FitchRatings

RATING ACTION COMMENTARY

Fitch Publishes Lundin Energy AB's First-Time 'BBB-' IDR; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 08 Jun 2021: Fitch Ratings has published Lundin Energy AB (Lundin) a first-time 'BBB-' Long-Term Issuer Default Rating (IDR) with Stable Outlook.

The rating reflects our expectation that Lundin will see production volumes sustained above 200 thousand barrels of oil equivalent per day (kboepd) over 2021-2025. This, alongside more favourable prices, supports strong funds from operations (FFO) generation and FFO net leverage on average at below 2x over the same period. These factors drive an operating and financial profile that is in line with that of peers rated in the 'BBB' category.

The rating is supported by Lundin's superior asset quality with very low operating costs, operations that are concentrated in the favourable jurisdiction of Norway (AAA/Stable), and strong liquidity. These factors are partially offset by the company's small reserve size compared with similarly rated peers', production concentration mainly at one field, a medium-term reliance on unproven reserves and on M&A to maintain production volumes, and an opportunistic dividend policy.

Feedback

KEY RATING DRIVERS

Superior Asset Quality: Lundin benefits from a top-tier asset base, primarily through its 65% interest in the Edvard Grieg field where it is an operator and a 20% non-operating interest in the Johan Sverdrup mega-field. The high-quality asset base drives Lundin's industry-leading cost profile with a consolidated cash operating expenditure of USD3-USD3.5/boe over our 2021-2025 forecast horizon, and a pre-dividend break-even free cash flow (FCF) of USD10/boe on a 2P basis based on the company's calculations. This allows Lundin to continue generating positive cash flow to service debt and dividends even with trough-level hydrocarbon prices.

Long Asset Life: Lundin's assets, especially Johan Sverdrup, are long-life conventional fields yielding predictable production volumes over the long term, with limited capex requirements once development is completed. As of end-2020, Lundin had a 2P reserve life index in excess of 11.2 years, which implies a strong ability to defer capex during periods of weak prices.

Solid Medium-Term Production: Johan Sverdrup, a mega-field operated by Equinor, reached its phase 1 plateau production mid-2020 and contributed to raising the company's production to around 165kboepd in 2020 from 93kboepd. We expect Lundin's production to increase materially through 2021, driven by performance at the Johan Sverdrup and Edvard Grieg fields. This supports Fitch's assumption of a fairly de-risked production increase to over 200kboepd by 2023.

Reserve Replacement Key: We expect the current asset base to support increasing production through 2023, but Lundin will need to successfully develop 3P reserves and implement projects underway to maintain production above 200kboepd in the latter years of our forecast horizon. Lundin may also offset natural field declines through acquisitions and further positive revisions on Edvard Grieg and/or Johan Sverdrup's production profiles. The company is also taking steps towards expanding and diversifying its reserve base further, including a pipeline of nine organic development options targeting 200 million barrels of oil equivalent (mmboe) of net resources.

Asset Concentration Mitigated: Although Lundin's production is skewed towards Edvard Grieg and Johan Sverdrup, which we expect will contribute on average 90% of volumes through 2025 (Johan Sverdrup contributing on average 66%), we view the high concentration risk as largely mitigated by Lundin's robust business interruption insurance policies in place.

Flexible Financial Policy: Lundin has demonstrated its commitment to maintaining its credit profile and liquidity position during periods of stress in the industry. This is evident in the reduction in dividends in 1H20 to USD1/share, shortly following an initial 2019 dividend announcement of USD1.8/share and compared with 2018 dividend of USD1.48/share. This preserved total cash flow by USD37 million during 2020.

Dividend Increase: Following the recent recovery in oil prices to above USD50/bbl and completion of Lundin's refinancing, the company announced a dividend increase to USD1.8/share, an 80% increase on existing levels, which will result in a USD136 million cash outflow in 2021. We expect dividends to be sustained at around USD450 million per annum in 2022-2024, which is manageable under our forecast, and we anticipate management will continue to size dividends such that they remain manageable in relation to the company's cash flow generation.

Tax Regime Overhaul Positive: Lundin is subject to the Norwegian tax regime for oil & gas producers, whose recent temporary amendments have allowed for meaningful near-term cash savings for producers via accelerating the tax-deductibility of capex as well as providing for significant tax-base reductions. These tax revisions have had a positive impact on liquidity, which was key to Lundin being able to navigate the low-price environment of 2020 without a meaningful rise in leverage.

In addition, Lundin has earmarked nine projects for accelerated development with development plans to be submitted before end-2022 to benefit from the more favourable tax conditions throughout the development and completion phase of these projects.

Favourable Partnership Structures: Lundin's single largest asset, and the primary contributor to future production volumes, is Johan Sverdrup. While high reliance on non-operated partnerships is typically credit-negative for an exploration & production company, a strict voting mechanism in the Johan Sverdrup partnership agreement effectively prevents the operator and other partners with larger working interest stakes from making operational or financial decisions without Lundin's consent. Further mitigants include a record of successful cooperation between Lundin and its partners, and the supportive governance inherent within its operations in Norway.

DERIVATION SUMMARY

Lundin's production (2020: 165kboepd) compares well with that of Aker BP (BBB-/Stable, 2019: 156kboepd, 2020e: 210kboepd), Murphy Oil Corporation (BB+/Negative, 2019: 173kboepd, 2020e: 190-200kboepd) and Neptune Energy Group Midco Limited (BB/Stable, 2019 & 2020e: 142kboepd). It has lower 1P reserves and 1P reserves life than Murphy Oil (825mmboe, 11.5 years) or Aker BP (666mmboe, 12 years) but higher than Neptune

(405mmboe, eight years). Its similarly rated peers have larger scale, but Lundin has an industry-leading cost per barrel and low leverage, which is expected to trend in line with that of Aker BP and substantially lower than lower-rated peers'.

KEY ASSUMPTIONS

-Growing production output to 185kboepd in 2021, 196kboepd in 2022, 241kboepd in 2023 followed by some moderation to 223kboepd in 2024, and 206kboepd in 2025

- Average Brent crude oil price of USD58/bbl in 2021, followed by USD53/bbl through to 2025

- Average natural gas price (TTF/NBP) of USD4.5/mcf in 2021 and 2022, followed by USD5/mcf through to 2025

- Capex excluding exploration & appraisal expenditures at USD952 million in 2021, USD526 million in 2022, USD489 million in 2023, USD580 million in 2024, and USD335 million in 2025

- Exploration & appraisal expenditures at USD260 million in 2021, followed by USD150 million per year to 2025

- Dividend per share of USD1.6 from 2022

- USD/NOK 8.39 in 2021 and 8.29 to 2025

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Production volumes above 275kboepd alongside a meaningful diversification of reserves and production on a sustained basis.

- FFO net leverage consistently below 1.5x, supported by a conservative financial policy.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO net leverage above 2.5x on a sustained basis.

- Failure to replenish reserves in a timely manner such that production falls below 200kboepd on a sustained basis.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Lundin is mainly funded by a USD5 billion corporate credit facility that replaced virtually all existing debt facilities in December 2020. It included four term loans totalling USD3.5 billion with USD500 million due in 2022 and USD1 billion per year from 2023 until 2025. It is complemented by a USD1.5 billion revolving credit facility (RCF) due in 2025, of which USD0.5 billion was drawn as of 31 December 2020.

We expect Lundin's FCF and RCF availability to be sufficient to cover debt maturities until 2024, while 2025 maturities will need to be refinanced. Should performance be weaker than expected, we believe that financial discipline, such as capex and dividend curtailments, can support liquidity and deleveraging capacity. Moreover, the Norwegian tax regime is supportive at times of low oil prices.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

ISSUER PROFILE

Lundin is an independent oil & gas producer focused on exploiting offshore oil & gas resources in the Norwegian Continental Shelf area of the North Sea.

SUMMARY OF FINANCIAL ADJUSTMENTS

Capital leases of USD30 million excluded from financial debt.

Depreciation of right-of-use assets and lease-related interest expense of USD3 million deducted from EBITDA and FFO.

Capitalised financing fees of USD37 million added back to financial debt.

DATE OF RELEVANT COMMITTEE

28 May 2021

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY/DEBT	RATING		
Lundin Energy AB	LT IDR	BBB- Rating Outlook Stable	Publish

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 30 Apr 2021)

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APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Lundin Energy AB	-

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