Three Northern European TSOs Ratings Affirmed As Congestion Income Is Broadly Credit Neutral; Outlooks Remain Stable

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- The power price environment in Europe has led some European transmission system operators (TSOs) to receive massive amounts of congestion income since second-half 2021. We expect large power price spreads between price areas to lead to continued high congestion income in 2023 for TSOs in Northern Europe. Over 2021-2022, Norwegian Statnett received Norwegian krone (NOK)28.2 billion (€2.5 billion), Finnish Fingrid €1.2 billion, and Latvian Augstsprieguma Tikls (AST) €147 million of congestion income.
- In the EU, congestion income is regulated and must be used to cover investment to reduce bottlenecks. In 2022, some regulators allowed congestion income to be used to cover increased market-based expenditure.
- Congestion income improves companies' liquidity and reported net debt since cash received is fully fungible. However, at the end of each period, regulators are keen for operators to spend congestion income as soon as possible. We therefore see the cash inflow as temporary and essentially credit-neutral.
- As a result, we affirmed our ratings on all the three TSOs.
- The outlooks remain stable as we do not expect congestion income to result in stronger credit metrics in the long term for the three TSOs, mostly because we expect the three TSOs will invest congestion income to reduce future congestion risks and to cover operating costs. In Norway, we expect Statnett to balance the excess congestion income through tariff reduction in 2023 so that total revenue corresponds with the maximum allowed revenue over time.

PARIS (S&P Global Ratings) April 14, 2023--S&P Global Ratings today affirmed its long-term issuer credit ratings on:

- Finnish Fingrid Oyj at 'AA-',
- Norwegian Statnett SF at 'A+', and
- Latvian Augstsprieguma Tikls (AST) at 'A-'.

We also affirmed our 'A-1+' short-term issuer credit rating and 'K-1' Nordic regional scale rating on Fingrid and our 'A-1' short-term issuer credit rating on Statnett.

The outlooks on the three TSOs remain stable.

Congestion income comes from power price spreads between different price zones and is regulated by the EU. In Northern Europe (Nordics and Baltics), the electricity market is divided into 15 different price areas (five in Norway, four in Sweden, two in Denmark, one in Finland and one per Baltic country) connected by interconnectors that must match demand and supply of electricity at the lowest possible price at any time. Should the demand between zones exceed the physical capacity of the transmission lines, a price difference arises, and the volumes exported/imported across the border between two zones give rise to a price difference, which when multiplied by the volumes, yields the congestion income. Cross national border congestion revenue is equally shared between the two TSOs on each side of the border. It is calculated according to the following formula:

- Congestion income [€] = Transmission in the day-ahead market [MW] * Price difference between areas [€/MWh] * duration of the congestion

The EU regulation on congestion income allocation (Article 19) indicates that congestion income must be used to:

- Guarantee the actual availability of the allocated capacity, or
- Finance spending to maintain or increase cross-zonal capacities to suppress bottlenecks by optimizing the use of existing interconnectors or expanding their capacity.

Should the two above stated priorities be fulfilled, residual congestion income can be used to reduce tariffs, depending on each regulator's approval.

Despite the boost to credit ratios under IFRS, we don't view any change to the underlying quality of the networks. The only benefit of the congestion income in credit quality terms is a temporary improvement in liquidity. Under IFRS, congestion income is a cash flow item typically reported in working capital movements. Part of it is recognized in the income statement as "other income" to compensate for associated costs for cross-zonal transmission while another part is used for investments as defined, in the EU, by Article 19. In the EU, capital expenditure (capex) financed by congestion income doesn't lead to regulated asset base (RAB) growth, i.e. future EBITDA growth and credit metrics are not supported by the use of congestion income to finance capex. Secondarily, while in Finland, depreciation from these assets is included in the regulatory formula, this is not the case for Latvia. Unused congestion income is placed on a separate line ("congestion income") in liabilities but from a treasury perspective is fully fungible with the TSO's other cash holdings; EU regulations do not set a time limit for using this income. In 2022, we understand that Latvian and Finnish regulators approved the use of the congestion income to compensate for higher market-based costs stemming from higher power prices, as typically 1%-2% of the power is lost in the transmission process and related to transmission losses and system services. Such approvals enabled networks to stabilize EBITDA and to reduce the expected tariff increase of 2023 and 2024. In Norway, as congestion revenue is fully recognized as operating revenue, Statnett could fully use this income for general purposes and reduce tariffs close to zero.

While IFRS leads to volatile ratios in 2022 and 2023, we view the accrued deferred income as transitory. The large share of congestion income received has improved networks' liquidity since end-2021, which we factor into our analysis as a tangible benefit. However, we view the underlying quality of TSO cashflows as unchanged and consistent with our view of regulatory frameworks as strong for Norway (see "Norwegian Electricity Distribution And Transmission Regulatory Framework: Supportive," published Oct. 15, 2020) and Finland ("Finland's Electricity Transmission And Distribution Regulatory Frameworks: Very Supportive," May 11, 2021), and strong/adequate for Latvia ("Latvian Gas And Electricity Transmission And Gas Storage Regulatory Frameworks: Mostly Supportive," Nov. 30, 2022). This is because we ignore the temporary benefit of (as yet) unused congestion income and focus on regulatory cash flows and debt to assess the TSOs' financial profiles. Credit metrics will largely be above our upside thresholds under IFRS until the balances of accrued unused congestion income reduce from 2024 and should disappear by 2025-2026 depending on the accumulation of new congestion income received and the development of market-based costs as well as TSOs' investment in congestion or compensation to users via lower tariffs. In Norway, we expect the effect to disappear as early as end-2023 because of setting tariffs close to zero.

Fingrid Oyj

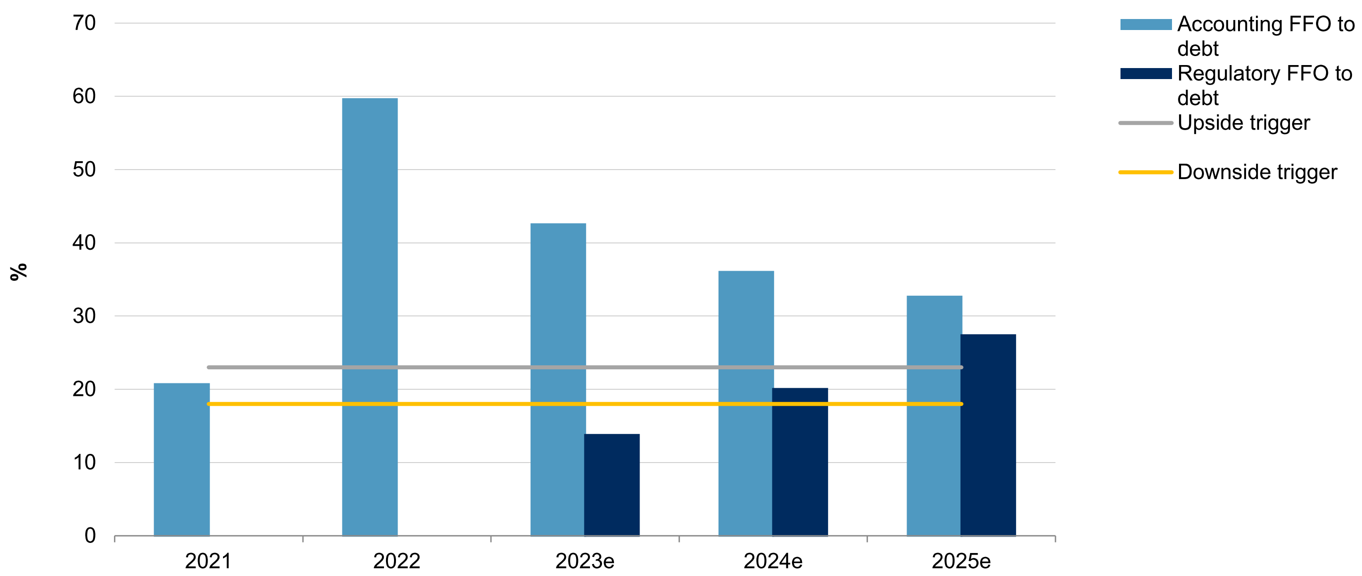
Fingrid is Finland's national electricity TSO and owner of the Finnish power transmission grid. It is connected to the Nordic region through two interconnectors with Sweden and two with Estonia. Fingrid is majority owned by the Finnish government, which holds 53% of the shares and 71% of the voting rights.

Over 2021-2022, Fingrid received €1.2 billion of congestion income, of which it used €382 million to offset expenses (€248 million) and for investments (€134 million); over the same period, total capex amounted to €475 million. As of year-end 2022, the balance of accrued congestion income reached €1,064 million.

To partially give back to end-users as per regulation, Fingrid has cancelled three months of tariffs in 2023 (January, February, and June) which could be supplemented by another three months upon Fingrid's request. Lower tariff revenue will be compensated by congestion income already accrued or to be received in 2023 and recognized as revenue. Combined with annual investments to improve cross-border connections as per the EU regulation, we expect the balance of accrued congestion income to gradually reduce to about €200 million by 2025. We focus on funds from operations (FFO) to debt reverting to about 20% as early as 2024, consistent with expectations for the 'a+' stand-alone credit profile (SACP).

Chart 1

Fingrid: Congestion income has a temporary effect on FFO to debt



FFO--Funds from operations. e--Estimate. Source: S&P Global Ratings.

Outlook

The stable outlook reflects our assumption that Fingrid will remain strategically important to the Finnish government as Finland's monopoly TSO, with stable and predictable underlying earnings supported by a favorable regulatory framework. We anticipate that Fingrid's ratio of FFO to debt--based on regulatory EBITDA and adjusting for unused congestion income--will recover to 18%-23% from 2024 after Fingrid recognizes congestion income as revenue and uses the balance for investments.

Downside scenario. We could lower our ratings on Fingrid if its SACP weakened to 'a'. This could be due to deteriorating credit measures, with FFO to debt falling well below 18% and no signs of recovery. This could occur if one or more of the following occurs:

- Fingrid doesn't sufficiently use congestion income for investments or to compensate for lower tariffs over the next three years.
- Congestion income is well below our base-case assumption or changes to the regulation on use of congestion income result in a negative effect on ratios for Fingrid.
- Fingrid materially increases dividends or capex with work-in-progress capex flowing into the RAB; or
- The regulator imposes a substantial change to the regulatory framework for the upcoming four-year period starting 2024 that results in significantly lower remuneration. We currently

view such a change as unlikely.

Upside scenario. Rating upside is limited. We could raise the ratings on Fingrid if we revised upward its SACP. This would likely stem from a strengthening of the financial risk profile on the back of a long-term solution and balancing of congestion income in the regulation including FFO to debt reaching and stabilizing above 23% after the use of congestion income for revenue and investments.

We could also upgrade Fingrid if we saw a higher likelihood of extraordinary support from the government, which we currently do not expect.

Augstsprieguma Tikls (AST)

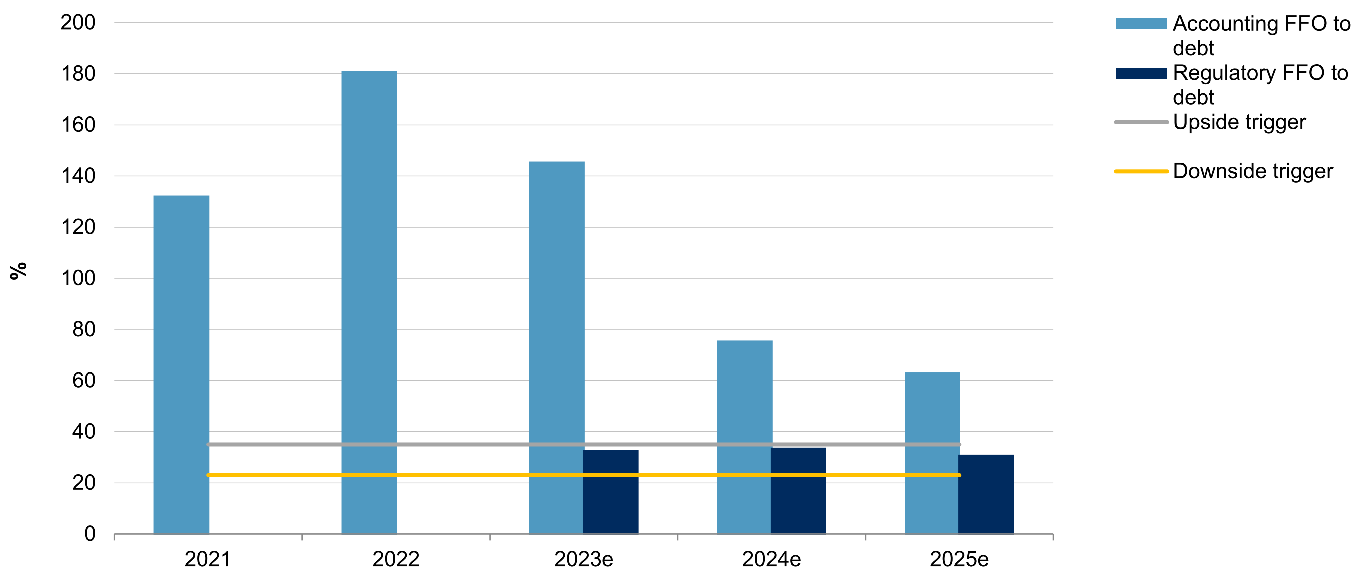
AST is Latvia's national electricity TSO and owner of the Latvian power transmission grid. It transmits approximately 9 terawatt hours (TWh) of electricity throughout Latvia and neighboring countries, including Estonia, Lithuania, Russia, and Belarus, through seven interconnections (two with Estonia, four with Lithuania, and one with Russia). The import of electricity from Russia to the Baltic States and Finland has been stopped since May 2022.

Over 2021-2022, AST received €147 million of congestion income of which it used €66 million to offset congestion-related expenses and for investments. As approved by the regulator, AST used an additional €36.5 million to cover for increased operating expenditure resulting in a year-end 2022 balance of accrued congestion income of €143 million.

To reduce the tariff increase for the new tariff period the regulator approved AST's partial use of the balance of accrued congestion income to compensate for higher costs. We therefore now expect AST to recognize €40 million-€45 million in 2023 as revenue prior to new tariffs being enforced, reducing the balance of accrued congestion income to about €100 million-€110 million by year-end 2023 and resulting in FFO to debt around 30%-33% over 2023-2024.

Chart 2

AST: Congestion income has a temporary effect on FFO to debt



FFO--Funds from operations. e--Estimate. Source: S&P Global Ratings.

Outlook

The stable outlook reflects our expectation of stable and predictable cash flows from AST's regulated transmission activities, with FFO to debt around 30%-33% over the medium term. Cash inflows from congestion income provide a significant liquidity buffer.

Downside scenario A downgrade could stem from a lower SACP. This could occur if FFO to debt fell below 23% without recovery prospects, which could result if regulations did not enable cost pass-through, although we consider this unlikely.

A one notch downgrade of the sovereign would not trigger an automatic downgrade of AST.

Upside scenario We see prospects for an upgrade as remote given AST's small size, the short track record of its operations, and the current regulatory regime. Longer term, an upgrade would be consistent with FFO to debt above 35% within a stable power price environment, coupled with a combination of some of the following factors:

- A track record of the regulatory framework providing cost recovery;
- Strong buildup of the RAB, supporting regulated revenue;
- More clarity on financial policy; and
- The company's commitment to business and financial behavior consistent with a higher rating.

A one-notch upgrade of the sovereign would not per se trigger an upgrade of AST.

Statnett SF

Statnett is Norway's national electricity TSO and owner of the Norwegian power transmission grid. It operates the Norwegian power transmission network across Norway's five price zones and also connects the power system to neighboring countries including Sweden, Denmark, Germany, Netherlands, and the U.K.

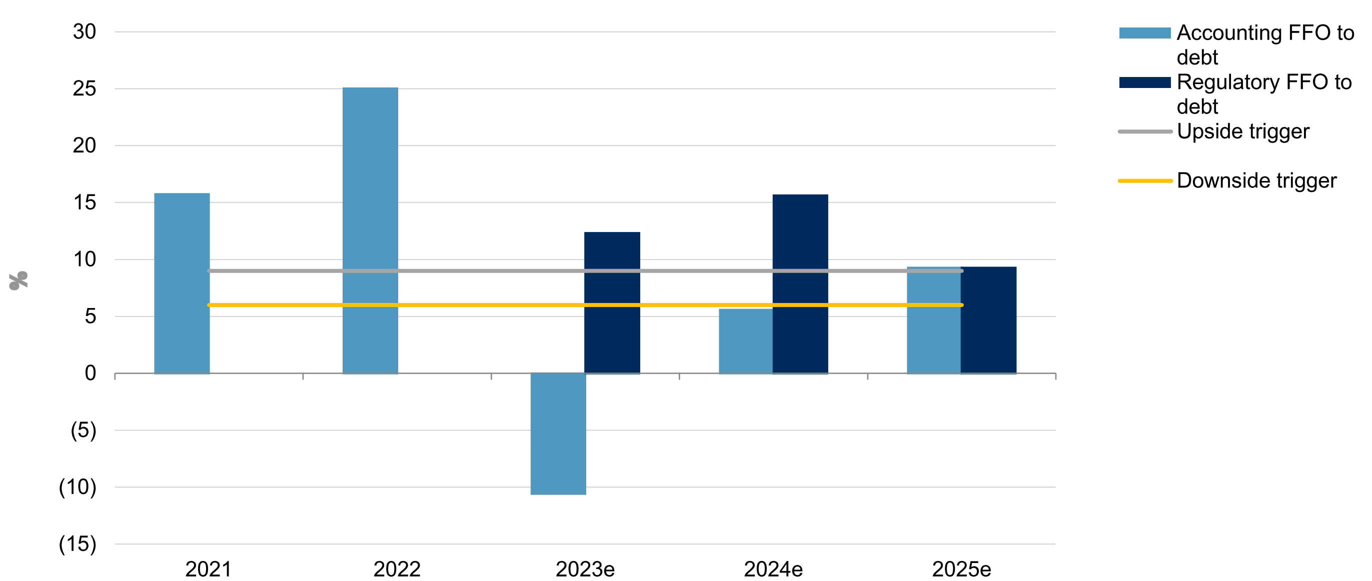
Over 2021-2022, Statnett's congestion income, reported as regulated revenue, reached NOK28.2 billion. This level of reported revenue is above the permitted revenue calculated from the regulatory formula, so to offset this, Statnett has both reduced grid tariffs close to zero since April 2022 and until year-end 2023 and has also extraordinarily transferred some congestion income to distribution system operators (DSOs) to cover their own increased expenses (NOK5.9 billion in 2022 and NOK2.3 billion in first-quarter 2023).

We forecast Statnett will continue benefitting from high congestion income of about NOK9 billion-NOK10 billion in 2023 before this income falls below the 2021 level from 2024. This translates into underlying revenue stabilizing around NOK18 billion-NOK19 billion over the next two years, taking into account the change in balance of higher/lower revenue (calculated as reported income minus permitted income), which is used to adjust tariffs annually.

By 2025, we expect underlying and IFRS ratios of FFO to debt to converge toward the 6%-9% band consistent with the current rating, and debt to EBITDA to average about 6x.

Chart 3

Statnett: Congestion income has a temporary effect on FFO to debt



FFO--Funds from operations. e--Estimate. Source: S&P Global Ratings.

Outlook

The stable outlook reflects our expectation that Norway's stable and predictable regulatory framework will continue to support Statnett's cash flow.

Downside scenario The primary rating driver is the SACP. We would consider a downgrade if FFO to debt fell below 6%, with no signs of recovery. This could occur, for example if:

- Statnett's capex increases beyond our expectations.
- The Norwegian regulator's benchmark assessment results in a very low efficiency score.
- Statnett changes its financial policy, becoming more aggressive.

In addition, we could lower the rating if our assessment of the likelihood of extraordinary government support for Statnett weakens, which we do not anticipate at this stage.

Upside scenario We could raise the ratings if Statnett's financial risk profile strengthens compared with our forecasts. This could result from a deleveraging plan or scaling down of its investment plan combined with a credible commitment to stronger credit metrics, with underlying FFO to debt sustainably above 9% in times of stable market conditions and power prices. We would also expect debt to EBITDA below 8x on average in such a scenario.

Ratings Score Snapshot

	Fingrid Oyj	Augstsprieguma Tikls	Statnett SF
Issuer Credit Rating	**AA-/Stable/A-1+**	**A-/Stable**	**A+/Stable/A-1**
Business risk:	Excellent	Strong	Excellent
Country risk	Very Low	Intermediate	Very Low
Industry risk	Very Low	Very Low	Very Low
Competitive position	Excellent	Satisfactory	Excellent
Financial risk:	Intermediate	Intermediate	Aggressive
Cash flow/leverage	Minimal (low volatility table)	Minimal (medial volatility table)	Aggressive (low volatility table)
Anchor	a+	bbb+	bbb
Modifiers:			
Diversification/Portfolio effect	Neutral	Neutral	Neutral
Capital structure	Neutral	Neutral	Neutral
Financial policy	Neutral	Neutral	Neutral
Liquidity	Strong	Adequate	Adequate
Management and governance	Satisfactory	Fair	Satisfactory
Comparable rating analysis	Neutral	Negative	Neutral
Stand-alone credit profile:	a+	bbb	bbb
Related government rating	AA+	A+	AAA
Likelihood of government support	High (+3 notches)	High (+2 notches)	Very High (+4 notches)

ESG credit indicators:

- Fingrid Oyj: E-2, S-2, G-2
- Augstsprieguma Tikls: E-2, S-2, G-2
- Statnett SF: E-2, S-2, G-2

Related Criteria

- 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
- General Criteria: Methodology For National And Regional Scale Credit Ratings , June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions , March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers , Dec. 16, 2014
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry , Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities , Nov. 13, 2012
- 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

- Latvian Gas And Electricity Transmission And Gas Storage Regulatory Frameworks: Mostly Supportive, Nov. 30, 2022)
- Finland's Electricity Transmission And Distribution Regulatory Frameworks: Very Supportive, May 11, 2021
- Norwegian Electricity Distribution And Transmission Regulatory Framework: Supportive, Oct. 15, 2020

Ratings List

Ratings Affirmed	
Augstsprieguma Tikls	
Issuer Credit Rating	A-/Stable/--
Ratings Affirmed	
Fingrid Oyj	
Issuer Credit Rating	AA-/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AA-
Commercial Paper	A-1+
Ratings Affirmed	
Statnett SF	
Issuer Credit Rating	A+/Stable/A-1
Senior Unsecured	A+

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.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914