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Research Update:

Norwegian Renewable Energy Producer Statkraft AS Upgraded To 'A' Amid Elevated Power Prices; Outlook Stable

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Rating Action Overview

- We expect that Statkraft will be able to capitalize on its low-cost hydropower production, which is largely unhedged, and currently elevated energy prices over 2022 and 2023, resulting in a much stronger balance sheet than we previously expected.
- We believe prices will remain high through 2023, due to a structural shift from the successful connection of submarine interconnectors linking prices more closely with those of continental Europe and the U.K., which are generally higher due to greater reliance on fossil-based production.
- We now expect the company's funds from operations (FFO) to debt will remain at about 200% over 2022 and 2023, compared with 30%-40% previously, and remain above 100% by 2024, and we forecast EBITDA above Norwegian krone (NOK)40 billion this year.
- We raised our issuer credit ratings on Statkraft to 'A/A-1' from 'A-/A-2'.
- The stable outlook reflects our expectation that the company will maintain FFO to debt well above 30%, despite its capital expenditure (capex) plans.

Rating Action Rationale

Statkraft's low-cost hydro assets in the Nordics are highly competitive, with a very low cost base and high output. We expect that Statkraft will fully capitalize on its low generation cost and elevated energy prices over 2022 and 2023, resulting in a much stronger balance sheet. As Europe's largest generator of renewable energy, Statkraft is benefiting immensely from elevated prices, also because it is able to increase production when prices are favorable. Since power prices have become much more volatile, we believe this will support Statkraft's price realization in 2022 and 2023 even more then historically (typically has been about 5% higher than spot prices). This is thanks to it hydro assets, which represent the vast majority of its production portfolio (or about 77% of installed capacity) and 90% of Statkraft's total generation at 63 terawatt-hours

(TWh) in 2021, out of the total 69.9TWh. These can be switched on and off within minutes, which lends Statkraft great flexibility in shifting production. We believe that Statkraft's, with a large share of plannable production capacity, has improved its position and that it will continue to benefit even more from the flexibility, since capacity additions to the system in generally are intermittent and therefore volatility likely will increase. Additionally, Statkraft does not use financial hedging, which lately not been sufficient, given that the spread between price areas within Nord pool varies greatly and therefore has resulted in unperfect hedges and created additional uncertainty. Instead, Statkraft has for a long time entered into long-term contracts with industrial players. The company has in this way locked in about one-third of its total estimated generation of 22TWh-24TWh for 2022-2024; about 14TWh are already locked in through 2030 with fixed prices. In our view, this secures some lower level of cash flows, but also allows Statkraft to benefit from the current price situation.

According to our estimates, the company's cash cost for its hydro production is close to €8 per megawatt-hour (/MWh). During 2022, Nord pool system prices have on average been well above €100/MWh. With these market conditions, Statkraft's earnings from its Nordic hydro generation have boosted cash flow significantly during a short period. We expect this to continue, at least over 2022 and 2023. This was very visible in its first-quarter 2022 report, with underlying EBITDA of NOK20 billion, already above our previous expectation for the full year of NOK15 billion-NOK18 billion, or about 67% of the full-year EBITDA for 2021. It was also well above full-year EBITDA for 2019 of NOK20 billion and NOK13 billion for 2020. In our revised forecast for 2022, we assume EBITDA of NOK38 billion-NOK43 billion, with electricity prices of €80/MWh-€100/MWh. Thereafter, we believe that electricity prices will soften somewhat to €50/MWh-€70/MWh and EBITDA to NOK26 billion-NOK36 billion. This is still well above historical EBITDA contributions of NOK14 billion-NOK18 billion. That said, market volatility has increased greatly in recent years.

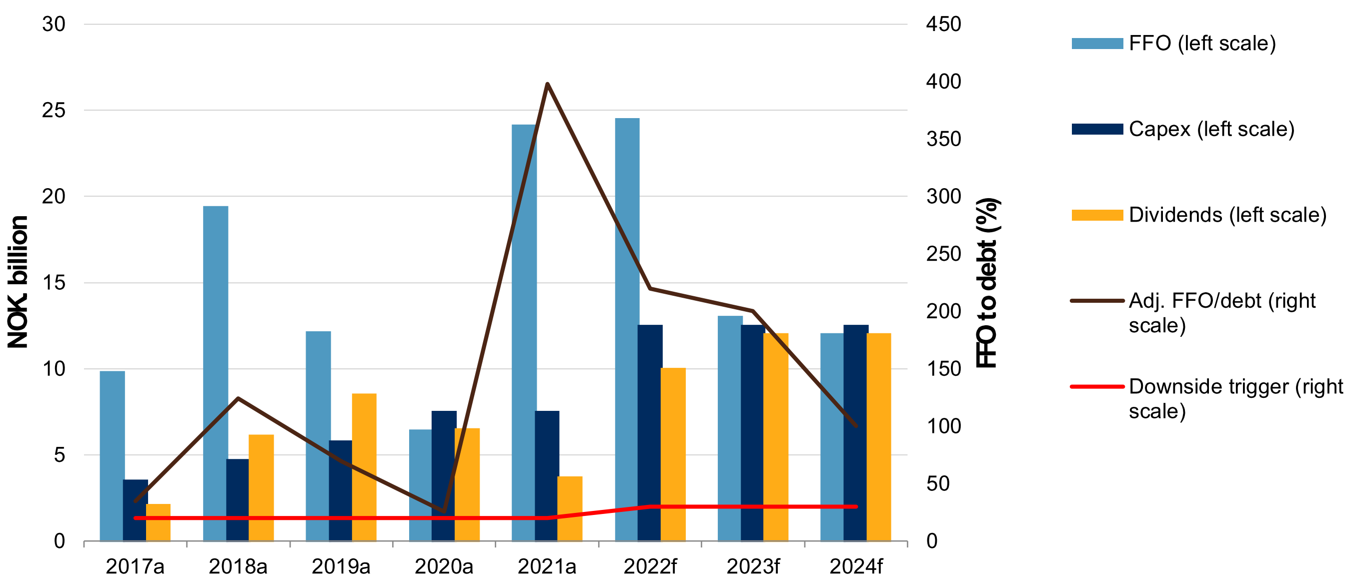
Despite an ambitious capex plan, we forecast only moderate debt increases and very strong credit metrics, albeit with more volatility than in the past, due to prices and delayed tax payments. As a direct consequence of the increased power prices, we expect operating cash flow will increase materially, but also be more volatile than in the past. By year-end 2022, we expect FFO to debt above 200% and slightly below 200% in 2023, before deteriorating but remaining above 100% in 2024. This is because of our assumption that prices will soften, but also due to Statkraft's ambitious capex plan. The company plans annual investments of about NOK13 billion and dividends of about NOK10 billion-NOK12 billion. Despite the hefty build-out plans, we now expect that Statkraft will be able to finance capex almost solely with operating cash flows and therefore that the rapidly gained balance sheet strength will remain, in contrast with many peers. We now expect debt of only NOK7 billion-NOK14 billion, compared with NOK17 billion-NOK35 billion during 2016-2020. This could be changed by acquisition activity, which management has signaled for a while is part of its strategy, although it has not been able to execute on it. In our base case, we do not assume large acquisitions, but believe there is headroom for acquisitions in addition to our estimate of NOK11 billion-NOK13 billion capex. We do not consider a larger acquisition as unlikely, but it is not included in our base case. If one takes place, we expect it will be within renewable generation, or potentially within district heating, therefore having a neutral to moderately positive effect of business risk.

Fluctuations in tax payments in combination with volatile prices could create some volatility in cash flows year over year. Additionally, cash flow volatility for Statkraft is also driven by its tax payments related to hydro generation, because that tax is paid the following year. Dividends are based on profit from the previous year, and therefore could cause volatility when profits fluctuate, for example as seen in 2020. We therefore base our view on Statkraft's financial risk on the three-year average FFO to debt. For 2022, we expect FFO will reach about NOK25 billion, which includes the tax payment of about NOK14 billion, which is based on prior years' earnings. For 2023, we expect additional tax payments, reaching roughly NOK16 billion-NOK17 billion, which lowers FFO to about NOK14 billion-NOK16 billion under our base case, since we at the same time assume EBITDA will soften. For hydro generators in Norway, it is our understanding that the total marginal tax rate amounts to 59%. This is high compared with European standards, and therefore undermines the EBITDA-to-FFO ratio more than is typical for Europeans peers, as well as our supplementary ratios, such as FFO to debt, which we nevertheless assume as above 100% over the coming years. Due to elevated and volatile energy prices, we adjust the financial risk profile downward two categories.

Additionally, Statkraft's dividend policy states that it will distribute 85% of earnings related to its Norwegian hydro business, and 25% of profits from other business activities. Since the majority of earnings stem from Norwegian hydro, this results in dividend payments of about NOK10 billion-NOK12 billion annually.

Chart 1

Statkraft's Credit Metrics To Remain Very Strong, But Volatile
FFO to debt remains above 100%



Capex--Capital expenditure. a--Actual. f--Forecast. NOK--Norwegian krone. FFO--Funds from operations.
Source: S&P Global Ratings.

The ambitious growth and capex plan would likely be funded by a higher share of operating cash then in our previous base case. The company aims to develop 9 gigawatts (GW) by 2025. We don't expect that Statkraft will maintain and operate all of it, on the contrary, we expect Statkraft to farm down large parts of the 9GW. Statkraft currently has 19GW of installed capacity in total, as of year-end 2021, and it remains unclear to us, how much of the 9GW renewable capacity will be kept versus sold. Regardless, we view this as a very ambitious target, which will require substantial investments and annual development of 2.5GW-3.0GW of renewable energy. The main focus of the growth capex plan is related to wind and solar development. Statkraft does have some offshore wind projects in its pipeline, but these extend beyond 2025 and do not affect the capex plan in coming years. In total we foresee that that the capex plan will translate into annual capex of NOK11 billion-NOK13 billion over 2022 to 2024, up from NOK5 billion-NOK7 billion in 2018-2020. Given the company's improved cash flow profile, we believe the increased capex easily could be absorbed within the 'A' rating.

Statkraft's investment program is regionally diversified and includes some investments in emerging markets, but we expect most investments to be in Europe and the Nordic region. It is also diverse in terms of type of assets: wind, solar, and hydro. We see increased execution risk and political risk in emerging markets. However, we do not believe that Statkraft's current investment plan will materially shift its earnings profile from a geographic perspective.

The company's Nordic low-cost hydro portfolio puts Statkraft in a unique position in terms of generation assets. A hydro plant's lifetime is significantly longer than that of a wind or solar plant. While the current investment plan, which has increased generation from solar and wind, could dilute Statkraft's business risk profile from a production cost perspective, it increases diversification in terms of sources and geography.

Statkraft plans divest part of its 9GW of renewable capacity under development, which gives the company flexibility to finance part of the capacity build-out from the proceeds. It is our understanding that Statkraft has been more of a developer in recent years, but is considering maintaining additional projects under its own operations. We believe that Statkraft's newly developed assets are attractive, and under normal market conditions it will have the flexibility to divest them. Given current electricity prices and cash flows, Statkraft also has the possibility to keep the assets under its own operating umbrella, which should result in healthy EBITDA growth in coming years.

We believe a structural shift is behind higher electricity prices, and that prices will remain volatile and high in the Nordics, giving Statkraft the potential to achieve high prices. We acknowledge that electricity prices have been extremely volatile in recent years, especially in the Nordics. In 2018-2019, prices were high (compared historically) at about €40/MWh-45/MWh, then very low in 2020 at about €11/MWh on average, and in 2021 they returned to about €60/MWh and are even higher currently. We expect volatile prices to stay, but we believe that there have been structural changes that will shift prices upward for a longer period of time. There are several factors that have impacted prices in the Nordics.

- Electricity is not generated where it is needed, which creates the need for a massive transmission network that is currently lagging. We understand that it will take an additional three-to-five years before this is solved.
- Nordic electricity prices are now more closely linked to those of Continental Europe and the U.K. due to the recent successful connection of submarine interconnectors. This includes the North Sea Link (connecting Norway and the U.K.) and NordLink (connecting Norway and Germany), which were connected in 2021 and each have a maximum capacity of 1,400MW.
- Given that Continental Europe and the U.K. are more dependent on fossil fuel, such as gas and coal, they have seen commodity prices and power prices increase massively after Russia's invasion of Ukraine, and this has also resulted in higher Norwegian and Nordic electricity prices. Additionally, carbon emission prices have also risen to about €80/MWh since the end of 2021, fueling higher energy prices in Europe and the U.K., which are now being passed on to the

Nordics.

- Additional production from wind and solar drive volatility. But we believe that Statkraft could benefit, since its production is flexible, and therefore it can lower capacity when wind capacity is high and driving down prices, while then increasing capacity when prices are more favorable.

We foresee that Statkraft will benefit from both increased Nordic prices and the volatility in prices, since it has the capability to switch swiftly in generation capability, and thereby outperform the average price.

Our rating on Statkraft factors in two notches of uplift for extraordinary government support. The group is 100% owned by Norway (AAA/Stable/A-1+). We see the risk of privatization as remote, given that the government stipulates that, by law, its hydro assets should remain at least two-thirds publicly owned.

Outlook

The stable outlook reflects our expectation that Statkraft will continue to benefit greatly from elevated energy prices, resulting in FFO to debt comfortable above 30%, despite our expectation of significant investments of NOK11 billion-NOK13 billion annually through 2024. We believe the current rating could have some headroom for M&A activity, in the NOK25 billion-NOK30 billion range, however, we do not include this in our base case.

Upside scenario

Prospects for a higher rating are constrained by the company's capex program and lack of clarity regarding investments and potential M&A activity, including the long-term impact on Statkraft's financial ratios.

Downside scenario

We could take a negative rating action if Statkraft undertook a large acquisition or project that could not be funded by operating cash flows, or a material cost overrun occurs, notably if this were to coincide with lower electricity prices in the Nordic region and result in FFO to debt unexpectedly returning to the 20%-30% range.

In addition, we could take a negative rating action if government support weakened, for example, if the government privatized a significant part of its ownership in Statkraft it could lead to a downgrade. However, we consider this unlikely over the near-to-medium term.

Company Description

Norwegian state-owned power generator Statkraft is the largest producer of renewable energy in Europe. In 2021, Statkraft produced 67TWh of renewable energy (70TWh in total) and reported underlying EBITDA of NOK31 billion.

The company had total installed capacity of almost 19GW as of December 2021, with hydro representing about 77%. In 2021, Statkraft produced 54.5TWh in Norway, which represents about 40% of Norway's total consumption. About 96% of total generation is from renewable sources. Statkraft has the lowest carbon intensity footprint per generation unit among peers and is the

European power generator we rate with less than 30 grams of CO_2 per kilowatt-hour.

Statkraft aims to be a leader in the renewable energy sector. The company mainly invests in Norway and the Nordics, but also in other markets to develop hydro, solar, and wind power plants. It invests solely in renewables.

The company aims to develop 9GW of renewable energy by 2025, with annual development of 2.5GW-3.0GW. So far, 1.7GW has been complete (thereof 0.6GW is divested), and 1.7GW is under construction).

The Norwegian government's 100% ownership of Statkraft is managed by the Ministry of Trade, Industry, and Fisheries.

Our Base-Case Scenario

Assumptions

- Norwegian GDP growth of 2.9% in 2022, 2.5% during 2023, and 2.0% in 2024.
- Nord Pool System price averaging €80/MWh-€100/MWh in 2022, and about €50/MWh-€70/MWh in 2023 and 2024.
- Total annual production volume of about 72TWH-76TWh, and about 70%-80% of generation stemming from Nordic Hydro.
- Long-term contracts with fixed prices for about one-third of estimated production.
- Annual capex of NOK11 billion-NOK13 billion, which could absorb smaller acquisitions.
- Dividends based on net profit: 85% of earnings related to Norwegian hydro; and 25% of earning from other activities.
- Hydro generation tax in Norway being paid the following year.
- Larger M&A transactions are not included in our base case.

Key metrics

Statkraft AS -- Key Metrics

(Bil. NOK)	2019a	2020a	2021a	2022p	2023f	2024f
EBITDA	20	13.1	27.8	40-45	32-37	27-32
Funds from operations (FFO)	12.1	6.4	24.1	23-26	12-15	11-14
Debt	17.4	24.9	6.1	10-12	6-9	12-15
FFO to debt	69.5	25.6	398	150	150	100
Debt to EBITDA	0.9	1.9	0.2	0.2-0.4	0.2-0.4	0.4-0.6

a--Actual. p--Projected. f--Forecast.

Liquidity

We assess Statkraft's liquidity as strong. We expect that the company will maintain liquidity sources that exceed uses by about 1.6x over the next 12 months and 1.0x in the subsequent 12 months. We also assume that liquidity sources will exceed uses even if EBITDA were to decrease by 30%. We understand that Statkraft's credit facilities are free from onerous financial covenants. We view the company as having solid relationships with its banks and a high standing in credit markets, despite the geopolitical situation and its effect on financial markets. Statkraft issued senior unsecured green bonds, with a total amount of NOK5.5 billion at the end of May this year. The company also increased and extended its revolving credit facility (RCF) to €1.3 billion from NOK9.2 billion (equivalent to about €900 million) this year.

We expect the state ownership to further increases access to bank financing. We view risk management as very prudent overall.

We estimate Statkraft's principal liquidity sources for the 12 months from March 31, 2022, as:

- Cash and cash equivalents of NOK 28.6 billion;
- Access to about unused committed facility of €1.3 billion (NOK13 billion) maturing in 2027; and
- Cash FFO, which we expect to be about NOK28 billion.

We estimate Statkraft's principal liquidity uses for the 12 months from March 30, 2022, as

- Capex of NOK11 billion-NOK13 billion;
- Working capital outflow of NOK7 billion;
- Dividends of about NOK10 billion; and
- Debt maturities of about NOK18.4 billion.

Environmental, Social, And Governance

ESG credit indicators: To E-1, S-2, G-2 -- From E-2, S-2, G-2

We believe that Statkraft is among the best-positioned power generators in Europe, given it is Europe's largest renewable producer and that it has the lowest carbon footprint per produced electricity unit among our rated utilities in Europe. As such, environmental factors are a positive consideration in our credit rating analysis of Statkraft. We therefore revised upward our environmental credit indicator to E-1 from E-2, previously. Statkraft's carbon footprint in terms of CO_2 emissions per MWh of power generation was 28 kilograms during 2021. This allows Statkraft to focus fully on growth, and not on transitioning its generation fleet, unlike other generators that have thermal generation that needs to be phased out or transformed into using renewable sources of fuel. Social and governance factors are a neutral consideration in the credit rating.

Issue Ratings - Subordination Risk Analysis

Capital structure

Statkraft's reported debt stood at NOK38.6 billion in December 2021. Essentially, all the debt is issued by the parent company, Statkraft AS.

Analytical conclusions

The issue rating on Statkraft's senior unsecured debt is 'A', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating	**A/Stable/A-1**
Business risk:	Strong
Country risk	Very low
Industry risk	Moderately high
Competitive position	Excellent
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
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: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Upgraded

	To	From
Statkraft AS		
Statkraft SF		
Statkraft Energi AS		
Issuer Credit Rating	A/Stable/A-1	A-/Stable/A-2
Statkraft AS		
Senior Unsecured	A	A-

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 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 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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; or Stockholm (46) 8-440-5914