Credit Rating Announcement

16 October 2023

Scope affirms A-/Stable issuer rating on Tensio AS

The affirmation reflects the company's strong market position as one of Norway's largest regulated grid operators, good profitability and moderate leverage. High investment needs and projected negative free operating cash flow are constraints.

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 affirmed Tensio AS' A-/Stable issuer rating.

Rating rationale

The affirmation reflects Tensio's continued strong business risk profile and the expectation of a weaker financial risk profile in the medium term. The business risk profile (assessed at A+) continues to be backed by Tensio's sole exposure to fully regulated power distribution, which is associated with very low industry risk. The company has a monopoly as the grid operator for Trondelag county (that includes the newly Scope-rated Trondheim municipality), which has a 270,000 customers and over 29,000km of regulated distribution grids. This market position is strengthened by Norway's robust and stable economy and a well-established regulatory framework governed by the Norwegian Water Resources and Energy Directorate and the RME with a tariff system that allows a timely pass-through of an increased cost base. Rising interest rates, inflation and Tensio's position as Norway's most efficient grid operator will provide its already good profitability with positive tailwinds in the medium term. Given this monopolistic position, the company's lack of product and geographical diversification does not weigh down the rating.

Tensio's performance developed negatively in 2022 despite consumption ending at 6,870 GWh, up from 6,613 GWh in 2021. The decreasing performance was mainly caused by Tensio invoicing for NOK 279m less than its revenue cap for 2022 which led to decreased revenues and an EBITDA margin of 34%, down from 41% in 2021.

Distributors in the Nordics were also impacted by the surging energy prices seen throughout Europe that led to higher-than-expected grid losses. In addition, Norwegian distributors were hesitant to increase tariffs to compensate for these increased losses, as Norwegian housholds were also experiencing great increases in living costs. In parallel, the Norwegian transmission system operator (Statnett) was experiencing record-high congestion income[1] from its unique ability to transfer power across power price regions. To help mitigate the negative effect on local distributors, the Norwegian government and Statnett implemented a scheme towards the end of 2022, whereby Statnett will transfer parts of this congestion income to local distributors on a monthly basis until end-2024.

So far in 2023, Tensio's performance has improved from end-2022 levels, as exemplified by an EBITDA margin of 47%. Driven by revenues closer to the revenue cap, the aforementioned compensation scheme and better cost coverage (such as in 2021 and 2022), rising interest rates and inflation roll into the Norwegian Water Resources and Energy Directorate's cost cover calculation. Scope expects profitability to remain strong in the medium term, as exemplified by EBITDA margins ranging from 41% in 2023E to 43% in 2025E.

Tensio also experienced an increase in net financial costs to NOK 111m in 2022, from NOK 90m in 2021. Tensio has one bond linked to the interbank interest rate and one linked to the consumer price index; both saw their rate increase in 2022 and so far in 2023. Scope believes inflation and interest will continue to increase in the short-term and that this will increase Tensio's net financial costs quite substantially.

The financial risk profile (assessed at BB+) continues to be constrained by Tensio's relatively high leverage, as exemplified by a Scope-adjusted debt/EBITDA of 6.3x at end-2022, up from 3.8x in 2021. This is outside the negative rating action trigger of 6.0x established in last year's review. However, adjusted for the fact that Tensio invoiced NOK 279m less than its state-set revenue-cap, leverage looks better at 4.6x. The rating trigger also highlights that leverage has to be sustained at above 6.0x and Scope's projections show deleveraging to around 5.0x in the medium term, driven by increasing profitability and a less volatile operating environment than in 2022. Projected negative free operating cash flow is another constraining factor as Scope believes it will not improve in the medium term, as the Norwegian transmission grid requires substantial upgrades to facilitate new intermittent technology, the electrification of Norwegian industry and to help the Norwegian government to meet its climate targets[2]. Combined with continued dividend payouts, Scope projects negative discretionary cash flow that will necessitate additional external financing in the coming years. The increased gross debt, rising inflation and interest rates are expected to put downward pressure on Tensio's debt protection, as measured by Scope-adjusted EBITDA/net interest, which Scope expects will decline towards 4.6x in 2023E before gradually recovering towards 5.3x in 2025E.

Liquidity is adequate. As a pure grid operator, Tensio has predictable liquidity requirements as swings in working capital are minimal. However, because of a timing effect between Statnett's compensation for increased grid losses (paid at the end of every month) and the (running) cost of covering grid losses, Tensio increased its committed facilities to NOK 600m (from NOK 300m) to provide a sufficient liquidity buffer. It also entered into a new term loan with the Nordic Investment Bank for NOK 500m and took out a new bank loan for NOK 200m in H1 2023. Consequently, as of July 2023, the company had unrestricted cash and unutilised facilities totalling NOK 844m. This provides sufficient cover for an upcoming NOK 650m bond maturity in November 2023 and Tensio does not have any other large maturities before in 2025. Refinancing needs will therefore be limited in the medium term, but as mentioned, Scope expects negative discretionary cash flow, which will necessitate additional external financing.

As regards supplementary rating drivers, parent support continues to warrant a one-notch uplift from Tensio's standalone rating, based on Scope's Government Related Entity rating methodology and using a bottom-up approach. Scope's assessment of Tensio's indirect majority municipal ownership is based on potential parent support, determined not by the standalone performance or credit quality of TrønderEnergi and Nord-Trøndelag Elektrisitetsverk, but by the capacity and willingness of their municipal owners to provide support.

Outlook and rating-change drivers

The Stable Outlook reflects Scope's expectation that Tensio will continue to generate cash flow from monopolistic and regulated grid operations. The Outlook also assumes that the company will strive to recapitalise, which should result in leverage, in terms of Scope-adjusted debt/EBITDA, of around 5.0x. Scope also assumes that the company will remain indirectly majority-owned by Norwegian municipalities.

A positive rating action could be warranted if Tensio maintained Scope-adjusted debt/EBITDA at around 4x, providing significant headroom to its leverage target, following positive free operating cash flow and reduced dividend distributions.

A negative rating action could occur if a financial policy change significantly weakened Tensio's financial risk profile, exemplified by Scope-adjusted debt/EBITDA around 6x on a sustained basis. A reduction in indirect municipal ownership to below 50% and the loss of government-related entity status could also trigger a downgrade.

[1] Income generated when power is transferred from a lower-price to a higher-price region

[2] https://www.regjeringen.no/en/aktuelt/norways-new-climate-target-emissions-to-be-cut-by-at-least-55-/id2944876/

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 this Credit Rating and/or Outlook, (General Corporate Rating Methodology, 15 July 2022; 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 Rating: 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 Rating 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 Rating and/or Outlook and the principal grounds on which the Credit Rating and/or Outlook are based. Following that review, the Credit Rating was not amended before being issued.

Regulatory disclosures
The Credit Rating and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Rating and/or Outlook are UK-endorsed.
Lead analyst: Michael-Marco Simonsen, Associate Director
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The Credit Rating/Outlook were first released by Scope Ratings on 25 November 2020. The Credit Rating/Outlook were last updated on 14 October 2022.

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.

About Scope Group

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