STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Summary:

Kraftringen Energi AB (publ)

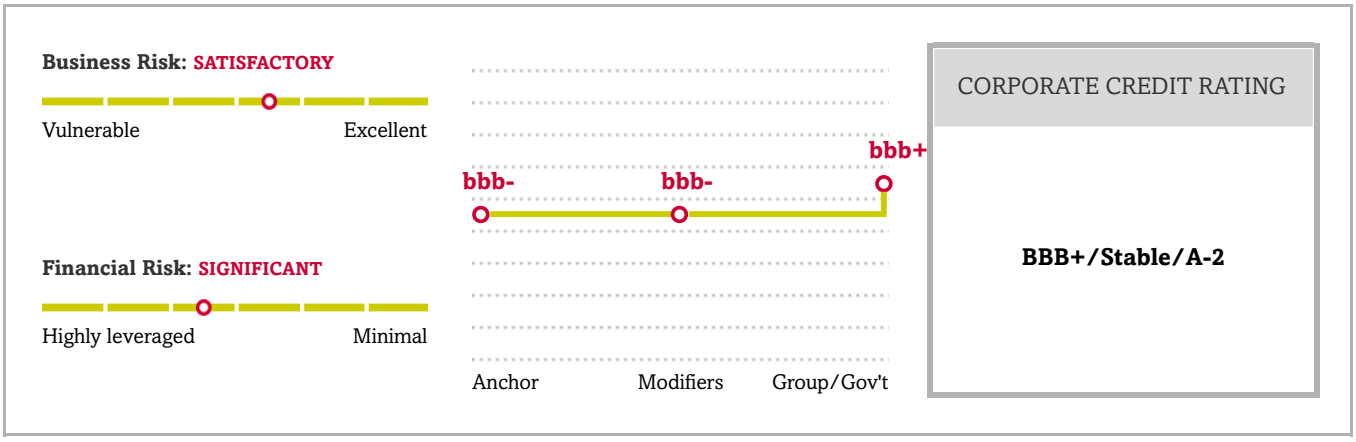
Primary Credit Analyst:
Alf Stenqvist, Stockholm (46) 8-440-5925; alf.stenqvist@standardandpoors.com

Secondary Contact:
Lovisa Forsloef, Stockholm (46) 8-440-5908; lovisa.forsloef@standardandpoors.com

Table Of Contents

Summary:

Kraftringen Energi AB (publ)



Rationale

Business Risk: Satisfactory	Financial Risk: Significant
• About 35% 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.	• Continued relatively high debt following the significant debt-funded investment in the new CHP plant. • Moderate shareholder distribution policy, with a minimum yearly dividend of Swedish krona (SEK) 60 million. • Gradual improvement in credit metrics because the new CHP plant has increased electricity production and decreased fuel costs since its inauguration in 2014.

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 completion of the debt-funded CHP plant in the first half of 2014. 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 weakened in contrast 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 materially 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 SEK150 million to SEK200 million between 2013 and 2015, primarily as a result of increased electricity production and lower fuel costs.
- Annual capital expenditures decreasing to about SEK550 million in 2014 and 2015 from SEK1.2 billion in 2013.
- Dividends remaining at least SEK60 million per year.

Key Metrics

	2013a*	2014e	2015f
EBITDA margin (%)	17.3	22.0-24.0	22.0-24.0
FFO to debt (%)	17.1	18.0-20.0	19.0-21.0
FFO cash interest (x)	6.3	5.0-6.0	6.0-7.0

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

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 two-thirds of its EBITDA, 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 assessment 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 note, however, that both the Administrative Court and the Administrative Court of Appeal have ruled in favour of the distribution service operators, and we do not currently anticipate that the outcome would cause any negative deviations to our forecasts on Kraftringen Energi.

However, Kraftringen Energi's limited scale and diversity constrains its competitive position, in our view. The electricity distribution grid covers a relatively small area, which 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, exposing it to operational difficulties. We also note that, although Kraftringen Energi operates as a natural monopoly in the local district heating market, there is no defined regulatory framework that would guarantee cost cover to offset 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 recent significant debt-funded investment in the Ortofta CHP plant, which led to a deterioration of credit measures: The ratio of FFO to debt decreased to 17% at year-end 2013 from 29% in 2012.

Nevertheless, the company's shareholder distribution policy is moderate, in our view, and the new CHP plant supports cash flows, which we expect will lead to a gradual improvement in FFO to debt to about 20% in 2015. 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 stem from regulated electricity distribution and district heating, which reduces the volatility of cash flows, in our view.

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%, and that the company will maintain adequate headroom under its financial covenant.

We further believe that the company has a sound relationship with its banks, a satisfactory standing in the credit markets, as shown by bond issues in 2013 and 2014, and prudent risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• SEK30 million in cash and cash equivalents as of Sept. 30, 2014; • Access to SEK1 billion through two SEK500 million committed credit lines maturing in 2019-2020, used as back-up 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; • Access to a credit facility with the municipality of Lund of SEK120 million maturing in 2016; and • Forecast FFO of at least SEK460 million annually.	• At least SEK60 million of forecast annual dividends; • About SEK550 million of forecast capital expenditures in 2014 and a similar amount in 2015; and • As of Sept. 30, 2014, debt maturities of SEK1,046 million in the next 12 months, of which SEK1,000 million relate to commercial paper.

Other Credit Considerations

The modifiers do not have any impact on the rating.

Government Influence

In accordance with our criteria for government-related entities, we see 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 Lund'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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (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

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 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
- Group Rating Methodology, Nov. 19, 2013
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
- 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

Related Research

- Country Risk Assessments Update: November 2014, Nov. 26, 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-

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com