

Electric - Corporate  
Special Report

# Nordic Utilities 2009 Outlook

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- [Fitch: European Utilities Face Weaker Interest Cover Ratios \(2 Dec 08\)](#)

## Overview

Fitch Ratings' outlook for Nordic utilities in 2009 is stable. The sector is fundamentally sound, and issuers have generally had good overall access to capital markets, albeit at a higher cost, enabling them to maintain relatively conservative debt maturity profiles. Fitch therefore does not expect Nordic utility issuers to face refinancing or liquidity issues either in 2009 or in 2010.

Wholesale electricity prices (Nord Pool prices) are expected to be in the EUR35-40 per megawatt hour (MWh) range in 2009, slightly below the 2008 average due to lower commodity and CO2 emission prices. At the same time, the economic slowdown will result in more moderate electricity demand. Electricity consumption is likely to grow at an average rate of less than 1% per year for the Nordic region.

Issuers may therefore face some decrease in profit from their generation business, although this is likely to be less pronounced for utilities with low-cost nuclear and/or hydropower generation. The extent of earnings erosion will also depend on an issuer's hedging strategy, which in the case of the large integrated Nordic utilities tends to be relatively conservative.

The agency would expect issuers to scale back and/or defer some discretionary capex earmarked for renewable investment (primarily wind) in a declining free cash flow (FCF) environment. Fitch notes that the large integrated utilities have the flexibility to do this, thus limiting downward pressure on credit ratios. Large-scale M&A activity is less likely in an environment where bank debt is not readily available, and expensive. Small- to medium-sized acquisitions and asset swaps are more likely in the landscape of 2009.

Fitch does not anticipate any significant regulatory changes in 2009. In Sweden, a new ex-ante regulatory framework for distribution companies is being formulated, and should be announced during 2009. This will replace the current ex-post system which many network companies consider unsatisfactory.

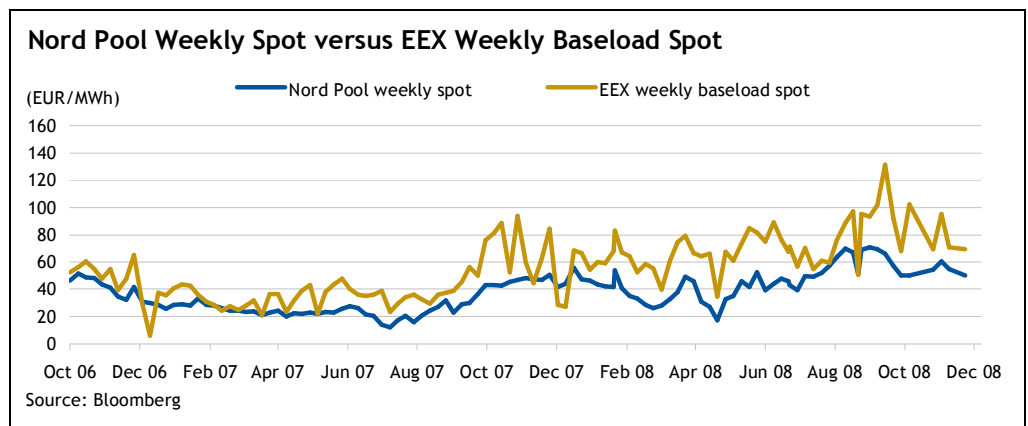
## Ratings of Nordic Utilities

Company	Long-Term IDR	Outlook	Senior Unsecured Rating
Fortum Corporation	A	Negative	A+
Fingrid Oyj	AA-	Stable	AA
Teollisuuden Voima Oyj	A-	Stable	A-
Statkraft As	BBB+	Stable	BBB+
DONG Energy A/S	A-	Stable	A-
Vattenfall AB	A+	Negative	AA-

Source: Fitch

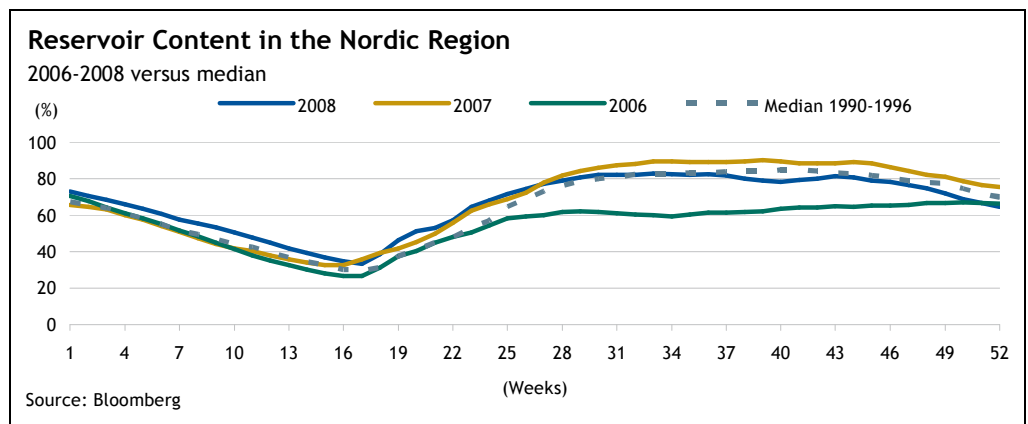
## Nord Pool Price Trends

The average price in 2008 for Nord Pool spot was EUR45/MWh (2007: EUR28/MWh), driven by high commodity and CO2 emission prices for much of the year, as well as below-average reservoir levels from September. Forward prices showed a rising trend through the first half of 2008, only to fall sharply in October/November as oil, coal and CO2 emission prices plunged.



Nord Pool prices tend to remain below German EEX prices, although an increased correlation between the two has been apparent since 2007. Despite market coupling of the exchanges, Fitch expects only a very gradual convergence of prices.

The year 2008 began with reservoirs showing an average surplus of 9 terrawatt hours (TWh) above the long-term average. By end-September, reservoirs were 6TWh in deficit, with levels persisting below the long-term average during the peak winter months.



For 2009, as previously mentioned, Fitch expects average Nord Pool prices to be in the EUR35-40/MWh range.

### Continued Tight Demand and Supply

The Nordic region as a whole tends to be self-sufficient in electricity, and has a strong bias towards low-cost hydropower and nuclear power generation capacity. Only in years of low precipitation does the region become a net importer of electricity. However, with demand growth estimated at 1%-2% per annum over the medium term, and with very limited net new investment, Fitch expects demand and supply to remain tight. The agency therefore believes that the medium-term outlook for Nord Pool prices is relatively robust.

### Limited Net New Capacity

The only major new plant build in the Nordic region is the 1,600MW nuclear plant, Olkiluoto 3 (OL3) in Finland, owned by Teollisuuden Voima Oyj (TVO, 'A-/Stable), the completion of which has been delayed to 2012. Finland is the one Nordic country which is a large net importer of electricity (14% of 2007's electricity consumption was imported from Russia). Some industry sources have predicted an "electricity production gap" by 2020 in Finland if no further investment is made. Finland's acceptance of new nuclear build-out as a viable, low-cost and emission-free energy is partly a result of concerns over security of supply.

Three generators are applying for permission to build a further (sixth) nuclear plant in Finland: TVO, Fortum Corporation ('A'/Negative) and Fennovoima, a consortium of E.ON AG ('A'/Stable) and Finnish and Swedish industry and energy companies. The approval process is lengthy, but the government is expected to provide a "decision-in-principle" by 2010-11. This would add an additional 1,000-1,800MW, but the plant is unlikely to be commissioned before the late 2010s.

Smaller capacity additions in 2009-2010 include upgrades of existing hydro (Norway, Sweden, Finland) and nuclear assets (Sweden, Finland), as well as new build of combined heat and power (CHP)/heat generation plants (Sweden, Finland, Denmark).

## Other Key Drivers

### Capex

All the Nordic countries in the EU face stringent targets under ETS III for CO2 emissions and energy generated from renewables. For example, the percentage of energy generated from renewables must increase by 2020 to 49% for Sweden (from 40% in 2005), to 38% for Finland (from 29% in 2005), and to 30% for Denmark (from 17% in 2005).

In the early part of 2008, and prior to the accelerated deterioration in financial markets, many of the large integrated Nordic utilities set out ambitious renewable capex programmes, which if fully implemented in the time-frame indicated could lead to increased debt and leverage ratios. Much of this capex, however, is discretionary, and Fitch believes it may be scaled back in 2009-2010 and shifted to later years.

Some uncertainty also remains with regard to the framework for large-scale wind build-out, for example in Finland where it now seems likely that a feed-in tariff system will be implemented (in contrast to Sweden's and Norway's green certificate system). Fitch believes that small- and medium-sized renewable investments in wind abroad, such as in the UK, will continue to be made by issuers such as Statkraft As ('BBB+' / Stable), DONG Energy A/S ('A-' / Stable) and Vattenfall AB ('A+' / Negative).

An improvement in electricity connections (interconnection between countries and regions) and removing transmission bottlenecks continues to be a priority issue in the EU. Major projects in the Nordic region include the 800MW Fenno-Skan 2 (Finland-Sweden, due for completion in 2011); the 600MW interconnection between west and east Denmark; the 600MW Skagerack 4 (Norway-Denmark, due for completion in 2012); and the 700MW Nor-Ned (Norway-Netherlands, completed May 2008). This has – and will – increase the capex of transmission systems operators (TSOs), such as Fingrid Oyj ('AA-' / Stable) over the next four years.

### M&A, Consolidation, Divestment

Fitch expects limited large-scale M&A activity in 2009. Access to bank debt for debt-financed acquisitions is less readily available and also expensive, and the agency believes that issuers will take a relatively cautious approach. However, the Baltic region, as well as the Netherlands with its radical programme of unbundling, could be areas of potential interest. Opportunities for the largest companies for further consolidation within the Nordic market are restricted due to anti-trust considerations.

Most of the integrated Nordic utilities are already unbundled (i.e. they have split up transmission and generation activities), with transmission assets owned and operated by independent TSOs. DONG divested its remaining transmission assets to the Danish TSO, Energinet.dk, earlier in 2008; Vattenfall is in the process of selling its transmission assets in Germany; while Fortum has announced its intention to sell its 25% stake in Fingrid by 2011-12.

### Dividends

Continued large dividend payouts may constrain the financial profile of issuers in an environment of decreasing FCF, as leverage may be negatively impacted.

### Regulatory

Sweden is moving from an ex-post to ex-ante regulatory system for distribution companies. The current ex-post system is considered unsatisfactory by network companies, as the model is based on a theoretical reference network where the financial value of production (or network performance) is compared with the amount charged by the network company. If the network company bills its customers above the equivalent value of its network performance, it is deemed to have charged excessive tariffs.

In Norway, the new ex-ante system has been in place since January 2007 and has been generally well received. The new model incorporates shorter review periods for revenue caps; and cost efficiency is determined by cost norms, as opposed to an x-factor. Investment incentives are greater as the cost base is reviewed more frequently.

### Ownership

The large integrated utilities are likely to remain majority state-owned in the medium term. DONG's partial privatisation (a reduction in state ownership from 73% to 51%) was postponed again early in 2008, and is unlikely to be revisited in 2009 given the turmoil in financial markets.

### Conclusion

Fitch's outlook for Nordic utilities in 2009 is stable due to a fundamentally sound sector. The agency expects the large integrated utilities, particularly those with low-cost nuclear and or hydropower generation to maintain solid earnings performance, despite a lower than average expected Nord Pool price and more moderate electricity demand in 2009 compared with 2008. The medium-term outlook for Nord Pool prices is relatively robust due to demand and supply remaining tight on account of limited net new investment in the region. While companies will continue to invest in renewables, Fitch believes some of this spend is discretionary and can and will be deferred if necessary, thus limiting downward pressure on credit ratios. Large-scale M&A activity is likely to be limited in the current environment where bank debt is less readily available and expensive. Fitch does not expect any significant regulatory changes in 2009.

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