

Croatia's utility company boasts hydro credentials

Hrvatska Elektroprivreda's strong position in the supply segment offsets growing competition and supports its credit profile in the context of investment needs to expand and upgrade Croatia's ageing infrastructure



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Hrvatska Elektroprivreda is a vertically integrated Croatian utility with 85% market share. It operates with three main segments: electricity generation, transmission, distribution and supply comprising the vast majority of revenues. The company has a natural monopoly in the electricity transmission and distribution segments in Croatia and owns 95% of generation capacity.

Despite the liberalisation of Croatia's electricity supply market in 2008, Hrvatska Elektroprivreda's market share remains at around 85%, from 96% in 2008. It's strong position in the supply segment offsets growing competition, especially given its significant generation asset base, concentrated in hydro and nuclear power.

48% of Hrvatska Elektroprivreda's generation comes from hydropower. The rest is split between nuclear (8%), natural gas (16%), fuel oil (21%) and coal (7%). The hydro output mix can vary between 35% and 60%, depending on whether it's a wet or dry year. Croatia imports 20% of its electricity, but again this can vary between 10% and 29%, depending on the weather.

A close look at the fundamentals

This also causes volatility in Hrvatska Elektroprivreda's financial results.

- EBITDA was HRK 2.1bn in 2012 (a dry year), and in a wet year in 2014 it was HRK 5.1bn.
- In general, electricity prices are high in the Balkans, falling to German/Austrian levels in wet periods as the need to import supplies or make up the shortfall in more expensive gas-fired plants reduces. Over half of Hrvatska Elektroprivreda's electricity is sold subject to free market conditions, exposing it to price developments in the wider Balkan area (low liquidity at the Croatian Power Exchange means that electricity prices are in practice highly correlated to levels at the Hungarian Power Exchange).
- On the regulated side, Hrvatska Elektroprivreda's 100% ownership of the Croatian Transmission System, and the ownership and operation of the distribution network account for almost half EBITDA, adding to cash flow predictability. However, regulatory periods are set at just one year. Tariffs tend to be set too low, especially in the heating segment, putting pressure on EBIT.
- The key to Hrvatska Elektroprivreda's financial set-up is low leverage, which is crucial, given its earnings volatility. For instance, FFO interest cover ranged from 5.7x in 2012 to 10.0x in 2014 and is now over 140%. These strong metrics support Hrvatska Elektroprivreda's credit profile in the context of significant investment required to expand and upgrade Croatia's ageing infrastructure.
- Hrvatska Elektroprivreda's reliance on hydro and nuclear generation insulates it from the EU's drive to reduce carbon emissions.
- Liquidity is strong. Hrvatska Elektroprivreda has a plentiful cash position and low debt redemptions until its bond matures in 2022. Moreover, it has access to HRK 1.3bn of uncommitted multipurpose facility lines with domestic banks, which expire in 1Q20.

Its ratings of Ba2/BB/- incorporate the possibility of the government selling a 25% stake. The IPO plan was announced in Dec 2014 and reiterated by Croatia's prime minister in Jan 2017. However, the implementation and timing of the sale remain unclear.