Vardar AS
Kingdom of Norway, Utilities

SCOPE BBB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2022	2023	2024E	2025E
Scope-adjusted EBITDA interest cover	24.8x	7.2x	4.7x	5.9x
Scope-adjusted debt/EBITDA	1.6x	2.4x	3.2x	2.4x
Scope-adjusted free operating cash flow/debt	48%	15%	12%	29%

Rating rationale

The rating reflects a standalone credit assessment of BBB and a one-notch uplift based on our assessment of parent support from Vardar's Norwegian municipal owners.

The standalone credit assessment of BBB reflects the main exposure to low-cost, environmentally friendly hydropower generation (ESG factor: credit positive) from a 2/7 share in the Usta and Nes hydropower plants and a 12.91% ownership stake in Å Energi. It also reflects a good financial risk profile, with Scope-adjusted debt/EBITDA returning to around 2.5x after an expected peak of 3.2x in 2024 following the acquisition of Västraby wind park, and strong internal financing capacity. The assessment is constrained by the small scale and high asset concentration of Vardar's consolidated businesses versus larger peers, as well as moderate geographical diversification. It is also held back by the cyclical operating environment with exposure to volatile power prices.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation of the lower but still supportive power prices in southern Norway continuing over the next few years. It further reflects our view that Vardar will maintain Scope-adjusted debt/EBITDA between 2x and 3x over 2024-2026. This view is underpinned the company's willingness (as per its financial policy) and ability to keep net debt constant by adapting discretionary cash outflows to operating results. The view also incorporates Å Energi's dividend policy, under which the payout in year (t) is based on the result in year (t-2), which provides high visibility on Vardar's dividend income through 2026. Lastly, we expect the company to maintain its core assets, including the Usta and Nes power plants and its stake in Å Energi.

The upside scenario for the ratings and Outlooks is: Scope-adjusted debt/EBITDA of around or below 1.0x. This is seen as remote given the company's intention to keep reported net debt near the current level.

The downside scenarios for the ratings and Outlooks are (individually): 1) Scope-adjusted debt/EBITDA ratio of around 3.0x for a prolonged period as a result of i.e. a significant deterioration in Å Energi's credit profile (and therefore its perceived dividend capacity) or 2) the loss of government-related entity status (deemed remote).

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
28 Nov 2024	Affirmation	BBB+/Stable
21 Nov 2023	Initial rating	BBB+/Stable

Ratings & Outlook

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

Analysts

Thomas Faeh
+47 93 05 31 40
t.faeh@scoperatings.com

Per Haakestad
+47 92 29 78 11
p.haakestad@scoperatings.com

Related Methodologies

General Corporate Rating Methodology; October 2023

European Utilities Rating Methodology; June 2024

Government Related Entities Rating Methodology; September 2024

Scope Ratings GmbH

Karenslyst allé 53
N-0279 Oslo
Phone +47 21 09 38 35

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

in

Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Low-cost, environmentally friendly hydropower and wind power generation (positive ESG factor) • Robust and recurring dividend income from a 12.91% ownership stake in Å Energi • Good financial risk profile with Scope-adjusted leverage of around 2.5x and strong internal financing capacity • Low mandatory maintenance capex, providing financial flexibility • High profitability as measured by the EBITDA margin and Scope-adjusted ROCE • Long-term committed municipal owners with capacity and willingness to provide potential parent support	• Exposure to volatile power prices for unhedged power generation volumes • Small scale and high asset concentration in consolidated hydropower, wind power and district heating businesses • Modest geographical diversification with most direct and indirect power generation located in regional markets exhibiting high price correlation • Investments going mainly into early-stage growth companies, involving more risk than mature assets

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA of around or below 1.0x. This is seen as remote given the company's intention to keep reported net debt near the current level.	• Scope-adjusted debt/EBITDA ratio of around 3.0x for a prolonged period as a result of i.e. a significant deterioration in Å Energi's credit profile (and therefore its perceived dividend capacity). • The loss of government-related entity status (deemed remote).

Corporate profile

Vardar is a Norwegian utility company owned by 19 municipalities within the former county of Buskerud. The company is mainly exposed to hydropower generation in southern Norway through its 2/7 share in the Usta and Nes[1] power plants and recurring dividends from a 12.91% ownership stake in Å Energi[2]. It is also involved in district heating, wind power and solar activities.

[1] Both plants are operated by Hafslund (which owns 4/7), and Vardar's share of annual mean production is around 0.7 TWh.

[2] Å Energi is a fully integrated utility and Norway's third largest hydropower producer, with mean annual production of 11.3 TWh. It is also active in distribution grid operations and energy retail. Å Energi was established in November 2022 through a merger of Agder Energi and Glitre Energi. Prior to the merger, Glitre Energi was owned 50/50 by Vardar and Drammen municipality.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA interest cover	6.1x	24.8x	7.2x	4.7x	5.9x	5.4x
Scope-adjusted debt/EBITDA	4.1x	1.6x	2.4x	3.2x	2.4x	2.4x
Scope-adjusted free operating cash flow/debt	21%	48%	15%	12%	29%	23%
Liquidity	> 200%	> 200%	> 200%	> 200%	169%	> 200%
Scope-adjusted EBITDA in NOK m						
EBITDA	235	641	329	251	288	293
Dividends received from Glitre/Å Energi	66	96	209	140	229	176
Other items	-	-	-	-	-	-
Scope-adjusted EBITDA	**300**	**738**	**538**	**391**	**517**	**469**
Funds from operations in NOK m						
Scope-adjusted EBITDA	300	738	538	391	517	469
less: (net) cash interest paid	(50)	(30)	(74)	(84)	(87)	(86)
less: cash tax paid per cash flow statement	(15)	(93)	(224)	(123)	(59)	(86)
Other non-operating charges (accruals/deferrals)	15	(0)	15	-	-	-
Funds from operations (FFO)	**251**	**615**	**254**	**184**	**371**	**296**
Free operating cash flow in NOK m						
Scope-adjusted FFO	251	615	254	184	371	296
Change in working capital	26	(24)	(26)	(6)	11	(5)
less: capital expenditure (net)	(16)	(16)	(39)	(30)	(30)	(30)
Lease amortisation	(2)	(2)	(2)	(2)	(2)	(2)
Free operating cash flow (FOCF)	**259**	**574**	**188**	**147**	**350**	**259**
Net cash interest paid in NOK m						
Net cash interest paid	53	45	114	93	99	99
Net cash interest received	(7)	(19)	(44)	(14)	(16)	(17)
Interest expense on pensions	2	2	3	3	3	3
Interest component of operating leases	1	1	1	1	1	1
Net cash interest paid	**50**	**30**	**74**	**84**	**87**	**86**
Scope-adjusted debt in NOK m						
Reported gross financial debt	756	858	857	1,081	1,081	1,081
less: cash and cash equivalents	(109)	(270)	(163)	(381)	(426)	(521)
add: non-accessible cash	68	63	36	36	36	36
add: pension adjustment	21	26	26	26	26	26
Shareholder loan from Buskerud municipality	508	508	508	508	508	508
Scope-adjusted debt	**1,244**	**1,185**	**1,264**	**1,271**	**1,225**	**1,130**

Table of contents

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)

Business model built around sustainable energy generation

Vardar's business model is focused on sustainability as it is mainly exposed to the production of clean hydroelectric power through directly and indirectly owned hydropower plants. As a result, the company holds a favourable position in the EU taxonomy. This should support future cash flow generation and reduce the risk of headwinds from regulation and political interference relating to sustainability matters. In addition, its exposure to hydropower generation (direct and indirect) and electricity distribution (indirect only) guarantees its continued status as a GRE.

Investments focused on reducing greenhouse gas emissions

Vardar focuses its growth investments on sustainable areas, including wind power and solar, as well as other areas supporting its overall sustainability target of contributing to reduced greenhouse gas emissions.

No governance issues

Vardar applies governance principles as recommended by Norwegian market standards. No negative credit-relevant factors pertaining to corporate governance were observed.

[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-

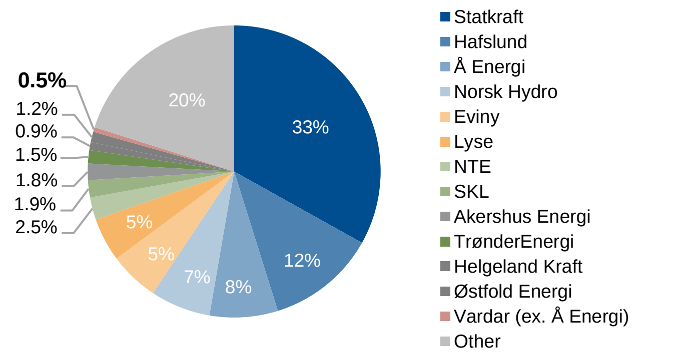
Main exposure to volatile but low-cost hydropower generation

Vardar's business risk profile reflects its main exposure to low-cost and environmentally friendly hydropower generation, which is supplemented by wind power and district heating activities. The assessment is constrained by the small scale and high asset concentration of directly owned generation activities, but we see this as partially balanced by the company's 12.91% ownership in Å Energi.

Ownership in Å Energi

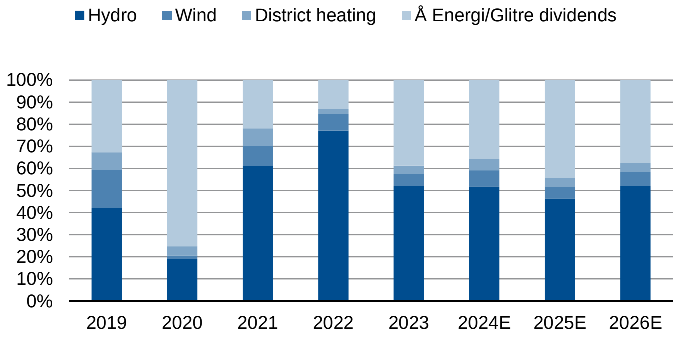
Recurring dividend income from Å Energi is expected to comprise a large share of operating cash flow, underpinned by Å Energi's strong credit profile (rated A-/Stable) and dividend policy of paying out 70% of results over time. We also view the joint ownership agreement with Drammen municipality positively, which enables Vardar to independently veto against changes to Å Energi's dividend policy and core business composition.

Figure 1: Normalised market shares in Norwegian hydropower generation



Sources: NVE, Scope

Figure 2: Estimated split of Scope-adjusted EBITDA by segment



Sources: Vardar, Scope estimates

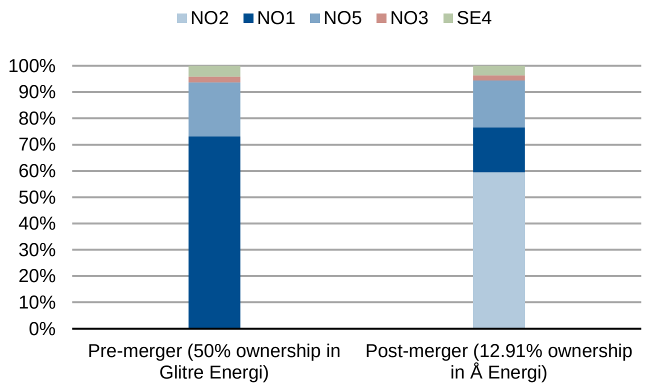
Small scale but strong position in merit order system

Vardar's directly and indirectly owned hydropower generation is favourably positioned in the merit order system due to low marginal production costs, which is more important than volumes for the market position of a power utility. The Usta and Nes power plants and Å Energi both have a high share of water reservoir capacity of around 55% of mean annual output. This is viewed as a credit-positive aspect since it provides flexibility to provide electricity when supply is constrained, such as during peak-load hours or periods with limited output from intermittent energy sources. It also reduces the exposure to volume risk in dry hydrological years versus peers with mainly run-of-river power plants.

Moderate diversification

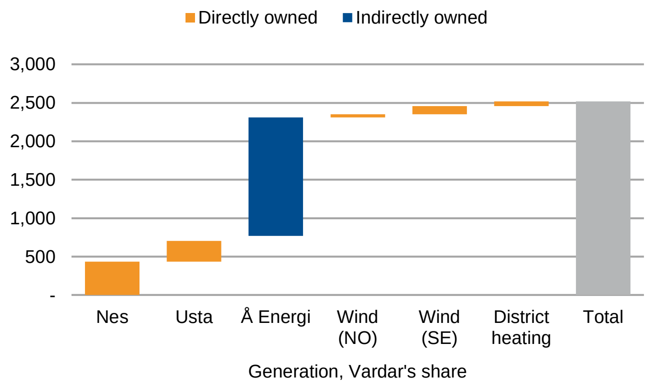
Overall diversification is moderate. The company's income streams from district heating and wind power generation (10%-15% of Scope-adjusted EBITDA) help mitigate part of the high concentration of consolidated energy generation on the Usta and Nes power plants. In addition, diversification benefit from robust dividend income provided by the ownership in Å Energi. These dividends reflect cash flow generated by a more diversified portfolio of 73 hydropower plants, as well as power distribution and energy retail activities. In terms of pricing risk, the company is mainly present in southern Norway within the NO1, NO2 and NO5 bidding zones, where power prices exhibit a strong correlation. The concentration in bidding zones with correlated prices is considered to be partially mitigated by interconnectors to other countries, including those to the UK and continental Europe from the NO2 bidding zone, as this gives southern Norway more exposure to electricity prices in other markets.

Figure 3: Estimated exposure of direct and indirect power generation by bidding zone, based on mean annual output



Sources: Vardar, Scope

Figure 4: Directly and indirectly owned energy generation based on mean annual output, Vardar's share (GWh)

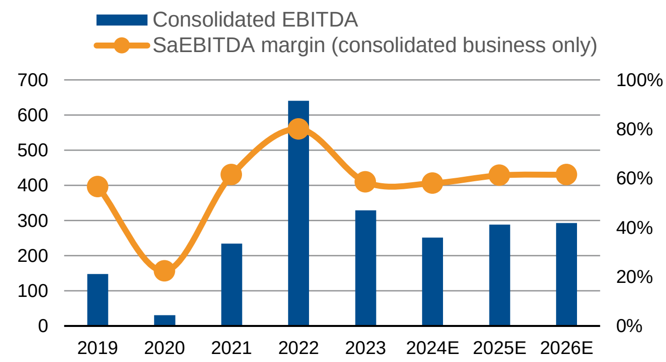


Sources: Vardar, Scope

Above-average profitability and efficiency versus European peers

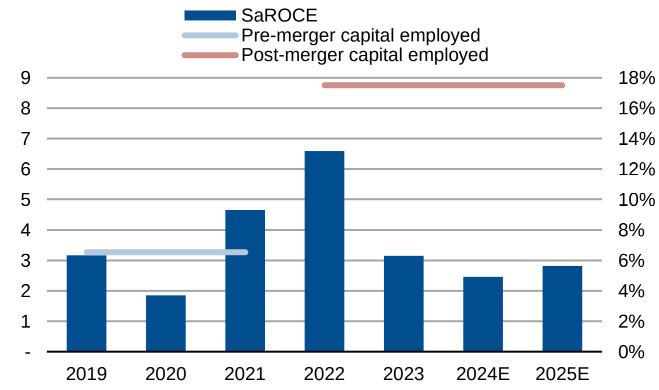
Profitability and efficiency are strong factors in Vardar's business risk profile, driven by low-cost hydropower and wind power generation. The consolidated group EBITDA margin is expected to remain at around 60%, with relatively low volatility due to a low absolute cost base, which is volume-dependent to some extent. Scope-adjusted return on capital employed is more volatile as there is no revenue component, illustrating the exposure of absolute EBITDA to achieved power prices. There was a transactional impact on capital employed from the merger of Glitre Energi and Agder Energi in November 2022, as figure 6 illustrates. We have accounted for this when interpreting the level versus peers with more depreciated balance sheets.

Figure 5: Consolidated EBITDA (NOK m, LHS) and Scope-adjusted EBITDA margin (RHS) development



Sources: Vardar, Scope estimates

Figure 6: Scope-adjusted ROCE (RHS) and comparison of pre- and post-merger capital employed (NOK bn, LHS)



Sources: Vardar, Scope estimates

Financial risk profile: BBB+

Good financial risk profile supports the rating

The financial risk profile (assessed at BBB+) supports the company's standalone credit assessment. Overall, the financial profile reflects manageable indebtedness and strong free operating cash flow. Paired with low mandatory maintenance capex, this results in good financial flexibility.

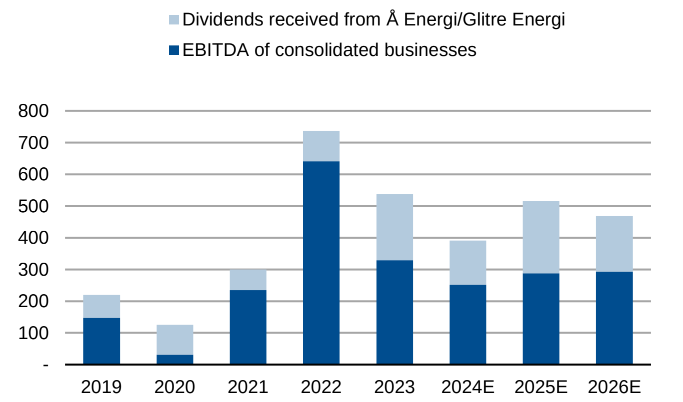
High visibility of forecasted dividend income from Å Energi

We note positively the two-year time lag in Å Energi's payout policy, with the dividend paid in year (t) being based on the result in year (t-2) – a dynamic that makes Vardar's credit metrics less correlated with power prices in a given year. It also provides high visibility of forecasted dividend income through 2026.

Adjustments

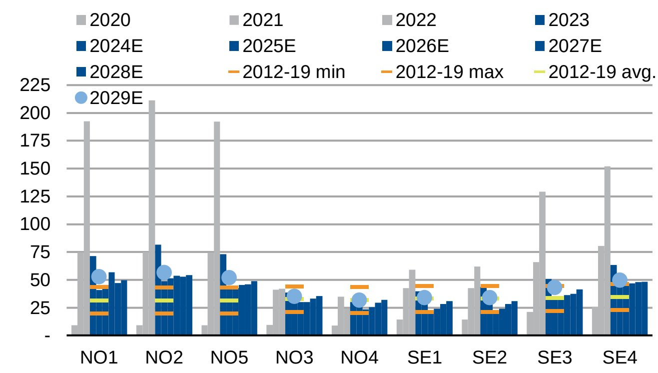
In terms of adjustments and the calculation of credit metrics, Scope-adjusted EBITDA is adjusted for recurring dividends received from Å Energi. In addition, Scope-adjusted debt fully accounts for the subordinated loan of NOK 508m from Buskerud municipality. The loan is subordinated to other outstanding debt and operating costs, but it does not qualify as a hybrid debt position as it has a determined maturity in 2031, no defined interest deferral and no conversion rights or mandatory replacement.

Figure 7: Scope-adjusted EBITDA development, NOK m



Sources: Vardar, Scope estimates

Figure 8: Statnett's simulated power prices for 2023-28 versus historical levels, EUR/MWh (not Scope's forecast)



Sources: Nordpool, Statnett's 2023-28 short-term market analysis from September 2023, Scope

Main assumptions

We assume continued power prices of around EUR 47/MWh in southern Norway (i.e. the NO1, NO2 and NO5 bidding zones), which compares to a historical average of about EUR 30/MWh over 2012-2019, but significantly below last year's forecast of around EUR 70/MWh. We also note indications from recent analysis by various bodies, including Statnett (Figure 8), that the pricing environment remains supportive beyond 2026, though on a lower level than previously anticipated. In addition, the rating case assumes:

i) Hydropower generation volumes in line with annual mean production and 65 GWh per annum available for purchase on secondary concession power rights

ii) Dividend income from Å Energi of NOK 229m in 2025 and NOK 176m in 2026

iii) Yearly EBITDA contributions from district heating and wind power generation of NOK 25m and NOK 60m respectively

iv) Maintenance capex of around NOK 30m p.a.

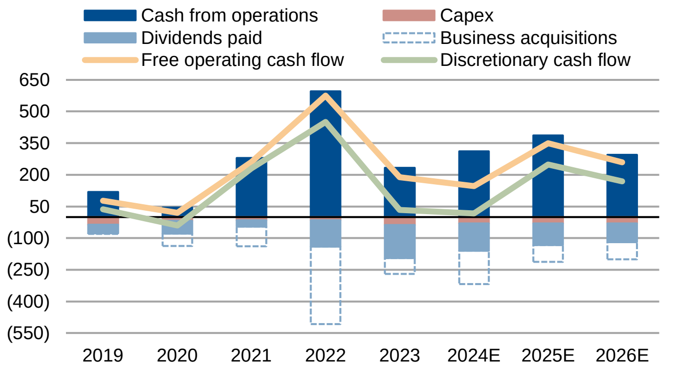
v) Discretionary spending to be adapted to the level of free operating cash flow, leading to a stable net debt position of around NOK 1.2bn

vi) No dividends from associated companies such as Zephyr, Solcellespesialisten and Sunly

Strong internal financing capacity, supported by low mandatory capex

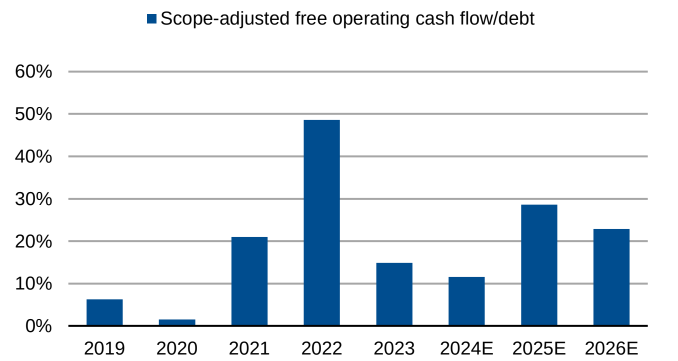
Scope-adjusted EBITDA is expected to be between NOK 390m-520m over 2024-2026, including yearly dividends of NOK 140m-230m from Å Energi. This should support continued positive free operating cash flow even in a less favourable pricing environment, due to low mandatory capex of only NOK 30m per year. With the Scope-adjusted free operating cash flow/debt ratio expected to average around 20%, we consider internal financing capacity to be a strong element in the financial risk profile.

Figure 9: Cash flow profile[4], NOK m



Sources: Vardar, Scope estimates

Figure 10: Internal financing capacity



Sources: Vardar, Scope estimates

Net debt expected to remain relatively unchanged

The company's high deleveraging capacity in the absence of dividend payouts and growth investments is viewed positively as it provides financial planning flexibility, which enables Vardar to adapt its level of cash outflows if needed. We expect the company will use its financial flexibility to bring net debt down to around the pre-wind-Park-acquisition level of NOK 1.1bn-1.2bn.

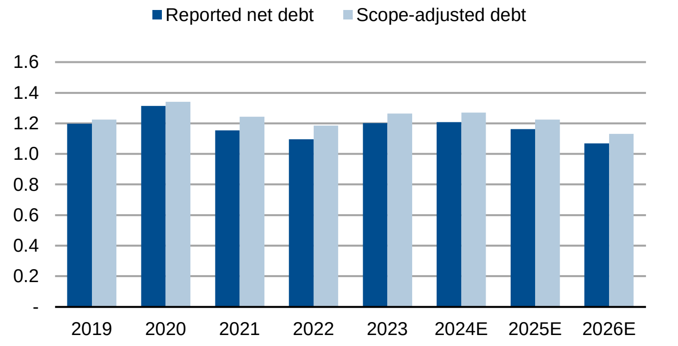
Expected leverage of 2.5x but subject to power prices and net debt assumption

Electricity prices have fallen compared to last year's long-term price curve, but the long-term picture remains the same with an elevated price curve. We expect Vardar's leverage as measured by the Scope-adjusted debt/EBITDA ratio to stabilise around 2.5x throughout 2025-26. The peak in leverage observed in 2024E is due to the rather significant acquisition of the Västraby wind park in Sweden in H2 2024, which was financed with debt. This takes the leverage to over 3x our forecasts at the end of 2024, before returning to levels consistent with our historical base case, driven by i) the EBITDA contributions from this acquired wind farm, ii) a slight increase in electricity prices expected in its operating areas and, most importantly, iii) the increase in dividends from Å Energi based on the results achieved.

Dividends from Å Energi are expected to comprise around 40% of Scope-adjusted EBITDA over the coming years. As a result, Vardar's leverage ratio is comparatively less exposed to taxation than that of other Norwegian utilities with a larger share of directly owned hydropower plants, a factor we considered in our peer comparisons.

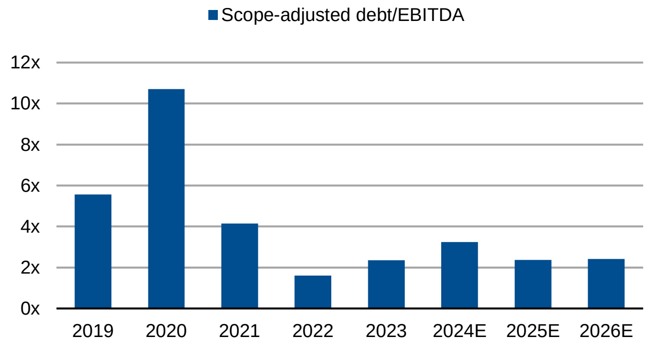
[4] Dividends paid excludes an extraordinary dividend payout of NOK 700m in 2019 relating to the sale of the 77% stake in Nelja Energia.

Figure 11: Indebtedness, NOK bn



Sources: Vardar, Scope estimates

Figure 12: Leverage development

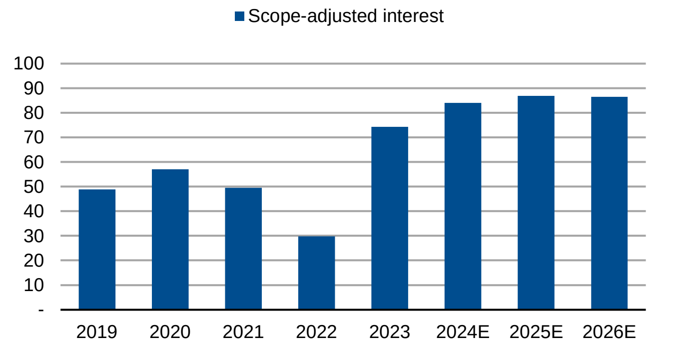


Sources: Vardar, Scope estimates

Good debt protection

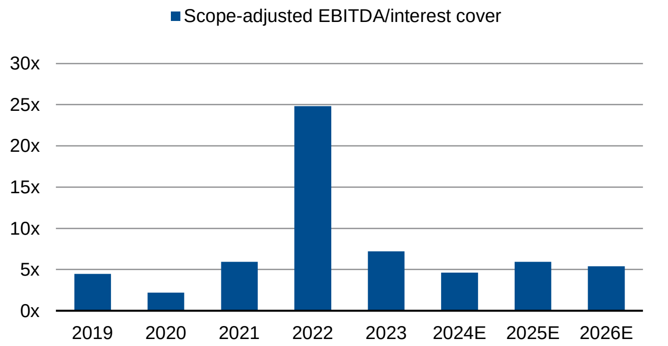
With slightly higher debt levels, we expect debt protection metrics, as measured by Scope-adjusted EBITDA interest cover, to average around 5.5x, down from the previous forecast of around 6.5x. This expectation incorporates higher interest costs going forward as two thirds of outstanding debt is exposed to floating rates. Given the company's goal of maintaining a stable net debt position, we do not expect any external financing needs over the next few years besides refinancing.

Figure 13: Development of net interest paid, NOK m



Sources: Vardar, Scope estimates

Figure 14: Development of debt protection



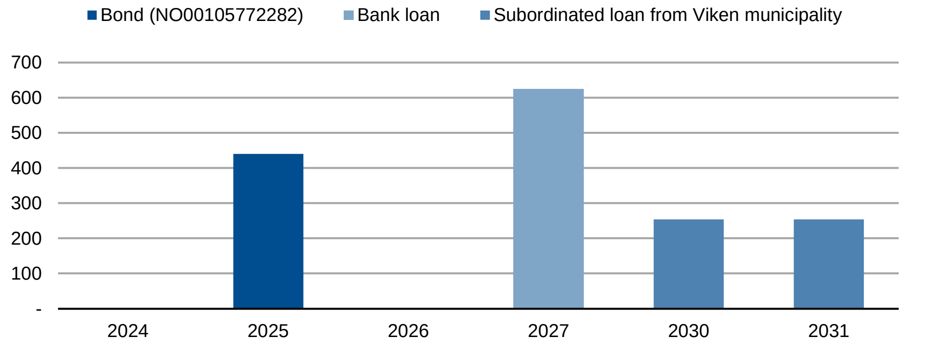
Sources: Vardar, Scope estimates

Adequate liquidity

Liquidity is adequate, with no debt maturities until mid-2025. At end-2023, availability liquidity included unrestricted cash of NOK 207m and NOK 50m of undrawn committed credit lines. Liquidity is further supported by positive forecasted free operating cash flow of more than NOK 150m per annum. Upcoming debt maturities of NOK 440m in 2025 include a bond maturing in June, which we expect to be refinanced by a new bond issue of the same size.

Balance in NOK m	2023	2024E	2025E
Unrestricted cash (t-1)	207	127	345
Open committed credit lines (t-1)	50	50	50
Free operating cash flow	188	147	350
Short-term debt (t-1)	1	1	440
Coverage	**No ST debt**	**No ST debt**	**169%**

Figure 15: Debt maturity profile excluding operating leases as of Q2 2024, NOK m



Sources: Vardar, Scope

Financial covenants

We anticipate the company will be able to maintain good headroom under its financial covenants[5], which include: i) adjusted equity to be at least 150% of external interest-bearing debt, ii) cash and cash equivalents to exceed next year's interest cost, and iii) operating cash flow adjusted for next year's dividend payout to exceed next year's interest cost (t+1).

Supplementary rating drivers: +1 notch

No impact from financial policy

We assess no credit impact from financial policy. The company has a dividend policy of paying out 50% of net profit adjusted for significant non-cash items, but subject to financial robustness. Additionally, we believe the company will take financial decisions aimed at maintaining an investment grade credit rating, although it has no publicly stated targets for credit ratios or rating commitments.

Joint ownership with Drammen municipality for stakes in Å Energi

In terms of structure, we note positively the company's formal agreement with Drammen municipality to exercise joint ownership in Å Energi, which gives both of Vardar and Drammen greater influence over major decisions relating to dividend policy and core business composition.

A one-notch uplift granted for parent support

The issuer rating incorporates a one-notch uplift to the standalone credit assessment of BBB reflecting the company's GRE status and leading to an issuer rating of BBB+. We have applied the bottom-up approach using the framework outlined in Scope's Government Related Entities Methodology. Our conclusion of a one-notch uplift reflects the public sponsor's 'high' capacity and 'medium' willingness to provide support. In addition to Vardar's importance to the policy objectives of its owners, we note that hydropower generation assets in Norway are required by law to be at least two-thirds owned by the state or municipalities. The rating uplift is 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

Short-term debt rating: S-2

The short-term debt rating of S-2 reflects the underlying BBB+/Stable issuer rating and adequate liquidity, in addition to good access to external funding from banks and debt capital markets.

Senior unsecured debt rating: BBB+

Senior unsecured debt is rated BBB+, the same level as the issuer rating.

[5] Interest cost used for the calculation of covenants ii)-iii) does not include interest incurred on the subordinated loan from Buskerud county municipality.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer