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# Caruna Networks Oy

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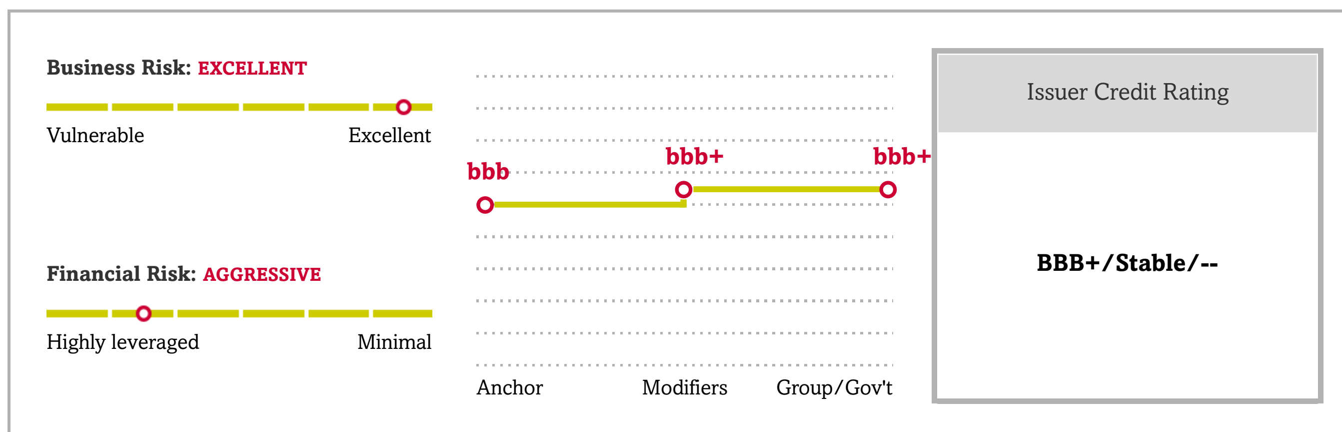
# Caruna Networks Oy




## Credit Highlights

### Overview

| Key strengths | Key risks |
|---|---|
| Fully regulated electricity distribution system operator (DSO), operating under a well-established and supportive regulatory framework resulting in stable cash flow. | Limited headroom in credit metrics, with funds from operations (FFO) to debt just above our downside threshold at 9% for the rating and increasing leverage. |
| Largest DSO in Finland, with a 20.6% market share in an otherwise scattered market structure, allowing for a comparative cost advantage and economy of scale. | A bill before parliament that could change the regulatory framework. If approved, this will have negative effects on remuneration, but the magnitude remains unclear until the regulator announces the final changes. |
| Decreasing outages, because a higher share of network is secured via underground cabling. | Large shareholder loans contributing to aggressive shareholder distributions, exceeding free operating cash flow (FOCF) and resulting in negative cash flow and increased debt. |

***Shareholder distributions are aggressive and increasing, although S&P Global Ratings expects Caruna Networks Oy (Caruna) will maintain credit metrics commensurate with the rating.*** The company plans to increase its shareholder distributions in terms of dividends as interest paid on shareholder loans is expected to remain flat. Total shareholder distributions of €140 million-€160 million is planned in 2021 and €110 million-€130 million annually in 2022-2023, up from €79 million in 2020. We view this as an aggressive increase, and expect it to consume more than 60% of FFO in 2021.

***We expect limited headroom to remain, but understand Caruna is committed to the rating.*** While the shareholder structure recently changed, Caruna has previously shown flexibility in shareholder distributions, and continue to expect it active will manage credit metrics commensurate with the rating. We therefore believe the company will strive to maintaining FFO to debt above 9% and debt to EBITDA at about 8x, which we deem in line with the rating, by lower shareholder renomination if needed.

***Despite declining investment, we believe discretionary cash flow (DCF) will remain negative.*** While the main investments came in the past few years, peaking at €300 million in 2017, we expect capital expenditure (capex) to stabilize at €130 million-€150 million over our three-year forecast period. Caruna's regulated asset base amounted to €3 billion by the end of 2020, up more than €1 billion compared to 2016. We expect the regulated asset base (RAB) to reach almost €3.2 billion by 2023, a 60% increase from 2016. Instead, and clearly less credit friendly, we now expect shareholder distributions to reach €140 million-€160 million in 2021 from €79 million in 2020, resulting in negative DCF. Despite this, under our base-case scenario, Caruna's credit metrics will be stable. We also believe the owners will

remain flexible and are willing lower dividends to maintain the ratings if needed. We expect the company's FFO to debt will remain comfortably above 9% and debt to EBITDA at about 8x, including connection fees, which we consider commensurate with a 'bbb+' stand-alone credit profile.

***Stable and predictable cash flow will continue from Caruna's fully regulated businesses.*** Its 100% regulated electricity distribution operations under a supportive regulatory framework ensures stable and predictable cash flow. We understand that the weighted average cost of capital (WACC) used for calculating allowed income under the regulatory framework will decrease because of a lower risk-free rate. The WACC is currently linked to the higher of the 10-year average or previous year's (April-September) average of the Finnish government's 10-year bond. Despite the lower WACC, we expect Caruna to increase revenue in 2021-2023. This is because of its large capex program since 2016, investing about €1.2 billion that increased its RAB to €3.04 billion by the end of 2020, and its allowed income to a larger extent than the lower WACC effect. We therefore forecast EBITDA to increase gradually to €335 million-€345 million by 2023 from €305 million in 2020.

***Caruna's position as the largest DSO in Finland with a widely spread network underpins our business assessment.*** The company is Finland's largest DSO, with a market share of 20.6% measured in share of electricity transmitted on the distribution network. Finland's electricity distribution market is highly fragmented with about 80 operating DSOs. We expect Caruna to maintain its position as the largest player on the Finnish DSO market, ahead of the main peer Elenia with a 12.7% market share. We understand it's a comparative advantage to have a larger-scale DSO network than smaller. This is because the underlying framework allows for outperformance in terms of investment cost. All investment that adds to RAB, are added from a set price list, not according to actual cost. Caruna manages on average its procurements at a lower price than the underlying price list due to economies of scale, so we expect it to continue to be more profitable than the smaller operators in the Finnish DSO market.

***We foresee only minor changes to the regulatory framework if the bill is approved.*** The government has referred a bill to change the Electricity Market Act to the parliament. According to the Energy Authority, changes under consideration center mainly on four factors--a ceiling on annual tariff increases, unit prices, WACC, and incentives--and could take effect in 2022, the middle of the current regulatory period. If these changes result in a significant cut in remuneration, a negative rating action could follow. Although we view the changes as immaterial and balanced, it does not change our overall view of the regulatory framework. Nevertheless, changes to the ongoing regulatory framework run contradictory to our view of regulatory stability.

***We don't expect changes in shareholder structure to lead to any changes in financial policy.*** Following recent announced changes in the shareholder structure, which we expect to close in second-quarter 2021 upon regulatory approval, we expect KKR and OTPP to each own 40% of Caruna group, AMF Pension 12.5%, and Elo Mutual Pension Insurance Co. the remaining 7.5%. We understand from discussions with management that the changes are unlikely to lead to any significant changes in financial policy. The current financial policy already assumes generous shareholder distributions, which weighs negatively on the rating. If the financial policy became more aggressive, we might consider a negative rating action, given that rating headroom is limited. As before, no shareholder will have a majority stake, meaning no one company has direct control over Caruna's strategy or cash flow.

**Outlook: Stable**

The stable outlook reflects our expectation that the company's EBITDA and FFO will continue increasing, driven by higher allowed regulatory return during the regulatory period that started in 2020, despite decreasing WACC. We expect that Caruna will adjust its shareholder distributions to protect credit metrics if the regulator implements changes that have a negative impact on remuneration. We expect FFO to debt comfortably over 9% and debt to EBITDA at about 8x, including connection fees, which we consider commensurate with a 'bbb+' stand-alone credit profile.

### Downside scenario

Rating downside could emerge if Caruna's shareholder renumeration continues to consume a large part of its cash flow, leading to negative DCF and implying weaker credit ratios, FFO to debt below 9% without signs of recovery, or debt to EBITDA sustainably above 8x and increasing, including connection revenue. This could also materialize if Caruna's operating performance is weaker than we anticipate due to material acquisitions, or larger shareholder returns or capex than expected.

The rating could also come under pressure if the regulator imposes and implements a substantial change to the regulatory framework during the current period (2020-2023) that would result in significantly lower remuneration, for example changing the risk-free rate component, and resulting in a lower WACC.

### Upside scenario

We believe a positive rating action is unlikely within the next two years. We believe that ratings upside would require a change in financial policy that supports stronger credit ratios. We could upgrade Caruna if FFO to debt is 12% or above and debt to EBITDA remains lower than 7x, including connection fees.

## Our Base-Case Scenario

### Assumptions

We make the following assumptions in our base-case scenario for 2021-2023:

- Finland's GDP increase by 2.3% in 2021, 1.5% in 2022, and 1.4% in 2023.
- Very limited impact from COVID-19 and related lockdowns.
- Stable contribution from predictable DSO activities, with the next regulatory reset date in 2024 and no major changes to the framework in the existing period.
- Pre-tax WACC at 5.35%, 4.99%, and 4.76% for 2021, 2022, and 2023, respectively.
- Annual capex of €130 million-€150 million
- Annual connection revenues of €12 million-€15 million.
- No material acquisitions.

### Key metrics

| Caruna Networks Oy--Key Metrics* | | | | | |
|---|---|---|---|---|---|
| | **2019a** | **2020a** | **2021f** | **2022f** | **2023f** |
| EBITDA (mil. €) | 302.0 | 305.0 | 310-320 | 325-335 | 335-345 |
| FFO (mil. €) | 230.0 | 236.0 | 235-245 | 245-255 | 255-265 |
| Shareholder distributions (mil. €) | 75.0 | 79.0 | 140-160 | 110-130 | 110-130 |
| Debt (mil. €) | 2,513.0 | 2,503.0 | 2,500-2,600 | 2,500-2,600 | 2,500-2,600 |
| FFO/debt (%) | 9,2 | 9.4 | 9.0-9.5 | 9.5-10.0 | 9.5-10.5 |
| Debt/EBITDA (x) | 8,3 | 8.2 | 7.8-8.2 | 7.5-8.0 | 7.5-8.0 |
| EBITDA margin (%) | 64,7 | 64.1 | 63-68 | 63-68 | 65-70 |
| DCF/debt (%) | (3.5) | (2.5) | (4)-(2) | (2)-(0) | (2)-(0) |

FFO--Funds from operations. DCF--Discretionary cash flow. a--Actual. e--Estimate. f--Forecast.

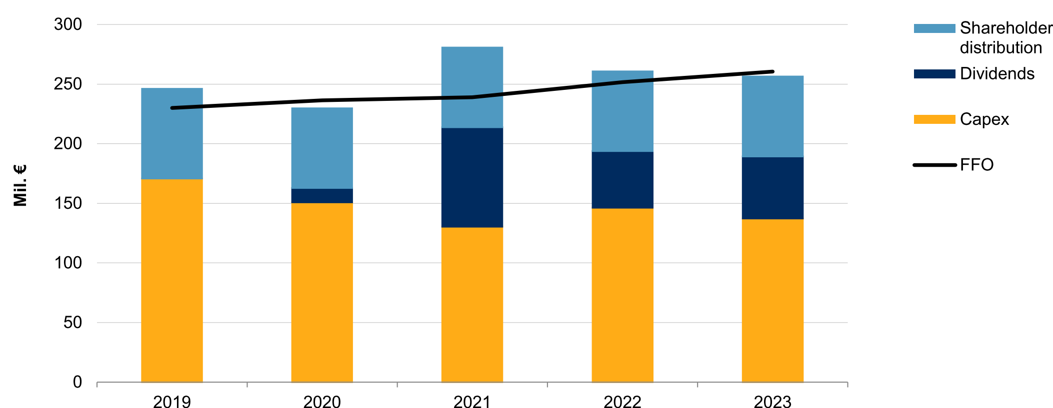
## Company Description

Caruna is a Finnish power distribution system operator (DSO) that was founded in 2014 as a spin-off from Fortum. It is the largest power DSO in Finland, with 20.6% market share of power distribution, followed by Elenia Verkko Oyj (senior secured debt rating: BBB+/Stable) with 12.7% in 2020. Caruna distributes electricity to about 700,000 customers (about 1.5 million people) in its geographical areas.

Caruna is composed of Caruna Oy and Caruna Espoo Oy, which together operate 87,400 kilometers of network in Finland (56% of which is underground cable). Caruna Espoo operates in urban areas with a high number of consumers, while Caruna Oy operates in mostly rural areas requiring high investment dowing to the larger network. At year-end 2019, the average cabling rate for Caruna was 56% (54% for Caruna Oy and 76% for Caruna Espoo), reaching 58% as of June 30, 2020.

The company is owned by infrastructure funds (80%) and employment pension companies (20%).

**Funds From Operations Do Not Fully Cover Investments And Dividends**




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

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## Peer Comparison

**Table 1**

| Caruna Networks Oy--Peer Comparison | | | |
|---|---|---|---|
| **Industry sector: Electric** | | | |
| | **Caruna Networks Oy** | **Elenia Verkko Oyj*** | **Ellevio AB*** |
| Ratings as of March 17, 2021 | BBB+/Stable/-- | BBB+/Stable | BBB/Stable |
| | **--Fiscal year ended Dec. 31--** | | |
| | **2020** | **2019** | **2019** |
| Business risk profile | Excellent | Excellent | Excellent |
| Financial risk profile | Aggressive | Aggressive | Aggressive |
| Anchor | bbb | bbb | bbb |
| Liquidity | Strong | Strong | Strong |
| Comparable rating analysis | +1 notch | Neutral | -1 notch |
| SACP | bbb+ | bbb | bbb- |
| SED enhancement | N/A | +1 notch | +1 notch |
| Issuer/issue ratings | bbb+ | bbb+* | bbb* |
| **(Mil. €)** | | | |
| Revenue | 475.3 | 298.6 | 649.6 |
| EBITDA | 304.5 | 182.7 | 380.2 |
| Funds from operations (FFO) | 236.3 | 104.6 | 262.9 |
| Interest expense | 50.7 | 64.8 | 112.1 |
| Cash interest paid | 57.0 | 66.4 | 110.7 |
| Cash flow from operations | 167.6 | 118.9 | 366.0 |
| Capital expenditure | 150.9 | 166.1 | 371.7 |
| Free operating cash flow (FOCF) | 16.6 | (47.2) | (5.7) |
| Discretionary cash flow (DCF) | (62.2) | (63.0) | (5.7) |
| Cash and short-term investments | 60.1 | 29.2 | 1.9 |
| Debt | 2,503.4 | 1,627.3 | 3,740.8 |
| Equity | 688.9 | 219.7 | 2,696.9 |
| **Adjusted ratios** | | | |
| EBITDA margin (%) | 64.1 | 61.2 | 58.5 |
| Return on capital (%) | 5.4 | 5.4 | 2.5 |
| EBITDA interest coverage (x) | 6.0 | 2.8 | 3.4 |
| FFO cash interest coverage (x) | 5.1 | 2.6 | 3.4 |
| Debt/EBITDA (x) | 8.2 | 8.9 | 9.8 |
| FFO/debt (%) | 9.4 | 6.4 | 7.0 |
| Cash flow from operations/debt (%) | 6.7 | 7.3 | 9.8 |
| FOCF/debt (%) | 0.7 | (2.9) | (0.2) |
| DCF/debt (%) | (2.5) | (3.9) | (0.2) |

*Note: Elenia and Ellevio do not have issuer credit ratings on them; we use issue ratings for comparison purposes due to the structural debt enhancement. N/A--Not applicable.

Caruna, similar to its Nordic peers, operates within a stable regulatory environment with historical transparency and predictability. It is also the largest DSO in Finland with about a 22.7% market share in terms of network length, with Elenia being second and Ellevio AB operating in Sweden. All three companies face similarities in weather conditions so have large capex programs to reduce outages through underground cabling and increased security of supply. However, Ellevio's capex plan is twice as large as that of Caruna and Elenia, emphasizing the need for investment in Sweden.

In addition, following the 2019 repayment of Elenia's shareholder loans, only Caruna and Ellevio have shareholder loans that we expect will not be repaid in the medium term. Caruna's shareholder loans amount to about €780 million and Ellevio's amount to about €2 billion. However, we exclude the loans from debt in our ratio calculations, reflecting their equity-like features such as subordination, maturities beyond other debt, and the possibility of accruing interest.

## Business Risk: Excellent

Caruna benefits from low-risk, stable network operations, within a framework we view as transparent and credit supportive. The company's position as the biggest DSO in Finland with a widely spread network underpins its business risk profile.

We assess the regulatory framework for electricity DSOs in Finland as strong. The Finnish Energy Authority is a regulatory body independent from the government with no instances of political interference. The remuneration is based on the determined RAB and WACC with full recovery of operating spending and capex allowed by the regulator. In addition, networks, and notably DSOs, benefit from incentives including quality, efficiency, investment, innovation, and security of supply. We therefore consider the regulatory framework supportive, predictable, and transparent.

On Jan. 28, the Finnish government submitted changes to the Electricity Market Act and the Act on the Supervision of the Electricity and Natural Gas Markets. The bill mainly includes four changes that could affect the regulatory framework for DSOs in 2022:

- A ceiling on annual tariff increases: The proposal states to reduce the annual increase ceiling for transmission charges to 8% from 15%. In our view, this will have a limited effect, because the WACC is decreasing, so there is no need to increase tariffs significantly in coming years.
- WACC: The bill stresses that there is a need for the risk-free interest rate to reflect changes in market interest rates quickly enough. We understand that the option to use the 10-year average or the previous year's (April-September) average of the Finnish government's 10-year bond will be excluded, resulting in a temporary dip in WACC to about 4%, instead of about 5% using the 10-year average.
- Unit price: This takes into account the significant reduction in investment costs since 2016, as well as allows an assessment of the cost-effectiveness of investment according to the proposal. We understand that the update price list is not set and will not be retroactive, meaning only future investments are affected, not existing RAB.
- Incentives: The bill states that there is no longer a need for a security of supply incentive because the timeframe for security of supply targets has increased. If the incentive is taken out from allowed income, it will only have a limited negative effect on Caruna of €2 million-€4 million on EBITDA.

This amendment to the framework in the middle of the regulatory period, isn't expected but doesn't change our view of

the framework's stability if the changes happen as presented. We view the changes as immaterial and balanced, although we found it a bit remarkable that they come under the existing regulatory period. We estimate the lower WACC and allowed revenue to decrease our S&P Global Ratings-adjusted FFO for Caruna by about €10 million annually; this is immaterial for our metrics calculation notably because the company has the possibility to lower shareholder distributions significantly to protect the rating.

## Financial Risk: Aggressive

Caruna's earnings only consists of regulated DSO activities that we see as stable and predictable. Therefore, we expect our S&P adjusted FFO over 2021-2023 to be stable at €235 million-€265 million, driven by an increasing regulatory asset base that allows for higher allowed regulatory return. This is despite a decreasing WACC related to the regulatory framework; WACC for 2020 was 5.73%, and we expect a gradual decrease toward 4.5% by 2023. We have not factored in the changes from the bill proposal, because it has not been passed.

Debt is continuing to increase as cash flow remains negative because of capex and aggressive shareholder distributions. Caruna's capex has been large in the past few years. We expect investments to decrease to €130 million-€150 million on average compared to peak investment of almost €300 million in 2017. Underground cabling has decreased outages and increased security of supply, but has also increased debt, because cash flow has not covered investment. We expect debt will reach €2.6 billion by 2023, up from €2.5 billion in 2020.

We forecast Caruna's DCF to remain negative despite a smaller capex program, because its shareholder distributions are increasing. We understand that the company plans to increase its shareholder distributions, with increasing dividends, on top of payments to existing shareholder loans amounting to €774 million at 8.5% and resulting €67 million in interest payments. We forecast shareholder remuneration of €140 million-€160 million in 2021 and €110 million-€120 million annually in 2022 and 2023, respectively, up from €75 million in 2019. We view this as an aggressive increase because we expect it to consume more than 60% of FFO in 2021. That said, we expect Caruna to balance its shareholder distributions and show flexibility to maintain credit metrics commensurate with the rating.

### Financial summary

**Table 2**

**Caruna Networks Oy--Financial Summary**

**Industry Ssector: Electric**

| | --Fiscal year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| | **2020** | **2019** | **2018** | **2017** | **2016** |
| **(Mil. €)** | | | | | |
| Revenue | 475.3 | 466.4 | 454.1 | 426.4 | 384.0 |
| EBITDA | 304.5 | 301.8 | 287.8 | 270.0 | 233.0 |
| Funds from operations (FFO) | 236.3 | 230.0 | 207.9 | 200.6 | 163.9 |
| Interest expense | 50.7 | 56.8 | 56.6 | 52.8 | 54.0 |
| Cash interest paid | 57.0 | 60.9 | 69.4 | 62.4 | 69.0 |
| Cash flow from operations | 167.6 | 157.0 | 130.2 | 123.5 | 99.4 |
| Capital expenditure | 150.9 | 170.9 | 262.4 | 293.5 | 273.2 |

**Table 2**

## Caruna Networks Oy--Financial Summary (cont.)

**Industry Ssector: Electric**

| | --Fiscal year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| | **2020** | **2019** | **2018** | **2017** | **2016** |
| Free operating cash flow (FOCF) | 16.6 | (13.9) | (132.2) | (170.0) | (173.8) |
| Discretionary cash flow (DCF) | (62.2) | (89.0) | (212.6) | (250.4) | (214.1) |
| Cash and short-term investments | 60.1 | 88.5 | 57.5 | 42.9 | 59.8 |
| Gross available cash | 60.1 | 88.5 | 57.5 | 42.9 | 59.8 |
| Debt | 2,503.4 | 2,513.3 | 2,368.5 | 2,199.5 | 2,044.1 |
| Equity | 688.9 | 673.2 | 791.3 | 806.0 | 777.2 |
| **Adjusted ratios** | | | | | |
| EBITDA margin (%) | 64.1 | 64.7 | 63.4 | 63.3 | 60.7 |
| Return on capital (%) | 5.4 | 5.3 | 5.2 | 5.2 | 4.5 |
| EBITDA interest coverage (x) | 6.0 | 5.3 | 5.1 | 5.1 | 4.3 |
| FFO cash interest coverage (x) | 5.1 | 4.8 | 4.0 | 4.2 | 3.4 |
| Debt/EBITDA (x) | 8.2 | 8.3 | 8.2 | 8.1 | 8.8 |
| FFO/debt (%) | 9.4 | 9.2 | 8.8 | 9.1 | 8.0 |
| Cash flow from operations/debt (%) | 6.7 | 6.2 | 5.5 | 5.6 | 4.9 |
| FOCF/debt (%) | 0.7 | (0.6) | (5.6) | (7.7) | (8.5) |
| DCF/debt (%) | (2.5) | (3.5) | (9.0) | (11.4) | (10.5) |

## Reconciliation

**Table 3**

## Caruna Networks Oy--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts(Mil. €)

| | --Fiscal year ended Dec. 31, 2020-- | | | | | | |
|---|---|---|---|---|---|---|---|
| **Caruna Networks Oy reported amounts** | | | | | | | |
| | **Debt** | **Shareholders' equity** | **EBITDA** | **Operating income** | **Interest expense** | **S&P Global Ratings' adjusted EBITDA** | **Dividends** |
| Reported | 3,333.9 | (84.7) | 304.5 | 171.0 | 117.5 | 304.5 | 12.0 |
| **S&P Global Ratings' adjustments** | | | | | | | |
| Cash taxes paid | -- | -- | -- | -- | -- | (11.1) | -- |
| Cash interest paid | -- | -- | -- | -- | -- | (125.9) | -- |
| Cash interest paid: Other | -- | -- | -- | -- | -- | 69.0 | -- |
| Reported lease liabilities | 2.9 | -- | -- | -- | -- | -- | -- |
| Postemployment benefit obligations/deferred compensation | 0.3 | -- | 0.0 | 0.0 | 0.0 | -- | -- |
| Accessible cash and liquid investments | (60.1) | -- | -- | -- | -- | -- | -- |
| Nonoperating income (expense) | -- | -- | -- | 2.2 | -- | -- | -- |
| Debt: Shareholder loans | (773.6) | -- | -- | -- | -- | -- | -- |

**Table 3**

| Caruna Networks Oy--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts(Mil. €) (cont.) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Equity: Other | -- | 773.6 | -- | -- | -- | -- | -- |
| EBITDA: Gain (loss) on disposals of PP&E | -- | -- | (0.0) | (0.0) | -- | -- | -- |
| Interest expense: Shareholder loan | -- | -- | -- | -- | (66.9) | -- | -- |
| Dividends: Other | -- | -- | -- | -- | -- | -- | 66.9 |
| Total adjustments | (830.6) | 773.6 | (0.0) | 2.1 | (66.9) | (68.1) | 66.9 |
| **S&P Global Ratings' adjusted amounts** | | | | | | | |
| | **Debt** | **Equity** | **EBITDA** | **EBIT** | **Interest expense** | **Funds from operations** | **Dividends paid** |
| Adjusted | 2,503.4 | 688.9 | 304.5 | 173.2 | 50.7 | 236.3 | 78.9 |

## Liquidity: Strong

We assess Caruna's liquidity as strong. We anticipate that available liquidity sources will exceed cover cash outflow by about 2.1x. We also expect that sources will cover uses even if EBITDA declined 30% compared with our base-case scenario, and that the company will retain significant headroom under the financial covenants.

In our assessment of liquidity, we also factor in our view of Caruna's solid relationship with banks as recently proven with extending its revolving credit facility (RCF) facility in November last year, and no upcoming debt maturities until 2023.

| Principal liquidity sources | Principal liquidity uses |
|---|---|
| • €60 million cash available as of Dec. 31, 2020<br>• €290 million available under its RCF and overdraft facility both maturing in 2025 and<br>• Our expectation that Caruna will generate cash FFO of about €240 million | • Working capital outflows of €13 million in the next 12 months<br>• Annual capex of about €140 million<br>• No debt maturities over the coming 12-24 months<br>• Shareholder distribution of €140 million-€160 million in 2021, including interest on the shareholder loan |

### Debt maturities

Caruna has no debt maturities until 2023, when its benchmark bond of €500 million is due. Also, the company has a conservative average total debt to maturity of about 12 years.

## Covenant Analysis

Although we do not rate Caruna under our structurally enhanced debt criteria, the company has several protective covenants. Caruna continues to comply with the debt restriction covenants stipulated in its documentation and as per our analysis.

The financing structure includes the following covenants for events of default:

- FFO to senior debt of no less than 4%; and
- FFO to interest on senior debt of no less than 1.2x

The documentation also includes lock-up covenants for shareholder distributions, including:

- FFO to interest on senior debt of at least 1.7x (12 months backward and forward);
- FFO to senior debt of at least 5% (12 months backward and forward); and
- FFO to senior debt of at least 5.5% (36 months forward).

As of Dec. 31, 2020, the FFO-to-debt ratios were 9.5% (backward) and 9.3% (forward); FFO to interest on senior debt was 5.1x (backwards) and 5.3x (forward), showing significant headroom at both covenant levels. We forecast that Caruna will maintain significant headroom under the financial covenants. In addition, the lock-up covenants prohibit shareholder distributions if FFO to debt drops below 5% or FFO to interest below 1.7x. Furthermore, a breach of the financial covenants will not automatically mean a default. Instead, there will be a 12-month standstill period, during which there will be no enforcement of security and the 12-month liquidity facility should cover scheduled payments.

## Environmental, Social, And Governance(ESG)

In 2011 Finland was hit by a major storm, Tapani, which led to extensive outages in Caruna's network. The storm and the utility's performance were important factors in legislation--the Energy Authority's Electricity Market Act (2013). Since then, the company has executed a significant investment program to weatherproof the network and better secure supply. This has resulted in a higher debt burden and pressure on financial metrics. We expect Caruna's capex program will remain high for several years (included in our base-case assumptions). This investment is added to the RAB, which allows collection of higher revenues supporting cash flow. We believe that the company is better prepared for storms, and less sensitive to weather interruptions and exposure to substantial fines.

Our business risk profile assessment also reflects Caruna's corporate responsibility strategy to manage its environmental, social, and governance exposure. The company has performance targets for customer and employee safety, minimization of adverse effects on the environment, customer satisfaction, sustainable sourcing of materials, and local economic impact. We expect management to execute its strategy and generally meet its performance targets. We are not aware of any other material adverse ESG factors likely to further affect the company's credit quality.

## Group Influence

The wider group includes several holding companies above Caruna. Following a major refinancing in 2016, the new debt is secured by the assets of the operating companies and some holding companies, including Caruna Networks B.V. This security group is ring-fenced from the top holding companies in the wider group and is subject to common terms in the covenant package. We view this security group as an insulated subsidiary, in line with our group rating methodology.

We view the group credit profile of the insulated group as equal to Caruna's 'bbb+' stand-alone credit profile. This is because the two holding companies above Caruna in the ring-fenced structure have no assets or liabilities of their own.

## Ratings Score Snapshot

**Issuer Credit Rating**

BBB+/Stable/--

**Business risk: Excellent**

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

**Financial risk: Aggressive**

- **Cash flow/leverage:** Aggressive

**Anchor: bbb**

**Modifiers**

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Positive (+1 notch)

**Stand-alone credit profile : bbb+**

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
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## Business And Financial Risk Matrix

| | Financial Risk Profile | | | | | |
|---|---|---|---|---|---|---|
| **Business Risk Profile** | Minimal | Modest | Intermediate | Significant | **Aggressive** | Highly leveraged |
| **Excellent** | aaa/aa+ | aa | a+/a | a- | **bbb** | bbb-/bb+ |
| Strong | aa/aa- | a+/a | a-/bbb+ | bbb | bb+ | bb |
| Satisfactory | a/a- | bbb+ | bbb/bbb- | bbb-/bb+ | bb | b+ |
| Fair | bbb/bbb- | bbb- | bb+ | bb | bb- | b |
| Weak | bb+ | bb+ | bb | bb- | b+ | b/b- |
| Vulnerable | bb- | bb- | bb-/b+ | b+ | b | b- |

## Ratings Detail (As Of March 17, 2021)*

| | |
|---|---|
| **Caruna Networks Oy** | |
| Issuer Credit Rating | BBB+/Stable/-- |
| **Issuer Credit Ratings History** | |
| 27-Jan-2016 | BBB+/Stable/-- |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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