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Ratings

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Ellevio AB

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Ellevio AB

Credit Highlights

None

Overview	
Key Strengths	**Key Risks**
Fully regulated business with stable and predictable cash flows.	Uncertainty in the regulated framework, with risk of lower revenues for the next regulatory period, 2020-2023.
Natural monopoly, one of the three largest electricity Distribution System Operators (DSOs) in Sweden.	Large portion of shareholder loans in the capital structure, with somewhat high shareholder distributions.
Protective financing structure.	Relatively high leverage.

Fully regulated business. Ellevio's business risk profile benefits from fully regulated electricity distribution operations, with natural monopoly positions in its service areas. Each regulation period of four years has pre-set revenue frames, based on the company's regulatory asset base and the regulated weighted-average cost of capital (WACC). For the current regulatory, 2016-2019, WACC is 5.85%.

Uncertainty surrounding the regulatory environment in Sweden.The Swedish government has issued an ordinance that implies lower WACC for DSOs. We anticipate a lower WACC during the upcoming regulatory period starting 2020, with price decreases and lower revenues for DSOs as a result, but partially offset by the possibility to bring forward under-recovered revenues from previous regulatory periods.

Protective financing structure. Ellevio's structure contains dividend restriction covenants, restrictions on mergers and acquisitions, a standstill period, and certain other features that provide creditors with more certainty of cash flows.

Flexible financial policy and networks development strategy. In our view, Ellevio is committed to its financial policy and maintaining funds from operations (FFO) to debt above 6%. We expect the company to show financial flexibility and adjust shareholder distributions and capital expenditure (capex) to make up the difference in case of a shortfall.

Outlook

The stable outlook on Ellevio's senior secured debt reflects the group's steady and predictable earnings, supported by a favorable regulatory framework. We anticipate that Ellevio will maintain credit measures--such as senior FFO to debt of at least 6%--which we see as the minimum level commensurate with the ratings.

Downside scenario

We could take a negative rating action if earnings volatility or deterioration, which could weaken its credit measures, arises from the upcoming regulatory period. A material acquisition or excessive shareholder returns could also pressure the rating. We could consider a downgrade, if FFO to debt decreased to below 6% for a prolonged period.

Upside scenario

We see limited upside potential, reflecting our view of Ellevio's financial policy and covenant structures. We could take a positive rating action, however, if Ellevio's credit measures strengthened sustainably, for example, on the back of lower dividends resulting in reduced debt. We could consider a higher rating on the class A debt if the group's financial risk profile improved, reinforced by the group's financial policy, resulting in senior FFO to debt of sustainably above 8% (that is, excluding the class B debt).

Raising the rating on the class B debt would hinge on a stronger subordinated stand-alone credit profile (SACP), as well as a higher SACP and rating on the class A debt.

Our Base-Case Scenario

Recent developments

Ellevio's half-year 2018 results were in line with our forecast; it reported net sales of Swedish krona (SEK) 3,542 million, up from SEK3,538 million in 2017. EBITDA, of SEK2,252 million, was 1% higher than last year. These results corroborate our view of the sustainable business model.

Ellevio is continuing with its sizable capex program with over 1,000 ongoing investment projects in total. The capex program will proceed the coming years, and will add pressure to credit metrics.

The present regulatory period, with WACC at 5.85%, ends in December 2019. WACC for the upcoming period is not yet determined, but in current market conditions, would be set at about 3%. A lower WACC would force Ellevio to reduce prices, and subsequently lead to lower earnings.

Assumptions	Key Metrics

Assumptions

- Ellevio's revenues are mostly affected by the regulation of its network rather than external macro factors such as GDP growth. We expect a price decrease from 2020 when the new regulation comes into effect. However, details regarding the upcoming regulation period are still uncertain.
- Capex of about SEK3.0 billion-SEK3.8 billion annually for the next few years.
- Shareholder returns of about SEK1.0 billion throughout, although we assume these are flexible in order to sustain credit metrics.
- Ellevio will be allowed to move its under-recovered revenues from the first regulatory period to the upcoming (third) regulatory period.

Key Metrics

	2017A	2018E	2019E	2020E
EBITDA* (bil. SEK)	4.3	4.2-4.4	4.2-4.4	3.8-4.0
FFO/debt	7.5	7-8	7-8	6-7
Debt* (bil. SEK)	34,460	37-39	38-40	40-42
Debt/EBITDA (x)	8.5	8.5-9.5	8.5-9.5	10-11

*S&P Global Ratings Adjusted. A--Actual. E--Estimate

Base-Case Projections

We expect pressure on credit metrics starting in 2020. Implementation of the new regulatory framework in 2020 with lower WACC will lead to forced price decreases and therefore put pressure on credit ratios.

Flat revenue growth in 2018-2019. With continued price increases planned for the current period. We anticipate that Ellevio will lower prices in 2020, which will immediately depress revenues and earnings.

Stable adjusted EBITDA margins of around 60%-62% in 2018 and 2019 and 58%-60% subsequently. In our view, Ellevio will not be able to offset the lower revenues with lower operating costs. The possibility to transfer under recovered funds to the upcoming period partially mitigates the revenue decrease.

Pressure on FFO to debt from 2020. We see less headroom to rating threshold in terms of FFO to debt from 2020 due to price decreases.

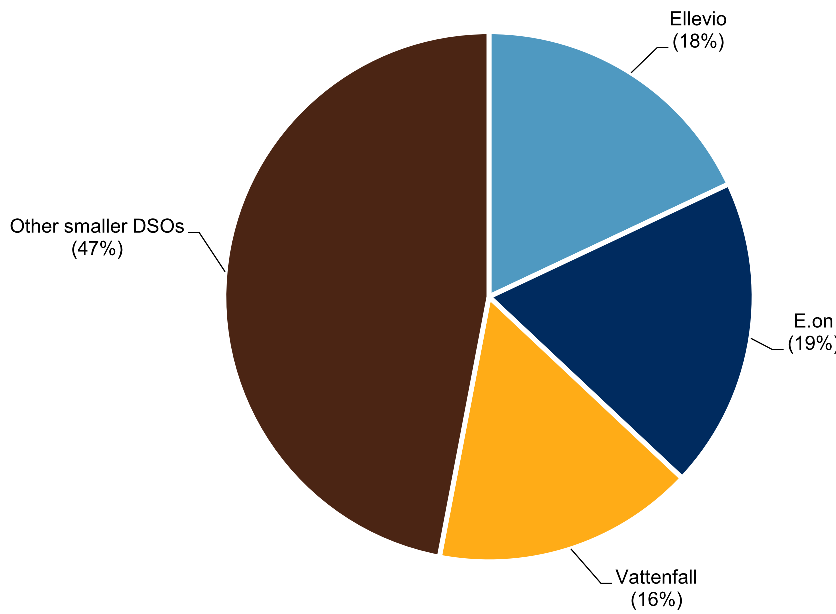
Company Description

Ellevio is one of the three largest electricity DSOs in Sweden, together with Vattenfall and E.ON. Ellevio's market share, in terms of customers, is about 18%. It has about 941,000 customers, and operates in four Swedish regional areas, with the majority of its customers in the Stockholm area. As well as delivering electricity, Ellevio is responsible for maintaining and developing its network. The Government and Energy Markets Inspectorate regulates all of Ellevio's operations, primarily through the Swedish Electricity Act, and by different ordinances. In 2017, the company reported sales of SEK7 billion and EBITDA of SEK4.3 billion (€420 million equivalent).

Ellevio is owned by Omers Infrastructure Holdings (formerly Borealis Infrastructure Management; with a 50% share); two of the Swedish states' buffer funds within the national pension system AP3 (20%) and AP1 (12.5%); and Folksam (17.5%), which acquired Ellevio from Fortum Oyj for SEK60.6 billion (€6.6 billion) in June 2015.

Chart 1

Share Of DSO Customers In Sweden



Source: Ellevio AB.

Business Risk

Our view of Ellevio's business risk profile benefits from the fully regulated electricity distribution operations, with natural monopoly positions in its service areas.

We view the Swedish regulatory framework for electricity distribution as stable, transparent, and predictable, with a long track record. This is despite some modifications in methodology between regulatory periods.

The Swedish government issued an ordinance in August 2018 that implies that the WACC could fall to as low as 3.0% under current market conditions, compared with the current WACC of 5.85%. This would lead to price decreases, and thus lower revenues and weaker margins from 2020, when the new regulation comes into effect. More positively, a recent court ruling allows the DSO to transfer under-recovered revenues from earlier periods to the upcoming period. This has been appealed, and we will monitor the outcome. We view the possibility to transfer under-recovered funds as positive since it reduces the negative effect of the lower WACC.

Peer comparison

Table 1

Ellevio AB -- Peer Comparison

Industry Sector: Electric

	Ellevio AB	Elenia Finance Oyj	Caruna Networks Oy
(Mil. €)	--Fiscal year ended Dec. 31, 2017--	--Fiscal year ended Dec. 31, 2017--	--Fiscal year ended Dec. 31, 2017--
Revenues	708.7	342.3	426.4
EBITDA	440.8	188.1	270.0
Funds from operations (FFO)	282.5	145.4	217.3
Net income from cont. oper.	29.3	0.0	28.8
Cash flow from operations	211.5	101.4	123.5
Capital expenditures	241.1	146.3	293.5
Free operating cash flow	(29.6)	(44.9)	(170.0)
Dividends paid	168.5	54.3	80.5
Discretionary cash flow	(198.1)	(99.1)	(250.4)
Cash and short-term investments	1.0	24.5	42.9
Debt	3,760.6	1,514.3	2,246.3
Equity	2,710.0	282.4	806.0
Adjusted ratios			
EBITDA margin (%)	62.2	55.0	63.3
Return on capital (%)	2.8	5.3	4.4
EBITDA interest coverage (x)	3.1	4.4	5.1
FFO cash int. cov. (X)	2.0	2.1	1.8
Debt/EBITDA (x)	8.5	8.0	8.3
FFO/debt (%)	7.5	9.6	9.7
Cash flow from operations/debt (%)	5.6	6.7	5.5
Free operating cash flow/debt (%)	(0.8)	(3.0)	(7.6)
Discretionary cash flow/debt (%)	(5.3)	(6.5)	(11.1)
Total debt/debt plus equity (%)	58.1	84.3	73.6

Ellevio has a similar business risk profile to its Nordic peers, operating within a stable regulatory environment with historical transparency and predictability. Ellevio is the second largest DSO in Sweden with a market share of 18% (E.ON has a 19% market share). Caruna is the largest in Finland with a 19% market share, and Elenia the second largest at 18%.

All three companies have large capex programs, and a large portion of shareholder loans. Ellevio and Elenia have a larger debt burden than Caruna compared with their earnings, and we view Caruna's financial risk profile as slightly stronger than Ellevio's and Elenia's.

Ellevio shows strong performance in terms of outage time per customer. This is due to more robust weather-proofing than peers, such as a higher underground cabling rate and more remote controlled disconnectors. In comparison, Elenia expects to achieve a cabling rate of 70% by 2028, compared with the current 42%. Caruna is at approximately 45%, expecting to reach 51% by the end of 2018. Ellevio had a comparable cable rate at 76% year-end 2017, and is scheduled to reach 84% by 2020. Weather proofing, such as cabling, will lead to fewer outages and lower compensation fees.

According to the Swedish Energy Markets Inspectorate, Ellevio had the largest proportion of customers with the least outages during 2016. The average outage time (SAIDI) for Swedish DSOs was 79 minutes during 2016; Ellevio reported an average of 44 minutes in the Stockholm area, and 96 minutes in rural areas.

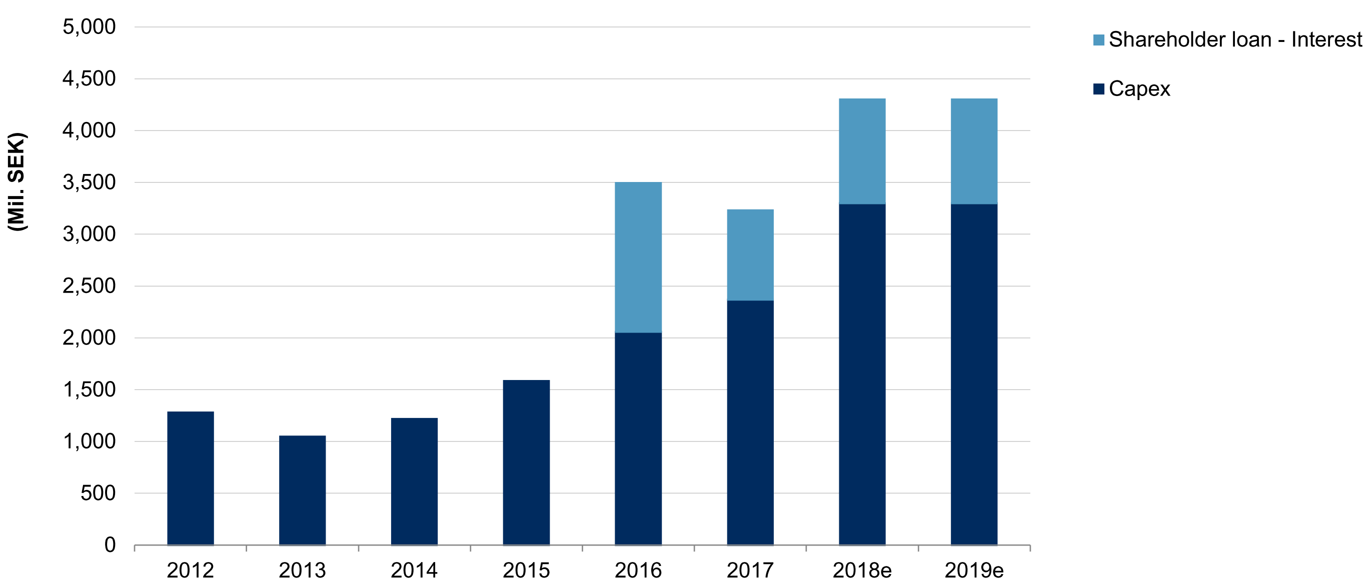
Financial Risk

We expect stable EBITDA and FFO over the short term, reflecting limited price increases. We forecast that FFO to debt will stay between 6.0% and 8.0% through 2019 because we anticipate Ellevio will continue investing heavily in its network and returning substantial cash to shareholders, primarily through payments on shareholder loans.

In the medium term, we anticipate price decreases in 2020 due to the new regulation period with lower WACC, resulting in slightly weaker credit ratios but still in the region of the current ones (FFO to debt: 6%-8%). We also understand that Ellevio's shareholder returns are flexible and could be reduced if necessary to preserve credit ratios (before reaching dividend lock-up levels). We expect Ellevio to adjust its capex program and shareholder distributions when the WACC is lowered.

Chart 2

Ellevio's Capex And Shareholder Loan Interest



e--Estimate. SEK--Swedish krona. Source: S&P Global Ratings.

Financial summary

Table 2

Ellevio AB -- Financial Summary			
Industry Sector: Electric			
	--Fiscal year ended Dec. 31--		
(Mil. SEK)	**2017**	**2016**	**2015**
Revenues	6,964.0	6,607.0	6,128.0
EBITDA	4,329.5	4,061.9	3,392.0
Funds from operations (FFO)	2,775.2	2,720.4	1,734.6
Net income from continuing operations	288.0	-239	15,463.4
Cash flow from operations	2,077.2	1,097.4	2,687.5
Capital expenditures	2,369.0	2,057.0	1,583.2
Free operating cash flow	(291.8)	(959.6)	1,104.3
Dividends paid	1,656.0	1,652.0	1,985.2
Discretionary cash flow	(1,947.8)	(2,611.6)	(880.9)
Debt	36,952.7	34,459.6	33,040.0
Preferred stock	0.0	0.0	0.0
Equity	26,629.0	26,413.0	6,162.7
Debt and equity	63,581.7	60,872.6	39,202.8
Adjusted ratios			
EBITDA margin (%)	62.2	61.5	55.4
EBITDA interest coverage (x)	3.1	3.6	2.5
FFO cash int. cov. (x)	2.0	1.6	3.8
Debt/EBITDA (x)	8.5	8.5	9.7
FFO/debt (%)	7.5	7.9	5.2
Cash flow from operations/debt (%)	5.6	3.2	8.1
Free operating cash flow/debt (%)	(0.8)	(2.8)	3.3
Discretionary cash flow/debt (%)	(5.3)	(7.6)	(2.7)
Net Cash Flow / Capex (%)	47.2	51.9	(15.8)
Debt/debt and equity (%)	58.1	56.6	84.3
Return on capital (%)	2.9	3.1	5.9
Return on common equity (%)	4.8	(4.0)	454.8
Common dividend payout ratio (un-adj.) (%)	0.0	0.0	12.8

SEK--Swedish krona.

Liquidity

We assess Ellevio's liquidity position as strong. Available liquidity sources should be well in excess of 1.5x liquidity uses over the near term and above 1.0x over the coming 24 months. We also assume that liquidity sources will exceed uses even if EBITDA were to decrease by 30%.

Principal Liquidity Sources	Principal Liquidity Uses
According to our calculations, Ellevio's liquidity sources as of Sept. 30, 2018 comprise: • Available cash and marketable securities of about SEK42 million. • Access to committed credit lines of about SEK10.8 billion. • Forecast FFO of about SEK2.6 billion.	Expected cash outflows include: • Capex of about SEK3.3 billion per year. • Dividends of about SEK1.0 billion per year.

Debt maturities

Ellevio has no debt maturities in the coming 12 months and about SEK3.5 billion in the subsequent 12 months.

Financial covenants

The credit facility contains covenants for lock-up of 10.75x and for default stipulating debt to EBITDA of 12.00x, , and interest cover of 1.7x and 1.2x, respectively. Ellevio complies with the debt-maturity limitations in the documentation, and has met all of its financial covenants in the past. We forecast Ellevio will retain headroom under its financial covenants over the next few years.

Other Credit Considerations

We view negatively the significant portion of, and payments on, the shareholder funds in the capital structure, which are in the form of shareholder loans. However, we exclude the loans from debt in our ratio calculations, reflecting their equity-like features such as deep subordination, maturities beyond all other debt, and the possibility of accruing interest.

Issue Ratings--Subordination Risk Analysis

Structural Enhancements

Ellevio is the operating company in the Ellevio group, which comprises four holding companies. The ultimate owners are international investor OMERS Infrastructure; two Swedish national pension funds (AP3 and AP1); and Swedish mutual insurance company Folksam. Following debt refinancing, Ellevio and its immediate holding company Ellevio Holding 4 AB have formed a ring-fenced financing structure, with Ellevio as the borrower. We rate Ellevio's senior secured debt one notch higher than Ellevio's SACP because of structural features designed to increase cash flow certainty for the debtholders. These features include:

- Restrictions on mergers, acquisitions, and asset disposals, and a share pledge over the assets and shares of the operating and holding company (to the extent allowed by legislation). Security over fixed assets, such as real property, and business mortgages are, however, not material in relation to secured debt.

- Dividend- and debt-restricted payment conditions and a covenanted liquidity structure that should, in our opinion, allow Ellevio's financing group to manage temporary cash flow shocks.
- An automatic 12-month standstill period after an event of default, during which time creditors can take control of Ellevio and either aim for operational recovery or sell the shares in the operating and immediate holding company.
- Prudent management of foreign exchange, refinancing, and counterparty risks.

Reconciliation

Ellevio's consolidated accounts are prepared under International Financial Reporting Standards. Our key analytical adjustments relate to shareholder loans, post-retirement benefit obligations, asset-retirement obligations, surplus cash, hybrid capital, and other debt, including liabilities to owners of non-controlling interests due to consortium agreements and margin calls received (see table 3).

Table 3

Reconciliation Of Ellevio AB Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. kr)

	--Fiscal year ended Dec. 31, 2017--							
Ellevio AB reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**
Reported	56,432	6,202	4,207	2,161	2,996	4,207	4,117	--
S&P Global Ratings adjustments								
Interest expense (reported)	--	--	--	--	--	(2,996)	--	--
Interest income (reported)	--	--	--	--	--	1	--	--
Current tax expense (reported)	--	--	--	--	--	(190)	--	--
Operating leases	516.7	--	122.5	35.0	35.0	87.5	87.5	--
Postretirement benefit obligations/deferred compensation	--	--	--	--	--	9.7	(34.3)	--
Surplus cash	(10)	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	1	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(2,093)	--
Debt - Accrued interest not included in reported debt	441	--	--	--	--	--	--	--
Debt - Shareholder loans	(20,427)	--	--	--	--	--	--	--
Equity - Other	--	20,427	--	--	--	--	--	--
Interest expense - Shareholder loan	--	--	--	--	(1,656)	1,656	--	--
Dividends - Other	--	--	--	--	--	--	--	1,656
Total adjustments	(19,479.3)	20,427.0	122.5	36.0	(1,621.0)	(1,431.8)	(2,039.8)	1,656.0
S&P Global Ratings adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends paid**
Adjusted	36,952.7	26,629.0	4,329.5	2,197.0	1,375.0	2,775.2	2,077.2	1,656.0

Ratings Score Snapshot

Senior Secured Debt Rating: BBB/Stable/--

Subordinated Debt Rating: BB+/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: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile : bbb-

Related Criteria

- 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- 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 - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of November 30, 2018)	
Ellevio AB	
Senior Secured	BBB
Senior Secured	BBB/Stable
Subordinated	BB+
Subordinated	BB+/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.

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