24 February 2022 Corporates

Eidsiva Energi AS
Norway, Utilities

SCOPE BBB+ STABLE

Corporate profile

Eidsiva Energi AS is the largest electricity grid company in Norway following the merger with Hafslund E-CO. Today, Eidsiva has more than 949,000 grid customers, serving almost 2m individuals through a grid network of more than 66,000 km. Activities in the group also include a growing district heating and broadband operation. Eidsiva holds a 42.8% stake in hydro power producer Hafslund E-CO Vannkraft AS (HEV) as an associated company. Eidsiva is fully owned by Norwegian municipalities, through Innlandet Energi Holding (49.4%), Åmot municipality (0.6%) and the City of Oslo (50% through Hafslund AS).

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
EBITDA/interest cover (x)	7.7x	7.4x	7.4x	8.5x
Scope-adjusted debt (SaD)/EBITDA (excl. dividends from HEV)	4.6x	9.3x	6.7x	5.0x
SaD/SaEBITDA (Incl. dividends from HEV)	4.1x	7.7x	5.0x	4.4x
Scope-adjusted funds from operations/SaD	20.9%	10.1%	17.3%	18.2%
Free operating cash flow/SaD	10.6%	-5.4%	-0.5%	1.2%

Rating rationale

Scope Ratings has affirmed the BBB+/Stable issuer rating on Eidsiva Energi AS along with the BBB+ senior unsecured debt rating and S-2 short-term debt rating.

The issuer rating of Eidsiva reflects the company's continued strong business risk profile and the prospect of an improved financial risk profile going forward. It also incorporates a one-notch uplift for the company's continued status as a government-related entity (GRE).

Even with growing operations within district heating and broadband, the company's business risk profile continues to be driven by a monopolistic position within regulated grids. The company operates in an area with a growing population and caters predominately to households. This creates stable and predictable cash flow as energy is not easily substituted even if prices increase.

The company's grid losses increased in the second half of 2021 due to record-high energy prices. Further, under the Norwegian system, excess losses can only be passed on to end-customers through tariff increases in the following years. As a result, the Scope-adjusted EBITDA at end-2021, at 26%, was slightly less than our projection (28%). Scope-adjusted EBITDA also includes the contribution from minority holding HEV, which had a good 2021 due to the record energy prices, showing the diversification benefit of the longstanding ownership. Finally, performance is expected to be strong once tariffs are increased.

Ratings & Outlook

Corporate issuer rating	BBB+/ Stable
Short-term debt rating	S-2
Senior unsecured debt rating	BBB+

Lead analyst

Michael-Marco Simonsen
+47 23 96 39 97
+47 94 43 50 34
m.simonsen@scoperatings.com

Related Methodologies

European Utility Methodology, March 2021

Corporate Rating Methodology, July 2021

Government Related Entities Methodology, May 2021

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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Liquidity ratios ended 2021 in line with our projections and are adequate. The company continues to extend its maturity profile, issuing five bonds since our last review. At YE 2021, the company had NOK 555m in cash and NOK 2.5bn in unused long-term credit lines, which can cover its short-term debt of around NOK 2bn. We expect the company to continue to roll over long-term financing and maintain a balanced maturity profile.

Stable Outlook

Outlook and rating-change drivers

The Stable Outlook continues to reflect the expectations that: i) monopolistic, regulated grid operations will continue to contribute the most to EBITDA; ii) leverage, as measured by Scope-adjusted debt (SaD)/SaEBITDA, will decrease below 5.25x into the medium term; iii) capital expenditures will remain high: iv) free operating cash flow will turn positive into the medium term; and v) Eidsiva will continue to be owned by Norwegian municipalities.

A positive action could be warranted by an improved financial risk profile, exemplified by a SaD/SaEBITDA sustained at around 4x due to improved free operating cash flow or asset disposals.

A negative rating action could be triggered by a weaker financial risk profile, exemplified by a SaD/SaEBITDA sustained at above 5.25x and interest coverage at below 5x. This could be due to higher capex and/or dividends than projected. The company losing its status as a government-related entity is another trigger for a negative rating action.

Rating drivers

Positive rating drivers	Negative rating drivers
• Norway's largest grid company, with significant EBITDA share from monopolistic power distribution • Long-term, supportive and committed municipality owners resulting in a one-notch uplift under the bottom-up approach of Scope's government-related entities methodology • Significant dividend income from 42.8% ownership in Norway's second largest hydro power producer, as well as profitable broadband and bioenergy businesses	• Ongoing sizeable investment phase, resulting in negative free operating cash flow and external funding requirements • Somewhat weak financial credit ratios expected in the short term • Sizeable and increasing dividend payout ratio despite high investment ambitions

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improved free operating cash flow or asset disposals, reducing SaD/SaEBITDA to around 4x on a sustained basis	• Weak financial risk profile for a prolonged period with a SaD/SaEBITDA of well above 5.25x and interest coverage of below 5x • Loss of status as a government-related entity

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
EBITDA/interest cover	7.7x	7.4x	7.4x	8.5x
Scope-adjusted debt (SaD)/EBITDA (excl. dividends from HEV)	4.6x	9.3x	6.7x	5.0x
Scope-adjusted debt (SaD)/SaEBITDA (Incl. dividends from HEV)	4.1x	7.7x	5.0x	4.4x
Scope-adjusted funds from operations/SaD	20.9 %	10.1 %	17.3 %	18.2 %
Free operating cash flow/SaD	10.6%	-5.4%	-0.5%	1.2%
Scope-adjusted EBITDA in NOK m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	3,095	1,811	2,635	3,747
Operating lease payments in respective year	0	0	0	0
Dividends received from HEV	369	380	900	500
Scope-adjusted EBITDA	**3,464**	**2,191**	**3,535**	**4,247**
Scope-adjusted funds from operations in NOK m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	3,095	1,811	2,635	3,747
less: (net) cash interest as per cash flow statement	-450	-296	-477	-502
less: cash tax paid as per cash flow statement	-3	-289	13	-362
add: depreciation component, operating leases	0	0	0	0
Other items (inc. dividends from HEV)	359	485	900	500
Scope-adjusted funds from operations	**3,001**	**1,711**	**3,070**	**3,384**
Scope-adjusted debt in NOK m	**2020**	**2021**	**2022E**	**2023E**
Reported gross financial debt	16,700	17,405	18,392	19,674
less: cash and cash equivalents	-2,454	-555	-698	-1,097
add: cash not accessible	50	57	57	57
add: pension adjustment	43	0	0	0
Scope-adjusted debt	**14,339**	**16,907**	**17,751**	**18,634**

Full-year 2021 result slightly below projections

Eidsiva ended FY 2021 with credit metrics slightly below our projections. The main reason was the higher-than-expected financial impact from grid losses due to record-high energy prices because power disappears as operators transport energy from producers to the end-customers (mainly households in Eidsiva's case).

Extraordinarily high power prices

The record energy prices are largely due to the limited ability to efficiently transport power from the north of Norway to the south. Furthermore, energy exports from southern Norway to the UK and Germany have increased. These factors, coupled with a dry winter in the south, resulted in the record energy prices in Eidsiva's grid concession area.

Business risk profile continues to be driven by regulated grid operations

The grid losses resulted in a lower relative EBITDA contribution from grid operations in 2021. Despite this, Eidsiva's business risk profile remains strong, driven by its monopolistic position in regulated grids. Looking at the five-year average EBITDA contribution by segment, grid operations still dominates with 68%. Furthermore, we project a further increase once the company increases its tariffs from 2022.

Grid efficiency rating of 111% for FY 2021

Eidsiva's operations have been stable and developed well, with a good grid efficiency rating of 111% for 2021. Furthermore, both district heating and broadband operations were profitable in 2021 – the former helped by the increased prices and the latter by an increase in customer numbers and in the average usage per user due to Covid-related restrictions.

Liquidity ratios in 2021 were in line with our projections and are adequate. The company refinanced a NOK 2.5bn revolving credit facility and issued five bonds since our last review. The revolving credit facility consists of two tranches with different maturities, but we consider it likely that the company will carry out an option to have both tranches mature together in 2026.

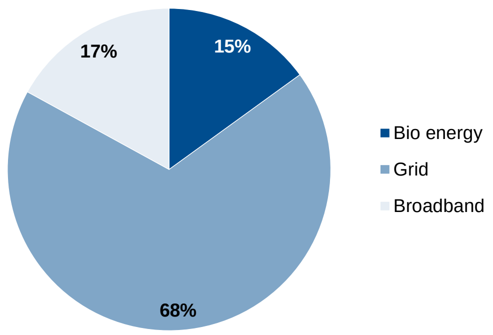
Ratings for business and financial risk profiles remain unchanged

Summary of business and financial risk profiles

We continue to assess Eidsiva's business risk profile at A. We do not expect any changes in the company's fundamental long-term earnings and profitability. The company operates in an area with almost 2m inhabitants and its position is protected by the Norwegian grid concession system. We expect profitability to recover and even surpass the historical average with the increase in tariffs in 2022 and in dividend income from HEV helped by the high energy prices.

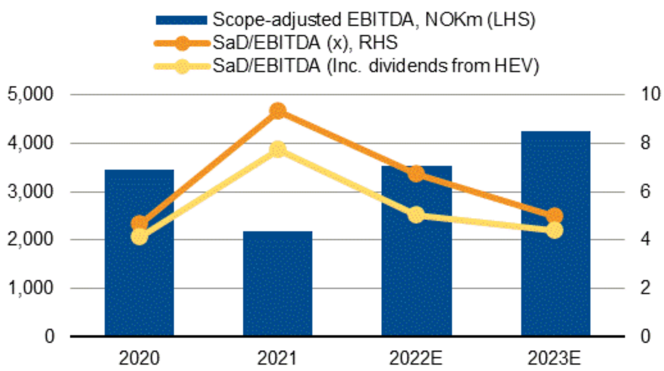
The financial risk profile also remains at BB. This is because we previously forecasted slightly weaker metrics for 2021 following the low energy prices in 2020 (affecting potential dividends from HEV), high capex and substantial dividends paid to the municipal owners. Although the actual 2021 credit metrics were slightly weaker than projected, we now project a quicker deleveraging going forward.

Figure 1: Five-year average EBITDA contribution per segment



Source: Scope estimates / company annual accounts

Figure 2: Scope-adjusted leverage development



Source: Scope estimates

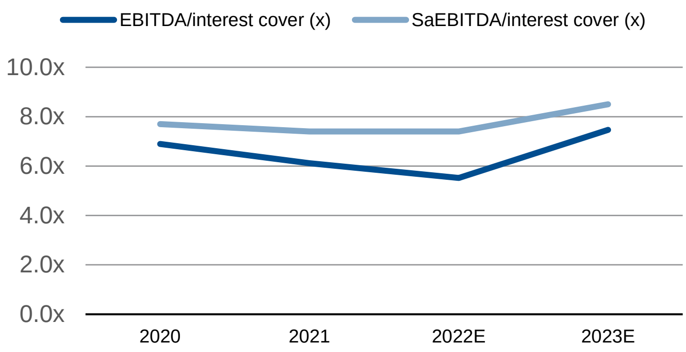
Updated Scope forecast

Forecast a major boost to profitability in 2022/2023

Our updated forecast still expects substantial levels of capex and dividend paid. This is based on historical investments in grid capital as well as Eidsiva's municipal owners needing to cover the increased costs due to Covid-19. We continue to project an improvement in SaD/SaEBITDA to 5x by 2023, but at a faster rate than in our last review, based primarily on our view that the increased tariffs will provide a major boost to profitability in 2022/2023. We also expect HEV to contribute even more than in our original expectation.

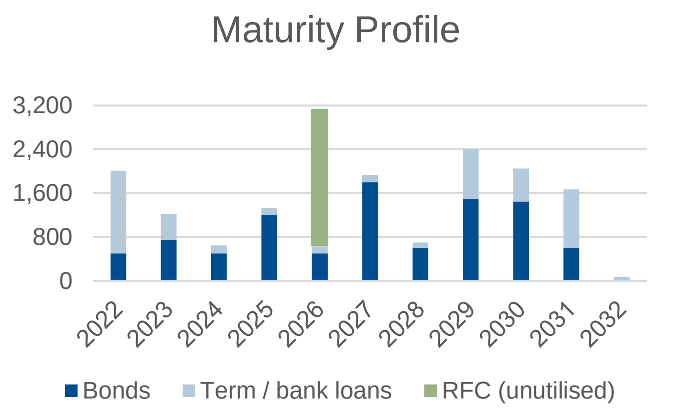
Refinancing needs are expected to be lower going forward. We still expect the company to refinance yearly, primarily through long-term issues such as senior unsecured bonds (green or normal), based on our projection of negative discretionary cash flows of NOK -1.7bn over the next two years. The company's green bond issues in early 2022 were very well received by the market, which shows the company's ability to source funds. Finally, we project the interest coverage ratio to stay above 7x going forwards, in line with our former expectations.

Figure 3: EBITDA interest cover (excl. & incl. HEV dividends)



Source: Scope estimates

Figure 4: Maturity profile (in NOKm) at YE 2021 (excl. leasing)



Source: Scope estimates

One notch uplift based on governmental ownership

Supplementary rating drivers

We continue to use our bottom-up approach to analyse Eidsiva's parent support, and the one-notch uplift assigned for municipality ownership has not changed.

Eidsiva's financial policy is prudent and requires no rating adjustment. Our new projections assume no structural transactions, but we note that the company is still open to participating in the consolidation of the Norwegian utility sector. We consider these strategic ambitions in the context of management's dedication to maintaining its financial strength and thus its desire to protect its investment grade rating.

Long-term and short-term debt ratings

All debt is issued by Eidsiva Energi AS, and the affirmation of the BBB+ senior unsecured debt rating is in line with the issuer rating. This is based on the company's standard bond documentation, which includes a pari passu and negative pledge.

The S-2 short-term debt rating has also been affirmed, reflecting the solid short-term debt coverage and continued good access to both bank loans and debt markets.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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