

**Rating Action: Moody's affirms Eesti Energia's Baa3 ratings; outlook stable**

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Frankfurt am Main, January 20, 2022 -- Moody's Investors Service (Moody's) has today affirmed the Baa3 long-term issuer and senior unsecured ratings of Estonian national electricity and oil shale company Eesti Energia AS (Eesti Energia). The outlook remains stable. At the same time Moody's affirmed the Prime-3 short-term issuer rating and Eesti Energia's ba3 Baseline Credit Assessment (BCA).

**RATINGS RATIONALE**

Today's rating action reflects Moody's view that Eesti Energia is making progress on the transition to a less carbon-intensive business profile with a focus on expanding renewable generation capacity through the company's recently listed, 77.2% owned subsidiary Enefit Green AS (EGAS). Nonetheless, the associated substantial investments, in combination with the company's oil shale-related activities, which remain exposed to commodity price volatility and tightening environmental regulations, will weigh on the company's standalone credit profile, reflected in Moody's expectations of weaker credit metrics over the next 2-3 years. The rating benefits, however, from a high probability of support from the company's owner, the Government of Estonia (A1 stable), for example through capital measures if needed.

Eesti Energia's current business mix is characterized by significant exposure to environmental risks, predominantly carbon regulation, as the company operates oil shale-fueled electricity plants and produces shale oil products, which are mostly used as feedstock for maritime fuels. The company seeks to reduce its carbon exposure by investing heavily in low-carbon activities, such as renewable power generation, distribution grid operations and related network services, for example high-speed internet. In addition, Eesti Energia will also increase its shale oil production, which provides for a less carbon-intensive use of its oil shale reserves compared to power generation, by building a third shale oil plant.

In 2021, economic growth in combination with other factors led to steeply rising energy prices, reflected in Eesti Energia's increase of power output from its hybrid thermal, mostly oil-shale fueled plants by 41% year over year in the first nine months of 2021, with biomass and shale gas accounting for around one third of the fuel mix. The electricity segment, including renewables, was also the largest contributor, at more than 60%, to the company's reported total EBITDA of EUR179.1 million during that period, up from EUR148.9 million in the same period a year earlier. Conversely, shale oil earnings did not benefit from higher oil prices as losses on derivatives almost completely eliminated the segment's EBITDA.

Looking ahead, Moody's expects the company's earnings to remain volatile. At the same time, the company's standalone credit quality, or Baseline Credit Assessment (BCA) of ba3, continues to be supported by a strong and stable contribution from regulated distribution activities, accounting for some 40% of reported EBITDA in the first nine months of 2021, as well as by cash flows from renewables electricity generation which benefits to a large degree from support schemes. However, the ramp-up period required for new low-carbon investments and the resulting pressure on the company's financial profile will leave Eesti Energia's BCA weakly positioned over the next few years.

The rating affirmation nevertheless reflects Moody's expectation that pressure on the BCA is highly likely to be offset by support from Eesti Energia's government owner, as demonstrated by the Government of Estonia's past equity injections, dividend restraint and approval for the listing of EGAS, all of which are underpinning the funding of the company's strategic investments. Eesti Energia falls under Moody's rating methodology for Government-Related Issuers (GRI) due to its 100% ownership by the Government of Estonia. Given the combination of (1) moderate default dependence; and (2) the likelihood of high support from its owner, the Government of Estonia, in case of financial distress, Eesti Energia's Baa3 rating incorporates three notches of uplift from the BCA of ba3.

**STRUCTURAL CONSIDERATIONS**

The listing of a 22.8% minority share of EGAS in October 2021 generated proceeds for both Eesti Energia and EGAS, contributing to the funding of their planned capital expenditures. Since EGAS will also have to partly finance new projects with own debt, bondholders at the parent company level will be exposed to increased

structural subordination risk. Given that the majority of the company's earnings continues to be generated by fully controlled subsidiaries that are debt free, Moody's at this time does not apply notching to the holding company's ratings.

#### RATIONALE FOR THE STABLE OUTLOOK

The stable outlook on Eesti Energia's ratings reflects Moody's expectation that the company will continue to benefit from high support from its owner, the Government of Estonia. The current BCA reflects Moody's expectation that the company will be able to maintain its leverage, expressed as funds from operations (FFO)/net debt, sustainably at least in the mid teens in percentage terms.

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

Upward pressure on Eesti Energia's ratings is unlikely to materialise in the medium term but could develop in the long term through a combination of the following: (1) successful execution of the investment program; and (2) the maintenance of good liquidity and a financial profile comfortably and sustainably in excess of the current guidance. A one-notch upgrade of the BCA may not necessarily lead to a higher rating level.

Eesti Energia's BCA could come under downward pressure if (1) the company were not able to maintain a financial profile commensurate with the current guidance, that is, if FFO/net debt were to decline below the mid teens in percentage terms on a sustained basis; (2) the company's liquidity profile were to deteriorate; or (3) there were material adverse changes to the market and/or regulatory environment where the company operates that are not addressed through adequate adjustment of the financial profile. A one-notch downgrade of the BCA may not necessarily lead to a downgrade of the rating. The rating could be downgraded if (1) Eesti Energia was to demonstrate a materially lower BCA that was not compensated by some form of support from the Estonian government; (2) structural subordination were to increase materially; or (3) the credit quality of the Government of Estonia or the support assumptions currently incorporated into Moody's assessment were to weaken materially.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017 and available at [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_1066389](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1066389), and Government-Related Issuers Methodology published in February 2020 and available at [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_1186207](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1186207). Alternatively, please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of these methodologies.

Headquartered in Tallinn, Eesti Energia AS is the dominant vertically integrated utility and leading oil shale mining company in Estonia. The group owns approximately 80% of the country's generation capacity, owns and operates the largest electricity distribution network and is the second largest producer of liquid fuels from oil shale. Eesti Energia is 100% owned by the Government of Estonia. For the last twelve months ended 30 September 2021, Eesti Energia reported revenues of EUR1,077.0 million and EBITDA of EUR243.7 million.

#### 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 at: [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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