Glitre Energi AS Norway, Utilities

BBB STABLE

Corporate profile

Glitre Energi AS is a Norwegian energy utility operating mainly in the Buskerud county and Hadeland area. It is vertically integrated, with activities primarily in power production, distribution and power sales but also in broadband services through its 26.5% ownership of Viken Fiber. Glitre Energi has an annual hydropower production of about 2.4 TWh and supplies energy to approximately 50,000 retail customers. In terms of distribution, the company builds and operates a roughly 8,100 km power grid serving around 94,000 customers. Glitre Energi is owned by Drammen municipality (50%) and Buskerud county municipality (50%, via the company Vardar).

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	7.4x	7.9x	7.9x	8.0x
Scope-adjusted debt (SaD)/EBITDA	3.4x	3.5x	3.3x	3.4x
Scope-adjusted FFO/SaD	18.5 %	7.9 %	23.3 %	16.0 %
FOCF/SaD	9.2 %	-4.9 %	11.4%	3.3%

Rating rationale

Scope Ratings affirms its BBB corporate issuer rating on Glitre Energi AS, as well as the S-2 short-term rating and BBB senior unsecured ratings.

The issuer rating is positively affected by Glitre Energi's share of monopolistic grid operations and relatively stable group profitability. The latter is influenced by the substantial hedging arrangement for its more volatile power generation business, which has helped the company to report group EBITDA margins of above 40% in the past. Glitre Energi's vertically integrated value chain supports our overall business risk assessment, although this is dampened slightly by low profitability in some non-core businesses. Limited geographical outreach for selected segments, some asset concentration risk, and a lack of flexibility in water-reservoir capacity (due to run-of-the-river power plants) also affect the company's business risk profile.

Glitre Energi's positive free operating cash flow over time supports its overall financial risk profile. Although we expect slightly higher capex in the short term, Scope-adjusted leverage ratios should remain stable, at around 3.5x in the medium term. As a result, we continue to assess Glitre Energi's overall financial profile as solid, helped by a normal anticipated power production level and forward power price indications in the market. Our new forecast estimates for Glitre Energi closely match our expectations from last year. We therefore continue to place the company well within the BBB area for a vertically integrated utility, in accordance with our methodology.

Glitre Energi has lower internal liquidity cover than last year, due to debt maturing in 2020. We expect this debt to be refinanced during H1 2020, but the company also has undrawn credit facilities to bridge the gap if needed. Cash collateral requirements related to derivatives hedging of power prices have also affected liquidity recently.

Ratings & Outlook

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

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Related Methodologies

European Utilities

Government Related Entities

Corporate Ratings

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Outlook

The Stable Outlook reflects our expectations that Glitre Energi will continue to be a diversified utility, with operations in power production, distribution and sales. Further, we expect the company to fund its medium-term planned capex programme using internally generated cash flow; and to reduce volatility through hedging initiatives. As a result, we anticipate key credit metrics to remain largely unchanged in the medium term.

A positive rating action could be warranted if Glitre Energi were to materially increase the share of its distribution business or deleverage to a Scope-adjusted debt (SaD)/EBITDA of below 3.0x on a sustained basis.

A negative rating action is possible if the company were to participate in a debt-financed structural transaction that either substantially weakened its business risk profile or resulted in a SaD/EBITDA of well above 4x and prolonged negative free operating cash flow generation.

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 who are willing and able to provide potential parent support	• Limited geographical diversification outside main local regions in Norway • Low profitability in power sales and limited contribution from share of non-core businesses • No water reservoir capacity and some asset concentration risk at power plants

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Increasing share of distribution business • Improved financial risk profile, exemplified by deleveraging to a SaD/EBITDA ratio of below 3.0x on a sustained basis	• Debt-financed transaction that weakens either Glitre's business risk profile or its financial risk profile • A weaker credit profile with a SaD/EBITDA ratio of well above 4x and prolonged negative free operating cash flow

Financial overview, numbers in NOK m

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	7.4x	7.9x	7.9x	8.0x
Scope-adjusted debt/EBITDA	3.4x	3.5x	3.3x	3.4x
Scope-adjusted debt (excl. sub. shareholder loan) / EBITDA	2.9x	3.1x	2.9x	2.9x
Scope-adjusted FFO/Scope-adjusted debt	18.5 %	7.9 %	23.3 %	16.0 %
FOCF/Scope-adjusted debt	9.2 %	-4.9 %	11.4%	3.3%
Scope-adjusted EBITDA	**2017**	**2018**	**2019F**	**2020F**
EBITDA	731	794	767	781
Operating lease payments in respective year	21	25	0	0
Scope-adjusted EBITDA	752	820	767	782
Scope-adjusted funds from operations	**2017**	**2018**	**2019F**	**2020F**
EBITDA	731	794	767	781
less: (net) cash interest as per cash flow statement	-89	-87	-97	-96
less: cash tax paid as per cash flow statement	-141	-150	-339	-307
add: depreciation component operating leases	14	15	0	0
Other items	-41	-344	260	42
Scope funds from operations (FFO)	474	229	591	420
Scope-adjusted debt	**2017**	**2018**	**2019F**	**2020F**
Reported gross debt	2,688	2,323	2,320	2,320
Cash, cash equivalents	-763	-103	-206	-109
cash not accessible	40	20	20	20
Pension adjustment	58	55	52	50
Operating lease obligation	167	229	0	0
Subordinated owner loan	374	374	374	374
Scope-adjusted debt (SaD)	2,565	2,898	2,560	2,655

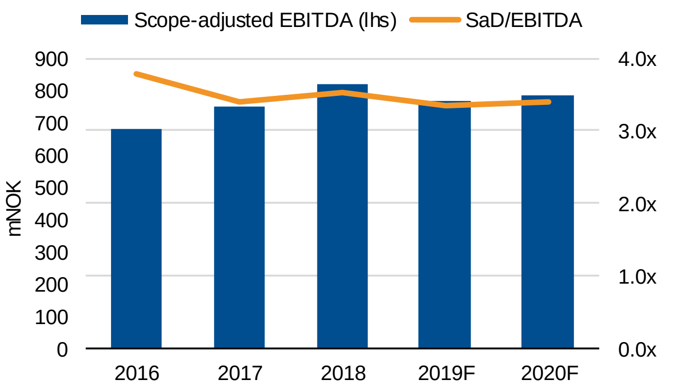
Glitre's operational developments in line with Scope's expectations

So far, the company's financial performance in 2019 has been largely in line with our expectations. The hydro power production segment has seen increased EBITDA, and its relative contribution to overall group EBITDA this year has also risen. We expect this trend to continue into 2020. Despite the shift towards a greater EBITDA contribution from the more volatile hydro power market, we do not expect volatility to increase materially in terms of achieved power prices, due to Glitre Energi's maintenance of its hedging policy. The company's ambition is to reduce the underlying volatility in production by hedging a relatively high percentage of anticipated production next year (around 50%), and then reducing this in the following years.

Cash flow in 2019 has been influenced by the payment of higher taxes and a reversal of some of the cash collateral that was placed last year, related to the company's financial derivatives hedging in the power market when forward prices changed. These cash flow changes can become material when there are large price fluctuations in the market, e.g. a positive NOK 263m effect in 9m 2019 versus a negative effect of NOK 242m in the corresponding period in 2018. In addition to the Nasdaq contracts, Glitre Energi also uses over-the-counter or bilateral hedging agreements, and regularly checks whether they should be increased going forward.

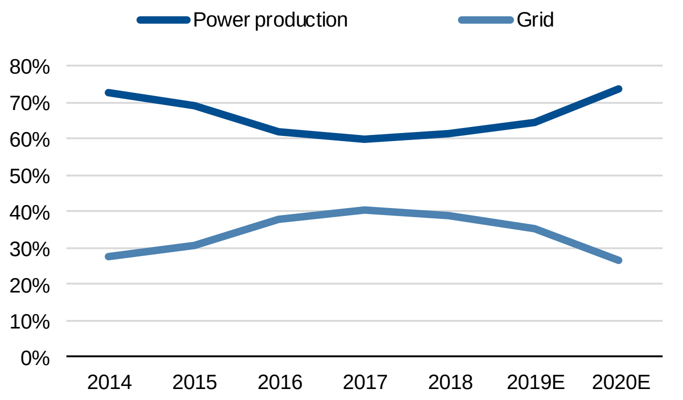
With respect to Glitre Energi's second and third largest segments in terms of EBITDA contribution, the operating results in power distribution have declined moderately this year, while the retail power sales division is reporting a stable but small profit. With respect to the latter, Glitre Energi and Agder Energi recently announced their intention to combine their digital power sales solutions (Oss Norge AS and Flyt respectively) in an effort to increase competitiveness for future digital customer services.

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



Source: Company, Scope

Figure 2: Share of group EBITDA development (in %)



Source: Company, Scope

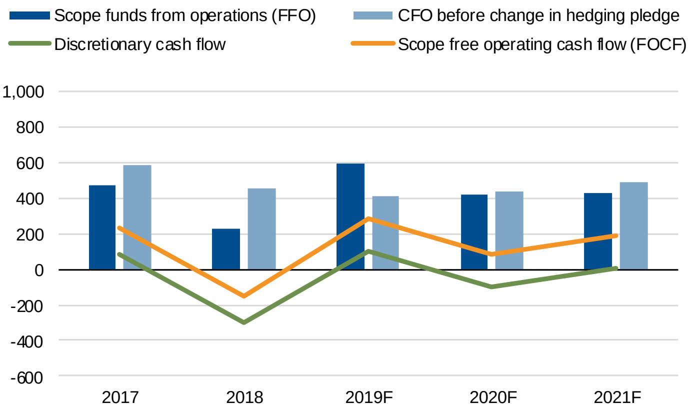
Updated Scope forecast

We have updated our financial forecast for Glitre Energi, following our review of recent performance and market conditions. Overall, there are no material changes to our forecast from last year. We therefore expect credit metrics to remain more or less unchanged in the medium term. Still, taking a more detailed look ahead into 2020, we anticipate that the trend towards a lower contribution from monopolistic grid operations, which began in 2019, will continue. This is a result of lower expected tariffs and an adjustment of allowed income, but also higher expected power production volumes, which will be positive for the group. With this in mind, we expect overall EBITDA to increase slightly in 2020 compared to 2019. Thus, with a moderate increase in capex and a stable dividend distribution, we believe that Glitre Energi's credit metrics will remain stable in 2020.

Glitre Energi's liquidity totalled NOK 1.3bn at the end of Q3 2019, consisting mainly of undrawn available credit lines. As illustrated in Figure 3, we anticipate free operating cash flow to stay positive, while discretionary cash flow could become slightly negative next year.

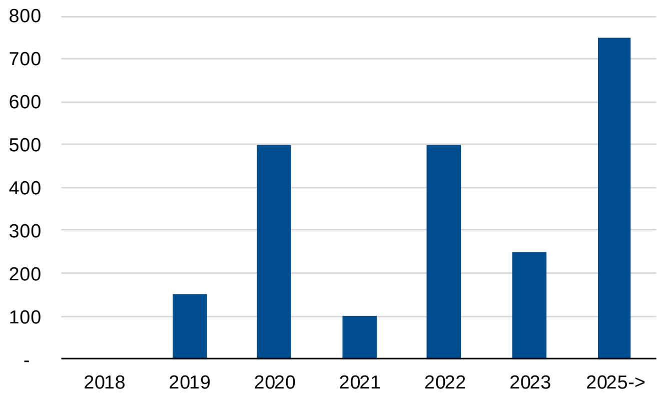
Our projections do not assume any structural transactions, but we note that the company has been open to selling non-core assets and participating in the ongoing consolidation among Norwegian utility companies. Thus, selected transactions in the coming years continue to be likely, which increases event risk to some degree. However, management is very dedicated to maintaining a solid financial standing in the market, supporting the view that its financial policy will include the protection of its investment grade rating.

Figure 3: Cash flow development (NOK m)



Source: Company, Scope

Figure 4: Debt maturity profile, at mid-Dec 2019 (NOK m)



Source: Company, Scope

Summary of business and financial risk profiles

While our business risk profile assessment for Glitre Energi has not changed on the whole, the individual drivers have changed somewhat. In particular, the company's business risk profile receives more support from its proven stability and high profitability, which counterbalances the higher implicit industry risk it is exposed to now that power contributes a higher share of future earnings. Our financial risk profile assessment is also unchanged from last year, although we note positively that debt protection metrics are stabilising at higher levels than in the past.

Supplementary rating drivers

We continue to use our bottom-up approach to analyse Glitre Energi's parent support, and the one-notch uplift assigned for municipality ownership has not changed. From 2020, Glitre Energi will have the underlying municipalities in Buskerud (instead of the county municipality) as new indirect owners through its direct owner Vardar. This ownership change at Vardar does not affect our parent support assessment for Glitre Energi.

Short-term rating

Despite Glitre Energi's lower internal liquidity ratio at present (due to the maturing debt), overall liquidity is adequate and justifies an affirmation of our S-2 short-term rating, in accordance with our methodology.

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