Credit Rating Announcement 21 November 2023

Scope assigns BBB+/Stable first-time rating to Vardar

The rating reflects the company's low-cost and environmentally friendly power generation, and its robust dividend income from a 12.91% ownership in Å Energi. It also reflects a good financial profile and status as a government-related entity.

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 assigned an issuer rating of BBB+/Stable to Vardar AS. Scope has also assigned a BBB+ rating to the company's senior unsecured debt and an S-2 short-term debt rating.

Rating rationale

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

Vardar's business risk profile (assessed at BBB-) reflects its main exposure to low-cost and environmentally friendly hydropower generation (positive ESG factor), which supports strong profitability. The company's consolidated activities have small scale and include 0.7 TWh of mean annual hydropower generation from a 2/7 share in the Usta and Nes power plants, 54 MW of installed wind capacity, and around 60 GWh of yearly district heating volumes. The business risk profile is further supported by the company's robust dividend income from a 12.91% ownership stake in Å Energi AS, reflecting recurring cash flow generated by more diversified and vertically integrated utility operations. In addition to being held back by the small scale and high asset concentration of directly owned power generation activities, the assessment is negatively impacted by the cyclical operating environment with exposure to volatile power prices.

Vardar's ownership in Å Energi is considered part of its core business as dividends received are expected to comprise a material and recurring part of operating cash flow. This creates some concentration risk; however, that risk is partially balanced by the high robustness of those dividends, supported by Å Energi's strong credit profile (rated A-/Positive by Scope) and its dividend policy of paying out 70% of underlying profit from two years back. The two-year time lag in payouts from Å Energi improves the visibility of forecasted cash flow and reduces volatility in Vardar's credit metrics. Additionally, Scope has a positive view of Vardar's ability to veto against changes to Å Energi's payout policy and core business composition, enabled by a joint ownership agreement with Drammen municipality.

For the next two years, Scope assumes power prices of around EUR 70/MWh in the NO1, NO2, and NO5 bidding zones in southern Norway. Under these market conditions, Scope-adjusted EBITDA is expected to range between NOK 470m-540m, including yearly dividends of NOK 140m-210m from Å Energi. This should support continued positive free operating cash flow even in a less favourable pricing environment, due to low mandatory capex of only NOK 10m-20m per year.

The financial risk profile (assessed at BBB+) supports the company's credit rating and is driven by manageable indebtedness, low mandatory capex and strong free operating cash flow. This results in good financial flexibility. Vardar's leverage as measured by Scope-adjusted debt/EBITDA is expected to stay around 2.0x-2.5x throughout 2023-25. Since dividends from Å Energi are expected to comprise 30%-40% of Scope-adjusted EBITDA over the coming years, the company's leverage is comparatively less exposed to taxation than that of Norwegian utilities with a larger share of directly owned hydropower plants – a factor that was considered in peer comparisons. Further, the rating case assumes Vardar will use its financial flexibility to keep net debt around the current level of NOK 1.1bn by balancing discretionary investments and shareholder remuneration against free operating cash flow.

Liquidity is adequate, with no debt maturities scheduled for 2024. At end-2022, available liquidity included unrestricted cash of NOK 207m and NOK 50m in committed undrawn credit lines. Liquidity is further supported by expected positive free operating cash flow of more than NOK 200m per annum. The next maturing debt is a NOK 440m bond due in 2025, followed by a NOK 400m bank loan with maturity in 2026. The bank loan includes a one-year extension right. Scope believes that maturing capital market debt will likely be refinanced by new debt issuance.

The issuer rating incorporates a one-notch uplift on the standalone credit assessment of BBB reflecting the company's GRE status and leading to an issuer rating of BBB+. Scope has applied a 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 financial support, if required. 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.

One or more key drivers of the credit rating action is considered an ESG factor.

Outlook and rating-change drivers

The Stable Outlook reflects Scope's expectation of supportive power prices in southern Norway continuing over the next few years, albeit at lower levels than in 2022 and H1 2023. It further reflects Scope's view that Vardar will maintain a leverage (Scope-adjusted debt/EBITDA) between 2.0x and 2.5x over 2023-2025. This view is underpinned by the company's willingness (as per its financial policy) and ability to keep net debt stable by adapting discretionary cash outflows to operating results. The view also incorporates Å Energi's dividend policy with the payout in year (t) being based on the result in year (t-2), which supports visibility on Vardar's dividend income through 2025. Lastly, Scope expects the company to maintain its core assets, including the Usta and Nes power plants and its stake in Å Energi.

A positive rating action could be warranted if stronger credit metrics were sustained, as exemplified by a Scope-adjusted debt/EBITDA of around 1.0x or below. This is seen as remote given the company's intention to keep reported net debt near the current level.

A negative rating action could be triggered if Scope-adjusted debt/EBITDA reached about 3.0x on a sustained basis. This could be driven by lower-than-expected power prices, an adverse change in financial policy, and/or a significant deterioration of Å Energi's credit profile (and thereby its dividend capacity). The loss of government-related entity status (deemed remote) could also result in ratings pressure.

Long-term and short-term debt ratings

Senior unsecured debt is rated BBB+, the same level as the issuer rating.

The short-term debt rating of S-2 reflects the underlying BBB+/Stable issuer rating and adequate liquidity, in addition to good access to external funding from banks and debt capital markets.

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; Government Related Entities Rating Methodology, 13 July 2023; European Utilities Rating Methodology, 17 March 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 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.
Lead analyst: Per Haakestad, Senior Specialist
Person responsible for approval of the Credit Ratings: Sebastian Zank, Managing Director
The Credit Ratings/Outlook were first released by Scope Ratings on 21 November 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

About Scope Group

With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

Contact

Analyst	Per Haakestad	p.haakestad@scoperatings.com
Team leader	Sebastian Zank	s.zank@scoperatings.com

Scope Ratings GmbH • Lennéstraße 5 • D-10785 Berlin • Phone: +49 30 27891-0 • Fax: +49 30 27891-0
www.scoperatings.com