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Research Update:

Finnish Electricity Operator Fingrid Outlook Revised To Negative On Same Sovereign Action; 'AA-/A-1+' Ratings Affirmed

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Overview

- On April 11, 2014, we revised our outlook on our 'AAA' ratings on the Republic of Finland to negative.
- We consider Finnish electricity operator Fingrid Oyj a government-related entity with a "high" likelihood of extraordinary government support in the event of financial distress.
- We are therefore revising our outlook on Fingrid to negative and affirming our 'AA-/A-1+/K-1' ratings on the company.
- The negative outlook reflects our view that the Finnish government's ability to provide support to Fingrid in a financial stress scenario could potentially weaken, and that a downgrade of Finland would likely result in a downgrade of Fingrid.

Rating Action

On April 14, 2014, Standard & Poor's Ratings Services revised its outlook on Finnish electricity transmission system operator (TSO) Fingrid Oyj to negative from stable. At the same time, we affirmed the 'AA-' long-term and 'A-1+' short-term corporate credit ratings and 'K-1' Nordic regional scale rating.

Rationale

The outlook revision follows our similar action on the Republic of Finland (see "Outlook On Finland Revised To Negative On Subpar Growth Prospects; 'AAA/A-1+' Ratings Affirmed", published April 11, 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 two notches 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:

- "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 all of Fingrid's cash flows. 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. 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 the incentives embedded in the regulation. These incentives are, however, contained. We also take comfort in that 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. While congestion revenues do not affect the allowed profit under the regulatory framework, we see the short-term volatility in profitability 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 14%-16% over the next few of years. Fingrid has undergone a significant investment program in recent years. However, we expect the company will invest about €140 million annually over the next few years, which is significantly lower 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 our expectation of increasing dividend payouts. While there is currently no stated policy we expect that dividends in the next few years could be significantly higher than the €13 million the company paid in 2013.

Under our base case, we assume:

- No changes to the regulatory framework, as the current regulatory period lasts until the end of 2015.
- Continuing tariff increases, with an 8% increase from the beginning of 2014 followed by an increase of 7% in 2015.

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

- FFO to debt of about 14%-16% in 2014 and 2015.

Liquidity

The short-term rating on Fingrid is 'A-1+'. 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.

Principal Liquidity Sources

- €217 million in cash and marketable securities as of Dec. 31, 2013;
- Access to an undrawn €250 million committed revolving credit facility, maturing in April 2018; and
- Projected FFO of about €160 million for the next 12 months.

Principal Liquidity Uses

- Debt maturities of €319 million, of which €214 million is related to commercial paper;
- Capital expenditure of approximately €150 million; and
- Proposed dividends of €7 million for 2013. We do not anticipate that any potential increase in dividends would impair the group's "adequate" liquidity position.

Outlook

The negative outlook reflects our view that the Finnish government's ability to provide support to Fingrid in case of financial stress could potentially weaken, and that a downgrade of Finland would likely result in a downgrade of Fingrid.

Downside scenario

In line with our methodology for GREs, we could lower the rating on Fingrid if we lowered the rating on Finland.

We could also lower the rating if we revised downward our assessment of the likelihood of support from the government. This could happen, for example, if the government no longer held a majority stake in Fingrid. We could also lower the rating if Fingrid's SACP weakened to 'bbb+' or lower. Although unlikely at this stage, this could result from a major regulatory overhaul, a change in the group's financial policies, or a significant deterioration of Fingrid's credit measures and financial risk profile.

Upside scenario

All else remaining equal, a revision of the outlook on Finland to stable would lead to a similar rating action on Fingrid.

We could also revise the outlook to stable if our assessment of Fingrid's SACP improved to 'a+'. This could happen if Fingrid's credit measures improved to the higher end of our "intermediate" financial risk profile range, 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.

Ratings Score Snapshot

Corporate Credit Rating: AA-/Negative/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: AAA
- Likelihood of local government support: High (+2 notches)

Related Criteria And Research

Related criteria
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9,

2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008

Related research

- Country Risk Assessments Update: February, Feb. 11, 2014
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013

Ratings List

CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Fingrid Oyj		
Corporate Credit Rating	AA-/Negative/A-1+	AA-/Stable/A-1+
Nordic Regional Scale	--/--/K-1	--/--/K-1
Senior Unsecured	AA-	AA-
Commercial Paper	A-1+	A-1+

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