Moody's Investors Service

Credit Opinion: Statkraft AS

Global Credit Research - 16 Oct 2009

Oslo, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
Other Short Term	P-2
Parent: Statkraft SF	
Outlook	Stable
Bkd Senior Unsecured	Aaa

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Key Indicators

Statkraft AS

	2006	2007	2008
(FFO + Interest) / Interest	**7.4x**	**4.9x**	**4.9x**
FFO / Net Debt	**24.4%**	**19.0%**	**22.8%**
RCF / Net Debt	**8.8%**	**-2.9%**	**2.2%**
FCF / Net Debt	**-6.4%**	**-6.0%**	**2.7%**

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Statkraft AS is Norway's leading generator of electricity; the company's output (primarily hydro based) covers 35% of Norway's consumption. As of end 2008 the company had 15.5GW of installed capacity; 40TWh of reservoir capacity; with 53TWh of production sold in 2008 - mainly into the Nordic area, albeit with around 10% now sold to Germany. In recent years it has pursued a policy of expansion into downstream activities in Norway as well as expanding into thermal and renewables production in Northern Europe in order to diversify its business risk profile.

In line with this strategy, in December 2008, Statkraft implemented a swap deal with E.ON under the terms of which E.ON acquired Statkraft's 44.6% shareholding in E.ON Sverige and one hydroplant in Sweden in exchange for a portfolio of 7TWh flexible power production assets. These include hydropower and district heating in Sweden; hydro- and gas power assets in Germany and hydropower in the UK, as well as E.ON AG shares worth EUR2.2 billion. Moreover, Statkraft is present in some hydropower projects in Southeast Europe, South East Asia and Latin America.

Statkraft AS is 100% owned by Statkraft SF, in turn 100% owned by the Norwegian government.

Rating Rationale

Statkraft's Baa1/P-2 ratings reflects the application of Moody's joint default analysis for Government Related Issuers (GRI) which combines the underlying strength of the company or Baseline Credit Assessment (BCA) and the credit support that the government of Norway could provide in a distress situation. Under this methodology, the rating gives 2 notches uplift from the BCA for potential government support, reflecting the following inputs:

- BCA: 10 (on a scale of 1 to 21, where 1 represents lowest credit risk; 10 is equivalent to Baa3);

- Local currency rating of the Norwegian government: Aaa, stable outlook;

- Dependence: Medium;

- Support: Medium.

BUSINESS RISK FACTORS

In deriving the BCA of "10", Moody's applies the recently published methodology for Unregulated Utilities and Power Companies (August 2009). Under this methodology, Statkraft is considered as an Unregulated Power Company and on application of the rating grid, maps to a Baa3 which is in line with its current BCA of 10. Statkraft AS has a relatively higher business risk compared to other European utilities due to its principal role as a generator with a very limited retail supply and distribution base; electricity production and sales generated around 82% of EBITDA in 1H 2009. Statkraft derives further cash flow from its industrial holdings as well as the consolidation of its 66% ownership in Skagerak Energi - a small utility active in the generation, supply, networks and district heating sectors in Norway. Skagerak Energi contributed a further 13% to EBITDA in 1H 2009, with the balance of 5% coming from Emerging Market and Direct Customers.

Statkraft benefits from its strong market position as Norway's leading generator of low marginal-cost and environmentally-friendly hydro production. The company controls a large number of reservoirs which can mitigate some of the significant volume and price risk as a result of the high, but variable, hydrological input in the Nordic power system.

STRATEGY

Moody's also factors into its rating, Statkraft's strategy which remains focused on expanding its power generation activities in the Nordic and European markets, and to a more minor extent, in international markets, via a combination of organic investments and acquisitions. It has an ambitious investment plan aimed at (i) developing its already strong hydro generation capacity and investing in environmentally friendly gas-fired, wind and other renewables capacity, (ii) developing the application of new technologies in these fields, and (iii) development of its industrial holdings in Norway strengthening the group's position in the grid, retail sales and district heating segments in Norway - if possible through consolidation and rationalisation of existing operations plus the pursuit of organic and acquisition growth. Statkraft would like to gain majority control if possible of key shareholdings in Norway (BKK is currently 49.9% and Agder Energi 45.5% owned.)

Current projects include 1100MW of wind power development in Sweden via a joint venture with SCA; a portfolio of 7 hydro plants in Turkey (633MW) as well as a 340MW joint venture project in Albania, a 315MW joint venture offshore and onshore wind power projects in the UK, and small scale hydro, district heating and wind projects in Norway.

Overall 85% or investments are planned to be in renewable power out of a total investment plan for 2009-2015 of EUR10.5 billion/NOK90 billion. This plan is however linked to a request for new equity to its owner of EUR940 million/NOK8 billion and the plan, which is flexible, will need to be reduced if not received. Moody's understands that Statkraft is still awaiting the Government's decision on the proposed equity injection.

FACTOR 1: Market Assessment, Scale, and Competitive Position

MARKET AND COMPETITIVE POSITION

Statkraft scores a Baa on this factor, reflecting its strong market position but reflecting the reality of operating in a competitive market place. It has a leading market position in Norway with 35% market share in the generation market. It is also the fourth largest generator in Sweden. In the relatively fragmented Nordic market, Statkraft is the third largest generator with around 12-14% of total power generation. Nord Pool is the most transparent and liquid of the European wholesale electricity markets,

Statkraft's Norwegian hydropower plants have load factors typically of around 45-50%, reflecting a relatively high installed capacity compared to hydrological conditions. Whilst companies in the Baa category, generally have higher load factors, Moody's also recognises the high level of availability this gives to Statkraft, which combined with large reservoirs, leads to increased production flexibility, enabling Statkraft to produce significant volumes when market conditions are favourable.

The Nord Pool is more volatile in terms of pricing than other European electricity pools, given the high but variable hydro content and high availability of nuclear power (both low marginal cost technologies). However given these features, they generally feature the cheapest wholesale prices in Europe. Nord Pool prices are however also influenced by central European prices given increased interconnection and Statkraft's hydro plants will become even more valuable as CO_2 costs are further priced into European electricity prices.

GEOGRAPHIC DIVERSITY

Statkraft scores Ba on this factor as the bulk of Statkraft's assets are in the Nordic sector. In terms of geographical diversity, 72% of Statkraft installed capacity (15.5GW) is in Norway. The company is also present in Sweden, Germany, UK and Southeast Europe. In 2008, around 10% of production was in Germany, whilst 90% was in the Nordic countries.

Statkraft also has a majority stake in SN Power (60% from January 2009), this company is used as a financial holding for Statkraft's equity investments mainly in South America and Southeast Asia. The company has installed capacity of 1000MW; with 500MW under development and a further pipeline of assets. Those international activities are high-risk but are limited in scope. It is active in further developing projects in emerging markets via SN Power. Overall the company aims to continue the diversification away from Norway and hydro power mainly into mainland Europe and the UK, concentrating in wind and gas assets. In addition, hydropower projects in South-East Europe are under development.

FACTOR 2: Cash Flow Predictability of Business Model

HEDGING STRATEGY

Statkraft scores Baa on this factor, reflecting the fact that Statkraft has quite predictable cash flows for a company principally focused on generation - reflecting both a combination of spot and long term hedges that it has in place. This factor also recognises the value of its control over 40% of the reservoirs in Norway, which cover 90% of Statkraft's own production, hence giving it a high degree of flexibility in its portfolio.

Statkraft hedges much of its production through long-term bilateral supply contracts. In the Nordic market around 50% of production is pre-sold long-term. Statkraft also hedges parts of the production under term contracts through Nord Pool. The remainder of the production is sold spot on the continental and Nordic exchanges. Statkraft uses the flexibility afforded it by its reservoir-based hydro production, to optimise its portfolio with regard to the timings and amount of volumes of electricity to be sold and at what price. In addition, there is a built-in hedge between production volumes and electricity prices in Nord Pool which helps reduce volatility (ie when prices are low because of high hydrological levels, the company is likely to sell greater volumes). Further new capacity build-out both in Norway and Continental Europe should also help to hedge the company's exposure to pricing volatility

Statkraft has in place a number of long term contracts at commercial rates and also has access to end-users - primarily via its control of Fjordkraft (via Statkraft AS and Skagerak Energi) and Trondheim Energi.

However Statkraft's profitability is somewhat depressed by a number of politically-driven, out-of-the-money industrial and concessionary contracts (12TWh in 2009), although the industrial contracts will gradually expire by 2012. Many of these contracts are with power-intensive and wood-processing industries - the pricing on the industrial contracts was set by the Norwegian Parliament, and the concession agreements mean that Statkraft supplies municipalities at below-market prices. These tail off in the intermediate term (to 3.3TWh in 2012) and Statkraft has secured new contracts to replace them at higher prices. Recently Statkraft entered into a 20 year contract to supply Boliden Odda for 900GWh per annum and it has other long term agreements for around 10TWh. Moody's believes that the company's cash flows will be boosted incrementally over the years as a result.

FUEL STRATEGY AND MIX

81% of Statkraft's installed capacity is based off hydro power, 14% is gas , 2% wind power with 3% derived from district heating. Statkraft has diversified from its 2007 position where 98% of installed capacity was based off hydro power. Given this concentration, Statkraft scores Ba on this category although Moody's also recognises that the company will increasingly diversify its generation capacity through new investments - primarily focused on "green" energy, both within and outside of Norway.

OPERATIONAL CHARACTERISTICS AND CAPITAL REQUIREMENTS

Moderate levels of capex are required for maintenance and for environmental related expenditures. In 1H2009, around NOK432 million was spent on maintenance capex given the high quality and long expected life of its assets. Statkraft scores A on this factor as most outages are expected to be short - the average outage for Statkraft's hydro power plants over the past 5 years was less than 45 days.

FACTOR 3: FINANCIAL POLICY

Statkraft scores Baa, as do most European utilities, in this category. This reflects the fact that the company manages its investments to its financial flexibility. The government's policy of taking high dividends out of the company to date, has somewhat constrained the company's flexibility to invest - but should the government not accede to the company's current request for new equity, Moody's would expect the company to tailor its financial investments accordingly.

FACTOR 4: FINANCIAL METRICS

Statkraft's financial profile has strengthened in recent years from the early part of the decade aided by a series of asset disposals. 2005 and 2006 were highly profitable years for Statkraft, although 2007 results experienced a decline as a result of high hydro levels leading to lower prices. However, the company's EBITDA on a normalised basis (ie excluding the impact of one-off items relating to the E.On transaction) at the end of 2008 was higher than in previous years - mainly driven by high production (53.4TWh - partially as a result of an increase in installed capacity from 12.4 to 15.4MW at the end of 2008) at high prices and good operations and market activities. Spot prices in 2008 were up EUR16.8 to EUR44.7 per MWh. 2008 numbers were additionally impacted by the transaction with E.ON mentioned earlier - the gain on the E.ON asset swap had a non-cash impact of NOK25.5 billion.

Statkraft's profitability is volatile given its high reliance on hydro levels. Nonetheless Statkraft engages in dynamic hedges to mitigate this volatility and also enters into long term sales to help mitigate such risks. Additionally there is an inverse correlation between hydro production volumes and prices as prices tend to go down when hydro production is high which has some offsetting benefits.

Statkraft's very strong operating margins compared with other utility peers (given the very low marginal cost of hydro production) also weakened slightly on consolidation of Fjordkraft, a retailer, as from 2007, and may decline further as the company invests in activities outside its hydro production.

Funds From Operations (FFO)/net debt is a key indicator of the company's core operating strength in relation to debt. FFO improved in 2008 leading to a FFO to net debt ratio close to 23% (vs. 19% in 2007). Strong FFO is however tempered by the government's policy on dividends and hence the company's ability to retain cash in the company. In recent years, the government has continued to extract significant dividends out of Statkraft (over 90%) resulting in low Retained Cash Flow/Net Debt. A policy of maintaining a dividend in the upper quartile was reconfirmed in the December 2006 White Paper. In 2008, RCF to net debt was just above 2%.

1H 2009 RESULTS

Despite a drop in consumption in the Nordic area of 6%, prices held steady largely as a result lower nuclear production and a weakened hydrological balance in the Nordic system - the average system price was around EUR36 per MWh, similar to a year earlier. Prices were more sharply impacted in Germany though, as a result of the economic slowdown and related impact on commodity prices. Operating profit was lower at NOK4.2 billion vis NOK5.7 billion (1H 2008) although 2008 was an exceptional year.

The company continues to target high investments. The company has total investments through 2015 targeted of NOK90 billion (formerly NOK70 billion), of which 85% in renewable power production. The ability to execute on further large acquisitions will be influenced by the willingness of the government to inject equity to help fund the investments and to counterbalance partially the large dividends extracted from the company.

Moody's would generally expect the company to show that it can sustain ratios (adjusted in line with Moody's methodologies) in the following ranges for the current rating category: RCF/net debt of 9-12%, FFO/net debt of mid-high teens and FFO/interest coverage of at least 3-4x. FFO/net debt should remain comfortably positioned at these levels in order to compensate for weaker retained cash flow which continues to be depressed by high dividend payouts.

Assuming the government continues to extract high dividends, then this will continue to reduce significantly the company's financial flexibility and to have a major impact on retained cash flow. Moody's also notes that the Government has indicated that it will be prepared to make equity injections in conjunction with certain projects, although these cannot be predicted.

Statkraft's future financial profile will therefore be dependent on (i) the ongoing level of dividends extracted from the company, (ii) the level of power prices, (iii) the size and scale of its investment programme, and (iv) the willingness of the government to inject equity if necessary for a large acquisition or investment programme.

Moody's notes that the company's financial ratios, in particular, FFO/net debt, is in any event more likely to deteriorate in the current more difficult environment, where forward power prices are lower than in recent years. This pressure could additionally apply if it pursues its targeted large capex plan without suitably supportive equity injections or dividend policies.

Liquidity

Statkraft's liquidity is quite healthy. Cash flows can be quite variable over a twelve month period given variations in production and pricing levels. Operating cash flow over the next 12 months should be largely sufficient to meet committed capex and dividends. 2H 2009 debt repayments are NOK2.2 billion, with 2010 total maturities standing at NOK5.4 billion. Statkraft has a committed long term back up bank facility of NOK5 billion maturing in 2012 and a NOK3 billion facility maturing in 2013 (These contain a Material Adverse Effect clause as a representation at each drawing linked to the Borrower's ability to perform its obligations under these agreements). Statkraft has a policy of maintaining sufficient liquidity to cover at least a 6 month period, including the significant annual dividend extracted by its State owner. Statkraft has a change of ownership control covenant in some back-up and bond facilities.

Recent Events

The Norwegian Government, announced in October 2009, in conjunction with its budget, that it would take an 85% dividend on 2009 profits from Statkraft SF, Statkraft AS' parent company, which is marginally lower than last year, but still rather high.

RELATIONSHIP WITH ITS OWNER

A White Paper on State Owned Companies was published in December 2006. This clarified the following:

(i) The dividend for Statkraft will be in the upper quartile: i.e. in the range of 75-100%. When the government first came to power in Autumn 2005, it indicated that it would consider a more sustainable dividend in the region of 50%.

(ii) Statkraft will remain 100% State-owned: Under the current Government there is no possibility of privatization, as was envisaged by the previous government. The government has reinforced Statkraft's vision to be Europe's leading provider of environmentally friendly energy.

(iii) The new document also states that preferably, investments outside the Nordic area should be made with other partners. This approach suggests that the company can invest without necessarily involving other companies, as was previously required.

(iv) There is a general comment in the paper (not specifically directed at Statkraft) that "wholly owned companies may get equity injections if needed if projects are interesting and profitable".

CORPORATE STRUCTURE

With effect from 1 October 2004, the Statkraft group was reorganised. The bulk of the operating activities of Statkraft SF (now the ultimate holding company) were reorganised into a limited liability company, Statkraft AS and its subsidiaries. The aim of this incorporation was among other factors to improve Statkraft's competitiveness. Statkraft AS is now the financial holding company of the group where external debt is issued.

Statkraft SF continues to hold only some domestic power plants subject to state ownership and overseas plants in Laos. Outstanding obligations of Statkraft SF incurred before 1.1.2003, remain at the level of Statkraft SF. These obligations continue to benefit from the state backed guarantee and are Aaa-rated (please see credit opinion for Statkraft SF). Corresponding back-to-back loans are in place with Statkraft AS. All Statkraft's loans have pari passu clauses, with the inter-company loans mirroring the terms of the State backed loans and hence the debt at SF ranks pari passu with all external non-guaranteed debt at AS (as well as with intercompany debt).

OTHER GRI FACTORS

Support is medium. This reflects a strong indication of support from the current Labour-led government, re-elected in 2009, for Statkraft. The December 2006 White Paper reinforced the strategic importance of Statkraft which the Government has said will not be privatised. Whilst it continues to propose high dividends it has also indicated that capital injections will be available for the right business opportunity.

Moody's also notes that under the Norwegian Industrial Licencing Act, only majority (two-thirds), publicly-owned companies can own power plants or waterfall rights and hold their licence in perpetuity, in keeping with the notion that "the country's hydropower resources belong to, and shall be managed for, the benefit of the general public."

Medium dependence reflects the strong contribution from Statkraft's domestic operations to its profitability.

Rating Outlook

The outlook is stable. The company has improved its operating cash flows in recent years, however potentially weaker power prices than in the recent past, concerns over high dividend levels and a lack of clarity as to how large investments will be funded in the future act as a constraint on the rating.

What Could Change the Rating - Up

The company would need to be able to achieve and sustain at least RCF/debt of mid-teens, FFO/debt of high teens/twenties, and FFO/interest of 4-5x or over for a notch upgrade.

Otherwise, a significant shift upward in support would be needed to move the rating upwards, which seems unlikely in the foreseeable future. The rating is not very sensitive to shifts in dependence.

What Could Change the Rating - Down

Downward pressure could result if the company made very significant investments - possibly without appropriate support by way of equity injection or lower dividends - such that it were to result in a much weaker financial or business profile than currently indicated for its rating. A reduction in the perceived level of support from the government, particularly if that was accompanied by a still very high, or unpredictable, dividend policy could also have a negative impact. A one-notch downgrade in the sovereign rating, however, at current support levels would not impact the final rating.

Rating Factors

Statkraft AS

Unregulated Utilities and Power Companies	Aaa	Aa	A	Baa	Ba	B
Factor 1: MARKET ASSESSMENT, SCALE AND COMPETITIVE POSITION (20%)						
a) Market and Competitive Position				x		
b) Geographic Diversification					x	
Factor 2: CASH FLOW PREDICTABILITY OF BUSINESS MODEL (20%)						
a) Hedging Strategy				x		
b) Fuel Strategy and Mix					x	
c) Capital Requirements and Operating Performance			x			
Factor 3: FINANCIAL POLICY (10%)				x		
Factor 4: FINANCIAL STRENGTH METRICS (50%)*						
a) FFO + Interest / Interest				5.5x		
b) FFO/Net Debt				22.0%		
c) RCF/Net Debt						3.0%
d) FCF/Net Debt						-2.8%
Rating:						
a) Indicated Rating from Methodology				Baa3		
b) Actual BCA Assigned				10		

* 3-year historical average

Government-Related Issuer	Factor
a) Baseline Credit Assessment	10(Baa3)
b) Government Local Currency Rating	Aaa
c) Default Dependence	Medium
d) Support	Medium

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