FitchRatings

Fitch Affirms Teollisuuden Voima Oyj at 'BBB', Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-Warsaw/London-21 May 2015: Fitch Ratings has affirmed Teollisuuden Voima Oyj's (TVO) Long-term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB' and its Short-term IDR at 'F3'. The Outlook on the Long-term IDR is Stable.

The affirmation reflects TVO's solid operating performance in 2014 and its financial and business profile remaining in line with Fitch's expectations. TVO continues to benefit from demonstrated strong shareholder support. Delays to the commissioning of the third 1,600 MW nuclear power plant Olkiluoto 3 (OL3) and further weakening of the wholesale power price outlook are mitigated by the likely significant postponement of a fourth nuclear power station (Olkiluoto 4 (OL4)) and, as a result, lower capex over the next 5-10 years. The Stable Outlook is dependent on strong shareholder support remaining in place through the delays.

The nine-year delay of OL3 against the original schedule to late 2018 increases production costs through additional financing costs. Combined with a decrease in forward Nord Pool prices, the delay continues to erode the value creation for TVO's shareholders who off-take at cost electricity produced by TVO and by OL3 when it is operational. The delay is also negative for TVO's cash flows as the company has to service debt related to OL3, while full cost coverage of OL3 by TVO's shareholders, including interest costs, may be initiated only when the plant is commissioned.

KEY RATING DRIVERS

Not-for-Profit Nuclear Generator

The ratings and Stable Outlook reflect TVO's position as a not-for-profit Finnish nuclear generator, producing at-cost electricity for its six shareholders. The two largest shareholders are Pohjolan Voima Oy (PVO), a not-for-profit generator owned by a consortium of Finnish industrials (mainly pulp and paper) and utilities which owns a 58.5% stake in TVO and Fortum Power & Heat, a 100% owned subsidiary of Fortum Corporation (A-/Negative), which owns 25.8% of TVO. For more details on Fitch's analytical approach to rating Mankala companies see "Analytical Features of Finnish Not-for-Profit Electricity Generators" dated 12 December 2013 on www.fitchratings.com).

Low All-in Electricity Price

The production costs of TVO's two existing nuclear units, Olkiluoto 1 (OL1) and Olkiluoto 2 (OL2), 880MW each, are competitive (about EUR20/MWh), compared with forward Nord Pool prices of about EUR28/MWh for 2015-2018. TVO's average production costs will increase substantially when OL3 is operational, mainly due to the depreciation and interest costs of the new unit that will start to be compensated by TVO's shareholders.

No Merchant, Volume Risk

TVO has no wholesale electricity price or volume exposure, as its shareholders are the at-cost off-takers of the electricity produced. Shareholders have an incentive to keep costs low and to off-take their proportion of the energy due to the large fixed costs they have to cover according to TVO's articles of association. If a shareholder fails to cover annual fixed costs (80% of total costs paid one month in advance, which also includes debt instalments) and variable costs (around 20% of costs) in proportion to their off-take, TVO would cut electricity supply and sell the electricity to another shareholder, or onto the Nordic electricity exchange (Nord Pool).

Strong Shareholder Support

Shareholders remain committed to OL3 even as escalating costs erode competitiveness against Nord Pool prices. A EUR300m loan was committed in 2013 in response to the additional delay for OL3, maintaining the equity/debt commitment at 25/75%. The shareholder base has been stable since inception and electricity sold onto Nord Pool has been zero.

Weak Credit Ratios

As TVO is a not-for-profit company, Fitch considers traditional leverage or coverage ratios, which are weak, as less relevant to the ratings than for utilities operating on a fully commercial basis. In 2014, TVO's funds from operations (FFO) including cash interest paid was negative and FFO interest cover was below 1x as interest expense related to OL3 debt in the construction phase is not covered by shareholders but capitalised.

Strong Operational Performance

TVO's nuclear power plants are some of the most efficient in the world, with an outstanding safety record partly due to strict Finnish safety standards. In 2014 TVO achieved its highest production output to date at 14.7TWh due to the extensive refurbishment that has taken place of both nuclear units. In the past ten years, TVO's achieved a high, around 95% average utilisation rate of its nuclear power plant.

Asset Concentration Risk
The ratings are constrained by asset concentration risk, as about 97% of total production comes from a single nuclear power plant. This is mitigated by TVO's excellent operational and safety record.

Low Political Risk
Finland has a supportive regulatory environment for the construction of nuclear power plants, given the country's concerns over security of supply (TVO is a key generator of base-load electricity in Finland - it accounts for around 18% of Finnish total electricity consumption), the need for reasonably-priced electricity for its energy-intensive industries, and stringent EU CO2 emission requirements requiring the phase-out of thermal plants.

Olkiluoto 4
TVO's Board of Directors recently proposed to its shareholders that due to the delays to OL3 the company will not apply for a construction license for OL4 by the June 2015 deadline. TVO's earlier application to extend the period of validity of the decision-in-principle for OL4 from June 2015 to 2020 was rejected by the government in September 2014. As a result, we expect that the OL4 project is likely to be postponed by at least several years, and could be reinstated, probably after OL3 is operational in 2018. This would lead to a lower capex plan in the next 5-10 years. In Fitch's view, a binding commitment to build OL4, when OL3 is not fully operational, could be negative for the ratings.

So far TVO has spent EUR80m on the OL4 project (planning works, application for the decision-in-principle). This amount was fully funded by the shareholders.

Fully Funded Nuclear Liabilities
Under the Finnish Nuclear Act, nuclear operators' (non-discounted) nuclear liabilities (assessed annually) must be fully funded through contributions to a centrally administered fund.

KEY ASSUMPTIONS
Fitch's key assumptions within our rating case for the issuer include:
- Fitch calculates projected EBITDA and credit ratios hypothetically in a profit-making scenario, assuming that TVO is able to sell its electricity output at market prices instead of at-cost prices. This measures the incentive for shareholders to maintain their at-cost off-takes, as well as the theoretical dividend that would instead be paid in a profit-making scenario.
- Electricity price remains constant over the forecast period (EUR41.7/MWh, which equals the 2005-2014 average spot price in Finland).
- OL3 is fully operational from 2019.
- Average production costs of TVO to increase to about EUR32/MWh in the first few years of OL3 operations from about EUR20/MWh in 2013-2014 (with OL1 and OL2).

RATING SENSITIVITIES
Positive: Future developments that could lead to positive rating action include:
- A favourable outcome for TVO in its litigation with OL3 construction contract supplier, the Areva-Siemens consortium, with a significant compensation for the delay, thus decreasing TVO's production costs. A resolution is not expected until after the commissioning of OL3.
- Significantly higher equity funding.

Negative: Future developments that could lead to negative rating action include:
- Evidence of reduced support from shareholders or structural changes in the Mankala principle lowering the strength of shareholder support.
- Further OL3 delays, impacting TVO's production costs, litigation costs materialising with the OL3 contract supplier, and any adverse regulatory or fiscal changes.
- A binding commitment to the construction of OL4 when OL3 in not fully operational and significant debt funding as a result.
- TVO's production costs exceeding Nord Pool prices on a sustained basis when OL3 is completed, signifying reduced value creation at TVO for its shareholders.
- A decline in operating performance, safety issues and significantly reduced liquidity reserves.
- Expected equity ratio falling towards the minimum covenanted threshold of 25%.

LIQUIDITY AND DEBT STRUCTURE
TVO maintains adequate liquidity, with cash of at least EUR90m. As of end-March 2015, cash and cash equivalents were EUR377m (including EUR200m of money market funds) against short-term debt obligations of EUR239m. An undrawn revolving credit facility of EUR1.5bn (of which EUR50m matures in 2016 and EUR1.45bn matures in 2018), together with committed but undrawn shareholder loans of EUR400m allocated to the OL3 project, largely cover capex and maturing debt requirements in 2015-17. Fitch expects the company to have committed funding to cover funding needs related to capex and debt refinancing for two years on a rolling basis.

TVO's EUR4.6bn debt at end-March 2015 comprises mostly bonds (60% of debt), both public and private placements and a loan from the Finnish State Nuclear Waste Management Fund which is re-lent to TVO's shareholders (22% of debt). About 62% of TVO's total debt is allocated to the OL3 project.

In February 2015 TVO issued a EUR500m 10-year bond under its EMTN Programme with an annual coupon of 2.125%.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable criteria, 'Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage', dated 28 May 2014, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage

Additional Disclosure
Solicitation Status