

Lyse AS

Norway, Utilities


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 an operator of renewable energy and is the country's sixth-largest hydroelectric power producer. Lyse has also drawn on its experience of building and operating power grid infrastructure to further establish itself as a national leader in fibre-optic broadband. At present, the company operates in three business areas: energy, power grids and telecommunications.

Key metrics

Scope credit ratios	2017	2018	Scope estimates	
			2019F	2020F
EBITDA/interest cover (x)	8.2x	11.6x	8.8x	8.9x
Scope-adjusted debt (SaD)/EBITDA	3.8x	2.3x	3.0x	2.9x
Scope-adjusted FFO/SaD	17%	34%	18%	23%
Free operating cash flow (FOCF)/SaD	-0.8 %	11.9 %	-1.7%	4.5%

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 rating of BBB+.

The rating is supported by Lyse's diversified business model, operating within energy production, power distribution and telecommunications. Currently around 40% of EBITDA is generated by the combined share of robust infrastructure segments (such as monopolistic power distribution and its fibre-optic television and broadband services), with the remaining 60% attributed to more volatile energy-producing segments. The latter is dominated by a low-cost hydro portfolio and a relatively large hydro reservoir capacity, which help to optimise production. Going forward, we expect this to be enhanced by the completion of the new Lysebotn power plant last year.

After a record year for hydropower production in 2018 (7.5TWh), we expect the energy segment to normalise to mean historical levels. Combined with further anticipated growth in telecom, this is expected to lead to a nearly even EBITDA contribution between power production and grid/telecom in the medium term (telecom could reach up to 40%).

Lyse's financial performance and credit metrics at YE 2018 were better than our expectations, explained largely by the record-high hydro power production, higher achieved market prices for electricity, and the Skangass disposal. Operating free cash flow was high as a result, helping to reduce net debt by NOK 0.9bn.

The financial risk profile for 2019 has been bolstered by the strong metrics in 2018. However, 2018 was exceptional due to the record high production. Therefore, we expect credit metrics to normalise in 2019 (exemplified by Scope-adjusted debt/EBITDA increasing to around 3x in 2019 from 2.3x in 2018). However, we also project negative free operating cash flow (FOCF) in 2019 due to lower anticipated production output, and the continued high level of investment in telecom. Nevertheless, we estimate FOCF to become positive again from 2020 as investment needs lessen.

Ratings & Outlook

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

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Related methodology

European Utility Methodology,
March 2019

Corporate Rating Methodology,
March 2019

Government Related Entities
Methodology,
July 2018

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

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Outlook

The Stable Outlook reflects our expectation that Lyse will maintain its diversified business model (generation, grid and telecom), robust financial risk profile, and strong liquidity that fully covers both shorter-term debt maturities and the current investment programme. We expect leverage to stay at around 3x on average in the short to medium term and the EBITDA contribution from energy to decrease slightly going forward. The Outlook also reflects our expectation of an unchanged ownership structure.

A rating upgrade could be warranted if cash flows were higher than our estimates, due to consistently higher achieved market prices or lower capex, which then translate into sustainable positive free cash flow, deleveraging, and an improved financial risk profile exemplified by a Scope-adjusted debt (SaD)/EBITDA of staying below 3.0x on a sustainable basis.

A negative rating action is possible if the financial risk profile weakened going forward through lower wholesale prices or debt-financed transactions or investments, resulting in a leverage of above 4.0x for a prolonged period.

Rating drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none"> • 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 • Profitable and environmentally friendly hydropower production with a large reservoir capacity • Committed, long-term owners (16 municipalities) 	<ul style="list-style-type: none"> • Volatility of achievable prices in power generation • Currently in a relatively large investment phase within telecom • Limited diversification by geographical pricing markets and relatively high asset concentration risk in Lyse's major hydro plants

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • Reduced investments and positive free cash flow in the long term which maintain credit metrics (i.e. SaD/EBITDA staying below 3x) 	<ul style="list-style-type: none"> • Large debt-financed acquisition of other businesses or significantly lower prices, resulting in a sustainably weakened financial risk profile (i.e. SaD/EBITDA >4x)



Financial overview

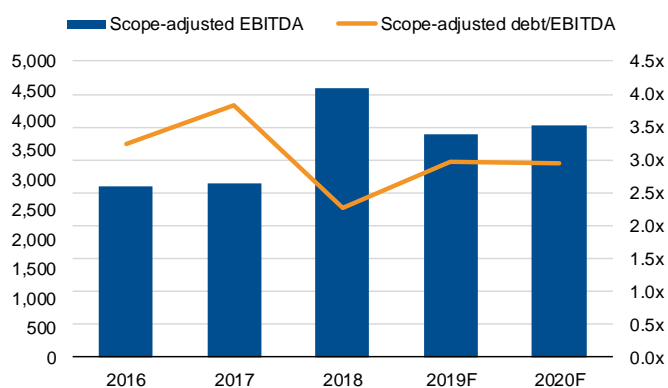
	Scope estimates			
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Scope-adjusted FFO/SaD	17%	34%	18%	23%
FOCF/SaD	-0.8 %	11.9 %	-1.7%	4.5%
Scope-adjusted EBITDA in NOK m				
EBITDA	2,756	4,336	3,597	3,732
Add: operating lease payments in respective year	171	201	220	215
Scope-adjusted EBITDA	2,927	4,537	3,817	3,947
Scope-adjusted funds from operations in NOK m				
EBITDA	2,756	4,336	3,597	3,732
Less: (net) cash interest per cash flow statement	-333	-329	-391	-397
Less: cash tax paid per cash flow statement	-650	-616	-1,336	-900
Add: depreciation component, operating leases	139	165	176	168
Add: other items	-8	-28	20	20
Scope-adjusted funds from operations	1,896	3,522	2,060	2,616
Scope-adjusted debt in NOK m				
Reported gross financial debt	13,867	14,402	14,642	13,454
Less: cash, cash equivalents	-3,505	-5,104	-4,384	-2,907
Add: cash not accessible	67	121	67	67
Add: pension adjustment	119	86	86	86
Add: operating lease obligations	674	776	997	895
Add: asset retirement provisions	18	35	35	35
Scope-adjusted debt	11,239	10,315	11,442	11,629

Operational developments since Scope's previous rating report

Record high hydro-power production in 2018

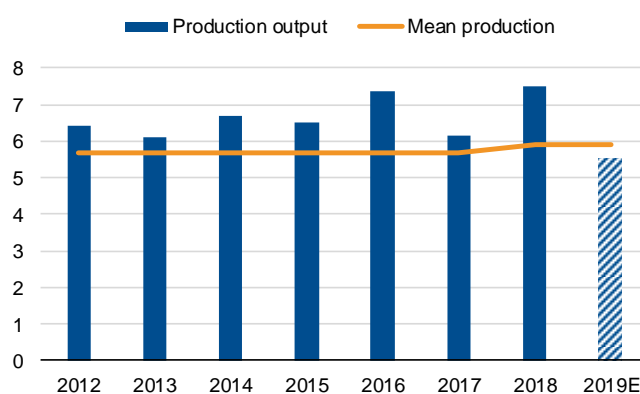
Lyse delivered better FY 2018 results than our expectations, driven by strong improvements in hydropower and telecom. Hydropower EBITDA increased by more than 30% in 2018, on the back of a record-high 7.5TWh of electricity production and a significant increase in market prices from 2017. Telecom also contributed positively even when adjusting for the positive Viken Fiber consolidation effect. In terms of cash flow, the divestment of the remaining 30% of Skagass in Q4 helped to reduce net debt.

Figure 1: Scope-adjusted leverage development (NOK m)



Source: Scope estimates

Figure 2: Hydro-power production level (in TWh)



Source: Scope, Company

Increased liquidity, S-2 rating affirmed

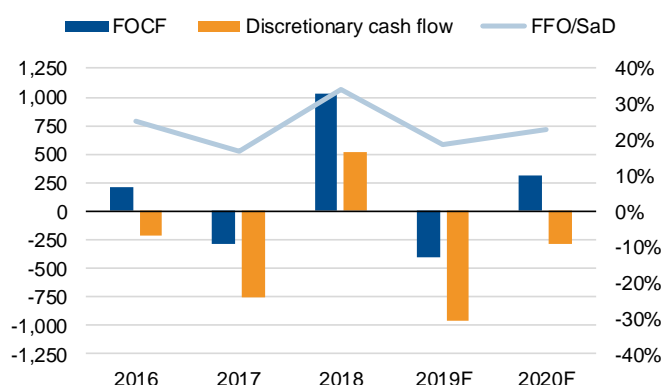
Lyse's operating cash flow covered capex and dividends by good margin in 2018 and was used to decrease net debt by almost NOK 1bn. Some of that excess liquidity was also placed in short-term financial assets (mainly covered bonds and municipality bonds). This has led to improved liquidity, boosted by the undrawn credit facilities that were extended last year. Despite a relatively large debt balance maturing in 2020, the company's liquidity is 'better than adequate', according to our methodology, and justifies an affirmation of our S-2 short-term rating.

Updated Scope forecast

Positive FOCF expected again in 2020

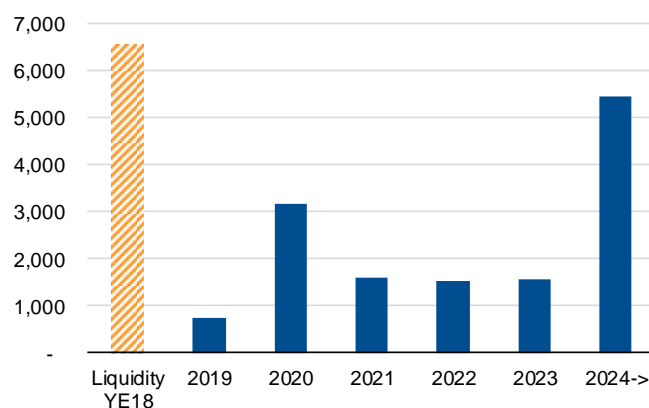
Based on market developments and operational updates from the company since our last review, we have adjusted the company's medium-term forecast. The higher forward price curve for electricity in the market and the new Lysebotn power plant are positive drivers for the energy division, while the expected return to mean production volumes have a negative effect on cash flow compared with 2018 numbers. Investments are still expected to be high in the telecom business, after peaking in 2018 at NOK 2.5bn. From 2020, we expect investment to be lower for telecom but higher for grid infrastructure, which could keep the group's overall investment level at above NOK 2bn p.a. until 2022, according to our assumptions. We expect the high continued investment in the short to medium term to be funded with internally generated cash flow from 2020. We also expect dividends to grow moderately going forward, and discretionary cash flow to be break-even within three years.

Figure 3: Cash flow development (NOK m on LHS)



Source: Scope estimates

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



Source: Scope, Company

Government-related entity methodology from Scope

Since our latest affirmation of Lyse's issuer rating in May 2018, we published our government-related entity (GRE) methodology. This now also applies to Lyse alongside the utility-specific rating methodology. The methodology is used to assess the level of support and the corresponding uplift from the standalone rating. We use the bottom-up approach to analyse Lyse, and the one-notch uplift assigned for the ultimate 100% municipality ownership has not changed since the last review.

To assess the likelihood of support, we considered Lyse's importance in Norway, political willingness for financial support, and the potential for political or investor turmoil should support be withheld. Further, Norway's Industrial Licensing Act, which states that hydropower assets must be owned two-thirds by the public at all times, as well as monopoly regulations governing the grid business, confirm our assessment. Based on the GRE methodology grid, we assess both the capacity and likelihood of government support at 'medium' and give a one-notch uplift to Lyse's standalone rating of BBB.



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