6 March 2020 | Corporates

Encavis AG
Germany, Renewable Energy

SCOPE BBB- STABLE

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, generating 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 estimates		
Scope credit ratios	**2017**	**2018**	**2019E**	**2020E**	**2021E**
EBITDA/interest cover	3.4	3.7	3.6	3.6	3.9
Scope-adjusted debt (SaD)/EBITDA (incl. non-recourse debt[1])	8.8	8.3	8.0	8.8	7.9
Free operating cash flow/SaD[2]	1%	3%	-3%	-7%	5%
Liquidity[3]	>100%	>100%	86%	>100%	>100%

Monitoring note

Scope has updated its rating case and financial forecasts for Encavis AG. The update underpins the BBB-/Stable/S-2 issuer rating of Encavis AG and its financing subsidiary Encavis Finance BV as well as the BBB- rating for senior unsecured debt and BB for subordinated (hybrid) debt such as the convertible hybrid bond (ISIN DE000A19NPE8).

This publication does not constitute a credit rating action. For the official credit rating action release click here.

The BBB-/Stable issuer rating is strongly supported by our view on the company's protected business model, bolstered by either prioritised feed-in of generated electricity under availability-based remuneration schemes or risk mitigation through long-term power purchase agreements (PPAs). The company's Fast Forward 2025 growth strategy, which earmarks a doubling of capacities by 2025 (3.4 GW in 2025E against 1.7 GW at YE 2020E) is expected to stabilise the business profile as an independent power producer any further through a reduction of incremental effects from specific generation assets or regions.

The rating is constrained by the company's weaker financial risk profile relative to its business risk profile, with high leverage including non-recourse debt at project SPV level and modest, but robust, debt protection measures (interest coverage). Reflecting the company's debt maturity profile, sound liquidity measures over the next few years and publicly communicated financial policy, we believe that the company will keep debt levels under control as it expands its asset base. Our updated forecasts for 2019E-21E signal a slightly improved headroom on the company's EBITDA against our negative rating trigger.

---

[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 2019/2020E.
[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 and Research

Corporate Rating Methodology

Rating Methodology: European Renewable Energy Corporates

European electricity: Renewables-based PPAs transform sector, Oct 2019

2020 European Utilities Outlook, Feb 2020

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
• No project developments, only active in acquiring 'ready to build' or 'up and running' power plants • Prioritised feed-in under guaranteed tariffs for most of the power generation portfolio, with an average remaining feed-in period of 13 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	• Weaker financial risk profile than business risk profile: o High leverage including non-recourse debt levels o 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: o Covenants on debt service coverage ratios and cash reserves; and o Company's willingness to provide liquidity to SPVs when needed

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• More granular power generation portfolio, and improved EBITDA/cash interest coverage of above 4.0x on a sustained basis	• An EBITDA/cash interest coverage of below 2.75x

Financial overview

			Scope estimates		
Scope credit ratios	**2017**	**2018**	**2019E**	**2020E**	**2021E**
EBITDA/interest cover	3.4	3.7	3.6	3.6	3.9
SaD/EBITDA (including non-recourse debt)[1]	8.8	8.3	8.0	8.8	7.9
Free operating cash flow/SaD[2]	1%	3%	-3%	-7%	5%
Liquidity[3]	>100%	>100%	86%	>100%	>100%
Scope-adjusted EBITDA in EUR m	**2017**	**2018**	**2019E**	**2020E**	**2021E**
EBITDA	190.4[4]	195.3[4]	216.9	213.4	234.7
Operating lease payments in respective year	7.7	8.1	-	-	-
Other (gains from company mergers i.e. 'badwill')	-23.7	-8.4	-	-	-
Other (gains/losses from asset disposals and EBITDA relating to minorities)	-	-	-14.5	-5.0	-5.0
Scope-adjusted EBITDA	**174.5**	**195.1**	**202.4**	**208.4**	**229.7**
Scope-adjusted interests in EUR m	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Net interest paid	49.9	48.5	53.5	54.1	55.0
Interest component, operating leases (Scope estimates)	2.0	2.2	-	-	-
50% of interest paid on hybrid debt	-	2.6	2.6	3.9	3.9
Scope-adjusted interest	**51.9**	**53.3**	**56.1**	**58.0**	**59.0**
Scope-adjusted debt in EUR m	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Reported gross financial debt	1,509.9	1,627.1	1,770.2	1,792.1	1,917.3
add: 50% of hybrid bond	47.7	47.7	77.7	77.7	77.7
less: cash, cash equivalents	195.6	252.5	326.0	162.1	318.7
add: cash not accessible	71.2	76.9	80.7	88.9	86.3
add: asset retirement obligations	26.1	39.7	43.3	45.4	52.0
add: NPV of operating lease obligations (Scope estimates)	100.1	112.0	-	-	-
less: other (derivative positions)	21.8	22.3	22.3	-	-
Scope-adjusted debt	**1,537.7**	**1,628.7**	**1,623.6**	**1,842.0**	**1,814.7**

[4] Reported EBITDA for 2017 and 2018 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 2019-21E 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.

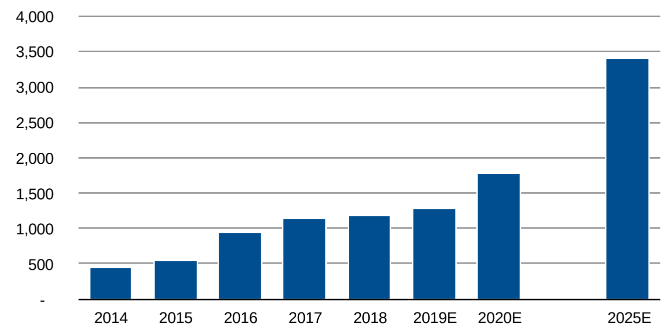
Regulated business for another 13 years

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

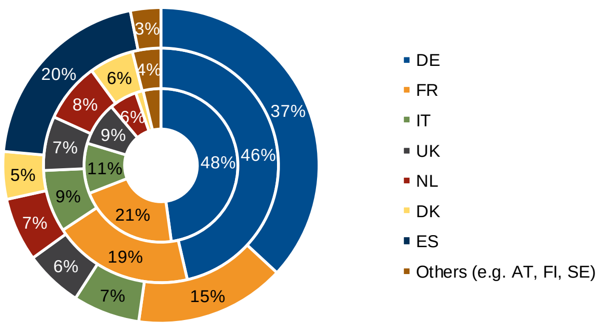
Following the phase-out of fixed feed-in tariffs and premiums for renewable energy capacities in major European markets and the switch to tenders and market-based contracts, Encavis' market position will likely become weakened through new capacity additions over the next years. Initial closures of long-term 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, expected completion by YE 2020) and an undisclosed utility off-taker (300 MW, expected completion by YE 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 = Sept 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 double generation capacities by 2025 (3.4 GW vs 1.7 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 2 GW pipeline (including 500 MW currently under construction) with five 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.

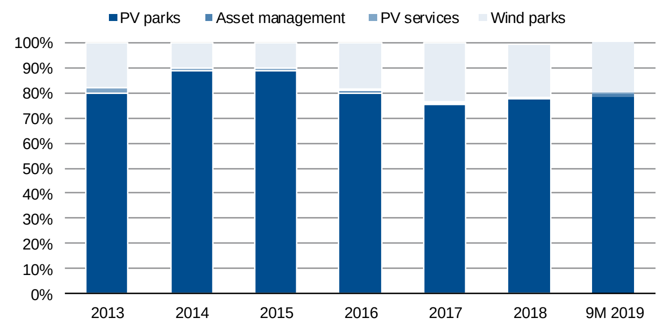
The exposure to wind parks and solar power plants will become increasingly balanced, limiting incremental effects from potential operational disruptions or the underperformance of an asset. The increased exposure to solar power plants in areas with comparatively strong and robust solar irradiation as well as the strategy to spread the operational exposure to more volatile wind parks will gradually stabilise Encavis' cash flow stream.

Correlation risks will be further mitigated within certain regions with the addition of new regions such as the Netherlands (new 14 MWp solar park acquired in 2019), Denmark (addition of another 81 MWp wind park in 2019) as well as the current construction of the two solar parks in Spain. This will smoothen overall power generation volumes.

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.

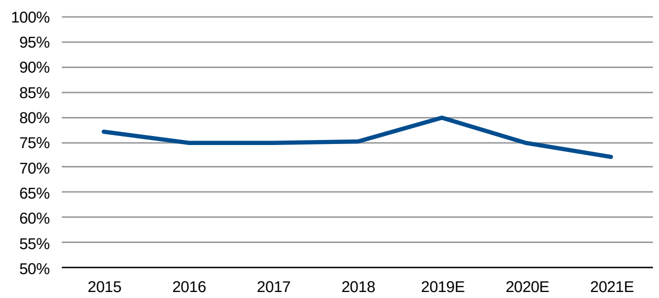
Figure 3: Segment mix (based on EBITDA*)



* 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

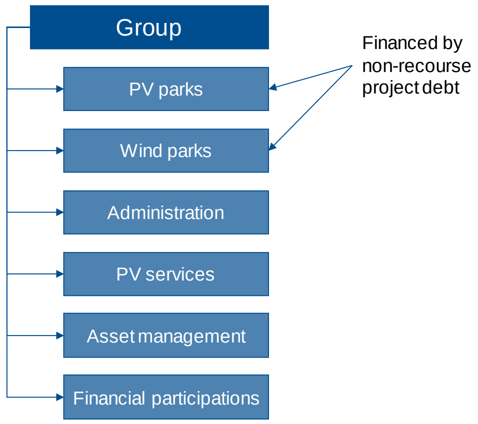
Limited price risks on generated electricity as well as sound diversification drive the company's strong profitability, reflected by its EBITDA margin of above 70%. Minimum post-tax internal rates of return on new projects, depending on the market, are also expected to maintain group margins going forward. 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.

Financial risk profile

Financial risk profile strongly impacted by non-recourse debt

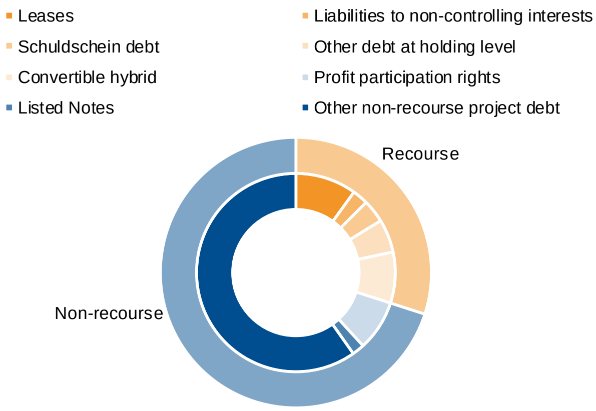
The issuer rating remains largely constrained by the company's financial risk profile (rated BB). Projects are mainly financed with secured non-recourse debt (see figures 5 and 6). Project loan amortisation aligns with the duration of the underlying remuneration model, e.g. fixed tariffs or contracted 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 2019E



Sources: Encavis, Scope

Adjustments and projections

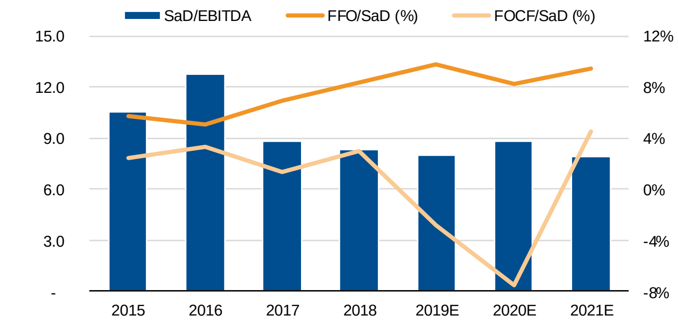
To assess Encavis' creditworthiness through key credit metrics such as leverage, debt protection and liquidity measures, we have adjusted the company's reported figures for the following items:

- 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:

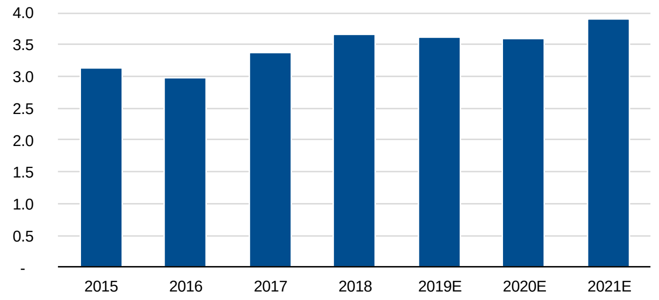
- Further revenue growth in 2020E, which fully reflects capacity additions in Denmark (acquired in late 2019); significant revenue growth in 2021E, owing to the new 500 MW solar power plants in Spain; no further project acquisitions; additional projects to further boost our forecasts
- A slight decrease 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

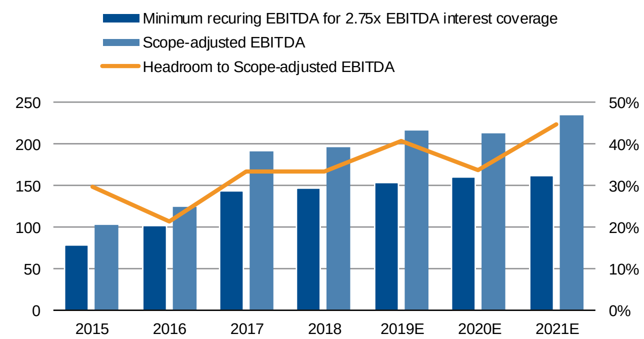
High leverage due to large portion of non-recourse project debt, but good interest coverage

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.

Significant headroom on EBITDA forecasts against negative rating-change trigger

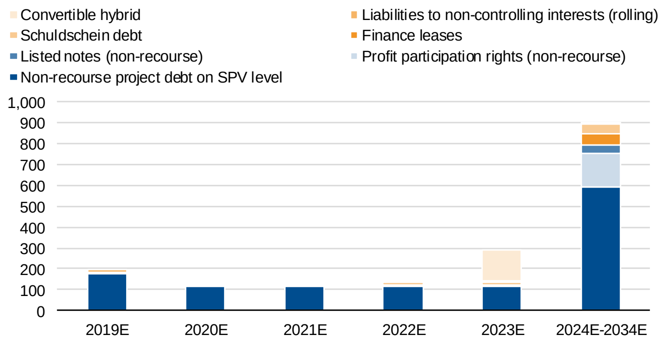
A significant deterioration of the financial risk profile would entail EBITDA falling short of our estimates by more than 30% for 20/21 (see Outlook triggers). With the business becoming increasingly robust as a function of improving scale and diversification, we are comfortable that there is significant 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 2018 (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 110m), 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 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 66m as at September 2019. 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 242m at the end of September 2019 and the committed long-term credit lines of around EUR 40m. 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

The 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;
- Encavis' most recent capital increase via a private placement with new shareholder Versicherungskammer Bayern;
- The commitment to a minimum 25% equity ratio, as measured by equity (including convertible hybrid instruments) divided by total assets (28% at YE 2017; 26% at YE 2018; ≥25% estimated at YE 2019);
- 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 in 2021.

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

Frankfurt am Main

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

Phone +49 69 66 77 389-0

Paris

1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com