2 February 2023 Corporates

DNV Group AS
Norway, Business Services

SCOPE A STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	21.7x	26.0x	28.8x	18.3x
Scope-adjusted debt/EBITDA	Net cash	Net cash	Net cash	Net cash
Scope-adjusted funds from operations/debt	Net cash	Net cash	Net cash	Net cash
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	Net cash	Net cash

Rating rationale

DNV's leading global position in maritime classification, which is the cornerstone of the company, is the primary driver of the rating, with the business risk profile assessed at BBB+ and financial risk profile at AA. In addition, through its Energy System business, DNV has a key role in the increasingly secular transition to cleaner energy among its industry clients (positive ESG factor). DNV is pursuing a growth strategy primarily in other business areas that will sacrifice some historical profitability in the next few years, as the company has also significantly increased its headcount in 2022. DNV's conservative financial profile partly offsets this margin stagnation, as the company is expected to continue to have a net cash position, robust liquidity and strong cash flow. We expect the issuer to sustain financial leverage as measured by Scope-adjusted debt/EBITDA of well below 1.0x, with a net cash position.

Outlook and rating-change drivers

The Stable Outlook incorporates the expectation that the issuer will continue to have a net cash position in the next few years, driven by relatively stable profit margins, while maintaining its leading position in maritime classification/services. Moreover, it reflects the assumption that the issuer will maintain and follow its conservative financial policy, which includes significant headroom under its own maximum leverage of 2.0x. It also assumes that there will be no dividends in the near term and that DNV will maintain adequate liquidity, notably via significant cash on hand and committed loans.

A positive rating action is seen as remote but could be triggered if DNV sustained its net cash position while increasing profitability through successful execution of organic and inorganic growth, which would also improve diversification. This would likely be in connection with DNV's historically conservative financial policy regarding shareholder returns and indebtedness, M&A and capex. This could also be driven by a sustained recovery in the group's profitability, signalling that DNV had gained significant traction in its targeted growth business areas.

A negative rating action might be warranted if Scope-adjusted debt/EBITDA were to approach towards 1.0x, particularly due to a change in financial policy.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
02 Feb 2023	New rating	A/Stable

Ratings & Outlook

Issuer	A/Stable
Short-term debt	S-1
Senior unsecured debt	A

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Related Methodology and Related Research

General Corporate Rating Methodology; July 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• A leading global position and longstanding reputation in maritime services/classification • Requisite/non-discretionary nature of services in certification and assurance, which also helps with revenue visibility • High level of cash and ample liquidity buffer at group and parent levels • Ultimate ownership structure ensuring prudent financial policy and removing pressure for shareholder returns • Increasing importance of ESG and related compliance; accelerated push to cleaner energy in macro environment, which should boost the Energy Systems business (positive ESG factor)	• Relatively low profit margins to remain stagnant or potentially face minimal decline in next few years of expansion • Concentration on Maritime business area, especially as driver of profitability • Reliance on M&A for a significant portion of top line growth in other business areas where the market is more fragmented • Risk of lack of focus through a range of business areas and small or non-core ventures • Room to improve in terms of recurring revenue base, although some business areas are project-based by nature

Positive rating-change drivers	Negative rating-change drivers
• Remote • Sustained net cash position, alongside increasing profit margins and execution of organic and inorganic growth strategy	• Scope-adjusted debt/EBITDA approaching towards 1.0x

Corporate profile

DNV’s stated mission to protect life, property and the environment is reflected in its various business areas. It is the leading classification society and advisor in the shipping and maritime industry and also offers testing, certification and advisory services to the energy and oil and gas sectors. As a globally recognised certification body, DNV aids customers in the areas of business assurance and supply chain. Additionally, DNV operates as a software and digital solutions provider and an independent expert in assurance and risk management. The company has about 13,000 employees in over 100 countries. DNV generated revenue of over NOK 21bn in 2021.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	31.9x	21.7x	26.0x	28.8x	18.3x	20.0x
Scope-adjusted debt/EBITDA	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
Scope-adjusted funds from operations/debt	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
Scope-adjusted EBITDA in NOK m						
EBITDA	3,529	3,481	3,673	4,130	4,480	4,965
Operating lease payments	0	0	0	0	0	0
Other items: adjusted for capitalised development costs	-421	-237	-198	-290	-350	-350
Scope-adjusted EBITDA	**3,108**	**3,244**	**3,475**	**3,840**	**4,130**	**4,615**
Funds from operations in NOK m						
Scope-adjusted EBITDA	3,108	3,244	3,475	3,840	4,130	4,615
less: (net) cash interest paid	-79	-107	-104	-75	-167	-173
less: cash tax paid per cash flow statement	-610	-671	-738	-842	-920	-1,007
less: pension interest	-18	-42	-30	-58	-58	-58
add: depreciation component of operating leases	0	0	0	0	0	0
Funds from operations	**2,400**	**2,424**	**2,604**	**2,864**	**2,985**	**3,376**
Free operating cash flow in NOK m						
Funds from operations	2,400	2,424	2,604	2,864	2,985	3,376
Change in working capital	247	1,419	-351	-798	-622	-449
Non-operating cash flow	0	0	0	-	-	-
less: capital expenditure (net, tangible assets)	-127	-101	-144	-204	-350	-250
less: lease amortisation	-421	-466	-437	-493	-538	-581
Scope-adjusted free operating cash flow	**2,100**	**3,275**	**1,673**	**1,369**	**1,475**	**2,097**
Net cash interest paid in NOK m						
Interest paid per cash flow statement	129	133	120	126	218	224
Interest received per cash flow statement	-50	-26	-16	-51	-51	-51
Interest expense, pensions	18	42	30	58	58	58
add: interest component, operating leases	-	-	-	-	-	-
Net cash interest paid	**97**	**150**	**134**	**133**	**225**	**231**
Scope-adjusted debt in NOK m						
Reported gross financial debt	1,982	1,747	4,767	4,991	5,171	5,344
less: cash and cash equivalents	-3,809	-5,365	-6,936	-7,736	-7,956	-8,878
add: non-accessible cash	1,254	737	735	820	843	941
add: pension adjustment	603	814	67	70	74	77
add: operating lease obligations	-	-	-	-	-	-
Scope-adjusted debt	**30**	**-2,067**	**-1,368**	**-1,854**	**-1,868**	**-2,515**

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Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g., raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g., in production)		Health and safety (e.g., staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g., transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g., business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

ESG profile supportive of market and competitive position

Through DNV's business area of Energy Systems, the company plays a role in and benefits from industry transition to more sustainable, green energy such as renewables. As a market leader in renewable energy consulting and certification, this positively impacts DNV's competitive position and credit profile.

Transparency is high at DNV with regards to environmental, social and governance areas and disclosures. We highlight the issuer's clear objectives and track record regarding the reduction of carbon emissions, including the use of 100% renewable energy by 2025 (currently approx. 60%), a 50% reduction of its carbon footprint, and eventually becoming climate positive. Its financial policy includes guidance on dividend policy, leverage and rating commitment. The level of financial and other disclosures is also high, and the issuer has a sufficiently designed supervisory structure including the presence of independent board members.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e., those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB+

DNV is captured under the industry risk profile of business services, which is assessed at BBB. It reflects the medium entry barriers of a service built around expertise (highly skilled/specialised) and the medium barriers to entry in many asset-light service models.

DNV faces market entry barriers based on reputation and acceptance of a limited number of competitors in the testing, inspection and certification industry. DNV is therefore able to scale its know-how across regions or projects for its clients. In addition, there is limited substitution risk in maritime classification/services and business assurance as vessel classification and other certifications are ongoing requirements for customers to operate their own businesses or conduct trade.

Global leadership position in maritime classification, forming the backbone of profitability

DNV's competitive position is driven by its global leading position in maritime classification/services. The company commands about 20%-25% market share of classification services globally, and the company has reported that among new builds, DNV captured an outsized share of about 23-33% in 2021-2022 due to a recent boom in container vessels.

The market is consolidated, with the top six players' combined market share accounting for more than 80%. Main competitors include Lloyd's Register (LR), American Bureau of Shipping (ABS) and Nippon Kaiji Koykai (NK), followed by Bureau Veritas (BV) and Registro Italiano Navale (RINA). Having a leading presence worldwide puts DNV in the range of other companies that have very strong global, rather than regional positions.

In other business areas, DNV has a more mixed market share profile, largely due to end-market fragmentation, but is overall anchored by its legacy and entrenched position as a market leader in maritime classification/services and product assurance and certification, as well as several niches.

DNV sits at the higher/premium price point in the market, as it tends to handle complicated vessels and classifications. The limited options in longstanding and reputable classification service providers protects DNV's pricing strategy, as well as profitability in the Maritime segment and DNV Group as a whole. DNV's established know-how also allows it to scale relatively easily to projects or classifications for other vessels of a carrier or to a new region with existing clients without significant administrative hurdles or barriers to entry.

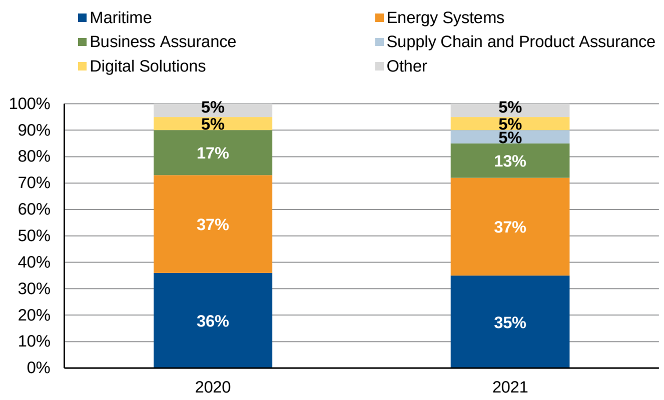
Diversified geographically and by service offering, though still reliant on end-markets of Maritime, Energy Systems business areas

DNV's business model reflects a balance in geographies and a range of services. The three regions of Europe and Africa, Asia Pacific and North and South America contributed roughly equally to 2021 revenues at 27%, 25%, and 21% respectively, with additional revenues attributed to headquarters in Norway split globally.

However, it is still heavily skewed towards the end-markets of the Maritime business area and to a lesser extent towards those of Energy Systems. In 2021, the Maritime and Energy Systems business areas accounted for 35% and 37% of revenue, respectively. The company's expansion in Business Assurance, Supply Chain and Product Assurance, Digital Solutions and ventures in The Accelerator such as cyber security is expected to further diversify revenue and reduce DNV's dependence on its traditional core segments, albeit with a manageable impact on near-term profitability.

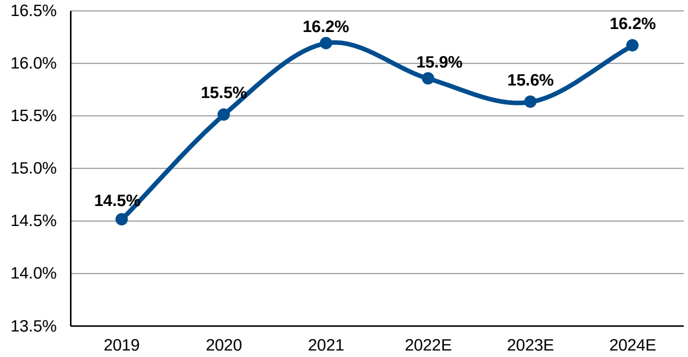
As DNV is a service-oriented business model, relationships are tended to in a customer-centric manner, and there is collaboration with clients to make use of digital solutions and channels to improve the customer journey, as well as DNV's cost competitiveness. Distribution methods for services also adapted to changing conditions in the pandemic, including remote audits, drone inspections, and AI-driven support, which were all scaled up. Aside from the value creation for the customer through project engagements, this approach can also benefit cross-sell and market share within certain market segments as customer satisfaction and relationship strength grow.

Figure 1: Segment diversification by revenue



Source: DNV

Figure 2: Scope-adjusted EBITDA margin



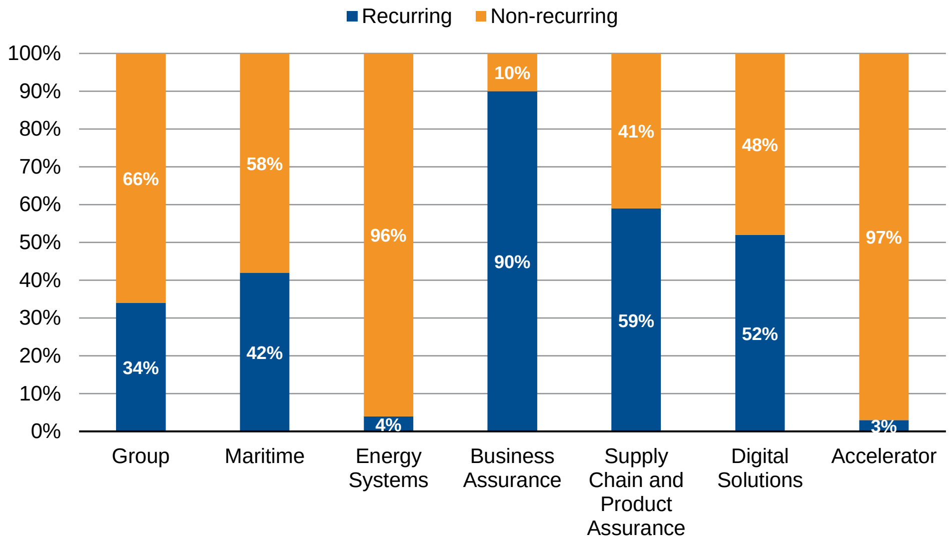
Sources: DNV, Scope (estimates)
Sa : Scope-adjusted (for capitalisation of intangibles)

Projected reported EBITDA margin is expected to stay roughly stable 2022 on a year over year basis, followed by some recovery over the forecast. There is more of a dip in Scope-adjusted EBITDA margin (approx. 30 bps) due to the expected increase in capitalized development costs. This delay in profitability improvement is due to the company's plan to expand its business areas primarily outside of Maritime and the related spike in headcount in 2022. As margins are lower in some of the other business areas, there could be a slight dilutive effect on group profitability, even with the stable Maritime business area providing some offsetting impact.

Relatively stable profit margin, supported by high revenue visibility

In addition, due to the mandatory nature of certain DNV services and expertise, revenues are very visible and cyclical. Maritime has a multi-year structure, typically of five years, for fleet in service classifications, while Business Assurance reflects a three-year cycle. Other services are more short term and project-based, with more volatility tied to projects, depending on the degree of reliance on either capex or opex budgets at the customers. The volatility of earnings is therefore low to medium.

Figure 3: Revenue by contract type, 2021



Source: DNV

DNV Group overall has about 34% recurring revenues (5% digital services, 29% analog services), with a wide range among business areas. The relatively high share of recurring multiyear revenues of about one third provide stability and visibility to DNV's performance but is much lower than companies focusing on software/IT services, for example, though this is offset in part by high retention metrics in several segments.

In terms of churn or retention among the relevant business areas, the retention rate for fleet in service in Maritime is very high, and other services also build on long-term client relations. Business Assurance has high contract retention as well, and the Digital Services business area also benefits from low revenue churn.

Financial risk profile: AA

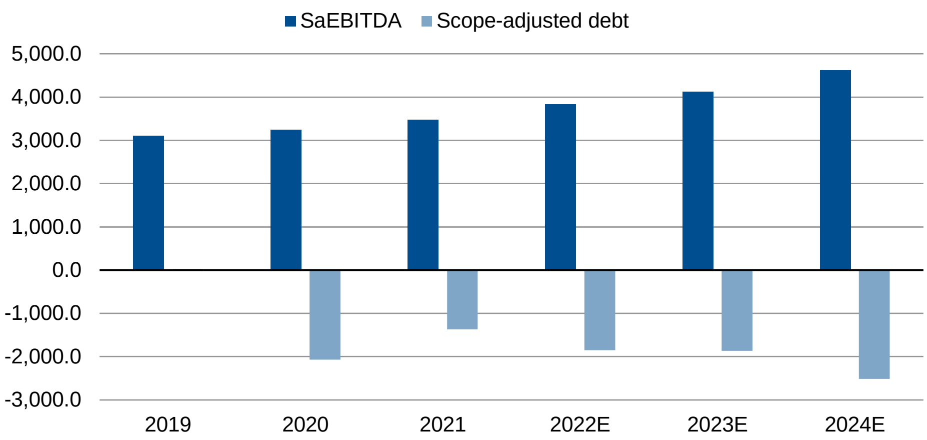
Conservative financial policy underpins net cash position, in conjunction with strong cash flow generation

The financial risk profile reflects DNV's forecasted trajectory as DNV pursues growth as part of its strategic plan to 2025. 2022 benefitted from organic and inorganic growth and maintained stability in profitability, though we still factor in macroeconomic risks and potential pressures on the company's growth plan in 2023-2025.

Our rating scenario assumes the following:

- Per annum revenue growth of over 10% in 2022E, then in the high single digits in 2023E to 2025E, reflecting outperformance in Maritime and the push to grow both organically and inorganically, particularly in business areas outside Maritime, such as cyber security and supply chain
- EBITDA margin stagnation in 2022 due to the significant headcount increase and high pace of expansion into new businesses and business areas primarily outside the Maritime segment with lower margins; improvement of about 100 bps over the forecast
- Yearly working capital outflow in 2022-2025 related to expansion, improving over the period
- Capex (tangible assets) at less than 2% of revenue per year
- No dividends/group contributions
- Discretionary M&A over forecast period of about NOK 7bn to support inorganic growth
- No issuance of new debt, assuming the NOK 2,998m term loan would be refinanced at the same amount

Figure 4: Scope-adjusted debt vs. EBITDA (in NOK m)



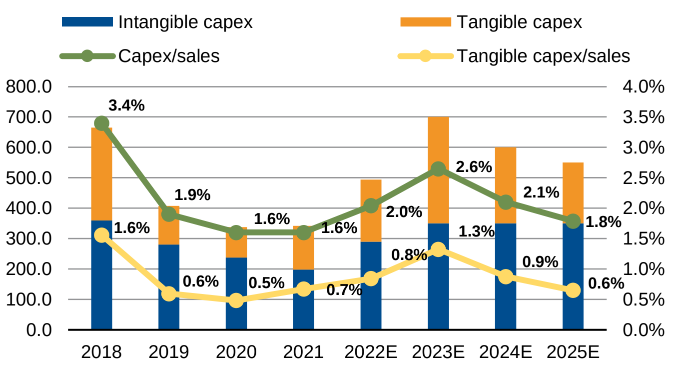
Sources: DNV, Scope (estimates)

Despite the forecasted near-term stagnation to slight decline in profitability, DNV is still expected to maintain a net cash position as measured by Scope-adjusted debt/EBITDA in the forecast period.

Interest coverage is expected to stay very high at near or above 20x, as debt is expected to stay relatively constant and EBITDA to improve again after 2022. We have already incorporated rising interest costs in the forecast, with the floating-rate term loan comprising all of the company's external debt and a forecasted all-in rate of 4.3% beyond 2022.

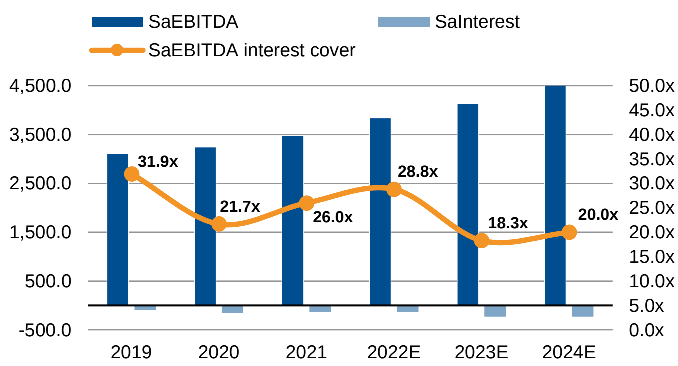
Increased working capital needs to support the expansion into business areas other than Maritime will continue throughout the forecast. We expect cash flow generation to grow further in the next several years as both profitability and working capital management improve. Strong cash flow is also supported by limited debt issuance (stable Scope-adjusted debt) and relatively low capex requirements. The low tangible capex margin (excluding intangible capex, largely related to capitalized development costs) is credit positive for the financial risk profile and also in line with other asset-light companies in the business services sector.

Figure 5: Capex (in NOK m, LHS) and Capex margin



Sources: DNV, Scope (estimates)

Figure 6: Interest cover (in NOK m, LHS)



Sources: DNV, Scope (estimates)

The company's strategic plan for growth relies in significant part on inorganic contribution, which Scope estimates will lead to significant cash outlay for M&A of NOK 7bn in the forecast period. Despite this ramp up in investment for external targets, about two thirds of top line expansion is expected to be organic.

Adequate liquidity

Liquidity is adequate given the robust coverage of short-term financial maturities by unrestricted cash, availability under its undrawn committed credit facility and free operating cash flow, as outlined in the table below. The only sizeable maturity is the term loan in 2024, which we expect will be refinanced.

Balance in NOK m	2021	2022E	2023E
Cash and equivalents (t-1)	5,365	6,936	7,736
Restricted cash (t-1)	-737	-735	-820
Free operating cash flow	1,673	1,369	1,475
Open committed credit lines (t-1)	3,000	3,000	3,000
Short-term debt (t-1)	439	358	402
Coverage, internal	**1434%**	**2116%**	**2089%**
Coverage, internal + external	**2117%**	**2954%**	**2835%**

Supplementary rating drivers: +/- 0 notches

No supplementary rating drivers apply to the rating.

Long-term and short-term debt ratings

Senior unsecured debt rating: A

We have assigned an A instrument rating on senior unsecured debt, in line with the issuer rating. The instrument rating is applicable to all senior unsecured debt issued by DNV.

Short-term debt rating: S-1

Based on adequate liquidity and DNV's A/Stable issuer rating, we have assigned a short-term rating of S-1. The short-term rating reflects the company's sustainable liquidity profile in terms of short-term debt coverage and its good access to external corporate funding. Including all internal and external sources of liquidity, coverage of short-term debt is projected at over 200% each year over the 2022-2025 forecast period.

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