Research Update:

Italian Multi-Utility Iren SpA Upgraded To 'BBB' On Successful Plan Execution; Outlook Stable

April 27, 2023

Rating Action Overview

- Italian multi-utility Iren SpA recently updated its strategic plan to 2030, with gross investments of €10.5 billion over 2023-2030. This follows a resilient operating performance in 2022 despite a volatile energy market and adverse government measures, with 2022 reported EBITDA up 3.8% year-on-year.
- We anticipate continuous growth driven by sustained capital expenditure (capex), with adjusted EBITDA expected to increase to close to €1.30 billion in 2025 compared with €1.04 billion this year.
- At the same time, we expect Iren will continue to benefit from predictable cash flows through a high share of fully regulated network, waste, and district heating activities, which will represent at least 60% of its earnings mix.
- We therefore raised our long-term issuer credit and issue ratings on Iren and its senior unsecured debt to 'BBB' from 'BBB-'.
- The stable outlook reflects our expectation that Iren will maintain consolidated adjusted funds from operations (FFO) to debt comfortably above 18% over 2023-2025, and factors in management's commitment to the rating level and its well-balanced financial policy.

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Rating Action Rationale

Results for 2022 showed the resilience of Iren's business model, despite some one-off items due to regulatory intervention. S&P Global Ratings-adjusted FFO to debt ended at 17.9% and debt to EBITDA at 4x in fiscal 2022. While these metrics are below our expectations, they were affected by €107 million in exceptional costs from regulatory intervention, of which €44 million related to windfall taxes and €63 million was a loss from a derivative instrument that lost its cash flow hedging nature, as the national regulator unilaterally changed the underlying commodity index for heat and gas retail. Without these, FFO to debt would have been 20.6%, which in our view demonstrates the resilience of Iren's operations. While net reported financial debt was close to €3.35 billion, up 15.2% year on year mainly from higher investment, a €78 million cash inflow from strong working capital management contained this, as the company sold the gas it had stored with limited price risk and kept trade receivables at bay. The company's integrated portfolio sustained EBITDA because higher capacity market earnings, organic growth in regulated activities, and a larger renewables energy contribution more than offset the losses from squeezed margins in the retail segment. Last year, Iren reached 145 megawatts (MW) of installed solar and wind capacity, mainly thanks to the acquisition of Puglia Holding for an enterprise value of about €166 million and has a pipeline of 70 MW under construction and more than 400 MW under authorization.

We believe uncertainty has eased, improving visibility on metrics trajectory. While the material upside from high power prices has somewhat weakened compared with our most recent base-case scenario as the energy market slowly but steadily normalizes, we think reduced uncertainty related to further government intervention for this year more than mitigates this. We understand the Italian government is gradually phasing out most of the high-impact measures in the retail market and Iren has gradually started to reprice contracts. In addition, we anticipate that the windfall tax measure's continuation will have only a limited cash impact of €3 million this year for the company, which it has already accounted for in the 2022 financial accounts, and most remaining measures will end as planned at the end of June. Furthermore, to account for lower hydro volumes, affected by the persistent drought, Iren adopted a double hedging strategy for 2023, with one contract on hydro volumes and one on the power retail portfolio with a higher share of energy sourcing that is hedged. We believe this adapted strategy will help the company recover margins on the retail market, while keeping full upside on extra hydro volumes should production normalize, although this is not our base-case scenario. To limit operational issues linked to water scarcity on its thermal and cogeneration fleet in northern Italy, Iren is adapting its fleet with air cooling mechanisms rather than water-intensive ones previously. Finally, the company has secured more than half of the gas it needs for its client portfolio for next winter, which should limit the magnitude of working capital swings related to gas storage.

The updated business plan confirms Iren's strategic priorities, with a strong focus on regulated networks and renewables until 2030. The update envisages total gross capex of €10.5 billion from 2023-2030, a slight increase of about €200 million from the previous plan in 2021. A significant portion of the new plan is dedicated to the decarbonization of the group's energy mix, with an upgrade of the company's renewables installed capacity to 3.0 gigawatts (GW) by 2030 from 2.2 GW before. On a net basis, the generation business will deploy 32% of the investment. The company's other main axes of growth remain networks and waste. While we will continue to monitor how Iren advances on the plan, we believe the company has demonstrated its ability to undertake large investments, with net capex and acquisitions last year of more above €1.1 billion, more than double the level in 2019. We expect similar or higher levels for the next few years, with relatively limited execution risk, given most of the inorganic investment have been fast-tracked and investment is heavily skewed toward either decarbonization objectives or regulated businesses. This should lead to reported EBITDA rising to close to €1.5 billion in 2026 and more than €1.8 billion in 2030.

Iren's business risk profile will continue to benefit from a large share of regulated activities, including district heating (which we now consider regulated). One of the key strengths in our assessment of Iren's business risk remains the large share of earnings from fully regulated water, power, gas, and urban waste collection and disposal activities under a regulatory framework we assess as strong. Thanks to the plan's largest share of net investments being for networks (35%) and largely regulated waste activities (20%), we expect these business units' contribution add to the stability and visibility of its cash flow. We further include in our definition of regulated activities district heating, which makes up 7%-10% of EBITDA, bringing the total share of regulated earnings to at least 60% of EBITDA. While the regulatory advantage for district heating is not as strong as for pure networks and urban waste because tariffs are not set by the national regulator, these are quasi-monopoly activities carried out under long-term concessions that generally bring predictable cash flows. This is because tariffs allow for pass-through of costs to final customers and sensitivity to volumes is limited overall, given that more than 70% of the portfolio is skewed toward domestic or public clients and the churn rate is very low. For these reasons, we assess district heating's regulatory advantage as adequate (compared with strong for other activities). We also factor in the national regulator's intention to regulate district heating more formally, in line with what was recently done with waste.

We expect Iren will be less exposed to energy market volatility. Our view of the company's business risk is further supported by its commitment to dispose of its combined-cycle gas turbine plant in Turbigo by 2026, which we view positively because it will lower its emissions while reducing its reported net debt. After this, Iren will only have contracted cogeneration and no pure merchant exposure on its conventional generation fleet. This, combined with renewables growth linked to power purchase agreement development, will make the company less exposed to energy market volatility. A business mostly skewed toward what we consider purely regulated or highly contracted earnings more than offsets our expectation of slightly increasing cash flow leakage from the disposal of a 49% minority stake in gas distribution assets this year and expected equity contributions from partners to finance a part of its investments in renewables. This enhanced view of Iren's business positioning led us to lower our expectation of consolidated FFO to debt expectation to 18% from 20% previously.

Earnings growth and strong cash flow will allow Iren to keep leverage under control. We anticipate adjusted EBITDA will reach close to €1.3 billion in 2025. Adjusted leverage will remain under control thanks to strong operating cash flow of about €900 million a year on average over 2023-2025, which limits debt additions to finance capex and dividends. Our net debt trajectory calculation already accounts for disposals and third-party contributions. As a result, we expect consolidated adjusted FFO to debt will consistently be above 18% over the next few years and improving to at or above 20% from next year, a trajectory that we believe is commensurate with the 'BBB' rating.

Iren's well-balanced financial policy also supports the rating. The company 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 4.0x-4.2x adjusted. It also stated its intention to attain FFO to debt close to or above 20% as the business plan progresses. Although we note Iren's generous shareholder policy, with dividends increasing 10% through 2025, we believe the company would be prepared to enact credit remedy measures in case of a deviation from the expected improving credit metrics, such as remodulating its investments. Iren has a material size of minority interests that result in some cash flow leakage, with noncontrolling interests representing about 14% of the company's total equity in 2022.

Outlook

The stable outlook reflects our expectation that Iren will maintain consolidated adjusted FFO to debt comfortably and sustainably above 18% over 2023-2025. Our stable outlook considers management's target of not surpassing net reported debt to EBITDA of 3.5x, while delivering on its 2030 strategic plan without significant cost overruns or operational setbacks. We also take into account management's commitment to the rating, with our understanding the company is willing to enact measures should financials deteriorate close to or below the rating thresholds. Our stable outlook also factors in no material deterioration of the current economic and operating environments.

Downside scenario

We could downgrade Iren if consolidated FFO to debt falls below 18% over a prolonged period. This could happen if:

- The company undertakes larger cash acquisitions or increases its dividend, deviating from what we view as a well-balanced financial policy;
- Iren does not successfully implement its strategic plan; or
- Significant unexpected changes in the regulatory environment for the company's businesses impede its ability to achieve EBITDA targets.

Rating downside could also occur if Italy's economy turns more negative or in case of further severe disruptions to energy markets, although this is not part of our base-case scenario.

Upside scenario

Although unlikely in the next two years, we could raise our rating if Iren strengthens its credit metrics and achieves consolidated adjusted FFO to debt above 23% sustainably.

Company Description

Iren is one of Italy's largest multi-utilities. With headquarters in Reggio Emilia, its coverage regions are Emilia Romagna, Piedmont, and Liguria, all in northwest Italy. In 2022, the group reported EBITDA of about €1.06 billion. It operates in four core businesses:

- Networks (39% of 2022 EBITDA): 60% is integrated water services, 21% gas distribution, and 19% electricity distribution.
- Energy and district heating (34%): 36% is district heating, 27% thermal and cogeneration, 24% hydro and photovoltaic, and the remainder energy efficiency services.
- Waste (25%): 80% is regulated urban waste collection and disposal, and 20% waste treatment.
- Market (retail; 1%): mostly gas and district heating sales.
- Other services (less than 1%): mainly electric mobility and public lighting.

In 2022, 59% of EBITDA came from regulated activities under a regulatory framework that we assess as having a strong regulatory advantage. These figures include energy and water networks, as well as regulated urban waste collection and disposal. In addition, 12% of EBITDA came from district heating activities (which we consider regulated with an adequate regulatory advantage), and the rest from generation, retail, and waste treatment activities.

At year-end 2022, the group served more than 8 million customers and Iren's public shareholders represented more than 50% of its share capital, with the largest being the municipalities of Genoa

(18.85%), Turin (13.8%), and Reggio Emilia (6.42%). Other public shareholders include the municipalities of Parma, Piacenza, and some small municipalities in the provinces of Reggio Emilia and La Spezia. About 45% of capital is free floating. Four main shareholder pacts between municipalities guarantee that no single municipality can act unilaterally on the company's strategic decisions.

The group is listed on the Milan Stock Exchange (Borsa Italiana) with a total capitalization of about €2.5 billion as of April 26, 2023.

Our Base-Case Scenario

Assumptions for 2023-2025

- Real GDP growth in Italy of 0.36%, 1%, and 1.39% in 2023, 2024, and 2025, respectively. However, GDP's impact on Iren's revenue is limited, given the large share of EBITDA coming from regulated and contracted activities. Consumer price index (CPI) growth of 6.5% in 2023, 2.25% in 2024, and 2.04% in 2025, with remuneration in the networks segment indexed annually to inflation.
- Remuneration of Iren's regulated activities driven by weighted-average cost of capital (WACC) at 4.8% for water services, 5.6% for gas, 5.2% for electricity distribution, 5.6% and 6% for waste collection and disposal, respectively. We do not assume an increase in WACC for the next two years.
- The business plan sustaining EBITDA growth, with adjusted EBITDA rising on average more than 9% per year, mainly through renewables, networks, and the waste business.
- Adjusted EBITDA margin gradually improving to above 20% in 2025 from 12.5% in 2022.
- Gradually normalizing conditions this year in Italian energy prices, while hydro generation remains affected by the drought.
- Average cash taxes of about €150 million annually, with no windfall tax beyond 2023.
- Working capital changes improving gradually through 2025 but remaining negative.
- Average annual capex of more than €1 billion, including inorganic investments.
- Average annual cash dividends of close to €200 million, in line with the company's dividend policy.
- Adjusted debt increasing to €4.9 billion in 2025 from €3.9 billion in 2022.
- Cost of debt not materially increasing above 2%.
- Iren proactively refinancing its €500 million bond due in October 2024.
- The partial sale of gas distribution networks not leading to additional weakness of pro forma (compared with consolidated) credit metrics.

Key metrics

Iren SpA—Key Metrics

	2021a	2022a	2023f	2024f	2025f
EBITDA (mil. €)	952.7	982.5	1,000-1,050	1,150-1,200	1,250-1,300
Capex (mil. €)	756.1	896.3	700-750	1,200-1,250	1,100-1,150
Dividends (mil. €)	149.5	157.6	165-175	195-205	220-230
FFO to debt (%)	21.3	17.9	19.5-20.5	20.5-21.5	21-22
Debt (mil. €)	3,628.5	3,901.6	4,100-4,200	4,550-4,650	4,850-4,950
Debt to EBITDA (x)	3.8	4.0	3.8-4.3	3.5-4.0	3.5-4.0

Note: All figures S&P Global Ratings-adjusted. FFO--funds from operations. Capex--Capital expenditure. a--Actual. e--Estimate.

Liquidity

Iren's liquidity is adequate. In our view, as of March 31, 2023, the company's planned available cash and committed credit lines cover cash outlays--mainly capex, debt service, and dividends--by 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 March 31, 2023, include:

- Our estimate of about €490 million of cash and liquid investments fully available for use;
- Available undrawn committed credit lines of €225 million maturing beyond 12 months; and
- Our forecast of about €915 million of cash FFO in that time.

Principal liquidity uses as of the same date include:

- Limited debt maturities of about €54 million over the next 12 months;
- Net capex of about €860 million;
- Working capital outflows; and
- Dividends of about €175 million.

Covenants

Financial covenants include leverage and interest coverage tests with the main objective to limit additional debt. Most of Iren's loans include a leverage covenant set at 5.5x and an interest coverage covenant at 4.0x. We expect the company will comply with these covenants with substantial headroom in the next 12 months.

Issue Ratings - Subordination Risk Analysis

Capital structure

We do not consider Iren's capital structure complex. At year-end 2022, it comprised about €4.3 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, so we rate the senior unsecured debt 'BBB', the same as the long-term issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Stable/--
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	Neutral (no impact)
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
- 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 | 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: 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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Italy 'BBB/A-2' Ratings Affirmed; Outlook Stable, April 21, 2023
- EMEA Utilities Outlook 2023: France, Italy, And Spain: Credit Quality To Withstand Fiscal And Regulatory Intervention, Jan. 19, 2023
- Italian Multi-Utility Iren SpA Affirmed At 'BBB-'; Outlook Remains Positive, Dec. 12, 2022
- Italian Multi-Utility A2A Affirmed At 'BBB/A-2' On Revised Strategic Plan; Outlook Negative, Dec. 7, 2022
- Western Europe Regulated Gas Utilities Handbook 2022, Nov. 4, 2022
- Hera SpA, May 20, 2022
- Italian Water Distribution Framework: Supportive, Feb. 22, 2022
- European Water Regulatory Frameworks, Feb. 17, 2022

Ratings List

Upgraded; Outlook Action

	To	From
IREN SpA		
Issuer Credit Rating	BBB/Stable/--	BBB-/Positive/--
Senior Unsecured	BBB	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914