

### Summary:

## Statkraft AS

**Primary Credit Analyst:**

Andreas Kindahl, Stockholm (46) 8-440-5907; andreas\_kindahl@standardandpoors.com

**Secondary Credit Analyst:**

Gustav Liedgren, Stockholm +46 (0) 8 440 5916; gustav\_liedgren@standardandpoors.com

### Table Of Contents

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Statkraft AS

**Credit Rating:** A-/Negative/A-2

## Rationale

The ratings on Norway-based multiutility company Statkraft AS (Statkraft) reflect the group's position as the third-largest Nordic power generator, its competitive and low-cost hydropower generation asset base, and its 100% state ownership. These factors are offset by the inherent volatility of Statkraft's earnings generation as a result of its exposure to hydropower and wholesale power prices and by Standard & Poor's Ratings Services' expectation that Statkraft's credit measures will weaken as a result of the company's significant investment program and aggressive dividend policy. Furthermore, large minority stakes in electric utilities limit Statkraft's access to cash flow from these holdings, and some of its growth investments are in higher-risk countries, in our view, which could weigh on our assessment of the group's business risk profile.

The group's large number of hydropower stations and huge reservoirs mitigate the significant share of weather-sensitive hydropower in its power generation portfolio. In addition, Statkraft has hedged a large proportion of its power output through bilateral contracts with industrial clients or through the Nordic power exchange.

We currently assess Statkraft's stand-alone credit profile at 'BBB'. In our opinion, there is a "moderately high" likelihood that the government of the Kingdom of Norway (AAA/Stable/A-1+) would provide timely and sufficient extraordinary support to Statkraft in the event of financial distress.

In accordance with our criteria for government-related entities, our view of a "moderately high" likelihood of extraordinary government support is based on our assessment of Statkraft's:

- "Important" role for the Norwegian economy, in light of its vast domestic hydropower resources, which we view as highly strategic to Norway's power supply; and
- "Strong" link with the Norwegian government, its owner, and our view that the risk of privatization is remote.

## Key business and profitability developments

Statkraft reported strong earnings in the first half of 2010. This was mainly owing to high power prices and increased demand for power in the first quarter, which resulted from cold weather in the Nordic region, low availability of nuclear base-load capacity, and a recovery of demand for industrial power. Statkraft was able to take advantage of the strong market conditions largely because of its large share of hydroelectric plants with reservoir capacity, which gives it the flexibility to adjust production to fluctuations in market power prices.

However, high hydroenergy production levels and dry weather have reduced water reservoir levels, which is likely to result in lower hydro production capacity for the remainder of 2010. Consequently, despite likely healthy power prices, we expect Statkraft's profitability to be lower in the second half of 2010, albeit still strong on a full-year basis.

### Key cash flow and capital-structure developments

Statkraft has requested a capital injection and a less aggressive dividend policy from the Ministry of Trade and Industry, targeting dividends of between 50%-75% of net profit instead of the current 75%-100%. In Statkraft's view, these measures will help it maintain a healthy financial risk profile throughout the heavy investments it expects to undertake over the next 3-5 years.

We understand that Statkraft has not yet received approval for its request. Consequently, and following a recent strategic review, Statkraft has announced that it will likely scale back its investment program and refocus its strategy. In addition, it has announced its intention to reduce its stake in Bergenshalvoens Kommunale Kraftselskap AS (BKK; not rated) from 49% and has recently sold its electricity grid company in Trondheim.

For the 12 months ended June 30, 2010, Statkraft's ratio of adjusted funds from operations (FFO) to debt improved to 27% from 18% in the fiscal year ended Dec. 31, 2009. This largely reflects improved profitability in the first half of 2010. We project, however, that this ratio will gradually weaken in the near to medium term, mainly as a result of high and partly debt-funded investments and continuously high dividend payouts. Furthermore, the first cash flows from the new investments are likely to be limited in the near to medium term, mainly because of the relatively long lead times to complete projects. Our expectation of a gradual weakening of the financial risk profile weighs on our assessment of Statkraft's credit risk profile.

### Short-term credit factors

The short-term rating is 'A-2'. We consider Statkraft's liquidity to be adequate. As of June 30, 2010, the company reported on-balance-sheet cash of about Norwegian krone (NOK) 10.9 billion (about €1.4 billion), access to an unused NOK5 billion multicurrency revolving credit facility maturing in 2012, an unused NOK3 billion multicurrency revolving credit facility maturing in 2013, and NOK400 million in uncommitted bank lines. This compared with short-term debt of NOK6.4 billion as of the same date.

Statkraft SF, Statkraft AS' parent company, has announced that it will pay about NOK4.2 billion in dividends to the state in 2010, likely in the third quarter. Consequently, Statkraft AS will distribute NOK7.4 billion in contributions to Statkraft SF, which largely covers its parent's dividend payments and debt amortizations of NOK2.7 billion.

In addition, we understand that Statkraft will spend about NOK3.6 billion on investments in 2010, of which NOK1.2 billion was already spent in the first half of the year. Consequently, taking into account recent debt issues and projected cash flows for 2010, we believe Statkraft will need to raise about NOK2 billion-NOK3 billion in debt for the remainder of 2010 to cover negative cash flows and extend debt maturities.

Statkraft has a policy of holding liquidity (cash and committed credit lines) to cover at least six months' of outflows, including the annual dividend payment, without external financing.

Covenants attached to Statkraft's borrowing arrangements relate mainly to restrictions regarding indebtedness at group subsidiaries and government guarantees and ownership.

## Outlook

The negative outlook reflects our concerns that Statkraft's business and financial risk profiles could weaken over the near to medium term, due to the company's still-significant investment program, which will be partly debt funded and partly directed to higher-risk countries.

The ratings could be lowered should any measures to strengthen Statkraft's capitalization fail to sufficiently offset the impact of the planned increase in investment levels on the company's stand-alone credit profile. We would also consider a negative rating action if a prolonged period of low electricity wholesale prices or poor hydro availability were to result in a weaker-than-expected earnings performance, or if we see that the likelihood of government support were decreasing.

We might revise the outlook to stable if Statkraft receives adequate financial support from its owner to undertake its planned investment program or if Statkraft takes other actions to strengthen its financial profile. We would consider an FFO-to-debt ratio of 15%-20% and only moderately negative cash flows after dividend payments to be consistent with the current ratings.

## Related Criteria And Research

Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009

**Additional Contact:**

Infrastructure Finance Ratings Europe; InfrastructureEurope@standardandpoors.com

**Additional Contact:**

Infrastructure Finance Ratings Europe; InfrastructureEurope@standardandpoors.com

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