Research Update:

Utility Eesti Energia Outlook Revised To Negative From Stable On Takeover Bid For Subsidiary Enefit Green; 'BB+' Rating Affirmed

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Rating Action Overview

- On March 27, 2025, Eesti Energia announced its plan to buy out the 22.8% minority interests in Enefit Green, its renewable subsidiary. The group estimates the move will strengthen competitiveness and we expect a boost in EBITDA by about €40 million-€50 million by 2027.
- However, given the transaction cost of about €205 million in 2025, funded principally with cash and new debt, the company faces high leverage even though it has reined in its renewable generation expansion plan.
- As a result, we revised our outlook on Eesti Energia AS to negative from stable and affirmed the 'BB+' issuer credit rating and the 'B' junior subordinated rating on the €400 million hybrid instrument.
- The negative outlook indicates we could lower the rating if funds from operations (FFO) to debt did not recover to above 19% by 2026, from our estimate of 17% in 2025.

Rating Action Rationale

The outlook revision reflects deterioration in Eesti Energia's credit metrics due to the announced takeover of Enefit Green, which it will fund with cash and debt. Specifically, the company expects to finance the transaction with cash and issuance of a new bond. We estimate Eesti Energia's S&P Global Ratings-adjusted FFO to debt will decrease to 17% in 2025 due to the €205 million takeover bid for Enefit Green and based on our assumption of no dividends distributed this year. In addition, we expect the company will only gradually deleverage to close to 19% in 2026, depending largely on EBITDA improvements coming from its more integrated group structure and the delisting of the Enefit Green subsidiary. This is absent any unexpected major integration missteps or other business disruptions.

We understand the delisting of Enefit Green could improve the competitiveness of Eesti Energia and its ability to hedge its retail and generation exposures. The termination of power purchase agreements between Enefit Green and Eesti Energia's retail subsidiary, as well as more efficient trading between the group entities and its dispatchable and flexible power generation fleets, could enhance its profitability. We will monitor risk management and improvement of hedges throughout the group as we consider the EBITDA as volatile and difficult to predict due to its large exposure to market prices in Estonia and neighboring countries.

We expect investments to roughly halve in 2025 year on year and halve again in 2026, with limited new projects at Enefit Green. Large projects like the new Enefit 280-2 oil production plant will be completed in 2025, and we now expect that, in order to protect leverage, the company will cut uncommitted growth capital expenditure (capex) related to renewable projects from 2025. This also reflects challenges in developing renewable projects because their rates of return are too low based only on merchant prices. Although protecting any further debt increase, the postponement of capex would keep the group from achieving its decarbonization targets and renewable EBITDA growth after 2028.

We continue to assess management and governance as moderately negative, now with a one-notch impact, based on company complexity, risk management and significant strategic shifts. We believe management of regulatory, market price, and volume risks is consistent with our updated view. This leads to relatively higher volatility in profitability and difficulty in predicting future cash flow generation compared with its closest peers. In addition, we will monitor reputational risks from strategy changes and communication consistency--depending notably on profitability improvements--and any impact on Eesti Energia's ease of funding.

The moderately negative management and governance is currently offset by a positive comparable rating analysis modifier which reflects expectations of credit metrics at the better end of the aggressive financial risk profile, using the standard volatility table under our criteria.

We expect the likelihood of support from the Estonian government to remain moderately high as the company is at the forefront of national energy objectives. We do not include a capital injection or dividend cuts in our base case as we believe such support from the Estonian state is uncertain and could fund additional capex. We continue to assess the likelihood of extraordinary government support to Eesti Energia as moderately high, based on our assessment of the company's:

- Strong link with the Estonian government, which owns 100% of Eesti Energia, with no expected change.
- Important role for the government, given that Eesti Energia's operations are strongly aligned with the government's interests, in particular ensuring that Estonia is self-sufficient in electricity.

Outlook

The negative outlook reflects our expectation that in 2025 Eesti Energia's FFO to debt will weaken below 19% before recovering to that level, or very close, in 2026. This is because we expect the EBITDA improvements from delisting Enefit Green will only be gradual while the transaction will increase net debt by €205 million in 2025. We expect a dividend cut in 2025 and resumed dividend distribution to the Estonian state from 2026.

Downside scenario

We could lower the rating if Eesti Energia's operating and financial performance does not improve so that FFO to debt does not recover to 19% in 2026. This could arise from:

- Power prices decreasing below €70 per megawatt hour(/MWh) in 2025-2027, leading to weaker generation earnings on merchant-exposed production as hedges are rolled over;
- Low power production on renewables and thermal units;
- Squeezed retail margins; and
- Increased investment or cost overruns--absent sufficient remedial measures like subsidies, proceeds from disposals, or dividend cuts.

We could also downgrade Eesti Energia if the volatility of its cash flow generation increases, notably alongside:

- Material decreases in regulated networks' EBITDA contribution, for example from adverse regulatory decisions;
- Delays in phasing out highly polluting oil shale plants with absence of supportive remuneration.

Weakening liquidity and any issues with covenant waivers could also pressure the rating. However, this is not our current base-case expectation.

Upside scenario

We could revise the outlook to stable on Eesti Energia if FFO to debt stabilizes above 19%, provided the business position does not weaken.

This would most likely result from:

- Stronger operating results due to higher Estonian area power prices, operating efficiencies for power generation, or positive revisions to the regulatory framework for electricity distribution; or
- Ongoing government support, for example in the form of dividend cuts or capital injections.

We could also revise the outlook to stable if FFO to debt stabilizes above 19% and Eesti Energia's cash flow volatility materially decreases based on:

- A higher share of earnings from regulated network activities;
- Capacity market mechanism, ensuring the continuity of supply during peak periods, on strategic reserve thermal plants; and
- Lower market price exposure with renewable generation contracts representing the bulk of cash flows.

Finally, should we perceive a higher likelihood of extraordinary support from the Estonian state, for example with guarantees on Eesti Energia's debt or material equity injections, we could revise the outlook to stable.

Company Description

Eesti Energia AS is a vertically integrated energy company based in Estonia, with limited international operations. It is 100% owned by the Estonian government. The company's main operation areas are:

- Electricity generation, with about 3.8 terawatt hours (TWh) of capacity;
- Oil shale production of about 451,000 metric tons;
- Electricity distribution, including 93% coverage in Estonia; and
- Related customer solutions.

Reported EBITDA amounted to €398 million in 2023. On average, about 60% of EBITDA comes from electricity and heat generation and the supply of electricity in Baltic countries; about 30% from regulated electricity distribution in Estonia; and 10% from natural gas sales, oil shale production, and other services, also mostly in Estonia. Unaudited reported EBITDA for 2024 amounted to €398 million.

Our Base-Case Scenario

Assumptions

- Estonian real GDP to expand by 1.9% in 2025, 2.5% in 2026, and 2.1% in 2027.
- Inflation: Consumer price index easing to 4.2% in 2025, 3.6% in 2026, and 2.2% in 2027.
- Subsidiary Enefit Green is 100% consolidated, no minority interest post transaction.
- Nord Pool electricity price in the Baltics remaining at about €80-€90/MWh in 2025-2027.
- Electricity generation:
- --Renewable generation at about 2.5 TWh in 2025 and increasing to around 3.5 TWh in 2027.
- --Thermal generation remaining at around 1.5 TWh -2.0 TWh in 2025-2027.
- Distribution system operation activities:
- --Average distribution tariff to remain stable during 2025-2027 with weighted average cost of capital (WACC) around 6.3%.
- --Stable volume levels over 2025-2027.
- EBITDA margin at about 19%-20% over 2025-2027.
- Cost of debt at about 6%-6.8% over 2025-2027.
- Net capex of about €360 million in 2025, then about €150 million-€200 million annually in 2026 and 2027.
- No dividends in 2025. Dividends of about €40 million-€60 million in 2026-2027 paid to the state.
- We exclude any potential capital injection from the state from our base case.

Key metrics

Eesti Energia AS--Forecast summary

Period ending	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. EUR)	2022a	2023a	2024p	2025f	2026f	2027f
EBITDA	343	430	398	390-410	390-420	420-450
Less: Cash interest paid	(19)	(60)	(96)	(100)-(85)	(90)-(75)	(90)-(75)
Less: Cash taxes paid	(12)	(25)	(8)	(9)-(11)	(15)-(30)	(20)-(30)
Funds from operations (FFO)	312	371	294	275-300	285-315	300-340
Capital expenditure (capex)	454	691	615	350-400	150-200	140-190
Dividends	56	82	88	0-15	60-80	45-65
Debt	796	1,543	1,425	1,700-1,800	1,650-1,750	1,550-1,650
Adjusted ratios						
Debt/EBITDA (x)	2.3	3.4	3.6	4.2-4.4	3.8-4.1	3.3-3.5
FFO/debt (%)	39.2	24.0	20.7	16-18	18-20	21-23

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. p--Preliminary. f--Forecast. EUR--euro.

Liquidity

We consider Eesti Energia's liquidity to be adequate, based on our estimate that cash sources will cover uses by more than 1.2x over the 12 months started Jan. 1, 2025, and our expectation that the company will negotiate successfully waivers on its covenants in case of breach. The debt maturity profile is relatively staggered, as Eesti Energia has a €600 million loan, of which €300 million matures in February 2028 and €300 million is amortizing.

Principal liquidity sources

Principal liquidity sources over the 12 months started Jan. 1, 2025, include:

- Cash and cash equivalents of about €460 million.
- Undrawn committed revolving credit facility and long-term loan agreements of €220 million maturing in more than one year.
- Our forecast of cash FFO of about €305 million.

Principal liquidity uses

Principal liquidity uses for same period include:

- Debt maturities of about €169 million.
- Working capital outflow of €63 million.
- Committed capex of about €360 million.
- €205 million for the purchase of Enefit Green shares.

Covenants

The company's €600 million syndicated loan documentation includes a default covenant based on a maximum adjusted net leverage ratio of 3.5x, along with a minimum debt service coverage ratio of 1.2x, both tested semi-annually. We see a risk that the 3.5x net leverage ratio covenant could be breached in 2025. Eesti Energia has a track record of obtaining waivers for its covenants and we expect it will do so and prevent a breach in 2025. We will closely monitor the situation as well as any negotiation process.

Environmental, Social, And Governance

Environmental factors are a highly negative consideration in our credit rating analysis of Eesti Energia. Its emissions are higher than those of many rated peers in Europe, at about 340 grams of carbon dioxide per kilowatt hour (gCO_2/KWh) for its total energy production and 440 gCO_2/KWh for electricity production. This ranks Eesti Energia at about the same level as Electricity Supply Board (378 gCO_2/KWh) but with higher pollution than CEZ a.s. (330 gCO_2/KWh) and Fortum including Uniper (320 gCO_2/KWh). That said, the company aims to increase its share of electricity generated from renewable sources to at least 80% by 2030, and targets carbon neutrality by 2045, which is in line with the Paris Agreement. However, the company plans to continue using oil shale in thermal power plants for security of supply, but to phase out this energy source during 2026-2030. This, in our view, places Eesti Energia in the bottom tier of performers when it comes to the energy transition.

Issue Ratings--Subordination Risk Analysis

Capital structure

Eesti Energia has about 40% of its debt at Enefit Green. There is limited subordination risk.

Eesti Energia issued a €400 million hybrid in July 2024.

Analytical conclusions

We rate the hybrid instrument 'B', two notches below the 'bb-' stand-alone credit profile (SACP) to reflect subordination (one notch as Estonia's jurisdiction is unranked) and deferral of interests.

Rating Component Scores

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Component	
Foreign currency issuer credit rating	BB+/Negative/--
Local currency issuer credit rating	BB+/Negative/--
Business risk	Fair
Country risk	Intermediate Risk
Industry risk	Intermediate Risk
Competitive position	Fair
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb-
Diversification/portfolio effect	Neutral/Undiversified
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Adequate
Management and governance	Moderately Negative
Comparable rating analysis	Positive
Stand-alone credit profile	bb-

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, Feb. 10, 2025
- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Eesti Energia Downgraded To 'BB+' From 'BBB-' On Elevated Leverage Expectations; Outlook Stable, March 13, 2025
- Eesti Energia AS , Oct. 15, 2024
- Research Update: Eesti Energia AS 'BBB-' Ratings Affirmed; Outlook Negative, Nov. 24, 2022

Ratings List

Ratings list		
Ratings Affirmed; Outlook Action		
	To	**From**
Eesti Energia AS		
Issuer Credit Rating	BB+/Negative/--	BB+/Stable/--
Ratings Affirmed		
Eesti Energia AS		
Junior Subordinated	B	