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Research Update:

Electricity Distributor Ellevio's Subordinated Debt Rated 'BB+'; Senior Secured Debt Affirmed At 'BBB'; Outlook Stable

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Overview

- Swedish electricity distribution company Ellevio AB plans to issue subordinated debt (class B) under its €10 billion EMTN program, from which the company previously issued senior secured debt (class A).
- We are assigning our 'BB+' issue credit rating to Ellevio's subordinated debt (class B), and we are affirming our 'BBB' rating on the senior secured debt (class A).
- This reflects that we rate the class B debt two notches below the class A due to its subordination and deferability.
- The stable outlook on the senior secured debt reflects Ellevio's stable and predictable earnings, which are supported by a favorable regulatory framework, and our anticipation that Ellevio will maintain credit measures in line with the current ratings, including funds from operations to debt of at least 6%.

Rating Action

On Jan. 23, 2018, S&P Global Ratings assigned its 'BB+' issue credit rating to the subordinated debt (class B) that is part of the €10 billion Euro Medium-Term Note (EMTN) program of Swedish electricity distribution system operator Ellevio AB.

At the same time, we affirmed our 'BBB' rating on Ellevio's senior secured debt (class A). The outlook on the senior secured debt is stable.

Rationale

The 'BBB' rating on the senior secured debt reflects our 'bbb-' assessment of the stand-alone credit profile (SACP) of Ellevio's financing group plus one notch of uplift for structural enhancements. The 'BB+' rating on the subordinated debt program reflects the 'bbb-' subordinated SACP on the company. We note Ellevio currently does not have any outstanding subordinated debt, but we understand that the amended EMTN program would likely be followed by issuance in the near term, subject to market conditions.

The class A debt reflects our forecast ratios for the company based on senior debt only, whereas the rating on the class B debt is based on ratios including both senior and subordinated debt. We see no material difference between the two ratios, and therefore the SACP and subordinated SACP are at the same level. In addition, the rating on the subordinated debt is constrained by the risk of nonpayment as Ellevio could defer principal and interest in case of insufficient funds.

In our view, Ellevio's business risk profile benefits from 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 and minor weaknesses relating to customer compensation in the event of longer unplanned outages.

We anticipate increases in EBITDA and funds from operations (FFO) over the next few years, relating to price increases, a growing asset base, and the now-consolidated Nynäshamn Energi (a regulated distribution network acquired in late 2016). We expect, however, 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. At the same time, we note that capital expenditures (capex) should be added to the regulatory asset base and therefore increase the allowed regulatory return. We also understand that Ellevio's shareholder returns are flexible and can be reduced if needed to preserve credit ratios (before reaching dividend lock-up levels).

Liquidity

We assess liquidity as strong, based on Ellevio's adequate headroom under all its financial covenants and available liquidity sources likely being well in excess of 1.5x liquidity uses over the next 12 months. We assume that sources will continue to cover uses even if EBITDA declines by 30% from our base–case projection.

We also acknowledge Ellevio's track record in the capital markets over the past year, leading us to regard its market access as high and bank relationships as solid. We do not see Ellevio's liquidity position as exceptional because we believe that headroom under its capex facility will gradually reduce as the expansionary investment program progresses.

We estimate that Ellevio's principal liquidity sources as of June 30, 2017, include:

- Cash of about Swedish krona (SEK) 55 million;
- FFO of SEK2.4 billion-SEK2.6 billion over the next 12 months; and
- About SEK8.3 billion available under bank lines of about SEK9.3 billion, comprising a SEK8.1 billion capex facility and SEK1.2 billion working capital facility, both maturing in May 2020.

In addition, Ellevio has a super senior liquidity facility of SEK1.4 billion for class A debt and a SEK0.1 billion liquidity facility for class B debt, which are intended for use only during a potential 12-month standstill period.

We therefore do not include these facilities in liquidity sources for ongoing outflows.

We project that Ellevio's principal liquidity uses, also as of end-June 2017, will consist of:

- Amortizing debt maturities of about SEK0.9 billion over the next 12 months;
- Annual capex of SEK2.4 billion-SEK2.7 billion; and
- Roughly SEK1.2 billion of shareholder returns annually.

Financial covenants

The credit facility contains covenants for lock-up and default stipulating debt to EBITDA of 10.75x and 12.00x, respectively, and interest cover of 1.7x and 1.2x. Ellevio complies with the debt-maturity limitations in the documentation, and has complied with all of its financial covenants in the past. Based on our forecasts, we believe Ellevio will have comfortable headroom under its financial covenants over the next few years.

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 FFO to debt of at least 6%, which we see as the minimum level commensurate with the ratings.

Downside scenario

Downside risk would primarily relate to any unexpected unfavorable changes to the regulatory framework for Ellevio, which could cause earnings volatility or deterioration, with a subsequent negative impact on credit measures. A material acquisition or excessive shareholder returns could also create rating pressure. We could consider a lower rating if, for example, FFO to debt decreased to below 6% for a prolonged period.

Upside scenario

We currently see limited upside potential, reflecting our view of Ellevio's financial policy and covenant structures. A positive rating action could materialize, however, if credit measures were to strengthen 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 a ratio of 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 SACP, as well as stronger SACP and rating on the class A debt.

Ratings Score Snapshot

Senior Secured Debt: BBB/Stable
Subordinated Debt: BB+

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: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Negative (-1 notch)

Stand-alone credit profile: bbb-

Issue Ratings

Structural enhancements.
Ellevio is the operating company in the Ellevio group, which includes 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.

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 - Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Framework Methodology, Sept. 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 - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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 List

Ratings Affirmed

Ellevio AB	
Senior Secured	BBB/Stable

New Rating

Ellevio AB	
Subordinated	BB+

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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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.