# FITCH AFFIRMS TEOLLISUUDEN VOIMA OYJ AT 'BBB', OUTLOOK STABLE

Fitch Ratings-Warsaw/London-23 May 2014: 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 for the Long-term IDR is Stable.

The affirmation reflects Fitch's assessment of TVO's financial and business profile remaining in line with expectations. Even with a further weakened medium-term outlook for the forward Nord pool wholesale electricity prices and potential further delays on the commissioning of the third 1,600 MW nuclear plant Olkiluoto 3 (OL3), TVO continues to benefit from demonstrated strong shareholder support and fixed off-take agreements. The Stable Outlook is dependent on strong shareholder support remaining in place through the delays.

The multi-year delay of OL3 continues to increase production costs through additional financing costs. This, combined with a decrease in forward Nord Pool prices, 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 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 under what is known as a Mankala model. 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) 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. In December 2013 Fitch published a Primer on the "Analytical Features of Finnish Not-for-Profit Electricity Generators" (available on www.fitchratings.com), which discusses the analytical approach to rating Mankala companies.

Production costs of TVO's two existing nuclear units, Olkiluoto 1 and Olkiluoto 2, 880MW each, are highly competitive (about EUR20/MWh), compared with forward Nord Pool prices of about EUR30/MWh for 2014-2018. However, TVO's average production costs will increase substantially when OL3 is operational. This is 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 legally cover. 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 shareholdings available for sale have generated a large number of interested buyers and electricity sold onto Nord Pool has been zero over the last five years.

Weak Credit Ratios
As TVO does not seek to maximise profit, Fitch considers traditional leverage or coverage ratios, which are weak, as less relevant to the ratings than in a case of utilities operating on a fully commercial basis. In 2013, 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 due to strict Finnish safety standards. In 2013 TVO produced its highest production output to date at 14.6TWh due to the extensive refurbishment that has taken place on both plants.

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

Low Political Risk
Finland has a highly 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 17% of Finnish total electricity consumption), the need for cheap electricity for its energy- intensive industries, and stringent EU $CO_2$ emission requirements requiring the phase-out of thermal plants. Given the above, a tax of EUR50m has also been levied on low carbon generators from 2014. The impact on TVO is expected at between EUR5m-EUR10m (an additional cost for TVO that would be passed on to its shareholders).

Olkiluoto 4
Olkiluoto 4's (OL4) nuclear power plant competitive bids have been received. However, citing the delay of OL3, TVO has recently asked the government to extend the deadline for a decision in principle on OL4 to 2020 from 2015. In Fitch's view, a binding commitment to build OL4, when OL3 is not fully operational, may be a rating risk.

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.

LIQUIDITY AND DEBT STRUCTURE

TVO maintains adequate liquidity, with cash of at least EUR90m. As of end-2013, cash and cash equivalents were EUR144m against short-term debt obligations of EUR210m. An undrawn revolving credit facility of EUR1.5bn (EUR50m matures in 2016 and EUR1.45bn matures in 2018), together with committed but undrawn shareholder loans of EUR720m, largely cover capex and maturing debt requirements in 2014-16. Fitch expects the company to have committed funding to cover funding needs related to capex and debt refinancing for two years.

RATING SENSITIVITIES

Positive: Future developments that could lead to positive rating actions include:

- A favourable outcome for TVO in its litigation with construction contract supplier Areva, 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 actions include:
- Evidence of reduced support from shareholders

- Further OL3 delays, impacting TVO's production costs, litigation costs materialising with Areva, 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%

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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 5 August 2013, are available at www.fitchratings.com

Applicable Criteria and Related Research: