

Research

Analysis Update: Norsk Hydro ASA

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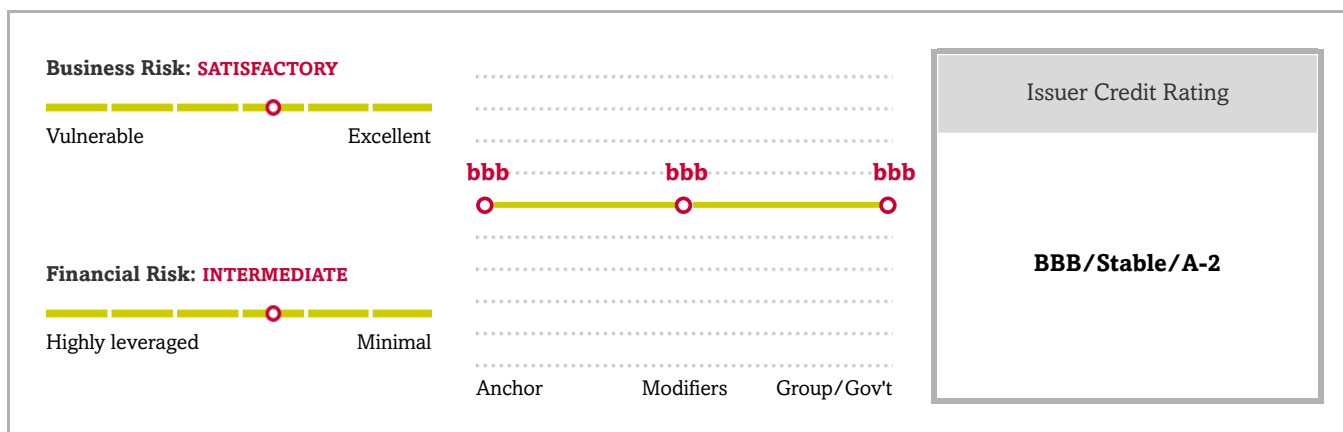
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Related Research

Analysis Update: Norsk Hydro ASA



Credit Highlights

Overview

Key strengths	Key risks
Tenth-largest producer of primary aluminum globally (2.1 metric tons [mt] annually), fully integrated into bauxite, alumina, power, and downstream operations.	Exposure to volatile aluminum industry conditions. Limited capacity growth, higher demand for aluminum, and tighter regulation could reduce the volatility somewhat.
Position in the second quartile of the industry's cost curve.	High cash flow volatility, mainly driven by the cyclicity of aluminum prices.
Cost-cutting program across the organization to support more stable profit and free cash flow contribution over the cycle. Hydro power plants and new energy projects should provide more stability.	Previous limited pressure on dividends, to be replaced by more generous payouts.
Conservative financial policies and demonstrated commitment to keep modest leverage.	Further pressure on the company to accelerate its green agenda.

Early signs of a recovery in performance, combined with internal and external growth initiatives, make S&P Global Ratings more optimistic about the outlook on Norsk Hydro ASA for 2021. This follows a strong rebound in the demand for aluminum in the first half of the year and small production deficit propelled by abnormal aluminum and ingot premiums prices (\$2,100/ton and about \$300/ton as of June 30, 2021, respectively). The better-than-expected market conditions translated into an underlying EBITDA of close to Norwegian krone (NOK) 12 billion in first-half 2021, compared to our previous (February 2021) assumption of an underlying EBITDA of NOK14.5 billion-NOK16.0 billion for the entire year. We understand that demand is likely to remain strong in the coming quarters (Norsk Hydro's order book for the entire year is almost fully booked). As a result, we now project EBITDA of NOK25 billion-NOK27 billion 2021 and NOK22 billion-NOK25 billion in 2022. Some of the increase is explained by the company's cost-cutting and commercial initiatives, so its profitability base should be much higher if aluminum industry conditions reversed overnight.

After meeting its financial objectives, more dividends are now expected. With expectations of discretionary cash flow (DCF; free cash flow after capital expenditure [capex] and dividends) of more than \$5 billion and additional proceeds of €435 million from the divestment of the rolling division, Norsk Hydro is going to be almost debt-free by the end of the year, compared with NOK29 billion as of Dec. 31, 2020 (as part of the divestment, the company's pension liabilities were reduced by about NOK10 billion). Looking ahead to 2022, we believe that Norsk Hydro is unlikely to allocate material amounts to further reduce its debt, and the company will direct more operating cash flow to capex and

returns to shareholders.

Norsk Hydro aims to become even greener. With limited opportunities to develop its smelting capacities or expand its upstream business, the company continues to look for attractive projects along its chain value, notably green initiatives. In late 2020, it announced two new projects:

- Development of its energy division. After the creation of Lyse Kraft DA in late 2020(a joint venture [JV] with the Norwegian industrial group Lyse), which holds some of Norsk Hydro's hydropower plants, Hydro announced an acquisition of 260-megawatt wind farm along with Eolus; and
- Development of its recycling business. In 2020, the recycling business contributed about NOK1.6 billion to overall EBITDA, and the company plans to double that contribution by 2025. In the second quarter, Norsk Hydro already guided for a preliminary capex of NOK0.5 billion-NOK1.0 billion from 2022-2025.

We believe that with these projects, along with other measures, the company is well positioned to meet its target of reducing its carbon dioxide emissions by 30% by 2030.

Outlook: Stable

Our stable outlook reflects the ample headroom under the rating as the aluminum industry conditions remain very prevailing. But it also reflects the limited step up in the company's portfolio to support an upgrade.

Under our base-case scenario for 2021, which incorporates an aluminum price of about \$2,100/ton, we expect Norsk Hydro to report adjusted EBITDA of NOK25 billion-NOK27 billion. This will translate into a very strong flow DCF of more than NOK5.0 billion, and adjusted funds from operations (FFO) to debt exceeding 100%. We expect similar results in 2022.

We continue to view adjusted FFO to debt of 40% through the cycle--together with positive DCF--as commensurate with the rating. During the low point of the cycle, FFO to debt could drop temporarily to 35% or slightly lower without putting immediate pressure on the rating. On the flipside, when aluminum prices are high, we expect the company's adjusted FFO to debt to be well above 45%, building some headroom to withstand the cyclical of the primary aluminum industry.

Downside scenario

Unless industry conditions reversed sharply in the coming months and Norsk Hydro deviated from its supportive financial policy, we do not view a downgrade as likely in the coming 12 months.

In our view, the main risk for a downgrade could be triggered by a large debt-funded acquisition. We view such a scenario as less likely as the company has a handful of organic projects, before pursuing inorganic growth.

Upside scenario

We see a higher rating on Norsk Hydro as unlikely in the coming 12-18 months. An upgrade would be supported by Norsk Hydro consistently achieving:

- Less cash flow volatility supported by a shift from the legacy aluminum production (mining and primary aluminium production) to power generation and downstream activities.
- A financial policy commensurate with adjusted FFO to debt above 60% over the cycle. To date, Norsk Hydro's financial policy is more in line with the rating. Such a financial policy should be supported also by relatively low debt balance and a positive DCF (excluding special returns to the shareholders) through the cycle. Even if the company adopted a more demanding financial policy, we would probably need some track record of meeting the objectives through the cycle.

Company Description

Norsk Hydro is the world's 10th-largest primary aluminum producer and is fully integrated. Its portfolio includes:

- Primary aluminum production (about 30% of EBITDA over 2017-2020), encompassing nine smelters with total capacity of 2.1 mt, of which about 50% is in Norway, with the remainder in Qatar, Canada, Australia, Brazil, and

Slovakia. The smelters are in the second quartile of the global cost curve.

- Bauxite and aluminum operations in Brazil (25%), meeting its own smelting needs, but also selling to other companies. Norsk Hydro's Alunorte refinery is in the first quartile of the global cash cost curve.
- Hydro power plants (13%).
- Downstream business (25%), including recycling and extruded products (the rolled products, which were part of the downstream business, were divested in 2021 and contributed about 7% of the group's EBITDA).

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/A-2

Business risk: Satisfactory

- **Country risk:** 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:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Related government rating:** AAA
- **Likelihood of government support:** Low (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Downstream Industry, Dec. 20, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Methodology For Standard & Poor's Metals And Mining Price Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Industry Top Trends 2021: Metals And Mining, Dec. 10, 2020
- Metal Price Assumptions: Vaccinations To Restore Vigor In 2021, Dec. 18, 2020

Business And Financial Risk Matrix						
Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of August 2, 2021)*	
Norsk Hydro ASA	
Issuer Credit Rating	BBB/Stable/A-2
Issuer Credit Ratings History	
19-Nov-2010	BBB/Stable/A-2
06-May-2010	BBB-/Watch Pos/A-3
20-Mar-2009	BBB-/Negative/A-3

Ratings Detail (As Of August 2, 2021)*(cont.)

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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