Sunnhordland Kraftlag AS
Kingdom of Norway, Utilities

STABLE
BBB+

Key metrics

			Scope estimates	
Scope credit ratios	2022	2023	2024E	2025E
Scope-adjusted EBITDA/interest cover	Net cash	Net cash	46.7x	17.8x
Scope-adjusted debt/EBITDA	Net cash	Net cash	0.9x	1.1x
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	0%	-10%

Rating rationale

The issuer rating reflects Sunnhordland Kraftlag AS' (SKL) standalone credit assessment of BBB and a one-notch uplift related to its status as a government-related entity.

SKL's business risk profile (assessed at BBB-) reflects its low-cost and environmentally friendly power generation portfolio (ESG factor: positive), mainly based on hydro. The assessment is constrained by exposure to industry-inherent volatility, as well as moderate diversification, given the sole focus on power generation and the presence of asset concentration risk.

The financial risk profile (assessed at A) is unchanged and continues to support SKL's standalone credit assessment. The company's credit metrics are expected to weaken following the Midtfjellet acquisition, with leverage increasing towards 1x by YE 2024. This is still in line with the current assessment, but with less headroom than in our previous update.

Outlook and rating-change drivers

The Outlook is Stable, reflecting our expectation that SKL's leverage (Scope-adjusted debt/EBITDA) will remain around 1x for the next few years, despite more moderate power prices and continued, higher-than-historical investments in line with the company's ambition for further growth.

The upside scenario for the ratings and Outlook is:

- Leverage remaining well below 1x on a sustained basis.

The downside scenarios for the ratings and Outlook are (individually or collectively):

- Leverage weakening to above 2.5x on a sustained basis.
- A change that negatively would impact our assessment of potential financial support from the indirect municipal owners.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
12 Nov 2024	Outlook change	BBB+/Stable
29 Nov 2023	Outlook change	BBB+/Positive
28 Nov 2022	Upgrade	BBB+/Stable
13 Dec 2021	New	BBB/Stable

Rating & Outlook

Issuer	BBB+/Stable
Senior unsecured debt	BBB+

Analyst

Per Haakestad
+47 92 29 78 11
p.haakestad@scoperatings.com

Thomas Faeh
+47 93 05 31 40
t.faeh@scoperatings.com

Related Methodologies

General Corporate Rating Methodology; October 2023

European Utilities Rating Methodology; June 2024

Government Related Entities Rating Methodology; September 2024

Scope Ratings GmbH

Karenslyst allé 53
N-0279 Oslo
Phone +47 21 09 38 35

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Environmentally friendly and low-cost power generation portfolio (positive ESG factor) – mainly comprising hydro with fairly large reservoirs • Above-average profitability as measured by the EBITDA margin and return on capital employed • Strong financial risk profile with low leverage despite increased debt following the Midtfjellet acquisition in Q3 2024 • Committed long-term owners who indirectly through municipalities have the capacity and willingness to provide financial support if needed	• Exposure to industry-inherent volatility of power prices for unhedged power generation • Low geographical and horisontal diversification, given the only operation is power generation in southwest Norway • High dependency on the largest power plants • Free operating cash flow expected to remain pressured by growth capex in the next few years

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA of well below 1x on a sustained basis	• Scope-adjusted debt/EBITDA sustained above 2.5x • A change that negatively would impact our assessment of potential financial support from the indirect municipal owners

Corporate profile

Founded in Stord, Norway, in 1946, Sunnhordland Kraftlag (SKL) is a utility company focused on renewable energy generation in southwest Norway. It has a generation portfolio of 0.9 GW that generates around 3 TWh of electricity annually, of which hydro constitutes roughly 85%. The remaining comes from wind power through the recently acquired 95% stake in Midtfjellet Vindkraft AS.

SKL is owned by two domestic, municipal-owned utilities, Haugaland Kraft and Eviny, holding 59.7% and 38.2% respectively, while the remaining 2.1% is held by Stord municipality.

Financial overview

			Scope estimates		
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	Net interest income	Net interest income	46.7x	17.8x	18.5x
Scope-adjusted debt/EBITDA	Net cash	Net cash	0.9x	1.1x	1.2x
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	0%	-10%	4%
Scope-adjusted EBITDA in NOK m					
EBITDA	4,830	1,813	1,336	1,502	1,571
Other items	-	-	-	-	-
Scope-adjusted EBITDA	**4,830**	**1,813**	**1,336**	**1,502**	**1,571**
Funds from operations in NOK m					
Scope-adjusted EBITDA	4,830	1,813	1,336	1,502	1,571
less: Scope-adjusted interest	31	52	(29)	(84)	(85)
less: cash tax paid per cash flow statement	(935)	(3,108)	(998)	(789)	(613)
Other non-operating charges before FFO	287	(274)	-	-	-
Funds from operations (FFO)	**4,214**	**(1,518)**	**309**	**629**	**873**
Free operating cash flow in NOK m					
Scope-adjusted FFO	4,214	(1,518)	309	629	873
Change in working capital	5	(36)	(9)	3	1
Non-operating cash flow	-	-	-	-	-
less: capital expenditure (net)	(186)	(135)	(300)	(800)	(800)
less: operating lease payments	-	-	-	-	-
Free operating cash flow (FOCF)	**4,032**	**(1,689)**	**0**	**(168)**	**74**
Net cash interest paid in NOK m					
Net cash interest per cash flow statement	(31)	(52)	29	84	85
Other	-	-	-	-	-
Net cash interest paid	**(31)**	**(52)**	**29**	**84**	**85**
Scope-adjusted debt in NOK m					
Reported gross financial debt	622	614	2,129	2,197	2,464
less: available cash and cash equivalents	(3,979)	(1,370)	(983)	(613)	(669)
add: pension adjustment	14	18	35	35	35
Scope-adjusted debt	**(3,343)**	**(738)**	**1,182**	**1,619**	**1,831**

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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)	
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)

Sustainable business model

SKL's core business activity is the generation of clean, low-cost electricity, mainly based on hydro. This rules out transition and stranded risk and should support the company's future cash flow generation by ensuring the continued, strong position in the merit order system.

Furthermore, the company's portfolio of large hydropower plants underpins its government-related status as those assets are required to be at least two-thirds publicly owned.

[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.

Business risk profile: BBB-

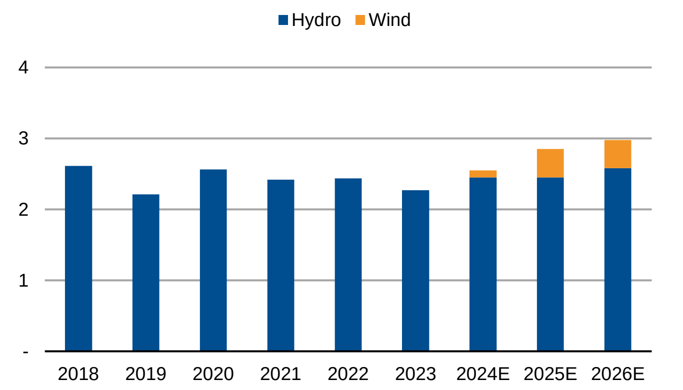
Good business risk profile

SKL's business risk profile continues to reflect its low-cost and environmentally friendly power generation portfolio (ESG factor: positive) in southwest Norway (NO2 pricing area), mainly based on hydro.

Wind power added to generation portfolio in Q3 2024

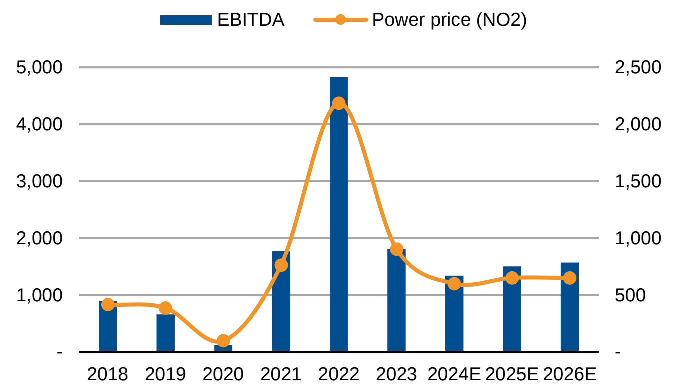
SKL's consolidated hydropower portfolio has an installed capacity of around 720 MW and generated 2.3 TWh of electricity in 2023. This was below its mean annual generation of around 2.5 TWh. Midtfjellet wind farm, which SKL acquired in Q3 2024, supplements the core exposure to hydro, adding installed capacity of 150 MW and an expected annual generation of 0.4 TWh.

Figure 1: Consolidated generation volumes by technology, TWh



Sources: SKL, Scope estimates

Figure 2: Scope-adjusted EBITDA (NOK m, lhs) versus the average power price in NO2 (NOK/MWh, rhs)



Sources: SKL, Nordpool, Scope estimates

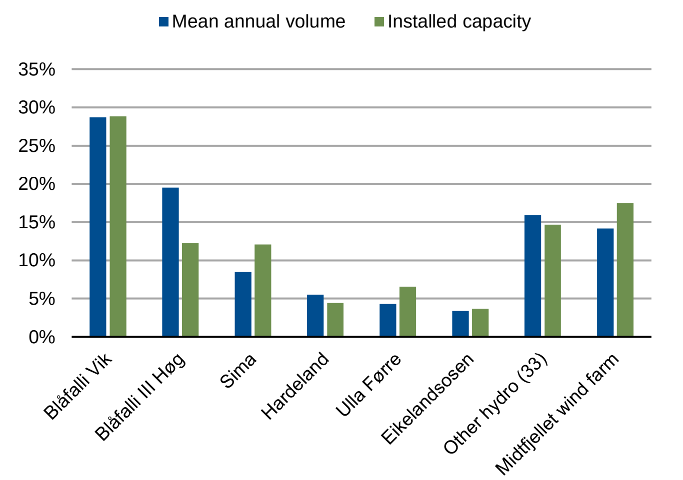
Strong position in merit order mitigates small size

Despite its small size, we still consider SKL to have a good market position. This is because of the clean carbon footprint and low marginal cost of generation of its power generation portfolio, ensuring a favourable position in the merit order and high utilisation factors.

Flexibility provided by reservoirs

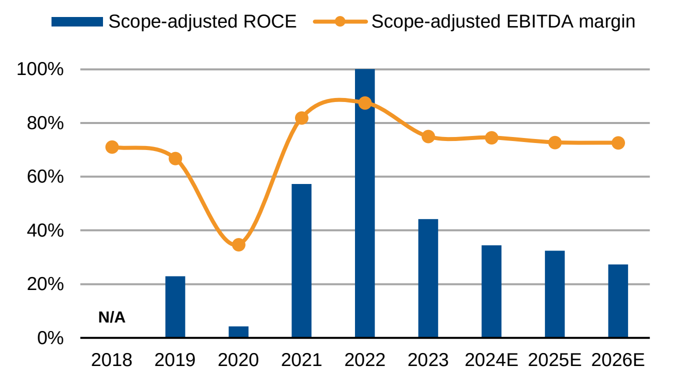
SKL's largest hydropower plants benefit from access to sizeable reservoirs. They are therefore expected to become increasingly important as a dispatchable power source with more variable generation coming into the energy mix.

Figure 3: Asset concentration of generation portfolio



Sources: SKL, Scope

Figure 4: Profitability ratios



Sources: SKL, Scope estimates

Asset concentration risks

SKL's power generation portfolio is relatively concentrated (Figure 3). Despite the improvement provided by Midtfjellet wind farm, more than half of the company's generation volume and installed capacity relies on its three largest power plants. This increases vulnerability to event risks, such as adverse weather or technical failures that results in a prolonged standstill period.

Industry-inherent volatility of power prices

SKL's business risk profile is hampered by the industry-inherent merchant risks in non-regulated power generation. The achievable power price in Norway's NO2 area can be highly volatile (Figure 2), which results in fluctuating cash flows.

EBITDA performance to normalise

Scope-adjusted EBITDA decreased to NOK 1,813m in 2023, down from NOK 4,830m in 2022. We expect a further weakening in EBITDA to between NOK 1,300m and NOK 1,600m in the next couple of years as the power price in NO2 has continued to fall throughout 2024. The level of regional power prices in south Norway is impacted by surrounding power markets in the Nordics and Europe through interconnectors. In terms of pricing risk, we therefore do not overemphasize the limited geographical diversification of SKL.

Strong profitability

Profitability remains a supportive element of the business risk profile. The company's margins continue to normalise as power prices fall from their peaks in 2022 and H1 2023, with the EBITDA margin declining from 88% in 2022 to 75% in 2023. We expect the margin to stabilise in a range of 70%-75% in the current price environment. These levels are among the highest among our rated Norwegian and European utilities and reflect SKL's core exposure to hydro. The company operates mostly without any hedging, although for Midtfjellet wind farm, approximately 2/3 of the expected volume is under PPA agreements for the next few years.

Financial risk profile: A

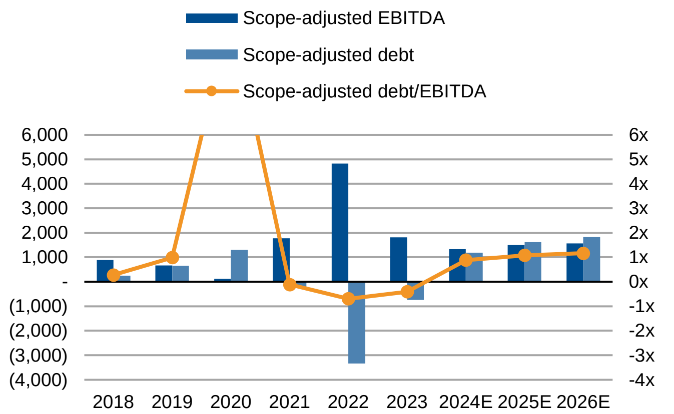
Main assumptions

Our financial projections for 2024-2026 are mainly based on more moderate power prices, a significant increase in investment spending, and maintenance of the dividend policy.

Increased Scope-adjusted debt in 2024

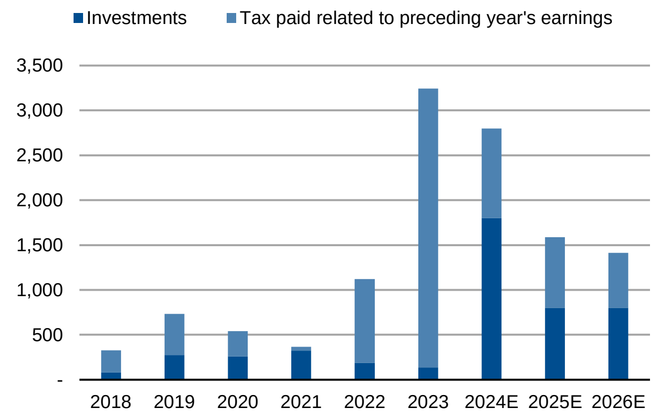
We estimate that Scope-adjusted debt will be around NOK 1.2bn at end-2024, thus well above the net cash position of NOK 0.7bn at end-2023. The difference is mainly attributed to the acquisition of Midtfjellet, which has resulted in a debt increase of approximately NOK 1.5bn in Q3 2024. However, more moderate power prices as well as high taxes and dividends paid based on the strong performance in 2023 are also contributing.

Figure 5: Scope-adjusted EBITDA and debt (NOK m, lhs) and leverage (rhs)



Sources: SKL, Scope estimates

Figure 6: Investments and tax payments, NOK m



Sources: SKL, Scope estimates

Leverage to exceed 1x in the next few years

SKL's leverage remains strong according to our guidance table for non-regulated utilities, with Scope-adjusted debt/EBITDA expected to be slightly below 1x in 2024 and between 1.0x-1.5x over 2025-2026. The weakening in leverage is driven by growth investments, as the company is deploying the cash accrual provided by surging power prices in 2021-2023.

Debt protection is very strong

SKL's debt protection (EBITDA interest cover) remains very strong, and is expected to exceed 10x going forward, compared to net interest income in 2023.

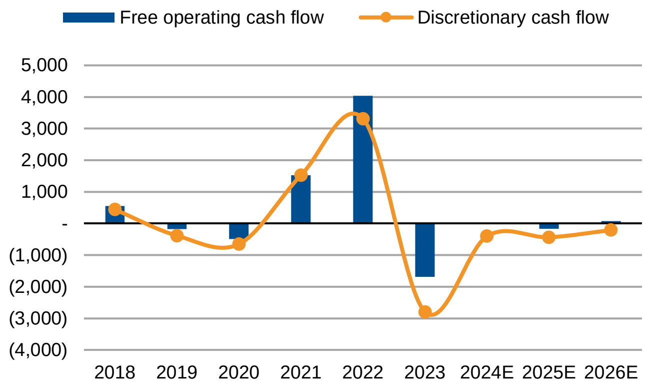
Ramp-up of capex in 2025-2026…

Our capex forecast of NOK 800m per annum in 2025-2026 considers SKL's goal of reaching a generation volume of 4 TWh by 2030; however, we highlight that included capex could be scaled back if required, e.g. in case of weaker-than-expected market conditions.

…puts some pressure on cash flow generation

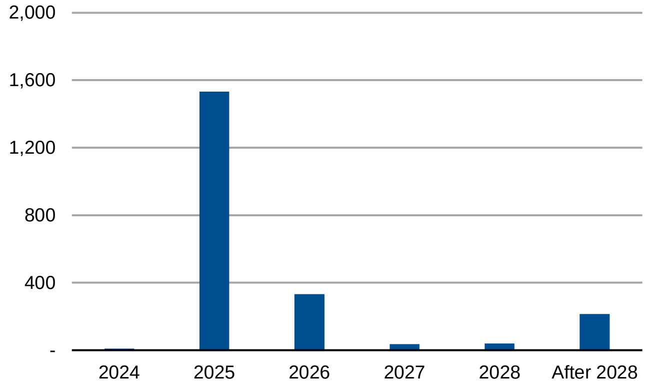
This capex projection is expected to result in slightly negative free operating cash flow in 2024-2026, on average, despite possible tax deductions for hydro investments under the resource rent tax regime. Consequently, we anticipate that maintenance of the dividend policy will likely require debt financing.

Figure 7: Scope-adjusted cash flows, NOK m



Sources: SKL, Scope estimates

Figure 8: Debt maturity profile as of Q3 2024, NOK m



Sources: SKL, Scope

Adequate liquidity

Liquidity remains adequate. As of YE 2023, substantial cash and cash equivalents of NOK 1.4bn and an unused NOK 300m overdraft facility supported liquidity while there were no major debt maturities in 2024.

However, the liquidity ratio for 2025 is forecasted to below 100%, mainly due to the NOK 1.2bn bridge financing established in Q3 2024 for the Midtfjellet acquisition, with maturity in Q3 2025. This is expected to be managed by SKL through its good access to external financing from banks and capital markets, making the occasionally low liquidity ratios less worrying.

Balance in NOK m	2023	2024E	2025E
Available cash and cash equivalents (t-1)	3,979	1,370	983
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	(1,689)	0	(168)
Short-term debt (t-1)	-	3	1,533
Coverage	**No short-term debt**	**>200%**	**53%**

Supplementary rating drivers: +1 notch

Financial policy

We have made no adjustment for financial policy, as this is already reflected in our financial risk profile assessment. SKL aims to keep an investment-grade profile; thus, we believe management is committed to adapt capex plans and shareholder remuneration against this goal.

One-notch uplift for parent support

The issuer rating incorporates a one-notch uplift to the standalone credit assessment of BBB considering the company's status as a government-related entity, resulting in a final issuer rating of BBB+. We have applied the bottom-up approach using the framework outlined in our Government Related Entities Rating Methodology. The one-notch uplift reflects the public sponsors 'high' capacity to provide a credit uplift and 'medium' willingness to provide financial support in the remote scenario of financial distress.

Long-term debt ratings

Senior unsecured debt rating: BBB+

The senior unsecured debt rating has been affirmed at BBB+, in line with the issuer rating.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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