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Research:
Fingrid Oyj

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Corporate Credit Rating

AA-/Stable/A-1+

Business Profile

[1] 2 3 4 5 6 7 8 9 10

Financial policy:
Moderately aggressive

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+

Company Contact

Major Rating Factors

Strengths:

- Monopoly transmission operator in the stable macroeconomic environment of Finland, characterized by steady growth in electricity demand;
- Favorable cost-plus regulation allowing significant freedom in tariff-setting, capital expenditures, and quality settings; and
- 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 (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.

During 2002, Fingrid transmitted 62 terrawatt-hours of electricity--equivalent to three-quarters of Finland's total consumption for the same period--to about 100 customers through its 14,000 kilometer electricity grid. Electricity consumption in 2002 grew by 3.3% on 2001--slightly higher than the historic growth rates of about 2% per year over the past 10 years. Standard & Poor's expects 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. Capital expenditure needs in infrastructure are expected be moderate in the medium term, and will mainly be focused on grid refurbishment. In 2002, the project to increase cross border capacity between Russia and Finland was completed, adding 400 megawatts (MW) in transmission capacity from Russia.

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, at 80% at Dec. 31, 2002, including capital notes (67% excluding capital notes), but is expected fall to about 70% over the next six years due to moderate investment needs and the early redemption of €137 million ($147.9 million) of capital notes. Funds from operations (FFO) interest cover was 3.0x at Dec. 31, 2002, 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 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 of guarantees or deposits from the participants. In 2002, Fingrid--in addition to the other Nordic transmission system operators--acquired a 20% stake in the newly created Nord Pool Spot AS, which is the exchange for physical power trade in the Nordic countries. This event has no credit impact for Fingrid.

Liquidity.

At year end 2002, Fingrid had €101 million in cash and marketable short-term securities. In December 2002, Fingrid signed a €400 million multicurrency revolving credit facility expiring December 2007, replacing its former bank revolver of €391 million. This new facility, together with cash and liquid assets, serves as backup for short-term use. 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, 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 moderate investment needs in the medium term, a reduction in debt is likely, as is a gradual improvement in FFO interest coverage ratios.

Business Description

Fingrid began operations on Sept. 1, 1997, following the transfer of the main grid businesses of state-owned electric utility Imatran Voima Oy (now known as Fortum Oyj; Fortum) and Pohjolan Voima Oy (PVO), a private sector electric consortium to the company. 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 power system operations (power system operations, balance management and grid operation), which was previously managed by the wholly owned subsidiary Fingrid System Oy (merged into the parent company from Dec. 31, 2002). The group also includes the wholly owned subsidiary Fingrid Varavoima Oy, which manages the 672-MW gas turbine reserve capacity.

In July 2002, Fingrid became owner of 20% of the Nordic physical electricity exchange, Nord Pool AS, along with the other Nordic system operators, which also own 20% each (Denmark is split, with the two existing system operators each owning 10%). At the same time, Fingrid's 50%-owned Finnish electricity exchange, El-Ex Electricity Exchange Ltd., was merged into Nord Pool Spot AS. 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

Excellent operational track record.

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 2002, Fingrid was in the top tier 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 2002 (13,550MW), Fingrid's supply experienced virtually no disturbances. Electricity losses accounted for 1.5% of the volume transmitted in 2002, which is low for the industry.

A stable growth market environment and increased transmission capacity.

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.

In 2002, Fingrid finalized the construction of a 400 kilovolt interconnection from Russia, adding yet another 400 MW in additional import capacity. The entire import capacity of 1,300 MW is now fully reserved by electricity importers. In fiscal 2002, Fingrid's turnover increased to €273 million, from €241 million in 1998, owing partly to exceptional market conditions, with very high spot prices at the end of 2002 that led to higher-than-normal turnover in the system balance operations. Tariffs have basically remained unchanged between 2000 and 2003. Operating profit in 2002 increased to €91 million in 2002 from €85 million in 2001, mainly as a result of extraordinary bottleneck revenues caused by pricing imperfections in the Nordic pricing area. The trend for operating profit is expected to be stable over the next couple of years, despite tariffs negotiated for the period 2003-2005 remaining at 2001 levels.

Fingrid's grid networks are well scaled 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.

Light-handed regulation of Fingrid's natural monopoly operations.

Finland's regulatory regime is flexible and underpins the ratings Fingrid. Electricity transmission and distribution are natural monopolies, regulated and monitored by the Energy Market Authority, an independent government agency. The light-handed cost-of-service regulation stipulates that network tariffs must be reasonable, public, and non-discriminatory. Network companies are allowed to cover their costs and make reasonable ROE, and 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 emergency reserve gas turbines through revenues from power system operations (former Fingrid System Oy), as 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). 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 2002, all transit capacity from Russia was sold. On the Russian side, the electricity giant RAO UES of Russia (B/Stable/--) is responsible for export and transmission arrangements.

New grid service contracts, valid for 2002-2004, were negotiated at the end of 2001, and came into force on Jan. 1, 2002. Tariffs during this period will be based on the 2001 price level, with a permitted adjustment for inflation throughout the period, although such an adjustment will not be made in 2003.

Table 1 Fingrid Oyj Operating Statistics

	--Year ended Dec. 31--				
	2002	**2001**	**2000**	**1999**	**1998**
Generic data					
GDP growth (%)	2.9	0.6	5.2	4.0	5.1
Inflation (%)	2.6	1.1	3.0	1.2	1.5
Per-capita income ($)	30,010	25,480	24,350	24,000	23,840
Fingrid data					
No. of employees	210	204	270	273	272

No. of customers	100	100	100	98	103
Operations and maintenance excluding depreciations (mil. €)	129.7	105.7	96.8	91.6	87.5
Transmission operations					
Type of network (kv)	**400/220/110**				
Units transmitted (TWh)	62.0	59.9	64.7	59	55.8
System peak demand (GW)	13.5	13.3	13.2	13.1	13.1
Total transmission lines (kilometers)	13,841	13,843	13,843	13,693	13,855
Underground lines/total lines (%)	0.72	0.72	0.72	0.72	0.72
Transmission energy losses (%)	1.5	1.2	1.5	1.5	1.54
Avg. transmission revenues (€ cents/kWh)	0.255	0.253	0.259	0.277	N.A.
Avg. operations and maintenance costs excluding depreciations (€ cents/kWh)	0.211	0.176	0.150	0.155	N.A.
Kv--kilovolts. TWh--terrawatt-hours. GW--Gigawatts. KWh--Kilowatt-hours. N.A.--Not available. €1 = $0.944.					

Financial Policy: Moderately aggressive

Setting aside the flexible regulation and stable revenue base, Fingrid's financial profile could be seen as weak. At year-end 2002, total debt to capital was 78% including capital notes (67% when treating the capital notes as equity; see Capital Structure and Financial Flexibility). Although Fingrid's capital structure is bordering on aggressive, its financial policy is characterized by prudent risk management; currency risks are fully hedged, and the interest rate risk is adjusted to the to three-year grid-service contract period. In addition, the company has diversified funding sources and 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. A five-year fixed-margin dividend level was decided at the time of Fingrid's formation, and it is reset at the end of each period. The dividend is 1.5% over the five-year Finnish government bond. Over the next five years, the payout ratio is projected to average about 60% (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 through refined operation methods and maintenance scheduling. Furthermore, the cost for power transmission losses has decreased significantly since Fingrid began operations, owing to the price pressure in the highly competitive Nordic electricity market. 95% of expected energy losses are hedged during the remaining tariff period, ending 2004.

Operating profit is expected to remain at about €85 million-€90 million per year, while profit before tax is expected to improve to about €37 million over the next five to six years from about €30 million, due to lower debt costs. This assumes unchanged tariffs in real terms and increasing depreciation charges, as well as an annual 1%-2% increase in transmission volumes. The pre-tax interest coverage ratio is expected to improve slightly to about 2.4x over the next five years, from 2.1x in 2002. 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. In the medium term FFO to debt is expected to average a weak 11%, and FFO coverage of interest expenses is expected to average about 3.5x, compared with 3.3x in 2002. The planned redemption of €137 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 180% over the next five 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 €40 million and €50 million per year for the same period, with depreciations averaging between about €50 million and €60 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. This build-up is expected to continue over the next five years.

Table 2 Fingrid Oyj Profitability					
	--Year ended Dec. 31--				
	2002	2001	2000	1999	1998
Income statement (mil. €)					
Gross revenues	274	242	236	235	226
Operating expenses (excluding DD&A)	130	105	99	92	88
Depreciations and amortizations	53	52	49	47	41
EBITDA	147	138	140	145	141
Interest incurred	44	41	44	48	43
Net interest incurred	41	41	41	46	41
Net income	39	34	37	2	39
Earnings protection					
Pretax interest coverage (x)	2.1	2.1	2.1	2.1	2.3
Net pretax interest coverage (x)	2.2	2.1	2.1	2.1	2.4
EBITDA interest coverage (x)	3.4	3.4	3.2	3.0	3.3
Total debt/EBITDA (%)	7.3	7.5	7.4	7.5	7.4
Return on avg. equity (%)	15.3	14.9	17.4	18.1	21.2
Annual expenditure growth (excluding DD&A)	23.7	6.1	7.9	4.7	247.4
Total operating expenditures/revenues (%)	47.3	43.3	41.9	39.0	38.6
Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend. DD&A--Depreciation, depletion and amortization.					

Table 3 Fingrid Oyj Cash Flow					
	--Year ended Dec. 31--				
	2002	2001	2000	1999	1998
Cash flow (mil. €)					
Net income	39	34	37	34	39
Depreciation	53	52	49	47	41
Funds from operations (FFO)	100	94	96	95	96
Preferred dividends	11	11	11	9	9
Common dividends	7	7	7	7	2
Net cash flow (NCF)	82	75	78	78	84
Net capital expenditures (capex)	48	47	35	30	82
Discretionary cash flow	(12)	(5)	62	27	13
Cash flow adequacy					
Capex/avg. total capital (%)	4	4	3	2	7
NCF/capex (%)	171	159	224	260	102
NCF/capex and net acquisitions (%)	171	159	224	74	102
FFO/avg. total debt (%)	9	9	9	9	9
FFO/avg. net debt (%)	10	9	9	9	9
FFO interest coverage (x)	3.3	3.3	3.2	3.0	3.2
FFO net interest coverage (x)	3.5	3.3	3.3	3.1	3.4
Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend. DD&A--Depreciation, depletion and amortization.					

Capital structure and financial flexibility.

Fingrid's leverage is very high, at about 78% at year-end 2002, down from 86% in 1998, and this ratio is projected to continue to reduce slightly over the next five years. The utility issued €137.9 million in 30-year capital notes in 1997, and €30 million in 30-year debentures of a capital loan nature 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 Fingrid 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%. If all the capital notes are treated as equity, Fingrid's leverage would decrease to about 67% at year-end 2002.

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 CP programs. Fingrid uses its syndicated revolving credit facility as a backup for short-term debt.

Fingrid's liquidity position is sound. At year-end 2002, Fingrid had €101 million in cash and marketable short-term securities. In December 2002, Fingrid signed a €400 million multi-currency revolving credit facility expiring December 2007, replacing its former bank revolver of €391 million. This new facility, together with cash and liquid assets, serves as back-up for short-term use. There are no material financial covenants or material adverse change clauses in the existing credit agreements.

Table 4 Fingrid Oyj Capital Structure

	--Year ended Dec. 31--				
	2002	**2001**	**2000**	**1999**	**1998**
Balance sheet (mil. €)					
Cash and short-term financial investments	101	64.3	52	60	37
Net plant	1,032	1,033	1,038	1,039	974
Total assets	1,379	1,338	1,337	1,358	1,275
Short-term debt	178	250	336	265	326
Long-term debt	893	785	697	822	713
Common equity	269	242	221	199	171
Total capitalization	1,339	1,277	1,254	1,286	1,210
Balance-sheet ratios (%)					
Short-term debt/total capital (%)	13	20	27	21	27
Long-term debt/capital (%)	67	61	56	64	59
Common equity/total capitalization (%)	20	19	18	16	14
Total debt/total capitalization (%)	80	81	82	84	86
Net debt/total capitalization (%)	80	81	82	84	86
Treating 100% of preferred capital notes (PCNs) as debt, and 100% of interest on PCNs as dividend.					

Table 5 Fingrid Oyj Peer Comparison

Company	**Statnett SF**	**Eltra amba**	**Fingrid Oyj**	**Elkraft System amba**	**Elkraft Transmission amba**
Corporate credit rating	AA+/Stable/A-1+	AA/Stable/A-1+	AA-/Stable/A-1+	AA/Stable/A-1+	AA-/Stable/A-1+
Year of data	2001	2001	2002	2002	2002
Country	Norway	Denmark	Finland	Denmark	Denmark
Type of operations	Transmission and system operator	Transmission and system operator	Transmission and system operator	System operator	Transmission operator
Financial policy	Moderate	Moderate	Moderately aggressive	Moderate	Moderate

Transmission volume (TWh)	148	20.9	62	14.3	14.3
Grid network length (kilometers)	10,300	1,000	14,000	N.A.	565
Financial statistics (mil. €)					
Gross revenue	2,086.6	813.6	274	481.2	44
EBITDA	192.9	81.0	144	5.1	35
Funds from operations (FFO)	148.6	106.7	100	(3.0)	33.2
Total assets	1,672.7	531.7	1379.3	333.8	370
Total debt	761.5	221.4	1070.2	109.2	173.4
Net debt	575.4	217.8	1057.2	100	172.8
FFO interest coverage (x)	3.9	9.3	3.3	0.25	4.9
FFO/net debt (%)	26.4	49.0	9.6	(0.03)	19
Total debt/total capital (%)	55.0	47.0	80.0	97.0	52
TWh--Terrawatt-hours. N.A.--Not available.					

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