12 September 2022 Corporates

Encavis AG
Germany, Renewable Energy

SCOPE BBB- POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	3.6x	4.2x	4.7x	4.7x
Scope-adjusted debt/EBITDA (incl. non-recourse debt)	7.7x	6.2x	5.5x	5.7x
Scope-adjusted debt/EBITDA (excl. non-recourse debt)	1.2x	0.4x	0.4x	0.4x
Scope-adjusted free operating cash flow/debt	7%	8%	4%	2%

Rating rationale

The rating primarily reflects the company's largely protected position as an independent power producer with own generation portfolio that comprises about 2.0 GW in more than 200 renewable power plants. This is supplemented by about 1.2 GW in around 90 plants operated as part of its asset management for third parties across Western Europe (ESG factor: credit-positive environmental risk factor). The rating remains largely constrained by the company's financial risk profile.

Outlook and rating-change drivers

The Positive Outlook reflects our expectation that Scope-adjusted EBITDA/interest cover will remain above 4x over the next few years, supported by gradually improving diversification. The rating Outlook also assumes a limited impact on credit metrics from adverse regulatory interventions. We believe Encavis will continue to acquire renewable power plants and keep increasing dividends, leaving free and discretionary cash flows at near break-even. Moreover, the rating Outlook assumes that Encavis will provide financial support to a project SPV if needed to prevent reputational damage spreading to the whole group.

A rating upgrade could be warranted if Encavis maintained Scope-adjusted EBITDA/interest cover above 4.0x on a sustained basis, accompanied by further improvements in geographical diversification with focus on jurisdictions with relatively stable regulatory environments and granularity of the own portfolio.

We could revise the Outlook back to Stable if Encavis failed to (i) maintain Scope-adjusted EBITDA/interest cover above 4.0x on a sustained basis e.g. as a result of lower operating cash flows due to major operational disruptions, material adverse regulatory interventions or significantly rising interest rates on new loans; or (ii) meaningfully improve diversification and granularity of its portfolio. A rating downgrade, while remote, could be considered if Scope-adjusted EBITDA/interest cover fell below 2.75x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
12 Sep 2022	Outlook change	BBB-/Positive
1 Oct 2021	Affirmation	BBB-/Stable
1 Oct 2020	Affirmation	BBB-/Stable

Ratings & Outlook

Issuer	BBB-/Positive
Short-term debt	S-2
Senior unsecured debt	BBB-
Subordinated hybrid debt	BB

Analyst

Marlen Shokhitbayev, CFA, CESGA
+49 30 27891 127
m.shokhitbayev@scoperatings.com

Related Methodologies

Corporate Rating Methodology; July 2022

Rating Methodology: European Renewable Energy Corporates; January 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers

• No involvement in project development, only active in acquiring 'ready to build' or 'up and running' renewable energy power plants (ESG factor: credit-positive environmental factor)
• Prioritised feed-in under guaranteed tariffs for most of its power generation portfolio, with an average remaining feed-in period of over 10 years and the option to extend power plant lifetimes
• Closure of significant power purchase agreements (PPAs) with creditworthy counterparties, as off-takers for future capacities do not benefit from feed-in tariffs
• One of Europe's largest independent power producers, with a power generation portfolio comprising about 2.0 GW in more than 200 renewable power plants, supplemented by about 1.2 GW in around 90 plants operated as part of its asset management for third parties
• Robust diversification across mature European markets for renewable energy projects and sound asset diversification with further diversification from investment pipeline (medium-term 3.5 GW)
• Financing structure with secured non-recourse project loans and execution of conversion of hybrid convertible
• Robust liquidity
• Risk mitigation via extensive insurance coverage and the prudent operation and maintenance of project sites
	• Financial risk profile weaker than business risk profile:
	  ○ High leverage including non-recourse debt levels
	  ○ Moderate, but improving, interest coverage (3.5x-4.5x)
	• EBITDA margin potentially weakened by future capacity additions (depending on acquisition prices and negotiated PPAs), albeit remaining above 70%
	• Volume risks as a result of adverse weather effects or business interruptions
	• Regulatory risks on regulated generation capacities
	• Exposure to reputational damage upon the default of a project SPV, somewhat mitigated by:
	  ○ Covenants on debt service coverage ratios and cash reserves; and
	  ○ Company's willingness to provide liquidity to SPVs when needed

Positive rating-change drivers	Negative rating-change drivers
• More granular and geographically diversified power generation portfolio and Scope-adjusted EBITDA/interest cover of above 4.0x on a sustained basis	• Outlook back to Stable: no meaningful improvement in portfolio diversification or Scope-adjusted EBITDA/interest cover below 4.0x • Downgrade: Scope-adjusted EBITDA/interest cover of below 2.75x (remote)

Corporate profile

MDAX-listed Encavis invests in and operates solar power plants and wind farms in Germany, Spain, France, Denmark, the Netherlands and Italy, among others. The company is one of Europe's leading independent producers of renewable energy, operating about 3 GW, including the capacities operated as part of its asset management for third parties. The company is not involved in project development.

Financial overview[1]

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	3.6x	3.6x	4.2x	4.7x	4.7x	4.7x
Scope-adjusted debt/EBITDA (including non-recourse debt)	7.9x	7.7x	6.2x	5.5x	5.7x	5.6x
Scope-adjusted debt /EBITDA (excluding non-recourse debt)	1.2x	1.2x	0.4x	0.4x	0.4x	0.4x
Scope-adjusted free operating cash flow/debt	7%	7%	8%	4%	2%	3%
Scope-adjusted EBITDA in EUR m						
EBITDA	217.6	228.4	280.3	312.7	327.8	345.4
Other (mainly result from initial consolidation)	1.5	1.3	-23.9	-	-	-
Other (mainly gains/losses from asset disposals and EBITDA relating to minorities, share-based remuneration, minority adjustments)	-0.1	-4.3	3.0	-12.0	-17.0	-17.0
Scope-adjusted EBITDA	**219.1**	**225.4**	**259.4**	**300.7**	**310.9**	**328.4**
Free operating cash flow in EUR m						
Funds from operations	142.9	140.1	170.4	220.0	234.2	253.1
Change in working capital	-13.8	10.2	8.3	-5.3	-1.6	-1.8
less: capital expenditure (net)	-5.0	-35.0	-43.2	-150.0	-200.0	-200.0
Free operating cash flow (FOCF)	**124.1**	**115.4**	**135.6**	**64.6**	**32.7**	**51.3**
Net cash interest paid in EUR m						
Net cash interest per cash flow statement	57.5	58.6	57.2	61.5	64.0	67.2
50% of interest paid on hybrid debt	2.6	3.9	3.9	2.3	2.3	2.3
Capitalised interest on AROs	0.2	0.1	0.1	0.1	0.1	0.1
Net cash interest paid	**60.2**	**62.6**	**61.3**	**63.9**	**66.4**	**69.7**
Scope-adjusted debt in EUR m						
Reported gross financial debt	1,793.8	1,827.1	1,875.7	1,923.3	2,013.3	2,103.3
add: 50% of hybrid bond	74.3	74.3	123.2	123.2	123.2	123.2
less: cash and cash equivalents	-222.5	-231.0	-444.6	-420.0	-411.5	-412.5
add: restricted cash	58.0	63.5	50.4	52.1	54.3	55.8
add: asset retirement obligations	49.2	60.2	72.1	56.3	56.3	56.3
less: other (derivative positions)	-31.5	-62.3	-74.5	-74.5	-74.5	-74.5
Scope-adjusted debt (SaD)	**1,721.2**	**1,731.9**	**1,602.2**	**1,660.4**	**1,761.1**	**1,851.6**

[1] We reallocated selected items in cash flow statement that resulted in an increase in free operating cash flow in 2020 to EUR 115m from EUR 95m. As a result of this change, the Scope-adjusted free operating cash flow/debt ratio is now 7% in 2020 compared to 5% previously.

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Environmental, social and governance (ESG) profile[2]

Environment		Social	Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management	Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Sustainability considerations

Renewable electricity generation in Europe benefits from tailwinds amid ongoing energy transition. This is reflected as one of the key credit rating drivers for Encavis.

Encavis identified material sustainability topics on which it wants to focus. These are grouped into four fields:

- Strategy & Governance: sustainably integrated corporate strategy, further development of the energy system, responsibility in the value chain.
- Economy: contribute to energy transition, new business segments and models, operational excellence, winning new fund investors.
- Environment: help in the fight against climate change, sustainable increase in the efficiency of existing wind and solar parks, biodiversity.
- Social: employee satisfaction, social acceptance and positive contribution, human resources development and employee skills.

The achievement of some of the non-financial sustainability goals is linked to the management compensation. While we appreciate the role of the sustainability goals at Encavis, at the current time these are not considered as having any additional significant impact on the credit quality of the company.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. Scope only considers ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: A-

Business risk profile supported by protective business model and growing diversification

Encavis' business risk profile strongly supports its issuer rating. The rating primarily reflects the company's largely protected position as an independent power producer, with a generation portfolio of around 2 GW (owned assets) comprising more than 200 renewable energy power plants across Western Europe (ESG factor: credit-positive environmental risk factor). Encavis' power generation activities are supplemented by capacities managed for external parties via the company's growing asset management division.

No involvement in project development

It is important to note that Encavis only finances 'ready to build' and operational renewable energy plants and is not involved in higher-risk activities such as project development or engineering, procurement and construction. Encavis only acquires new or existing generation capacities benefiting from either tariffs or long-term PPAs with contracted off-takers that fulfil a predefined minimum internal rate of return. This broadly secures the cash flows and profitability of these power plants.

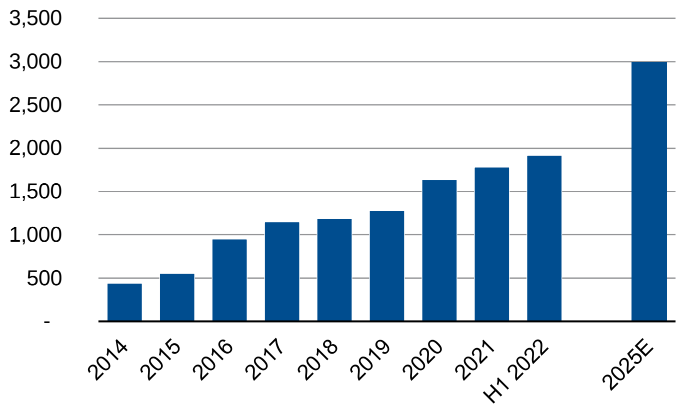
Widely protected business model

We regard Encavis' business model as broadly protected because the majority of its generation assets benefit from the prioritised feed-in of generated electricity under availability-based remuneration schemes. Merchant risk for unregulated power plants is widely hedged through long-term power purchase agreements with creditworthy counterparties.

Portfolio ramp-up limits impact of adverse developments from single assets or jurisdictions

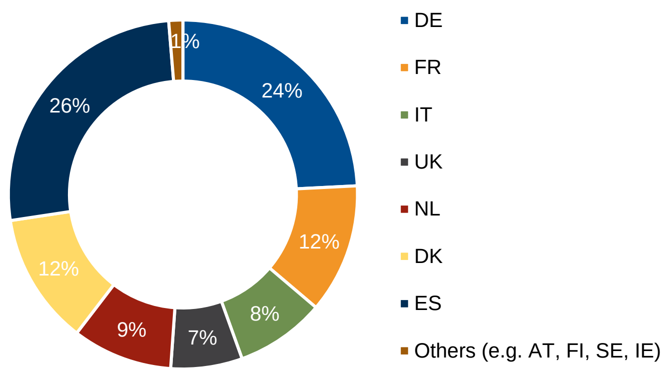
The risk of regulatory interventions is largely mitigated by solid and improving geographic diversification with focus on jurisdictions with relatively stable regulatory environments, as evidenced by recent capacity additions in the Netherlands, Germany and the Nordic countries. Although weather effects entail some cash flow volatility, we expect such effects will be increasingly mitigated by the ongoing portfolio ramp-up. This is supported by the rising granularity of power plant sites going forward, which will limit the incremental effects from single generation sites due to adverse weather or tariff/price adjustments. As such, we believe that Encavis will be able to retain a strong margin, e.g. an EBITDA margin of above 70%, and solid cash flow conversion.

Figure 1: Development of owned generation capacities connected to the grid (in MW)



Sources: Encavis, Scope

Figure 2: Net own capacity by geography (as of H1 2022)



Sources: Encavis, Scope

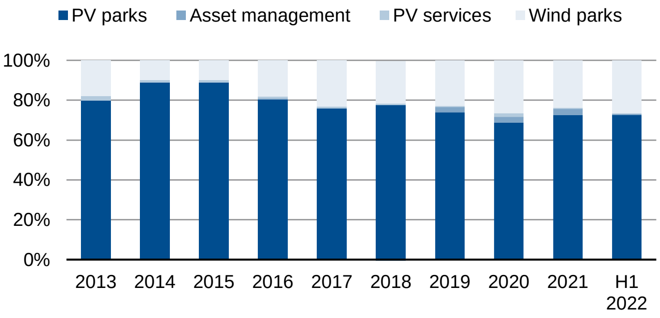
Growth targets supported by access to project pipeline of various developers and new ESG-linked credit line

Based on the company's internal availability of funding, we expect the portfolio ramp-up will be broadly covered by operating cash flow. At the same time, the closure of an EUR 125m ESG-linked multi-year revolving credit facility in August 2021 is expected to accelerate expansion as part of Encavis' 'Fast Forward 2025' growth strategy, which targets growing the signed owned generation portfolio to 3.4 GW by 2025 (3.0 GW connected to the grid, compared to around 2.0 GW as of June 2022). The rise in financial shooting power should enable the company to make opportunistic bolt-on acquisitions of up-and-running renewable energy power plants and invest in ready-to-build power plants, partly sourced from the 3.5 GW project pipeline of its numerous project development partners.

Risk mitigation through insurance coverage

Robust cash flow across the generation portfolio is also ensured by operations and maintenance (O&M) being largely covered in-house, alongside a prudent approach to business interruptions and property damage.

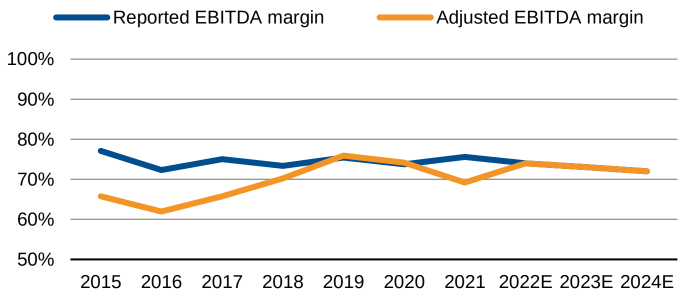
Figure 3: Segment mix (based on EBITDA*)



* Not including consolidation

Sources: Encavis, Scope

Figure 4: Development of clean* EBITDA margin



* Reported EBITDA adjusted for IFRS-related valuation effects

Sources: Encavis, Scope

Recent developments

The re-opening of economies after the Covid-19 crisis led to higher demand for energy bolstering power prices which in large parts of Europe depend on prices for carbon and fossil fuels such as coal or natural gas. Reduced gas supplies from Russia resulted in significantly higher gas and power prices in H2 2021. The Russia-Ukraine war has aggravated the European energy crisis, pushing power prices to new highs. We expect power prices will decline from their current high, but to remain volatile at elevated levels for a prolonged period.

Asymmetrical exposure to power prices

While Encavis' business model is widely protected from the exposure to low power prices, it benefits from very high prices through subsidised projects in Germany and the Netherlands, where feed-in tariffs represent a floor price with upside potential should market prices exceed subsidised prices, as well as through exposure to merchant volumes (max. 5% of total). This is already evidenced by strong H1 2022 results with revenue and EBITDA each 40% above prior year figures while electricity generation grew by 17%. The company also raised its FY 2022 financial guidance and is working on the strategy update as the financial targets set by the 'Fast Forward 2025' plan are likely to be achieved earlier than expected.

Prolonged periods of elevated power prices support the overall performance

Prolonged periods of elevated power prices should further support overall performance once short-term hedges are renewed at higher levels. Increasing PPA prices for new projects that more than offset higher development costs and moderately increasing interest rates will also bolster performance. This view is also supported by the consistently high demand for renewable power, with current supply levels not remotely able to meet demand.

No significant impact on operations from high inflation and disrupted supply chains yet

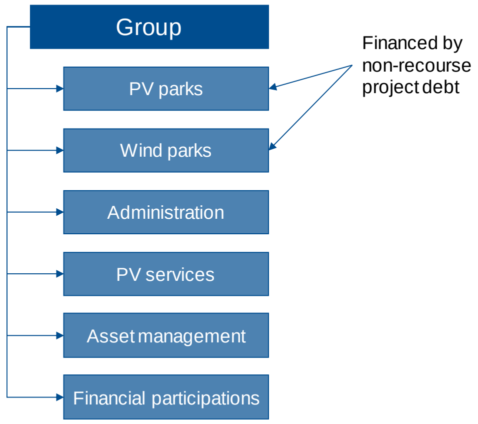
We understand that the current high inflation in Europe does not have a significant impact on Encavis' business activities at present. As Encavis has avoided best-effort supply agreements, the disruption of global supply chains has not yet affected the operation or completion of solar and wind parks. The escalation of tensions around Taiwan, which together with China is one of the largest suppliers of solar panels and other crucial components for power plants, could represent a major risk for the development of new projects. We do not anticipate any downside from this risk factor yet and will treat it as an event risk should it materialise.

Financial risk profile: BB+

Financial risk profile strongly impacted by non-recourse debt

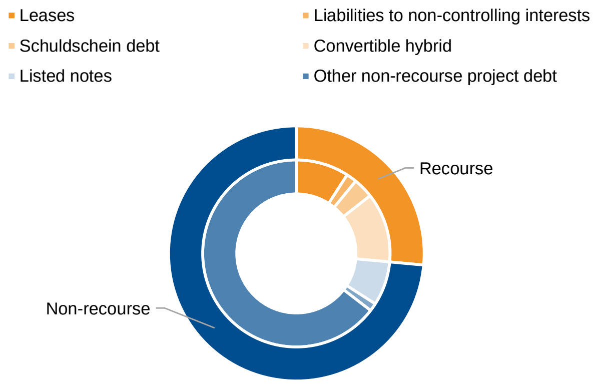
The issuer rating remains largely constrained by the company's financial risk profile. Projects are mainly financed with secured non-recourse debt (see Figures 5 and 6). Project loan amortisation aligns with the duration of the underlying remuneration model, e.g. fixed tariffs or contracted tariffs within a PPA. This strongly reduces credit risks at group level as the banks that finance the projects have no recourse to Encavis, only to the respective borrowers. However, we strongly believe that Encavis would be likely to provide extra financial support, e.g. via an equity injection or a shareholder loan, to avoid the reputational damage arising from a project default, for example if a project SPV faced a liquidity shortfall or breached financial covenants.

Figure 5: Simplified financing structure



Sources: Encavis, Scope illustration

Figure 6: Financing structure at YE 2021



Sources: Encavis, Scope

Adjustments and projections

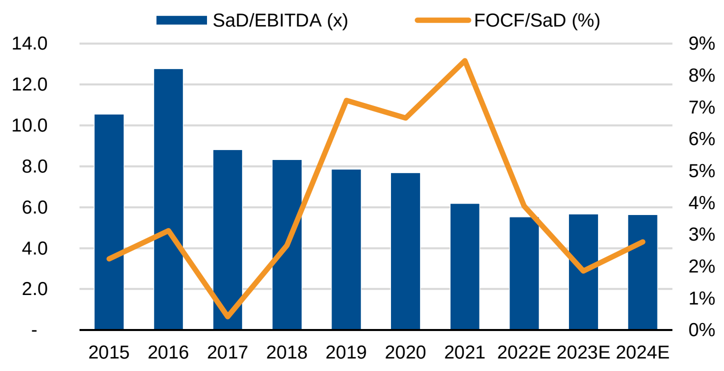
In order to assess Encavis' creditworthiness using key credit metrics such as leverage, debt protection and liquidity measures, we have adjusted the company's reported figures for the following items:

- SaD, i.e. the company's debt balance includes:
  - Gross financial debt (recourse debt such as Schuldschein debt, leases, liabilities to non-controlling shareholders, bilateral loans and non-recourse project debt);
  - 50% of the hybrid convertible, which Encavis accounts for fully as equity in line with IAS 32;
  - Unrestricted cash, which excludes restricted cash in SPVs (debt-servicing and project reserves); and
  - The full amount of asset retirement obligations (although we believe many power plants will continue to operate after the feed-in tariffs or PPAs expire).
- Interest payments are adjusted for:
  - 50% of dividend payments related to the hybrid convertible; and
  - Capitalised interest on asset retirement obligations.
- Scope-adjusted EBITDA reflects:
  - Adjustments for non-cash and non-operating items such as IFRS-related valuation effects regarding the initial consolidation of new wind and solar parks; and
  - Gains and losses from asset disposals; and
  - Share-based employee remuneration.

Our cash flow projections for the next few years incorporate the following assumptions and drivers:

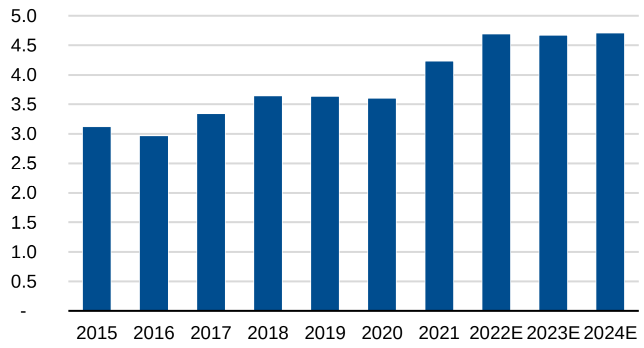
- Continued revenue growth driven by capacity additions and a strong increase in electricity prices, with +27% in 2022. Further topline growth of 5%-10% p.a. thereafter, stemming from new and as yet undisclosed portfolio additions from the pipeline
- Gradual decrease in operating margins; assumptions of lower profitability on newly acquired projects and margin dilution from expansion into O&M and asset management
- Debt repayments in line with debt maturities at group level and amortisations of project debt in proportion to expected project lifecycles, primarily funded by operating cash flow
- New capacity additions largely funded by debt
- Gradual increase in dividend payouts (based on a conservative approach to the potential use of scrip dividends)

Figure 7: Scope-adjusted leverage and cash flow cover



Sources: Encavis, Scope estimates

Figure 8: Scope-adjusted EBITDA/interest cover



Sources: Encavis, Scope estimates

EBITDA growth and utilisation of of hybrid debt support improved credit metrics

We recognise the company's improving credit profile. This is based on:

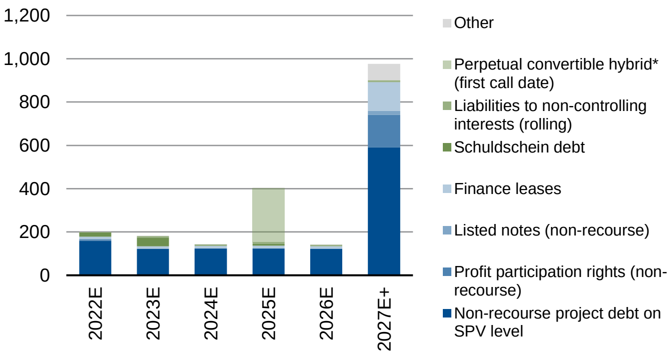
- Improving leverage, which is bolstered by the full conversion of the EUR 150m hybrid convertible into equity and the subsequent issuance of the new EUR 250m hybrid convertible in November 2021 (we account for 50% of this exposure as debt);
- Anticipated operating growth and elevated power prices, which are expected to result in EBITDA growing faster than the company's net interest burden; and
- The expectation that discretionary cash flow will remain positive or near break-even, with net capex and shareholder remuneration (including scrip dividends) widely covered by the operating business.

We note that despite recent interest rate increases and further potential interest rate hikes, market rates remain below average of the Encavis' debt portfolio, which enables the company to refinance its existing debt at improved conditions. As a result, we expect Scope-adjusted EBITDA/interest cover will remain above 4x and Scope-adjusted debt/EBITDA will decrease below 6x (remain below 1x excluding non-recourse project debt) in the next few years.

Outlook revised to Positive

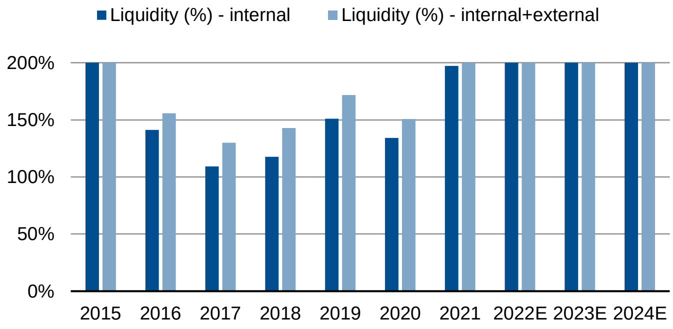
Significant strengthening in credit metrics paired with the company's gradually improving geographical diversification and granularity of the own portfolio drive the Outlook change to Positive from Stable

Figure 9: Maturity schedule at YE 2021 (in EUR m)



Sources: Encavis, Scope estimates

Figure 10: Liquidity ratios



Sources: Encavis, Scope estimates

Robust liquidity and good access to external financing

Liquidity ratios are expected to stand comfortably above 110% at all times, supported by a large unrestricted cash cushion of EUR 264m at the end of June 2022 and committed long-term credit lines of EUR 145m. We assume that amortising loans on the project level (EUR 120-130m p.a.) can sufficiently be covered by operating cash flow of the project companies. This is also backed by a significant amount of cash reserves at the project SPVs (aggregated amount of EUR 51m as of June 2022). Ultimately, we believe that Encavis has demonstrated a diversified approach to external funding, including bank and capital market financing on the project level as well as private debt (shareholder loans and Schuldschein debt) and public debt on the group level, which should support external funding if needed.

Balance in EUR m	2021	2022E	2023E
Unrestricted cash (t-1)	167.5	394.2	367.9
Open committed credit lines (t-1)	39.4	145.0	145.0
Free operating cash flow (t)	135.6	64.6	32.7
Short-term debt (t-1)	153.7	180.3	175.1
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

Financial policy supports robust financial profile

Encavis' financial policy remains adequate and supports robust levels of creditworthiness. We believe that the company's expansion through selected growth opportunities via acquisitions and organic capacity additions will be balanced with maintaining the quality of its financial risk profile. We also believe that Encavis will diligently balance the interests of creditors (at project and group levels) and shareholders, as evidenced by:

- The use of financial covenants and cash reserves at project level. Moreover, Encavis is likely to provide extra financial support to project SPVs;
- The use of a hybrid convertible instruments, which keeps leverage under control and is in the interest of creditors, as evidenced by the full conversion of the instrument issued in 2017 into shares in Q4 2021;
- The commitment to a minimum equity ratio of 24%, as measured by equity (including convertible hybrid instruments) divided by total assets;
- Encavis' transparent dividend guidance for the period to 2021, with a total growth rate of 50% (based the benchmark 2016), reflecting expectations of steadily increased cash flows from additional generation capacities. We see this dividend increase as reasonable, especially considering the introduction of a scrip dividend in 2016, which

provides some indirect creditor protection. Going forward, the dividend size will be decided every single year depending on cash flow generation, investment forecast and financing situation of the company, including the option of no dividend.

Long-term and short-term debt ratings

Senior unsecured rated BBB-

Senior unsecured debt remains rated at the level of the issuer rating.

Hybrid debt rated BB

Contractually subordinated (hybrid) debt is affirmed at BB, two notches lower than the issuer rating.

S-2 short-term rating

The short-term debt rating is affirmed at S-2. This reflects Encavis' sustained robust liquidity and its diversified exposure to external funding channels, i.e. from banks and capital markets at project level and from private sources (i.e. shareholder loans and Schuldschein debt) and public sources at group level.

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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