16 October 2023

Corporates

Tensio AS
Kingdom of Norway, Utilities

A- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	10.8x	6.3x	4.6x	4.6x
Scope-adjusted debt/EBITDA	3.8x	6.4x	5.2x	4.7x
Scope-adjusted FFO/debt	23%	11%	15%	17%
Scope-adjusted FOCF/debt	0%	-7%	-5%	-2%

Rating rationale

The issuer rating reflects a strong business risk profile (assessed at A+), highlighted by Tensio's sole exposure to fully regulated power distribution, which is associated with very low industry risk. The company has a regulated monopoly as the grid operator in Trondelag county (includes newly Scope-rated Trondheim municipality) and its position is further bolstered by Norway's robust and stable economy, and a well-established regulatory framework that allows for timely cost-coverage.

The financial risk profile (assessed at BB+) remains constrained by relatively high leverage and negative free operating cash flow. Scope-adjusted debt/EBITDA is expected to average around 5x in the medium-term, driven by higher EBITDA. Grid investments and continued dividends will likely produce negative discretionary cash flows, necessitating more external financing. In addition, rising interest rates and inflation will put pressure on debt coverage, with Scope-adjusted EBITDA/net interest declining to the 4-5x range.

The issuer rating reflects a standalone credit assessment of BBB+ and a one-notch uplift for Tensio's GRE status. The uplift is driven by the anticipated capacity and willingness of the company's indirect municipality owners to provide support if needed.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Tensio will continue to generate cash flow from monopolistic and regulated grid operations. The Outlook further reflects an expectation that Scope-adjusted debt/EBITDA will stay around 5x going forward, and that free operating cash flow will be negative due to high capex. We also assume the company will remain indirectly majority-owned by Norwegian municipalities.

A positive rating action could be warranted if Tensio keeps Scope-adjusted debt/EBITDA with significant headroom to its leverage target, following positive free operating cash flow and reduced dividend distributions, at around 4x on a sustained basis.

A negative rating action could be triggered by a financial policy change that significantly weakened Tensio's financial risk profile, exemplified by Scope-adjusted debt/EBITDA around 6x on a sustained basis. A reduction in indirect municipal ownership to below 50% and the loss of GRE status could also trigger a downgrade.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
Oct 2023	Affirmation	A-/Stable
Oct 2022	Affirmation	A-/Stable
Nov 2021	Affirmation	A-/Stable

Ratings & Outlook

Issuer A-/Stable

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Related Methodologies

General Corporate Rating Methodology; July 2022

European Utilities Rating Methodology; March 2023

Government Related Entities Methodology; July 2023

Related Research

European utilities: continued electricity price hedging promises producer gain, consumer pain, Apr 2023

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

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Monopolistic power distribution company with stable and predictable cash flows and above average profitability • Operating in a supportive and well-established regulatory framework in Norway with tariffs based on cost-plus mechanisms • Rated as Norway's most efficient grid operator at year-end 2022 • Committed long-term owners who indirectly through municipalities have capacity and willingness to provide support if needed	• High financial leverage and debt financing requirements to carry out planned grid investments • Relatively high investment requirements indicate negative free operating cash flow in the medium term • Continued dividend ambitions that will likely need to be funded with debt • Limited geographical outreach with its network only serving municipalities in Northern Norway

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA around 4x on a sustained basis	• Scope-adjusted debt/EBITDA ratio around 6x on a sustained basis • Reduced indirect municipality ownership to below 50% and the loss of GRE status

Corporate profile

Tensio is a Norwegian utility company focusing solely on regulated regional and local electricity distribution. The company's service territory is Trøndelag County in Mid-Norway, where it is responsible for the power supply through construction, operation and maintenance of its power grid. In total, the company owns and operate over 29,000 km of cable (air, ground, and sea), 13,000 local network stations and 100 electrical substations, and serves 272,366 customers. The company is the third largest power grid operator in Norway measured by the number of customers, and it has around 600 full-time employees across Trøndelag County. As of year-end 2022 Tensio was rated as one of the most efficient grid operators in Norway by The Norwegian Water Resources and Energy Directorate (NVE).

Tensio AS is a relatively new company established by TrønderEnergi (rated BBB/Positive Outlook by Scope), Nord-Trøndelag Elektrisitetsverk (NTE) and Kommunal Landspensjonskasse Gjensidig Forsikringsselskap (KLP) in June 2019. TrønderEnergi Nett (now Tensio TS) and NTE Nett (now Tensio TN) were taken out of TrønderEnergi and NTE to form a new and larger power grid operator (Tensio AS).

Financial overview

			Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	10.8x	6.3x	4.6x	4.6x	5.3x
Scope-adjusted debt/EBITDA	3.8x	6.4x	5.2x	4.7x	4.8x
Scope-adjusted FFO/debt	23%	11%	15%	17%	17%
Scope-adjusted FOCF/debt	0%	-7%	-5%	-2%	-1%
Scope-adjusted EBITDA in NOK m					
EBITDA	968	664	900	1,042	1,066
Other items	-	-	-	-	-
Scope-adjusted EBITDA	**968**	**664**	**900**	**1,042**	**1,066**
Funds from operations in NOK m					
Scope-adjusted EBITDA	968	664	900	1,042	1,066
less: (net) cash interest paid	-83	-103	-191	-218	-197
less: cash tax paid per cash flow statement	-	-24	-1	-	-
less: pension interest	-3	-6	-6	-6	-6
Other items	-35	-68	10	-	-
Funds from operations (FFO)	**847**	**463**	**712**	**818**	**863**
Free operating cash flow in NOK m					
Funds from operations	847	463	712	818	863
Change in working capital	-70	65	-9	7	-5
less: amortisation of leases	-25	-25	-26	-26	-26
less: capital expenditure (net)	-746	-811	-900	-900	-900
Other items	-	-	-	-	-
Free operating cash flow (FOCF)	**6**	**-309**	**-223**	**-101**	**-68**
Net cash interest paid in NOK m					
Net cash interest	48	99	191	218	197
add: pension interest	4	6	6	6	6
Other items	-	-	-	-	-
Net cash interest paid	**52**	**105**	**197**	**224**	**203**
Scope-adjusted debt in NOK m	**2021**	**2022**			
Reported gross financial debt	3,900	4,112	4,812	4,901	5,079
less: cash and cash equivalents	-321	-1	-280	-120	-82
add: non-accessible cash	-	-	-	-	-
add: pension adjustment	129	114	114	114	114
Other items	-	-	-	-	-
Scope-adjusted debt	**3,707**	**4,226**	**4,647**	**4,895**	**5,111**

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Environmental, social and governance (ESG) profile[1]

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)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

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

High ESG focus and transparency with separate sustainability reporting

Tensio strives to be a driving force behind the green shift, by providing a power grid that has the capacity and efficiency needed for the Norwegian government to reach its stated climate goals[2] by 2030. This is because those goals rely heavily on new intermittent generation and the electrification of Norwegian industry, both of which will lead to an increased strain on power grids. Tensio has shown that it will honour its role in achieving these goals, as one of Norway's largest regulated power distributors, by investing heavily in its power grids over the medium term. We believe this also solidifies Tensio's status as a government-related entity (GRE).

Most generation supplying electricity to the Tensio's service territory comes from hydropower and wind assets, and a power grid is crucial to efficiently utilise this energy. The company has a sustainable ESG strategy in place for 2023-25 with four main pillars: i) continuous focus on reducing negative climate footprint; ii) taking an active role in the green transition; iii) being an attractive and safe employer; and iv) ensuring a societal value-creating power system. These pillars focus on direct impact stakeholders.

The Norwegian utility sector is subject to clear regulatory and reputational risks via a concession system. It was further exemplified in September 2022, when the government imposed a temporary windfall tax because of the soaring prices and permanently raised the resource rent tax rate on hydro generation assets. As a pure grid operator, these changes do not directly affect Tensio.

Overall, we do not see any ESG factors as drivers of Tensio's rating but acknowledge its efforts and crucial role in facilitating the green transition.

[1] 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.
[2] www.regjeringen.no/en/aktuelt/norways-new-climate-target-emissions-to-be-cut-by-at-least-55-/id2944876/

Business risk profile: A+

Industry risk profile: AA

Based on Tensio's sole exposure to fully regulated power distribution, we assess its industry risk as low (AA according to our utilities methodology).

Stable and supportive regulatory framework that ensures timely cost coverage

Norway's power distribution market is highly fragmented, with around 120 regional and local grid operators nationwide. However, in terms of market share, the 10 largest operators serve two-thirds of the customer base of approximately three million (based on connection points). Distribution grid operators (DSOs) naturally hold a national or regional monopoly regardless of their size, resulting in a lower importance of size for their market position. We deem Norway's tariff setting and regulatory framework for DSOs to be well established and reliable. Tariffs are reviewed regularly and based on a two-year backward-orientated approach, ensuring timely pass-through of an increased cost base. Within the framework, operators are also granted a defined return on invested capital.

Monopoly position – third largest DSO in Norway

Tensio's business risk profile, assessed at A+, continues to be supported by its natural monopoly as the grid operator in Trondelag, with more than 270,000 customers and over 29,000 km of regulated distribution grids, making it the third largest distributor in Norway. In addition to having a monopoly, Tensio's market position is further strengthened by our view of Norway's robust economy, plus a stable service territory.

Given its monopolistic position, Tensio's lack of product and geographical diversification is considered less important for the rating, while overall diversification is the weakest part of the business risk profile. However, we favourably note that the majority of Tensio's customers are private housholds which are less likely to reduce consumption in the face of increasing spot power prices.

Profits down in 2022, driven by higher grid losses and revenue below revenue cap

Tensio's performance developed negatively in 2022 despite consumption ending at 6,870 GWh, up from 6,613 GWh in 2021. The decreasing performance was mainly caused by Tensio invoicing for NOK 279m less than its revenue cap for 2022 which led to decreased revenues and an EBITDA margin of 34%, down from 41% in 2021.

Distributors in the Nordics were also impacted by the surging energy prices seen throughout Europe that led to higher-than-expected grid losses. In addition, Norwegian distributors were hesitant to increase tariffs to compensate for these increased losses, as Norwegian housholds were also experiencing great increases in living costs.

In parallel to the local distributors experiencing higher grid loss, the Norwegian transmission system operator (Statnett) was experiencing record high congestion revenue[3] from its unique ability to transfer power across power price regions. To help mitigate the negative effect on local distributors, the Norwegian government and Statnett implemented a scheme towards the end of 2022, where it transfers parts of this congestion revenue to local distributors on a monthly basis until the end of 2024. This helps alleviate the burden on local distributors and will be favourable for Tensio's short-term profitability.

Tensio, Norway's most efficient grid operator going into 2023

Tensio's profitability is also directly dependent on the regulatory conditions set by NVE and its cost efficiency compared to Norwegian peers. The cost efficiency score is calculated by the regulator and is based on benchmark analysis with other Norwegian DSOs, where a rating of 100% is considered average. Typically, DSOs with above average efficiency scores will earn higher returns on invested capital than the defined regulatory benchmark return and show better underlying profitability margins, while less

[3] Revenue generated when power is transferred from a lower-price region to a higher-price region.

efficient DSOs will see lower returns. Tensio was rated as Norway's most efficient grid operator going into 2023, which will translate to higher return on invested capital.

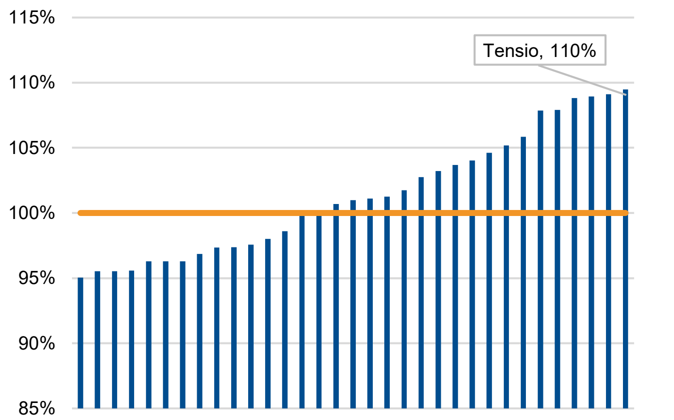
Profitability to remain strong in the medium term

So far in 2023 Tensio's performance has significantly recovered from 2022 levels, as exemplified by an EBITDA margin of 47%. Driven by the aforementioned compensation scheme, Tensio's best-in-class efficiency as well as better cost coverage from 2021-2022 cost levels, rising interest rates and rising inflation roll into NVE's revenue cap calculation. We expect profitability to remain strong in the medium term, as exemplified by EBITDA margins ranging from 41% in 2023E to 43% in 2025E.

Transmission costs may affect margins after 2024

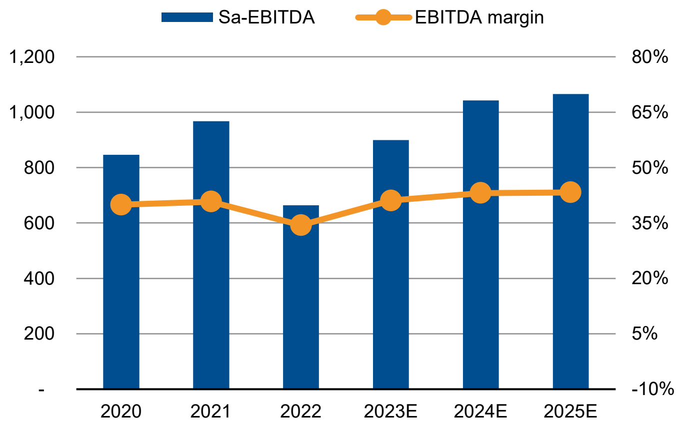
It should be noted that EBITDA margins will be subject to price risk again once Statnett's compensation scheme ends after 2024. However, due to the regulatory environment Tensio operates within, these will be result and cash flow neutral over time. In addition, Tensio predominantly operate in the NO3 price region of Norway, where power prices have been significantly lower than in Southern Norway which is directly interconnected to continental Europe.

Figure 1: NVE efficiency score, 2022 (pillars represent Norwegian grid operators)



Sources: NVE, Scope

Figure 2: Scope-adjusted EBITDA (NOK m) and margin (%)



Sources: Scope (estimates)

Financial risk profile: BB+

Financial risk profile remains the weakest part of Tensio's credit assesment

Tensio's financial risk profile, assessed at BB+, remains the weakest part of the credit assesment and continues to be constrained by relatively high leverage, negative free operating cash flows and decreasing debt cover.

Assumptions & adjustments

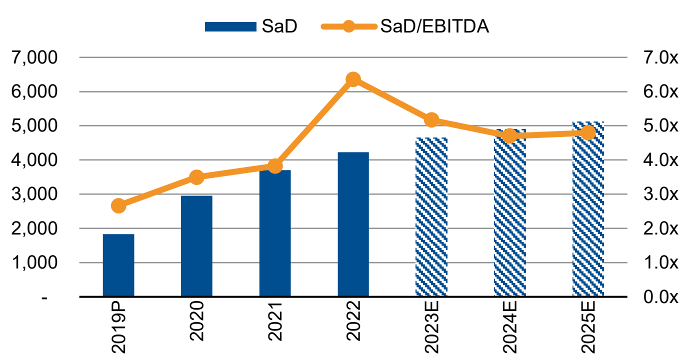
Looking forward, we have made the following assumptions and adjustments to form our updated basecase:

- Updated price scenario: we estimate prices in bidding zone NO3 to remain around EUR 40/MWh in 2023-25.
- Assumed slight growth in consumption throughout the forecast.
- Assumed increasing interest costs; following the rapid increase in the three-month Norwegian interbank rate and the rising inflation, both of which are used as reference rates for parts of Tensio's financing.
- Assumed higher-than-historical capital expenditures, around NOK 900m per year, all of which related to upgrade and maintenance of Tensio's distribution grids.
- Assumed continued dividends, around NOK 200m per year, which allows Tensio to balance high capital expenditures and keep leverage around 5.0x.

Leverage to normalise around 5.0x in the medium term

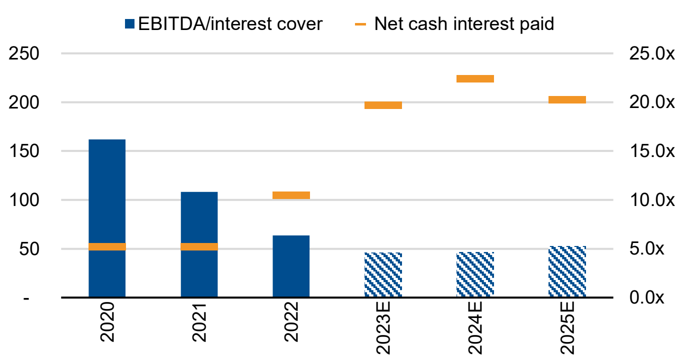
Tensio ended 2022 with a higher-than-expected leverage, as exemplified by a Scope-adjusted debt/EBITDA of 6.3x, up from 3.8x in 2021. This was mainly driven by the aforementioned heightened grid losses and its revenues which came in substantially below its revenue cap. Adjusted for the NOK 279m Tensio did not pass on to its end customers, the leverage ratio looks substantially stronger, at 4.6x. So whilst Tensio's year-end leverage was higher than the negative rating action trigger of 6.0x established during last year's review, we do not consider this a breach. Further, one of the prerequisites for a negative rating action was that leverage was sustained at such high levels and Tensio's H1 2023 accounts already shows that leverage is down to 4.3x again following the company's strong performance. Our updated projections shows that high investments and continued dividends will necessitate additional interest-bearing debt, with Scope-adjusted debt increasing from NOK 4,226m in 2022 to NOK 5,111m by the end of 2025. In parallel, we see EBITDA increasing, effectively keeping Tensio's leverage ratio around 5.0x in the medium-term.

Figure 3: Debt (NOK m, lhs) and leverage (x, rhs)



Sources: Tensio, Scope (estimates)

Figure 4: Net interest paid (NOKm, lhs) and EBITDA/interest cover (x, rhs)



Sources: Tensio, Scope (estimates)

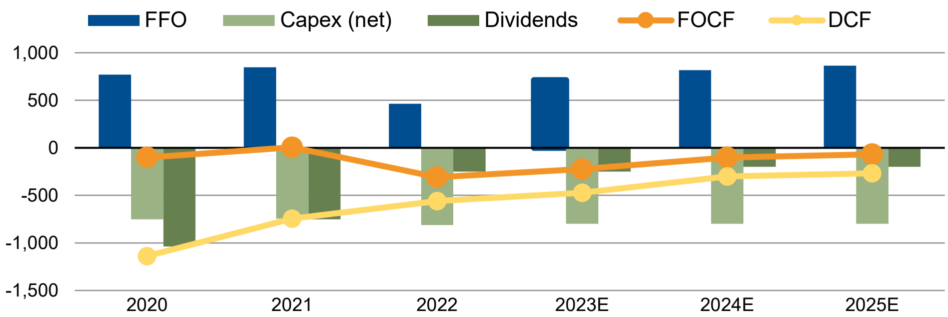
Inflation and rising interest to put pressure on debt cover

Tensio also experienced an increase in net financial costs to NOK 111m in 2022, from NOK 90m in 2021. Tensio has one bond linked to the interbank interest rate and one linked to the consumer price index; both saw their rates increase in 2022 and so far in 2023. We believe inflation and interest rates will continue to increase in the short-term and that this will increase Tensio's net financial costs quite substantially. The increased gross debt, rising inflation and interest rates are expected to put downward pressure on Tensio's debt protection, as measured by Scope-adjusted EBITDA/net interest, which we expect will decline towards 4.6x in 2023E before gradually recovering towards 5.3x in 2025E.

Satisfactory funds from operation but free operating cash flows to remain negative

As a regulated grid operator, Tensio's operating cash flow is not subject to power price driven working capital changes, like many other Nordic utilities. Despite a decrease in 2022, following extraordinary circumstances, we project funds from operation to remain good in the medium term, driven by the aforementioned increase in profitability and a less volatile operating environment. Nonetheless, we expect free operating cash flow to be negative in the medium term, as the Norwegian transmission grid requires substantial upgrades to facilitate new intermittent technology, the electrification of Norwegian industry and to help the Norwegian government to meet its climate targets.[4] We therefore expect Tensio to invest around NOK 900m per year going forward, with the majority being growth investments. Combined with our belief that Tensio will continue to pay out dividends, we see discretionary cash flows remaining negative and necessitating additional external financing in the coming years.

Figure 5: Scope-adjusted cash flows (NOKm)



FFO = Funds from operation
FOCF = Free operating cash flow
DCF = Discretionary cash flow

Sources: Scope (estimates)

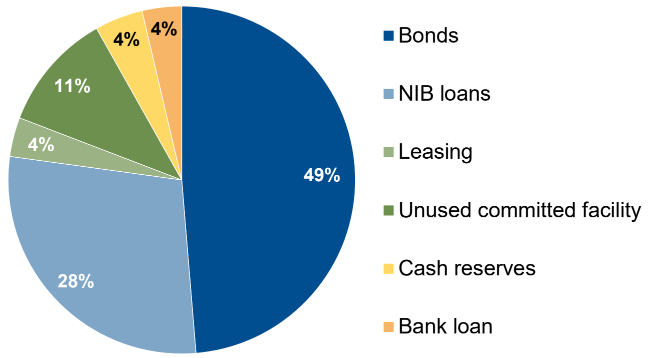
Liquidity remains adequate

As mentioned, Tensio has predictable liquidity requirements as swings in working capital are minimal. However, because of a timing effect between Statnett's compensation for increased grid losses (paid at the end of every month) and the running cost of covering grid losses, Tensio increased its committed facilities to NOK 600m (from NOK 300m) to provide a sufficient liquidity buffer. It also entered into a new term loan with the Nordic Investment Bank for NOK 500m and took out a new bank loan for NOK 200m in H2 2022.

As of July 2023, the company had unrestricted cash and unutilised facilities totalling NOK 844m. This provides sufficient cover for an upcoming NOK 650m bond maturity in November 2023 and Tensio does not have any other large maturities before in 2025. Refinancing needs will therefore be limited in the medium term, but as mentioned, we expect negative discretionary cash flow, which will necessitate additional external financing.

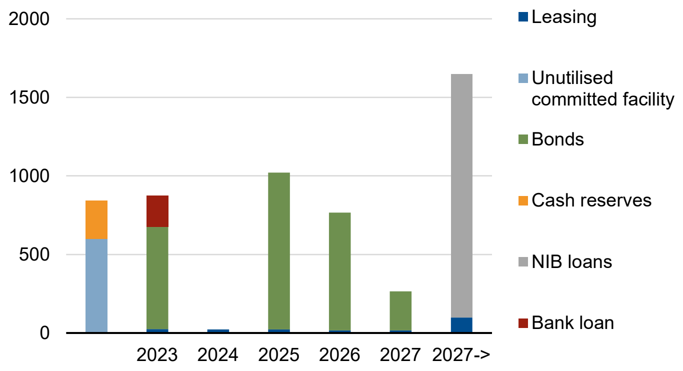
[4] https://www.regjeringen.no/en/aktuelt/norways-new-climate-target-emissions-to-be-cut-by-at-least-55-/id2944876/

Figure 6: Funding mix at H1 2023



Sources: Scope (estimates)

Figure 7: Debt maturity profile at H1 2023 (NOKm)



Sources: Scope

Balance in NOK m	2021	2022	2023E	2024E
Unrestricted cash (t-1)	163	321	1	280
Open committed credit lines (t-1)	600	300	600	600
Free operating cash flow (t)	6	-309	-223	-101
Short-term debt (t-1)	1,050	-	864	886
Coverage	**73%**	**No Debt**	**44%**	**88%**

Supplementary rating drivers: +1 notch for parent support

No adjustment for financial policy

We have made no adjustment for financial policy, which we assess as satisfactory. The financial policy outlines some key principles, including that net debt/EBITDA should remain around 5.0x. Tensio has no explicit dividend policy, but we consider it likely that dividends would give way if it risked jeopardising the leverage target.

One-notch uplift for indirect majority municipal ownership

With respect to parent support from the indirect municipal owners, including the newly AAA/Stable Scope-rated Trondheim municipality, we assign a one-notch uplift from the standalone credit assessment based on our government related entity (GRE) methodology, using a bottom-up approach. We have accounted for the ownership of all municipality shareholders as that of a single shareholder due to Tensio's strategic importance for Trondheim County.

The indirect ownership and common interest between municipalities allow us to assess the willingness to provide support in case Tensio needs it. Although this indirect municipality ownership is slightly more complex than direct ownership, we deem it highly likely that the municipality owners would be able and willing to support Tensio, despite the lack of explicit terms or guarantees. This warrants a one-notch uplift, and the rationale is in line with that of other Scope-rated Norwegian utility peers. The one-notch uplift on the BBB+ standalone credit assessment results in an issuer rating of A-.

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