Research Update:

Italian Multi-Utility Iren SpA Rated 'BBB-' On New Strategic Plan With Accelerated Investments; Outlook Positive

December 9, 2021

*(**Editor's Note:** We corrected this Research Update on Dec. 10, 2021, because the carbon intensity figure was misstated in the "Environmental, Social, And Governance" section. A corrected version follows.)*

PRIMARY CREDIT ANALYST

Massimo Schiavo
Paris
+ 33 14 420 6718
Massimo.Schiavo
@spglobal.com

SECONDARY CONTACTS

Federico Loreti
Paris
+ 33140752509
federico.loreti
@spglobal.com

Claire Mauduit-Le Clercq
Paris
+ 33 14 420 7201
claire.mauduit
@spglobal.com

Rating Action Overview

- Iren SpA (Iren) reported EBITDA of €927 million in 2020, making it one of Italy's largest multi-utilities, while its share of fully regulated activities (about 50% of EBITDA), and strong local positioning in Italy's wealthy northwestern region support our view of its strong business risk profile.
- On Nov. 11, 2021, Iren unveiled its updated 2021-2030 strategic plan, which aims to more than double gross annual investments to €1,270 million per year from €500 million-€600 million on average during 2015-2020.
- We anticipate these investments will be funded with more than €900 million of additional net reported debt in 2023 compared with year-end 2020 and increase adjusted EBITDA by about 8% per year.
- We assigned our 'BBB-' long-term issuer credit and issue ratings to Iren and to its senior unsecured debt.
- The positive outlook reflects our expectation that, despite the sizable increase in capital expenditure (capex), Iren's credit metrics will likely continue improving through 2023, with potential to raise the rating if adjusted funds from operations (FFO) to debt moves above 20% and adjusted debt to EBITDA declines below 4.0x on a sustainable basis over the next two years.

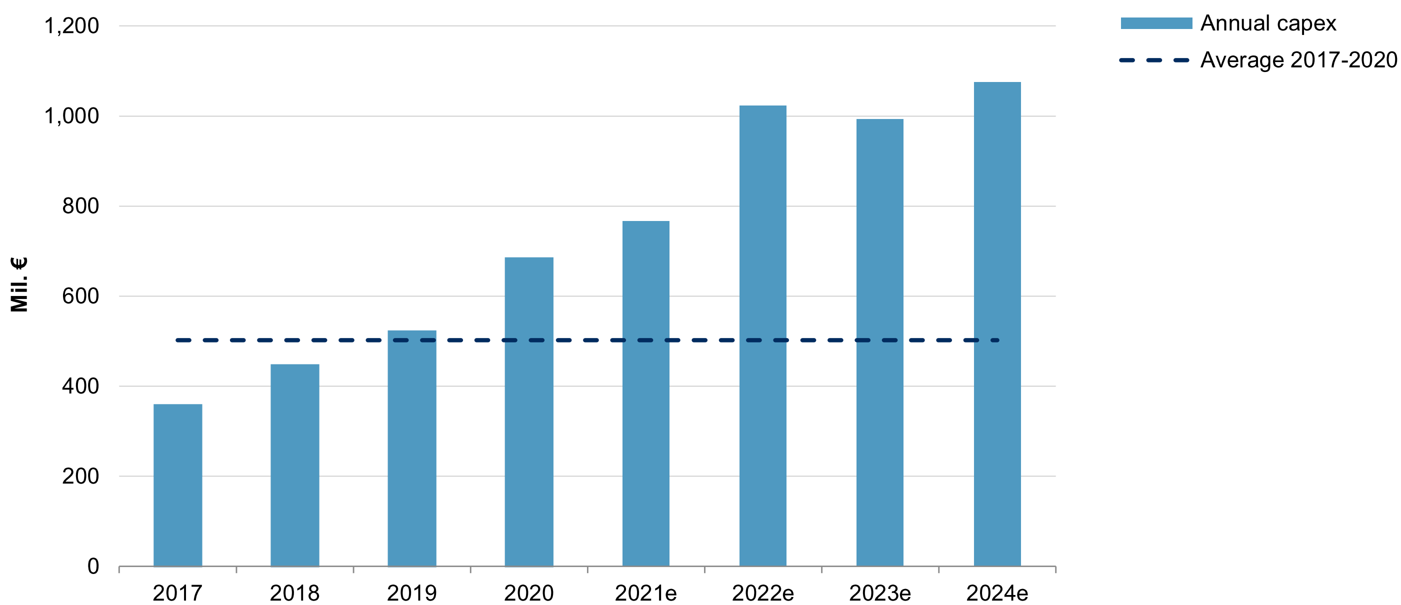
Rating Action Rationale

Iren's credit quality reflects its solid position in Italy as one of the largest multi-utilities and its high share of regulated activities. Iren is a large player in the Italian utilities sector, concentrated in some of Italy's wealthiest regions in the northwest. It remains smaller than its closest peers Hera SpA and A2A SpA in terms of EBITDA (reported EBITDA of €927 million in 2020 compared with A2A's €1,204 million and Hera's €1,123 million). At the same time, Iren's strong business risk profile benefits from the significant contribution of fully regulated water, gas, and power distribution activities and urban waste collection and treatment under long-term concessions remunerated based on regulated tariffs established by national regulator Autorità di Regolazione per Energia, Reti e Ambiente (ARERA). We also note that Iren operates the largest district heating network in the country, which we view as supportive thanks to the long-term contracted nature of the service.

Iren is entering a capex supercycle, with annual net investments expected to average €930 million over the next three years, focused on the energy transition. Iren has unveiled its ambitious capex plan for 2021-2030, totaling €12.7 billion of gross investments, of which almost €5 billion will be spent by 2024. These figures exclude €1.4 billion of subsidies the group will receive, of which €0.3 billion are under the Italian Recovery Fund (PNRR). A significant portion of the new investment plan is dedicated to the decarbonization of the group's energy mix, with a strong acceleration in renewables. We expect most of the additions will come online only in the second part of the plan and we understand this will be done mostly through greenfield projects across Italy. The group expects to add 2.2 gigawatts (GW) of renewable energy source capacity (from its 1 GW pipeline)--about 80% solar and 20% wind--and 0.3 GW of storage by 2030. Renewable installed capacity is set to reach 2.8 GW in 2030 from 0.6 GW at year-end 2020. To this end, Iren intends to finance part of the projects by partnering with minority equity investors, but we do not believe this will materially increase the group's complexity or its cash flow leakage in the medium term. The boost in renewables capacity will be accompanied by exiting thermal generation by 2026. We view the disposal of the newly revamped combined cycle gas turbine (CCGT) Turbigo plant positively from a business and financial risk perspective, since the company will exit from a thermal generation asset while cashing in significant proceeds.

Iren's Net Capex Will Accelerate Substantially

Iren's Net Capex Will Accelerate Substantially
2017a-2024e



Capex--Capital expenditure. A--Actual. e--Estimate. Source: Company disclosures, S&P Global Ratings.

Capital allocation remains skewed toward regulated or long-term contracted activities. Regulated activities will represent about 38% of total group investments over the plan, with most in water distribution. As a result, we expect regulated asset base (RAB) growth of 2x year-end 2020 levels to reach €4.8 billion in 2030. In addition, urban waste collection, transport, and disposal (the latter starting from 2022) are also regulated in Italy under a framework set by ARERA with a RAB-based remuneration mechanism similar to the one in power and gas distribution. We therefore expect about 80% of total waste EBITDA to be regulated starting from next year. Iren's investments into the waste segment (€2.5 billion, 20% of the 10-year plan) are mostly related to waste management and processing, with the aim to increase treatment capacity by fully renewing the waste treatment fleet with 21 new plants, half of which will come into operation in 2024.

Organic growth and continuous improvement in credit metrics support our positive outlook, despite the capex acceleration. We forecast adjusted EBITDA will increase an average of 8% per year to well above €1 billion by 2023, from about €900 million at year-end 2020. Such growth, combined with stable earnings from regulated activities, will generate annual cash flow from operations of more than €900 million every year on average in 2021-2023, which will almost entirely cover projected investments. We expect free cash flow after capex and dividends to be negative by about €200 million per year, which is ultimately why the group's debt increase will remain manageable and offset by earnings growth. As a result, we also expect adjusted FFO to debt will remain at about 20% in the coming years, which is why we might consider an upgrade if the company maintains these metrics on a sustainable basis. This will ultimately depend on the successful implementation of its strategic plan and management's financial policy.

Iren remains committed to investment-grade metrics and the strategic plan will test the group's financial policy. Iren publicly reiterated its commitment to preserve strong financials, with a maximum leverage threshold set at 3.5x reported net debt to EBITDA, which corresponds to roughly 4.0x-4.2x on an adjusted basis. The company expects leverage to peak in 2024 and then gradually decrease toward 2.5x in 2030. This is reflected in our S&P Global Ratings-adjusted debt to EBITDA increasing in 2022 to slightly above 4.0x. That said, we do not expect credit metrics will materially diverge from our current base-case assumptions, given the company's generous but clear shareholder remuneration policy, with dividends increasing 10% through 2025 from €0.1 expected in 2021, and contained small mergers and acquisitions (M&A). Indeed, inorganic growth through M&A or new concessions, which we understand will mostly be in the regulated gas and waste segments, is included in our projected investments.

Outlook

The positive outlook on Iren reflects our expectation that it will continue to strengthen its position in the regulated segment, thanks to its ambitious capex plan, while improving its credit metrics. If Iren successfully executes its plan, we believe it can maintain adjusted FFO to debt of about 20% over 2021-2023, with debt to EBITDA not increasing substantially above 4.0x. Indeed, our positive outlook takes into account management's target of not surpassing net reported debt to EBITDA of 3.5x.

Upside scenario

We would raise the rating on Iren to 'BBB' if credit metrics continue to improve over 2021-2023, adjusted FFO to debt increases above 20%, and adjusted debt to EBITDA trends below 4.0x, both on a sustainable basis. This could happen if:

- Iren successfully delivers on its new strategic plan, notably by fully deploying the expected investments, which on average will almost double over the next few years compared to the historical average, while maintaining the same level of returns.
- Operating performance, especially in terms of post-pandemic economic recovery and energy prices, continues to support the company's earnings trajectory.
- Iren maintains a supportive financial policy, without unexpected increases in dividends or material debt-funded acquisitions.
- Iren continues to deliver on its cost of debt reduction plan through successful refinancing and green instruments, with average cost of debt trending toward 1.4% (as per our expectations) by 2024.

Downside scenario

We could revise the outlook to stable if adjusted FFO to debt remains below 20% and debt to EBITDA does not decline below 4.0x. This could happen if:

- Contrary to its public commitment and to its investments plan, Iren undertakes large M&A without significant remedy measures or substantially increases its dividends in a way that would materially deviate from what we currently view as a well-balanced financial policy.
- Changes in the regulatory framework for Iren's network business impede the group's ability to achieve its EBITDA targets, although we view this as unlikely.
- The economic environment in Italy deteriorates sharply, thereby hampering Iren's growth strategy.

Company Description

Iren is one of Italy's largest multi-utilities. With headquarters in Reggio Emilia, its reference regions are Emilia Romagna, Piedmont, and Liguria, all located in northwest Italy. In 2020, the group reported revenue of €3.725 billion and EBITDA of about €927 million. It operates in four core businesses:

- Networks (41% of 2020 EBITDA): 56% integrated water services, 23% gas distribution, and 21% electricity distribution.
- Energy generation and district heating (25%): 53% district heating, 25% hydro and photovoltaic, 17% thermal and cogeneration, and the remainder energy efficiency services.
- Waste (19%): 80% urban waste collection (regulated) and disposal, and 20% special waste and nonurban disposal.
- Market (retail; 16%): 59% gas sales, 38% electricity sales, and 4% district heating sales and downstream.
- Other services (less than 1%): mainly electric mobility and public lighting.

At year-end 2020, the group had over 8,000 employees and served more than 8 million customers.

On the same date, Iren's public shareholders represented more than 50% of its share capital, with the largest being the municipalities of Genova (18.85%), Turin (13.8%), and Reggio Emilia (6.42%). Other public shareholders include the municipalities of Parma, Piacenza, and other small municipalities in the provinces of Reggio Emilia and La Spezia. The concentration of shares is therefore relatively low and about 48% of capital is free floating. Four main shareholder pacts (patti parasociali) between municipalities guarantee that no single municipality can act unilaterally on the company's most important strategic decisions.

The group is listed in the Milan Stock Exchange (Borsa Italiana) with a total market capitalization of €3.5 billion as of December 2021.

Our Base-Case Scenario

Assumptions

For 2021-2023:

- Recovery of economic conditions in Italy, with real GDP growth of 6% in 2021, followed by 4.4% in 2022, and 1.8% in 2023. That said, GDP's impact on Iren's revenue is only limited, given the large share of EBITDA from regulated and contracted activities.

- EBITDA growth is sustained by the new strategic plan, with adjusted EBITDA rising about 8% per year, driven mainly by energy generation, networks, and the waste business.
- EBITDA margins hover at about 22% through 2023.
- Average cash taxes of €135 million annually.
- Negative changes in working capital of roughly €40 million in 2021 and €46 million in 2022. We then project a positive working capital inflow of about €80 million in 2023.
- Average annual capex of about €930 million, including inorganic investments.
- Average annual cash dividends of €165 million.
- Increasing adjusted debt, reaching €4.3 billion in 2023 from €3.4 billion in 2020.
- Cash interest paid of about €50 million on average per year, on the back of a decreasing cost of debt following liability management operations conducted in 2018-2020.
- The upcoming weighted-average cost of capital review for regulated activities in Italy, starting 2022, has a marginal impact on Iren's earnings, thanks to the indexation of remuneration to higher inflation and Iren's diversity of activities.

Key metrics

Iren SpA—Key Metrics

	2019a	2020a	2021e	2022e	2023e
EBITDA* (mil. €)	871.5	863.7	930-945	1,000-1,050	1,050-1,100
Capex*(mil. €)	522.1	683.9	760-770	1,020-1,050	980-1,010
Dividends* (mil. €)	150.2	149	150-160	150-160	180-190
FFO to debt* (%)	18.2	20.0	19.5-20.5	19.5-20.5	20.0-21.0
Debt* (mil. €)	3,429.4	3,414.7	3,750-3,800	4,100-4,200	4,250-4,350
Debt to EBITDA* (x)	3.9	4.0	3.8-4.2	3.9-4.3	3.8-4.2

FFO—funds from operations. a--Actual. e--Estimate. Capex--Capital expenditure.

Liquidity

Iren's liquidity is adequate. In our view, as of Sept. 30, 2021, the company's planned available cash and committed credit lines cover cash outlays--mainly capex, debt service, and dividends--by a little more than 1.2x over the next 12 months. Furthermore, Iren has a high credit standing in the capital markets, strong relationships with banks, and solid and prudent risk management.

Principal liquidity sources as of Sept. 30, 2021, include:

- Our estimate of about €544 million of cash and liquid investments fully available for use;
- Available undrawn committed credit lines of €175 million maturing beyond 12 months, which reduce to about €100 million over the following 12 months; and
- Our forecast of about €783 million of cash FFO over the next 12 months.

Principal liquidity uses as of the same date include:

- Debt maturities of about €43 million over the next 12 months, which increase to €385 million over the subsequent 12 months;
- Capex of about €960 million over the next 12 months;
- Working capital outflows of about €45 million; and
- Dividends of more than €152 million.

Covenants

Financial covenants include leverage and interest coverage tests with the main objective to limit additional new debt.

Two of Iren's bonds and most of its loans include a leverage covenant set at 5.5x and an interest coverage covenant set at 4x. We expect Iren will comply with these covenants with substantial headroom in the next 12 months.

Environmental, Social, And Governance

ESG Credit Indicators: E-2 S-2 G-2

Environmental, social, and governance (ESG) factors have a limited overall impact in our analysis of Iren. The group has good positioning in regulated power, gas and water networks, which represented about 40% of 2020 EBITDA. Iren has a relatively small generation base, with 2,852 megawatts (MW) and 2,300 MW of installed capacities for electricity and heat, respectively.

Under its new 2021-2030 business plan, the company plans to reduce its carbon intensity substantially (we anticipate a decrease of 50% over 2020-2030), by increasing its share of renewables in the generation mix (additional 2.2 GW of capacity in 2030, notably solar and wind) and decommissioning its thermal generation by 2026. We view positively the fact that Iren has the largest district heating network in Italy. Carbon intensity was relatively low in 2020 at 332 grams of carbon dioxide per kilowatt-hour (gCO_2/kWh). Despite its public shareholding, there is no record of political interference with the company's strategic decisions.

Issue Ratings - Subordination Risk Analysis

Capital structure

We do not consider Iren's capital structure complex. At year-end 2020, it comprised about €3.6 billion of debt, almost all of which was senior unsecured.

Analytical conclusions

Most of the group's consolidated debt is at the parent company level, rather than at operating subsidiaries. In our view, there is no subordination of debt, and therefore we rate the senior unsecured debt 'BBB-', the same level as the long-term issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Positive/--

Business risk: Strong

- Country risk: Moderately High
- Industry risk: Low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/Leverage: Significant (medial volatility table)

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: Negative (-1 Notch)

Stand-alone credit profile: bbb-

- Group credit profile: bbb-

ESG Credit Indicators: E-2 S-2 G-2

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: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Related Research

- Italian Utilities Snam, Terna, And MM Outlooks Revised To Positive After Similar Action On Italy; Ratings Affirmed, Oct. 29, 2021
- Italy Outlook Revised To Positive From Stable On Commitment To Pro-Growth Reforms; 'BBB/A-2' Ratings Affirmed, Oct. 22, 2021
- European Electric Utilities Face Higher Social Risks Than Their U.S. Peers, Oct. 14, 2021
- Fit for 55: The Gains (And Pains) For European Utilities, Sept. 29, 2021
- The Energy Transition And What It Means For European Power Prices And Producers: September 2021 Update, Sept. 17, 2021
- MM SpA, Sept. 10, 2021
- Gruppo Hera SpA Assigned ESG Evaluation Of 81; Preparedness Strong, July 12, 2021
- A2A SpA, July 13, 2021
- Italian Multi-Utility A2A's Partnership With Ardian Will Increase Growth In Renewables And A2A's Complexity, Jun 14, 2021
- Hera SpA, June 30, 2021
- Italian Utility Edison SpA Upgraded To 'BBB' On Improved Performance And Credit Metrics; Outlook Stable, May 21, 2021
- Italian Multi-Utility Hera SpA Upgraded To 'BBB+' On Improved Credit Metrics; Outlook Stable, May 7, 2021
- Italian Electricity And Gas Transmission And Distribution Frameworks: Supportive, Jan. 20, 2021

Ratings List

New Rating; Outlook Action	
IREN SpA	
Issuer Credit Rating	BBB-/Positive/--
Senior Unsecured	BBB-