Finnish Power Distributors Elenia And Caruna Ratings Put On CreditWatch Negative On Regulatory Remuneration Cuts

October 29, 2021

PRIMARY CREDIT ANALYST

Daniel Annas
Stockholm
+46 (8) 4405925
daniel.annas
@spglobal.com

SECONDARY CONTACTS

Per Karlsson
Stockholm
+ 46 84 40 5927
per.karlsson
@spglobal.com

Emeline Vinot
Paris
+ 33 014 075 2569
emeline.vinot
@spglobal.com

ADDITIONAL CONTACT

Infrastructure Finance Ratings Europe
InfrastructureEurope
@spglobal.com

- Revisions to the framework for Finnish electricity distribution system operators (DSOs) before the current regulatory period ends will lead to a weighted-average 17% cut in existing regulatory asset value (RAV) from 2022, following changes to the WACC formula that will reduce DSOs' remuneration by almost 100 basis points (bps) next year.
- We now assess the Finnish framework for DSOs as strong/adequate rather than strong, since the changes imply a risk of further revisions and uncertainty regarding future compensation, including potential intervention.
- Consequently, for the current ratings we are revising upward our funds from operations (FFO) to debt thresholds for the ratings to above 12% for Caruna from 9%, and to more than 10% for Elenia from 8%.
- As a result, we are placing our 'BBB+ long-term ratings on Caruna Networks OY and our 'BBB+' issue ratings on Elenia Verkko OYJ's senior secured debt on CreditWatch negative.
- The CreditWatch reflects the possibility of a downgrade if the companies cannot implement remedy measures to improve their creditworthiness.

STOCKHOLM (S&P Global Ratings) Oct. 29, 2021--S&P Global Ratings today placed its 'BBB+' ratings on Finland-based Caruna Networks OY and on Elenia Verkko OYJ's debt on CreditWatch with negative implications.

We believe the regulatory environment for DSOs in Finland has weakened as a result of significant changes to the framework in the middle of the regulatory period, leading to a cut in remuneration. It is unusual for frameworks to be amended in the middle of a regulatory period, and this goes against our view of a stable and supportive framework. In our view, introducing a new unit price list that results in a substantial lowering of the RAV by 2022, also including investments already made and completed, does not align with a strong regulatory framework. On average, the regulatory assets base, which is the starting point for the reasonable return calculation, has been reduced by 17% on a weighted-average basis for all DSOs in Finland. We view this as a significant reduction that is a rare occurrence among other European regulatory frameworks that we assess as strong. At the same time, the regulator has changed the methods to calculate the risk-free rate component of the weighted-average cost of capital (WACC), resulting in a drop in the WACC by about 100 bps to about 3.97% compared with the expected figure of about 4.96%. Previously, the higher of the 10-year average or the previous year's (April-September) average of the Finnish government's 10-year bond was chosen as the risk-free rate component. However, for the 2022 annual WACC update, the 10-year bond average is excluded. That said, we understand that excluding the 10-year bond average has only a limited impact from 2024 since the gap resulting from the two methods would by then likely be narrower.

In our view, the Finnish regulatory framework for DSOs has weakened and, as a result, stronger metrics are required for the current ratings. This follows our reassessment of the Finnish regulatory framework to strong/adequate from strong. The revision of our metrics thresholds for Caruna and Elenia is to compensate for perceived higher business risks, since the regulatory framework is an important component of our assessment of DSOs' competitive advantage. We benchmark the credit metrics for Finnish DSOs against the more demanding medial financial risk table instead of the current low volatility table under our methodology.

Caruna Networks OY

Caruna is the largest regulated electricity DSO in Finland, with EBITDA projected at €310 million-€320 million in 2021. According to our current base case, we foresee FFO to debt staying close to 10% (including connection revenue) in 2021-2023. However, we have increased the threshold for this metric at the 'BBB+' rating level to 12% from 9% to maintain the rating. Historically, the company has adjusted its shareholder remuneration to keep FFO to debt above our threshold, but with limited headroom. Given the recent changes in the framework, over the coming month we will monitor the company's willingness and ability to improve its financial position.

CreditWatch

The CreditWatch placement stems from our view that under the revised regulatory framework, FFO to debt above 12% is a more appropriate threshold for Caruna for the rating. However, the company may find it difficult to maintain its 'bbb+' stand-alone credit profile in view of reduced remuneration from 2022 and the risk of further regulatory changes.

We could downgrade Caruna if the company's credit metrics do not show clear signs of improvement, including near-term remedy measures that would strengthen FFO to debt to 12% or higher, such as a change in financial policy regarding dividends, or an equity injection.

We aim to resolve the CreditWatch within the next three months, depending on Caruna's ability and willingness to demonstrate its commitment to the current rating with a plan to improve its financial position commensurate with a 'BBB+' rating.

Elenia Verkko OYJ

Elenia's main business is electricity distribution, as the second largest DSO in Finland, with EBITDA expected to total about €200 million for 2021. In our base case, we foresee FFO to debt on average at 9% (including connection revenue) in the coming years. However, we raised our FFO to debt threshold for our rating on Elenia's debt to 10% (including connection revenue) from 8% as a consequence of our reassessment of the Finnish regulatory framework for DSOs to strong/adequate from strong.

We continue to view as positive features in Elenia's senior secured debt that support an uplift to the rating. The rating remains one notch above the senior secured debt's stand-alone credit profile, thanks to structural features designed to increase cash flow certainty for debtholders. These include restricted payment conditions and a covenanted liquidity structure that should, in our opinion, enable Elenia to manage temporary cash flow shocks. Debtholders benefit from features that include:

- Two levels of financial covenants (trigger events and events of default) and an automatic 12-month standstill period after an event of default; and
- A €60 million liquidity facility that is available to draw on if the group enters a standstill and sufficient to cover finance charges.

CreditWatch

The CreditWatch reflects our view that Elenia may find it difficult to maintain its 'bbb' stand-alone credit profile in view of reduced remuneration from 2022 and the risk of further regulatory changes. In the past, the company has adjusted its shareholder remuneration to maintain FFO to debt commensurate with the rating but with limited headroom.

We could downgrade Elenia if its credit metrics do not show clears signs of improvement, including near-term remedy measures that would strengthen its financial position, such as a change in financial policy regarding shareholder remuneration, or an equity injection.

We aim to resolve the CreditWatch within the next three months, depending on Elenia's ability and willingness to demonstrate its commitment to the current rating level with a plan including remedy measures to improve its financial position as we believe is commensurate with the rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Utilities: Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses, Feb. 24, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010