

Statkraft AS

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Table Of Contents

Major Rating Factors

Rationale

Outlook

Business Description: Europe's Largest Renewable Energy Producer

Business Risk Profile: Competitive, Low-Cost Hydro-power Portfolio

Financial Risk Profile: Constrained By Aggressive Dividend Policy

Financial Statistics/Adjustments

Statkraft AS

Major Rating Factors

Strengths:

- Strong market position as competitive low-cost generator of electricity.
- Prudent trading and hedging strategies.
- Ongoing support and potential extraordinary support from the Norwegian state as the sole shareholder.

Corporate Credit Rating

A-/Stable/A-2

Weaknesses:

- Exposure to competitive markets and volatile electricity prices.
- Weather-exposed generation profile, as generation fleet is largely hydro-based.
- Significant investment program, partly aimed at high-risk markets.
- Aggressive dividend policy and a high effective tax rate.

Rationale

The ratings on Norwegian state-owned utility Statkraft AS reflect its position as the third-largest Nordic power generator, its competitive and flexible hydro-power generation asset base, and full state ownership. We view positively the Norwegian government's recent announcement that it has decided to contribute Norwegian krone (NOK) 14 billion to Statkraft through a capital increase. This, we believe, is a strong commitment of ongoing support from the government and will allow Statkraft to implement its large investment program without damaging its financial risk profile.

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.

Statkraft is 100% state-owned. 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 and strong link to the government. We assess the group's stand-alone credit profile as 'bbb'

Key business and profitability developments

Statkraft reported strong earnings in the nine months of 2010. This was mainly owing to high power prices and increased demand for power in the first quarter, which resulted from cold weather 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 in the first quarter of 2010 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 have reduced water reservoir levels, which is likely to result in lower hydro-production capacity for the remainder of 2010 and possibly into 2011. Consequently, despite likely healthy power prices, we expect Statkraft's profitability to be lower in the next few quarters, albeit still strong on a full-year basis in 2010.

Key cash flow and capital-structure developments

On Dec. 15, 2010, it was announced that the Norwegian parliament (Stortinget) had decided to strengthen Statkraft's capital base with a NOK14 billion (about €1.7 billion) equity injection. The equity increase should, in our view, lead to a sustained, albeit modest, improvement of Statkraft's financial risk profile. We believe, however, that Statkraft is likely to upsize its investment program in the next few years, which is likely to largely counterbalance the positive contribution to credit metrics resulting from the capital increase.

For the 12 months ended Sept. 30, 2010, the ratio of adjusted funds from operations to debt improved to 28% from 18% at the end of the fiscal year ended Dec. 31, 2009. This largely reflects improved profitability in the first nine months of 2010, particularly in the first quarter. Operating income in the near term is likely to be pressured by low hydro-reserves in Norway, resulting in lower hydro-production volumes. Hydro-production volumes are a key cash flow driver for Statkraft.

Short-term credit factors

The short-term rating is 'A-2'. We consider Statkraft's liquidity to be adequate. As of Sept. 30, 2010, the company reported on-balance-sheet cash and short-term investments of about NOK5.7 billion, access to an unused NOK5 billion multicurrency revolving credit facility maturing in 2012, an unused NOK3 billion multicurrency revolving credit facility maturing in 2013, and NOK400 million in uncommitted bank lines. This compared with short-term debt of NOK6.9 billion as of the same date. We believe Statkraft will seek to extend its credit facilities in the next few quarters to mitigate refinancing risks.

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, without external financing. Furthermore, financial flexibility is strongly 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. At the beginning of December 2010, the stake was valued at about €1.9 billion (NOK15 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 credit profile will stabilize as a result of the NOK14 billion capital increase. We would consider a ratio of funds from operations to debt of 15%-20% and only moderately negative cash flows after dividend payments 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.

Business Description: Europe's Largest Renewable Energy Producer

With total installed capacity of 15,806 megawatts as of Dec. 31, 2009, Statkraft is the third-largest electricity generator in the Nordic region and the largest renewable energy producer in Europe. Statkraft owns and operates hydro-power plants, mainly in Norway but also across the Nordic region. Statkraft is also expanding the proportion of gas-fired generated capacity, currently amounting to about 2,200 megawatts located in Norway and in Germany, and the company has made investments in wind power. Through its majority-owned venture, SN Power, Statkraft makes hydro-power investments in emerging markets. Statkraft owns shares in several regional utilities in Norway, with downstream operations including electricity distribution, retail sales, and district heating.

The Norwegian government's ownership of Statkraft is managed by the Ministry of Trade and Industry. Restructured in 2004, Statkraft became a limited-liability company owning the majority of the group's assets and liabilities. The group's ultimate parent company, Statkraft SF (A-/Stable/A-2), maintains direct liability for all sovereign-guaranteed debt, and ownership of some Norwegian hydro-power plants and one of Statkraft's overseas hydro-power projects. Statkraft Energi AS (A-/Stable/A-2), 100% owned by Statkraft AS, is the core member in the Statkraft group, comprising the majority-owned Norwegian hydro-power plants and the group's Nordic trading and wholesale operations.

Government support and GRE methodology impact

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 hydro-power resources, which we view as highly strategic to Norway's power supply. Another strategic objective for Statkraft is to secure and develop Norway's competencies within the renewable energy sector.
- "Strong" link, based on full state ownership, and our view that the risk of privatization is remote. Although Statkraft's board of directors is formally independent, and the management is relatively autonomous, we take the view that the government retains a strong influence over high-level strategic decision making.

Any privatization of Statkraft would require parliamentary approval and would likely be a politically sensitive issue. Furthermore, in Norway, hydro-power assets are subject to a legal requirement (hjemfallsretten) under which power plants that are more than one-third owned by private owners must be returned to the state at no cost after 60 years. Public owners such as Statkraft face no such limitations. The concession legislation restricts private ownership in publicly owned power assets to no more than one-third, effectively preventing full privatization of Statkraft.

Government guarantee status has been abolished for liabilities incurred on or after Jan. 1, 2003. All remaining debt carrying state guarantees (NOK1.4 billion at Sept. 30, 2010) resides within Statkraft SF. This debt is protected by a back-to-back lending arrangement between Statkraft SF and Statkraft, and ranks *pari passu* with Statkraft's other

debt obligations.

Business Risk Profile: Competitive, Low-Cost Hydro-power Portfolio

Statkraft's "strong" business risk profile is underpinned by the company's:

- Highly competitive, low cost generation asset base consisting mainly of hydro-power plants, representing 84% of installed capacity. The low cost, flexible, and zero-carbon emission profile of its significant hydro-power assets supports the ratings. Statkraft's large number of hydro-power stations and huge reservoirs mitigate the weather-related (low precipitation) risk of hydro-power production. Although we view gas-fired generation as carrying higher business risk than hydro-power, Statkraft's gas-fired generation plants are largely viewed as modern and efficient. Over the longer term, we expect the company's reliance on hydro-power to decline slightly, as a large proportion of investments will be directed into wind parks. However, we understand gas-fired power stations are not likely to remain a core part of future new investments.
- Dominant domestic market position in Norway and leading position in the Nordic region as the third-largest Nordic electricity generator. Statkraft is also Europe's largest renewable power generator, and compares favorably with rated peers with more carbon-intensive generation portfolios.
- Prudent strategy of selling forward its electricity generation output. Statkraft systematically sells forward the bulk of its projected output, either through long-term contracts with industrial clients or through hedging arrangements. This reduces earnings volatility. The main offtake market for Statkraft's electricity hedging is the Nord Pool power exchange. We expect forward hedging on Nord Pool to increase in the next few years, as the share of compulsory sales to the Norwegian industry is likely to decrease. This, we believe, will trigger a clearer formalization of Statkraft's dynamic hedging strategy, bringing it into line with the three-year forward hedging strategies of its peers.

Statkraft's business risk profile is underpinned by the economically stable and developed Nordic market, which is characterized by high per capita electricity demand.

These strengths are partly offset by Statkraft's:

- Exposure to competitive and volatile wholesale electricity markets. Statkraft operates in the fully deregulated Nordic electricity market and the continental European electricity and gas wholesale markets. Although the company's consistent use of hedging instruments should offer protection against near- to medium-term price fluctuations, a prolonged period of low power prices or poor hydrological conditions could have a significant impact on Statkraft's earnings performance.
- Significant investment program, partly directed to higher-risk countries and including project-related risks. We believe Statkraft will upsize its investment spending for the coming five years. We believe a greater part of this investment will be directed into renewable energy sources, including hydro-power and on/offshore wind parks. Furthermore, we believe that a majority of investments will be directed outside Norway, as Statkraft is likely to pursue its international growth strategy, primarily targeting hydro-power investments in Southeastern Europe as well as in select emerging markets outside Europe, through majority-owned SN Power AS.
- Compulsory sales to Norwegian industry under low-price, government-imposed power contracts (about 8.8 terawatt hours in 2009) will be phased out by 2012, which should support the group's profitability. Statkraft, however, will continue to supply 2-3 terawatt hours of power annually under long-term regulated contracts to Norwegian municipalities and to some industrial companies, as compensation for previously granted concessions.

Financial Risk Profile: Constrained By Aggressive Dividend Policy

The main weaknesses of Statkraft's "significant" financial risk profile are:

- An aggressive dividend policy. We view the current dividend requirements on Statkraft, defined by the government to be in the range of 75%-100% of reported net profit, as aggressive. This policy, which effectively prevents Statkraft from accumulating cash, continues to constrain the ratings.
- Statkraft's cash flow-based debt protection is somewhat volatile, and has periodically been weak, following significant swings in power prices. Historically, this effect has been amplified by low-price statutory sales contracts.
- Our expectations of negative free operating cash flows in the next few years due to the company's aggressive investment program. This, we believe, will largely counterbalance the positive effects of the government's expected capital injection over the longer term and result in weaker cash flow credit metrics than rated Nordic peers.

These weaknesses are offset by:

- Strong financial flexibility. We view the 4.17% holding in E.ON AG, received by Statkraft under a swap agreement, as a financial investment, which could be divested in the event of financial distress. This stake is valued at around NOK15 billion and could be sold with relative ease on the stock markets.
- Recent evidence of ongoing support from the Norwegian government. We believe that the NOK14 billion capital injection by the Norwegian government will allow Statkraft to implement an augmented investment program without damaging its financial risk profile. This, in our view, supports the group's credit risk profile.
- Flexible capital spending. Statkraft has the ability to adjust its growth-related capital expenditure budget according to demand. We understand that expansionary investments occur only if economically justified. For this reason, we assume lower spending and more conservative management of cash flow during difficult times.

Financial Statistics/Adjustments

Statkraft adopted International Financial Reporting Standards on Jan. 1, 2007. We make a number of analytical adjustments to Statkraft's accounts (see table 1) of which the more notable include the addition of post-retirement obligations, capitalization of operating leases, and the reversal of unrealized changes in the value of energy contracts from operating income.

Table 1

Reconciliation Of Statkraft AS Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. NOK)*									
--Fiscal year ended Dec. 31, 2009--									
Statkraft AS reported amounts									
	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	45,660	57,634	9,770	9,770	7,027	1,832	12,714	12,714	3,755
Standard & Poor's adjustments									
Operating leases	769	--	96	42	42	42	54	54	67

Table 1

Reconciliation Of Statkraft AS Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. NOK)* (cont.)									
Postretirement benefit obligations	1,505	--	54	54	54	54	19	19	--
Capitalized interest	--	--	--	--	--	7	-7	-7	-7
Reclassification of nonoperating income (expenses)	--	--	--	--	2,597	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	-4,155	--
Minority interests	--	7,267	--	--	--	--	--	--	--
Other	--	--	2,813	2,813	2,813	--	-3,250	--	--
Total adjustments	2,274	7,267	2,963	2,909	5,506	103	-3,185	-4,090	60

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	47,934	64,901	12,733	12,679	12,533	1,935	9,529	8,624	3,815

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Table 2

Statkraft AS--Peer Comparison*							
	DONG Energy A/S†	Vattenfall AB†	Fortum Oyj	Statkraft AS	Verbund AG	CEZ a.s.	
Ratings as of Dec. 17, 2010	A-/Stable/A-2	A/Negative/A-1	A/Stable/A-1	A-/Stable/A-2	A-/Stable/--	A-/Stable/--	
Stand-alone credit profile	bbb+	a-	a-	bbb	bbb+	bbb+	
Business risk profile	Satisfactory	Strong	Strong	Strong	Strong	Strong	
Financial risk profile	Intermediate	Intermediate	Intermediate	Significant	Significant	Intermediate	
GRE qualifier	Moderate	Moderate	Moderate	Moderately high	Moderate	Moderately high	
Installed capacity 2009 (GW)		7.0	39.8	13.8	15.8	8.6	14.4
Electricity production 2009 (TWh)		18.1	158.9	65.3	56.9	29.9	65.3
(Mil. €)	--Fiscal year ended Dec. 31, 2009--						
Revenues		6,621	20,051	5,435	3,098	3,483	7,537
Operating income (bef. D&A)		1,260	5,093	2,356	1,536	1,294	3,655
Net income from cont. oper.		153	1,259	1,312	909	644	1,952
Funds from operations (FFO)		896	3,433	2,248	1,040	997	2,982
Capital expenditures		2,071	4,616	824	473	487	2,602
Free operating cash flow		-914	-251	1,443	1,068	511	608
Discretionary cash flow		-1,208	-959	555	-170	108	(398)
Debt		5,161	20,512	7,718	5,784	4,462	5,949
Debt and equity		10,640	34,877	16,175	13,616	7,856	13,776

Table 2

Statkraft AS--Peer Comparison* (cont.)						
Adjusted ratios						
Oper. income (bef. D&A)/revenues (%)	19	25	43	50	37	48
EBIT interest coverage (x)	2.1	2.7	7.0	6.5	4.6	12.0
EBITDA interest coverage (x)	4.3	4.7	8.3	6.6	5.0	15.0
Return on capital (%)	5	9	11	10	17	22
FFO/debt (%)	17	17	29	18	22	50
Free operating cash flow/debt (%)	-18	-1	19	19	11	10
Discretionary cash flow/debt (%)	-23	-5	7	-3	2	(7)
Debt/EBITDA (x)	4.2	4.1	3.3	3.8	3.5	1.6
Total debt/debt plus equity (%)	49	59	48	42	57	43
Common dividend payout ratio (%)	42	41	68	99	60	41

*Fully adjusted (including postretirement obligations). †Excess cash and investments netted against debt. GRE--Government-related entity.

Table 3

Statkraft AS--Financial Summary*						
--Fiscal year ended Dec. 31--						
	2010**	2009	2008	2007	2006	2005
Rating history	A-/Negative/A-2	A-/Negative/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
(Mil. NOK)						
Revenues	28,077	25,675	25,061	17,600	16,054	13,221
Operating income (bef. D&A)	13,869	12,733	14,004	9,697	11,290	9,407
Net income from continuing operations	8,365	7,532	33,012	6,466	7,348	5,473
Funds from operations (FFO)	12,749	8,624	14,614	6,965	8,463	8,917
Capital expenditures	3,159	3,815	2,207	1,902	3,611	2,235
Free operating cash flow	10,224	5,714	9,288	5,741	2,926	9,981
Dividends	11,536	10,260	8,396	7,895	4,990	72
Discretionary cash flow	-1,312	-4,546	892	-2,154	-2,064	9,909
Debt	44,904	47,934	43,205	38,935	33,607	32,236
Equity	58,142	64,901	72,324	44,391	44,565	39,877
Debt and equity	103,046	112,835	115,529	83,325	78,172	72,113
Adjusted ratios						
Oper. income (bef. D&A)/revenues (%)	49	50	56	55	70	71
EBIT interest coverage (x)	7.1	6.5	5.9	6.0	8.8	4.6
EBITDA interest coverage (x)	6.9	6.6	6.0	5.3	8.2	4.6
Return on capital (%)	13	10	13	13	15	12
FFO/debt (%)	28	18	34	18	25	28
Free operating cash flow/debt (%)	23	12	21	15	9	31
Discretionary cash flow/debt (%)	-3	-9	2	-6	-6	31
Debt/EBITDA (x)	3.3	3.8	3.1	4.0	3.0	3.4
Debt/debt and equity (%)	44	42	37	47	43	45

Table 3

Statkraft AS--Financial Summary* (cont.)

*Fully adjusted (including postretirement obligations). **Rolling 12 months to Sept. 30.

Ratings Detail (As Of December 17, 2010)***Statkraft AS**

Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured (11 Issues)	A-

Corporate Credit Ratings History

30-Nov-2010	A-/Stable/A-2
22-Oct-2009	A-/Negative/A-2
30-Jun-2009	BBB+/Watch Pos/A-2

Business Risk Profile

Strong

Financial Risk Profile

Significant

Related Entities**Statkraft Energi AS**

Issuer Credit Rating	A-/Stable/A-2
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Statkraft SF

Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured (4 Issues)	A-

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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