BKK AS
Norway, Utilities

SCOPE STABLE BBB+

Corporate profile

BKK AS is a Norwegian utility company, operating mainly in the southwestern part of Norway. The company's main activities are hydropower production and power distribution. It also offers broadband, district heating and other energy related services, and is a minority shareholder in several Norwegian utility companies. Historically, BKK Production has generated around 7.5 TWh of power annually, while the Distribution business has almost 250,000 customers. BKK is owned by 17 local municipalities (54.6%), Statkraft (43.4%), Tysnes Kraftlag (1.7%) and Etne Elektrisitetslag (0.35%).

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	10.5x	5.7x	9.8x	10.1x
Scope-adjusted debt (SaD)/EBITDA	4.2x	7.7x	3.7x	3.9x
Scope-adjusted funds from operations/SaD	8.8 %	7.3 %	23.0 %	16.0 %
Free operating cash flow/SaD	21.9%	0.7%	12.1%	2.3%

Rating rationale

Scope Ratings has affirmed its BBB+/Stable issuer rating on BKK AS along with a BBB+ senior unsecured debt rating and an S-2 short-term rating.

The issuer rating continues to be supported by BKK's business risk profile, which reflects low-cost, environmentally friendly hydropower portfolio assets, a meaningful share of a power distribution business and above-average profitability margins for a vertically integrated utility company. BKK's business risk profile is also supported by its diversification into telecommunications and district heating through companies in its FEM segment. Furthermore, several associated companies on BKK's balance sheet (almost NOK 5bn book value) provide a meaningful dividend contribution to the company.

BKK's financial risk profile came under some negative pressure last year due to historically low power prices in its service territory. However, so far in 2021, there has been much less negative pressure on the leverage ratio thanks to significantly higher power prices achieved, lower taxes paid and the final disposal of the remaining Fjordkraft shares, generating a large amount of cash flow in 2021. We also anticipate a slight increase in the profitability of BKK's monopolistic distribution business going forward. However, its EBITDA contribution will be marginally below our normalised contribution from this segment in the short term, due to the strong power production segment. Overall, we expect selected credit metrics to improve in 2021, exemplified by Scope-adjusted leverage returning to below 4x.

The liquidity situation is adequate if we compare available cash and undrawn credit lines (NOK 4.4bn) to short-term debt maturities (NOK 1.6bn) at Q1 2021. Given BKK's prudent financial policy and manageable capex programme for the next few years, we expect free operating cash flow to remain positive in the short-to-medium term.

Ratings & Outlook

Corporate issuer rating	BBB+/ Stable
Short-term rating	S-2
Senior unsecured rating	BBB+

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Related Methodologies

European Utility Methodology

Corporate Rating Methodology

Government Related Entities Methodology

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Outlook and rating-change drivers

The Stable Outlook reflects our expectation that BKK's financial risk profile will continue to be supported by good interest cover and positive free operating cash flow (FOCF) generation, which will mitigate the slightly weaker leverage ratio. It further assumes that the company will maintain its prudent financial policy, including manageable capex plans and reasonable dividend pay-outs. The Outlook also reflects our expectation of continued majority ownership by the combined municipalities.

A positive rating action could be warranted if BKK generates positive discretionary cash flow and deleverages, resulting in lower financial credit metrics, e.g. average Scope-adjusted debt (SaD)/EBITDA of 3x on a sustained basis.

A negative rating action could be warranted by substantially lower wholesale power prices, leading to negative FOCF and weaker credit metrics, e.g. SaD/EBITDA of well above 4x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Very profitable and cost-efficient hydropower production, with assets in good geographical locations with high precipitation • High profitability margins vs peers, with active hedging strategy and meaningful share of distribution business stabilising volatility • Committed, long-term majority municipality owners, with willingness and capacity to provide support	• Relatively large exposure to volatility in power prices • Ambitious investment plans to grow its production and grid business • Somewhat high leverage recently, albeit expected to come down

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Positive discretionary cash flow leading to sustainable improvement in credit metrics (e.g. SaD/EBITDA stabilising at 3x or lower for a sustained period) • Increasing share of stable and more efficient grid businesses, which could lead to better business risk profile rating	• Materially lower wholesale power prices and reduced hedging that increases volatility • Persistently weaker financial credit profile over time, e.g. negative FOCF and SaD/EBITDA well above 4x

Financial overview

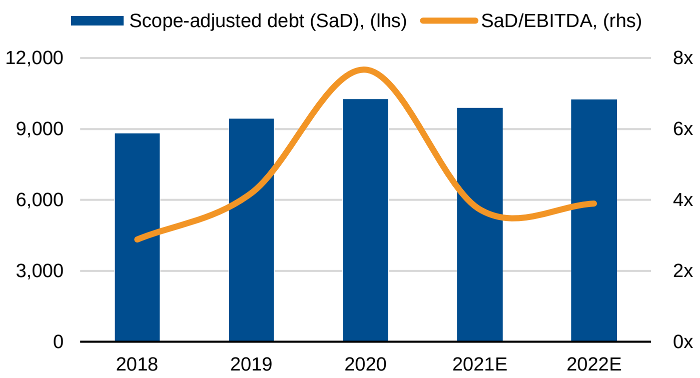
			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	10.5x	5.7x	9.8x	10.1x
SaD/EBITDA	4.2x	7.7x	3.7x	3.9x
Scope-adjusted FFO/SaD	8.8 %	7.3 %	23.0 %	16.0 %
FOCF/SaD	21.9%	0.7%	12.1%	2.3%
Scope-adjusted EBITDA in NOK m				
EBITDA	2,254	1,340	2,651	2,632
Add: adjustments	-	-	-	-
Scope-adjusted EBITDA	**2,254**	**1,340**	**2,651**	**2,632**
Scope-adjusted funds from operations in NOK m				
EBITDA	2,254	1,340	2,651	2,632
Less: (net) cash interest per cash flow statement	-214	-236	-272	-259
Less: cash tax paid per cash flow statement	-1,128	-683	-198	-871
Add: other items (incl. dividends from associated companies)	-78	329	92	140
Scope-adjusted funds from operations	**834**	**750**	**2,273**	**1,642**
Scope-adjusted debt in NOK m				
Reported gross financial debt	10,515	11,472	12,137	11,673
Less: cash, cash equivalents	-1,289	-1,410	-2,467	-1,643
Add: cash not accessible	2	0	0	0
Add: pension adjustment	218	218	218	218
Add: other	-	-	-	-
Scope-adjusted debt	**9,446**	**10,280**	**9,888**	**10,248**
Liquidity				
Liquidity (internal and external) ratio	1.4	1.8	2.1	4.6
Total available liquidity in NOK m	**2,787**	**2,910**	**3,967**	**3,143**

Operational developments since our last rating report

BKK's full year 2020 results were slightly below our expectations, mainly due to even lower power prices achieved than anticipated in the middle of last year. This resulted in slightly higher leverage than expected. On the positive side, BKK still managed to report positive FOCF, due to its Fjordkraft shares sell down. So far in 2021, there has been much less negative pressure on the leverage ratio thanks to significantly higher power prices achieved this year, lower taxes paid and the final disposal of the remaining Fjordkraft shares, generating a large amount of cash.

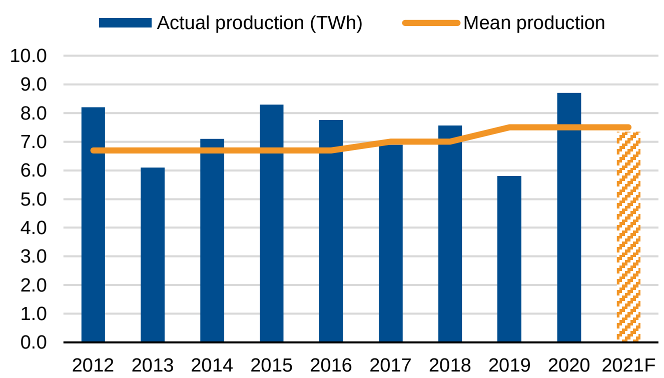
We expect BKK to produce slightly less than its average hydropower electricity level (7.5 TWh) in 2021, which is well below its output in 2020 (8.7 TWh). Still, profitability will be much better again, as prices this year are higher than last year. BKK's monopolistic distribution business is also likely to increase its profitability slightly going forward. However, its EBITDA contribution will be slightly below our normalised EBITDA contribution from this segment in the short term, due to the strong production segment.

Figure 1: Scope-adjusted debt (NOK m) and leverage (x)



Source: Company, Scope

Figure 2: Hydropower production level (in TWh)



Source: Company, Scope

Although BKK has been in an investment phase and has further growth ambitions, we do not see increased transactional risks at the moment. We believe the company will cautiously seek participation in potential transactions in the Norwegian utility market. The newly announced cooperation on offshore wind projects together with Shell and Lyse is still in an early exploratory phase.

Updated Scope estimates

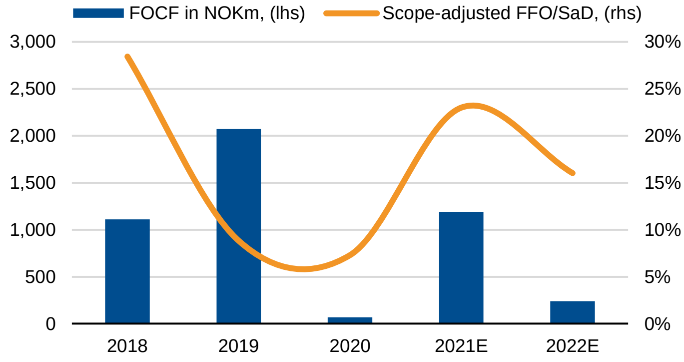
We have updated our financial forecast for BKK based on the Q1 2021 numbers, the company's recent operating performance and current market conditions and prospects. Overall, we forecast improved operational cash flow, which is positive for selected key credit ratios compared to the last two historical years.

The main drivers behind our forecast and credit ratio expectations are:

- A strong revenue recovery in 2021 thanks to higher achieved power prices and a normalised production level in BKK's production unit
- Less taxes paid in 2021, due to the low result in 2020; we anticipate a return to more normalised, higher tax levels in 2022
- Relatively high capex the next few years – mainly grid related but also related to some expansion in other businesses
    - No further disposals assumed

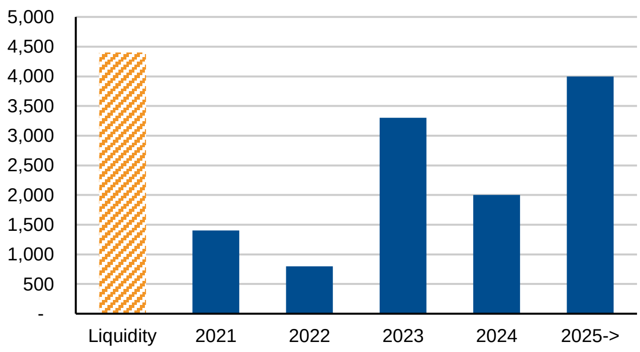
Based on these assumptions, we expect selected credit metrics to improve and leverage to return to below 4x this year.

Figure 3: Free operating cash flow (NOK m) and Scope-adjusted funds from operations/Scope-adjusted debt (%)



Source: Company, Scope

Figure 4: Liquidity and debt maturities, as of Q1 2021 (NOK m)



Source: Company, Scope

Summary of business and financial risk profiles

Overall, there is no change in our business risk profile assessment of BBB+, which is supported by BKK's high average profitability and efficiency, as well as its vertical integration including monopolistic grid businesses. We continue to see BKK's financial risk profile as weaker than its business risk profile but note that it should improve somewhat during 2021. Despite high leverage lately, the company's track record of delivering positive FOCF over the cycle provides comfort that its financial risk profile should return to less aggressive levels in 2021 based on the latest power price forward curves. BKK's possession of substantial reserves in its associated company holdings continues to provide potential liquidity, but also potential transactional opportunities and risks.

Supplementary rating drivers

We make no adjustment for financial policy. Management has publicly announced to the company's owners that the dividend ratio over time should be 70% but that there may be deviations from this if investment needs put too much pressure on the capital structure and its current credit rating.

We analysed BKK's parent support using our bottom-up approach as described in our Government Related Entity Methodology. The one notch of uplift assigned for the 54.6% municipality ownership in BKK has not changed. Thus, the issuer rating remains at BBB+, based on a standalone rating of BBB and a one-notch uplift for parent support.

Long-term and short-term debt ratings

The BBB+ senior unsecured debt rating, which is in line with the issuer rating, is based on the company's standard bond documentation, which includes a pari passu clause and negative pledge. Senior unsecured bonds are issued at the parent level.

The S-2 short-term rating reflects good short-term debt coverage as well as good access to both bank loans and debt capital markets.

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