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Elenia Finance Oyj

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Up To €3 Billion Multicurrency Medium-Term Notes Program

This presale report is based on information as of Dec. 3, 2013. The ratings shown are preliminary. This report does not constitute a recommendation to buy, hold, or sell securities. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings.

Final ratings will depend upon receipt and satisfactory review of all final transaction documentation, including legal opinions. Accordingly, the preliminary ratings should not be construed as evidence of final ratings. If Standard & Poor's does not receive final documentation within a reasonable time frame, or if final documentation departs from materials reviewed, Standard & Poor's reserves the right to withdraw or revise its ratings.

Class	Rating	Amount (€000s)	Interest (%)	Legal final maturity
2013-1	BBB	500,000	TBC	TBC

TBC--To be confirmed

Transaction Participants	
Issuer	Elenia Finance Oyj
Borrower	N/A
Guarantors	Elenia Oy Elenia Lampo Oy Lakeside Network Investments Holdings B.V. Elenia Finance (SPSS) S.A.R.L.Elenia Holdings S.A.R.L.
Arrangers	The Royal Bank of Scotland PLC and HSBC Bank PLC
Bond trustee	Citicorp Trustee Co. Ltd.
Security trustee	Citicorp Trustee Co. Ltd.
Liquidity facility providers	HSBC Bank PLC, Royal Bank of Canada, The Royal Bank of Scotland PLC, and Credit Agricole Corporate and Investment Bank
Bank account provider	Nordea Bank Finland PLC
Paying agent	Citibank N.A.

Supporting Ratings

Institution	Ratings
HSBC Bank PLC as liquidity facility provider	AA-/Negative/A-1+
Royal Bank of Canada as liquidity facility provider	AA-/Stable/A-1+
The Royal Bank of Scotland PLC as liquidity facility provider	A-/Negative/A-2
Credit Agricole Corporate and Investment Bank as liquidity facility provider	A/Negative/A-1

Rationale

The preliminary 'BBB' rating assigned to Elenia Finance Oyj's €3 billion multicurrency medium-term notes (MTN) program reflects Standard & Poor's Ratings Services assessment of:

- Elenia's underlying credit quality and ability to generate sufficient cash flows to support the program; and
- The structural features in the program's structure.

The notes issued under the program will have a securitized structure and be 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 and potential private placements by Elenia Finance.

Although there is no direct loan from Elenia Finance to Elenia Oy, the proposed debt will be 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 tax law.

The ratings on the notes are based on our analysis of Elenia group's underlying credit quality stemming from its excellent business risk profile, and on our view of a high level of debt. 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 Elenia will continue to generate stable and predictable cash flows.

In our view, 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 program's 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, in our opinion, 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.

Major Rating Factors

Strengths

- Elenia's excellent business risk profile. About 85% of the group's EBITDA comes from the electricity distribution business, which operates under a stable and predictable regulatory framework that ensures a high degree of certainty of cost cover and a return on the regulatory asset base. The regulated nature of electricity distribution contributes to high predictability of cash flows;
- The district heating business, which contributes 15% of EBITDA and operates as a natural monopoly. It is therefore expected to generate stable cash flows, although it does not benefit from a similar regulated framework as that for electricity distribution;
- Stronger security than for other transactions in the market. Elenia has pledged nearly all of its assets as collateral, whereas similar transactions in the U.K. have mainly relied on share pledges over the operating companies;
- Ring-fencing of the financing group;
- Prudent debt-management policies, with a covenanted spread of maturities and interest rate hedging;
- 12 months of liquidity support through dedicated accounts or facilities;
- A strong covenant package to protect debtholders, including limitations on additional debt, a defined cash waterfall of payments giving senior debt priority, a minimum level of financial performance, and restrictions on distributions;
- Two levels of financial covenants (trigger events and events of default) and an automatic 18-month stand-still period after an event of default. These provide creditors with significant control over Elenia at an early stage of any financial/operational difficulty or material changes in business circumstances. We believe this could prevent Elenia from going into administration, minimize the borrower probability of default, and create an additional credit cushion; and
- Resilient cash flows. In our view, only a significant stress on cash flows would cause Elenia to default.

Weaknesses

These strengths are somewhat offset by the following weaknesses:

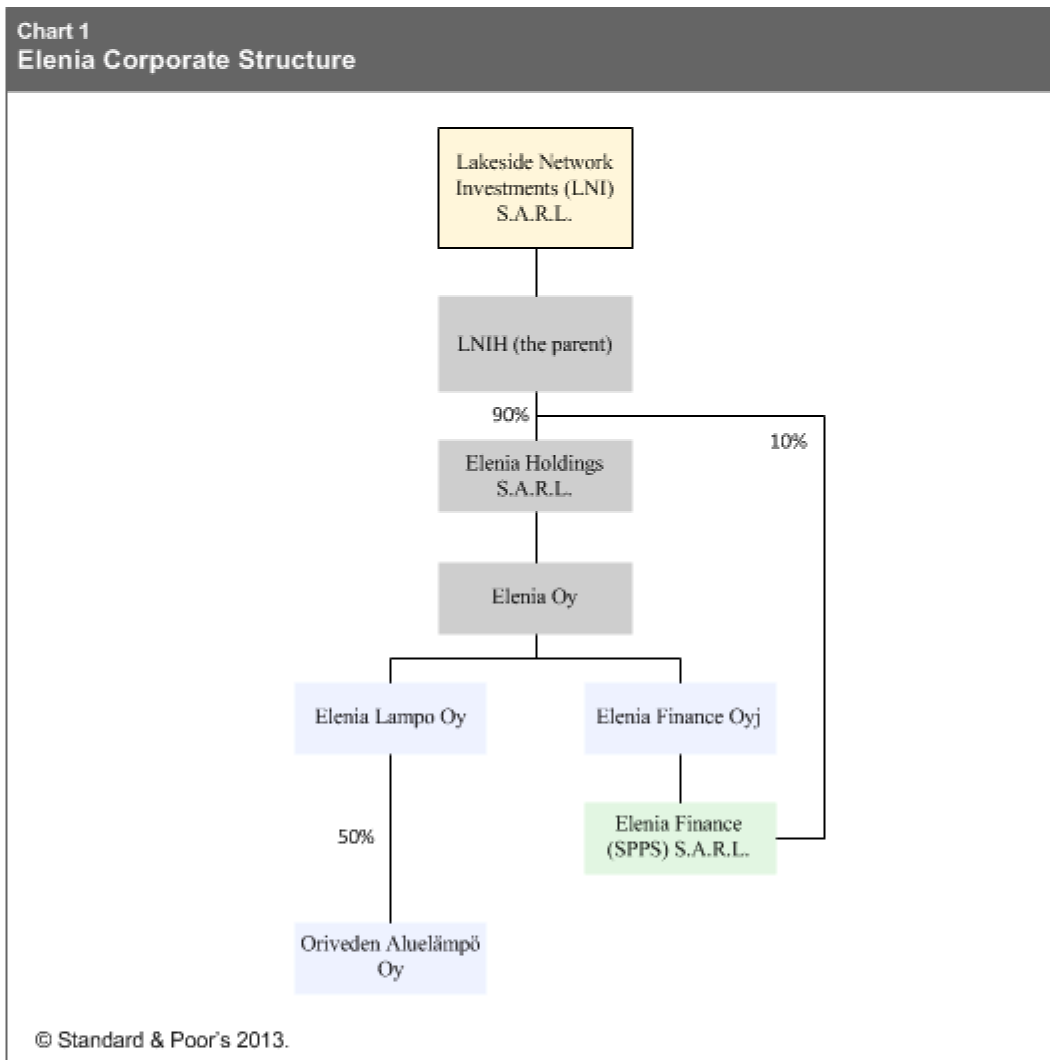
- No maximum loss amount with regard to the difference between actual controllable costs and the reference costs set by the regulator. This means that if Elenia were to incur significant unexpected costs, for example because of a storm, it will not immediately receive compensation for those costs through the framework. We note, however, that the maximum loss from regulatory outage costs is capped at 20% of reasonable return in any given year;
- Regulatory reset every fourth year. Although we don't expect major changes to the framework, the reset introduces

a degree of uncertainty;

- Elenia's aggressive financial policy under which all available free cash is distributed to shareholders. We forecast that debt to EBITDA will be close to the 9.5x covenant threshold over most of the life of the transaction, although the initial leverage ratio would be at about 7x. We also forecast the adjusted FFO-to-debt ratio to deteriorate toward 7%;
- The relatively weak independence of Elenia's board. Shareholder-appointed directors outnumber the independent directors at both Elenia Finance and Elenia Oy. However, decisions related to bankruptcy filing require a unanimous vote of Elenia Finance's board. Therefore independent director(s) can block such a move by voting against it;
- Limited incentive under the program structure for Elenia to target debt-protection measures that are materially higher than the covenant levels;
- Direct exposure to the credit quality of swap counterparties. The terms of the swaps used to hedge exposure to interest rates and inflation do not include substitution language. According to our counterparty criteria, without such language, we could lower the ratings on the notes should a counterparty be downgraded below the rating on the notes and we consider the transaction to be weaker without this swap or that a default of the counterparty could lead to material mark-to-market realization. Although this does not currently constrain the rating on the program, future rating actions on counterparties could have implications for the program;
- The risk of lower recoveries for secured creditors than our current base-case assumption, because certain swaps will rank super senior to the notes. This would be the case if the company had a significant amount of super-senior hedge transactions outstanding at the time of default; and
- This transaction's relatively complex structure. There is no direct loan from Elenia Finance to the parent, which could lead to unintended consequences in financial distress. The transaction documents are, however, clear that all secured creditors rank pari passu.

Corporate Structure

The corporate structure regarding the transaction is similar to that in standard U.K. regulated utility transactions with an operating company; the holding company provides security in the form of a pledge over the operating company's shares (see chart 1).



The entities financing the transaction (the financing group) comprise:

- Elenia Oy (Elenia), the license holder and operating company for the electricity distribution business;
- Elenia Lampo Oy (Elenia Heat), the operating company for the district heating business;
- Elenia Holdings S.A.R.L. (Luxco), which owns Elenia and will pledge its shares in Elenia as security;
- Lakeside Network Investment Holding B.V. (LNIH; the parent company), whose sole purpose under its constituent and financing documents is to own the shares of Luxco and act as the holding company of companies within the ring-fence structure;
- Elenia Finance Oyj (the issuer), which we expect to issue notes to fund the Elenia group's ongoing capital requirements and to repay existing senior facilities; and
- Elenia Finance (SPPS) S.A.R.L. (Luxco 2), subsidiary of the issuer, which is used to pass on the proceeds.

Unusually, the issuer does not lend any of the proceeds from the notes to Elenia, but uses all of it to buy equity and subscribe to subordinated profit-participating securities (SPPS) in Luxco, via Luxco 2. This is done to maintain third-party treatment on the notes under Finnish tax law. In our view, this structure increases the complexity of the

transaction. However, in our view, the bondholders will be able to use the guarantee structure to share recoveries on a pari passu basis with all the other secured lenders.

During the life of the transaction we would expect Elenia to fund the payments of the issuer via capital increases or payment through group contributions. If the issuer has a cash shortfall, it can draw on the loan from Elenia and Elenia Heat.

The transaction meets our ring-fencing criteria; therefore, we consider the financing group entities to be insulated from the ultimate owners, a consortium of infrastructure investors comprising 3i Networks Finland LP, GS International Partners II L.P., and Ilmarinen Mutual Pension Insurance Co.

Rating methodology

Consistent with our criteria "Methodology For Considering Pre-Insolvency Structural Protections In Europe," published Dec. 13, 2012, our assessment of Elenia's credit quality consists of an analysis of the underlying electricity distribution and district heating businesses, and of the structural features supporting the financing group's business and financial profiles.

In our view, various structural elements add to the certainty and stability of the group's cash flows. These features include dedicated liquidity reserves, a cash flow waterfall, tight covenants, fixed and floating security, and strict limitations on business activities.

Our analysis of financial performance follows a blended approach to examine forecast financial ratios and prescribed covenanted levels.

Ring-fencing

We regard the quality of Elenia's ring-fencing mechanism as adequate and similar to that of rated peers. Elenia's board has an independent director, although outnumbered by appointed directors. In line with covenants in the notes' documentation, Elenia Finance also has an independent director. Regulatory oversight strengthens the ring fence, although we view the Finnish regulator as less hands-on than in the U.K., where comparable transactions are located. Also, in Finland, there are no regulatory ring-fencing provisions for underperforming assets.

The basic purpose of the structure is to isolate Elenia's low-risk regulated electricity distribution and district heating businesses from the ultimate parent, LNIH, and the ultimate ownership group. Under our criteria, we are unlikely to rate a company above its parent unless some form of ring-fencing partly or completely separates the entities from a credit perspective.

In our view, the type of ring-fencing in place allows us to largely separate Elenia's creditworthiness from that of its parent. This reflects our assessment of security provided, as well as restrictive financial and business covenants within the finance documents that are supported by regulatory oversight of the utility's operations. Having a special-purpose intermediate holding company at the head of the ring-fenced financing group and some limited independent representation within Elenia's board complement this oversight. Combined, we consider that these structural, legal, and regulatory measures provide sufficient impediments and disincentives to make it less likely that the ultimate owner and its creditors would hinder Elenia in times of financial distress.

Having LNIH within the ring fence creates a structural barrier between Elenia and the ultimate owners. LNIH's sole purpose is to act as a holding company and to own the shares of LNI, and thus provide lenders with security in the form of a pledge over LNI's shares. LNI has a similar function.

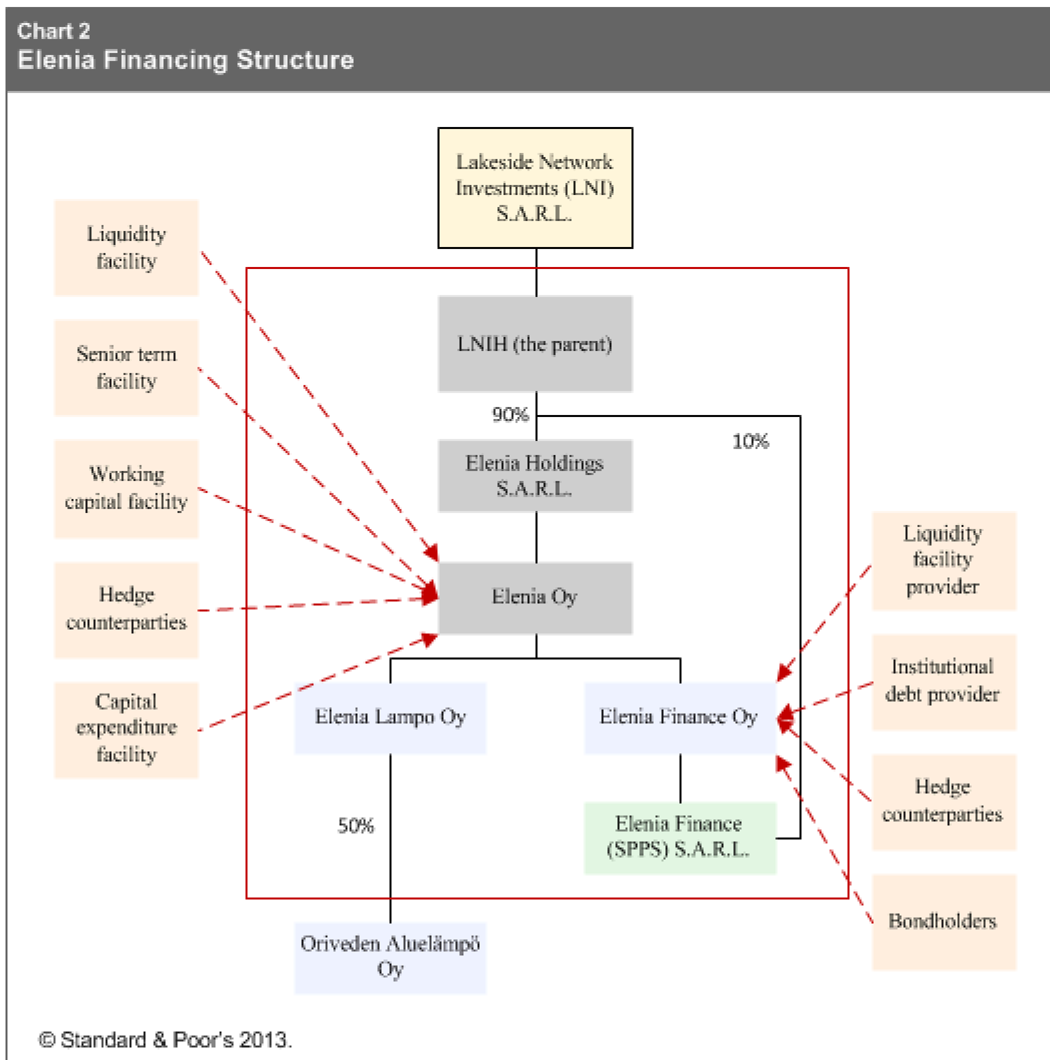
The legal ring fence stems from the constitutional documents of the companies involved, and from the covenant and security package in the finance documents. Key features include:

- A series of trigger events, the breach of which could require Elenia to present a remedial plan to the security trustee;
- The security package within the financing group, which should act as a deterrent to any action against the security providers from the equity or subordinated lenders;
- Restrictions on the financing group's business activities, as stated in the financing documents and the companies' memoranda of association; and
- A statement in the articles of association that the issuer's board has to vote unanimously to file for insolvency. This effectively gives the independent director on Elenia Finance's board a veto regarding insolvency filing.

Regulatory oversight underpins the ring-fencing structure, increasing the likelihood that the legal and structural aspects would be implemented. However, the Finnish regulator does not have the ability to prohibit payments from operating companies to any of the parent entities. Consequently, we see this transaction structure as weaker than similar transaction in the U.K. utilities sector because the bondholders are relying solely on the strength of the financial documentation.

Financing Structure

The finance documents are structured to create different levels of priority access to Elenia's operating cash flow and different levels of security. They also define the ranking, both in servicing and redemption, of the notes issues.



Covenant structure encourages prudent debt management

In our opinion, the debt concentration covenants in the documentation only somewhat lessen refinancing risk. Because Finland does not disclose regulated asset values for utilities, the debt maturity limit is a nominal €500 million in any three-year period. In our view, this covenant is weaker than in similar transactions in the U.K. water sector, because it allows material bullet maturities. The limit equates to about 50% of initial debt and is therefore weaker than the 20% of regulated capital value (RCV) over a two-year period and 40% RCV in a five-year period that we have observed in other transactions. Also, the debt maturity covenant does not capture breaks within the hedging document, which could pose further refinancing risk.

The interest rate hedging policy in the financing documents requires that at least 85% of liabilities outstanding be at fixed rates, or index linked until the end of the current regulatory period, and 50% for the next regulatory period. In practice, the level of hedging would need to reflect the balance between the desire for medium-term interest cost certainty, and the risk of the regulator assessing that the issuer has locked in too much high-priced debt if interest rates fall, which could lead to a negative regulatory decision. In addition, Elenia cannot take foreign currency exposure in

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terms of interest or principal payments.

Elenia did not have any inflation-linked swaps outstanding at closing of the transaction and it addresses interest rate swaps as part of the refinancing process.

The Elenia group can enter into financial derivatives with early termination provisions, as long as the total nominal amount outstanding on these swaps is less than 10% of its total secured debt, and that "swap breaks" falling due in any two-year period do not exceed 3.5% of secured debt. In our view, this additional two-year limit on swap contracts with breaks is a stronger feature than in other similar transactions, and should limit the potential impact on liquidity of any mark-to-market losses. However, should the company enter into unfavorable swaps, this could become a material liquidity burden and may affect the ratings.

Other hedging considerations

The banks providing the currency and interest-rate hedging for the notes have not incorporated substitution clauses into the agreements for those arrangements. According to our financial counterparty criteria, therefore, a weak link exists between the ratings on the notes and the ratings on the hedge providers. Consequently, if a swap counterparty were downgraded we could lower the ratings on the notes. However, at this stage, the ratings on the counterparties do not constrain the ratings on the notes.

Intercreditor arrangements offer standard protection

The security trust and intercreditor deed (STID) and the common terms agreement (CTA) regulate the rights of the various creditors of Elenia, Elenia Heat, and the issuer (Elenia Finance). The CTA and STID prescribe the priority of payments of obligations outstanding under both the pre- and post-acceleration of payments, and during the enforcement of security. The shareholder loans are subordinated to the secured bondholders and cannot cause accelerated repayment of the secured debt. Moreover, creditors of shareholder loans have no voting rights in relation to ending a stand-still period for as long as any secured debt remains outstanding.

The security trustee acts in accordance with instructions from the financing group.

Security is limited by law and regulation, but is a key feature of the ring-fence mechanism

Under the MTN program, the creditors have the benefit of a security package, which is more extensive than in similar transactions in the U.K. We, however, essentially view the security package as a defensive measure, in that it prevents other parties from taking security over the same assets. Under the Finnish regulatory regime, there is no restriction on pledging regulated assets. The security for the notes represents most of the operating assets of Elenia and Elenia Heat. In addition, we regard the pledge over the shares in Elenia and Luxco as a powerful disincentive to the parent group to draw cash from Elenia in times of its own financial stress. This is because, in doing so, the parent group would risk losing the shares to Elenia's and the issuer's lenders. As such, it is a key component of the ring fence.

The secured debt of the issuer and Elenia group is secured by a first-ranking mortgage over nearly all of Elenia's physical assets and by pledges over the shares of the entities in the financing group. Elenia's main creditor is the issuer, Elenia Finance, through the security and guarantee structure, bank lenders, and hedging agreements. Furthermore, the creditors benefit from a business mortgage, which is similar to floating charges under British law, although it recognizes more priority claims.

We rate utility finance transactions, such as this one, according to our criteria for pre-insolvency structural protections. This is due to the absence of appropriate legal and structural features that ensure continued control for secured creditors if Elenia were to become insolvent. Under Finnish insolvency law, should Elenia file for bankruptcy, the secured creditors could recover their investment by realizing on the security, but cannot control Elenia's cash flows during the process. We believe that the secured creditors would first try to sell the pledged shares in Luxco as a quicker way to recover their investment, and this can be accomplished without court proceedings.

Liquidity support

The financing group's liquidity resources provide additional cash to the operating business and credit enhancement to the rated debt. High leverage means that Elenia's financial flexibility is limited, and it would need extra liquidity to deal with any significant cash flow fluctuations or one-time shocks. This liquidity buffer is designed to provide a way of overcoming short- to medium-term cash flow shortages until other mechanisms take effect.

Elenia must maintain a debt-service reserve (DSR) account or DSR liquidity facilities, which combined, must cover the next 12 months' forecast cash interest and finance charges on the secured debt. The DSR liquidity facilities are to be irrevocable and available at any time, including during a standstill.

The liquidity facility would be renewed or, if not renewed, fully drawn, with the proceeds deposited in the DSR account. These amounts would then only be repaid when the facility has been refinanced. Drawing on the DSR account or the liquidity facility results in a distribution lock-up. The liquidity facility has a provision stipulating that any drawing because of the downgrade of a counterparty must be repaid if the company pays a dividend. This means that Elenia has a significant incentive to replace amounts drawn on the liquidity facility by depositing funds on the DSR account. This clause takes effect five years after the DSR liquidity facility agreement is signed.

Covenants are similar to those in other water utility securitizations

We elevate the ratings on the program above that of Elenia's underlying credit quality because the aim of Elenia's financing structure is to prevent insolvency. It does this by providing creditors with significant control over Elenia at an early stage of financial or operational difficulty or of material changes in business circumstances. This is accomplished through two levels of covenants--linked to trigger events or default--and an automatic stand-still period of at least 18 months after an event of default.

Under normal business conditions, Elenia operates within the set covenants package, with no creditor involvement beyond ongoing communication, as per the information covenants.

In the first level of covenants, the trigger-event condition would be breached if:

- The interest coverage ratio is less than 1.7x;
- The leverage ratio (net debt to EBITDA) is more than 9.5x;
- There is a deficit on the debt-service payment account or liquidity facility, or drawings are made from the DSR account or the DSR liquidity facility;
- There is insufficient liquidity to cover forecast capital expenditures or working capital requirements, even combined with cash balances and amounts available under the related facilities;
- An event of default is continuing;
- The auditors qualify Elenia accounts in a way that could cause the covenant calculations to be inaccurate;

- Any draft legislation or similar government directive reaches a final reading or equivalent step, or is brought into force, that could have a material adverse effect for Elenia's creditors;
- The aggregate nominal value of any super-senior accretion on inflation-linked hedging agreements exceeds 8% of senior debt;
- A license amendment could materially hamper Elenia's business;
- Elenia is notified by, or involved in proceedings with, the regulator regarding the transfer of its electricity system to another system operator, subject to a material adverse-effect test or if the transfer would lead to a breach of the default ratio; and
- The ratings on the notes are lowered to speculative grade ('BB+' or lower).

The primary consequence of a trigger event is the prohibition of dividends or payments under intercompany loans to affiliated companies outside the financing group until the breach is remedied. Moreover, the security trustee may request a plan of remedial actions or a meeting with management if the breach continues for more than 12 months. The security trustee can also ask for further information about the causes of the trigger event.

In most cases, the cause of the breach is likely to be temporary and would correct itself. If it doesn't, then the next level--a default--would be reached and more drastic action taken.

Event-of-default triggers are both financial and nonfinancial. Events of default include, among others:

- A drop of the interest cover ratio to below 1.2x;
- Increase of the leverage ratio beyond 10.5x;
- Nonpayment of debt within three days of the due date;
- Failure of Elenia, the issuer, or another obligor to meet obligations under the transaction documents;
- Misrepresentation by Elenia or the issuer on any finance document;
- Cross default with respect to any member of the financing group or the issuer, such as failure to pay any financial debt (other than secured or subordinated debt) in excess of €5 million. Cross default could also occur if financial debt of more than €20 million is accelerated;
- Inability of the issuer or an Elenia group member to pay its debts (or declared unable by a relevant court), actual or intended suspension of payments on debts, or negotiations with creditors to reschedule any debt;
- Corporate action, legal proceedings, or other procedure to suspend debt payments, such as through a moratorium;
- Transfers of the licensed business without the written consent of the security trustee, or Elenia's receipt of notice that its license will be revoked; and
- Legal barriers. The issuer, Elenia, or another obligor may no longer have the legal right to, or be prevented from, meeting material obligations under the finance documents, or security provided may no longer be enforceable.

If there is a default on debt within the notes program, an automatic standstill of claims takes effect. This means that creditors that signed the STID (essentially, all the lenders within the ring fence) cannot enforce their right to the security for a period of 12 months, unless 66.67% of the creditors vote for termination of the stand-still period.

The aim of the standstill is to allow lenders and management time to work out a solution, rather than have the company placed in administration. Although a standstill may be appealing from a lender's point of view, because it reduces the risk of the company going into administration, we do not consider that it reduces default risk.

Under a standstill, the priority of payments is similar to that under insolvency, and debt would continue to be serviced to the maximum extent possible. The standstill applies to claims by creditors, not to the servicing of debt by the issuer

or Elenia. Because a standstill applies to the issuer and Elenia, but not to the parent, secured creditors can enforce their claim on the parent's shares in Elenia at any time during the standstill and use the proceeds from sale of these shares to service the outstanding debt. In a standstill, only the DSR facility remains available.

Business Risk Analysis

The major supports for our view of Elenia's excellent underlying credit quality are:

- Finland's supportive, stable, transparent, and predictable regulatory framework, which has a long and proven track record. The group also benefits from very flexible tariff-setting regulation. Elenia can change tariffs at any time, subject to a 30-day notice period. For example, in 2010 when profitability was below the allowed levels, Elena increased tariffs by more than 10%.
- Elenia's monopolistic district heating operations, with relatively steady demand due to the Finnish climate. In Finland, the owner of the heating grid enjoys a local monopoly because no third-party access to the grid is allowed. Although there is no regulatory framework for district heating, the prices and profits are supervised by the Finnish Competition and Consumer Authority. District heating benefits from strong political support because it accounts for approximately 47% of the country's heating market. As such, we do not foresee any major changes to the current framework.
- Strong market position. Elenia is the second largest distribution system operator in Finland, covering a geographic area of approximately 600 kilometers, which provides a degree of diversification in the event of extraordinary weather conditions.
- Relatively low customer concentration and a good split among customer segments in terms of volumes of electricity delivered.

These supports are partly offset by:

- Risk of uncompensated costs in case of unexpected cost increases. To calculate the regulatory efficiency incentive, the regulator compares actual controllable costs against a reference cost level, based on the cost in previous periods and a general efficiency target. The difference in costs is not capped. This means that if Elenia incurs significant unexpected costs, for example after a storm that led to repair costs and customer compensation, it will not immediately receive compensation for those costs through the framework. Although we recognize that the increased cost will raise the reference level for the next regulatory period, this does not mean the utility would recover these costs in the future, in full and on time.
- Regulatory reset every fourth year. Although we don't expect major changes to the framework, it introduces a degree of uncertainty. In addition, there is a minor risk that the regulator could revise certain parameters before a new pricing period, such as to the weighted average cost of capital. The current regulatory period will end in 2015. We note, however, that the regulator holds discussions with stakeholders before finalizing the regulatory parameters and has previously revised its initial propositions after receiving feedback from industry participants. In any case, we do not expect possible changes to result in any material swings in Elenia's earnings.
- Somewhat limited pricing power in district heating. There is no restriction or formal regulation on the pricing of district heating. A general pricing method for district heating is based on an alternative-cost pricing method, whereby the price is set at, or close to, the cost of the customer's second-best alternative. This means the company has somewhat limited flexibility in setting tariffs because it needs to maintain cost competitiveness against other heating sources, such as electric heating. In addition, the Finnish Competition Authority monitors prices to determine whether they are excessive. District heating is also somewhat vulnerable to volume risk because the

operator has to deliver heat no matter how much heat is needed. This can hamper profitability because peak capacity mainly comes from oil-fired generation, which has high and fluctuating marginal costs.

Underlying Outlook

Our view of Elenia's underlying credit quality reflects our expectation of continued stable earnings and cash flows from the company's low-risk regulated electricity distribution business. We believe that Elenia should be able to maintain a financial risk profile in line with our expectations for the ratings, including adjusted FFO to debt of at least 6%.

Sensitivities

To gauge how well the financial covenants support Elenia's credit quality, we have stressed EBITDA figures to understand at what levels trigger events and events of defaults could occur. We took this approach because Elenia does not have regulatory-asset-based covenants. In our view, Elenia performs robustly under our stress scenarios:

- EBITDA would have to fall by 15%-20% to cause a trigger event, during which Elenia would still be able to generate adequate cash flows to meet debt-service payments, while investing significant amounts in capital expenditure, based on currently available liquidity.
- EBITDA would have to drop by 25-30% for the transaction to breach an event-of-default covenant, which is a more severe deterioration than what we would anticipate in an economic scenario correlating to 'BBB' stress (this scenario is outlined in "Understanding Standard & Poor's Ratings Definitions," published on June 3, 2009, on RatingsDirect).

We have applied all the stresses to our base-case forecast, which is more conservative than the company's forecasts. This underlines the resilience of the ratios obtained. We have also stressed the average interest rates to reflect an environment in which Elenia's credit quality is deteriorating.

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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