FitchRatings

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Fitch Affirms Statkraft at 'BBB+'; Outlook Stable

Fitch Ratings - London - 01 Jun 2021: Fitch Ratings has affirmed Norwegian-based power generation company Statkraft AS's Long-Term Issuer Default Rating (IDR) at 'BBB+' with Stable Outlook. A full list of rating actions is below.

The affirmation reflects our view that the credit profile of Statkraft remains supported by its highly competitive Norwegian hydro power assets, which benefit from a low cost of production and a highly flexible fleet, driving healthy operating cash flows. Exposure to wholesale power prices is partly offset by the company's sizeable, long-term contracts and forward trading.

The IDR continues to benefit from a single-notch uplift to Statkraft's Standalone Credit Profile (SCP) at 'bbb', reflecting the company's links with the Norwegian sovereign.

Key Rating Drivers

Highly Competitive Hydro: The strong competitive position of Statkraft in the Nordic generation market continues to be supported by its Norwegian hydro power assets, which have significant scale at approximately 25% of Europe's reservoir capacity, its ability to store capacity across multiple years and low production costs. Fitch estimates that Statkraft generated around 51TWh from hydro power in 2020 at a cash cost of around EUR7/MWh, which supports its position as one of the lowest-cost producers in Europe.

Volatile Spot Prices: We assume medium-term prices (Nord Pool) at around EUR28/MWh, which is higher than our assumption last year. Nordic power prices increased to above their long-term historical average during 1Q21 with Statkraft achieving above EUR40/MWh for its spot-rate power sales. This was driven by an improved hydrological balance following an exceptionally wet

2020, which saw Nordic power prices declining to below EUR10/MWh during 2Q20. Nordic power prices continue to be heavily influenced by weather, which affects both supply and demand.

Stabilising Long-Term Contracts: Exposure to volatile spot prices is partially offset by long-term contracts representing about 40% of Statkraft's power generation for the next two years (declining to about 30% by end-2025), which, in Fitch estimates, are contracted at power prices close to long-term average market prices and support revenue visibility. Statkraft continues to enter into new forward sales; however, we expect new contracts to be less profitable than existing ones. Nevertheless, we view long-term electricity market fundamentals, including improved interconnectors, as supportive of Statkraft's credit profile.

Growth Strategy Presents Execution Risks: Fitch foresees the share of EBITDA outside Nordics growing to 25% by 2025, from 9% currently. Under its strategy, it could spend an average of NOK10 billion on capex, including NOK2 billion maintenance capex annually, primarily on hydro and wind assets and, to a lesser extent, solar, in Europe and some emerging economics with high growth potential.

We assess the regulatory regimes in potential target markets such as Brazil, Chile, Turkey and India as less predictable than in Europe. Statkraft, nevertheless, has significant capex flexibility with currently committed capex below NOK4 billion in 2023.

Comfortable Credit Metrics: We expect Statkraft's funds from operations (FFO) net leverage to remain within our rating sensitivities of between 2.5x and 3.5x for the current rating despite higher dividend payment as well as higher cash tax assumption for 2022, driven by strong performance expected in 2021. Profitability will mostly be driven by underlying power prices, while capex-driven growth will drive free cash flow (FCF) and leverage. Statkraft is considering increased international asset rotation (pre-construction phase), which could provide additional cash flows.

Government Ownership: Statkraft is 100%-owned by the Norwegian state, which regards its ownership as value-creating and is focused on responsible management of Norwegian natural resources. Statkraft's international growth strategy is indirectly supported by the state through the dividend policy and, previously, also equity injections. Statkraft's IDR includes a single-notch uplift above the SCP, reflecting the government links under Fitch's Government-Related Entities (GRE) Rating Criteria.

Strong Support Factor: We assess status, ownership and control as 'Moderate' because the company is governed by commercial law with a limited government role in day-to-day management. We assess socio-political implications of a default as 'Moderate' as we expect Statkraft will continue to operate even under financial distress. We assess support track record as 'Strong', considering past equity injections and support for international growth, while financial implications of a default are 'Weak', as Norway (AAA/Stable) and other GREs are unlikely to be materially affected by a default of Statkraft.

Derivation Summary

Statkraft is well-positioned relative to its Nordic peer Fortum Oyj (BBB/Negative) due to its low-cost, flexible hydro-asset base and lower exposure to thermal generation, allowing it a slightly higher debt capacity at the same standalone rating. Statkraft's low proportion of regulated and quasi-regulated earnings compared with the wider top European utilities peer group is credit-negative. Its leverage profile is less aggressive relative to Nordic peers' and Statkraft benefits from stronger ties with the Norwegian government, resulting in a one-notch IDR uplift from its SCP.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Medium- to long-term Nord Pool prices of about EUR28/MWh

- Average capex of about NOK7 billion per year for 2021-2025

- Dividends in line with the company's policy to pay out 85% net profit from Norwegian hydro power business and 25% of net profit from all other business activities

- Generation volume to remain broadly stable between 65TWh and 70TWh during 2021-2025 based on currently committed capex

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- An improvement in structural business attributes with increase in contracted revenues or a change in financial strategy leading to substantially stronger credit metrics, such as FFO net leverage trending towards 2.5x

- Stronger links with the government

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO net leverage rising sustainably above 3.5x, which could be due to significantly higher expansionary capex than Fitch's assumptions

- Weakening links with the Norwegian state

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Liquidity and Debt Structure

Strong Liquidity: Total liquidity at end-2020 amounted to over NOK17 billion, including NOK6.4 billion of cash and NOK11.2 billion of unused credit facilities. This compared with short-term maturities of NOK4 billion (excluding lease liabilities). We forecast positive free cash flow (FCF) for 2021 of around NOK2 billion, due to strong recovery in power prices, before turning negative for 2022 due to higher cash taxes, and neutral-to-negative FCF thereafter.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Fitch Ratings Analysts

Raman Singla
Director
Primary Rating Analyst
+44 20 3530 1728
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Carlos Baeta
Senior Analyst
Secondary Rating Analyst
+44 20 3530 2616

Josef Pospisil, CFA
Managing Director
Committee Chairperson
+44 20 3530 1287

Media Contacts

Adrian Simpson
London
+44 20 3530 1010
adrian.simpson@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Statkraft AS	LT IDR	BBB+	Affirmed		BBB+
	ST IDR	F2	Affirmed		F2
• senior unsecured	LT	BBB+	Affirmed		BBB+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.21 Dec 2020) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub.30 Sep 2020)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub.30 Apr 2021)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Statkraft AS UK Issued, EU Endorsed

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