

Tear Sheet:

VR Group

December 21, 2022

Recent Developments

S&P Global Ratings believes that VR-Yhtymä Oyj (VR Group)'s flexible balance sheet will provide a buffer against tighter margins and a weaker economic backdrop. We expect inflation in Finland to reach more than 7% in 2022 and around 4% in 2023. We believe it is uncertain to what extent VR Group will be able to increase its long-distance rail fares to offset higher costs, since it aims to maintain solid passenger volumes. As such, we expect that margins will not recover as quickly as previously anticipated and could stay at 14%-16% in 2022 and 2023. This is despite our projection that long-distance passenger rail volumes will return to 2019 levels in 2023, rather than in 2025 as we previously expected.

Nevertheless, we expect that VR Group will continue to exercise high flexibility in spending and dividends to maintain leverage commensurate with the current rating, in the face of higher-than-expected cost increases or slower traffic recovery. Owing to this, as well as inflation-linked contracts in the group's commuter rail, bus, freight, and Swedish operations, we anticipate that S&P Global Ratings-adjusted funds from operations (FFO) to debt will remain above 35% on average over the next three years.

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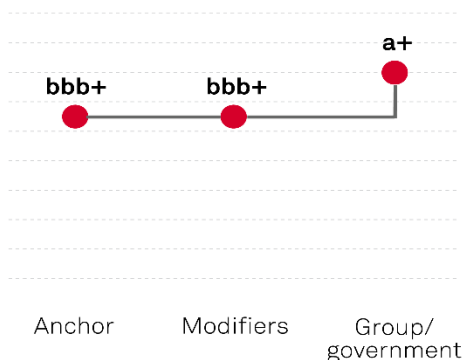
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Ratings Score Snapshot

Business risk: **Satisfactory**



Financial risk: **Modest**



A+/Stable/--

Issuer credit rating

Recent Research

- Full Analysis: Finland, Oct. 31, 2022
- VR Group's Senior Unsecured Bond Issued Rated 'A+', May 23, 2022
- Research Update: Finnish National Passenger Rail Operator VR Group affirmed at 'A+'; Outlook Stable, May 16, 2022
- Full Analysis: VR Group, Feb. 2, 2022

Company Description

VR Group is the national rail transport operator in Finland. It is 100% owned by the Finnish government, and currently operates as the sole operator in the long-distance passenger rail segment. VR Group also operates in freight rail under the name VR Transpoint, with a market share exceeding 95% even after the sector was opened up to competition in 2007.

Outlook

The stable outlook reflects our expectation that VR Group's capital structure can accommodate to some extent a potentially softer operational environment than we previously expected, given historically low leverage. However, in the face of weaker-than-expected traffic recovery or higher-than-expected inflation that is not mitigated, we also expect the group will control its shareholder distributions and capital spending, such that its adjusted FFO to debt remains above 35% over 2022-2024.

Downside scenario

We could lower the rating if FFO to debt deteriorated below 35% without signs of recovery, which could result from materially slower traffic volume recovery than anticipated. We could also lower the rating if we believed the group's financial flexibility has deteriorated, for instance if VR Group is obliged to pay dividends or is unable to defer spending to manage inflationary pressures.

We could also lower the rating, by at least one notch, if earnings from operations that are more volatile than passenger rail services materially increase. This could be the case, for example, if bus transportation exceeds more than one-third of VR Group's total earnings. Downward pressure on the rating could also materialize if VR Group's competitive position weakened significantly following the potential entry of new players in the market and profitability materially declined.

Upside scenario

We currently see an upgrade of VR Group as unlikely. We may revise upward our assessment of VR Group's stand-alone credit profile (SACP) if the group demonstrates its ability to maintain a solid competitive position despite the liberalization of rail passenger services and the bus operations continue to contribute less than one-third of total earnings. However, absent any changes in our assessment of the likelihood of government support, an upgrade of VR Group would require a three-notch improvement of the SACP, which we see as unlikely.

A one-notch upgrade of Finland (AA+/Stable/A-1+) will not affect our rating on VR Group.

Key Metrics

VR Group--Key Metrics*

Mil. €	2020a	2021a	2022e	2023f	2024f
Revenue	822.3	883.6	1,000.0-1,050.0	1,250.0-1,300.0	1,300.0-1,400.0
Revenue growth (%)	(20.5)	7.5	18.0-20.0	19.0-21.0	3.0-5.0
EBITDA	123.7	125.2	145.0-150.0	225.0-230.0	230.0-235.0
EBITDA margin (%)	15.0	14.2	14.0-15.0	17.0-18.0	17.0-18.0
Funds from operations (FFO)	108.4	112.2	125.0-130.0	200.0-205.0	205.0-210.0

Capital expenditure	151.6	152.2	175.0-180.0	250.0-280.0	250.0-280.0
Dividends	0.0	100.0	Around 40.0	0-20.0	0-20.0
Debt	87.6	238.1	360.0-370.0	440.0-450.0	530.0-540.0
Debt to EBITDA (x)	0.7	1.9	Around 2.5	Around 2.0	2.0-2.2
FFO to debt (%)	123.8	47.1	35.0-37.0	40.0-45.0	35.0-40.0

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Financial Summary

VR-Yhtymä Oyj--Financial Summary

Period ending	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021
Reporting period	2016a	2017a	2018a	2019a	2020a	2021a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	1,203	1,269	1,302	1,034	822	884
EBITDA	161	230	224	220	124	125
Funds from operations (FFO)	137	204	169	189	108	112
Interest expense	16	18	20	13	9	9
Cash interest paid	9	12	12	10	15	9
Operating cash flow (OCF)	174	192	164	196	100	138
Capital expenditure	101	120	117	177	152	152
Free operating cash flow (FOCF)	72	72	46	19	(52)	(14)
Discretionary cash flow (DCF)	(28)	(120)	(54)	(104)	(52)	(114)
Cash and short-term investments	291	176	214	290	199	66
Gross available cash	291	176	214	290	199	66
Debt	40	134	78	30	88	238
Common equity	1,353	1,203	1,235	1,336	1,274	1,279
Adjusted ratios						
EBITDA margin (%)	13.4	18.2	17.2	21.3	15.0	14.2
Return on capital (%)	2.1	7.3	7.2	7.2	(1.9)	(1.8)
EBITDA interest coverage (x)	10.4	13.1	11.0	16.9	13.4	14.0
FFO cash interest coverage (x)	16.7	17.8	14.9	19.6	8.5	13.0
Debt/EBITDA (x)	0.2	0.6	0.3	0.1	0.7	1.9
FFO/debt (%)	343.9	152.2	217.0	620.5	123.8	47.1
OCF/debt (%)	437.0	143.4	210.7	646.8	113.7	58.0
FOCF/debt (%)	181.6	53.6	59.8	63.9	(59.4)	(5.9)
DCF/debt (%)	(71.5)	(89.9)	(68.8)	(340.9)	(59.4)	(47.9)

Peer Comparison

VR-Yhtymä Oyj--Peer Comparisons

	VR-Yhtymä Oyj	Vygruppen AS	NS Groep N.V.
Foreign currency issuer credit rating	A+/Stable/--	BBB+/Negative/A-2	A/Stable/--
Local currency issuer credit rating	A+/Stable/--	BBB+/Negative/A-2	A/Stable/--
Period	Annual	Annual	Annual
Period ending	2021-12-31	2021-12-31	2021-12-31
Mil.	EUR	EUR	EUR
Revenue	884	1,526	3,394
EBITDA	125	128	450
Funds from operations (FFO)	112	110	431
Interest	9	21	31
Cash interest paid	9	18	23
Operating cash flow (OCF)	138	154	(246)
Capital expenditure	152	29	554
Free operating cash flow (FOCF)	(14)	125	(800)
Discretionary cash flow (DCF)	(114)	125	(800)
Cash and short-term investments	66	250	753
Gross available cash	66	250	753
Debt	238	806	1,674
Equity	1,279	299	1,876
EBITDA margin (%)	14.2	8.4	13.3
Return on capital (%)	(1.8)	(9.1)	2.1
EBITDA interest coverage (x)	14.0	6.2	14.5
FFO cash interest coverage (x)	13.0	7.1	19.6
Debt/EBITDA (x)	1.9	6.3	3.7
FFO/debt (%)	47.1	13.6	25.7
OCF/debt (%)	58.0	19.1	(14.7)
FOCF/debt (%)	(5.9)	15.5	(47.8)
DCF/debt (%)	(47.9)	15.5	(47.8)

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
- Climate transition risks					- N/A					- N/A				

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Environmental factors are a positive consideration in our credit rating analysis of VR Group. The group is key in helping Finland achieve its carbon neutral objectives by 2035 and a 50% reduction in emissions by 2030. The group aims to reduce emissions by 15% (per unit of output) over the next four years from the 2019 level. Positively, the group's entire fleet of passenger trains is already carbon neutral, and the group has operated with 100% renewable electricity since 2008. Social factors have an overall neutral influence, balancing the group's responsibility for meeting national social objectives, including wide rail connections across Finland, versus the negative impact from the pandemic. The latter provoked a sharp drop in passenger volumes of more than 30% in 2020. However, the group maintained stronger financial metrics than peers, thanks to very low financial leverage, supported by its government owner.

Rating Component Scores

Foreign currency issuer credit rating	A+/Stable/--
Local currency issuer credit rating	A+/Stable/--
Business risk	Satisfactory
Country risk	Very Low
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk	Modest
Cash flow/leverage	Modest
Anchor	bbb+
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb+

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: 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

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