Norwegian Energy Company Equinor (formerly Statoil) Upgraded To 'AA-/A-1+'; Outlook Stable

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- Equinor (formerly Statoil)'s credit metrics continue to strengthen, with the ratio of funds from operations (FFO) to debt improving to about 70% in first-quarter 2018.
- Given Equinor's conservative financial policy and currently supportive market conditions, we think the company can sustain strong credit metrics even if oil prices declined to $55 per barrel earlier than we anticipate.
- We are therefore raising our ratings on Equinor to 'AA-/A-1+' from 'A+/A-1'.
- The stable outlook reflects our expectation that Equinor's cash flow generation would remain strong even if oil prices decrease somewhat, with FFO to debt staying at about 60% on average.

MOSCOW (S&P Global Ratings) May 18, 2018--S&P Global Ratings said today that it has raised its long- and short-term issuer credit ratings on Norway-based energy company Equinor ASA (formerly Statoil ASA) to 'AA-/A-1+' from 'A+/A-1'.
The outlook is stable.

We also raised our issue ratings on Equinor's senior unsecured debt instruments to 'AA-' from 'A+'. 
At the same time, we raised our long-term issuer credit and financial strength ratings on Equinor's captive insurance company Statoil Forsikring AS to 'A+' from 'A'. The outlook is stable.

The upgrade reflects our view that currently supportive market conditions will enable Equinor to build meaningful headroom in its credit metrics, allowing it to sustain FFO to debt averaging 60% or higher. The company's FFO to debt had already approached 70% at the end of first-quarter 2018 on a last-12-months basis. Given Equinor's conservative financial policies, and our expectations of strengthening cash flows, irrespective of the oil price, we think the company could sustain such metrics even if oil prices were to decline to our long-term assumption of $55 per barrel of oil equivalent (boe) earlier than we anticipate.

We believe the company has several options when responding to potential oil price volatility. Notably, we take into account the following:

- We generally view Equinor's financial policy as supportive for the rating. We understand that, despite the improved market conditions, Equinor is prioritizing the strengthening of its balance sheet in the near term, ahead of acquisitions or a material increase in shareholder distributions. The gearing ratio (according to the company's definition) is still at the higher end of the 15%-30% range, and we understand management aims to improve it in 2018.

- Ratings-adjusted net debt had decreased by about $1.5 billion as of March 31, 2018, to $12.9 billion from $13.7 billion the previous year.

- The company's shareholder distribution policy has been historically less restrictive to its credit quality than that of the largest oil majors. In our base case, we assume a gradual dividend increase and start of share buybacks. However, we believe the company will not proceed with them if hydrocarbon prices were to decline materially.

- The company has flexibility to cut its capital expenditure (capex) by 10%-20%, in our view. Notably, Equinor has confirmed its intention to invest in the U.S. market only if the investments meet its internal return targets.

- We also take into account that Equinor's new production features lower break-even levels and will therefore involve more higher-value barrels that partly or fully offset the impact of our assumed decline in oil prices. For example, Equinor assesses the volume-weighted break-even oil price for its new generation project portfolio at $21, with the Johan Sverdrup breakeven being below $20. This compares favorably with that of many of Equinor's larger peers and supports our assessment of its business.
The rating remains underpinned by Equinor's strong business position as one of the world's largest energy producers, with a solid portfolio of new projects. The key constraints to the rating, apart from exposure to volatile oil prices, include very limited downstream operations and weak diversification. Given the very low country risk in Norway, which has stable tax and regulatory regimes, this asset concentration is a positive factor, in our view, compared with the higher exposure of peers to emerging markets.

We incorporate one notch of uplift in our long-term rating on Equinor since we believe there is a moderately high likelihood of the company receiving extraordinary government support.

We assess Equinor's liquidity position as strong, reflecting that its liquidity sources exceed uses by more than 1.5x for the coming 12 months. We also take into account Equinor's historically prudent approach to liquidity management and established access to the capital markets.

The stable outlook reflects our expectation that Equinor's cash flow generation would likely remain strong, even under somewhat lower oil prices than currently or under our 2018 price deck assumption of $65/bbl, supporting maintenance of FFO to debt at about 60% on average. Although the financial headroom for the rating is not very strong at present, we think that currently supportive oil prices and Equinor's financial framework will help the company build more leeway during 2018.

We view potential ratings upside as limited in the next 12-24 months, since it would require a material increase in production and, importantly, in reserves; as well as diversification by country and type of activity to match that of the supermajors, such as Total or BP.

We do not think a further increase in the oil price could support a higher rating, given the constraints on Equinor's business.

We could lower the rating if FFO to debt drops below 60% on average as a result of lower oil prices or more aggressive financial policies than we anticipate. Such a scenario could materialize, for example, if oil prices and our price assumptions declined below $55/bbl for an extended period and the company were unable to take sufficient measures (such as cost, capex, or dividend cuts) to counteract the effects on its credit profile.

RELATED CRITERIA

- Criteria - Corporates - General: Reflecting Subordination Risk In
- Corporate Issue Ratings, March 28, 2018
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