

Statnett SF

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Major Rating Factors

Strengths:

- Status as the monopoly transmission system operator in one of the world's wealthiest countries.
- Transparent, stable, and supportive regulatory environment.
- Very high likelihood of support from 100% owner, the Kingdom of Norway, in the event of financial distress.

Weaknesses:

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

Corporate Credit Rating

A+/Stable/A-1

Rationale

The ratings on Norway's 100% owned electricity 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'. The ratings also reflect our opinion that there is a "very high" likelihood that the Kingdom of Norway (AAA/Stable/A-1+) would provide the company timely and sufficient extraordinary support in the event of financial distress. Our opinion is based on our assessment of Statnett's "very important" role for and "very strong" link with Norway.

Our SACP assessment is supported by Statnett's excellent business profile as Norway's monopoly TSO that owns and operates most of the main Norwegian power grid, and that the company operates under a transparent and stable regulatory framework. The SACP is, in our view, constrained by significant investment plans, which will be largely debt-funded and in turn could hurt the company's financial risk profile over the medium term.

Key business and profitability developments

Statnett operates under a revenue cap regulatory regime, in which the company is allowed to cover costs for the operation and depreciation of the power grid and provide a reasonable return on invested capital. However, the company sometimes posts profits or losses in excess of the allowed return, typically because of fluctuations in congestion revenues, which is the ownerless income on the electricity spot market that arises when electricity is transmitted from areas with low electricity prices to those with high prices. Statnett therefore makes profit or loss adjustments in subsequent years through higher or lower tariffs for its customers. The regulatory framework facilitates adequate compensation for new investments, in our view. Statnett is permitted to increase tariffs on Jan. 1 of the first year of operation of an investment.

Statnett reported revenues of Norwegian krone (NOK) 4.2 billion (about €537 million) for the first nine months of 2011, compared with NOK5.2 billion in the corresponding period in 2010. This decrease was due to a lower grid tariff in response to revenues exceeding the allowed amount in 2010 and lower congestion revenues. Excluding NOK863 million in excess of allowed revenues, which mainly stemmed from congestion charges, EBITDA for the period was NOK976 million compared with NOK1.352 billion a year earlier. Although we recognize that

congestion revenues could be volatile in the near to medium term, we expect Statnett's underlying profit to be stable, owing to the current regulatory framework.

Key cash flow and capital-structure developments

Statnett has initiated its ambitious investment plan, under which it aims to invest about NOK40 billion through to 2020. The Norwegian government previously rejected the company's request for an equity capital increase, which leads us to believe that Statnett may fund these investments on its own. Consequently, we expect Statnett's credit metrics to weaken over the near term because new investments will not generate cash flow until completed. Nevertheless, Statnett is unlikely, in our view, to be able to fully implement its investment plan in the near term. In turn, credit metrics may not weaken as severely as projected under the investment plan.

For the 12 months ended Sept. 30, 2011, funds from operations (FFO) to adjusted debt stood at 21.9%, while FFO to interest was 8.6x and debt to debt and equity was 61%. We view these metrics as strong for the current ratings but mainly owing to the higher congestion revenues during the period. Although Statnett's credit metrics are difficult for us to forecast, given the fluctuations in congestion revenues, we expect FFO to debt in the near term to average more than 5%-6% for a two-year period, and to exceed 6% in the medium term. Debt leverage is likely to exceed 70% over the medium term as a result of a gradual buildup in debt to fund investments.

Liquidity

The short-term rating is 'A-1'. Statnett's liquidity profile is adequate, according to our criteria. As of Sept. 30, 2011, the company had NOK222 million in liquid assets and NOK355 million in marketable securities. At the same date, the company had access to an undrawn NOK3.5 billion revolving credit facility maturing in January 2016. This compares with short-term reported debt of NOK2.5 million as at Sept. 30, 2011. We also note that Statnett recently signed a NOK1.3 billion loan maturing in 2027 with the Nordic Investment Bank to be used as financing for the Skagerrak 4 transmission cable to Denmark and an upgrade of an existing cable in the Oslofjord bay. This loan, which we understand was drawn down in November 2011, strengthens Statnett's liquidity and maturity profile, in our view.

Although free operating cash flow (FOFC) was NOK1.9 billion in 2010, we anticipate negative FOFC in 2011 onward, primarily owing to higher capital expenditures. In our view, Statnett's increasing future funding needs, and likely negative FOFC generation call for careful liquidity management at the current rating level. We will continue to closely monitor Statnett's plans regarding its liquidity policies and funding, in light of the increased investment program. At the current ratings, we assume Statnett will maintain a prudent approach to liquidity management and prefunding 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 its likely decrease in financial leverage to levels we consider commensurate with the current rating. For example, we expect FFO to debt to average about 5%-6% over any given two-year period.

We could lower the ratings if our assessment of the company's probability of extraordinary government support

were to weaken. A downward revision of the 'bbb' SACP, for example as a result of a further weakening of the financial risk profile or aggressive liquidity management, could put pressure on the ratings. Any further debt-financed investments beyond our current expectations could weaken the financial profile.

A strengthening of the financial risk profile and SACP, however, could lead to a positive rating action. This could result from the company scaling down its investment program, resulting in higher credit metrics than we expect. It could also stem from a meaningful equity injection from Norway, although we think this is unlikely at this point. We could also raise the ratings if we were to revise upward our assessment of extraordinary government support, which we also view as unlikely.

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 and an insurance captive related to grid activities, and a 30% stake in the Nordic power exchange, Nord Pool Spot AS (not rated).

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 power to the strategically important oil industry, and
- "Very strong" link with Norway, 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 Norwegian energy market.

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

We classify Statnett's business risk profile as "excellent," under our criteria, owing to the following factors:

- 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 continuous 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 adjusted for in subsequent years and, in turn, passed on to customers through higher or lower tariffs. As a result, revenues and operating profits tend to fluctuate widely every year, but should be stable over the medium term. Earnings volatility is, however, likely to decline, in our view, since Statnett introduced an equalization scheme in 2011, in which tariff changes will be smoothed out over longer time periods.

These supports are partly offset, in our view, by:

- The risk of winter capacity shortages, which have emerged during the very low-temperature winters over the past few years. This could hurt operations 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.
- Rather low industry return on capital, at about 5%-6%. This reflects 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

We classify Statnett's financial risk profile as "aggressive," under our criteria, owing to the following weaknesses:

- An extensive investment program through to 2020. Statnett is planning to spend NOK40 billion to upgrade its transmission system and enhance supply security in the region. Because a request for an equity injection from the owner was previously turned down, the investments are likely to be funded mainly by additional debt. This will significantly weaken debt-protection metrics over the medium term, in our view. We expect debt leverage at about 66% in 2011, but greater than 70% over the medium term.
- Aggressive dividend policy. Statnett's policy is to distribute 50% of profits (adjusted for higher or lower income) to its owners in dividends. This policy has been in place since 2006 and was recently extended to 2015. Although we consider this payout ratio high, especially in the light of the company's large investment program, we see it as a positive that the ratio will be fixed and predictable throughout the forecast period.

These weaknesses are mitigated, in our view, by:

- Statnett's status as a well-established borrower, with access to the stable domestic market and 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 gross debt, surplus cash of NOK1.7 billion, because we assume Statnett does not need this cash for its day-to-day operations. 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										
--Fiscal year ended Dec. 31, 2010--										
Statnett SF reported amounts										
(Mil. NOK)	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	11,757.0	7,680.0	7,247.0	3,945.0	3,279.0	337.0	3,804.0	3,804.0	132.0	1,892.0
Standard & Poor's adjustments										
Postretirement benefit obligations	475.9	(227.5)	--	(5.0)	(5.0)	14.0	7.9	7.9	--	--
Surplus cash and near cash investments	(1,722.0)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	43.0	(43.0)	(43.0)	--	(43.0)
Reclassification of nonoperating income (expenses)	--	--	--	--	116.0	--	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	22.0	22.0	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(135.0)	--	--
Minority interests	--	(22.0)	--	--	--	--	--	--	--	--
Total adjustments	(1,246.1)	(249.5)	0.0	(5.0)	111.0	57.0	(13.1)	(148.1)	0.0	(43.0)
Standard & Poor's adjusted amounts										
Adjusted	10,510.9	7,430.5	7,247.0	3,940.0	3,390.0	394.0	3,790.9	3,655.9	132.0	1,849.0

Table 1

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

NOK--Norwegian krone.

Table 2

Statnett SF--Peer Comparison
Industry Sector: Electric Utility

	Statnett SF	Energinet.dk SOV	Fingrid Oyj	Elia System Operator S.A./N.V.	Terna SpA
Rating as of Nov. 22, 2011	A+/Stable/A-1	AA/Stable/A-1+	AA-/Stable/A-1+	A-/Stable/A-2	A/Negative/A-1
Country	Norway	Denmark	Finland	Belgium	Italy
Stand-alone credit profile	bbb	a	a	N.A.	a
Business risk profile	Excellent	Excellent	Excellent	Excellent	Excellent
Financial risk profile	Aggressive	Intermediate	Significant	Significant	Intermediate
GRE qualifier	Very high	Very high	High	N.A.	Moderately high
	--Average of past three fiscal years--				
(Mil. €)					
Revenues	570.7	648.8	403.1	860.3	1,358.6
EBITDA	240.4	209.9	132.6	382.2	1,018.9
EBIT	178.5	96.4	75.1	274.1	726.4
Net income from continuing operations	126.6	41.0	31.4	196.6	369.1
Funds from operations (FFO)	192.5	192.4	101.5	243.3	647.2
Capital expenditures	330.9	136.9	125.4	199.7	882.5
Free operating cash flow	(142.6)	88.2	(25.7)	51.0	(166.3)
Dividends paid	36.6	0.0	6.9	65.0	355.4
Discretionary cash flow	(179.2)	88.2	(32.5)	(14.1)	(521.7)
Cash and short-term investments	34.1	49.8	60.6	208.5	12.5
Debt	1,383.9	1,259.9	859.0	2,754.7	4,413.2
Equity	740.2	710.9	459.9	1,747.5	2,475.3
Adjusted ratios					
EBITDA margin (%)	41.7	32.3	32.9	44.4	75.0
EBITDA interest coverage (x)	4.1	4.6	4.5	2.8	6.8
EBIT interest coverage (x)	3.0	2.1	2.6	2.0	4.9
Return on capital (%)	8.3	4.2	5.3	6.5	10.7
FFO/debt (%)	13.3	15.3	11.8	8.8	14.7
Free operating cash flow/debt (%)	(12.0)	7.0	(3.0)	1.9	(3.8)
Discretionary cash flow/debt (%)	(14.6)	7.0	(3.8)	(0.5)	(11.8)
Debt/EBITDA (x)	6.0	6.0	6.5	7.2	4.3
Total debt/debt plus equity (%)	65.5	63.9	65.1	61.2	64.1

Table 3

Statnett SF--Financial Summary					
Industry Sector: Electric Utility					
	--Fiscal year ended Dec. 31--				
(Mil. NOK)	2010	2009	2008	2007	2006
Revenues	7,247.0	2,862.0	4,256.0	3,415.0	3,205.0
EBITDA	3,940.0	291.0	1,760.0	1,568.0	1,015.0
EBITDA adjusted for higher/lower income	1,753.00	1,324.00	1,039.00	1,548.00	1,275.00
EBIT	3,390.0	(295.0)	1,329.0	1,175.0	397.0
Interest Expense	394.0	438.0	622.0	417.0	310.0
Net income from continuing operations	2,198.0	(480.0)	1,517.0	651.0	163.0
Funds from operations (FFO)	3,655.9	(125.0)	1,205.0	1,260.0	829.0
Capital expenditures	1,849.0	1,607.0	5,463.0	2,847.0	2,109.0
Free operating cash flow	1,941.9	(2,124.0)	(4,087.0)	(1,132.0)	(1,079.0)
Dividends paid	132.0	499.0	318.0	152.0	87.0
Discretionary cash flow	1,809.9	(2,623.0)	(4,405.0)	(1,284.0)	(1,166.0)
Debt	10,510.9	12,008.5	13,178.0	10,018.0	8,435.0
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	7,430.5	5,319.2	6,089.0	5,187.0	4,538.0
Debt and equity	17,941.4	17,327.7	19,267.0	15,205.0	12,973.0
Adjusted ratios					
EBITDA margin (%)	54.4	10.2	41.4	45.9	31.7
EBIT interest coverage (x)	8.6	(0.7)	2.1	2.8	1.3
FFO interest coverage (x)	10.3	0.9	3.1	4.2	3.9
FFO/debt (%)	34.8	(1.0)	9.1	12.6	9.8
FFO/debt (%) adjusted for higher/lower income	14.0	7.6	3.6	12.4	12.9
Net cash flow/capital expenditures (%)	190.6	(38.8)	16.2	38.9	35.2
Debt/debt and equity (%)	58.6	69.3	68.4	65.9	65.0
Return on capital (%)	19.0	(1.6)	7.7	8.3	3.2
Return on common equity (%)	32.4	(8.7)	22.1	9.7	1.9
Common dividend payout ratio (unadjusted) (%)	14.3	(27.5)	32.9	48.8	53.4

N.M.--Not Meaningful. NOK--Norwegian krone.

Related Research And Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of November 22, 2011)

Statnett SF

Corporate Credit Rating

A+/Stable/A-1

Ratings Detail (As Of November 22, 2011) (cont.)	
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 Sept. 30, 2011)	
2011: NOK0.7 bil.	
2012: NOK2.2 bil.	
2013: NOK0.1 bil.	
2014: NOK1.2 bil.	
Thereafter: NOK7.0 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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