Research Update:

Aker BP ASA Upgraded To 'BBB'; Outlook Stable

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Rating Action Overview

- Shareholders have formally approved Aker BP ASA's $14 billion acquisition of Lundin Energy AB (Lundin), clearing one of the last hurdles for the transaction's completion. We expect that the deal will be approved by the regulator, and could close by the end of third-quarter 2022.
- In our view, the transaction should strengthen the company's credit profile, because the benefits of larger scale and diversity should outweigh the modest leverage increase.
- We raised the rating on Aker BP and its unsecured notes to 'BBB' from 'BBB-'.
- The stable outlook indicates that Aker BP will maintain strong credit metrics with funds from operations (FFO) to debt of above 60% in the next few years, and consistently above 50% even in the industry downturn.

Rating Action Rationale

The Lundin acquisition will strengthen Aker BP's business profile, adding scale but also allowing it to maintain a very favorable cost position and low carbon intensity across the whole portfolio. The combined company should produce more than 400,000 barrels of oil equivalent per day (boepd) in 2022, with potential to increase to 500,000 boepd in 2023, which is double the size of the existing business. This should support the relative positioning of the business risk profile within the satisfactory category.

High profitability and cash flow conversion will remain the company's core strengths after the acquisition. With a relatively low operating cost of close to $7 per barrel (/bbl) and a supportive tax regime in Norway, Aker BP has among the highest cash conversion rates of all rated exploration and production (E&P) companies globally. This will remain unchanged because Lundin's assets boast similar characteristics. We expect that profitability and cash flow conversion will remain dependent on the evolution of Norway's tax regime. At this stage, we do not anticipate any meaningful changes to Norway's tax regime, which provides strong support to the company's operating performance stability.

We expect Aker BP to retain strong financial flexibility post-transaction. The financial risk profile will likely remain unchanged by the transaction since the deal is largely share-based. Due to strong prices and supportive taxes, Aker BP has built headroom in its credit metrics and liquidity, which should allow it to absorb a $2 billion cash outflow. The current credit metrics are inflated not only due to high prices, but also because of the supportive temporary tax regime. We think the company will be able to maintain FFO to debt at 60% even under normalized tax conditions. Given the stronger business, we could tolerate a temporary weakening of FFO to debt to about 50%, provided it stems from market conditions rather than capital structure considerations.

Aker BP's financial policies and the framework should support the 'BBB' rating. Aker BP boasts a track record of conservative leverage, with net debt to EBITDAX (earnings before interest, taxes, depreciation, amortization, and exploration expense) remaining below 1.5x. In addition, Aker BP's proactive and prudent liquidity management leaves flexibility to seize inorganic opportunities that could complement organic expansion projects. The company significantly cut its dividend in 2020, reflecting a drop in prices, and it is now progressively increasing dividends as market conditions remain supportive. This allows for discounted cash flow to remain positive in most scenarios.

Outlook

The stable outlook indicates that Aker BP will maintain strong credit metrics in 2022-2023, with FFO to debt of above 60%. We think the company will continue to generate meaningful positive free cash flow and its dividends will reflect the market conditions.

Upside scenario

The ratings upside is remote, as higher-rated peers generally have much larger scale and diversity. Aker BP plans meaningful investments over the next five years, but these are unlikely to increase production to significantly above 500,000 boepd. Generally, 'BBB+' rated companies have not only larger production, but also exposure to several countries and other business lines, such as refining, chemicals, retail, or renewables.

Downside scenario

We could lower the rating if the company prioritizes shareholder remuneration, resulting in FFO to debt falling to below 60% in the current market conditions or below 50% in the downturn. A meaningful revision of Norway's very supportive tax regime could also result in rating downside, but we assess the likelihood as low.

Company Description

Aker BP is a midsize oil and gas exploration and production company operating in the North Sea. With production of about 209,000 boepd in 2021, it is one of the most important players on the Norwegian continental shelf. Aker BP is primarily owned by the Norwegian Aker Group (37.14%) and BP PLC (27.85%), with the remaining shares (35.01%) held by other shareholders. The company is listed in the Oslo Stock Exchange and has a market capitalization of about Norwegian krone (NOK) 122 billion (about $13.9 billion).

Our Base-Case Scenario

- Oil prices at $85/bbl for the rest of 2022, $70/bbl for 2023, and $55/bbl in 2024 and subsequent years, according to our latest price assumptions. The current Brent spot price is about $110/bbl.
- Pro forma the acquisition, production of close to 400,000 boepd in 2022, then rising to 450,000 boepd–500,000 boepd in 2023.
- Production costs of about $7/bbl-$7.5/bbl in 2022, and $6/bbl-$7/bbl in 2023.
- Capital expenditure (capex) of about $2 billion-$2.3 billion in 2022, increasing to about $3 billion in 2023, as the company progresses with Valhall expansion and investments in the NOAKA project.
- Tax payments, 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 $1 billion-$1.5 billion in 2022, and $1.5 billion-$2 billion in 2023. As our base case implies price reduction toward $55/bbl, we expect the company will adjust the dividend payments downward in 2024.

Key metrics

- FFO to debt of above 60% in 2022-2023
- Debt to EBITDA of below 1x in 2022-2023

Liquidity

We assess Aker BP's liquidity as strong. We project that 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 Jan. 1, 2022:

- Cash availability of about $2 billion;
- Undrawn lines of around $3.4 billion, pro forma extension/reduction; and
- Lease-adjusted FFO of about $6.5 billion in the next 12 months and about $5.7 billion-$6 billion in the subsequent 12 months.

Liquidity uses, as per our estimates, for the same period include:

- No debt maturities in the next 12 months;
- Working capital outflow of around $1 billion;
- Capex of about $2 billion-$2.3 billion in 2022, then increasing to about $3 billion in 2023; and
- Dividends of about $1 billion-$1.5 billion in the next 12 months and $1.5 billion-$2.0 billion in the subsequent 12 months.

Covenants

The major covenant is net debt to EBITDA below 3.5x and EBITDA interest coverage of a minimum of 3.5x. We anticipate that the company will be 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 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/Stable/--

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)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

ESG credit indicators: E-4, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

Ratings List

Upgraded; Outlook Action

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