

Global Credit Research - 14 Dec 2010

Oslo, Norway

## Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	A2
ST Issuer Rating	P-1

## Contacts

Analyst	Phone
Raffaella Altamura/London	44.20.7772.5454
Helen Francis/London	
Monica Merli/London	

## Key Indicators

Statnett SF	2009	2008	2007
(FFO + Interest Expense) / Interest Expense	3.4x	3.1x	4.1x
Net Debt / Net Fixed Assets	69.6%	66.3%	64.5%
FFO / Net Debt	9.5%	12.5%	14.9%
RCF / Capex	0.5x	0.4x	0.4x
RCF / Net Debt	5.3%	9.6%	13.3%

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

## Opinion

### Corporate Profile

Statnett SF ("Statnett", rated A2/stable outlook, P-1) is the owner of around 90% of Norway's high-voltage electricity grid and has a strategic position as the country's sole electricity transmission system operator ("TSO"). Statnett is wholly owned by the Norwegian government.

### Recent Developments

On 13 December 2010, Statnett announced that it had signed an agreement with Hafslund ASA for the acquisition of grid facilities and associated properties in the Oslo area for a consideration of NOK331 million. The transaction is expected to be finalised by year-end.

Statnett recently announced its 3Q 2010 results, with revenues totalling NOK5 billion (vs. NOK1.9 billion as of September 2009). The increase is mainly due to congestion revenues, which resulted in higher revenues of NOK1.55 billion in the first nine months to September 2010 (see below for further details).

### Rating Rationale

Given Statnett's full ownership by the Norwegian state, the company falls within the scope of Moody's rating methodology for government-related issuers (GRIs), which was updated in July 2010. Hence, the company's A2 rating reflects the combination of the following components:

- Credit risk profile of Statnett on a stand-alone basis, known as the Baseline Credit Assessment ("BCA"), of "9" (on a scale of 1 to 21, where 1 represents the lowest credit risk), which is equivalent to the "Baa2" rating category. Statnett's BCA mainly reflects the company's status as Norway's sole TSO operating in a well established regulatory framework and the sizeable investment programme foreseen for the period 2011-15, which is expected to materially impact the company's financial profile;
- Aaa/stable outlook local currency rating of the Norwegian government;
- High dependence, taking into consideration the domestic nature of Statnett's activities and its revenue sources;
- Strong support, reflecting (i) the current government's disciplined approach to Statnett's dividend payments; (ii) the government's relatively supportive stance towards state-owned companies in general; and (iii) the expectation that the government will maintain its full ownership of Statnett in the foreseeable future. Moody's also factors in the government's supportiveness as evidenced by the more favourable regulatory

regime implemented, continued emphasis on Statnett's strategic position as the country's sole TSO and its key role in expanding and maintaining the high-voltage network system in Norway. Whilst the market-oriented approach of the Norwegian government means that it would only intervene under the most extreme circumstances, Moody's believes that this would be the case in respect of a strategic utility infrastructure such as the national grid.

As a result of these parameters, Statnett's A2 rating incorporates a three-notch uplift from its stand-alone credit quality for potential government support under Moody's GRI methodology.

#### **DETAILED RATING CONSIDERATIONS**

When assessing Statnett's BCA, Moody's applies its Rating Methodology for Regulated Electric and Gas Networks, published in August 2009. The methodology examines the core factors that Moody's considers most relevant to electric and gas network operators, sets out the range of possible outcomes by factor and maps these to a rating range. Each factor is appropriately weighted and in combination contributes to the rating output by the methodology grid. Measurements are quantitative where an appropriate metric is defined. However, for some sub-factors, qualitative judgment is necessary to determine the appropriate category. For illustrative purposes, the methodology relies upon historical financial results, while ratings incorporate Moody's expectations for future performance. The suggested rating under the methodology grid for Statnett is Baa1, as summarised in the table below and based on the 2007-09 average key credit metrics. The grid-indicated rating is one notch higher than the company's BCA, as the latter incorporates the expectation of a weakening in the company's financial profile in light of its sizeable capex plan.

#### **FACTOR 1: REGULATORY ENVIRONMENT AND ASSET OWNERSHIP MODEL**

##### **(a) Stability and Predictability of Regulatory Regime: Aa**

Statnett operates in a stable, transparent and well established regulatory framework, which has gradually improved in recent years. Prior to 1997, tariffs were set on the basis of a cost-plus system, replaced by a revenue cap regime introduced by the regulator NVE with the aim of lowering tariffs through the use of incentives. In addition, in 2007 the regulator introduced a number of positive changes in the revenue cap structure, including: (i) annual update of the basis for the revenue cap, with faster revenue recognition of the return on new investments (ii) a shortening of the time lag for operating cost recognition to two years (previously, these were recognised at the start of the next regulatory period); and (iii) an improved basis for the NVE rate (i.e. the regulatory rate of return) on the company's Regulated Asset Base ("RAB"). These changes underpin the stability of Statnett's credit profile, thus supporting the positioning in the Aa category under this methodology factor.

##### **(b) Asset Ownership Model: Aaa**

Moody's scores Statnett in the Aaa category under this factor, recognising the fact that in its role as sole Norwegian TSO, the company also owns its transmission grid assets. Moody's notes that Statnett operates its transmission assets under a licence granted by the Norwegian regulator NVE, which could theoretically be terminated in case of underperformance or mismanagement. Nevertheless, Moody's understands that, in such instance, Statnett would continue to maintain ownership of its electricity grid, thus underpinning the Aaa positioning under this rating factor.

##### **(c) Cost and Investment Recovery: A**

Under the current framework, Statnett's tariffs reflect the application of a revenue cap mechanism, which guarantees a minimum revenue stream to cover operational and maintenance costs, transmission losses, depreciation, return on investments and system operation costs. The revenue cap includes recognition of operational and maintenance costs with a two-year delay, although adjusted for inflation. Depreciation and investments, following a change which became effective on 1 January 2009, are recognised in the revenue cap upon commissioning of the relevant asset, thus effectively removing the time lag previously included in the tariff formula. This new approach includes the assumption of a transitional period for 2009 and 2010 in order to maintain compensation for investments commissioned in 2007 and 2008 respectively. The return on investments is calculated on the basis of the daily average yield of a five-year government bond multiplied by a factor of 1.14 plus a risk premium of 2.39%. The revenue cap is set annually, and is calculated based on accounting figures as of two years back for operating costs and the same year for investments, adjusted for an efficiency norm deriving from benchmarking Statnett against other TSOs in Europe.

Statnett's positioning in the A category under this factor recognises the current transparent revenue cap setting mechanism, enabling timely cost and investment recovery, as well as the fact that Statnett is subject to efficiency targets in the form of benchmarking the company against other TSOs.

##### **(d) Revenue Risk: Aa**

Moody's scores Statnett in the Aa category under this factor, in light of the company's limited exposure to volume risk associated with the revenue cap regime (as opposed to a price cap framework). Under the current system, should revenues be lower or higher than expected, the tariffs charged to customers are amended in the subsequent year.

#### **FACTOR 2: EFFICIENCY AND EXECUTION RISK**

##### **(a) Cost Efficiency: A**

Statnett has a good track record in respect of quality of service provided. Over the past years, the comparative exercise finalised by the regulator in conjunction with the annual tariff setting process suggested an efficiency assumption of 100% for Statnett, thus implying a high cost performance vs. regulatory assumptions and supporting the A positioning in this category.

##### **(b) Scale and Complexity of Capital Programme: B**

As part of its ongoing capex programme, Statnett has identified necessary investments through 2020 totalling approximately NOK40 billion, mainly related to new grid projects and interconnections with the aim of meeting growing power transmission needs in Norway and connections to other Nordic and European countries. Of this amount, Statnett plans to invest NOK17-20 billion in 2011-15 (i.e. approximately NOK3.4-4 billion per annum). With the aim of assessing the complexity of such investment plans, Moody's compares the size of Statnett's planned annual capex with its asset base. In Statnett's case, whilst a RAB is considered in the revenue cap formula, its detailed calculation, individual components and future evolution are not publicly available and disclosed by the regulator. Therefore, Moody's refers to net tangible fixed assets

as a proxy for this measure (approximately NOK17 billion as of December 2009), with projected annual capex over 2011-15 representing more than 20% of the company's fixed assets and resulting in the B positioning under this rating factor. Nevertheless, Moody's also notes that, whilst ongoing investments are recognised in fixed assets, capex are reflected in the RAB and remunerated upon commissioning.

### FACTOR 3: STABILITY OF BUSINESS MODEL AND FINANCIAL STRUCTURE

#### (a) Ability and willingness to Pursue Opportunistic Corporate Activity: A

Statnett has a strong track record of no material corporate activity (ie M&A, disposals and investments) which supports the company's positioning in the A category under this factor. Nevertheless, Moody's notes that there are no specific restrictions limiting management's discretion to potentially pursue significant corporate activity included either in the licence, the company's by-laws, financing and debt documentation, or any other binding agreement.

#### (b) Ability and Willingness to Increase Leverage: Baa

With this factor, Moody's aims at addressing the likelihood that a company may potentially alter its capital structure, based on the degree of discretion left to management and shareholders. In Statnett's case, its financing and debt documentation does not include restrictive financial covenants aimed at limiting a potential material increase in leverage and specifically protecting creditors. Nevertheless, Moody's notes that Statnett has maintained a stable financial policy. These considerations support Statnett positioning in the Baa category under this factor. In this context, Moody's also notes last year's rejection of Statnett's request for an equity injection of NOK4 billion to its owner, Norway's Ministry of Petroleum and Energy. The decision was mainly based on the assumption that Statnett has capacity to fund planned investments through debt and that the company maintains the obligation to perform capex despite the rejection of its equity request.

#### (c) Targeted Proportion of Operating Profit Outside of the Core Regulated Business: Aa

Statnett is not specifically subject to contractual, statutory or regulatory restrictions prohibiting investments outside the electricity transmission business. Currently, Statnett's additional business divisions include Statnett Transport (offering transport services for heavy equipment for participants in the Norwegian electricity market), Statnett Forsikring (a small captive insurance company) and a 30% stake in Nord Pool Spot AS (the Nordic Power Exchange for trade in physical power contracts). Moody's notes that these businesses are somewhat complementary to the core regulated electricity transmission activity, which generates virtually all Statnett's operating profit, thus supporting the positioning in the Aa rating category for this input.

### FACTOR 4: KEY CREDIT METRICS

Over the last years, Statnett has managed to generally maintain its key credit metrics in line with expectations. Nevertheless, Moody's notes that 2008 financials were positively impacted by approximately NOK721 million of revenues exceeding Statnett's regulatory allowed income and related to congestion and trade revenues from the NorNed subsea cable. This excess income was recovered in 2009 through lower tariffs. In addition, Moody's notes that the delay in the completion of the NorNed cable and Statnett's reserve generation facilities, initially expected to be commissioned in 2007 and delayed to 2008, resulted in the postponement of the associated regulatory compensation from 2009 to 2010. This factor, associated with increased congestion revenues (cumulative higher revenues of NOK1.55 billion as of September 2010), are expected to result in a material positive impact on Statnett's 2010 credit metrics. However, the volatility historically characterising Statnett's financials is expected to materially decline in the future, in light of a tariffs smoothing mechanism to be implemented from 2011 onward.

With regard to dividends, the government has expressed its commitment to a more stable dividend policy, with an expected payout of around 50% for 2010. While the government will still be able to change the dividend as part of its annual budget if it so wishes, Moody's notes that there are no indications related to a potential change in strategy.

Going forward, Statnett is expected to significantly increase capex, in conjunction with the implementation of its investment plan of NOK17-20 billion in 2011-15. Capex will be mainly related to new grid projects aimed at increasing interconnections and meeting growing power transmission needs in Norway. In Moody's view, Statnett's planned debt-funded investments will result in a material deterioration of the company's financial profile over the medium term.

Moody's notes the regulatory change which has removed the previous two-year time lag for the remuneration of capex recognised in the company's RAB. Whilst this measure should result in a more timely recognition of a return on investments, Moody's also notes that capex continue to be remunerated upon commissioning. Therefore, this measure is not expected to materially offset the weakening in the company's projected credit metrics deriving from Statnett's ambitious investment programme and debt requirements associated with it.

Going forward, to support the current rating, Moody's expects Statnett to exhibit ratios of FFO Interest Coverage of at least 2.0x and FFO/Net Debt of at least 6%. This ratio guidance recognises the company's low business risk profile, underpinned by a well established regulatory framework and transparent tariff setting system, as well as Statnett's position as a natural monopoly, with virtually all of its operating profit derived from stable regulated electricity transmission activities. Furthermore, this ratio guidance allows for the peak of Statnett's investment programme and factors in the company's prudent and established liquidity policies.

### Liquidity

Statnett's liquidity profile is healthy and is based on a policy aimed at having sufficient liquidity reserves to be able to fund operations and investments over a twelve-month period without accessing the capital markets. Primary sources of liquidity include the company's generally stable operating cash flow generation and significant cash and liquid securities balances. Secondary sources include a NOK2 billion revolving credit facility (undrawn as of 30 September 2010) maturing in May 2012, which is maintained solely for back-up purposes. It benefits from the absence of restrictive conditionality, such as a repeating MAC clause, rating triggers and financial covenants, but stipulates a mandatory prepayment if the Norwegian government were to reduce its stake in Statnett below 51%. However, this is not anticipated in the near future. Together, these sources would provide sufficient funds to cover payments expected over the next 12 months for capital expenditure and dividends. Of the NOK11.3 billion of debt as of September 2010, NOK0.4 billion matures by September 2011.

For short-term funding purposes Statnett usually accesses the Norwegian CP market, with long-term funding mainly concluded through its EUR1.5 billion EMTN programme (not rated by Moody's), under which the company issues bonds both in Norway and abroad (mainly Switzerland and Japan). The drawn portion under this programme is about EUR0.9 billion as of 30 September 2010.

## Rating Outlook

The outlook associated with Statnett's rating is stable, reflecting the expectation that, despite some concentration of investments, the company should broadly meet the minimum ratio guidance indicated above over the medium term. However, Moody's cautions that, in light of the sizeable level of projected investments, Statnett has limited financial headroom at the current rating level.

### What Could Change the Rating - Up

Upward rating pressure could develop as a result of a material strengthening in credit metrics, with FFO Interest Coverage above 2.5x, an FFO/Net Debt ratio above 9% and an RCF/Net Debt ratio of at least 7%. Nevertheless, in light of the significant investment programme ahead, Moody's does not expect any positive pressure on Statnett's rating in the near term.

### What Could Change the Rating - Down

Negative pressure on Statnett's rating could arise as a result of a weaker than anticipated financial profile inconsistent with the minimum ratio guidance indicated above, resulting from weak operational performance, cost and capex overruns, further increase in planned investments and/or implementation of an overly aggressive dividend policy. Material adverse changes in the regulatory framework, impacting Statnett's business risk profile, would also result in downward rating pressure.

## Rating Factors

### Statnett SF

Regulated Electric and Gas Networks	Aaa	Aa	A	Baa	Ba	B
<b>Factor 1: Regulatory Environment and Asset Ownership Model (40%)</b>						
a) Stability and Predictability of Regulatory Regime		x				
b) Asset Ownership Model	x					
c) Cost and Investment Recovery (Ability and Timeliness)			x			
d) Revenue Risk		x				
<b>Factor 2: Efficiency and Execution Risk (10%)</b>						
a) Cost Efficiency			x			
b) Scale and Complexity of Capital Programme						x
<b>Factor 3: Stability of Business Model and Fin. Structure (10%)</b>						
a) Ability and Willingness to Pursue Opportunistic Corp. Activity			x			
b) Ability and Willingness to Increase Leverage				x		
c) Targeted Proportion of Op. Profit Outside Core Reg. Activities		x				
<b>Factor 4: Key Credit Metrics (40%) [1][2]</b>						
a) FFO Interest Coverage			3.5x			
b) Net Debt / Net Fixed Assets				66.9%		
c) FFO / Net Debt			12.1%			
d) RCF / Capex						0.4x
<b>Rating:</b>						
a) Indicated Rating from Grid			Baa1			
b) Actual BCA Assigned			Baa2			

Government-Related Issuer	
(a) Baseline Credit Assessment	9 (Baa2)
b) Government Local Currency Rating	Aaa
c) Default Dependence	High
d) Support	Strong

[1] Standard adjustments in accordance with "Rating Methodology: Moody's Approach to Global Standard Adjustments in the Analysis of Financial Statements for Non-Financial Corporations, Part 1, Part 2 and Part 3." [2] Average ratios for 2007-2009; Source: Moody's Financial Metrics



© 2010 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ARE MOODY'S INVESTORS SERVICE, INC.'S ("MIS") CURRENT OPINIONS OF THE

**RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.**

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moodys.com](http://www.moodys.com) under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Any publication into Australia of this document is by MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001.

Notwithstanding the foregoing, credit ratings assigned on and after October 1, 2010 by Moody's Japan K.K. ("MJKK") are MJKK's current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, "MIS" in the foregoing statements shall be deemed to be replaced with "MJKK". MJKK is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO.

This credit rating is an opinion as to the creditworthiness or a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.

