Research Update:

Aker BP 'BB+' Ratings Affirmed; Outlook Remains Positive

June 3, 2019

Rating Action Overview

- Aker BP continues to deliver a robust operational performance, and we expect this will continue over 2019-2020, assuming the Johan Sverdrup oil field comes online as expected.
- Aker BP has refinanced its reserve base lending facility with a revolving credit facility, simplifying its capital structure.
- We are therefore affirming our 'BB+' ratings on Aker BP.
- The positive outlook reflects our view of an increasing likelihood that we could upgrade Aker BP in the next six to 12 months if the Johan Sverdrup field is launched on schedule, and the company maintains funds from operations to debt sustainably above 45%.

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Rating Action Rationale

The positive outlook continues to reflect our view of Aker BP's achieved and anticipated growth in production and reserves, and continuing relatively favorable oil prices. As a result, the company posted funds from operations (FFO) to debt of about 60% at year-end 2018. We anticipate a strong performance over 2019-2020, and now expect FFO to debt of about 45% at year-end 2019, following a year of significant capital expenditure. We believe these levels are commensurate with a 'BBB-' rating, but for the company to maintain these metrics over the longer term, production will have to increase.

Such an increase will ultimately depend on the successful and timely startup of the Johan Sverdrup field. Aker BP holds an 11.6% working interest in this field (operated by Equinor), which is by far the largest in the North Sea, with peak production of more than 600 thousand barrels of oil equivalent per day (kboepd). The field also represents 33% of the company's proved and probable hydrocarbon reserves, underlining its importance to Aker BP. However, if the Johan Sverdrup is launched on schedule, we could upgrade Aker BP sooner than expected, within the next six to 12 months.

Aker BP's recent refinancing of its reserve base lending facility (RBL) with a revolving credit facility (RCF) also supports the rating and outlook because it simplifies the company's capital structure, and offers more leeway for growth initiatives.

Financial policy continues to be very important for the rating, with the company targeting increased scale. At the same time, Aker BP's dividends are increasing in parallel with production levels, although we do not anticipate any one-off distributions in our base case. We anticipate the company will still generate positive discounted cash flow from 2020. We also believe there will be much less committed spending for the company once Johan Sverdrup phase 1 is on stream. However, the company has several organic opportunities, notably the North of Alvheim Krafla Askja (NOAKA) project, although discussions among partners on how to proceed will likely push back investments that could provide upside to overall scale and fuel capital investments in the years to come. We also understand the company could continue its mergers and acquisitions strategy, and start spending more on exploration in a more favorable price environment.

Aker BP's improved business position is a result of past inorganic growth, but also due to increased reserves through exploration. Overall, probable and proved reserves have increased to 917 million barrels of oil equivalent (mmboe) compared with 913mmboe one year ago, and we expect production will reach about 200kboepd by 2020, compared with 158kboepd in 2018. This increase stems mainly from our expectation of production additions from the giant Johan Sverdrup field, one of the most important industrial projects in Norway in the next 50 years. With phase one set to be completed in late 2019 and an estimated plateau production of 440kboepd, Johan Sverdrup could add up to 50kboepd to the group's production in 2020. Additionally, there is potential for further organic growth with 785mmboe of probable resources, including from the NOAKA project, which could become the first energy-positive, zero-emissions field development on the Norwegian Continental Shelf. With potential for further acquisitions, certain relative weaknesses, notably diversification and scale, could be materially diminished versus peers. This is important as by 2020, in our current base case, 25% of production will stem from the Johan Sverdrup field.

Outlook

The positive outlook reflects our view that Aker BP could build on its improved business position, while maintaining conservative credit metrics. We now assume that FFO to debt will decline to about 45% in 2019 from 60% at year-end 2018, thanks to high capital expenditure (capex) until the Johan Sverdrup field is launched and starts producing.

In our base case, we assume that oil prices will decline from the current level of about $70 per barrel (bbl) to about $55/bbl in 2021. However, if prices remain supportive for longer than we assume, and the company achieves higher production growth, EBITDA and free cash flow growth would be more material. This could support more opportunities to strengthen the business, and credit measures commensurate with a 'BBB-' rating.

Upside scenario

We could raise the rating in the coming six to 12 months if the Johan Sverdrup field comes online on time and to plan, and the company achieves FFO to debt of above 45% on a sustainable basis. Exploration successes and continued options to expand the business would also support a higher rating, because increased scale and diversification would support more stable and predictable cash flow generation.

Downside scenario

We could revise the outlook to stable if the company experience weak operating performance or faces a weaker market environment than in our base case, which we view as relatively unlikely. We could also revise the outlook to stable if the company's demonstrates a much more aggressive financial policy than we assume, including higher dividend distribution or leveraged acquisitions, resulting in FFO to debt well below 45%.

Company Description

Aker BP is a midsized oil and gas exploration and production company, operating in the North Sea. With current production of about 160kboepd, it is one of the most important players in the Norwegian continental shelf. Aker BP is primarily owned by BP PLC and Norwegian Aker Group.

Our Base-Case Scenario

- Oil prices of $60/bbl for the rest of 2019 and 2020, and $55/bbl for 2021. We then assume $55/bbl for subsequent years, according to our latest price deck. The current Brent spot price is close to $70/bbl, which, if it continues, could result in higher FFO for the full-year 2019 than in our base case.
- A production increase in 2019, with production of about 160kboepd, increasing further in 2020, when we assume Johan Sverdrup will be producing, leading group production to peak at about 200kboepd.
- Production costs of about $12/bbl for the next two years, compared with $10/bbl in 2017. This is because a higher share of production will come from the Valhall field, which has higher costs, and as reserves at the low-cost Alvheim field are depleted. We assume a gradual decrease to about $8/bbl as Johan Sverdrup comes on stream.
- Annual capex of $1.5 billion-$2 billion for 2019 including abandonment expenses. We assume the company will spend about $500 million on exploration per year in 2019 and 2020.
- Taxes are set according to the Norwegian tax regime. We assume the company will be in a cash tax-paying position from 2019. This also implies that capex spending and the associated 89% tax refund will significantly impact the tax payments going forward.
- Dividends of $750 million paid in 2019. We anticipate the company will increase this amount by $100 million per year over the coming years, in line with their guidance.

Liquidity

We assess Aker BP's liquidity as strong, given that the company's sources over the uses are over 2x over the next 24 months. This ample headroom allows for further growth initiatives, supporting the rating. Furthermore, the replacement of the RBL with the RCF will remove the risk of lower availability from the redetermination process. We do not assess the liquidity as exceptional despite the strong ratio, because we do not believe the company will maintain this liquidity level, particularly as growth initiatives are likely in the future. Additionally, we note Aker BP's reliance on one key facility.

We anticipate the company will have the following principal liquidity sources over the 12 months started April 1,2019:

- Estimated unrestricted cash on the balance sheet of $114 million;
- Pro forma availability of about $2.9 billion under the company's RCF;

- FFO of about $1.8 billion;

We anticipate the company will have the following principal liquidity uses over the same period:

- Capex and decommissioning costs of about $1.5 billion;
- Dividends of $750 million.

We anticipate that covenant headroom will remain ample at more than 70%. Key covenants are the leverage ratio covenant (net debt to EBITDA below 3.5x.

Issue Ratings - Recovery Analysis

Key analytical factors

- The company has just refinanced its secured RBL with an unsecured RCF, positively affecting our recovery analysis for the unsecured bond. As all debt in the capital structure is now unsecured and ranks pari passu, the recovery prospect for the rated bonds has increased, and is close to 100% on our updated valuation. It remains rated 'BB+' with a recovery of 3 (capped), because we do not notch up unsecured debt for 'BB' category ratings.
- We assume the RCF would be drawn at 85% at default.
- The enterprise value is determined by the 917 million barrels of probably reserves, about three-quarters of which represent proved reserves.
- The '3' recovery rating is underpinned by the group's significant oil and gas reserves and our valuation of these reserves under our assumptions. Our assumptions incorporate value from the proved and probable reserves, the latter 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.
- In our hypothetical default scenario, we assume a payment default by Aker BP in 2024, 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 previous defaults in this sector.
- We value the company as a going concern and see the primary source of recovery as the company's oil reserves. This includes our assumption that the oil reserves would have reduced on the path to default.

Simulated default assumptions

- Simulated year of default: 2024
- Jurisdiction: Norway

Simplified waterfall

- Net EV at default (after 5% administrative costs): $4.6 billion

- Unsecured debt claims: $4.6 billion
- --Recovery expectations: 50%-70% (capped at 3)

All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Positive/--

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Intermediate

Competitive position: Satisfactory

- Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb-

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 ratings analysis: Negative (-1 notch)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, 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

Ratings Affirmed	
Aker BP ASA	
Issuer Credit Rating	BB+/Positive/--
Senior Unsecured	BB+
Recovery Rating	3(65%)