Corporates

Rating news 07 Oct 2024

Scope affirms A- issuer rating on Tensio, Outlook Stable

The affirmation reflects Tensio's low business risks as a pure-play electricity distribution system operator. Credit metrics are expected to be sustained at moderate levels despite continued high capex.

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.

The full list of rating actions and rated entities is at the end of this rating action release.

Key rating drivers

Business risk profile: A+ (unchanged). Tensio's business risk profile benefits from its sole exposure to power distribution, which is associated with low business risks given its natural monopoly and the fully regulated operating environment. Given its natural monopoly, the company's lack of horizontal and geographical diversification is less important for its credit quality. However, overall diversification remains the weakest element of its business risk profile.

Although Tensio has lower customer outreach than many European peers operating in more densely populated areas, it is one of the largest electricity distribution system operators in Norway. The company has around 0.3m customers through its two grid subsidiaries, Tensio TS and Tensio TN, which places it behind only Glitre Nett and Elvia among domestic peers. Over 2022-2023, Tensio's customer base grew by 3.5%, driven mainly by electrification and population growth.

Tensio's comparatively large domestic scale benefits its business risk, as distribution system operators of a certain size tend to deliver more stable and higher regulatory cost efficiency. This supports the likelihood of a consistent and above-average return on invested capital over time under the incentives of Norway's regulation – underpinning the robustness of Tensio's cash flow generation and credit ratios.

Scope expects a relatively stable EBITDA* margin in the next few years, remaining at a good level of 40%-45% – similar to 43% in 2023 and 45% in H1 2024. The stable development in profitability is expected to be driven by an EBITDA recovery following the negative impact of a NOK 205m revenue deficit in 2023. Tensio had a deficit of NOK 123m on its regulatory revenue balance at YE 2023, which has resulted in tariffs that are more in line with the company's allowed revenue throughout 2024 and likely in 2025-2026. This should help to offset a gradual normalisation of the regulatory benchmark return (WACC) level, with both inflation and interest rates expected to decrease over the forecast period.

Financial risk profile: BB+ (unchanged). Tensio's financial risk profile reflects moderate credit metrics and the ongoing pressure on cash flow generation from high capex, which constrains the rating.

Scope-adjusted debt was NOK 4.9bn as of YE 2023. Scope still expects high capex to result in negative free operating cash flow in the medium term, reflecting that Tensio needs to upgrade and expand its electricity grid to meet future capacity requirements. Combined with Tensio's continued dividend ambitions, Scope therefore expects a moderate, gradual growth of Scope-adjusted debt by NOK 0.2bn-0.4bn per annum.

The agency expects leverage (Scope-adjusted debt/EBITDA) to stabilise at around 4.5x in 2024-2026, as Tensio has reached a more normalised level on its regulatory revenue balance. This follows the significant deficit revenue of NOK 293m in 2022 and NOK 205m in 2023, which resulted in leverage above 5x in those years. In Scope's opinion, the current leverage of around 4.5x is representative of Tensio's long-term, average level for leverage.

Scope expects debt protection (Scope-adjusted EBITDA/interest cover) to stabilise at around 5x in the next few years. This is a good level and an improvement compared to 4.5x in 2023 due to higher Scope-adjusted EBITDA.

Liquidity: adequate. Tensio's liquidity is mainly supported by good access to external financing. The company operates with a low cash balance (NOK 1m at both YE 2022 and YE 2023) and uses a 12-month rolling overdraft facility as its main source to cover short-term liquidity needs. As of YE 2023, the undrawn amount as well as the capacity on the overdraft facility was NOK 600m. Tensio reduced the capacity to NOK 400m in February 2024 and the overdraft was undrawn at H1 2024.

Despite low liquidity ratios, Tensio is unlikely to run into liquidity issues. This reflects its strong investment grade credit quality with sole exposure to regulated activities. It also reflects its proven, good access to external financing through different channels, including both bank and capital market funding.

The next debt maturity is a NOK 750m bond maturing in May 2025, followed by a NOK 250m bond in November 2025. Scope believes these maturities are likely to be refinanced with similar debt instruments.

Tensio maintained headroom to its financial covenant in 2023. The covenant requires Tensio to maintain interest-bearing debt (excluding leases and any subordinated debt) below 65% of the grid capital. As of YE 2023, the ratio was 55%. Scope expects that growth in assets will mitigate the impact of increasing debt levels, keeping the ratio below 65%. The covenant applies to all loan agreements entered into prior to 2024. The bond issued in June 2024 is therefore exempt.

Supplementary rating drivers: +1 notch (unchanged). Scope makes no adjustment for financial policy or peer context considerations. However, the financial policy is implicitly reflected throughout the agency's assessment of Tensio's financial risk profile. The company's dividend policy is not based on a specific payout ratio or an absolute amount. Instead, dividend payouts are assessed against Tensio's defined maximum threshold for leverage (net debt/EBITDA based on local GAAP) of 5x. Scope considers this a prudent approach, which supports financial flexibility and the stability of credit ratios.

Parent support continues to warrant a one-notch uplift on Tensio's standalone credit assessment. This is based on Scope's Government Related Entities (GRE) Rating Methodology, using a bottom-up approach. The one-notch uplift reflects Scope's assessment of the 'High' capacity and 'Medium' willingness of Tensio's indirect majority municipal owners to provide financial support. Therefore, the one-notch uplift is not driven by the standalone performance or credit quality of the direct utility owners, TrønderEnergi and Nord-Trøndelag Elektrisitetsverk.

Outlook and rating sensitivities

The **Stable Outlook** is based on Scope's view that Tensio is likely to generate sufficient operating cash flow to cover most of its planned capex while keeping leverage (Scope-adjusted debt/EBITDA) between 4.5x and 5.0x in 2024-2026. The Outlook further assumes continued indirect, majority municipal ownership and no material increase in Tensio's risk appetite through a less restrictive financial policy.

The **upside scenario** for the rating and Outlook is:

1) Leverage improving to around 4x or below on a sustained basis.

The **downside scenarios** for the rating and Outlook are (individually):

1) Leverage weakening to around 6x or above on a sustained basis.
2) Change in the company's government-related entity status due to a reduction in indirect municipal-ownership to below 50%.

Environmental, social and governance (ESG) factors

ESG considerations are neutral for the rating.

The green transition requires Tensio, as the only electricity distribution system operator in its service territory, to ensure its grid has the capacity and efficiency to support the achievement of domestic, Nordic and European climate goals. These goals involve the introduction of new, intermittent power generation capacity and further growth in the consumption of electricity (e.g. due to electrification), leading to a higher strain on Tensio's grid. Tensio is supporting these goals by striving to allocate capex appropriately and develop new technology to better utilise its own grid and the wider power system.

While Tensio is not shielded from regulatory or reputational risks, Scope does not consider these detrimental to its credit quality. Scope highlights the fact that Norway's regulatory framework has been fairly stable over a long period of time and is transparent with regard to future cash flow visibility.

The strategic importance of reliable power distribution for the indirect municipal owners further underpins Tensio's government-related entity status.

All rating actions and rated entities

Tensio AS

Issuer rating: A-/Stable, affirmation

**All credit metrics refer to Scope-adjusted figures.*