FitchRatings

Fitch Downgrades Fingrid to 'A'; Stable Outlook

Fitch Ratings - London - 28 January 2019: Fitch Ratings has downgraded Fingrid Oyj's Long-Term Issuer Default Rating (IDR) to 'A' from 'A+'. The Outlook is Stable. The senior unsecured rating has also been downgraded to 'A+' from 'AA-'. Fitch has affirmed the Short-Term IDR at 'F1'.

The downgrade mainly reflects the change in the dividend policy, with a reserve distribution of EUR50.1 million in 2018 (on top of 100% of net profit for the 2017 financial year based on Finnish GAAP), which we expect could be replicated in the next years, although with different amounts. Our updated rating case takes this factor, among others, into account and results in an average funds from operations (FFO) net adjusted leverage of 5.2x for 2018-2023, with a sizeable breach of our negative rating threshold for the 'A+' rating (4.7x). Fingrid has a strong position for the remaining two ratios (net debt/regulatory asset base (RAB) ratio rising to 42% towards end of the plan, dougle-digit FFO interest coverage), which is reflected in the Stable Outlook, together with the very solid business profile.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Fingrid Oyj	LT IDR A Downgrade		A+
	ST IDR F1 Affirmed		F1
senior unsecured	LT A+ Downgrade		AA-

KEY RATING DRIVERS

Dividend Policy and Increasing Leverage: In 2018 Fingrid's board of directors decided to distribute a dividend of EUR173.5 million, including EUR123.4 million paid in April (corresponding to 100% of Fingrid Oyj's net profit for the 2017 financial year based on Finnish GAAP) and an additional EUR50.1 million paid in August. Historically, the company's financial policy has included the distribution of the whole net profit of the parent based on Finnish GAAP, but we believe that the distribution of reserves could occur again in the next few years, also due to the room for leverage increase and the declining net income expected in the plan horizon.

Fitch assumes that every year Fingrid will distribute additional cash as well as the whole net income from the previous year. This results in increasing FFO net adjusted leverage to above the negative rating guideline compared with our previous expectations and is the main driver of the downgrade.

No Impact from GRE Application: The Finnish state (AA+/Positive) holds a controlling stake in Fingrid

(53.1% of shares; 70.9% of voting rights) and in 2016 it defined a minimum level of shareholding of 50.1% in the company, therefore we apply our Government-Related Entities Rating Criteria. However, this has no rating impact and we rate Fingrid on a standalone basis, as we see a weak track record of support, which has also never been needed by the company, and a weak financial implication of Fingrid's default for Finland. We assess the ownership and control as strong, mainly due to the state's commitment to retain control, and the socio-political impact of a default as moderate, as Fingrid's financial default would be unlikely to materially affect its service provision.

Supportive Regulatory Framework: The regulatory environment in Finland is among the most supportive in EMEA, with a long track record of ex-ante regulation, regulatory models applied for long periods (currently 2016-2023, with risk premium of debt updated after four years) and a cooperative interaction with its independent regulator, the Finnish Energy Authority Energiavirasto. Under Finnish law, Fingrid can set its own tariffs within the limits of the maximum allowed profit defined by the authority for each period. The company establishes its capex programme and has a good control over the pattern of its results, limiting cash flow volatility in single years.

Declining Allowed Returns: The pre-tax nominal weighted average cost of capital (WACC) of around 5.3% for 2019 allows Fingrid to earn adequate returns on its RAB. However, we expect WACC to decline to around 4.4% by 2023, as the key risk-free rate is defined as the higher of the 10-year Finnish government bond yield observed on average in April-September in the previous year or the average of the previous 10 years. This mechanism will reduce the group's earnings toward the end of the regulatory period, weakening leverage metrics. However, strong net debt/RAB and interest cover ratios support the Stable Outlook.

Favourable Treatment of Congestion Income: Fingrid receives congestion income related to the price differential between Finland and other Nordpool price areas (mostly Sweden). Cash received from congestion income is unrestricted, but under EU law, this income must be used for reducing cross-border congestion or it will be treated as regulated income. We exclude congestion income from our FFO calculations. However, we see congestion income as a positive factor, since it funds part of Fingrid's planned capex.

Low Risk of Underperformance: Fingrid benefits from the ability to pass on its operational costs to tariffs, as the efficiency requirements embedded in the allowed profit have an only negligible financial impact. The company has been consistently ranked among the most efficient transmission system operators in global peer studies, demonstrating strong operational efficiency.

DERIVATION SUMMARY

Fingrid's 'A' rating is the highest that Fitch assigns to a regulated network in Europe, reflecting a very strong business and financial profile. The company benefits from a benign regulatory framework, which includes the possibility of setting its own tariffs in the context of the allowed profits defined by the authority. This is unique for a European network. Red Electrica (A/Stable) has the same rating but a lower debt capacity (downgrade to A- with an FFO adjusted net leverage of 4.5x compared with 5.7x for Fingrid) mainly due to a less mature and benign regulatory framework. Fingrid's financial leverage is lower than most of its peers, including Terna (BBB+/Stable) and National Grid Electricity Transmission (A-/Stable).

We apply the GRE criteria to the company, which does not have any impact on the rating.

KEY ASSUMPTIONS

- Pre-tax WACC declining to around 4.4% by 2023
- Congestion income of between EUR23 million - EUR31 million per year until 2022, although this is not included in EBITDA or FFO as it is excluded from allowed profits
- Fingrid to achieve maximum regulatory allowed profit over 2018-2023 with no sizable under- or over-recoveries
- Average capex of around EUR115 million through 2018-2023
- Dividends for FY19 in line with previous year. For FY20-FY23, dividends according to policy (100% of net income) with an additional distribution of EUR25 million per year

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- FFO adjusted net leverage below 4.7x, net debt/RAB below 45%, or FFO interest coverage increasing above 6.5x on a sustained basis may lead to an upgrade
- Evidence of stronger links with the parent (i.e. tangible government support) may be positive for the rating

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- FFO adjusted net leverage above 5.7x, net debt/RAB above 55%, or FFO interest coverage falling below 5.5x on a sustained basis may lead to a downgrade

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: Fingrid's funding position is adequate to cover operating requirements, capital expenditure and upcoming debt maturities. At June 2018 the company's cash and short-term investments of EUR102 million, together with a EUR300 million committed and undrawn revolving credit facility (due in 2022), results in total liquidity of EUR402 million. This compares with short-term debt of around EUR270 million. Fingrid has a financial policy in place to hold cash and undrawn credit facilities to cover a minimum of 110% of 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% any given year). We project Fingrid's free cash flow to be slightly negative through the forecast horizon.

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (/site/re/10024585)
Government-Related Entities Rating Criteria (pub. 25 Oct 2018) (/site/re/10047173)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019) (/site/re/10058988)

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