

Encavis AG

Germany, Renewable Energy



Corporate profile

SDAX-listed Encavis invests in and operates solar power plants and wind farms in Germany, France, the UK, and Italy, among others. The company is one of Europe's leading independent power producers of renewable energy, operating almost 2 GW including the capacities acquired and operated as part of its asset management for third parties. The company is not involved in project development.

Key metrics

Scope credit ratios	Scope estimates				
	2018	2019	2020E	2021E	2022E
EBITDA/interest cover	3.7	3.6	3.4	3.7	4.0
Scope-adjusted debt (SaD)/EBITDA (incl. non-recourse debt ¹)	8.3	7.9	8.6	8.1	7.5
Free operating cash flow/SaD ²	3%	6%	-4%	3%	4%
Liquidity ³	>100%	>100%	63%	>100%	>100%

Rating rationale

Scope has affirmed its BBB-/Stable issuer rating on Encavis AG and its financing subsidiary Encavis Finance BV. Concurrently, Scope affirmed the long-term ratings for senior unsecured debt at BBB-, for subordinated (hybrid) debt at BB and for short-term debt at S-2.

The affirmation reflects our continued view on Encavis' protected business model, continuously improving diversification and high leverage. Leverage is strongly driven by the non-recourse debt at project level. The company's indebtedness is balanced by robust debt protection, sound liquidity and largely positive free operating and discretionary cash flow generation. We see the company's credit profile to improve gradually, bolstered by the ongoing portfolio ramp-up under the Fast Forward 2025 growth strategy and a solidifying EBITDA interest coverage at around 4.0x.

The Outlook is Stable and incorporates Scope's expectation that Encavis will keep EBITDA/cash interest coverage above 3.0x into the medium term. Scope also believes the company will continue to acquire renewable energy power plants and increase dividends, leaving free and discretionary cash flows at breakeven. The rating Outlook further assumes that Encavis will provide financial support to a project SPV if needed to prevent reputational damage spreading to the whole group.

Scope would consider a negative rating action if EBITDA/cash interest coverage fell below 2.75x. e.g. as a result of lower operating cash flows due to major operational disruptions or rising interest rates on new loans.

A positive rating action could be warranted if Encavis further improved the granularity of its power generation portfolio and strengthened EBITDA/cash interest coverage to above 4.0x on a sustained basis.

¹ Includes non-recourse debt at the level of SPVs which makes up around 70% of total interest-bearing Debt (see figures 5 and 6).

² Free operating cash flows expected to be negative during the current investment phase in 2020E.

³ Reflects sources and uses of funding relating to the coverage of upcoming debt maturities and capex through free operating cash flows.

Ratings & Outlook

Corporate rating	BBB-/Stable
Short-term rating	S-2
Senior unsecured rating	BBB-
Subordinated (hybrid) debt	BB

Analyst

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

Related Methodologies

[Corporate Rating Methodology](#)

[Rating Methodology: European Renewable Energy Corporates](#)

Scope Ratings GmbH

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
<ul style="list-style-type: none"> • No project developments, 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 the power generation portfolio, with an average remaining feed-in period of more than 10 years with the option to extend power plant lifetimes • Closure of significant PPAs with strong counterparties, as off-takers for future capacities do not benefit from feed-in tariffs • The company being one of the largest European independent power producers, with a total capacity of almost 2 GW across more than 200 sites • Sound asset diversification across mature European renewable energy markets and assets, with further diversification from the investment pipeline (short-term 500 MW; medium-term 2,000 MW by 2025) • Financing through secured non-recourse project loans • Sound liquidity • Risk mitigation via extensive insurance coverage and the prudent operation and maintenance of project sites 	<ul style="list-style-type: none"> • Weaker financial risk profile than business risk profile: <ul style="list-style-type: none"> ○ High leverage including non-recourse debt levels ○ Modest, but robust, interest coverage (3-4x) • EBITDA margin potentially weakened through future capacity additions (depending on acquisition prices and negotiated PPAs), albeit remaining above 70% • Exposure to reputational damage upon the default of a project SPV, mitigated somewhat by: <ul style="list-style-type: none"> ○ Covenants on debt service coverage ratios and cash reserves; and ○ Company's willingness to provide liquidity to SPVs when needed

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • More granular power generation portfolio, and improved EBITDA/cash interest coverage of above 4.0x on a sustained basis 	<ul style="list-style-type: none"> • An EBITDA/cash interest coverage of below 2.75x



Financial overview

	Scope estimates				
Scope credit ratios	2018	2019	2020E	2021E	2022E
EBITDA/interest cover	3.7	3.6	3.4	3.7	4.0
SaD/EBITDA (including non-recourse debt) ¹	8.3	7.9	8.6	8.1	7.5
Free operating cash flow/SaD ²	3%	6%	-4%	3%	4%
Liquidity ³	>100%	162%	63%	128%	114%
Scope-adjusted EBITDA in EUR m	2018	2019	2020E	2021E	2022E
EBITDA	195.3 ⁴	217.6 ⁴	221.2	239.9	260.3
Operating lease payments in respective year	8.1	-	-	-	-
Other (gains from company mergers i.e. 'badwill')	-8.4	1.5	-	-	-
Other (gains/losses from asset disposals and EBITDA relating to minorities, share-based remuneration, minority adjustments)	0.3	0.0	-3.1	-7.0	-12.0
Scope-adjusted EBITDA	195.3	219.1	218.0	232.9	248.3
Scope-adjusted interests in EUR m	2018	2019	2020E	2021E	2022E
Net interest paid	48.5	57.5	59.3	59.4	58.1
Interest component, operating leases (Scope estimates)	2.2	-	-	-	-
50% of interest paid on hybrid debt	2.6	2.6	3.9	3.9	3.9
Scope-adjusted interest	53.3	60.0	63.3	63.4	62.0
Scope-adjusted debt in EUR m	2018	2019	2020E	2021E	2022E
Reported gross financial debt	1,627.1	1,793.8	1,834.8	1,800.9	1,755.5
add: 50% of hybrid bond	47.7	74.3	74.3	74.3	74.3
less: cash, cash equivalents	252.5	222.5	150.4	123.7	103.2
add: cash not accessible	76.9	58.0	61.9	61.6	60.8
add: asset retirement obligations	39.7	50.4	63.2	72.3	79.5
add: NPV of operating lease obligations (Scope estimates)	112.0	-	-	-	-
less: other (derivative positions)	22.3	31.5	-	-	-
Scope-adjusted debt	1,628.7	1,722.4	1,883.8	1,885.4	1,867.0

⁴ Reported EBITDA for 2018 and 2019 comprises non-cash income such as gains from company mergers (badwill), the cancellation of the interest advantage from subsidised loans (government grants) and non-cash income from other periods, as well as non-operating expenses. Scope's EBITDA estimates for 2020-22E do not include such items.

Business risk profile

Business risk profile supported by protective business model and growing diversification

The group's **business risk profile (assessed at A-)** strongly supports the issuer rating. This is due to the protected business model and consistent cash flow from the more than 200 generation sites, resulting in around 2 GW of generation capacity including capacities managed for external parties via the company's growing asset management division.

No project developments

It is important to note that Encavis is only engaged in financing '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.

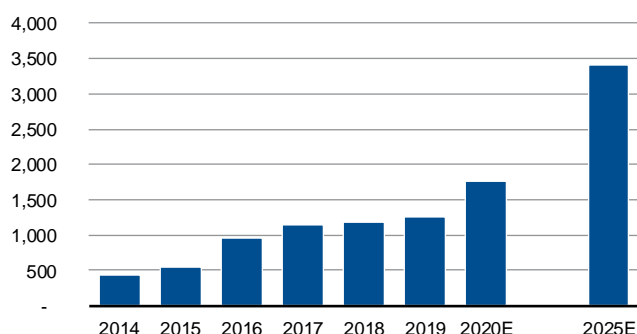
Regulated business for another 13 years

Another strong credit-positive is the existing generation portfolio, which benefits from fixed tariffs under availability-based remuneration schemes for another 13 years on average. Despite price risks being eliminated through these schemes, Encavis and the different project SPVs for wind and solar parks still bear volume risks as a result of adverse weather effects or business interruptions.

PPAs effectively hedge against price risks of unregulated power generation capacities

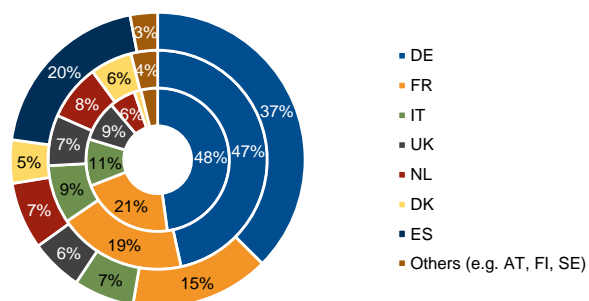
Following the phase-out of fixed feed-in tariffs and premiums for renewable energy capacities in major European markets and the switch to tenders and market-based contracts, Encavis' market position will likely become weakened through new capacity additions over the next years. Initial closures of long-term bilateral/multilateral PPAs for large power plants in the UK and in Spain have demonstrated the rising importance of these contracts for mitigating merchant risks (long-term contracts for fixed volumes and prices) stemming from unregulated power generation. Solar PPAs have been finalised in Spain with off-takers such as Amazon (200 MW, commissioned in Q3 2020) and an undisclosed utility off-taker (300 MW, expected date of commissioning in Q4 2020). From our perspective, the closed PPAs are effective at protecting against merchant risks through their structure and features, with a corresponding amortisation profile of related debt, as well as providing a buffer against unexpected underperformance in power generation, thereby avoiding volume and performance risks and the need to source electricity at disadvantageous conditions.

Figure 1: Strong expansion of owned power generation capacities (in MW)



Sources: Encavis, Scope

Figure 2: Operated capacity by geography (inner circle = YE 2018; middle circle = YE 2019; outer circle = YE 2020E)



Sources: Encavis, Scope

Ambitious medium-term growth strategy to bolster stability of cash flow streams

Encavis' medium-term growth strategy, Fast Forward 2025, aims to strongly boost generation capacities by 2025 (3.4 GW vs 1.8 GW at YE 2020E). This will further strengthen the company's market position by making the generation portfolio more robust against disruptions in single power plants and below-average power output in specific regions.

We believe the timeframe, while ambitious, is achievable given the company's setup and the industry tailwinds, i.e.

- There is a continued focus on energy transition in Europe with more channels to finance green and sustainability-linked projects;
- Encavis has secured a 3 GW pipeline with various strategic partners (project developers/EPC contractors) for ready-to-build capacities;
- Encavis is well positioned to execute on its strategy in light of the rising importance of corporate and utility PPAs in Europe (see [utilities outlook 2020](#) and [extra research on how PPAs transform the European renewables sector](#)); and
- The strategy's rigid execution would strengthen Encavis' overall market position and diversification in the medium term.

Steadily improving diversification mitigates volume risks

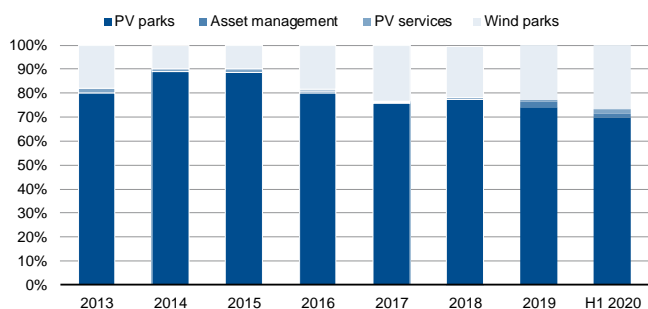
The continued ramp-up of Encavis' power generation portfolio will strengthen its business profile, cash flow stability and diversification.

The exposure to wind parks and solar power plants will become increasingly balanced, limiting the incremental effects from potential operational disruptions or the underperformance of an asset. The increased exposure to solar power plants in areas with comparatively strong and robust solar irradiation as well as the strategy to spread the operational exposure away from more volatile wind parks will gradually stabilise Encavis' cash flow stream. Correlation risks will be further mitigated through the realisation of new projects from the pipelines of development partners, e.g. SolarCentury, Sonovis and GreenGo, in numerous markets such as Italy, Spain, Denmark, Germany and France. Moreover, we expect the reinvestment of proceeds from the sale of minority shares in wind parks to smoothen cash flow generation.

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 the prudent approach to business interruptions and property damage.

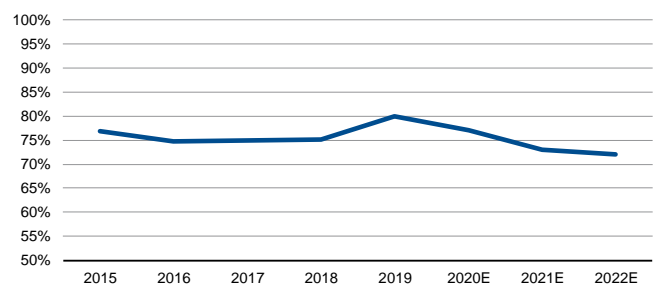
Figure 3: Segment mix (based on EBITDA*)



* Not including consolidation

Sources: Encavis, Scope

Figure 4: Development of clean* EBITDA margin



* Reported EBITDA adjusted for IFRS-related valuation effects

Sources: Encavis, Scope

Strong EBITDA margin of above 70% at group level

Limited price risks on generated electricity as well as sound diversification drive the company's strong profitability, reflected by its EBITDA margin of above 70%. Minimum post-tax internal rates of return on new projects, depending on the market, are also expected to maintain group margins going forward. Nevertheless, we expect profitability to deteriorate slightly in the next few years, due to new portfolio additions not being subject to feed-in tariffs and the expansion into low-margin activities such as O&M and asset management.

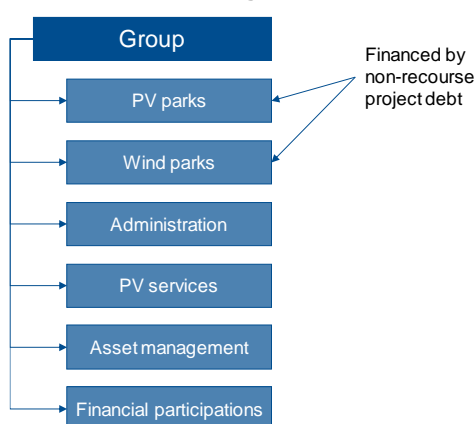
Given the remuneration model for generated electricity and the nature of wind and solar power plants, Encavis' operating performance is broadly unexposed to Covid-19 related lockdowns (evidenced by the robust EBITDA margin of around 80% for H1 2020).

Financial risk profile

Financial risk profile strongly impacted by non-recourse debt

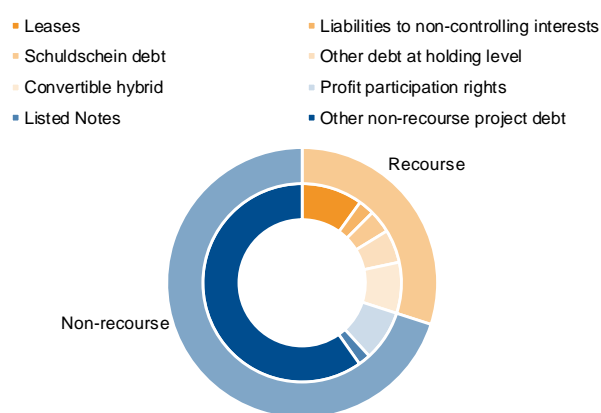
The issuer rating remains largely constrained by the company's financial risk profile (rated BB). Projects are mainly financed with secured non-recourse debt (see figures 5 and 6). Project loan amortisation aligns with the duration of the underlying remuneration model, e.g. fixed tariffs or contracted tariffs within a PPA. This strongly reduces credit risks at group level as banks which finance the projects have no recourse to the companies, only to the respective borrowers. However, we strongly believe that Encavis is 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 faces a liquidity shortfall or has breached financial covenants.

Figure 5: Simplified financing structure



Sources: Encavis, Scope illustration

Figure 6: Financing structure at YE 2019



Sources: Encavis, Scope

Adjustments and projections

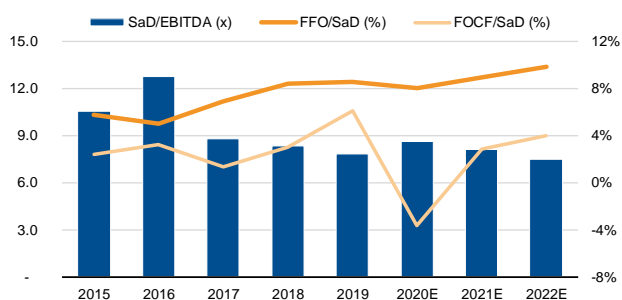
To assess Encavis' creditworthiness through key credit metrics such as leverage, debt protection and liquidity measures, we have adjusted the company's reported figures for the following items:

- Scope-adjusted debt (SaD), i.e. the company's debt balance includes the following:
 - 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);
 - An estimation of the net present value of operating leases for the years prior to 2019; 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;
 - Significant gains or losses from asset disposals; and
 - An estimated interest component relating to operating leases for the years prior to 2019.
- 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
 - Annual payments for operating leases for the years prior to 2019.

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

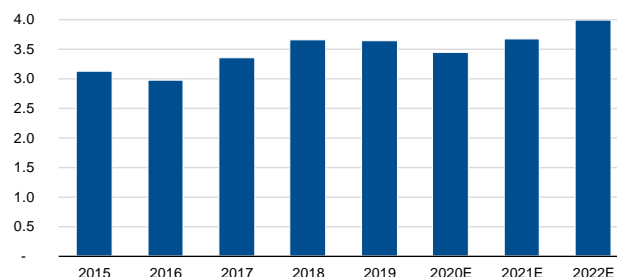
- Further revenue growth in 2020E, which fully reflects capacity additions in Denmark (81 MW wind farm acquired in Q4 2019), Germany (14.4 MW wind farm acquired in Q2 2020) and increased shares from the buyout of solar parks
- Significant revenue growth in 2021E, owing to the new 500 MW solar power plants in Spain and further topline growth in 2022E reflecting the anticipated execution of various projects from the pipeline of development partners
- A slight decrease in operating margins; assumptions of lower profitability on newly acquired projects and margin dilution from expanding into O&M and asset management
- Debt repayments in line with debt maturities at group level and amortisations of project debt in proportion to the expected project lifecycles
- New capacity additions being largely debt-funded
- Increased dividend payments (taking a conservative approach on the potential use of scrip dividends)

Figure 7: Scope-adjusted leverage



Sources: Encavis, Scope estimates

Figure 8: EBITDA interest coverage



Sources: Encavis, Scope estimates

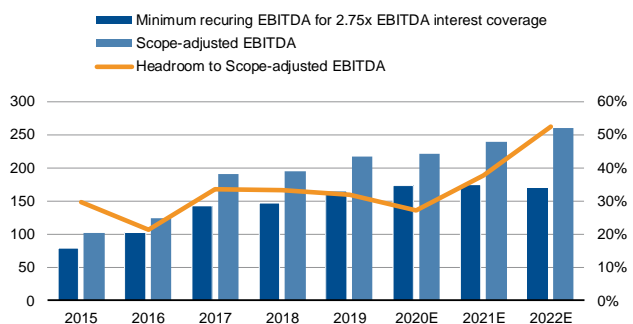
High leverage due to large portion of non-recourse project debt, but good interest coverage

Encavis' leverage – as measured by a SaD/EBITDA of above 8x – does not fully represent the company's financial risk profile, in our view. We believe the company's credit risks are better represented by debt protection measures – as measured by a recurring EBITDA/cash interest coverage – which we expect to remain between 3-4x, trending up towards 4.0x

Significant headroom on EBITDA forecasts against negative rating-change trigger

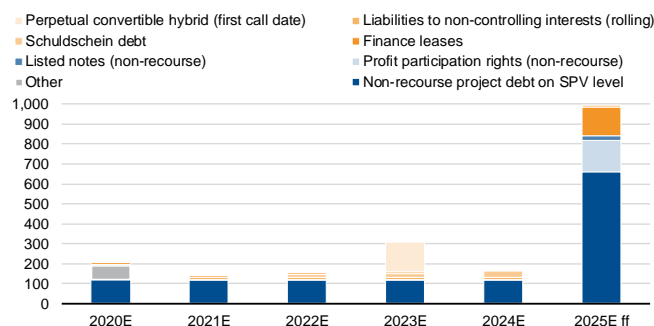
A significant deterioration of the financial risk profile would entail EBITDA falling short of our estimates by more than 30% for 2021E and 2022E (see Outlook triggers). With the business becoming increasingly robust as a function of improving scale and diversification, we are comfortable that there is significant headroom against a potential downgrade.

Figure 9: Rising headroom on EBITDA to potential negative rating action



Sources: Scope estimates

Figure 10: Maturity schedule at YE 2019 (in EUR m)



Sources: Encavis, Scope

Robust liquidity and good access to external financing

Liquidity remains sound despite the high leverage. Besides the aggregated debt referring to amortising non-recourse project finance debt (~EUR 120m), Encavis has little exposure to maturing debt on the holding level (leasing obligations over the next two years). Larger maturities on the holding level will need to be refinanced such as the Schuldschein debt (EUR 73m between 2022E-28E) and a perpetual convertible hybrid (first call date in 2023E of EUR 150m if not fully/partially converted into equity). We assume amortising loans on the project level to be sufficiently covered by the operating cash flows of the project SPVs, backed by their significant cash reserves totalling EUR 64m as at June 2020. As mentioned earlier, we further assume that the company is likely to inject cash into an SPV in case of a liquidity constraint. According to the company, this has happened only once: in 2013 for a wind park, with the cash injection provided via a shareholder loan.

Liquidity ratios are expected to be consistently well above 100%, supported by the large unrestricted cash cushion of EUR 182m at the end of June 2020 and the committed long-term credit lines of around EUR 35m. Ultimately, we highlight that Encavis' diversified approach on external funding, including bank and capital market financing on the project level as well as both private (shareholder loan and Schuldschein debt) and public debt on the group level.

Supplementary rating drivers**Adequate financial policy**

Encavis' financial policy is adequate given the high leverage and amortisation of project debt. We believe that the group's expansion through selected growth opportunities via acquisitions and organic capacity additions will be balanced with maintaining the financial risk profile's quality. We also believe that the group 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, as mentioned previously, the group is likely to provide extra financial support to project SPVs;
- The usage of equity and equity-like funding;
- The commitment to an equity ratio around 25%, as measured by equity (including convertible hybrid instruments) divided by total assets;
- Moderate dividend growth of 50% envisaged over five years starting from 2016, which we estimate to be manageable, as well as the introduction of a scrip dividend; and
- The use of the hybrid convertible instrument in 2017 with a tap-up in 2019 to keep leverage under control. Creditors may benefit if the instrument is converted into shares either partially or fully.

Outlook and rating-change drivers**Stable Outlook**

The Outlook is Stable and incorporates our expectation that Encavis will keep EBITDA/cash interest coverage above 3.0x into the medium term. We also believe the company will continue to acquire renewable energy power plants and increase dividends, leaving free and discretionary cash flows at breakeven. Moreover, our Outlook assumes Encavis will provide financial support to a project SPV if needed, to prevent reputational damage spreading to the whole group.

Rating downside

We would consider a negative rating action if EBITDA/cash interest coverage fell below 2.75x. e.g. as a result of lower operating cash flows due to major operational disruptions or rising interest rates on new loans.



Rating upside

A positive rating action could be warranted if Encavis further improved the granularity of the power generation portfolio and strengthened EBITDA/cash interest coverage above 4.0x on a sustained basis.

Long-term and short-term debt ratings

Senior unsecured rated BBB-

While Encavis has no outstanding senior unsecured capital market debt, senior unsecured debt is rated at the level of the issuer.

Hybrid debt rated BB

Contractually subordinated debt (convertible hybrid bond; ISIN: DE000A19NPE8) whose interest can be deferred under certain conditions is rated BB, two notches lower than the issuer's rating.

S-2 short-term rating

In light of Encavis' sustained liquidity measures and its diversified exposure to external funding channels, i.e. from banks and capital markets at project level and from private (i.e. shareholder loans and Schuldschein) and public sources at group level, our short-term rating is S-2.



Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin
Phone +49 30 27891 0

London

3rd Floor
111 Buckingham Palace Road
UK-London SW1W 0SR

Oslo

Haakon VII's gate 6
N-0161 Oslo
Phone +47 21 62 31 42

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main
Phone +49 69 66 77 389-0

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid
Phone +34 914 186 973

Paris

23 Boulevard des Capucines
F-75002 Paris
Phone +33 1 8288 5557

Milan

Via Paleocapa 7
IT-20121 Milan
Phone +39 02 30315 814

info@scoperatings.com
www.scoperatings.com

Disclaimer

© 2020 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Analysis GmbH, Scope Investor Services GmbH and Scope Risk Solutions GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.

Scope Ratings GmbH, Lennéstrasse 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Guillaume Jolivet.