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Research:
Fingrid Oyj

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Corporate Credit Rating	
	AA-/Stable/A-1+

Outstanding Rating(s)	
Fingrid Oyj	
Sr unsecd debt	AA-
CP	
Foreign currency	A-1+
Pfd stk	
Local currency	A-

Corporate Credit Rating History	
Feb. 17, 1998	AA/A-1+
Nov. 19, 1998	AA-/A-1+

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Major Rating Factors

Strengths:

- Monopoly transmission operator in a stable macroeconomic environment (Finland) characterized by a steady growth in electricity demand;
- Favorable cost-plus regulation allowing significant freedom in tariff setting, investments, and quality settings; and
- Ability to increase tariffs at very short notice.

Weaknesses:

- Weak financial profile with high leverage and low debt service coverage ratios.

Rationale

The ratings on Fingrid Oyj are based on the utility's strong business position as the monopoly electrical transmission grid company and system operator in the politically and economically stable Republic of Finland (AAA/Stable/A-1+). The ratings also reflect Fingrid's stable revenue base, a favorable cost-plus regulatory regime, and a focused and prudent strategy. These factors balance a weak financial profile attributable to high leverage and weak debt service ratios.

In 2001, Fingrid transmitted 59.9 terrawatt-hours of electricity--equivalent to three-quarters of Finland's total consumption--to about 100 customers through its 14,000-kilometer electricity grid. Finland's economy is highly developed, with a high per capita electricity consumption of about 15,000 kilowatt-hours (kWh). Electricity consumption grew by 3% in 2001, which was slightly higher than the historic growth rates of about 2% per year over the past 10 years. Standard & Poor's expects future annual growth rates to be between 1%-2% in the medium term.

Compared with peers, Fingrid's track record on network efficiency is excellent, with virtually no bottlenecks or disturbances, and highly efficient operations. Transmission losses have been at a low 1%-1.5% over the last four years. Investment needs in infrastructure are expected be moderate in the medium term, and will mainly be focused on grid renovation.

Fingrid benefits from Finland's cost-of-service electricity grid regulation, which allows cost cover, reasonable ROE, and a high degree of flexibility in tariff setting and capital expenditures. Tariffs are mainly charged to consumption, which enhances revenue stability.

Fingrid's debt leverage is high, and was 81% for the fiscal year ended 2001 including capital notes in debt (68% excluding capital notes in debt), but is expected fall to about 70% within the next six years due to moderate investment needs and the early redemption of EUR137 million ($128.5 million) in capital notes. Funds from operations (FFO) interest cover was 3.0 times (x) in 2001, but is also expected to improve to more than 3.5x over the medium term, due to stable operating cash flow and the reduction of debt.

Fingrid also manages Finland's 'balance adjustment' system (Fingrid System Oy). This system balances the difference between electricity production and electricity consumption by allocating the costs of the imbalances to the market participants. Counterparty risk in this business is limited through the continual monitoring of positions and the requirements of guarantees or deposits from the participants.

Outlook

Fingrid's stable monopoly position and revenue base and its flexible regulatory regime are expected to remain unchanged for the foreseeable future. This should enable the utility to avoid financial difficulties, despite its highly leveraged balance sheet. No further tariff reductions or leverage increases are expected. Due to moderate investment needs in the medium term, a reduction in debt is likely, as is a gradual improvement in FFO interest cover ratios.

Business Description

Fingrid began operations on Sept. 1, 1997, following the merger of the transmission grid operations of state-owned electric utility Imatran Voima Oy (now known as Fortum Power and Heat Oy; Fortum) and Pohjolan Voima Oy (PVO), a private sector electric consortium. The Finnish State owns 12.3% share of Fingrid's equity (representing 16.4% of votes), with Fortum and PVO each holding 25.0% (each representing 33.4% of the votes). Finnish institutional investors own the remainder.

Fingrid's operations are divided into three main business areas: grid service business (customer service); grid asset management (grid planning and development); and corporate services (centralized corporate functions), as well as the wholly owned subsidiaries Fingrid System Oy (power system, balance management, and grid operation), and Fingrid Varavoima Oy (management of the 672-megawatt (MW) gas turbine reserve capacity). Fingrid also holds a 50% stake in the Finnish electricity exchange EL-EX Electricity Exchange Ltd. Fingrid's business strategy is highly focused, and Standard & Poor's expects the utility to refrain from venturing outside its core business in Finland.

Business Profile

The strong business profile primarily reflects Fingrid's monopoly position as electricity transmission service operator in Finland, as well as the existing flexible cost-plus regulation. In addition, Fingrid has an excellent operational track record compared with peers. In 2001, Fingrid was number one in an international benchmark study on maintenance involving 25 fellow grid operators around the world. Despite the all-time high in peak-load electricity consumption in Finland in 2001 (13,300MW), Fingrid's supply experienced virtually no disturbances. Electricity losses accounted for 1.2% of the volume transmitted in 2001, which is low for the industry.

Electricity consumption growth in Finland has historically been steady at about 2% per year, and the macroeconomic environment is favorable, with 1%-2% growth expected in the medium term. Interconnection transmission lines with Russia, owned by Fingrid, are reserved and used in full, and these provide additional supply to the transmission market. Despite real reductions in tariffs, Fingrid's turnover increased to EUR241 million in fiscal 2001 from EUR226 million in 1998. Operating profit, however, fell to EUR85 million in 2001 from EUR98 million in 1998. The negative trend for operating profit is expected to end during the next couple of years due to the inflation-adjusted tariffs negotiated for the period 2002-2004.

Fingrid's grid networks are well sized for domestic transmission needs and represent a significant strategic and economic asset. The level of import versus export generally depends on the supply of hydropower in the Nordic market. The construction of a new 440-kilovolt transit line with a capacity of 500MW, begun in 2001 and expected to be finished in 2002, will increase the total transmission capacity from Russia to 1,400MW, thereby adding additional transmission supply.

Finland's regulatory regime is flexible and underpins the ratings on the utility. Electricity transmission and distribution are natural monopolies, regulated and monitored by the Energy Market Authority (EMA), an independent government agency. The light-handed cost-of-service regulation stipulates that network tariffs must be reasonable, public, and nondiscriminatory. Network companies are allowed to cover their costs and make reasonable ROE. Tariff increases do not need to be sanctioned. Within the regulatory framework, transmission tariffs are decided by the board of directors following discussions with the utility's customers. There is no regulation of capital expenditures. Fingrid is also allowed to cover the costs of operating its peak-load gas turbines through revenues from Fingrid System Oy's operations, as the peak-load reserve is considered part of the utility's system responsibility.

According to the tariff agreement, exceptional adjustments could take place at Fingrid's discretion in the case of force majeure or other significant events beyond Fingrid's control (such as increased financial costs). Cross-border transmission tariffs to Sweden and Norway have been abolished, but cross-border tariffs to Russia are expected to remain in place in the medium term. In 2001, all transit capacity from Russia was sold. On the Russian side, the electricity giant RAO UES Rossii is responsible for export and transmission arrangements.

New voluntary grid service contracts, valid for 2002-2004, were negotiated by the end of 2001, and came into force on Jan. 1, 2002. Tariff prices during this period will be based on the 2002 price level and adjusted for inflation throughout the period.

Table 1 Fingrid Oyj Operating Statistics					
	--Year ended Dec. 31--				
	2001	2000	1999	1998	1997
Generic data					
GDP growth (%)	0.6	5.2	4.0	5.1	6.0
Inflation (%)	1.1	3.0	1.2	1.5	1.2
Per-capita income ($)	25,480	24,350	24,000	23,840	23,314
No. of employees	204	270	273	272	242
No. of customers	100	100	98	103	105
Operations and maintenance excluding depreciation (mil. EUR)	105.7	96.8	91.6	87.5	25.2
Transmission operations					
Type of network (kv)	400/220/110				
Units transmitted (TWh)	59.9	64.7	59	55.8	52
System peak demand (GW)	13.3	13.2	13.1	0.9	0.9
Total transmission lines (kilometers)	13,843	13,843	13,693	13,855	13,600
Underground lines/total lines (%)	0.72	0.72	0.72	0.72	0.76
Transmission energy losses (%)	1.2	1.5	1.5	1.54	1.73
Avg. transmission revenues (EUR cents/kWh)	0.403	0.259	0.277	N.A.	N.A.
Avg. operations and maintenance costs (EUR cents/kWh)	0.176	0.150	0.155	N.A.	N.A.
Kv--kilovolts. TWh--terrawatt-hours. GW--Gigawatts. KWh--Kilowatt-hours. N.A.--Not available. EUR1 = $0.944.					

Financial Policy: Aggressive

Excluding the utility's flexible regulation and stable revenue base, Fingrid's financial profile could be seen as weak, with a financial policy bordering on aggressive. At year-end 2001, total debt to capital was 81% including capital notes in debt (68% when treating the capital notes as equity; see Capital Structure and Financial Flexibility). Fingrid's financial strategy, however, is focused and prudent. Its objectives are to diversify its funding sources and maturity profile, hedge against foreign-exchange exposure, and adjust the interest-rate risk to the tariff period. Derivatives are used for hedging purposes only.

Fingrid's shares are not listed, and institutional investors have made their investment in Fingrid with the aim of a safe and stable dividend. A fixed-dividend level was decided at the time of Fingrid's formation. Over the next five years, the payout ratio is projected to average about 60% (when treating the interest on capital notes as dividend).

Financial Profile

Profitability and cash flow.

Fingrid's profitability is weak but stable, reflecting the voluntary tariff policy adopted by the utility. Fingrid aims to further improve cost efficiency through its strong position in negotiations with external contractors for maintenance and new construction, as well as refined operation methods and maintenance scheduling. The utility has also benefited from falling interest rates. Furthermore, the cost for power transmission losses has decreased significantly since Fingrid started operations, owing to the price pressure in the highly competitive Nordic electricity market.

Operating profit is expected to remain at about EUR80 million annually, while profit before tax is expected to improve to about EUR37 million over the next five to six years from about EUR30 million, due to lower debt costs. This assumes unchanged tariffs in real terms and increasing depreciation chargers, as well as an annual 1%-2% increase in transmission volumes. Operating income (before depreciation) to sales decreased in 2001, but is now expected to remain stable at about 55%-60% in the medium term. This ratio is expected to improve slightly to about 2.4x over the next five years, from 2.0x in 2001. Interest payments on capital notes, averaging about 20% of expected total interest expenses over the next five years, are deferrable.

The level of Fingrid's debt depresses cash flow debt coverage ratios, but the regulatory and tariff regimes provide the utility with flexibility. FFO to debt is expected to average a weak 11%, and FFO coverage of interest expenses is expected to average about 3.5x in the medium term (3.0x in 2001). The planned redemption of EUR137 million in capital loan debentures in 2007 could improve the ratio in the longer term. Cash flow is expected to more than cover capital expenditures, at an average of about 170%, over the next six years. Fingrid has no major investment plans in terms of domestic grid enhancements or subsea cables over the forecast period until 2007. Ongoing investments are expected to average between EUR40 million and EUR50 million per year for the same period, with depreciation averaging between about EUR50 and EUR60 million.

The Finnish corporate tax system allows tax-deductible excess depreciation, and Fingrid will use this to minimize tax payments and smooth out net results. This allocation is enabling the utility to build up an untaxed reserve, which will allow it to maintain a stable dividend policy. The buildup is expected to continue over the next five years.

Capital structure and financial flexibility.

Fingrid's leverage is very high, and was about 81% at year-end 2001, down from 86% in 1998. This ratio is projected to continue to reduce slightly over the next five years. The utility issued EUR137.9 million in 30-year capital notes in 1997, and EUR30 million in 30-year debentures of a capital loan nature (capital notes) in November 1999. Standard & Poor's considers both these instruments to be preferred capital notes with deep subordination, rated 'A-'--three notches below the issuer credit ratings on Finland--as principal and interest can be deferred even after the maturity of the notes if there are not sufficient distributable reserves. Any deferred interest or principal will remain the liability of Fingrid, however, and repayment will continue to be deferred until the liabilities have been repaid in full out of distributable reserves. The utility has a significant reliance on these instruments, with the ratio of preferred capital to total preferred capital and equity at about 45%. Treating 100% of the capital notes as equity would reduce Fingrid's leverage to about 70% at year-end 2001.

Although Fingrid's financial flexibility is restricted by its high leverage and dividend payout policy, this is offset by a flexible regulatory regime that allows for tariff increases and by a deferrable capital expenditure program. Fingrid's policy is to cover short-term debt with a cash balance and backup facilities. The utility is tapping both the domestic and international capital markets, and has established domestic and international medium-term note and commercial paper programs. The utility uses its syndicated revolving credit facility as a backup for short-term debt.

Table 2 Fingrid Oyj Financial Statistics

	--Year ended Dec. 31--				
	2001	**2000**	**1999**	**1998**	**1997**
Income statement (mil. EUR)					
Gross revenues	242.0	236.0	235.0	226.0	75.0
Operating expenses (excluding DD&A)	105.0	99.0	92.0	88.0	25.0
Depreciation and amortization	52.0	49.0	47.0	41.0	13.0
EBITDA	138.0	140.0	145.0	141.0	51.0
Interest incurred	41.0	44.0	48.0	43.0	15.0
Net interest incurred	41.0	41.0	46.0	41.0	14.0
Net income	34.5	36.7	2.2	39.1	2.2
Earnings protection					
Pretax interest coverage (x)	2.1	2.1	2.1	2.3	2.5
Net pretax interest coverage (x)	2.1	2.1	2.1	2.4	2.6
EBITDA interest coverage (x)	3.4	3.2	3.0	3.3	3.4
Total debt/EBITDA (%)	7.5	7.4	7.5	7.4	19.3
Return on avg. equity (%)	0.1	0.2	0.2	0.2	N.A.
Annual expenditure growth (% excluding DD&A)	0.1	0.1	0.0	2.5	N.A.
Total operating expenditure/revenues (%)	0.4	0.4	0.4	0.4	0.3

Balance sheet (mil. EUR)					
Cash and equivalents	3.4	2.7	2.3	2.9	0.4
Net plant	1,032.5	1,038.4	1,039.4	973.6	927.7
Total assets	1,338.4	1,337.4	1,357.7	1,275.1	1211.7
Short-term debt	250.1	335.8	264.7	326.1	346.5
Long-term debt	784.6	696.9	822.3	712.6	632.1
Preferred stock	0	0	0	0	0
Common equity	242.3	221.3	199.4	171.0	197.2
Total capitalization	1,277.0	1,254.1	1,286.3	1,209.8	1,175.7
Total off-balance-sheet obligations	0	0	0	0	0
Balance-sheet ratios (%)					
Short term debt/total capital	20.0	27.0	21.0	27.0	29.0
Long term debt/capital	61.0	56.0	64.0	59.0	54.0
Preferred stock/total capital	0.0	0.0	0.0	0.0	0.0
Common equity/total capital	19.0	18.0	16.0	14.0	17.0
Total debt/total capitalization	81.0	82.0	84.0	86.0	83.0
Net debt/total capital	81.0	82.0	84.0	86.0	83.0
Cash flow (mil. EUR)					
Net income	34.5	36.7	33.5	39.1	2.2
Depreciation	51.9	49.1	46.9	40.7	13.1
Funds from operations (FFO)	93.9	96.1	94.5	95.5	34.6
Preferred dividends	11.3	11.3	9.4	9.4	0.0
Common dividends	7.2	7.2	7.2	2.4	0.0
Net cash flow (NCF)	75.4	77.6	77.9	83.8	34.6
Net capital expenditures (capex)	47.4	34.7	30.0	81.9	21.4
Discretionary cash flow	(4.7)	61.7	26.9	12.6	3.6
Cash flow adequacy					
Capex/avg. total capital (%)	4	3	2	7	N.A.
NCF/capex (%)	159	224	260	102	162
NCF/capex and net acquisitions (%)	159	224	74	102	3
FFO/avg. total debt (%)	9	9	9	9	N.A.
FFO/avg. net debt (%)	9	9	9	9	N.A.
FFO interest coverage (x)	3.0	3.2	3.0	3.2	3.3
FFO net interest coverage (%)	3.0	3.3	3.1	3.4	3.4
Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend. N.A.--Not available.					

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