

Tear Sheet:

Ellevio AB

July 10, 2023

Ellevio AB's credit ratios remain on track, despite uncertainty around tariffs. The company's revenue in the first quarter of 2023 and its EBITDA performance met our expectations, albeit with a limited cushion for underperformance at the current rating level. We expect Ellevio will increase tariffs to offset the rise in inflation-related costs and reduce its regulatory deficit, which we estimate will be Swedish krona (SEK) 1.4 billion at the end of 2023, over the next four years. This will result in funds from operations (FFO) to senior debt of around 7%-8% in 2023 before softening to 6%-7% in 2024, which is in line with the rating. We believe there is limited downside risk to our assumption. Lastly, we expect Ellevio will continue to adjust shareholder remuneration to keep the credit ratios in line with the current rating.

Uncertainty continues to linger around the final terms for the ongoing regulatory period (RP3) as well as for the upcoming regulatory period (RP4). Despite RP3 (2020-2023) ending in just a few months, the final weighted average cost of capital (WACC) level for RP3 and RP4 (2024-2027) has not been decided upon. Furthermore, Sweden's courts of appeal has recently decided that the Swedish regulator, the Energy Market Inspectorate, does not have legal support to redefine electricity network companies' revenue framework calculations for RP4. In our current base case, which resulted in the credit ratios above, we assume that WACC will not fall below floor levels of 2.35% in RP3 and 3.50% in RP4.

From a rating perspective, all this translates into continued, credit-dilutive uncertainty. This applies to both the stability of the framework and the compensation levels. We expect the regulator will announce the compensation levels for RP3 and RP4 in October 2023.

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Recent Research

- Europe's Utilities Face A Power Price Cliff From 2026, June 22, 2023
- Industry Top Trends 2023: EMEA Utilities, Jan. 23, 2023
- Ellevio AB, Nov. 3, 2022
- Ellevio AB Outlook Revised To Stable From Negative On Improving Regulatory Environment; Issue Ratings Affirmed, July 12, 2021
- Swedish Electricity DSOs Remain In Limbo As The Regulator Appeals Court Decision On Their Remuneration, March 18, 2021

Company Description

Together with Vattenfall and E.ON, Ellevio is one of the three largest electricity distribution system operators in Sweden, with about 18% of customers (971,000 customers in four Swedish regional areas, with a concentration in the Stockholm area). In total, it had 80,000 kilometers of power lines and distributed 25.0 terawatt-hours in 2022. As well as delivering electricity, Ellevio is responsible for maintaining and developing its network.

The Swedish government and the Energy Markets Inspectorate regulate all of Ellevio's operations, primarily through the Swedish Electricity Act and different ordinances. In 2022, the company reported sales of SEK7.5 billion (€635 million) and EBITDA of SEK3.96 billion (€340 million).

Ellevio is owned by Omers Infrastructure Holdings (50%), Third Swedish National Pension Fund (20%), AMF (12.5%), and Folksam (17.5%).

Outlook

The stable outlook reflects our forecast of continually rising EBITDA and FFO. It assumes that WACC will not drop below 2.35% but will likely be closer to 3.89% when applying previous regulatory period methods to the current one (RP3). The outlook also reflects our expectation that Ellevio will continue to adjust shareholder remuneration to protect the rating if needed, for example by not paying interest on its shareholder loans if WACC remains at 2.35%. On the other hand, we expect that the company will pay shareholder remuneration if WACC increases substantially from 2.35%. We expect FFO to senior debt at 7%-8%, debt to EBITDA below 10x over 2023-2027 for the senior debt, and debt to EBITDA below 12x for all debt, including subordinated debt. We consider this commensurate with the 'BBB' issue rating for Ellevio's senior debt and the 'BB+' issue rating for its subordinated debt.

Downside scenario

We could lower the ratings if Ellevio was unable to exercise flexibility in its financial policy, for example by increasing shareholder remuneration or lowering capex, and if this resulted in FFO to debt below 6% or debt to EBITDA above 10x for the senior debt. This would most likely be triggered by shareholder remuneration. We could lower the subordinated debt rating if we lowered the senior debt rating or if debt to EBITDA rose above 12x at the consolidated level, including subordinated debt.

Upside scenario

A positive rating action is unlikely, in our view. If WACC increased significantly after a favorable court ruling, Ellevio would increase its shareholder remuneration and maintain FFO to debt commensurate with a stand-alone credit profile (SACP) of 'bbb-'. We could, however, consider an upgrade if the company was to commit to a deleveraging plan, resulting in FFO to debt sustainably above 8% and debt to EBITDA below 9x for senior debt. We view this as unlikely over the outlook horizon, given the company's business plan.

Key Metrics

Ellevio AB—Forecast summary

Period ending	Dec-31-				
	2021	2022	2023	2024	2025

Ellevio AB—Forecast summary

(Mil. SEK)	2021a	2022a	2023f	2024f	2025f
EBITDA	3,832	4,051	4,500-5,000	4,000-4,500	5,000-5,500
Funds from operations (FFO)	2,613	2,862	3,000-3,500	2,000-2,500	3,000-3,500
Capital expenditure (capex)	3,590	3,249	3,500-4,000	5,000-5,500	4,500-5,000
Shareholder Distribution	--	--	1,000-1,500	1,000-1,500	1,000-1,500
Discretionary cash flow (DCF)	153	513	(2,000)- (1,500)	(3,500)- (3,000)	(3,000-2,500)
Debt	39,946	39,401	40,000- 45,000	40,000- 45,000	45,000- 50,000
Adjusted ratios					
Debt/EBITDA (x)	10.4	9.7	7.0-8.0	8.5-9.5	7.0-8.0
FFO/debt (%)	6.5	7.3	8.5-9.5.	6.0-7.0	8.5-9.5
DCF/debt (%)	0.4	1.3	0-5	(5)-(0)	(8)-(7)

Financial Summary

Ellevio AB--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	SEK	SEK	SEK	SEK	SEK	SEK
Revenues	6,964	7,058	6,810	6,790	7,257	7,659
EBITDA	4,330	4,321	3,986	3,740	3,832	4,051
Funds from operations (FFO)	3,013	2,542	2,756	2,599	2,613	2,862
Interest expense	1,375	1,791	1,176	1,178	1,191	1,226
Cash interest paid	1,117	1,672	1,161	1,127	1,175	1,174
Operating cash flow (OCF)	2,111	2,558	3,837	3,105	3,743	3,762
Capital expenditure	2,369	2,610	3,897	3,449	3,590	3,249
Free operating cash flow (FOCF)	(258)	(52)	(60)	(344)	153	513
Discretionary cash flow (DCF)	(1,270)	(654)	(60)	(344)	153	513
Cash and short-term investments	10	56	20	14	12	14
Gross available cash	10	56	20	14	12	14
Debt	36,512	38,942	39,217	39,667	39,946	39,401
Common equity	26,629	26,538	28,273	29,976	32,309	34,696
Adjusted ratios						
EBITDA margin (%)	62.2	61.2	58.5	55.1	52.8	52.9
Return on capital (%)	3.6	3.3	2.5	2.7	2.9	3.0
EBITDA interest coverage (x)	3.1	2.4	3.4	3.2	3.2	3.3
FFO cash interest coverage (x)	3.7	2.5	3.4	3.3	3.2	3.4

Ellevio AB--Financial Summary

Debt/EBITDA (x)	8.4	9.0	9.8	10.6	10.4	9.7
FFO/debt (%)	8.3	6.5	7.0	6.6	6.5	7.3
OCF/debt (%)	5.8	6.6	9.8	7.8	9.4	9.5
FOCF/debt (%)	(0.7)	(0.1)	(0.2)	(0.9)	0.4	1.3
DCF/debt (%)	(3.5)	(1.7)	(0.2)	(0.9)	0.4	1.3

Peer Comparison

Ellevio AB--Peer Comparisons

	Ellevio AB	Elenia Verkko Oyj	Caruna Networks Oy
Foreign currency issuer credit rating	--	--	BBB/Stable/--
Local currency issuer credit rating	--	--	BBB/Stable/--
Period	Annual	Annual	Annual
Period ending	2022-12-31	2022-12-31	2022-12-31
Mil.	SEK	SEK	SEK
Revenue	7,659	3,690	5,399
EBITDA	4,051	2,382	3,496
Funds from operations (FFO)	2,862	1,887	2,827
Interest	1,226	413	585
Cash interest paid	1,174	435	629
Operating cash flow (OCF)	3,762	1,833	1,928
Capital expenditure	3,249	1,713	1,406
Free operating cash flow (FOCF)	513	121	522
Discretionary cash flow (DCF)	513	(254)	(612)
Cash and short-term investments	14	570	649
Gross available cash	14	570	649
Debt	39,401	19,891	28,278
Equity	34,696	(1,655)	8,161
EBITDA margin (%)	52.9	64.6	64.8
Return on capital (%)	3.0	7.7	5.8
EBITDA interest coverage (x)	3.3	5.8	6.0
FFO cash interest coverage (x)	3.4	5.3	5.5
Debt/EBITDA (x)	9.7	8.4	8.1
FFO/debt (%)	7.3	9.5	10.0
OCF/debt (%)	9.5	9.2	6.8
FOCF/debt (%)	1.3	0.6	1.8

Ellevio AB--Peer Comparisons

DCF/debt (%)	1.3	(1.3)	(2.2)
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Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
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ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Rating Component Scores

Class A Issue rating	BBB/Stable
Business risk	Excellent
Country risk	Very Low
Industry risk	Very Low
Competitive position	Strong
Financial risk	Aggressive
Cash flow/leverage	Aggressive (Low Volatility Table)
Anchor	bbb
Diversification/portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Strong
Management and governance	Satisfactory
Comparable rating analysis	Negative (-1)
Stand-alone credit profile	bbb-
Structural enhanced debt	+1 notch
Class B Issue rating	BB+/Stable
Business risk	Excellent
Country risk	Very Low
Industry risk	Very Low
Competitive position	Strong
Financial risk	Highly Leveraged
Cash flow/leverage	Highly Leveraged (Low Volatility Table)
Anchor	bbb-
Diversification/portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Strong
Management and governance	Satisfactory
Comparable rating analysis	Negative (-1)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019

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- Criteria | Corporates | Utilities: Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses, Feb. 24, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, 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

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