S&P Global
Ratings

RatingsDirect®

Elenia Finance Oyj

Primary Credit Analyst:
Alf Stenqvist, Stockholm (46) 8-440-5925; alf.stenqvist@spglobal.com

Secondary Contact:
Gustav B Rydevik, London 00442071761282; gustav.rydevik@spglobal.com

Table Of Contents

Elenia Finance Oyj

Rationale

None

The 'BBB' issue ratings on the secured debt of Finnish electricity distribution and district heating company Elenia Finance Oyj (Elenia) are based on S&P Global Ratings' assessment of the Elenia group's stand-alone credit profile (SACP) at 'bbb-' and a one-notch uplift for structural enhancements.

Business Risk	Financial Risk
• About 85% of operations in regulated electricity distribution, with stable and predictable revenues and cash flows. • About 15% of operations in district heating, with a natural monopoly position in the catchment area, although there are some volume and commodity risks.	• An aggressive financial policy, under which we assume that all free cash is distributed to shareholders. • High debt, and expectations of gradually weakening credit metrics resulting from a fully debt-funded capital expenditure (capex) program and high shareholder distributions. • Flexibility to adjust shareholder distributions and capex to unexpected deterioration of cash flows. • Credit-supportive structural features.

Outlook

The stable outlook on Elenia reflects our expectations of the group's continued stable earnings and cash flows from its 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 on the debt, including S&P Global Ratings-adjusted funds from operations (FFO) to debt of at least 6%.

Downside scenario

Assuming no change to the business risk profile, 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.

Upside scenario

Given our assessment of high leverage and relatively weak credit metrics, combined with an aggressive financial policy, we see the likelihood of an upgrade as limited at this time. However, we could consider raising the ratings if Elenia's financial policy were to change, leading to stronger credit measures than we currently expect, for example with adjusted FFO to debt exceeding 8% on a sustainable basis.

Our Base-Case Scenario

Recent developments

- We understand that Elenia's ultimate owners are currently reviewing their ownership of Elenia's parent holding company Lakeside Networks Investments Holding B.V. At this stage, we have not incorporated any potential changes to the ring-fenced financing structure nor to Elenia's credit quality as a result of this review.
- Elenia needs to make continued high investments in order to achieve a targeted 70% underground cabling rate by 2028.
- During the one major storm of 2017, roughly 22,000 of Elenia's customers were affected, but the group restored all connections in under 24 hours.

Assumptions

- EBITDA margin in the distribution business of about 60%-65%, reflecting a weighted average cost of capital (WACC) of about 5.64% (post-tax) during the remainder of the current regulatory period (2016-2019).
- EBITDA margin in the district heating operations of about 30% in 2017 and 2018.
- Annual capex of about €140 million over 2017-2018.
- Increasing leverage as a result of relatively aggressive shareholder distributions.

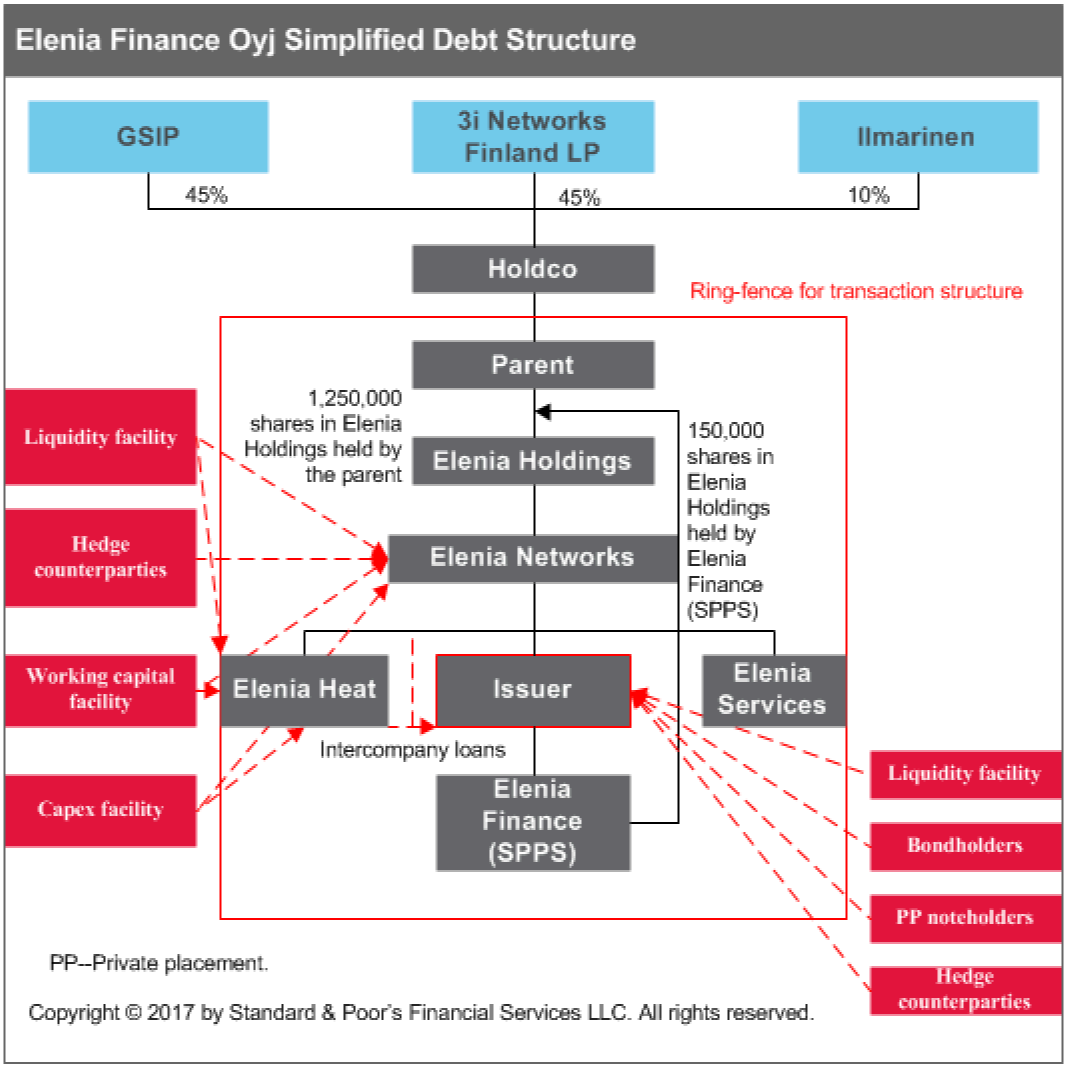
Key Metrics

	2016	2017f	2018f
FFO/debt (%)	9.8	8.0-9.0	7.5-8.5
Debt/EBITDA (x)	7.9	8.5-9.5	8.5-9.5
Interest coverage (x)	1.7	3.5-4.5	3.5-4.5

f--Forecast. FFO--Funds from operations.

Company Description

Elenia's main business operation is electricity distribution, and it is the second-largest electricity distribution operator in Finland. It also runs district heating operations, partly based on own generation. Elenia was formed in 2011 as Vattenfall divested its Finnish operations to LNI Acquisition, a consortium consisting of the infrastructure funds 3i Infrastructure (45%), Goldman Sachs Infrastructure Partners (45%), and Finnish Mutual Pension Insurance Company Ilmarinen (10%). Elenia's financing structure is ring-fenced, and the financing group is de-linked from its ultimate parent company. The debt issued by the financing group includes structural enhancements designed to reduce the likelihood of default.



Business Risk

We regard Elenia's business risk profile as excellent, mainly due to 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 network companies to be well-established, predictable, and supportive. We believe that the modifications to the framework for the regulatory period starting 2016 supported Elenia's credit profile, since they have increased the allowed regulatory return for the operators. The WACC for the period has increased to about 5.64% (2017) from about 3.1% (2015) in the previous period. The change was intended to support investments in the grids to renew the aged network and reduce outages, for example those caused by storms.

Following the distribution tariff increases announced by certain Finnish distribution system operators (DSOs) in 2016, the Ministry of Economic Affairs and Employment issued a government bill in May 2017 that restricts DSOs, including

Elenia, from increasing their distribution tariffs by more than 15% (after taxes) over any rolling 12-month period. We understand, however, that this would not constrain Elenia's ability to fully obtain its regulatory allowed return.

We also note that, although the district heating business does not benefit from a similar regulatory framework, it 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.

Peer comparison

Table 1

Elenia Finance Oyj Peer Comparison			
	Elenia Finance Oyj*	**Ellevio AB**	**Caruna Networks Oy**
(Mil. €)	**--Fiscal year ended Dec. 31, 2016--**		
Revenues	318.7	689.2	384.0
EBITDA	169.2	424.0	233.0
Funds from operations (FFO)	132.0	284.0	182.7
Interest expense	37.5	117.8	54.0
Net income from continuing operations	(15.4)	(24.9)	(31.6)
Cash flow from operations	67.1	114.7	99.4
Capital expenditures	125.3	214.6	273.2
Free operating cash flow	(58.2)	(99.9)	(173.8)
Discretionary cash flow	(58.2)	(272.2)	(173.8)
Cash and short-term investments	14.9	5.7	59.8
Debt	1,337.5	3,594.6	2,089.8
Adjusted ratios			
EBITDA margin (%)	53.1	61.5	60.7
Return on capital (%)	4.6	3.0	3.7
EBITDA interest coverage (x)	4.5	3.6	4.3
FFO cash interest coverage (x)	1.7	1.6	2.1
Debt/EBITDA (x)	7.9	8.5	9.0
FFO/debt (%)	9.9	7.9	8.7
Cash flow from operations/debt (%)	5.0	3.2	4.8
Free operating cash flow/debt (%)	(4.4)	(2.8)	(8.3)
Discretionary cash flow/debt (%)	(4.4)	(7.6)	(8.3)

*Figures are for the Elenia group consolidated.

Financial Risk

Elenia's aggressive financial risk profile is constrained by high debt, and we expect its credit measures will weaken. We anticipate that FFO to debt will deteriorate toward 7% over the next few years and that debt to EBITDA will be close to the 9.5x covenant threshold over most of the remaining term of the debt. We assume that the group will increase debt under the capex facility to fund future investments, while distributing all available cash flow to shareholders in the form of interest on subordinated loans ultimately from shareholders. Our forecast is further supported by the limited incentive under the debt program's structure for Elenia to target credit measures that are materially stronger than the covenant levels.

In our assessment of Elenia's SACP, we also take into consideration that all of the shareholders' participation is in the form of subordinated loans, which--although we treat them as equity--indicate a more aggressive structure than one in which the shareholder participation is in the form of pure equity. We also acknowledge that the loans mature in over 15 years and we believe that the issuer intends to extend the maturity date of the non-common equity financing to at least 30 days after all the other debt matures and to repeat rollovers if necessary. We further understand that the shareholder loans would be sold together with the common equity in case of any change in ownership.

Financial summary

Table 2

Elenia Finance Oyj Financial Summary		
	--Fiscal year ended Dec. 31--	
(Mil. €)	**2016**	**2015**
Revenues	318.7	286.9
EBITDA	169.2	136.9
Funds from operations (FFO)	132.0	102.2
Net income from continuing operations	(15.4)	(43.9)
Cash flow from operations	67.1	38.1
Capital expenditures	125.3	113.4
Free operating cash flow	(58.2)	(75.3)
Dividends paid	0.0	0.0
Discretionary cash flow	(58.2)	(75.3)
Debt	1,337.5	1,219.0
Preferred stock	0.0	0.0
Equity	398.0	470.9
Debt and equity	1,735.5	1,689.9
Adjusted ratios		
EBITDA margin (%)	53.1	47.7
EBITDA interest coverage (x)	4.5	3.8
FFO cash interest coverage (x)	1.7	1.3
Debt/EBITDA (x)	7.9	8.9
FFO/debt (%)	9.9	8.4
Cash flow from operations/debt (%)	5.0	3.1
Free operating cash flow/debt (%)	(4.4)	(6.2)
Discretionary cash flow/debt (%)	(4.4)	(6.2)
Net cash flow / capex (%)	105.3	90.0
Return on capital (%)	4.6	3.2
Return on common equity (%)	11.3	41.0
Common dividend payout ratio (un-adj.) (%)	0.0	0.0

Figures are for the Elenia group consolidated.

Liquidity

We view Elenia's liquidity as adequate. We believe that available liquidity sources (cash, committed credit facilities, and operating cash flow) should be in excess of 1.1x forecast near-term cash outflows, such as shareholder loan distributions and committed capex. In our assessment of liquidity, we also factor in qualitative factors, such as Elenia's sound relationships with banks, satisfactory standing in credit markets, and likely ability to absorb high-impact, low probability events with limited refinancing. We assume that Elenia will continue to maintain adequate headroom under its financial covenants.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and liquid investments of about €70 million as of June 30, 2017. • FFO of €140 million or more over the next 12 months. • €410 million available under credit facilities as of June 30, 2017.	• Capex of about €140 million over the next 12 months. • Shareholder distributions, which we understand are undecided and flexible, but which we assume that on an annual basis would likely be in excess of the €120 million paid in 2016.

Covenant Analysis

Elenia continues to comply with its debt restriction covenants stipulated in its documentation and as per our analysis below.

Elenia's financing structure includes the following financial covenants for events of default:

- Net debt to EBITDA of 10.5x.
- FFO to net finance charges of 1.2x.

The documentation also includes lock-up covenants for shareholder distributions, which are:

- Net debt to EBITDA of 9.5x.
- FFO to net finance charges of 1.7x.

As of June 30, 2017, the ratios were 7.65x and 4.46x, respectively, showing significant headroom at both covenant levels, although we believe that headroom will reduce over the next 12 months, with the group estimating 8.75x and 4.23x at June 30, 2018. At the same time, we believe that Elenia has great flexibility to reduce shareholder distributions even before reaching lock-up covenants.

Structural Enhancements

The ratings on the notes also reflect various structural features designed to increase cash flow certainty for debtholders, including restricted payment conditions and a covenanted liquidity structure that should, in our opinion, enable Elenia to manage temporary cash flow shocks. The debtholders benefit from the following features, which include, but are not limited to:

- Two levels of financial covenants (trigger events and events of default) and an automatic 12-month standstill period after an event of default. These covenants provide creditors with significant control over Elenia at an earlier stage of financial or operational difficulty, or following material changes in business circumstances. The covenants reduce the borrower's probability of default and create an additional credit cushion.
- A liquidity facility provided by suitably rated counterparties is available to draw on if the group enters standstill, and is sufficient to cover finance charges. The liquidity facility remains undrawn at the end of September 2017 and amounts to €60 million.
- 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.

Ratings Score Snapshot

Senior secured debt rating: BBB/Stable

Business risk: Excellent

- Country risk: Low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: bbb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Negative (-1 notch)

Stand-alone credit profile: bbb-

- Structural enhancements: +1 notch

Reconciliation

Table 3

Reconciliation Of Elenia Finance Oyj Reported Amounts With S&P Global Ratings Adjusted Amounts

	--Fiscal year ended Dec. 31, 2016--						
Elenia Finance Oyj reported amounts							
(Mil. €)	**Debt**	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	1,892.8	(144.1)	168.4	84.8	99.9	168.4	66.3
S&P Global Ratings adjustments							
Interest expense (reported)	--	--	--	--	--	(99.9)	--
Interest income (reported)	--	--	--	--	--	0.3	--
Current tax expense (reported)	--	--	--	--	--	(0.1)	--
Operating leases	0.8	--	0.9	0.1	0.1	0.8	0.8
Postretirement benefit obligations/deferred compensation	0.9	--	--	--	0.1	(0.1)	(0.0)
Surplus cash	(14.9)	--	--	--	--	--	--
Dividends received from equity investments	--	--	0.1	--	--	0.1	--
Non-operating income (expense)	--	--	--	0.3	--	--	--
Debt--shareholder loans	(542.1)	--	--	--	--	--	--
Equity--other	--	542.1	--	--	--	--	--
EBITDA--income (expense) of unconsolidated companies	--	--	- 0.2	(0.2)	--	(0.2)	--
EBIT--income (expense) of unconsolidated companies	--	--	--	0.2	--	--	--
Interest expense--shareholder loan	--	--	--	--	(62.7)	62.7	--
Total adjustments	(555.3)	542.1	0.8	0.4	(62.5)	(36.5)	0.7
S&P Global Ratings adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	1,337.5	398.0	169.2	85.2	37.5	132.0	67.1

Figures are for the Elenia group consolidated.

Related Criteria

- 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 Transaction Structure Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- Criteria - Corporates - General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of December 4, 2017)	
Elenia Finance Oyj	
Senior Secured	BBB/Stable

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com