# Lyse AS
# Norway, Utilities

SCOPE BBB+ STABLE

## Corporate profile

Lyse AS (Lyse) is a Norwegian utility which is fully owned by a group of 16 municipalities in south-western Norway. Lyse is a significant national operator of renewable energy, and is the country's sixth-largest hydroelectric power producer today. Lyse has also drawn on its experience of building and operating power grid infrastructure to further established itself as a national leader in fibre-optic broadband. At present, the company operates in three business areas: energy, power grid and telecommunications.

## Key metrics

| | | | Scope estimates | |
|---|---|---|---|---|
| **Scope credit ratios** | **2016** | **2017** | **2018F** | **2019F** |
| EBITDA/interest cover (x) | 8.4x | 10.0x | 8.2x | 8.2x |
| Scope-adjusted debt (SaD)/EBITDA | 3.2x | 3.6x | 3.5x | 3.5x |
| Scope-adjusted FFO/SaD | 25 % | 17 % | 20 % | 20 % |
| Free operating cash flow (FOCF)/SaD | 7.2 % | -0.8 % | 0.4 % | 3.1% |

## Rating rationale

**Scope Ratings affirms its BBB+/Stable corporate issuer rating on Lyse as well as its S-2 short-term rating and senior unsecured ratings of BBB+.**

The current rating on Lyse is supported by its diversified business model, dominant and profitable position in fibre optics, its low-cost hydro portfolio and relatively large hydro reservoir capacity. As a result, we estimate that the company will continue to see stable operational cash patterns, supporting the rating in a phase when major investments are expected to keep leverage in the 3.5x region (including the subordinated shareholder loan) until 2019.

Scope recognises the stable operational development in all of Lyse's main business segments since the publication of our last report. The company's diversified business model, with a large combined share of robust infrastructure segments (such as power distribution and its dominant position in fibre-optic broadband) in addition to its energy segment, is expected to remain firm and support stable cash generation.

Scope acknowledges that Lyse's FY 2017 credit metrics have proved somewhat better than expected (demonstrated by SaD/EBITDA of 3.6x vs Scope's expectation of 3.8x). The main financial performance deviations from Scope's previous 2017 estimates were due to two main items last year, i.e. the consolidation of Viken Fiber and the sell-down of Skangas from 49% to 30%. More detail on these two items and comments on Scope's updated financial forecast will be provided later in this report.

At the end of 2017, Lyse reported substantial liquidity with cash and undrawn credit lines of NOK 5.2bn which we estimate will comfortably cover expected funding and refinancing needs in the next few years. Lyse's financial strategy aims to have a cash coverage level of at least nine months, even if the minimum level is set at six months. The cash coverage definition from Lyse only includes liquid funds (excl. undrawn credit lines) which is intended to cover operational and investment activities, in addition to debt maturities and dividends. Based on current company levels and Scope estimates, Lyse has more than met its own targets, with a ratio of around two years.

### Ratings & Outlook

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


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### Related Research

European Utilities Methodology, January 2018

Scope rates Lyse AS at BBB+; outlook Stable, May 2017


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Scope also notes that the company has made an adjustment to its financial strategy going forward, which we judge to be credit supportive. The company now targets an official credit rating of at least BBB+, while maintained is goal to further diversify its funding sources.

## Outlook

The Stable Outlook reflects Scope's expectations that Lyse will maintain its diversified business model (generation, grid and telecom), and not jeopardise its financial risk profile with its current investment programme. Scope expects Lyse's leverage to stay relatively flat until 2019 and then decline, as investment levels are expected fall. Scope recognises that Lyse should be able to fund its investments using its own cash flow over the cycle. The rating outlook also reflects Scope's perception of an unchanged ownership structure.

A rating upgrade could be warranted if the company improves its financial risk profile and deleverages to a level below 3.0x on a sustainable basis, bolstered by consistently higher wholesale prices in the Nordpool market for instance.

A negative rating action is possible if the company's financial risk profile were to be weakened by sustainably depressed wholesale prices, resulting in a leverage of above 4.0x for a prolonged period.

### Rating drivers

| Positive rating drivers | Negative rating drivers |
|---|---|
| • Robust and diversified business model, given its monopolistic structure in power transmission, profitable telecom business, and the power generation portfolio's advantageous position in the merit order system<br>• Profitable and environmentally friendly hydropower production with a large reservoir capacity<br>• Committed, long-term owners (16 municipalities) | • Volatility of achievable prices in power generation<br>• Currently in a relatively large investment phase which places pressure on financial risk profile<br>• Limited geographical diversification and high asset concentration in Lyse's major hydro plants, with potential incremental effects from a standstill |

### Rating-change drivers

| Positive rating-change drivers | Negative rating-change drivers |
|---|---|
| • Reduced investment needs and positive free cash flow after dividends in the long term, which improve credit metrics on a sustainable basis (i.e. SaD/EBITDA <3x)<br>• Further disposals of Skangass - releasing cash for debt repayment | • Large debt-financed acquisition of other businesses, resulting in a sustainably weakened financial risk profile (i.e. SaD/EBITDA >4x)<br>• Significantly lower achievable wholesale prices in the Nordpool market |

## Financial overview

| | | | Scope estimates | |
|---|---|---|---|---|
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| EBITDA/interest cover (x) | 8.4x | 10.0x | 8.2x | 8.2x |
| SaD/EBITDA | 3.2x | 3.6x | 3.5x | 3.5x |
| Scope-adjusted FFO/SaD | 25 % | 17 % | 20 % | 20 % |
| FOCF/SaD | 7.2 % | -0.8 % | 0.4 % | 3.1% |
| **Scope-adjusted EBITDA in NOK m** | | | | |
| EBITDA | 2,702 | 2,990 | 3,158 | 3,257 |
| Add: operating lease payments in respective year | 193 | 171 | 152 | 129 |
| **Scope-adjusted EBITDA** | **2,895** | **3,160** | **3,310** | **3,387** |
| **Scope-adjusted funds from operations in NOK m** | | | | |
| EBITDA | 2,702 | 2,990 | 3,158 | 3,257 |
| Less: (net) cash interest per cash flow statement | -333 | -333 | -374 | -385 |
| Less: cash tax paid per cash flow statement | -404 | -650 | -537 | -589 |
| Add: depreciation component, operating leases | 163 | 139 | 121 | 102 |
| Add: other items | 214 | -242 | -50 | -40 |
| **Scope-adjusted funds from operations** | **2,343** | **1,902** | **2,317** | **2,346** |
| **Scope-adjusted debt in NOK m** | | | | |
| Reported gross financial debt | 10,643 | 13,867 | 13,830 | 13,798 |
| Less: cash, cash equivalents | -2,062 | -3,505 | -2,865 | -2,577 |
| Add: cash not accessible | 56 | 67 | 67 | 67 |
| Add: pension adjustment | 112 | 119 | 119 | 119 |
| Add: operating lease obligations | 607 | 674 | 576 | 496 |
| Add: asset retirement provisions | 18 | 18 | 18 | 18 |
| **Scope-adjusted debt** | **9,374** | **11,239** | **11,744** | **11,921** |

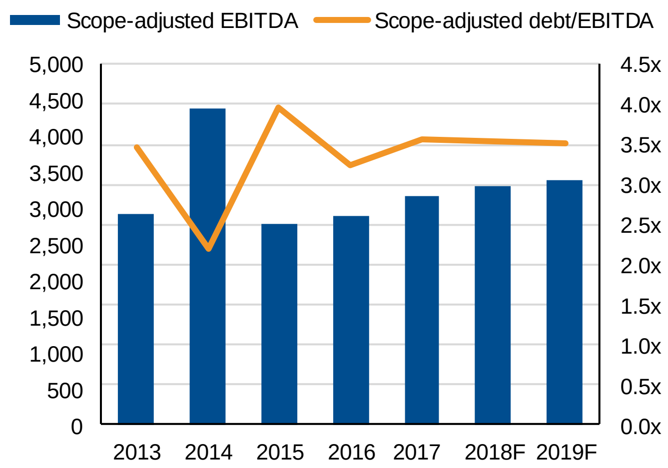
## Latest financial developments

The main financial deviations from Scope's previous 2017 estimates can be explained by two main items, i.e. the consolidation of Viken Fiber and the sell-down of Skangas from 49% to 30%.

As of 1 December 2017, Viken Fiber was fully consolidated into the Lyse numbers, following a new additional shareholder agreement between the two owners Lyse (71%) and Glitre (29%) which triggered a change in accounting practices from the joint venture-based equity method to full group consolidation (i.e. company control was transferred to Lyse, but there was no change in actual shareholdings). In addition to the balance sheet effects, consolidation also produced a NOK 952m unrealised gain on the company's income statement, which Scope has excluded from its EBITDA metrics calculations. The second item, i.e. the Skangas sell-down, did not have any material income statement effect, but resulted in a NOK 0.5bn positive cash inflow in 2017.

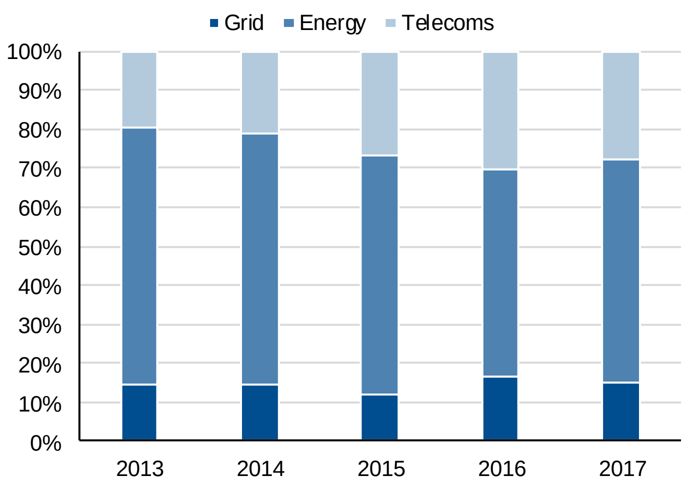
Altogether, Scope recognises that Lyse's FY 2017 credit metrics proved slightly better than expected. We also note that NOK 1.4bn of Viken Fiber debt is now included in the 2017 numbers, but only one month's revenue, which means that the SaD/EBITDA figure at YE 2017 is not fully representative. On the operational side, we highlight the fact that lower than expected power production in the energy segment in 2017 was compensated for by the attainment of higher power prices. Moreover, the segment also started the new year with higher reservoir levels (83% of capacity) which Scope views positively, giving the company great flexibility with regard to optimising its production.

**Figure 1 – Scope-adjusted leverage development**




Source: Lyse, Scope

**Figure 2 – Segment split based on EBITDA**



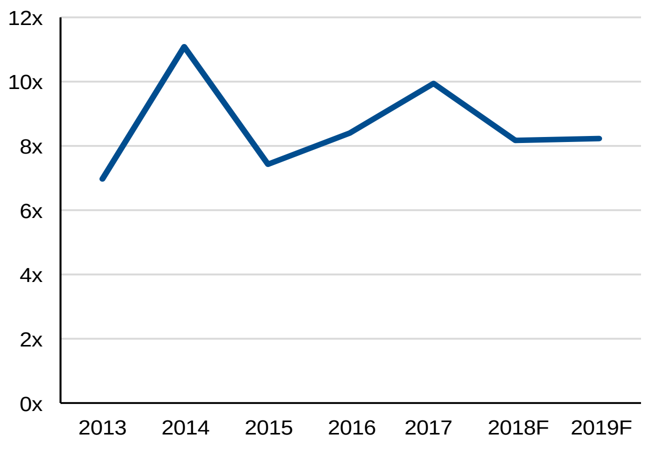

Source: Lyse, Scope

## Updated Scope forecast

Based on the operational developments since our latest update, we have made limited adjustments to our longer-term forecast for the company. Still, Scope has adjusted its 2018 figures due to the consolidation of Viken into the company accounts as of December 2017, which alone resulted in top line growth by more than NOK 0.5bn and increased capex estimates. In addition, Scope has included the company's new accounting practice for power retail sales within the energy division starting in 2018 (i.e. Lyse will recognise the gross sales number in the group accounts, not only the net amount going forward). This change will increase Scope's revenue estimates and thus reduce the EBITDA margin, but will have no cash flow implications at all.

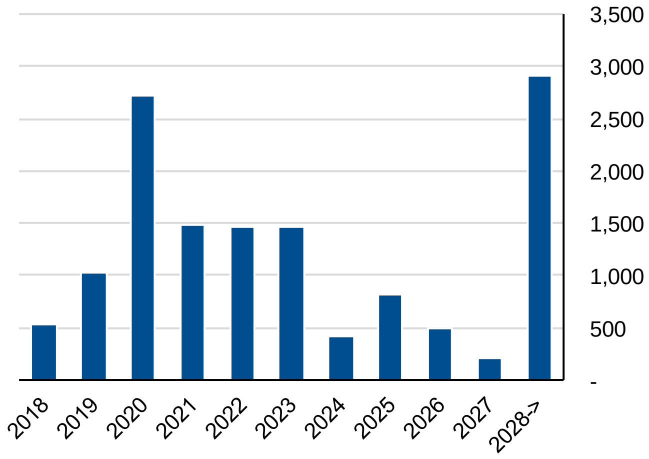
The effects of the accounting adjustments on selected credit metrics are limited where Scope expects stable credit metrics and operational cash flow to improve in the short to medium term. Scope still expects positive volume effects from the new Lysebotn power station from late 2018 which, coupled with its reservoir capabilities, should enable Lyse to achieve above-average power prices in the market. For the longer-term horizon, Scope sees Lyse's investment levels declining somewhat post 2020, as Lysebotn II will be ready and the telecom segment is expected to see lower investment in new optical fibre instalments.

**Figure 3 – Scope-adjusted EBITDA/interest coverage**




Source: Lyse, Scope

**Figure 4 – Debt maturity profile, at YE17**




Source: Lyse, Scope

The consolidation of Viken Fiber into the group accounts added debt with maturity in 2020 which now stands out in the maturity profile. Scope notes that this debt is granted to Viken Fiber on a standalone basis by its banks, with no direct guarantee from Lyse (or Glitre). Although refinancing risk appears to be somewhat higher in 2020 than in the other years, Scope notes that the substantial reported liquidity at present, together with a prudent financial policy with respect to liquidity, minimise potential negative effects. Scope also understands that the company has refinanced a NOK 0.3bn undrawn revolving credit facility this year, extending the maturity to 2021, and is assumed to extend the maturity of another NOK 0.5bn undrawn credit facility later this year. With respect to new financing, Scope has a positive view of the company's recent issue of more long-term funding. In 2017, Lyse issued both 12 and 15 year NOK bonds, extending its maturity profile for the 2028 debt bracket and beyond (Figure 4). While in 2018, it followed up diversifying its funding sources by entering the EUR market, issuing EUR 90m in the German "Namensschuldverschreibung" market (two tranches with 12 and 15 years maturities).

Scope's view on Lyse's liquidity profile is reflected in the assigned S-2 short-term rating. Scope regards Lyse's liquidity and financial flexibility as 'better than adequate' in accordance with our methodology to determine the liquidity situation of corporate entities.

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