Tensio AS
Norway, Utilities

A- STABLE

Corporate profile

Tensio AS is a Norwegian utility company operating solely in regulated electricity distribution with regional and distribution network grids. The company is the second largest regional grid company in Norway and its service territory is Trøndelag County in Central Norway. It owns and operates 29,000 km of cable (air, ground and sea), 13,000 local network stations and 130 electrical substations, and serves 267,000 customers. Tensio was formed in June 2019 by TrønderEnergi (40% owner), Nord-Trøndelag Elektrisitetsverk or NTE (40%) and Kommunal Landspensjonskasse gjensidig forsikringsselskap or KLP (20%) and combines Tensio TS and Tensio TN.

Key metrics

		Scope estimates		
Scope credit ratios	**2020A**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	16.2x	8.5x	6.8x	6.7x
Scope-adjusted debt (SaD)/EBITDA)	3.5x	4.4x	4.9x	4.9x
Scope-adjusted funds from operations/SaD	26%	20%	17%	17%
Free operating cash flow/SaD	Neg.	0%	Neg.	Neg.

Rating rationale

Scope Ratings has affirmed its A-/Stable issuer rating on Norwegian utility company Tensio AS.

The issuer rating continues to reflect Tensio's strong business risk profile and the prospect of a weaker financial risk profile. Our business risk profile assessment is driven by Tensio's sole exposure to regulated power distribution, which is associated with very low industry risk. Tensio's monopolistic service territory (Trøndelag County, Central Norway) for electricity distribution accounts for only 9% of Norway's population, which still makes it the second largest distribution grid operator for electricity in Norway after Elvia. Given this monopolistic position, the company's lack of product and geographical diversification is not important for the rating. Its market position is further strengthened by Norway's robust and stable economy as well as the well-established regulatory framework governed by NVE-RME. Over time, we expect the combination of the two grid companies to result in streamlined operations and, in turn, improved efficiency.

Following the recent refinancing and recapitalisation in the last twelve months, Tensio's financial risk profile is moving closer to a normalised capital structure in line with its financial policy (i.e. leverage of close to 5x). Key to our financial risk assessment are: i) the company's high investment requirements going forward, which will continue to result in negative free operating cash flow (FOCF) in the medium term; and ii) its plan to distribute excess capital through ordinary (or potential extraordinary) dividends to its owner.

Overall, we assess liquidity as adequate. Ratios have improved lately, following the refinancing of short-term debt with longer debt tenors. Going forward, we project some new funding needs due to negative discretionary cash flow, but much less than during the last year.

Ratings & Outlook

Issuer rating A-/Stable

Lead analyst

Henrik Blymke
+47 21 09 38 36
h.blymke@scoperatings.com

Related Methodologies

European Utility Methodology

Corporate Rating Methodology

Government Related Entities Methodology

Scope Ratings GmbH

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 36

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

As regards supplementary rating drivers, the company's new financial policy leads to no adjustment as it is already incorporated in our financial risk profile assessment. Parent support continues to warrant a one-notch uplift from Tensio's standalone rating, based on the application of our Government Related Entity (GRE) rating methodology, using a bottom-up approach. Our assessment of indirect majority municipal ownership of Tensio is based on potential parent support, determined not by the standalone performance or credit quality of TrønderEnergi and NTE, but by the capacity and willingness of their municipal owners to provide support if needed. This rationale is in line with our approach to other Scope-rated Norwegian utility peers with majority municipality ownership.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Tensio will continue to generate cash flow from monopolistic and regulated grid operations. The Outlook also assumes that the company will strive towards planned recapitalisation, which should result in leverage, in terms of Scope-adjusted debt (SaD)/EBITDA, moving closer to 5x. We also assume that the company will remain indirectly majority owned by Norwegian municipalities.

A positive rating action could be warranted if Tensio keeps SaD/EBITDA with significant headroom to its leverage target, following positive FOCF and reduced dividend distributions, at around 4x on a sustained basis.

A negative rating action could be triggered by a financial policy change that significantly weakened Tensio's financial risk profile, exemplified by SaD/EBITDA moving towards 6x on a sustained basis. A reduction in indirect municipal ownership to below 50% and the loss of GRE status could also trigger a downgrade.

Rating drivers

Positive rating drivers	Negative rating drivers
• Pure monopolistic power distribution company with stable and predictable cash flows • Operating under a well-established regulatory framework in Norway • Long-term and committed majority owners, which indirectly have the capacity and willingness to provide parent support through the municipalities	• Aim of increasing leverage through extraordinary dividends to meet targeted capital structure • High investment needs indicate negative FOCF in the medium term • Limited geographical outreach and short track record as a combined company (i.e. not fully merged)

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Positive FOCF and reduced dividend distributions, exemplified by SaD/EBITDA of around 4x on a sustained basis	• Change in financial policy that could significantly weaken financial risk profile, exemplified by SaD/EBITDA moving towards 6x on a sustained basis • Reduced indirect municipal ownership to below 50% and loss of GRE status

Financial overview

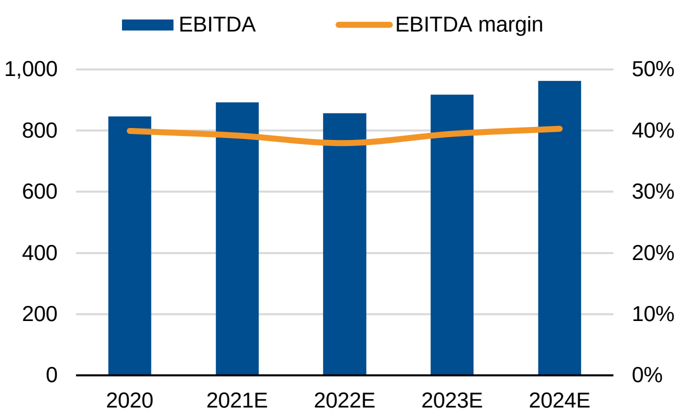
		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	16.2x	8.5x	6.8x	6.7x
SaD/EBITDA	3.5x	4.4x	4.9x	4.9x
Scope-adjusted funds from operations/SaD	26%	20%	17%	17%
FOCF/SaD	-2.9%	0.1%	-3.7%	-4.0%
Scope-adjusted EBITDA, in NOK m				
EBIT	550	570	525	566
add: depreciation	296	322	332	352
Scope-adjusted EBITDA	**846**	**892**	**857**	**918**
Scope-adjusted funds from operations, in NOK m				
EBITDA	846	892	857	918
less: (net) cash interest per cash flow statement	-52	-101	-122	-133
less: cash tax paid per cash flow statement	0	0	0	0
add: depreciation component, operating leases	-	-	-	-
add: other	-21	-34	-34	-34
Scope-adjusted funds from operations	**769**	**757**	**700**	**751**
Scope-adjusted debt, in NOK m				
Reported gross financial debt	2,986	3,900	4,381	4,616
less: cash, cash equivalents	-169	-161	-312	-252
add: cash not accessible	7	7	7	7
add: pension liability adjustment	136	136	136	136
other	-	-	-	-
Scope-adjusted debt	**2,959**	**3,882**	**4,212**	**4,507**
Liquidity				
Total available liquidity (cash & undrawn credit lines) in NOK bn	**0.8**	**0.5**	**0.6**	**0.6**

Recent events and updated Scope forecast

Tensio's main financial credit metrics have developed slightly more favourably than anticipated one year ago, in connection with the initial coverage. The positive development is the result of an increased top line due to high volumes and greater allowed income, in combination with good cost control, which lowered other operating costs. In terms of operations, Tensio's development has been stable and good, with a continued focus on enhanced efficiency from the combination of the previous NTE and TrønderEnergi grid divisions. The cost improvement programme is well ahead of plan, and the company has identified further synergies and efficiencies that can be realised in the years ahead.

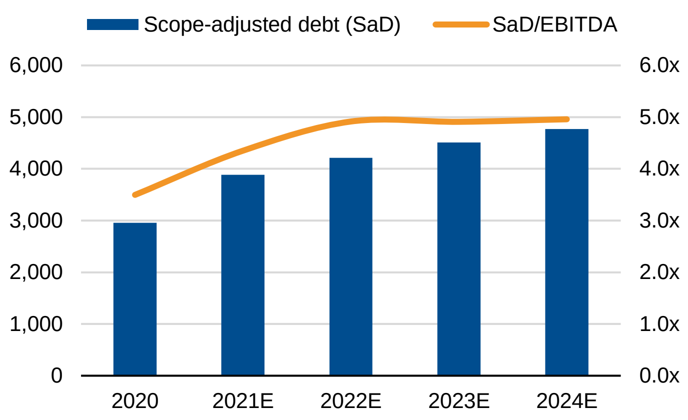
As of June 2021, leverage has decreased compared to YE 2020. This is, however, slightly misleading as the company approved another capital allocation to the owner in Q2 2021, which was executed in September 2021. Since the initial rating, Teniso has carried out two such transactions (Q4 2020 and Q3 2021), which combined have transferred NOK 1.5bn back to the owners through extraordinary dividends, relating to the original transactions when Tensio was created. This development is in line with our expectations and management's previous statement that it would increase leverage towards 5x.

Figure 1: EBITDA in NOK m (LHS) and margin % (RHS)



Source: Scope estimates

Figure 2: SaD in NOK m (LHS) and SaD/EBITDA (RHS)



Source: Scope estimates

We have updated our financial forecast for Tensio based on H1 2021 numbers, its recent operating performance and current market conditions and prospects. Overall, we forecast improved profitability but also increasing capex. We still expect the high investment requirements going forward to result in negative FOCF in the medium term, which, combined with the plan to distribute capital through extraordinary dividends to the owner, will continue to increase leverage. However, the leverage ratio is still likely to stay comfortable below 5x this year. We believe that Tensio will aim to move very close to a leverage of 5x, which is an important part of the company's financial policy.

Capital expenditure is mainly for maintenance and upgrades in the regional grid. It is also earmarked for new grid investments due to the building of power production plants by other companies.

Liquidity ratios have improved lately, with short-term debt refinanced via a 10-year loan granted by the Nordic Investment Bank. In September this year, the company also raised NOK 750m with a new five-year senior unsecured green bond. Refinancing needs will therefore be limited until the next debt maturity in 2023. Going forward, we project some new funding needs due to the negative discretionary cash flow, but much less than over the last year, following the recent debt transactions.

Summary of business and financial risk profiles

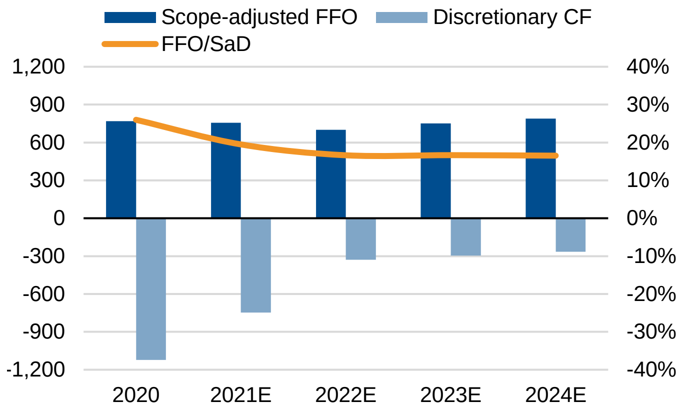
Regulated power distribution

Given Tensio's sole exposure to regulated power distribution, we assess industry risk as very low, which is a positive driver for the overall business risk profile. Further, given Tensio's monopoly position in its service territory, its lack of product and geographical diversification is not important for the rating.

Cost reduction and synergies should lead to higher efficiency and profit margins

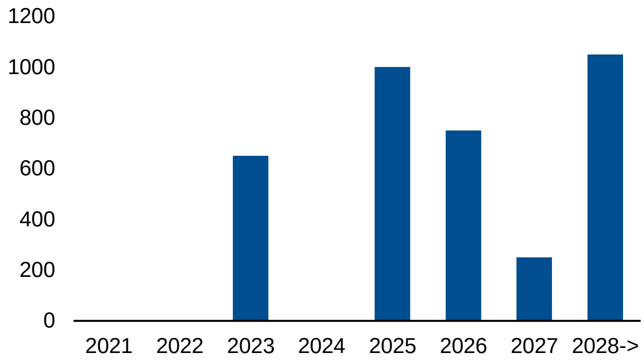
Tensio's profitability is highly dependent on regulatory conditions set by NVE-RME and its operational efficiency compared with Norwegian peers. Over time, we believe the combined Tensio will benefit from streamlined operations and thus improved efficiency and profit margins. Overall, we assess Tensio's business risk profile as being in the strong A category.

Figure 3: FFO & Discretionary cash flow in NOK m (LHS) and FFO/SaD (RHS)



Source: Scope estimates

Figure 4: Debt maturity schedule (excl. leasing amortisation) in NOK m



Source: Scope estimates

Our financial risk profile assessment is mainly forward looking, as the two grid companies were initially combined without transferring much debt from the two owners. Thus, historical credit metrics are less relevant pre-2020. However, based on the current financial policy in place, Tensio's investment programme and recapitalisation plans, we expect the company to move closer to a normalised capital structure by the end of 2021.

High investments result in negative FOCF

Although we expect operating cash flow to be solid and stable, the company's high investment requirements are likely to result in negative FOCF in the medium term. Overall, the negative anticipated FOCF, combined with plans to increase leverage towards 5x through dividends, constrains Tensio's financial risk profile.

Supplementary rating drivers

Financial policy accounted for in financial risk profile assessment

We make no adjustment for Tensio's new financial policy, as this is already incorporated in our financial risk profile assessment. The key principles of the company's financial policy are its target of net debt/EBITDA below 5x and the distribution of excess cash after investment requirements via dividends.

One-notch rating uplift for indirect majority municipal ownership

Parent support continues to warrant a one-notch uplift from the standalone rating based on our GRE rating methodology, using a bottom-up approach. Although Tensio does not have a single majority shareholder, we view the two utility owners (TrønderEnergi and NTE) as one due to their collective strategy, shareholder agreement and common interest in the company. The indirect majority municipal ownership in Tensio is based on potential parent support, determined not by the standalone performance or credit quality of TrønderEnergi and NTE, but by the ability and willingness of the municipal owners to provide support if needed.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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