Finland-Based Utility Elenia's Secured Debt Assigned 'BBB' Ratings

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OVERVIEW

- Finnish electricity distribution and district heating group, Elenia, has issued debt through a secured €3.0 billion multicurrency program.
- We are assigning our 'BBB' ratings to the program, and to the €500 million notes and €150 million notes issued under the program by Elenia Finance Oyj.
- The notes are secured structured instruments backed by the operating cash flows of Elenia Oy and Elenia Lampo Oy.

STOCKHOLM (Standard & Poor's) Dec. 17, 2013--Standard & Poor's Ratings Services today assigned its 'BBB' rating to Elenia Finance Oyj's secured €3 billion multicurrency debt program.

At the same time, we assigned our 'BBB' ratings to the €500 million notes and €150 million notes issued by Elenia Finance. The notes have a securitized structure and are backed by Elenia Oy's and Elenia Lampo Oy's operating cash flows.

The Elenia group comprises Elenia Oy, the regulated electricity distribution business, and Elenia Lampo, the district heating business. Elenia Finance is the group's finance subsidiary. In addition to supporting Elenia Finance's obligations under the debt program, Elenia Oy's and Elenia Lampo's operating cash flows will finance the group's operations as well as bank debt at Elenia Oy.

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Although there is no direct loan from Elenia Finance to Elenia Oy, the debt is guaranteed by Elenia Oy and Elenia Lampo. We understand the proceeds from the notes issuance will be channeled to Elenia Oy via a Luxembourg-based holding company, to maintain third-party treatment under Finnish law.

The ratings on the notes are based on our analysis of the Elenia group's underlying credit quality stemming from its excellent business risk profile, and on our view of high leverage. We complement this analysis by looking at the structural features included in the transaction documentation and the credit support the group will receive from the pre-insolvency structural protections.

We base our view of the Elenia group's excellent business risk profile mainly on our assessment of the fully regulated electricity distribution business, which accounts for approximately 85% of the group's EBITDA. We consider the Finnish regulatory framework for electricity distribution companies to be well established, predictable, and supportive. Although there are relative weaknesses regarding regulatory incentives in the event of extraordinary weather conditions, we view such events as rare and therefore the related risk as sufficiently contained. We also note that the district heating business does not benefit from a similar regulatory framework, but operates as a natural monopoly and shows stable profitability. We therefore anticipate that the Elenia group will continue to generate stable and predictable cash flows.

The main rating constraint is the high level of debt, which results in relatively weak cash flow debt-coverage metrics. In our base case, we expect that Elenia will continue to generate stable earnings from its regulated electricity distribution business. However, we anticipate that Elenia's adjusted ratio of funds from operations (FFO) to debt will gradually weaken to about 7% over the next few years, from an anticipated 10% in 2014, because of the expected 100% debt funding of future capital expenditure and likely generous shareholder distributions.

The ratings also reflect various structural features in the notes that, in our view, increase cash flow certainty for debtholders. These include payment restrictions and a covenanted liquidity structure that we believe should allow Elenia to manage temporary cash flow shocks and keep secured creditors in a strong position should the group fall into financial difficulty. On the other hand, in our view, the notes' structure and the Finnish regulatory environment are less robust than in other markets.

We could lower the ratings should Elenia struggle to maintain adjusted FFO to debt of at least 6%, taking into account some variation with regard to the annual regulatory surplus or deficit. We could also lower the ratings following any unfavorable regulatory changes that led us to revise our view of the group's business risk profile. A negative rating action could also follow should the Elenia group enter into significant super-senior hedges, because this could weaken the position of senior creditors in a financial stress scenario.

We currently see limited rating upside. We could, however, consider raising the ratings if Elenia's financing structure changed, leading to stronger credit measures than we currently expect, for example, with adjusted FFO to debt exceeding 8% on a sustainable basis.

RELATED CRITERIA AND RESEARCH

- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Methodology For Considering Pre-Insolvency Structural Protections In Europe, Dec. 13, 2012
- Understanding Standard & Poor's Ratings Definitions, June 3, 2009
- Ring-Fencing a Subsidiary, Oct. 19, 1999

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