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, retail power sales, energy management, contracting and district heating. By power generation, Agder Energi is Norway's fourth-largest energy supplier. The group wholly and partly owns 49 power stations that produce an annual average of 8.1 TWh of renewable energy. Agder Energi Nett owns and operates regulated transmission and distribution networks in Vest-Agder and Aust-Agder, while the group's LOS brand sells power to end-users both in retail and the corporate segment. Agder Energi is owned by 30 local municipalities (54.5%) and Statkraft Industrial Holding AS (45.5%).

Key metrics

			Scope estimates	
Scope credit ratios	2016	2017	2018F	2019F
EBITDA/interest cover (x)	9.3x	11.2x	10.8x	9.8x
Scope-adjusted debt (SaD)/EBITDA	3.9x	3.6x	3.2x	3.7x
Scope-adjusted FFO/SaD	20%	21%	21%	14%
Free operating cash flow (FOCF)/SaD	8.2 %	0.7 %	11.0 %	2.7%

Rating rationale

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

The issuer rating continues to be driven by Agder Energi's vertically integrated business model, with core activities in power generation, distribution and retail sales. Although the profit from power distribution has declined and is expected to represent a smaller part of the group EBITDA in 2018, Agder Energi benefits from its low-cost hydropower activities which have seen higher volumes and power prices. The company's substantial hedging measures in power production have somewhat influenced the effects of recent power-price spikes in the market, but the company has also benefitted from adjusting its shorter-term hedging level downwards. Scope still favours the company's ambition to reduce the segment's underlying volatility.

The group's financial risk profile is supported by strong debt protection metrics, measured by interest cover of well above 10x, and relatively stable indebtedness, measured by Scope-adjusted debt/EBITDA of between 3-4x. For those two ratios, Agder Energi outperformed Scope's expectations from August 2017. At segment level, however, the grid business underperformed in Q1 2018 due to a tough winter with heavy snowfall and power outage in the Agder region.

Regarding cash flow and liquidity, Scope forecasts a continuation of positive FOCF, but highlights that discretionary cash flow has been constrained by high dividends in the past. In May 2018, the company announced a new dividend policy that eliminates the dividend floor and will be based on adjusted underlying profit after-tax (IFRS). While the removal of the minimum dividend is positive, Scope anticipate minimal impact on our assessment of available liquidity, which remain supported by the company's sizable undrawn credit lines and good access to bank and bond markets.

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 assigns BBB+/Stable rating to Agder Energi, 22 August 2017

Government Related Entities Methodology, July 2018

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Outlook

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

A rating upgrade may be warranted if Agder Energi deleveraged to below 3.0x on a sustained basis, bolstered, for instance, by lower investment needs and dividend payouts.

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

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	• Relatively high dividend payout historically coupled with sizeable investment needs which has put discretionary cash flow in negative territory • General exposure towards the highly cyclical power generation industry • Loss-making contracting services in the Norwegian part of Otera (but expected to be sold off)

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 well above 4x and negative FOCF/SaD for a prolonged period

Financial overview

			Scope estimates	
Scope credit ratios	**2016**	**2017**	**2018F**	**2019F**
EBITDA/interest cover (x)	9.3x	11.2x	10.8x	9.8x
SaD/EBITDA	3.9x	3.6x	3.2x	3.7x
Scope-adjusted FFO/SaD	20%	21%	21%	14%
FOCF/SaD	8.2 %	0.7 %	11.0 %	2.7%
Scope-adjusted EBITDA in NOK m				
EBITDA	2,205	2,597	2,797	2,552
Add: operating lease payments in respective year	83	75	62	62
Scope-adjusted EBITDA	2,288	2,672	2,859	2,614
Scope-adjusted debt in NOK m				
Reported gross financial debt	9,143	9,240	9,300	9,444
Less: cash, cash equivalents	-543	-61	-434	-149
Add: cash not accessible	20	9	10	10
Add: pension adjustment	0	0	0	0
Add: operating lease obligations	325	325	268	268
Scope-adjusted debt	8,945	9,513	9,145	9,574
Liquidity in NOK m				
Unrestricted cash position	523	52	424	149
Undrawn committed lines	1,500	2,320	2,500	2,500
Total available liquidity	2,023	2,372	2,924	2,649
Liquidity ratios				
Liquidity (internal + external)	1.5 x	1.0x	1.9x	1.9x
Liquidity (internal)	0.6x	0.3x	0.6x	0.4x

Developments since Scope's previous rating report

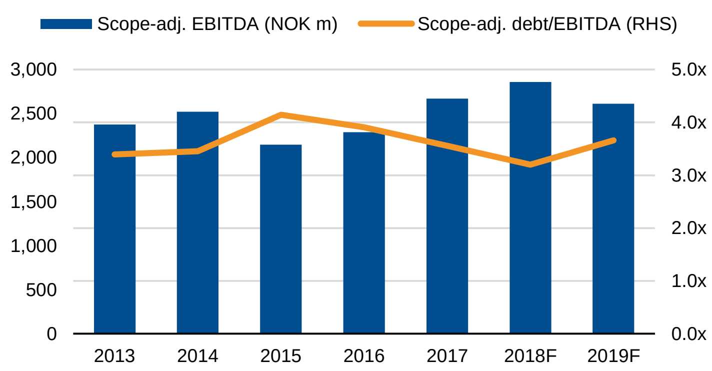
Agder Energi's latest financial figures (FY2017 and Q1 2018) have broadly confirmed Scope's expectations for key credit metrics as per its initial rating report in August 2017. The group has recently enjoyed relatively high production levels and power prices, boosting its profits in production, and has also reduced its short-term power price hedging level. Scope views positively that the EBITDA contribution from production compensated for the recent decline in the grid business, with the latter affected by power outage during winter 2018 due to heavy snowfall in the region causing fallen or bending trees onto its power lines.

Despite the grid segment's underperformance in 2018, the overall group's leverage and interest cover aligned with Scope's expectations. Still, Scope notes that the rising EBITDA share of unregulated power production will affect the group's overall industry risk and business risk profiles if this leads to a longer-term change in the agency's normalised segment-split assessment. However, this is not Scope's base case, as Agder Energi Nett is expected to revert back to significantly higher profitability in 2019 on our estimates.

Agder Energi made two separate announcements in 2018, which Scope assesses overall to be credit-neutral:

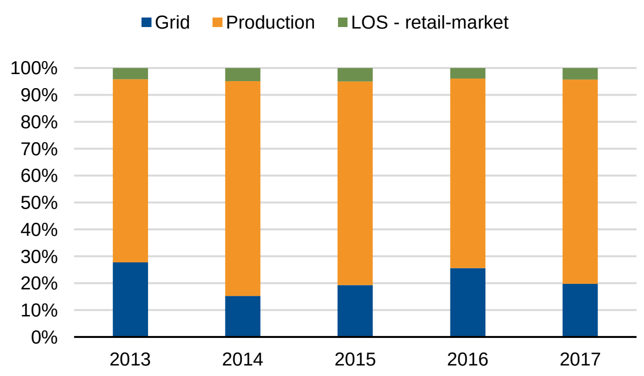
- March 2018: The municipality owners in both Agder Energi and Skagerak Energi decided to no longer pursue the "merger-talks" initiated by Statkraft. In Scope's opinion, this reduces transactional event risk in the short-term, though the agency still highlights the general consolidation trend in the industry.
- May 2018: The company announced it will sell 51% of the Norwegian part of Otera (the loss-making contractor business) to Roadworks. While Scope views this positively, there is no material rating impact. While the transaction is expected to generate some cash inflow in Q3 2018, Scope believes that, more importantly, this business is better handled outside of the group, expecting a complete exit at a later stage.

Figure 1: Scope-adjusted leverage development



Source: Company, Scope

Figure 2: Segment split (in %) based on EBITDA

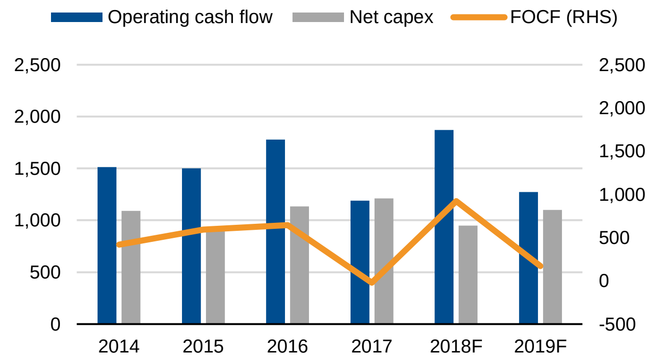


Source: Company, Scope

Updated Scope forecast

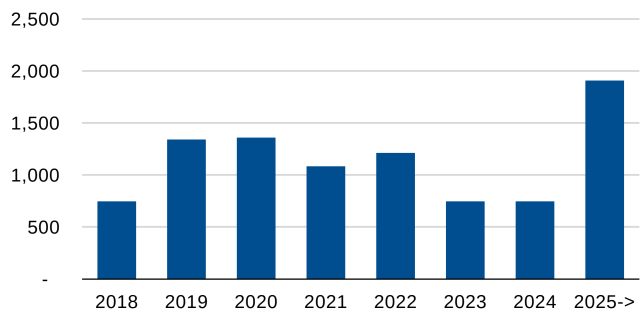
Key changes to Scope's financial estimates in the short to medium term relate to 2018 figures. Higher anticipated production and achieved prices will likely generate higher group EBITDA than Scope's previous estimates, despite lower profits in the grid business. Net income is expected to be affected by negative mark-to-market on hedging contracts. In terms of cash flow, Scope has increased estimates on taxes paid in 2019. Moreover, management introduced a new dividend policy in May 2018 applying to the years 2018-2020. The new policy no longer has a dividend floor (NOK 400m previously) and will be based on approximately 70% of underlying IFRS after-tax profit adjusted for certain unrealised effects and one-off impacts. Scope estimates that the new policy, together with revised estimates, will not change overall discretionary cash flow materially, but the agency welcomes the elimination of the dividend floor.

Figure 3: Scope-adj. EBITDA/interest coverage (NOK m)



Source: Company, Scope

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



Source: Company, Scope

Scope's view on the group's liquidity has not changed materially since the last review, with Agder Energi well covered in the short term. As of Q1 2018, Agder Energi had NOK 0.2bn in cash and NOK 2.5bn in undrawn committed credit lines, which together more than covers its NOK 1.8bn in short-term debt.

New government related entity methodology from Scope

On 13 July 2018, Scope published its new government-related entity methodology, which now also applies to Agder Energi alongside the agency's utility-specific corporate methodology. The new methodology was used to assess the level of support and the corresponding uplift from the stand-alone rating. Scope still used its bottom-up approach to analyse Agder Energi, and the one notch-uplift assigned for the 54.5% municipality ownership in Agder Energi has not changed.

Regarding likelihood of support, Scope considered Agder Energi's importance in Norway, political willingness, and the potential for political/investor turmoil should support be withheld. Further, Scope assess Norway's Industrial Licensing Act, which states that hydropower assets must be owned two-thirds by the public at all times. Scope also takes into account that Agder Energi's grid business is subject to monopoly regulations.

Based on the new methodology grid, Scope assesses both the capacity and likelihood of government support at 'medium', which after adjustment corresponds to a one-notch uplift from Agder Energi's standalone rating of BBB.

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