31 July 2024

Corporates

TrønderEnergi AS ('TE')
Kingdom of Norway, Utilities

SCOPE BBB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2022	2023	2024E	2025E
Scope-adjusted EBITDA/interest cover	21.5x	11.3x	9.1x	11.0x
Scope-adjusted debt/EBITDA	2.9x	2.5x	2.7x	2.7x
Scope-adjusted funds from operations/debt	29%	22%	4%	14%
Scope-adjusted free operating cash flow/debt	10%	50%	-6%	6%

Rating rationale

The BBB+ issuer rating reflects TE's standalone credit assessment of BBB and a one-notch uplift related to its status as a government-related entity. The issuer rating reflects the expectation that TE's profitability will continue to be high in the medium term, as legacy hedges entered into at lower prices are being phased out of the hedge portfolio.

The business risk profile, assessed at BBB-, is supported by TE's environmentally friendly and cost-efficient hydropower generation in central Norway. In addition, the utility's exposure to monopolistic electricity distribution through its 40% stake in Tensio, Norway's second largest regulated grid operator, also supports the business risk assessment.

The financial risk profile, assessed at BBB+, is driven by the expectation that the unwinding of legacy hedges entered into at lower prices will lead to an improved EBITDA margin as the company will be able to capitalise on above-average electricity prices, as forecasted.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that power prices in the NO3 zone will remain at around EUR 40/MWh into 2025 and beyond, combined with TE not planning material growth capital expenditure and/or additional shareholder remuneration beyond that included in our base case.

The upside scenario for the ratings and Outlook is further improvement of the financial risk profile, exemplified by Scope-adjusted debt/EBITDA significantly below 2.5x on a sustained basis.

The downside scenario for the ratings and Outlook is deterioration of the financial risk profile, exemplified by Scope-adjusted debt/EBITDA significantly above 3.5x on a sustained basis.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
27 June 2024	Upgrade	BBB+/Stable
27 June 2023	Outlook change	BBB/Positive
22 June 2022	New	BBB/Stable

Ratings & Outlook

Issuer	BBB+/Stable
Short-term debt	S-2
Senior unsecured debt	BBB+

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Related Methodologies

General Corporate Rating Methodology; October 2023

European Utilities Rating Methodology; June 2024

Government Related Entities Rating Methodology; July 2023

Related Research

ESG considerations for the credit ratings of utilities; April 2021

Utilities credit outlook: slightly positive, favouring power generators vs grid/network operators, February 2024

Nordic utilities: north-south price gap benefits southern generators; TSOs also gain, November 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

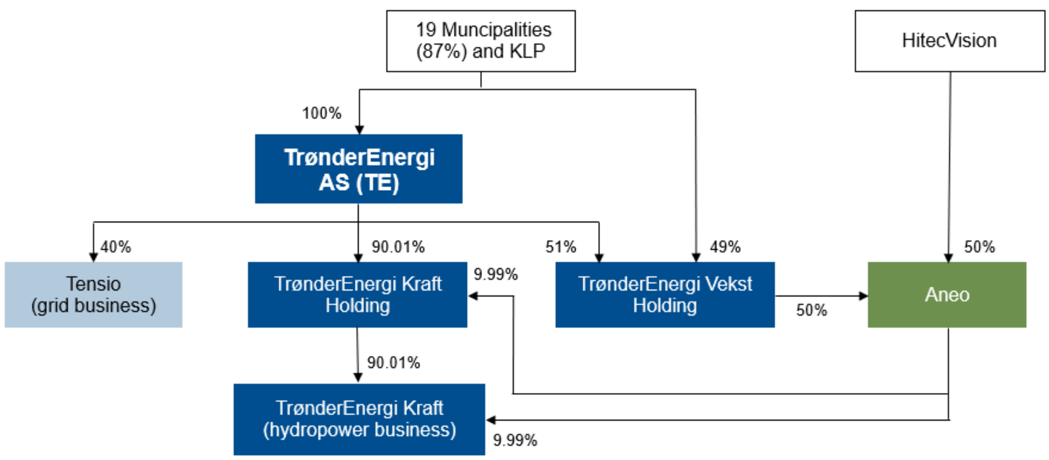
Positive rating drivers	Negative rating drivers
• Environmentally friendly hydro power production, which is cost-efficient and profitable – positive ESG factor. • 40% stake in monopolistic power distribution grid operations with stable dividends going forward. • Long-term, supportive, and committed municipal owners, warranting a one notch upgrade under GRE methodology. • Strong profitability, as measured by EBITDA margin of around 50%, as well as low debt and high liquidity. • Ownership in Aneo (indirectly 25%) which produces energy based on windpower, another positive ESG factor. Expected to contribute significant dividends to TE from 2030 onwards.	• Limited geographical diversification and some asset concentration risk in power production. • Uncertain political climate and whether resource rent tax may be further increased or further penalise utilities which hedge their anticipated power production. • Power price exposure and the uncertainty of environmental factors affecting power production, resulting in potential of higher leverage ratio going forward. • Municipal owners potentially wanting higher dividend payments in the long term, at the expense of deleveraging. • Transactional event risks, as a result of company's historical use of hedging.

Positive rating-change drivers	Negative rating-change drivers
• Further improvement of the financial risk profile, exemplified by Scope-adjusted debt/EBITDA significantly below 2.5x on a sustained basis.	• Deterioration of the financial risk profile, exemplified by Scope-adjusted debt/EBITDA significantly above 3.5x on a sustained basis. • Loss of status as a government-related entity (remote).

Corporate profile

TrønderEnergi AS (TE) is a municipally majority-owned Norwegian utility company focused on environmentally friendly hydropower production in the NO3 price region in central Norway. The company's annual electricity production was 1.7 TWh in 2023 and its mean production is estimated at 1.8 TWh, making it one of the smaller hydropower producers in Norway. TE is also exposed to monopolistic electricity distribution through its 40% stake in Norway's third-largest regulated electricity distributor, Tensio AS. In October 2022 TE transferred all non-hydro-generating assets to joint-owned growth company Aneo. TE's organisational structure after the transfer of assets to Aneo is as follows:

Figure 1: Structure of TrønderEnergi AS



Sources: TE, Scope

Financial overview

				Scope estimates		
Scope credit ratios	**2021[1]**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	15.7x	21.5x	11.3x	9.1x	11.0x	14.0x
Scope-adjusted debt/EBITDA	2.1x	2.9x	2.5x	2.7x	2.7x	2.4x
Scope-adjusted funds from operations/debt	53%	29%	22%	4%	14%	25%
Scope-adjusted free operating cash flow/debt	35%	10%	50%	-6%	6%	17%
Scope-adjusted EBITDA in NOK m						
EBITDA	562	486	585	601	598	633
add: received Tensio dividend *less* dividend paid to new growth company	300	180	27	53	59	49
Scope-adjusted EBITDA	**862**	**666**	**612**	**654**	**657**	**681**
Funds from operations in NOK m						
Scope-adjusted EBITDA	862	666	612	654	657	681
less: (net) cash interest paid	-55	-31	-54	-72	-60	-49
less: cash tax paid per cash flow statement	-53	-129	-250	-316	-212	-216
less: pension interest	-1	-1	0	0	0	0
Other items[2]	206	60	30	-195	-139	0
Funds from operations (FFO)	**960**	**566**	**337**	**70**	**246**	**416**
Free operating cash flow in NOK m						
Funds from operations	960	566	337	70	246	416
Change in working capital	-96	-285	472	-69	0	-4
less: capital expenditure (net)	-233	-88	-54	-100	-125	-125
Free operating cash flow (FOCF)	**631**	**193**	**755**	**-99**	**121**	**287**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	49	25	54	72	60	49
add: interest component, pensions	1	1	0	0	0	0
Add: interest component, hybrid debt	5	5	0	0	0	0
Net cash interest paid	**55**	**31**	**54**	**72**	**60**	**49**
Scope-adjusted debt in NOK m						
Reported gross financial debt	3,343	3,113	2,812	2,812	2,812	2,812
add: subordinated (hybrid) debt	72	72	0	0	0	0
less: cash and cash equivalents	-1,701	-1,238	-1,319	-1,070	-1,041	-1,179
add: non-accessible cash	114	7	2	0	0	0
add: pension adjustment	17	4	0	4	0	0
Scope-adjusted debt (SaD)	**1,845**	**1,958**	**1,495**	**1,745**	**1,770**	**1,633**

[1] To better represent the new structure, 2021 figures were restated in TE's 2022 accounts.
[2] Other items in 2024E/2025E are the cash flow effects from hedges closed and recognised in the P&L for 2022

Table of Content

Environmental, social and governance (ESG) profile[3]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Efficient low emission generation considered a competitive advantage

As a hydropower producer, TE has a favourable ESG profile, highlighted by its very efficient generation and an estimated carbon intensity of less than 20gCO2e/kWh compared to the European average of 255gCO2e/kWh. In addition, the exposure to hydropower generation ensures that TE remains a government-related entity and retains the benefits associated with this status.

Regulatory risks highlighted in 2022

Despite an inherently positive sustainability profile, Norwegian utilities are still subject to regulatory and reputational risks. This was evident in 2022 when the extraordinary rise in electricity prices increased scrutiny on Norway's state-owned electricity sector, leading to the temporary imposition of a windfall tax and a permanent increase in the resource rent tax rate on hydrogeneration assets. While the windfall tax was reversed in October 2023, the increased resource rent tax will reduce future cash flows.

Dark green certification from CICERO

TE has a well-integrated ESG framework and ambitions. The company has issued green bonds and its green-bond-framework has received a 'dark green' certification from CICERO.

[3] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB-

New holding structure successfully implemented in October 2022

TE's business risk profile is highlighted by the company's environmentally friendly and low-cost hydropower production in favourable geographical locations in central Norway, as well as its exposure to monopolistic electricity distribution through its minority stake in Tensio. TE transferred its non-hydropower operations to Aneo in October 2022, and under the new structure we view TE primarily as a pure-play hydropower producer.

Blended industry risk profile: BB+

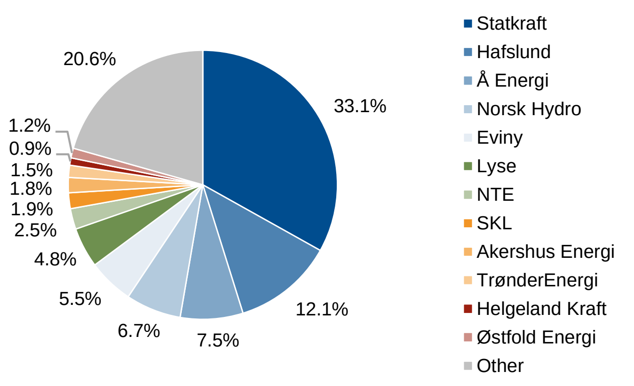
TE's significant exposure to unregulated power generation results in high merchant risk due to volatile electricity prices, as illustrated by the realised hedge losses in 2022 and the hedge losses to be realised in 2024 and 2025. We factor in parts of TE's exposure to regulated grid operations through its minority stake in Tensio, which provides stability through predictable dividend income. However, we give slightly less weight to these dividends as TE only has a minority stake (40%) and lacks control.

Utility segment	Industry risk	Normalised exposure
Unregulated generation	BB	84%
Regulated grid operations	AA	16%
Blended industry risk	**BB+**	

Small hydro generator; well placed with low-cost assets

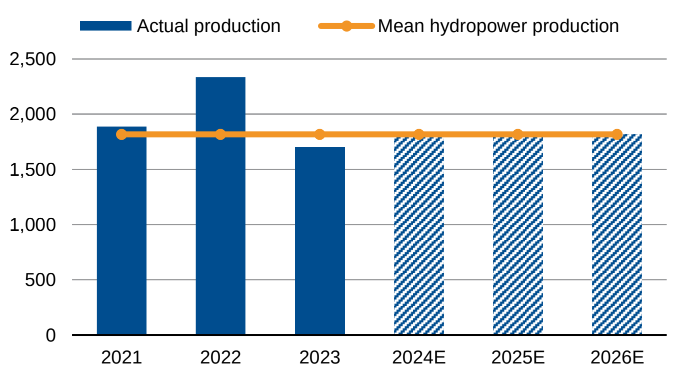
TE had an actual production of 1.7 TWh in 2023 (2.3 TWh in 2022) from 17 wholly or partly owned plants located in the NO3 price zone. Its annual mean production of 1.8 TWh makes it a small Norwegian hydropower producer, accounting for an estimated 1%-2% of Norway's annual hydropower production. However, we continue to emphasise that size is of little importance for a utility's market position, with more weight being given to factors such as merit order position, emissions, and adeptness of the generating assets. TE's hydropower plants are favourably placed in the Nordic and European merit order systems, as evidenced by an estimated carbon intensity of less than 20gCO2e/kWh (compared to the European average of 255gCO2e/kWh). The company can regulate around 30% of its annual mean production, which is credit positive as it provides generation flexibility and the ability to optimise output when prices are high, such as during peak load periods. We expect TE to benefit more from this in the longer term as the share of intermittent generation is expected to increase in the Nordic region and Europe.

Figure 2: Estimated market shares in Norwegian hydropower generation



Sources: NVE-RME, Scope

Figure 3: TE's actual hydropower production vs. mean hydropower production (GWh)



Sources: TE, Scope (estimates)

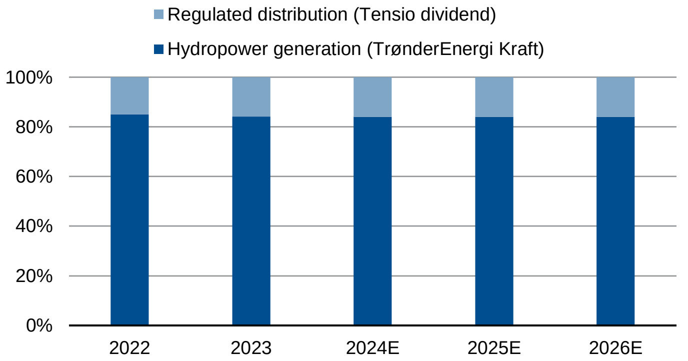
Exposure to monopolistic grid operations through dividends

The exposure to Tensio's grid monopoly is positive for TE's market position and overall business risk profile, as the predictable and stable dividends from Tensio help to offset the more volatile cash flows from power production. In terms of TE's 40% stake in Tensio, we also highlight the joint shareholder agreement with the other major owner (NTE) and Tensio's obligation to distribute all cash (after operational needs and debt service) to shareholders.

Segment diversification helped by stake in Tensio

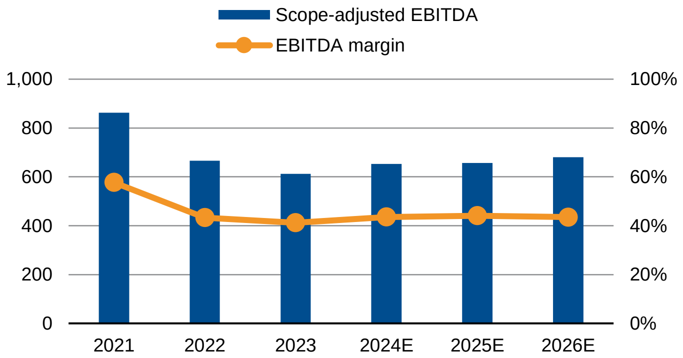
TE has slightly better segment diversification than other pure-play power producers, with around 84% of its Scope-adjusted EBITDA coming from hydropower production and the remainder from grid dividends. The company has a favourable exposure to renewables growth through its 25.5% stake in Aneo, although the joint venture is unlikely to pay dividends soon, so the impact on diversification and the overall business risk profile is limited for now.

Figure 4: Segment split of Scope-adjusted EBITDA



Sources: TE, Scope (estimates)

Figure 5: Scope-adjusted EBITDA (NOK m, LHS) and EBITDA margin (%, RHS)

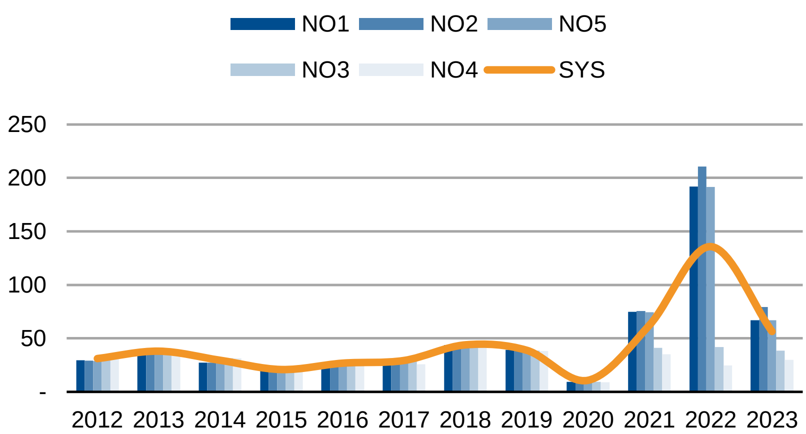


Sources: TE, Scope (estimates)

Regional presence in Norway within the NO3 bidding zone

Geographically, TE's operations are concentrated in the Trøndelag area in central Norway, with an exposure to only one bidding zone (NO3) within the NordPool market. Geographical diversification is therefore limited compared to large European peers, but in line with most Norwegian utilities due to the regional structure of Norway's power sector.

Figure 6: Power prices in Norway (by bidding zone) and the Nordic system price, in EUR/MWh



Sources: NordPool, Scope

Some asset concentration in the hydropower portfolio

TE's hydropower production is spread across 17 fully or partly owned plants. However, TE is highly dependent on its two largest plants, Driva (around 25% of total production) and NEA (around 18%), and any prolonged interruption in their production would have a material adverse effect on cash flow. Such standstills are nonetheless unlikely.

Less upside in achieved prices than southern Norway producers

In terms of achievable prices for electricity generation, the NO3 bidding zone is less optimal than in southern Norway (NO1, NO2 and NO5)due to structural bottlenecks in the Norwegian regional grid that prevent efficient energy transfer between the zones. In addition, southern Norway has the pressure of being directly connected to continental Europe, which makes prices in the south much more exposed to European energy balances, and therefore electricity prices are higher in southern Norway. In the medium term, we expect NO3 spot prices to be around EUR 40/MWh, which is well above the historical average of around EUR 30/MWh.

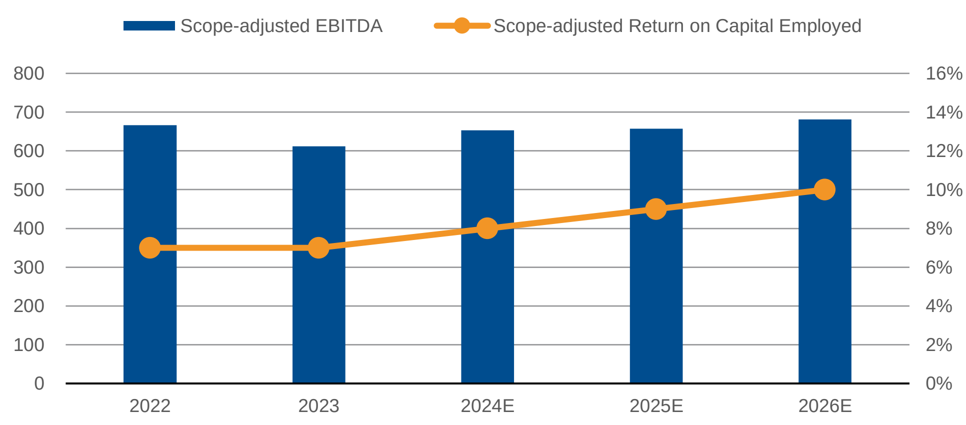
Strong operating profitability versus our European peer group

TE's profitability, as measured by the Scope-adjusted EBITDA margin, is considered very strong at 41% in 2023 which is unchanged from 2022 when Scope-adjusted EBITDA came in at 42%. We expect profitability to improve to around 45% in the medium term as legacy hedges made at lower prices roll out and TE is able to capitalise on higher electricity prices in NO3. The forecasted Scope-adjusted EBITDA margin of 45% is considerably below last year's forecast of 60% due to continued inflationary pressures and higher than expected interest rates, which increase the pressure on profitability. Nevertheless, an estimated EBITDA margin of 45% in the medium term still considered very strong. TE owns 81% of TrønderEnergi Kraft AS, a highly profitable hydropower producer, which remains the only consolidated business after the transfer of wind power generating assets to Aneo in 2022.

Recently fair value-adjusted balance sheet contributes to below-average assessment on return on capital employed

Profitability as measured by Scope-adjusted return on capital employed (Scope-adjusted ROCE) is more volatile than the EBITDA margin. While EBITDA is correlated with the top line, average capital employed is not. As part of the restructuring, TE's holdings in Aneo and Tensio were adjusted to fair value. This leads to a lower Scope-adjusted ROCE of around 8% as compared to most other Scope-rated Norwegian utilities at around 15% or higher.

Figure 7: Scope-adjusted EBITDA (NOK m, LHS) and Scope-adjusted Return on Capital Employed (RHS)



Sources: TE, Scope (estimates)

Financial risk profile: BBB+

The financial risk profile supports TE's issuer rating. The assessment is mainly driven by the strong interest coverage and low leverage. Based on a flat power price assumption in 2024-2026 for the NO3 zone of EUR 40/MWh and an assumed dividend from Tensio of NOK 100m per year, Scope-adjusted EBITDA is expected to increase from NOK 612m in 2023 to around NOK 650m in 2024-2025. This should support deleveraging, with Scope-adjusted debt/EBITDA expected to be around 2.7x in 2024-2025. Given the high capex visibility, which mainly comprises maintenance of hydropower assets, we see the main risk factors for weaker-than-forecast credit ratios as lower-than-expected electricity prices.

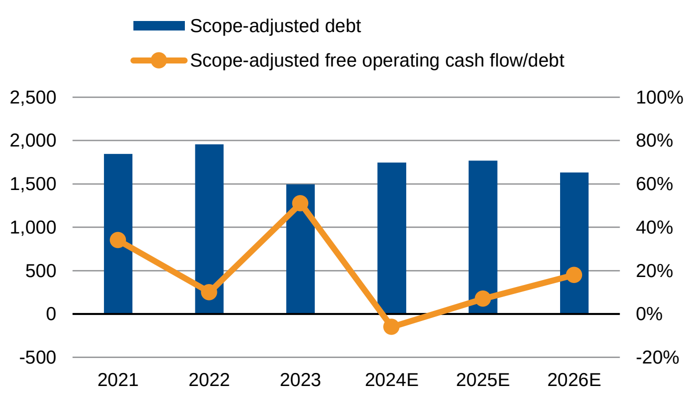
Legacy hedging portfolio to negatively affect results and operating cash flow in 2024 and 2025

TE had a relatively large legacy hedge portfolio for its hydropower generation, which for 2022 resulted in a realised loss of NOK 354m and subsequently negatively impacted the EBITDA. As a result of this realised loss, TE's Board of Directors decided to unwind these hedges in the spring of 2023, and while the hedge ratio for hydropower will decrease significantly in 2024 and onwards, operating cash flows in 2024 and 2025 will remain burdened by the settlement of these legacy hedge positions with cash outflows of NOK 195m (in 2024) and NOK 139m (in 2025).

The main assumptions in the rating base case scenario are:

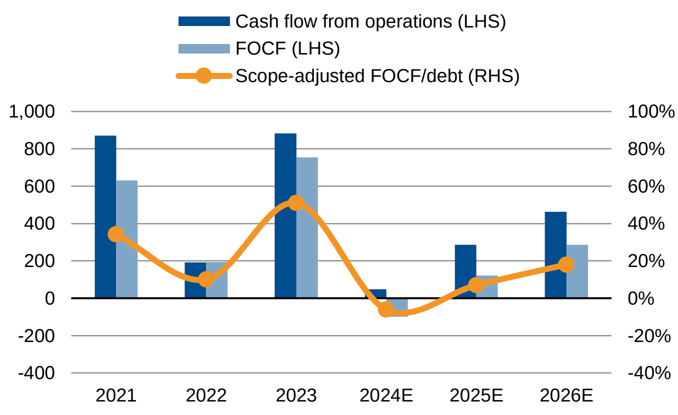
- Flat power price curve in NO3 of EUR 40 per MWh in 2024-2025
- Hydropower production equal to annual mean production of 1.8 TWh
- Capex of NOK 100m-125m yearly
- Dividends received from Tensio of NOK 100m p.a.
- Ordinary dividend payouts from TE of NOK 150m, as decided by the board of directors of TE in April 2024.

Figure 8: Development in Scope-adjusted debt (NOK m, LHS) and Scope-adjusted FOCF/debt (%, RHS)



Sources: TE, Scope (estimates)

Figure 9: Cash flow overview (NOK m) and cash flow cover

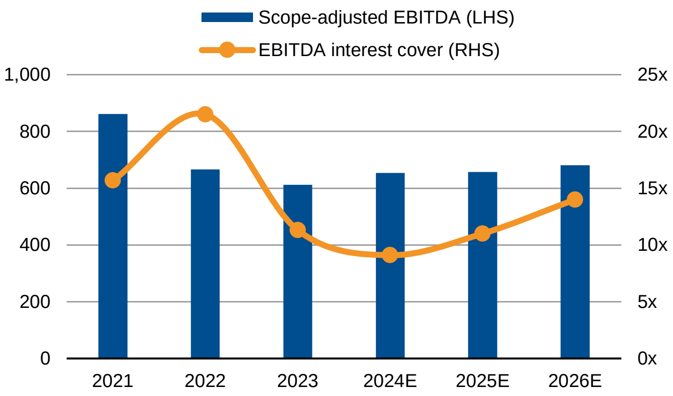


Sources: TE, Scope (estimates)

High internal financing capacity and robust interest cover

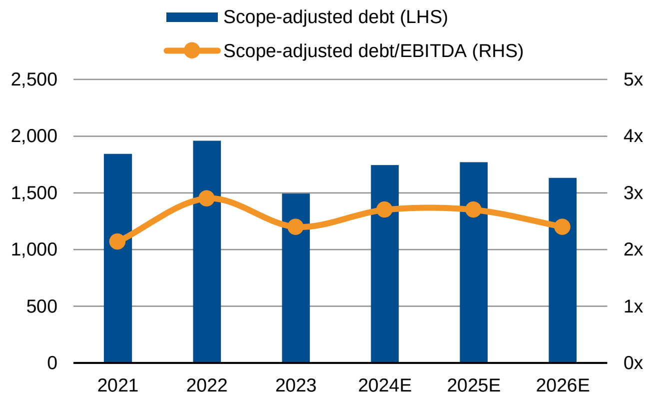
In addition to the improved leverage forecast at below 3.0x in 2024-2025, we also expect TE to maintain a high internal financing capacity, supported by low and predictable capex of NOK 100m-125m per year, consisting mainly of hydropower maintenance. Debt protection metrics as measured by EBITDA interest cover is expected to remain strong at around 10.0x. TE has limited refinancing needs before 2025 due to a significant portfolio of liquid financial assets.

Figure 10: Scope-adjusted EBITDA (NOK m) and Scope-adjusted EBITDA interest cover



Sources: TE, Scope (estimates)

Figure 11: Scope-adjusted debt (NOK m) and Scope-adjusted debt/EBITDA



Sources: TE, Scope (estimates)

Transaction risks to reduce

Despite the large transactions of recent years, we expect deal activity to decline. Following the deconsolidation of TE's grid network business with the creation of Tensio with NTE Nett in 2019, and the Aneo transaction in 2022, the only majority-owned business left is hydropower. However, TE has the right to buy back Aneo's hydropower stake. Therefore, TE may intend to regain full ownership, but we believe only if it can execute the transaction while maintaining a strong balance sheet.

Liquidity is strong with cash and cash equivalents of NOK 1.3bn at end-2023

Liquidity remains adequate. At end-2023, TE had NOK 1.3bn in unrestricted cash and short-term investments, which is more than sufficient to cover upcoming debt maturities of NOK 300m and NOK 600m in 2024 and 2025 respectively. While TE's committed undrawn credit lines include revolving credit facilities amounting to NOK 55m, larger facilities are not required due to the company's ample liquid investment portfolio that stood at NOK 689m, as at YE 2023. The company should, however, have no problem adding larger facilities if needed.

Balance in NOK m	2023	2024E	2025E
Unrestricted cash (t-1)	1,231	1,317	1,070
Open committed credit lines (t-1)	-	-	-
Free operating cash flow (t)	755	-99	121
Short-term debt (t-1)	297	300	600
Coverage	**>200%**	**>200%**	**199%**

Supplementary rating drivers: +1 notch (GRE)

One-notch uplift related to GRE status

We use our bottom-up approach to assess TE's parent support under our Government Related Entities Methodology, which justifies a one-notch rating uplift for the majority municipal ownership. This assessment reflects TE's ownership by 19 municipalities in Trøndelag (around 87% share) and the mutual insurance company Kommunal Landspensjonskasse (around 13%). The uplift is driven by the expected ability and willingness of TE's Norwegian municipal owners to provide financial support if needed.

Sound financial policy

We do not make any adjustments for financial policy, although we consider it to be sound. TE's Board of Directors decided in April 2024 to limit dividend payments to the owners to NOK 150m per year. The dividend policy is open to be revisited every 4 years, at the earliest in 2027.

Long-term and short-term debt ratings

BBB+ senior unsecured rating

The BBB+ rating on senior unsecured debt is in line with the issuer rating.

Short-term debt rating of S-2

The S-2 short-term debt rating is based on the underlying BBB+/Stable issuer rating and backed by the strong short-term liquidity cover and conservative liquidity management. The rating is further supported by well-established bank relationships and good standing in the capital markets.

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