Credit Rating Announcement

24 January 2024

Scope upgrades issuer rating of Norwegian utility Eidsiva to A-/Stable from BBB+/Stable

The upgrade is driven by the improved financial risk profile enabled by a stronger-than-expected performance, continued robust cash flows from its grid operation and cash dividends from Hafslund ECO Vannkraft.

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope Ratings GmbH (Scope) has today upgraded the issuer rating of Norwegian grid operator Eidsiva Energi AS to A- from BBB+ and affirmed its Stable Outlook. Concurrently, the senior unsecured debt rating has been upgraded to A- from BBB+, whilst the short-term debt rating has been upgraded to S-1 from S-2.

Rating rationale

The rating upgrade is attributed to Scope's assessment of Eidsiva's stronger-than-anticipated financial risk profile, which is likely to persist based on continued good performance in its regulated grid operations and sizeable cash dividends from its ownership in hydro power generator Hafslund Eco Vannkraft (HEV) (positive ESG factor). This will provide ample cash flows to pursue relatively high grid investments and dividend payments while keeping leverage at moderate levels, as exemplified by Scope-adjusted debt/EBITDA projected around 3.5x in the medium term. While cash dividends from HEV are subject to volatility and external factors such as achievable power prices in the generator's price region, Scope remains comfortable assessing the financial risk profile at BBB-, up from BB. The business risk profile remains at A, underpinned by Eidsiva's dominant position as Norway's largest distribution system operator (DSO). Additionally, the company holds strong positions in its remaining business segments, including district heating and broadband. Scope considers Eidsiva’s issuer rating to be aligned with an A- rating, including a one-notch uplift considering its status as a government-related entity. The Stable Outlook reflects Scope's belief that leverage will remain around 3.5x in the medium term.

The financial performance of Eidsiva in 2022 was shaped by unprecedented shifts in market conditions as well as changes in regulatory frameworks. For Eidsiva, the surging power prices led to a sharp increase in costs to cover grid losses as well as higher operational costs. Despite rising costs, Eidsiva opted to delay tariff adjustments to mitigate the burden on Norwegian households. Consequently, the company’s profitability was at a record low at H2 2022, when the Norwegian government and the Norwegian transmission service operator (Statnett SF) put in place a temporary scheme to alleviate the pressure on Norwegian grid operators: tariffs imposed by Statnett on local grid operators were reduced and congestion income was directly transferred from Statnett to local grid operators to compensate for the inflated costs[1]. As the largest DSO in Norway, Eidsiva greatly benefited from this scheme and ended the year on a stronger note than expected in Scope's last rating review.

As of Q3 2023 power prices were substantially lower than for the same period in 2022. This impacted Eidsiva directly through lower profitability in district heating and indirectly through reduced earnings in HEV. In addition, transfers of congestion income from Statnett were also 50% lower than for the same period last year. In parallel, the grid business benefited from lower costs associated to grid losses, lower overhead costs, and improved cost coverage as 2021/22's cost levels, higher interest rates, higher inflation, all were incorporated in the state set revenue cap and allowed rate of return calculation. Consequently, the company's grid business reported a strong EBITDA margin of 42% at Q3 2023 (21% at Q3 2022).

In addition, the remaining segments delivered EBITDA margins around 40% and contributions from HEV were already above 2022 levels, as HEV's profits in 2023 were less impacted by legacy hedges and fair value adjustments than for the same period in 2022. Consequently, Eidsiva reported an EBITDA margin of 67% at Q3 2023 (40% if income associated companies was excluded).

A long-term loan given to HEV by Eidsiva of NOK 2.0bn was repaid in April 2023. This repayment resulted in a corresponding reduction in "other financial fixed assets" on the company's balance sheet. Scope believes it is highly probable that Eidsiva will distribute a portion of the repayment proceeds to its shareholders. Additionally, Scope anticipates that Eidsiva will utilise the remaining proceeds to reduce its net interest-bearing debt, either through debt repayment or the accumulation of additional cash reserves.

Going forward, Scope anticipates that Eidsiva's income will rise, driven by sustained high investments in grid capital and the inclusion of recent years' higher-than-historical cost levels in the state's revenue cap calculation. Further, Scope expects that Eidsiva's profitability will improve in the medium term due to the following factors: i) Transfers of congestion income from the Norwegian TSO in 2023, ii) Improved cost coverage, iii) Continued higher-than-historical power prices, resulting in higher-than-historical cash dividends from HEV, and iv) Synergies realised upon completion of a larger IT project in 2023.

However, some factors are expected to negatively impact EBITDA: i) No transfers of congestion income from the Norwegian TSO for 2024 and 2025, ii) Inflationary pressure on wages and other operational expenses, and iii) Continued higher-than-historical power prices, leading to higher-than-historical grid losses and service costs.

In conclusion, Scope expects EBITDA margin adjusted for dividends from associated companies (HEV) to increase towards 38% in the medium term, compared to 30% in 2022 and 35% on average historically. Reported EBITDA margins are expected to peak at 56% in 2023E before decreasing to 44% in the medium term, driven by higher-than-historical but decreasing income from HEV.

Scope assumes continued investments of approximately NOK 3bn per year, dividends in line with the company's stated dividend policy, robust cash flows generated by Eidsiva's grid operations, and still significant, albeit declining, cash dividends from HEV. This results in a forecasted reduction in leverage from 3.7x in 2022 to 3.3x in 2023E, followed by a slight increase to around 3.5x in the medium term.

The company's projected interest coverage ratio will likely weaken from 11.4x in 2022 to 7.5x in 2023E, before reaching a low of 5.8x in 2024E. This decline is primarily attributed to the loss of substantial interest income following the repayment of the previously mentioned loan to HEV. Additionally, rising interest rates will impact the portion of the company's financing that is floating rate (five out of 19 bonds).

Eidsiva's liquidity remains adequate, with NOK 3.5bn in committed credit facilities and NOK 3.4bn in cash reserves compared to NOK 2.8bn in short term debt as of Q3 2023.

Regarding supplementary rating drivers, Scope continues to apply its bottom-up approach for government-related entities to analyse Eidsiva's parental support and maintains the one-notch uplift assigned for its Norwegian municipality ownership.

One or more key drivers for the credit rating action are considered ESG factors.

Outlook and rating-change drivers

The Stable Outlook reflect Scope's expectation that i) monopolistic, regulated grid operations will continue to contribute the most to EBITDA; ii) leverage remains around 3.5x on a sustained basis; iii) capital expenditure will remain high in the medium term; and iv) Eidsiva will remain municipality owned.

A positive action could be triggered by an improving financial risk profile, exemplified by Scope-adjusted debt/EBITDA sustained significantly below 3.0x, thanks to improved free operating cash flow and/or asset disposals.

A negative rating action could be triggered by a weakening financial risk profile, exemplified by Scope-adjusted debt/EBITDA sustained above 5.0x, which could be due to lower than-expected power prices, higher-than-expected capex and/or extraordinary dividend payments. The loss of its government-related entity status could also trigger a negative rating action albeit deemed remote.

Long-term and short-term debt ratings

All debt is issued by Eidsiva Energi AS.

The rating on senior unsecured debt has been upgraded to A-, in line with the issuer rating.

Scope has also upgraded the short-term debt rating to S-1, reflecting the underlying issuer rating of A-/Stable, sufficient short-term debt coverage and good access to both bank and bond financing.

1. https://www.regjeringen.no/no/aktuelt/pressemelding-flaskehalsinntekter/id2942438/

Stress testing & cash flow analysis

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

Methodology

The methodologies used for these Credit Ratings and/or Outlook, (General Corporate Rating Methodology, 16 October 2023; European Utilities Rating Methodology, 17 March 2023; Government Related Entities Rating Methodology, 13 July 2023), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. 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 Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity and Scope Ratings' internal sources.

Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings and/or Outlook were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.

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The Credit Ratings/Outlook were first released by Scope Ratings on 8 December 2017. The Credit Ratings/Outlook were last updated on 25 January 2023.

Potential conflicts

See www.scoperatings.com under Governance & Policies/Regulatory for a list of potential conflicts of interest disclosures related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

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