TrønderEnergi AS
Kingdom of Norway, Utilities

SCOPE BBB POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	15.5x	20.1x	9.7x	9.6x
Scope-adjusted debt/EBITDA	2.1x	2.8x	3.4x	2.7x
Scope-adjusted funds from operations/debt	52%	31%	11%	10%
Scope-adjusted free operating cash flow/debt	34%	10%	29%	5%

Rating rationale

The issuer rating continues to reflect TrønderEnergi's (TE) standalone credit assessment of BBB- and a one-notch uplift related to its status as a government related entity. The Positive Outlook reflects the prospect of a sustained improvement in performance and thereby in key credit metrics, primarily driven by the higher generation profitability once low-price hedges roll out and hedge ratios decrease, enabling the company to realise the higher-than-historical average prices as forecasted.

The business risk profile, assessed at BBB-, is highlighted by TE's environmentally friendly and efficient hydropower production in central Norway. TE's exposure to monopolistic power distribution from its 40% stake in Norway's third-largest regulated power distributor, Tensio, also continues to support the credit.

The stronger financial risk profile, raised to BBB, is largely based on a forward-looking analysis given TE's new structure, implemented in H2 2022. While the transaction that led to the new structure was expected to weaken leverage metrics, a higher-than-expected NO3 price and stronger cash flows led to much-improved financial flexibility. Further, capex of the restructured TE now only relates to its hydropower operations in TrønderEnergi Kraft. We therefore expect discretionary and free operating cash flows to be more predictable going forward, supporting the financial risk profile.

Outlook and rating-change drivers

The Positive Outlook reflects the potential rating upside if power prices in the NO3 zone were able to stay at around EUR 40MWh until 2025 and beyond, paired with no material spending on growth or higher dividends than forecasted in our base case.

A rating upgrade could be conducted if financial metrics remained strong and the company would not distribute dividends well beyond our forecasts leading to a Scope-adjusted debt/EBITDA sustained below 3.0x.

A revision to the Stable Outlook could be triggered if Scope-adjusted debt/EBITDA showed the potential to move and be sustained above 3.0x. This could be driven by lower-than-expected power prices or more aggressive shareholder remuneration than anticipated. Further ratings downside could materialise if credit metrics significantly weakened, e.g. if Scope-adjusted leverage moved towards 4.0x. While considered a remote scenario, a loss by TE of its status as a government-related entity would also cause ratings pressure.

Date	Rating action/monitoring review	Issuer rating & Outlook
27 Jun 2023	Outlook change	BBB/Positive
22 Jun 2022	New	BBB/Stable

Ratings & Outlook

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

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Related Methodologies

General Corporate Rating Methodology; July 2022

European Utilities Methodology; March 2023

Government Related Entities Methodology, May 2022

Related Research

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

Positive 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 stable dividends going forward
- Long-term, supportive and committed municipal owners, warranting a one-notch uplift under our Government Related Entities Methodology
- Solid free operating cash flow generation and debt protection
- Increased visibility on future cash flows after all non-hydro operations were transferred out in 2022

Negative rating drivers

- Limited geographical diversification in different pricing areas and asset concentration risk in power production
- Spot price exposure for unhedged power production volumes, introducing volatility in credit metrics

Positive rating-change drivers

- Scope-adjusted leverage sustained below 3.0x

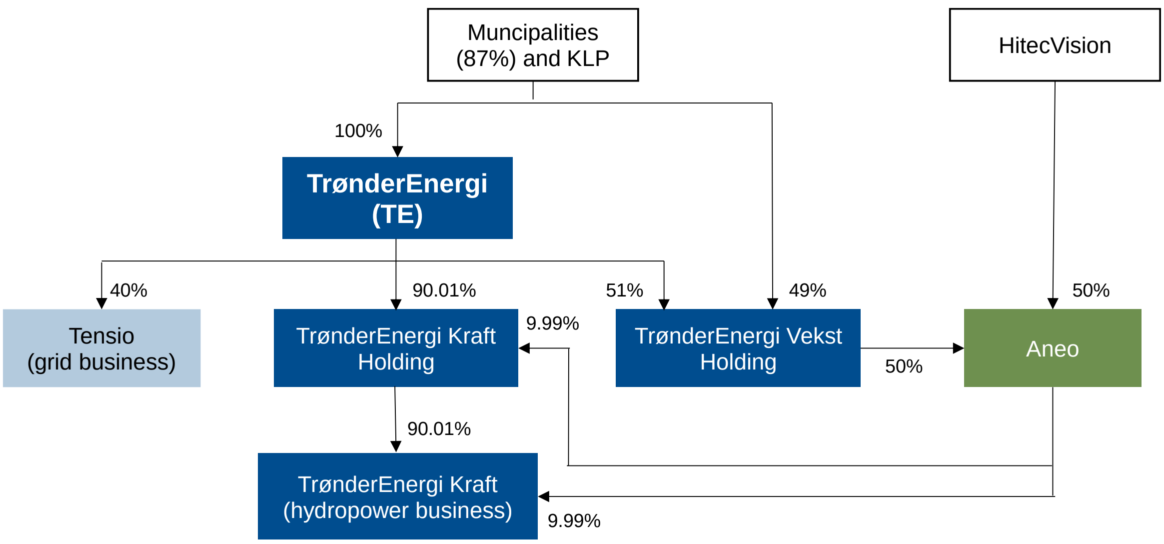
Negative rating-change drivers

- Outlook revision to Stable: non-materialisation of Scope-adjusted leverage of below 3.0x
- Negative Outlook or even downgrade: significant weakening of leverage towards 4.0x
- Loss of status as a government-related entity (remote)

Corporate profile

TrønderEnergi AS (TE) is a municipally majority-owned Norwegian utility company focused on environmentally friendly hydropower production in the NO3 price region in central Norway. The company's annual power production was 2.3 TWh in 2022 and its mean production is estimated at 1.8 TWh, making it one of the smaller hydropower producers in Norway. TE is also exposed to monopolistic power distribution through its 40% stake in Norway's third-largest regulated power distributor, Tensio AS. 2022 was transformative for TE after it transferred in October all non-hydro-generating assets to joint-owned growth company Aneo.

Figure 1: New structure of TE (post-transaction)



Sources: Scope

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021[1]**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	5.8x	15.5x	20.1x	9.7x	9.6x	9.4x
Scope-adjusted debt/EBITDA	3.3x	2.1x	2.8x	3.4x	2.7x	2.8x
Scope-adjusted funds from operations/debt	18%	52%	31%	11%	10%	11%
Scope-adjusted free operating cash flow/debt	5%	34%	10%	29%	5%	6%
Scope-adjusted EBITDA in NOK m						
EBITDA	43	562	471	431	567	575
add: received Tensio dividend *less* dividend paid to new growth company (see figure 1)	431	300	180	46	55	55
Scope-adjusted EBITDA	**474**	**862**	**651**	**477**	**623**	**630**
Funds from operations in NOK m						
Scope-adjusted EBITDA	474	862	651	477	623	630
less: (net) cash interest paid	-79	-54	-31	-49	-65	-67
less: cash tax paid per cash flow statement	-105	-53	-129	-250	-195	-227
less: pension interest	-2	-1	-1	-	-	-
Other items[2]	4	206	75	-	-195	-140
Funds from operations	**291**	**959**	**565**	**177**	**167**	**196**
Free operating cash flow in NOK m						
Funds from operations	291	959	565	177	167	196
Working capital change	7	-96	-285	338	-12	-2
less: capital expenditure (net)	-213	-233	-88	-50	-70	-95
Free operating cash flow	**85**	**630**	**191**	**465**	**85**	**99**
Net cash interest paid in NOK m						
Net interest paid from cash flow statement	49	49	26	47	65	67
add: interest component, pensions	2	1	1	-	-	-
add: interest component, hybrid debt	30	5	5	3	-	-
Net cash interest paid	**81**	**56**	**32**	**49**	**65**	**67**
Scope-adjusted debt in NOK m						
Reported gross financial debt	2,459	3,343	2,995	2,698	2,398	2,133
add: subordinated (hybrid) debt	72	72	72	-	-	-
less: cash and cash equivalents	-1,020	-1,701	-1,238	-1,109	-734	-408
add: non-accessible cash	33	114	7	7	7	7
add: pension adjustment	37	16	4	4	4	4
add: operating lease obligations	-	-	-	-	-	-
Scope-adjusted debt	**1,581**	**1,844**	**1,840**	**1,600**	**1,675**	**1,736**

[1] To better represent the new structure, 2021 figures were restated in TE's 2022 accounts.
[2] Other items in 2024E/2025E are the cash flow effects from hedges closed and recognised in the P&L for 2022

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Environmental, Social and Government (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)

Efficient low emission generation considered a competitive advantage

As a hydropower producer, TrønderEnergi has a favourable ESG profile, highlighted by its very efficient generation and estimated carbon intensity of 19gCO2e/kWh against the European average of 250gCO2e/kWh. Such a strong position is supportive of cash flow generation and access to funding, thanks to the high utilisation factor of its hydro assets and the low risk of adverse regulation and political interference. In addition, the exposure to hydropower generation guarantees that TE will remain a government-related entity and retain the benefits this status confers.

Regulatory risks highlighted in 2022

Despite a positive sustainability profile, Norwegian utilities are still subject to regulatory and reputational risks. This became evident during 2022 when the extraordinary rise in electricity prices increased scrutiny on Norway's publicly owned power sector, leading to the temporary imposition of a windfall tax and a permanent increase to the resource rent tax rate on hydro generation assets. While the windfall tax applies to prices of EUR 70 per MWh or greater, which are unlikely in TE's price region, the increased resource rent tax will reduce cash flows.

Dark green certification from CICERO

TrønderEnergi has a well-integrated ESG framework and ambitions. The company has issued green bonds and its green-bond-framework has received a 'dark green' certification from CICERO.

[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-

New holding structure successfully implemented in October 2022

TE's business risk profile is highlighted by the company's environmentally friendly and low-cost hydropower production in favourable geographical locations in central Norway, as well as its exposure to monopolistic power distribution minority stake in Tensio. In line with our assumption under our last review, TE transferred its non-hydro operations to Aneo in October 2022. Under the new structure we predominantly consider TE as a pure-play hydropower producer.

Blended industry risk profile: BB+

TE's significant exposure to unregulated power generation results in high merchant risk due to volatile power prices, as exemplified by the realised hedge losses in 2022. We continue to factor in parts of TE's exposure to regulated grid operations through its minority stake in Tensio, which provides stability through predictable dividend income. However, we continue to give slightly less weight to these dividends as TE only has a minority shareholding and lacks control.

Utility segment	Industry risk	Normalised exposure
Unregulated generation	BB	84%
Regulated grid operations	AA	16%
Blended industry risk	**BB+**	

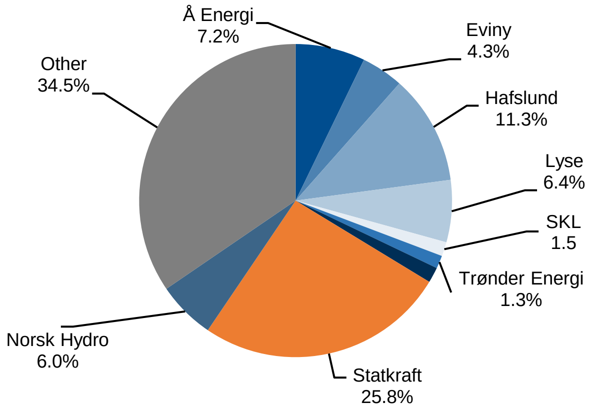
Small hydro generator; well placed with low-cost assets

TE had an actual production of 2.3 TWh in 2022 (1.9 TWh in 2021) from 17 wholly or partly owned plants located in the NO3 price zone. Its annual mean production of 1.8 TWh makes it a small Norwegian hydropower producer, accounting for an estimated 1.3%-2% of Norway's annual hydropower production. However, we still emphasise that size is of little importance for a utility's market position, with more weight given to factors such as merit order position, emissions, and adeptness of the generating assets. TE's hydro power plants are favourably placed in the Nordic and European merit order systems, as exemplified by an estimated carbon intensity of 19gCO2e/kWh (compared to European average of 250gCO2e/kWh). The plants are also highly profitable, with EBITDA margins of close to 70% when adjusted for realised effects from hedges. Lastly, the company can regulate around 34% of its annual mean production, which is credit-positive as it ensures flexibility in generation and the ability to optimise output when prices are high such as during peak-load hours. We anticipate that TE will benefit more from this in the longer term as the share of intermittent production in the Nordic region and Europe is expected to increase.

Exposure to monopolistic grid operations through dividends

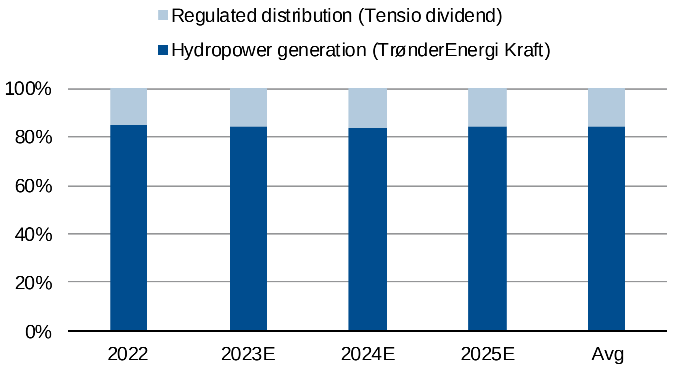
The exposure to Tensio's grid monopoly is positive for TE's market position, as well as for the overall business risk profile, as the predictable and stable dividends from Tensio help offset the more volatile cash flows from power production. As for TE's 40% stake in Tensio, we also highlight the joint shareholder agreement with the other large owner (NTE) as well as Tensio's obligation to distribute all cash after operational needs and debt service to shareholders.

Figure 2: TE's estimated market share in Norwegian power generation



Sources: Scope (estimates)

Figure 3: Segment split of Scope-adjusted EBITDA



Sources: Scope (estimates)

Segment diversification helped by stake in Tensio

TE has slightly better segment diversification than other pure-play power producers, with around 85% of its Scope-adjusted EBITDA coming from hydropower production and the remainder from grid dividends. However, we note that the higher-than-historical NO3 prices drove up the contribution from generation above the level in last year's review (around 25%). The company has a favourable exposure to renewables growth through the 25.5% stake in Aneo, though the joint venture is unlikely to pay dividends soon, making the impact on diversification and the overall business risk profile limited for now.

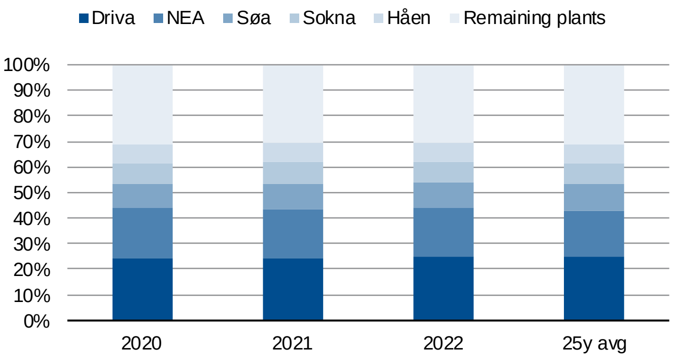
Regional presence in Norway within the NO3 bidding zone

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

Some asset concentration in the hydropower portfolio

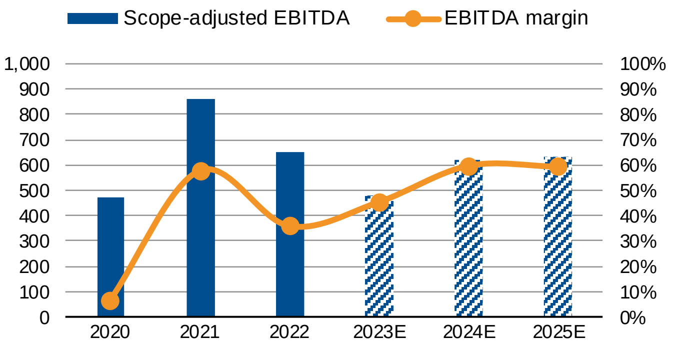
TE's hydropower production is spread across 17 fully or partly owned plants. However, TE is highly dependent on its two largest plants, Driva (around 25% of total production) and NEA (around 18%), and any prolonged interruption in their output would have a material adverse impact on cash flow. Such standstills are nonetheless unlikely.

Figure 4: Production dependency on largest hydropower plants



Sources: TrønderEnergi, Scope

Figure 5: Scope-adjusted EBITDA (NOKm, LHS) and EBITDA margin (%, RHS)



Sources: NordPool, Scope (estimates)

Less upside in achieved prices than southern Norway producers

In terms of achievable prices for power generation, the NO3 bidding zone is less optimal than in southern Norway (NO1, NO2 and NO5). The differences are due to structural bottlenecks in the Norwegian regional grid that prevents efficient energy transfers between zones. In addition, southern Norway has the pressure of being directly connected with continental Europe, making prices in the south much more exposed to European energy balances. Still, we project NO3 spot prices of around EUR 40 per MWh into the medium term, which is well above historical average of around EUR 30 per MWh.

Strong operating profitability versus our European peer group

TE's profitability, as measured by the Scope-adjusted EBITDA margin, was down to 42% in 2022 due to NOK 342m in realised hedge losses. This is still strong despite being less than we had projected last year (55%). Further, we project significantly improved profitability in the medium term once hedges made at low prices roll out and hedge ratios decrease. This will likely enable TE to realise forecasts of higher-than-historical prices in NO3, driving up the EBITDA margin above 60% in 2025.

Recently fair value-adjusted balance sheet contributes to below-average assessment on return on capital employed

Profitability as measured by Scope-adjusted return on capital employed (Scope-adjusted ROCE) is more volatile than the EBITDA margin. While EBITDA is correlated with the top line, average capital employed is not. Also, as part of the restructuring, TE's holdings in Aneo and Tensio were adjusted to fair value. This leads to a lower assessment for Scope-adjusted ROCE of around 9% as compared to most other Scope-rated Norwegian utilities at around 15% or above.

Financial risk profile: BBB

Financial risk profile raised to BBB from BB+

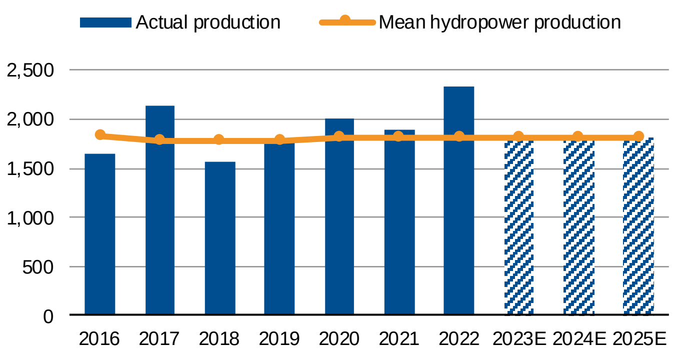
The financial risk profile, raised to BBB from BB+, is supporting TE's credit rating. The improvement is mainly driven by the stronger-than-expected 2022 financial results and the prospect of more supportive power prices than anticipated in the previous rating update in June 2022. Based on a flat power price assumption in 2023-2025 for the NO3 zone of EUR 40 per MWh (up from around EUR 30 per MWh in the previous rating update) and dividends from Tensio assumed at NOK 100m yearly, Scope-adjusted EBITDA is foreseen to increase to around NOK 630m in 2024-2025 from NOK 477m in 2023, which includes the negative effects from the legacy hedging portfolio. This should support a faster deleveraging than expected despite the increased resource rent tax, with Scope-adjusted debt/EBITDA expected at around 2.75x in 2024-2025 against around 3.5x forecasted in the previous rating update. Given the high capex visibility, which mainly comprises the maintenance of hydropower assets, we believe the main risk factors for weaker-than-forecasted credit ratios are lower power prices as well as more aggressive shareholder remuneration than assumed.

New structure implemented after successful establishment of Aneo in H2 2022

Our analysis remains mainly forward-looking due to the new structure implemented in H2 2022 after the establishment of Aneo (see Corporate Profile section). Under the new structure, TE consolidates its hydropower business through 81%-owned subsidiary TrønderEnergi Kraft, while accounting for the 40% stake in Tensio and the 25.5% indirect stake in Aneo as minority shareholdings.

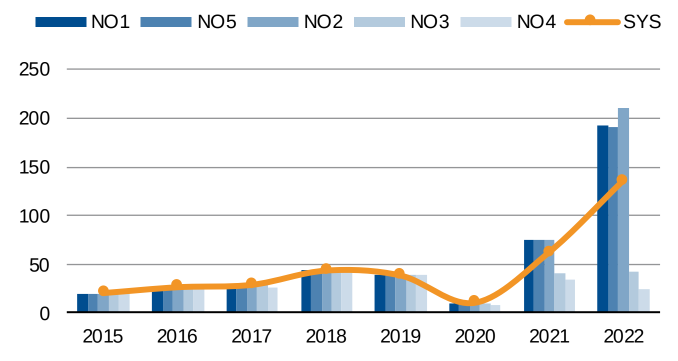
We continue to calculate TE's credit metrics using consolidated figures as a starting point. We then add to Scope-adjusted EBITDA the dividends received from Tensio and Aneo and subtract the minority holdings' share (i.e. the 19% stake owned by Aneo) of dividends paid by TrønderEnergi Kraft. Thus, we use actual dividend flows and not the share of results. In 2022, we also excluded from Scope-adjusted EBITDA the NOK 80m of transaction costs relating to the establishment of Aneo since this is non-recurring.

Figure 6: TE's actual hydropower production and mean production (TWh)



Sources: TrønderEnergi, Scope (estimates)

Figure 7: Power prices in Norway (by bidding zone) and the Nordic system price, in EUR/MWh



Sources: NordPool, Scope

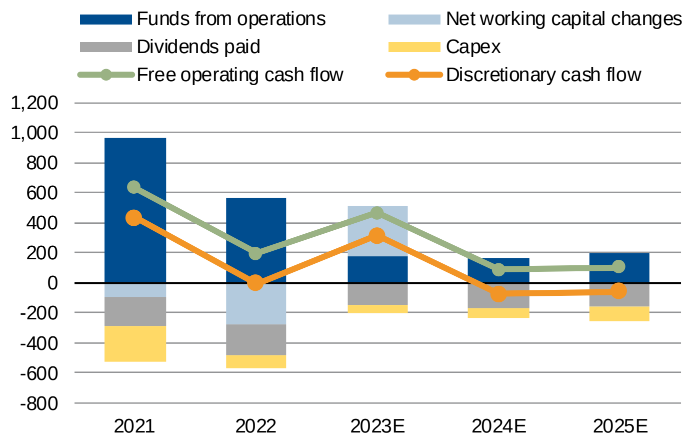
Legacy hedging portfolio to negatively affect results and operating cash flow in 2023-25

TE has a relatively large legacy hedging portfolio for its hydropower generation at prices well below our applied price curve. This portfolio is expected to negatively affect results, which we incorporate into our estimates. The hedge ratio for hydropower will likely reduce significantly after 2023, which would push up EBITDA given our price assumptions. However, operating cash flows in 2024 and 2025 are expected to remain weighed down by settlement of legacy hedging positions from wind assets transferred to Aneo in 2022, with approximate cash outflows of NOK 195m (in 2024) and NOK 140m (in 2025).

The main assumptions in the rating base case scenario are:

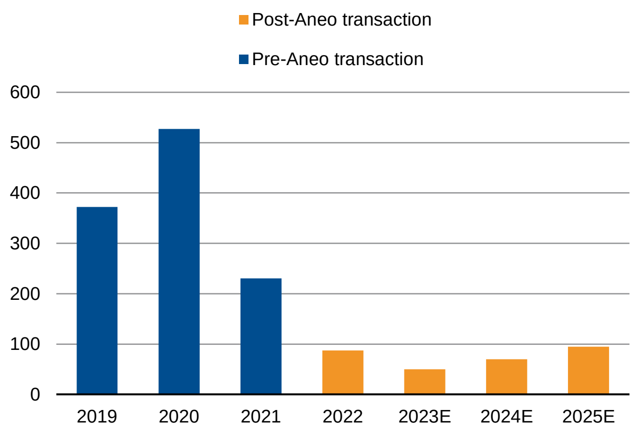
- Flat power price curve in NO3 of EUR 40 per MWh in 2023-2025
- Hydropower production equal to annual mean production of 1.8 TWh
- Capex of NOK 50m-100m yearly
- Dividends received from Tensio of NOK 100m p.a.
- Ordinary dividend payouts from TE of close to its minimum payout (i.e. around NOK 150m) to mitigate negative cash flow effects from its legacy hedging portfolio

Figure 8: Cash flow overview (NOK m)



Sources: Scope (estimates)

Figure 9: Capex excluding business acquisitions and divestments (NOK m)

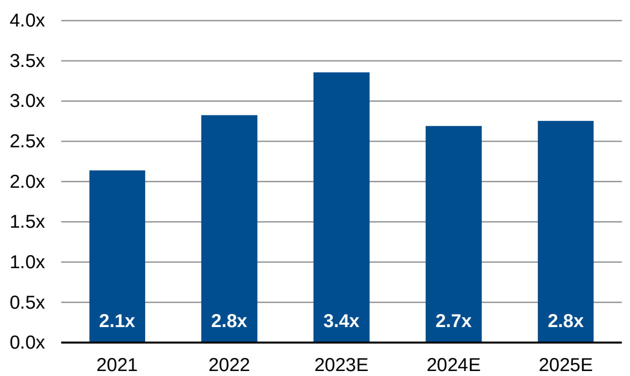


Sources: Scope (estimates)

High internal financing capacity and robust interest cover

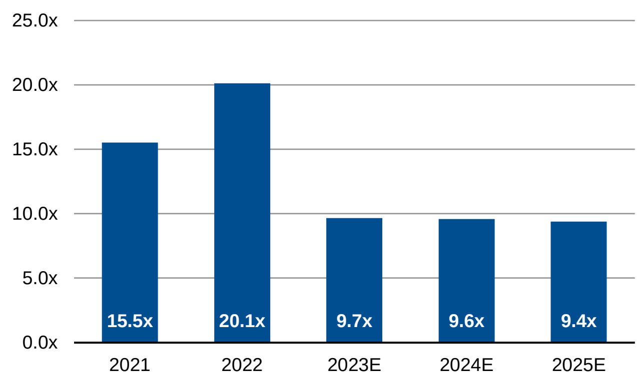
Aside from the improved leverage forecasted at below 3.0x in 2024-2025, we foresee that TE will likely maintain high internal financing capacity, supported by low and predictable capex of NOK 50m-100m yearly. We also expect capex to comprise mainly the maintenance of hydro power plants and potentially some expansion and/or optimisation projects. Further, debt protection metrics as measured by EBITDA interest cover are expected to stay strong at around 9.0x. While rising interest rates are feeding through to the cost of debt, the company's high share of fixed-rate debt of around 50% at end-2022 helps to slow the acceleration of the interest burden, supported also by the limited refinancing needs before 2025 due to a significant liquidity portfolio.

Figure 10: Scope-adjusted debt/EBITDA (x)



Sources: Scope (estimates)

Figure 11: Scope-adjusted EBITDA interest cover (x)



Sources: Scope (estimates)

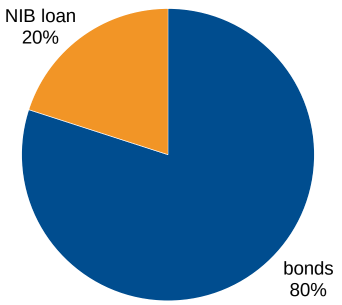
Transaction risks to reduce

Despite the major transactions in recent years, we expect deal activity to lessen. After TE's deconsolidation of the grid business with the creation of Tensio with NTE Nett in 2019 and the Aneo transaction in 2022, the only majority-owned business left relates to hydropower. However, TE has the right to repurchase Aneo's hydropower stake. Therefore, TE could intend to regain the full stake, but we believe only if it can conduct the transaction while maintaining a strong balance sheet.

Liquidity is strong with cash and cash equivalents of NOK 1.2bn at end-2022

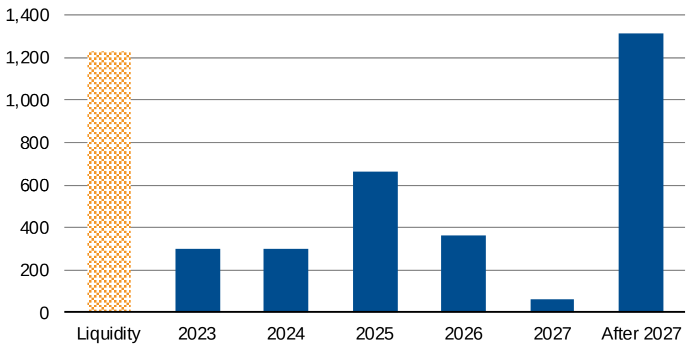
Liquidity remains adequate. At end-2022, TE had NOK 1.2bn in unrestricted cash and short-term investments, which is more than enough to cover upcoming debt maturities of NOK 297m and NOK 300m in 2023 and 2024 respectively. In addition, the company has notified that it will exercise its right to early redemption of its NOK 144m subordinated hybrid loan in June 2023. While TE's committed undrawn credit lines only comprise minor revolving credit facilities amounting to NOK 55m, larger facilities are not required to due to the company's large liquid portfolio. However, it should have no issues adding larger facilities if needed.

Figure 12: Fixed- and floating-rate exposure in existing debt



Sources: Scope (estimates)

Figure 13: Debt maturity profile at YE 2022, in NOK m



Sources: Scope (estimates)

Balance in NOK m	2022	2023E	2024E
Unrestricted cash (t-1)	1,701	1,238	1,109
Open committed credit lines (t-1)	-	-	-
Free operating cash flow (t)	191	465	85
Short-term debt (t-1)	347	297	300
Coverage	**512%**	**571%**	**396%**

Supplementary rating drivers: +1 (GRE)

One-notch uplift related to GRE status

We use our bottom-up approach to assess 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 Trondheim municipalities (around 87% share) and mutual insurance company Kommunal Landspensjonskasse (around 13%). The uplift is driven by the anticipated capacity and willingness of TE's Norwegian municipality owners to provide financial support if needed.

Sound financial policy

We make no adjustment for financial policy, though we consider it sound. TE's dividend policy targets a ratio of about 75%, but with a minimum of NOK 200m yearly if this does not jeopardise the financial risk profile, currently applied to maintain the investment-grade credit rating. No new financial policy has been made official since the new corporate structure was finalised. However, we expect the dividend distribution policy to serve as a floor and believe any excess capital will likely be distributed to owners rather than being used to improve the financial risk profile more than necessary.

Long-term and short-term debt ratings

BBB senior unsecured rating

The rating on senior unsecured debt has been affirmed at BBB, in line with the issuer rating.

Short-term debt rating of S-2

The affirmed short-term debt rating of S-2 is based on the underlying BBB/Positive issuer rating and backed by the strong short-term liquidity cover and conservative liquidity management. The rating is further supported by well-established bank relationships and good standing in the capital markets.

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