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 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.

Key metrics

			Scope estimates		
Scope credit ratios	2019	2020	2021E	2022E	2023E
EBITDA/interest cover	3.6	3.6	3.6	4.0	4.1
Scope-adjusted debt (SaD)/EBITDA (incl. non-recourse debt)	7.9	7.7	6.8	6.7	6.7
Scope-adjusted debt (SaD)/EBITDA (excl. non-recourse debt)	1.2	1.2	0.9	0.9	0.9
Free operating cash flow/SaD	7%	5%	5%	4%	3%
Liquidity	>110%	>110%	>110%	>200%	>200%

Rating rationale

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

The affirmation reflects our unchanged view on Encavis' largely protected business model paired with the company's continuously improving diversification and gradually strengthening credit metrics. We also expect robust operating cash flow and the full conversion of the EUR 150m hybrid convertible debt to support leverage and EBITDA interest coverage.

The rating Outlook remains Stable and incorporates our expectation that EBITDA interest coverage will trend towards 4.0x over the next few years. We also believe that Encavis will continue to acquire renewable energy power plants and keep increasing dividends, leaving free and discretionary cash flows at around breakeven. 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 positive rating action could be warranted if Encavis strengthened EBITDA interest coverage to above 4.0x on a sustained basis, together with further improvements in the granularity of its power generation portfolio.

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. In light of the expected gradual improvement in EBITDA interest cover but also improved leverage to below 7x (Scope-adjusted debt [SaD]/EBITDA), Encavis has gained substantial headroom to such a negative action.

Ratings & Outlook

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

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

info@scoperatings.com
www.scoperatings.com

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Rating drivers

Positive rating drivers	Negative rating drivers
• 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 over 10 years and the option to extend power plant lifetimes • Closure of significant power purchase agreements (PPAs) with strong counterparties, as off-takers for future capacities do not benefit from feed-in tariffs • One of the largest European independent power producers, with an operated production capacity of about 3 GW across more than 250 sites • Sound diversification across mature European markets for renewable energy projects and sound asset diversification with further diversification from investment pipeline (medium-term 3,000 MW) • Financing structure with secured non-recourse project loans and execution of conversion of hybrid convertible • Sound liquidity • Risk mitigation via extensive insurance coverage and the prudent operation and maintenance of project sites	• Financial risk profile weaker than business risk profile: o High leverage including non-recourse debt levels o Modest, but robust, interest coverage (3-4x) • 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 as recently evidenced for part of generation assets in France • Exposure to reputational damage upon the default of a project SPV, somewhat mitigated 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	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	3.6	3.6	3.6	4.0	4.1
SaD/EBITDA (including non-recourse debt)	7.9	7.7	6.8	6.7	6.7
SaD/EBITDA (excluding non-recourse debt)	1.2	1.2	0.9	0.9	0.9
Free operating cash flow/SaD	7%	5%	5%	4%	3%
Liquidity	>110%	>110%	>110%	>200%	>200%
Scope-adjusted EBITDA in EUR m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	217.6	228.4	243.6	252.3	257.5
Other (gains from company mergers i.e. 'badwill')	1.5	1.3	0.0	0.0	0.0
Other (gains/losses from asset disposals and EBITDA relating to minorities, share-based remuneration, minority adjustments)	-0.1	-4.3	-4.6	-9.6	-9.6
Scope-adjusted EBITDA	**219.1**	**225.4**	**239.0**	**242.6**	**247.9**
Scope-adjusted interests in EUR m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Net interest paid	57.5	58.6	61.9	60.6	60.3
50% of interest paid on hybrid debt	2.6	3.9	3.9	0.0	0.0
Capitalised interest on AROs	0.2	0.1	0.1	0.1	0.1
Scope-adjusted interest	**60.2**	**62.6**	**66.0**	**60.7**	**60.4**
Scope-adjusted debt in EUR m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	1,793.8	1,827.1	1,788.3	1,784.3	1,805.3
add: 50% of hybrid bond	74.3	74.3	0.0*	0.0	0.0
less: cash, cash equivalents	-222.5	-231.0	-235.6	-242.9	-243.4
add: restricted	58.0	63.5	62.5	61.9	62.1
add: asset retirement obligations	49.2	60.2	80.6	84.6	88.8
less: other (derivative positions)	-31.5	-62.3	-62.3	-62.3	-62.3
Scope-adjusted debt	**1,721.2**	**1,731.9**	**1,633.5**	**1,625.6**	**1,650.5**

* Hybrid debt to be fully converted into equity in Q4 2021.

Business risk profile

Business risk profile supported by protective business model and growing diversification

Encavis' **business risk profile (assessed at A-)** 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 almost 2 GW (owned assets) comprising more than 250 renewable energy power plants across Western Europe (ESG: credit-positive environmental risk factor). Encavis' generation activities are supplemented by capacities managed for external parties via the company's growing asset management division.

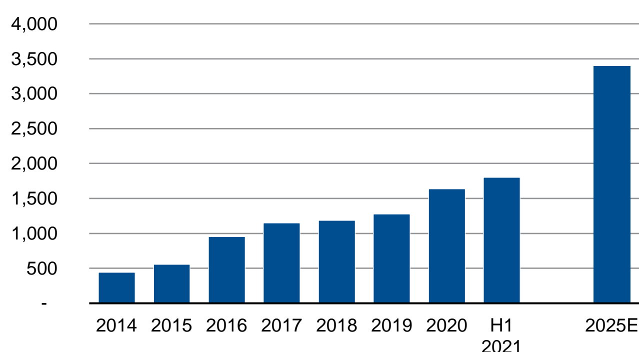
No project developments

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.

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

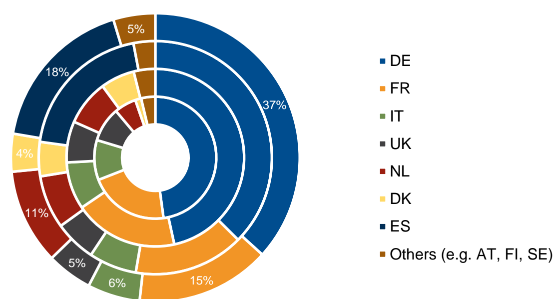
We regard Encavis' business model as widely protected because the vast majority of generation assets benefit from the prioritised feed-in of generated electricity under availability-based remuneration schemes. Merchant risk for unregulated power plants is widely hedged through long-term power purchase agreements with creditworthy counterparties. Despite some regulatory risk, recently evidenced by retroactive tariff cuts for some of Encavis' solar assets in France, the company's granular power generation portfolio ensures robust cash flow generation. Although weather effects entail some cash flow volatility, we expect such effects to be increasingly softened by the ongoing portfolio ramp-up, paired with 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: Strong expansion of owned power generation capacities (in MW)



Sources: Encavis, Scope

Figure 2: Operated capacity by geography (inner circle = YE 2018; middle circles = YE 2019/20; outer circle = YE 2021E)



Sources: Encavis, Scope

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

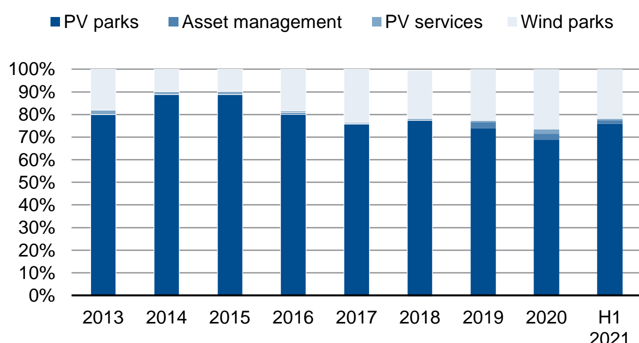
Based on the company's internal funding power, we expect the portfolio ramp-up to be widely covered by operating cash flow. At the same time, the closure of a new EUR 125m ESG-linked multi-year revolving credit facility is expected to accelerate expansion as part of Encavis' 'Fast Forward 2025' growth strategy, which targets growing the owned generation portfolio to 3.4 GW by 2025 (compared to around 1.8 GW as of June 2021). 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 sources from the 3 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.

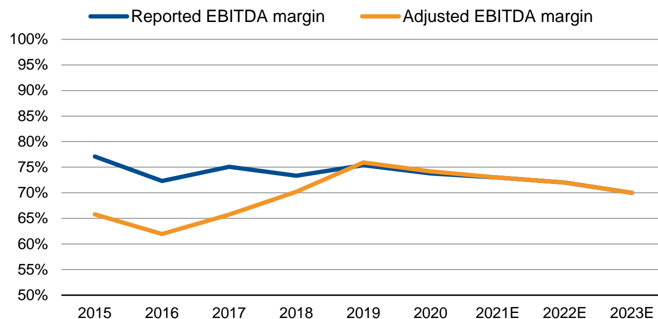
Figure 3: Segment mix (based on EBITDA*)



* Not including consolidation

Sources: Encavis, Scope

Figure 4: Development of clean* EBITDA margin



* Reported EBITDA adjusted for IFRS-related valuation effects

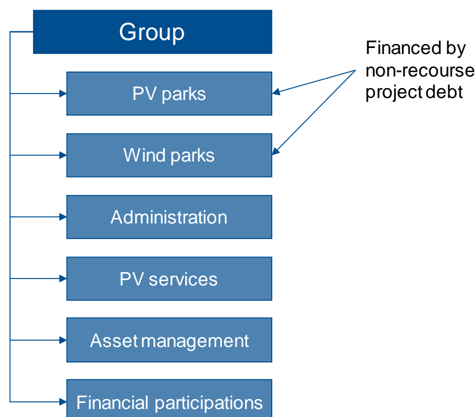
Sources: Encavis, Scope

Financial risk profile

Financial risk profile strongly impacted by non-recourse debt

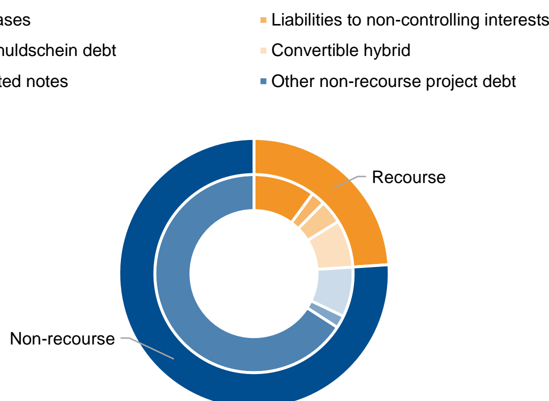
The issuer rating remains largely constrained by the company's **financial risk profile (assessed at BB)**. Projects are mainly financed with secured non-recourse debt (see Figures 5 and 6). Project loan amortisation aligns with the duration of the underlying remuneration model, e.g. fixed tariffs or contracted tariffs within a PPA. This strongly reduces credit risks at group level as the banks which finance the projects have no recourse to the companies, 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 2020



Sources: Encavis, Scope

Adjustments and projections

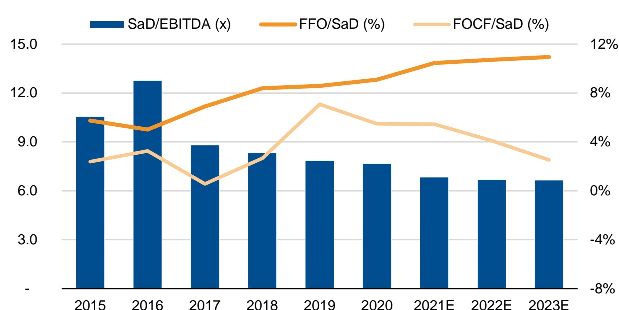
In order to assess Encavis' creditworthiness using key credit metrics such as leverage, debt protection and liquidity measures, we have adjusted the company's reported figures for the following items:

- 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 for the years 2017-20, 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 for the years 2018-21;
    - Significant gains or losses from asset disposals; 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:

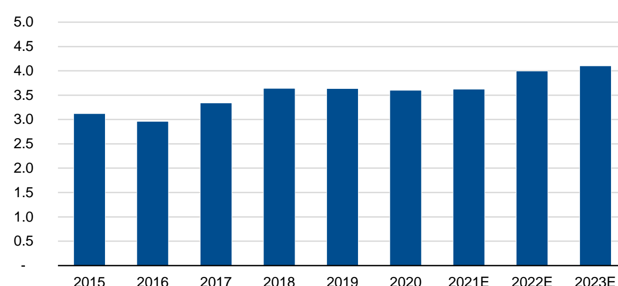
- Continued revenue growth in line with the expansion strategy, with +14% backed by added capacities in Spain and Finland. Further topline growth of 5% p.a. thereafter stemming from new and as yet undisclosed portfolio additions from the pipeline
- Gradual decrease in operating margins; assumptions of 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: EBITDA interest coverage



Sources: Encavis, Scope estimates

EBITDA growth and conversion of hybrid debt into equity support improved credit metrics

We recognise the company's gradually improving credit profile and widened headroom to a potential negative rating action. This is based on:

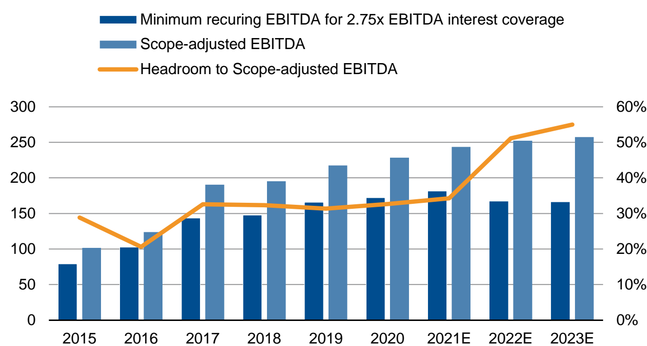
- improving leverage, which is bolstered by the envisioned full conversion of the EUR 150m hybrid convertible into equity (we accounted for 50% of this exposure as debt);
- anticipated operating growth, which is expected to result in EBITDA growing faster than the company's net interest burden; and
- our expectation that discretionary cash flow will remain positive or around breakeven, with net capex and shareholder remuneration (including scrip dividends) widely covered by the operating business.

These trends are likely to result in a leverage – as measured by SaD/EBITDA – of below 7x by YE 2021 (around 1x excluding non-recourse project debt) and EBITDA interest coverage trending at around 4.0x. Nonetheless, leverage will remain high at above 6x, primarily driven by the large exposure to non-recourse debt at the level of project companies, which makes up around 75% of Encavis' total exposure to financial debt.

EBITDA forecasts have widening headroom against negative rating-change trigger

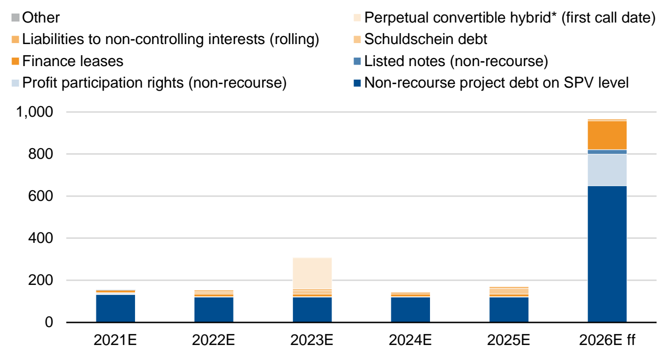
Our updated forecasts for 2021E-23E signal increased headroom for the company's EBITDA against our negative rating-change driver. EBITDA would need to come in 35%-55% lower than forecasted before it reached an EBITDA interest cover of 2.75x, which is the defined trigger for ratings pressure.

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



Sources: Scope estimates

Figure 10: Maturity schedule at YE 2020 (in EUR m)



* convertible to be converted into equity on 4 Oct 2021

Sources: Encavis, Scope estimates

Robust liquidity and good access to external financing

The company's liquidity remains very robust despite its high leverage. Besides the aggregated debt associated with amortising non-recourse project finance debt (EUR 120-130m p.a.), Encavis has little exposure to maturing debt on the holding level (basically just lease obligations, amortising shareholder loans and Schuldschein debt over the next two years, totalling around EUR 20-30m amortising every year). We assume that amortising loans on the project level can sufficiently be covered by the project companies' operating cash flows. This is also backed by a significant amount of cash reserves at the project SPVs (aggregated amount of EUR 62.5m as of June 2021). Furthermore, we assume that the company would be likely to inject cash into an SPV, e.g. via a shareholder loan or an equity injection, if a liquidity constraint arises on the project level.

Liquidity ratios are expected to stand comfortably above 110% at all times, supported by the large unrestricted cash cushion of EUR 177m at the end of June 2021 and committed long-term credit lines of EUR 125m. 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.

Supplementary rating drivers

Financial policy supports robust financial profile

Encavis' financial policy remains adequate and supportive of robust 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, as mentioned previously, Encavis is likely to provide extra financial support to project SPVs;
- The use of a hybrid convertible in 2017 with a tap issue in 2019, which keeps leverage under control and is in the interest of creditors, as evidenced by the full conversion into shares in Q4 2021;
- The commitment to an equity ratio of around 25%, as measured by equity (including convertible hybrid instruments) divided by total assets;
- Encavis has provided a 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, also considering the introduction of a scrip dividend in 2016, which provides some indirect creditor protection.

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 debt is affirmed at BB, two notches lower than the issuer rating. We note that Encavis' only outstanding debt position under this rating category, namely the EUR 150m hybrid convertible bond, will be redeemed by conversion into equity on 4 Oct 2021.

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

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

Phone +34 914 186 973

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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