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Tear Sheet:
Západoslovenská energetika, a.s.

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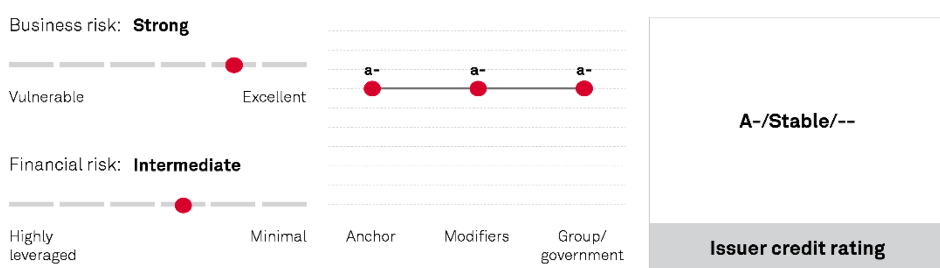
Ratings Score Snapshot



Recent Research

Given Západoslovenská energetika, a.s' (ZSE's) size, we expect its procurement-tariff price deficit will be steep in 2022 (about €90 million) due to the increase in power prices, which we anticipate will impact EBITDA and funds from operations (FFO) to debt. ZSE incurred network losses in year-end 2021, and the cost recovery mechanism embedded in the Slovakian regulatory framework means that the company is due to recover these losses with a two-year lag. Given the expected sizable financial impact, we understand the company is in talks with the Regulatory Office for Network Industries (RONI; the Slovak energy regulator), to be compensated earlier to mitigate the impact on the credit metrics. RONI is considering compensating for 2021 losses (about €30 million) and part of 2022 losses in 2022 (T+1 and T+0, respectively, versus T+2). We will monitor the negotiations and impact it might have on the credit metrics, although we are not concerned should the T+2 mechanism was to remain applicable for 2022 network losses.

We expect ZSE's EBITDA to decrease to €180 million-€190 million in 2022 from €265 million in 2021 absent any deficit correction resulting in FFO to debt between 19%-21%, still above the rating threshold of 18%. Depending on the degree of 2021-2022 loss deficit correction, we forecast EBITDA could reach between €200 million-€240 million in 2022 resulting in FFO to debt of 23%-30%,

On April 8, 2022, E.ON SE (BBB/Stable/A-2) and the Slovak Republic (A+/Negative/A-1), represented by the Ministry of Economy, entered into the agreement to consolidate ZSE and Vychodolosvenska Energetika Holding a.s. (VSE; not rated). VSE has similar operations as ZSE, as a natural monopoly in power distribution, but in eastern Slovakia. It supplies electricity and gas; it is 49% owned by E.ON and 51% owned by the Slovak state. In 2020, it posted EBITDA of roughly €127 million and reported debt stood at €232 million. The transaction was expected to close fourth-quarter 2022, but we now expect the transaction to close in first-quarter 2023 due to outstanding antitrust approval. VSE is considering a possible debt refinancing. Upon fulfilment of the conditions preceding transaction completion, ZSE will become VSE's sole shareholder. We will monitor the transaction to ascertain how it might affect ZSE's business and financial risk but overall, we would expect the transaction to have a modest positive impact due to increased economies of scale. Since leverage at VSE is lower than ZSE, we do not expect the enlarged group's debt leverage or credit ratios to materially change.

If the settlement results are in ZSE’s favor, losses related to gas supply reduction are expected to be covered by Gazprom due to the breach of contract. Gazrom reduced its supply to ZSE by 70% since June 2022, which resulted in a €8 million financial loss plus an expected up to €11 million of estimated replacement costs (incorporated in our forecast). ZSE is claiming the realized market loss from Gazprom, given the breach of volume-related contractual terms for 2023 deliveries.

Company Description

ZSE is the sole distribution system operator (DSO) in the relatively wealthy service area of Western Slovakia and has a very strong position as the region's electricity supplier. It is the largest of three regional DSO providers in the country (ZSE, Stredoslovenska energetika [SSE], and VSE). E.ON holds 49% of the shares in ZSE, the Western Slovakia distribution company; EP Infrastructure holds 49% of the shares in SSE, the distribution company operating in Central Slovakia; and E.ON holds 49% of the shares in VSE, the Eastern Slovakia distribution company. The remaining shares at each DSO are held by the state. Although ZSE is 51% state-controlled, the company's operations and strategy are sufficiently autonomous.

In 2021, ZSE distributed 9.9 terawatt-hours (TWh) of electricity throughout Western Slovakia (compared with 9.4TWh in 2020) and supplied 6.3 TWh of the power and 3.5TWh of gas.

At year-end 2021, ZSE posted EBITDA of €247 million (S&P Global Ratings-adjusted: €264 million) and financial debt of €657.7 million (S&P Global Ratings-adjusted: €678.4 million), which leads to our adjusted FFO-to-debt ratio of about 30%.

Outlook

The stable outlook reflects our forecast of continued stable and predictable earnings and cash flow from what we see as ZSE's relatively low risk regulated distribution business. We also anticipate that the utility will maintain its very strong retail supply position in its service area and will remain shielded against the current energy crisis.

Downside scenario

We could lower the rating on ZSE if we took a similar rating action on Slovakia and--at the same time--revised downward the utility's stand-alone credit profile (SACP) by one notch, assuming our view of extraordinary state support for ZSE does not change. We could also lower the rating if we revised the SACP downward by two notches.

We could consider revising the SACP if, for example, there were unexpected negative changes to the regulatory framework, the deficit resulting from network losses settlement on spot payments were not compensated under regulatory mechanisms in a timely manner, or ZSE's operating or capital investment costs were higher than the regulator allows. We could also revise downward the SACP if the utility's credit metrics weakened, notably if adjusted FFO to debt fell below 18% without any prospect of recovery. This could occur if the company adopted more aggressive shareholder policies in terms of leverage tolerance or dividend payouts.

Upside scenario

We see an upgrade as unlikely because ZSE has a stable cash flow profile combined with its aggressive financial policy. We could raise the rating on ZSE if we upgraded Slovakia, or if ZSE posted an adjusted FFO-to-debt ratio sustainably above 28%, assuming our view of the likelihood of extraordinary government support did not change.

Key Metrics

Company Name--Key Metrics*

Mil. $	2020a	2021a	2022e	2023f	2024f
EBITDA	256.9	264.9	180-190	240-250	270-280
Debt	586.9	678.4	680-690	680-690	680-690
FFO to debt (%)	37.5	30	19-21	25-27	30-32
Capital Expenditure	125	136	120-230	110-120	120-130

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Financial Summary

Zapadoslovenska energetika a.s.--Financial Summary

Period ending	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021
Reporting period	2016a	2017a	2018a	2019a	2020a	2021a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	1,001	1,065	1,125	1,285	1,211	1,341
EBITDA	198	203	207	246	257	265
Funds from operations (FFO)	155	145	145	210	210	204
Interest expense	26	23	26	19	19	19
Cash interest paid	22	22	22	19	19	19
Operating cash flow (OCF)	172	127	112	231	203	138
Capital expenditure	67	61	80	126	125	136
Free operating cash flow (FOCF)	105	66	32	105	78	2
Discretionary cash flow (DCF)	47	16	(38)	41	4	(88)
Cash and short-term investments	81	95	44	82	83	11
Gross available cash	81	95	44	82	83	11
Debt	569	553	609	587	587	672
Common equity	3	50	80	155	217	269
Adjusted ratios						
EBITDA margin (%)	19.7	19.0	18.4	19.1	21.2	19.7
Return on capital (%)	25.6	25.9	24.1	26.4	25.1	23.1
EBITDA interest coverage (x)	7.6	8.7	7.9	12.8	13.4	13.8

Zapadoslovenska energetika a.s.--Financial Summary

FFO cash interest coverage (x)	7.9	7.5	7.5	12.1	12.3	12.0
Debt/EBITDA (x)	2.9	2.7	2.9	2.4	2.3	2.5
FFO/debt (%)	27.3	26.2	23.9	35.8	35.7	30.3
OCF/debt (%)	30.2	23.0	18.4	39.3	34.5	20.5
FOCF/debt (%)	18.4	12.0	5.3	17.9	13.2	0.2
DCF/debt (%)	8.3	2.9	(6.3)	7.1	0.6	(13.1)

Peer Comparison

Zapadoslovenska energetika a.s.--Peer Comparisons

	Zapadoslovenska energetika a.s.	Electricity Supply Board	Alliander N.V.	CEZ a.s.	Electricity North West Ltd.
Foreign currency issuer credit rating	A-/Stable/--	A-/Stable/A-2	A+/Stable/A-1	A-/Stable/--	BBB+/Stable/A-2
Local currency issuer credit rating	A-/Stable/--	A-/Stable/A-2	A+/Stable/A-1	A-/Stable/--	BBB+/Stable/A-2
Period	Annual	Annual	Annual	Annual	Annual
Period ending	2021-12-31	2021-12-31	2021-12-31	2021-12-31	2021-03-31
Mil.	EUR	EUR	EUR	EUR	EUR
Revenue	1,341	5,319	2,120	9,035	522
EBITDA	265	1,493	776	2,081	336
Funds from operations (FFO)	204	1,214	670	1,750	210
Interest	19	155	44	191	99
Cash interest paid	19	168	41	189	92
Operating cash flow (OCF)	138	1,411	660	2,366	196
Capital expenditure	136	935	865	1,283	186
Free operating cash flow (FOCF)	2	476	(205)	1,082	10
Discretionary cash flow (DCF)	(88)	386	(303)	(42)	(46)
Cash and short-term investments	11	276	623	1,071	405
Gross available cash	11	276	623	1,091	405
Debt	672	5,770	2,590	7,569	2,119
Equity	269	4,111	4,522	6,544	797
EBITDA margin (%)	19.7	28.1	36.6	23.0	64.3
Return on capital (%)	23.1	5.7	5.2	4.0	6.5
EBITDA interest coverage (x)	13.8	9.6	17.7	10.9	3.4
FFO cash interest coverage (x)	12.0	8.2	17.3	10.3	3.3
Debt/EBITDA (x)	2.5	3.9	3.3	3.6	6.3
FFO/debt (%)	30.3	21.0	25.9	23.1	9.9
OCF/debt (%)	20.5	24.5	25.5	31.3	9.2
FOCF/debt (%)	0.2	8.3	(7.9)	14.3	0.5

Zapadoslovenska energetika a.s.--Peer Comparisons

DCF/debt (%)	(13.1)	6.7	(11.7)	(0.5)	(2.2)

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Rating Component Scores

Foreign currency issuer credit rating	**A-/Stable/--**
Local currency issuer credit rating	**A-/Stable/--**
Business risk	**Strong**
Country risk	Intermediate
Industry risk	Very Low
Competitive position	Satisfactory
Financial risk	**Intermediate**
Cash flow/leverage	Intermediate
Anchor	**a-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**a-**

Related Criteria

- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011