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Statnett SF

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Major Rating Factors

Corporate Credit Rating
A+/Stable/A-1

Strengths:

- Monopoly transmission system operator operating in one of the world's wealthiest areas.
- Transparent, stable, and supportive regulatory environment.
- Very high likelihood of support in a situation of financial distress from its 100% owner, the Kingdom of Norway.

Weaknesses:

- Significant debt-financed capital expenditure plans.
- Aggressive dividend policy and weak financial credit metrics.

Rationale

The ratings on Norway's 100% owned transmission system operator (TSO), Statnett SF, are based on the company's stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'bbb' as well as our opinion that there is a "very high" likelihood that the Kingdom of Norway (AAA/Stable/A-1+) would provide timely and sufficient extraordinary support in the event of financial distress. Our opinion is based on our assessment of Statnett's role for the Kingdom of Norway as "very important" and the link between Statnett and Norway to be "very strong".

Statnett's SACP is supported by an excellent business profile as the monopoly Norwegian TSO, and a regulatory framework which is transparent and stable. The SACP is, in our view, constrained by significant investment plans, which will be largely debt-funded, with negative effects for the company's financial risk profile over the medium term.

Key business and profitability developments

Statnett reported revenues of Norwegian krone (NOK) 3.8 billion (about €480 million) for the first six months of 2010, a significant increase compared with the corresponding period in 2009 (NOK1.3 billion). The positive effect was mainly derived from unusually high congestion revenues.

Statnett operates under a revenue cap regulatory regime, under which the company is allowed to cover costs for the operation and depreciation of the grid and provide a reasonable return on invested capital. The regulatory framework allows adequate compensation for new investments. Statnett is allowed to increase tariffs on Jan. 1 in the first year of operation of the investment.

Key cash flow and capital-structure developments

Statnett is targeting about NOK40 billion in investments through 2020, including NOK19 billion through 2014. These investments may have to be funded by Statnett on a stand-alone basis, as the Norwegian government has previously rejected a request from the company for an equity capital increase. As a result, we expect Statnett's credit metrics to weaken over the near term, as new investments will not be cash flow generative until the year of completion.

For the 12 months ended June 30, 2010, funds from operations (FFO) to debt stood at 17%, while FFO to interest and debt-to-capital stood at 7.1x and 65%, respectively. We expect FFO to interest and FFO to debt to stabilize at about 2.2x and 5%, respectively, with the latter reaching a low in 2011 at about 4%. Debt leverage is expected to climb above 75% over the medium term as a result of a gradual build-up in debt levels to fund investments.

Liquidity

Statnett's liquidity profile is adequate, in our view. As of June 30, 2010, the company had NOK713 million in liquid assets and NOK582 million in marketable securities. At the same date, the company had access to an undrawn NOK2 billion revolving credit facility maturing in May 2012. This compares with short-term reported debt of NOK491 million as at June 30, 2010. Free operating cash flow (FOFC) was negative NOK2.1 billion in 2009, and although we believe it will turn positive in 2010 we expect negative FOFC beyond 2010. This is primarily due to higher capital expenditures. In our view, Statnett's increasing future funding needs, and negative FOCF generation calls for careful liquidity management at the current rating level. We will continue to monitor Statnett's plans regarding its liquidity policies and funding closely in light of the increased investment program. At the current rating level, we assume Statnett will maintain a prudent approach to liquidity management and pre-funding of capital expenditures.

According to the company's financial policy, liquidity and committed facilities should cover refinancing and investment needs for the coming 12 months.

Outlook

The stable outlook reflects our view of Statnett's stable monopoly position and favorable tariff structure. It also reflects our expectations that Statnett will be able to contain a likely deterioration in its financial performance to levels we consider adequate at the current rating level. For example, we would expect FFO to debt to average about 5% over any given two-year period.

We could lower the ratings if our assessment of the probability of extraordinary government support were to weaken. A downward revision of the 'bbb' SACP, for example as a result of further weakening of the company's financial risk profile, could put pressure on the ratings. Any further debt-financed investments beyond our current expectations could cause such a weakening of the financial profile.

A strengthening of the financial risk profile and SACP, however, could lead to a positive rating action. This could be the result of a scaling down of the company's investment program. Although currently unlikely, we could also raise the ratings if we were to revise our assessment of extraordinary government support.

Business Description

Statnett is the monopoly TSO of the Norwegian power system. It owns and operates about 10,000 kilometers of 420 kilovolt (kV), 300 kV, and 132 kV power lines; four subsea cables; and about 100 substations and similar facilities. Statnett's key task as a TSO is to balance supply and demand consistently. This includes supervision and coordination of the operations of the entire Norwegian power system, and administration of the Main Grid Commercial Arrangement. As a TSO, Statnett owns and operates most of the main Norwegian power grid and the Norwegian section of power lines and subsea cables to other countries (the company owns 90% of the main grid and leases the remainder from other utilities). It also develops the main transmission grid system and plans, builds, owns, and operates interconnectors. The company's regional grid installations are rented to, or operated in conjunction with, other companies.

Statnett's other businesses include a small transport operation related to grid activities, and a 30% stake in the Nordic power exchange, Nord Pool Spot AS.

Government Support And GRE Methodology Impact

In accordance with our criteria for government-related entities (GREs), our view of a "very high" likelihood of extraordinary government support is based on our assessment of Statnett's:

- "Very important" role as Norway's monopoly TSO, including its clear public policy role within the context of the Norwegian energy market and supplying the strategically important oil industry with power, and
- "Very strong" link with the Norwegian state, as demonstrated by the company's full government ownership, remote privatization prospects due to its legal status, and strategic importance to the government.

As required by the company's state enterprise status, Statnett is wholly state owned through the Ministry of Petroleum and Energy. Our analytical approach is based on Statnett's full government ownership, remote privatization prospects due to its legal status, and strategic importance to the government. The Norwegian government considers Statnett to have a natural monopoly status and a clear public policy role within the context of the Norwegian energy market.

Business Risk Profile: Monopoly-Based Business Activities And Efficient Operations Offset By Volatility In Earnings

The major supports for the company's "excellent" business risk profile are:

- Core monopoly-based business activities as the national TSO in Norway. Statnett's position as the monopoly provider of main grid services in one of the world's wealthiest countries should ensure stable demand, ongoing growth in electricity usage, and continued strong payment discipline. Statnett's income is largely based on lease revenues from its main grid installations and regional grid assets.
- Efficient grid and system operations, with a proven ability to cope with the, often harsh, Norwegian terrain and climate.
- A stable and transparent regulatory regime. Statnett is regulated by an independent regulator, the Norwegian Water Resources and Energy Directorate, and operates under a revenue-cap regime under which the company is allowed to cover costs for the operation and depreciation of the grid and provide a reasonable return on invested capital. The revenue cap is set based on a combination of Statnett's actual financial figures and a norm cost based on benchmarking against other TSOs in Europe. Any profit or loss in excess of the allowed return is now adjusted for in subsequent years and, hence, passed on to customers in terms of higher or lower tariffs. As a result, revenues and operating profits tend to fluctuate widely from year to year, but should be stable seen over the medium term. Earnings volatility is, however, likely to decline, in our view, since Statnett will introduce an equalization scheme in 2011 in which tariff changes will be smoothed out over longer time periods.

These supports are partly offset by:

- The risk of winter capacity shortages, which have emerged during the very cold winters of the past few years. This could prove operationally challenging for Statnett and other Nordic TSOs. Statnett has actively addressed the issue, however, through the construction of reserve power generation capacity and additional power lines in critical areas.
- Industry return on capital is rather low at about 5%-6% - a reflection of the relatively low yield produced by transmission grid assets.

Financial Risk Profile: Increased Debt Burden Due To Extensive Investment Program Balanced By Proven Access To The Capital Markets

The main weaknesses of the company's "aggressive" financial risk profile are:

- An extensive investment program over the next 10 years. Statnett is planning to spend NOK40 billion to upgrade the transmission system and enhance security of supply in the region. As an equity injection from the owner has previously been turned down, the investments are expected to be funded mainly by additional debt. This will significantly weaken debt-protection metrics over the medium term, in our view. We expect FFO to interest and FFO to debt to stand at about 2.2x and 5% respectively over the near to medium term, although the levels are likely to be significantly higher in 2010. We expect debt leverage at about 65% in 2010, but to climb above 75% over the medium term.
- Aggressive dividend policy. Statnett's policy is to distribute 50% of profits to its owners in dividends and there are no indications from the owner of any future change in dividend policy.

These weaknesses are mitigated by:

- Statnett's status as a well-established borrower, with access to the stable domestic market and as well as international capital markets.
- Limited currency and interest-rate exposure, which is further mitigated by Statnett's use of swap instruments. To reduce overall interest-rate risk, Statnett aims to achieve a high correlation between the rate used to calculate the revenue cap and the interest rate on its debt. All foreign-currency debt is converted into Norwegian krone through currency swaps, to match the company's revenue base.

Financial Statistics/Adjustments

Statnett's financial statements are prepared in accordance with International Financial Reporting Standards. We subtract from debt surplus cash of NOK896 million. This comprises unrestricted cash and marketable securities, and investments in short-term money market funds. We have otherwise made only minor analytical adjustments to Statnett's reported figures (see table 1).

Table 1

Reconciliation Of Statnett SF Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. NOK)*

	--Fiscal year ended Dec. 31, 2009--								
Statnett SF reported amounts									
	Debt	**Shareholders' equity**	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Capital expenditures**
Reported	12,340.0	5,618.0	259.0	259.0	(403.0)	376.0	(466.0)	(466.0)	1,658.0
Standard & Poor's adjustments									
Postretirement benefit obligations	509.6	(267.8)	32.0	32.0	32.0	11.0	(0.7)	(0.7)	--
Surplus cash and near cash investments	(896.0)	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	51.0	(51.0)	(51.0)	(51.0)
Reclassification of nonoperating income (expenses)	--	--	--	--	76.0	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	392.0	--
Total adjustments	(386.4)	(267.8)	32.0	32.0	108.0	62.0	(51.7)	340.4	(51.0)
Standard & Poor's adjusted amounts									
	Debt	**Equity**	**Operating income (before D&A)**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**	**Capital expenditures**
Adjusted	11,953.6	5,350.2	291.0	291.0	(295.0)	438.0	(517.7)	(125.7)	1,607.0

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Related Research

See "Enhanced Methodology And Assumptions For Rating Government-Related Entities", published June 29, 2009 on RatingsDirect.

Table 2

Statnett SF -- Peer Comparison*

	Statnett SF§	Energinet.dk SOV¶	Fingrid Oyj§	Elia System Operator S.A./N.V.	TenneT Holding B.V.¶
Rating as of Oct. 15, 2010	A+/Stable/A-1	AA/Stable/A-1+	A+/Stable/A-1	A-/Negative/A-2	A-/Stable/A-2

Table 2

Statnett SF -- Peer Comparison* (cont.)					
	--Fiscal year ended Dec. 31, 2009--				
(Mil. €)					
Revenues	345.4	647.1	361.2	733.7	562.2
Net income from cont. oper.	(57.9)	61.3	24.7	84.3	72.1
Funds from operations (FFO)	(15.2)	228.6	73.9	230.3	70.6
Capital expenditures	193.9	138.3	127.5	138.2	348.5
Debt	1,442.5	1,264.4	857.9	2,698.9	1,402.8
Equity	645.6	725.2	447.8	1,412.1	727.6
Adjusted ratios					
Oper. income (bef. D&A)/revenues (%)	10.2	36.4	31.9	47.4	35.2
EBIT interest coverage (x)	(0.7)	2.3	2.1	1.9	2.1
EBITDA interest coverage (x)	0.7	4.7	4.5	2.5	4.1
Return on capital (%)	(1.6)	5.0	3.9	6.3	5.7
FFO/debt (%)	(1.1)	18.1	8.6	8.5	5.0
FFO/debt target (%)	5	10	10-11	8-9	6
Debt/EBITDA (x)	41.1	5.4	7.6	7.9	7.2

*Fully adjusted (including postretirement obligations). ¶Fully adjusted. §Excess cash and investments netted against debt.

Table 3

Statnett SF -- Financial Summary*					
	--Fiscal year ended Dec. 31--				
	2009	**2008**	**2007**	**2006**	**2005**
Rating history	AA/Watch Neg/A-1+	AA-/Stable/A-1+	AA/Stable/A-1+	AA/Stable/A-1+	AA/Stable/A-1+
(Mil. NOK)					
Revenues	2,862.0	4,256.0	3,415.0	3,205.0	3,113.0
Net income from continuing operations	(480.0)	1,517.0	651.0	163.0	174.0
EBITDA	291.0	1,760.0	1,568.0	1,015.0	1,212.0
EBITDA adjusted for higher/lower revenue	1,292.0	1,001.0	1,515.0	1,266.0	930.0
Funds from operations (FFO)	(125.7)	1,201.9	1,260.0	824.2	874.6
Capital expenditures	1,607.0	5,463.0	2,847.0	2,109.0	671.0
Free operating cash flow	(2,124.7)	(4,090.1)	(1,132.0)	(1,083.8)	(297.4)
Cash and short-term investments	0.0	995.0	1,038.0	790.0	1,484.0
Debt	11,953.6	12,943.4	9,819.5	8,243.8	7,184.6
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	5,350.2	6,227.9	5,292.0	4,641.3	4,590.6
Debt and equity	17,303.8	19,171.2	15,111.5	12,885.1	11,775.2
Adjusted ratios					
EBIT interest coverage (x)	(0.7)	2.1	2.8	1.3	1.6
EBITDA interest coverage (x)	0.7	2.8	3.8	3.3	3.4
FFO int. cov. (x)	0.9	3.1	4.2	3.9	3.5
FFO/debt (%)	(1.1)	9.3	12.8	10.0	12.2

Table 3

Statnett SF -- Financial Summary* (cont.)					
Free operating cash flow/debt (%)	(17.8)	(31.6)	(11.5)	(13.1)	(4.1)
Discretionary cash flow/debt (%)	(21.9)	(34.1)	(13.1)	(14.2)	(9.3)
Net Cash Flow / Capex (%)	(38.9)	16.2	38.9	35.0	75.2
Debt/debt and equity (%)	69.1	67.5	65.0	64.0	61.0
Return on common equity (%)	(8.7)	22.1	9.7	1.9	1.3
Common dividend payout ratio (un-adj.) (%)	(27.5)	32.9	48.8	53.4	212.6

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Ratings Detail (As Of October 15, 2010)*	
Statnett SF	
Corporate Credit Rating	A+/Stable/A-1
Senior Unsecured (8 Issues)	A+
Corporate Credit Ratings History	
14-Jan-2010	A+/Stable/A-1
14-Oct-2009	AA/Watch Neg/A-1+
30-Jun-2009	AA/Stable/A-1+
30-Jan-2009	A+/Stable/A-1
05-Mar-2008	AA-/Stable/A-1+
Business Risk Profile	Excellent
Financial Risk Profile	Aggressive
Debt Maturities	
(As of Dec. 31, 2009) 2010: NOK 1.6 bil. 2011: NOK 0.7 bil. 2012: NOK 1.8 bil. 2013: NOK 0.1 bil. 2014: NOK 1.1 bil. Thereafter: NOK 6.4 bil.	

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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