3 July 2023 | Corporates

Helgeland Kraft AS
Kingdom of Norway, Utilities

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	7.8x	6.1x	6.1x	5.4x
Scope-adjusted debt/EBITDA	4.0x	4.5x	3.2x	4.1x
Scope-adjusted FFO/debt	15%	21%	25%	13%
Scope-adjusted FOCF/debt	4%	13%	3%	-8%

Rating rationale

The affirmed BBB/Stable issuer rating reflects our view that a stronger-than-projected year-end 2022 financial risk profile will enable Helgeland to pursue higher-than-historical investments, whilst upholding financial metrics at historical averages, despite increased resource rent tax imposed on Norwegian hydropower producers in 2022. Further supported by projections of good and stable profitability, with EBITDA-margins between 27-29% and NO4 spot prices expected around EUR 30 per MWh until 2025. The issuer rating reflects a standalone credit assessment of BBB- and a one-notch uplift based on the municipal owners' anticipated capacity and willingness to provide support if needed.

Helgeland's business risk profile, assessed at BBB, remains the strongest element in the assessment. It is highlighted by a vertically integrated business model with a considerable contribution from monopolistic regulated power distribution (around 45% of EBITDA on average) as well as efficient and environmentally friendly hydropower production (positive ESG factor). The company reported poor generation performance in H1 2022, driven by realised hedge losses. Yet it still ended the year with stronger performance and a stronger financial risk profile (BB+) than we projected last year. This was driven by strong H2 2022 performance in its regulated distribution and retail operations.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that: i) monopolistic, regulated grid operations and efficient, low-cost hydropower production will continue to contribute around 80%-90% of EBITDA; ii) the company's concession area will remain stable; iii) capital expenditures will remain around NOK 400m-500m per annum, driven by investments in regulated distribution; iv) operating profitability will pick up after 2022 and remain satisfactory in the short to medium term; v) the company will continue to be owned by Norwegian municipalities, whose willingness and capacity to provide support is deemed medium.

A positive action could be triggered by an improved financial risk profile, exemplified by a Scope-adjusted debt/EBITDA of around 3.5x, sustained.

A negative rating action could be triggered by a weaker financial risk profile, exemplified by a Scope-adjusted debt/EBITDA of more than 5.0x, sustained. The company losing its status as a government-related entity is another trigger for a negative rating action, albeit deemed remote.

Date	Rating action/monitoring review	Issuer rating & Outlook
3 Jul 2023	Affirmation	BBB/Stable
4 Aug 2022	New	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; July 2022

European Utilities Rating Methodology; March 2023

Government Related Entities Rating Methodology; May 2022

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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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Vertically integrated utility with a substantial share of operating profits from stable and profitable monopolistic power distribution • Cost-efficient and environmentally friendly energy production from hydropower facilities with reservoir capacities (positive ESG factor) • Governmental ownership through long-term, committed, municipal owners	• Higher Scope-adjusted debt/EBITDA ratio than similarly rated peers • Cash flows and financial credit ratios are negatively impacted when market prices are low, as exemplified in FY 2020 and H1 2022 figures. • Asset concentration risk in its hydropower production assets • Limited geographical diversification beyond its concession area of Helgeland

Positive rating-change drivers	Negative rating-change drivers
• Stronger financial risk profile, exemplified by deleveraging to a Scope-adjusted debt/EBITDA ratio of around 3.5x on a sustained basis	• Weaker financial risk profile, exemplified by a Scope-adjusted debt/EBITDA ratio of above 5.0x on a sustained basis • Loss of municipal ownership (remote)

Corporate profile

Helgeland Kraft AS is a Norwegian integrated utility company headquartered on the northwest coast of Norway in a city called Mosjøen. It is fully owned by 14 municipalities that are all located in its regulated concession area. The company is vertically integrated, with activities in regulated energy distribution, unregulated hydropower production and energy retail. It fully owns 18 hydropower plants with an annual production capacity of 1,300 GWh. It also operates two additional plants through operating agreements and has joint ownership of smaller hydropower companies in the area. The company's monopolistic energy distribution consists of the operation and maintenance of district and regional networks. Its total network spans over 8,100 km and transfers over 6100 GWh of energy annually to around 47,000 customers. Lastly, the company has a profitable energy retail operation that caters to around 100,000 customers. Most of these customers are in the Helgeland area but some are in Sweden as the company fully owns Swedish energy retailer Storuman Energi AB.

Financial overview

			Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	7.8x	6.1x	6.1x	5.4x	5.8x
Scope-adjusted debt/EBITDA	4.0x	4.5x	3.2x	4.1x	4.1x
Scope-adjusted FFO/debt	15%	21%	25%	13%	16%
Scope-adjusted FOCF/debt	4%	13%	3%	-8%	-5%
Scope-adjusted EBITDA in NOK m	**2021**	**2022**	**2023E**	**2024E**	**2025E**
EBITDA	541	481	606	543	586
Other items[1]	4	-34	-	-	-
Scope-adjusted EBITDA	**545**	**447**	**606**	**543**	**586**
Funds from operations in NOK m	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA	545	447	606	543	586
less: (net) cash interest paid	-58	-61	-84	-87	-86
less: cash tax paid per cash flow statement	-7	-103	-17	-147	-106
less: pension interest	-12	-13	-14	-14	-14
Change in provisions	-131	152	-	-	-
Funds from operations	**337**	**422**	**491**	**295**	**380**
Free operating cash flow in NOK m	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Funds from operations	337	422	491	295	380
Change in working capital	-23	138	-24	19	-4
Capital expenditure (net)	-221	-294	-400	-500	-500
Free operating cash flow	**93**	**266**	**67**	**-186**	**-124**
Net cash interest paid in NOK m	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Net interest per cash flow statement	58	61	84	87	86
Interest expense pensions	12	13	14	14	14
Net cash interest paid	**70**	**74**	**99**	**101**	**100**
Scope-adjusted debt in NOK m	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Reported gross financial debt	2,426	2,381	2,455	2,607	2,759
less: cash and cash equivalents	-546	-578	-663	-536	-483
add: non-accessible cash	145	106	88	88	88
add: pension adjustment	38	13	13	13	13
Shareholder loan	113	90	68	45	23
Scope-adjusted debt	**2,175**	**2,011**	**1,960**	**2,217**	**2,399**

[1] 2022 impairment loss taken after settlement was reached between jointly owned generator Smisto and its entrepreneur

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Environmental, social and governance (ESG) profile[2]

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)

Efficient, low-emissions generation considered a competitive advantage

As a hydropower producer, Helgeland has a favourable ESG profile, highlighted by low-cost (EUR 4 per MWh), environmentally friendly production. In addition, investments in its regulated distribution segment are instrumental in facilitating a higher share of intermittent generation and the electrification of industry. Both are crucial to reaching climate goals set by Norwegian and European lawmakers. This position should support future cash flow generation and access to funding through high utilisation factors of its hydro assets and lower the risk of headwinds from regulation and political interference. In addition, we consider its exposure to transition risk as low and expect its ESG profile to protect its GRE status.

Regulatory risks highlighted in 2022

Despite a positive sustainability profile, Norwegian utilities are still subject to regulatory and reputational risks. This became evident during 2022 when extraordinarily high electricity prices directed much attention at Norway's power sector. It was further exemplified in September 2022 when the government imposed a temporary windfall tax because of high prices and permanently raised the resource rent tax rate on hydropower generation assets. Helgeland is not affected by the windfall tax as prices rarely exceed EUR 70 per MWh in NO4. However, the resource rent tax directly impacts future cash flows.

Dark green certification from CICERO

In connection with the issuance of green bond loans, Helgeland established a green bond framework that has received a CICERO dark green certification (highest rating). The company also received a governance score of 'good'.

[2] 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

Helgeland's business risk profile is highlighted by the company's vertically integrated business model, with environmentally friendly and low-cost hydropower production as well as monopolistic regulated power distribution. The latter is considered a stabilising force for the company's cash flows, and the regulated environment leads to a good market position and a good industry risk assessment.

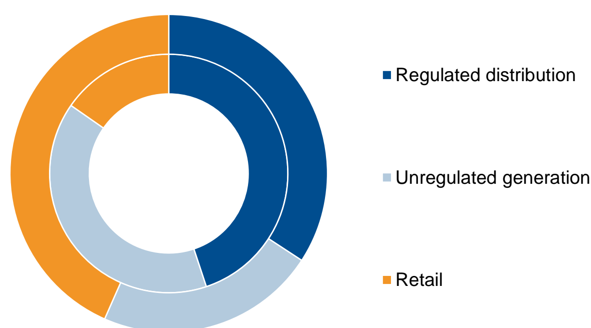
Industry risk profile: BBB+

Helgeland operates within several sub-segments as identified by Scope's European Utilities Rating Methodology. We have therefore applied a blended industry risk assessment. To isolate the underlying, long-term industry risk the company faces, we estimate the normalised EBITDA contribution from the respective segments.

Industry / risk	Normalised contribution
Unregulated energy generation / BB	40%
Regulated energy distribution / AA	45%
Energy retail / BBB	15%
Blended industry risk	**BBB+**

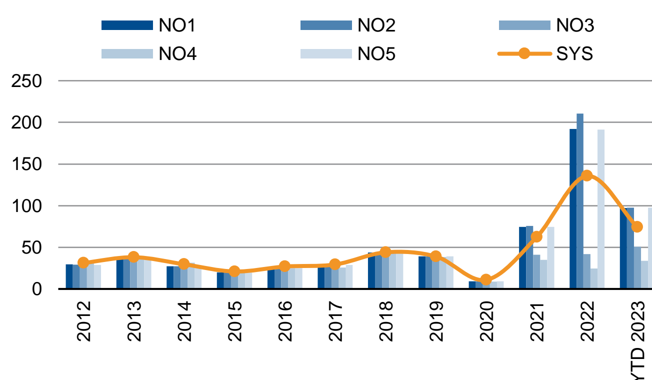
Unregulated generation and retail are both considered to have higher industry risk than regulated energy distribution. This is because cash flows from generation are considered to have a higher correlation with market prices, whilst retail is considered to have significantly lower barriers to entry. Regulated distribution is considered to have lower risk fundamentals as prices are regulated through state-set tariffs, and market positions are protected by state-determined concession areas. Using the blended industry risk approach, we therefore assess the company's industry risk at BBB+.

Figure 1: Segments' average revenue (%, outer ring) and EBITDA contribution (%, inner)



Sources: Helgeland Kraft AS, Scope

Figure 2: Nordic power prices (EUR/MWh)



Sources: Nordpool, Scope

Five different price regions in the Norwegian utilities market

The Norwegian utilities market is separated into five different price regions, classified as NO-NO5. NO1 is located the furthest south, and NO4 is located furthest north. Historically, these regions have operated with very similar price levels (Figure 2). However, since 2021 there has been a discrepancy between the various regions, driven by structural bottlenecks in the regional transmission grid between the north and south. This effectively traps energy in regions with surplus energy, pushing prices down. In addition, the south of Norway has had direct interconnectors to continental Europe since H2 2021. Consequently, European energy balances now influence prices in the south more than hydrological factors did historically and still does in the north.

Strong retail market position in its home market

When assessing the company's competitive position, we consider the sum of all the company's segments with their respective strengths and weaknesses. Overall, we consider Helgeland's market position to be strong in its home markets, driven by high capacity utilisation, efficient hydropower assets and sizeable monopolistic distribution operations.

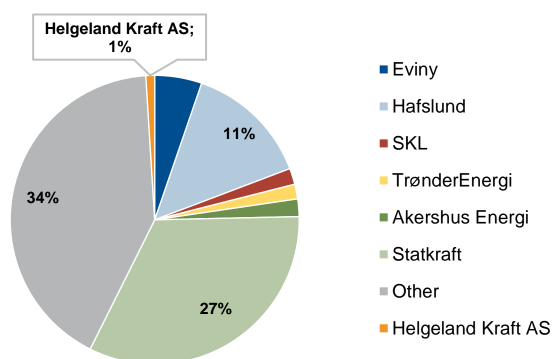
18 fully owned hydropower facilities

The company operates 18 hydropower production facilities, all of which are in the Helgeland area. This geographical concentration risk is partly mitigated by Helgeland's large geographical area of over 18,000 sq km (compared to Oslo with 454 sq km). However, in terms of production capacities, we note that the company's top three production facilities contribute over 60% of its total yearly production. This poses a risk as any downtime at these facilities could have a large impact on the company's overall performance.

Small, but capable and efficient hydropower generation

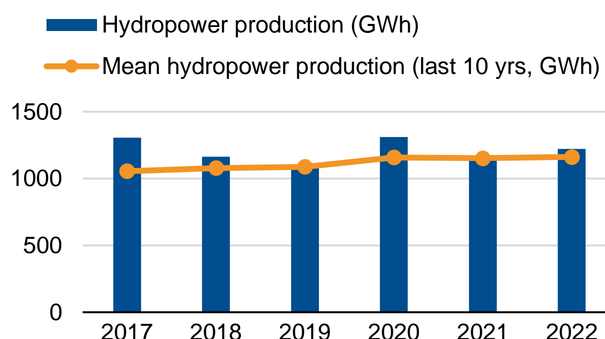
In aggregate, the company has a theoretical production capacity of 1.3 TWh annually. We estimate total Norwegian power production at approximately 163 TWh per year. This means that the company is relatively small, with an estimated market share of 0.8%. We note the modest size compared to other Norwegian and European utilities. However, we still consider the company to have a satisfactory market position for its generation operations. This is because its hydropower assets are capable and efficient, with low variable costs. We also note that the largest facilities have reservoir capacities, which enable the company to regulate production if needed. This makes the company less exposed to volume risk during dry hydrological years. This mitigating factor is reflected in the company's very stable 10-year mean production level of around 1.1-1.2 TWh.

Figure 3: Market position in power generation in Norway (%)



Sources: Public, Scope (estimates)

Figure 4: Historical generation volumes and mean generation



Sources: Helgeland Kraft AS, Scope

8,100 km of distribution network, from the Atlantic Ocean to the Swedish border

The company also operates 8,100 km of regulated distribution networks delivering power to 47,000 customers in the Helgeland area. Helgeland has a relatively affluent population of 77,000 inhabitants. The population has remained relatively stable over the last 10 years, supported by local industries like ferry operations, transport and fishing. So although there is a trend of migration from the north to the south of Norway, we project these numbers will remain stable over the medium term. The company's end customers are mainly residential (39,000 of the 47,000), but it has seen higher demand from local industries in the context of electrification projects. This could mitigate a potential population decline in the longer run. The high share of residential customers is considered positive for stability as residential clients are less likely to adjust consumption based on short-term price fluctuations.

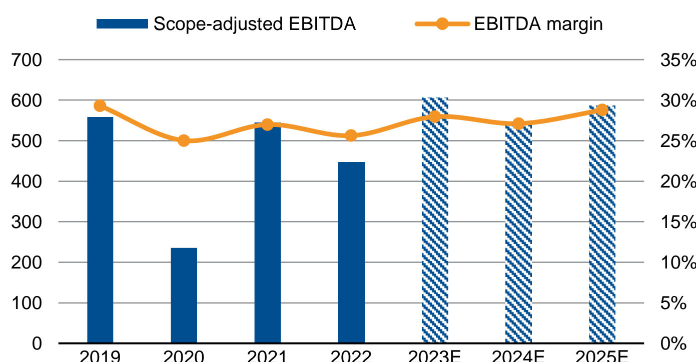
A small, regulated distributor that punches above its weight in terms of volumes

Compared to Norwegian distributors that cater to more densely populated areas (Eidsiva with 940,000 customers, for instance), the company's operations are rather small. However, considering that Helgeland transfers an estimated 5% of annual Norwegian power generation while only having 1.5% of Norway's population in its region, it punches above its weight. We also continue to highlight that distribution is a government-protected, monopolistic environment, which makes size less relevant. There is no competition for distribution revenues, and regulation allows for timely cost coverage. We note positively the company's regulated distribution operations both in terms of its market position and projected future earnings.

Strong local market position in retail, driven by high level of engagement

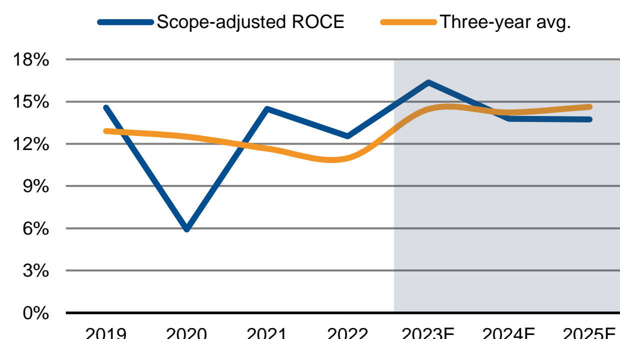
Lastly, the company has substantial retail activity, with around 100,000 customers across Norway and Sweden. Most of these clients are in the Helgeland area, where the company has an estimated market share of over 85%. This market share is driven by the company's engagement with and support of local communities. Beyond its home territory of Helgeland, the company is represented in Sweden through its fully owned subsidiary Storuman Energi AB. This subsidiary's retail operations are fully exposed to competition and contribute less to overall EBITDA than generation and distribution.

Figure 5: Scope-adjusted EBITDA (NOK m, LHS) and EBITDA margin (%, RHS)



Sources: Helgeland Kraft AS, Scope (estimates)

Figure 6: Scope-adjusted ROCE (%) and three-year average Scope-adjusted ROCE (%)



Sources: Helgeland Kraft AS, Scope (estimates)

Satisfactory historical performance slightly below other Norwegian integrated utilities

Performance as measured by Scope-adjusted EBITDA has historically been in the 25%-30% range. We deem this satisfactory but not that it is slightly below other integrated utilities in the Norwegian market. We identify a below-average efficiency rating (and therefore lower allotted income) for the company's distribution operations as one of the reasons behind its lower profitability. We also note that the company's efficiency rating has been negatively impacted by a rather large pension cost taken in 2015. Since this efficiency is measured on a five-year basis, we expected the company's efficiency rating (and allotted income) to increase from 2021, and it did. Lastly, we note that the company's overall performance fluctuates with price levels, driven by fluctuations in unregulated generation. Historically, the company has pursued a dynamic hedging strategy, where it has used financial hedges for up to 60% of future expected volumes.

Realised losses on hedges influenced performance for H1 2022

These financial hedges use the SYS price as a reference price. Due to the increasing divergence between SYS prices and the different regional prices, such hedges have become less effective since 2021. This was the main reason behind Helgeland's decision to cut its hedged positions in H1 2022 as there was no correction in sight. This led to realised hedge losses and poor generation performance at the time. Since then, the company has not hedged its generation, which enabled it to fully capitalise on higher-than-expected NO4 prices in H2. This brought year-end operating profitability in generation up to breakeven.

Significant improvement in performance for H2 2022

The company ended 2022 with a consolidated EBITDA margin of 25.6%, which is on the lower end of Helgeland's historical range and compared to other Nordic integrated utilities. Yet it was still a significant improvement from the time of our last review, when the H1 2022 EBITDA margin was reported at 21.3%. The improvement in the second half of 2022 was driven by several factors, especially: i) significant improvement in generation as NO4 spot prices increased from the record-low levels seen in H1 2022; ii) above-historical-average performance in regulated distribution as lower prices led to lower grid losses and the decision by the Norwegian TSO (Statnett) to cut the tariffs it charges to local regulated distributors; and iii) strong full-year performance in the company's retail segment, which reported a year-end EBITDA margin of 14% (vs a historical average of around 8%).

This shows the diversifying benefit of Helgeland's high level of vertical integration and how the various business segments balance out negative effects from unforeseen events like the realised losses on hedged generation.

Good Scope-adjusted ROCE

Profitability as measured by the newly introduced Scope-adjusted return on capital employed (ROCE) is more volatile than the EBITDA margin. While EBITDA is correlated with the top line, average capital employed is not. We therefore focus on Helgeland's three-year average Scope-adjusted ROCE, which oscillates around 13%. This is considered good but slightly below many other Scope-rated Norwegian utilities, which typically stand at around 15% or above.

Better performance projected, but headwinds from investment in regulated distribution

Going forward, we project performance will pick up from the low levels seen in 2022. This will be driven by: i) a significant ongoing contribution from regulated distribution, with EBITDA margins of around 33%; ii) a strong recovery in generation as this efficient and unhedged business will produce high profits when coupled with projected NO4 prices of between EUR 30-35 per MWh; and iii) the company's track record of utilising its reservoir capacity to realise power prices at 10% above the market on average. We also expect some headwinds, particularly within regulated distribution, where we expect significant investments in the medium term to accommodate high demand from local industry. This is expected to counter the positive effects from higher interest rates and higher inflation, which increase government-regulated income levels over time. This leads to projected EBITDA margins ranging between 27%-29% in the medium term.

Financial risk profile: BB+

Year-end 2022 financial risk profile stronger than projected

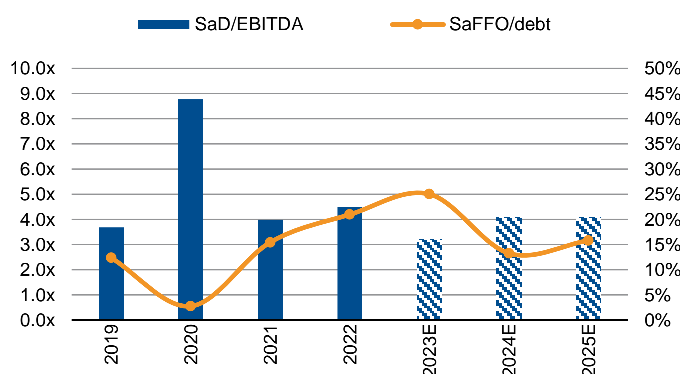
The company's financial risk profile (BB+) reflects a year-end financial profile that was stronger than projected. In addition, the updated base case reflects the prospect of more supportive power prices than anticipated in the previous rating update. Coupled with our profitability and price projections of EUR 35 per MWh in 2023 and EUR 30 per MWh for 2024 and 2025, this leads to operating cash flows that are likely to enable higher-than-historical investments whilst maintaining a financial profile commensurate with stated financial leverage targets (average three-year NIBD/EBITDA[3] ratio of over 4.0x). Further, besides maintenance investments in hydropower and the grid, the projected investments are expected to have a high level of discretion. Meaning that if the market shifts, we believe the company will be able to adjust investments to mitigate any impact on financial metrics.

[3] NIBD/EBITDA following the company's definition, which adjusts for one-offs in EBITDA and does not include pension liabilities in NIBD.

Projected leverage ratios to remain high, with gradual deleveraging in the medium term

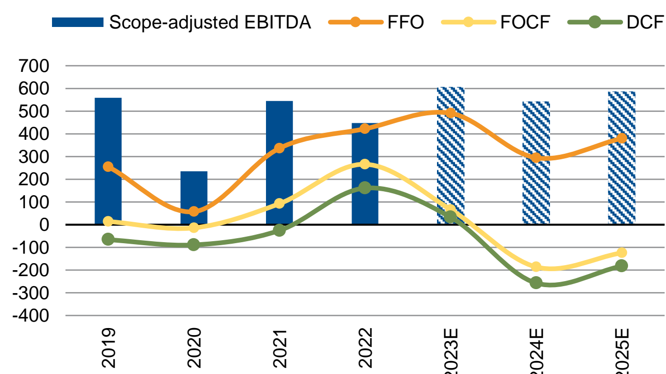
Utilities typically have greater leverage and longer debt maturities than average industrial companies. This is because their higher debt is often backed by highly efficient long-term assets. We therefore factor in Helgeland's regulated distribution assets when assessing its leverage metrics. We expect the company to gradually increase leverage in the medium term to a level commensurate with its own financial targets, exemplified by a Scope-adjusted debt/EBITDA ratio ranging from a historical low of 3.2x in 2023E to 4.1x in 2025E. Funds from operations (FFO) is a metric we normally do not highlight for utilities. However, we note Helgeland's strong projected FFO in 2023E, driven by low taxes to be paid following 2022 results. Further, the newly introduced increase in the resource rent tax for Norwegian hydropower generators is expected to put downward pressure on cash flows from 2023E onwards. This would effectively reduce Helgeland's investment capacity at a time when many would argue that the Nordics and Europe need heavy investment in renewable energy.

Figure 7: Scope-adjusted debt/EBITDA (x, LHS) and Scope-adjusted FFO/debt (%, RHS)



Sources: Helgeland Kraft AS, Scope (estimates)

Figure 8: Scope-adjusted cash flows (NOK m)



Sources: Helgeland Kraft AS, Scope (estimates)

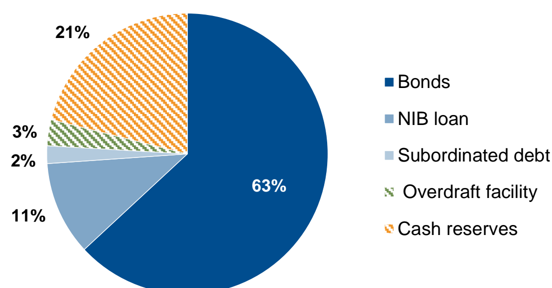
Satisfactory projected debt coverage in the face of rising interest rates

We measure the company's ability to service its debt by looking at Scope-adjusted EBITDA/interest expenses. Despite relatively high debt levels, the company's historical debt protection is considered satisfactory, with average coverage of around 6.0x for the last three years. We project higher financing costs due to inflationary pressures and rising forward interest rates. We also expect an increase in gross debt to finance some investments in the medium term, as evidenced by negative free operating cash flows projected for 2024E and 2025E. This will be partly mitigated by several bond maturities in the medium term that have high interest. 40% of Helgeland's bonds are fixed-rate, which we expect will dampen the impact that rising interest rates have on its funding costs. In sum, we project continued satisfactory coverage ratios in the 5.4x-6.1x range in the short to medium term.

Historically satisfactory FFO generation and slightly negative discretionary cash flows

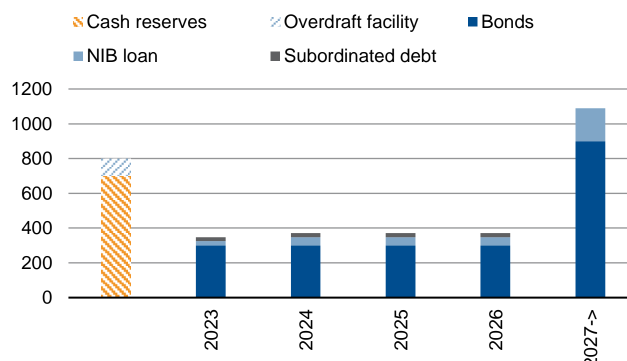
Historically, the company has had satisfactory and rather stable FFO generation (except for 2020 and 2023E). It has also successfully adjusted its capex levels so free operating cash flow (FOCF) revolves around zero. Dividends, on the other hand, depend on performance from the preceding year, making this balancing act more difficult. The resulting FOCF is still considered acceptable, although we note that FOCF has been negative more often than not in recent years. In future we expect the company to focus its investments on its distribution network and capex levels to be between NOK 400m-500m, which is higher than in recent years (around NOK 250m). We have not factored in any discretionary capex as we expect Helgeland to focus on its higher-than-historical investments and maintaining dividends for its municipal owners.

Figure 9: Funding sources, Q1 2023



Sources: Helgeland Kraft AS, Scope (estimates)

Figure 10: Maturity profile (NOK m), Q1 2023



Sources: Helgeland Kraft AS, Scope (estimates)

Adequate liquidity

At Q1 2023 the company had around NOK 700m in unrestricted cash reserves and NOK 100m in long-term undrawn credit lines. These funds and our projected cash flows are expected to comfortably cover maturities of around NOK 350m in 2023. The same goes for 2024E, whose coverage we estimate at above 130%.

The company has a very even maturity profile in which each year's maturities consist of one NOK 300m bond, amortisation of subordinated debt and amortisation of its NIB loan. Helgeland has a successful track record of using the capital markets, and we believe it will continue to issue new bonds in the NOK 300m-500m range to refinance future maturities.

Balance in NOK m	2022	2023E	2024E
Unrestricted cash (t-1)	401	472	576
Open committed credit lines (t-1)	100	100	100
Free operating cash flow (t)	266	67	-186
Short-term debt (t-1)	600	348	371
Coverage	**128%**	**184%**	**132%**

Supplementary rating drivers: + 1 notch

We have made no adjustments for financial policy, but we note that the company actively monitors quantitative and qualitative factors that affect its creditworthiness and compliance with its financial covenants. The company has two covenants related to external financing; one relates to a minimum of 30% equity and one to a NIBD/EBITDA ratio of less than 6.0x. We acknowledge that the company is (and is projected to remain) compliant with these covenants. However, the covenants are so generous that we do not consider them to have a disciplinary effect.

Government-related entity with one-notch uplift

Helgeland is 100% owned by 14 Norwegian municipalities, which also constitute its regulated concession area. We have used our government-related entities (GRE) methodology and assigned a one-notch uplift to the company's standalone credit rating. The one-notch uplift for ownership is in line with other Scope-rated Norwegian utilities with majority or full municipality ownership but no explicit guarantees.

Based on the methodological framework, we assess both the overall capacity and likelihood of the owner to provide support. This includes an evaluation of strategic importance, ease of substitution and default implications. Considering the company's activities and relative market share in its respective concession area, we consider it to provide a critical public service. We also consider the owners to be somewhat dependent

on the company to pay them yearly dividends to balance their municipal budgets. Therefore, the capacity to provide support is considered moderate.

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB

Helgeland Kraft AS is the issuer of all outstanding debt.

The rating on senior unsecured debt is BBB, in line with the issuer rating.

Short-term debt rating: S-2

The short-term debt rating has been upgraded to S-2, which is based on an underlying BBB issuer rating and reflecting sufficient short-term debt coverage and access to internal and external sources of liquidity (e.g. access to credit facilities and cash on hand) and Helgeland Kraft's long-term issuer credit rating.

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