Agder Energi AS
Norway, Utilities

BBB+ NEGATIVE

Corporate profile

Agder Energi AS (Agder Energi) is a vertically integrated utility company based in Norway with activities in hydroelectric power production, network operation, energy management, as well as retail power sales, district heating and venture investments (with the latter three under its 'Market' division). For power generation, Agder Energi is Norway's fourth-largest energy supplier. The group either wholly or partly owns 49 power stations, which on average produce around 8TWh of renewable energy each year. Agder Energi Nett owns and operates regulated transmission and distribution networks in Agder county, while the group's LOS and Entelios brands sell power to retail and corporate end-users. Agder Energi is owned by 30 local municipalities (54.5%) and Statkraft Industrial Holding AS (45.5%).

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	14.8x	9.6x	5.7x	7.5x
Scope-adjusted debt (SaD)/EBITDA	3.0x	4.8x	6.6x	4.8x
Scope-adjusted funds from operations/SaD	24%	4%	13%	16%
Free operating cash flow/SaD	10.4 %	-7.6%	-0.0%	5.0%

Rating rationale

Scope Ratings has today changed the Outlook on the BBB+ issuer rating of Agder Energi from Stable to Negative. At the same time, the BBB+ issuer rating, S-2 short-term rating and BBB+ senior unsecured rating have been affirmed. The Outlook change reflects the risk of further pressure on leverage and free operating cash flow generation in the event that low power prices persist.

The issuer rating continues to be driven by the company's vertically integrated business model, with core activities in power generation, distribution and retail sales. The vertical structure combined with active and high hedging activity helps to mitigate the underlying volatility in power generation. Although the EBITDA contribution from the company's monopolistic distribution segment improved last year and is expected remain on this trend in 2020, the underperformance of its hydropower segment this year is clearly a negative factor. The company's hedging contracts, at higher power prices than current market levels, still provide a mitigating effect, making cash flow projections in 2020 higher than if the unhedged position had been greater.

Going into 2020, Agder Energi's financial risk profile was already stretched in relation to Scope's negative rating drivers, limiting the headroom for a further deterioration in credit metrics. In 2019, low production and lower grid profitability resulted in negative free operating cash flow (FOCF) and a Scope-adjusted debt (SaD)/EBITDA of above 4x. We anticipate key credit metrics to deteriorate throughout 2020, resulting in a lower financial risk profile rating, which is the main reason for the current pressure on the issuer rating. Although investment in 2020 is expected to reduce from the levels in 2019, credit metrics are likely to weaken further if not helped by cash inflow via the sale of non-core assets. We expect FOCF to be slightly negative and leverage ratios to remain well above our rating scale for a longer period. Internally generated liquidity ratios are still somewhat below those of peers, but overall liquidity is adequate, helped by increased undrawn credit lines.

Ratings & Outlook

Corporate rating	BBB+/ Negative
Short-term rating	S-2
Senior unsecured rating	BBB+

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Related Methodologies

Corporate Rating Methodology, Feb 2020

Rating Methodology European Utilities, Mar 2020

Government Related Entities Methodology, Jul 2020

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Outlook

The Negative Outlook on Agder Energi's rating reflects the increased risk of a longer low-price environment that weakens key credit metrics. Our base case indicates that these key credit metrics could remain weak throughout 2021 if no other cash inflow measures are taken. As such, we have lowered the company's financial risk profile rating, which is the main reason for the current pressure on the overall issuer rating.

A positive rating action (i.e. returning to a Stable Outlook) may be warranted if Nordic power prices improved, or if Agder Energi disposed of non-core assets or reduced investment or dividend payouts, resulting in positive discretionary cash flow and a sustainable improvement in credit metrics, exemplified by SaD/EBITDA returning below 4x.

A negative rating action is possible if the low Nordic power prices were to persist and no external cash inflow is generated from non-core asset disposals, leading to a SaD/EBITDA of above 4x and a negative FOCF/SaD for a prolonged period.

Rating drivers

Positive rating drivers	Negative rating drivers
• Vertically integrated business model with monopolistic power distribution, strong position of hydropower generation in the merit system and leading retail sales business • Profitable and environmentally friendly hydropower production (ESG factor) with substantial hedging agreements and sizeable reservoir capacity • Long-term, committed majority owners (25 municipalities) that are jointly organised and have the capacity and willingness for potential parent support	• Low power prices and sizeable investments that have resulted in negative discretionary cash flow • General exposure towards the highly cyclical power generation industry • Consistently low internally generated Scope-adjusted liquidity ratio in recent years

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Non-core asset sales, and reduced investment or dividend payouts, resulting in positive discretionary cash flow and sustainably improved credit metrics, exemplified by SaD/EBITDA returning below 4x	• Persistently low power prices and no external cash inflow from non-core asset disposals, leading to a SaD/EBITDA of above 4x and negative FOCF/SaD for a prolonged period

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	14.8x	9.6x	5.7x	7.5x
SaD/EBITDA	3.0x	4.8x	6.6x	4.8x
Scope-adjusted funds from operations/SaD	24%	4%	13%	16%
FOCF/SaD	10.4 %	-7.6%	-0.0%	5.0%
Scope-adjusted EBITDA in NOK m				
EBITDA	2,983	2,234	1,705	2,324
Add: operating lease payments in respective year	83	-	-	-
Scope-adjusted EBITDA	**3,066**	**2,234**	**1,705**	**2,324**
Scope-adjusted funds from operations in NOK m				
EBITDA	2,983	2,234	1,705	2,324
Less: (net) cash interest per cash flow statement	-190	-232	-302	-312
Less: cash tax paid per cash flow statement	-609	-990	-666	-319
Add: depreciation component, operating leases	66	-	-	-
Add: other incl. dividend income & cash settlement hedging	290	-542	697	100
Scope-adjusted funds from operations	**2,540**	**470**	**1,435**	**1,794**
Scope-adjusted debt in NOK m				
Reported gross financial debt	9,260	10,758	11,881	11,642
Less: cash, cash equivalents	-383	-131	-639	-554
Add: cash not accessible	19	20	20	20
Add: operating lease obligations	359	-	-	-
Scope-adjusted debt	**9,255**	**10,647**	**11,262**	**11,108**
Liquidity				
Liquidity (internal and external)	1.9	1.2	1.3	2.0
Liquidity (internal)	0.5	(0.3)	0.1	0.5
Total available liquidity in NOK m	**2,864**	**3,131**	**4,139**	**4,054**

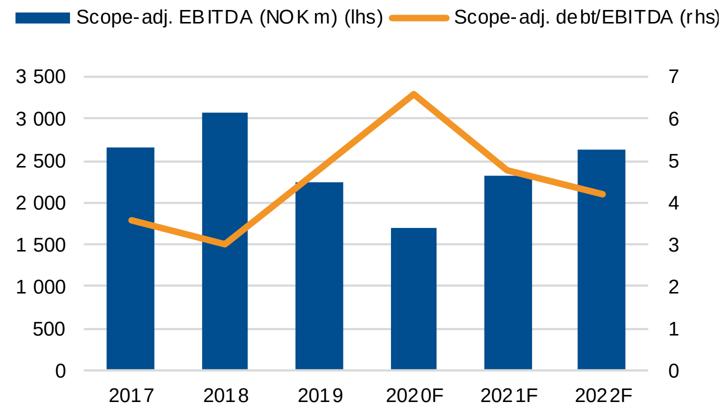
Operational developments since Scope's previous rating report

Hydropower contribution much lower this year

Although Agder Energi's FY 2019 financial performance was below our previous expectations, more relevant to the analysis is the development during 2020 regarding the significant hydrological surplus in Norway due to high snow/water reservoirs, which has put pressure on Nordic power prices. Agder Energi is clearly affected despite its hedging activities making a significant positive contribution to achieved prices compared to the spot prices. With the forward price curve for 2021 also on a downward trend, the company could be more severely impacted if the lower prices prevail.

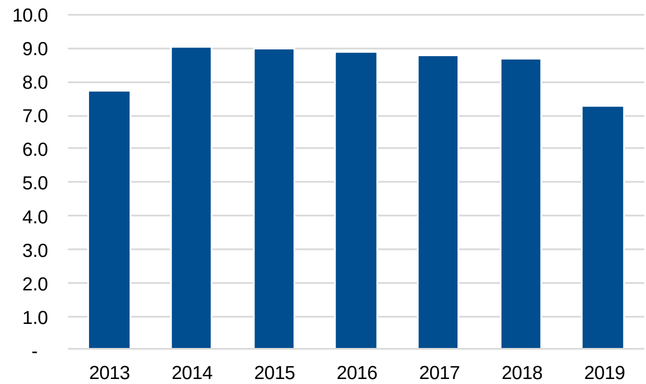
We expect the company to produce more hydropower in 2020 than in 2019 (7.3TWh), but the overall profitability margin to be much weaker – thus, the higher volume will not compensate for the lower prices. Positively, we see that some of the company's hedging contracts are at higher prices than the relevant market levels. We have revised our assumptions for long-term normalised EBITDA contributions, previously at 80% from hydropower and 15% from grid operations, now at 70% and 25% respectively, with the remaining still generated by the other businesses.

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



Source: Scope estimates

Figure 2: Hydro-power production (in TWh)



Source: Scope, Company

With new investment plans at moderate levels, gross capex in 2020 is estimated to be below that in 2019, which could make FOCF close to neutral this year after the high negative figure in 2019. Although the low-price environment is having a negative impact, cash settlements from hedge contracts as well as lower tax payments are contributing positively.

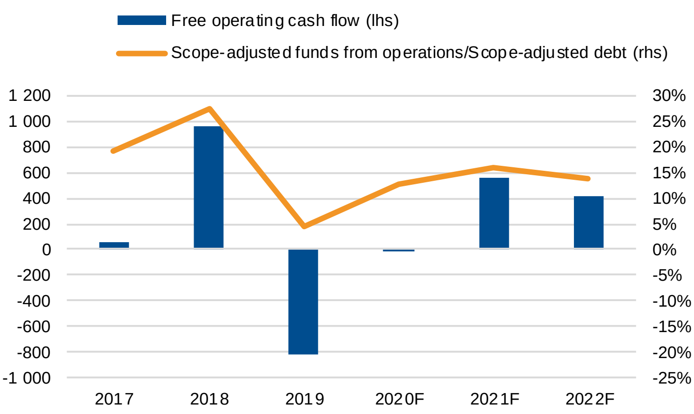
Cash flow in 2020 helped by hedging and lower taxes paid

While Agder Energi has sought to improve its liquidity ratio by adding more available credit facilities, its internal liquidity ratio remains somewhat below the peer average.

Updated Scope forecast

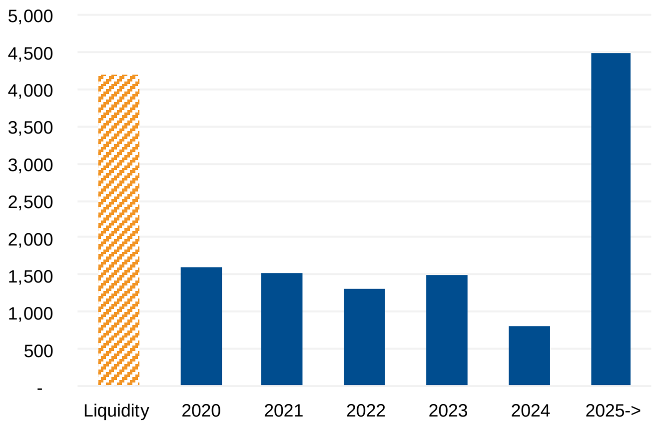
We have revised down the company's medium-term EBITDA forecast, mainly due to the lower expected contribution from its hydropower businesses. Our forecasted numbers do not incorporate new strategic initiatives or non-core asset divestments, but we assume the company will revisit these measures during the year, given the new CEO in place and the potential for a new strategy. The company's active role in venture investments and technological developments affecting the industry are assumed to remain important but insignificant for group profitability.

Figure 3: Cash flow development (NOK m)



Source: Scope estimates

Figure 4: Debt maturity profile, as mid-2020 (NOK m)



Source: Scope, Company

Summary of business and financial risk profiles

Our BBB business risk assessment of Agder Energi has not changed for the last 12 months, but there is some downward pressure on the profitability and efficiency measure. The company's business risk profile is now better than its financial risk profile (FRP) after the latter deteriorated during the year. The financial risk profile is constrained by the high leverage for the rating category, while debt protection still shows adequate characteristics. Capex coverage and free operating cash flow were both negative last year but could return to being slightly positive this year. Overall liquidity, including external financing sources like undrawn credit lines, is adequate, helped by further available credit lines that were secured this year to improve financial flexibility.

Supplementary rating drivers

Agder Energi´s standalone rating is BBB, with one-notch added for parent support, giving an overall issuer rating of BBB+. We still use our bottom-up approach to analyse Agder Energi's parent support (within the Government Related Entity Methodology), and the one notch-uplift assigned for the 54.5% municipality ownership in Agder Energi has not changed. The cooperation between Statkraft and the other municipality owners in Agder Energi remains strong, and we assess Statkraft to be a supportive and strategic owner.

We make no adjustment for financial policy. However, we note positively the management's target of a minimum credit rating of BBB+, which implicitly directs its actions towards maintaining a certain credit profile. As a result, we expect the company to start acting on this during H2 2020 in order to mitigate against the expected deteriorating FRP.

Long-term and short-term debt ratings

The senior unsecured rating is in line with the issuer rating. The S-2 short-term rating reflects the company's sufficient short-term debt coverage and good access to banks and debt capital markets.

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