S&P Global
Ratings

RatingsDirect®

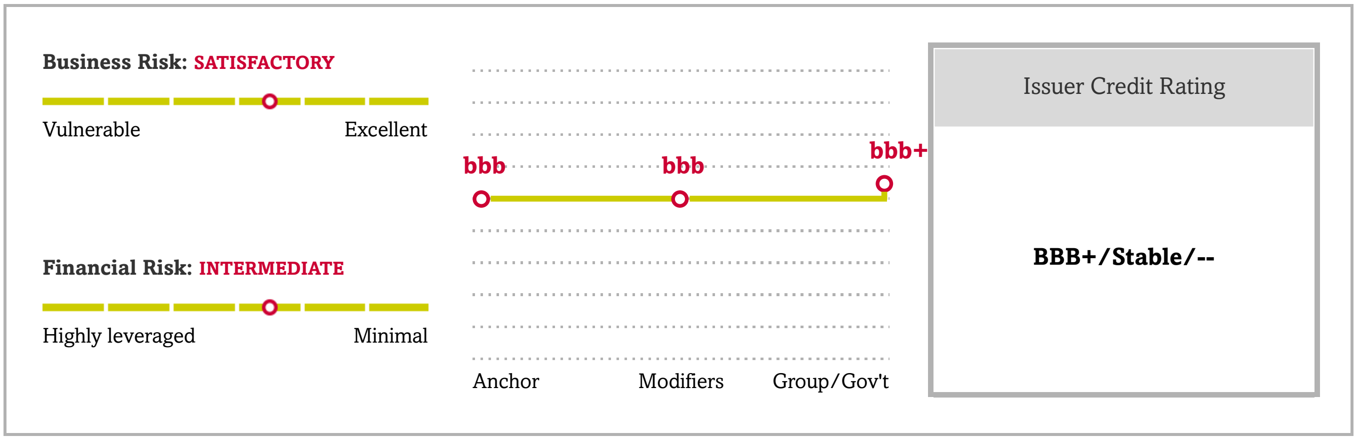
AB Ignitis grupe

Primary Credit Analyst:
Daniel Annas, Stockholm +46 (8) 4405925; daniel.annas@spglobal.com

Secondary Contact:
Per Karlsson, Stockholm + 46 84 40 5927; per.karlsson@spglobal.com

Table Of Contents

AB Ignitis grupe



Credit Highlights

Overview	
Key strengths	**Key risks**
Integrated utility with diversified revenues stream and about 40%-50% on average of EBITDA (€180 million-€200 million) from regulated activities during 2022 to 2024, with a supportive regulatory framework and predictable cash flows.	Increasing exposure to electricity market prices and production volume as Ignitis invests heavily in renewable generation; as a result, we expect the share of regulated contribution to total EBITDA could decrease to 30%-40% from 60%-70% historically, which implies higher earnings volatility.
Dominant market position in Lithuania, producing almost 50% of domestic generation and as such having an important role as a government vehicle to increase domestic generation and lower the country's electricity deficit.	Because of elevated energy prices, temporary regulatory differences are emerging and creating large working capital outflows. However, the Lithuanian Parliament has decided to compensate consumers directly from state budget.
Its renewable generation portfolio currently benefits from elevated electricity prices and boosts earnings thanks to low operational costs. We now forecast EBITDA to improve to €400 million-€440 million by 2022 from €335 million during 2022 and to improve toward €500 million by end-2024.	Ambitious step up in investments over the coming years, with planned annual investments of about €500 million during 2022-2024, up from €237 million in 2021, resulting in an almost doubling of debt toward €1,700 million at end-2024 from €983 million in 2021.
Expected timely support from the 74.99% owner, Lithuania (A+/Stable/A-1), providing Ignitis with a one-notch uplift from its stand-alone credit profile (SACP).	

S&P Global Ratings expects a solid improvement in EBITDA to about €400 million-€440 million in 2022 and 2023, up from €335 million in 2021, as Ignitis' unhedged generation portfolio is benefiting from elevated electricity prices. As a result of increasing installed generation capacity, the share of regulated contribution to EBITDA could shrink and cash flows could become more sensitive to market prices and therefore likely more volatile. However, Ignitis has signed long-term PPAs for the majority of its generation in the coming years, which should mitigate electricity price exposure and earnings volatility. Electricity prices have been significantly higher during 2022, averaging about €200/MWh in Lithuania in 2022 compared to €90/MWh during 2021. This has translated into improved cash flows from Ignitis' generation portfolio--mainly its renewable generation portfolio, which does not operate under regulated schemes with fixed prices. EBITDA contribution from its renewable assets therefore more than tripled to €119 million compared to same period last year (€36 million) as the group was able to capture the market price increase.

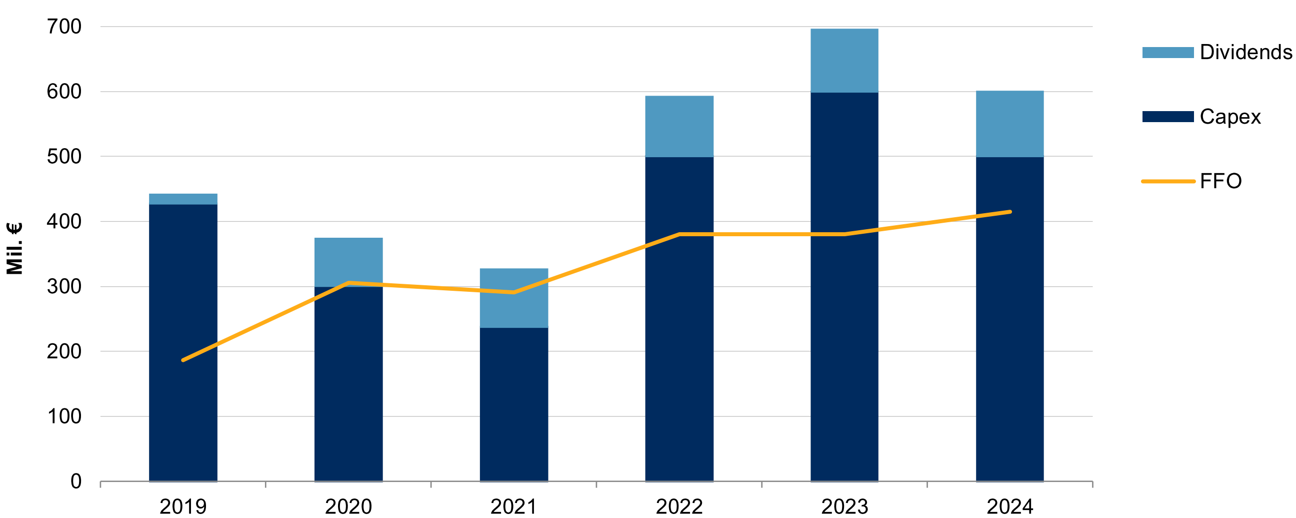
While EBITDA is increasing, the company's share of revenues exposed to market price volatility and volume risk has increased to about 60%-70%, up from 20%-30% in 2020-2021. We now believe that renewables will represent the majority of EBITDA mainly because of elevated power prices and the growth of installed capacity to about 60%-70% of total EBITDA as prices remains elevated and as Ignitis continues to expand its generation capacity.

As a consequence, its regulated activities--namely networks and its flexible generation, which we perceive to be more stable and predictable--will represent less than 50% of consolidated EBITDA. This will weigh on Ignitis' business risk, in our view, but we expect regulated earnings will still constitute a meaningful stake of above 40% on average and remain a corner stone of Ignitis' strategy. We also expect EBITDA from networks to gradually increase to about €200 million annually by 2025, up from €145 million in 2021, and that the company will continue to invest in regulated assets. This somewhat mitigates the increasing market risk exposure from its expansion into renewable generation. Over time we therefore anticipate the share of regulated earnings in total EBITDA will remain above 40% on average.

We expect Ignitis' credit ratios to benefit from elevated electricity prices, with FFO to debt of 25%-30% during 2022-2024.

Chart 1

Funds From Operations Don't Cover For Capex And Dividends - Debt increases



Source: S&P Global Ratings.

An ambitious step up in investments to €1.7 billion-€2.0 billion during 2022-2025 could result in negative cash flows and debt building up over time. Ignitis' investments are mostly in unsubsidized renewable generation assets, which carry both market price and volume risks and will increase earnings volatility and therefore business risk. Ignitis' renewable generation investments will likely constitute about 50%-60% of its total investments for 2022-2025. It has an ambitious target to reach 4.0GW renewable installed capacity by 2030, up from 1.2GW currently. Success will, however, depend on the offshore wind auction in Lithuania of 700MW expected in 2023. The company currently has renewable generation assets under construction of 186MW and another 212MW under development (advanced stage), and aims to develop a further 1,760MW of renewable capacity under development (early stage).

We also expect Ignitis will make significant investments in its networks of about €200 million annually on average, representing about 40% of total annual investments. This should translate into sustainable and predictable cash flows from regulated activities.

If regulated activities represent less than one-third of EBITDA on a sustainable basis, we could revise upward the credit ratios thresholds for the current rating. This is particularly notable if we assessed that its business risk had increased because of increased volatility. The supportive and predictable regulatory framework remains the key credit factor underpinning our assessment of Ignitis' satisfactory business risk profile as it enhances the group's cash flow stability. We expect Ignitis' electricity and gas networks to contribute €160 million-€200 million in EBITDA annually during 2022-2024, which should constitute at least one-third of total EBITDA.

Higher-than-expected energy prices have negatively affected working capital but the state has declared it will compensate the company for the regulatory outflows, although this comes with a delay. The set tariff for public supply regulation did not factor in electricity prices being as high as they have turned out to be so far during 2022. In fact, electricity prices have been significantly higher than anticipated, averaging about €200/MWh in Lithuania in 2022 compared to €90/MWh during 2021. This has resulted in Ignitis collecting lower tariffs than needed to match actual costs of electricity and led to a significant working capital outflow of about €170 million as of June 30, 2022. We understand that the working capital outflow has increased further since then. The government has announced a compensation plan of about €570 million, the majority of which will be used to reduce Ignitis' working capital needs and to limit the increase in customers' tariffs.

Maintaining a sufficient gas inventory has created a sizable capital tie-up for Ignitis given that gas prices have also been high. At the end of June, gas-related working capital had increased by another €200 million and will continue to increase. We note that Ignitis does not face any price risk related to its gas purchases and even earns a premium in the international market.

We understand that Ignitis' total working capital outflows have been significantly higher in 2022 than in previous years, reaching about €800 million as of June 30. To meet this Ignitis has signed bank facilities of €719 million.

In our view, Ignitis currently has sufficient liquidity and back-up facilities to meet the temporary peak in liquidity outflow. The company has shown its ability to access short-term bank funding amid tough market conditions. We also view positively the new mechanism for compensating consumers, which implies that the state will compensate them directly through a tariff implemented at the end of June 2022. This should decrease Ignitis' working capital needs. But if prices stay high, or even increase, the pressure on Ignitis' working capital is likely to remain elevated.

Ignitis is playing an increasingly important role in Lithuania's strategy to become less dependent on energy imports. In 2021 Lithuania only produced about 4.7 terawatt hours (TWh), which was almost 9% less than in 2020. The country is currently heavily dependent on electricity imports. In 2021 about 70% of its domestic demand for electricity was met via imports, of which about 17% was from Russia. Imports from Russia ceased in May 2022 and are now solely from Sweden, Poland, Estonia, and Latvia. Lithuania had already suspended interconnectors from Belarus during 2020.

Ignitis produce almost 50% of electricity in Lithuania.

In 2018, the state issued a "National Energy Independence Strategy" to decrease its dependency on electricity from other countries and increase renewables generation. The aim is that 45% of the country's electricity consumption will be from renewables by 2030 before increasing to 80% by 2050. We believe that Ignitis will play a key role in the government reaching these targets given its strong position as the national vehicle to carry out the investments and reach 2GW of developed capacity by 2024, if needed. Our 'BBB+' long-term rating on Ignitis includes one notch of uplift because we believe the government would support the company if it faced difficulties outside the ordinary course of business. We don't think the government will sell or dilute its ownership because we expect it to maintain its majority stake.

Outlook: Stable

The stable outlook on Ignitis reflects our expectation that the operating and regulatory environment will remain supportive over the next two years, mainly because of what we see as its relatively low-risk regulated distribution business. We also expect Ignitis will undertake asset rotations if needed to protect its credit ratios. We anticipate that its funds from operations (FFO) to debt will be 25%-30% during 2022-2024.

Downside scenario

We could lower the ratings if Ignitis' financial and operating performances materially deviate from our base case, leading us to revise down our assessment of its SACP. This could result from:

- Weaker and more volatile cash flows such that FFO to debt deteriorates significantly below 23% without any prospects for recovery;
- A large debt-financed acquisition amid the extensive investment program;
- Materially higher investments than our base case;
- Pressure on liquidity, which is not our base case; or
- If regulated earnings represent on average less than one-third of total EBITDA.

We could also lower the rating if we see a reduced likelihood of the company receiving extraordinary support from the Lithuanian government, which we do not expect.

Upside scenario

We see rating upside as unlikely mainly due to Ignitis' heavy investment program. However, we could raise the ratings on the company if we revised the SACP up to 'bbb+', which could happen if the group achieved FFO to debt sustainably above 30% with neutral to slightly negative discretionary cash flow.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Lithuania of 1.7% during 2022.
- WACC for gas networks at 3.98% for 2022 and 2023, and 4.16% for electricity distribution networks.
- Elevated power price in Lithuania will continue with prices well above €150/MWh for the remaining of 2022 and during 2023.
- Working capital seasonal peaking at €800 million.
- Interest costs of about €30 million-€40 million annually.
- Annual dividends will increase gradually toward €110 million by 2024 from about €85 million in 2021.

Key Metrics

AB Ingitis grupe--Key Metrics

(Mill. €)	2021a	2022p	2023f	2024f
EBITDA	335.0	400-440	400-440	450-490
Funds from operations (FFO)	290.8	360-400	360-400	390-430
Capital expenditure	237.8	480-520	500-600	450-550
Dividends	87.8	88.0	100-110	100-120
Debt	983.4	1400-1500	1500-1600	1600-1700
Debt to ebitda (x)	2.9	3.0-3.5	3.0-3.5	3.0-3.5
FFO to debt (%)	29.6	25-30	25-30	25-30

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

Ignitis' investments in additional renewables generation should return healthy cash flows as capacity increases and prices remain high, but will not cover its ambitious investment plan. We expect debt to nearly double from what it was in 2021 and reach almost €1,700 million by end-2024. But given its increased earnings from renewables generation in 2022--in which prices were not hedged nor under a PPA or a subsidy scheme and so fully captured elevated electricity prices--Ignitis' FFO is significantly improved. As Ignitis has now signed long-term PPA contracts for the majority of its generation, we do not expect a similar price realization in 2023 and onward, as in 2022, but that EBITDA will remain at higher levels compared to 2021. However, because of its large capex needs, we expect negative discretionary cash flows and increasing debt and funding needs. We therefore forecast FFO to debt at 25%-30% in 2022-2024.

Company Description

Ignitis is a leading utility and renewable energy company in the Baltic region. Its core business is operating electricity and gas distribution networks and managing and developing its green generation portfolio. The group also manages strategically important flexible generation assets and provides customers and solutions services, including the supply of electricity and gas, solar, e-mobility, improved energy efficiency, and innovative energy solutions for households and businesses.

The company's reported EBITDA was €335 million in 2021. Electricity and gas distribution networks represented 44% of its adjusted EBITDA in 2021, and green generation represented 32% of total adjusted EBITDA. Its strategy is to expand its renewable generation portfolio and reach 4GW of installed capacity by 2030. Its electricity generation fleet has a capacity of 2,156MW. In 2021, the company distributed 10.4TWh of electricity to 1.8 million customers across Lithuania and generated about 2.3TWh of electricity. The Lithuanian government, represented by the Lithuanian Ministry of Finance, owns 74.99% of the group.

Peer Comparison

Table 1

AB Ignitis grupe (publ)--Peer Comparison

Industry sector: Electric

	AB Ignitis grupe	**Eesti Energia AS**	**Augstsprieguma Tikls**	**MVM Group**
Rating	BBB+/Stable	BBB-/Negative	A-/Stable	BBB-/Stable
Sovereign Rating	Lithuania: A+	Estonia: AA-	Latvia: A+	Hungary: BBB
% of Government Ownership	74.99%	100%	68%	100%
Role	Important	Important	Very Important	Very Important
Link	Strong	Strong	Strong	Strong
Likelihood of Extraordinary Support	Moderately High	Moderately High	High	High
GRE-Uplift	SACP: +1 notches	SACP: +2 notches	SACP: +2 notches	no uplift
SACP	bbb	bb	bbb	
Business Risk Profile	Satisfactory	Satisfactory	Strong	Satisfactory
Country Risk	Intermediate	Intermediate	Intermediate	Intermediate
Industry Risk	Low	Intermediate	Very low	Intermediate
Competitive Position	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Financial Risk Profile	Intermediate	Aggressive	Intermediate	Intermediate
Anchor	bbb	bb	bbb+	bbb-
Modifiers				
Diversification/portfolio effect	Neutral	Neutral	Neutral	Neutral
Capital Structure	Neutral	Neutral	Neutral	Neutral
Liquidity	Adequate	Adequate	Adequate	Strong
Financial Policy	Neutral	Neutral	Neutral	Neutral
Management / Governance	Satisfactory	Satisfactory	Fair	Fair
Comparable Rating Analysis	Neutral	Neutral	Negative (-1n notch)	Neutral
	--Fiscal year ended Dec. 31, 2021--			
(Mil. €)				
Revenue	1,868.9	1,313.0	127.5	7,725.7
EBITDA	335.1	292.9	90.6	667.7
Funds from operations (FFO)	290.8	272.6	87.8	457.2
Interest expense	23.6	29.3	2.1	36.6
Cash interest paid	26.0	19.3	2.7	27.6
Cash flow from operations	73.6	178.8	91.0	1,748.3

Table 1

AB Ignitis grupe (publ)--Peer Comparison (cont.)

Industry sector: Electric

	AB Ignitis grupe	Eesti Energia AS	Augstsprieguma Tikls	MVM Group
Capital expenditure	237.8	217.5	32.0	645.5
Free operating cash flow (FOCF)	(164.2)	(38.7)	59.1	1,102.8
Discretionary cash flow (DCF)	(278.7)	(38.7)	51.1	1,102.2
Cash and short-term investments	448.5	198.0	48.5	2,076.0
Debt	983.4	784.1	69.1	18.2
Equity	1,849.0	2,465.6	465.3	5,778.6
Adjusted ratios				
EBITDA margin (%)	17.9	22.3	71.0	8.6
Return on capital (%)	8.0	3.9	9.9	0.7
EBITDA interest coverage (x)	14.2	10.0	43.8	18.2
FFO cash interest coverage (x)	12.2	15.1	33.3	17.6
Debt/EBITDA (x)	2.9	2.7	0.8	0.0
FFO/debt (%)	29.6	34.8	127.1	2,517.1
Cash flow from operations/debt (%)	7.5	22.8	131.7	9,625.7
FOCF/debt (%)	(16.7)	(4.9)	85.4	6,071.8
DCF/debt (%)	(28.3)	(4.9)	73.8	6,068.5

Financial summary

Table

AB Ignitis grupe--Financial Summary

Industry sector: Combo

	--Fiscal year ended Dec. 31--				
	2021	**2020**	**2019**	**2018**	**2017**
(Mil. €)					
Revenue	1,868.9	1,215.4	1,080.6	1,024.3	1,081.2
EBITDA	335.1	333.7	205.9	140.8	227.8
Funds from operations (FFO)	290.8	305.5	186.5	123.3	213.7
Interest expense	23.6	23.0	15.9	13.2	7.9
Cash interest paid	26.0	18.7	14.8	11.2	4.5
Cash flow from operations	73.6	264.3	163.4	168.5	131.6
Capital expenditure	237.8	300.6	427.5	415.4	232.5
Free operating cash flow (FOCF)	(164.2)	(36.2)	(264.1)	(247.0)	(100.9)
Discretionary cash flow (DCF)	(278.7)	(108.8)	(278.0)	(327.6)	(166.3)
Cash and short-term investments	448.5	657.3	130.7	127.8	171.8
Gross available cash	448.5	657.3	130.7	127.8	171.8
Debt	983.4	666.6	989.9	763.5	464.3
Equity	1,849.0	1,843.8	1,348.6	1,302.5	1,343.6
Adjusted ratios					
EBITDA margin (%)	17.9	27.5	19.1	13.7	21.1

Table

AB Ignitis grupe--Financial Summary (cont.)

Industry sector: Combo

	--Fiscal year ended Dec. 31--				
	2021	**2020**	**2019**	**2018**	**2017**
Return on capital (%)	8.0	9.1	4.4	2.8	8.2
EBITDA interest coverage (x)	14.2	14.5	12.9	10.7	28.7
FFO cash interest coverage (x)	12.2	17.4	13.6	12.0	48.4
Debt/EBITDA (x)	2.9	2.0	4.8	5.4	2.0
FFO/debt (%)	29.6	45.8	18.8	16.2	46.0
Cash flow from operations/debt (%)	7.5	39.7	16.5	22.1	28.3
FOCF/debt (%)	(16.7)	(5.4)	(26.7)	(32.3)	(21.7)
DCF/debt (%)	(28.3)	(16.3)	(28.1)	(42.9)	(35.8)

Liquidity: Adequate

We assess the company's liquidity as adequate. We project sources of liquidity to cover uses by about 1.2x over the next year. Qualitative factors that support our assessment include its good relationships with local banks, seen during the recent and quick expansion of its short-term credit facilities of €719 million. These facilities were needed to meet increasing working capital requirements during 2022 when the government required Ignitis to temporarily cover grants payments to its customers. We believe its access to local bank financing is further supported by its status as a state-owned entity and we think the state would provide liquidity support if needed. Ignitis being the operator of nonreplaceable infrastructure further underpins our view.

We note that Ignitis relies mostly on local banks and its access to the international bond markets would likely be weaker. This reflects the fact that it rarely accesses the capital markets and that Lithuania's proximity to Russia may have further decreased its market access. We do not believe Ignitis could easily absorb a high-impact, low-probability event without refinancing. Such an event could create a major cost over-run of its capex plans or lead to operating challenges at any of its major power generating plants. We do not expect Ignitis will be required to compensate consumers without the government reimbursing Ignitis within a short time frame.

Principal liquidity sources as of Sept. 30, 2022, include:

- €290 million of unrestricted cash and cash equivalents;
- About €350 million of cash FFO;
- Unused bank facilities of about €270 million maturing in second-half 2024; and
- Working capital inflow of about €365 million.

Principal liquidity uses

- €310 million of debt due within the next year;
- €500 million-€600 million of capex; and
- €90 million-€110 million in dividends.

Debt maturities

Ignitis has no maturing or refinancing needs until 2027 when one bond of €300 million matures followed by another of a similar amount in 2028.

Covenant Analysis

Ignitis has a loan agreement with the European Investment Bank that includes several covenants, including maintaining an investment-grade rating.

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 Indicators: Definition And Applications," published Oct. 13, 2021.

Government Influence

The ratings on Ignitis benefit from one notch of uplift owing to our view of a moderately high likelihood of timely and sufficient extraordinary government support in case of financial distress. This reflects our assessment of Ignitis':

- Strong link with the Lithuanian government, its sole owner through the Ministry of Finance. We believe the government's 74.99% stake in the company is unlikely to change, and that the government will remain the controlling party; and
- Important role for the government. Ignitis' operations are strongly aligned with the state's interest, particularly ensuring Lithuania's self-sufficiency in electricity and its commitment to become net carbon-dioxide-neutral.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/--

Business risk: Satisfactory

- **Country risk:** Intermediate
- **Industry risk:** Low
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb

Modifiers

- **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 : bbb

- **Related government rating:** A+
- **Likelihood of government support:** Moderately high (+1 notch from SACP)

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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of November 11, 2022)*

AB Ignitis Group	
Issuer Credit Rating	BBB+/Stable/--
Senior Unsecured	BBB+
Issuer Credit Ratings History	
12-Nov-2020	BBB+/Stable/--
31-May-2019	BBB+/Negative/--
18-Oct-2017	BBB+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.