Credit Rating Announcement

25 January 2023

Scope affirms Eidsiva's issuer rating at BBB+/Stable

The affirmation reflects Eidsiva's continued competitive strength as Norway's largest distribution grid operator, its low industry risk, and projected substantial capex and dividend payouts.

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope Ratings GmbH (Scope) has affirmed its BBB+/Stable issuer rating on Norwegian utility Eidsiva Energi AS. Scope has also affirmed the issuer's BBB+ rating for senior unsecured debt and its S-2 rating for short-term debt.

Rating rationale

The affirmation of the issuer rating reflects Eidsiva's continued strong business risk profile and the prospect of an improved financial risk profile. While Eidsiva's operations in district heating and broadband are growing, the company's business risk profile continues to be defined by its monopolistic position within grid operations. Additionally, Eidsiva's 43.5% ownership in Norway's second largest hydro power producer Hafslund Eco Vannkraft (HEV) contributes to diversification (positive ESG factor).

In 2021, Eidsiva incurred substantial grid losses. With the rise of energy prices in its service territory, losses increased further in 2022. Under the Norwegian system, higher-than-expected losses can only be passed on to end-customers through tariff increases at the next tariff review. As a result, Scope-adjusted EBITDA margin hit 7%, a record low in H1 2022. In H2 2022, the Norwegian government and the Norwegian transmission service operator (Statnett SF) put in place a temporary scheme to prevent further tariff increases for already pressed households: congestion income is directly transferred from the transmission operator to Norwegian district service operators[1]. As the largest district service operator in Norway, Eidsiva greatly benefits from this scheme, as reflected in the company's Q3 2022 report, showing a YTD Scope-adjusted EBITDA margin of 30%.

Higher energy prices generally lead to grid losses and lower profit for Eidsiva. On the other hand, they increase the profit of hydro power producer HEV, Eidsiva's minority holding. Eidsiva therefore received over NOK 500m in dividends from HEV in H1 2022.

Scope's medium-term base case expects slightly improved profitability over the next three years, with an average Scope-adjusted EBITDA margin of 35%. This is based on i) payments from Statnett SF, expected to compensate for higher-than-usual grid losses in 2022-2023; and ii) an increased income cap for Eidsiva, driven by rising interest rates and the corresponding 2021-2022 cost base, which will be factored into the income cap calculation towards the end of Scope's forecast.

The company's financial risk profile remains significantly weaker than its business risk profile. Eidsiva's capex, mainly related to regulated distribution, will likely be substantial going forwards, leading to an aggregate negative discretionary cash flow of NOK 1.2bn in the medium term. Scope-adjusted debt is therefore expected to increase to over NOK 18bn at YE 2024. This results in leverage higher than the industry average in the medium term, as exemplified by a projected Scope-adjusted debt/EBITDA ratio of between 6.1x in 2022 and 4.8x in 2024. These metrics are within the leverage thresholds highlighted during Scope's last review and therefore did not negatively impact the overall financial risk profile.

Eidsiva's liquidity is in keeping with Scope's projections and is adequate. Further, in order to accommodate higher net working capital requirements due to heightened energy prices, Eidsiva has refinanced and increased its committed facilities to NOK 3.5bn (from NOK 2.5bn) in H1 2022.

Regarding supplementary rating drivers, Scope continues to apply its bottom-up approach for government-related entities to analyse Eidsiva's parental support and maintains the one-notch uplift for its Norwegian municipality ownership.

One or more key drivers for the credit rating action are considered ESG factors.

Outlook and rating-change drivers

The Stable Outlook continues to reflect Scope's expectation that i) monopolistic, regulated grid operations will continue to contribute the most to EBITDA; ii) leverage to develop within a range of 4.0-5.5x on a sustained basis; iii) capital expenditure will remain high in the medium term; iv) free operating cash flow will turn positive in the medium term; and v) Eidsiva will remain municipality-owned.

A positive rating action could be triggered by an improving financial risk profile, exemplified by Scope-adjusted debt/EBITDA sustained at around 4x thanks to improved free operating cash flow or asset disposals.

A negative rating action could be triggered by a weaker financial risk profile, exemplified by Scope-adjusted debt/EBITDA sustained at above 5.5x and an interest coverage below 5x, which could be due to higher-than-expected capex and/or dividends. The loss of its government-related entity status could also trigger a negative rating action.

Long-term and short-term debt ratings

All debt is issued by Eidsiva Energi AS.

The BBB+ senior unsecured debt rating has been affirmed in line with the issuer rating, based on the company's standard bond documentation, which includes a pari passu and negative pledge.

The S-2 short-term debt rating has also been affirmed, reflecting the short-term debt coverage and continued good access to both bank loans and debt markets.

1. https://www.regjeringen.no/no/aktuelt/pressemelding-flaskehalsinntekter/id2942438/

Stress testing & cash flow analysis

No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlook, (European Utilities Rating Methodology, 17 March 2022; General Corporate Rating Methodology, 15 July 2022; Government Related Entities Rating Methodology, 6 May 2022), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlook and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity and Scope Ratings' internal sources.

Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.

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The Credit Ratings/Outlook were first released by Scope Ratings on 8 December 2017. The Credit Ratings/Outlook were last updated on 24 February 2022.

Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

About Scope Group

With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

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