S&P Global Ratings

Research

Finnish Nuclear Power Producer TVO 'BB+/B' Ratings Affirmed; Outlook Stable

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- We are applying our 2013 Corporate Methodology to the rating on Finland-based nuclear power producer TVO in order to better align our ratings assessment with our understanding of the company's underlying risks and the atypical "not-for-profit" nature of organization, being a "Mankala" company.
- As a result of our review, we are affirming our 'BB+/B' long-term and short-term corporate credit ratings on TVO and our 'BB+' issue rating on the €1.3 million revolving credit facility and €4.0 billion euro medium-term note program.
- The stable outlook reflects the stability of TVO's cash flow driven by the contractual nature of its revenue and cost structure backed by its shareholders. It also reflects our assumption that the completion of the third nuclear reactor will not face further significant delays or cost overruns, and that TVO's cost advantage versus market prices will not deteriorate further.

On Dec. 13, 2016, S&P Global Ratings affirmed its 'BB+/B' long-term and short-term corporate credit ratings on Finland-based nuclear power producer Teollisuuden Voima Oyj (TVO). The outlook is stable.

We also affirmed our 'BB+' issue rating on TVO's €1.3 million revolving credit facility (RCF) and €4.0 billion euro medium-term note program (EMTN).

The affirmation reflects TVO's protection from competition and market price volatility thanks to the contractual arrangements with its shareholders. TVO's ratings are also supported by its importance in the Finnish electricity market as it generates about 20% of total electricity produced in Finland, and this share will grow when its third nuclear reactor comes on-stream, scheduled for end of 2018. Its existing plants have a strong operational track record, with a high capacity utilization rate (above 90%, despite recent years' outages for upgrades) and the contractual ability to pass through its fixed and variable costs to shareholders insulates the company from volatility of profitability.

TVO is a Finnish nuclear power operator operating under a "Mankala" model. Its purpose is to provide a stable electricity supply at cost to its shareholders, which are Finnish industry, utilities, and municipalities.

According to TVO's articles of association, the shareholders are severally liable for the company's annual variable and fixed costs (accounting for about 80%-85% of total costs), including interest expenses and loan instalments. We believe that TVO's shareholders view their stakes as long term. They have shown support by supplying equity in the form of shareholder loans to help fund the third nuclear power plant Olkiluoto 3 (OL3). Our view of the shareholders' willingness and ability to continue providing support to TVO is incorporated as a positive adjustment in our final rating.

We also see the shareholders' support to TVO as an effective mitigant to TVO's weakening cost competitiveness due to the deterioration in Finnish power prices and future price expectations. Future prices are currently predicted by the market to be at a similar level to TVO's expected full cost of production when the third nuclear power plant OL3 is commissioned at the end of 2018. In our view, despite this diminishing the cost advantage TVO currently offers to its shareholders, we expect them to continue support the company.

The ratings are constrained by the company's high level of debt (about €5 billion) compared to its EBITDA, also taking into consideration the expected increase of tariffs charged from shareholders after commissioning of OL3. The debt level has increased significantly over the past years due to cost overruns in the OL3 project. We understand that due to the company's business model, TVO's financial ratios are less indicative than those of profit-maximizing enterprises. Nevertheless, we still consider that its financial metrics are likely to remain under pressure even after the OL3 commissioning, and that it would take many years before the company undertakes any meaningful deleveraging. At the same time, we note that TVO, according to its articles of association, can always charge its shareholders its yearly interest expenses, which is a positive credit factor.

TVO has a relatively short-dated debt-maturity profile--about four years--compared with the economic lifetime of its asset base of over 40 years. This increases the company's exposure to refinancing risk. Although TVO should be able to charge its shareholders for instalments and interest payments on loans falling due annually--in accordance with its loan agreements--TVO's debt does not benefit from any guarantees.

- Finnish area power prices of about €30-€32/megawatt hour (mwh) reducing to about €25-€27/mwh in the medium term.
- TVO will continue to fully cover its production costs (including interest expenses) for existing plants OL1 and OL2, which we expect will remain competitive in the near term.
- No unexpected outages at OL1 and OL2.
- No further cost overruns in the completion of OL3.
- Use of €300 million of shareholder loan commitments for OL3.

Based on these assumptions, we arrive at the following credit measures:

- Debt to EBITDA of about 15x-17x from 2019 onwards; and
- FFO interest coverage of 2.3x- 2.4x from 2019.

We now analyze TVO under our 2013 Corporate Methodology to better align our ratings assessment with our understanding of the company's underlying risks and the atypical "not-for-profit" nature of the organization being a Mankala company. We note that, in the event that shareholders refuse to purchase the power, the company is also entitled to sell electricity to third parties. The ability to sell surplus power into the market at the market price provides some degree of flexibility that pure not-profit entities do not have. Furthermore, although TVO is not a profit maximizer as such, we acknowledge that the company has to maintain its cost competitiveness in the long term in order to remain attractive for its shareholders and that higher tariffs will be charged after OL3 is commissioned in order to cover for the increased costs, and gradually repay TVO's debt.

The stable outlook reflects the stability of cash flow driven by the contractual nature of TVO's revenue and cost structure backed by its shareholders. It also reflects our assumption that the completion of the third nuclear reactor will not face further significant delays or cost overruns, and that TVO's cost advantage versus market prices would not further deteriorate.

We could lower the rating on TVO if we see further deterioration in Finnish area power prices or an unexpected increase in the cost of completion of OL3, as this could indicate weakening cost advantage and lower future value for shareholders. We could also lower the ratings if we saw signs that the financial risk profile further weakens beyond our expectations during the final completion of OL3, or if we would doubt that there would be a gradual improvement following the completion of the plant at the end of 2018. This could, for example, be the case if there were continued cost overruns and delays of completing the plant or any cash outflows from the arbitration process with the supplier, and if this were not mitigated by extended shareholder support. Finally, we could also lower the ratings if we saw a diminishing willingness or ability of the shareholders to support TVO.

We could raise the rating on TVO if the company significantly reduced its leverage, but we see this scenario as unlikely at the moment.

RELATED CRITERIA

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