4 November 2020 | Corporates

Green Network S.p.A
Italian Republic, Utilities

STABLE
BBB-

Corporate profile

Established in 2003, Green Network Group is an Italian energy (electricity and gas) retailer and wholesaler primarily serving corporate end-customers in the country. From 2021, it will also distribute energy in France. The company serves around 300,000 end-customers and its business is supplemented by power generation (biomass, solar and wind) through direct and indirect subsidiaries.

Green Network is entirely owned by the two founding partners, Piero Saulli (chairman) and Sabrina Corbo (executive vice president), under the roof of SC Holding S.r.l.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2020***	**2021F**	**2022F**
EBITDA/interest cover (x)	5.9	18.1	5.8	5.6
Scope-adjusted debt (SaD)/EBITDA (x)	4.6	0.7	2.1	1.8
Scope-adjusted funds from operations/SaD	17%	133%	38%	44%
Free operating cash flow/SaD	73%	104%	10%	19%

*annualised

Rating rationale

Scope Ratings assigns a BBB-/Stable first-time issuer rating to Italian utility company, Green Network S.p.A. along with an S-2 short-term rating and a BBB- senior unsecured debt rating.

Green Network's business risk profile is supported by its coverage of a niche energy supply market (electricity and gas). Current developments in the Italian market, especially with regulated tariffs ending by 2022, could also benefit the company. Nevertheless, the business risk profile is constrained by its high churn rate, low diversification and low profitability.

The overall issuer rating is mainly supported by the financial risk profile, which is significantly stronger than the business risk profile. Despite volatility in credit metrics over the past few years, Green Network's leverage (measured by Scope-adjusted debt/EBITDA) has been low and is expected to be around 2x in the future, which includes converted debt-like payables arising from the agreement with E-Distribuzione. We believe there is further potential for deleveraging, via positive expected discretionary cash flow and the collection of intergroup receivables, primarily from UK-based sister company Green Network UK plc. The overall issuer rating is also supported by the conservative financial policy, with no plans for M&A nor dividend distributions.

Ratings & Outlook

Corporate rating	BBB-/Stable
Short-term rating	S-2
Senior unsecured debt	BBB-

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Related Methodologies

Corporate Rating Methodology, 26 February 2020

European Utilities Rating Methodology, 18 March 2020

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Outlook

Stable Outlook

The Stable Outlook for Green Network incorporates no further large acquisitions and the continued support of one notch awarded to the rating, reflecting our perception of management's conservative financial policy. As a result, the Stable Outlook encompasses our view that indebtedness will remain low (with a leverage of below 2.5x) while the interest coverage will remain stable. It also incorporates Green Network's niche position in Italy and our perception that the company's EBITDA margin will improve to around 5% thanks to its strategic change.

Ratings upside

A positive rating action could happen if Green Network improves its business risk profile, for example, through greater stability in cash flow generation and higher operating margin levels in the next couple of years.

Ratings downside

The rating could come under pressure if Green Network's leverage moves towards 3x. This could be due to debt-financed M&A, or dividends distributed at a level that is harmful to the financial risk profile. Higher cash outflow through intercompany loans to the UK business could also put the rating under pressure. A rating downgrade could be triggered following a removal of the rating uplift provided by financial policy.

Rating drivers

Positive rating drivers	Negative rating drivers
• Coverage of niche in energy supply (electricity and gas) for SMEs, large industrial companies and residential customers, with more than 300,000 contracts • Trends on Italian market, especially with regulated tariffs ending by 2022 (credit-positive ESG factor) • Strategic shift to focus on margins rather than volumes • Low indebtedness • Positive discretionary cash flow providing further room for deleveraging • Factoring and insurance coverage largely ensuring cash collection • Moderate and robust interest coverage	• High churn rate, a market feature in Italy • Modest share on both electricity market and gas market • Low geographical diversification • Risk of only partial collection on intercompany receivables or further cash outflow from increased intercompany financing

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Greater stability in cash flow generation • Higher operating margin levels in the next couple of years	• Leverage of towards 3x • Potential removal of the rating uplift provided by financial policy • Higher intercompany loan exposure

Financial overview

			Scope estimates		
Scope credit ratios	**2018**	**2020***	**2021F**	**2022F**	**2023F**
EBITDA/interest cover (x)	5.9	18.1	5.8	5.6	5.7
Scope-adjusted debt (SaD)/EBITDA	4.6	0.7	2.1	1.8	1.5
Scope-adjusted funds from operations/SaD	17%	133%	38%	44%	53%
Free operating cash flow/SaD	73%	104%	10%	19%	23%
Scope-adjusted EBITDA in EUR m					
EBITDA	19.5	153.1	47.2	45.6	44.8
Operating lease payments in respective year	2.2	-	-	-	-
Other	-0.8	-1.1	-1.1	-1.1	-1.1
Scope-adjusted EBITDA	**20.8**	**152.0**	**46.0**	**44.5**	**43.6**
Scope-adjusted interests in EUR m					
Interest paid	7.6	14.7	9.1	9.0	8.8
less: interest received	-3.3	-5.2	-	-	-
add: interest on pensions					
add: operating leases interests	0.3	-	-	-	-
Other	-1.4	-1.1	-1.1	-1.1	-1.1
Scope-adjusted interests	**3.2**	**8.4**	**8.0**	**7.9**	**7.7**
Scope-adjusted debt in EUR m					
Reported gross financial debt	110.5	81.9	78.3	74.4	74.4
Add: debt-like payables (E-Distribuzione)	-	134.0	127.0	104.9	84.2
add: other debt	-	-	-	-	
less: cash and cash equivalents	-31.6	-108.9	-108.1	-97.6	-92.4
add: cash not accessible	-	-	-	-	-
add: pension adjustment	-	-	-	-	-
add: operating lease obligations	6.6	-	-	-	-
Scope-adjusted debt	**85.5**	**106.9**	**97.2**	**81.6**	**66.2**

*annualised

Business risk profile

Green Network's business risk profile (assessed at BB-) is supported by its niche market position in Italy, but constrained by its low profitability and diversification.

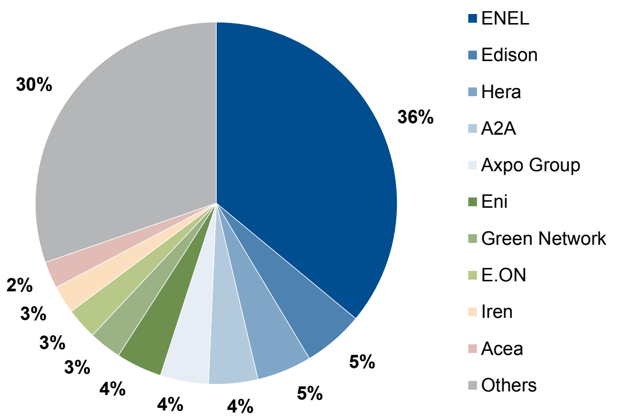
Power supply highly fragmented and dominated by incumbents

Power supply is a highly competitive segment with low entry barriers, dominated by the supply divisions of the large European incumbents (e.g. Iberdrola, Gas Natural Fenosa, EDF, Engie, Uniper, and RWE). Smaller players therefore need to find market niches or establish a supply model that provides a competitive edge, e.g. by procuring own generation capacities or entering into long-term power purchase agreements (PPAs) with other power generators.

Modest market shares in relation to overall market consumption volumes

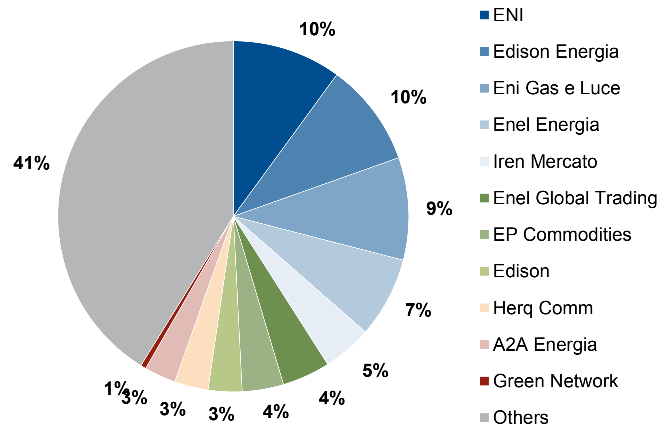
While Green Network's growth in power supply has been strong over the past four years (from 120,000 customer points with 4TWh in 2016 to more than 300,000 customer points with around 10TWh in 2019/2020), primarily as a result of its portfolio, its overall shares in relevant markets remain very modest at around 3% for electricity, far behind Enel's 36%, and less than 1% for gas.

Figure 1: Electricity market shares in Italy



Source: Green Network, Scope

Figure 2: Gas market shares in Italy



Source: Green Network, Scope

Uncertainty of Italian tariff liberalisation on Green Network's business

In 1999, the Italian Parliament approved the liberalisation of electricity prepared by the government according to the deadlines set in the European Commission Directives. The implementation of the EC Directive on electricity was given by the Bersani Decree (Law 79/99) in February 1999 and led to the dismantlement of Enel (electricity), the creation of an independent system operator (Gestore della rete di trasmissione nazionale, Grtn), which remains state owned, the organisation of the wholesale market as a pool market run by Gestore del mercato elettrico (owned by Grtn), the prohibition for a firm to own more than 50% of total installed power or to sell more than 50% of total energy (including imports), and the progressive access of the Italian market to eligible clients (mainly industrial companies and consortiums).

In 2000, the Italian Parliament also approved the liberalisation of gas prepared by the government according to the deadlines set in the EC Directives. This led to the dismantlement of Eni following the legal separation of its transport and storage activities, and the introduction of third-party access with regulated tariffs as defined by the regulator. The EC Directives also led to the introduction of antitrust ceilings in the interim period of liberalisation: i) from January 2002, no single operator could enter more than 75% of gas into the national transport network, with this threshold reduced by 2% each year until 2010, with a final market share of 61%; and ii) from January 2003 to December 2010, firms were prohibited to sell more than 50% of gas to end-customers.

However, the full switch to a liberalised electricity market, initially planned for 2019, has been postponed twice, to 2020 and now to 2022. The rationale is that the market is too concentrated and consumers are unable to make an informed choice.

Under the current regulatory scheme, Italy's electricity customers are still mainly supplied by local incumbents at a regulated price (53.5% of residential customers and 40.9% of SMEs). The phase-out of the regulated tariffs should lead to 27m 'new' customers (mostly from Enel) on the free market (credit-positive ESG factor), some of which could go to Green Network. Nevertheless, the end of regulated tariffs could be an opportunity for European incumbents to enter the market.

Current trends on Italian market could benefit Green Network

Current trends on the Italian market could be an opportunity for Green Network to keep growing. Gestore dei Mercati Energetici SpA (Italian power exchange) will reduce payment terms to seven days, which will exert more cash flow pressure, especially on weaker or smaller players (around 30% of the market). The pressure on cash flow for smaller players will also come from higher capex due to the need for digitalisation. Market liberalisation is also expected to intensify price competition, compounding the risks for smaller and weaker players. Green Network also asserted that the new consumers' needs will limit cross-selling. Overall, Green Network expects these developments to lead to small players progressively exiting the market, which could be an opportunity for Green Network to secure new customers.

Strategic shift: focusing on margins rather than volumes

Since 2016, Green Network has been focusing on the acquisition of more profitable clients and the optimisation of its customer base. As a result, the group has decreased its contracts with energy-intensive clients, which normally entail high volumes but low margins, to foster a more profitable residential and SME customer base. To reduce the risk exposure to SMEs, 99% of SME receivables are covered by Euler Hermes. During the management meeting, Green Network also asserted that bad debtors account for less than 1% of the total.

No upcoming change regarding market developments outside Italy over the next few years

Despite the anticipated increase in customers by 2027 (from 300,000 to 500,000), Green Network will remain a niche player. In addition, Green Network's growth ambitions in non-domestic markets are limited (retail activity to begin in France in 2021; no other developments disclosed).

High churn rate

Italian market is characterised by high churn rates, and Green Network is no exception, with an average of 50%. The company is seeking to decrease its average churn rate to 30%, by implementing a loyalty programme (e.g. by being in contact with clients and offering premiums and discounts), helping to decrease customers' overall electricity bills and offering a new e-commerce channel (Green Network Store). The expected churn rate remains high.

PPAs and hedging secure competitive edge in electricity supply

The company mitigates execution risks on volume growth in its home market by closing PPAs. Green Network does not disclose existing PPAs, but its relationships with large industrial companies provide a competitive advantage on the PPA market. On the one hand, sourcing electricity through PPAs safeguards Green Network's ability to provide competitive pricing for end-customers, compared to procuring the required energy volumes in the spot market. On the other hand, they could be harmful if agreements are set at a higher price than the selling price.

The group also sells gas and electricity to end-customers at both fixed and variable prices. To minimise the risk deriving from the simultaneous sale at a fixed price from variable-price procurement, the company uses hedging to fix the procurement price for volumes estimated to be sold at a fixed price.

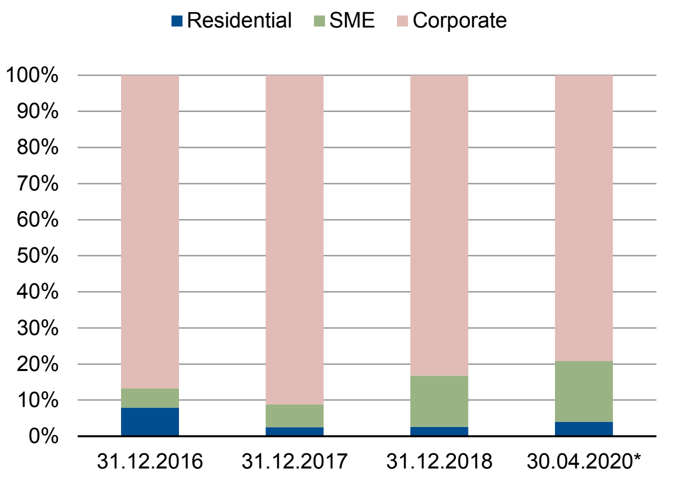
Low geographical diversification

Risk mitigation through geographical diversification is low. Energy is supplied only in Italy, with some concentration in the north, while almost all energy is generated in Italy. From 2021, Green Network will have retail activity in France. Nevertheless, we can expect revenue in France to be low, especially at the beginning, as that market can be tough to penetrate due to mistrust in new market players and a lack of information about switching providers.

Spread across SMEs, large and residential customers

In power supply, the spread across more than 300,000 service points (230,000 customers for electricity; more than 80,000 for gas) provides further risk mitigation. Nevertheless, all points are located in Italy. We can expect some improvement in terms of localisation with the retail activity in France from 2021. To be noted is that Green Network is shifting its strategy away from large volumes and towards higher margins. Indeed, large volumes with low margins were recorded among the large corporate clients. The new strategy is to focus on SMEs and residential customers to generate higher margins.

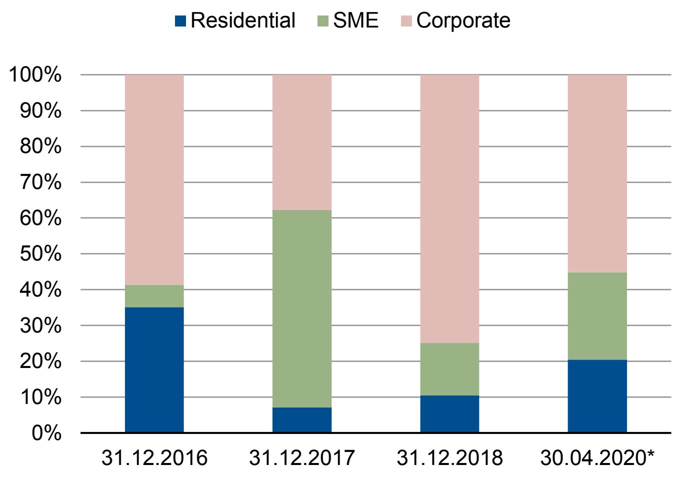
Figure 3: Customer split in supplied power volume



*from January 2019 to April 2020

Source: Green Network, Scope

Figure 4: Customer split in supplied gas volume



*from January 2019 to April 2020

Source: Green Network, Scope

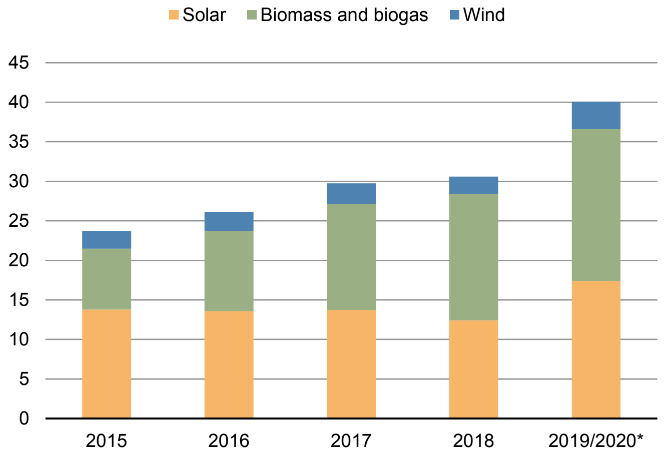
Energy generation: a minor activity

Generation business is minor for the group, at less than 1% of net sales. Almost all of its generation assets are located in Italy (seven relevant sites and less important sites, generating two-thirds of total power output), with the remainder in Romania (one site, generating one-third of total power output but more two-thirds of total solar output). The current generation fleet is made up of solar parks in Italy and Romania as well as biomass and biogas plants and wind parks, but only in Italy.

Low and fluctuating profitability, which should improve in the coming years

Green Network's Scope-adjusted EBITDA margin has fluctuated between 1% and 6%. The margin is likely to improve thanks to the strategic change. Incorporating the company's new strategy and the market's evolution, Green Network's profitability is expected to decrease from 6.2% in 2019/20 to 4.8% in 2020/21 and 4.7% in 2021/22.

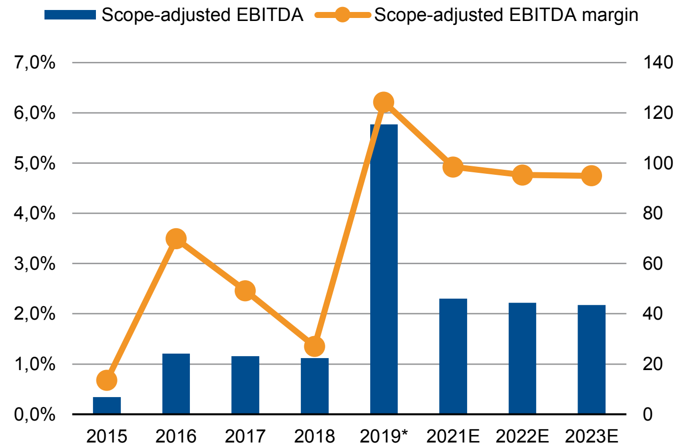
Figure 5: Generation fluctuation in existing generation portfolio (in GWh)



*from January 2019 to April 2020

Source: Green Network, Scope

Figure 6: Scope-adjusted EBITDA (in EUR m) and EBITDA margin



*from January 2019 to April 2020

Source: Green Network, Scope

Negative impacts from Covid-19 crisis have been offset

In Italy, the Covid-19 crisis resulted in electricity demand decreasing by 18% between March 2019 and 2020. For Green Network, volumes sold went down by 13% between March 2019 and 2020 and 32% between April 2019 and 2020. The lower demand was mainly driven by lower activity among large companies, by respectively 27% and 85% YoY in March and April 2020). Nevertheless, the lower consumption has been offset by the positive effect caused by a decrease in forward prices.

Financial risk profile

Green Network's financial risk profile (assessed at BBB+) supports the overall issuer rating. We expect Green Network's leverage ratio to be under 2.5x in the medium term and its interest cover ratio to remain around 6x.

Rating reflects low leverage

In previous years, Green Network's leverage was volatile, ranging from below 2.0x in 2015/16 to above 4.0x in 2017/18, a result of customer portfolio acquisitions in 2017 and 2018. Nevertheless, our rating case reflects a leverage ratio, including debt agreements with E-Distribuzione[1], of 2.3x at the end of the current business year, with a gradual shift to 1.7x by the business year ending in April 2023, bolstered by our expectations of a gradual reduction in net debt and a broadly flat EBITDA development. We flag that the development of leverage could materially be affected by receivables from affiliates, primarily regarding the roughly EUR 100m receivable (as of July 2020) from sister company Green Network UK plc, a subsidiary of SC Holding S.r.l. A net reduction in intragroup receivables through cash collection could further decrease Green Network's leverage. Vice versa, additional financial support of the sister company through an extension of intercompany loans would hold back Green Network's anticipated deleveraging. Overall, we deem the company's comparatively low leverage to hugely support its credit strength.

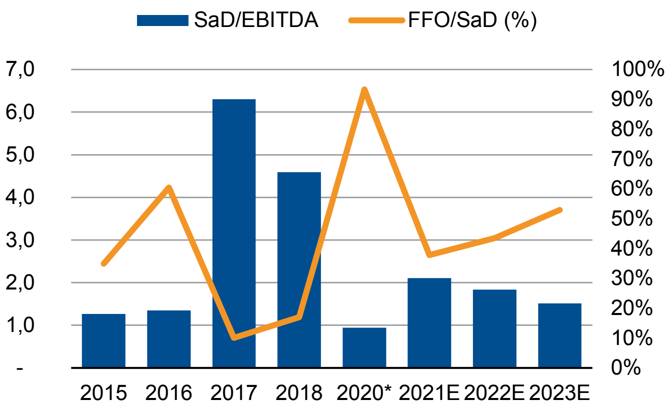
Moderate and robust interest coverage

Green Network's debt protection – as measured by Scope-adjusted EBITDA/Scope-adjusted interest – is assessed to be moderate, standing at around 6x. We expect debt protection to remain at the current level, reflecting our forecasts about a broadly flat

[1] Green Network S.p.A. entered legal proceedings against companies in the Enel Group to claim back approximately EUR 340m in system costs that Green Network claimed had been unduly paid. As a result, the company's total trade debt to Enel Distribuzione S.p.A. (ED) equalled about EUR 343m in February 2020. The parties negotiated to write off 50% of the trade debt (61% including VAT) to a net amount of EUR 171m. This write-off was in exchange for, among other things, abandoning proceedings and part of the written-off balance. On 29 April 2020, the two parties agreed to this amount. The remaining debt, net of VAT resulting from the write-off and amounting to EUR 134m, will be repaid according to a structured six-year plan consistent with the 2020-26 business plan.

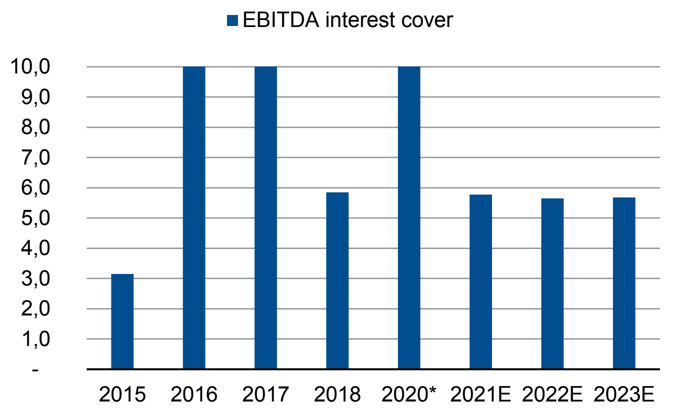
EBITDA development and the company's organic growth plan, which entails no significant, newly debt-financed activities.

Figure 7: Scope-adjusted leverage



*annualised Source: Green Network, Scope

Figure 8: EBITDA interest coverage



*annualised Source: Green Network, Scope

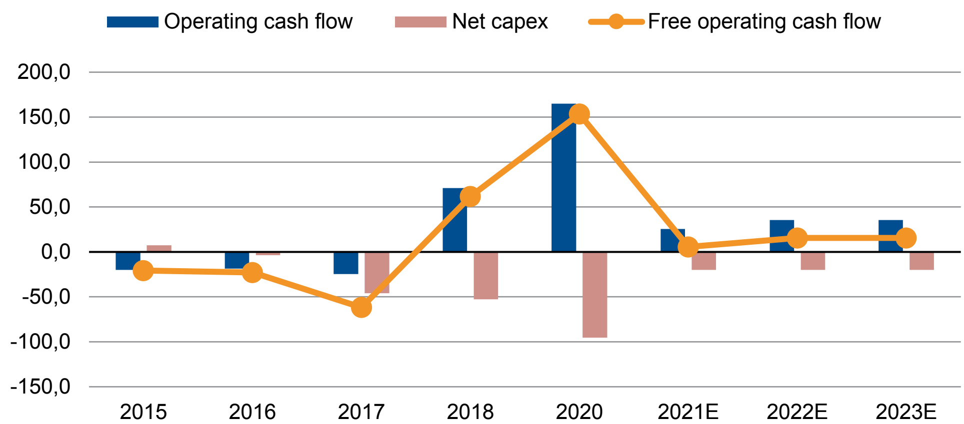
Positive discretionary cash flows provide further room for deleveraging

We expect Green Network's operating business to broadly cover debt service and net investment needs. Incorporating annual net capex of about EUR 20m, free operating cash flows are forecasted in the EUR 5m-15m range over the next two years. As the company is refraining from distributing dividends, according to its public business plan, further deleveraging is expected. Consequently, we believe that Green Network can strengthen its financial profile over the next few years, unless the company aims at dynamic growth (ruled out for the time being).

Factoring and insurance coverage largely ensuring cash collection

Despite the company's large outreach to corporate clients, particularly SMEs, which are increasingly threatened by Covid-19-related payment delays or even defaults, we believe the risks arising from receivables collection and thus cash conversion will largely be mitigated by the wide use of factoring facilities, at more than EUR 100m, and the group's insurance over trade receivables, covering more than EUR 200m.

Figure 9: Cash flows metrics (in EUR m)



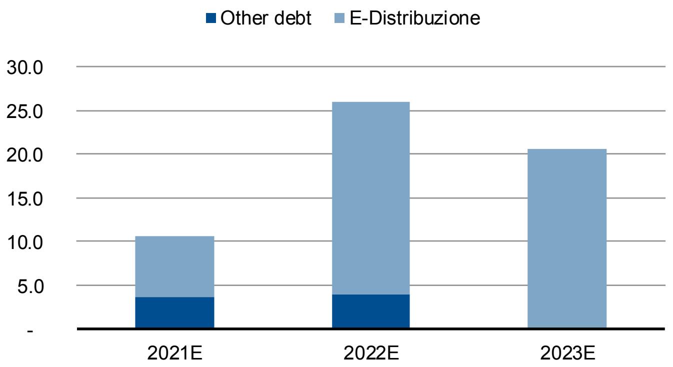
Source: Green Network, Scope

Robust liquidity important for commodity-based business

Liquidity is sound and robust and strongly supported by the low indebtedness. With free operating cash flows being positive, limited external financing is required. We expect the limited amounts of maturing debt, including amortisation paid to E-Distribuzione, to be well covered by unrestricted cash (EUR 30m at the end of the current business year, ending in July 2020) and internal financing from positive free operating cash flows.

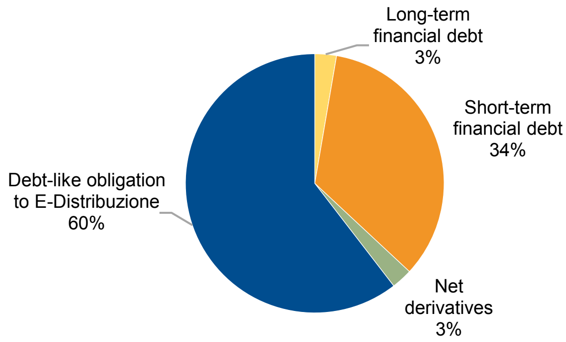
Moreover, liquidity is backed by the wide array of available funding programmes such as factoring, reverse factoring, receivables securitisation and credit facilities, whose total undrawn amount is estimated at more than EUR 100m. Hence, we regard the liquidity profile as supportive for Green Network's commodity-based business.

Figure 10: Expected payment schedule (in EUR m)



Source: Green Network, Scope

Figure 11: Debt structure



Source: Scope calculations

Supportive conservative financial strategy

The group publicly stated that it only plans to grow organically in the coming years and plans no M&A. It will also dispose opportunistically of non-core assets (properties and investments in companies operating in renewable energy). The group does not expect to distribute dividends for the five next years as it had done for the last 15 years.

Long-term debt and short-term ratings

Senior unsecured debt rating of BBB-

All senior unsecured debt issued by Green Network is rated BBB-, at the level of the issuer.

S-2 short-term rating

Reflecting the solid short-term debt coverage (strong internal and external liquidity ratio) and access to external financing, we have assigned an S-2 short-term rating.

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