

# RatingsDirect®

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## Summary:

# Stockholm Exergi Holding AB (publ)

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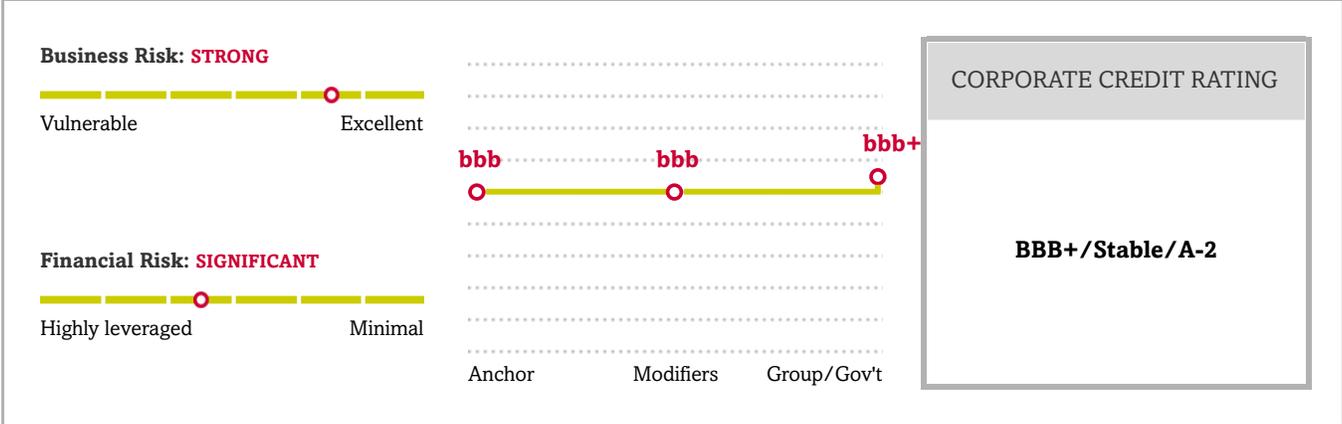
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Summary:

# Stockholm Exergi Holding AB (publ)



## Rationale

Business Risk: Strong	Financial Risk: Significant
<ul style="list-style-type: none"> <li>Stable district heating business accounts for about 85% of operations.</li> <li>Diverse customer base and fuel mix.</li> <li>Limited geographic diversification with all operations in the constantly evolving Stockholm region.</li> </ul>	<ul style="list-style-type: none"> <li>Relatively high debt following significant investment in the new combined heat and power plant.</li> <li>Medial cash flow volatility supporting stability in credit measures.</li> <li>Strong interest coverage for the significant financial risk profile.</li> </ul>

**Outlook: Stable**

S&P Global Ratings' stable outlook reflects our expectation that Sweden-based district heating company Stockholm Exergi AB operating cash flows will continue to be supported by its stable heating operations. It also reflects our expectation that credit measures will remain comfortably above 15% FFO-to-debt.

**Upside scenario**

We could consider an upgrade if Stockholm Exergi's financial policy supported a sustainable improvement of its 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% on a sustainable basis.

**Downside scenario**

We could consider a negative rating action if credit metrics were to deteriorate substantially, with FFO to debt below 15% with no expectation of a swift recovery. This could result, for example, from any significant further debt-funded investment, operational underperformance, or higher-than-expected dividends. 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.

**Our Base-Case Scenario**

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>• Low-single-digit revenue growth over forecast period.</li> <li>• Annual heating volume growth on average five per cent over our forecast period.</li> <li>• Annual capex of about SEK1.7 billion in 2018 decreasing to about SEK1.3 billion in 2019 and 2020.</li> <li>• Dividends of SEK800 million per year.</li> </ul>		<b>2017A</b>	<b>2018E</b>	<b>2019E</b>
	EBIDA Margin	44.5	45-47	46-48
	FFO/debt	22.1	20-22	21-23
	FFO cash interest	18.9	12-14	12-14
A--Actual. E--Estimate				

**Company Description**

Stockholm Exergi (formerly Fortum Varme) is the largest provider of district heating in the Stockholm region and has a roughly 80% market share in its operating area. Stockholm Exergi provides heating for over 800,000 people in and around Stockholm. Of the 10,400 individual customers roughly 5,000 are apartment building associations. On top of

this Stockholm Exergi provides cooling to about 400 customers. The district heating network is made up of 2,900km of underground pipes. In 2017 Stockholm Exergi had sales of roughly SEK6.7 billion. The company is 50% owned by the City of Stockholm and 50% by Fortum Oyj. Around 85% of revenues is from district heating, 10% from electricity production and 5% from district cooling.

## Business Risk: Strong

Stockholm Exergi's business risk profile reflects its satisfactory competitive position in district heating operations, which account for about 85% of the company's revenues and EBITDA. Although there is no defined regulatory framework for district heating in Sweden, the company is the sole district heating network operator in its area, with implicit oversight from the Swedish Competition Authority. We view the current market-based framework for district heating as predictable, which brings stability to the business.

The stable operating environment is, however, somewhat offset by volume and fuel price risks related to district heating, with warmer or colder winters leading to volume volatility. The absence of a defined tariff regulation for cost cover means there is no guarantee that the company could recover costs arising from the aforementioned volatility, but we note that its operating profit has historically been relatively stable, and completion of their new plant should also support operating efficiency.

Stockholm Exergi's business risk profile is also supported by its diverse customer base, which mainly consists of real estate companies and housing associations. These generally exhibit more stable demand than industrial customers. The company also benefits from a diverse fuel mix, which enables it to react to prevailing fuel prices by switching between different fuel types. The company is, however, exposed to geographic concentration because all of its operations are in the City of Stockholm region. This concentration is partly mitigated by the region's very strong and dynamic local economy.

## Peer comparison

Table 1

Stockholm Exergi Holding AB (publ) -- Peer Comparison				
Industry Sector: Combo				
	Stockholm Exergi Holding AB (publ)	Fortum Oyj	Tekniska verken i Linköping AB	KELAG
Rating as of May 15, 2018	BBB+/Stable/A-2	BBB/Negative/A-2	A+/Stable/A-1	A/Stable/--
	--Fiscal year ended Dec. 31, 2017--			--Fiscal year ended Dec. 31, 2016--
(Mil. €)				
Revenues	690.8	4,520.0	492.5	1,319.8
EBITDA	307.6	1,358.5	139.0	227.3
Funds from operations (FFO)	265.6	977.1	133.8	192.2
Net income from cont. oper.	122.3	866.0	15.9	86.5
Cash flow from operations	276.3	986.1	134.8	160.4

Table 1

Stockholm Exergi Holding AB (publ) -- Peer Comparison (cont.)				
Industry Sector: Combo				
	Stockholm Exergi Holding AB (publ)	Fortum Oyj	Tekniska verken i Linköping AB	KELAG
Rating as of May 15, 2018	BBB+/Stable/A-2	BBB/Negative/A-2	A+/Stable/A-1	A/Stable/--
Capital expenditures	182.7	657.0	69.3	108.2
Free operating cash flow	93.6	329.1	65.5	52.2
Discretionary cash flow	52.9	(647.9)	65.5	12.0
Cash and short-term investments	0.0	3,897.0	35.5	167.5
Debt	1,202.2	2,552.2	177.3	505.0
Equity	1,218.1	13,287.0	502.9	873.6
<b>Adjusted ratios</b>				
EBITDA margin (%)	44.5	30.1	28.2	17.2
Return on capital (%)	6.1	6.2	4.2	9.3
EBITDA interest coverage (x)	16.6	5.8	26.8	13.4
FFO cash int. cov. (X)	18.9	6.5	N.M.	12.5
Debt/EBITDA (x)	3.9	1.9	1.3	2.2
FFO/debt (%)	22.1	38.3	75.5	38.1
Cash flow from operations/debt (%)	23.0	38.6	76.1	31.8
Free operating cash flow/debt (%)	7.8	12.9	37.0	10.3
Discretionary cash flow/debt (%)	4.4	(25.4)	37.0	2.4

N.M. - Not Meaningful.

## Financial Risk: Significant

Stockholm Exergi's financial risk profile is supported by its improving ratios following the completion of its fully debt-funded investment in the CHP plant. Since the completion, the ratios have steadily improved with de-leveraging and improved cash flows. We expect FFO to debt to remain around 21%-23% in 2018-2019. The new plant is increasing cash flows through additional electricity production and lower fuel costs. We also take into account the company's medial cash flow volatility, resulting from the relative stability of its district heating operations.

## Financial summary

Table 2

Stockholm Exergi Holding AB (publ) -- Financial Summary					
Industry Sector: Combo					
	--Fiscal year ended Dec. 31--				
	2017	2016	2015	2014	2013
Rating history	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	-/-/-

Table 2

## Stockholm Exergi Holding AB (publ) -- Financial Summary (cont.)

	--Fiscal year ended Dec. 31--				
	2017	2016	2015	2014	2013
<b>(Mil. kr)</b>					
Revenues	6,788.0	6,746.0	6,323.0	6,654.0	7,133.0
EBITDA	3,022.0	2,799.0	2,824.5	2,892.0	2,827.0
Funds from operations (FFO)	2,609.4	2,414.2	2,070.7	2,410.9	2,196.1
Net income from continuing operations	1,202.0	1,172.0	792.0	1,151.0	1,180.0
Cash flow from operations	2,714.4	2,296.2	1,958.7	2,195.9	2,713.1
Capital expenditures	1,795.0	1,593.0	2,520.0	3,100.0	2,314.0
Free operating cash flow	919.4	703.2	(561.3)	(904.1)	399.1
Dividends paid	400.0	400.0	400.0	400.0	400.0
Discretionary cash flow	519.4	303.2	(961.3)	(1,304.1)	(0.9)
Debt	11,812.9	12,317.1	13,086.1	12,409.7	11,069.2
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	11,969.0	11,236.0	10,430.0	10,065.0	9,517.0
Debt and equity	23,781.9	23,553.1	23,516.1	22,474.7	20,586.2
<b>Adjusted ratios</b>					
EBITDA margin (%)	44.5	41.5	44.7	43.5	39.6
EBITDA interest coverage (x)	16.6	15.2	4.6	9.1	8.4
FFO cash int. cov. (x)	18.9	18.7	4.4	8.1	32.5
Debt/EBITDA (x)	3.9	4.4	4.6	4.3	3.9
FFO/debt (%)	22.1	19.6	15.8	19.4	19.8
Cash flow from operations/debt (%)	23.0	18.6	15.0	17.7	24.5
Free operating cash flow/debt (%)	7.8	5.7	(4.3)	(7.3)	3.6
Discretionary cash flow/debt (%)	4.4	2.5	(7.3)	(10.5)	(0.0)
Net Cash Flow / Capex (%)	123.1	126.4	66.3	64.9	77.6
Return on capital (%)	6.2	6.0	6.2	6.9	7.5
Return on common equity (%)	10.3	10.5	7.0	11.1	12.0

N.M. - Not Meaningful.

**Liquidity: Adequate**

We view Stockholm Exergi's liquidity as adequate, reflecting that available liquidity sources in terms of cash, committed credit facilities, and operating cash flow should be in excess of 1.1x of forecast near-term cash outflows, such as debt repayments and committed capital expenditure. We also expect that sources will exceed uses even if EBITDA declines by 10%. We believe that the company has sound relationships with banks, generally prudent risk management, and no restrictive financial covenants in its loan documentation.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• Cash of roughly SEK150 million as of Dec. 31, 2017.</li> <li>• Forecast FFO of around SEK2.5 billion in the 12 months from Dec. 31, 2017.</li> <li>• An unused SEK3 billion committed overdraft facility maturing in June 2020.</li> </ul>	<ul style="list-style-type: none"> <li>• Expected capex of around SEK1.8 billion in 2018, which we believe could be reduced under a stress scenario.</li> <li>• SEK1.1 billion of loans maturing in 2018.</li> <li>• Expected dividend payments of SEK800 million, which we anticipate could be reduced in a stress scenario.</li> </ul>

## Government Influence

In accordance with our criteria for government-related entities (GREs), our view that there is a moderate likelihood of extraordinary support from the City of Stockholm is based on our assessment of Stockholm Exergi's:

- Strong link to the City of Stockholm. This is based on the City of Stockholm's 50% ownership of the company and our view that the city of Stockholm has no plans to reduce its stake in Stockholm Exergi. The remaining 50% is owned by Fortum Oyj, and the two shareholders have equal voting rights and board representation.
- Limited importance for the City of Stockholm. Although Stockholm Exergi provides the vast majority of all heating in the City of Stockholm, we assess that, given the joint ownership with Fortum, the City of Stockholm is primarily interested in Stockholm Exergi's operations and that its services could be provided by a private sector entity.

## Ratings Score Snapshot

### Corporate 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)

## Issue Ratings--Subordination Risk Analysis

### Capital structure

Stockholm Exergi's debt structure consists of senior unsecured debt issued by Stockholm Exergi.

### Analytical conclusions

Stockholm Exergi's debt is rated 'BBB+', the same level as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

**Table 3**

#### Reconciliation Of Stockholm Exergi Holding AB (publ) Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. kr)

	--Fiscal year ended Dec. 31, 2017--							
Stockholm Exergi Holding AB (publ) reported amounts								
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Capital expenditures
Reported	11,648.0	11,967.0	3,043.0	1,701.0	159.0	3,043.0	2,694.0	1,797.0
Standard & Poor's adjustments								
Interest expense (reported)	--	--	--	--	--	(159.0)	--	--
Interest income (reported)	--	--	--	--	--	1.0	--	--
Current tax expense (reported)	--	--	--	--	--	(232.0)	--	--
Operating leases	286.9	--	43.0	20.6	20.6	22.4	22.4	--
Surplus cash	(149.0)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	2.0	(2.0)	(2.0)	(2.0)
Non-operating income (expense)	--	--	--	1.0	--	--	--	--
Non-controlling Interest/Minority interest	--	2.0	--	--	--	--	--	--

**Table 3**

<b>Reconciliation Of Stockholm Exergi Holding AB (publ) Reported Amounts With S&amp;P Global Ratings Adjusted Amounts (Mil. kr) (cont.)</b>								
Debt - Accrued interest not included in reported debt	27.0	--	--	--	--	--	--	--
EBITDA - Derivatives	--	--	(64.0)	(64.0)	--	(64.0)	--	--
Total adjustments	164.9	2.0	(21.0)	(42.4)	22.6	(433.6)	20.4	(2.0)
<b>S&amp;P Global Ratings adjusted amounts</b>								
	<b>Debt</b>	<b>Equity</b>	<b>EBITDA</b>	<b>EBIT</b>	<b>Interest expense</b>	<b>Funds from operations</b>	<b>Cash flow from operations</b>	<b>Capital expenditures</b>
Adjusted	11,812.9	11,969.0	3,022.0	1,658.6	181.6	2,609.4	2,714.4	1,795.0

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- 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: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

<b>Business And Financial Risk Matrix</b>						
<b>Business Risk Profile</b>	<b>Financial Risk Profile</b>					
	Minimal	Modest	Intermediate	<b>Significant</b>	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+/a	a-/bbb+	<b>bbb</b>	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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