Hafslund AS
Kingdom of Norway, Utilities

SCOPE A- POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	17x	31x	20x	17x
Scope-adjusted debt/EBITDA	1.2x	0.5x	1.0x	1.4x
Scope-adjusted free operating cash flow/debt	67%	102%	-10%	-3%
Liquidity	>200%	>200%	>200%	>200%

Rating rationale

The rating is driven by our view on Hafslund's significantly improved financial risk profile. Granted, the utility's financials will remain volatile and strongly dependent on external factors such as achievable power prices. But we are comfortable assessing the financial risk profile at A-, backed by expectations of persistent elevated electricity market prices in the Nordics. Combined with an unchanged business risk profile assessment of BBB+ and a one-notch uplift due to the utility's status as a government-related entity, we deem Hafslund's issuer rating commensurate with a rating of A-. The Positive Outlook signals further rating upside should Hafslund sustain its leverage at a low level of around 2.0x beyond 2025E.

Outlook and rating-change drivers

We maintained the Positive Outlook on the rating given further potential rating upside. The Positive Outlook reflects the possibility that Hafslund will retain a stronger financial risk profile over a prolonged period should achievable power prices remain at elevated levels for several more years. In addition, a stronger financial risk profile could be retained if Hafslund did not use the large headroom on its leverage for massive capex expansion. Overall, we see a good chance that Hafslund will keep its leverage, as measured by the Scope-adjusted debt/EBITDA ratio, at around 2.0x.

A rating upgrade could be warranted if credit metrics, as exemplified by a Scope-adjusted debt/EBITDA ratio of around or below 2.0x, were sustained. This implies that EBITDA would stay higher than NOK 10bn even under more normal power generation prices, whilst the company seeks significant external funding for growth projects over the next few years.

A negative rating action, such as a revision to a Stable Outlook, could be triggered if our expectation of leverage remaining at or below 2.0x (Scope-adjusted debt/EBITDA) became less likely. This could be driven by significantly lower-than-expected power prices, higher-than-expected capex, or structural transactions that weigh on the company's financial risk profile. Further rating downside could evolve if Hafslund's credit metrics were expected to deteriorate strongly, e.g. through an increase in leverage to around 4.0x. Alternatively, rating pressure would arise if the company lost its status as a government-related entity, a change that is deemed to be remote.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
5 Jun 2023	Upgrade	A-/Positive
7 Jun 2022	Outlook change	BBB+/Positive
9 Jul 2021	New	BBB+/Stable

Ratings & Outlook

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

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Related Methodologies

General Corporate Rating Methodology; July 2022

European Utilities Rating Methodology; March 2023

Government Related Entities Rating Methodology; May 2022

Related Research

ESG considerations for the credit ratings of utilities; April 2021

European utilities: continued electricity price hedging promises producer gain, consumer pain, Apr 2023

Nordic utilities: north-south price gap benefits southern generators; TSOs also gain, Nov 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Norway's 2nd largest power producer; leading position in the Nordics as a profitable and low-cost hydro power generator (positive ESG factor) with significant water reservoir capacity • Long-term, supportive and committed municipality owner, justifying an uplift from the standalone credit assessment • Widened outreach through new exposure to district heating and cooling business via Celsio (formerly Fortum Oslo Varme) • Very strong profitability – as measured by EBITDA margin of more than 70% and SaROCE of about 15% on average • Indirect exposure to robust grid operations through recurring dividend inflow from its 50% ownership in Norway's largest electricity distribution grid company (Elvia) via Eidsiva	• Large exposure to the volatility in power prices for its unhedged power production output • Weak cash flow and weak financial credit ratios when market prices are low, as exemplified with FY 2020 numbers • Limited geographical outreach within and outside of Norway

Positive rating-change drivers	Negative rating-change drivers
• Sustained leverage of around 2.0x or lower	• Outlook reversion to Stable: Non-materialisation of a leverage of about 2.0x or lower • Ratings pressure as expressed through a Negative Outlook or even downgrade: Significant deterioration of the leverage to around 4.0x • Loss of GRE status due to change of ownership which is deemed remote

Corporate profile

Hafslund is a Norwegian utility that is wholly owned by the City of Oslo. Although the company's corporate history is very long, the group structure changed significantly in 2019 with the swap of assets with Eidsiva Energi, thereby forming two companies with a primary focus on either power generation or grid operation. Today, Hafslund is Norway's second largest power producer, with operating responsibility for an annual hydro power production of about 20 TWh. It also has a joint venture in grid operations (Elvia) through its 50% stake in Eidsiva Energi AS (BBB+/Stable) and has a 49% interest in Fredrikstad Energi AS. Its main hydropower assets are placed in Hafslund Eco Vannkraft (of which Eidsiva Energi owns 43.5%). In Q2 2022, Hafslund also became the majority owner (60%) of Celsio (previously known as Fortum Oslo Varme), with Infranode and HitecVision each owning 20%.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	4x	17x	31x	20x	17x	12x
Scope-adjusted debt/EBITDA	9.1x	1.2x	0.5x	1.0x	1.4x	2.1x
Scope-adjusted debt (excluding shareholder loans)/EBITDA	6.6x	0.7x	0.2x	0.6x	1.0x	1.6x
Scope-adjusted funds from operations/debt	-2%	76%	143%	0%	11%	9%
Scope-adjusted free operating cash flow/debt[1]	-8%	67%	102%	-10%	-3%	-6%
Scope-adjusted EBITDA in NOK m						
EBITDA	1,624	9,611	19,806	14,753	12,274	9,974
Other items	525	513	450	500	550	600
Scope-adjusted EBITDA	**2,149**	**10,124**	**20,256**	**15,253**	**12,824**	**10,574**
Funds from operations in NOK m						
Scope-adjusted EBITDA	2,149	10,124	20,256	15,253	12,824	10,574
less: (net) cash interest paid	(568)	(605)	(664)	(777)	(765)	(854)
less: cash tax paid per cash flow statement	(2,047)	(273)	(4,701)	(14,535)	(10,119)	(7,740)
Funds from operations (FFO)	**(466)**	**9,246**	**14,891**	**(60)**	**1,941**	**1,979**
Free operating cash flow in NOK m						
Funds from operations	(466)	9,246	14,891	(60)	1,941	1,979
Change in working capital	(555)	(650)	(527)	134	49	45
Non-operating cash flow	116	264	(2,806)	-	-	-
less: capital expenditure (net)	(622)	(590)	(870)	(1,500)	(2,500)	(3,200)
less: lease amortisation	n/a	(19)	(29)	(29)	(29)	(29)
Free operating cash flow (FOCF)	**(1,527)**	**8,251**	**10,659**	**(1,455)**	**(540)**	**(1,204)**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	568	605	664	777	765	854
Change in other items	-	-	-	-	-	-
Net cash interest paid	**568**	**605**	**664**	**777**	**765**	**854**
Scope-adjusted debt in NOK m						
Reported gross financial debt	15,063	13,591	16,029	13,670	15,255	16,990
less: subordinated (hybrid) debt	5,364	5,264	7,339	5,422	5,422	5,422
less: cash and cash equivalents	(1,008)	(6,988)	(13,497)	(4,319)	(2,695)	(601)
add: non-accessible cash	57	364	558	279	140	70
add: pension adjustment[2]	-	-	-	-	-	-
Scope-adjusted debt (SaD)	**19,476**	**12,231**	**10,429**	**15,052**	**18,122**	**21,881**

[1] Historical metrics have been restated due to the inclusion of lease amortisation.
[2] No adjustments for pension obligations given a constant overfunding of outstanding pensions.

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Environmental, social and governance (ESG) profile[3]

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)

Cheap and clean electricity generation

As a producer of clean hydroelectric power, Hafslund and its business model revolve around sustainability (ESG factor), fulfilling the UN's Sustainable Development Goal #7 (Affordable and clean energy). This is signalled by the company's very low carbon intensity, with a specific carbon intensity of less than 20g CO_2e/kWh. Such a position: i) rules out transition risks; and ii) ensures high utilisation of the hydropower generation portfolio, a high margin, robust cash flow generation and limited headwinds from regulation and political interference. Moreover, the exposure to hydropower generation guarantees a consistent GRE status.

Growth areas focused on sustainability

While the potential for hydro power generation in Norway has largely been exploited, Hafslund focusses its growth projects on other sustainable areas such as offshore wind, solar, electric charging and carbon capture.

Heat business aiming at circular economy

Moreover, Hafslund's exposure to the generation of district heating and cooling is primarily based on waste incineration, which promotes a circular economy. Currently, the company builds the world's first climate-positive waste incineration plant with carbon capture and storage capabilities.

Very strong ESG rating

We acknowledge Hafslund's well-integrated ESG framework and ambitions, including publications of green financing reports. The company has received an ESG Second Party Opinion from Cicero, attaining a 'Dark Green Rating' (highest possible outcome). The company has issued one green bond, with proceeds used exclusively for low-carbon solutions and climate change adaption. All projects take into account environmental concerns, social impacts, landowners and potential local resistance.

No issues on Governance

The company applies market standard Governance Principles. We did not observe any negative credit-relevant factors pertaining to Corporate Governance.

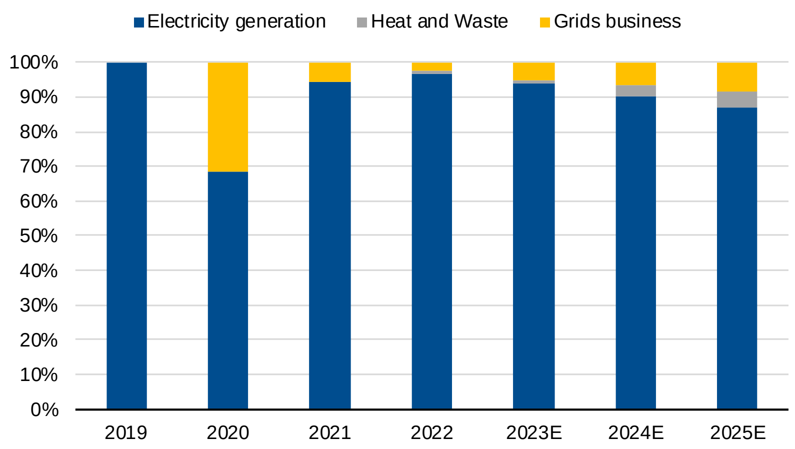
[3] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB+

Leading electricity and district heating supplier in Norway

The rating continues to reflect a BBB+ business risk profile. The successful integration of Norway's largest district heating and cooling company Celsio (formerly Fortum Oslo Varme) has put Hafslund's business on a broader footing and will likely develop into a major growth driver for the company. This is paired with gradual growth in cash generation via an indirect exposure to regulated grid activities and associated dividend payments from equity stakes in associated companies, primarily Eidsiva Energi. Whilst Hafslund's cash flow exposure will remain strongly geared towards its core business in unregulated power generation from hydropower plants, the growing cash flow exposure to power distribution and district heating provides the business with stability (see figure 1). This is particularly important in light of Hafslund's large exposure to volatile electricity generation prices and its core exposure to spot market prices due to limited hedging activities. Whilst we assume supportive electricity prices over the next few years in a range largely above the historical average, adverse price developments, e.g. due to heavy rainfall, cannot be ruled out.

Figure 1: Relative segment split*



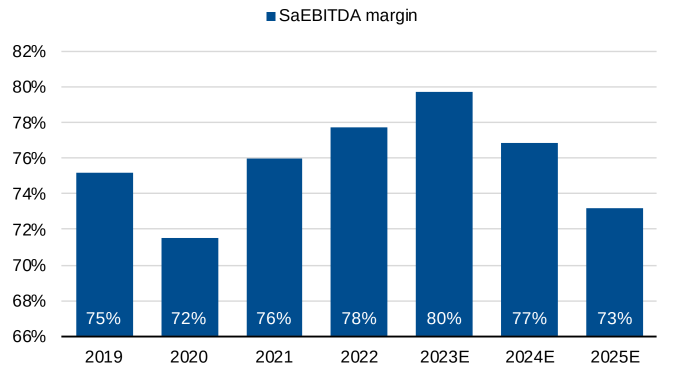
* EBIT for electricity and heat business and dividend income for the grids business used as proxies for the segment split

Sources: Hafslund, Scope estimates

Strong profitability

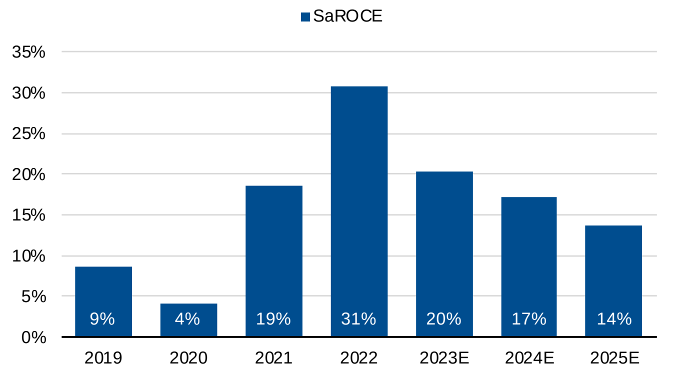
Favourable market fundamentals and the company's setup will likely translate into persistent strong profitability as measured by the Scope-adjusted EBITDA margin and Scope-adjusted ROCE. The consolidated group EBITDA margin (excluding income from associates) reliably stands above 60% given the low operating cost base of Hafslund's core business in electricity generation. Operating costs for hydropower production, such as for pumping, energy purchases and transmission costs, are relatively low and vary with power prices and volume. As the cost base is comparatively low in absolute terms, margin fluctuation is also rather low. Granted, district heating and cooling is a business that is exposed to much higher operating costs pertaining to raw materials procurement and the operation of incineration plants, and the company's exposure to this business is growing. But we do not foresee material risks that the group EBITDA margin and Scope-adjusted ROCE will fall significantly below 60% and 15% respectively.

Figure 2: Very strong EBITDA margin



Sources: Hafslund, Scope estimates

Figure 3: Solid but more volatile return on capital employed



Sources: Hafslund, NASDAQ, Scope estimates

Geographical outreach and high exposure to industry-inherent risk remain rating constraints

Overall, the solid business risk profile remains supported by Hafslund's position as a major electricity generator in Norway (behind the leader, Statkraft). This is backed by its low-cost hydro production and flexibility from high reservoir capacity as well as direct and indirect exposures to monopolistic electricity grids and district heating and cooling. The assessment remains constrained by the industry-inherent volatility of power prices and limited business reach within and outside Norway.

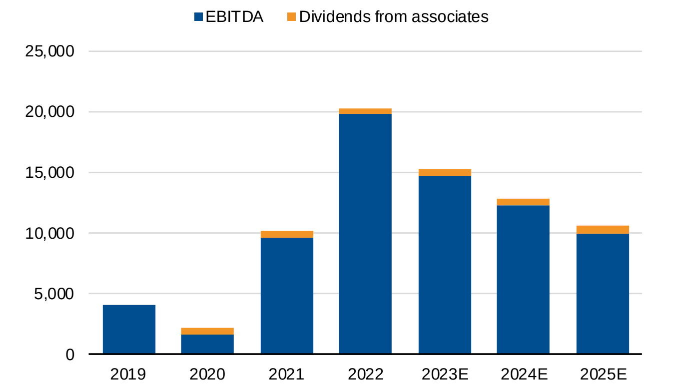
Financial risk profile: A-

Adjustments

In terms of adjustments and the calculation of credit metrics, we note that the company's 50% ownership in Eidsiva Energi is accounted for as an equity investment in the group's IFRS accounts. In our Scope-adjusted EBITDA, however, we include the recurring dividend from Eidsiva Energi. Our Scope-adjusted debt fully accounts for shareholder loans provided by the City of Oslo. They do not qualify as hybrid debt positions. However, as the exposure to such loans is significant and interest on them could be eliminated in case of operating losses, we show the effect on the Scope-adjusted leverage.

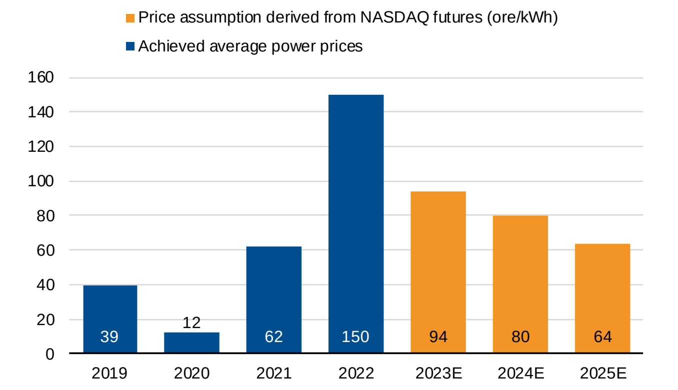
Following market developments in the Nordics, including extraordinarily high electricity prices in 2021 and 2022 due to 1) low rainfalls in the southern regions of Norway, and 2) the energy squeeze in Europe, Hafslund has benefited hugely with its low-cost hydropower generation. Together with an improved long-term price curve this leads to upward pressure on the financial risk profile. Even after the strong impact from taxes (raised 'Grunnrente tax' and extra-profit tax to all electricity sales at prices above 70 ore/kWh) but also strongly increased capex, the financial risk profile has advanced to a higher level. Based on higher-than-average achievable electricity prices and a gradually growing dividend income from regulated activities from Eidsiva we expect Scope-adjusted EBITDA to settle at a level above NOK 10bn per annum.

Figure 4: Scope-adjusted EBITDA in NOK m



Sources: Hafslund, Scope estimates

Figure 5: Electricity prices



Sources: Hafslund, NASDAQ, Scope estimates

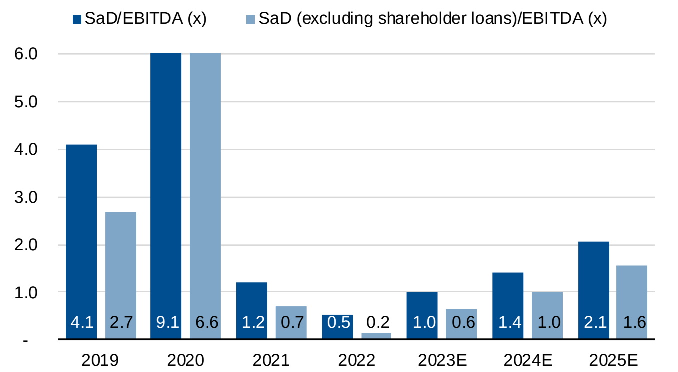
Leverage currently at a very strong level …

Hafslund's improved financial risk profile (assessed at A-) strongly supports its standalone credit assessment. Leverage, as measured by the Scope-adjusted debt/EBITDA has settled at a very low level of less than 1.0x over the past two years. This has been bolstered by a strong improvement in operating results (EBITDA) and consistent cash accrual, which brought down net debt and Scope-adjusted debt respectively. As a result, leverage is deemed to be very solid, particularly in light of the company's significant exposure to subordinated shareholder loans (NOK 7.3bn at YE 2022 of which NOK 1.9bn have already been repaid in 2023), which make up more than 30% of its total interest-bearing debt.

… but ratios expected to revert to a normalised level

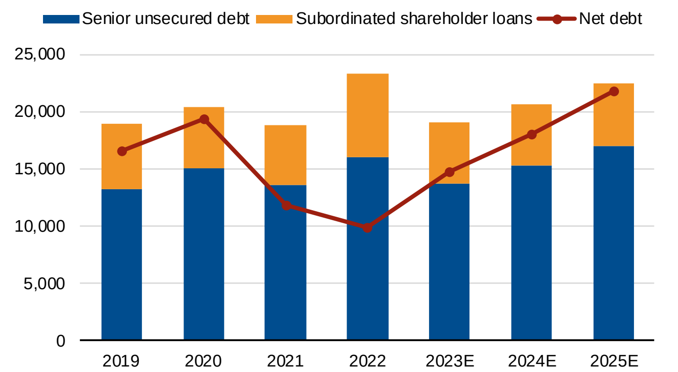
We expect continued cash flow support from elevated – albeit decreasing – electricity prices of 100-60 ore/kWh in the relevant pricing zones (NO1/NO5) over the next few years. Moreover, recurring dividends from associates – primarily Eidsiva – are expected to settle at a level of more than NOK 600m per annum. This should support a sustained EBITDA level of NOK 14bn-10bn over the forecasted period. We believe Hafslund will partially deploy its current strong leverage for growth investments, primarily backed by operating cash flows and the solid cash buffer. Even under the assumption of large tax payouts, increasing capex for growth projects, significant dividend payouts and an overall increase in gross financial debt through new debt issuance, leverage is only expected to increase to about 2.0x, keeping the company's financial risk profile in good shape. We highlight the company's leverage excluding subordinated shareholder loans which is forecasted to remain below 1.5x over the medium term.

Figure 6: Leverage expected to revert to a higher level on 'normalised' achievable electricity wholesale prices



Sources: Hafslund, Scope estimates

Figure 7: Debt development in NOK m

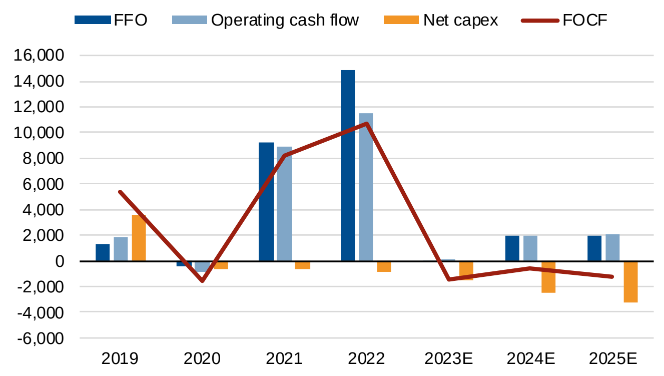


Sources: Hafslund, Scope estimates

Ample internal financing capacity but volatile FOCF

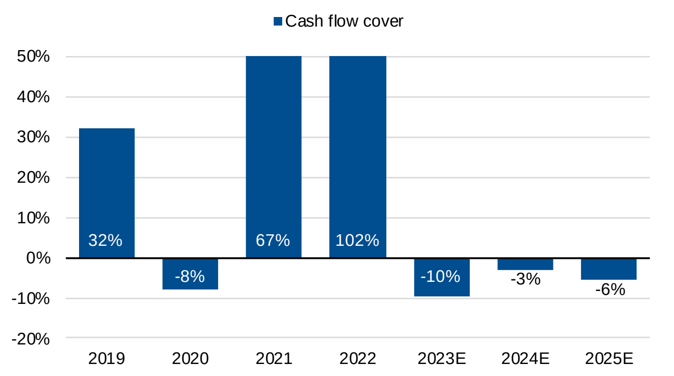
Hafslund continues to have ample internal funding capacity for capital expenditures. Historically, capex has been covered comfortably by operating cash flow. Going forward, Hafslund is likely to deploy its large leverage headroom for increased capex and opportunistic growth opportunities, which -combined with tax payments- can put some pressure on the generation of positive free operating cash flow. Nonetheless, the largest part of expected capex payouts remains covered by operating cash flow. As annual free operating cash flow and the resulting cash flow cover (FOCF/Scope-adjusted debt) remain volatile due to tax payments, working capital swings and opportunistic capex, we base its judgement about the utility's internal funding capacity on average cash flow cover of about 14% for the years 2020-25E. While we expect credit metrics to normalise from the very strong levels seen at YE 2022, it has no major concerns about a significant erosion of credit metrics.

Figure 8: Huge swings pertaining to FOCF generation (all in NOK m) …



Sources: Hafslund, Scope estimates

Figure 9: … leading to volatile cash flow cover

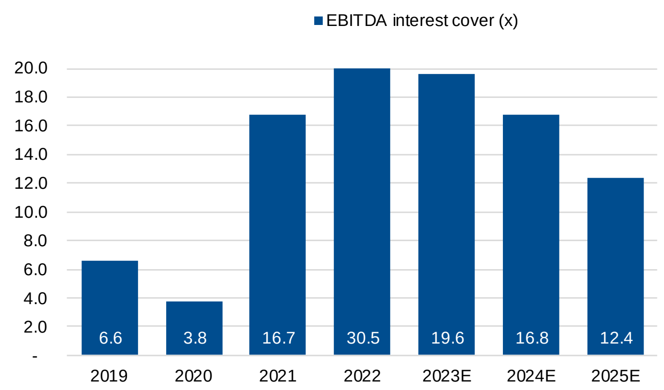


Sources: Hafslund, Scope estimates

Very strong interest coverage expected despite rising interest rates and growing debt exposure

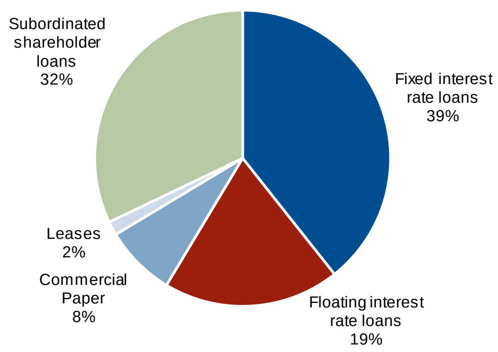
Similar to Hafslund's leverage development, its debt protection metrics have settled at a very solid level following the strong operating results in 2021 and 2022. We flag a significant exposure to floating-rate debt, which amounts to around 20% of total interest-bearing debt, and assumes a rising interest burden over next few years, driven by rising interest rates (effective interest rate is assumed to rise from 3.7% in 2022 to 4.3% in 2025E), along with increasing gross debt exposure. However, we are still forecasting that the company will comfortably sustain EBITDA interest coverage of more than 10x over the next few years.

Figure 10: Solid debt protection



Sources: Hafslund, Scope estimates

Figure 11: Significant exposure to floating rate debt at YE 2022

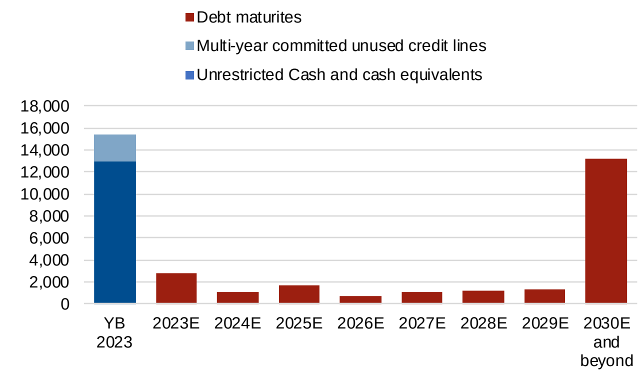


Sources: Hafslund, Scope estimates

Adequate liquidity and well-distributed maturity schedule

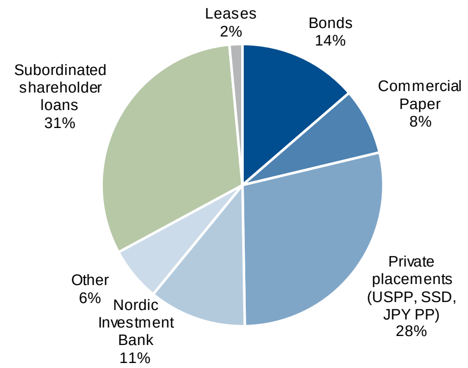
The liquidity profile remains very strong despite forecasted pressure from potential capex and large tax payments. Between 2023 and 2025, Hafslund faces refinancing needs of about NOK 5.5bn (including NOK 1.7bn of commercial paper). Such positions and FOCF that is expected to be slightly negative are comfortably covered by the company's unrestricted cash buffer of roughly NOK 13bn at YE 2022 and available credit facilities. As of YE 2022, Hafslund had access to a NOK 2,500m committed unused credit facility with expiry in November 2027 (plus the option of a one-year extension). Whilst we believe Hafslund is likely to refinance maturing debt pertaining to bonds and private placements through the issuance of similar debt positions, such positions can comfortably be covered by available cash sources. Moreover, we highlight the company's wide access to different funding sources, including bonds, bank debt, private placement debt and shareholder loans.

Figure 12: Debt maturity schedule at YE 2022 (in NOK m)



Sources: Hafslund, Scope

Figure 13: Diversified funding structure as of YE 2022



Sources: Hafslund, Scope

Balance in NOK m	2022	2023E	2024E
Unrestricted cash (t-1)	6,624	12,939	4,040
Open committed credit lines (t-1)	2,500	2,500	2,500
Free operating cash flow (t)	10,659	(1,455)	(540)
Short-term debt (t-1)	975	2,859	1,033
Coverage	**2029%**	**489%**	**581%**

Supplementary rating drivers: + 1 notch

Prudent financial policy

Hafslund's financial policy is deemed prudent. It focuses on retaining an investment-grade rating and active monitoring of quantitative and qualitative factors that affect creditworthiness in order to maintain high financial flexibility. Given the company's status as a municipality-owned entity, we see little risk that Hafslund will prioritise shareholder remuneration over creditor protection. While the company does not publicly stick to specific minimum/maximum financial thresholds, we believe it steers its capex and shareholder remuneration in a way that will not jeopardise the rating.

Status as government related entity grants one-notch uplift

The rating continues to incorporate a one-notch uplift to the standalone credit assessment of BBB+, resulting in a final issuer rating of A-. This follows the framework set out in our rating methodology for government-related entities with a bottom-up rating approach, reflecting a conservative assessment of the capacity of the public sponsor (the City of Oslo, which is the 100% shareholder) to provide a credit uplift and its willingness to provide financial support if needed (something that is deemed highly remote). The public sponsor's creditworthiness is deemed to be significantly higher than Hafslund's standalone credit assessment, signalling a high capacity for a credit uplift. We assess the public sponsor's willingness to be significant, given Hafslund's primary exposure to hydropower generation assets, which need to be in the hands of public authorities. Overall, the rating uplift is restricted to just one notch, in line with other Scope-rated Norwegian utilities with majority or full public ownership but no explicit guarantees on their debt or financial support.

Long-term and short-term debt ratings

Senior unsecured debt rating: A-

Senior unsecured debt is rated at the same level as the issuer. Hafslund's senior unsecured bonds display standard bond documentation, including pari passu and negative pledge.

Short-term debt rating: S-1

The S-1 short-term debt rating reflects the underlying issuer rating of A-/Positive and robust short-term debt coverage, as well as good access to external funding from banks and debt capital markets.

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