

Summary:

Statnett SF

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Summary:

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Credit Rating: A+/Stable/A-1

Rationale

The ratings on Norway's 100% owned electricity transmission system operator, Statnett SF, are based on the company's stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'bbb'. Our view of Statnett's SACP is based on an excellent business risk profile and an aggressive financial risk profile. 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.

Statnett's business risk profile is underpinned by its position as the monopoly electricity transmission system operator in one of the world's wealthiest nations. It is also supported by a stable and favorable regulatory regime, under which Statnett is allowed to cover its costs and earn a reasonable return on its invested capital. Relative weaknesses are risks of capacity shortages during cold winters and a rather low return on capital.

Our view of Statnett's financial risk profile takes into account the company's active use of financial leverage to fund large investments and an aggressive dividend policy. These weaknesses are partly offset by the company's status as a well-established borrower with limited currency and interest rate exposure.

The long-term ratings contain four notches of uplift, in accordance with our criteria for government-related entities. Our view that there is a "very high" likelihood of extraordinary government support is based on our assessment of Statnett's "very important" role for and "very strong" link with Norway.

S&P base-case operating scenario

In our base-case scenario, we anticipate that Statnett will continue to be supported by a transparent and favorable regulatory regime. The regulatory framework, which insulates Statnett from volume risk and demand fluctuations, determines the annual revenue level which Statnett can charge its customers. This ensures that underlying operations are stable and predictable, in our view. In addition to grid tariffs, Statnett earns congestion revenues, which occur when electricity prices are different between pricing areas due to bottlenecks in the grid. Congestion revenues are inherently difficult to forecast, and hence sometimes Statnett posts actual revenues which are different from allowed revenues. Statnett therefore makes profit or loss adjustments in subsequent years through higher or lower tariffs for its customers. Although we recognize that congestion revenues can be volatile and hence create large fluctuations in Statnett's revenue profile from year to year, we expect underlying profit to be stable.

Statnett has launched a significant investment program under which it aims to invest Norwegian kronor (NOK) 40 billion-50 billion until 2021. This can be compared with the NOK14 billion invested in 2006-2010. We assume the company will manage project risk appropriately and minimize the cost inflation associated with construction.

S&P base-case cash flow and capital-structure scenario

In our base case scenario, Statnett will increase its financial leverage considerably over the next five years. This is due to the investment program, which we assume will be debt-funded after the Norwegian government previously rejected a request for a capital increase. Consequently, we expect Statnett's credit metrics to weaken over the near

term because new investments will not generate cash flow until completed. If all investments were to be completed, we believe debt to debt and equity could increase above 75% over the medium term compared with 59% in 2010. Nevertheless, Statnett is unlikely, in our view, to be able to fully implement its investment plan as the concession process is often lengthy. In turn, credit metrics may not weaken as severely as projected during the investment plan period.

We believe the regulatory framework will continue to support Statnett's cash flows, and that funds from operations to debt adjusted for higher earnings will run at 5%-6% in the near to medium term, adjusted for higher/lower revenues.

Liquidity

The short term rating is 'A-1'. We view Statnett's liquidity profile as "adequate" under our criteria and calculate that liquidity sources will exceed liquidity needs by 1.2x over the next 12 months.

As of Sept. 30, 2011, we estimate liquidity sources were in excess of NOK6.1 billion. These include:

- Cash of NOK222 million and marketable securities of NOK355 million.
- Access to an undrawn committed revolving credit facility of NOK3.5 billion maturing in January 2016.
- Funds from operations of about NOK2.1 billion.

We estimate that Statnett's liquidity needs over the next 12 months to be about NOK5 billion, comprising:

- Short-term debt of NOK2.5 billion.
- Committed capital expenditures of about NOK2.3 billion.
- Dividend payments of NOK170 million.

In addition, we 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 Oslofjord bay. This loan, which we understand was drawn in November 2011, strengthens Statnett's liquidity and maturity profile, in our view.

In our view, Statnett's increasing future funding needs, and likely negative discretionary cash flow generation (cash flow after investments and dividends) 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 rating level, we assume Statnett will maintain a prudent approach to liquidity management and prefunding capital expenditures.

Outlook

The stable outlook reflects our view of Statnett's stable monopoly position and favorable tariff structure. It also reflects our expectations that although credit metrics will weaken, Statnett will be able to contain its financial risk profile in line with the current ratings. For example, we expect funds from operations to debt to average about 5%-6% over any given two-year period and debt to debt and equity to stay below 75% for the current rating level.

We could lower the ratings if our assessment of the likelihood of extraordinary government support were to weaken. A lowering of the 'bbb' SACP, for example as a result of a weakening financial risk profile or aggressive liquidity management, could put pressure on the ratings.

A strengthening of the financial risk profile and consequently SACP, however, could lead to a positive rating action. This could result from the company scaling down its investment program, resulting in consistently better credit metrics than we currently expect. It could also stem from a meaningful equity injection from the government of Norway, although we think this is unlikely in the near term. We could raise the ratings if we were to revise upward our assessment of extraordinary government support, which we also view as unlikely, due to the Norwegian government's hands-off approach in managing its state-owned entities.

Related Criteria And Research

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