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Research Update:

# Aker BP Outlook Revised To Stable On Anticipated Quick Rebound In Credit Metrics; 'BBB-' Rating Affirmed

**June 29, 2020**

## Rating Action Overview

- In response to the challenging market environment, Aker BP ASA has cut dividend payments materially, and will benefit from a temporary Norwegian tax reform.
- Consequently, we now anticipate a quick rebound in credit metrics with funds from operations (FFO) to debt well above 45% in both 2021 and 2022.
- We are therefore revising out outlook on Aker BP to stable from negative and affirming the 'BBB-' rating.
- The outlook is stable because we think the company is committed and able to take mitigating actions against the weaker oil price and because we think its business is resilient to weaker scenarios than in our base case.

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## Rating Action Rationale

**Prompt management and board action allows for increased headroom.** Although Aker BP has revised up its planned capital expenditure (capex) after cutting it by 20% earlier, on the back of an announced tax reform, the company announced two-thirds lower dividend in the first quarter (Q1) of 2020, reduced exploration expenses, and cut operational costs by about 25% versus the earlier budgeted plan. These measures will address reduced cash flows from weaker oil prices in 2020. Furthermore, the Norwegian krone has materially weakened against the U.S. dollar during the oil price collapse, which should result in lower operating expenditure.

**Norwegian tax law changes allows higher flexibility in liquidity.** Although the overall cumulative tax paid over time does not change materially, the short-term effect is significant, allowing immediate deduction of capex in the first year to over 70%. It is a major support to liquidity through increased cash flow generation, as well as spurring higher capex, notably with the recent submission of the plan for development and operation for the Hod project. Overall, the tax paid in

2020 through 2022 will be much lower than in our previous base case and production could grow at a more accelerated pace.

**Higher production in 2020 despite cuts announced by the Norwegian government.** The government's production cuts announced in 2020 in response to global supply/demand imbalance do not materially affect Aker BP. This is because the company already had strong performance in Q1 (average production was about 9% higher in Q1 2020 than in Q4 2019, notably thanks to good operational performance and ramp-up of the large Johan Sverdrup field. The company is in line to meet its 2020 guidance that it will average 205,000-220,000 barrels of oil equivalent per day (boepd).

**Aker BP is prepared to meet volatility in crude oil prices.** We think the company shows superior resilience to lower oil prices than similar sized companies. This is the result of low levels of operating expenditure for offshore operations as well as the additional support of countercyclical currency effect (the krone tends to depreciate when oil prices drop). Furthermore, Norway's tax regime provides some protection against downside risk and also limits upside, which improves the overall volatility over the cycle. Finally, Aker BP's projects have low break-even levels, for example, below $20 for Johan Sverdrup, and sanctioning of new projects is typically done at levels well below (about $30) our long-term price assumption of $55.

## Outlook

The stable outlook reflects our expectation that Aker BP will again achieve FFO to debt above 45% within 12 months on the back of lower dividends and near term tax burden, and strongly increasing production. Although high capex can result in a temporary increase in leverage, this would occur in the context of the favorable Norwegian fiscal regime.

### Upside scenario

We view an upgrade over the next 12-24 months as unlikely, owing to Aker BP's smaller scale and scope than 'BBB' rated peers. We expect Aker BP would require significant capex to develop its own resources, or further large acquisitions to improve its business risk profile to that of 'BBB' rated peers. The company would also need to maintain FFO to debt greater than 45% under prevailing industry conditions.

### Downside scenario

We could lower the ratings if Aker BP's credit measures do not improve as anticipated. This could be the case if:

- There is a deeper drop in oil prices, well below $40 per barrel (/bbl) in 2021-2022 leading FFO to debt remaining lower than 45%;
- Material debt-funded growth that would similarly likely block improvement of credit metrics; or
- Reversion to much higher dividends leading to materially negative discretionary cash flow (DCF).

## Company Description

Aker BP is a midsize oil and gas exploration and production company operating in the North Sea. With current production of about 208,000 boepd, it is one of the most important players on the Norwegian continental shelf. Aker BP is primarily owned by BP PLC (30%) and the Norwegian Aker Group (40%), with remaining shares (30%) held by other shareholders. The company is listed in the Oslo Stock Exchange and has a market capitalization of about $7 billion.

## Our Base-Case Scenario

- Oil prices at $50/bbl in 2020, and $55/bbl for 2021 and subsequent years, according to our latest price estimates. The current Brent spot price is about $40/bbl.
- A production rise in 2020 to about 215,000 boepd, increasing further in 2021 as investments in assets continues.
- Production costs of about $8/bbl in 2020 with low-cost Johan Sverdrup coming on stream (a project with production costs of about $2/bbl) and supportive currency effect.
- Annual capex of about $1.4 billion, including decommissioning spend, for 2020-2021. This figure could increase depending on investment decisions on undeveloped reserves and resources. We assume the company will spend about $300 million on exploration per year in 2020 and 2021.
- Cash tax payments from 2019, set according to the Norwegian tax regime. This also implies that capex spending and the associated 91% tax deduction will significantly affect future tax payments, because capex is relatively high.
- Dividends of $425 million paid in 2020. We anticipate the company will increase this amount by $50 million-$100 million per year over the coming years as we assume higher oil prices.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt of about 30%-35% in 2020 and above 60% in 2021 and 2022;
- Debt to EBITDA of about 2.2x in 2020 and 1.1x in 2021; and
- DCF to debt of about $200 million negative in 2020 and positive $900 million in 2021.

## Liquidity

Aker BP's liquidity as strong. We project its cash sources will cover cash uses by more than 2x over the next 24 months. This ample headroom allows for potential further growth initiatives, supporting the rating. In addition, the replacement of the reserve base lending facility with a revolving credit facility (RCF) last year removed the risk of lower availability from the redetermination process. We do not assess liquidity as exceptional, despite the strong ratio, based on our qualitative assessment.

Principal liquidity sources for the 12 months started April 1, 2020:

- Estimated unrestricted cash on the balance sheet of $323 million;
- Availability of about $3.7 billion under the RCF; and

- FFO of about $1.8 billion in next 12 months and around $2.4 billion in subsequent 12 months, as well.

Principal liquidity uses over the same period:

- Short-term debt of $255 million in next 12 months;
- Capex and decommissioning costs of about $1.3 billion in the next 12 months and around $1.1 billion in the subsequent 12 months; and
- Dividends of about $330 million in next 12 months and around $500 million in the subsequent 12 months.

## Covenants

The major covenant is net debt to EBITDA below 3.5x and EBITDA interest coverage of minimum of 3.5x. We anticipate the company is able to maintain considerable headroom under its covenants.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

The capital structure comprises majorly of various bonds issued by Aker BP with a minor amount drawn from its $4.0 billion RCF. This facility was recently extended by one year and now matures in 2025. There is no secured debt.

### Analytical conclusions

We rate the senior unsecured debt issued by Aker BP 'BBB-', in line with the issuer credit rating, since there is no significant subordination risk.

## Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)

- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

**Ratings Affirmed; Outlook Action**

| | To | From |
|---|---|---|
| **Aker BP ASA** | | |
| Issuer Credit Rating | BBB-/Stable/-- | BBB-/Negative/-- |
| Senior Unsecured | BBB- | |