

Research Update:

Finnish Electricity Distributor Elenia Verkko 'BBB' Rating Placed On CreditWatch Negative On Regulatory Update

January 10, 2024

Rating Action Overview

- On Dec. 29, 2023, Finland's electricity regulator published its final decision on weighted average cost of capital (WACC) parameters, along with its calculation of the asset base for the 2024-2031 regulatory period.
- While S&P Global Ratings anticipates Elenia Verkko's regulatory asset base (RAB) will not expand as fast as we previously expected, the higher WACC should offset this.
- Therefore, we have placed our 'BBB' senior secured debt rating on Elenia Verkko on CreditWatch with negative implications.
- This indicates that we could lower the ratings by one notch if we anticipate that Elenia Verkko will not maintain funds from operations (FFO) to debt above 8% over the regulatory period ending 2031.

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Rating Action Rationale

The final decision of the 2024-2031 regulatory period suggests a cut in asset valuation.

Finnish electricity regulator the Energy Authority has published its criteria for this period, which started on Jan. 1, 2024. It includes three main elements that could have a significant credit impact on Finnish distribution networks:

- The existing asset base will be frozen at the 2024-unit price, with no adjustment for inflation at the end of the period.
- The unit prices will not be frozen for four years or asset base adjusted with inflation at the end of the period, as it has been previously. For investments made during the 2024-2031 regulatory period, the unit prices will be inflation-adjusted for each of those years and will be based on the average construction cost incurred by the industry during the investment period. Network operators will know final unit prices at the end of the period, not the beginning as before. This may impact the distribution system operators (DSO)'s capex plans, possibly resulting in

lower-than-expected spending, despite the government's carbon neutral goal by 2035.

- Unlike the October 2023 proposal, regulatory WACC remains based on median parameters and not on quartiles. It is confirmed at 7.37% for 2024 compared with the previously expected 6.9%.

Elenia Verkko Oyj's FFO to debt could fall below 8% without remedy measures. Although in our base case for the 'bbb-'stand-alone credit profile (SACP), we expect Elenia's FFO to debt will remain above 8%--this represents a downward trend from 10.1% in 2021 and toward the 8%-8.3% expected by 2025, following the 2022 cut to RAB. The 2024-2031 regulatory methodology could indicate a slower growth of RAB as the changes listed above come into effect. In addition, the lack of inflation adjustment as of end 2023 is likely to reduce our revenue expectations for this new regulatory period. With limited headroom in Elenia's FFO-to-debt ratio, keeping metrics above 8% would depend on remedy measures taken.

CreditWatch

We aim to resolve the CreditWatch within the next three months, once we know what remedy measures Elenia potentially could undertake to maintain FFO to debt above 8% over the new regulatory period.

Company Description

Elenia's main business operation is electricity distribution. It is the second-largest electricity DSO in Finland, behind Caruna Networks Oy, with a 12% market share and a network of about 76,700 kilometers, serving about 438,000 end users. In 2022, the company reported EBITDA of €204 million, excluding International Financial Reporting Standard (IFRS) 15 adjustments.

Elenia's main owners are Valtion Eläkerahasto and Allianz Capital Partners (ACP) on behalf of the Allianz Group, together with Allianz subsidiaries and investment vehicles managed or advised by ACP and Macquarie Super Core Infrastructure Fund.

Elenia's financing structure is ring-fenced. The financing group's issued debt includes structural enhancements designed to reduce the likelihood of default and the risk to creditors.

Our Base-Case Scenario

Assumptions

- Finland's GDP to grow 1.3% in 2024 and 1.5% in 2025.
- No tariff increases over 2024-2027.
- Pretax WACC at 7.37% for 2024 as per the final decision.
- EBITDA margins to be around 60%-65%.
- The company activates its cumulative allowed income over 2024-2027; that deficit is expected at €55 million at year-end 2023.
- Shareholder distributions of about €100 million-€110 million in 2024 and €45 million-€50 million in 2025.

- Capex of about €140 million-€150 million over the new regulatory period.
- No mergers or acquisitions.

Key metrics

Elenia Verkko Oyj--Key Metrics*

Mil. €	--Fiscal year ended Dec. 31--			
	2021a	2022a	2023e	2024f
EBITDA	223.0	214.0	200-220	210-230
Funds from operations (FFO)	178.0	169.0	160-170	160-170
Capital expenditure	157.0	154.0	110-130	140-160
Dividends	70.0	14.0	140-160	90-110
Debt	1,767.0	1,786.0	1,800-2,000	1,800-2,000
Debt to EBITDA (x)	7.9	8.4	9.0-9.5	8.5-9.0
FFO to debt (%)	10.1	9.5	8.5-9.0	8.2-8.7

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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 | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Finnish Networks' Rating Headroom Could Shrink On 2024-2031 Regulatory Update, Dec. 8, 2023
- Elenia Verkko Oyj, June 13, 2023.

Ratings List

CreditWatch/Outlook Action

	To	From
Elenia Verkko Oyj		
Senior Secured	BBB/Watch Neg	BBB/Stable

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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