

Småkraft AS

Rating Action Report

LONG-TERM RATING

BB

OUTLOOK

Stable

SHORT-TERM RATING

N4

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Småkraft AS assigned 'BB' long-term issuer rating; Outlook stable

Nordic Credit Rating (NCR) said today that it had assigned a 'BB' long-term issuer rating to Norway-based [Småkraft AS](#). The outlook is stable. At the same time NCR assigned an 'N4' short-term issuer rating. NCR has also assigned 'BBB-' issue ratings to Småkraft's senior secured bonds to reflect material recovery prospects for secured creditors.

Rating rationale

The long-term rating reflects the company's comparatively high financial gearing, volatile margins and weak credit metrics. The rating is also constrained by the company's volatile operating environment, with large exposures to spot prices, limited diversity of pricing areas, and lack of reservoirs in its run-of-river plants, subjecting the company to additional hydrological risks. However, these factors are partly offset by the company's business model, which includes a high proportion of volume-dependent costs.

We see the company's position within the merit order system of power generation as a credit strength, with essentially no risk of having to limit production capacity and an ability to generate high margins at low system prices. We view the company's cost flexibility, generation of green energy, low impact on the natural environment and low carbon emissions as positive. The rating is supported by the company's strong committed owners and their willingness to provide equity funding for growth initiatives. We believe that the company can operate at higher leverage than industrial companies due to the asset intensity of the power industry, the liquidity of the company's power plants and its strong owners.

The rating on the company's senior secured bonds at 'BBB-', two notches above the long-term issuer rating reflects our expectations of material recovery prospects for secured creditors' in the event of a financial default. This is supported by the company's relatively low financial gearing in relation to the fair value of its power plants.

Stable outlook

The outlook is stable, reflecting our view that the company will refinance upcoming maturities at funding costs in line with our forecast. We expect Småkraft's margins to improve due to higher than historical system prices and cost-efficient operations, enabling it to offset some of the impact from increased funding costs. We expect owners to continue to support the company by providing equity for its acquisitions and for Småkraft to maintain its diverse funding structure with a high proportion of fixed-interest arrangements.

We could raise the rating to reflect improved credit metrics, with NCR-adjusted FFO/net debt above 15% and NCR-adjusted EBITDA/net interest above 3.5x over a protracted period. We could also raise the rating to reflect increased scale with stabilising profit margins.

We could lower the rating to reflect increased financial gearing with NCR-adjusted FFO/net debt below 5% or NCR-adjusted EBITDA/net interest below 2.0x over a prolonged period. The rating could also be lowered due to deteriorating operating conditions, with low energy prices and lower power generation, or if there are changes in ownership, negatively affecting risk appetite.

Rating list

Long-term issuer credit rating:
Outlook:
Short-term issuer credit rating:
Senior secured issue rating:

Rating

BB
Stable
N4
BBB-

Figure 1. Småkraft rating scorecard

Subfactors	Impact	Score
Operating environment	20.0%	bb
Market position	10.0%	bb+
Size and diversification	10.0%	bb+
Operating efficiency	10.0%	a
Business risk assessment	50.0%	bbb-
Ratio analysis		b
Risk appetite		bb
Financial risk assessment	50.0%	b+
Indicative credit assessment		bb
Liquidity		Adequate
ESG		Adequate
Peer calibration		Neutral
Stand-alone credit assessment		bb
Support analysis		Neutral
Issuer rating		BB
Outlook		Stable
Short-term rating		N4

Figure 2. Capital structure ratings

Seniority	Rating
Senior secured	BBB-

Type of credit rating:	Long-term issuer credit rating Short-term issuer credit rating Issue credit rating
Publication date:	The rating was first published on 31 Aug. 2023.
Office responsible for the credit rating:	Nordic Credit Rating AS (NCR), Oslo, Norway. NCR is a registered credit rating agency under Regulation (EC) No 1060/2009.
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Were ESG factors a key driver behind the change to the credit rating or rating outlook?	No.
Methodology used when determining the credit rating:	NCR's Corporate Rating Methodology published on 8 May 2023 NCR's Rating Principles published on 24 May 2022 NCR's Group and Government Support Rating Methodology published on 18 Feb. 2022 The methodology and principles documents provide analytical guidance to NCR's rating activities including but not limited to, assumptions, parameters, cash flow analysis, and stress-testing. NCR's methodologies and principles can be found on our website nordiccreditrating.com/governance/policies . The historical default rates of entities and securities rated by NCR will be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA) .
Materials used when determining the credit rating:	Annual- and quarterly reports of the rated entity, Bond prospectuses, Company presentations, Data provided by external data providers, External market reports, Meetings with management of the rated entity, Non-public information, Press reports/public information, Website of rated entity.
Potential conflicts of interest:	The rating is NCR's independent opinion of the rated entity's relative creditworthiness. The rating is solicited, i.e. it is prepared for a fee paid by the rated entity. At the time of analysis and publication neither NCR nor any of the analysts or persons involved in the rating process held any interest, ownership interest or securities in the rated entity. NCR does not have any direct or indirect shareholder with a holding of more than 5% of NCR's shares and votes. For further information, please refer to NCR's conflict of interest policy which is available on: https://nordiccreditrating.com/governance/policies
Additional information:	Prior to publication, the rating was disclosed to the rated entity. The issuer was given 24 hours (of which 8 business hours) to remark on factual errors and/or the inadvertent inclusion of confidential information, if applicable. The rating was not amended after the review by the issuer. No stress test was performed. Standard cash flow forecasting was performed. NCR's rating is an opinion regarding the relative creditworthiness of an entity or an instrument. It is not a prediction, guarantee or recommendation to buy, hold or sell securities. NCR assigns outlooks to issuer ratings to indicate where they could move in the near term, normally 12–18 months. Further information on the rating process, rating definitions and limitations is available on our website: nordiccreditrating.com/governance/policies .
Ancillary services provided:	No ancillary services were provided.
Regulations:	This rating was issued and disclosed under Regulation (EC) No 1060/2009.
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