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Research Update:

Statkraft AS Upgraded To 'A-', Off Credit Watch On Likelihood Of Government Support; Outlook Negative

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Research Update:

Statkraft AS Upgraded To 'A-', Off CreditWatch On Likelihood Of Government Support; Outlook Negative

Overview

- We recently revised our methodology for rating government-related entities.
- We are raising our long-term corporate credit rating on Norway-based utility Statkraft AS to 'A-' from 'BBB+', and removing it from CreditWatch, where it was previously placed with positive implications.
- The negative outlook reflects our expectation of a weakening of Statkraft's business and financial risk profile over the near to medium term, due to the company's expanded investment program.

Rating Action

On Oct. 22, 2009, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Norway-based utility Statkraft AS to 'A-' from 'BBB+', and removed it from CreditWatch, where it was placed on June 30, 2009, with positive implications. At the same time, the short-term credit rating was affirmed at 'A-2'. The outlook is negative.

We also raised the long-term corporate credit rating on the parent company, Statkraft SF, to 'A-' from 'BBB+', and removed it from CreditWatch, where it was also placed on June 30, 2009, with positive implications. The short-term credit rating was affirmed at 'A-2'. The outlook is negative.

Rationale

The upgrade reflects our revised methodology for rating government-related entities and our opinion 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, based on the company's vast domestic hydropower resources, which are viewed as highly strategic to Norway's power supply. Another strategic objective for Statkraft is to secure, and develop, Norway's competencies within renewable energy.
- "Strong" link, based on the full state ownership of Statkraft, and in our view remote risk of privatization. Although Statkraft's board of directors is formally independent, and the management is relatively autonomous, we believe that the government retains a strong influence over high-level strategic decision making.

We consider Statkraft's business risk profile to be strong, reflecting the group's position as the third-largest Nordic power generator; its competitive, low-cost hydropower generation; its holdings in downstream electric utilities; and its 100% state ownership. These factors are offset by Statkraft's significant financial risk profile resulting from the inherent volatility in the company's generation earnings and an aggressive dividend policy; a significant investment program, partly directed into higher-risk countries; and large minority stakes in electric utilities, which limit access to cash flow.

Statkraft has asked its shareholder, the Norwegian Ministry of Trade and Industry, for a Norwegian krone (NOK) 8 billion capital injection, alongside a request for a less aggressive dividend policy, targeting dividends between 50%-75% of net profit (from the current 75%-100%). We expect these measures, if implemented, to strengthen Statkraft's equity by about NOK27 billion until 2015, partly offsetting the negative effects of the company's expanded investment program, which will be partly debt-funded. As indicated in the draft state budget for 2010, a pending review of Statkraft's proposal appears to be linked to a review of the company's strategy, which is being simultaneously undertaken by the ministry. At this point, the extent to which the government is prepared to support Statkraft through the proposed measures remains unclear, as well as any strategic implications from the review. We will closely monitor related developments and their ultimate impact on Statkraft's stand-alone credit profile, which is currently assessed at 'BBB'.

Short-term credit factors

The short term rating is 'A-2'. We consider Statkraft's liquidity to be adequate. As at June 30, 2009, the company had an on-balance-sheet cash and liquidity position of NOK19.3 billion, access to an unused NOK5 billion multi-currency revolving credit facility maturing in 2012, an unused NOK3 billion multi-currency revolving credit facility maturing in 2013, and NOK400 million in uncommitted bank lines. This compares with short-term debt of NOK10.4 billion at the same date. The build-up of a significant cash position at the end of the second quarter of 2009 was due to the 2008 dividend of NOK10 billion which will be paid out during the second half of 2009. The extraordinarily high dividend is expected to be paid in installments in July, September, and December, to minimize the strain on Statkraft's liquidity.

Statkraft's cash flow generating ability will be tempered by its ambitious investment program, which includes significant capital expenditure, as well as potential acquisitions of ownership stakes in minority-owned downstream operations. Free operating cash flow generated in the 12-month period ended June 30, 2009 was strong at NOK12.5 billion. However, the announced increase in capital spending is likely to result in weaker free operating cash flow over the near to medium term. Covenants in Statkraft's borrowing arrangements relate mainly to restrictions regarding indebtedness at group subsidiaries. Some covenants also relate to government guarantees and ownership.

Outlook

The negative outlook reflects our anticipation of a weakening of Statkraft's business and financial risk profile over the near to medium term, due to the company's expanded investment program, which will be partly debt funded, and which is partly directed to higher-risk countries.

The ratings could be lowered should any measures to strengthen Statkraft's capitalization fail to sufficiently offset the impact of the planned increase in investment on the company's stand-alone credit profile. They could also be lowered following a longer period of low electricity wholesale prices, resulting in a weaker-than-expected earnings performance, as well as on signs of any weakening of government support.

We may revise the outlook to stable, should Statkraft receive adequate financial support from its shareholder to undertake its planned investment program, or should the size and scope of the program be significantly moderated.

Related Research

Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009

Principles Of Corporate And Government Ratings, June 26, 2007

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Statkraft AS		
Statkraft SF		
Statkraft Energi AS		
Long-term Corporate Credit Rating	A-/Negative	BBB+/Watch Pos

Ratings Affirmed

Statkraft AS		
Statkraft SF		
Statkraft Energi AS		
Short-term Corporate Credit Rating	A-2	

Upgraded; CreditWatch/Outlook Action

	To	From
Statkraft AS		
Senior Unsecured	A-	BBB+/Watch Pos
Statkraft SF		
Senior Unsecured	A-	BBB+/Watch Pos

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