

Summary:

Statkraft AS

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Statkraft AS

Credit Rating: A-/Stable/A-2

Rationale

The ratings on Norwegian state-owned utility Statkraft AS are based on the group's stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses as 'bbb', as well as our opinion that there is a "moderately high" likelihood that the Norwegian government would provide timely and sufficient extraordinary support in the event of financial distress.

Statkraft's SACP reflects its position as the third-largest Nordic power generator, its competitive and flexible hydro-power generation asset base, and on-going support from its 100% owner, the Norwegian government.

These factors are offset by the inherent volatility of Statkraft's earnings generation as a result of its exposure to hydro-power and wholesale power prices, a significant investment program, a high effective tax rate (including resource rent and natural resource taxes), and the group's 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 high-risk countries, in our view, which could weigh on our assessment of the group's business risk profile.

We believe that there is a "moderately high" likelihood that the Norwegian government will provide timely and sufficient extraordinary support to Statkraft in the event of financial distress. This is based on our assessment of Statkraft's "important" role in light of its vast domestic hydropower resources, which we view as highly strategic to Norway's power supply. It is further based on the group's "strong" link to the government, reflecting full state ownership, and our view that the risk of privatization is remote.

Key business and profitability developments

In 2010, Statkraft reported strong earnings, mainly owing to high power prices and increased demand for power, which resulted from low temperatures 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 strong market conditions largely because of its large share of hydro-electric plants with reservoir capacity, which gives it the flexibility to adjust production to fluctuations in market power prices.

However, high hydro-energy production levels and dry weather in 2010 have reduced reservoir levels, and resulted in lower Nordic hydropower production in the first quarter of 2011. This was also the primary reason for a decline in the group's reported adjusted EBITDA by 28% compared with first quarter 2010, to about NOK4.2 billion. The low reservoir levels and resulting decline in hydropower production are likely to continue to impact Statkraft's profitability negatively over the near term. The low reservoir levels and the fact that a large part of production volumes are tied up in long-term industry contracts also reduces the group's ability to benefit from currently healthy spot power prices.

Key cash flow and capital-structure developments

In December 2010, the Norwegian parliament decided to strengthen Statkraft's capital base with a NOK14 billion (about €1.7 billion) equity injection. The equity increase has, in our view, led to a sustained, albeit modest, improvement of Statkraft's financial risk profile, and shows a strong commitment of ongoing support from the government. The proceeds are, however, aimed at supporting Statkraft's major investment program over the next few years, which is likely to largely counterbalance the positive contribution to credit metrics. As a negative rating factor, we note that the government has maintained a high dividend requirement from Statkraft, with NOK8 billion to be paid out in 2011, equivalent to 85% of the group's adjusted profit after tax and minority interests in 2010.

In 2010, the ratio of adjusted funds from operations to debt improved to about 33% from 18% in 2009. This largely reflected improved profitability and increased cash flows as a result of higher prices and production. Strong operating cash flows combined with modest capital expenditure also resulted in good free cash flows which were partly used to lower total debt. We expect, however, that lower hydropower production volumes over the near term will weaken the group's credit measures in 2011, but that they will remain in line with our expectations for the ratings.

Liquidity

The short-term rating is 'A-2'. We consider Statkraft's liquidity to be adequate, based on our assumption that available liquidity sources would cover anticipated cash outflows by at least 1.2x in the next 12-18 months, the relatively light covenants attached to the group's loan documentation, and its sound relationships with its banks.

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 by 1.5x-4.0x, without external financing. As of March 2011, Statkraft reported on-balance-sheet cash and cash equivalents of about NOK23 billion, and access to an unused NOK12 billion multicurrency revolving credit facility maturing in 2016. This compared with reported short-term debt of NOK6.6 billion as of the same date. The current high cash balance is expected to cover anticipated significant negative free cash flows in the near term as a result of high dividend payments and increased investments.

Financial flexibility is further supported by the group's holding of a minority share in E.ON AG (A/Stable/A-1), which is listed on the Frankfurt stock exchange. On March 31, 2011, the stake was valued at about NOK14 billion based on the E.ON share price.

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

Outlook

The stable outlook reflects our expectation that Statkraft's financial risk profile will remain in line with our expectations for the ratings as a result of the NOK14 billion capital increase, which will support the group's expansionary investment program. We further assume that Statkraft would use its flexibility in cutting spending if needed to protect its credit measures. Taking into account the on-going support from the government, we would consider a ratio of funds from operations to debt of 15%-20% to be consistent with the current ratings.

The ratings could come under pressure as a result of concerns over a gradual deterioration of Statkraft's business risk profile over the longer term, which could result from the company's significant investment program with its attached execution risks. In addition, we believe that the program will be partly implemented in high-risk countries.

We would also consider a negative rating action if a lengthy 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 is decreasing. The latter could result from a significant dilution of state ownership, a possibility that, we deem unlikely, even in the long term.

Any upside to the ratings would likely be the result of an unexpected change to the company's financial strategies and targets, which would include a focus on maintaining higher credit metrics than those currently factored into the ratings.

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