Encavis AG
Germany, Renewable Energy

SCOPE STABLE BBB-

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	**2016**	**2017**	**2018E**	**2019E**	**2020E**
EBITDA/interest cover	3.0	3.4	3.1	3.2	3.2
Scope-adjusted debt (SaD)/EBITDA (incl. non-recourse debt)	12.8	8.8	8.4	8.1	8.2
SaD/EBITDA (excl. non-recourse debt)	2.4	1.9	2.2	2.3	2.5
Free operating cash flows/SaD	3%	1%	1%	2%	2%

Rating rationale

Scope affirms the BBB-/Stable/S-2 issuer rating of independent power producer Encavis AG and its financing subsidiary Encavis Finance BV. Senior unsecured debt is affirmed at BBB-. The rating on the hybrid convertible is affirmed at BB.

The BBB- issuer rating benefits from the company's protected business model, bolstered by the prioritised feed-in of generated electricity under availability-based remuneration schemes; and the diversification of the power generation fleet. The rating is constrained by the company's weaker financial risk profile as measured by the high leverage and comparatively modest debt protection (interest coverage), which are mitigated in part by the large non-recourse debt exposure at project level, sound liquidity measures, and adequate financial policy.

Senior unsecured debt is rated at the level of the issuer. 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.

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 incorporates the assumption that Encavis will provide financial support in case one of the many project SPVs faces some liquidity constraint or breaches financial covenants in order to avoid reputational damages for the whole group.

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.

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.

Ratings & Outlook

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

Analysts

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

Related methodologies and ratings

Corporate Rating Methodology, Feb 2019

Rating Methodology: European Renewable Energy Corporates, Jan 2019

Energy transition a boon for green bonds, Mar 2019

Germany's coal exit: Mixed medium to-long term implications, Jan 2019

European utilities outlook 2019: Political, regulatory risks move centre stage, Dec 2018

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Tel. +49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• 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 15 years with the option to extend power plant lifetimes • The company being one of the largest European independent power producer, 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 • Financing through secured non-recourse project loans • Sound liquidity • Risk mitigation via extensive insurance coverage and the prudent operation and maintenance of project sites	• High leverage levels including non-recourse debt • Low interest coverage (3-4x) • The potential dilution of margins through future capacity additions (depending on acquisition prices and negotiated PPAs), albeit remaining above 70% (EBITDA margin) • Potential reputational damage upon the default of a project SPV, mitigated somewhat by i) covenants on debt service coverage ratios and cash reserves; and ii) the company's willingness to provide liquidity to SPVs when needed

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Further improvements reg Encavis' business risk profile by an even more granular power generation portfolio and strengthened its financial risk profile as reflected by 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	**2016**	**2017**	**2018E**	**2019E**	**2020E**
EBITDA/interest cover	3.0	3.4	3.1	3.2	3.2
SaD/EBITDA (including assumed non-recourse debt)	12.8	8.8	8.4	8.1	8.2
SaD/EBITDA (excluding assumed non-recourse debt)	2.4	1.9	2.2	2.3	2.5
Free operating cash flow/SaD	3%	1%	1%	2%	2%
Scope-adjusted EBITDA in EUR m	**2016**	**2017**	**2018E**	**2019E**	**2020E**
EBITDA	123.8*	190.4*	178.6	186.3	186.3
Operating lease payments in respective year	4.5	7.7	8.1	8.9	9.4
Other (primarily gains from company mergers i.e. 'badwill')	-17.7	-23.7	-	-	-
Scope-adjusted EBITDA	**110.5**	**174.5**	**186.7**	**195.2**	**195.6**
Scope-adjusted interests in EUR m	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Net interest paid	35.2	49.9	56.0	56.0	56.0
Interest component, operating leases (Scope estimates)	1.8	2.0	2.2	2.3	2.4
50% of interest paid on hybrid debt	-	-	2.6	2.6	2.6
Scope-adjusted interest	**37.1**	**51.9**	**60.7**	**60.8**	**61.0**
Scope-adjusted debt in EUR m	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Reported gross financial debt	1,451.0	1,509.9	1,502.6	1,476.0	1,449.3
thereof, non-recourse debt	1,305.3	1,357.4	1,317.8	1,291.2	1,264.6
add: 50% of hybrid bond	-	48.7	48.7	48.7	48.7
less: cash, cash equivalents	189.0	195.6	167.7	135.2	100.1
add: cash not accessible	63.2	71.2	71.2	71.2	71.2
add: asset retirement obligations	22.3	26.1	28.7	30.1	30.1
add: NPV of operating lease obligations (Scope estimates)	91.1	100.1	110.2	115.7	121.4
less: other (derivative positions)	26.4	21.8	21.8	21.8	21.8
Scope-adjusted debt	**1,412.1**	**1,538.6**	**1,571.8**	**1,584.6**	**1,598.9**

* Reported EBITDA for 2016 and 2017 comprises non-cash income such as gains from company mergers [badwill], 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 2018-2020 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.

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 power purchase agreements with contracted off-takers which fulfil a predefined minimum internal rate of return. This broadly secures the cash flows and profitability of these power plants.

Regulated business for another 15 years

A strong credit-positive is the existing generation portfolio, which benefits from fixed tariffs under availability-based remuneration schemes for another 15 years on average. As price risks are eliminated, Encavis and the different project SPV for wind and solar parks still bear volume risks as a result of adverse weather effects or business interruptions.

Steadily improving diversification mitigates volume risks

Scope regards Encavis' growing and credit-supportive diversification along with the expansion of its power generation portfolio as an overall risk-mitigating driver. The steadily improving business diversification is relating to:

i) The increasingly balanced exposure to wind parks and solar power plants, which limits incremental effects from potential operational disruptions or the underperformance of an asset. This is particularly important as wind power generation is more volatile than for solar.

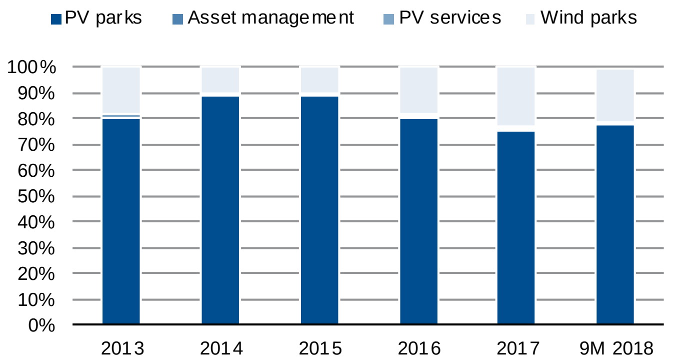
ii) New regional markets such as the Netherlands (new 44 MWp solar park, starting operations in late 2018) and Denmark (addition of an existing 16.5 MWp wind park in Q3 2018) as well as future projects in Ireland and Spain. This reduces correlation risks within certain regions, thereby smoothing overall power generation volumes.

iii) A further investment pipeline, which adds more than 750 MWp of capacity over the next three years in addition to the envisaged 300 MWp solar park in Spain. Moreover, the involvement of co-investors such as the Ireland Strategic Investment Fund or project developer Solarcentury ensure diligent maintenance of the acquired generation sites.

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.

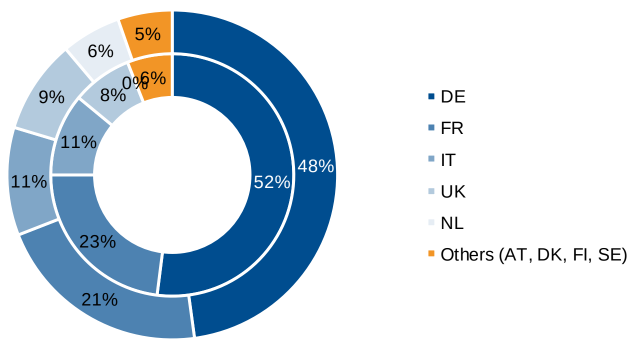
Figure 1: Segment mix (based on EBITDA*)



* Not including consolidation

Sources: Encavis, Scope

Figure 2: Operated capacity by geography (outer circle: Sep 2018; inner circle: Dec 2016)



Sources: Encavis, Scope

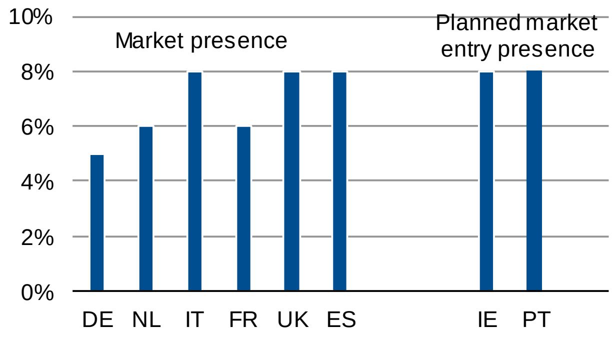
Low-risk strategy for unregulated generation

After availability-based remuneration schemes for renewable energy are phased out, Encavis' future growth will be based on demand-based power generation under so-called power purchase agreements. The company announced its first such project in Q4 2018: the acquisition of a 300 MW solar park in Spain developed by Solarcentury, expected to start operations in 2020. In our view, the growing exposure to market-based contracts will slightly weaken Encavis' market position in the medium to long term, because of the higher counterparty risks linked to off-takers and the need to source electricity externally should contracted power plants underperform. On the other hand, the power purchase agreements will also provide protection over a prolonged period due to Encavis' aim to have agreements last for more than five years and to deal with creditworthy off-takers.

Strong EBITDA margin of above 70% at group level

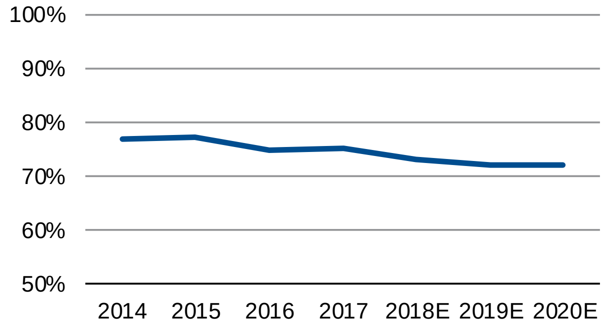
Limited price risks on generated electricity as well as sound diversification drive the company's strong profitability, reflected by its EBITDA margin of above 70%. Minimum post-tax internal rates of return on new projects, depending on the market, are also expected to maintain group margins going forward.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

Figure 3: Minimum post-tax IRR for different markets (solar)



Sources: Encavis, Scope

Figure 4: Development of clean* EBITDA margin



* Reported EBITDA adjusted for IFRS-related valuation effects

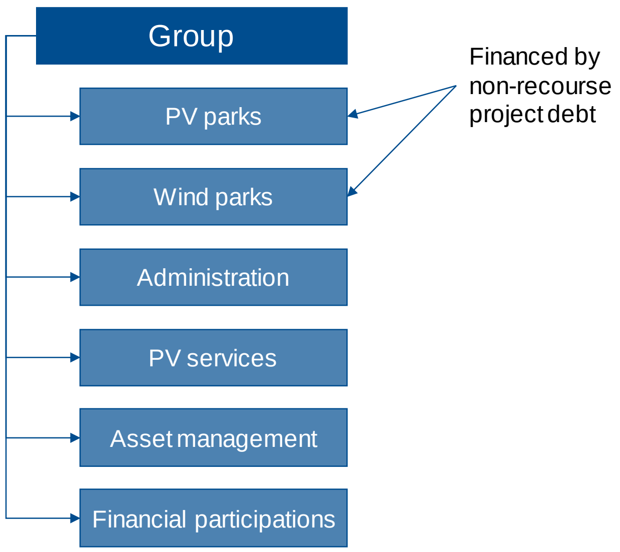
Source: Encavis, Scope

Financial risk profile

Financial risk profile strongly impacted by non-recourse debt

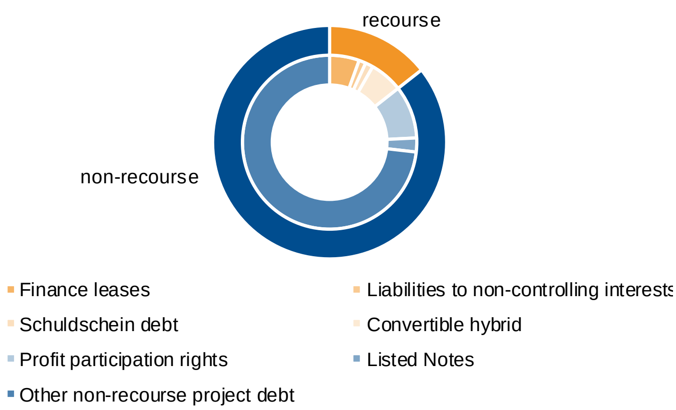
The issuer rating is tempered by Encavis' **financial risk profile (rated BB)**. Projects are mainly financed with secured non-recourse debt (see figures 5 and 6). Project loan amortisation aligns with the duration of the underlying remuneration model, e.g. fixed tariffs or contracted tariffs within a power purchase agreement. 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. At group level, Encavis only carries Schuldschein debt, convertible hybrid debt, shareholder loans, and finance leases. Nevertheless, if a project SPV is faced a liquidity shortfall or has breached financial covenants, 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.

Figure 5: Simplified financing structure



Sources: Encavis, Scope illustration

Figure 6: Financing structure at YE 2017



Sources: Encavis, Scope

Adjustments and projections

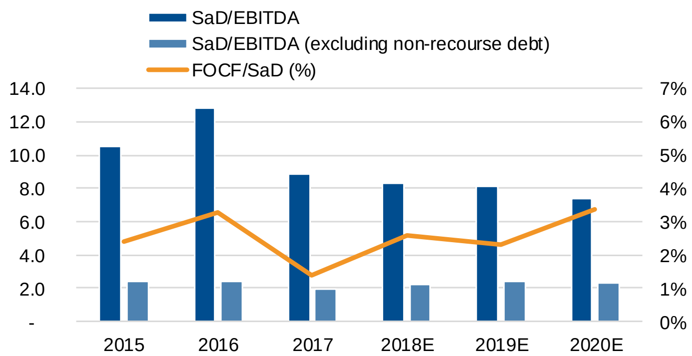
To assess Encavis' creditworthiness through key credit metrics such as leverage, debt protection and liquidity measures, Scope has adjusted for the following items:

- Scope-adjusted debt, i.e. the company's debt balance includes the following:
  - Gross financial debt (Schuldschein debt, finance leases, liabilities to non-controlling shareholders and non-recourse project debt, profit participation rights);
  - 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);
  - The full amount of asset retirement obligations (although we believe many power plants will continue to operate after the feed-in tariffs or power purchase agreements expire); and
  - An estimation of the net present value of operating leases.
- Scope-adjusted interest payments are adjusted for:
  - 50% of dividend payments related to the hybrid convertible; and
  - An estimated interest component relating to operating leases.
- 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.

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

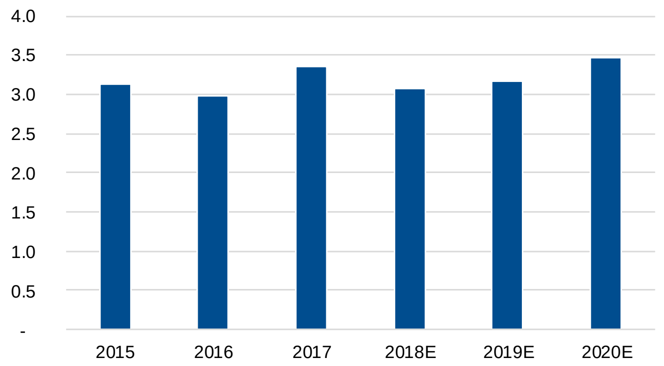
- Further revenue growth in 2019. This incorporates the capacity added from the Dutch solar plant and the Danish wind park.
- Flat revenues for 2020 and further top-line growth in 2021, owing to the new 300 MW solar power plant in Spain and the 44 MW solar plant in the Netherlands. We assume no further project acquisitions. Additional projects will further boost our forecasts.
- A slight decrease in Encavis' operating margins. We assume 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

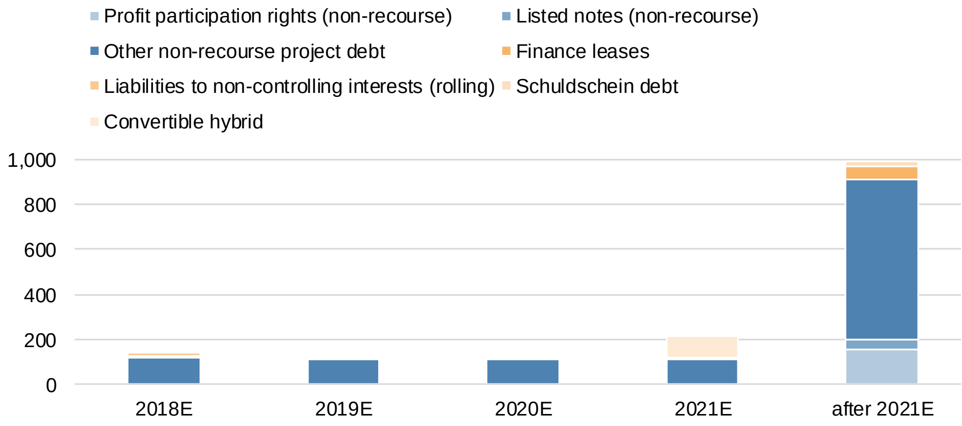
High leverage due to large portion of non-recourse project debt, but good interest coverage

Encavis' leverage – as measured by a Scope-adjusted debt/EBITDA of above 8x or between 2-3x excluding non-recourse debt – 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, i.e. a recurring EBITDA/cash interest coverage of between 3-4x. A significant deterioration of the financial risk profile would entail EBITDA falling short of our estimates by more than 10% for 2019/20 and more than 20% for 2021 (see outlook triggers).

Robust liquidity and good access to external financing

Upcoming debt maturities predominantly relate to non-recourse debt at project level. At group level, about EUR 40m on both the rolling shareholder loan and finance leases has to be repaid between 2019-2021; and the EUR 97m convertible hybrid has to be refinanced in 2021, otherwise it is converted into equity. We assume that amortising loans at project level (c. EUR 110m annually) can be covered by the operating cash flows of the SPVs. Moreover, the SPVs had a combined cash reserve of more than EUR 80m as of June 2018 (over EUR 70m at YE 2017). At group level, we expect Encavis to fully cover upcoming debt maturities through: i) c. EUR 130m of unrestricted cash as at end-June 2018 (EUR 120m at YE 2017); ii) consolidated free operating cash flows; and iii) around EUR 35m of committed credit lines.

Figure 9: Maturity schedule at YE 2017 (in EUR m)



Sources: Encavis, Scope

S-2 short-term rating

As a result, Encavis' liquidity is sound despite the high leverage, with liquidity ratios expected at well above 100% on a sustained basis. Encavis has taken a diversified approach to external funding, 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. The above factors have led to the affirmation of Encavis' **S-2 short-term rating**.

Adequate financial policy

The Encavis' financial policy is adequate given the high leverage and amortisation of project debt. From our perspective, the group's expansion has significantly decelerated over the last two years, focusing more on selected growth opportunities via acquisitions and on maintaining the quality of the financial profile. We believe the group will diligently ensure that the interests of creditors (at project and group levels) and shareholders are balanced, 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 commitment to at least a 25% equity ratio, as measured by equity (including convertible hybrid instruments) divided by total assets (28% at YE 2017; 28% expected at YE 2018);
- Moderate dividend growth of 50% envisaged over five years starting from 2016, which is manageable according to our estimates, as well as the introduction of a scrip dividend; and
- The use of the hybrid convertible instrument in 2017 to keep leverage under control. Creditors may benefit if it is converted into shares either partially or fully in 2021.

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

Disclaimer