FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Aker BP ASA at 'BBB-', Outlook Stable

Mon 11 May, 2020 - 3:03 PM ET

Fitch Ratings - London - 11 May 2020: Fitch Ratings has affirmed Aker BP ASA's Long-Term Issuer Default Rating (IDR) at 'BBB-', with a Stable Outlook.

The affirmation and Stable Outlook reflect Fitch's expectation that the company should be able to maintain leverage in line with our guidance despite low oil prices. Our view is supported by Aker BP's decision to significantly cut the dividend, increase production, its low costs and a supportive tax regime.

The rating is constrained by Aker BP's scale, its focus on offshore operations and concentration of reserves in a single country. There is also some uncertainty on the timing and scope of its potential projects, in particular North of Alvheim Krafla Askja (NOAKA), which may have an impact on the company's financial profile.

KEY RATING DRIVERS

Large Independent Producer In Norway: Aker BP is one of the largest independent exploration and production (E&P) companies in Norway. Aker BP holds 9% of oil reserves in the country and 5% of hydrocarbon reserves, according to the Norwegian Petroleum Directorate. Unlike some of its peers, Aker BP operates most of its projects. It has the highest production growth potential among regional peers, based on management's guidance. Aker BP's operations are focused on offshore developments which imply a higher level of operational risk compared to onshore operations.

Johan Sverdrup Drives Production Growth: In 1Q20, Aker BP's production increased to 208 thousand barrels of oil equivalent per day (kboepd), up a third over its average 2019 output. Johan Sverdrup, which is operated by Equinor and in which Aker BP has a 11.6% stake, has been the largest contributor to the company's recent production growth. John Sverdrup has very strong economics because of its size, with a breakeven oil price below USD20/bbl. This has helped Aker BP significantly reduce its unit production costs.

Minimal Impact From Oil Cuts: Norway has voluntarily committed to cut production by 250 thousand barrels per day (kbpd) in June and by 134 kbpd for the rest of the year relative to the reference production of 1,859 kbpd. We therefore assess that Norway's annual 2020 production will be broadly in line with the 1Q output of about 1,725 kbpd. While the government has yet to allocate cuts across fields the company expects to maintain its production guidance for the year of 205-220 kboepd.

Ambitious Production Targets Under Review: We previously expected that Aker BP's production would increase to around 240 kboepd by 2023, assuming that 70% of its prospective projects are approved for development. Management previously guided that Aker BP's production potential is around 300 kboepd by 2023-25 (or 400 kboepd by 2025-27, including NOAKA). We now conservatively assume the company's production to be at around 200 kboepd in 2022-2023, given that Aker BP has put non-sanctioned projects on hold.

We assume Aker BP's capex will fall sharply in 2021 and start rising in 2022-2023, potentially leading to increased production starting from 2022-2023 and/or beyond the forecast horizon (post-2023), though the production profile will depend on the nature of new sanctioned (approved) projects.

Low Production Costs: Aker BP's production costs are low for a company focusing predominantly on liquids. In 2019, the company estimated its unit production costs at USD12/boe, and expects this will fall to USD7-8/boe in 2020 based on the low-cost Johan Sverdrup start-up, Norwegian krone depreciation and cost-cutting measures. Aker BP targets full-cycle project break-even oil price below USD35/boe; planned projects are in line with this level.

Large Reserves: Based on projected 2020 production, the company's reserve life is comfortable at nine years for proved reserves (1P) and 12 years for proved and probable reserves (2P). In addition to its 2P reserves of 906 million barrels of oil equivalent (MMboe) at end-2019, Aker BP assesses its contingent (2C) resources at 931MMboe, mainly represented by the NOAKA project, Valhall Area and Ula Area. Those should enable Aker BP to replenish reserves organically over time.

Conservative Financial Profile: We view Aker BP's leverage target of maintaining net debt to EBITDAX below 1.5x as reasonably conservative. Our base-case forecasts funds from operations (FFO) net leverage to increase to 2.4x at end-2020 from 1.8x at end-2019 and to moderate at around 2x over 2021-2023. However, we recognise that leverage may be negatively impacted by the timing of new potential projects and possibly acquisitions, particularly after the prices have recovered.

Dividends Under Review: Aker BP is cutting its 2Q20 dividend by two-thirds and has guided that the dividend is likely to be kept at this level for the rest of the year. This effectively means the cash dividend in 2020 will be 50% lower than originally forecast. The company said it will review its longer-term dividend guidance. We view this decision as credit positive and believe it reflects Aker BP's commitment to an investment-grade rating.

Stable Operating Environment: In contrast to many other oil producing countries, the operating environment in Norway (AAA/Stable) is strong. The tax rate is high (78%), but the effective tax rate paid by many upstream companies, including Aker BP, is lower given deductions for decommissioning, exploration and additional capital allowances. There is a risk that over the longer term the state may become less supportive towards the industry, particularly as pressure grows for greener energy. Aker BP's focus on a single country makes it more vulnerable to potential regulatory changes.

Proposed Tax Relief: To stimulate investments the Norwegian government has proposed to reduce the near-term tax burden on oil and gas producers by temporarily allowing them to write off investments more quickly rather than over six years as currently permitted. This would improve Aker BP's liquidity and potentially future earnings, as well as mitigate the impact of low prices on its cash flow generation. The final parameters of the tax package are yet to be defined and we do not incorporate it in our forecasts.

Rating On Standalone Basis: Aker BP is owned by Aker ASA (not rated, 40%) and BP plc (A/Stable, 30%), with the rest of shares being free float. We rate Aker BP on a standalone basis as there is no control from any of its shareholders. The presence of two strong and experienced shareholders in the structure supports the rating. In particular, we think that Aker BP has strategic importance for BP, and the company's default would have very negative reputational consequences for BP.

We also view the liquidity position of both BP and Aker ASA as strong, which means that they are less likely to push for high dividends before prices have recovered.

DERIVATION SUMMARY

Aker BP is one of the largest European E&P companies by the level of production and reserves and focusing exclusively on the Norwegian Continental Shelf (NCS). We expect company's production to average around 205 kboepd in 2020, lower than that of Wintershall Dea (BBB/Stable, 617 kboepd in 2019) and Diamondback Energy, Inc (BBB/Stable, 283 kboepd), but higher than that of Neptune Energy Group Midco Limited (BB/Negative, 142 kboepd), though Aker BP has the potential to significantly increase production from non-sanctioned projects. In 2019, Aker BP's leverage was similar to those of Diamondback and Marathon Oil Corporation (BBB/Negative). Unlike Wintershall Dea and Neptune Energy, Aker BP's production is focused on oil, which generates stronger unit margins.

KEY ASSUMPTIONS

- Base-case assumptions for Brent: USD35/bbl in 2020, USD45/bbl in 2021, USD53/bbl in 2022, and USD55/bbl thereafter

- Stress-case assumptions for Brent: USD30/bbl in 2020, USD35/bbl in 2021, USD40/bbl in 2022, and USD50/bbl thereafter

- Upstream production: around 205 kboepd in 2020-2023

- Capex, excluding exploration and decommissioning expenses: USD1.2 billion in 2020; USD675 million in 2022; USD900 million in 2022 and USD1.1 billion in 2023

- Dividends: around USD570 million on average in 2020-2023

- Cash taxes: around USD600 million on average over 2020-2021; this excludes the impact of the tax package which has yet to be approved by the parliament

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Production growth sustainably above 300 kboepd while keeping FFO net leverage below 2.0x could lead to an upgrade.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO net leverage consistently above 2.7x

- Production falling consistently below 175 kboepd, e.g. due to higher-than-expected production declines at brownfields

- Inability to replenish reserves and/or proved reserves falling consistently below 600MMboe

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Aker BP has a strong liquidity position, which is unlikely to be challenged by low oil prices in the next two years. We project that under our base case the company would have around USD3.5 billion of available liquidity at both end-2020 and end-2021, mainly consisting of unutilized balance under its revolving credit facility. The latter consists of a three-year working capital facility due in May 2022 (USD2.0 billion), and a five-year liquidity facility due in May 2024 (USD2.0 billion). Aker BP's liquidity position could be further improved by the tax package yet to be finalised and approved by the parliament.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Aker BP ASA	LT IDR	BBB-	Affirmed
• senior unsecured	LT	BBB-	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 01 May 2020)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Aker BP ASA	EU Issued

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Energy and Natural Resources Corporate Finance Europe Norway