TrønderEnergi AS
Norway, Utilities

SCOPE BBB STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022P[1]	2023E
Scope-adjusted EBITDA/interest cover	5.8x	17.2x	8.2x	8.7x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	3.3x	1.8x	4.1x	3.7x
Funds from operations/SaD	17%	48%	14%	21%
Free operating cash flow/SaD	11%	42%	10%	18%

Rating rationale

The issuer rating reflects TrønderEnergi's (TE) standalone credit quality of BBB- and a one-notch uplift from parent support. The uplift is driven by the anticipated capacity and willingness of TE's Norwegian municipality owners to provide support if needed.

TE's issuer rating is supported by the company's business risk profile, which benefits from the company's environmentally friendly and low-cost hydropower production, as well as exposure to monopolistic power distribution through its minority stake in Tensio. The business risk profile is constrained by the companies limited geographical diversification across different power pricing areas, exposure to significant price volatility for unhedged power production volumes and some transactional event risks.

Our assessment of the financial risk profile is largely forward looking due to the company's new structure which will be implemented upon closing of the transaction with HitecVision. While the transaction initially will have a negative effect on leverage, we expect a relatively timely improvement to around 3.5x in 2023-24E. The consistency of discretionary and free operating cash flows should be more predictable going forward, as limited expansionary capex is expected in TE after the transaction, supporting the financial risk profile.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that the proposed transaction with HitecVision will go through, and that TE will be willing and able to reduce the initially estimated higher leverage ratio during next year. Further, it assumes TE should generate positive FOCF, based on our current power price assumptions and the stable cash dividends received from Tensio. The Outlook also reflects our expectation that TE's majority municipality ownership will remain unchanged.

A positive rating action is currently remote given the ongoing transaction and our assumption that the owners will prefer to increase the dividend rather than operate the new TE with a more conservative capital structure than needed.

A negative rating action is possible if achieved power prices becomes lower than expected or the company announces a more aggressive financial policy leading to additional investment, higher dividend payouts, or new structural transactions that result in negative FOCF or Scope-adjusted debt/EBITDA of above 3.75x on a sustained basis.

Ratings & Outlook

Issuer	BBB/Stable
Short-term debt	S-2
Senior unsecured debt	BBB

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Related Methodologies

Corporate Rating Methodology; July 2021

Rating Methodology: Government Related Entities Methodology, May 2022

European Utility Methodology, March 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Environmentally friendly and low-cost hydropower production, resulting in solid profitability (positive ESG factor) • Exposure to monopolistic power distribution grid operations through minority stake in Tensio with relatively stable dividends going forward • Long-term, supportive, and committed municipal owners, warranting a one-notch uplift under our Government Related Entities Methodology	• Limited geographical diversification in different pricing areas and some asset concentration risk in power production • Spot price exposure for unhedged power production volumes, introducing volatility in credit metrics • Transactional event risks, based on TE's active history of making structural transactions

Positive rating-change drivers	Negative rating-change drivers
• Improved financial risk profile through higher achieved prices combined with a new financial policy that stipulates more conversative dividend payouts and leverage targets	• Lower achieved power prices or a more aggressive financial policy with additional investment, higher dividend payouts or new structural transactions that result in negative FOCF or SaD/EBITDA of above 3.75x on a sustained basis

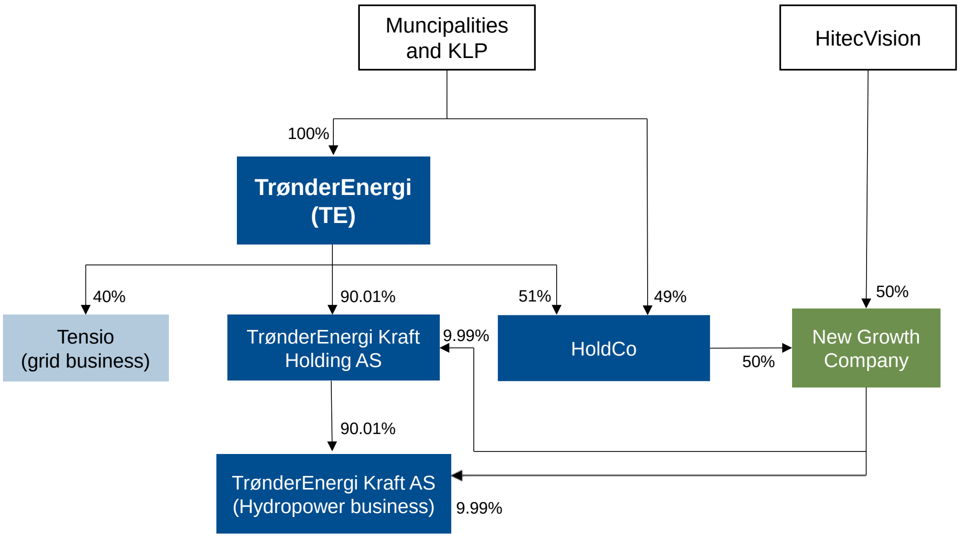
Corporate profile

TrønderEnergi AS (TE) is a Norwegian utility company focused on environmentally friendly power production with operations located in the Trondheim area in Mid-Norway. The company's annual power production was 2.7 TWh (1.8 TWh hydro and 0.9 TWh onshore wind) in 2021. After combining its electricity grid operations with NTE Nett in 2019 into a new dedicated grid operator, the company continues to be in a transformation phase with regard to strategy and structure, after it recently announced the intention to establish a new holding structure as part of a transaction with private equity firm HitecVision. TE is owned by 18 municipalities in the Trondheim region (86.7%) and the mutual insurance company Kommunal Landspensjonskasse (13.3%).

New organisational structure

In March 2022, TE entered into an agreement with HitecVision to establish a new growth company focusing on renewables and energy solutions. The growth company will be 50/50 owned by HitecVision and a new holding company. The holding company will be 51% owned by TrønderEnergi and 49% by TrønderEnergi's owners. The ownership of 81% of TE's hydropower assets and TE's ownership share of 40% in the grid operator Tensio will remain in TE. The plan is to transfer all other business to the new growth company. This includes assets and activities in wind power, energy management and services, property, as well as a minority share of 19% in TE's hydropower. HitecVision will contribute growth capital in the form of cash corresponding to the value of assets transferred from TE. The transaction is targeted to be closed in the second half of 2022.

Figure 1: Expected new structure of TE (post-transaction)



Sources: Scope

The rationale of the transaction is by our understanding to establish a structure that allows for growth within renewables and energy services. Such growth is difficult in the current TE due to the high capital needs and municipality owners' preference for stable dividends, as well as government restrictions on non-public ownership in hydro assets. The 81% hydropower stake to be left in TE ensures continued dividends to municipality owners and compliance with the ownership restrictions in the hydro business.

Thus, post-transaction, we expect all growth in renewables and green energy solutions to come in the new joint company established with HitecVision (New Growth Company), which will have an initial investment capacity of NOK 15-20bn. Further, we expect the existing company (TE) to focus on its core business (hydropower production and grid exposure), servicing its debt and paying dividends to its owners.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022P[1]**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	10.2x	5.8x	17.2x	8.2x	8.7x	8.6x
SaD/Scope-adjusted EBITDA	1.8x	3.3x	1.8x	4.1x	3.7x	3.4x
Funds from operations/SaD	44%	17%	48%	14%	21%	22%
Free operating cash flow/SaD	-4%	11%	42%	10%	18%	18%
Scope-adjusted EBITDA in NOK m						
EBITDA	389	60	654	321	312	348
add: received Tensio dividend *less* dividend paid to New Growth Company (see figure 1)	820	414	300	100	139	125
Scope-adjusted EBITDA	**1,209**	**474**	**954**	**421**	**451**	**473**
Funds from operations in NOK m						
Scope-adjusted EBITDA	1,209	474	954	421	451	473
less: (net) cash interest paid	-119	-82	-55	-51	-52	-55
less: cash tax paid per cash flow statement	-92	-105	-53	-132	-53	-70
Other items	-75	-13	-36	0	0	0
Funds from operations	**924**	**274**	**810**	**238**	**346**	**348**
Free operating cash flow in NOK m						
Funds from operations	924	274	810	238	346	348
Working capital change	-23	5	50	0	6	-6
less: capital expenditure (net)	-990	-101	-144	-60	-50	-60
Free operating cash flow	**-89**	**178**	**715**	**178**	**302**	**282**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	-119	-82	-55	-51	-52	-55
add: interest component, operating leases	0	0	0	0	0	0
Net cash interest paid	**-119**	**-82**	**-55**	**-51**	**-52**	**-55**
Scope-adjusted debt in NOK m						
Reported gross financial debt	2,204	2,459	3,199	2,995	2,698	2,398
add: subordinated (hybrid) debt	425	72	72	72	0	0
less: cash and cash equivalents	-577	-1,020	-1,701	-1,327	-1,012	-806
add: non-accessible cash	26	33	114	0	0	0
add: pension adjustment	41	37	16	0	0	0
add: operating lease obligations	0	0	0	0	0	0
Scope-adjusted debt	**2,120**	**1,581**	**1,700**	**1,740**	**1,687**	**1,592**

[1] Proforma estimate, assuming the proposed transaction is completed resulting in the structure shown in Figure 1, with effective date Jan 1st 2022 for informational / comparable purposes.

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Environmental, Social and Government (ESG) profile[2]

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)

Sole focus on environmentally friendly energy production and services

The European utility sector has made progress in 'greening' power generation portfolios in recent years following Europe's significant climate ambitions. TE's position as a low-cost hydropower producer, which is one of the key drivers for the credit rating, is also a positive ESG factor. We further note positively that TE have issued green bonds and achieved a Cicero certification of 'dark green'.

Significant growth ambitions of new green business

Going forward, TE has large-scale ambitions for further investments into renewable energy and green solutions, which it will carry out together with HitecVision in a jointly established growth company (see figure 1), where TE will have a 25.5% ownership stake. The spoken goal of the new entity is to become a leading renewables company in the Nordics, and to be active along the entire energy value chain. This includes renewable power production from wind, hydro, solar and hydrogen, as well as energy management and downstream solutions. The new company's investment capacity of NOK 15-20bn in its initial phase, with prospects of significantly more in the longer term, underbuilds these ambitions and strengthens TE's ESG profile further.

[2] The ESG profile only evaluates the extent to which ESG factors are credit relevant. Our evaluations are not mutually exclusive or collectively exhaustive as these factors overlap and evolve. We only consider an ESG factor relevant to our credit rating process if it has a ubiquitously discernible and material impact on the rated entity's cash flow profile and, by extension, its overall credit quality.

Business risk profile: BBB-

New holding structure in the second half of 2022

Our analysis assumes the proposed transaction with HitecVision, scheduled to close in the second half of 2022, will go through as presented. Under the new structure, we consider TE as a pure-play hydropower producer with exposure to monopolistic grid operations and renewables growth through its minority stakes in Tensio and the joint venture set up with HitecVision.

Blended industry risk profile: BB+

TE's industry risk profile is characterized by its significant exposure to unregulated power generation which results in high merchant risk due to volatile power prices. The company's exposure to regulated grid operations with predictable dividend streams from its 40% stake in Tensio provides some stability. However, we give slightly less weight to these grid dividends due to TE's only minority shareholding and lack of control.

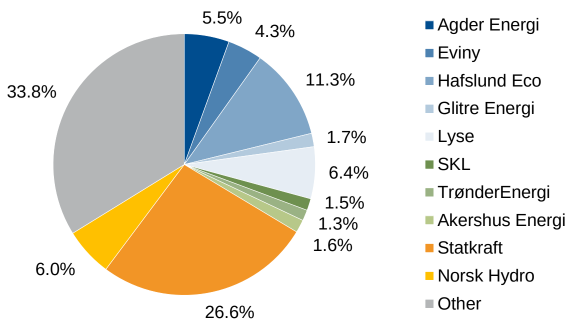
Small hydro generator; well placed with low-cost assets

TE had a production of around 2.7 TWh in 2021, of which 1.9TWh from hydropower and the remainder from wind. As the wind portfolio will be transferred to the new company later this year, we base our assessment on the around 2 TWh of consolidated hydropower production which will be left in TE. With this volume, TE is a relatively small power producer in Norway, let alone the Nordic region and Europe. However, we consider size to be less important for the market position and credit quality of a power utility, and view positively TE's low-cost hydropower assets which has a favorable position in the merit order and high capacity utiilisation. Further supporting TE's market position is some flexibility in production due to sizeable reservoir capacity, suggesting benefits in terms of achievable prices.

Exposure to monopolistic grid operations through dividends

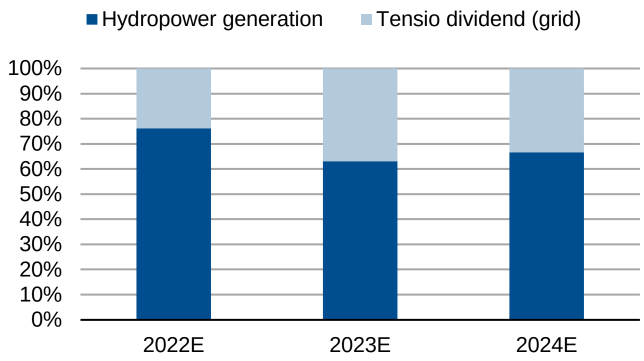
The exposure to Tensio's grid monopoly is positive for TE's market position, as well as the overall business risk profile, through the grid operator's predictable and stable dividends which helps offset TE's more volatile cash flows from power production. As for the 40% stake in Tensio, we highlight the joint-control shareholder agreement between the two largest owners TE and NTE, as well as Tensio's obligation to distribute all cash after operational needs and debt service to shareholders.

Figure 2: Shares[3] of Norwegian power generation in 2021 (total 157 TWh)



Sources: Scope (estimates)

Figure 3: Segment split of Scope-adjusted EBITDA



Sources: Scope (estimates)

Segment diversification helped by stake in Tensio

TE is somewhere between the larger integrated utilities and pure-play power producers in terms of segment diversification with around 60-70% of Scope-adjusted EBITDA coming from hydropower production and the remainder from grid dividends. The company has favourable exposure to renewables growth through the 25.5% stake in the joint venture

[3] The shares presented in the chart is net of any subsidiary if the subsidiary is also included in the chart. For instance, based on Statkraft's 45.5% ownership in Agder Energi, Statkraft's production is reduced by its appropriate share of Agder Energi's production.

with HitecVision, though the JV is unlikely to pay dividends in the near future, so the impact on diversification and the overall business risk profile is limited for the time being.

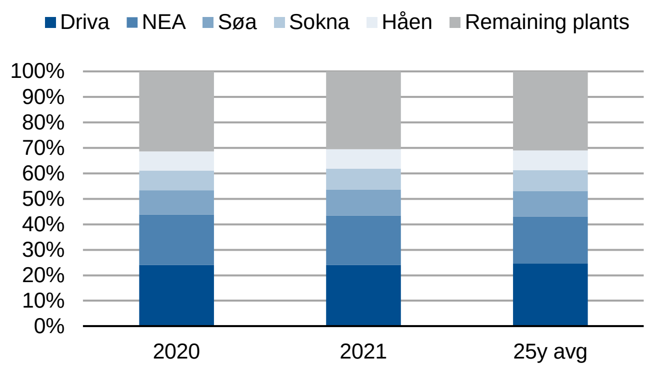
Regional presence in Norway within the NO3 bidding zone

Geographically, TE's operations are concentrated in the Trøndelag area in the middle of Norway, with exposure to only one bidding zone (NO3) within the Nord Pool market. Geographical diversification is therefore limited compared with larger European peers, but more in line with most of the Norwegian utilities due to the predominantly regional structure of Norway's power sector.

Some asset concentration in the hydropower portfolio

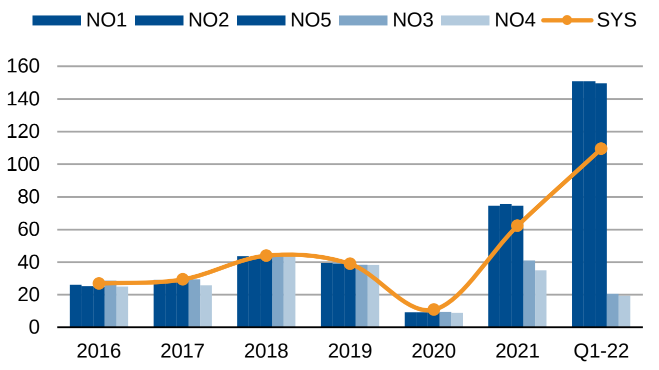
TE hydropower production is spread across 18 fully or partly owned plants. However, TE is highly dependent on its largest plants Driva (25% of total production) and NEA (18%) so any prolonged interruption in their output would have a material impact on cashflow. Such standstills are nonetheless unlikely.

Figure 4: Production dependency on largest hydropower plants



Sources: TE annual report, Scope

Figure 5: Power prices in Norway (by bidding zone) and the Nordic system price, in EUR/MWh



Sources: Scope, NordPool

Less upside in achieved prices than southern Norway producers

In terms of achievable prices for its power generation, TE's geographical location in the NO3 bidding zone is less than optimal due to weaker price prospects than in southern Norway (NO1, NO2 and NO5 bidding zones). The makes a change from the past when prices were relatively equal across all bidding zones. The weaker price prospects results largely from strong growth in wind generation in northern Sweden and central/northern Norway which negatively affects the NO3 price, paired with north-south bottlenecks in the Nordic transmission grid which limits the positive impact from higher southern prices.

Strong operating profitability versus our European peer group

TE's profitability is a key strength in its overall competitive position with high EBITDA margins resulting from its low-cost hydropower assets. We expect profitability to improve following the upcoming transaction, as the deconsolidation will dispense some unprofitable growth expenses and operations. Specifically, EBITDA margins should remain above 50% which will come purely from the hydropower business. We also expect somewhat less volatility as the company has increased hedging, with substantial volumes locked in for the coming years. TE's profitability is weaker than comparable companies in southern Norway due to the less favourable price prospects in NO3, though above most of our rated European utility peers.

Financial risk profile: BB+

New structure assumed effective from 1st Jan. 2022 in our proforma 2022 figures

When calculating TE's credit metrics we assume the proposed transaction went through on 1st January 2022, though the deal is scheduled to close in the second half of 2022, in order to have comparable proforma figures.

Under the new holding structure, credit metrics are based on consolidated figures for the hydropower business where TE will own 81%[4], while the 40% stake in Tensio and the 25.5% stake in the new growth company are reflected as minority shareholdings. Thus, we include received dividends from Tensio in Scope-adjusted EBITDA, while we subtract the new growth company's[5] share of dividends from the hydropower business.

The main drivers behind our forecasted credit metrics are:

- Power prices of 27.5-30 EUR/MWh in NO3, and annual hydropower production of around 1.8 TWh
- Mostly maintenance capex (hydropower) in TE post-transaction
- Continued predictable and stable grid dividends from Tensio, as well as dividends paid to municipality owners and KLP

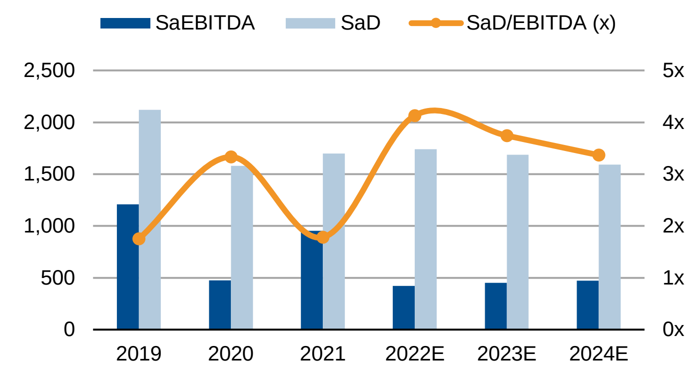
Credit metrics set to weaken versus previous levels

Our base-case forecast is for weaker credit metrics in 2022-24E than in the past. This is primarily caused by the impact of the upcoming transaction, as well as likely slightly lower future prices in the NO3 bidding than in the past. Specifically, we forecast Scope-adjusted debt/EBITDA of 4.1x in 2022E, falling to less than 3.75x in 2023-24E. This improvement should be helped by limited growth capex resulting in positive FOCF and discretionary cash flows in the period. Interest cover to remain above 7x.

Tensio dividend, hedging helps offset power price volatility

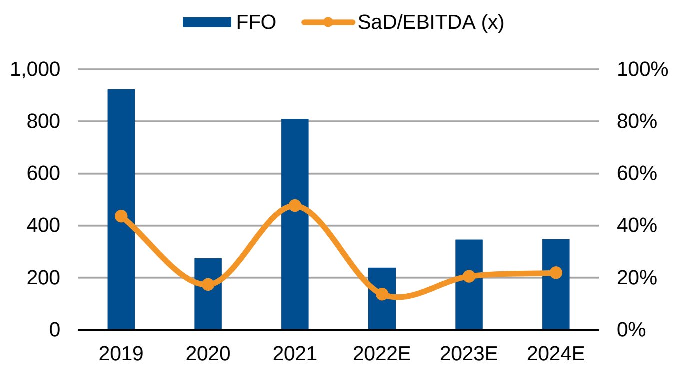
At the same time, credit metrics could remain volatile as there is no change in TE's exposure to power generation and thus power-price volatility. This exposure was exemplified in 2020, when Scope-adjusted debt/EBITDA rose to above 4x due to extraordinary low prices. TE's has reduced its short-term exposure to volatile prices through relatively heavy hedging for the next few years, and also benefit from stable dividends from Tensio. This supports the financial risk profile, as it limits the risk that TE will be unable to deleverage in the coming years, in our view.

Figure 6: SaEBITDA NOK m (LHS) and leverage x (RHS)



Sources: Scope (estimates)

Figure 7: Funds from operations in NOK m and relative to Scope-adjusted debt (%)



Sources: Scope (estimates)

Fewer transaction risks in future

While TE several major has undertaken transactions in recent years leading to changes in the company structure, we expect less deal activity in the future. The only majority-owned business left in TE will be the hydropower activities. TE deconsolidated its grid business with the creation of Tensio with NTE Nett in 2019. This year's transaction involves the transfer of TE's non-hydro asset to the new venture.

Lower and more predictable capex levels

As for future investment, the new venture with HitecVision will bear the load of capital spending for future growth to which TE will not contribute with any cash. This provides

[4] While we consolidate the hydropower business, note that the actual cash flows to TE (rated entity) will come in the form of dividends
[5] We assume that dividends paid to TE from the new growth company will be zero in the foreseeable future

more clarity on future investment, which will consist primarily of maintenance capex for the hydro assets (NOK 50-60m annually), and potentially with some expansion and/or optimisation of existing plants.

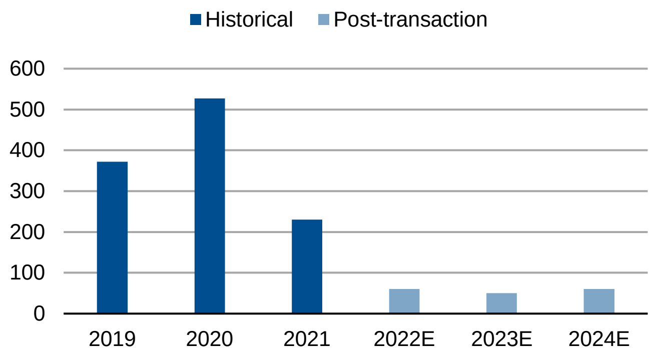
Positive FOCF and discretionary cash flows over time

Based on the more predictable and lower capex level, the hydropower business should more than cover its own investments, resulting in positive free operating cashflow, helped by likely predictable dividends from Tensio. Accumulated discretionary cash flow should be positive in 2022-24E based on assumed future dividends paid from TE to its municipality owners and KLP of minimum NOK 200m p.a., with any amount above this tied to internal guidelines for leverage. This will help the company deleverage over the coming years to less than 3.75x Scope-adjusted debt/EBITDA, an important development for the current credit rating.

Adequate liquidity and well-distributed maturity schedule

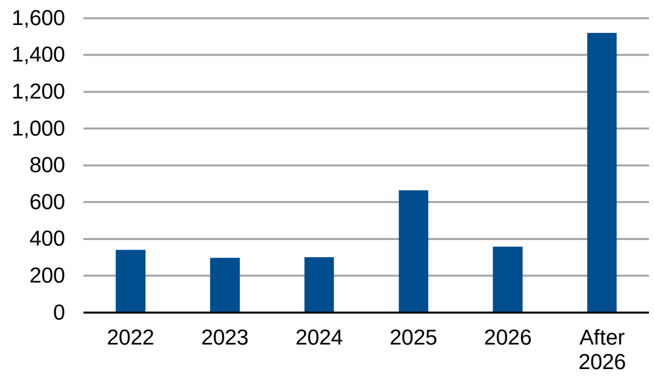
No debt will be transferred out of TE as part of the upcoming HitecVision transaction. The subordinated hybrid bond of NOK 144m, which currently is given a 50% equity credit, is assumed to be replaced with standard debt in 2023 based on management guidance. New debt could be taken out at TE or in the hydropower business (see Figure 1), which we treat as equivalent based on the consolidated majority ownership.

Figure 8: Capex development excluding business acquisitions and divestments, NOKm



Sources: Scope (estimates)

Figure 9: Debt maturity profile at YE 2021, in NOKm



Sources: Scope (estimates)

At YE 2021, the company had NOK 1.3bn in cash plus NOK 400m in marketable securities, which is well above the NOK 347m in short-term debt. Following the transaction and currently high cash balance, the company is less in need of any backstop credit facilities. Liquidity is assessed to be adequate.

Supplementary rating drivers: +1 notch for GRE

One-notch uplift from parent support

We use our bottom-up approach to analyse TE's parent support under our Government Related Entities Methodology, which justifies a one-notch rating uplift for the majority municipality ownership. This assessment reflects TE's ownership by 19 municipalities (approx. 87% share) in the Trondheim region and mutual insurance company Kommunal Landspensjonskasse (around 13%).

Sound financial policy

We make no adjustment for financial policy, which we assess as sound. TE's dividend policy targets a ratio of about 75%, but with a minimum of NOK 200m yearly as long as its financial risk profile, in line with its current investment grade credit rating, is not jeopardised. No new official financial policy has been announced following the new corporate structure. However, we expect the dividend distribution policy to serve as a floor and believe that any excess capital will most likely be distributed to the owners rather than being used to improve the financial risk profile more than necessary.

Long-term and short-term debt ratings

Short term rating of S-2 and BBB senior unsecured rating

Overall liquidity justifies an assignment of S-2 short-term rating. Senior unsecured debt is assigned at BBB, in line with the issuer rating.

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