S&P Global
Ratings

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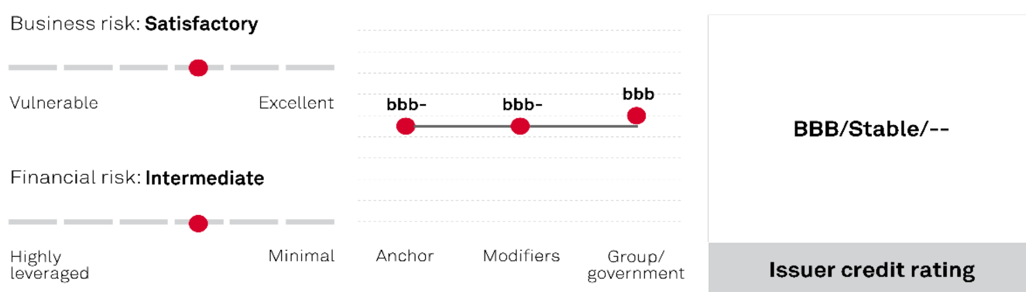
Var Energi ASA

March 20, 2023

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
Strong growth ahead in projects that have relatively low execution risks.	Relatively high production cost for its oil and gas.
A flexible dividend policy and conservative leverage targets.	Concentration in Norway, although this is a stable country.
Robust liquidity and ample financial flexibility.	No diversification outside upstream.
Largest shareholder provides additional comfort.	

S&P Global Ratings expects the strong conditions in European oil and gas markets to continue to boost cash flows at Norway-based oil and gas exploration and production company Vår Energi ASA in 2023. Gas contributes a relatively high proportion of the company's revenue; in 2022, gas production contributed 48% of total revenue and natural gas liquids a further 4%. Because of the strong market, Vår Energi generated record operating cash flows of $5.7 billion in 2022. Although gas prices have since softened, we still expect Title Transfer Facility (TTF) gas prices to be high at $20 per million British thermal units (mmbtu) in 2023 and to remain well above pre-2022 levels in 2024 and 2025. Although it will pay relatively high cash taxes, the company's cash flow from operations is also likely to remain high at about $4.5 billion-$5.0 billion for the next two years.

Leverage will remain low, with a comfortable level of headroom under the rating. Vår Energi has lowered its debt-to-EBITDA ratio to 0.3x, well below its over-the-cycle target of 1.3x. Although production is not forecast to materially increase during 2023, the company is still set to reach 350 thousand barrels of oil equivalent per day (kboepd) by year-end 2025. We expect the company to be able to fund its production growth from its cash flow generation because of the high prices it is realizing, combined with tax deductions from capital expenditure (capex). Vår Energi itself also expects to pay a dividend representing 30% of after-tax cash flow from operations in 2023. Vår Energi's policy is to pay out 20%-30% of operating cash flow after taxes in dividends--thus, if market conditions weaken, it will directly affect dividend levels, smoothing out market volatility. Overall, we anticipate that the company will have ample financial flexibility in the next 12-24 months and will maintain funds from operations (FFO) to debt well above 45%, a level commensurate with the 'BBB' rating.

Vår Energi's financial flexibility is increasing because of its strong cash generation. Its bridge-to-bond facility matures in November 2023 and it has only $500 million left to be repaid; in our view, this could easily be paid from available liquidity, if needed. Currently, available liquidity exceeds $3.5 billion. We therefore anticipate that the company will retain its ample financial flexibility, allowing it to balance the development of projects in its organic growth pipeline against the need to generating meaningful cash flows after investments, and to make shareholder distributions while maintaining low leverage ratios. The leverage target of 1.3x does allow for merger and acquisition (M&A) activities that could further boost growth, given that leverage is close to 0x.

Eni, Vår Energi's largest shareholder, is a very large and diversified energy company, which we view as supportive of Vår Energi's creditworthiness. Eni's strong balance sheet suggests that it would be able to offer financial support to Vår Energi, in case of need. Conversely, the long-term value represented by Vår Energi's oil and gas reserves gives Eni an incentive to support it, in our view. The Norwegian assets also fit well within the long-term strategy of Eni's upstream segment. We capture this potential support through a one-notch uplift to the stand-alone credit profile. Even after the IPO, Eni remains the majority owner, and aims to remain so in the long term.

Vår Energi's oil and gas comes from high-production-cost assets previously owned by Eni and ExxonMobil, and the company depends on new projects to reduce these costs. The company's guidance indicates that production cost per barrel will be $14.5-$15.5 in 2023. We view this as relatively high; it exceeds the costs incurred by peers Aker BP ($7-$8) and Equinor ($6). We assume, however, that operating expense per barrel will decrease in the coming years, especially as new production from the biggest development projects--Balder X, Breidablikk, and Johan Castberg--start producing with an estimated cost of US$4/boe. These are planned to produce 140kboepd at peak

Outlook

The stable outlook on Vår Energi indicates that in our view, development projects in Norway will push production toward 350 kboepd by end 2025, and that the company will be able to maintain FFO to debt at about 45% over the cycle, even under lower oil price scenarios. The Norwegian fiscal regime, combined with Vår Energi's flexible dividend policy, also support relatively low volatility in its credit metrics.

Downside scenario

We could lower the rating to 'BBB-' if any of the following were to occur:

- If Eni was to further reduce its stake in the company, or something else caused us to revise down Vår Energi's status within the Eni group or to anticipate that Eni was less likely to offer support;
- Vår Energi undertook a transformational acquisition that pushed its net debt to EBITDAX (earnings before interest, taxes, depreciation, amortization, and exploration expense) leverage metric to well above 1.3x, with no prospect of rapid deleveraging. This would cause FFO to debt to remain close to or below 30%; or
- The industry experienced a major downturn. However, given the Norwegian tax framework and the company's hedging strategy, we see this risk as relatively limited.

Upside scenario

We think an upgrade is relatively remote at this stage, given that it would require not only stronger credit metrics on a sustainable basis, but also a fundamental improvement in the business. We could upgrade Vår Energi if continued exploration success and potential growth led to an increase in sustainable production toward 500 kboepd, while maintaining a reserve life of close to 10 years and significantly lower costs. An upgrade would also require a higher share of operated assets, so that the company had more control over its growth and investments. Rating upside would also be tied to a robust financial risk profile, with FFO to debt of about 60% on average.

Our Base-Case Scenario

Assumptions

- S&P Global Ratings' price deck for Brent oil of $90/bbl for the remainder of 2023, $80/bbl in 2024, and $55/bbl thereafter.
- Title Transfer Facility (TTF) gas prices of $22/mmbtu for the remainder of 2023, $20/mmbtu in 2024 and beyond.
- Norwegian krone to U.S. dollar exchange rate of 9.6 in 2023, 9.4 in 2024 and 9.2 thereafter.
- Production increasing to about 225,000 boepd in 2023 and 260,000 boepd in 2024. Larger increases in 2025, when Johan Castberg should be producing.
- Operating costs gradually increasing toward $15/bbl in 2023 (from $12 per barrel in 2022), before reducing toward $8/bbl during 2025-2026.
- Capex of about $2.5 billion-$2.7 billion per year in 2023-2025.
- Neutral to positive discretionary cash flow in 2023 and 2024.
- No significant M&A, but we note current financial flexibility could allow for inorganic growth.

Key metrics

Var Energi ASA--Key Metrics*

Bil. $	2021a	2022e	2023f	2024f
Funds from operations (FFO)	4.6	5.8	3.8-4.2	3.7-4.1
Capital expenditure	2.6	2.7	2.5-2.7	2.5-2.7
Free operating cash flow (FOCF)	1.9	2.9	1-1.4	0.9-1.3
Dividends	0.95	0.78	1.0-1.2	1.0-1.2
Debt	6.0	3.9	3.6-3.9	3.7-4
Debt to EBITDA (x)	1.3	0.4	0-0.5	0.1-0.6
FFO to debt (%)	76.5	150	>60	>60

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Company Description

Established in 2018, Vår Energi is one of the largest independent Norwegian oil and gas producer. It is exclusively focused on oil and gas upstream operations, from several offshore fields on the Norwegian Continental Shelf. Its proven reserves as of year-end 2022 totaled 673 million barrels of oil equivalent (mmboe) and 2P reserves of 1,070 mmboe (72% oil, 23% natural gas, and 5% natural gas liquids). Its average daily production was 220 kboe in 2022.

Business Risk

Our assessment of Vår Energi's business risk primarily reflects the company's strong position as a midsized and relatively conservative oil and gas producer. The main constraints are those generally associated with the oil and gas sector, including exposure to volatile prices and the need to maintain high capex, especially to limit cash taxes.

With about 220 kboepd in hydrocarbon production in 2022, and 673 mmboe of proved reserves, Vår Energi is one of the larger independent companies in Norway. That said, it is much smaller than many of its international peers, which have a broader geographical presence, with all the company's production coming from its domestic region of Norway. Over the past few years, Vår Energi has made significant discoveries in Norway, which should effectively offset any depletion to its reserves and result in production growth of about 50% through 2025. Important new fields include the Johan Castberg field in the Barents Sea, and the Balder X and Breidablikk fields in the North Sea, with the latter being a tie-in to the Grane platform. In our view, Vår Energi's ambition of maintaining a $30 per barrel of oil equivalent break-even level is competitive and provides the company with a cushion against hydrocarbon price volatility. Combined with its prudent hedging policy (100% of 2023 production is hedged), this target suggests that Vår Energi will be well protected against potential market drop backs.

Despite a strong business position in Norwegian upstream, Vår has no diversification into downstream or other businesses, such as a scalable renewable energy portfolio. We consider this lack of meaningful downstream operations to be a relative weakness compared with oil supermajors, which have lower cash flow sensitivity to commodity prices. That said, in our opinion, the weakness is materially mitigated by countercyclical variations in operating costs and cash taxes, thanks to the group's presence in Norway.

Vår Energi's operated assets form a small share of total assets because it acquired assets from Exxon that were mainly nonoperated. The company intends to increase its share of operated assets over time, but it will take time. This is mitigated, in our view, because Vår Energi is a financially robust entity that is not as dependent as lower rated peers on maintaining full flexibility over the timing of capex. As such, the marginal loss of flexibility from low operatorship does not present a significant risk to its financials. Furthermore, the partner-operated fields (where Vår Energi typically has a large equity stake) are mostly Equinor-operated. Equinor, the largest oil and gas exploration and production entity in Norway, is known for its very high operating efficiency and has a long track record.

Financial Risk

For the oil and gas industry we view FFO to debt as a key metric that enables us to account for major differences in tax regimes across different jurisdictions. In the coming years, we anticipate that Vår Energi will be able to maintain FFO to debt well above the rating threshold of 45%, allowing it to invest in growing the business. Despite the relatively high capex planned for 2023-2025, we think it will generate sufficient cash from its current production to retain meaningful cash after capex and dividends. Other Norwegian companies, such as Aker BP or Equinor also post very strong credit metrics. The high gas prices, particularly in Europe, have been key to maintaining this record over the past 18 months and we expect them to remain high through 2023-2024.

Although the company is exposed to the inherent volatility of commodity prices, it has natural hedge due to the fiscal regime in Norway, as well as its own financial hedges that it put in place to limit price impact. Its sensitivity to oil prices is therefore relatively limited--a $10 variation in Brent oil price would affect net income by $115 million.

On financial policy, the company adheres to a prudent target of net debt to EBITDAX of 1.3x over the cycle and is currently well below that metric. As dividends are based on the cash generated from operations, we anticipate that weaker market conditions would translate into lower dividend distributions, protecting the balance sheet over the cycles.

Debt maturities

As of January 2023:

- 2023: $1.1 billion
- 2024: None (a $1.5 billion undrawn working capital facility comes due,)
- 2025: None
- 2026: None (a $1.5 billion undrawn RCF facility comes due)
- 2027 and beyond: $2.5 billion

Liquidity

Vår Energi's liquidity is strong. Although there is a relatively large maturity in November 2023, the available liquidity is ample and there is no immediate refinancing need.

Principal liquidity sources

- Estimated unrestricted cash on the balance sheet of about $400 million;
- Availability of about $3 billion under the bank facility; and
- FFO of about $5 billion-$6 billion.

Principal liquidity uses

- Short-term debt of $0.5 billion;
- Capex and decommissioning costs of about $2.5 billion-$3.0 billion; and
- Dividends of about $1.0 billion-$1.2 billion under current market conditions.

Environmental, Social, And Governance

ESG credit indicators: E-4, S-2, G-2

Environmental factors are a negative consideration in our credit rating analysis of Vår Energi ASA. This stems from the broad challenges the oil and gas industry faces in terms of long-term demand prospects, given the rapidly evolving regulation and increased demand for renewable energy. Vår Energi only operates in Norway, a jurisdiction where we deem regulation to be stringent and the track record of safety and environmental standards to be above average. This is somewhat mitigated by strictly offshore operations, the relative diversification on the Norwegian Continental Shelf, and use of technologies to improve efficiency while reducing greenhouse gas emissions in operations (electrification from shore [hydropower], offshore wind and carbon capture and storage)

Group Influence

Our rating on Vår Energi is one notch higher than the 'bbb-' stand-alone credit profile for the company. This reflects our view that Eni could extend extraordinary financial support if Vår Energi were to suffer financial distress. We assess Vår Energi as a moderately strategic entity of Eni because:

- Vår Energi's is 63.04% owned by Eni and, in our view, Vår Energi is a strategically important asset to Eni's upstream strategy. It also has a presence in a stable OECD country and low carbon-intensity production.
- Vår Energi is unlikely to be sold. Eni has been present in Norway for decades and Vår Energi fits well with the Eni group strategy, as well as contributing to operating cash flows through dividend payments.

Issue Ratings--Subordination Risk Analysis

Capital structure

The capital structure mostly comprises unsecured credit facilities, notably a $0.5 billion bridge-to-bond facility that we anticipate will be repaid through issuance under the company's newly set up euro medium-term note program; and $2.5 billion in senior unsecured notes. The company has two undrawn credit facilities totaling $600 million that mature in 2023; a working capital facility of $1.5 billion, maturing in 2024; and a liquidity facility of $1.5 billion, maturing in 2026.

Analytical conclusions

We rate the senior unsecured debt issued by Vår Energi at 'BBB', in line with the company's long-term issuer credit rating, because there is no significant subordination risk, in our view.

Rating Component Scores

Foreign currency issuer credit rating	BBB/Stable/--
Local currency issuer credit rating	BBB/Stable/--
Business risk	Satisfactory
Country risk	Very low
Industry risk	Moderately high
Competitive position	Satisfactory
Financial risk	Intermediate
Cash flow/leverage	Intermediate
Anchor	bbb-
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb-
Group credit profile:	a-
Entity status within group:	Moderately strategic (+1 notch)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings Detail (as of March 17, 2023)*

Var Energi ASA	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Issuer Credit Ratings History	
21-Jul-2022	BBB/Stable/--
Related Entities	
Eni International B.V.	
Issuer Credit Rating	A-/Stable/A-2
Eni Lasmo PLC	
Issuer Credit Rating	A-/Stable/--
Eni SpA	
Issuer Credit Rating	A-/Stable/A-2
Junior Subordinated	BBB
Senior Unsecured	A-
Eni U.S. Inc.	
Issuer Credit Rating	A-/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.