

Research Update:

# Norwegian Hydro Generator Statkraft AS Affirmed At 'A-'; Outlook Stable

May 11, 2020

## Rating Action Overview

- Power prices in the Nordic region have deteriorated dramatically in 2020, a consequence of very high precipitation leading to strong hydro generation, together with increasing output from wind generation, and, less demand following a warm winter, and the effects of COVID-19 depressing power demand of about 3%-7%.
- We believe Statkraft's flexible European generation, mainly Norwegian hydro power, which generated Norwegian krone (NOK) 13.2 billion in EBITDA last year, will suffer from the low power prices and we expect contribution deteriorate to NOK 11 billion-NOK12 billion and NOK8.5 billion-NOK9.5 billion in 2020 and 2021, respectively.
- We anticipate negative cash flow during 2020, so we expect that the utility's credit ratios will weaken significantly, due to weaker earnings, but also since tax and dividends related to the strong year 2019 will impact cash flows in 2020.
- We are affirming our ratings, including our 'A-' long-term issuer credit rating on Statkraft, as tax and dividends will be adjusted in accordance with lower earnings and reflected in 2021.
- The stable outlook indicates that the company will withstand low power prices with maintaining healthy headroom toward our funds from operations (FFO)-to-debt rating threshold of 20% in coming years despite extremely low power prices.

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## Rating Action Rationale

**Very low power prices from flooded supply, together with decreasing demand because of a milder winter and COVID-19-related issues, will lead to deterioration in earnings.** We expect lower power prices will lead to a decline in EBITDA contribution for Statkraft's power generation business, to about NOK9 billion in 2021, down from NOK13.2 billion in 2019. Statkraft does not hedge to the extent of peers such as Vattenfall (69% for 2020), Fortum (75% 2020), or Orsted's levels of power purchase agreements (PPA) at about 85% of expected generation. Instead Statkraft has, via industrial contracts, fixed prices for about 30%% of its expected Nordic electricity generation in 2020; about 7% is hedged via financial derivative contracts, which we

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understand are well above current market prices. This should mitigate the price effect to some extent for 2020, and we therefore expect a more material impact on earnings and cash flow in 2021. For 2021, fixed contracts will have decreased to about 18% from 30% in 2020, and financial contracts at about 2% from about 7% in 2020. However, we also consider Statkraft's track record of higher achieved power prices compared to Nord pool system prices, by an average of 4.5%, as its hydro generation portfolio makes it possible to adjust generation by the hour. The utility can therefore capture peak prices better than peers.

**Lower power prices are mostly a consequence of very high water levels in Nordic reservoirs, and a mild and windy winter.** As a consequence, power prices in 2020 has been falling, spot prices stands at €5-€10 per megawatt-hour (MWh), which is well below the 2019 average of €39/MWh. We now expect power prices in the region to remain depressed from 2020-2023, below €25/MWh on average. In addition, we expect COVID-19 to lead to reduced demand of 3%-7% in 2020, also affecting 2021 demand. While we see that lower demand will contribute negatively both to earnings and the power balance, we expect the lower prices to be the largest factor in the expected decline in credit ratios.

**Depressed Nord Pool power prices (down about 70% from 2019 levels) will affect earnings significantly in 2020, leading to more volatility in 2020-2022.** So far this year, extreme weather conditions with very high precipitation together with windy conditions have resulted in significant increased generation and lower electricity prices in the Nordics. We expect that extreme weather conditions will recur more often than historical patterns have shown and could result in volatile power prices and earnings. We expect Statkraft's EBITDA to deteriorate to NOK15 billion-NOK16 billion in 2020, down about 25% from S&P Global Ratings-adjusted EBITDA in 2019. The utility had two very strong years in 2018 and 2019, with EBITDA of NOK20 billion-NOK24 billion, when power prices were high. This is thanks to the company's flexible low-cost hydro asset portfolio, with only marginal operating costs, and low maintenance costs.

**We assess Statkraft's business risk as strong.** This reflects Europe's largest portfolio of flexible hydropower plants and reservoir capacity, and its Nordic low-cost hydro asset portfolio with only marginal operating costs and low maintenance costs are a key driver for our assessment. In addition, its generation asset portfolio mainly consists of renewable generation, and has therefore only minimal exposure toward carbon dioxide emission or other commodity prices.

**We expect a temporary slowdown in Statkraft's ambitious investment plan, supporting ratios.** In this environment, we assume that the utility will not materially increase its investments, and instead carry out its committed ones. Statkraft have communicated that it intends to invest NOK 60 billion-NOK80 billion in renewable energy, while maintaining the rating, and increasing installed capacity with about 9-gigawatt growth by 2025. About two-thirds of investments until 2025 are planned in Europe, with more than a third of the European investments to take place in Norway. We understand that there will also be considerable growth in markets where Statkraft is already present, like South America and India. We see limited headroom to increasing investments to earlier communicated levels when power prices are under significant pressure, because operating cash flows would not cover a material increase toward NOK10 billion annually.

**Tax and dividend payments related to a strong result in 2019, together with committed investments, will not be covered by operating cash flows in 2020.** We foresee a significant negative cash flow of NOK12 billion-NOK14 billion in 2020 because Statkraft's earnings are depressed by very low power prices, together with significant outflows in terms of dividends,

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taxes, and committed investments. This will increase debt to NOK33 billion-NOK34 billion by the end of 2020.

- Statkraft has set dividends of NOK6.5 billion, based on net profit in 2019 and in accordance with the dividend policy. In contrast to some peers, there has been no discussion to lower dividends.
- Taxes paid is based on 2019 earnings, and will have a cash flow effect the following year, namely 2020. They will amount to about NOK6 billion. As earnings are decreasing rapidly, this will have a relative large effect on cash flow in 2020.
- The company have an ambitious capital expenditure (capex) plan, with already committed investments, and we expect Statkraft's capex at about 6-7 billion in 2020.

For the coming years, we expect this to smoothen out, with recovery and positive cash flows starting from 2021 onward.

**We expect a material decline in credit ratios, but staying consistent with the rating.** All in all, we expect FFO to debt to deteriorate to 26%-27% in 2020 but to recover to 31%-33% in 2021, as taxes paid and dividends will reflect the lower earnings and stabilizing cash flow. At the same time, we expect debt to EBITDA of 2.0x-2.5x during the period. At year-end 2019, Statkraft's ratios was strong for the rating, with FFO to debt of about 70%, so the decline in ratios is material. Debt will increase to NOK33 billion-NOK34 billion, from NOK17 billion at year-end 2019. We view those ratios as well above our threshold for the rating, but the ample headroom in 2019 has almost disappeared because of very low power prices and our expectation of substantial negative cash flows during 2020. In the coming year, capacity addition from renewables, namely wind generation, could lead to significant volatility in supply, causing volatility in prices and credit ratios. We expect management not to increase investments to levels that have previously been communicated, with investment of about NOK10 billion annually because it would have a direct impact on its credit ratios with further debt increases.

## Outlook

The stable outlook reflects our assumption that cash flow from Statkraft's hydropower segment will remain profitable despite very low electricity prices in the Nordics. The outlook also signifies that we anticipate Statkraft's potential new investments will be well below NOK 10 billion as previously communicated investment level by the company, as long as power prices are under pressure.

Despite power prices below €10/MWh, and thanks to the company's relatively low debt levels, we expect Statkraft's FFO to debt to drop to about 27% in 2020, then recover to 30%-35% in 2021 and 2022. We also expect the utility's relationship with the Norwegian government to be stable.

## Downside scenario

We could lower the ratings if Statkraft's FFO to debt deteriorates below 20% without signs of recovery. This could follow further electricity price decreases or debt-funded investments. We could also lower the rating if the business risk profile comes under strain; for example, if it makes significant investments in geographical areas that bear higher risks than its current investments. We could also lower the rating if our assessment of government support is changed, although we view this as very unlikely.

## Upside scenario

Prospects for a higher rating are constrained by low electricity prices that we expect to continue for at least throughout 2020. In addition, constraining upside potential is the lack of clarity regarding investments, including the long-term impact on Statkraft's financial ratios. We see rating upside for the utility as limited in the coming years.

## Company Description

Norwegian-based Statkraft is the largest renewable energy producer from hydro in Europe, with about 61 terawatt-hours (TWh) of generation in 2019. Statkraft's majority generation stems from its hydro plants in Norway and Sweden as it represent about 72% of installed capacity. Its total installed capacity at about 19,700 MW in 2019 generated about 61 TWh, with reporting EBITDA of about €2 billion. Almost all of its EBITDA stems from power generation, with the vast majority from its hydro production in Norway. About 90% of EBITDA stems from its Nordic activities. Other generation sources are onshore wind, solar, and district heating. Statkraft is also present in other markets: Nordic countries other than Norway, the rest of Europe, South America, India, and Nepal. The company's ambition is to expand its renewable portfolio in Europe, South America, and India by investing up to NOK10 billion a year until 2025. The majority of investments, about two-thirds of the investments, are planned in Europe, with more than a third of the European investments expected in Norway.

## Our Base-Case Scenario

### Assumptions

- Norwegian real GDP to decline 6% in 2020 with a recovery of about 4% in 2021
- Continued subdued power prices in the Nordic region, on average at €10/MWh and €15-€20 in 2020 and 2021, respectively
- Statkraft's generation segment, which has about 30% of expected generation under industry fixed contracts during 2020, and about 7% covered with financial hedges well above market prices
- Tough power market conditions in Nordic and lower power demand from COVID-19-restrictive measures in 2020 and 2021

### Key metrics

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures over 2019-2020:

(Bil. NOK)	2019a	2020e	2021e
EBITDA	20.0	15-16	13-14
Debt	17.4	32-33	32-33
Capex	5.8	6-7	5-6

(Bil. NOK)	2019a	2020e	2021e
Dividends	8.5	6.5	3-4
FFO/debt (%)	69.5	27-28	31-33
Debt/EBITDA (x)	0.9	2.0-2.2	2.3-2.5

NOK--Norwegian krone. FFO--Funds from operations.

## Liquidity

We assess Statkraft's liquidity position as strong. We expect that the group will maintain liquidity sources that exceed liquidity uses by about 1.5x over the next 12 months. We also assume that liquidity sources will exceed uses even if EBITDA were to decrease by 30%, and understand that Statkraft's credit facilities are free from onerous financial covenants. We also view the utility as having solid relationships with its banks, a high standing in credit markets, despite the COVID-19-related market turmoil. All in all, we view risk management as prudent.

According to our calculations, Statkraft's liquidity sources as of March 31, 2020, comprised:

- Available cash and marketable securities of about NOK7.0 billion
- Access to committed credit lines of about NOK11.2 billion. In this figure, we include a revolving credit facility of NOK9.2 billion and an overdraft facility of NOK2.0 billion
- Forecast FFO of about NOK9.5 billion

Principal liquidity uses as of March 31, 2020 include:

- Reported debt due with one year of NOK2.6 billion
- Capex of about NOK6 billion-NOK7 billion in 2020 and NOK5.0 billion-NOK5.5 billion in 2021, respectively
- Dividends of NOK 6.5 billion in 2020 and about NOK4.0 billion in 2021

Debt maturities:

- 2020: NOK2.6 billion
- 2021: NOK2.0 billion
- 2022: NOK9.8 billion
- 2023: NOK6.1 billion

## Ratings Score Snapshot

Issuer Credit Rating: A-/Stable/A-2

Business risk: Strong

- Country risk: Very low
- Industry risk: Moderately high
- Competitive position: Excellent

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Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (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: Moderately high (+2 notches from SACP)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, 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

## Ratings List

### Ratings Affirmed

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**Statkraft AS**

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**Statkraft SF**

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**Statkraft Energi AS**

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Issuer Credit Rating A-/Stable/A-2

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**Statkraft AS**

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Senior Unsecured A-

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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