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Research Update:

Finnish Electricity Transmission Operator Fingrid Oyj Lowered To 'A+/A-1' Following Downgrade Of Finland; Outlook Stable

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Overview

- On Oct. 10, 2014, we lowered our rating on Finland to 'AA+' from 'AAA'.
- We consider Finnish electricity transmission system operator Fingrid Oyj to be a government-related entity with a "high" likelihood of extraordinary government support in the event of financial distress, and we believe that the government's ability to support Fingrid has weakened.
- We are therefore lowering our long- and short-term global scale ratings on Fingrid to 'A+/A-1' from 'AA-/A-1+', but affirming our 'K-1' Nordic regional scale rating on the company.
- The stable outlook reflects our assumption that Fingrid will remain strategically important to the Finnish government as Finland's monopoly transmission system operator, with stable and predictable underlying earnings supported by a favorable regulatory framework.

Rating Action

On Oct. 14, 2014, Standard & Poor's Ratings Services lowered its long- and short-term global scale corporate credit ratings on Finnish electricity transmission system operator (TSO) Fingrid Oyj to 'A+/A-1' from 'AA-/A-1+'. The outlook is stable.

At the same time, we affirmed our 'K-1' Nordic regional scale rating on the company.

Rationale

The rating action follows our downgrade of Finland, and reflects our belief that the Finnish government's ability to support Fingrid has weakened (see "Research Update: Finland Long-Term Ratings Lowered To 'AA+' On Weak Economic Growth; Outlook Stable," published Oct. 10, 2014, on RatingsDirect).

The ratings on Fingrid reflect the company's stand-alone credit profile (SACP), which we assess at 'a', based on its "excellent" business risk profile and "intermediate" financial risk profile. The long-term rating further includes one notch of uplift based on our opinion that there is a "high" likelihood that the Republic of Finland would provide timely and sufficient extraordinary support to Fingrid in the event of financial distress.

In accordance with our criteria for government-related entities (GREs), our view that there is a "high" likelihood of extraordinary support from the Republic of Finland is based on our assessment of Fingrid's:

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- "Strong" link with the Finnish government, which owns 53% of the shares, with 71% of the voting rights; and
- "Very important" role, as Finland's monopoly TSO, given its clear strategic importance for the government in ensuring electricity transmission stability and development of the transmission grid.

Fingrid's "excellent" business risk profile is mainly based on our assessment of the Finnish regulatory framework for TSOs, which regulates virtually all of Fingrid's operations. We view the regulatory framework as stable and predictable. The current methodology for calculating allowed profit has been in place since 2005 with only minor adjustments, and we expect no major changes in the medium term, although we note that some modifications may be made for the next regulatory period, 2016-2019. We also assess the framework as having a good level of cost recoverability, with some minor weaknesses. The company's allowed profit under the regulatory framework covers all operational costs, with the exception of some incentives embedded in the regulation. These incentives can, however, be both positive or negative and are limited. Furthermore, Fingrid operates an efficient grid, as evidenced by several international benchmarking studies, which should make the company well placed to meet the regulators' expectations.

Since 2011, when the Finnish government became the majority owner, the company has gradually increased its tariffs, in turn increasing return on capital to 6.8% in 2013. Compared with that of other regulated utilities, Fingrid's profitability is, however, relatively volatile. While profits are conditioned under the regulatory framework, some elements, such as congestion revenues, are difficult to predict, which creates short-term volatility in profitability, and which we see as a relative weakness.

Fingrid's intermediate financial risk profile reflects relatively modest leverage, low cash flow volatility, and our forecast of funds from operations (FFO) to debt of 13%-16% over 2014-2016. Fingrid has undergone a significant investment program in recent years. However, we expect the company will invest about €140 million-€150 million annually over the next few years--significantly less than the €227 million invested in 2013. At the same time, the company has been increasing its tariffs to bring profits to the level allowed under the regulatory framework. This has improved FFO to debt from to 14.8% in 2013 from 9.9% in 2011. The tariff increases are somewhat offset by increasing dividend payouts following the company's revised dividend policy, which states that substantially all of the parent company's profits should be distributed as dividends. In addition, following higher-than-expected market-related income (including congestion income) and lower costs (including cost of reserves) in 2014, Fingrid has announced a tariff decrease of 2% for 2015.

Under our base case, we assume:

- No changes to the regulatory framework, as the current regulatory period lasts until the end of 2015.
- A tariff decrease of 2% in 2015 following the tariff increase of 8% from the beginning of 2014.
- Net investments of about €130 million annually in 2014 and 2015.

Based on these assumptions, we arrive at the following credit measures for 2014 and 2015:

- FFO to debt of about 13%-16%.

Liquidity

We assess Fingrid's liquidity position as "adequate" under our criteria. We consider that Fingrid's liquidity sources will exceed its funding needs by over 1.1x in the next 12 months and that sources will exceed uses even if EBITDA declines by 10%. We further believe that the company has a sound relationship with its banks, a satisfactory standing in the credit markets, and prudent risk management. In addition, Fingrid's revolving credit facility is free from financial covenants that could prevent the company from drawing under it.

Principal liquidity sources:

- €203 million in cash and marketable securities as of June 30, 2014;
- Access to an undrawn €250 million committed revolving credit facility, maturing in April 2018; and
- Projected FFO of about €160 million-€175 million for the next 12 months.

Principal liquidity uses:

- Short-term debt maturities of €248 million as of June 30, 2014;
- Annual net investments of about €130 million; and
- Annual dividends broadly similar to the €82 million (including extraordinary dividend) paid in the first half of 2014.

Outlook

The stable outlook reflects our assumption that Fingrid will remain strategically important to the Finnish government as Finland's monopoly TSO, with stable and predictable underlying earnings supported by a favorable regulatory framework. Based on this, we anticipate no significant changes in Fingrid's SACP. For the current SACP, we anticipate that the ratio of FFO to debt will remain at about 13%-15%.

Upside scenario

We could raise the ratings if Fingrid's SACP improved one notch to 'a+'. We believe that this would most likely be an effect of Fingrid's financial risk profile improving toward the higher end of "intermediate," for example, if FFO to debt improved sustainably to about 20%. We view this as unlikely in the near term, given the significant investment program and our expectation of increasing dividend payments. We could also raise the ratings if we revised up the likelihood of extraordinary government support to "very high," for example, if the government strengthened its control over Fingrid, either by materially increased ownership or other means.

Downside scenario

We currently see limited downside to the ratings. Assuming no change in the ratings on Finland or our assessment of extraordinary government support, we couldlower the ratings if we revised downFingrid's SACP to 'bbb' or lower. Although unlikely at this stage, this could result from a major regulatory overhaul, or a significant deterioration of Fingrid's credit measures and financial risk profile to the "aggressive" category.

Ratings Score Snapshot

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

Business risk: Excellent

- Country risk: Low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a

Sovereign rating: AA+

Likelihood of local government support: High (+1 notch from SACP)

Related Criteria And Research

Related Criteria

- General Criteria: Standard & Poor's National And Regional Scale Mapping Tables - September 30, 2014
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - January 02, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry - November 19, 2013

- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - December 09, 2010
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Commercial Paper - April 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008

Related Research

- Country Risk Assessments Update: May 2014, May 14, 2014
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013

Ratings List

	Ratings	
	To	From
Fingrid Oyj		
Corporate credit rating		
Foreign and Local Currency	A+/Stable/A-1	AA-/Negative/A-1+
Nordic Regional Scale	--/--/K-1	--/--/K-1
Senior Unsecured		
Foreign and Local Currency	A+	AA-
Commercial Paper		
Local Currency	A-1	A-1+

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