

# Eidsiva Energi AS

## Norway, Utilities



### Corporate profile

Eidsiva Energi AS (Eidsiva) is a Norwegian company engaging in utility-related operations primarily in the Hedmark and Oppland counties. Eidsiva is a fully vertically integrated utility, with activities in power production, power distribution and retail sales. The company also provides broadband services. Eidsiva has an annual average hydropower production of about 3.4TWh and around 400GWh of district heating production. As part of its distribution business, the company builds, operates and renews a power grid (airlines and ground cables) with a range of over 22,500 kilometres. The group is owned by 27 municipalities and two county municipalities, Oppland and Hedmark.

### Key metrics

Scope credit ratios	Scope estimates			
	2016	2017	2018F	2019F
EBITDA/interest cover (x)	4.0x	4.2x	3.9x	6.3x
SaD/EBITDA	5.8x	5.5x	6.3x	5.5x
Scope-adjusted FFO/SaD	8.6 %	10.5 %	9.4 %	13.2 %
FOCF/SaD	-8.6 %	2.3 %	-7.6 %	-1.3%

### Rating rationale

**Scope Ratings affirms its BBB- corporate issuer rating on Eidsiva Energi AS, as well as the S-2 short-term rating and BBB- senior unsecured ratings. Scope has also placed the issuer rating under review for possible upgrade.**

Following the 15 November letter of intent (LoI) between Eidsiva Energi and Hafslund E-CO regarding a merger of their main activities, we anticipate an improvement in Eidsiva's business risk profile. Should the transaction go ahead, Scope anticipate a minimum one-notch upgrade of the issuer rating.

The issuer rating of Eidsiva benefits from the vertically integrated business model, which helps to stabilise profitability. In the last two years, regulated grid revenues as a share of group EBITDA has declined towards 30%, while hydro and district production have increased (helped by higher prices). Still, the company's business risk profile benefits from a meaningful share of protected infrastructure grid business as well as the growing contribution to profitability by its fibre/broadband activities, which is positive for the company's blended industry risk assessment. Although Eidsiva's geographical footprint is relatively small, we consider this mitigated by its monopolistic grid operations and the secured use of low-cost hydropower generation assets. The company's hedging of power production has dampened the positive effects from power market price spikes in 2018, but we are still in favour of Eidsiva's ambition to reduce underlying volatility.

Eidsiva's financial risk profile continues to be weaker than its business risk profile. The Scope-adjusted leverage ratio (excluding the shareholder loan) has averaged around 5.9x during 2016-18, which is aggressive for the company's rating category. Positively, the conversion of the shareholder loan into equity, as agreed by the municipal owners, combined with the anticipated improvement in operational profitability during 2019, should result in better credit metrics going forward. Still, the extensive investment plans

### Ratings & Outlook

Corporate ratings	BBB-
Short-term rating	S-2
Senior unsecured rating	BBB-

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### Related methodologies

European Utilities,  
January 2018

Government-Related Entity,  
July 2018

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until 2020 are having negative effects on free cash flow and the need for external financing. The positive effect on interest coverage by converting the shareholder loan into equity is somewhat offset by the lower cash flow through a higher expected dividend to owners. Still, the discretionary nature of dividends versus fixed interest payments is a credit-positive.

We assess Eidsiva's liquidity to be sufficient, helped by a reasonable level of undrawn credit lines, and a good track-record of access to both bond markets and bank debt. These funding sources are essential as the company still runs a sizeable capex programme (grid and broadband in particular), which will necessitate new debt and refinancing.

### Review

For Eidsiva, the November 15 Lol means that Hafslund Nett (Hafslund E-CO's regulated grid business) will be merged with Eidsiva Nett, by giving Hafslund E-CO payment in Eidsiva Energi shares. As a result, Eidsiva Energi will have a new 50% owner, which indirectly will be the City of Oslo. The Lol also means that Eidsiva's unregulated production business will be partly sold-off and merged together with E-CO Energi AS, with payment in shares in this new production company (ownership >20%; final percentage is not ready, but it will be a minority ownership for Eidsiva). The rationale by Scope for placing Eidsiva Energi's rating under review for possible upgrade reflects the following anticipated effects should the transactions go ahead:

- The new Eidsiva entity would generate around 80% of Scope-adjusted EBITDA from monopolistic regulated grid operations. This would improve the blended industry assessment of Eidsiva (i.e. the new minority interest in power production will be accounted for as an associated company)
- Improved market dominance and customer diversification through the addition of roughly 720,000 grid customers in the Oslo, Akershus and Østfold regions (Eidsiva Nett currently has 162,000 customers, mainly in Headmark and Oppland counties)
- A larger and more cost-efficient grid company, which should improve cash flow stability
- The expectation that the combined entity's financial credit metrics will not be weaker than Eidsiva's on a standalone basis today

A final agreement could take up to 6 months we think, at which point more information should be available on the companies' financing structure. We note that both the Norwegian authorities and the municipality owners would have to approve the proposed transaction. Although, the City of Oslo would become a new 50% owner in Eidsiva alongside with the existing owners (the 27 municipalities and two county municipalities), the proposed transaction is not expected to have any negative effect on Scope's government-related entity assessment of Eidsiva.

### Rating-change drivers

A positive action could be warranted if the letter of intent is officially agreed upon, which would improve the business risk profile without materially worsening the financial risk profile. On a standalone basis, a rating upgrade could also be warranted if Eidsiva starts to report positive free cash flows or sells assets with the effect of reducing overall leverage, exemplified by a Scope-adjusted leverage ratio of below 5x on a sustained basis.

A negative rating action is currently remote given the letter of intent, but could be triggered if the letter of intent is terminated and Eidsiva instead enters into a debt-financed structural transaction that proves detrimental to its business risk profile, or if the financial risk profile weakens due to an adverse market situation.



#### Rating drivers

<b>Positive rating drivers</b>	<b>Negative rating drivers</b>
<ul style="list-style-type: none"><li>• Diversified business model, with a large share of monopolistic power distribution, as well as profitable broadband and bioenergy businesses</li><li>• Long-term, supportive and committed municipality owners</li><li>• Environmentally friendly hydropower production, with favourable placing in the merit order system</li></ul>	<ul style="list-style-type: none"><li>• Ongoing, sizeable investment phase, resulting in negative free cash flow and external funding requirements</li><li>• Somewhat aggressive financial credit ratios, even when adjusting for the subordinated owner loan</li><li>• Limited geographical outreach for businesses outside its main counties</li></ul>

#### Rating-change drivers

<b>Positive rating-change drivers</b>	<b>Negative rating-change drivers</b>
<ul style="list-style-type: none"><li>• Improved business risk profile if the transaction as described in letter of intent is completed</li><li>• Scope-adjusted leverage ratio of below 5x on a sustained basis</li></ul>	<ul style="list-style-type: none"><li>• Debt-financed structural transaction altering the business risk profile negatively</li><li>• Sustainably lower wholesale prices placing severe pressure on financial risk profile</li></ul>



## Financial overview

	Scope estimates			
Scope credit ratios	2016	2017	2018F	2019F
EBITDA/interest cover (x)	4.0x	4.2x	3.9x	6.3x
Scope-adjusted debt/EBITDA	7.0x	6.5x	6.3x	5.5x
Scope-adjusted debt (excl. shareholder loan)/EBITDA	5.8x	5.5x	6.3x	5.5x
Scope-adjusted FFO/SaD	8.6 %	10.5 %	9.4 %	13.2 %
FOCF/SaD	-8.6 %	2.3 %	-7.6 %	-1.3%
<b>Scope-adjusted EBITDA in NOK m</b>				
EBITDA	1,245	1,393	1,302	1,575
Add: operating lease payments in respective year	35	47	48	48
<b>Scope-adjusted EBITDA</b>	<b>1,280</b>	<b>1,440</b>	<b>1,350</b>	<b>1,623</b>
<b>Scope-adjusted debt in NOK m</b>				
Reported gross financial debt	6,999	7,473	8,094	8,456
Less: cash, cash equivalents	-122	-291	-277	-256
Add: cash not accessible	53	72	70	70
Add: pension adjustment	270	269	260	251
Add: operating lease obligations	270	364	364	364
Subordinated owner loan	1,519	1,519	0	0
<b>Scope-adjusted debt</b>	<b>8,989</b>	<b>9,405</b>	<b>8,510</b>	<b>8,885</b>
<b>Liquidity in NOK m</b>				
Unrestricted cash position	69	219	207	186
Undrawn committed lines	1,292	1,200	1,200	1,200
<b>Total available liquidity</b>	<b>1,361</b>	<b>1,419</b>	<b>1,407</b>	<b>1,386</b>
<b>Liquidity ratios</b>				
Liquidity (internal and external)	1.2	1.9	3.5	2.5
Liquidity (internal)	0.3	1.0	1.7	1.4

### Operational developments since Scope's previous rating report

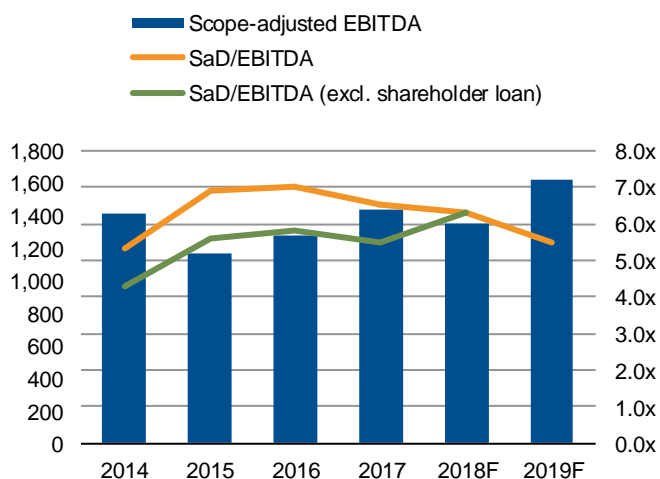
Eidsiva's power production was lower than expected in 2018, mainly due to volumes in Q3 being 40% below normal levels. For the first nine months in 2018, Eidsiva benefited from higher power prices, but its hedging of power production dampened the overall positive effect on its financials. We are still in favour of its ambitions to reduce underlying volatility, but understand that the higher forward price curve could also negatively impact 2019 numbers. Since YE2018, longer-term bilateral customer contracts have remained in place, while shorter-term Nasdaq hedging contracts has been reduced.

The grid business had an unusually high rate of weather-related interruptions at the beginning of this year, which impacted profitability. On the other hand, income from the broadband business and associated companies contributed positively. Overall, the vertically integrated business model helps to stabilise profitability, and the company seems on track to meet our expectations for FY 2018.

### Two company announcements on 15 November 2018

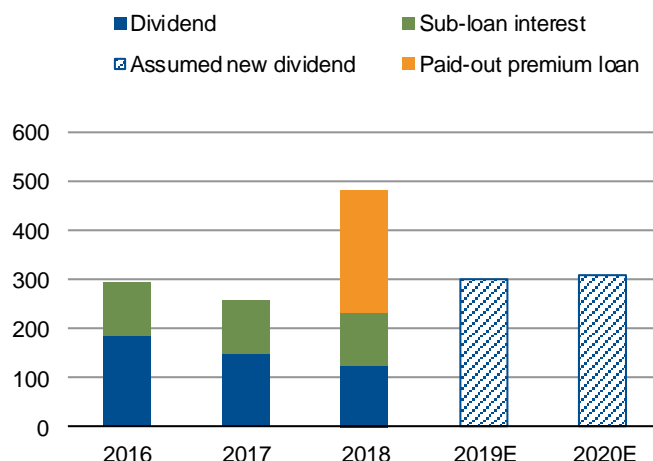
On 15 November, Eidsiva and Hafslund E-CO announced their intention to merge their main businesses, and Eidsiva confirmed that all municipality owners have officially agreed to convert the shareholder loan into equity. We view positively the effect the latter will have on Q4 2018 figures, although we note the negative impact on cash flow through a pay-out of the loan premium and the potential for a higher dividend. Still, the conversion into equity will boost free operating cash flow and interest coverage going forward, increasing the discretionary nature of the shareholder payment.

Figure 1: Scope-adjusted leverage development (NOK m)



Source: Company, Scope

Figure 2: Shareholder distribution (NOK m)



Source: Company, Scope

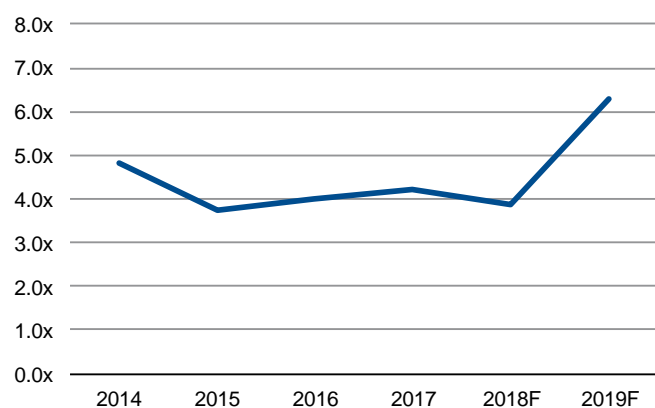
### Updated Scope forecast

Our financial performance forecast for Eidsiva was adjusted for the decision to convert the shareholder loan into equity as well as updated operational assumptions for 2019. The Scope forecast excludes potential effects from the letter of intent, as it is not approved and lack many financial valuation aspects.

With 2019 production anticipated to return to a normalised annual level and updated power prices with the forward curve, we anticipate higher group profitability in 2019 than in 2018. Cash flow will be impacted negatively by the decision in Q4 2018 to pay owners the mark-to-market premium to redeem the shareholder loan early. The reduction of

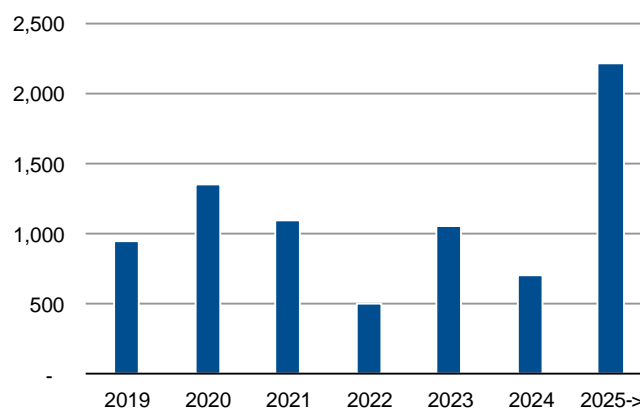
interest expenses from 2019 onwards is expected to be offset by the higher anticipated dividend pay-out.

**Figure 3: Scope-adjusted EBITDA/interest coverage (x)**



Source: Company, Scope

**Figure 4: Debt maturity profile, as of Q3 2018 (NOK m)**



Source: Company, Scope

Eidsiva's liquidity remains sufficient and has not changed materially since the last review, with the company well covered in the short term. At the end of Q3 2018, Eidsiva had NOK 0.3bn in cash and NOK 1.2bn in undrawn committed credit lines, which together cover its NOK 1.0bn in short-term debt. The company also enjoys good access to bank debt and bond markets, which is beneficial, as the current capex programme would necessitate new debt and refinancing in the future, based on our estimates.

### New government-related entity methodology from Scope

On 13 July 2018, Scope published its new government-related entity methodology, which now also applies to Eidsiva alongside the utility-specific rating methodology. The new methodology is used to assess the level of support and the corresponding uplift from the standalone rating. We use the bottom-up approach to analyse Eidsiva, and the one notch-uplift assigned for the 100% municipality ownership has not changed since the last review.

To assess the likelihood of support, we considered Eidsiva's importance in Norway, political willingness for financial support, and the potential for political or investor turmoil should support be withheld. The owners' willingness is clearly evident in the conversion of the shareholder loan into equity to improve the balance sheet. Further, Norway's Industrial Licensing Act, which states that hydropower assets must be owned two-thirds by the public at all times, as well as monopoly regulations governing the grid business, confirm our assessment.

Based on the new methodology grid, we assess both the capacity and likelihood of government support at 'medium', which has given a one-notch uplift from Eidsiva's standalone rating of BB+. The proposed transaction described in the letter of intent is not expected to have any negative effect on this assessment if completed as planned.



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