

Rating Action: Moody's revises EWE's outlook to positive, affirms Baa1 ratings

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Frankfurt am Main, December 13, 2019 -- Moody's Investors Service (Moody's) has today revised the outlook on EWE AG's (EWE) ratings to positive from stable. The rating agency has also affirmed the Baa1 issuer rating, the (P)Baa1 rating of the company's €2.0 billion medium-term note programme, and the Baa1 senior unsecured ratings of the existing bonds issued under this programme.

RATINGS RATIONALE

OUTLOOK CHANGE TO POSITIVE

The outlook revision to positive reflects Moody's expectations of improvement in EWE's ratios of funds from operations (FFO) to net debt and retained cash flow (RCF) to net debt to levels in the high- and mid-twenties in percentage terms, respectively, following EWE's announcement on 6 December that Ardian Infrastructure (Ardian) will acquire a 26% equity stake in EWE. This is because part of the net sale proceeds (representing the 10% treasury shares that EWE owns directly) will flow directly to EWE and therefore boost its cash position. EWE expects to receive the equity sale proceeds by Q1 2020, subject to approval by the Federal Cartel Office. The outlook change to positive further reflects EWE's track record of solid financial performance over the past few years with FFO/net debt of nearly 21% for fiscal year 2018 and 24% for the twelve months ending 30 June 2019.

RATING AFFIRMATION

EWE's rating affirmation reflects the stable and predictable cash flows generated by its monopoly-regulated energy distribution activities, accounting for approximately 50% of earnings before interest and taxes (EBIT). In addition, EWE's long-term contracts stabilise its competitive businesses of power generation, gas storage and waste-to-energy by partially mitigating wholesale power price exposure. EWE has a fairly strong market position in its core region, which somewhat reduces the risk inherent in its competitive supply activities. EWE's rating affirmation also reflects the modest de-risking of activities outside its core market following the sale of its Turkish activities, which concluded in June 2019.

Notwithstanding the anticipated inflow of cash in early 2020 and expected near-term boost to financial metrics, Moody's expects some of the financial ratio improvement to be temporary, as EWE reinvests over time proceeds to deliver on its strategic plan. Moody's believes that EWE's plan may be modified over the next year to fully incorporate Ardian's view, because they are seen as a partner to deliver on EWE's strategic plan. Ardian will have two seats on the supervisory board. EWE however faces headwinds in delivering on its strategy to continue its expansion in the renewables business, particularly its focus on onshore wind. New capacity and development has come to a slow-down, largely driven by poor auction results and increased permitting delays.

The rating affirmation also reflects that EWE's liquidity remains strong with €445 million in reported cash at June 30, 2019. In addition, EWE has €750 million in committed funds available under a syndicated revolving credit facility maturing in November 2023 and €361 million in available short-term bilateral facilities.

Given its ownership structure, Moody's considers EWE as a government-related issuer (GRI). However, the Baa1 rating does not incorporate any uplift from EWE's standalone credit quality, expressed as a baseline credit assessment (BCA) of baa1, based on Moody's assessment of (1) low probability of extraordinary support by the municipalities that own EWE, due to the fragmented nature of EWE's municipal ownership; and (2) moderate dependence, given that a large part of EWE's revenues are generated within the regions and cities that also comprise EWE's municipal owners, but recognizing a portion of EWE's earnings are generated outside of Lower Saxony.

WHAT COULD CHANGE THE RATING UP / DOWN

The ratings could be upgraded following approval of the equity stake sale and clear visibility on long-term investment plans, following input from EWE's new equity owner. An upgrade would also need to show

continuation of FFO/net debt at least in the low twenties and RCF/net debt comfortably in the high teens, both in percentage terms. This ratio guidance could be amended as EWE's strategy is updated and the risk profile of its investment programme evolves.

Moody's could revise the outlook back to stable should the Federal Cartel Office fail to approve the equity stake sale. Moody's could also revise the outlook back to stable should financial performance deteriorate over the course of the next year such that FFO/net debt and RCF/net debt fall below the low twenties and the high teens, both in percentage terms, respectively.

While a downgrade is unlikely given the positive outlook, deterioration in FFO/net debt to below the high teens and deterioration in RCF/net debt to below the mid-teens, both in percentage terms, would warrant downward pressure. A change in EWE's business risk profile that would increase exposure to higher risk countries or result in increasing volatility of cash flows would also warrant downward pressure.

Headquartered in Oldenburg, Germany, EWE AG is one of Germany's largest regional utilities and provides energy distribution and supply as well as telecommunications and IT services to customers in the federal state of Lower Saxony and parts of eastern Germany.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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