

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

28 Sep 2020

Frankfurt am Main, September 28, 2020 -- Moody's Investors Service (Moody's) has today affirmed the Baa3 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.

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

The rating action reflects Moody's view that Eesti Energia's weaker standalone credit profile, arising from adverse business conditions and reflected in subdued commodity prices of electricity and oil, is offset by 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 high exposure to environmental risks, predominantly carbon regulation, is a key driver of the company's rating. The company's oil shale-fueled electricity production has been under pressure since EU carbon prices began to rise steeply in the second half of 2018 and it is exposed to competition from cheaper power coming from Nordic countries and Russia, leading to a decrease of generation by around 70% year over year in the first six months of 2020. The company seeks to reduce the carbon exposure of its businesses by planning to invest 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 2020 the coronavirus pandemic has led to a sharp global economic contraction, which is also reflected in lower energy demand and a concurrent decline in power prices in Europe and oil prices, and is accompanied by high uncertainty about the path of recovery. Against this backdrop Eesti Energia's reported EBITDA has fallen to EUR104.6 million from EUR146.8 million in the first six months of 2020, mostly driven by unprofitable oil shale power generation, which already suffered from increased competition from Nordic hydropower. Looking ahead, Moody's expects the company's earnings to weaken further, which will require it to review its investments plans and may lead to a longer transition period away from the carbon-intensive generation of electricity from oil shale than previously assumed.

Weaker earnings will exert downward pressure on the company's standalone credit quality, or Baseline Credit Assessment (BCA) of ba3, which is already constrained by the time lag of earnings from new investments with longer ramp-up periods and the evolving nature of the electricity markets in which Eesti Energia operates. Although the ba3 BCA continues to be supported by (1) a strong contribution from regulated distribution activities, accounting for 40% of reported EBITDA in the first six months of 2020, which support the stability of Eesti Energia's cash flow, and (2) sizeable cash flows from renewables electricity generation which benefits to a large degree from support schemes, pressure could further increase if the planned listing of a minority stake of the group's renewables business was delayed.

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 recent EUR125 million cash equity injection to help funding 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) high 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.

Amongst the funding sources of Eesti Energia's capital expenditure program is the planned listing of a minority share of its renewables business, Enefit Green, in the near future. Since Enefit Green is financing its activities with own debt, bondholders at the parent company level will be exposed to increased structural subordination risk. Given that the company's earnings continue to be mostly generated by fully controlled subsidiaries that

are debt free and that Eesti Energia as majority shareholder of Enefit Green has access to its earnings through dividends, 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 rating is unlikely to materialise in the near and 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. An upgrade of the BCA may not necessarily lead to a higher rating.

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 adjustments of the business transition plans and financial profile. A 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.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1066389, and Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207. Alternatively, please see the Rating Methodologies page on www.moodys.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 six months ended 30 June 2020, Eesti Energia reported sales revenues of EUR394.8 million and EBITDA of EUR104.6 million.

LIST OF AFFECTED RATINGS

..Issuer: Eesti Energia AS

Affirmations:

.... ST Issuer Rating, Affirmed P-3

.... LT Issuer Rating, Affirmed Baa3

....Senior Unsecured Regular Bond/Debenture, Affirmed Baa3

Outlook Actions:

..Issuer: Eesti Energia AS

....Outlook, Remains Stable

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.moodys.com/researchdocumentcontentpage.aspx?>

[docid=PBC_79004](#).

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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