FitchRatings

Fitch Assigns Aker BP First Time 'BBB-' Rating; Outlook Stable

Fitch Ratings - London - 04 June 2019:

Fitch Ratings has assigned Aker BP ASA a Long-Term Issuer Default Rating (IDR) of 'BBB-'. The Outlook is Stable.

Aker BP is one of the largest independent companies operating on the Norwegian Continental Shelf (NCS). Its 'BBB-' rating and Stable Outlook are supported by (i) the expected increase in production to above 200 thousand barrels of oil equivalent (kboepd) by 2020, driven by the start-up of the very large Johan Sverdrup field in 4Q19, where Aker BP has a 11.6% stake and where we see execution risks as low; (ii) its potential to increase production and optionality with regards to growth and capex plans; (iii) low production and full-cycle costs; (iv) relatively low leverage and conservative financial policy, with the target of maintaining net debt to EBITDAX below 1.5x; (v) the stable operating environment in Norway, where taxes are high but the state supports the industry by offering favourable tax incentives, eg for exploration and decommissioning; and (vi) robust liquidity, which should enable the company to proceed with its growth plans.

Constraints on the rating include (i) Aker BP's new progressive dividend plan, which could put its free cash flow (FCF) generation under some pressure; (ii) its high capital intensity in 2019 and potentially beyond; and (iii) some uncertainty with regards to the timing and scope of its non-sanctioned projects, in particular North of Alvheim Krafla Askja (NOAKA), which may have an impact on the company's near-term financial profile.

Key Rating Drivers

Large Independent Producer In Norway: Aker BP is one of the largest independent exploration and production (E&P) companies operating in Norway. According to the Norwegian Petroleum Directorate, Aker BP holds 10% of total oil reserves in the country (making it the third-largest liquids producer after state-controlled Equinor and fully state-owned Petoro), and has the highest number of licenses after Equinor. Unlike some of its peers, Aker BP is the operator in most of its projects, and has the highest production growth potential amongst peers in the region, based on management's guidance.

Rising Production: Our base case forecasts Aker BP's oil and gas production rising from 154kboepd in 2018, including 79% of liquids, to around 210kboepd in 2020 (mainly on the back of Johan Sverdrup) and to around 240kboepd in 2023. This assumes that around 70% of the company's prospective projects are sanctioned, excluding NOAKA. Management guides that production could potentially exceed 300kboepd by 2025 (or 400kboepd, including NOAKA).

Johan Sverdrup On Track: Johan Sverdrup will be the largest contributor to Aker BP's near-term production growth. Aker BP has a 11.6% stake in the project, which is operated by Equinor and is expected to come on-stream in November 2019 and to ramp-up fairly quickly to the full capacity of 440kboepd (50kboepd net to Aker BP). Phase 2 will add 220kboepd to gross and 25kboepd to net production from 2023. We view execution risks as fairly low given that an estimated 90% of the project has been completed to date. Owing to its size, John Sverdrup has very strong economics with breakeven oil price below USD20/bbl, and should help Aker BP further reduce its already low production costs.

Decision On NOAKA Delayed: The NOAKA project is not factored into our rating case but could substantially increase Aker BP's production, although there is some uncertainty with regards to its scope and timing. The project consists of several separate oil and gas discoveries operated by either Equinor or

Aker BP. It has been delayed as the two companies are trying to choose between two alternative development concepts. It is not clear yet whether Aker BP and Equinor will end up developing NOAKA together or do so independently, which may be less economical and, in our view, may imply asset swaps.

Sanctioning NOAKA will likely result in increased capital intensity compared with our base case and the need to increase borrowings over the medium term, although this would have to be assessed against Aker BP's higher operating cash flows and improved business profile. NOAKA may contribute around 100kboepd of incremental production to Aker BP from 2022-23, and the company's net contingent reserves (2C) associated with NOAKA are around 300 million barrels of oil equivalent (MMboe).

Low Production Costs: Aker BP's production costs are low for a company focusing predominantly on liquids. In 2018, the company estimated its unit production costs at USD12/boe, and expects this will fall to USD7-10/boe once Johan Sverdrup and other projects go into production. Aker BP targets full-cycle project break-even oil price below USD35/boe, and its projects in the pipeline are in line with this threshold. Low production and full-cycle costs hedge Aker BP against a low-oil price scenario.

Strong Reserve Life Replacement: Based on 2018 production, the company's reserve life is strong at 12 years for proved (1P) and 16 years for proved and possible (2P), although this is likely to somewhat fall and become more in line with that of peers as Aker BP ramps up production. Over 2016-2018, the company increased its 1P reserves to 683MMboe from 374MMboe, and 2P reserves to 917MMboe from 498MMboe, mainly as a result of its merger with BP Norge in 2016 and acquisition of Hess Norge in 2017. The organic reserve replacement ratio over the years was also strong at around 140% for 1P and around 150% for 2P. In addition, Aker BP assesses its contingent (2C) reserves at 946MMboe, mainly represented by the NOAKA project and Valhall Area.

Conservative Financial Profile: We view Aker BP's leverage target of maintaining net debt to EBITDAX below 1.5x as reasonably conservative. Based on our expectations for taxes, exploration, decommissioning and operating lease charges, this target roughly translates into funds from operations (FFO) adjusted net leverage between 2.25x-2.75x. Our base case forecasts FFO adjusted net leverage to increase to 2.4x at end-2019 from 1.0x at end-2018 and to moderate to below 2.0x in 2020-2021 before rising to 2.0x-2.5x in 2022-23. However, we recognise that leverage may be impacted by the timing of new potential projects and possibly acquisitions.

Dividends Could Pressurise FCF: Aker BP publicly targets dividends to grow to USD750 million in 2019 from USD450 million in 2018, and then to increase by USD100 million per year. While we expect FCF before dividends to be strong after 2019, FCF after dividends, assuming our conservative oil price assumptions, are forecast to turn negative beyond 2021 under our base case. However, this is mitigated by management's public aim to maintain net debt to EBITDAX below 1.5x, which we assume will translate into a moderation of cash dividends in case of underperformance, e.g. as a result of lower-than-assumed oil prices.

Our base case shows that Aker BP should have the capacity to increase dividends as planned and maintain leverage within our sensitivities.

Potential Upside From Exploration: We understand from management that after the acquisitions completed over the last several years, Aker BP has increased its focus on organic growth. Aker BP is well-positioned to increase its reserves through exploration, given that it has the highest number of licenses among other independent players on the NCS. In 2018-19, the company made two discoveries, both in the Alvheim area - Frosk in February 2018 (gross resource estimate: 30-60MMboe, net to Aker BP: 20-39MMboe) and Froskelar in March 2019 (60-130MMboe gross, net estimates are not available as some of the resources may be located outside of the license area).

Stable Operating Environment: In contrast to many other oil producing countries, the operating environment in Norway (AAA/Stable) is strong, which supports Aker BP's rating. The oil and gas sector plays an important role in the economy, and over the past decade the government has taken steps to re-vitalise investors' interest towards the NCS. The tax rate is high (78%), but the effective tax rate paid by many upstream companies, including Aker BP, is lower given deductions for decommissioning, exploration and additional capital allowances. We view the Norwegian tax system as mature and stable, which implies relatively low tax and regulatory risks compared to developing countries. We do not think that major changes in regulation are likely in the foreseeable future.

Rating On Standalone Basis: Aker BP is owned by Aker ASA (40%) and BP plc (A/Stable, 30%), with the rest of shares being free float. We rate Aker BP on a standalone basis as there is no control from any of its shareholders. The presence of two strong and experienced shareholders in the structure supports the rating. In particular, we think that Aker BP has strategic importance for BP, and the company's default would have very negative reputational consequences for BP.

Derivation Summary

Aker BP is one of the largest European E&P companies by the level of production and reserves and focusing exclusively on the NCS. The company's production should exceed 200kboepd once the enormous John Sverdrup field off Norway, in which it has an 11.6% stake, comes on stream in late 2019. Its longer-term production potential is larger with management's guidance above 400kboepd. The level of production Aker BP should achieve in 2020 is consistent with the lower end of the 'BBB' category, although lower than that of Noble Energy (BBB-/Positive, 346kboepd in 2018) and Hess Corporation (BBB-/Negative, 277kboepd). However, Aker BP's lower scale of production is offset by its low costs, robust profitability, high optionality with regards to capex given its operatorship status in most of the projects and supportive regulatory regime in Norway.

Aker BP's policy is to increase dividends but at the same time to maintain debt level at a reasonably conservative level. Under the base case we forecast FFO adjusted net leverage to remain below 2.5x in 2019-2023, and to be broadly in line with that of Encana Corporation (BBB/Stable), Noble Energy and Hess Corporation.

No Parent/Subsidiary Linkage, Country Ceiling constraints, or Operating Environment factors influenced the rating.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Oil price deck: USD65/bbl in 2019, USD62.5/bbl in 2020, USD60/bbl in 2021, and USD57.5/bbl in 2022-23

- Upstream production rising to around 210kboepd in 2020 and to around 240kboepd by 2023 as Johan Sverdrup and other projects starting up and ramping up

- Around 70% of the company's prospective projects are sanctioned, excluding NOAKA; capex averaging USD1.2 billion over 2019-2023

- Taxes rising to around USD600 million in 2019 and to above USD1 billion per year in 2020-2023

- Dividends increasing in line with the stated target: USD750 million in 2019 rising by USD100 million per year

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

Production growth sustainably above 300MMbpd while keeping FFO adjusted net leverage below 2.0x could lead to an upgrade to 'BBB'.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- FFO adjusted net leverage consistently above 2.75x (2019E: 2.4x)

- Production remaining below 175MMbpd due to delays with greenfield projects (including Johan Sverdrup) and/or higher-than-expected production declines at brownfields

- Inability to replenish reserves and/or proved reserve life falling below 10 years.

Liquidity and Debt Structure

Strong Liquidity: Aker BP's liquidity position is strong. It has obtained a USD4 billion senior unsecured revolving credit facility (RCF) to refinance its USD4 billion reserve-based lending facility. The new RCF includes a USD2 billion working capital facility due in 2022 and a USD2 billion liquidity facility due in 2024 and potentially extendable by two years. At end-2018 Aker BP had no short-term debt, and the nearest maturity is a USD224 million bond due 2020. According to our base case, the company has substantial liquidity buffers until 2022.

Summary of Financial Adjustments

Rigs Excluded From Capitalised Leases: We capitalise Aker BP's operating leases using the standard 8x multiple with the exception of rig lease payments. Rigs are used for the purposes of exploration and development drilling rather than for on-going production activity, and are normally contracted for a relatively short period of time (one to three years) to match duration of exploration or development projects.

Date of Relevant Committee

24-May-2019

Sources of Information

RATING ACTIONS

ENTITY/DEBT	RATING		
Aker BP ASA	LT IDR BBB- O New Rating		

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)

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