FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Statkraft at 'BBB+'; Outlook Stable

Tue 02 Jun, 2020 - 12:31 PM ET

Fitch Ratings - London - 02 Jun 2020: Fitch Ratings has affirmed Norwegian-based power generation company Statkraft AS's Long-Term Issuer Default Rating (IDR) at 'BBB+' with Stable Outlook. A full list of rating actions is below.

The affirmation reflects our view that the credit profile of Statkraft remains supported by its highly competitive Norwegian hydro power assets, which benefit from a low cost of production and a highly flexible fleet, driving healthy operating cash flows. The recent decline in power prices will adversely impact profitability and weaken credit metrics for 2020 beyond our rating sensitivities.

Fitch forecasts a moderate improvement in power prices over the medium term, which while significantly below our earlier expectations, would bring credit metrics in line with rating sensitivities. Exposure to market conditions is partly offset by the company's sizeable, albeit declining, long-term volume and price contracts. The IDR continues to benefit from a single-notch uplift to Statkraft's Standalone Credit Profile (SCP) at 'bbb' for sovereign support.

We have tightened Statkraft's leverage guidelines by 0.3x to reflect our expectations of decreasing contracted volumes and a more challenging price environment in the medium term.

KEY RATING DRIVERS

Lower Power Prices: We expect medium-term prices (Nord Pool) to be around EUR20/MWh, which are lower than our previous expectations. The recent decline in power prices, to as low as EUR15.4/MWh for 1Q20, driven by an exceptionally mild and rainy winter but also heavy snow in some regions, and declines in fuel and CO2 prices due to the global economic crisis, will impact Statkraft's 2020 profits.

Long-Term Contracts Partly Mitigate Effects: Exposure to the low spot prices is partially offset by long-term contracts representing about 40% of Statkraft's Nordic power generation at the beginning of 2020 (declining to about 30% by end-2020), which are contracted at significantly higher power prices.

We expect this share to fall in the coming years, and new contracts to be less profitable than existing ones.

Positive Long-Term Fundamentals: Over the medium-term, in addition to the fuel prices, supply factors such as increased wind power generation capacity, improved interconnectors with the continent and the UK and demand factors such as a slight increase in demand driven by transportation, data centres and industry will be important in determining the level of power prices. In this context, we see our current price assumption as conservative.

Growth Strategy Presents Execution Risks: Statkraft forsees the share of EBITDA outside Nordics growing to 25% by 2025 from 9% currently. Under its strategy, it could spend up to NOK8 billion on expansionary capex, in addition to NOK2 billion maintenance capex, annually, primarily on hydro and wind assets and, to a lesser extent, solar, in Europe and some emerging economics with high growth potential. We assess the regulatory regimes in potential target markets such as Brazil, Chile, Turkey and India as less predictable than in Europe. Statkraft nevertheless has significant capex flexibility as currently committed capex falls below NOK4 billion in 2021 and below NOK3 billion from 2022 onwards.

Credit Metrics: We expect Statkraft's credit metrics to weaken in 2020 on lower power prices, higher dividend payment as well as higher cash tax assumption, also due to a one-off payment. We expect credit metrics to be within our rating sensitivities from 2021 onwards. Profitability will mostly be driven by underlying power prices, while capex-driven growth will be an important driver of credit-profile development.

Highly Competitive Hydro: The strong competitive position of Statkraft in the Nordic generation market continues to be supported by its Norwegian hydro power assets, which have significant scale at approximately 25% of Europe's reservoir capacity, its ability to store capacity across multiple years and low production costs. Fitch estimates that Statkraft generated around 53TWh from hydro power in 2019 at a cash cost of around EUR7/MWh, which supports its position as one of the lowest-cost producers in Europe.

State Support: Statkraft is 100%-owned by the Norwegian state, which regards its ownership as value-creating, as underlined by the requirement for Statkraft to keep their headquarters in Norway and to contribute to profitable and responsible management of Norwegian natural resources. The state governs on a commercial basis under strict corporate governance rules and has supported Statkraft through direct equity injections in 2010 and 2014. Statkraft's international growth strategy is indirectly supported by the state through the dividend policy. We provide a single-notch uplift to Statkraft's SCP for state support under Fitch's Government-Related Entities (GRE) Rating Criteria.

Key Support Factors: Under the GRE criteria we assess status, ownership and control as moderate because the company is governed by commercial law with limited government role in day-to-day management. We assess socio-political implications of a potential default as moderate as we expect Statkraft will continue to operate even under financial distress. Support track record and expectations are strong, considering past equity injections, while financial implications of a potential default are weak, as Norway is rated 'AAA'/Stable.

DERIVATION SUMMARY

Statkraft is well-positioned relative to its Nordic peer Fortum Oyj (BBB/Negative) due to its low-cost flexible hydro-asset base and lower exposure to thermal generation, allowing it a slightly higher debt capacity at the same standalone rating. Statkraft's low proportion of regulated and quasi-regulated earnings compared with the wider top European utilities peer group is credit-negative. Its leverage profile is less aggressive relative to Nordic peers' and Statkraft benefits from strong strategic ties with the Norwegian government, resulting in a one-notch uplift to Statkraft's SCP for state support.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Medium- to long-term Nord Pool prices of about EUR20/MWh

- Capex of NOK5 billion per year for 2021 - 2024

- Dividends in line with the company's policy to pay out 85% net profit from Norwegian hydro power business and 25% of net profit from all other business activities

- NOK/EUR based on Fitch sovereign team's projections

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- An improvement in current business conditions, increase in contracted revenues or a change in financial strategy leading to substantially stronger credit metrics, such as funds from operations (FFO) adjusted net leverage trending towards 2.5x

- Stronger links with the government

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO adjusted net leverage rising sustainably above 3.5x, which could be due to sustained low power prices close to current levels or significantly higher expansionary capex than Fitch assumptions

- Weakening links with the Norwegian state

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Total liquidity at end-2019 amounted to over NOK26 billion, including NOK15.1 billion of cash and NOK11.2 billion of unused credit facilities. This compared with short-term maturities of NOK4.2 billion (excluding lease liabilities). We expect the strong cash position to diminish on expansionary capex and lower earnings. We forecast substantially negative free cash flow (FCF) for 2020 of around NOK12 billion, before turning neutral for 2021-2024 on the back of modest recovery in power prices as well as lower cash taxes.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Statkraft AS	LT IDR	BBB+	Affirmed	BBB+
	ST IDR	F2	Affirmed	F2
• senior unsecured	LT	BBB+	Affirmed	BBB+

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Raman Singla
Associate Director
Primary Rating Analyst
+44 20 3530 1728
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Harry Monthen
Associate Director
Secondary Rating Analyst
+44 20 3530 1247

Antonio Totaro
Senior Director
Committee Chairperson
+39 02 879087 297

MEDIA CONTACTS

Adrian Simpson
London
+44 20 3530 1010
adrian.simpson@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

Short-Term Ratings Criteria (pub. 06 Mar 2020)

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Statkraft AS	EU Issued

DISCLAIMER

HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

READ LESS

COPYRIGHT

independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a

print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Corporate Finance Utilities and Power Europe Norway