EVN AG
Austria, Utilities

A+ STABLE

Corporate profile

EVN AG is Austria's second-largest utility with a fully integrated business model. Besides its electricity and gas infrastructure, the company is also exposed to other infrastructure services such as water treatment and supply, waste management and cable television. The government of Lower Austria holds 51% of EVN via holding company NÖ Landes-Beteiligungsholding GmbH, fulfilling the minimum ownership required by law.

Key metrics

			Scope estimates		
Scope credit ratios	2018/19	2019/20	2020/21E	2021/22E	2022/23E
EBITDA/interest cover (x)	19	16	14	22	25
Scope-adjusted debt (SaD)/EBITDA (x)	1.4	1.5	1.4	1.2	1.1
Free operating cash flow/SaD	23%	25%	18%	14%	20%
Liquidity	>200%	>200%	>200%	>200%	>200%

Scope Ratings has assigned an A+/Stable issuer rating to Austria's EVN AG. Concurrently, Scope has assigned an S-1+ short-term rating as well as an A+ rating for senior unsecured debt.

EVN's A+ issuer rating reflects a standalone credit quality of A plus a one-notch uplift based on our view of EVN as a government-related entity.

The standalone issuer rating reflects our view of EVN's robust business model paired with a strong financial risk profile that is one of the best among European integrated utilities. EVN is well able to manage challenging economic phases without threatening its credit quality. This is thanks to its fully integrated business model, diversification, and dominant exposure to regulated activities (such as energy distribution and regulated power generation) and robust utility segments (such as water and heat supply, cable television and telecommunications).We expect the group's business to be further strengthened by its plan to accelerate capex in regulated and quasi-regulated assets in its core region of Lower Austria. At the same time, the capex programme will likely be balanced with operating cash flow and dividends at levels that do not jeopardise the low indebtedness.

The Stable Outlook reflects a consistently improved financial risk profile with a Scope-adjusted leverage (SaD/EBITDA) sustained at 1.5x or below. This is underpinned by our view of the group's solid ability to balance capex and shareholder remuneration against operating cash flow and thereby keep its net debt broadly constant. The Outlook also reflects our view that EVN's ownership structure will not change as the government of Lower Austria is required by law to retain a majority stake.

A positive rating action could occur if Scope-adjusted leverage moved to 1.0x or below. However, Scope deems this remote as the company would likely balance additional deleveraging against higher capex and/or shareholder remuneration.

A negative rating action could be warranted by leverage deteriorating to above 1.5x on a sustained basis. This could be due to a higher-than-expected net capex or lower-than-expected earnings contribution from new investments and/or the volatile businesses such as energy supply and environmental services. Alternatively, a negative rating action could be triggered if Lower Austria reduced its share to a minority stake (unlikely due to the legislation).

Ratings & Outlook

Corporate rating	A+/Stable
Short-term rating	S-1+
Senior unsecured rating	A+

Analyst

Sebastian Zank, CFA
+49 30 27891 225
s.zank@scoperatings.com

Related Methodologies

Corporate Rating Methodology

Rating Methodology: European Utilities

Rating Methodology – Government Related Entities

Scope Ratings GmbH

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Tel. +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Vertically integrated business model with regulated power distribution; strong position for unregulated power generation (hydro); leading position in energy supply in Lower Austria • Volatility in power generation, trading and environmental services offset by exposure to less cyclical sectors (regulated and quasi-regulated) such as grids, heat, telecommunications, water and contracting of remaining reserve capacities • Strong geographical diversification across eastern Europe and different infrastructure segments • Enhancement of cash flow profile through recurring contributions from holdings, especially RAG, Energie Burgenland, EVN KG and Verbund AG • Further stabilisation of cash flows through accelerated investments, primarily in low-risk utility segments, e.g. regulated grids and regulated renewables (ESG factor) • Consistent de-risking of power generation portfolio with full exit from coal-fired power generation following recent Walsum-10 disposal (less than 25% of future power generation volumes related to thermal) Generation portfolio strongly geared towards renewables and reserve capacity for remaining thermal capacity (ESG factor) • Improving footprint in environmental services, with an order backlog of more than EUR 1.0bn • Strong sustained financial risk profile with leverage of up to 1.5x and strong debt protection (EBITDA interest coverage of well above 10x) • Strong internal liquidity with theoretically no external (re)financing needs • Positive rating impact from shareholder structure with Lower Austria as controlling shareholder	• Volume risks in power generation in dry hydrological years and/or meagre wind years in addition to industry-inherent volatility of achievable prices for outright unregulated power generation • Higher market risks in south-eastern Europe • Potential for group margins to be significantly affected by volatile trading business and environmental services

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Further deleveraging leading to a sustained SaD/EBITDA of around or below 1.0x	• Sustained weakening of financial risk profile as measured by a SaD/EBITDA of above 1.5x • Change in shareholder structure with Lower Austria waiving its majority share following an amendment to the legal requirement to hold at least 51%

Financial overview

			Scope estimates		
Scope credit ratios	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**	**2022/23E**
EBITDA/interest cover (x)	19	16	14	22	25
SaD/EBITDA (x)	1.4	1.5	1.4	1.2	1.1
Free operating cash flow/SaD (%)	23%	25%	18%	14%	20%
Liquidity (%)	>200%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**	**2022/23E**
Reported EBITDA	632	590	746	704	753
Adjustments (including gains/losses on asset disposals, one-off items, operating leases and recurring dividends from shareholdings, and foreign exchange gains/losses)	43	23	-111	-	-
Scope-adjusted EBITDA	**675**	**613**	**635**	**704**	**753**
Scope-adjusted debt in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**	**2022/23E**
Reported gross financial debt including finance leases	1,133	1,233	1,268	1,136	1,136
less: Cash and cash equivalents	336	468	540	404	438
add: Adjustment for unfunded pension obligations (two-thirds of unfunded pension gap)	155	152	135	128	121
add: Adjustment for asset retirement obligations	17	17	-	-	-
Scope-adjusted debt	**968**	**933**	**863**	**859**	**819**
Liquidity – funding sources and uses in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**	**2022/23E**
Unrestricted cash and cash equivalents (t-1)	354	336	468	540	404
Free operating cash flow (t)	223	234	151	117	166
Committed undrawn credit lines (t-1)	492	605	530	530	530
Short-term debt (t)	**89**	**69**	**115**	**407**	**120**

Business risk profile

Business risk profile assessed at A-

Despite its small size compared to other pan-European utilities, we assess EVN's business risk profile as comparatively low risk and widely diversified, leading to largely resilient operating performance. This is due to:

i) its fully integrated utility business model in electricity supply focused on robust regulated infrastructure;

ii) diversification across different markets in central and south-eastern Europe;

iii) significant exposure to other low-risk and less cyclical infrastructure segments such as television/cable networks, drinking-water supply, and heat generation;

iv) its increased focus on strengthening its regulated business in its core market (Lower Austria) through an ongoing ramp-up of renewable energy capacities and the upgrade of its grid infrastructure, supporting the energy transition in Austria (ESG factor: credit-positive environmental rating driver); and

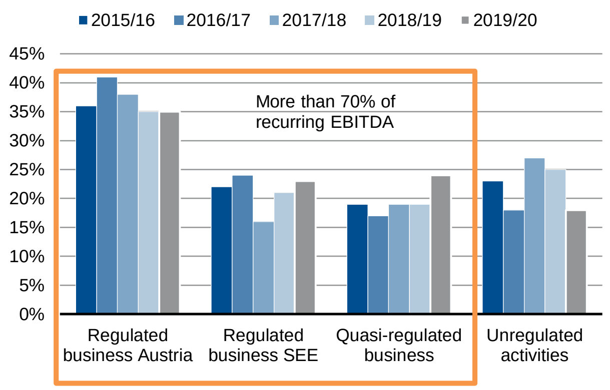
v) limited legacy risks related to the generation portfolio, already rectified through the operation of remaining thermal capacities as reserve capacity (ESG factor: credit-positive environmental rating driver).

However, EVN's business risk profile remains constrained by i) its exposure to volatile energy trading and supply as well as project development activities in environmental services; ii) higher market risks for activities in south-eastern Europe; and iii) the company's overall profitability profile.

Resilient and diversified business profile

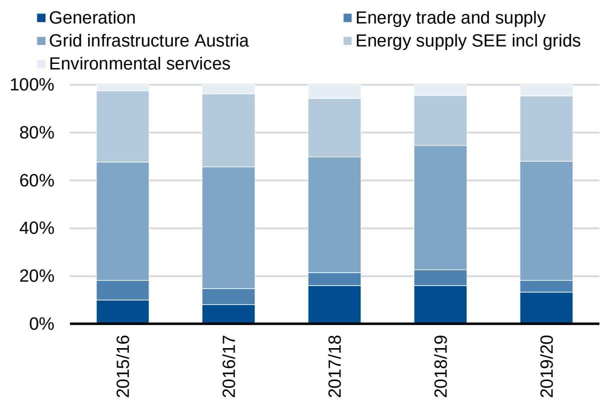
EVN's operating performance has proved very resilient overall, even against external shocks including the current Covid-19 crisis and related lockdowns, which has led to negative effects on power generation and distribution volumes. Such resilience is due to the company's solid diversification, its large exposure to regulated and quasi-regulated infrastructure segments, at more than 70% of its recurring cash flow (see Figure 1), and the large portion of hedging in the more volatile areas of energy supply and thermal power generation.

Figure 1: Recurring share of regulated vs unregulated business



Source: EVN, Scope

Figure 2: Capex allocation to lower-risk and high-margin segments such as grid infrastructure



Source: EVN, Scope

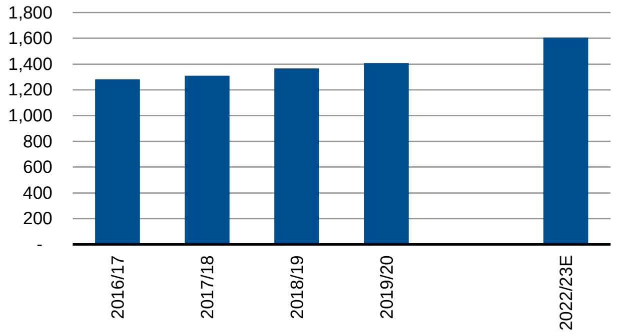
Strong exposure to low-risk regulated and quasi-regulated utility segments

The company continues to allocate most of its investments (reliably more than 75% of annual gross capex) to low-risk regulated and quasi-regulated infrastructure segments (see Figure 2) such as distribution grids, district heating, renewable energies (e.g. onshore wind), and water supply. Cash flow generation is likely to strengthen through robust and non-substitutable infrastructure services.

Importance of grid expansion for energy transition limits regulatory/political risks

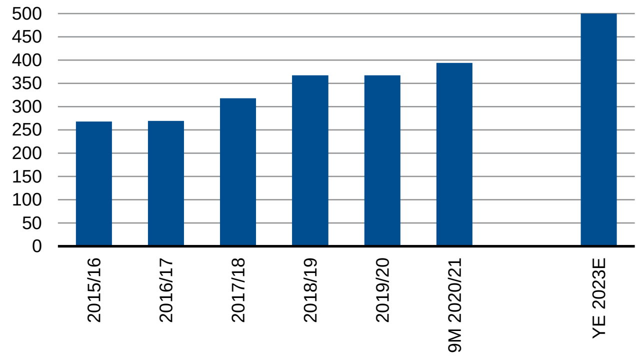
The group's business model is fully focused on the energy transition in Austria. A major part of EVN's medium-term capex programme (Strategy 2030, with capex increasing to EUR 450m-500m yearly from an average range of EUR 330m-370m in recent years) is earmarked for ramping up renewables generation and upgrading distribution grids. This initiative is likely to be supported by the recently passed 'Erneuerbare Ausbau Gesetz'[1]. Overall, we believe tailwinds will benefit EVN's business, reducing the likelihood of unexpected adverse regulatory changes (ESG factor: credit-positive environmental and social factor).

Figure 3: Steady growth in regulated asset base (EUR m) with forthcoming stimulus from accelerated grid investments



Source: EVN, Scope estimates

Figure 4: Gradual ramp-up of regulated onshore wind portfolio (MW)



Source: EVN, Scope estimates

Cash flows from regulated grid robust despite reduced interest rates

We believe EVN's regulated electricity grid and gas network activities in Lower Austria will remain a major cash flow driver despite the reduced interest rates on invested capital (regulated asset base – RAB). We assume the cash flow effect from a reduced weighted average cost of capital (WACC)[2], applied to EVN's RAB as compensation for invested capital, will be comfortably offset by the steady expansion in the RAB (see Figure 3) and the positive effect on regulated distribution tariffs from an above-average productivity factor. Lower cash flow contributions caused by the lower-than-expected distribution volumes is expected to be recovered well in the following years, with some time lag, as displayed by the higher tariffs from January 2021 in electricity and gas distribution. This should compensate for unearned revenues. The regulatory framework ensures robust cash flow generation and broadly stable margins over the long term.

Robust cash flow diversification

EVN's credit quality is supported by its diversified outreach across a wide range of low-correlated utility segments and countries. Moreover, EVN's cash flow benefits from recurring cash flow of more than EUR 100m a year from strategic investments in other robust ventures, primarily RAG-Beteiligungs-Aktiengesellschaft, Burgenland Holding AG, and Verbund AG.

Transformation of generation portfolio providing improved cash flow resilience

The company's power generation segment remains one of the more volatile sources of cash flow for the group. Even so, the realignment of its power generation business is seen as credit-positive, with a rising share from regulated wind assets and the reserve capacity for remaining thermal generation assets. The risk of non-controllable market prices and cash flow volatility is mitigated by: i) the partial closure of EVN's thermal generation assets; ii) the medium-term contraction of the remaining thermal generation

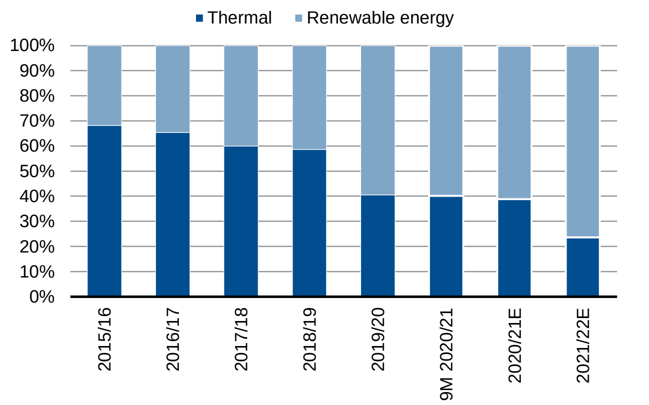
[1] The cornerstones of Austria's renewable energy strategy are i) a boost of power generation from renewable energy sources of 27 TWh by 2030; ii) remuneration of newly installed capacities based on market premiums for 20 years; iii) a strengthening of grid infrastructure under the ÖNIP (Integrierter österreichischer Netzinfrastrukturplan); and iv) continued auctions for the operation of thermal back-up power plants.

[2] The WACC for gas assets has reduced for the current five-year regulatory period (2018-22), to 5.2% for new gas distribution network assets and 4.88% for the existing RAB of distribution system operators with average efficiency parameters, from 6.42% in the previous regulatory period. WACC was similarly adjusted for the new regulatory period (2019-23) in electricity distribution, down from 6.42% to 5.2% for new regulated assets and 4.88% on the existing RAB of distribution system operators with average efficiency parameters.

capacity at Theiß (430 MW) until October 2022 as reserve capacity with transmission grid operator APG[3]; and iii) the gradual ramp-up of regulated wind assets to 500 MW by YE 2023 from about 400 MW in June 2021. While volume risks remain for unregulated generation assets (primarily hydro) and regulated wind assets during meagre wind years or dry hydrological years, the increased diversification of generation assets to the portfolio will gradually decrease risks of incremental effects from an underperformance of single generation assets.

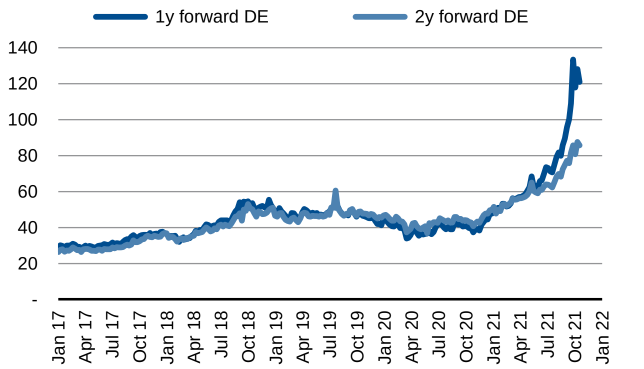
Ultimately, cash flow downside in EVN's power generation will likely be limited thanks to i) its ongoing de-risking with regards to thermal power generation, as signalled by the capacity closures of Theiß, Korneuburg and Dürnrohr gas and hard coal capacities over the past few years; and ii) the more recent disposal of its 49% stake in the Walsum-10 hard coal power plant. We also see significant cash flow upside in the context of higher electricity wholesale prices across Europe, which will follow EVN's ongoing restructuring of its power generation portfolio, with a large remaining exposure to unregulated hydro and regulated wind assets (either under tariff or market premia), expected at around 75% of future generation volumes. While the current prices may not be sustained once gas prices ease, higher-than-average wholesale prices will likely support cash flow upside for the yet unhedged part of EVN's hydro volumes in BY 2021/22 and particularly in BY 2022/23 given the largely unhedged generation exposure.

Figure 5: Consistent decarbonisation of power generation as displayed by shrinking share of thermal generation volumes



Source: EVN, Scope estimates

Figure 6: Electricity wholesale prices (baseload) in Germany as proxy for Austria (EUR/MWh)



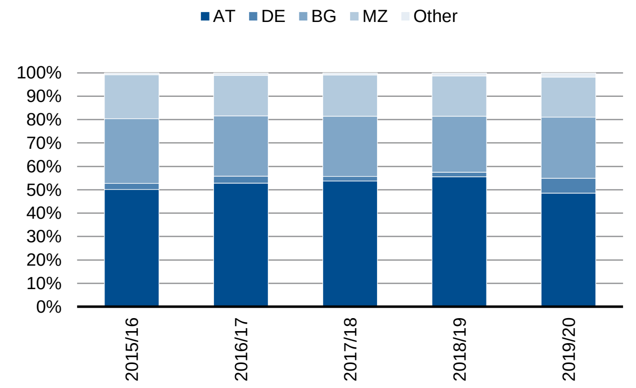
Source: Bloomberg, Scope

Strong market position in regional energy supply

We highlight EVN's strong market coverage in energy supply - over 70% and 30% in electricity and gas supply, respectively - in its core market of Lower Austria, a market also characterised by comparatively low churn rates. We believe EVN's strong coverage is linked to its product offering as a 'one-stop shop' for electricity, gas, heat and other services.

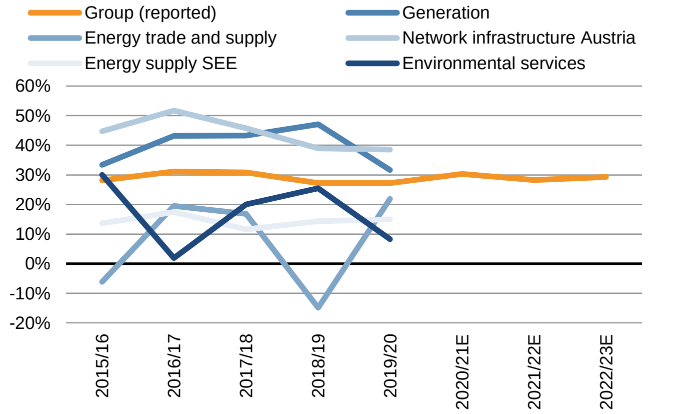
[3] Thereafter, EVN can participate in tenders for a prolongation of contracted reserve capacity with APG.

Figure 7: Geographical outreach (based on sales)



Source: EVN, Scope

Figure 8: Margin volatility in energy trading and environmental services (EBITDA margin)



Source: EVN, Scope estimates

Volatile business from energy trading to be absorbed by robust business segments

Cash flow generation in EVN's trading and generation divisions tends to be volatile and even negative (e.g. due to adverse energy procurement, price and volume volatility for the remaining thermal capacities, and meagre output from wind power plants or in dry hydrological years). However, we believe that the company's core activities in Austria can largely absorb potential margin swings, with a recurring EBITDA margin at more than 30%. The lower-margin and more volatile segments, such as energy trading and environmental services, still constrain EVN's business risk profile.

Higher business risks in less robust south-eastern European markets

On the negative side, EVN's business risk assessment remains tempered by the higher political, market and regulatory risks present in the liberalised south-east European markets, primarily Bulgaria and Macedonia, which contribute more than 20% of recurring group EBITDA. Regulatory frameworks in those markets are not as robust and reliable as that of 'e-control' in Austria. The company is therefore more likely to face adverse tariff adjustments, which could erode profitability and cash flow.

Project risks for environmental projects largely mitigated

Similarly, EVN's projects in south-eastern Europe and outside of Europe, primarily for environmental services, pose some incremental risks. We expect environmental services to grow significantly over the next few years, bolstered by more than EUR 1.0bn in orders from diverse markets such as Kuwait, Germany, Poland, Lithuania, and Bahrain. While there are potential execution risks for the projects addressing drinking water, wastewater treatment and sewage sludge utilisation as well as potential pressure on net working capital, we believe these risks can largely be mitigated by EVN subsidiary WTE's experience in this area and the public authority funding of these projects.

Financial risk profile

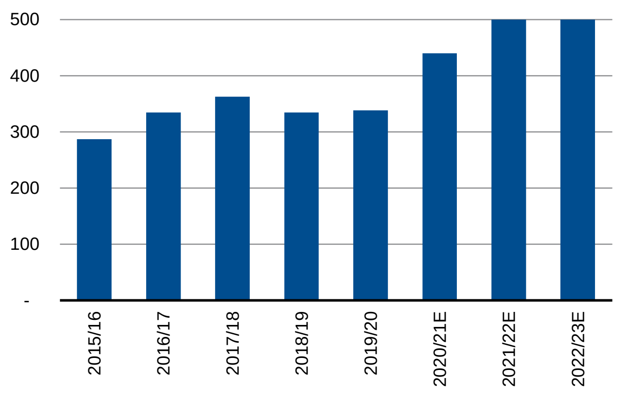
Financial risk profile: A+

We regard EVN's financials to be fully commensurate with an A+ financial risk profile. This is reflected in the low indebtedness, robust debt protection metrics, and focus on positive free operating cash flow and break-even discretionary cash flow. The financial risk profile strongly supports the solid investment grade rating and is among the strongest of the European integrated utilities.

Our forecasts primarily reflect the following assumptions:

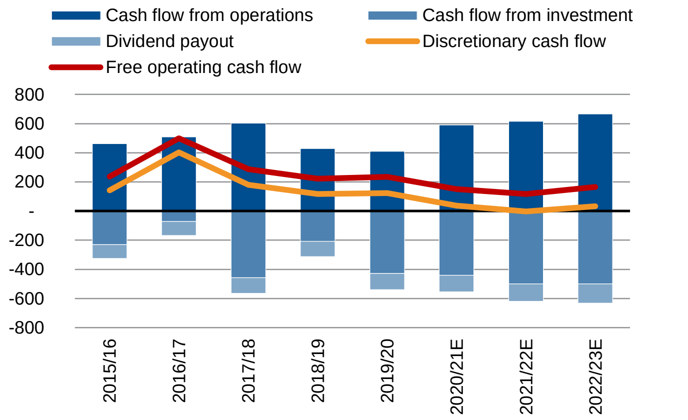
- Significant topline growth over the next three years related to rising energy prices that affect unregulated generation and energy supply, but also the continued boost from environmental services division and stimulus stemming from accelerated capex in generation and distribution
- Broadly stable EBITDA margin of around 25%, with the lower margins in south-eastern Europe, environmental services and energy supply being offset by improving margins in power generation and by the increasing contribution from the high-margin renewables and energy distribution segments
- Continued positive margins in energy trade and supply, following price increases in 2019 and general restructuring of the hedging policy
- Recurring cash dividends from strategic shareholdings (RAG, Energie Burgenland, Verbund) at around EUR 100m yearly
- Use of cash buffer and strong operating cash flows to fully cover capex of EUR 450m-500m with no need for additional debt financing
- Debt amortisation in line with maturity schedule (with refinancing backed by positive free operating cash flow and open committed credit facilities)
- Refinancing of EUR 300m corporate bond ahead of the bond's maturity in April 2022 through a similar debt instrument
- Continued rolling-over of EUR 75m short-term debt from credit lines into next year
- Slightly increased dividend payments in line with an assumed payout ratio of 40%-50% on recurring net profits

Figure 9: Accelerated capex (EUR m)



Source: EVN, Scope estimates

Figure 10: Cash flow profile (EUR m)



Source: EVN, Scope estimates

Scope-adjusted leverage expected to remain below or at 1.5x

We expect EVN's leverage as measured by SaD/EBITDA to be sustained within a corridor of 1.0-1.5x. Reflecting the company's accelerated capex plan under 'Strategy 2030', which balances net capex against operating cash flow and shareholder remuneration, we expect EVN's indebtedness to remain stable. The acceleration in annual capex to EUR 450m-500m (vs an average of around EUR 330m-370m over the past few years) will be offset by gradual improvements in operating cash flow that are likely to keep free operating cash flow positive. Incorporating some headroom for slightly increasing dividend payouts, discretionary cash flow is expected to remain at breakeven, which will keep net debt, including 100% of pension obligations, broadly unchanged at around EUR 1.0bn. Bolstered by a gradually increasing Scope-adjusted EBITDA (to EUR 753m in BY 2022/23E from EUR 635m in BY 2020/21E), the company's leverage is expected to slightly improve within the above-mentioned corridor of towards 1.0x over a medium-term horizon.

Strong debt protection metrics

Debt protection metrics – as measured by Scope-adjusted EBITDA/interest – will likely remain very solid at above 14x, particularly after the 4.25% EUR 300m bond is refinanced in April 2022.

Financial policy focused on preserving strong credit quality

EVN's low sustained indebtedness is consistent with what we regard as a risk-averse financial policy. This is reflected by:

i) its focus on organic growth from internal sources, primarily in its core market, and limited aspirations for major M&A or growth in international projects beyond its current activities;

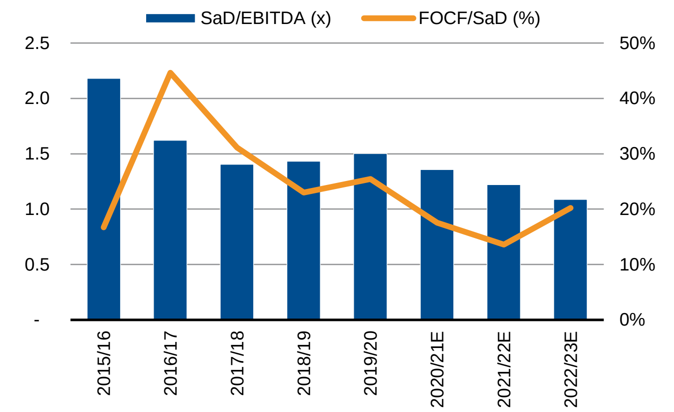
ii) a focus on low-risk assets;

iii) a net debt target (net financial debt plus pension obligations) of around EUR 1bn;

iv) a prudent dividend policy; and

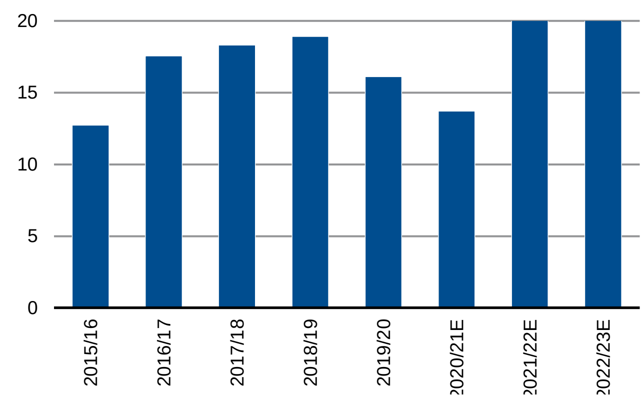
v) a clear focus on maintaining ratings in the A category.

Figure 11: Scope-adjusted leverage and cash flow cover



Source: EVN, Scope estimates

Figure 12: Debt protection: EBITDA interest coverage



Source: EVN, Scope estimates

Limited need for external financing

As highlighted above, EVN's capex strategy theoretically requires no external funding over the next few years. The company has wide access to different debt funding channels such as bank loans, different types of credit lines, public bonds from the company's EUR 2bn issuance programme[4] and Schuldschein debt.

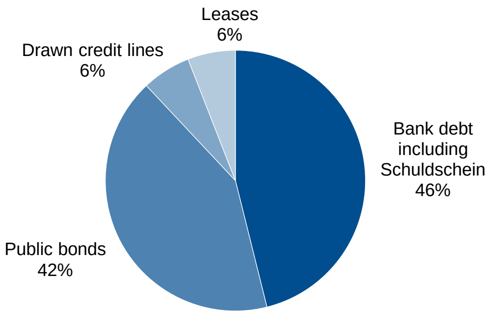
Solid liquidity

We deem EVN's liquidity as strong. Expected debt maturities of EUR 407m in BY 2021/22 and EUR 120m in BY 2022/23 (including EUR 75m from drawn credit lines being rolled over to the next year annually) are expected to be comfortably covered by internal liquidity sources. Liquidity sources include the unrestricted cash buffer of more than EUR 500m at end-June 2021, positive estimated free operating cash flow, and the strategic liquidity reserve related to its 12.6% stake in Verbund AG currently worth more than EUR 4.0bn. We foresee a limited need to draw down additional liquidity from the multi-year credit facilities of more EUR 500m as of June 2021.

[4] EVN's debt issuance programme was last updated in January 2017. The programme is currently inactive given the company's limited financing needs.

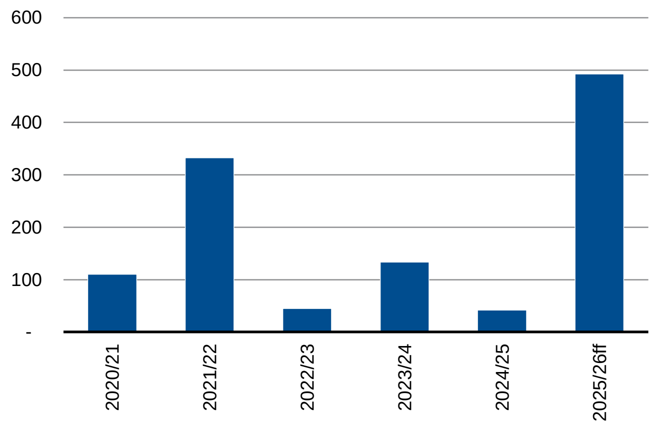
Refinancing is also no major concern, given the utility's strong business and financial risk profiles, its status as a government-related entity and broad access to public and private debt funding channels.

Figure 13: Financing structure as of Sep 2020



Source: EVN, Scope

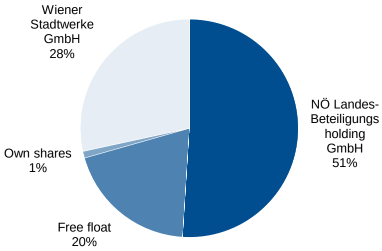
Figure 14: Maturity profile as of Sep 2020 (EUR m)



Source: EVN, Scope

Supplementary rating drivers

Shareholder structure



We incorporate a one-notch uplift to EVN's standalone rating of A, leading to a final rating of A+. This follows the framework set out in our rating methodology on government-related entities, reflecting the controlling parent's 'high' capacity and 'medium' willingness to provide support.

The federal state of Lower Austria, whose credit quality we deem equal or close to the Republic of Austria's (rated AAA/Stable by Scope), holds a 51% majority stake in EVN through its investment vehicle, NÖ Landes-Beteiligungsholding GmbH. The law[5] stipulates that the Lower Austrian province's equity stake in EVN must be at least 51%. In our view, EVN is essential to the federal state, particularly its gas and electricity distribution infrastructure. We note, however, that EVN would rather dispose of non-core assets in south-eastern Europe than risk a liquidity shortfall and request funding from its controlling shareholder.

Long-term and short-term debt ratings

A+ for senior unsecured debt

All senior unsecured debt has been assigned an A+ rating, the same level as the issuer rating.

S-1+ short-term rating

While EVN does not have a commercial paper programme at present, we assigned a short-term rating of S-1+. We expect internally and externally available liquidity to cover upcoming debt maturities by more than 200%. Moreover, we regard the group to have strong access to external funding from banks and investors through Schuldschein debt and public bonds.

[5] 'NÖ Beteiligungsgesetz' (7 February 2018) in conjunction with the 'Bundesverfassungsgesetz, mit dem die Eigentumsverhältnisse an den Unternehmen der österreichischen Elektrizitätswirtschaft geregelt werden' (7 February 2018)

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid
Paseo de la Castellana 141
E-28046 Madrid

Phone +34 915726711

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited
52 Grosvenor Gardens
London SW1W 0AU

Phone +44 2078245180

info@scoperatings.com
www.scoperatings.com

Disclaimer