Encavis AG
Germany, Utilities

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	4.2	6.3	4.8	4.8
Scope-adjusted debt/EBITDA (including non-recourse debt)	6.2	5.0	6.6	6.7
Scope-adjusted debt/EBITDA (excluding non-recourse debt)	0.4	1.1	1.8	1.7
Scope-adjusted free operating cash flow/debt	7%	13%	5%	4%

Rating rationale

The rating primarily reflects the company's largely protected position as an independent power producer with own generation portfolio that comprises about 2.1 GW across more than 200 renewable power plants. This is supplemented by about 1.4 GW in around 100 plants operated as part of its asset management for third parties across Western Europe (ESG factor: credit-positive environmental risk factor). The rating remains largely constrained by the company's financial risk profile.

Outlook and rating-change drivers

The Positive Outlook reflects our expectation that Scope-adjusted EBITDA/interest cover will remain above 4.0x and Scope-adjusted debt/EBITDA below 7.0x over the next few years, supported by Encavis' gradually improving diversification. The Outlook also assumes a limited impact on credit metrics from adverse regulatory interventions. We expect Encavis will continue to acquire renewable power plants and distribute no dividends, leaving free and discretionary cash flows at near break-even. Moreover, the rating Outlook assumes that Encavis will provide financial support to a project special-purpose vehicle (SPV) if needed to prevent reputational damage spreading to the whole group.

A rating upgrade could be warranted if Encavis maintained Scope-adjusted EBITDA/interest cover above 4.0x and Scope-adjusted debt/EBITDA were sustained at below 7.0x, together with further improvements in geographical diversification with a focus on jurisdictions with relatively stable regulatory environments and granularity of the own portfolio.

We could revise the Outlook to Stable if Encavis failed to i) maintain Scope-adjusted EBITDA/interest cover above 4.0x and/or Scope-adjusted debt/EBITDA were sustained at below 7.0x, e.g. as a result of lower operating cash flow due to major operational disruptions, material adverse regulatory interventions or significantly rising interest rates on new debt; or ii) meaningfully improve diversification and granularity of the own portfolio. A rating downgrade, while remote, could be considered if Scope-adjusted EBITDA/interest cover fell well below 3.0x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
27 Jul 2023	Affirmation	BBB-/Positive
12 Sep 2022	Outlook change	BBB-/Positive

Ratings & Outlook

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

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Related Methodologies and Research

General Corporate Rating Methodology; July 2022

European Utilities Rating Methodology; March 2023

ESG considerations for the credit ratings of utilities; April 2021

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Positive rating drivers	Negative rating drivers

• No involvement in project development, only active in acquiring 'ready to build' or 'up and running' renewable energy power plants (ESG factor: credit-positive environmental factor)
• Prioritised feed-in under guaranteed tariffs for most of its power generation portfolio, with an average remaining feed-in period of over 10 years and the option to extend the lifetime of power plants
• Significant power purchase agreements (PPAs) with creditworthy counterparties, as off-takers for future capacities do not benefit from feed-in tariffs
• One of Europe's largest independent power producers, with a power generation portfolio comprising about 2.1 GW in more than 200 renewable power plants, supplemented by about 1.4 GW in around 100 plants operated as part of its third-party asset management
• Robust diversification across mature European markets for renewable energy projects and sound asset diversification with further diversification from investment pipeline
• Financing structure with secured non-recourse project loans and execution of conversion of hybrid convertible
• Robust liquidity
• Risk mitigation via extensive insurance coverage and the prudent operation and maintenance of project sites
	• Financial risk profile weaker than business risk profile:
	  ○ High leverage including non-recourse debt
	  ○ Solid interest coverage
	• EBITDA margin potentially diluted by strong growth in low-margin photovoltaic services business
	• Volume risks as a result of adverse weather effects or business interruptions
	• Regulatory risks on regulated generation capacities
	• Exposure to reputational damage upon the default of a project SPV, somewhat mitigated by:
	  ○ Covenants on debt service coverage ratios and cash reserves; and
	  ○ Company's willingness to provide liquidity to SPVs when needed

Positive rating-change drivers	Negative rating-change drivers
• More granular and geographically diversified power generation portfolio, Scope-adjusted EBITDA/interest cover of above 4.0x and Scope-adjusted debt/EBITDA below 7.0x on a sustained basis	• Outlook revision to Stable: no meaningful improvement in portfolio diversification and/or Scope-adjusted EBITDA/interest cover below 4.0x and/or Scope-adjusted debt/EBITDA above 7.0x on a sustained basis • Downgrade: Scope-adjusted EBITDA/interest cover of well below 3.0x (remote)

Corporate profile

MDAX-listed Encavis invests in and operates solar power plants and wind farms in Germany, Spain, France, Denmark, the Netherlands and Italy, among others. The company is one of Europe's leading independent producers of renewable energy, operating about 3.5 GW, including the facilities operated as part of its asset management for third parties. The company is not involved in project development.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	3.6	4.2	6.3	4.8	4.8	4.6
Scope-adjusted debt/EBITDA (including non-recourse debt)	7.7	6.2	5.0	6.6	6.7	6.9
Scope-adjusted debt/EBITDA (excluding non-recourse debt)	1.2	0.4	1.1	1.8	1.7	1.6
Scope-adjusted free operating cash flow/debt[1]	6%	7%	13%	5%	4%	2%
Scope-adjusted EBITDA in EUR m						
EBITDA	228.4	280.3	376.5	310.2	358.4	409.5
Other (mainly result from initial consolidation)	1.3	-23.9	-26.5	-	-	-
Other (mainly gains/losses from asset disposals and EBITDA relating to minorities, share-based remuneration, minority adjustments)	-4.3	3.0	1.6	2.3	2.3	2.3
Scope-adjusted EBITDA	**225.4**	**259.4**	**351.6**	**312.5**	**360.7**	**411.9**
Free operating cash flow in EUR m						
Funds from operations	140.1	170.4	296.5	222.5	255.2	287.8
Change in working capital	10.2	8.3	-19.0	1.9	-6.0	-6.4
less: capital expenditure (net)	-35.0	-43.2	-42.6	-100.0	-150.0	-200.0
less: lease amortisation	-9.6	-19.0	-9.5	-14.3	-14.3	-14.3
Free operating cash flow	**105.8**	**116.6**	**225.5**	**110.2**	**85.0**	**67.1**
Net cash interest paid in EUR m						
Net cash interest per cash flow statement	58.6	57.2	52.9	62.0	72.0	87.0
50% of interest paid on hybrid debt	3.9	3.9	2.3	2.3	2.3	2.3
Capitalised interest on asset retirement obligations	0.1	0.1	0.7	0.7	0.7	0.7
Net cash interest paid	**62.6**	**61.3**	**55.9**	**65.0**	**75.0**	**90.1**
Scope-adjusted debt in EUR m						
Reported gross financial debt	1,827.1	1,875.7	2,137.0	2,230.5	2,507.6	2,856.4
add: 50% of hybrid bond	74.3	123.2	123.1	123.1	123.1	123.1
less: cash and cash equivalents	-231.0	-444.6	-344.4	-272.4	-194.7	-120.9
add: restricted cash	63.5	50.4	54.9	63.0	73.0	84.8
add: asset retirement obligations	60.2	72.1	50.5	50.5	50.5	50.5
less: other (derivative positions)	-62.3	-74.5	-258.2	-145.8	-145.8	-145.8
Scope-adjusted debt	**1,731.9**	**1,602.2**	**1,762.9**	**2,048.9**	**2,413.7**	**2,848.1**

[1] We deducted lease amortisation as part of our free operating cash flow calculation based on analytical judgement. That resulted in a decrease in Scope-adjusted free operating cash flow/debt in 2020 to 6% from 7% and in 2021 to 7% from 8%.

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

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

Legend

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

Sustainability considerations

Renewable electricity generation in Europe benefits from tailwinds amid the ongoing energy transition recently amplified by the European energy crisis. This is one of the key credit rating drivers for Encavis.

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

- Economy: contribution to the energy transition, development of new business areas, operational excellence, winning new clients for the asset management segment.
- Environment: contribution to combating the climate crisis, environmental compatibility of existing wind farms and solar parks, biodiversity
- Social: employee satisfaction, employee competence, social commitment
- Governance: responsible corporate management, responsibility in the value chain

In July 2023, the company announced that it plans to eliminate scope 1 and 2 emissions by 2030 and targets full carbon neutrality by 2040.

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

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

Business risk profile: A-

Business risk profile supported by protective business model and growing diversification

Encavis' business risk profile strongly supports its issuer rating. The rating primarily reflects the company's largely protected position as an independent power producer, with a generation portfolio of around 2.1 GW (owned assets) comprising more than 200 renewable energy power plants across Western Europe (ESG factor: credit-positive environmental risk factor). Encavis' power generation activities are supplemented by facilities managed for external parties via the company's growing asset management division.

No involvement in project development

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 that benefit from either tariffs or long-term PPAs with contracted off-takers and that fulfil a predefined minimum internal rate of return. This broadly secures the cash flows and profitability of the power plants.

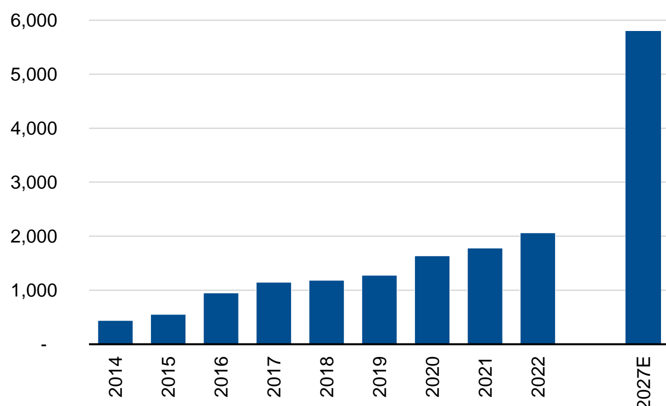
Widely protected business model

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

Asymmetrical exposure to power prices

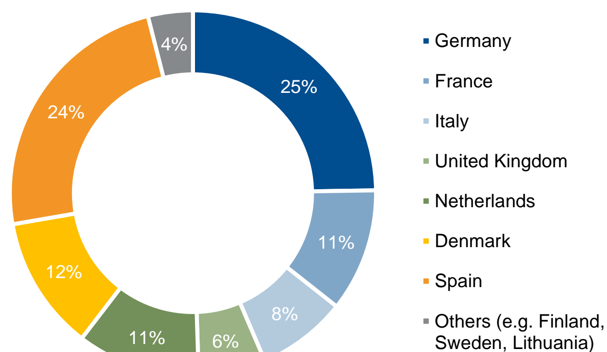
While Encavis' business model is widely protected from the exposure to low power prices, it benefits from very high prices through subsidised projects in Germany and the Netherlands, where feed-in tariffs represent a floor price with upside potential should market prices exceed subsidised prices, as well as through exposure to merchant volumes (maximum 5% of total) as evidenced in 2022.

Figure 1: Development of own generation capacity connected to the grid (in MW)



Sources: Encavis, Scope

Figure 2: Net own capacity by geography (as of Q1 2023)



Sources: Encavis, Scope

The European energy crisis accelerated the expansion of renewables

The European energy crisis accelerated the expansion of renewable energy. European governments plan to reduce their dependence on Russian fossil fuels and accelerate the green transition. The private sector is likely to keep increasing its demand for renewable power, driving up PPAs. This trend is also supported by the phasing-out of subsidies for renewable power generation and high power prices compared to pre-crisis levels. The latter is likely more than offset the combined effect on profitability of new projects stemming from high inflation and increased interest rates.

Strategy update

Given these circumstances, Encavis decided to accelerate its growth trajectory and pursue ambitious goals for 2027. The company plans to almost triple its generation capacity connected to the grid from 2.1 GW in at the beginning of 2023 to 5.8 GW by

2027, increase revenue from EUR 440m guided for 2023 to EUR 800m in 2027, and increase EBITDA from EUR 310m to EUR 520m. Gross investments of EUR 3.9bn will be mainly financed by non-recourse project finance debt; operating cash flow; new debt at holding level; and minority shareholders at project level. The company will also pay no dividends in 2023 and we expect no dividend payments in the next few years. We expect the updated strategy to have an overall neutral impact on the Encavis' business risk profile. The decreasing share of subsidised projects will likely be compensated by growing outreach and improving granularity of the own portfolio.

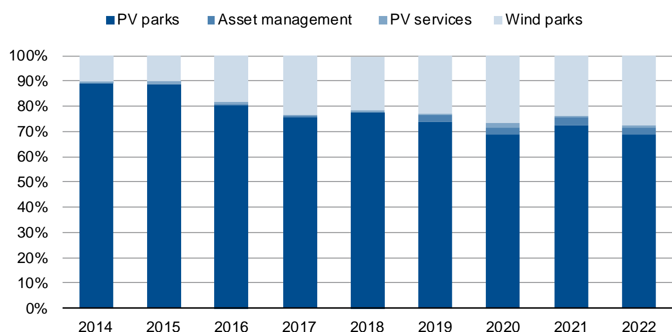
Portfolio ramp-up limits impact of adverse developments from single assets or jurisdictions

The risk of regulatory interventions is largely mitigated by solid and improving geographic diversification focused on jurisdictions with relatively stable regulatory environments, as evidenced by recent capacity additions in the Netherlands, Germany and the Nordics. Although the weather is responsible for some cash flow volatility, we expect such effects will be increasingly mitigated by the ongoing portfolio ramp-up. Cash flow stability is also supported by the rising granularity of power plant sites going forward, which will limit the incremental effects from single generation sites due to adverse weather or tariff/price adjustments.

Risk mitigation through insurance coverage

Robust cash flow across the power generation portfolio is also ensured by operations and maintenance being largely covered in house, alongside a prudent approach to business interruptions and property damage. Encavis strengthened its technical services expertise in solar energy installations by increasing its stake in Stern Energy SpA to 80% in October 2022.

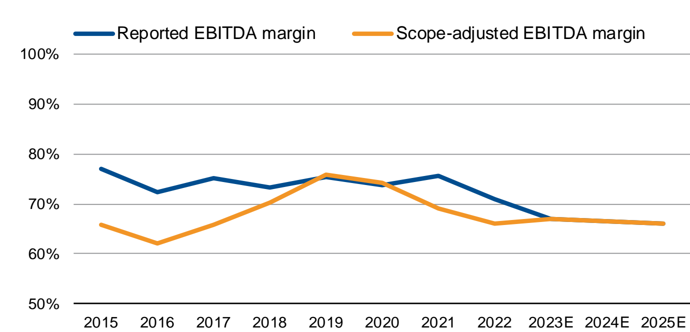
Figure 3: Segment mix (based on EBITDA*)



* Not including consolidation

PV: photovoltaic
Sources: Encavis, Scope

Figure 4: Development of clean* EBITDA margin



* Reported EBITDA adjusted for IFRS-related valuation effects

Sources: Encavis, Scope estimates

Some margin dilution due to strong growth in low-margin photovoltaic services business

Encavis should be able to retain high profitability, e.g. a Scope-adjusted EBITDA margin of above 60% despite some dilution driven by strong growth in low-margin photovoltaic services.

High inflation and disrupted supply chains have no significant impact on operations

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

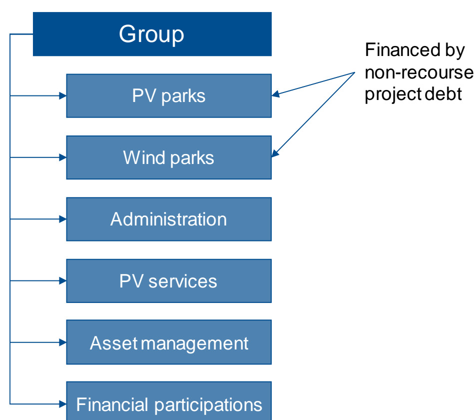
Financial risk profile: BB

Financial risk profile strongly impacted by non-recourse debt

The issuer rating remains largely constrained by the company's financial risk profile. Projects are mainly financed with secured non-recourse debt (see Figures 5 and 6). Project loan amortisation aligns with the duration of the underlying remuneration model,

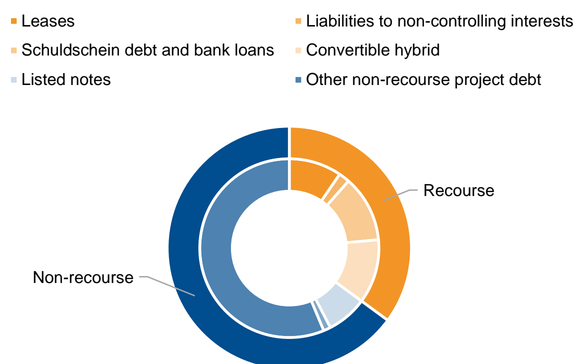
e.g. fixed tariffs or contracted tariffs within a PPA. This strongly reduces credit risks at group level as the banks financing the projects have no recourse to Encavis, only to the respective borrowers. However, Encavis would likely provide extra financial support, e.g. via an equity injection or a 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



PV: photovoltaic
Sources: Encavis, Scope illustration

Figure 6: Financing structure at YE 2022



Sources: Encavis, Scope

Adjustments and projections

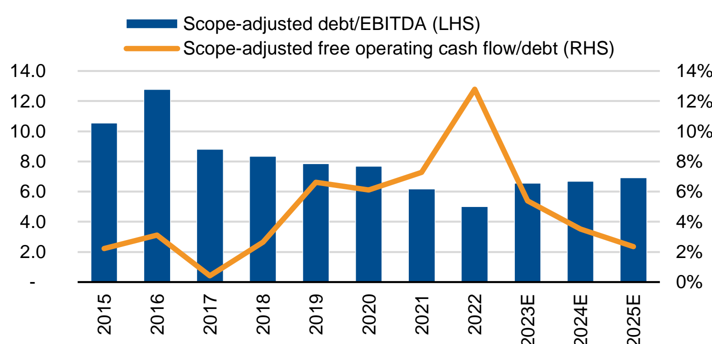
In order to assess Encavis' creditworthiness using key credit metrics such as leverage, debt protection and liquidity measures, we have adjusted the company's reported figures for the following items:

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

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

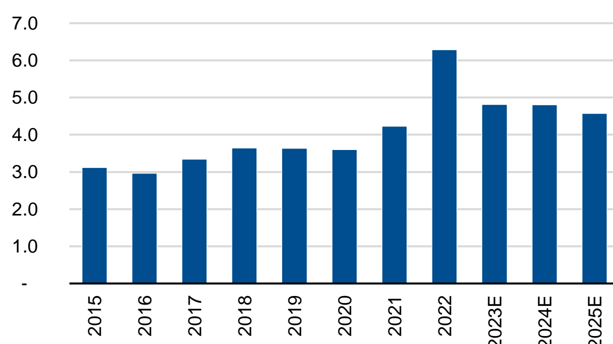
- Moderate revenue decline in 2023 mainly driven by a decrease in electricity prices that more than offsets additional revenue from the consolidation of Stern Energy and capacity additions. A yearly topline growth of around 15% thereafter, stemming from new and as yet undisclosed portfolio additions.
- Gradual decrease in operating margins primarily driven by active expansion into operations and maintenance business
- 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
- No dividend payouts

Figure 7: Scope-adjusted leverage and cash flow cover



Sources: Encavis, Scope estimates

Figure 8: Scope-adjusted EBITDA/interest cover



Sources: Encavis, Scope estimates

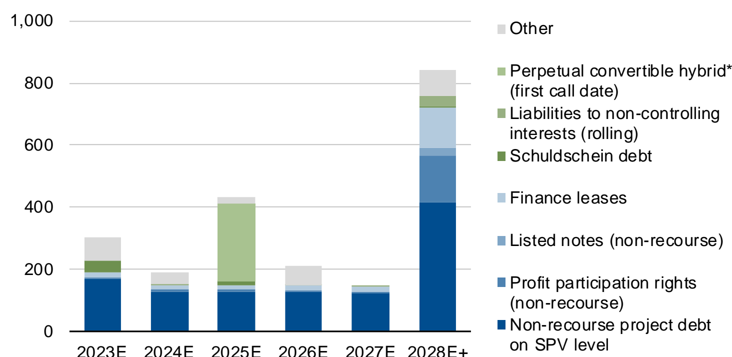
Strong 2022 performance

In 2022, the company generated record-high Scope-adjusted EBITDA of EUR 352m, much higher than in 2021. This was primarily driven by very high power prices but also higher power generation (up 14% YoY) and only slightly dampened by price caps in Spain, Italy and Germany (total impact EUR 25m). As a result, Scope-adjusted EBITDA/interest cover exceeded 6x and Scope-adjusted debt/EBITDA improved to 5x.

Projections for 2023-2025

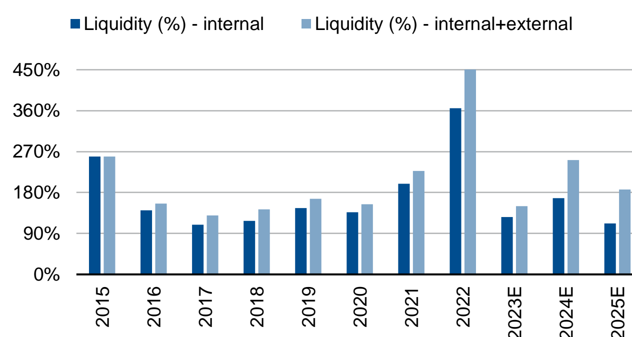
For 2023-2025, we expect strong financial results with annual Scope-adjusted EBITDA at around EUR 310m-420m, mainly driven by accelerated growth in generation capacity and only partly offset by lower power prices compared with the exceptionally high levels in 2022. We expect the company to increase total investment spending significantly to EUR 500m-700m per year. Considering the mainly debt-funded nature of investments and ongoing high interest rates, we expect Scope-adjusted EBITDA/interest cover to decrease to around 4x-5x and Scope-adjusted debt/EBITDA to increase to around 6x-7x. The Scope-adjusted free operating cash flow/debt ratio, which excludes acquisitions, is likely to remain positive.

Figure 9: Maturity schedule at YE 2022 (in EUR m)



Sources: Encavis, Scope estimates

Figure 10: Liquidity ratios



Sources: Encavis, Scope estimates

Robust liquidity and good access to external financing

Liquidity remains adequate. Liquidity ratios are expected to stand comfortably at above 110% in the foreseeable future, supported by a large unrestricted cash cushion of EUR 408m at end-March 2023 and committed undrawn long-term credit lines of EUR 146m. We assume that the amortisation of loans at project level (EUR 120m-130m yearly) can be sufficiently covered by the operating cash flow of the project companies. This is also backed by significant cash reserves at the project companies (aggregated amount of EUR 55m as at end-March 2023). Ultimately, Encavis has demonstrated a diversified approach to external funding, including bank and capital market financing at project level, as well as private debt (shareholder loans and Schuldschein) and public debt at group level, which could support external funding if needed.

Balance in EUR m	2022	2023E	2024E
Unrestricted cash (t-1)	394.2	289.5	209.4
Open committed credit lines (t-1)	145.0	76.7	146.0
Free operating cash flow (t)	225.5	110.2	85.0
Short-term debt (t-1)	169.6	316.8	175.3
Coverage	**>200%**	**150%**	**>200%**

Supplementary rating drivers: +/- 0 notches

Neutral financial policy supports robust financial profile

We maintain our neutral view of Encavis' financial policy. We believe that the company's expansion via acquisitions and organic capacity additions will be managed while maintaining the quality of its financial risk profile. We also believe that Encavis will diligently balance the interests of creditors (at project and group levels) and shareholders, as evidenced by:

- The use of financial covenants and cash reserves at project level. Moreover, Encavis is likely to provide extra financial support to project SPVs;
- The commitment to a minimum equity ratio of 24%, as measured by equity (including convertible hybrid instruments) divided by total assets;
- Encavis' flexible dividend policy with the dividend size being determined every year depending on the cash flow, investment forecast and financing situation of the company, including the option of no dividends as evidenced in 2023.
- The use of hybrid convertible instruments, which keeps leverage under control and is in the interest of creditors, as evidenced by the full conversion of the instrument issued in 2017 into shares in Q4 2021;

Long-term and short-term debt ratings

Senior unsecured rated BBB-

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

Contractually subordinated (hybrid) debt rated BB

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

S-2 short-term rating

The short-term debt rating is rated 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.

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