

# Østfold Energi AS

## Kingdom of Norway, Utilities



### Key metrics

Scope credit ratios	2021	2022	Scope estimates	
			2023E	2024E
Scope-adjusted EBITDA/interest cover	18.8x	160.4x	96.0x	57.5x
Scope-adjusted debt/EBITDA	0.3x	Net cash	Net cash	0.3x
Scope-adjusted funds from operations/debt	367%	Net cash	Net cash	91%
Scope-adjusted free operating cash flow/debt	350%	Net cash	Net cash	19%

### Rating rationale

The rating reflects a standalone credit assessment of BBB and a one-notch uplift based on our assessment of parent support from Østfold Energi's Norwegian municipal owners.

The standalone credit assessment reflects the main exposure to low-cost, flexible and environmentally friendly hydropower production (positive ESG factor) in southern Norway. It also reflects the strong financial profile with low Scope-adjusted leverage and good internal financing capacity. The assessment is constrained by low diversification in terms of utility segments and power generation assets compared to larger and more integrated peers. It is also largely held back by the cyclical operating environment with exposure to volatile power prices for unhedged production output.

### Outlook and rating-change drivers

The Stable Outlook reflects our expectation of the supportive power prices in southern Norway continuing in the next years, albeit at lower levels than in 2022 and H1 2023. Overall, we forecast Østfold Energi's Scope-adjusted debt/EBITDA ratio to remain below 1.0x in the next two years. The Outlook also assumes no major changes to Østfold Energi's core business composition or financial policy in addition to continued majority municipal ownership. It also incorporates a large leverage headroom for the current rating.

A positive rating action could be warranted by a sustained net cash position, or alternatively, by improved diversification as exemplified by reduced asset concentration.

A negative rating action may be taken if a return to a higher net debt position became likely, as exemplified by a Scope-adjusted debt/EBITDA ratio sustained above 2.5x. This could be driven by lower-than-expected power prices and/or increased investment ambitions. A loss of the government-related entity status (a remote likelihood) could also cause ratings pressure.

### Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
10 Nov 2023	Initial rating	BBB+/Stable

### Ratings & Outlook

Issuer	BBB+/Stable
Short-term debt	S-2
Senior unsecured debt	BBB+

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### Related Methodologies

General Corporate Rating Methodology; October 2023

European Utilities Rating Methodology; March 2023

Government Related Entities Methodology; July 2023

### Related Research

European utilities: continued electricity price hedging promises producer gain, consumer pain, Apr 2023

Nordic utilities: north-south price gap benefits southern generators; TSOs also gain, Nov 2022

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## Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none"><li>• Low-cost, flexible and environmentally friendly hydropower generation (positive ESG factor) with high water reservoir capacity</li><li>• Strong financial profile reflecting low leverage and good internal financing capacity</li><li>• High profitability as measured by EBITDA margin and Scope-adjusted ROCE</li><li>• Hedging policy which helps to mitigate some exposure to industry inherent volatility</li><li>• Long-term committed municipal owners with capacity and willingness to provide potential parent support</li></ul>	<ul style="list-style-type: none"><li>• Exposure to volatile power prices for unhedged power production volumes</li><li>• Asset concentration risk with most production output coming from only two hydropower plants – albeit partially mitigated by:<ul style="list-style-type: none"><li>○ insurance covering property damage and a two-year standstill period</li><li>○ no cumulative standstill risk since the plants are operationally independent</li></ul></li><li>• Limited diversification by utility segments and geographical pricing market</li><li>• Increased investments in the next years involving some execution risk related to growth projects</li></ul>
Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"><li>• Sustained net cash position</li><li>• Improved diversification, as exemplified by reduced asset concentration</li></ul>	<ul style="list-style-type: none"><li>• Scope-adjusted debt/EBITDA sustained above 2.5x</li><li>• Loss of GRE status (remote)</li></ul>

## Corporate profile

Østfold Energi is a Norwegian utility owned by Viken county municipality (45%) and 13 municipalities within the former Østfold county municipality. Its main activity is hydropower generation in southern Norway where it owns and operates mostly flexible hydro plants with annual mean production of 1.6 TWh and 0.8 TWh of water reservoir capacity. The company also owns 50% of Siso Energi<sup>1</sup> and is engaged in district heating, wind and solar activities.

<sup>1</sup> Siso Energi is owned equally by Østfold Energi and Salten Kraftsamband. It operates two hydropower plants in northern Norway with annual mean production of around 1.1 TWh.



## Financial overview

	2020	2021	2022	Scope estimates		
Scope credit ratios	2020	2021	2022	2023E	2024E	2025E
Scope-adjusted EBITDA/interest cover	3.5x	18.8x	160.4x	96.0x	57.5x	33.9x
Scope-adjusted debt/EBITDA	5.2x	0.3x	Net cash	Net cash	0.3x	0.6x
Scope-adjusted funds from operations/debt	-10%	367%	Net cash	Net cash	91%	63%
Scope-adjusted free operating cash flow/debt	-15%	350%	Net cash	Net cash	19%	5%
<b>Scope-adjusted EBITDA in NOK m</b>						
EBITDA	164	802	2,072	981	861	886
Other items <sup>2</sup>	12	37	72	33	33	33
<b>Scope-adjusted EBITDA</b>	<b>175</b>	<b>839</b>	<b>2,144</b>	<b>1,014</b>	<b>894</b>	<b>919</b>
<b>Funds from operations in NOK m</b>						
Scope-adjusted EBITDA	175	839	2,144	1,014	894	919
less: (net) cash interest paid	(46)	(42)	(10)	(8)	(13)	(24)
less: cash tax paid per cash flow statement	(175)	(22)	(432)	(1,397)	(625)	(509)
Other items	(42)	72	61	(125)	(15)	(14)
<b>Funds from operations (FFO)</b>	<b>(88)</b>	<b>848</b>	<b>1,762</b>	<b>(516)</b>	<b>241</b>	<b>372</b>
<b>Free operating cash flow in NOK m</b>						
Funds from operations	(88)	848	1,762	(516)	241	372
Change in working capital	(4)	30	20	-	-	-
less: capital expenditure (net)	(46)	(68)	(184)	(180)	(190)	(340)
<b>Free operating cash flow (FOCF)</b>	<b>(138)</b>	<b>810</b>	<b>1,598</b>	<b>(696)</b>	<b>51</b>	<b>32</b>
<b>Net cash interest paid in NOK m</b>						
Net cash interest per cash flow statement	46	42	10	8	13	24
Interest expense on pensions	2	2	2	2	2	2
Interest component, operating leases	1	1	1	1	1	1
Change in other items	-	-	-	-	-	-
<b>Net cash interest paid</b>	<b>50</b>	<b>45</b>	<b>13</b>	<b>11</b>	<b>16</b>	<b>27</b>
<b>Scope-adjusted debt in NOK m</b>						
Reported gross financial debt	1,178	849	425	425	425	525
less: cash and cash equivalents	(339)	(718)	(1,700)	(569)	(258)	(33)
add: non-accessible cash	10	54	52	52	52	52
add: pension adjustment	57	46	48	48	48	48
Other items	-	-	-	-	-	-
<b>Scope-adjusted debt</b>	<b>906</b>	<b>231</b>	<b>(1,175)</b>	<b>(44)</b>	<b>266</b>	<b>591</b>

<sup>2</sup> Dividends from associated companies (e.g. Siso Energi, Kvalheim Kraft DA, and Zephyr)

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**Environmental, social and governance (ESG) profile<sup>3</sup>**

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

**Legend**

- Green leaf (ESG factor: credit positive)
- Red leaf (ESG factor: credit negative)
- Grey leaf (ESG factor: credit neutral)

**Business model built around sustainable energy generation**

Østfold’s business model has a clear focus on sustainability as it is mainly exposed to hydroelectric power generation. This is highlighted by a far below-average carbon intensity in a European context of around 9g CO2e/kWh, placing it favourably in the EU taxonomy.

**Green bond framework attaining highest rating from Cicero**

Østfold Energi focuses its growth investments on sustainable areas such as hydropower, wind and solar. The company has a well-integrated ESG framework with public sustainability reports and a green financing framework, including an ESG Second Party Opinion from Cicero with the highest possible rating of Dark Green.

**No governance issues**

The company applies governance principles as recommended by Norwegian market standards and we did not observe any negative credit-relevant factors pertaining to corporate governance.

<sup>3</sup> These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity’s cash flow and, by extension, its credit quality.

**Business risk profile: BBB-**

**Blended industry risk profile: BB**

As an almost pure-play hydropower producer, Østfold Energi's industry risk is characterised by high cyclicalities since its financial performance is closely linked to achievable power prices, which can vary significantly from year to year. Its quasi-regulated district heating business is more stable with high entry barriers but contributes less to overall Scope-adjusted EBITDA and operating cash flow.

Segment	Industry risk	Normalised exposure
Unregulated generation	BB	98%
District heating	A	2%
<b>Blended industry risk</b>	<b>BB</b>	

**Directly owned mean annual hydropower production of about 1.6 TWh**

Østfold Energi has an annual mean hydropower production of about 1.6 TWh in southern Norway from directly owned hydro plants. In addition, it owns 50% of Siso Energi, which operates two hydro plants in northern Norway with a mean annual production of around 1.1 TWh. However, dividends from Siso Energi only amount to about NOK 20m yearly, which reduces the impact on the business risk assessment.

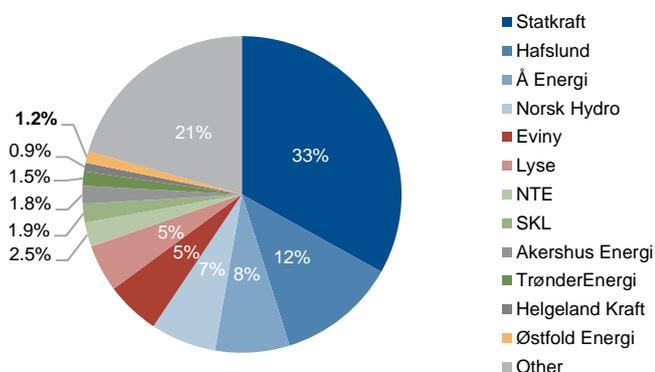
**Most credit-supportive position in merit order**

The company is a small power producer in Norway by market share (Figure 1). Nevertheless, Østfold Energi's low-cost and flexible hydro plants are placed in the most credit-supportive part of the merit order, which is more important than size for the market position of a power utility. Production flexibility is enhanced by water reservoir capacity of 0.8 TWh, equivalent to around 50% of annual mean production. Having water reservoirs also reduces exposure to volume risk in dry hydrological years versus peers with mainly run-of-river power plants.

**Ability to capture stronger prices due to flexible production**

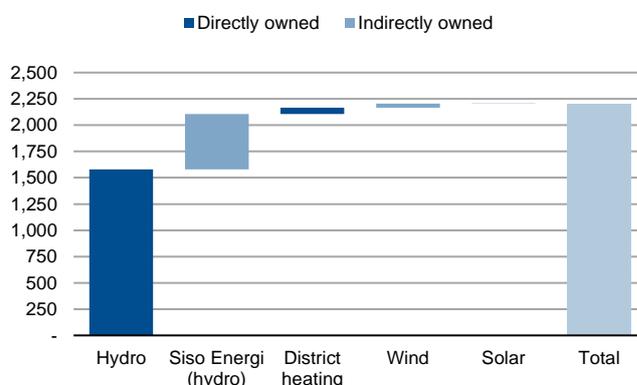
Since the company can provide electricity when supply is constrained, such as in peak-load hours or periods with low output from intermittent capacities, it can capture stronger prices. In recent years, Østfold Energi has achieved prices that were about 6%-8% higher than spot prices. Flexible generation capacity will likely become more valuable going forward as there is an increasing share of intermittent production (e.g. wind and solar) in the Nordic and European energy mix.

**Figure 1: Normalised market shares in Norwegian hydropower production**



Sources: NVE, Scope

**Figure 2: Østfold Energi's mean annual energy production by source and type of ownership, GWh**



Sources: Østfold Energi, Scope

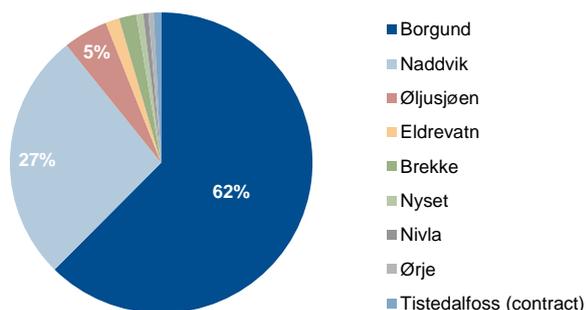
**Most production capacity in one regional bidding zone**

Excluding Siso Energi, around 97% of Østfold Energi's hydropower production is located within the NO5 bidding zone. The concentration on a single bidding zone is seen partly balanced by interconnectors to the UK and continental Europe from the NO2 bidding zone, as it gives southern Norway more exposure to electricity prices in foreign markets.

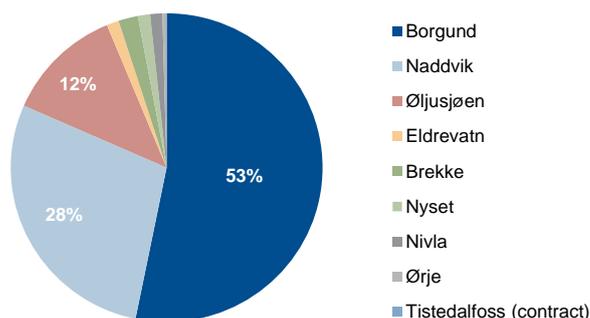
**Less diversified than larger and more integrated peers**

Most of operating cash flow is generated from only two hydropower plants, Borgund and Naddvik, which contribute around 90% of mean annual production. This asset concentration is partially reduced by insurance that cover property damage and a standstill period of up to two years. In addition, there is no cumulative standstill risk as the plants are operationally independent of each other.

**Figure 3: Mean annual output of directly owned hydro production by power plant**



**Figure 4: Installed capacity of directly owned hydro production by power plant**



Sources: Østfold Energi, Scope

Sources: Østfold Energi, Scope

**Annual district heating volumes of about 60 GWh**

In district heating, the company has six plants located in its concession areas of Rakkestad, Eidsberg and Sarsborg. The sales volume in district heating was 60 GWh in 2022. Customers are primarily public-sector entities or companies.

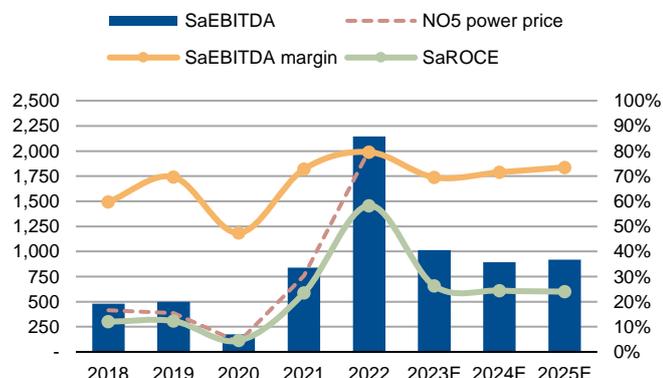
**Wind and solar activities**

Østfold Energi is also engaged in wind and solar activities through ownership in associated companies, including Kvalheim Kraft DA, Zephyr, Solgrid and Soleie. While the company has plans to invest in new wind and solar capacity, we expect hydropower to contribute most towards its target of developing 150 GWh of increased renewable energy production by 2027.

**Strong profitability**

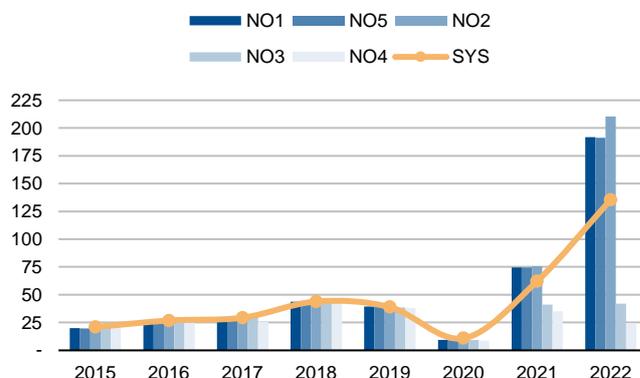
Strong profitability is a strength in Østfold Energi's business risk profile. The company's production has a low operating cost of close to NOK 0.10/kWh in addition to limited maintenance costs. As a result, the company's operations should remain cash flow positive also in adverse low-price scenarios. We expect the consolidated group EBITDA margin to stay around 70% with relatively low volatility due to the low absolute cost base, which is volume-dependent to some extent. Scope-adjusted return on capital employed is more volatile as there is no revenue component, illustrating the exposure of absolute EBITDA to achieved power prices. In terms of stability, we view positively the company's hedging policy with defined minimum shorter-term hedging levels of after-tax cash flow.

**Figure 5: Scope-adjusted EBITDA (NOK m, LHS) and NO5 power price (NOK/MWh, LHS) versus EBITDA margin and return on capital employed (RHS)**



Sources: Østfold Energi, Nordpool, Scope (estimates)

**Figure 6: Norwegian power prices by bidding zone versus Nordic system price (EUR/MWh)**



Sources: Nordpool, Scope

### Financial risk profile: A

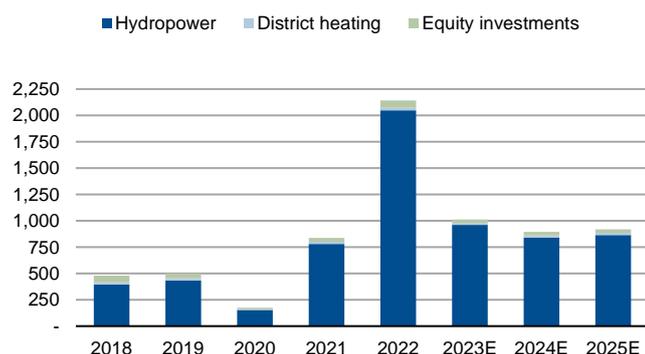
#### Strong financial risk profile

The standalone credit assessment is supported by a strong financial risk profile, reflecting low leverage and good internal financing capacity with low mandatory maintenance capex. We note positively the company's track record of keeping overall conservative credit metrics which together with the established hedging framework gives a buffer to handle the volatility of power prices.

#### Adjustments

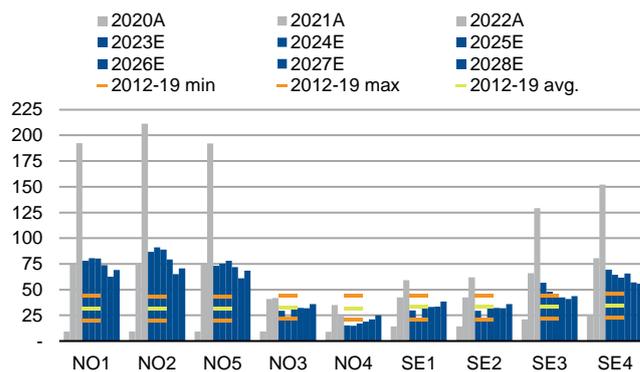
In terms of adjustments and calculation of credit metrics, Scope-adjusted EBITDA include recurring dividends received from the company's ownership stakes in Siso Energi, Kvalheim Kraft DA and Zephyr.

**Figure 7: Scope-adjusted EBITDA by source, NOK m**



Sources: Østfold Energi, Scope (estimates)

**Figure 8: Simulated 2023-2028 power prices by Statnett versus historical levels, EUR/MWh (not Scope's forecast)**



Sources: Nordpool, Statnett's 2023-2028 short-term market analysis from September 2023, Scope

#### Continued supportive power prices in the NO5 regional market

We assume continued higher power prices than historically of around EUR 70/MWh in the NO5 and NO1 bidding zones during 2024-2025, which compares to a historical average over 2012-2019 of around EUR 30/MWh. We also note that recent analysis from various bodies, including Statnett (figure 8), indicates that the pricing environment could remain supportive also beyond 2025. Additionally, our 2023-2025 base case assumes:

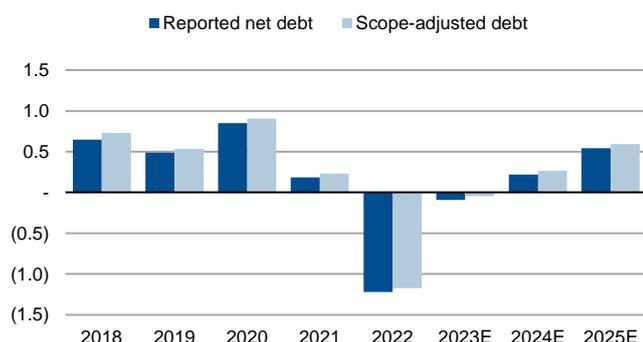
- Power generation volumes in line with mean annual production
- Maintenance capex of NOK 50m-70m yearly

- Growth capex of NOK 130m-270m yearly, of which a large part for the construction of Gravdalen, a hydropower plant scheduled to be completed in 2027 with annual production of around 55 GWh
- Business acquisitions of NOK 80m-200m yearly, mostly through investments in associated companies involved in wind and solar activities
- Dividends received from associated companies of NOK 33m per year, mainly from Siso Energi and Zephyr
- Ordinary dividends in line with payout policy of 65% of net income and no extraordinary payouts

**Leverage headroom to be partially used for growth investments**

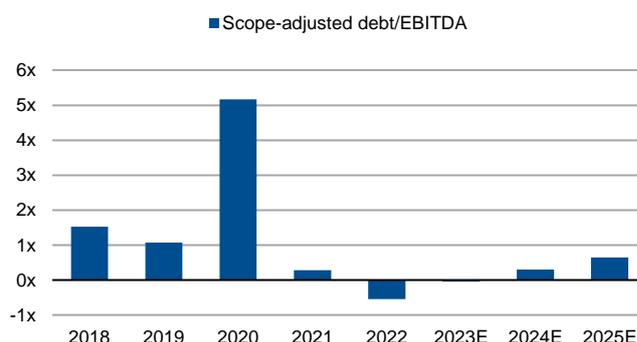
Enabled by high power prices, the company reduced its gross debt during 2021-2022 and net debt is forecast to be around zero at year-end 2023. Driven by continued higher power prices than historically in southern Norway, we expect financial results to remain strong with annual Scope-adjusted EBITDA of NOK 0.9bn-1.0bn in 2023-2025. The company is expected to partially deploy its strong balance sheet and leverage headroom for growth investments while maintaining its dividend policy. This will likely lead to a higher but still low leverage, with the Scope-adjusted debt/EBITDA ratio estimated to remain below 1.0x.

**Figure 9: Indebtedness, NOK bn**



Sources: Østfold Energi, Scope (estimates)

**Figure 10: Leverage development**

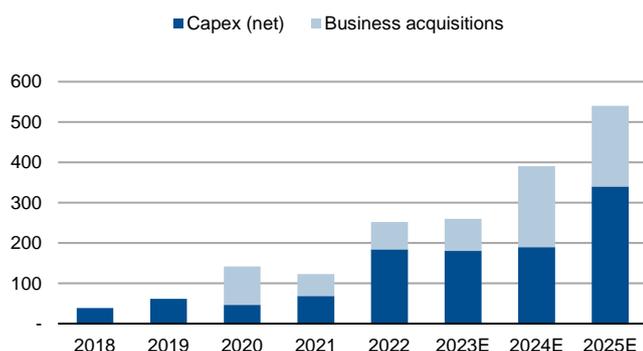


Sources: Østfold Energi, Scope (estimates)

**Good internal financing capacity**

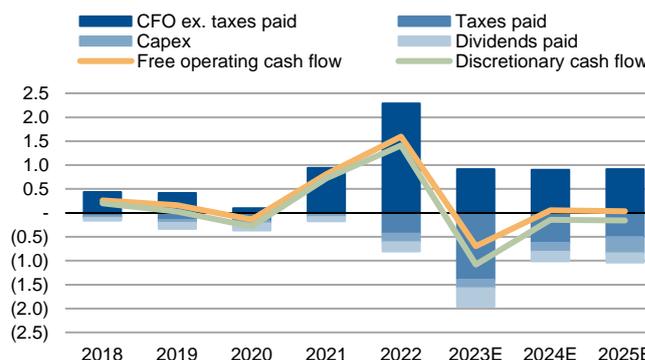
Based on an average Scope-adjusted free operating cash flow of NOK 276m over 2020-2025, the company is considered to have good internal financing capacity, as measured by the Scope-adjusted free operating cash flow/debt ratio. During 2022-2023, volatility in free operating cash flow is largely caused by periodisation of tax payments.

**Figure 11: Development in investment level, NOK m**



Sources: Østfold Energi, Scope (estimates)

**Figure 12: Cash flow profile, NOK m**



Sources: Østfold Energi, Scope (estimates)

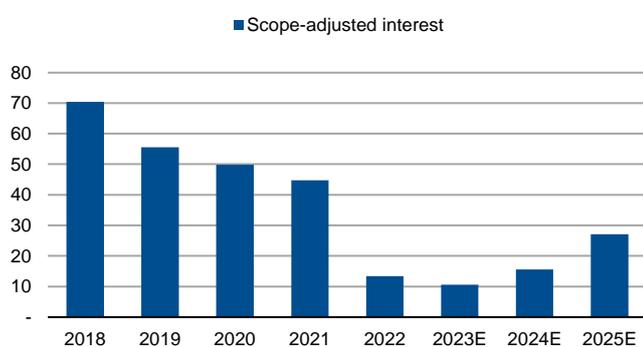
**Solid debt protection**

Scope-adjusted EBITDA interest cover is expected to remain very strong at levels of above 30x towards 2025.

**Adequate liquidity**

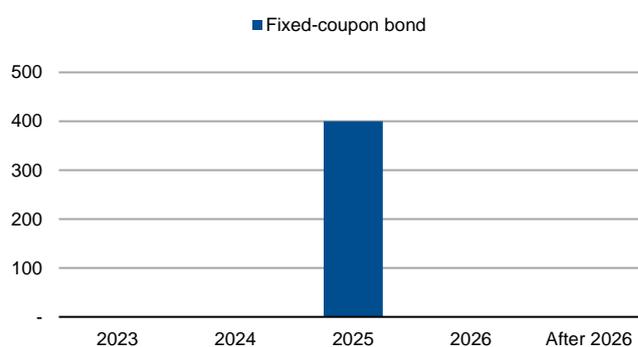
Liquidity is adequate. The company's gross debt only comprise one NOK 400m fixed-coupon bond maturing in Q3 2025. This compares to a total cash position (including short-term liquid investments) of NOK 433m at H1 2023. In addition, the company has an undrawn committed credit line of NOK 250m and a back-stop facility of NOK 500m with expiry in Q1 2024, which are expected to be extended. If needed, Østfold Energi also has wide access to funding sources such as bonds, bank debt, and potentially shareholder loans, which can provide additional external liquidity.

**Figure 13: Development in net interest paid, NOK m**



Sources: Østfold Energi, Scope (estimates)

**Figure 14: Debt maturity profile as of Q3 2023, NOK m**



Sources: Østfold Energi, Scope

Balance in NOK m	2022	2023E	2024E
Unrestricted cash (t-1)	664	1,648	516
Open committed credit lines (t-1)	250	250	250
Free operating cash flow	1,598	(696)	51
Short-term debt (t-1)	410	0	0
<b>Coverage</b>	<b>613%</b>	<b>No ST debt</b>	<b>No ST debt</b>

**Supplementary rating drivers: +1 notch**

**Prudent financial policy**

Østfold Energi's financial policy has no credit impact. The company has a dividend policy of paying out 65% of net profit and a goal of maintaining an investment grade credit rating.

**Change in municipal owners from 1 January 2024**

In terms of structure, Viken county municipality will be divided into three new county municipalities (Østfold, Akershus, and Buskerud) from 1 January 2024. Subsequently, Østfold county municipality will take over Viken's 45% ownership in Østfold Energi.

**One-notch uplift for parent support**

The issuer rating incorporates a one-notch uplift to the standalone credit assessment of BBB considering the company's status as a government-related entity. We have applied the bottom-up approach using the framework outlined in Scope's Government Related Entities Methodology. The conclusion of a one-notch uplift reflects the public sponsor's 'high' capacity and 'medium' willingness to provide support. In addition to Østfold Energi's importance in the policy objectives of its owners, we note that hydropower generation assets in Norway are required by law to be at least two-thirds owned by the state or municipalities. The rating uplift is in line with other Scope-rated Norwegian utilities with majority or full public ownership but no explicit guarantees on their debt or financial support.



### **Long-term and short-term debt ratings**

**Senior unsecured debt rating:**  
**BBB+**

Senior unsecured debt has been assigned a BBB+ rating, the same level as the issuer rating. Østfold Energi's outstanding NOK 400m senior unsecured bond display standard bond documentation, including pari passu and a negative pledge.

**Short-term debt rating: S-2**

The short-term debt rating of S-2 is based on the underlying BBB+/Stable issuer rating and reflects robust short-term debt coverage as well as good access to external funding from banks and debt capital markets.



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