16 August 2019 Corporates

Agder Energi AS
Norway, Utilities

SCOPE BBB+ STABLE

Corporate profile

Agder Energi AS (Agder Energi) is a vertically integrated utility company based in Norway with activities in hydroelectric power production, network operation, energy management, as well as retail power sales, district heating and venture investments (with the latter three under its 'Market' division). By power generation, Agder Energi is Norway's fourth-largest energy supplier. The group either wholly or partly owns 49 power stations that on average produce more than 8TWh of renewable energy each year. Agder Energi Nett owns and operates regulated transmission and distribution networks in Vest-Agder and Aust-Agder, while the group's LOS and Entelios brands sell power to retail and corporate end-users. Agder Energi is owned by 30 local municipalities (54.5%) and Statkraft Industrial Holding AS (45.5%).

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	11.2x	14.9x	9.5x	9.2x
Scope-adjusted debt (SaD)/EBITDA	3.6x	3.0x	3.8x	3.9x
Scope-adjusted FFO/SaD	19%	25%	12%	15%
Free operating cash flow (FOCF)/SaD	0.7 %	10.4 %	-0.7%	1.6%

Rating rationale

Scope Ratings affirms its BBB+/Stable issuer rating on Agder Energi, as well as the S-2 short-term rating and BBB+ senior unsecured rating.

The issuer rating continues to be driven by the company's vertically integrated business model, with core activities in power generation, distribution and retail sales. The vertical structure combined with active and high hedging activity helps to reduce the underlying volatility in each business segment. Although the mix of EBITDA contribution from its main segments is expected to improve in 2019 compared to 2018, we still expect the distribution segment to underperform until 2020. We also note that LOS and Entelios businesses are low profit margin contributors, which emphasises the importance of Agder Energi's beneficial low-cost hydropower activities and its current cash generation.

Following an improvement of the financial risk profile in 2018, we anticipate key credit metrics to deteriorate through to 2020. Key drivers for this are the lower profit contribution from hydropower and high investment needs. Ongoing hydropower projects include Skjerka, Åseral Nord and Fennefoss, while grid investments also dominate capex. As a result, we anticipate more or less break-even FOCF for these two years combined. Despite the pressure on FOCF, Agder Energi's financial risk profile continues to be supported by strong debt protection measures and leverage ratios that remain in line with our rating range of 3-4x Scope-adjusted debt (SaD)/EBITDA.

Given the high investment and relatively high maturing debt profile, we assess internally generated liquidity as somewhat below adequate at the moment. Still, adding available funds through undrawn credit lines (increased by NOK 1bn during July this year) and our assessment of the company's access to banks, bonds and the German market for Namensschuldverschreibung (registered bonds), we deem overall liquidity as adequate.

Ratings & Outlook

Corporate ratings	BBB+
Outlook	Stable
Short-term rating	S-2
Senior unsecured rating	BBB+

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Related Methodologies and research:

European Utility Methodology, March 2019

Corporate Rating Methodology, March 2019

Government Related Entities Methodology, July 2018

Affirmation of rating, Agder Energi, August 2018

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Outlook

The Stable Outlook on Agder Energi's rating reflects our expectation of: i) a continuation of the vertically integrated business strategy; ii) the ability to fund investments using internally generated cash flow over the cycle; and iii) the management's and owners' shared ambition to maintain a strong financial credit profile. Key credit metrics are therefore anticipated to stay within Scope's range mentioned below (in rating change drivers) for the medium term, following our updated forecast and key assumptions for market developments. The rating Outlook also reflects our assumption that majority ownership by the municipalities will continue.

A rating upgrade may be warranted if Agder Energi deleveraged to below 3.0x (SaD/EBITDA) on a sustained basis, bolstered, for instance, by lower investment needs or higher group operating profitability.

A negative rating action is possible if the company sees negative operating performance or were to participate in a debt-financed structural transaction that substantially weakens its credit profile, measured by a SaD/EBITDA of more than 4x and negative FOCF/SaD on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Vertically integrated business model with monopolistic power distribution, strong position of hydropower generation in the merit system and leading retail sales business • Profitable and environmentally friendly hydropower production with substantial hedging agreements and sizeable reservoir capacity • Long-term, committed majority owners (30 municipalities) that are jointly organised and have the capacity and willingness for potential parent support	• Sizeable investment needs, which puts discretionary cash flow in negative territory • General exposure towards the highly cyclical power generation industry • Consistently low internally generated Scope-adjusted liquidity ratio in recent years

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• In the longer term, reduced investment and dividend payouts resulting in positive free cash flow after dividends and sustainable improved credit metrics (i.e. SaD/EBITDA <3x)	• A structural transaction that weakens the capital structure or business risk profile on a sustained basis, with a SaD/EBITDA of above 4x and negative FOCF/SaD for a prolonged period

Financial overview

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	11.2x	14.9x	9.5x	9.2x
SaD/EBITDA	3.6x	3.0x	3.8x	3.9x
Scope-adjusted FFO/SaD	19%	25%	12%	15%
FOCF/SaD	0.7 %	10.4 %	-0.7%	1.6%
Scope-adjusted EBITDA in NOK m				
EBITDA	2,597	3,013	2,523	2,595
Add: operating lease payments in respective year	75	83	80	80
Scope-adjusted EBITDA	**2,672**	**3,096**	**2,603**	**2,676**
Scope-adjusted funds from operations in NOK m				
EBITDA	2,597	3,013	2,523	2,595
Less: (net) cash interest per cash flow statement	-222	-190	-255	-273
Less: cash tax paid per cash flow statement	-617	-609	-1,109	-824
Add: depreciation component, operating leases	59	66	62	63
Scope-adjusted funds from operations	**1,817**	**2,280**	**1,221**	**1,561**
Scope-adjusted debt in NOK m				
Reported gross financial debt	9,240	9,260	10,101	10,351
Less: cash, cash equivalents	-61	-383	-474	-212
Add: cash not accessible	9	19	20	20
Add: operating lease obligations	325	359	346	346
Scope-adjusted debt	**9,513**	**9,255**	**9,993**	**10,505**
Liquidity				
Liquidity (internal and external)	1.0	1.9	1.6	3.0
Liquidity (internal)	0.3	0.5	0.1	0.4
Total available liquidity in NOK m	**2,372**	**2,864**	**3,974**	**3,712**

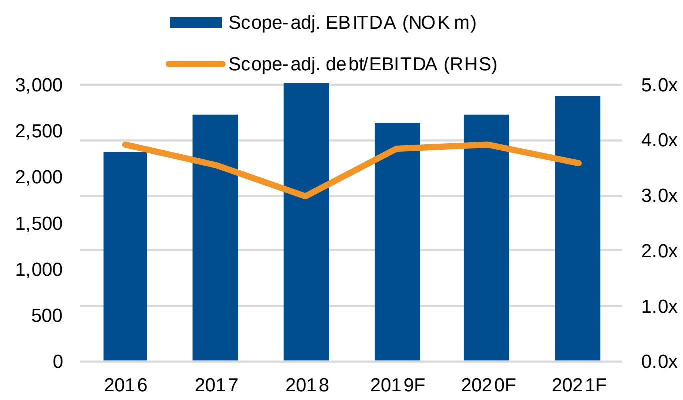
Operational developments since Scope's previous rating report

Hydropower contribution less dominant this year

Although the grid segment's underperformance in 2018 was less negative during H1 2019, we do not expect the segment's profitability to fully recover to normal until 2020. As a result, group EBITDA is still dominated by hydro power production, which contributed almost 90% of EBITDA in 2018. Volume output in hydropower is expected to dip in 2019, which will affect group profitability and cash flow negatively.

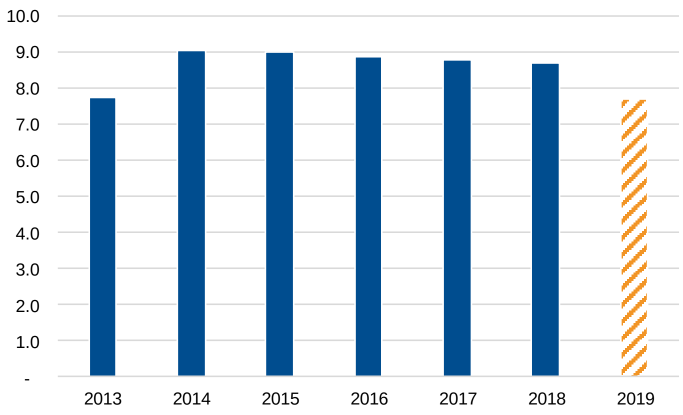
As production volume in 2018 of around 8.9TWh was well above the normalised level of 8.1TWh, we expect this year's volume to be below the normalised level. In our base case, we see a high likelihood of production being around 10-15% lower than last year's levels. If achievable power prices cannot compensate for the volume decline, we would see a negative effect on cash flow this year. The pricing assumption for the year also incorporates the effect of old hedging contracts, which are fixed at lower prices than this year's market levels.

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



Source: Scope estimates

Figure 2: Hydro-power production level (in TWh)



Source: Scope, company

Even with gross capex in 2019 estimated to be below that in 2018, we project FOCF to be negative this year. Lower production, higher tax payments as well as pricing and previous hedging effects are some of the explanations.

Increased financial flexibility through a new funding source and increased credit lines

We currently assess Agder's internally generated liquidity ratio as below adequate, driven by the weaker expected operating cash flow this year, relatively high capex and the short-term debt refinancing position. Still, overall liquidity, including financing sources like undrawn credit lines, is better than adequate. During the summer, the company also increased back-stop lines from banks from NOK 2.5bn to NOK 3.5bn, which has increased financial flexibility. In addition, we view it positively that the company has placed its first Namensschuldverschreibung (EUR 50m) on the German market, with tenors of 12 and 15 years. We expect the company to issue further debt with longer tenors, which will improve the debt maturity profile further.

Updated Scope forecast

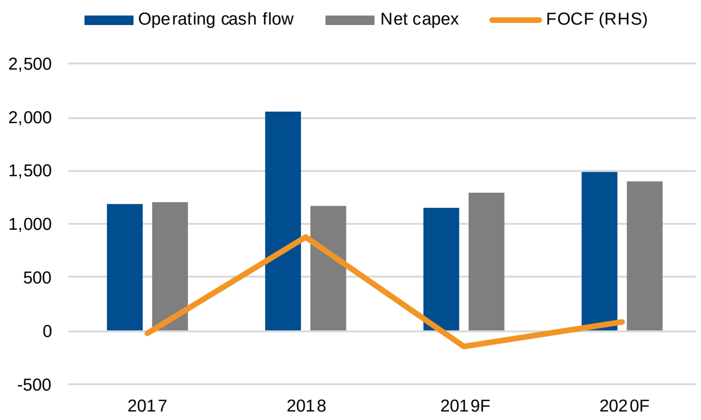
We have slightly revised down the figures from our previous 2019 forecast, mainly due to the lower expected production. Still, our financial credit ratio estimates in the short to medium term are largely unchanged, supported by strong debt protection measures and a leverage ratio that is expected to be in the range of 3-4x on a SaD/EBITDA level.

The company has long faced potential event risk through industry consolidation. In this regard, given last year's failed Skagerak deal and the CEO's planned retirement this year, we expect no significant developments in the short term until a new CEO is in place.

The company's active role in venture investments and technological developments affecting the industry, while important, still has had insignificant effects on group profitability. Still, these investments and businesses set a strategic focus for the group in the new landscape emerging for utilities. We favour the company's focus on energy solutions and digitalisation, which is important for more flexibility in the industry going forward, especially as more industries become electrified. Thus, we consider it likely that Agder Energi could continue to seek partners or merge with companies in more technological industries than with typical utilities.

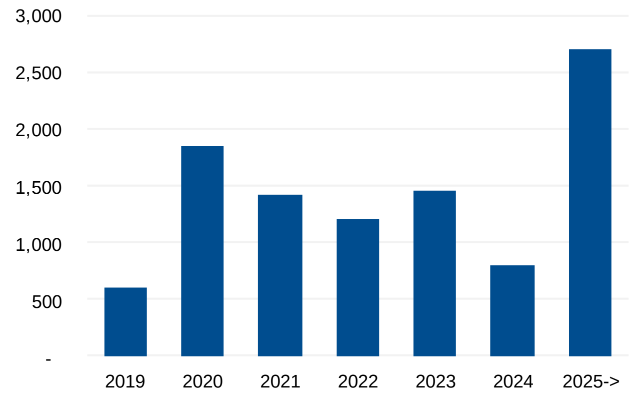
However, our forecast numbers do not incorporate any of the above event risks, but are based only on the latest forward power prices in the market and confirmed capex plans by the company.

Figure 3: Cash flow development (NOK m)



Source: Scope estimates

Figure 4: Debt maturity profile, as June 2019 (NOK m)



Source: Scope, Company

Summary of business and financial risk profiles

Our assessment of BBB for the business risk profile has not changed on the whole, but there has been some downward pressure on the profitability and efficiency measure. The financial risk profile is also still seen as BBB, with leverage and debt protection being the stronger elements, and capex cover and free cash flow being the weakest.

Supplementary rating drivers

We still use our bottom-up approach to analyse Agder Energi's parent support, and the one notch-uplift assigned for the 54.5% municipality ownership in Agder Energi has not changed.

Short-term rating

Despite the relatively low internal liquidity ratio that we have calculated, the company's overall liquidity is adequate and justifies an affirmation of our S-2 short-term rating, according to our methodology.

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