Nordkraft AS
Kingdom of Norway, Utilities

SCOPE — STABLE — BBB

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	12.8x	8.5x	4.2x	4.7x
Scope-adjusted debt/EBITDA	3.4x	2.9x	4.4x	4.0x
Scope-adjusted free operating cash flow/debt	8%	14%	-6%	-4%

Rating rationale

The rating reflects Nordkraft's diversified exposure to low-cost, environmentally friendly hydropower generation and regulated power distribution. It further reflects good profitability and a one-notch uplift to the standalone credit assessment for the utility's status as a government-related entity (GRE). Constraints include a moderate financial risk profile, exposure to volatile power prices, high dependency on the largest power plants, as well as comparatively small size and limited geographical diversification with cash-generating activities concentrated in northern Norway.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Nordkraft's leverage (debt/EBITDA) will stabilise at around 4x in 2025-2026. This is higher than in the past two years, as we assume that increased investments, mainly in the power grid, will put some medium-term pressure on cash flow generation. The Outlook also assumes: i) that the concession area will remain stable; ii) an unchanged, balanced business mix between regulated power distribution and hydropower generation; iii) an NO4 power price of around EUR 30/MWh; iv) no major investments in associated companies; and v) a continued GRE status based on direct and indirect majority ownership by Norwegian municipalities.

The upside scenario for the ratings and Outlook is:

- Improved financial risk profile, exemplified by Scope-adjusted debt/EBITDA sustained at around 3.5x or below.

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

- Weakening financial risk profile, as exemplified by Scope-adjusted debt/EBITDA sustained at around 5x or above.
- Loss of GRE status could also trigger a negative rating action, although we deem this possibility remote.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
19 Aug 2024	New	BBB/Stable

Ratings & Outlook

Issuer	BBB/Stable
Short-term debt	S-3
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

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

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Balanced business mix with sizeable exposure to regulated power distribution • Power generation portfolio of low-cost, flexible, and environmentally friendly hydropower assets (ESG factor) • Good profitability and efficiency • Good debt protection, as measured by EBITDA/interest cover • GRE status: Norwegian municipal owners with high capacity and medium willingness to provide financial support if needed	• Moderate financial risk profile, as exemplified by Scope-adjusted debt/EBITDA of around 4x • Exposure to volatile power prices • Investment phase for the grid business and continued dividend payments put pressure on cash flow • Asset concentration risk in the power generation portfolio • Small scale compared to larger domestic and European peers • Limited geographical diversification as operations are concentrated in northern Norway

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA sustained around 3.5x or below	• Scope-adjusted debt/EBITDA sustained at around 5x or above • Loss of GRE status (remote)

Corporate profile

Nordkraft is an integrated utility operating in the Hålogaland area of northern Norway. Its core activities include hydropower generation and power distribution, as well as operatorship of hydro plants and wind sites and project development. Nordkraft also has a portfolio of associated companies active in small-scale hydropower generation, electricity retail, fibre broadband, and development of industrial sites for power-intensive industry. Nordkraft is directly and indirectly 80.1% owned by a group of nine Norwegian municipalities, which constitute its grid concession area. The remaining 19.9% is held by Jamtkraft AB[1].

[1] A Swedish municipal-owned utility.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	8.7x	12.8x	8.5x	4.2x	4.7x	4.7x
Scope-adjusted debt/EBITDA	8.0x	3.4x	2.9x	4.4x	4.0x	4.2x
Scope-adjusted free operating cash flow/debt	5%	8%	14%	-6%	-4%	-3%
Scope-adjusted EBITDA in NOK m						
EBITDA[2]	199	546	929	456	550	578
Other items[3]	4	(6)	(315)	-	-	-
Scope-adjusted EBITDA	**202**	**540**	**614**	**456**	**550**	**578**
Funds from operations in NOK m						
Scope-adjusted EBITDA	202	540	614	456	550	578
less: (net) cash interest paid	(23)	(42)	(72)	(108)	(117)	(122)
less: cash tax paid per cash flow statement	-	(50)	(41)	(81)	(85)	(116)
Other items	65	36	7	7	7	7
Funds from operations (FFO)	**244**	**484**	**507**	**274**	**355**	**346**
Free operating cash flow in NOK m						
Funds from operations	244	484	507	274	355	346
Change in working capital	134	(356)	54	33	(16)	(7)
Non-operating cash flow	12	(47)	(45)	-	-	-
less: capital expenditure (net)	(310)	71	(275)	(420)	(420)	(420)
Free operating cash flow (FOCF)	**80**	**152**	**241**	**(113)**	**(81)**	**(81)**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	19	37	65	101	110	116
add: interest expense on pensions	5	5	7	7	7	7
Net cash interest paid	**23**	**42**	**72**	**108**	**117**	**122**
Scope-adjusted debt in NOK m						
Reported gross financial debt	1,850	2,080	2,100	2,300	2,550	2,800
less: cash and cash equivalents	(326)	(373)	(407)	(376)	(427)	(477)
add: non-accessible cash	50	49	7	7	7	7
add: pension adjustment	37	86	83	83	83	83
Scope-adjusted debt (SaD)	**1,611**	**1,842**	**1,782**	**2,013**	**2,213**	**2,412**

[2] Reported EBITDA excluding share of result in associated companies.
[3] Includes gains and losses on asset disposals (non-cash and cash).

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Environmental, social and governance (ESG) profile[4]

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)

Business model evolves around sustainability

Nordkraft's business model is centered around the generation of clean, low-cost hydroelectric energy, and the responsibility of ensuring that its power grid can cope with the requirements of the green transition, such as handling higher loads of intermittent electricity. This reduces transition or stranded asset risk and should support future cash flow through the high utilisation of power plants and a strong position in the merit order. We also view the portfolio of large-scale hydropower plants (over 10 MW) as protective for the company's GRE status, given the requirement of at least two-thirds public ownership.

Political and regulatory risk

Integrated Norwegian utilities are exposed to political and regulatory risks, as they provide profitable, critical public services such as grid infrastructure and hydropower generation. This has been illustrated by Norway's unpredictable taxation framework for power generators in recent years. However, we still see the overall framework conditions for utilities in Norway as sufficiently stable.

Green financing framework established in 2024

Nordkraft has established a green financing framework in 2024, receiving an ESG Second Party Opinion from S&P Global of 'Dark Green' (the highest possible outcome). The framework covers hydropower and power distribution network projects, which are classified as 'Electricity generation from hydropower' and 'Transmission and distribution of electricity' in the EU taxonomy.

No governance issues

We have not identified any negative credit-relevant factors relating to corporate governance.

[4] 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

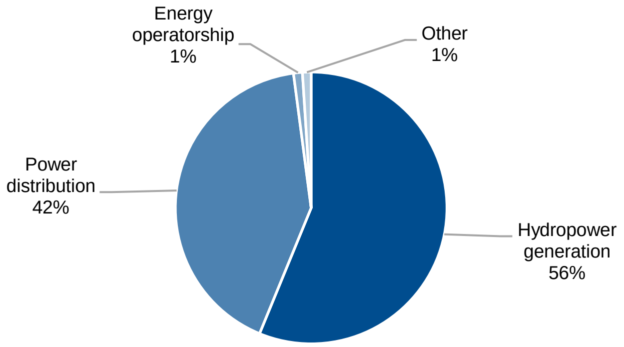
Nordkraft's business risk profile supports the rating. It reflects the company's increased scale and larger exposure to power distribution since 2021-2022 following the transactions with Hålogaland Kraft, Andøy Energi and Trollfjord Kraft. This is exemplified by the growth in the number of connection points and grid capital as of YE 2023 to 52,000 and NOK 1.8bn respectively, from 15,500 and NOK 0.4bn in 2020.

Integrated business model

Nordkraft operates an integrated business model with a balanced mix between hydropower generation and power distribution, each estimated to contribute around 50% of normalised, recurring Scope-adjusted EBITDA. While power generation (industry risk: BB) has high cyclicality with cash flow depending on volatile market prices, power distribution (industry risk: AA) is fully regulated and more stable. The diversification across these utility sub-segments with a low correlation of financial results is credit-supportive.

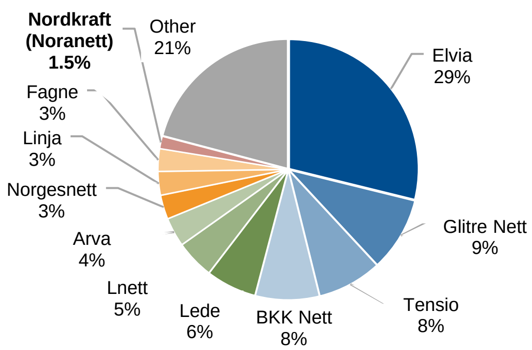
Nordkraft's activities in energy operatorship and project development make a smaller contribution to recurring EBITDA. We therefore see these as supplementary activities with less impact on the blended industry risk. This is also the case for Nordkraft's portfolio of associated companies (e.g. Cadre, Yve, Teneo and Aker Narvik) because no dividend income is expected in the short to medium term.

Figure 1: Scope-adjusted EBITDA by business area, 2023



Sources: Nordkraft, Scope (estimates)

Figure 2: Norwegian grid operators by size (share of connection points)



Sources: NVE-RME, Scope

Mean annual hydropower generation of 1 TWh

Nordkraft owns and operates 18 hydropower plants in northern Norway (NO4 price zone), with an installed capacity of 260 MW and an annual mean generation of around 1 TWh. This makes it a small power generator among domestic and European peers. However, the company's power generation portfolio still has a good market positon due to a strong position in the region's merit order, reflecting low marginal costs, access to water reservoirs, and a clean carbon footprint. The water reservoirs enable Nordkraft to regulate generation, thus reducing operating risks (e.g. of floods) and giving flexibility for provision of peak-load capacity.

Grid segment with 52,000 connection points

Nordkraft's grid segment serves approximately 52,000 connection points and a population of 72,000 in the Hålogaland area on the northwest coast of Norway. The grid activity is split into three separate entities: Noranett, Noranett Andøy and Noranett Hadsel. The split operation is mainly due to tariff differences. In general, we consider smaller grid operators to have higher risk than larger peers, especially those operating in more densely populated areas with stronger growth prospects (Eidsiva or Glitre Nett, for instance). However, the monopoly position and the regulated environment still result in overall low business risks. The grid segment is therefore expected to remain a robust source of long-term cash flow generation.

Operatorship portfolio of 269 MW

Nordkraft's energy operation business has a sizeable, growing portfolio of operating agreements for 269 MW (as of YE 2023), split into 49 hydropower plants and three wind power sites located across Norway. However, the contribution to group EBITDA is still low (NOK 6m in 2023).

Moderate diversification

Overall diversification is moderate. It is constrained by limited geographical diversification and customer outreach. This makes the company vulnerable to event risks (e.g. regulatory changes or adverse weather) as well as to unfavourable changes in the growth prospects of a single, local service territory. We further see some concentration risks in the power generation portfolio, with around 25% of generation capacity coming from the largest power plant and over 60% from the three largest.

Expected new electricity demand supported by low power price

We expect increased demand for electricity in Nordkraft's operating area and in northern Sweden from electrification and industry establishments to be supported by the low electricity price level. This has been highlighted by several, large investment decisions in northern Sweden from H2 Green Steel, Northvolt and SSAB, for instance, and is supportive for Nordkraft's operations which evolves around electricity supply.

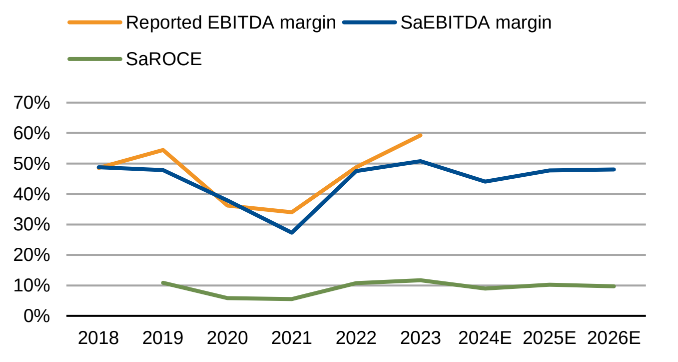
Good profitability

Good profitability helps to reduce Nordkraft's business risks. The low operating cost in hydropower generation supports a high margin and should enable Nordkraft to retain a group EBITDA margin of around 45% over time. Concurrently, the Scope-adjusted return on capital employed averages around 10%. This is good but slightly below many other Scope-rated Norwegian integrated utilities, mainly those with exposure to southern Norway, which have benefitted from a more favourable electricity price environment in recent years. Nordkraft has achieved a premium over the NO4 power price of around 30% in 2022-2023 by using the reservoir capacity of their hydropower plants. We have assumed the company to achieve such premium also in the future, though have lowered the assumed level to around 10% to reflect uncertainty if such performance will be achieved consistently.

Industry-inherent risk in hydropower generation

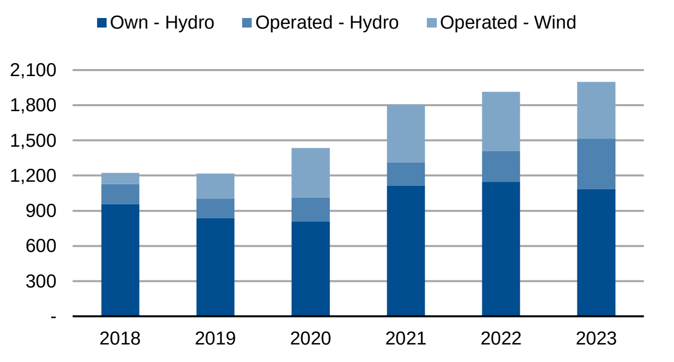
Despite solid profitability metrics, the assessment is negatively impacted by the industry-inherent volatility in hydropower generation.

Figure 3: Profitability metrics overview



Sources: Nordkraft, Scope (estimates)

Figure 4: Development of owned and operated power generation, GWh



Sources: Nordkraft, Scope

Financial risk profile: BB+

Moderate financial risk profile

Nordkraft's financial risk profile is moderate. As mentioned, the company's financials can be volatile given industry-inherent volatility in hydropower generation. However, we expect the changed business mix, with increased, sizeable contributions from power distribution since 2021-2022 to have a stabilising effect.

With regards to the changed business mix and the interpretation of credit metrics, we note that Hålogaland Kraft was consolidated in January 2021 and the grid segments of Trollfjord Kraft and Andøy Energi in September 2022.

Transmission bottlenecks have shielded the NO4 area from high European electricity prices, contrasting to southern Norway where power generators have benefitted from surging electricity prices. Concurrently, the large energy surplus in northern Sweden has further pushed down market prices in the NO4 area. So far in 2024, the NO4 price is EUR 32/MWh, compared to EUR 30/MWh in 2023, and EUR 24/MWh in 2022. We foresee price levels in line with historic levels at around 30 EUR/MWh for 2024-26. However, we note some uncertainty towards the tail-end of our forecast given the evolving energy balance in the region with prospect of growth in electricity consumption. Our assumed development for the NO4 power price is below Nordkraft's own assumption of an upward trajectory to around EUR 40/MWh in 2026, which would have the potential to support stronger credit metrics if such price level materialise.

For 2024-2026, our financial projections are further based on the following assumptions:

- Normalisation of power generation volumes from 2025
- Moderate growth in the grid segment
- No acquisitions or asset disposals
- Higher-than-historical capital expenditures of NOK 400m-450m p.a.
- Dividends of NOK 125m p.a.

Our adjustments

For the calculation of credit metrics, we have made the following adjustments to the company's reported financials:

- Scope-adjusted debt includes 50% of unfunded net pension liabilities
- Scope-adjusted EBITDA is adjusted for gains and losses from asset disposals and the share of result in associated companies
- Scope-adjusted interest accounts for the interest expense on unfunded pension liabilities

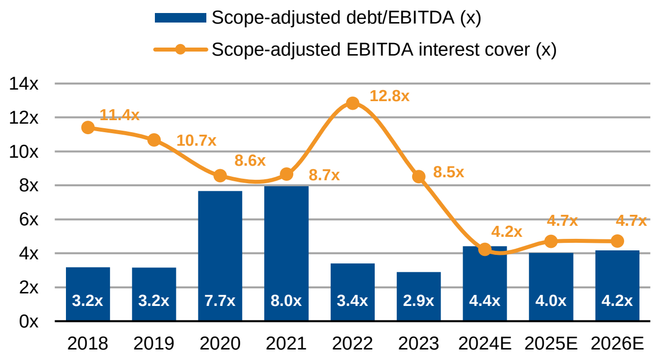
Financial performance to drop in 2024 before recovering again

We expect Scope-adjusted EBITDA to drop from NOK 614m in 2023 to around NOK 450m in 2024. This mainly reflects the expectation of below-normal hydropower volumes and the negative impact from an adverse weather event ('Ingunn') on the grid segment in Q1. Based on our medium-term assumptions, financial performance should recover in 2025-2026, as exemplified by forecasted Scope-adjusted EBITDA of NOK 550m-600m.

Scope-adjusted debt/EBITDA to stabilise at around 4x

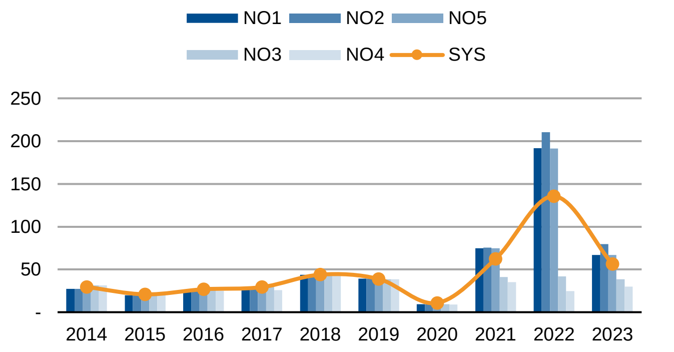
Leverage (Scope-adjusted debt/EBITDA) is expected to increase to around 4.5x in 2024 before stabilising at around 4x in the medium term. This is higher than the average level of 3.1x over 2022-2023, as we believe that high investments in the power grid and dividend payments will create some medium-term pressure on free operating cash flow and discretionary cash flow.

Figure 5: Leverage and debt protection



Sources: Nordkraft, Scope (estimates)

Figure 6: Norwegian power prices by bidding zone compared to the Nordic system price (SYS), EUR/MWh



Sources: Nordpool, Scope

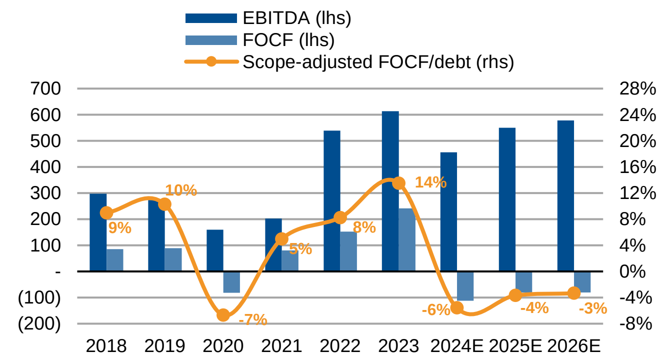
Good debt protection

We expect debt protection (Scope-adjusted EBITDA/interest cover) to weaken to 4x in 2024 but to subsequently improve to around 5x, supported by EBITDA growth. The weaker interest cover compared to 8.5x in 2023 is due to somewhat lower EBITDA, as well as higher 3m Nibor and the moderate, forecasted increase of debt levels, leading to higher interest payments.

Some pressure on free operating cash flow

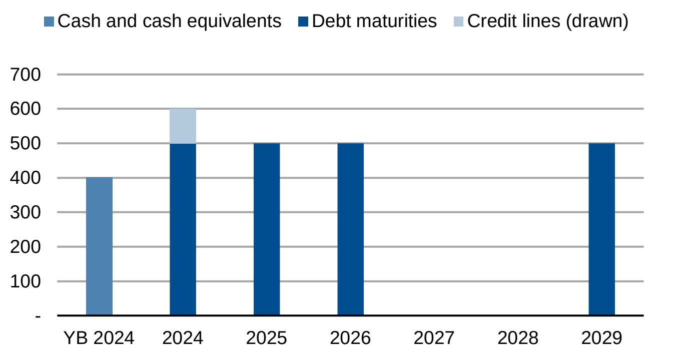
Nordkraft has good cash flow generation over time. Scope-adjusted free operating cash flow/debt has stayed positive in the past (Figure 8) but is expected to turn slightly negative for a temporary period in 2024-2026. This is mainly driven by the above-mentioned capex expectation for the distribution segment. The share of growth capex is around 70% of total capex, which makes the forecast of negative free operating cash flow less worrisome.

Figure 7: Cash flow overview, NOK m



Sources: Nordkraft, Scope (estimates)

Figure 8: Liquidity and debt maturity profile as of YE 2023 (NOK m)



Sources: Nordkraft, Scope

Balance in NOK m	2023	2024E	2025E
Unrestricted cash (t-1)	325	401	370
Open committed credit lines (t-1)	-	-	-
Free operating cash flow (t)	241	(113)	(81)
Short-term debt (t-1)	80	600	500
Coverage	**708%**	**48%**	**58%**

Adequate liquidity

Nordkraft's liquidity profile is adequate. Forecasted liquidity ratios are low (below 100%) throughout the forecast period, reflecting: i) debt maturities of NOK 600m in 2024 and NOK 500m in 2025; ii) pressure from forecasted negative free operating cash flow; and iii) available cash sources of around NOK 0.4bn in 2024-2025. However, Nordkraft has good access to external financing which can provide liquidity and which will likely cover the unfunded part of scheduled growth capex.

While Nordkraft has no multi-year credit lines, we note the company's two 12-month credit lines: i) an overdraft facility of NOK 100m; and ii) a revolving credit facility of NOK 400m. Both were undrawn as of Q1 2024. There has been a practice between Nordkraft and the banks of rolling these annually, which we expect to continue. Hence, we expect that upcoming debt maturities could also be covered partially or in full by a drawn down of such facilities, should the company not raise new debt through other funding channels.

Financial covenants

With an equity ratio (group level) of 48.9% and reported EBITDA/net interest of 14.3x in 2023, Nordkraft had good headroom under its financial covenants (equity ratio above 35% and EBITDA/net interest above 2x). The covenants apply to both of Nordkraft's loan agreements, covering all outstanding debt. No covenant breaches are expected in our rating case.

Supplementary rating drivers: +1 notch

Financial policy is neutral

We have made no adjustment for financial policy. Nordkraft does not have official targets for financial credit ratios besides those defined under the financial covenants in its loan agreements. However, we expect the company to maintain a long-term, balanced approach to investment levels and shareholder remuneration, reflecting its track record of leverage (reported net debt/EBITDA) below 3.5x in the past under normal market conditions.

+1 notch for parent support based on GRE status

The issuer rating incorporates a one-notch uplift to the standalone credit assessment of BBB-. This is based on Nordkraft's GRE status and a bottom-up approach according to the framework outlined in our Government Related Entities Methodology. The one-notch uplift reflects the public sponsor's capacity and willingness to provide support. Nordkraft has an aggregated, ultimate ownership of 80.1% by a group of nine Norwegian municipalities, of which Narvik municipality (35.6%) and Hålogaland Kraft Holding AS (37.6%) are the largest direct shareholders. We do not define the Swedish, municipal-owned utility Jamtkraft AB, which owns 19.9% of Nordkraft, as a public sponsor, because we view the incentives to provide financial support as higher among the Norwegian municipality owners as these constitutes Nordkraft's concession area.

We see the capacity for a credit uplift as high, based on the likely higher credit quality of the Norwegian municipalities' compared to Nordkraft's standalone credit assessment. We assess the willingness to provide support as medium, reflecting Nordkraft's responsibility for the power distribution system and ownership of large-scale (above 10 MW) hydropower plants (requiring at least two-thirds public ownership). Overall, the rating uplift is restricted to one notch, in line with other Scope-rated Norwegian utilities with majority or full ultimate, municipal ownership but no explicit guarantees on their debt or financial support.

Figure 9: Ownership structure

Direct owners of Nordkraft AS		Indirect, ultimate owners of Nordkraft AS	
Hålogaland Kraft Holding AS	37.62%	Harstad municipality	48.57%
		Tjeldsund municipality	17.14%
		Gratangen municipality	8.57%
		Lødingen municipality	8.57%
		Ibestad municipality	8.57%
		Kvæfjord municipality	8.57%
Narvik municipality	35.60%		
Jämtkraft AB	19.93%	Östersund municipality (Sweden)	98%
		Kroken municipality (Sweden)	1%
		Åre municipality (Sweden)	1%
Trollfjord AS	4.40%	Hadsel municipality	100%
Andøy Energi Holding AS	2.45%	Andøy municipality	100%

Sources: Nordkraft, Scope

Debt ratings

Nordkraft AS is the issuer of all outstanding debt.

Senior unsecured debt: BBB

Senior unsecured debt is rated BBB, in line with the issuer rating.

Short-term debt rating: S-3

The short-term debt rating of S-3 is based on the underlying BBB/Stable issuer rating and reflects the expected worse-than-adequate liquidity (internal and external) ratios of below 100%, as well as adequate access to external financing.

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