STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Kraftringen Energi AB (publ)

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Table Of Contents

Rationale

Outlook

Standard & Poor's Base-Case Scenario

Business Risk

Financial Risk

Liquidity

Other Modifiers

Government Influence

Ratings Score Snapshot

Related Criteria And Research

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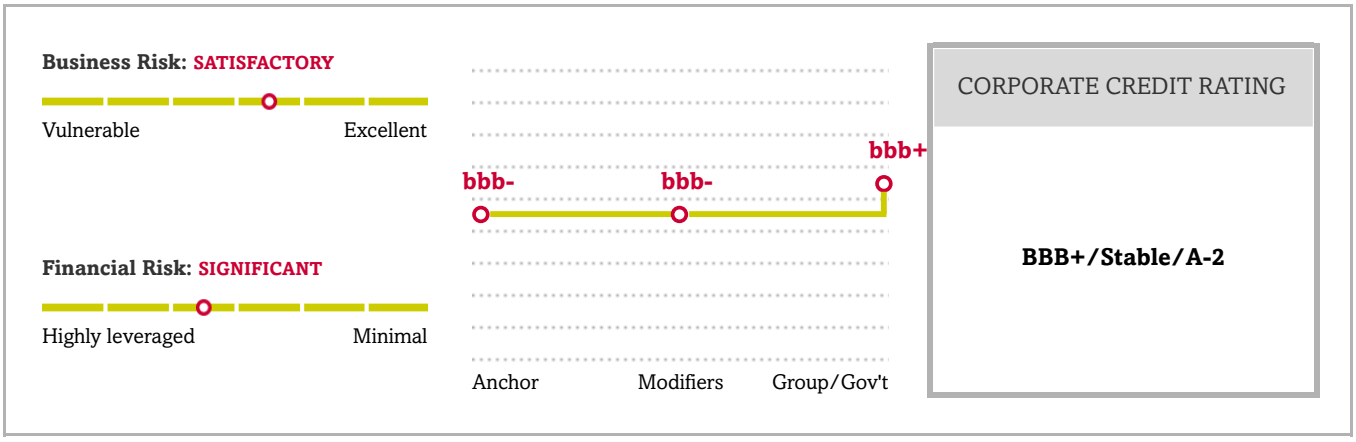

Rationale

Business Risk: Satisfactory	Financial Risk: Significant
• About 40% of operations in electricity distribution, following investment in a new combined heat and power (CHP) plant, and stable and predictable regulatory frameworks. • About 30% of operations in the stable district heating business. • Asset concentration, with limited geographic diversification of the distribution network and reliance on a few key power plants in district heating. • Exposure to volatile Nordic electricity markets through the electricity generation and supply businesses.	• Relatively high debt following the significant debt-funded investment in the new CHP plant. • Modest and stable shareholder distribution policy. • Likely improvement in credit metrics as the new CHP plant increases electricity production and decreases fuel costs.

Outlook: Stable

The stable outlook on Sweden-based multi-utility Kraftringen Energi AB (publ) reflects Standard & Poor's Ratings Services' view that the company's operating cash flows will continue to benefit from its regulated and stable electricity distribution operations and fairly steady district heating operations. It further reflects our expectations of a gradual recovery of credit measures following the recent completion of the debt-funded CHP plant. This includes our forecast of funds from operations (FFO) to debt improving to about 20% over the next two years.

Downside scenario

We could consider a negative rating action if Kraftringen Energi's credit measures did not improve according to our current forecasts, for example if FFO to debt stayed below 17%-18% for an extended period. This could result, for example, from any significant further debt-funded investment or operational underperformance. We could also lower the ratings if the regulatory framework for either electricity distribution or district heating were to weaken. In addition, we could also lower the ratings if we lowered our assessment of the likelihood of extraordinary support from the Municipality of Lund. This could result if Lund significantly diluted its ownership in the company.

Upside scenario

We could consider an upgrade if Kraftringen Energi's financial position improved to a level we view as commensurate with an "intermediate" financial risk profile. This could result, all else being equal, if the company's FFO-to-debt ratio improved to about 28% on a sustainable basis.

Standard & Poor's Base-Case Scenario

Assumptions

- Increase in EBITDA by about Swedish krona (SEK) 200 million between 2013 and 2015, as a result of increased electricity production and reduced fuel costs.
- Annual capital expenditures decreasing to about SEK350 million from 2015 onward, while dividends remain at their current level of SEK60 million.

Key Metrics

	2013a*	2014e	2015e
EBITDA margin (%)	20.2	18.0-22.0	18.0-22.0
FFO-to-debt (%)	16.8	18.0-20.0	18.0-20.0
FFO cash interest (x)	5.8	5.0-6.0	5.0-6.0

*Fully Standard & Poor's-adjusted. a--Actual. e--Estimate.

Business Risk: Satisfactory

Kraftringen Energi's "satisfactory" business risk profile reflects its operations in the very low risk regulated electricity distribution and stable district heating businesses, which make up approximately 70% of gross profit, and its operations in unregulated electricity generation and sales businesses, which we view as posing moderately high risk. It also reflects our assessment of the company's competitive position as "satisfactory."

The competitive position is supported by our view of the regulatory framework for electricity distribution in Sweden as stable and predictable, despite some uncertainty regarding the ongoing legal dispute between the regulator and distribution service operators related to the revenue caps for the 2012-2015 regulatory period. We estimate, however, that the outcome of the dispute will not likely result in lower revenue caps than those originally assigned by the regulator.

The competitive position is constrained by Kraftringen Energi's limited scale and diversity within the electricity distribution grid, given that it covers a relatively small area. This geographic concentration makes the company more vulnerable to extraordinary weather conditions. The company's district heating and electricity production businesses are also reliant on a few key assets, making the company more vulnerable to operational difficulties. We also note that, although the company operates as a natural monopoly in the local district heating market, there is no defined regulatory framework that would guarantee cost cover to offset the volatility that can arise from fluctuations in heating volumes and fuel prices, due, for example, to warmer temperatures during winter.

Financial Risk: Significant

Our assessment of Kraftringen Energi's financial risk profile as "significant" reflects the company's relatively high debt, due to the significant debt-funded investment in the Ortofta CHP plant, which has led to a temporary deterioration of credit measures. The ratio of FFO to debt was 17% at year-end 2013. At the same time, the company's shareholder distribution policy is modest, and we expect that the commissioning of the CHP plant will support cash flows from this year onward, leading to an improvement in FFO to debt toward 20% within the next two years. We benchmark Kraftringen Energi's credit metrics against our medial volatility table, as defined in our criteria, reflecting that about two-thirds of the company's earnings are derived from regulated electricity distribution, and district heating.

Liquidity: Adequate

We view Kraftringen Energi's liquidity position as "adequate" under our criteria. We believe that, over the next 12 months, available liquidity sources in terms of cash, committed credit facilities, and operating cash flow should be more than 1.1x forecast near-term cash outflows such as debt repayments, capital expenditures, and dividend payments. We also expect that sources will exceed uses even if EBITDA declines by 10%.

We further believe that the company has a sound relationship with its banks, a satisfactory standing in the credit markets, as shown by two bond issues in 2013, and prudent risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• SEK28 million in cash and cash equivalents as of June 30, 2014; • Access to SEK1 billion through two SEK500 million committed credit lines maturing in 2015-2016, used as backup financing for a SEK1 billion commercial paper program; • Access to a total of SEK600 million through revolving credit facilities with two Nordic banks, of which SEK300 million mature in 2016 and SEK300 million in 2017; and • Forecast FFO of at least SEK450 million.	• SEK60 million of forecast dividends annually; • SEK560 million of forecast capital expenditures in 2014; and • Debt maturities of SEK1,010 million in the next 12 months, of which SEK1,000 million relate to commercial paper.

Other Modifiers

The modifiers do not have any impact on the rating.

Government Influence

In accordance with our criteria for government-related entities, we are of the view that there is a moderately high likelihood of extraordinary support for the company from the Municipality of Lund. This is based on our assessment of Kraftringen Energi's:

- Strong link to the municipality, primarily reflecting the municipality's 82% ownership of the company through the holding company Kraftringen AB, in which the remaining shareholders are the municipalities of Eslöv (12%), Hörby (4%), and Lomma (2%). Kraftringen Energi's operations are strongly aligned with the interests of the four municipalities and, in particular, Lund, which has a strong affiliation with, and controlling influence over, the group; and
- Important role for Lund, given its focus on providing critical public services and contributing to Lund's environmental agenda.

Ratings Score Snapshot

Corporate Credit Rating

BBB+/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb-

- **Related government rating:** AAA
- **Likelihood of government support:** Moderately high (+2 notches from SACP)

Related Criteria And Research

Related Criteria

- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008

Related Research

- Country Risk Assessments Update: May 2014, May 14, 2014
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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