S&P Global Ratings

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Ellevio AB

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Ellevio AB

Credit Highlights

None

Overview

Key strengths	Key risks
All revenues and EBITDA (€350 million) stem from regulated business with a natural monopoly under a very supportive framework, with solid cost pass-through including inflation and tariff mechanism.	Remuneration for the ongoing regulatory period 2020-2023 is still not determined, which implies uncertainty for revenues and EBITDA.
Strong position as one of the three largest distribution system operators (DSOs) in Sweden; its large size allows for economies of scale and high operational efficiency.	Regulatory reset risk for the 2024-2027 period, as the regulator has not yet set the upcoming regulatory period terms.
Protective financing structure, which includes various structural features designed to protect bond holders.	Large portion of shareholder loans in the capital structure of SEK23 billion, leading to total shareholder distributions of about SEK1,500 million annually expected in 2023 and onward.
Owners' commitment to the current rating level providing flexibility in distribution.	High indebtedness, with net debt to EBITDA just below 10x in coming three years as annual negative DCF drives increasing debt toward SEK45 billion by end-2024.

Ellevio operates under a regulatory framework that S&P Global Ratings regards as very supportive; together with the company's operational efficiency, this underpins the excellent business risk profile. Ellevio 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 weighted-average cost of capital (WACC). As the RAB is annually updated with inflation, we do not expect currently high inflation (we forecast 6.8% for Sweden for full-year 2022 compared with 5.1% in 2021) to increase pressure on credit ratios.

We continue to view the Swedish regulatory framework as very supportive and favorable because it allows for full cost coverage and investments and RAB is allowed to be indexed annually to the Building Cost Index (BCI). With current estimates as of September, this will increase Ellevio's RAB by about 12% on top of investments.

Uncertainty lingers as to the final terms for the ongoing regulatory period (RP3) as the final WACC level has not yet been decided by the regulator because of long court proceedings. More or less since the regulator issued an ordinance in 2018, with a suggestion to materially lower the WACC level for RP3 (2020-2023), there has been an ongoing legal process to establish the WACC. All major DSOs have been involved in this. Despite several court rulings the authority has not yet been able to establish the WACC level for the current period; in the last outcome in June this year the court asked the regulator to recalculate the WACC. We take a negative view of the uncertainty created by this--noting there is still no final WACC for RP3. However, we understand that the WACC level should not be lower than 2.3% because the appealing party cannot be burdened with worse terms than those it had prior to the appeal. We think it plausible, however, that the WACC will be established at a slightly higher level. We currently assume, using same method to derive the WACC components for RP3 as we did for RP2 (2016-2019), an RP3 WACC of 3.89% (RP2 5.85%). Positively, the past year has shown us that the process effectively shields the framework from political interference and proves that DSOs can challenge authorities in court.

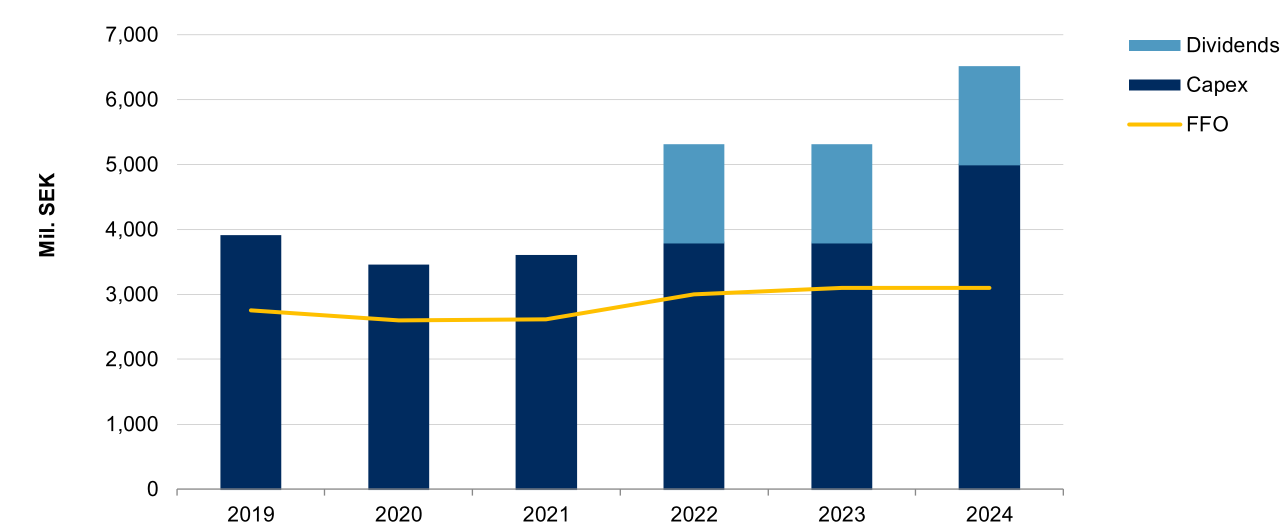
Furthermore, as companies are still legally allowed to transfer deficits from one period to the next, Ellevio has been able to moderate the impact by using unutilized, regulated allowed revenues from previous periods. Of the entities we rate in this sector, Ellevio has the highest exposure to Swedish regulated activities due to its size and the fact that it lacks the diversification of other big operators like Vattenfall and EON.

We view Ellevio's shareholders as committed to their financial policy and able to maintain funds from operations (FFO) to debt above 6%, which we deem to be in line with our current rating. The effect of higher remuneration is likely to be offset by recommencing sizable shareholder distributions. We expect Ellevio to start paying interest on its shareholder loan of SEK1.3 billion annually again from 2023 (the last time was during 2018).

If final outcome for the ongoing regulatory period or the new period starting in 2024 were to result in an unforeseen cut in remuneration for Ellevio, we believe that the company has the flexibility to postpone payments, or swiftly reduce capital expenditure (capex) to protect its credit ratios. Additionally, we also believe that the owners would be willing to cut shareholder remuneration to largely compensate for the lower regulated remuneration and protect credit ratios. We therefore forecast Ellevio's FFO to debt to remain around 7%-8% and its debt to EBITDA below 10x for its senior debt and about 6%-8% and below 12x for its total debt.

Chart 1

Funds From Operations Don't Cover For Capex And Dividends - Debt increases



SEK--Sweidsh krona. Source: S&P Global Ratings.

The energy transition and demand for electrification is creating additional needs for DSO investments and should translate into healthy annual RAB growth of at least 5.6% over 2020-2024. Despite initial signs of deteriorating remuneration, with the cut in the WACC rate to 2.35% from 5.85%, Ellevio has continued to make investments. It has invested about SEK3.5 billion annually, which has contributed to a healthy increase in its regulatory asset base. Despite WACC-related uncertainty, we assume Ellevio will further step up investments in RP4 to about SEK15 billion, significantly higher than the SEK11 million in RP2 (2016-2019). The impetus for such investments is increasing given greater demand for DSOs to make electricity distribution more efficient as ongoing electrification creates additional challenges for the grid. According to our estimates, we believe Ellevio's increase in RP4 capex translates into RAB growth of SEK9 billion or a 24% increase over the four years with total RAB at almost SEK50 billion by 2024 (this also includes indexation related to BCI estimates). This should translate into healthy growth in regulated revenues and EBITDA in the future.

In our view, Ellevio's ongoing investments and RAB build up during periods of uncertain remuneration will support growth in future remuneration and cash flows.

Structural features in the senior secured debt continue to support the rating. Ellevio is the borrower under a ring-fenced structure with two classes of debt--senior class A and subordinated class B. Under our methodology we look at:

- The senior debt ratios to determine the class A debt rating, which is one notch above the senior credit quality (stand-alone credit profile [SACP]) of 'bbb-'; and
- The consolidated debt ratios to determine the class B (total debt) rating, which is two notches below the class A debt or the same as the 'bb+' consolidated SACP, whichever is lower.

The senior debt's SACP benefits from a one-notch uplift due to various structural features designed to increase cash flow certainty for debtholders. These include restricted payment conditions and a covenanted liquidity structure that should, in our opinion, enable Ellevio to manage temporary cash flow shocks. The debtholders benefit from the following features:

- Two levels of financial covenants (trigger events and events of default) and an automatic 12-month standstill period after an event of default; and
- A liquidity facility available if the group enters a standstill and that is sufficient to cover finance charges for at least 12 months.

Outlook

The stable outlook reflects our forecast of continually improving EBITDA and FFO, assuming WACC not going below 2.35% and likely being closer to 3.89% when applying previous regulatory period methods to the current one. The outlook also reflects 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 it would pay shareholder remuneration if WACC increases from 2.35%. We expect FFO to debt at 7%-8% and debt to EBITDA below 10x throughout the period for the senior debt and debt to EBITDA below 12x for all (including subordinated) debt, which we consider commensurate with the 'BBB' issue rating for senior debt and the 'BB-' issue rating for 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 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 renumeration. 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. Even if WACC increased significantly after a favorable court ruling, Ellevio would increase its shareholder remuneration and maintain FFO to debt commensurate with a 'bbb-' SACP. We could, however, consider an upgrade if the company were 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 business plan.

Our Base-Case Scenario

Assumptions

- Swedish GDP growth of 2.2% and CPI at 8.4% in 2022.
- BCI of about 12% by end-2022 and inflating RAB by the same as per regulation.
- WACC of 3.89% until 2023 and thereafter 4.27% for the upcoming regulatory period commencing 2024 and ending 2027.
- DSOs' ability to carry-forward accumulated under-recovered funds from previous periods (SEK2 billion at the end of RP2).
- EBITDA about SEK4.0 billion-SEK4.5 billion over our forecast period.
- EBITDA margin at 53%-57%.
- Increased accelerated capex of SEK3.5 billion-SEK4.0 billion over 2022-2023 increasing to about SEK5.0 billion in 2024.
- Shareholder distributions (including interest on shareholder loans) of about SEK1.5 billion from 2022 onward unless lower WACC than expected.
- Subordinated debt not exceeding 10% of total debt.

Key Metrics

Ellevio--Key Metrics Table

(Mil. SEK)	2021a	2022e	2023f	2024f
EBITDA	3,831.5	3,900-4,100	4,000-4,400	4,200-4,600
Funds from operations (FFO)	2,612.9	2,900-3,100	2,900-3,300	2,900-3,300
Capital expenditure	3,590.0	3,600-4,000	3,600-4,000	4,800-5,200
Shareholder remunerations	0.0	1400-1600	1400-1600	1400-1600
Debt (Class A debt)	35,945.8	37,500-38,500	39,000-41,000	42,000-44,000
Debt to ebitda (Class A debt)	9.4	9.0.-9.5	9.5-9.9	9.5-9.9

Ellevio--Key Metrics Table (cont.)				
(Mil. SEK)	**2021a**	**2022e**	**2023f**	**2024f**
FFO to debt (Class A debt)	7.3	7-8	7-8	7-8
Debt (All debt)	39,945.8	41,500-42,500	43,000-45,000	46,000-48,000
Debt to ebitda (All debt)	10.4	10.-10.5	10.5-10.9	10.5-10.9
FFO to debt (Total debt)	6.5	6-7	6-7	6-7

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. SEK--Swedish krona.

We expect EBITDA above SEK4 billion in 2022 and to increase toward SEK4.5 billion at end-2024, which allows for higher investments and the restart of paying interest on the shareholder loans of about SEK1.3 billion in 2023. We view the company and owners as having proven supportive of the rating through flexible planning with investments and financial policy and no shareholder remunerations. That said, the latter is expected to resume and result in annual shareholder remuneration of about SEK1,500 million from 2023.

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 968,000 customers and operates in four Swedish regional areas, with most of its customers in the Stockholm area. It has in total 79,200 kilometers of power lines and distributed 27.5 terawatt-hours in 2021. As well as delivering electricity, Ellevio is responsible for maintaining and developing its network.

The Government and Energy Markets Inspectorate regulates all Ellevio's operations, primarily through the Swedish Electricity Act, and by different ordinances. In 2021, the company reported sales SEK7.2 billion and EBITDA of SEK3.7 billion (€350 million equivalent).

Ellevio is owned by Omers Infrastructure Holdings (50%); two of the Swedish states' buffer funds within the national pension system, AP3 (20%) and AP1 (12.5%); and Folksam (17.5%).

Table 1

Nordic Peer Comparison			
	Ellevio	**Caruna**	**Elenia**
Rating as of Oct. 14, 2022	na	BBB/Stable	na
Issue Ratings	BBB/BB+/Stable*	na	BBB/Stable
Business Risk Profile	Excellent	Excellent	Excellent
Country Risk	Very low	Very low	Very low
Industry Risk	Very low	Very low	Very low
Competitive Position	Strong	Strong	Strong
Financial Risk Profile	Aggressive	Aggressive	Aggressive
Cash Flow / Leverage	Aggressive	Aggressive	Aggressive
Volatility Table	Low	Medial	Medial
Anchor	bbb	bbb	bbb
Capital Structure	Neutral	Neutral	Neutral

Table 1

Nordic Peer Comparison (cont.)

	Ellevio	Caruna	Elenia
Liquidity	Strong	Strong	Strong
Financial Policy	Neutral	Neutral	Neutral
Management / Governance	Satisfactory	Satisfactory	Satisfactory
Comparable Rating Analysis	Negative (-1 notch)	Neutral	Negative (-1 Notch)
SACP	bbb-	bbb	bbb-
SED*	+1 Notch	na	+1 Notch

*Ellevio Senior Secured debt rated BBB and Subordinated debt rated BB+. **SED - Structural Enhanced Debt

Key Financial hightlights

	--Fiscal Year Ended Dec. 31, 2021--		
(Mil. €)			
Revenue	705.7	499.8	340.8
EBITDA	372.6	324.6	223.3
Funds from operations (FFO)	254.1	239.5	178.4
Interest expense	115.8	58.9	37.0
Cash interest paid	114.2	72.5	39.6
Cash flow from operations	364.0	184.6	188.6
Capital expenditure	349.1	138.9	157.2
Free operating cash flow (FOCF)	14.9	45.7	31.4
Discretionary cash flow (DCF)	14.9	(106.6)	(38.6)
Cash and short-term investments	1.2	60.8	71.8
Debt	3,884.4	2,545.5	1,767.0
Equity	3,141.8	663.6	(204.2)
Adjusted ratios			
EBITDA margin (%)	52.8	64.9	65.5
Return on capital (%)	2.9	6.1	8.9
EBITDA interest coverage (x)	3.2	5.5	6.0
FFO cash interest coverage (x)	3.2	4.3	5.5
Debt/EBITDA (x)	10.4	7.8	7.9
FFO/debt (%)	6.5	9.4	10.1
Cash flow from operations/debt (%)	9.4	7.3	10.7
FOCF/debt (%)	0.4	1.8	1.8
DCF/debt (%)	0.4	(4.2)	(2.2)

Table 2

Ellevio AB--Financial Summary

Industry sector: Electric

	--Fiscal year ended Dec. 31--				
	2021	**2020**	**2019**	**2018**	**2017**
(Mil. SEK)					
Revenue	7,257.0	6,790.0	6,810.0	7,058.0	6,964.0

Table 2

Ellevio AB--Financial Summary (cont.)

Industry sector: Electric

	--Fiscal year ended Dec. 31--				
	2021	**2020**	**2019**	**2018**	**2017**
EBITDA	3,831.5	3,739.5	3,985.5	4,321.0	4,329.5
Funds from operations (FFO)	2,612.9	2,599.1	2,755.8	2,541.8	3,013.5
Interest expense	1,190.6	1,178.4	1,175.7	1,791.2	1,375.0
Cash interest paid	1,174.6	1,127.4	1,160.7	1,672.2	1,117.0
Cash flow from operations	3,742.9	3,105.1	3,836.8	2,557.8	2,111.5
Capital expenditure	3,590.0	3,449.0	3,897.0	2,610.0	2,369.0
Free operating cash flow (FOCF)	152.9	(343.9)	(60.2)	(52.2)	(257.5)
Discretionary cash flow (DCF)	152.9	(343.9)	(60.2)	(654.2)	(1,269.5)
Cash and short-term investments	12.0	14.0	20.0	56.0	10.0
Gross available cash	12.0	14.0	20.0	56.0	10.0
Debt	39,945.8	39,667.2	39,216.5	38,942.5	36,511.7
Equity	32,309.0	29,976.0	28,273.0	26,538.0	26,629.0
Adjusted ratios					
EBITDA margin (%)	52.8	55.1	58.5	61.2	62.2
Return on capital (%)	2.9	2.7	2.5	3.3	3.6
EBITDA interest coverage (x)	3.2	3.2	3.4	2.4	3.1
FFO cash interest coverage (x)	3.2	3.3	3.4	2.5	3.7
Debt/EBITDA (x)	10.4	10.6	9.8	9.0	8.4
FFO/debt (%)	6.5	6.6	7.0	6.5	8.3
Cash flow from operations/debt (%)	9.4	7.8	9.8	6.6	5.8
FOCF/debt (%)	0.4	(0.9)	(0.2)	(0.1)	(0.7)
DCF/debt (%)	0.4	(0.9)	(0.2)	(1.7)	(3.5)

SEK--Swedish krona.

Table 3

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

	--Fiscal year ended Dec. 31, 2021--						
Ellevio AB reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
Reported	62,702.0	9,086.0	3,700.0	1,973.0	2,469.0	3,831.5	4,784.0
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	(44.0)	--
Cash interest paid	--	--	--	--	--	(1,139.0)	--
Operating leases	478.8	--	131.5	35.6	35.6	(35.6)	95.9
Accessible cash and liquid investments	(12.0)	--	--	--	--	--	--

Table 3

Ellevio AB--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. SEK) (cont.)							
Nonoperating income (expense)	--	--	--	60.0	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(1,137.0)
Debt: Shareholder loans	(23,223.0)	--	--	--	--	--	--
Equity: Other	--	23,223.0	--	--	--	--	--
Interest expense: Shareholder loan	--	--	--	--	(1,314.0)	--	--
Total adjustments	(22,756.2)	23,223.0	131.5	95.6	(1,278.4)	(1,218.6)	(1,041.1)
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	39,945.8	32,309.0	3,831.5	2,068.6	1,190.6	2,612.9	3,742.9

SEK--Swedish krona.

Liquidity

We view Ellevio's liquidity as strong because we believe its liquidity sources will exceed its near-term cash outflows by about 1.7x. We also 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 as of Sept. 30, 2022, include:

- Forecast FFO of about SEK2.8 billion
- Access to committed credit lines of about SEK7.2 billion maturing in more than 12 months

Principal liquidity uses for the 12 months from Sept. 30, 2022, include:

- Capex of about SEK3.8 billion.
- Debt repayment of SEK763 million.
- Shareholder remuneration of about SEK1.5 billion.

Covenant Analysis

The credit facility contains covenants for lock-up of 10.75x; and for default, stipulating debt to EBITDA of 12.00x and interest coverage of 1.7x and 1.2x for senior debt. It also contains lock-up and default covenants for total debt, with debt to EBITDA at 11.9x and 13.0x, respectively. Ellevio complies with the debt-maturity limitations in the documentation and has met all its financial covenants historically.

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

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 alphanumerical 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 Indicators: Definition And Applications," published Oct. 13, 2021.

Ratings Score Snapshot

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

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory
- Comparable rating analysis: Negative (-1 notch)

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-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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 | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Ratings Detail (As Of November 3, 2022)*	
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.