# Agder Energi AS
# Norway, Utilities

SCOPE BBB+ STABLE

## Corporate profile

**Agder Energi AS (Agder Energi) is a vertically integrated Norwegian utility company in the areas of hydroelectric power production, network operation, retail power sales as well as energy management, contracting and district heating. Measured in power generation, Agder Energi is Norway's fourth-largest energy supplier. The group's 49 wholly owned and partly owned power stations produce annually on average 8.1 TWh of renewable energy. Agder Energi Nett owns and operates the regulated transmission and distribution networks in Vest-Agder and Aust-Agder while LOS is the brand name for the retail segment. Agder Energi is owned by the 30 municipalities in the region (54.5%) and Statkraft Industrial Holding AS (45.5%).**

## Ratings

| | |
|---|---|
| Corporate issuer rating | BBB+ |
| Outlook | Stable |
| Senior unsecured debt | BBB+ |
| Short-term rating | S-2 |

## Rating rationale

**Scope Ratings assigns a corporate issuer rating of BBB+ to Norway-based Agder Energi AS. The Outlook for the rating is Stable. Scope also assigns an S-2 short-term rating. The company's senior unsecured debt is rated BBB+.**

The issuer rating reflects a standalone credit quality of BBB and a one-notch uplift based on Scope's view that the unified majority owner (30 Norwegian municipalities in the Agder region) is very supportive and has the ability and willingness to provide support if needed.

The corporate issuer rating reflects Scope's view of Agder Energi as a vertically integrated utility with a meaningful share of a robust infrastructure segment (power distribution). Coupled with its low-cost hydro power portfolio assets and the company's substantial hedging of anticipated production for the next three years, Scope recognises the measures taken by the company to reduce underlying volatility. Moreover, Agder Energi's business risk is also supported by LOS's leading market share in the retail segment, which is mainly described as a low-margin business with a low-risk sales procurement strategy (back-to-back).

Limiting factors for the business risk profile include low geographical diversification and a competitive environment for its retail activities and contracting services in Otera, with the latter also being loss-making.

Agder Energi's financial risk profile is supported by stable operating cash flow that has consistently been well above capex each year. Strong debt protection ratios, measured by interest coverage that is well above 8x, and relatively stable indebtedness, measured by Scope-adjusted debt/EBITDA in a range between 3-4x, are important factors for Scope's assessment of the company's financial risk.

Currently, Scope's constraints on the financial risk profile of Agder Energi relate to a relatively high dividend payout historically coupled with sizeable investment needs, which has put free cash flow after dividends in negative territory. Still, liquidity has been more than sufficient thanks in part to the company's good access to bank debt and debt capital markets.


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### Related Research // Methodology

Rating Methodology: Corporate Ratings, January 2017

European Utilities, January 2017

European Integrated Utilities: From Headwinds to Tailwinds, September 2016


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## Outlook

The Stable Outlook reflects Scope's expectation that Agder Energi will continue its vertically integrated business strategy within the key segments of generation, distribution and retail sales. It also reflects our view that Agder Energi should be able to fund its investments using its own internally generated cash flow over the cycle, coupled with the continued ambition of its management and owners to have a strong financial credit profile. Scope therefore anticipates that key credit metrics will stay relatively unchanged in the medium term based on our forecast and key assumption for market developments. The rating outlook also reflects Scope's assumption of continued majority ownership by the municipalities.

A rating upgrade could be warranted if Agder Energi deleveraged to a level below 3.0x on a sustained basis, bolstered by lower investment needs and dividend payouts, for instance.

Negative rating action is possible if the company were to participate in a debt-financed structural transaction that substantially weakens its credit profile on a sustained basis with SaD/EBITDA well above 4x and/or negative FCF/SaD for a prolonged period.

## Rating drivers

| Positive | Negative |
|---|---|
| • Vertically integrated business model with monopolistic power distribution, strong position of hydro power generation in the merit system and leading retail sales business | • Relatively high dividend payout historically coupled with sizeable investment needs has put free cash flow in negative territory |
| • Profitable and environmentally-friendly hydro power production with substantial hedging agreements and sizeable reservoir capacity | • Limited geographical diversification with Norway being its main region |
| • Long-term, committed majority owners (30 municipalities) that are jointly organised and show ability and willingness for potential parent support | • Loss-making contracting services in Otera |

## Rating-change drivers

| Positive | Negative |
|---|---|
| • In the longer term, if we see reduced investment and dividend payouts resulting in positive free cash flow after dividends and improved credit metrics (i.e. SaD/EBITDA <3x) | • A merger with Skagerak that is structured in a way that weakens the capital structure on a sustained basis, with SaD/EBITDA well above 4x and negative FCF/SaD for a prolonged period |

## Financial overview

| Scope key credit metrics | Historical | | Scope estimates | | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017F | 2018F | 2019F |
| EBITDA/interest cover (x) | 8.2x | 9.3x | 8.7x | 8.5x | 8.3x |
| Scope-adjusted debt/EBITDA | 4.1x | 3.9x | 3.7x | 3.7x | 3.8x |
| Free cash flow/Scope-adjusted debt | 7.4 % | 8.2 % | 3.7 % | 8.3 % | 6.0% |

| Scope-adjusted EBITDA (NOK m) | Historical | | Scope estimates | | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017F | 2018F | 2019F |
| EBITDA | 2,084 | 2,205 | 2,421 | 2,394 | 2,365 |
| Operating lease payments in respective year | 62 | 83 | 75 | 73 | 71 |
| Scope-adjusted EBITDA | 2,146 | 2,288 | 2,496 | 2,467 | 2,436 |

| Scope-adjusted debt (NOK m) | Historical | | Scope estimates | | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017F | 2018F | 2019F |
| Reported gross debt | 9,029 | 9,143 | 9,492 | 9,550 | 9,718 |
| Cash, cash equivalents | -473 | -543 | -546 | -678 | -708 |
| Less: cash not accessible | 4 | 20 | 10 | 10 | 10 |
| Operating lease obligation | 332 | 325 | 325 | 316 | 307 |
| Scope-adjusted debt (SaD) | 8,892 | 8,945 | 9,280 | 9,198 | 9,327 |

| Liquidity | Historical | | Scope estimates | | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017F | 2018F | 2019F |
| Unrestricted cash position (NOK m) | 469 | 523 | 536 | 668 | 708 |
| Undrawn committed lines (NOK m) | 1,500 | 1,500 | 2,500 | 2,500 | 2,500 |
| Liquidity ratio (internal and external)* | 1.7 | 1.5 | 1.2 | 3.9 | 2.7 |

*Based on free cash flow before dividends

## Business risk profile

Scope's analysis of a utility's business risk profile is split into two parts: i) industry risk and ii) competitive position. The latter includes our assessment of market position, diversification, and operating profitability/efficiency.

### Industry risk

Blended industry risk at BBB-

As Agder Energi's segments expose it to different industry fundamentals, we have incorporated a blended industry risk profile based on the differing characteristics and EBITDA provisions of each segment. We applied a normalised segment split of 70% for unregulated power generation, 25% for regulated grid operation, and 5% for retail – which is based on historical averages and forecast estimates. Based on this we assess Agder Energi's overall average weighted industry risk at BBB-.

The overall industry rating is supported by the regulated and stable distribution business, which has low cyclicality and high barriers to entry. Unregulated European power generation, on the other hand, exhibits highly cyclical features even when outright production volumes are fully hedged. When assessing the retail industry, where utilities sell self-generated or third-party energy to customers, we look at customer structure and energy-sourcing. Utilities with a high exposure to residential customers and back-to-back procurement, such as Agder Energi, carry comparatively low risks.

### Competitive position

Small in size, but generation portfolio is competitive

Scope regards Agder Energi's market position in its various business segments to be supported by the following:

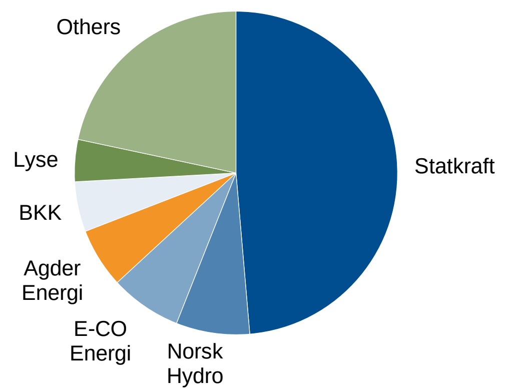
- Strong but small position in power generation (fourth in Norway) with a production output of about 8 TWh on average (6% of Norway's electricity consumption)
- Favourable position for power generation due to low-cost profile of hydro power
- Water reservoirs cover about 60% of annual production volume
- Monopoly position through operation of distribution grids in southern Norway, protected by high barriers to entry and stable regulation
- Strong B2C outreach (approx. 200k customers with about 18 TWh – 14% of Norwegian electricity consumption) through the retail business with a low-risk sales procurement strategy (back-to-back)
- Mitigation of pricing and volume risks in power generation though far-reaching hedging activities (>80% of tax adjusted generation exposure)

Nevertheless, Agder Energi's market position is hampered by:

- Full merchant risks for outright power production volumes (although hedged to a large extent given market's inherent price volatility)
- Limited geographical reach within Norway
- Volume risks in dry hydrological years

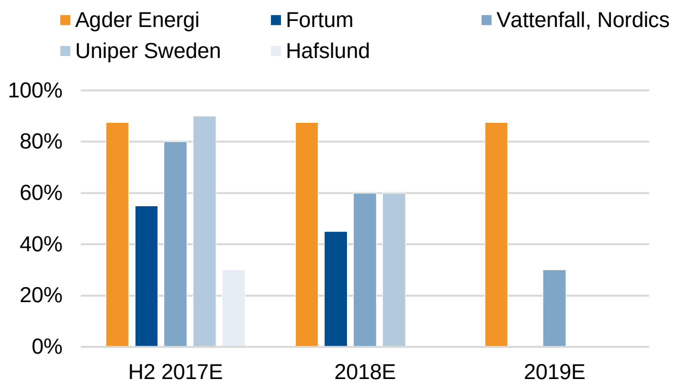
With an attributable mean electricity production of more than 8 TWh per annum, the company covers about 6% of Norway's demand for electricity and about 2% of the Nordpool market's demand. While Norway's dominating power generator Statkraft covers about 50% of electricity volumes, Agder Energi ranks fourth among Norwegian power generators (see figure 1). More importantly, the company's hydro plants hold an excellent position within the Nordic market's merit order system thanks to their comparatively low marginal costs of electricity generation (strong competitiveness of hydro against nuclear and fossil power generation).

**Figure 1 – Agder Energi's market position in terms of electricity generation in Norway (% of 130 TWh)**




Source: Agder Energi, Scope

**Figure 2 – Hedging of production***




Source: Agder Energi, Company reports, Scope.
*Agder Energi hedging ratio is the hedged percentage of tax adjusted exposure.

**High share of hedging compared to peers**

Given the industry's inherent merchant risks, Scope generally regards a large share of hedging activities to be credit-supportive as a high proportion of hedging can strongly mitigate substitution risks through competitors and consequently provide comfortable visibility for future earnings. Agder Energi currently hedges more than 80% of its annual exposure three years ahead of production. This is a fairly conservative approach in the Nordpool market compared to other Scandinavian utilities (see figure 2). While such extensive hedging limits the upside in years when wholesale prices are trending upwards, i.e. as a result of low hydro reservoirs or production shortfalls in major power plants such as nuclear in the Nordpool region, it safeguards Adger Energi's cash flow generation and secures generation margins over a longer time horizon. Scope therefore regards Agder Energi's hedging policy to be credit-supportive.

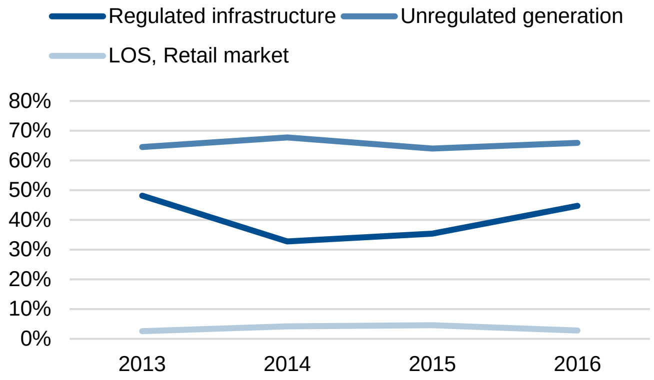
**Limited geographical diversification but full vertical integration**

Scope regards Agder Energi's limited geographical diversification, which is largely constrained to the domestic market, as a credit weakness. Still, we recognise the highly vertically integrated business model and the diversified customer base. Scope also regards Agder Energi's diversification within its power generation portfolio of 49 fully or partly consolidated hydro power plants to be sufficient.

**Margins affected by hedge accounting and increasing LOS sales**

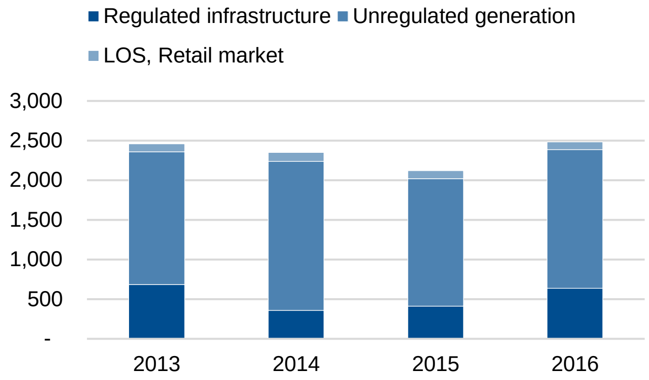
Scope considers Agder Energi's profitability profile to be relatively stable even though fluctuating factors stemming from electricity generation volumes, achievable prices, and IFRS hedging effects are present. Another factor we take into account is increasing sales to be generated by LOS going forward, which will reduce overall group margins compared to historical figures.

**Figure 3 – EBITDA margin development per segment***




Source: Agder Energi, Scope

**Figure 4 – Segment split based on EBITDA 2016**




Source: Agder Energi, Scope

## Financial risk profile

**Stable underlying business**

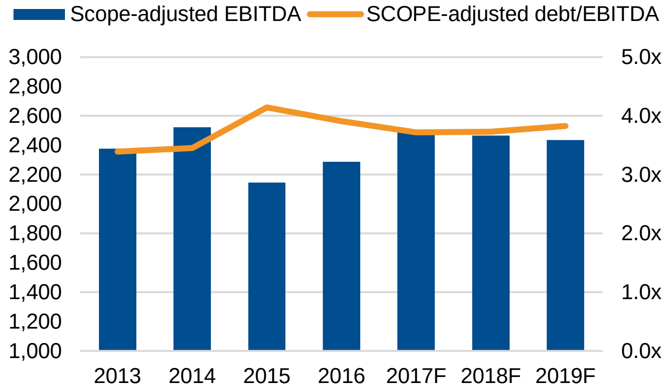
Looking at key credit metrics for Agder Energi over time, we see that adjusted leverage has largely stayed within the 3-4x area in recent years while interest coverage has been strong with a ratio above 8x. Scope also recognises that unrealised gains and losses on electricity and currency contracts have had a big impact on Agder Energi's IFRS income statement, but as these have no cash flow effects, we have focused on underlying developments over time.

Higher prices and volumes in the Norwegian retail division of LOS coupled with the acquisition effect of Telge Kraft (from November 2016) have led Scope to recognise that the retail division is taking a larger share of turnover but not of EBITDA. Given that LOS is a lower margin business than power generation and distribution, Scope expects Agder Energi to see further declines in overall group margins.

**Operating cash flow covers capex but not dividends**

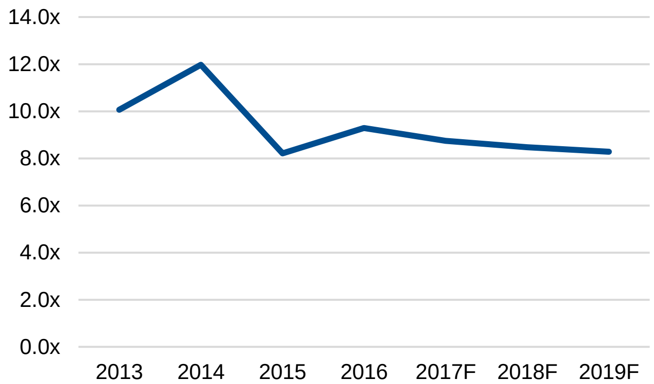
Still, Scope notes that on an absolute EBITDA and cash flow basis, the group will see improvements, which is important for overall funding of its investments plans. Operating cash flow has consistently been well above capex each year, but looking at FCF after dividends, the company has been and will be in need of some refinancing. Selected extraordinary asset sales have been done, and Scope favours the positive cash flow that came from the sale of Fosen Vind for instance, resulting in important reduced capex commitments going forward.

**Figure 5 – Scope-adjusted leverage development**




Source: Agder Energi, Scope

**Figure 6 – EBITDA/interest coverage development**



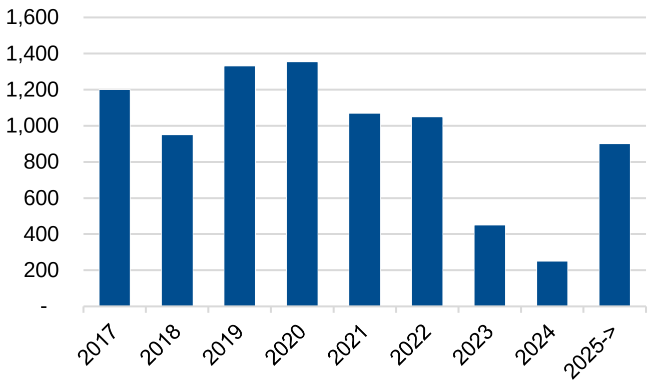

Source: Agder Energi, Scope

Even if capex is expected to be higher in 2017 than in 2016, Scope expects the company to fund its investments with operating cash flow. Moreover, the company will be positively influenced by further asset sales in both 2017 (NetNordic) and 2018 (Honna). Based on the current investment programme, power prices, an1d production estimates, we anticipate that Agder Energi will see relatively stable development in the medium term in terms of credit metrics over the cycle.

**Scope-adjusted debt to increase slightly, with continued, diversified funding sources**

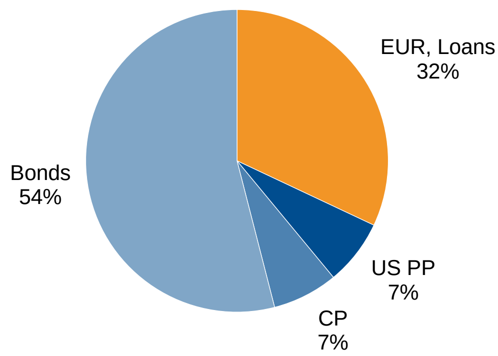
When assessing the utility's financial risk profile, Scope has primarily adjusted the reported debt for its exposure to operating leases. As of YE 2016, Scope-adjusted debt at Agder Energi is NOK 8.9bn, which we expect to increase somewhat to around NOK 9.3bn in the short to medium term. Currently, the company is mainly financed through the NOK bond market, but we also recognise the company's ability to get financing from a US private placement, the Nordic Investment Bank, and Scandinavian banks.

**Figure 7 – Debt maturity as of May 2017 (in NOK m)**




Source: Agder Energi, Scope

**Figure 8 – Funding structure at YE 2016**




Source: Agder Energi, Scope

**Municipal owners are reviewing dividend policy**

With respect to anticipated dividend payouts in the coming years, we note that municipalities are in the process of revising the policy guidelines. This is likely to happen in Q4 2017, which means that our forecasted dividend could come down starting in 2018. We are encouraged that the owners are looking into this. The rationale for the revision is based on the low energy-price environment anticipated for the medium term coupled with the company's ambition of having a credit profile that is among the strongest in its Norwegian utility peer universe.

## Liquidity

**S-2 short-term rating**

Scope assesses Agder Energi's liquidity profile as 'better than adequate' in accordance with our methodology to determine the liquidity of corporates, and so we assign a short-term rating of S-2.

**Liquidity headroom has increased during 2017**

At YE 2016, Agder Energi had NOK 0.5bn in cash and NOK 1.5bn in undrawn committed credit lines. This has further improved during 2017, with increased overdraft and committed credit lines of NOK 1bn, bringing total available credit facilities to NOK 2.5bn currently. When comparing its liquidity position to its short-term debt, the company is fully covered. The company also enjoys good access to bank debt and debt capital markets (i.e. 14 bonds/CP currently outstanding totalling more than NOK 5.8bn), and it has no financial covenants in its bond documentation. We also factor in its committed capex programme and its debt maturity profile, which make for robust liquidity, in our view, for an investment grade company.

| | | Scope estimates | | |
|---|---|---|---|---|
| | 2016 | 2017F | 2018F | 2019F |
| Unrestricted cash and undrawn credit lines (NOK m) | 2,023 | 3,036 | 3,168 | 3,208 |
| Cash flow from operations (NOK m) | 1,779 | 1,511 | 1,483 | 1,473 |
| Operating FCF before dividends | 646 | 261 | 683 | 473 |
| Cash flow available for debt repayment | -158 | -346 | 73 | -137 |
| Short-term debt maturity (NOK m) | 1,951 | 942 | 1,332 | 1,355 |

## Supplementary key rating drivers

**Financial policy aim to keep credit profile strong**

Scope views Agder Energi's financial policy as reassuring to the company's overall credit quality prospects. We note that the company continuously monitors selected credit ratios in order to stay within an implied strong investment grade profile. Although we deem the dividend payout level to have been relatively high recently, we favour the somewhat unusual dividend policy of a one-year delay (2017 payout is based on 2015 results), so that the company has time to decide on a fair capital structure. Moreover, the company and its owners are in the process of re-evaluating its dividend policy and leverage ratio (to be more conservative) in order to meet their common goal of having one of the best credit profiles in the Norwegian utility universe.

**30 Norwegian municipalities are the majority owner of Agder Energi**

Although Agder Energi does not have a single majority shareholder, Scope deems the group of 30 municipal shareholders in the Agder region as equivalent to a majority shareholder. The shareholder consortium has not changed since the establishment of the company, and the fact that they are structurally organised as one unit can be clearly seen in an organisation called Agdereierne. The municipal shareholders have also agreed to coordinate their votes at the AGM. They define themselves as strategic owners with a long-term, active ownership profile. The agreement also contains regulations on individual municipalities' ability to sell their shares to others, if the sell down results in reducing ownership below majority holdings collectively.

**Ownership structure supports overall creditworthiness**

In Scope's assessment of Agder Energi's credit rating, we note that there is no explicit support or guarantee from its municipal owners or Statkraft. While the company is in a good position to avoid a liquidity shortfall, Scope recognises that it would be very likely for majority owners to provide financial support in the theoretical event of financial distress. As a result, Scope considers Agder Energi's ownership structure as supportive for overall credit quality, giving a one-notch uplift to its standalone credit rating. Although the ultimate owners of both the municipalities and Statkraft are more creditworthy than Agder Energi, we put more weight on the ability and willingness of the unified municipalities.

# Regulatory disclosures

## Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Chief Executive Officer: Torsten Hinrichs, Dr Stefan Bund.

| **Rating prepared by** | **Rating committee responsible for approval of the rating** |
|---|---|
| Henrik Blymke, Lead Analyst | Olaf Tölke, Committee Chair |

The rating concerns an entity, which was evaluated for the first time by Scope Ratings AG.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

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## Key sources of information for the rating

☒ Annual reports/semi-annual reports of the rated entity
☒ Detailed information provided on request
☒ Interview with the rated entity
☒ Press reports/other public information
☒ Website of the rated entity
☒ Data provided by external data providers
☒ External market reports

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

## Methodology

The methodology applicable for this rating (Corporate Rating Methodology) is available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

## Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

## Conditions of use/exclusion of liability



## Rating issued by

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