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October 24, 2011

Summary:
Fingrid Oyj

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

Rationale

The rating on Finnish transmission system operator (TSO) Fingrid Oyj reflects the company's stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'a', as well as Standard & Poor's opinion that there is a "high" likelihood that The Republic of Finland (AAA/Stable/A-1+) would provide timely and sufficient extraordinary support in the event of financial distress.

Fingrid's SACP reflects its strategic monopoly position as the electrical TSO in Finland. It further reflects Fingrid's strong record of network efficiency, a transparent and favorable regulatory framework, and the company's clear strategic focus on the national electricity transmission network and enhancement of the Nordic electricity market. The SACP and the ratings are constrained by what we regard as Fingrid's "significant" financial risk profile in light of our expectations of relatively high leverage resulting from an extensive ongoing investment program, and some volume risk.

The "high" likelihood of extraordinary support is based on our assessment of Fingrid's "very important" role to Finland, reflecting its clear strategic importance to the government as the monopoly provider of an essential and critical service. It is further based on the company's "strong" link to the government, reflecting the state's majority ownership, which we expect to continue over the long term.

Key business and profitability expectations

Fingrid announced in September 2011 that it will increase grid tariffs by an average of 30% at the beginning of 2012, the first year in the new four-year regulatory period. Although an increase was expected, the magnitude of the rise is positive and will support the company's operating cash-flow generation in a period when investment requirements are significant. In the current regulatory period (2008-2011), we estimate that Fingrid has undercharged its customers by some €250 million compared with what was allowed under the regulatory framework. We understand Fingrid will not claim this amount back from customers as a result of an agreement with its new majority owners. This deficit was incurred due to Fingrid's previous ownership structure, whereby its largest owners were also its largest customers.

Fingrid's EBITDA margin was largely unchanged at 30% for the 12 months ended June 30, 2011, compared with 32% in the previous corresponding period. We expect that this ratio will gradually improve over the near to medium term as the planned tariff increase will directly result in higher margins.

Key cash flow and capital-structure expectations

Fingrid has initiated an ambitious €1.7 billion investment plan for 2010-2020, which includes enhancement of the transmission grid, strengthening of cross-border connections, and investments in reserve power. For the first six months of 2011, capital expenditure stood at €111 million, compared with €160 million for full-year 2010. In our view, this heavy investment program is likely to lead to continuing negative free operating cash flows and slightly increased debt levels, although the planned anticipated tariff increase will offset this to some extent.

For the 12 months ended June 30, 2011, funds from operations (FFO) to adjusted debt strengthened to 12.2%, compared with 11.6% in the corresponding previous period. Adjusted FFO to interest and debt to capital stood at 5.4x and 66% compared with 5.3x and 65%, respectively, in the same period in 2010. We expect the ratio of FFO to debt to remain above 10% over the near term and gradually move towards 13%-15% in the medium term, a level which we consider commensurate with the current SACP.

Liquidity

The short-term rating is 'A-1+'. We view Fingrid's liquidity position as adequate, in our view. Projected sources of liquidity--mainly operating cash flow, cash on the balance sheet and available committed credit lines--exceed projected uses that mainly consist of committed investments, debt maturities, and dividends by more than 1.2x over the next 12 months. In line with our liquidity criteria, we have included only debt maturities for the next six months as Fingrid has certain strong credit characteristics, namely well-established and solid relationships with its core Nordic and international banks, a high standing in the credit markets as evidenced by a recent bond issuance at very tight levels, and generally prudent financial risk management.

As of June 30, 2011, the group had €240 million in cash and marketable short-term securities and access to a fully undrawn €250 million revolving credit facility, maturing in April 2016. In addition, we understand that Fingrid issued a Swedish kronor 1.0 billion (about €109 million) bond in October 2011. This compares with €400 million in short-term debt, of which €270 million is due by the end of 2011.

We expect Fingrid to generate similar FFO in 2011 as it did in 2010. We expect this to improve in 2012 as a result of the planned tariff increase. We believe that discretionary cash flow will likely remain modestly negative over the near to medium term, due to the company's extensive investment program and gradually increasing dividends. The deficit will be covered with additional debt.

We will continue to closely monitor Fingrid's liquidity policies and funding plans closely in light of the large investment program. At the current rating level, we assume Fingrid will maintain a prudent approach to liquidity management and pre-funding of capital expenditures. We expect that Fingrid will continue to enjoy good access to the capital markets and fund most of its investments with longer-dated bonds.

Outlook

The stable outlook reflects our expectation that we would affirm the ratings on Fingrid, in accordance with our criteria on government-related entities, even if we were to lower our assessment of the company's SACP by one notch. It further reflects our belief that Fingrid will remain strategically important to the Finnish government as Finland's monopoly TSO, and that there will be no material changes in government ownership in the near to medium term.

We could raise the ratings if the likelihood of government support were to further increase, for example if the link between Fingrid and the Finnish state were to further strengthen. Conversely, we could lower the ratings if we perceived a weakening of the likelihood of extraordinary state support, for example, in the event of an unexpected dilution of the government ownership stake. In addition, we could lower the ratings if Fingrid's SACP were to weaken by more than one notch. This could result from a change in the group's financial policies, an unexpected shortfall in liquidity, and a significant negative impact on its credit measures and financial risk profile.

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