

Research Update:

Statnett SF 'A+' Rating Affirmed With A Stable Outlook

February 26, 2020

Rating Action Overview

- The Norwegian Energy Regulatory Authority (NVE) has announced that Statnett SF receives a 100% efficiency score; this leads us to expect the company will capture in full the revenue cap of its cost base.
- We expect continued ample rating headroom as our base-case scenario stipulated FFO to debt to be close to 9% on average in coming years, and debt to EBITDA on average at about 8.5x, both which we consider well commensurate with the 'bbb' stand-alone credit profile (SACP).
- We continue to view the regulatory environment for Norwegian as supportive, despite declining weighted average cost of capital (WACC), because we view the framework as stable and predictable; the WACC estimate for 2020 is 5.47%.
- We are therefore affirming our 'A+' rating and stable outlook on Statnett.
- Statnett's positive momentum in credit ratios post-2020 are hinged on RAB increasing as planned, and without cost overruns.

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Rating Action Rationale

The regulator has announced Statnett as 100% efficient, which supports its credit ratios. On Jan. 31, the NVE announced Statnett's revenue cap, including an updated WACC estimation, at 5.47% and confirmation of a maintained 100% efficiency score. The WACC estimate decreased 35 basis points from the actual 5.82% reported in 2019, pointing to declining free-rate risk, computed as the average five-year swap rate from the most recent calendar year. The current revenue-cap framework took effect in 2007. Although there is no set regulatory period-end, all major regulatory pillars must remain in place for at least five years. We continue to assess the Norwegian framework as supportive despite falling WACC, although we have seen much lower WACC in neighboring countries that has put their revenue under pressure. NVE has maintained the 100% efficiency score for 2020, and continued its benchmark review.

We understand that the benchmark report did not consider and capture the Norwegian price developments compared to rest of Europe, and neither the company's unique environmental challenges. Cabling over steep mountains and through deep fjords, for example, results in higher operating costs for Statnett compared with other transmission system operators (TSOs). The company was assessed as at least average also in the most recent review in 2012, leading to a 100% efficiency score for its allowed regulated-return calculation. The confirmation enables the company to maintain credit lines well in line with our expectations, and we forecast FFO to debt and debt to EBITDA closer to 9% and 8.5x on average, respectively, over the coming years, with an improving trend after 2020 as investment levels decrease. In our base case, we expect Statnett to retain the 100% score.

Our view of Statnett's business risk reflects our assessment of the strong Norwegian regulatory framework for TSOs, which regulates almost all of the company's cash flow. In our view, the framework is stable and predictable. The regulator has a long track record and demonstrates good business understanding. Although there is no set regulatory period-end, all major regulatory pillars must remain in place for at least five years.

Large ongoing projects increase capital expenditure (capex) as well as the regulatory asset base (RAB) and revenue. Statnett is about to complete a period of large investment, as capex has averaged Norwegian krone (NOK) 10 billion during 2017-2019. From 2020 we expect that capex will moderate to more normal levels of about NOK7 billion. This still includes some new projects and not only maintenance. The largest projects that are to be completed in 2020 and 2021 are two subsea interconnector projects with total combined investments of about NOK20 billion. We understand that both projects are on time to be completed in 2020 or 2021, and within budget. We expect the large investments to increase Statnett's RAB massively in 2019 to 2021, which will lead to increasing revenue, cash flow and improving credit ratios. All NordLink related investments was added to RAB in 2019, and we understand that NSL to be on time and within budget. We also consider a credit positive that Statnett could add to its RAB even if there should be delays from any counterparty, as long as Statnett's part is finalized. The subsea interconnectors are constructed in cooperation's TenneT Holding B.V. (A-/Stable/A-2) for NordLink; and with National Grid PLC (A-/Stable/A-2) for NSL.

Statnett has ample rating headroom in both FFO to debt and debt to EBITDA. We expect FFO to debt close to 9% and debt to EBITDA on average of 8.5x in coming years. Both ratios are well in line with our 'bbb' SACP assessment. We expect Statnett to report a RAB of about NOK56 billion in 2019, up NOK 16 billion from 2018, and we assume that RAB will reach NOK78 billion by end of 2021. Consequently, we forecast a substantial EBITDA increase of about 30%, reaching NOK6.7 billion by end of 2021 from NOK5.2 billion in 2018. As we acknowledge Statnett's improved trajectory after 2020, we monitor the progress of the capital intense constructions and its addition to RAB, but also the outcome from the regulator's efficiency score assessment later this year.

We expect no changes in financial policy or government support. Statnett is about to pay 50% of the group's net result after tax, as a dividend adjusted for post-tax higher or lower revenue starting accounting year 2019, implying a cash effect in 2020. We see this more of a return to its stated financial policy, as the owners have agreed to temporary lower the dividend payout ratio to 25% for accounting years 2014-2018, because of the heavily debt-financed capex program. Although, in our view, going back to the 50% payout ratio before the interconnectors are fully added to RAB and consequently increasing debt is somewhat aggressive since discretionary cash flows will be negative and increase debt.

Outlook

The stable outlook reflects our expectation that Norway's stable and predictable regulatory framework will continue to support Statnett's cash flow. It also reflects our assumption that Statnett will maintain its 100% efficiency score and that the two subsea interconnectors (NordLink and NSL) will be added to RAB as planned, increasing RAB to about NOK62 billion by the end of 2020 and NOK70 billion by the end of 2021.

We forecast that Statnett's FFO to debt about 9% in 2020, improve and increasing when the interconnectors are added to RAB to nearly 9.5% in 2021 and debt to EBITDA falling towards or below 8x.

Upside scenario

We could raise the ratings if Statnett's financial risk profile strengthens compared with our forecasts. This could result from a deleverage plan or scaling down its investment plan combined with financial policy committing to stronger credit metrics, with FFO to debt sustainably above 9% and with our expectations that also debt to EBITDA will be below 8x on average.

Downside scenario

We would consider a downgrade if FFO to debt fell below 6%, with no signs of recovery. This could occur, for example if:

- Statnett's capex increases further without offsetting measures.
- Unexpected delays or cost overruns on existing projects that regulated tariffs do not cover.
- The Norwegian regulator's benchmark assessment result in an efficiency score less than 100% for the company.
- Statnett changed its financial policy.

In addition, we could lower the rating if our assessment of the likelihood of extraordinary government support for Statnett weakens. This could be, for example, if the company's liquidity deteriorates without any supportive government action. That said, we view this as very unlikely.

Company Description

Oslo-headquartered Statnett is the monopoly TSO of the Norwegian power system, with reported EBITDA of about €550 million in 2019. It owns and operates 98% of the Norwegian power transmission network, as well as the Norwegian sections of power lines (about 11,000 kilometers of high voltage lines) and subsea cables to other countries. It also develops the main transmission grid system and plans, builds, owns, and operates interconnectors. Statnett's other businesses include a small insurance operation related to grid activities, a transportation company specialized in heavy equipment on road and sea, and fully owned subsidiary Elhub--a data hub for the Norwegian power market that began operations in February 2019.

In addition, the company partially owns imbalance settlement services provider eSett and power balance IT solutions provider Fifty together with other TSOs, and has a 10% stake in electricity market Nord Pool AS. None of these activities significantly contribute to the group's EBITDA.

Research Update: Statnett SF 'A+' Rating Affirmed With A Stable Outlook

Statnett is fully owned by the Norwegian government through the Ministry of Petroleum and Energy. The company is fully regulated and cash flow is stable and predictable.

Our Base-Case Scenario

- Revenue growth of 6.7% in 2019, 4.1% in 2020, and 11.4% in 2021.
- Statnett's efficiency score remaining at 100%.
- No fluctuations in congestion revenue.
- Investments of NOK10.7 billion in 2019, NOK7.2 billion in 2020, and about NOK6.4 billion in 2021.
- Interconnector projects proceeding according to plan with commission in 2021, as a major contributor of increasing RAB to about NOK56 billion in 2019, NOK62 billion by the end of 2020, and NOK71 billion by the end of 2021.
- Dividend payments of 50 % of the group's net result after tax, adjusted for post-tax revenue starting accounting year 2019 (meaning a cash effect in 2020). We expect annual dividends of NOK1.0 billion-NOK1.2 billion.
- No tax payments expected until 2023.
- Net debt being at NOK47.5 billion in 2019, reaching NOK56.5 billion by the end of 2021.

Statnett SF--Selected Indicators

(Mil. NOK)	2018a	2019p	2020f	2021f
EBITDA	5,195	5,550-5,600	5,900-6,000	6,650-6,700
FFO	4,385	4,600-4,700	4,750-4,800	5,300-5,350
Capital expenditure	8,174	10,250-10,350	6,950-7,000	6,100-6,200
Debt	42,786	47,550-47,600	52,950-53,000	56,350-56,400
RAB	40,891	56,150-56,250	61,950-62,050	70,550-70,650
FFO/debt (%)	10.2	9.5-10.0	8.5-9.5	9.5-10.0
Debt/EBITDA (x)	8.2	8.0-9.0	8.5-9.0	8.0-8.5
DCF/debt (%)	(11.1)	(11.5)-(10.5)	(10.5)-(9.5)	(6.5)-(5.5)

DCF--Discretionary cash flow. FFO--Funds from operations (S&P Global Ratings-adjusted). FOCF--Free operating cash flow. NOK--Norwegian krone. RAB--Regulated asset base. p--Projected. f--Forecast.

Liquidity

We view Statnett's liquidity as adequate, and we expect this to continue. We believe that available liquidity sources (cash, committed credit facilities, and operating cash flow) should exceed 1.2x forecast near-term cash outflows, such as dividends and committed capex. In our assessment of liquidity, we also factor in qualitative factors, such as the company's sound relationships with banks, satisfactory standing in credit markets, and likely ability to absorb high-impact, low-probability events with limited refinancing. Statnett's government-related entity status is a positive as it should also support bank financing.

Research Update: Statnett SF 'A+' Rating Affirmed With A Stable Outlook

According to our calculations, the company's liquidity sources as of Dec. 31, 2019, comprise:

- Forecast FFO of about NOK4.6 billion.
- Available cash and marketable securities of about NOK3.2 billion.
- Access to undrawn committed revolving credit facilities totaling to about NOK8 billion maturing in January 2024.

Expected liquidity uses as of the same date include:

- Capex of about NOK7 billion in 2020, and NOK6 billion in 2021.
- Debt repayments of about NOK4 billion in the next 12 months. This includes about NOK3 billion under its commercial paper program; NOK300 million and NOK224 million related to amortization payments in first- and second-quarter 2020, respectively; and NOK460 million related to maturing bonds in 2020.
- An expected shareholder distribution of about NOK1.1 billion.

Covenants

Statnett's credit facilities have no financial covenants.

Environmental, Social, And Governance

The utility industry, including TSOs, faces short- and long-term risks from environmental factors, but also safety and societal issues when cabling in challenging terrains and environments, such as under the sea, and over or through mountains. Overall, we believe that environmental risks are not material for Statnett from a credit perspective. The industry at large is challenged by climate change and a general transition away from fossil energy sources into volatile renewable generation. This affects Statnett's status as a TSO, with its role to ensure security of supply and balance the system. Furthermore, the company's ongoing interconnector projects are intended to meet additional demand from volatile renewable generation.

Statnett has an excellent track record in terms of project execution. Although the company's projects are exposed to high-risk situations, it has a good health and safety record, and regularly reviews procedures.

We assess Statnett's management and governance as satisfactory, based on the company's consistent good operating track record, effective project planning, and active approach toward corporate social responsibility.

Issue Ratings--Subordination Risk Analysis

Capital structure

Statnett's debt structure comprises senior unsecured debt in the form of bonds and loans issued at the parent level.

Analytical conclusions

We rate debt issued by Statnett 'A+', the same as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: A+/Stable/A-1

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

- Related government rating: AAA
- Likelihood of government support: Very high (+4 notches from SACP)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013

Research Update: Statnett SF 'A+' Rating Affirmed With A Stable Outlook

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Statnett SF

Issuer Credit Rating A+/Stable/A-1

Statnett SF

Senior Unsecured A+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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