responsible for system operation and power balance management, merged into the parent company, Fingrid Oyj. Now Fingrid has one subsidiary left - Fingrid Varavoima Oy (an emergency reserve power company), which manages gas turbine capacity and employs two people.

Management Strategy

CONSERVATIVE STRATEGY FOCUSED ON CORE BUSINESS SUPPORTS RATING

Since its inception, Fingrid has been very clearly focused on its role as transmission owner and operator, maintaining its grid for its customer needs. It also has responsibility for system and balancing operations.

It continues to maintain a very conservative and focused strategy and has never demonstrated acquisition ambitions outside its core functions. Fingrid's investments in 1999 for reserve capacity, and for a stake in Nord Pool Spot AS in 2002 were designed to ensure efficient balancing and system operations. Its key aim is to be a highly efficient operator, hence passing on low prices to its customers. In Moody's opinion, the company's management has a solid track record on delivering on its financial and business objectives.



Shareholder Structure

| | % ownership | % voting rights |
|------------------------------|-------------|-----------------|
| Insurance Companies | 38 | 16.7 |
| Finland (Aaa) | 12 | 16.7 |
| *PVO (amongst others, Stora) | 25 | 33.3 |
| Enso Baa1, UPM Kymmene Baa1 | | |
| Fortum* (Baa2 positive/Baa1) | 25 | 33.3 |

PVO is a cooperative representing a large number of key electricity users. In its turn it owns, amongst other generating interests, TVO(P-2), owner of two of Finland's five nuclear reactors and a coal fired plant.

Fingrid's shareholder structure has not changed since the establishment of the company. There are seven people on Fingrid's Board of Directors, the three largest shareholders (State, Fortum, PVO) have two representatives each. The Chairman is appointed on a rotation basis from these three shareholders for a two-year term. Fingrid's current Chairman Mr. Taisto Turunen, who represents the Ministry of Trade and Industry, started a two-year term in 2003. Three directors form a Compensation Committee, and the whole Board represents an Audit Committee.

Relationship with the State. The State has a strong representation in Fingrid through its 17% voting share and its presence on the Board; as such it has a supervisory role over its operations. Moody's believes that the State considers the company to be strategically important, but would look to the mechanisms at Fingrid's disposal (such as emergency tariff-raising powers) to help in case of a crisis.

In addition to being shareholders, the owners of PVO and Fortum are key users of Fingrid's services. The insurance companies represent financial interests in the company.

Fingrid's *Advisory Committee* represents key users in the industry, including in 2002 the 10 biggest clients, which provided 59.4% of Fingrid's revenues. Fingrid views the Advisory Committee's input as very important in the setting of tariffs, although they are not an official decision making body.

Key Rating Considerations

BUSINESS RISK FACTORS

Fingrid Is Exposed To Some Volume Risk Linked To Electricity Consumption, Partially Mitigated By Ability To Raise Tariffs Or Defer Capex

Fingrid benefits from its strategic monopoly position and its flexible cost plus framework. Fingrid basically agrees its prices with its customers with the aim of keeping them low as possible whilst maintaining sufficient financial flexibility to improve its capital structure.

Given its very focused strategy, Fingrid's key risks relate to its ability to generate revenues. These in turn are linked to volumes. Finland has a steady macroeconomic environment, and electricity consumption is predicted to continue to grow by 1-2% per annum (hence the recent approval for a fifth nuclear reactor in Finland); however a downturn in electricity consumption could have a negative impact on Fingrid's cash flows, if not adjusted through the tariff mechanism. In case of such an event, Fingrid would also have some flexibility to defer some of its maintenance capex programme.

The Regulatory Regime in Finland is very light-handed. Regulated by the Energy Market Authority (EMA), Fingrid operates under the Electricity Market Act of June 1995 under which "pricing of the network prices shall be reasonable". The regulatory regime in Finland is based on an ex-post as opposed to ex-ante system. Under this framework Fingrid's contracts are agreed bilaterally with its users and the EMA monitors for abuses or complaints, which it would then investigate, bringing actions against Fingrid if necessary.

Under this framework, Fingrid is allowed to cover costs, including financing costs, and to earn a reasonable return. (The current return for the shareholders, according to the company's dividend policy, is equal to the five year Finnish Government bond plus 1.5%.)

Regulatory oversight must also be set in the context of international studies, according to which Fingrid has the lowest transmission prices in Europe and the highest efficiency. Transmission tariffs are a relatively small proportion of overall electricity prices in Finland.

Since 1997, power transmission prices in Finland have decreased by 25% in real terms. Fingrid lowered prices in 1998 by 10%, and a year later by 5%. Since 2000, prices have not changed in nominal terms.

However Fingrid has the flexibility to raise tariffs if need be:

1. Under the Grid Services Agreement (2002-4) which frames the conditions of its contract with its clients, Fingrid has the right to increase prices in line with inflation each year as from 1 January 2002, but has not done so to date. It could apply for this cumulative increase at any point. Turnover has, however, been growing along with consumption growth, resulting in improved profits; Fingrid has been able to pass on the benefits of this trend to its customers by holding down tariffs.
2. Fingrid also has additional flexibility under the terms of its Grid Services Agreement (Section 9) signed by all clients, that allows Fingrid to increase transmission prices if necessary, in case of a significant external event, such as an energy or economic crisis. It would need to give one month's notice.

Financial Risk Factors

THE KEY RISK FACTORS ARE THE COMPANY'S HIGH LEVERAGE AND LOW DEBT PROTECTION MEASURES...

The company was incorporated with high debt in order to minimise the Weighted Average Cost of Capital contributing to keep tariffs as low as possible. Since its first rating it has gradually reduced its overall net debt levels and is gradually decreasing leverage; nonetheless debt protection measures are weaker than for companies in its peer group. This situation is mitigated by low business risk and predictable cash flow. Nonetheless, Moody's expects Fingrid to continue to focus on debt reduction, and failure to do so could impact the rating.

Profitability Has Been Stable, Considering Price Cuts

| Revenues and Profitability Eur million | 1999 | 2000 | 2001 | 2002 |
|---|------|------|------|------|
| Turnover | 235 | 236 | 242 | 273 |
| EBITDA | 143 | 137 | 137 | 144 |
| EBIT | 96 | 88 | 85 | 91 |
| Net financial expense | 55 | 52 | 52 | 52 |
| Profit before tax | 41 | 36 | 33 | 39 |

Underlying operating profits have been very stable, taking into account early tariff cuts. Fingrid's core revenues have been positively impacted by growth in consumption in Finland. It should be remembered that turnover figures and gross operating expenses are inflated by balancing activities (purchase and sale of electricity to balance the needs of the system), but the net margin of this activity tends to be very small - around €2 million. Fingrid also benefits from bottleneck revenues (bottlenecks occur when prices in a particular area exceed the System Price. In this case the transmission system operator (TSO) gets 15% of the difference) - 2002 was a good year with €14 million instead of the budgeted €3 million from this activity.

Fingrid Continues To Generate Free Cash Flow After Predictable Capex Needs

| Cash Flow and Coverage Eur million | 1999 | 2000 | 2001 | 2002 |
|--|------|------|------|------|
| EBITDA | 143 | 137 | 137 | 144 |
| Tax paid | -3 | -4 | -2 | -3 |
| working capital movement | 4 | 8 | -10 | -10 |
| FFO post working capital(pre-interest) | 144 | 140 | 125 | 131 |
| Net interest | -55 | -52 | -52 | -52 |
| dividends | -7 | -7 | -7 | -7 |
| RCF | 81 | 81 | 66 | 72 |
| capex and investments | -105 | -35 | -49 | -50 |
| FCF | -24 | 46 | 17 | 22 |
| FFO/net interest expense x | 2.6 | 2.7 | 2.4 | 2.5 |

From a cash-flow perspective, FFO pre-working capital has been stable - 2002 figures were boosted by exceptional levels of bottleneck revenues in 2002. Working capital movements in the accounts tend to reflect slight timing differences in settlement of receivables and payables over the year end - customers are billed monthly. Fingrid's capex has been steady and is normally around €40-45 million, although there have been a few exceptional invest-

ments. However FFO/net interest coverages are expected to slowly increase as financial costs and debt reduce, some of the more expensive swap arrangements roll off and FFO gradually increases.

According to the 2003-2007 investment plan, total investment capex will be approximately €40-45 million p.a.. Of this amount, €38-39 million will be covered by tariff income, and up to €5 million will be financed directly by the clients interested in a particular investment project. Around two-thirds is for new projects (connections, substations etc) and one-third for renewal of existing facilities, although this latter amount could be deferrable.

Dividend pay out is expected to stay at steady levels.

...Which Is Applied To Improving The Highly Leveraged Capital Structure

Fingrid has €874million of debt and €168million of preferred capital notes as of FYE 2002. Net interest expense of €52 million also includes €11 million of higher rate interest on preferred capital notes. Whilst Fingrid is allowed to treat these notes as equity, Moody's tends to treat such hybrid structures as closer to debt, because we believe that a highly rated company such as Fingrid is likely to pay interest despite the ability to defer it under the conditions of the notes. There is a step-up coupon in year 10 as an incentive to prepayment. Fingrid plans to repay the bulk of these in 2007 because of their relatively higher costs.

| Leverage Eur million | 1999 | 2000 | 2001 | 2002 |
|-----------------------------------|-------------|-------------|-------------|-------------|
| total debt | 918 | 864 | 859 | 874 |
| preferred capital notes | 168 | 168 | 168 | 168 |
| debt and capital notes(adj. Debt) | 1086 | 1032 | 1027 | 1042 |
| RCF/adjusted total debt | 7.50% | 7.80% | 6.40% | 6.90% |

Fingrid has been free cash-flow-positive after capex over the last few years, which has allowed for gradual debt reduction - a trend that is expected to continue over the next few years. The company thus anticipates a continuous improvement in both leverage and equity ratio, targeting an increase in its equity ratio to around 25% in 2006.

Fingrid does not take any foreign exchange risk, i.e. everything is swapped into euros, but it does keep some interest rate risk. In the past, Fingrid swapped all variable interest rate positions into a fixed rate, and therefore did not benefit from the falling interest rates of recent years. As these swaps roll off and Fingrid now adopts a more flexible and dynamic approach to hedging interest rate risk, the company expects debt interest, at 5.5% at the end of 2002, to reduce to below 5% in 2003.

Liquidity Is Healthy

Fingrid's liquidity profile is healthy. The company's on-going liquidity profile is characterised by predictable free cash-flow generation and healthy minimum cash and liquid securities balances. It normally makes fairly active use of the short-term ECP market with staggered long-term debt maturities, although it has ample committed bank back-up facilities. Over the forthcoming 12 months CP usage is anticipated to be lower than usual due to higher levels of long-term funding already put in place this year, hence improving the current liquidity profile.

Fingrid has recently put in place a five-year multicurrency credit facility that expires in 2007, for equivalent €400 million. It is maintained primarily for back-up purposes. There is no general Material Adverse Change clause. In the document Fingrid must attest that it is not in breach of or in default of any agreement that could reasonably be expected to have a material adverse effect.

Related Research

Special Comment

[Nordic Electricity Industry; February 2002, #73649](#)

Special Comment

[Moody's Comments On Recent Rating Actions And Trends Within The European Utility Sector, January 2003, #77148](#)

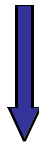
Analysis

[Red Electrica De Espana, March 2003, #77659](#)

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FINGRID Oyj
1 Jan 2003

- **Grid Service Business**
- **Grid Asset Management**
- **Power System Operation**
- **Corporate Services**



**FINGRID
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| Coupon | Type of Debt | Maturity | Moody's Rating |
|--------------------|-------------------------------|----------|----------------|
| Fingrid Oyj | | | |
| — | Euro Debt Issuance Program | — | Aa3 |
| 6.39% | Sub. Capital Notes | 2029 | A1 |
| 6.80% | Sub. Capital Notes | 2027 | A1 |
| 2.00% | Euro Medium Term Notes | 2010 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2010 | Aa3 |
| 4.25% | Euro Medium Term Notes | 2009 | Aa3 |
| 4.75% | Euro Medium Term Notes | 2008 | Aa3 |
| 5.52% | Euro Medium Term Notes | 2007 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2007 | Aa3 |
| 2.00% | Euro Medium Term Notes | 2007 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2006 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2006 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2006 | Aa3 |
| 7.21% | Euro Medium Term Notes | 2005 | Aa3 |
| 5.44% | Euro Medium Term Notes | 2005 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2005 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2005 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2005 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2004 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2004 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2004 | Aa3 |
| — | Flt Rt Euro Medium Term Notes | 2004 | Aa3 |
| — | Medium-Term Note Program | — | P-1 |
| — | Commercial Paper | — | P-1 |

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