MOODY'S
INVESTORS SERVICE

Credit Opinion: Statkraft AS

Global Credit Research - 11 Oct 2011

Oslo, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
Other Short Term	(P)P-2

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Key Indicators

Statkraft AS[1]

	6/30/2011	12/31/2010	12/31/2009	12/31/2008	12/31/2007
(CFO Pre-W/C + Interest) / Interest Expense	**6.6x**	**7.7x**	**5.0x**	**5.0x**	**4.9x**
(CFO Pre-W/C) / Debt	**22.1%**	**25.5%**	**16.2%**	**21.5%**	**17.5%**
RCF / Debt	**3.1%**	**7.1%**	**-5.0%**	**2.1%**	**-2.7%**
FCF / Debt	**1.0%**	**6.4%**	**-2.5%**	**2.6%**	**-5.5%**

[1] All ratios are calculated using Moody's Standard Adjustments. Source: Moody's Financial Metrics

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

Opinion

Corporate Profile

Statkraft AS (Baa1/P-2 stable outlook) is Norway's leading generator of electricity; the company's output, primarily hydro based, covers 35% of Norway's consumption. At Q2 2011, Statkraft has 16.1GW of installed capacity, with hydro operations and about 40 TWh of reservoir capacity. 57.4 TWh of production was sold in 2010 - mainly into the Nordic area, albeit with around 10% now sold to Germany. Statkraft's revenues are affected by swings in hydro production, with strong hydro conditions usually offset by weaker prices on the NordPool electricity trading framework. We expect that Statkraft will continue to invest in hydro projects in the Nordic area, as well as growing its non-European businesses, particularly in Turkey. In the past, Statkraft pursued a policy of expanding into thermal and renewables production in Northern Europe in order to diversify its business risk profile.

Statkraft acquired assets of 7 TWh through an asset swap with E.On in 2008 in return for its stake in E.ON Sverige. These assets 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 around EUR1.5 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. The present government has no intention of privatising the company. If government elections, due to take place in 2013, result in a change in government, that may present a mandate for change which, if it affects the level of support, could have an effect on the ratings.

The government sets broad objectives and policy for Statkraft, and also limits the ability of Statkraft to undertake certain overseas investment activities which can be credit positive. These include a dividend payout target in the range of 75-100% of Net Profit which is high compared to other rated entities - the government his indicated a dividend payment of 85% of the government's expectatons of net profit for full year 2011, equivalent to NOK5.015 billion.

The bulk of the operating activities of Statkraft SF (the ultimate holding company) are located in a limited liability company, Statkraft AS and its subsidiaries. The original aim of this structure was to improve Statkraft's competitiveness. Statkraft AS is 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 Jan 2003, remain at the level of 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).

Rating Rationale

Statkraft's Baa1/P-2 ratings reflect the company's strong market position as Norway's leading generator with a large proportion of low marginal cost hydro production, improving management of its energy portfolio which we expect to lead to higher achieved power prices and the benefit given by Moody's to the implied and actual support from its 100% ownership by the government of Norway (Aaa/Stable). The rating also takes into account the increasingly ambitious capital expenditure plans outside Statkraft's core market area, the exposure of Statkraft's revenues to power price and hydro output volatility, and the potential weakening of business risk through investment in non-hydro based renewables.

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 85% of EBITDA as of H1 2011. Statkraft derives further cash flow from its industrial holdings as well as the consolidation of its 66% ownership in Skagerak Energi - a regional utility active in the generation, networks and district heating sectors in Norway. Skagerak Energi contributed a further 13% to EBITDA in the first six months of 2011.

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.

The rating also factors an ambitious expansion plan, and a shift into higher risk activities (such as international hydro and offshore wind activities) could increase the riskiness of the business profile over time which may lead to more demanding metrics for the same rating category.

Recent Developments

Statkraft suffered from relatively poor hydrological conditions combined with higher than expected demand due to the cold and dry winter 2010/2011. Whilst higher prices in the Nordpool enabled Statkraft to increase its achieved generating price, the reduction in volumes substantially reduced available revenue. Power output in the first quarter of 2011 was restricted due to the requirement to ensure water availability for minimum supply volumes and environmental considerations, as hydro levels fell to 16% of maximum in March 2011. While we expect that the higher available power prices and higher volumes will push up revenues for 2012, the higher fuel costs combined with an increase in the use of thermal capacity and lower proportion of supply from the albeit still dominant hydropower production could increase costs of supply. Reservoir levels substantially recovered due to a very wet 2nd Quarter of 2011 to levels above those seen since 2009.

The Norwegian Government injected NOK14 billion of additional capital into parent company Statkraft SF in December 2010.

Statkraft's targeted investment programme for the period 2011-2015 is in the range of NOK70 - 80 billion. The bulk of investment is expected to be in renewable energy - Statkraft's growth of its interest in international renewable assets continues with the agreement of a PPA to take 50% of DONG Energy's output from some its UK offshore wind assets, in addition to the construction of a 517MW hydro plant in Turkey, estimated to cost EUR500m.

In August 2011, SN Power, Statkraft's 60% owned developer affiliate in South America, agreed to acquire a 40.65% stake in Desenvix for USD 440 million. The company is a hydro developer in Brazil with a small amount of operational hydro generation, but a significant pipeline of new projects, either planned or under construction, amounting to nearly 1,800 MW of capacity. The management of considerable additional development risk in distant countries could be a challenge for Statkraft over the next three to four years.

DETAILED RATING CONSIDERATIONS

The BCA of "10" (equivalent to a "Baa3") is derived from Moody's methodology for Unregulated Utilities and Power Companies (August 2009). Under this methodology, we view Statkraft as an Unregulated Power Company. Statkraft maps to a Ba1 due to a slight weakening of its average historical ratios. The assigned BCA is a notch higher than the indicated output from the methodology grid, reflecting the company's strong market position and portfolio flexibility, recognising the support of albeit irregular, capital injections and the government's strategic vision for Statkraft as an exporter of its hydro knowledge to overseas projects.

Statkraft's 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.

GRI ANALYSIS

Moody's views the ongoing level support as strong. This reflects a strong indication of support from the current Labour-led government, re-elected in 2009, for Statkraft. The April 2011 White Paper reinforced the strategic importance of Statkraft which the Government has said will not be privatised. Additionally the strength of the government's commitment to the company has been demonstrated by the recent capital injection, although it continues to extract high dividends. 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."

Moody's views the level of dependence as moderate, reflecting the moderate degree to which Statkraft and the government depend on the same customer base, and the low level of common credit risks that could cause a default.

The next governmental elections are due to take place in 2013 - a change in government could alter the priorities of the state towards Statkraft, which may alter the level of support that Moody's ascribes to the rating.

Output of the Baseline Credit Assessment Scorecard

FACTOR 1 : MARKET ASSESSMENT, SCALE AND COMPETITIVE POSITION (20%)

MARKET AND COMPETITIVE POSITION

Score: Baa

Statkraft has a leading market position in Norway with a 35% market share in generation. In the relatively fragmented Nordic market, Statkraft is the third largest generator with around 12-15% 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 vis a vis output. 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. However, on occasion, output can be reduced by a lack of water which can have a negative effect on revenues and profitability.

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). The power price is very sensitive to hydrological conditions, and are often the cheapest wholesale prices in Europe, unless conditions are particularly dry, as was the case in the first quarter of 2011. We expect Nord Pool prices to be increasingly influenced by central European prices as cross-border interconnections increase, which could lead to both lower volatility and higher prices over time. Statkraft's hydro plants would be likely to become more valuable as CO_2 costs lift the marginal cost of electricity production across Europe.

GEOGRAPHIC DIVERSITY

Score: Ba

Statkraft's assets are in the Nordic sector. In terms of geographical diversity, around 70% of Statkraft's installed capacity (15.8GW) is in Norway. The company is also present in Sweden, Germany, UK and Southeast Europe. Still around 90% of production in 2010 was in the Nordic countries, with the bulk of the remainder in Germany.

Statkraft also has a majority 60% stake in SN Power, with the remainder owned by the Norwegian state fund, Norfund. SN Power is used both as an operating company and financial holding for Statkraft's equity investments mainly in South America and Southeast Asia. The company, together with JVs and associates, has installed capacity of 1,454MW (its pro-rata share is 875MW); with 995MW under development and a further pipeline of assets. The international activities represent the largest investment in assets for Statkraft, as it seeks to export its hydro expertise. Statkrafts investments in Turkey will be among the larger hydro plants owned directly or indirectly by Statkraft. Overall the company aims to continue the diversification away from Norway and hydro power mainly into mainland Europe and the UK, concentrating on windfarm investments, with some investment in gas assets. In addition, hydropower projects in South-East Europe are under development. We expect that more than 15% of Statkraft's generation portfolio will be located outside Europe by 2015, which given the credit quality of the countries in which they are located, are expected to have lower quality cashflow generation.

FACTOR 2: CASH FLOW PREDICTABILITY OF BUSINESS MODEL (20%)

EFFECTIVENESS OF HEDGING STRATEGY

Score: Baa

Statkraft has relatively predictable cash flows for a company principally focused on generation, given the long term power agreements that it has in place. This factor also recognises the value of its control over 40% of the reservoirs in Norway, which covers some 90% of Statkraft's own production, hence giving it a high degree of flexibility in the portfolio. However low levels of precipitation are very likely to cause substantial reductions in revenue on a seasonal basis, as was the case after a very cold and dry winter 2010-11. System prices peaked at about EUR80 / MWH in December 2010, substantially above the average price of between EUR 40-50/MWh.

In the Nordic market around 50% of Statkraft's production is covered by long-term contracts which protects the company from significant price volatility, although many of these contracts have historically been at low prices. 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 limited 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 both in Norway and Continental Europe should also help to hedge the company's exposure to pricing volatility, to fully cover the demand base.

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 Statkraft Varme (formerly Trondheim Energi), which are municipality distribution and energy supply companies.

Moody's expects Statkraft's profitability to improve as the bulk of its politically-driven, out-of-the-money industrial contracts (9 TWh in 2010) will run off by the end of 2011. Many of these contracts are with power-intensive and wood-processing industries. Moody's expects that these contracts will be replaced by long-term agreements at higher prices, which should boost revenues as well as margins, providing greater insulation to power price and volume volatility. We expect that approaching half of Statkraft's output will be covered by long-term contracts from 2012 onwards, and that the company's cash flows will be boosted incrementally over the years as a result.

FUEL STRATEGY AND MIX

Score: Ba

At year end 2010, 81% of Statkraft's installed capacity was hydro power, with 14% gas-fired, 2% wind power, with 3% derived from district heating. The score reflects the high concentration and the exposure of the portfolio to rainfall risk. Moody's recognises that the company will gradually diversify its generation capacity through new investments - primarily focused on "green" energy, both within and outside of Norway, as well as the fact that in years with strong hydrological performance, the generation portfolio is highly flexible with low levels of plant concentration.

Moody's expects Statkraft to have a more flexible gas trading platform going forward, which will help it optimise the returns from its thermal portfolio, particularly as spark spreads have been very low during the first half of 2011.

CAPITAL REQUIREMENTS AND OPERATING PERFORMANCE

Score: A

Statkraft's maintenance capital expenditure of NOK1,000m in 2010 represented just over 1% of its asset base which appears to be very modest compared to other power companies. We expect maintenance capital expenditure as a proportion of assets to increase modestly over time, reflecting not only the higher costs of maintaining wind and thermal assets, but also reflecting the larger portfolio. 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(10%)

Score: Baa

Statkraft scores Baa, as do most European utilities, in this category. This reflects the fact that the company manages its investments according to its financial flexibility. The government's policy of taking high dividends out of the company to date, which we expect will be maintained in the range of 75-100% of net profits, has somewhat constrained the company's flexibility to invest. The injection of NOK14 billion by the government into Statkraft is intended to allow the company to invest in renewable energy projects without a significant increase in debt in the short term. However, we expect Statkraft will need to raise additional debt to continue funding growth.

Statkraft's results are subject to significant non-cash adjustments relating to its positions under its power contracts relating to market price, as well as to shareholdings. The company made a further negative adjustment of NOK2.14 billion for the first half of 2011, further to the write down of NOK3.6 billion in 2010, relating to the devaluation of its E.On shareholding, and which Moody's expects will be written down further at year end.

Liquidity

Statkraft's liquidity is currently strong, following the NOK14 billion equity injection in December 2010. We expect that Statkraft will have no need to raise additional debt to fund its committed capital expenditure projects until 2013. 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. In addition to the currently high unrestricted cash balances (NOK21.9 billion at Q2 2011), Statkraft has a NOK12 billion committed revolving credit facility which with an initial maturity of January 2016, which is currently undrawn.

Cash flows vary considerably over a twelve month period given prices and volumes are somewhat higher over the winter period. Operating cash flow over the next 12 months should be largely sufficient to meet committed capex and dividends. Liquidity requirements are increasing due to the high number of new projects that Statkraft is undertaking. Moody's expects that investment capex will roughly double from the 2010 level of NOK1.85 billion from 2011 to 2013, in addition to maintenance capex and acquisition activity. Statkraft has a committed long term back up bank facility of NOK12 billion maturing in 2016 which is undrawn.

Moody's expects cash balances to fall to about NOK 12bn at year end 2011, reflecting the increased capex and maintenance items, as well as the payment of dividends of approximately NOK 8bn.

Statkraft has a change of ownership control covenant in its back-up facility and some bonds.

Statkraft's future financial profile will be influenced by (i) the ongoing level of dividends extracted from the company, (ii) the level of power prices, (iii) the size and pace of its investment programme.

Factor 4: FINANCIAL STRENGTH METRICS (50%)

Statkraft's profitability can be somewhat volatile given its high reliance on hydro levels. This is somewhat mitigated by Statkraft's use of dynamic hedges and also the long term industrial contracts to help mitigate such risks, and control over significant reservoirs gives it significant flexibility. Additionally there is a partial inverse correlation between hydro production volumes and prices, as prices tend to go down when hydro production is high and conversely go up when production is low, which has some offsetting benefits. Increasing fuel and geographic diversification will also have more of an impact over time. On the plus side, Statkraft will also increasingly benefit from its CO2-light portfolio.

The government policy to extract significant dividends out of Statkraft (85% for the full year 2010) results in low, even negative, Retained Cash Flow/Net Debt and has an impact on the company's financial flexibility when it comes to investments, although the equity injection in December 2010 demonstrates the government's willingness to support strategic investment, in this case for renewable energy and overseas hydro electric projects.

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: FFO/net debt of mid-high teens and FFO/interest coverage of at least 3-4x. RCF/net debt should be positive based off dividend payouts on recurrent income.

6M 2011

Overall production of 24.4 TWh for the first 6 months, was 14% lower than the same period in 2010. Whilst prices were slightly higher than the like-for-like period during the preceding year, the reduction of volumes resulted in a 23.5% decrease in revenues. Statkraft's production appears to have been more heavily affected by the "winter drought conditions" than its peers. The lower levels of output resulted in lower revenue, although EBITDA was only slightly lower due to a reduction in thermal power output, reducing the effect of poor gas margins on the portfolio. Net revenues were further reduced by a NOK1.655bn negative swing in unrealised losses in the value of energy contracts, due largely to currency movement. Gas power production remained a negative profit contributor driven by low or negative spark spreads, and lower output due to scheduled outages. Lower net financial expenses also contributed together with positive changes in unrealised value of energy contracts.

The company gained from unrealised currency gains in the NOK and SEK against the EUR but this had no cash effect on the company's accounts.

Statkraft has demonstrated solid FFO/net debt metrics in recent years; in the high teens to early twenties. 2010 was a strong year due to high power prices. FFO/net debt metrics in 2011 are expected to be adequate for the rating, as Statkraft was not able to capitalize fully on higher Nordpool prices. As hydro levels have been restored, we expect both prices and demand to remain somewhat depressed for the remainder of the year.

Rating Outlook

The outlook is stable. The company is expected to demonstrate ratios with the range indicated for the rating category - maintaining FFO/interest of at least 3-4x, FFO/net debt of mid-high teens and positive RCF/net debt. While the NOK14 billion equity injection from the government in December 2010 provides strong levels of liquidity, the investment programme is challenging, future dividend levels are expected to remain high and if power prices fall, these ratios may be challenged.

What Could Change the Rating - Up

The company would need to be able to achieve and sustain RCF/net debt in the double digits, FFO/net 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 failed to maintain its financial profile in line with the current guidance. 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.

Rating Factors

Statkraft AS

Power Companies [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Market Assessment, Scale and Competitive Position (20%)							
a) Market and Competitive Position				X			
b) Geographic Diversity					X		
Factor 2: Cash Flow Predictability of Business Model (20%)							
a) Effectiveness of Hedging Strategy				X			
b) Fuel Strategy and Mix					X		
c) Capital Requirements & Operational Performance			X				
Factor 3: Financial Policy (10%)							
a) Financial Policy				X			
Factor 4: Financial Strength Metrics (50%)							
a) (CFO Pre-W/C + Interest) / Interest Expense (3 year Avg)				5.8x			
b) (CFO Pre-W/C) / Debt (3 year Avg)					20.9%		
c) RCF / Debt (3 year Avg)							1.2%
d) FCF / Debt (3 year Avg)					2.0%		
Rating:							
a)Indicated BCA from Grid					Ba1		
b) Actual BCA Assigned				Baa3			

Government-Related Issuer	**Factor**
a) Baseline Credit Assessment	Baa3
b) Government Local Currency Rating	Aaa
c) Default Dependence	Moderate
d) Support	Strong

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010; Source: Moody's Financial MetricsTM