FitchRatings

FITCH AFFIRMS FINGRID OYJ AT 'A'; OUTLOOK STABLE

Fitch Ratings-London-15 January 2016: Fitch Ratings has affirmed Finland-based utility Fingrid Oyj's Long-term Issuer Default Rating (IDR) at 'A,' with a Stable Outlook, senior unsecured rating at 'A+' and Short-term IDR at 'F1'.

The affirmation reflects the introduction of a higher allowed return on capital in the new eight-year regulatory period, which commenced on 1 January 2016. We expect Fingrid's resulting financial profile to position the company more strongly within the 'A' rating. We expect revenues to increase substantially during the period, offset by a higher assumption for dividend payments.

The new regulatory settlement allows for a higher return on capital and does not capture congestion charging in the annual profit target. These aspects are offset in the new settlement by no inflation allowance for the cost of materials.

KEY RATING DRIVERS

Tariffs Increasing

We expect the regulatory settlement to result in Fingrid introducing higher tariffs for its customers, gradually bringing regulatory profits in line with the new allowance. We expect funds from operations (FFO) adjusted net leverage to improve to close to 4.5x by 2017, which is strong for the rating. We expect capital expenditure to remain controlled, averaging about EUR165m for 2015-2017, largely reflecting strengthening work in the west of Finland to connect new renewables schemes and alleviate congestion. Fitch-calculated EBITDA and FFO exclude income for congestion charges, which we treat as being held for congestion-related projects.

Improving Free Cash Flow

Fitch expects capex to be lower than in previous years, averaging EUR110m over 2015-2025. Capex peaked in 2013 at EUR229m due to the completion of the Estlink 2 interconnector and reserve power capacity. Fingrid's ongoing investment programme is focused on the reinforcement of the Finnish high-voltage transmission grid.

A substantially higher dividend of EUR82m was paid in 2014, reflecting a higher distribution policy and high declared profits following tariff increases. Declared dividends have historically been much smaller due to low tariffs and resulting low net income. We expect dividend payments to increase again, reflecting the increase in allowed profits in the current regulatory period.

Highly Supportive Regulatory Framework

Fingrid benefits from a stable and highly supportive regulatory framework. The Finnish regulator, Energiavirasto (EV), establishes regulatory-allowed profit using a building block rate of return methodology under which Fingrid sets its own tariff, which is unique for a European transmission system operator (TSO). We expect Fingrid to raise its tariffs in steps (14% increase on average tariff applied for 2016) to the new maximum allowed tariff, rather than in a large one-off rise.

A new regulatory period commenced on 1 January 2016 and includes a considerable increase in the allowed profit. This is driven by a more favourable calculation of the cost of debt, based on 10-year average borrowing rates, or current borrowing rates, whichever is the higher, protecting Fingrid from the current sustained low interest rates. The regulatory methodology has been reset for eight years, with a review of allowed costs after four years.

No State Support Included

In accordance with Fitch's parent and subsidiary rating linkage methodology, the rating does not incorporate any uplift, despite the Finnish government (AAA/Negative/F1+) holding a 53% stake in Fingrid (70.9% voting rights). The company operates on an entirely commercial basis, with no tangible financial support from its majority owner.

KEY ASSUMPTIONS
Fitch's key assumptions within our rating case for the issuer include:
- Fingrid gradually raises tariff from 2016 onwards, reaching the maximum regulatory allowed profit under the new regulatory settlement from 2017 onwards.
- Gradually declining EBITDA from 2018 reflecting the impact of low interest rate environment on regulatory WACC (10-year average sovereign bond yield is expected to decrease).
- Congestion income not included in EBITDA or FFO as Fitch does not regard it as cash available for debt service.
- Average capex of EUR165m for 2015-2017 and EUR110m over 2015-2025.
- Dividend payments to increase substantially reflecting higher earnings and the company's dividend policy to distribute substantially all of parent company's profit as dividend.

RATING SENSITIVITIES
Positive: future developments that may, individually or collectively lead to positive rating action include:
-FFO adjusted net leverage falling below 4.5x, net debt/RAB falling below 45%, FFO gross interest rising above 6.5x on a sustained basis.
-Evidence of stronger links with the parent (eg tangible government support).

Negative: future developments that may, individually or collectively, lead to negative rating action include:
- FFO adjusted net leverage rising above 5.5x, net debt/RAV above 60%, FFO interest coverage falling below 4.0x on a sustained basis.

LIQUIDITY
Fingrid's liquidity is adequate to cover negative free cash flow and short-term debt maturities. Fingrid has a stated financial policy in place to hold cash and undrawn credit facilities to cover a minimum of 110% short-term debt. The company's liquidity profile is further supported by predictable operating cash flow and well diversified debt maturity profile (less than 30% of total debt maturing in any given year). In December 2015 Fingrid signed a new five-year EUR300m revolving credit facility containing two one-year extension options.

At 30 September 2015, cash and short term investments stood at EUR102m. Liquidity is adequate to cover expected negative free cash flow of about EUR80m after dividend payments in 2016, EUR138m bond maturities and EUR145m of outstanding commercial paper at the end of September 2015.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362