RESEARCH

Fingrid Oyj

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Corporate Credit Rating

AA-/Stable/A-1+

Business risk profile: Scale from 1 (strong) to 10 (weak)
1
Financial risk profile:
Aggressive
Debt maturities:
At Dec. 31, 2005 (including capital loans)
2006: €284.4 mil
2007: €92.1 mil
2008: €53.9 mil
2009: €87.6 mil
2010: €64.6 mil
2011 and thereafter: €209.2 mil
Collateralization:
Not meaningful.
Total debt:
At Dec. 31, 2006: €985.8 million.

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+

Major Rating Factors

Strengths:

- Monopoly transmission operator in the stable macroeconomic environment of Finland, which has steady growth in electricity demand
- Favorable cost-plus regulation allowing significant freedom in tariff setting, capital expenditure, and quality settings
- The 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. 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.

Fingrid is responsible for national power-balance management and settlement. Counterparty risk in this business is limited through the continual monitoring of positions and the requirement for guarantees or deposits from the participants. Fingrid benefits from Finland's cost-of-service electricity grid regulation, which allows cost cover, a reasonable ROE, and a high degree of flexibility in tariff setting and capital expenditures. Tariffs are mainly charged to consumption, thereby enhancing revenue stability.

Compared with its peers, Fingrid's track record on network efficiency is excellent: It has highly efficient operations, with virtually no bottlenecks or disturbances. The transmission system has accommodated the strong demand growth and substantial import/export volumes of recent years. Demand during the first half of 2006 was 11% higher than in the corresponding period in 2005. The low demand in 2005 was due to the labor market disputes in the Finnish forest products industry. Now that these disputes are resolved, demand growth is expected to return to 1%-2% in the medium term.

Capital expenditure needs in infrastructure are expected to be higher than normal in the medium term. In early 2005, Fingrid decided on a joint investment with Svenska Kraftnät, the Swedish transmission system operator, in a new cable connection to be built alongside the existing Fenno-Skan cable between Finland and Sweden. Fingrid's share in this investment is estimated at about €120 million, spread over 2008-2011. The project is not expected to have any material credit impact on Fingrid because costs can be covered by increased tariffs. Fingrid's tariffs are among the lowest in Europe and in 2006 they were lowered by 5%. Consequently, there should be considerable flexibility to increase tariffs if needed.

Fingrid's debt leverage remains high, amounting to about 72%, including capital loans of €167.9 million as debt, at the end of the first half of 2006. This is expected to fall to about 70% over the next five years, thanks to continued stable profits and limited increase in debt. Funds from operations (FFO) interest coverage is expected to stay at about 4.0x over the medium term.

Liquidity

Fingrid's liquidity position is sound. At June 30, 2006, Fingrid had €206 million in cash and marketable short-term securities. In November 2005, Fingrid signed a seven-year €250 million multicurrency revolving credit facility agreement, replacing the €400 million facility signed in 2002. This new €250 million multicurrency revolving credit facility, together with cash and liquid assets, serves as backup for short-term debt. There are no material financial covenants or material adverse change clauses in the existing credit agreements.

Outlook

The stable outlook reflects Fingrid's stable monopoly position and revenue base, and its flexible regulatory regime, both of which 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 higher investment needs in the medium term, a slight increase in debt is likely.

Business Description

Fingrid, established in 1997, is owned by the Finnish state--which has 12.3% of shares and 16.4% of votes--and private sector electric consortia Pohjolan Voima Oy and Fortum Oyj (A-/Stable/A-2), each holding 25.0%, and each representing 33.4% of votes. Finnish institutional investors own the remainder.

Fingrid is the national electricity transmission operator, and its operations are divided into three main business areas: grid service (customer service); grid asset management (grid planning and development); and power system operations (power system operations, balance management, and grid operation). Fingrid is also 20% owner of the Nordic physical electricity exchange, Nord Pool Spot AS.

Business Risk Profile

Strategy

Fingrid's business strategy is highly focused, and Standard & Poor's Ratings Services does not expect the utility to venture outside its core business in Finland.

Fingrid and Svenska Kraftnät, the Swedish transmission system operator, have decided to invest in a cable connection to be constructed alongside the existing Fenno-Skan cable and due to be operational by 2010. Fingrid's share of the investment is estimated at €120 million spread over 2008-2011. Fingrid has ample flexibility to raise tariffs to finance the investment, should it be considered necessary, since the grid agreement allows for a tariff increase by 3% in 2006 and 2007, respectively. Fingrid lowered the tariff by 5% in 2006, and so it could raise it by 11% in 2007. The investment is therefore not expected to have any material credit impact on Fingrid.

Regulation

Finland's regulatory regime is flexible and underpins the ratings on Fingrid. Electricity transmission is regulated and monitored by the Energy Market Authority (EMA), an independent government agency. Although a methodology for tariff evaluation has been established, the material rules of the Electricity Act regarding reasonable pricing will remain unchanged. The impact on Fingrid is limited.

EMA has already tested the reasonableness of Fingrid's tariffs under the previous methodology and came to the conclusion that historical tariffs had complied with Electricity Market Act's requirements. According to the new methodology, network companies can also cover their costs and make reasonable ROE, and tariff increases do not need to be sanctioned. Within the current regulatory framework, transmission tariffs are decided by the board of directors following discussions with customers. Fingrid is also allowed to cover the costs of operating its emergency reserve gas turbines through revenues from power system operations, because the maintenance of emergency reserve capacity 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 event of force majeure or other significant events beyond Fingrid's control (such as increased financial costs). Within the European Transmission System Operators area there exists an inter-transmission system operator compensation scheme, which replaces the transaction cross-border tariffs. The net cost of the current scheme is expected to be €5 million-€20 million annually. Cross-border tariffs to Russia are expected to remain in the medium term.

Markets

Fingrid has a monopoly position as electricity transmission service operator in Finland. Customers, of which there were 99 at the end of 2005, comprise electricity producers, major industrial enterprises, and regional and distribution network companies.

Demand grew by 11% in the first half of 2006. Electricity consumption growth in Finland has historically been steady, however, at about 2% per year, with 1%-2% growth expected in the medium term. The 1,300 MW of interconnection transmission lines with Russia, owned by Fingrid, are fully reserved and used by electricity importers, and they provide additional supply to the transmission market.

The existing tariff agreement runs for three years from 2005 to 2007. The customers have agreed to tariff increases by about 3% in 2006 and another 3% in 2007. Instead of increasing, the tariff for 2006 was lowered by 5%, creating headroom to increase by 11% in 2007. The decrease in tariff in 2006 was the first in five years. Fingrid's tariffs are very competitive in a European benchmark context.

Operations

Fingrid's operations are stable and operating profits are expected to be steady over the next couple of years. The financial impact of the Fenno-Skan investment is expected to be relatively limited. In addition, Fingrid has an excellent operational track record compared with its peers. The company has come out in the top tier in several international benchmark studies of maintenance and grid operation in recent years.

Fingrid's grid networks are well scaled for domestic transmission needs, and represent a significant strategic and economic asset. The level of import compared with export generally depends on the supply of hydropower in the Nordic market. In a normal year in the Nordic power system, Finland is a net importer of electricity, with import primarily from Russia and export to Sweden. When hydro levels are low in the Nordic system, the transit between Russia and Sweden and the rest of the Nordic countries becomes even higher. Fingrid has managed such situations well without disturbances in the domestic grid, although cross-border capacity has at times experienced some minor disruptions due to technical failures.

Table 1

Fingrid Oyj Operating Statistics

	--Year ended Dec. 31--				
	2005	**2004**	**2003**	**2002**	**2001**
No. of employees	231	220	218	210	204
No. of customers	99	98	100	100	100
Operations and maintenance cost excluding depreciations (mil. €)	174.1	151.3	155.6	129.7	105.7
Transmission operations					
Units transmitted (TWh)	63.4	67.3	66.6	62.0	59.9
System peak demand (GW)	13.5	13.6	14.0	13.5	13.3
Total transmission lines (kilometers)	13,980	13,980	13,879	13,841	13,843

Transmission energy losses (%)	1.6	1.7	1.9	1.5	1.2
Average transmission revenues (€ cents/kWh)	0.304	0.298	0.284	0.283	0.264
Average operations and maintenance costs excluding depreciations (€ cents/kWh)	0.249	0.225	0.212	0.211	0.176

TWh--terrawatt-hours. GW--Gigawatts. KWh--Kilowatt-hours. N.A.--Not available.

Competitive position/Profitability

Fingrid's profitability is weak but stable, reflecting the voluntary tariff policy adopted by the utility. Although tariff increases for 2006 and 2007 have been approved in principle by customers, Fingrid instead lowered tariffs by 5% in 2006. The cost of power transmission losses remains subject to variations in the volatile and highly competitive Nordic electricity market. Continued high Nordic power prices are expected to have a negative impact on earnings and cash flows.

As a result of increasing costs for energy losses, slightly increasing debt, and expected higher interest rates, operating profit is expected to trend down to well below €100 million over the medium term from €110 million in 2005. This assumes unchanged tariffs after the 5% reduction in 2006 in nominal terms, increasing depreciation charges, and an annual 1%-2% increase in transmission volumes. Of the €168 million of capital loans outstanding, €138 million will be redeemed in 2007 and €30 million in 2009.

Financial Risk Profile

Accounting

Fingrid introduced IFRS in financial 2005. The most notable changes compared with the previous accounting method, Finnish Accounting Standards, were the end of depreciation of intangible assets and the recognition of the fair values of electricity and financial derivatives. An impairment test will now be carried out annually in relation to intangible assets. Fingrid does not apply hedge accounting to its derivative instruments. The instruments are treated as assets and liabilities held for trading and changes in fair value will appear in the profit and loss account. Under normal circumstances, adjustment for derivatives value and depreciation of intangible assets will only have a minor impact (less than 5% of turnover) on the profit and loss account.

Fingrid's capital loans, totaling €168 million, are accounted for as debt and interest payments as interest in the IFRS accounts. This is consistent with Standard & Poor's treatment of the loans when calculating credit ratios, since the loans' equity content is regarded as minimal. The loans remain deeply subordinated to Fingrid's senior debt. In addition, annual interest payments and principal on both the 1997 (€138 million) and the 1999 capital loan (€30 million) can be deferred even after the maturity of the notes if there are not enough distributable reserves. The rating on the capital loans issued in 1997 and 1999 is two notches below the long-term issuer credit rating on Fingrid, one notch translating the subordination, and one the optional deferral. Standard & Poor's expects Fingrid to use the option to redeem the 1997 and 1999 loans in 2007 and 2009, respectively. The capital loans are likely to be replaced by ordinary debt.

Table 1

Reconciliation Of Fingrid Oyj 2005 Reported Amounts With Standard & Poor's Adjusted Amounts*

(Mil. €)

Fingrid Oyj reported amounts							
	Short- and long-term debt	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Operating cash flows**	**Operating cash flows**	**Capital expenditures**
	986	159	159	110	106	106	54
Standard & Poor's adjustments							
Operating leases	7	2	--	--	2	2	1
Surplus cash and near cash investments	(3)	--	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	(1)	--
Other	--	(14)	(14)	(14)	--	--	--
Standard & Poor's total adjustments	4	(12)	(14)	(8)	2	0	1
Standard & Poor's adjusted amounts							
	Debt	**Operating income (before D&A)**	**EBITDA**	**EBIT**	**Operating cash flows**	**Funds from operations**	**Capital expenditures**
	990	147	145	102	108	106	55

*This table illustrates the adjustments made by Standard & Poor's to the company's reported amounts for the year ended Dec. 31, 2005. The first section headed "Fingrid Oyj reported amounts" describes and shows amounts as reported by the company. The second section, headed "Standard & Poor's adjustments," shows our adjustments to these reported amounts. The third section, headed "Standard & Poor's adjusted amounts," describes and shows the amounts we use to calculate the fully adjusted ratios appearing elsewhere in this report. Please note that two reported amounts (operating income before D&A, and operating cash flows) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and operating cash flows and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Corporate governance/Risk tolerance/Financial policies

Although the company's capital structure is bordering on aggressive, its financial policy is characterized by prudent risk management. In addition, the company has diversified funding sources and a well-spread maturity profile, and has adequate back-up lines for liquidity purposes. 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. The dividend yield includes a 2% margin over the 30-year German government bond. The minimum yield is 6%. Over the next five years, the payout ratio is projected to average about 30% (treating the interest on capital notes as dividend).

Cash flow adequacy

In the medium term, FFO to debt is expected to average slightly more than 10%, falling slightly from its 2005 level of about 11%, and FFO coverage of interest expenses is expected to stay at about 4.0x (unchanged from 2005), due to increased interest expenses and lower earnings. The planned redemption of €137 million in capital loan debentures in 2007 could improve the ratio in the longer term. Due to the increase in capital expenditure over the coming years, cash flow is no longer expected to cover capital expenditure over the medium term. Total investments over the next five years are expected to amount to more than €500 million. The annual grid capital expenditure is therefore forecast to rise to €60 million-€70 million per year in the coming years, which is €10 million-€20 million higher than in the past, with depreciation charges averaging about €55 million-€65 million.

Interest payments on capital notes, averaging about 16% of expected total interest expenses over the next five years, are deferrable.

Capital structure/Asset protection

Fingrid's leverage is very high, at about 71.4% in the first quarter of 2005, including capital notes as debt. This is, however, expected to fall to less than 70.0% over the coming years because net profits are expected to be higher than the total debt increase.

Although Fingrid's financial flexibility is restricted by its high leverage and dividend payout policy, this is offset by a flexible regulatory regime--even under the new model--that allows for tariff increases. Fingrid's policy is to cover short-term debt with a cash balance and backup facilities. The utility is tapping the domestic and international money and capital markets, and has Euro CP and MTN programs. Fingrid uses its syndicated revolving credit facility as a backup for short-term debt. Fingrid has a €750 million MTN program, which is used as a long-term funding source.

Fingrid's liquidity position is sound. At June 30, 2006, Fingrid had €206 million in cash and marketable short-term securities. In November 2005, Fingrid signed a seven-year €250 million multicurrency revolving credit facility agreement, replacing the €400 million facility signed in 2002. This new €250 million multicurrency revolving credit facility, together with cash and liquid assets, serves as backup for short-term debt. There are no material financial covenants or material adverse change clauses in the existing credit agreements.

Table 3

Fingrid Oyj Peer Comparison*

(Mil. €)	Fingrid Oyj¶	Energinet.dk SOV	Statnett SF	Terna SpA¶	Red Electrica de Espana S.A.
Corporate credit rating§	AA-/Stable/A-1+	AA+/Watch Neg/A-1+	AA/Stable/A-1+	AA-/Stable/A-1+	AA-/Stable/A-1+
	--Fiscal year ended Dec. 31, 2005--				
Total revenues	319.1	4,425.0	5,244.0	1,087.4	865.7
Net income from continuing operations	55.7	555.0	174.0	297.9	153.5
Funds from operations (FFO)	106.5	1,508.0	873.2	469.5	423.1
Capital expenditure	54.5	166.0	671.0	281.2	261.9
Free operating cash flow	53.3	1,740.0	(298.8)	191.3	23.8
Cash and investments	0.0	270.0	509.0	0.0	18.8
Debt	990.2	6,298.0	7,184.6	2,529.0	2,837.4

Common equity	353.8	3,599.0	4,590.6	1,902.2	962.8
Total capital	1,344.0	9,897.0	11,775.2	4,431.2	3,800.3
Adjusted ratios					
EBIT interest coverage (x)	2.7	5.2	1.5	5.4	3.1
FFO interest coverage (x)	4.0	11.7	2.6	5.6	3.8
FFO/debt (%)	10.8	23.9	12.2	18.6	14.9
Discretionary cash flow/debt (%)	4.7	27.6	(9.3)	(1.9)	(2.1)
Net cash flow/capital expenditure (%)	183.2	908.4	75.0	81.6	129.9
Debt/total capital (%)	73.7	63.6	61.0	57.1	74.7
Return on common equity (%)	16.9	16.7	2.7	16.3	16.3
Common dividend payout ratio (unadjusted; %)	11.9	0.0	212.6	87.3	64.5

*Fully adjusted (including postretirement obligations). ¶Excess cash and investments netted against debt. §At Oct. 19, 2006.

Table 4

Fingrid Oyj Financial Summary*

	--Fiscal year ended Dec. 31--	
	2005	**2004**
Total revenues	319.1	303.8
Net income continuing	55.7	49.5
Funds from operations (FFO)	106.5	105.5
Capital expenditures	54.5	50.4
Free operating cash flow	53.3	52.1
Debt	990.2	995.4
Common equity	353.8	304.6
Total capital	1,344.0	1,300.0
EBIT interest coverage (x)	2.7	2.5
FFO interest coverage (x)	4.0	3.4
FFO/debt (%)	10.8	10.6
Discretionary cash flow/debt (%)	4.7	4.6
Net cash flow/capital expenditure (%)	183.2	196.3
Debt/total capital (%)	73.7	76.6
Return on average equity (%)	16.9	16.2
Common dividend payout ratio (unadjusted; %)	11.9	13.4

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Additional Contact: Infrastructure Finance Ratings Europe; InfrastructureEurope@standardandpoors.com