Research Update:

Swedish Electricity Network Ellevio AB Class A 'BBB' Rating And Class B 'BB+' Issue Ratings Affirmed

October 29, 2024

PRIMARY CREDIT ANALYST

Emeline Vinot
Paris
+ 33 014 075 2569
emeline.vinot@spglobal.com

SECONDARY CONTACTS

Per Karlsson
Stockholm
+ 46 84 40 5927
per.karlsson@spglobal.com

Maria Hjukstrom
Stockholm
maria.hjukstrom@spglobal.com

Rating Action Overview

- We expect Ellevio AB to continue to deliver operating results in the higher range of our expectations, with EBITDA at around Swedish krone (SEK) 4.7 billion for 2024 and SEK 5.2 billion for 2025. We expect increasing investment needs to increase Ellevio's adjusted debt to SEK55 billion by 2028 from SEK41.5 billion as of first-half 2024.
- Nevertheless, we believe its credit ratios will remain well within the rating expectations, with funds from operations (FFO) to senior debt reaching around 8% over 2024-2025, nearing 10% in 2026, and debt to EBITDA below 10x for all debt, including subordinated debt.
- We have revised our liquidity assessment for Ellevio to adequate from strong. However, we affirmed our 'BBB' issue rating on its Class A debt and our 'BB+' rating on its Class B issuance.
- The stable outlook reflects our view that Ellevio has the flexibility to adjust shareholder remuneration and that it is willing to protect the ratings.

Rating Action Rationale

Ellevio's results for the first half of the year are aligned with our expectation that it will increase investment and start paying interest on its shareholder loan while maintaining FFO-to-debt above 9%. The new regulatory period in Sweden--started in January 2024 and lasting until December 2027--allowed for a weighted-average cost of capital (WACC) of 4.53%, which results in higher allowed revenue for the period (compared with WACC of 3.39% for the previous regulatory period). This has supported Ellevio's EBITDA growth; as of end-June 2024, EBITDA reached SEK2.5 billion, up from SEK2.3 billion in 2023. The increase was also due to significant accumulated deficit from previous periods that Ellevio recovered through tariff increases.

Stronger EBITDA generation enabled Ellevio in first-half 2024 to:

- Increase capital expenditure (capex; including small acquisitions) to SEK1.6 billion from SEK1.5 billion year-on-year, slightly behind our expectation of SEK4.4 billion by year-end 2024.

- Resume dividends for the first time since 2019, with distribution of SEK500 million in the first half of 2024, however this did not affect Ellevio's credit ratios, which remained in line with the rating.
- Pay SEK1 billion of accumulated interests on its shareholder loan, for the first time since 2019.

Over the same period, Ellevio issued SEK3,000 million and €500 million of Class A green bonds under Ellevio's Euro medium-term note program and Green financing framework and extended its bank loan facilities to support increasing investments and to refinance the Class B debt coming due in February 2025.

Ellevio operates under a regulatory framework that we view as very supportive, which underpins the excellent business risk profile assessment. The company benefits from fully regulated electricity distribution operations, with a natural monopoly position in its service areas. Each four-year regulatory period has pre-set revenue frames, based on the company's regulatory asset base (RAB) and the regulated WACC. We continue to view the Swedish regulatory framework as very supportive and favorable because it allows for full cost and investment coverage. RAB is also allowed to be indexed annually to the building cost index (BCI).

The current regulatory period (RP4) started on Jan. 1, 2024, and will end Dec. 31, 2027. With current estimates as of March 31, 2024, this will increase Ellevio's RAB in 2024 by about 4.5% on top of investments. DSOs are also allowed to carry forward any regulated revenue deficits from one regulatory period to the next, making the framework relatively volume neutral. For Ellevio this means an approximate SEK2 billion of accumulated deficits from RP1 and RP2 that can be recovered into RP4 and RP5. In addition, in May 2024, the WACC for RP3 was assessed at 3.39% and applied retroactively resulting in a regulatory deficit for RP3 of SEK400 million that can be recovered over the following regulatory periods. In December 2023, the WACC for RP4 was approved at 4.53%. A combination of BCI increase and unit cost increase led to an allowed revenue increase by SEK3 billion over RP4. Compared with Finland, there is no annual cap in tariff increase, and we therefore expect Ellevio to increase tariffs annually to reach allowed revenue, although remaining at the low end of the tariff grid in Sweden compared with peers. However, we understand that by the end of RP4, the regulatory deficit should reach SEK1.7 billion and should be recovered over RP5 and RP6. We understand that several points could be discussed in the electricity legislation for RP5, which will start Jan. 1, 2028.

As the maturity of the SEK4 billion of Class B debt comes due in February, we revised our view of Ellevio's liquidity to adequate from strong. We believe that increasing investment will result in Ellevio increasing its financial debt and in turn lead to higher refinancing needs of about SEK5 billion annually over the coming years. Combined with higher interest as well as the upcoming SEK4 billion Class B debt maturing in less than six months, we believe that Ellevio will not be able to maintain a sources to uses ratio above 1.5x at all times, which we require for a strong liquidity assessment. We therefore revised our liquidity assessment to adequate from strong. This has no impact on our ratings on both Ellevio's Class A and Class B debts; and we continue to believe that management has prudent liquidity management. We expect the company to extend its revolving credit facility (RCF) and liquidity facility due 2026 and 2029 during the fourth quarter of 2024 due to increasing investment needs.

Outlook

The stable outlook reflects our expectation that Ellevio's EBITDA and FFO will increase gradually over 2024-2027 on the back of higher WACC for RP4 and the large regulatory deficit from RP1 and RP2 to be recovered in RP4. We expect FFO to senior debt of around 8% over 2024-2025, nearing 10% in 2026, and debt to EBITDA below 10x for all debt, including subordinated debt. The stable outlook also reflects our expectation that Ellevio has the flexibility to adjust shareholder remuneration to protect the ratings.

Downside scenario

We could lower the ratings if FFO to debt falls below 6% or debt to EBITDA rises above 10x for the senior debt. This would most likely be triggered by a reduction in Ellevio's flexibility in its financial policy, for example if it increases shareholder remuneration and capital expenditure. We could lower the subordinated debt rating if debt to EBITDA rises above 12x at the consolidated level, including subordinated debt.

Upside scenario

We are unlikely to take a positive rating action on Ellevio because we believe the significant headroom under the rating will be consumed by increased shareholder distributions or acquisitions should the opportunity arise.

We could, however, consider an upgrade if the company commits to a deleveraging plan, resulting in FFO to debt staying above 8% and debt to EBITDA remaining 9x for senior debt.

Company Description

Together with Vattenfall and E.ON, Ellevio is one of the three largest electricity DSOs in Sweden. Its market share, in terms of customers, is about 18%. It has about 970,000 customers and operates in six Swedish regional areas, with most of its customers in the Stockholm area. In total, it had 83,600 kilometers of power lines and distributed 24.2 terawatt-hours in 2023. 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 2023, the company reported sales of SEK8.2 billion and EBITDA of SEK4.63 billion (€400 million).

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

Liquidity

We now view Ellevio's liquidity as adequate as we believe its liquidity sources will exceed its near-term cash outflows by 1.0x in the next 12 months from Sept 30,2024; this compares with above 1.5x previously. The revision of our liquidity assessment is further emphasized by the increasing investment program needed over the coming years that will require Ellevio to increase its debt. However, we continue to view positively the company's sound relationships with banks, satisfactory standing in the credit markets, and likely ability to absorb high-impact, low-probability events with limited refinancing.

We assume that Ellevio will maintain adequate headroom under its financial covenants.

Principal liquidity sources include as of Sep 30,2024:

- No available cash and liquid investments.
- Access to undrawn committed credit lines of about SEK8.7 billion maturing in more than 12 months.
- Forecast FFO of about SEK3.5 billion-SEK3.7 billion.

Principal liquidity uses include over the same period:

- Annual capex of about SEK5 billion.
- Debt repayment of about SEK4.3 billion including the SEK 4 billion of Class B debt due February 2025.
- Flexible shareholder remuneration of about SEK2.5 billion including accrued interest on the shareholder loan.

Base Case Scenario

Assumptions

- Swedish GDP growth of 0.3% in 2024, 2% in 2025, 1.9% in 2026, and 1.9% in 2027.
- BCI of 2.53% in 2024, 1.47% in 2025, 1.99% in 2026, and 2.01% in 2026, and inflating RAB by the same rate as per regulation.
- Increased WACC of 4.53% for the current regulatory period (2024-2027) compared with 3.39% for the regulatory period that ended 2023.
- DSOs' ability to carry forward accumulated under-recovered revenue from previous periods.
- Annual average EBITDA of about SEK9 billion-SEK10 billion over 2024-2027.
- EBITDA margin of 54%-62% increasing year on year.
- We do not include working capital movements as dependent on cash pre-received for connection points.
- Increased annual average capex of SEK5.8 billion over 2024-2027 compared with SEK3.9 billion in 2023.
- We don't expect any acquisitions over the forecast period although we believe that should any opportunity arise, Ellevio will invest within its threshold of FFO to senior debt higher than 6%.
- We expect shareholder distributions (including payment of already accrued interests on shareholder loans) up to SEK2.5 billion from 2024 and thereafter.
- Subordinated debt not exceeding 10% of total debt.

Key metrics

Ellevio AB--Forecast summary

	--Fiscal year ended Dec. 31--				
(Mil. SEK)	2022a	2023a	2024e	2025f	2026f
EBITDA	4,051	4760	4,500-4,900	5,000-5,400	5,900-6,300
Funds from operations (FFO)	2,862	3479	2,900-3,300	3,500-3,900	4,800-5,200
Capital expenditure	3,249	3845	4,200-4,600	5,500-5,900	6,100-6,500
Shareholder remunerations	0	1003	2,400-2,600	2,400-2,600	2,400-2,600
Debt (class A debt)	35,401	37,304	39,000-41,000	43,000-45,000	46,000-48,000
Debt to EBITDA (class A debt)	8.7	7.8	8.0-9.1	8.0-9.0	7.3-8.1
FFO to debt (class A debt)	8.1	9.3	7-8	8-9	10-11
Debt (all debt)	39,401	41,304	43,000-45,000	47,000-49,000	50,000-52,000
Debt to EBITDA (all debt)	9.7	8.7	8.8-10.0	8.7-9.8	7.9-8.8
FFO to debt (total debt)	7.3	8.4	6-8	7-8	9-10

SEK--Swedish krona.

Ratings Score Snapshot

Class A Issue Credit Rating	BBB/Stable
Business risk:	Excellent
Country risk	Very low
Industry risk	Very low
Competitive position	Strong
Financial risk:	Aggressive
Cash flow/leverage	Aggressive
Anchor	bbb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bbb-
Structurally enhanced debt	+1 notch

Class B Issue Credit Rating	BB+/Stable
Business risk:	Excellent
Country risk	Very low

Class B Issue Credit Rating	**BB+/Stable**
Industry risk	Very low
Competitive position	Strong
Financial risk:	Aggressive
Cash flow/leverage	Aggressive
Anchor	bbb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bbb-
Subordination to Class A debt	-1 notch

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- 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
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Ellevio AB, July 23, 2024

Ratings List

Ratings Affirmed	
Ellevio AB	
Senior Secured	BBB/Stable
Subordinated	BB+/Stable

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.