

# Helgeland Kraft AS

## Norway, Utilities


**BBB** STABLE

### Key metrics

Scope credit ratios	2020	2021	Scope estimates	
			2022E	2023E
Scope-adjusted EBITDA/interest cover	3.5x	7.8x	4.2x	5.0x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	8.8x	4.0x	6.4x	4.8x
Funds from operations/SaD	2.4 %	15.3 %	5.9 %	14.8 %
Free operating cash flow/SaD	-1.1%	4.1%	-0.7%	3.5%

### Rating rationale

The issuer rating of Helgeland Kraft reflects a stand-alone credit rating (BBB-) and a one-notch uplift based on our assessment of parent support from the company's municipal owners. The uplift is driven by the anticipated capacity and willingness of the several municipalities to provide support if needed.

The company's business risk profile (BBB) is highlighted by a vertically integrated business model, with considerable contribution from monopolistic regulated power distribution, as well as efficient and environmentally friendly hydropower production (positive ESG factor). These two segments contribute the majority of the company's profits, but it is the sizeable contribution from distribution which shapes the overall favourable industry risk at BBB+.

The company's financial risk profile (BB+) is weaker than their business risk profile. Compared to other industry peers the company has high historical leverage, as measured by an average Scope-adjusted debt(SaD)/EBITDA of 5.5x the last three years. The company's historical debt protection is satisfactory, as measured by an average Scope-adjusted EBITDA / interest expense of 6.6x the last three years. However, we project some pressure on coverage as interest rates are expected to increase.

### Outlook and rating-change drivers

The Stable Outlook reflects our expectation that: i) monopolistic, regulated grid operations and efficient, low-cost hydro production will continue to contribute around 90% of EBITDA; ii) the company's concession area will remain stable; iii) capital expenditures will remain at around the historical average and be mainly related to maintenance; iv) operating profitability will be lower than in 2021 but still satisfactory in the short to medium term; v) the company will continue to be owned by Norwegian municipalities, whose willingness and capacity to support is deemed as medium by us.

A positive action could be warranted by an improved financial risk profile, exemplified by a Scope-adjusted debt/EBITDA of below 3.75x due to improved free operating cash flow or asset disposals.

A negative rating action could be triggered by a weaker financial risk profile, exemplified by a Scope-adjusted debt/EBITDA sustained at around 5.0x and an interest coverage sustained at below 5.0x. This could be due to higher capex and/or dividends than projected. The company losing its status as a government-related entity is another trigger for a negative rating action.

### Ratings & Outlook

Issuer	BBB/Stable
Short-term debt	S-3
Senior unsecured debt	BBB

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### Related Methodologies

[Corporate Rating Methodology; July 2022](#)

[European Utilities Rating Methodology; March 2022](#)

[Government Related Entities Methodology; May 2022](#)

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#### Positive rating drivers

- Vertically integrated utility with substantial share of operating profits coming from stable and profitable monopolistic power distribution
- Cost-efficient and environmentally friendly energy production from hydro production facilities with reservoir capacities (positive ESG factor)
- Governmental ownership through long-term, committed, municipal owners

#### Negative rating drivers

- Higher SaD/EBITDA than other comparable rated peers
- Cash flows and financial credit ratios negatively impacted when market prices are low, as exemplified with FY 2020 and Q1 2022 figures
- Asset concentration risk in their hydropower production assets
- Limited geographical diversification beyond their concession area of Helgeland

#### Positive rating-change drivers

- Improved financial risk profile, exemplified by a deleveraging to SaD/EBITDA < 3.75x

#### Negative rating-change drivers

- Worsened financial risk profile, exemplified by a SaD/EBITDA at around 5.0x and interest coverage below 5x on a sustained basis
- Loss of municipal ownership

## Corporate profile

Helgeland Kraft is a Norwegian integrated utility company headquartered on the north-west coast of Norway, in a city called Mosjøen. They are fully owned by 14 municipalities which are all located in the company's regulated concession area. The company is vertically integrated, with activities within regulated energy distribution, unregulated hydro power production and energy retail. The company has 18 fully owned hydropower plants with an annual production capacity of 1,300 GWh. They also operate two additional plants through operating agreements, and has joint ownership in smaller hydropower companies in the area. The company's monopolistic energy distribution consists of the operation, and maintenance, of both district and regional networks. Their total network spans over 8,100km and transfers over 6,100 GWh of energy annually, to around 46,000 customers. Lastly, the company has a profitable energy retail operation which caters to approximately 100,000 customers. The customers are mainly located in the Helgeland area, but also in Sweden as the company fully owns Swedish energy retailer Storuman Energi AB.



## Financial overview

			Scope Estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	3.5x	7.8x	4.2x	5.0x
SaD/Scope-adjusted EBITDA	8.8x	4.0x	6.4x	4.8x
Funds from operations/SaD	2.4 %	15.3 %	5.9 %	14.8 %
Free operating cash flow/SaD	-1.1%	4.1%	-0.7%	3.5%
Scope-adjusted EBITDA in NOK m	2020	2021	2022E	2023E
EBITDA	307	541	342	437
Disposal gains / losses disposal fixed assets	-80 <sup>1</sup>	0	0	0
Dividends associated company	8	4	0	8
<b>Scope-adjusted EBITDA</b>	<b>236</b>	<b>545</b>	<b>342</b>	<b>445</b>
Funds from operations in NOK m	2020	2021	2022E	2023E
Scope-adjusted EBITDA	236	545	342	445
less: (net) cash interest paid	-52	-58	-72	-79
less: cash tax paid per cash flow statement	-109	-7	-129	-39
less: pension interest	-14	-12	-10	-10
Change in provisions	-11	-135	0	0
<b>Funds from operations</b>	<b>50</b>	<b>333</b>	<b>131</b>	<b>317</b>
Free operating cash flow in NOK m	2020	2021	2022E	2023E
Funds from operations	50	333	131	317
Change in working capital	12	-23	54	-42
Non-operating cash flow	78	0	0	0
less: capital expenditure (net)	-163	-221	-200	-200
<b>Free operating cash flow</b>	<b>-23</b>	<b>89</b>	<b>-15</b>	<b>75</b>
Net cash interest paid in NOK m	2020	2021	2022E	2023E
Net interest per cash flow statement	-52	-58	-72	-79
Interest expense pensions	-14	-12	-10	-10
<b>Net cash interest paid</b>	<b>-66</b>	<b>-70</b>	<b>-82</b>	<b>-89</b>
Scope-adjusted debt in NOK m	2020	2021	2022E	2023E
Reported gross financial debt	2,471	2,426	2,326	2,280
less: cash and cash equivalents	-662	-546	-326	-318
add: non-accessible cash	63	145	50	50
add: pension adjustment	58	38	59	59
Shareholder loan	135	113	91	68
<b>Scope-adjusted debt</b>	<b>2,064</b>	<b>2,175</b>	<b>2,200</b>	<b>2,138</b>

<sup>1</sup> One off gain - disposal of Helgeland Invest AS.

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**Environmental, social and governance (ESG) profile<sup>2</sup>**

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

**Legend**

- Green leaf (ESG factor: credit positive)
- Red leaf (ESG factor: credit negative)
- Grey leaf (ESG factor: credit neutral)

**Inherently green operations with some industry-wide regulatory risks**

Sustainability is, and has always been a key driver behind the company’s operations, as the majority of their operations revolves around the production and distribution of clean energy to the surrounding areas. However, the company acknowledges their responsibilities beyond the production of clean energy and has developed an internal “policy for sustainability and social responsibility”. The policy incorporates everything from responsible consumption and production, to worker rights and involvement in the local community. Due to the environmentally friendly production in terms of CO2 emission power production, we deem it appropriate to acknowledge their resource management as a credit positive ESG factor.

Generally, the Norwegian utilities sector is subject to regulatory and reputational risks through the concession system. However, the regulatory environment is considered very stable, and predictable. This is also not considered company specific and is therefore reflected through industry and market assessments.

Lastly, the company is privately owned by several municipal owners. This comes with both benefits and complexities. The municipal owners all have their own public budgets to balance, and are therefore expected to require dividends whenever the company has satisfactory performance. However, this is not different from any profit maximising, publicly listed company.

<sup>2</sup> These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity’s cash flow and, by extension, its credit quality.

## Business risk profile: BBB

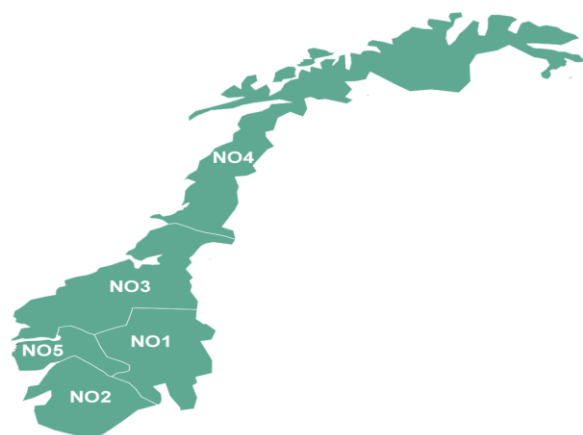
Industry risk profile: BBB+

Helgeland Kraft operates within several sub-segments as identified by Scope's European utilities methodology. We have therefore applied a blended industry risk. In order to isolate the underlying, long term industry risk the company faces, we estimate the normalised 4 year average EBITDA contribution from the respective segments.

Industry / Risk	Normalised 4 year average contribution
Unregulated energy generation / BB	46%
Regulated energy distribution / AA	42%
Energy retail / BBB	12%
<b>Blended Industry Risk</b>	<b>BBB+</b>

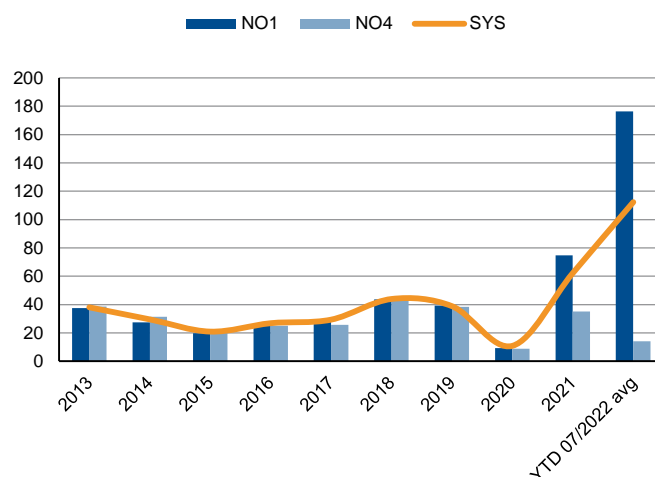
Unregulated generation and retail are both considered to have a higher industry risk than regulated energy distribution. This is because cash flows from generation is considered to have a higher correlation with market prices, whilst retail is considered to have significantly lower barriers to entry. Regulated distribution is considered to have lower risk fundamentals as prices are regulated through state set tariffs, and market positions are protected by state determined concession areas. Using the blended industry risk approach we therefore set the company's industry risk to BBB+.

Figure 1: Price regions - Norwegian utilities market



Five different price regions in the Norwegian utilities market

Figure 2: Nordic system - NO1 & NO4 power prices (EUR/MWh)



Sources: Statnett.no

Sources: Nordpool, Scope

The Norwegian utilities market is separated into 5 different price regions classified as NO-NO5 (Figure 1). NO1 is located the furthest South and NO4 is located furthest North. Historically, these regions have operated with very similar price levels (Figure 2). However, since 2021 there has been a discrepancy between the various regions. Even though all regions saw record price levels in 2021, the North was experiencing far lower prices than the South.

This was caused by several factors. However, the main reasons for this discrepancy was i) new interconnectedness between South Norway and continental EU, ii) A European energy deficit, now further exacerbated by Russia's invasion of Ukraine and the resulting sanctions on Russian fossil energy and ii) the inability to efficiently transfer excess energy from the North, to the South of Norway.



**Strong market position in its home market**

The majority of Helgeland Kraft's operation is located in their concession area of Helgeland, which is in the NO4 region.

When assessing the company's competitive position we consider the sum of all the company's segments, with its strengths and weaknesses. Overall, we consider Helgeland Kraft's market position as strong in its home markets, driven by high capacity utilisation and the efficient hydropower assets, as well as their sizeable monopolistic distribution operations.

**18 fully owned hydropower facilities**

The company operates 18 hydropower production facilities, all of which are located in the Helgeland area. This geographical concentration risk is partly mitigated by Helgeland's large geographical area of over 18,000 km<sup>2</sup>, as compared to Oslo at 454 km<sup>2</sup>. However, in terms of production capacities, we note that the company's top three production facilities contribute over 60% of the company's total yearly production. This poses a risk, as any downtime in these facilities could have a large impact on overall performance for the company.

**Small, but adept and efficient hydropower generation**

In aggregate, the company has a theoretical production capacity of 1.3TWh annually. We estimate the total Norwegian power production to be approximately 163 TWh per year. This means that the company is relatively small, with an estimated market share of 0.8%. We note the moderate size compared to other Norwegian and European utilities. However, we still consider the company to have a satisfactory market position for their generation operations. This is because the company's hydropower assets are considered adept, and efficient, with low variable costs. We also note that the largest facilities have reservoir capacities, which enable the company to regulate production if needed. This makes the company less exposed to volume risk during dry hydrological years. This is exemplified by the company's very stable 10 year mean production level of around 1.1-1.2 TWh.

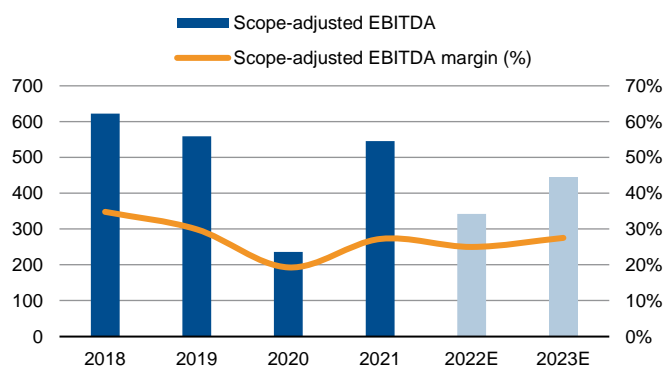
**8,100km of distribution network, from the Atlantic ocean to the Swedish border**

The company also operates 8,100km of regulated distribution networks, distributing power to 46,000 customers in the Helgeland area. Helgeland has a fairly affluent population of 77,000 inhabitants. The population has remained relatively stable over the last 10 years, supported by local industries like including ferry operations, transport, fishing and more. So even though there is a trend of migration from the North, to the South of Norway, we project these numbers to remain stable for the medium-term. The company's end customers are mainly residential (39,000 of the 46,000), but the company has seen increased demand from local industries in regards to "electrification projects". This could mitigate a potential population decline in the longer run. The high share of residential customers is considered positive in terms of stability, as residential clients are less likely to adjust consumption based on short-term price fluctuations. Compared to other Norwegian distributors who caters to more densely populated areas, the company's operations are rather small (v. Eidsiva with 940,000 customers). However, we highlight that distribution is a government protected, monopolistic environment, which makes size less relevant. There is no competition on distribution revenues, and regulation allows for a timely cost coverage. We positively note the company's regulated distribution operations both in terms of market position, as well as for projected future earnings.

**Strong local market position in retail, driven by high level of engagement**

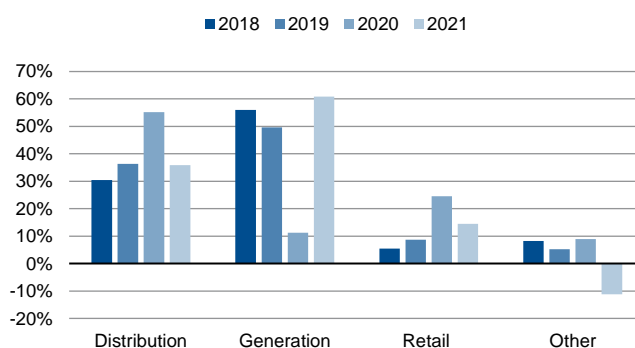
Lastly, the company has a substantial retail activity, with ~100,000 customers across Norway and Sweden. However, the majority of these clients are located in the Helgeland area, where the company has an estimated market share of > 85%. This market share is driven by the company's engagement with, and support of, the local communities. The company has a clear goal of contributing in ways beyond their annual dividend payments. They therefore sponsor everything from local soccer teams to bigger sporting- and cultural-events. This has resulted in a strong local brand. Beyond Helgeland, the company is also represented in Sweden through their fully owned subsidiary Storuman Energi AB. The retail operations are fully exposed to competition, and contributes less to overall EBITDA than Generation and Distribution.

**Figure 3: EBITDA (NOK m, LHS) & margin development**



Sources: Helgeland Kraft AS, Scope (estimates)

**Figure 4: Segments – EBITDA contributions (%)**



Sources: Helgeland Kraft AS, Scope

**Satisfactory historical operational performance, but slightly below other Norwegian integrated utilities**

The company's performance, measured by Scope-adjusted EBITDA, has historically been in the 25-30% territory. We deem this satisfactory, but note that it is slightly below other integrated utilities in the Norwegian market. We identify a below average efficiency rating (and therefore lower allotted income) for the company's distribution operations, as one of the reasons behind this lower profitability. We also note that the company's efficiency rating has been negatively impacted by a rather large pension cost taken in 2015. Since this efficiency is measured on a 5 year basis, we expect the company's efficiency rating (and allotted income) to steadily increase from 2021 and onwards. Lastly, we note that the company's overall performance fluctuates in accordance to price levels. This is due to the price sensitivity in generation, partly mitigated by the company's dynamic hedging strategy.

**Strong 2021 performance, projections of weaker performance going forwards**

For 2021, the company's performance benefited from strong increases in energy prices (figure 2 & 3). This led to a large positive effect in the company's generation, with a 61% contribution to overall EBITDA (figure 4), and 23% to revenues. This is a much higher contribution than historically, and shows the price sensitivity in generation. For 2022 so far the picture has been different, with price levels resembling those of 2020 in the North, whilst the South are still seeing record price levels. This is because of the aforementioned structural and geopolitical issues, which will take time to correct. We therefore project this price differential to persist in the short- to medium-term, and for the prices to gradually recover in the longer-term.

Since all of the company's generation and distribution assets are located in the North, we project downwards pressure on both topline and Scope-adjusted EBITDA for the short- to medium-term. However, we expect the company to benefit from the non-cyclical contribution from regulated distribution, to significantly dampen this downwards pressure.



## Financial risk profile: BB+

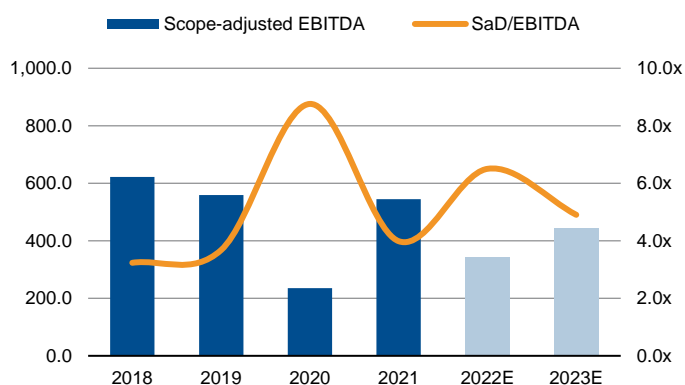
Modest leverage levels, satisfactory cash flow generation

Project leverage ratios to remain high, with gradual deleveraging in the medium-term

The company's financial risk profile (assessed at BB+) reflects a modest leverage, a satisfactory historical debt coverage, and acceptable cash flows. For our base case we have the following main assumptions; i) Low prices to persist throughout 2022, with a gradual normalisation towards forward market prices (EUR 30 MWh) in the medium-term, ii) Stable production levels, close to historical mean production, iii) Increasing profitability in distribution, due to an increased efficiency rating and grid expansions and iv) company to amortise their shareholder loan and extend their maturity profile going forwards.

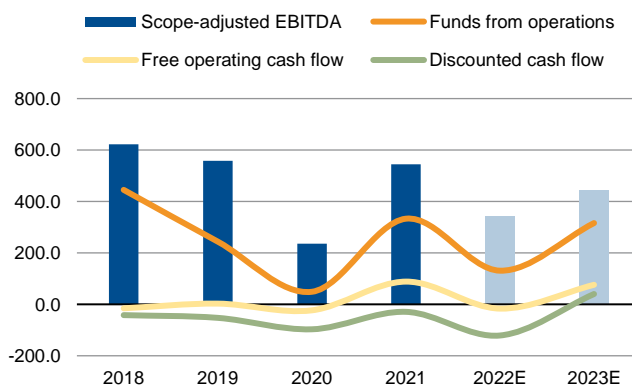
Utilities typically have greater leverage and longer debt maturities than average industrial companies. This is because the higher debt is often backed by highly efficient and long-term assets. However, even compared to other industry peers the company has high historical leverage, as exemplified by an average (SaD)/EBITDA of 5.5x the last three years. The number is negatively impacted by record low prices in 2020, and we expect a similar effect in 2022, as prices in their concession have been exceptionally low year to date. We therefore project the company's leverage to remain high in the short- to medium-term, but with a gradual deleveraging as price levels normalise.

Figure 5: Scope-adjusted EBITDA (NOK M, LHS) and leverage (RHS)



Sources: Helgeland Kraft AS, Scope (estimates)

Figure 6: Scope-adjusted cash flows (NOK m)



Sources: Helgeland Kraft AS, Scope (estimates)

Satisfactory historical debt coverage

We measure the company's ability to service their debt by looking at Scope-adjusted EBITDA/interest expenses. Despite relatively high debt levels, the company's historical debt protection is considered satisfactory, with an average coverage of 6.6x the last three years. Although positively impacted by the low interest rate climate prevalent in the same period, we still positively note the company's coverage. Going forwards we project higher costs of financing, due to inflationary pressures and rising forward interest rates. Partly mitigated by several bond maturities in the medium term which have high interest. We expect these to be refinanced at better terms, despite the increasing forward interest rates. Lastly, we also expect operational performance below historical averages. This will also put pressure on coverage. Still, we project moderate coverage ratios in the 4.0-5.0x range in the short- to medium-term.

Historically satisfactory FFO generation and slightly negative discretionary cash flows

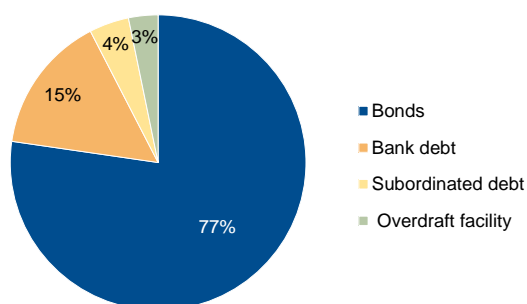
Historically, the company has had a satisfactory and rather stable FFO generation (except for 2020). They have also successfully adjusted their capex levels so FOCF revolves around zero. Dividends on the other hand is dependent on the performance the



preceding year, therefore this balancing act can be more difficult. Still, the resulting FOCF is considered acceptable, but we note that FOCF has been negative more often than not recent years.

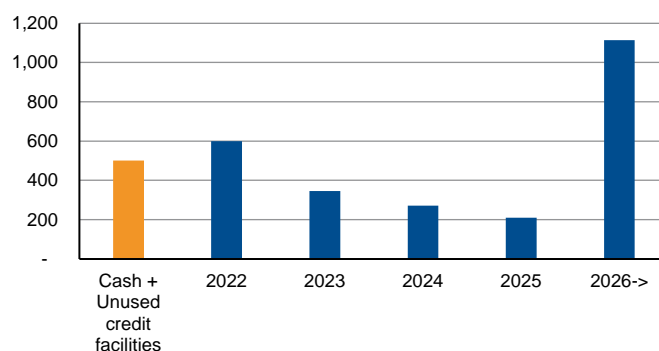
Going forwards we expect the company to focus their investments on their distribution network and capex levels to be around NOK 200m, which is lower than recent years (~NOK 250m). We do not factor in any major expansionary investments, as we expect the company to focus on deleveraging and maintaining dividends to their municipal owners. We believe that the low prices, inflationary pressure and high dividends based on good performance in 2021, will result in a slightly negative FOCF for 2022. Then for 2023 and onwards we see improvement, with normalising price levels and lower dividend payments.

**Figure 7: Funding sources YE 2021**



Sources: Helgeland Kraft AS, Scope

**Figure 8: Liquid assets & maturity profile at YE 2021 (NOK m)**



Sources: Helgeland Kraft AS, Scope (estimates)

### Adequate liquidity

At YE 2021, the company had NOK 692m in unrestricted cash reserves, and NOK 100m in long term undrawn credit lines. They also had no short-term debt. In 2022 the company has a maturity of NOK 600m, which is already partly refinanced by a NOK 300m green bond issuance in Q1 2022.

Still, we see downwards pressure on the company's liquidity in 2022, caused by high restricted cash from high tax payments on 2021's results, dividends and decreased cash flows. However, we expect the company to refinance the remaining NOK 300m in short term maturities without issues, based on a satisfactory standing in the capital markets. Beyond that, the debt maturity schedule is averaging around NOK 300m per year in the medium-term, indicating a relatively evenly distributed debt profile as seen in figure 8. Our projections indicate that the company will manage this comfortably.

Balance in NOK m	2021	2022E	2023E
Unrestricted cash (t-1)	559	401	276
Open committed credit lines (t-1)	100	100	100
Free operating cash flow	89	-15	75
Short-term debt (t-1)	0	600	346
<b>Coverage</b>	<b>N/A</b>	<b>81%</b>	<b>130%</b>



### Supplementary rating drivers: + 1 notch

We make no adjustment for financial policy, but note that the company actively monitors quantitative and qualitative factors that affect the company's creditworthiness and compliance with their financial covenants. The company has two covenants related to their external financing, one of minimum 30% equity and one of NIBD/EBITDA of less than 6.0x. We acknowledge that the company is (and is project to remain) compliant with these covenants. However, the covenants are so generous that we do not consider them to have any disciplinary effect.

#### Government Related Entity with one-notch uplift

Helgeland Kraft is 100% owned by 14 Norwegian municipalities which also constitutes their regulated concession area. We have used our government related entities (GRE) methodology and applied a one-notch uplift to the company's standalone credit rating. The one-notch uplift for ownership is in line with other Scope-rated Norwegian utilities with majority or full municipality ownership, but without explicit guarantees.

Based on the methodology framework, we consider both the overall capacity and willingness of the owners to provide support, which includes an evaluation of strategic importance, ease of substitution and default implications. Considering the company's activities and relative market share in their respective concession area, we consider them to provide a critical public service. We also consider the owners as somewhat dependent on the company to pay them yearly dividends to balance out their municipal budgets. Therefore, the capacity to provide support is considered moderate.

### Long-term and short-term debt ratings

#### Senior unsecured debt rating: BBB

The company had NOK 2.9bn of senior unsecured debt as of June 2022. Helgeland Kraft AS is the issuer of all outstanding debt. All senior unsecured debt has a negative pledge and pari passu conditions. We have assigned these a BBB rating, in line with the issuer rating.

#### Short-term debt rating: S-3

We have assigned an S-3 short-term rating, based on internal and external sources of liquidity (e.g. access to credit facilities and cash on hand), cash flow generation, adequate access to capital markets, and Helgeland Kraft's long-term issuer credit rating.



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