STANDARD & POOR'S RATINGS SERVICES
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Summary:

Kraftringen Energi AB (publ)

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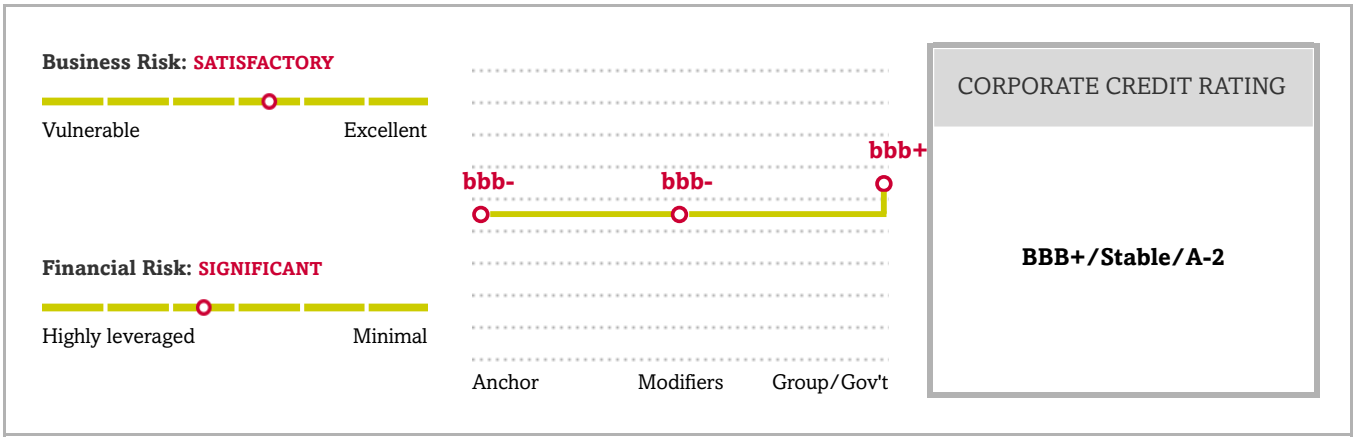

Rationale

Business Risk: Satisfactory	Financial Risk: Significant
• About 35% of operations in electricity distribution, which has a stable and predictable regulatory framework. • 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 a new combined heat and power plant in 2014. • Moderate shareholder distribution policy, with a minimum yearly dividend of Swedish krona 60 million. • Gradual improvement in credit metrics following increased electricity production and decreased fuel costs since the inauguration of the new CHP plant.

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 incorporates the gradual recovery of credit measures for Kraftingen Energi following the completion of the debt-funded combined heat and power (CHP) plant in the first half of 2014. This includes our forecast of funds from operations (FFO) to debt of 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 happen 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 occur, all else remaining 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) 150 million to SEK200 million (about €21 million) between 2013 and 2015, primarily as a result of increased electricity production and lower fuel costs.
- Annual capital expenditures of about SEK450 million in 2015, increasing to about SEK530 million in 2016 following increased investments in fiber.
- Dividends of at least SEK60 million per year.

Key Metrics

	2014	2015e	2016f
EBITDA margin (%)	23.7	23.0-25.0	24.0-26.0
FFO to debt (%)	21.7	19.0-21.0	20.0-22.0
FFO cash interest (x)	9.2	7.5-8.5	7.5-8.5

Data is Standard & Poor's fully adjusted. FFO--Funds from operations. f--Forecast. e--Estimate.

Business Risk: Satisfactory

Kraftringen Energi's satisfactory business risk profile primarily 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.

The company's competitive position is supported by our view of the regulatory framework for electricity distribution in Sweden as stable and predictable, despite periodical disputes between the regulator and distribution service operators related to the level of regulatory allowed return. The regulator lowered the allowed return on capital to 4.53% for the period 2016-2019, from 6.3% previously, which several distribution service operators have appealed. We note that the outcome of the previous dispute related to the 2012-2015 revenue caps was in favor of the operators. In addition, Kraftringen Energi does not fully use the allowed revenue cap, and it has not resulted in any negative deviations from 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 also rely 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

Kraftringen Energi's significant financial risk profile reflects the company's relatively high debt, due to the recent significant debt-funded investment in the Ortofta CHP plant, which has led to deterioration in credit measures. Our ratio of FFO to debt for the company 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. This has led to a gradual restoration of credit measures, and we forecast FFO to debt at about 20% in the next two years. We benchmark Kraftringen Energi's credit metrics against our medial volatility table, 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. 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, and prudent risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• SEK40 million in cash and cash equivalents as of Dec. 31, 2015; • 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 SEK300 million through revolving credit facilities with a Nordic bank, maturing in 2017; • Access to a credit facility with Lund of SEK120 million maturing in 2017; and • Forecast FFO of at least SEK500 million annually.	• At least SEK60 million of forecast annual dividends; • About SEK530 million of forecast capital expenditures in 2016; and • As of Dec. 31, 2015, debt maturities of SEK1,035 million in the next 12 months, of which SEK970 million relate to commercial paper.

Government Influence

We see a moderately high likelihood of timely and sufficient extraordinary support for Kraftringen Energi from the Municipality of Lund in the event of financial stress at Kraftringen Energi. This is based on our assessment of the company'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 company; 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

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

Related Criteria And Research

Related Criteria

- Standard & Poor's National And Regional Scale Mapping Tables, Jan. 19, 2016
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating 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
- 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: December 2015, Dec. 21, 2015
- 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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