MOODY'S

Rating Action: Moody's affirms EnBW's Baa1 rating; stable outlook

08 Dec 2022

Paris, December 08, 2022 -- Moody's Investors Service (Moody's) has today affirmed the Baa1 long-term issuer rating of EnBW Energie Baden-Wuerttemberg AG (EnBW) and the senior unsecured ratings of its guaranteed subsidiary, EnBW International Finance B.V.Concurrently, Moody's has affirmed the Baa3 subordinated debt ratings of EnBW, the Prime-2 short-term issuer rating, and the baa2 Baseline Credit Assessment (BCA). The outlook remains stable.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The affirmation of the Baa1 rating with a stable outlook reflects the view that EnBW will exhibit a credit profile commensurate with a Baa1 rating given that the residual financial risks associated with the procurement of gas by VNG - its 74% owned subsidiary - have now been substantially mitigated.

On 2 December, EnBW published a press release in which it informed that an agreement with the Government of Germany (Aaa Stable) had been found related to compensation for the increased gas acquisition costs that VNG will incur during the fourth quarter of 2022 relating to a 35 terawatt hour gas supply contract. Together with its third quarter results presented in November, EnBW had taken a provision of €600 million for the fourth quarter this year. This provision will now fall away. In its accounts, EnBW will, however, record an overall loss of around €1.18 billion in 2022 which relates to increased procurement costs of gas up until the end of the third quarter. The losses related to two gas contracts, both of which will terminate at the end of December this year.

As a consequence of the agreement with the Government, VNG has now withdrawn the application to the German Federal Ministry for Economic Affairs and Climate Action for stabilisation measures under section 29 of the Energy Security of Supply Act. Whereas the government will not now step in as a new shareholder in VNG, Moody's notes that VNG could still be in need of new equity from its shareholders in order to recapitalize its balance sheet following the losses incurred this year. Moody's estimates that EnBW's share of such a recapitalization – if any – would be an amount in the mid-to-high triple digit million euro range.

In spite of incurring losses of more than €1 billion in 2022 related to gas contracts, Moody's notes that EnBW has been able to offset the vast majority of these losses against higher earnings in its electricity generation segment. Both the company's renewables operations and conventional generation have benefited from the current elevated power price environment. Together with its third quarter results, EnBW guided toward only a 10% decline in adjusted EBITDA against its initial outlook for 2022. This would imply a full-year results in line with that of 2021. As the company will no longer be burdened by gas losses from 2023, the rating agency expects EnBW to demonstrate a very solid uptick in adjusted EBITDA next year. Whereas the electricity market revenue caps for some generation technologies proposed by the Government in Germany will restrict earnings growth, allowed revenues will still be at high levels from a historical perspective which will support EBITDA and cash flow growth in 2023.

Moody's notes, however, that EnBW is exploring the possibility of selling up to 49.9% of its transmission system operator, Transnet BW. A sale, if it was to occur, would increase the share of minorities in EnBW's capital structure. Upon announcement of such a transaction, Moody's would seek to better understand the implications for EnBW's business risk and financial profile and could seek to amend the current financial ratio rating triggers for maintenance of the current rating.

EnBW's credit quality continues to be underpinned by its scale and leadership position as a vertically integrated utility within Baden-Wuerttemberg; the significant proportion of earnings, around 50% of EBITDA, from low-risk regulated distribution and transmission activities; a growing share of renewables under contracts as EnBW continues to invest in line with its strategy; and its historically balanced financial policy and demonstrated commitment to maintaining a robust credit quality.

These positives are, however, balanced against the difficult operating environment in Germany for conventional generation; challenging retail markets given intense competition and the evolution of energy services; and execution risks related to a large investment programme, including offshore wind development.

Because of the 46.75% ownership by the Land of Baden-Wuerttemberg, EnBW is considered a Government-Related Issuer under our Government-Related Issuers Methodology, published in February 2020. Accordingly and based on our estimate of moderate support in case of financial distress and high dependence, the Baa1 rating factors in a one-notch uplift from the company's BCA of baa2.

The Baa3 long-term rating on the hybrid securities, which is two notches below the senior unsecured rating of Baa1 for EnBW, reflects the features of the hybrids that receive basket 'C' treatment, i.e. 50% equity or "hybrid equity credit" and 50% debt for financial leverage purposes.

RATIONALE FOR THE STABLE OUTLOOK

The stable rating outlook reflects Moody's expectations that EnBW will display solid growth in earnings in 2023 and 2024, allowing the company to still fund a substantial share of capital spending from generated cash flows. Moreover, the stable outlook factors in our expectation that the company will maintain a prudent financial policy and put in place mitigants should funds from operations (FFO)/net debt fall below 17% or if retained cash flow (RCF)/net debt falls below the company's 12% target.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward pressure could develop over time should EnBW's FFO/net debt move above 20% on a sustained basis. At the same time, Moody's would expect RCF/net debt to improve to the midteens in percentage terms.

The rating could be downgraded if credit metrics appear likely to fall persistently below the above guidance, with FFO/net debt persistently below 17% and RCF/net debt below 12%. A reduction in the government support assumption incorporated into EnBW's rating would also likely result in a downward rating adjustment.

LIST OF AFFECTED RATINGS

Affirmations:

..Issuer: EnBW Energie Baden-Wuerttemberg AG

....ST Issuer Rating, Affirmed P-2

....LT Issuer Rating, Affirmed Baa1

....Baseline Credit Assessment, Affirmed baa2

....Subordinate Regular Bond/Debenture, Affirmed Baa3

....Other Short Term, Affirmed (P)P-2

....Senior Unsecured Medium-Term Note Program, Affirmed (P)Baa1

..Issuer: EnBW International Finance B.V.

....BACKED Other Short Term, Affirmed (P)P-2

....BACKED Senior Unsecured Medium-Term Note Program, Affirmed (P)Baa1

....BACKED Senior Unsecured Regular Bond/Debenture, Affirmed Baa1

Outlook Actions:

..Issuer: EnBW Energie Baden-Wuerttemberg AG

....Outlook, Remains Stable

..Issuer: EnBW International Finance B.V.

....Outlook, Remains Stable

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017 and available at https://ratings.moodys.com/api/rmc-documents/75129, and Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/api/rmc-documents/64864. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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