Glitre Energi AS
Norway, Utilities

SCOPE BBB STABLE

Corporate profile

Glitre Energi AS (Glitre) is a Norwegian energy company performing utility-related activities mainly in the Buskerud county and Hadeland area. It is a vertically integrated utility company with primary activities in power production, distribution and power sales; and is also engaged in broadband services through its 29% ownership of Viken Fiber. Glitre has an annual hydropower production of about 2.4 TWh and supplies 53,000 retail customers with energy. As part of its distribution business, the company builds and operates a power grid of about 8,100 km, serving 89,000 customers. Glitre is owned by Drammen municipality (50%) and Buskerud county municipality (50%, via the company Vardar).

Key metrics

			Scope estimates	
Scope credit ratios	2015	2016	2017F	2018F
EBITDA/interest cover (x)	5.1x	6.2x	7.1x	6.7x
Scope-adjusted debt (SaD)/EBITDA	4.4x	3.8x	3.9x	4.0x
Scope-adjusted FFO/SaD	12.5 %	19.9 %	15.3 %	16.2 %
FCF*/SaD	-3.3 %	4.6 %	-2.3 %	0.2 %

*Based on free cash flow after dividends

Rating rationale

Scope Ratings assigns a corporate issuer rating of BBB to Norway-based Glitre Energi. Scope also assigns an S-2 short-term rating and a BBB rating to the company's outstanding senior unsecured bonds.

Glitre's business risk profile benefits from its relatively large share of protected power distribution grid operations which is expected to grow further in the future. Scope also recognises the company's relatively stable profitability and cash generation, backed by substantial hedging in its power generation business, which reduces cash flow volatility after tax. Glitre's integrated utility value chain is supportive of overall business risk, but low profitability in power sales and some non-core, loss-making operations weigh negatively. We also note the limited geographical outreach for some of the company's business segments as well as some asset concentration risk driven by the incremental effect of a standstill of one its larger and most important run-of-the-river power plants.

With regard to Glitre's financial risk profile, Scope highlights the company's positive free cash flow (before dividends), indicating its ability to fund investments with internally generated cash. Glitre's conversion of subordinated loans into equity during 2015 has helped to reduce the somewhat high leverage and strengthen selected credit ratios. Combining Glitre's current credit metrics with Scope's estimates going forward puts the company's financial risk profile in the low investment grade area, based on Scope's methodology. The company's liquidity situation is seen as strong, supported by undrawn credit lines, proven access to bond and bank debt, and an evenly distributed maturity profile.

Glitre's issuer credit rating of BBB is not based on explicit support or guarantees from its owners. Nevertheless, Scope regards Glitre's municipality ownership structure as strongly supportive of overall credit quality, warranting a one-notch uplift from the company's standalone credit rating (BBB-).

Ratings & Outlook

Long-term issuer rating	BBB/Stable
Senior unsecured debt	BBB/Stable
Short-term rating	S-2

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Outlook

The Stable Outlook reflects Scope's expectation that Glitre will continue as a diversified utility, with operations in power production, distribution and sales. It also reflects our view that Glitre should be able to fund its medium-term, planned capex programme using its own internally generated cash flow over the cycle. As a result, Scope anticipates that key credit metrics will remain relatively unchanged in the medium term. We also assume that the management and the owners will continue to strive towards a healthy financial credit profile. The rating outlook is also based on Scope's expectation that the municipalities will remain majority owners.

A rating upgrade could be warranted if Glitre were to materially increase the share of its distribution business and deleverage to a SaD/EBITDA level below 3.0x on a sustainable basis.

A negative rating action is possible if the company were to participate in a debt-financed structural transaction that substantially weakens its business profile and results in significant higher than 4x SaD/EBITDA and negative free cash flow before dividends for a prolonged period.

Rating drivers

Positive rating drivers	Negative rating drivers
• Well-integrated business model, with large share of monopolistic power distribution • Cost-efficient and environmentally-friendly hydropower production, with good and relatively stable profitability development due to established hedging agreements • Long-term, committed municipality owners which are willing and able to provide potential parent support	• Limited geographical diversification outside main local regions in Norway • Low profitability in power sales and loss-making contribution from its share of contracting business • No water reservoir capacity and some asset concentration risk at its power plants

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Increasing share of distribution business • Deleveraging to a SaD/EBITDA level below 3.0x on a sustainable basis	• Debt-financed transaction that significantly weakens its BRP • A sustained weaker credit profile with a SaD/EBITDA ratio well above 4x and negative free cash flow before dividend for a prolonged period

Financial overview

			Scope estimates	
Scope credit ratios	**2015**	**2016**	**2017F**	**2018F**
EBITDA/interest cover (x)	5.1x	6.2x	7.1x	6.7x
Scope-adjusted debt/EBITDA	4.4x	3.8x	3.9x	4.0x
Scope-adjusted debt (excl. subordinated loan)/EBITDA	3.8x	3.2x	3.4x	3.4x
Scope-adjusted FFO/SaD	12.5 %	19.9 %	15.3 %	16.2 %
FCF*/SCOPE-adjusted debt	-3.3 %	4.6 %	-2.3 %	0.2 %
Scope-adjusted EBITDA in NOK m	**2015**	**2016**	**2017F**	**2018F**
EBITDA	597	675	661	650
Operating lease payment in respective year	11	5	8	12
Scope-adjusted EBITDA	**608**	**680**	**670**	**662**
Scope funds from operations in NOK m	**2015**	**2016**	**2017F**	**2018F**
EBITDA	597	675	661	650
less: (net) cash interest as per cash flow statement	-98	-127	-88	-93
less: cash tax paid as per cash flow statement	-155	-70	-217	-195
add: depreciation component operating leases	6	0	3	6
Other non-cash related adjustments	-14	35	45	61
Scope funds from operations	**336**	**513**	**404**	**429**
Scope-adjusted debt in NOK m	**2015**	**2016**	**2017F**	**2018F**
Reported gross debt	2,793	2,491	2,688	2,478
Cash, cash equivalents	-673	-478	-609	-399
Cash not accessible	16	19	20	20
Pension adjustment	84	52	49	47
Operating lease obligation	96	114	123	128
Subordinated owner loan	374	374	374	374
Scope-adjusted debt	**2,690**	**2,572**	**2,645**	**2,648**

*Free cash flow after dividends

Business risk profile

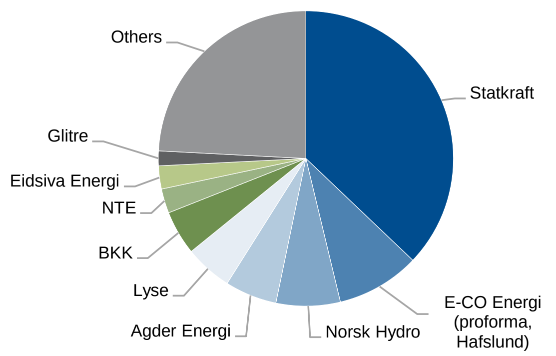
Scope's analysis of Glitre's business risk profile is split into industry risk and competitive position, whereby the latter includes our assessment of market position, diversification and operating profitability/efficiency.

Industry risk

Blended industry risks of BBB

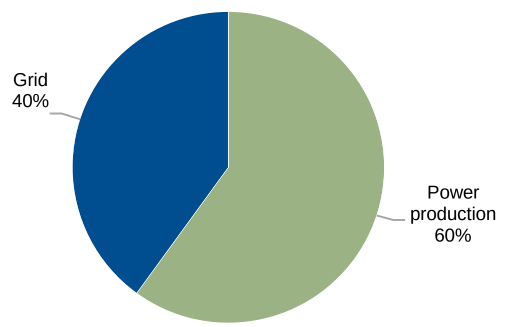
In accordance with Scope's rating methodology for utilities, we assess each of the company segments separately, taking their different characteristics into account. As Glitre's EBITDA contribution segments mainly consist of power generation (approx. 60%) and regulated grid (approx. 40%), these two segments directly impact Scope's overall blended industry risk assessment of BBB. In Scope's view, the general European power generation market is characterised by highly cyclical features and medium entry barriers, while the regulated distribution business has low cyclicality and high entry barriers. Glitre's direct exposure to power sales and indirect exposure to broadband services are considered in our competitive positioning analysis.

Figure 1: Norway's main hydro generation companies



Source: Company reports, Statistics Norway (SSB), Scope

Figure 2: Segment split based on normalised EBITDA



Source: Glitre, Scope

Competitive position

Small but favourably positioned

Scope assesses Glitres's competitive position based on the sum of its individual business segments. Its competitive position is, overall, supported by:

- A relatively large protected monopoly position through the operation of its distribution grids – this position is expected to expand further
- Strong, but still small, standing in the power generation market (ninth in Norway, i.e. 2% of Norway's electricity consumption), with a favourable position in the merit order system, due to the low-cost profile of hydropower
- Mitigation of pricing risk in power production through hedging activities
- Significant value and positive dividend/earnings from its minority-owned Viken Fiber

Nevertheless, Glitre's competitive position is hampered by:

- General volume risks in dry hydrological years, as the company has no water reservoir capacity – only river power plants
- Limited geographical outreach within Norway

Ninth largest hydropower producer in Norway, operating 20 river power plants

Glitre owns 10 wholly- and 10 partially-owned hydropower plants with an annual production of about 2.4 TWh. Although it is a relatively small utility company, Scope views Glitre's position within the Nordic market's merit order system to be excellent, thanks to the comparatively low marginal costs of hydropower electricity generation.

Glitre owns and operates river power plants located in eastern Norway, in an area with an abundance of water and small waterfalls. Compared to companies with reservoir capacity, Scope views Glitre's run-of-river plants as less flexible when it comes to adjusting and optimising production. Moreover, Glitre is more exposed to volume risk in dry hydrological years, compared to companies with a large reservoir capacity. Nevertheless, Scope recognises the company's cooperation with other hydropower producers through water regulators, thus having some indirect control over the amount of water coming through to its production facilities.

Growing share of regulated grid operations

Glitre's market position is supported by its exposure to regulated and protected grid operations. These activities are regarded as a robust cash flow source for the overall business, and, despite its relatively small size (13th largest grid company in Norway), they have achieved a high level of efficiency. Scope notes that the current business plan includes further consolidation in the grid business, with Glitre likely to merge with/acquire smaller grid operators in the years ahead (project 'Østafjells'). The company's ambitions towards 2025 could potentially mean that grid profitability would represent around 55% of company profit before tax in 2025 (up from 45% today). These plans are still very uncertain, and we take comfort in the management's desire to fund these possible investments with a combination of shares and debt in order to keep financial risk profile moderate.

Diversified business including several minority-owned company holdings

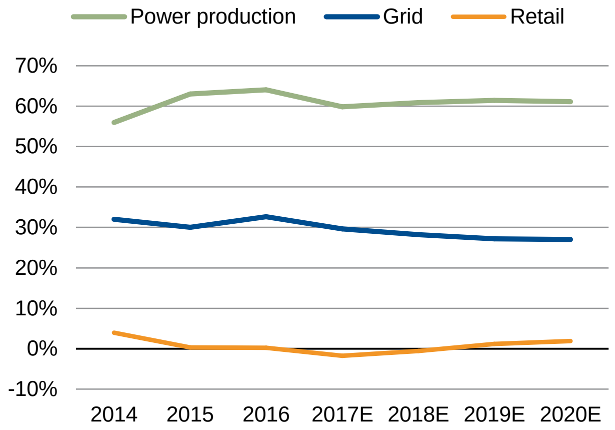
Scope has a positive view of Glitre's integrated business model as regards diversification, with utility-related business covering the key parts of the power utility's value chain from generation to distribution and power sales. In addition, we note the diversification into broadband, power-entrepreneur business, wind-project development and district heating – we do not, however, attach too much operational significance to these, as they have historically contributed little cash flow to the company. Going forward, Scope expects a higher contribution from Glitre's broadband/fibre shareholding (as this represents a good asset with meaningful anticipated market value), while the other businesses are likely to either be divested or generate little cash contribution.

In terms of diversification, Scope notes Glitre's geographical limitation to the Buskerud county and Hadeland area, if we exclude the minority-owned or non-core assets which it operates elsewhere. We also observe that power sales through Glitre Energi Strøm come entirely from Glitre's own producing assets, corresponding in volume terms to 44% of total company production. The reason Glitre Energi Strøm buys from its related company (at market terms) is that this allows it to guarantee its customers 100% renewable hydropower electricity. Glitre's power sales business is still relatively small (despite doubling in 2015), with approx. 50,000 customers, divided into private consumers (65% of revenues) and industrial customers (35%).

With 20 fully- or partly-owned hydro plants, Scope regards Glitre's diversification within its power generation portfolio to be slightly less than adequate, as we note some concentration risk due the importance of the largest plants. Glitre's largest hydropower plant accounts for around one quarter of the group's annual production, while the three largest make up roughly 50%.

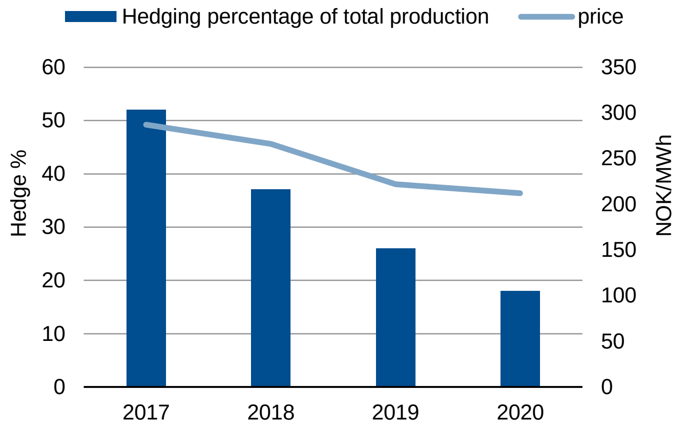
Scope has a positive view of the average underlying EBITDA margin for the group, which has consistently been above 40% in recent years. Nevertheless, we expect it to fall into the high 30s in the medium-term due to an increasing share of grid business (with a lower EBITDA margin) together with our estimates regarding power prices. With regard to the assessment of the volatility of overall group profitability, Scope considers the company's hedging policy when looking at fluctuating factors stemming from electricity generation volumes (with no reservoir capacity).

Figure 3: EBITDA margin development per main segment



Source: Glitre, Scope

Figure 4: Hedging % of anticipated hydro production volume



Source: Glitre, Scope

Volatility reduced by dedicated and well-defined hedging programme

The company has clear limits and routines for managing the risk associated with power prices using mainly financial power contracts. The purpose of Glitre's hedging policies is to achieve a high degree of predictability in cash flow after tax in NOK. Scope notes that historical hedging levels have been relatively consistent lately, with a hedge ratio of approx. 50% of next year's anticipated production volume. The company does not take currency risk on price-hedged volumes either.

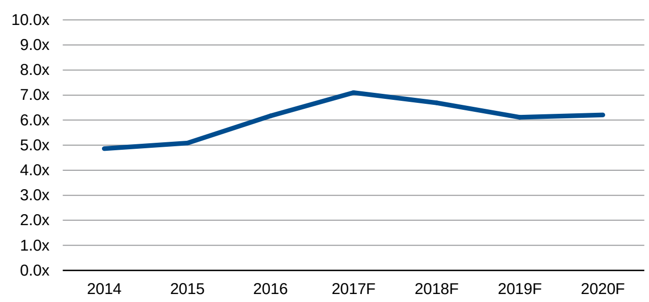
Scope also recognises the fact that Glitre's unhedged exposure to power price movements is lower than indicated in Figure 4. When taking the Norwegian 'grunnrente' tax into account, the company calculates that cash flow after tax would be largely unaffected by power price changes from 2018 if approx. 58% of its running production is price hedged. As a result, Scope views Glitre's total hedged share of its power generation business to be very high. For the longer term, the company uses a declining hedge ratio, as illustrated in Figure 4. When analysing the historical data, Scope observes that Glitre has consistently achieved good results with its hedging policy over the last five years, but, based on the current price development and outlook, we recognise that some of the outstanding hedges today are 'out-of-the-money'. Overall, however, Scope has a favourable view of the company's conservative hedging policy which stabilises volatility in its power production business.

Financial risk profile

Positive cash generation and improved credit ratios post subordinated loan conversion in 2015

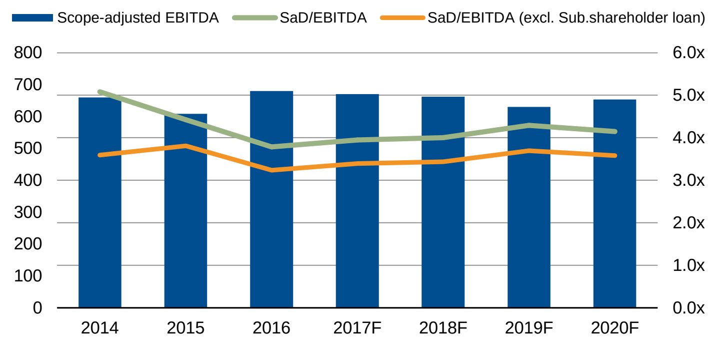
Glitre's financial risk profile is governed by the company's well established financial policy and targets. Scope acknowledges the company's delivery of positive free cash flow generation (before dividends) in recent years, despite the investment phase in the grid division. The financial risk profile was improved during 2015, when Glitre's conversion of a subordinated owner loan to equity took place, which helped to reduce leverage and bring the corresponding ratio down to more moderate levels below 4x. Together with a solid debt protection assessment, which has also improved in recent years, we would describe Glitre's financial risk profile today as in the low investment grade area based on our utility rating methodology.

Figure 5: EBITDA net interest coverage development



Source: Scope, Glitre

Figure 6: SaD/EBITDA



Source: Scope, Glitre

Growing share of grid business also affects margins

Overall, Scope considers Glitre's operational profitability and cash flow as relatively stable, supported by its strong position in regulated infrastructure and material hedging in the power generation business. Over the past three years, hydro power production's contribution to EBITDA has fallen slightly, which has been compensated for by a higher regulated infrastructure contribution. Glitre's decision to merge with Lier Everk and Hadeland Energi in 2015 has supported this development and we note that the company's strategic plan is to grow its regulated infrastructure business even further.

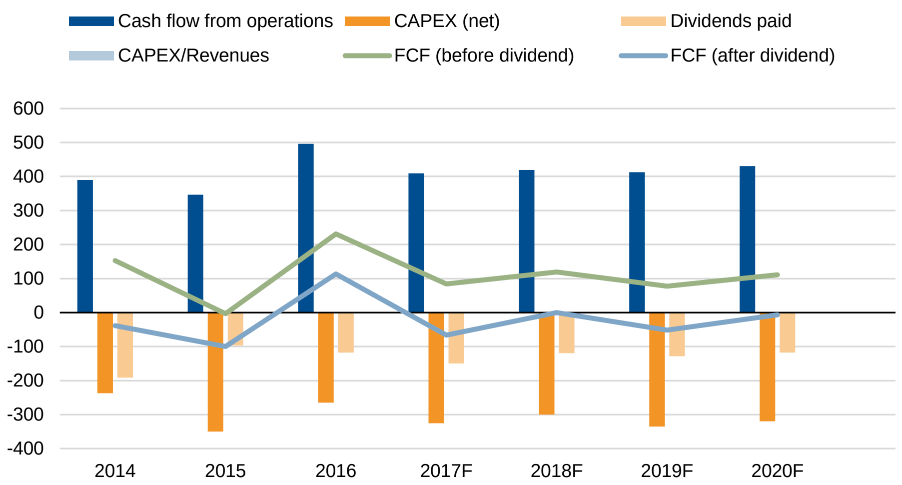
Investments mainly in the grid, but some maintenance in power generation from 2019

Glitre's cash conversion, as measured by funds from operations in relation to EBITDA, is projected to stay relatively stable in our medium-term forecast. With funds from operations above NOK 400m p.a., Scope notes that free cash flow before dividends will remain positive, despite continuous investment plans. Of the planned capex programme, more than 80% is expected to be directed towards grid operations in 2018 which has been the main investment focus the last couple of years. From 2019, we also anticipate some higher investment in Glitre's production business.

SaD/EBITDA expected to peak in 2019

At the end of 2017, SaD is expected to stand at NOK 2.6bn, largely unchanged from the figures reported at the end of Q3 2017. We estimate that leverage ratios, expressed as SaD/EBITDA, will remain below 4x until 2019. The small increase in leverage ratios in 2019 should be seen in conjunction with a decline in expected power production volume that year, as the company's largest power plant is up for scheduled maintenance and thus likely to have somewhat lower output that year.

Figure 7: Cash flow development

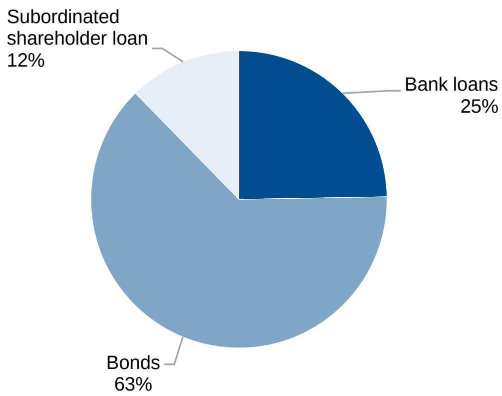


Source: Scope

Better than adequate liquidity, with S-2 short-term rating

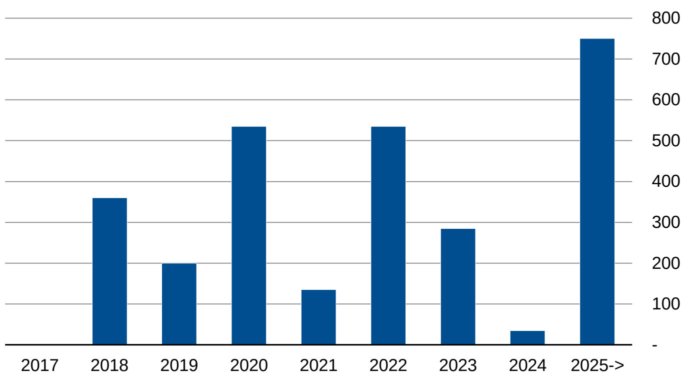
Scope views Glitre's liquidity situation as 'better than adequate', based on our ratings methodology criteria, resulting in an S-2 short-term rating. With the recent announcement of NOK 400m in long-term financing in November, the company has limited refinancing needs in the short term as well as having a total of NOK 1.25bn in undrawn credit lines, of which NOK 1bn matures in 2019 but is expected to be refinanced and extended in 2018. As illustrated in Figure 7, Scope anticipates cash flow before dividends to stay positive, while cash flow after dividends is projected to be in the break-even area. Our expectations with regard to the dividend pay-out are in line with the management's target, i.e. 60% of net income. We have not assumed any acquisitions or divestments in our base case, although we would expect the company to consider such moves if the terms and pricing are acceptable.

Figure 8: Funding structure Q3 2017



Source: Glitre, Scope

Figure 9: External debt maturity profile, as of Q3 2017



Source: Glitre, Scope

We expect the remaining subordinated loan to stay unchanged, paying an average interest rate of slightly more than 4%. Scope believes that this loan should be excluded from the senior debt calculations, as it is non-amortising (until 2045) and subordinated. Adjusting for the subordinated loan in our leverage ratio, SaD/EBITDA is currently 3.4x and would peak at 3.7x in 2019.

Supplementary key rating drivers

Well-defined financial policy and targets

Scope considers Glitre's financial strategy to be well-documented, with the overall objective being to ensure that the company has adequate long-term funding at the lowest possible cost. Although Scope has not made an explicit adjustment to its credit rating based on company policy, we take comfort in various financial targets which are considered absolute. The conversion of the subordinated loan to equity in 2015 is a sign of the management's dedication to keeping credit metrics at certain levels.

Although Glitre does not have a single majority shareholder, we view the two municipalities as one, due to their collective strategy and interest in the company. Drammen municipality and Buskerud county municipality (via its company Vardar), both have 50% of the shares, and established an 'owner-strategic platform' for the company in 2012 where the core business in Glitre was defined.

We have reviewed the fact that the Buskerud county owner is represented by another utility company (Vardar, which has a weaker standalone credit profile), and have concluded that potential support will not be determined by the performance or credit quality of Vardar, but solely by the ability and willingness of the municipality owner. As a result, we deem both owner ability and willingness to support Glitre to be very strong.

We also highlight the impact of the Norwegian government's ongoing desire to merge municipalities and county municipalities. As Buskerud county municipality will be merged with Akershus and Østfold in 2020, we expect the ownership structure of Glitre and Vardar to be up for review. Scope believes that one likely outcome would be the underlying municipalities in Buskerud becoming the direct owners of Glitre, as opposed to indirect owners through Vardar.

One-notch uplift from standalone rating based on municipality ownership

Scope emphasises the fact that Glitre's credit rating is not based on explicit support or guarantees from its municipal owners. However, it is highly likely that the municipalities would provide financial support in the theoretical event of financial distress.

As a result of the strong rating on the Norwegian state and its municipalities, we consider Glitre's ownership structure as supportive of the company's credit quality. We therefore apply a one-notch uplift to the BBB- standalone rating, resulting in an issuer rating of BBB. This is in line with Scope's practice for our rated Norwegian utility peers with majority municipality ownership.

Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings AG.
The rating analysis has been prepared by Henrik Blymke, Managing Director. Responsible for approving the rating: Werner Stäblein, Executive Director. The rating was first assigned by Scope on 04.01.2018. / The rating was last updated on 04.01.2018.

Methodology

The methodologies used for this rating and/or rating outlooks are Rating Methodology Corporate Ratings 2017 Jan & Rating Methodology European Utilities 2017 Jan. Available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scoperatings.com. The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

Stress testing & cash flow analysis

No stress testing was performed. Scope performed its standard cash flow forecasting for the company under review.

Solicitation, key sources and quality of information

The rated entity and/or its agents participated in the rating process. The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, third parties and Scope internal sources. Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Potential conflicts

Please see www.scoperatings.com for a list of potential conflicts of interest related to the issuance of credit ratings.

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