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Research Update:

Norwegian Oil And Gas Co. Aker BP Rated 'BB+'; Outlook Stable

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Table Of Contents

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Research Update:

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Overview

- Norway-based oil and gas exploration and production company Aker BP ASA has midsize reserves and production in a concentrated, albeit geopolitically stable, area.
- We consider that Aker BP has solid long-term production prospects, requires relatively high capital intensity to develop its reserves, and has a dividend policy that will allow for at least neutral discretionary cash flow.
- We are assigning our 'BB+' long-term corporate credit rating to Aker BP.
- The stable outlook reflects our expectation that the company will increase production in the medium term and maintain solid credit metrics through at least neutral discretionary cash flow over the business cycle.

Rating Action

On June 14, 2017, S&P Global Ratings assigned its 'BB+' long-term corporate credit rating to Norway-based oil and gas exploration and production company Aker BP ASA. The outlook is stable.

We also assigned a 'BB+' issue rating to Aker BP's proposed $500 million senior unsecured notes. The recovery rating of '4' reflects our expectation of average recovery (30%#50%; rounded estimate 40%), in the case of default.

Rationale

The rating on Aker BP reflects our view of the company's midsize reserve base and production levels, relatively high asset concentration, and the capital intensity required to develop its reserves into production and renew its consumed reserve base. We view positively management's experience, the swift integration of acquired assets in past years, and the company's ownership structure, mainly composed of Aker ASA and Aker BP PLC.

Aker BP has a midsize reserve base (529 million barrels of oil equivalent [mmboe] of 1P reserves and 711 mmboe of 2P reserves) and production (145,000 barrels of oil equivalent per day [boepd] in first-quarter 2017), with favorable long-term growth prospects and a high share of oil in its production (80%). The company also has a strong focus on operating efficiency, particularly as cost is a key strategic focus, notably through partnerships with suppliers, which we understand is fairly uncommon in the industry. This allows for relatively low breakeven costs per barrel for new projects and relatively high operating cash flows per barrel compared to peers.

Diversification is low in terms of geography, with all assets in Norway, however, Aker BP benefits from a stable fiscal environment and mature area with a track record of low disturbances. Tax regime incentivizes investments, resulting in good opportunities to develop reserves, although it comes at the cost of constant high capital expenditure (capex) weighing on free operating cash flow (FOCF) generation, or in the absence of investments, high taxes. Still, we note the $1.9 billion of undepreciated tax receivables that improves our view of future cash flows in the midterm and mitigates a spike in cash tax payments in the near to midterm if investments are lower.

We assess profitability as average despite the strong cost focus, since the company operates in a relatively high-cost environment (Norway). The business overall is satisfactory, in our view, although we believe it is relatively weaker compared with its investment-grade peers, notably as scale and diversification is limited on a relative basis. Weaknesses for the business risk profile includes the company's participation in the highly volatile exploration and production business, the company's current midsize hydrocarbon production base of just below 145,000 boepd in the first quarter of 2017, of which close to 45% came from the Alvheim field. This relative concentration is also present in development projects--with the Ivar Aasen field leading new production in the coming years and the Johan Sverdrup field in the midterm--increasing risks associated with potential cost overruns or production issues.

The company has put in place a dividend policy (minimum of $250 million per year) that could result, in conjunction with high capex, in neutral or negative discretionary cash flows (DCF) on a regular basis. Our view of the company's solid credit quality, with predictable cash flows in the long term and a capital structure that is adequate with regards to those future cash flows is supportive our rating. The company remains vulnerable to price swings, but has a high discipline for sanctioning new projects at low breakeven costs and is continuously improving its cost base; all this while operating in an already relatively low price environment.

Aker BP's significant financial risk profile is constrained by the need to fund its development assets and the debt required for that purpose. We estimate funds from operations (FFO) to debt will be 45% at year-end 2017. We anticipate credit measures will deteriorate through 2019 as production declines, until oil production commences at the Johan Sverdrup field.

In our base case, we assume:

- Oil prices of $50 per barrel (/bbl) for the rest of 2017 and 2018, and $55/bbl in 2019 and onward, according to the latest S&P Global Ratings' price deck.
- Given depletion rates, notably in the North Sea, Aker BP will be dependent on new projects coming on stream to increase volumes. Despite some new production in the next couple of years, those will not be sufficient, in our view, to mitigate natural decline in production. We

assume production of about 130,000 boepd in 2017 declining to about 110,000 boepd in 2019, notably as Alvheim production diminishes.
- Favorable mid- to long-term growth prospects as the company has a meaningful stake in the Johan Sverdrup field that should boost group production from 2020.
- In conjunction with the declining production over our 2017-2019 forecast, production costs per barrel will increase, notably due to a scale effect. Those stood at about $9/bbl in first quarter 2017. We assume they will be above $10/bbl in 2017 and increase thereafter until Johan Sverdrup comes on stream.
- Minor negative working capital (<50$ million) as the company starts new projects.
- Capex reducing from about $1 billion toward $650 million in 2019, notably as spending on Johan Sverdrup reduces as time to first oil diminishes. We include abandonment expenses in this figure of about $100 million in 2017.
- Taxes are set according to the Norwegian tax regime. We assume taxes will have a positive impact in 2017, due to refunds and neutral DCF in 2018-2019.
- Dividends of $250 million paid in 2017. Under our base case, we anticipate this figure to materially increase once Johan Sverdrup starts generating cash flows.
- Committed exploration expense of about $350 million in 2017 and less in 2018-2019. We note that those are discretionary and could be lowered if oil prices decline.
- No acquisitions. However, mergers and acquisitions has been, alongside organic projects such as Ivar Aasen, have been a key growth factor in recent years. Although the company has, in our view, a portfolio well adapted for organic growth, acquired growth could also supplement this. In the case of a larger acquisition, we would assess the impact on leverage and the business risk profile, but we do not anticipate a large debt-funded acquisition at this point.

Based on these assumptions, we arrive at the following credit measures:
- FFO to debt between 40%-50% in 2017 and about 30% in 2018.
- Improvement in credit metrics from 2020 based on both increased production and higher oil prices.
- Negative DCF in 2018-2019 as a direct consequence of the capex plan and annual dividends.
- Debt to EBITDA of slightly below 2x in 2017 and slightly above 2x in 2018.
- Ample liquidity coverage ratios.

Liquidity

We view Aker BP's liquidity as strong, based on the availability of funds under its reserve-based lending (RBL) facility and revolving credit facility, although we note the company plans to cancel its RCF, projected FOCF for the coming 12 months, and no debt maturities. We calculate that liquidity sources to uses will be comfortably more than 1.5x for the 12 months from April 1, 2017. Another factor underpinning Aker BP's liquidity is the ample headroom under its financial covenants.

We estimate the following principal liquidity sources for the 12 months from March 31, 2017:
- Estimated unrestricted cash on balance sheet of $183 million;
- Availability of about $2.4 billion under the company's RBL and RCF; and
- FFO generation of about $1.4 billion.

For the same period, our estimate of the principal liquidity uses includes:
- Capex of about $1 billion;
- Some swings in working capital; and
- $250 million in dividends.

Outlook

The stable outlook reflects our view that Aker BP's weighted-average credit metrics, although declining, will remain commensurate with the rating over the next three years, with FFO to debt in the mid-30% range. We anticipate metrics will improve when the Johan Sverdrup field starts producing, which is included in our base case.

Upside scenario

We could raise the rating in the next 12 months if we expect FFO to debt to improve and remain above 45% for a sustained period. This would most likely occur if average commodity prices were higher than our current price deck assumptions, or if the company increased its proved reserves and production more in line with higher-rated peers, while maintaining credit measures at the current level.

Downside scenario

We could downgrade the company if we expected FFO to debt to fall and remain below 30% for a prolonged period. This would most likely occur if capex exceeded cash flows and dividend payouts became more aggressive than our current estimates. If production was weaker than our projections, notably due to high depletion rates, or if the company pursued a heavily debt-financed acquisition, we could also lower the rating in the next year.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Satisfactory
- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bb+

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 rating analysis: Neutral (no impact)

Recovery Analysis

Key analytical factors

- The issue rating on the proposed $500 million senior unsecured notes is 'BB+' with a recovery rating of '4'.
- In our default scenario, we assume that the $550 million RCF will be cancelled as stated by the company within a month and not be part of the capital structure at default. We believe it is likely given that the line is undrawn, bears a higher margin than the RBL facility, and the company has ample availibility under the RBL facility. If that was not the case, and the company decided to keep the RCF in the structure, it could lead us to lower the issue rating by two notches and revise the recovery rating to '6', given the additional debt that would in such scenario rank ahead and the unsecured notes.
- The recovery rating is underpinned by the group's significant oil and gas reserves and our valuation of these reserves under S&P Global Ratings' assumptions. Our assumptions incorporate value from the 2P reserves; though on a reduced basis (see "Revised Assumptions For Assigning Recovery Ratings To The Debt Of Oil And Gas Exploration And Production Companies," published Sept. 14, 2012, on RatingsDirect).
- We have not attributed any value in default for tax assets.
- We understand that the proceeds from the issuance will be used to pay down existing drawings on the RBL facility; the $4 billion commitment on the RBL facility will remain unchanged. We understand from the documentation that the proposed notes rank pari passu with the company's existing Norwegian krone (NOK)1.9 billion (about $220 million)senior unsecured bond.
- In our hypothetical default scenario, we assume a payment default by Aker BP in 2022, due to operational delays in the fields currently under development, as well as weaker production rates and a prolonged period of low commodity prices, which are symptomatic of past defaults in this sector.
- We value the company as a going concern. We see the primary source of recovery as the company's oil reserves, which we value at about $4.7 billion at the point of default. This includes our assumption that the oil reserves would have reduced.

Simulated default assumptions

- Year of default: 2022
- Jurisdiction: Norway

Simplified waterfall

- Net value available to creditors: $4.5 billion
- Secured debt claims: $4.1 billion*
- Unsecured debt claims: $0.74 billion*
- ##Recovery expectation: 30%#50% (rounded estimate 40%)
- Recovery rating: 4

*All debt amounts include six months of prepetition interest.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Corporates - Industrials: Revised Assumptions For Assigning Recovery Ratings To The Debt Of Oil And Gas Exploration And Production Companies, Sept. 14, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating	
Aker BP ASA	
Corporate Credit Rating	BB+/Stable/--
Senior Unsecured	BB+
Recovery Rating	4(40%)

Additional Contact:
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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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.