

Research Update:

Lunds Energikoncernen Upgraded To 'BBB+/ K-1' On Reassessment Of Likelihood Of Extraordinary Support; Outlook Stable

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Overview

- We have revised our view of the overall likelihood that the municipal owners of Sweden-based multi-utility Lunds Energikoncernen AB (publ) (LEAB) would provide extraordinary support to the company in an event of financial distress.
- We are revising our assessment of the likelihood of extraordinary support to "moderately high" from "moderate".
- We are raising the issuer ratings on LEAB to 'BBB+/A-2/K-1' from 'BBB/A-2/K-2'.
- The stable outlook primarily reflects the stability of LEAB's monopoly operations, and our expectations of predictable earnings and solid operating cash flow generation.

Rating Action

On Feb. 5, 2010, Standard & Poor's Ratings Services raised its long-term issuer credit ratings on Sweden-based multi-utility Lunds Energikoncernen AB (publ) (LEAB) to 'BBB+' from 'BBB'. At the same time, the Nordic national scale rating was raised to 'K-1' from 'K-2'. The outlook is stable.

At the same time we affirmed the 'A-2' short-term issuer credit rating.

Rationale

The rating action reflects a revision of the likelihood that LEAB's municipal owners (Lund (82%), Eslöv (12%), Hörby (4%), and Lomma (2%) through holding company Kraftringen AB (NR)) would provide timely and sufficient extraordinary support to LEAB in an event of financial distress to "moderately high" from "moderate".

The majority owner, the Municipality of Lund is not rated, but we assess its credit quality in the high investment grade category. Following our revision, we now consider LEAB's role for the Municipality of Lund to be "important", whereas we previously considered it to be of "limited importance". We maintain our view that a private sector entity or another, larger government-related entity could undertake LEAB's operations if it should experience financial distress or cease to exist. We understand, however, that there is a broad political and strategic consensus among the owners that LEAB plays an important strategic role in the region, and that it should remain under

municipal control, even if it were to come under financial stress. This view on the part of the owners is, in our understanding, particularly strong with regards to LEAB's monopoly operations, such as electricity distribution and district heating.

Our assessment of the link between LEAB and the Municipality of Lund remains unchanged at "strong", primarily reflecting its 100% ownership by Kraftringen AB, a holding company owned by the controlling municipalities. The company's operations are strongly aligned with the interests of the four municipalities, and in particular, Lund, with which it has a strong affiliation and which has a controlling influence over LEAB. Furthermore, we assess the risk of privatization as remote given the lack of such an agenda across the political majority and opposition.

We reiterate our assessment of LEAB's stand-alone credit profile (SACP) as consistent with a 'BBB-' rating, reflecting its strong market position in the prosperous region of Skåne in southern Sweden and its stable monopoly operations in electricity distribution and district heating. More than 60% of LEAB's EBITDA comes from monopoly-type operations, which generate stable and predictable cash flows. The SACP and ratings are constrained by an expected significant weakening of debt-protection ratios in the medium term. This is based on a planned debt funded SEK2.4 billion investment in a new bio-fuelled combined heating and power (CHP) plant. Other negative rating factors include exposure to competitive electricity retail prices, and significant business and asset concentration.

Short-term credit factors

We perceive LEAB's liquidity position to be adequate. On Dec. 31, 2009, the company had SEK6 million in cash and SEK1.4 billion in undrawn committed credit facilities, of which SEK750 million related to facilities which back up a SEK1 billion commercial paper program. This compares with total short-term debt of about SEK1 billion at the same date. Of this amount, SEK750 million relates to outstanding commercial paper and drawings under two SEK500 million committed credit facilities, which mature in December 2010 and August 2011 and back the SEK1 billion commercial paper program. In our assessment of LEAB's liquidity position we assume that the company will address the December 2010 expiry of a SEK500 million credit facility in a timely manner. Failure to do so would put pressure on the liquidity position within the short term, in our opinion.

We expect LEAB to generate near zero or marginally negative discretionary cash flows during 2010 and approximately SEK100 million in 2011 due primarily to lower capital spending.

LEAB's debt facilities require the company to maintain an equity to assets ratio of at least 30%. At Dec. 31, 2009, the ratio stood at about 40%.

Outlook

The stable outlook reflects the stability of LEAB's monopoly operations and our expectations that the company will post predictable earnings and solid internally generated cash flows. We expect LEAB to post adjusted funds from operations to debt at around 20% over the cycle. In the coming years, we expect the company to comfortably achieve levels of FFO to debt above 20%. We have also factored in a likely temporary deterioration in this ratio over the medium-term to about 15%, on the assumption that construction of the bio-CHP plant commences in 2012 as planned.

We could revise the outlook to negative if LEAB's SACP were to come under pressure. This could be caused for example by unforeseen weaker pre-investment operating cash flow generation. A negative rating action could also materialize if larger-than-expected debt funded investments relating to the bio-CHP project causes the financial risk profile to weaken beyond our current expectations. Although currently unlikely, any weakening of actual or prospective shareholder support or privatization could also put pressure on the rating.

Upside potential is constrained by the expected weakening of the company's medium-term financial performance. We could, however, take a positive rating action following an abandonment of the bio-CHP project as a whole, or through a meaningful capital contribution by the shareholders.

Related Research

- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Corporate Ratings Criteria 2008, April 15, 2008

Ratings List

Upgraded; Ratings Affirmed

	To	From
Lunds Energikoncernen AB (publ) Corporate Credit Rating	BBB+/Stable/A-2	BBB/Stable/A-2

Upgraded

Nordic National Scale Rating	K-1	K-2
Commercial Paper	K-1	K-2

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