

Research Update:

Stockholm Exergi Holding AB 'BBB+' Rating Affirmed Following Change In Ownership Structure; Outlook Stable

July 6, 2021

Rating Action Overview

- Fortum Oyj has announced its intention to sell its 50% ownership in district heating provider Stockholm Exergi Holding AB (publ) to a consortium of pension funds for a consideration of €2.9 billion.
- We don't expect that the changes in ownership will lead to any meaningful impact on Stockholm Exergi's credit profile, because the group already operates independently from Fortum, and we expect its financial risk profile and policy to not change.
- We affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings on Stockholm Exergi, as well as our 'K-1' Nordic scale rating and 'BBB+' senior unsecured debt rating on the company.
- The stable outlook reflects the persistent nature of the heating operations that should continue supporting Stockholm Exergi's operating cash flow. We believe the company's financial risk profile will stay well in line with our parameters for the ratings, with funds from operations (FFO) to debt at 19%-22%, and debt to EBITDA will stay below 4.5x in 2021-2023.

PRIMARY CREDIT ANALYST

Daniel Annas
Stockholm
+46 (8) 4405925
daniel.annas
@spglobal.com

SECONDARY CONTACT

Per Karlsson
Stockholm
+ 46 84 40 5927
per.karlsson
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Rating Action Rationale

We don't expect the change in ownership to have any meaningful impact on Stockholm Exergi's credit profile. The new owners will replace Fortum in the shareholder agreement (SHA) between the City of Stockholm (AAA/Stable/A-1+) and Fortum (BBB/Stable/A-2), so we don't expect any meaningful changes to the financial policy and strategy. Stockholm Exergi is already operating independently from Fortum, meaning management proceeds autonomously. We further believe that the company have the in-house expertise to run its operation and to execute its projects. We understand that Stockholm Exergi plans to invest about Swedish krona (SEK) 14 billion over 2021-2025. The increased investments are mainly driven by two large projects, biocarbon capture and storage, together with investments in a new CHP plant starting in 2023 and 2025, respectively.

While Fortum will sell its share in Stockholm Exergi, Stockholm's 50% ownership will remain, which continues to enhance the group's stand-alone credit profile. Fortum announced on June 30 the sale for SEK29.5 billion (€2.9 billion) to a consortium of pension funds including APG, Alecta, PGGM, Keva, and AXA. We expect the transaction to close before the end of 2021. The City of Stockholm will continue to own the remaining 50% and have equal voting rights with the new owners. Part ownership by the city enhances the company's stand-alone credit profile with one notch and our 'BBB+' long-term rating on Stockholm Exergi continues to include one notch of uplift. This is because we believe the city will support the company if it faced difficulties outside the ordinary course of business. We consider a change in ownership support from the city unlikely.

The new ownership structure should not lead to any change in financial risk profile or policy, because the shareholder agreement will not change. We understand the buyer consortium will step in Fortum's place in the existing SHA, and thereby forced to comply with the current agreement. This ensures that key reserved matters and veto rights are retained as it is for the City of Stockholm and protecting Stockholm Exergi's credit quality, because the SHA stipulates dividend policy and leverage, debt to EBITDA ratio in the 3.5x-4.5x range. We therefore assess that the transaction as having a neutral impact on the company's financial risk profile. This is because Stockholm Exergi's control by the new owner is limited by the city's joint ownership and the SHA. In addition, the underlying shareholder agreement states that changes to the agreement requires 75% of votes for a change. We understand that the board structure will have a 50-50 split between the City of Stockholm and the consortium. In our view, this indicates that no party has full control of Stockholm Exergi, so it is unlikely that we will consolidate any potential new shareholder loan above the Stockholm Exergi level, as this can't be pushed down to Stockholm Exergi nor funded by increased dividend as long as the city remains as a 50% shareholder. We consider positive that the current SHA provides the basis for the company's financial policy.

Credit ratios remain stable thanks to very steady and predictable district heating operations. Stockholm Exergi's EBITDA has been SEK2.8 billion-SEK3.0 billion for the past five years. The company maintained stable EBITDA in 2020 despite very challenging conditions with a warmer-than-usual winter, extremely low electricity prices, and the pandemic. In 2020, EBITDA margin improved to 44% compared with 41% in 2019. This was mainly from lower demand for heat, since less expensive fuels were needed. The stable business is also underpinned by the district heating pricing model, where fixed costs represent about 40% of revenue. We expect that credit ratios will remain broadly unchanged: We forecast adjusted FFO to debt of 19%-22% and debt to EBITDA close to 4.5x and falling during the period, compared with 19.3% and 4.6x in 2020.

Outlook

Our outlook is stable because we expect Stockholm Exergi's stable heating operations will continue to support its operating cash flow. We believe the company's financial risk profile will likely stay well in line with our parameters for the ratings, including with the new shareholder structure. We forecast that Stockholm Exergi's credit metrics will remain near current levels in the coming three years, with FFO to debt at 19%-22%, comfortably above our 15% threshold. In addition, we forecast debt to EBITDA will stay below 4.5x in 2021-2023.

Downside scenario

We could consider a negative rating action if Stockholm Exergi's credit metrics were to deteriorate

substantially, with FFO to debt below 15% and limited prospects for a swift recovery. This could result, for example, from any significant further debt-funded investment, or operational underperformance from significantly higher fuel prices. In addition, we could lower the ratings if the City of Stockholm's ownership stake decreased, because this could lead us to revise down our assessment of the likelihood of extraordinary support.

Upside scenario

We could consider an upgrade if Stockholm Exergi's financial policy supported a sustainably improved financial position to a level we view as commensurate with an intermediate financial risk profile. This could materialize, all else being equal, if the company's adjusted FFO-to-debt ratio were to exceed 23% sustainably.

Company Description

Stockholm Exergi is the largest provider of district heating in the Stockholm region, with a production capacity of about 5,000 megawatts. It has roughly an 80% market share in its operating area, and reported EBITDA of about €280 million in 2020. Stockholm Exergi provides heating for over 800,000 people in and around Stockholm and the district heating network is made up of 1,600 kilometers of underground pipes. Of the 10,400 individual customers, roughly 5,000 are apartment building associations. Stockholm Exergi also provides cooling to about 400 customers. More than 90% of its district heating system is based on renewable or recycled energy.

Our Base-Case Scenario

Assumptions

- Revenue to increase in 2021 by about SEK500 million to about SEK7 billion, due to higher revenue from colder weather and electricity sales; then modest growth of 1%-3% in 2022 and 2023.
- District heating tariff increase of 0.5% in 2021, 2.0% in 2022, and 2.5% in 2023.
- EBITDA margin of about 42%-44% during 2021, then increasing toward 46%-48%, mainly driven by operating efficiencies.
- Capex of SEK1.50 billion-SEK1.7 billion in 2021 and 2022, then increasing to about SEK3.0 billion during 2023.
- Annual dividend payouts of about SEK850 million.
- Investments in the new CHP plant in Lövsta to not be material before the end of 2023.

Key metrics

Stockholm Exergi Holding AB (publ)--Key Statistics

(Mil. SEK)	2019a	2020a	2021f	2022f	2023f
EBITDA	2,882	2,835	2,800-3,000	3,100-3,300	3,300-3,500

Stockholm Exergi Holding AB (publ)--Key Statistics (cont.)

(Mil. SEK)	2019a	2020a	2021f	2022f	2023f
FFO	2,552	2,487	2,400-2,600	2,600-2,800	2,800-3,000
FFO to debt (%)	19.3	19.1	19-22	19-22	19-22

FFO--Funds from operations. SEK--Swedish krona. a--Actual. e--Estimate.

Liquidity

We view Stockholm Exergi's liquidity as adequate, reflecting that available liquidity sources should exceed forecast near-term cash outflows by about 1.4x. We also expect that sources will exceed uses even if EBITDA declines by 15%. We believe that the company has sound relationships with banks, and a high standing in credit markets. Demonstrating this are issuances in May, with one issuance of SEK800 million and a tap of SEK200 million with maturities in 2028 and 2024, respectively. Proceeds repaid maturing bonds of an equivalent amount. The company also has generally prudent risk management, and no restrictive financial covenants in its loan documentation.

Principal liquidity sources as of March 2021 include:

- Cash FFO of about SEK2.54 billion.
- Access to undrawn committed revolving credit facilities totaling SEK3.2 billion, maturing in 2023.

Principal liquidity uses, March 2021

- Debt maturities of about SEK1.61 billion, predominantly outstanding bonds.
- Capex of SEK1.5 billion-SEK1.7 billion in 2021 and 2022.
- Dividends of SEK850 million annually.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Strong

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bbb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile : bbb

- Related government rating: AAA
- Likelihood of government support: Moderate (+1 notch from SACP)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed

Stockholm Exergi Holding AB (publ)

Issuer Credit Rating	BBB+/Stable/A-2
Nordic Regional Scale	--/--/K-1
Senior Unsecured	BBB+

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