Credit Rating Announcement

26 March 2019

Scope upgrades Eidsiva's issuer rating to BBB+, Outlook Stable

The upgrade follows the agreement between the boards of Eidsiva and Hafslund E-CO, announced on 14 March 2019, to merge in accordance with the letter of intent from 20 November 2018. The ratings were previously under review for possible upgrade.

Rating action

Scope Ratings has upgraded the corporate issuer rating on Eidsiva Energi AS to BBB+ from BBB- and moved the Outlook to Stable (from under review for possible upgrade). Scope has also upgraded the senior unsecured rating to BBB+, while leaving the short-term rating unchanged at S-2. The new ratings are subject to final approval of the contemplated merger from the owners and authorities, which Scope expects in Q2 2019.

Rating rationale

The two-notch upgrade of Eidsiva’s issuer rating reflects the higher expected share of EBITDA from monopolistic grid business, which involves a less competitive market and more predictable cash flow. This will result in an improved weighted average industry rating in accordance with Scope’s Utility Rating Methodology. Market dominance, customer diversification and efficiency will also improve as Eidsiva will become the largest Norwegian grid company after the transaction.

Scope estimates that the new entity will generate around 80% of Scope-adjusted EBITDA from monopolistic regulated grid operations, less than 10% each from broadband and district heating, and only a small percentage from power sales. Power production will be represented through the 42.8% minority interest in E-CO Energi AS and not consolidated into Eidsiva going forward, but will be a source of valuable dividends. Hafslund E-CO’s power plants in Hafslund Produksjon Holding are excluded from the transaction.

The financial risk profile of the new Eidsiva will improve slightly due to the lower leverage and stronger debt protection. The increase in new debt by NOK 3.3bn (plus operating leases from Hafslund Nett) will be compensated for by higher EBITDA. Scope-adjusted leverage is expected to average around 5x in the short to medium term, and debt protection to average around 6x. These expected improvements translate into better ratings, also because Scope’s rating methodology allows weaker credit metrics for utility companies with a very high share of regulated grid business.

Scope expects free cash flow generation in the new Eidsiva to be only marginally better, as extensive investment plans will negatively affect discretionary cash flow and necessitate external financing until 2020.

However, cash flow is expected to be more predictable and less volatile going forward, thereby bolstering the Scope-adjusted funds from operations/debt ratio.

The liquidity assessment is subject to some uncertainties around the maturity of new debt. Scope has assumed Eidsiva will fund this through a bank bridge loan, which will later be refinanced with new long-term bonds and bank loans.

Scope also affirms the one-notch uplift related to the ownership structure. The City of Oslo will become a new 50% owner in Eidsiva alongside the existing owners, represented through a new holding company, Innlandet Energi Holding AS. The new holding company gives a stronger impression that the old Eidsiva municipality owners constitute one group (but with less control), while the City of Oslo brings more capacity for potential financial support.

The Stable Outlook reflects Scope's view of the high likelihood that the transaction will receive a final, formal approval from the municipalities in May and from the relevant authorities subsequently and will be implemented as planned. The expectation is based on the recommendation from the boards and the pre-sounding and support the transaction has already achieved among relevant parties.

Further, the Outlook is based on Scope's expectation that the new entity will generate a significant part of EBITDA from monopolistic, regulated grid operations; continue to enjoy good access to both banks and bond markets; and see improved operating profitability and funds from operations in the short to medium term.

Rating-change drivers

A positive action could be warranted if the company started to report positive free cash flow or to sell assets with the effect of reducing overall leverage, exemplified by a Scope-adjusted leverage ratio of around 4x on a sustained basis.

A negative rating action could be triggered if the municipality owners rejected the transaction proposal at their annual general meetings. Although this scenario is remote in Scope's view, a rejection would result in the former BBB- issuer rating being reinstated. Further, Scope may lower the ratings upon a Scope-adjusted debt/EBITDA of well above 5.25x for a prolonged period and an interest cover ratio of below 5x.

Stress testing & cash flow analysis

No stress testing was performed. Scope performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for this rating and rating outlook (Corporate Rating Methodology 2019, European Utilities Methodology 2019, Government Related Entities 2018) are available on www.scoperatings.com.
Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scoperatings.com.
The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The rated entity and/or its agents participated in the rating process.
The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, the rated entitities' agents, third parties and Scope internal sources.
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Prior to the issuance of the rating or outlook action, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being

issued.

Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.
Lead analyst Henrik Blymke, Managing Director
Person responsible for approval of the rating: Olaf Tölke, Managing Director
The ratings/outlooks were first released by Scope on 08.12.2017. The ratings/outlooks were last updated on 20.11.2018.

Potential conflicts

Please see www.scoperatings.com for a list of potential conflicts of interest related to the issuance of credit ratings.

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Scope Ratings GmbH, Lennéstrasse 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Directors: Torsten Hinrichs, Guillaume Jolivet.

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Contact

Analyst	Henrik Blymke	h.blymke@scoperatings.com
Team leader	Olaf Tölke	o.toelke@scoperatings.com

Scope Ratings GmbH • Lennéstraße 5 • Phone: +49 30 27891-0 • Fax: +49 30 27891-0
www.scoperatings.com

Executive Board: Torsten Hinrichs • District Court: Berlin: HRB 192993 B • VAT identification number: