S&P Global
Ratings

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Statnett SF

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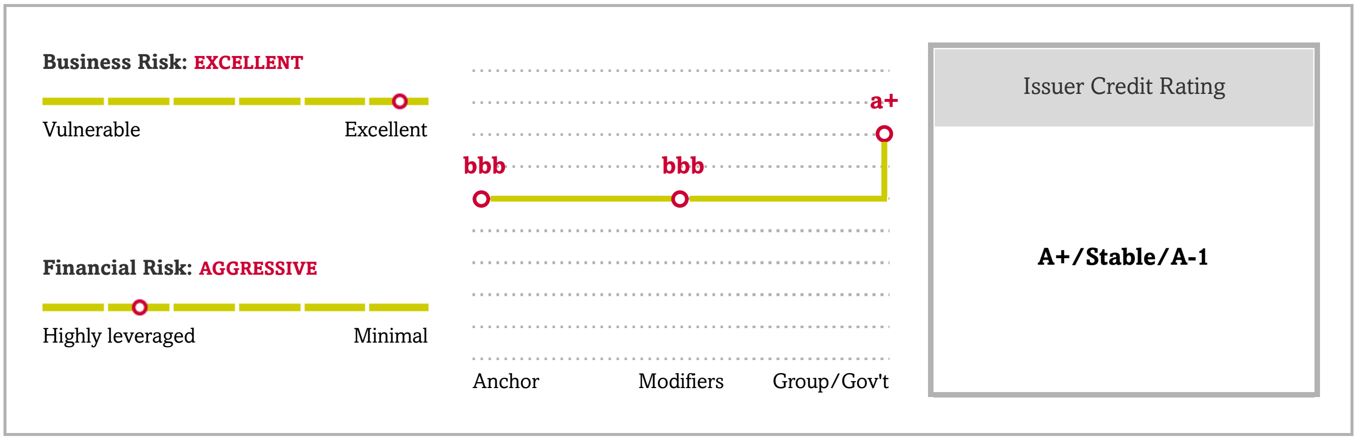

Credit Highlights

Overview

Key Strengths	Key Risks
Transmission system operator (TSO) that owns and operates 98% of the transmission network in Norway.	Large debt-funded capital expenditure (capex) program, with investment peaking at Norwegian krone (NOK) 30 billion on aggregate in 2018-2020.
Supportive regulation with a record of favorable cost coverage, leading to stable cash flow generation.	Projects with complex execution risk, including interconnectors NordLink and North Sea Link.
Efficient and reliable history of project executions.	Regulator's upcoming benchmark study, which could have a negative effect if Statnett doesn't meet the efficiency target.
Very high likelihood of support from the owner, the government of Norway (AAA/Stable/A-1+).	Increased dividend payments that will contribute to a larger debt burden.

S&P Global Ratings expects stable cash flow generation from Statnett's fully regulated business. In 2019 to 2020, we expect Statnett's funds from operations (FFO) to debt to recover to 8%-9%, which is appropriate for the rating. The rise from a forecast 7.5%-8.5% in 2018 is despite a sharp increase in debt, because FFO is supported by higher allowed revenue and EBITDA generation. We see the company's debt increasing because of two factors--a peak capex plan in 2019-2020 and increased dividend payments, with the payout ratio rising to 50% in 2019 from 25% in 2018, with a cash effect in 2020. We anticipate capex of about NOK11 billion in 2019, before declining toward NOK7 billion in 2020. S&P Global Ratings-adjusted debt is anticipated to increase by about 60% in 2020 compared with year-end 2017, to NOK56 billion from NOK35 billion. Investments will increase Statnett's regulatory asset base (RAB) and allowed revenue. However, we expect debt to EBITDA to increase toward 10x in 2018 before gradually declining to 9.5x by end-2020. Similarly, we expect debt will peak at about 110% of the RAB in 2018 before declining to 90% in the coming two years, but our forecast for adjusted debt to RAB, including assets under construction, is stable at about 76% for 2018-2022.

We see Statnett's regulatory framework as stable and predictable. Norway's regulator implemented changes to the allowed-regulated-revenue calculation for the country's TSOs in January 2019, but we believe these are not significant. We are still awaiting the upcoming benchmarking report from the regulator, which is expected later this year. If Statnett is given an efficiency score of less than 100% it will mean lower allowed revenue. However, we expect Statnett to maintain its 100% score.

Statnett's largest ongoing investments, the NordLink and North Sea Link (NSL) interconnectors, are on track. The company's investments related to the two interconnectors amount to NOK15 billion-NOK19 billion and will see capex peak in 2018-2020. We expect both projects will be finished on time and within budget, and added to the RAB in 2019 and 2021 respectively. This will see RAB increase about 35% by end-2019 to about NOK56 billion, in our view.

The company is fully owned by the Norwegian government and an essential part of the national infrastructure. Our 'A+' long-term rating on Statnett consequently includes four notches of uplift from its stand-alone credit profile (SACP), assessed at 'bbb'. We consider any change in ownership support very unlikely.

Outlook

Our stable outlook on Statnett reflects our expectation that Norway's stable and predictable regulatory framework will continue to support the company's cash flow.

We forecast that Statnett's credit metrics will weaken in 2018, with FFO to debt at 7.5%-8.5%, before recovering to 8.0%-9.0% in 2019-2020. However, we believe that its financial-risk profile will likely stay well in line with our parameters for the current ratings. In the long term, we expect FFO to debt of at least 6%, with some volatility due to unpredictable congestion revenue, which can push revenue higher or lower than allowed by the regulatory framework. We also expect FFO interest coverage to remain above 1.5x.

Downside scenario

We might lower the ratings if our assessment of the likelihood of extraordinary government support for Statnett weakens. This could be, for example, if Statnett's liquidity deteriorates without any supportive government action; although we view this as unlikely at present.

We would also lower the ratings if Statnett's SACP weakens to below 'bbb', owing to further deterioration of the financial risk profile. This could happen if Statnett's significant investment plan causes FFO to debt to fall below 6% and FFO interest coverage to fall below 1.5x, with no expectation of recovery.

Upside scenario

We could raise the ratings if Statnett's financial risk profile strengthens compared with our forecasts. This could result from another equity injection from the owner, the company scaling down its investment program, or financial policy committing to stronger credit metrics, with FFO to debt sustainably above 9%. We could also raise the ratings if we revise our assessment of extraordinary government support upward. However, we see this as unlikely at this point.

Our Base-Case Scenario

Assumptions

- Revenue growth of about 13% per annum in 2018-2019, and about 4% in 2020. This is mainly linked to an expanding RAB, after significant historical capex.
- Interconnector projects proceed according to plan, increasing the RAB to about NOK56 billion in 2019, and NOK62 billion by end-2020.
- Annual capex of about NOK11 billion in 2018-2019, before decreasing to about NOK7 billion. About one-third of this spending will be linked to the two interconnectors.
- Net debt of about NOK50 billion by end-2019, and about NOK56 billion by end-2020.
- No tax payments in the coming years because of Statnett's current tax surplus.
- A dividend payout ratio of 25% in 2018, increasing to regular levels of 50% in accounting year 2019. The cash effect is in the consecutive year.
- Potential fluctuations in congestion revenue are not taken into consideration.
- Statnett maintains its 100% efficiency score for the regulated rate-of-return calculation in the forecast period.

Key Metrics

	2017A	2018F	2019E	2020E
FFO to debt (%)	9.2	7.5-8.5	8.0-9.0	8.0-9.0
FFO cash interest coverage (x)	5.7	5-6	5-6	5-6
Debt to EBITDA (x)	8.2	9-10	9-10	9-10
Debt to RAB (%)*	99	110	90	90
Capex (NOK billion)	10.6	12	11	7

*RAB under construction is not included in RAB.

RAB--Regulatory asset base. NOK--Norwegian krone. FFO--Funds from operations. Capex--Capital expenditure. A--Actual. E--Estimate. F--Forecast. Figures are S&P Global Ratings adjusted.

Company Description

Oslo-headquartered Statnett SF is the monopoly TSO of the Norwegian power system, with reported EBITDA of about €380 million in 2017. Statnett owns and operates 98% of the Norwegian power transmission network and 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, it partly owns imbalance settlement services provider eSett and power balance IT solutions provider Fifty together with other TSOs, and a 28.2% stake in electricity market Nord Pool AS. None of these activities significantly contribute to the group's EBITDA.

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.

Business Risk

Our view of Statnett's business risk reflects our assessment of the strong Norwegian regulatory framework for TSOs, which regulates almost all of Statnett's cash flow. In our view, the framework is stable and predictable. The regulator has a long track record and demonstrates good business understanding. In January 2019, the regulator modified some parameters in the allowed regulated-revenue calculation. It reduced the risk-free rate to 1.5% from 2.5%, due to lower interest rates, and the credit-premium parameter in the weighted average cost of capital (WACC) model was adjusted upwards. This results in an estimated negative 0.4 percentage-point net effect for the regulated return rate in 2019.

The regulator has announced well in advance that parameters are being reviewed and could change from 2019. We do not see these changes as major and consider them a reasonable adaptation to reflect the current market situation. The current revenue-cap framework was introduced in 2007. Although there is no set regulatory period end, all major regulatory pillars must remain in place for at least five years.

The regulator has announced a benchmarking review in 2019. Statnett was assessed as at least average in the most recent review in 2012, leading to a 100% efficiency score for its allowed regulated-return calculation. We expect Statnett to retain the 100% score.

Apart from regulation, we also consider Statnett's dominant market position. The company owns 98% of the transmission network in Norway and expects to acquire the remaining 2%. It also operates an efficient grid and transmission system and has a proven ability to cope with the often-harsh Norwegian terrain and climate. This is supported by several international benchmarking studies, which have shown Statnett's transmission operations match its European peers' for efficiency.

In comparison, the unpredictable nature of congestion revenue, which can result in higher or lower revenue than the regulatory framework permits, can make Statnett's overall revenue volatile. The company pays back any accumulated higher revenue earned over time by adjusting tariffs. Currently, Statnett has repaid all higher revenue balances as of end-2018. Although we recognize that the payback of higher revenue and the volatility of congestion revenue can create large fluctuations in Statnett's revenue annually, we expect the underlying profit to remain stable.

Peer comparison

Energinet and Fingrid are other Nordic TSOs operating under a predictable, independent, and supportive regulatory framework. Fingrid enjoys lower profit volatility than its peers, due to Finland's different treatment of congestion revenue. Energinet has the largest debt burden in relation to EBITDA, although this is counterbalanced by its access to debt financing via the National Bank of Denmark. Statnett and Energinet have aggressive financial profiles due to their larger debt burdens, which have increased under very large capex programs in recent years. Their leverage levels of 9x-10x and 12x-13x are among the highest in Europe's regulated utilities sector.

Table 1

Statnett SF--Peer Comparison			
	Statnett SF	**Energinet.dk SOV**	**Fingrid Oyj**
Rating as of March 14, 2019	A+/Stable/A-1	AA-/Stable/A-1+	AA-/Stable/A-1+
(Mil. NOK)	**--Fiscal year ended Dec. 31, 2017--**		
Revenue	7,401.0	6,476.0	6,629.1
EBITDA	3,805.5	3,213.6	2,721.6
Funds from operations (FFO)	2,881.1	2,641.4	2,109.2
Net income from cont. oper.	813.0	(300.8)	1,285.1
Cash flow from operations	3,427.1	2,136.1	2,293.1
Capital expenditure	10,661.0	4,498.5	1,042.7
Free operating cash flow	(7,233.9)	(2,362.4)	1,250.4
Discretionary cash flow	(7,583.9)	(2,362.4)	287.8
Cash and short-term investments	2,163.0	1,237.4	822.8
Debt	35,002.7	40,662.7	10,206.3
Equity	14,008.5	7,183.1	7,838.5
Adjusted ratios			
EBITDA margin (%)	51.4	49.6	41.1
Return on capital (%)	3.0	0.4	9.5
EBITDA interest coverage (x)	6.1	5.1	11.8
FFO cash interest coverage (X)	5.7	4.1	12.5
Debt/EBITDA (x)	9.2	12.7	3.8
FFO/debt (%)	8.2	6.5	20.7
Cash flow from operations/debt (%)	9.8	5.3	22.5
Free operating cash flow/debt (%)	(20.7)	(5.8)	12.3
Discretionary cash flow/debt (%)	(21.7)	(5.8)	2.8

Financial Risk

Statnett's financial-risk profile is constrained by its extensive investment plan. The company expects to invest, on aggregate, NOK30 billion from 2018-2020 to upgrade its transmission system and enhance supply security in Norway. We expect Statnett's capex program to slow down after 2019, in line with major investments in its two interconnectors.

In our view, Statnett's investments will be mainly funded by additional debt, despite a NOK3.25 billion government equity injection in January 2014, and a reduced dividend-payout ratio, to 25% from 50%, to support the investment plan until 2019. In our view, net debt will increase by about NOK21 billion to end-2020 from end-2017, reaching about NOK56 billion. Based on this, we expect:

- Relatively stable FFO to debt of 8%-9% despite increasing debt.
- Debt to EBITDA to rise toward 10x in our forecast period.
- Debt to RAB higher than 100% in 2018, then declining to about 90% in 2019-2020.

Although, Statnett has significant additions to its RAB under construction, peaking at roughly NOK18 billion in 2018, these relate mainly to the two interconnectors. We expect these additions to be fully transferred to the RAB in the coming years.

Statnett's operations are regulated under a revenue cap. If total annual revenue from grid operations diverges from the cap, an imbalance is created and needs to be reduced over time by adjusting future grid tariffs. Imbalances can accumulate unexpectedly due to congestion revenue, which leads to higher- than-expected overall revenue. The payback mechanism should not see revenue decline more than forecast, but could see FFO to debt fluctuate without any significant change in the underlying credit quality. Therefore, when assessing Statnett's financial risk profile, we also take into account the company's comparatively strong interest-coverage ratios, and we assume that FFO cash interest coverage will remain above 1.5x. We also note that Statnett can postpone or adjust the annual payback amounts.

Financial summary

Table 2

Statnett SF--Financial Summary

Industry Sector: Electric					
	--Fiscal year ended Dec. 31--				
(Mil. NOK)	**2017**	**2016**	**2015**	**2014**	**2013**
Revenue	7,401.0	6,678.0	5,906.0	5,563.0	4,561.0
EBITDA	3,805.5	3,374.0	3,137.0	2,621.5	1,484.0
Funds from operations (FFO)	2,881.1	2,863.5	2,661.4	2,080.7	1,002.2
Net income from continuing operations	813.0	645.0	1,103.0	829.0	82.0
Cash flow from operations	3,427.1	3,085.5	2,033.4	2,923.7	1,230.2
Capital expenditure	10,661.0	7,549.0	5,681.0	5,810.0	5,546.0
Free operating cash flow	(7,233.9)	(4,463.5)	(3,647.6)	(2,886.3)	(4,315.8)
Dividends paid	350.0	357.0	321.0	0.0	117.0
Discretionary cash flow	(7,583.9)	(4,820.5)	(3,968.6)	(2,886.3)	(4,432.8)
Debt	35,002.7	27,021.8	21,095.8	21,253.9	18,904.3
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	14,008.5	13,867.0	13,605.0	12,629.0	12,135.0
Debt and equity	49,011.3	40,888.8	34,700.8	33,882.9	31,039.3
Adjusted ratios					
EBITDA margin (%)	51.4	50.5	53.1	47.1	32.5
EBITDA interest coverage (x)	6.1	6.3	5.8	4.7	2.9
FFO cash interest coverage (x)	5.7	6.7	6.3	5.3	3.6
Debt/EBITDA (x)	9.2	8.0	6.7	8.1	12.7
FFO/debt (%)	8.2	10.6	12.6	9.8	5.3
Cash flow from operations/debt (%)	9.8	11.4	9.6	13.8	6.5
Free operating cash flow/debt (%)	(20.7)	(16.5)	(17.3)	(13.6)	(22.8)
Discretionary cash flow/debt (%)	(21.7)	(17.8)	(18.8)	(13.6)	(23.4)
Net cash flow/Capex (%)	23.7	33.2	41.2	35.8	16.0
Return on capital (%)	3.0	3.1	4.3	4.5	1.6

Table 2

Statnett SF--Financial Summary (cont.)

Industry Sector: Electric

	--Fiscal year ended Dec. 31--				
(Mil. NOK)	**2017**	**2016**	**2015**	**2014**	**2013**
Return on common equity (%)	4.3	3.5	7.4	5.1	(0.7)
Common dividend payout ratio (un-adj.) (%)	43.1	55.3	29.1	0.0	142.7

Liquidity

We view Statnett's liquidity as adequate, supported by our view that available liquidity sources--including cash, FFO, and available credit facilities--will cover uses by at least 1.1x in the next 12 months. We also assume that liquidity sources will exceed uses even if EBITDA declines 10%. Statnett's solid relationships with banks and high standing in the credit markets further support the group's liquidity position.

Principal Liquidity Sources

(As of Dec. 31, 2018, for the next 12 months)

- NOK3.8 billion in cash and marketable securities.
- Access to undrawn committed revolving credit facilities (RCFs) totaling NOK8 billion, maturing in January 2022.
- Access to €200 million (roughly NOK1.9 billion) of undrawn European Investment Bank facilities.
- Cash FFO of about NOK4.3 billion.

Principal Liquidity Uses

(As of Dec. 31, 2018, for the next 12 months)

- Debt maturities of about NOK2 billion, predominantly outstanding commercial paper and bonds.
- Capex of about NOK11 billion in 2019 and about NOK7 billion in 2020.
- Expected dividend of about NOK450 million in 2019.

Covenant Analysis

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 quality perspective. The utility 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, we note that 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.

Government Influence

The long-term rating on Statnett is four notches higher than the 'bbb' SACP. This reflects our view of the very high likelihood that the government of Norway would provide timely and sufficient extraordinary support to the company in the event of financial distress, and is based on Statnett's:

- Very important role as Norway's monopoly TSO, including its clear public-policy position within the country's energy market, and as a supplier to to the strategically important oil industry.
- Very strong link with Norway, demonstrated by its full government ownership, remote privatization prospects due to its legal status, and strategic importance to the government.

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 at 'A+', the same as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Reconciliation

Table 3

Reconciliation Of Statnett SF Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. NOK)								
	--Fiscal year ended Dec. 31, 2017--							
Statnett SF reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Capital expenditure**
	39189	14011	3715	1312	400	3715	3615	10877
S&P Global Ratings' adjustments								
Interest expense (reported)	--	--	--	--	--	(400.0)	--	--
Interest income (reported)	--	--	--	--	--	54.0	--	--
Current tax expense (reported)	--	--	--	--	--	(367.0)	--	--
Operating leases	67.3	--	72.5	4.7	4.7	67.8	67.8	--
Postretirement benefit obligations/deferred compensation	296.3	(2.5)	2.0	2.0	2.0	11.4	(55.6)	--
Surplus cash	(2,054.9)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	216.0	(216.0)	(216.0)	(216.0)
Dividends received from equity investments	--	--	16.0	--	--	16.0	--	--
Non-operating income (expense)	--	--	--	74.0	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	16.0	--
Debt - Foreign currency hedges	(2,039.0)	--	--	--	--	--	--	--
Debt - Fair value adjustments	(456.0)	--	--	--	--	--	--	--
Total adjustments	(4,186.3)	(2.5)	90.5	80.7	222.7	(833.9)	(187.9)	(216.0)
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
S&P Global adjusted figures	35,002.7	14,008.5	3,805.5	1,392.7	622.7	2,881.1	3,427.1	10,661.0

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: 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
- 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	**Aggressive**	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	**bbb**	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of March 14, 2019)

Statnett SF	
Issuer Credit Rating	A+/Stable/A-1
Senior Unsecured	A+
Issuer 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+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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