



## Fitch Affirms Teollisuuden Voima Oyj at 'BBB-'; Outlook Stable

Fitch Ratings-Warsaw/London-28 September 2018: Fitch Ratings has affirmed Teollisuuden Voima Oyj's (TVO) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB-' and Short-Term IDR at 'F3'. The Outlook on the Long-Term IDR is Stable.

The affirmation reflects the approaching completion of the Olkiluoto 3 (OL3) nuclear power plant, the settlement agreement between TVO and OL3 plant supplier consortium (Areva NP, Areva GmbH and Siemens AG (A/Stable) and Areva SA, fully owned by the French state). It also incorporates an improved power price environment and hence value creation for TVO's shareholders. The settlement agreement reduces several uncertainties during final stages of the OL3 construction, such as TVO's final investment costs and the supplier consortium having sufficient funds to complete the project.

TVO continues to benefit from demonstrated strong support from its shareholders, evidenced through arrangements for fixed and variable cost coverage as well as committed shareholder loans covering part of the funding.

### KEY RATING DRIVERS

**OL3 Nears Commissioning:** The construction of the 1,600 MW OL3 nuclear power plant nears commissioning as additional critical milestones, such as cold and hot functional tests, have been successfully completed this year. The project has experienced a 10-year delay and substantial cost overruns resulting in the total project cost increasing to EUR5.5 billion from the originally planned EUR3.4 billion. The delay has been negative for TVO's cash flows as the company has to service debt related to OL3 without a cost pass through to shareholders in the construction phase. Cash flows will improve after the OL3 completion when TVO's shareholders' full cost coverage of OL3, including interest costs and asset depreciation, starts. Together with capex returning to maintenance levels after the OL3 completion, this should allow TVO to start deleveraging.

**OL3 Settlement Reduces Risks:** As a result of the settlement in March 2018, TVO will receive compensation of EUR450 million from the supplier consortium companies, and at the same time the supplier consortium companies will be entitled to receive an incentive payment of up to EUR150 million upon timely completion of the OL3 project. The settlement further specifies additional penalties paid by the supplier consortium in case of further delays beyond the end of 2019 (capped at EUR400 million), and also includes an undertaking and trust mechanism by supplier consortium to secure funds for completion of the project, including all guarantee periods.

The settlement reduces OL3's production costs by about EUR1/MWh (and average production costs of TVO's three units by about EUR0.5/MWh), which allows moderately better value creation for TVO's shareholders.

**Improvement in Power Prices:** Value creation for TVO's shareholders, which is one of the key rating considerations, has improved as Nordic power prices have shown some signs of recovery from the low levels in 2015 and 2016. TVO's average production costs will increase to close to EUR30/MWh after the commissioning of OL3 (mostly due to higher depreciation and interest costs) from current about EUR 20/MWh. This compares with Finnish area futures electricity prices of around EUR35/MWh for 2020-2021.

**Not-for-Profit Nuclear Generator:** The ratings reflect TVO's position as a not-for-profit Finnish nuclear generator, producing at-cost electricity for the company's six shareholders. TVO's largest shareholder (with 58.3%) is Pohjolan Voima Oyj (PVO), a not-for-profit generator owned by a consortium of Finnish industrials (mainly pulp and paper companies UPM-Kymmene Oyj and Stora Enso Oyj (BBB-/Stable)) and utilities. Its second-largest shareholder (with 25.8%) is Fortum Power & Heat Oy, a 100% owned subsidiary of Fortum Oyj (BBB/Stable).

**Strong Shareholder Support:** TVO's standalone rating benefits from demonstrated strong support from the company's shareholders, evidenced through arrangements for fixed and variable cost coverage and shareholder loans covering part of the funding. In December 2017, TVO's shareholders decided to increase the shareholder loan commitment by EUR150 million partly to support TVO after an additional delay of the OL3 project announced at that time. As a result, undrawn shareholder loan commitments increased to EUR350 million supporting the

company's liquidity.

**No Merchant, Volume Risk:** TVO has no direct 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 falling due annually) and variable costs (around 20% of costs) in proportion to their off-take, TVO would cut the electricity supply and sell the electricity to another shareholder or onto Nord Pool.

**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 - its nuclear plant accounts for roughly 16% of Finnish total electricity consumption), the need for reasonably-priced electricity for its energy-intensive industries, and stringent EU CO2 emission requirements driving the phase-out of thermal plants. After the completion of the OL3 plant planned for September 2019, the electricity produced by TVO will cover about 30% of the country's demand.

The Finnish government has recently approved the extension of the operating licences for the Olkiluoto 1 and 2 plant units by 20 years to 2038.

#### DERIVATION SUMMARY

As TVO is a not-for-profit company, Fitch considers traditional leverage or coverage ratios, which are weak compared with other European utilities such as Fortum (BBB/Stable) or Vattenfall AB (BBB+/Stable), as less relevant for the ratings than for utilities operating on a fully commercial basis. In 2017, TVO's funds from operations (FFO) after 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.

Compared with many other European utilities, TVO's ratings are constrained by asset concentration risk, as almost all electricity production is from a single nuclear power plant. This is mitigated by TVO's solid operational and safety record as TVO's nuclear power units are some of the most efficient in the world, with an outstanding safety record partly due to strict Finnish safety standards. In addition, TVO's rating is supported by demonstrated strong support from shareholders.

#### KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- 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.
- OL3 fully operational from September 2019.
- Average production costs of TVO to increase close to EUR 30/MWh in the first few years of OL3 operations, from around EUR21/MWh in 2017 (with OL1 and OL2 only).
- Finnish area prices of around EUR35/MWh in 2020-2021.

#### RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Structural long-term improvement in power price environment leading to enhanced value creation at TVO for its shareholders.
- Significantly higher equity funding.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- TVO's production costs significantly exceeding Finnish area prices on a sustained basis when OL3 is completed, leading to value destruction at TVO for its shareholders.
- Evidence of reduced support from shareholders (e.g. equity ratio falling towards the covenant level of 25%) or structural changes in the Mankala principle undermining the strength of shareholder support.
- Substantial OL3 delays leading to additional costs exceeding the EUR400 million penalty cap agreed in a settlement with the consortium companies.
- Any adverse regulatory or fiscal changes.
- A decline in operating performance, safety issues and significantly reduced liquidity reserves.

#### LIQUIDITY

Adequate Liquidity: Cash and cash equivalents as at end-June 2018 amounted to EUR102 million. Committed undrawn credit facilities amounted to EUR1,400 million, resulting in sufficient total liquidity to cover for 2018-2019 debt repayments of EUR767 million. In addition, the company has committed and undrawn shareholder loans of EUR350 million allocated to OL3 project costs if needed. The group's overall liquidity is considered adequate. After OL3 comes online and shareholders start to cover full costs (including interest costs and asset depreciation), total debt is projected to start declining gradually.

Contact:

Primary Analyst  
Arkadiusz Wicik  
Senior Director  
+48 22 338 6286  
Fitch Polska S.A.  
Krolewska 16  
00-103 Warsaw

Secondary Analyst  
Harry Monthen  
Analyst  
+44 20 3530 1247

Committee Chairperson  
Josef Pospisil  
Managing Director  
+44 20 3530 1287

Summary of Financial Statement Adjustments

- A standard multiple of 8x was applied to operating leases
- Fair value of cross currency swaps reflected in adjusted debt.

Media Relations: Adrian Simpson, London, Tel: +44 20 3530 1010, Email: [adrian.simpson@fitchratings.com](mailto:adrian.simpson@fitchratings.com)

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

**Applicable Criteria**

Corporate Rating Criteria (pub. 23 Mar 2018) (<https://www.fitchratings.com/site/re/10023785>)  
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)  
(<https://www.fitchratings.com/site/re/10024585>)  
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018) (<https://www.fitchratings.com/site/re/10036366>)  
Sector Navigators (pub. 23 Mar 2018) (<https://www.fitchratings.com/site/re/10023790>)

**Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form (<https://www.fitchratings.com/site/dodd-frank-disclosure/10046314>)  
Solicitation Status (<https://www.fitchratings.com/site/pr/10046314#solicitation>)  
Endorsement Policy (<https://www.fitchratings.com/regulatory>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY

10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

## **SOLICITATION STATUS**

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

### **Fitch Updates Terms of Use & Privacy Policy**

We have updated our Terms of Use and Privacy Policies which cover all of Fitch Group's websites. Learn more (<https://www.thefitchgroup.com/site/policies>).

### **Endorsement Policy**

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.