Research Update:

Norwegian Oil And Gas Company Aker BP Outlook Revised To Positive; 'BBB-' Rating Affirmed

April 30, 2021

Rating Action Overview

- Following Aker BP's strong performance in 2020 with funds from operations (FFO) of $2.1 billion in 2020, amid depressed market conditions, we believe the group is poised for continued robust performance in 2021-2022.
- We anticipate a gradual improvement of FFO to debt to above 60% in 2021, on the back of highly profitable barrels at $60 oil and expected low cash tax payments, since the temporary tax reform in Norway remains supportive.
- Strong cash flows should continue to support Aker BP's investments in strengthening its business.
- We therefore revised the outlook on Aker BP to positive from stable, and affirmed the 'BBB-' rating on the company.
- The positive outlook indicates that we could raise the ratings on Aker if FFO to debt remains at about 60%, even under normalized tax conditions, and Aker BP further strengthens its business by adding scale and diversity.

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Rating Action Rationale

Relatively low production costs and supportive market conditions should support Aker BP's high profit per barrel. We assume Brent oil prices of $60 per barrel (/bbl) over the coming two years and that production costs will stay below $10/bbl despite the appreciation of the Norwegian krone (we assume more than +10% in 2021 versus 2020). This leads us to anticipate strong cash generation with a material increase in operating cash flow before working capital change to about $2.5 billion-$3.0 billion from $2.2 billion in 2020. Although capital expenditure (capex) remains relatively high, the impact on cash flow is limited since the state will reimburse 71% of capex during the spending year. As such, we believe the company will be able to lower debt in 2021 on the back of positive discretionary cash flow (DCF) and gradually improve already strong credit metrics.

Production should stabilize above 200,000 barrels of oil equivalent per day (boepd) over 2021-2023, with further upside dependent on upcoming investment decisions. During first-quarter 2021, production soared to a record high of 222,000 boepd, and reserves at end-2020 were 641 million barrels of oil equivalent (mmboe)--although this is still below that of similarly rated peers (generally comfortably above 1,000mmboe). What's more, with the Johan Sverdrup Phase 2 and other smaller projects, production should inch toward 230,000 boepd through 2023. Beyond that, however, the company needs to launch important projects, such as NOAKA, or complement organic growth with mergers and acquisitions to further increase the scale and resilience of the business through diversification--a potential driver of our upside rating scenarios. With regards to environmental, social, and governance (ESG) factors, we believe that that the group will easily sustain long-term resilience. This is because, having low cash breakeven and being one of the lowest CO_2 emitters per barrel produced, the group is exposed to less risk than most sector peers. The challenge, however, is that the group will need to find and invest in similar low-cost and low-emitting assets in order to meet its own ESG targets.

Aker BP's financial policies and the framework supports the investment-grade rating. The company halved its dividends in 2020, and we think the new dividend framework will be more stable over the cycle. It involves a dividend of $450 million increasing by at least 5% annually, with additional shareholder distributions based on the oil price. This system allows for positive DCF in most scenarios. The group boasts a track record of conservative leverage, with net debt to EBITDAX remaining below 1.5x. We also note that Aker BP's proactive and prudent liquidity management leaves flexibility to seize inorganic opportunities that could complement organic expansion projects.

Outlook

The outlook on the long-term rating is positive. We think that, amid improving industry conditions for oil producers, and with a supportive local environment on the Norwegian continental shelf, Aker BP is well-positioned to achieve sustainably stronger credit metrics commensurate with a 'BBB' rating, namely average FFO to debt of close to 60% on average. Ratings upside would likely hinge on solid, sustained metrics even after the temporary tax reform ends, and that the current investment plans yield continued growth, improved scale, and better diversity.

Upside scenario

We could upgrade Aker BP over the next 12-24 months if FFO to debt remains close to 60%, even under normalized tax conditions, leading us to assess its financial risk profile as stronger than most 'BBB'-rated companies. However, we would not necessarily consider a one notch upgrade solely on the basis of a robust financial risk profile, owing to Aker BP's smaller scale and scope than 'BBB' rated peers. We assume Aker BP would lean on significant capex to develop its own resources, or additional large acquisitions, to improve its business risk profile in line with that of 'BBB' rated peers.

Downside scenario

We could revise the outlook to stable if Aker BP's credit measures decline well below our base-case anticipations. This could be the case if there is:

- A deeper drop in oil prices, well below $40/bbl in 2021-2022, leading FFO to debt remaining below 45%. FFO to debt approaching 30% could create rating pressure.
- Material debt-funded growth that materially lifts leverage; or
- A revised financial policy with much higher dividends, leading to materially negative 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 220,000 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 the remaining shares (30%) held by other shareholders. The company is listed in the Oslo Stock Exchange and has a market capitalization of about NOK88.5 billion (about $10.6 billion).

Our Base-Case Scenario

Assumptions

- Oil prices at $60/bbl for the rest of 2021 and 2022, and $55/bbl for 2023 and subsequent years, according to our latest price estimates. The current Brent spot price is about $65/bbl.
- A production rise in 2021 to about 210,000 boepd, nearing 230,000 boepd in 2023 as investments in assets continues and Johan Sverdrup phase 2 starts producing in 2022.
- Production costs of about $9/bbl in 2021-2022.
- Capex of about $1.8 billion in 2021 and $1.6 billion in 2022, including decommissioning spending. We assume the company will spend about $500 million on exploration per year in 2021-2022.
- Cash tax payments from 2019, set according to the Norwegian tax regime. This also implies that capex and the associated 91% tax deduction will markedly affect future tax payments, because capex is relatively high.
- Dividends of $450 million in 2021. We anticipate the company will increase this amount by 5%-10% each year thereafter and might distribute more if oil prices are above our $60/bbl base-case projection.

Key metrics

- FFO to debt of above 60% in 2021 and 2022;
- Debt to EBITDA of about 1x in 2021-2022; and
- DCF to debt of about $400 million-$500 million in 2021-2022.

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. We do not assess liquidity as exceptional, despite the strong ratio, based on our qualitative assessment.

We estimate the following principal liquidity sources as of April 1, 2021:

- Cash availability of $392 million.
- Undrawn lines of around $3.4 billion, pro forma extension/reduction.
- Lease adjusted FFO of around $2.5 billion in next 12 months and $2.2 billion in the subsequent 12 months.

This compares with the following estimate of principal liquidity uses as of the same date:

- No debt maturities in the next 12 months.
- Capex of $1.6 billion-$1.8 billion annually.
- Dividends of around $450 million in next 12 months and $475 million in 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 mostly comprises various bonds issued by Aker BP. The revolving credit facilities are currently undrawn.

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-/Positive/--

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Moderately High
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Ratings On Nine EMEA Oil And Gas Producers Affirmed Amid Increased Industry Risks, Jan. 28, 2021

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Aker BP ASA		
Issuer Credit Rating	BBB-/Positive/--	BBB-/Stable/--
Senior Unsecured	BBB-	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.