

Rating object	Rating information	
Latvenergo AS Creditreform ID: 400981253 Incorporation: 1991 Based in: Riga, Latvia Main (Industry): Generation, distribution and trade of electricity CEO: Mārtiņš Čakste	Corporate Issuer Rating: BBB+ / stable	Type: Initial rating Unsolicited Public rating
	LT LC Senior Unsecured Issues: BBB+ / stable	Short-term rating: L3
	Rating date: 4 July 2023 Monitoring until: withdrawal of the rating Rating methodology: CRA "Corporate Ratings" CRA "Non-Financial Corporate Issue Ratings" CRA "Corporate Short-Term Ratings" CRA "Government Related Companies" CRA "Rating Criteria and Definitions" Rating history: www.creditreform-rating.de	
<u>Rating objects:</u> Long- and short-term Corporate Issuer Rating: Latvenergo AS Long-term Local Currency (LT LC) Senior Unsecured Issues		

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Summary

Company

Latvenergo Group with its holding company Latvenergo AS (the Company, Latvenergo), located in Riga, Latvia, is one of the country's major utilities. Its activities comprise the distribution, generation and supply of electricity and heat, as well as trade in electricity and natural gas. The Republic of Latvia, represented by its Ministry of Economics, is the sole shareholder of the Company. Via its subsidiary Sadales tīkls AS, the largest distribution system operator in Latvia, the Group operates more than 92,000km of electricity distribution lines, providing electricity distribution services to 790 thousand customers. Within its generation business, the majority of electricity is produced by the three hydro power plants (HPP) on the Daugava river and by the two combined heat and power plants (CHPP), which also cover a substantial part of the thermal energy required for the heat supply of the city of Riga. Trade in electricity and gas, as well as a range of related products and services, is carried out under the brand Elektrum. The Group is one of the largest electricity traders in the Baltics, having 832 thousand customers, of which 194 thousand outside Latvia.

With 3,316 employees as of the end of the year, the Group generated revenue of EUR 1,841.8 million (2021: EUR 1,065.2 million) in 2022, and recorded a profit of EUR 183.9 million for the year (2021: EUR 71.6 million). The significant increase in revenue and the year result was largely driven by the substantial rise in energy prices.

Rating result

The current unsolicited corporate issuer rating (**BBB+ / stable**) attests a highly satisfactory level of creditworthiness to Latvenergo AS, representing a low-to-medium default risk for the Company.

Latvenergo AS is of strategic importance for the Republic of Latvia as its major electricity distribution grid operator and as one of the most important domestic energy suppliers. The Group benefits from a stable and overall supportive regulatory framework, with a substantial part of its EBITDA generated in a regulated environment and representing largely stable cash flows. Latvenergo's earnings are, however, dominated by electricity and heat generation business in Latvia and trade activities in the whole Baltic region, which are subject to a range of exogenous

risks such as weather conditions and water inflow, market, commodity supply and price volatility risks. In the 2022 financial year, against the backdrop of an extraordinarily favorable market environment, the Company saw a substantial increase in revenues and earnings, along with a sound and balanced financing structure and strong equity resources. The solid result of our key financial figures analysis for the last four years underpins our rating assessment. Given the fact that the Republic of Latvia owns 100% of the Company's shares, and based on our rating methodology for government-related companies, we assume that the Latvian government would be willing to support the Company in meeting any extraordinary financial shortfall. For this reason, and because of the direct correlation between the country's GDP growth and energy consumption, the rating of Latvenergo AS is linked to the sovereign rating of the Republic of Latvia (CRA rating **A / stable** as of 12 May 2023). Any change in the sovereign rating could have an impact on Latvenergo's corporate rating. The Company's affiliation with the Latvian government has a positive impact of one notch on the stand-alone rating of Latvenergo AS.

Outlook

The one-year outlook of the rating is **stable**. This assessment takes into account the clearly positive development in the 2022 financial year, followed by further growth in the first quarter of 2023, with satisfying generation figures and increasing revenues from trade activities as a result of an increase in sales prices and a continuously growing customer base. Based on its solid key financials to date, the Company should be able, in our view, to withstand any possible short-term deterioration of its earnings, which could result from the currently overall subdued economic sentiment and persisting uncertainties with regard to energy supply, and thus retain its rating.

Reference:

The relevant rating factors (key drivers) mentioned in this section are predominantly based on internal analyses, evaluations from the rating process, the derived valuations of the analysts participating in the rating and, if applicable, other rating committee members. The fundamental external sources used are specified in the sections "Regulatory requirements" and "Rules on the presentation of credit ratings and rating outlooks".

Excerpts from the financial key figures analysis 2022:

+ increase in sales
+ EBITDA, EBIT, EAT
+ Net total debt / EBITDA adj.
+ Return on investment

-Total assets
-Ratio of material costs to total costs

General rating factors summarize the key issues which – according to the analysts as of the date of the rating – have a significant or long-term impact on the rating, whether positive (+) or negative (-).

Current rating factors are the key factors which, in addition to the underlying rating factors, have an impact on the current rating.

Relevant rating factors

Table 1: Financials I Source: Latvenergo AS Annual Report 2022, standardized by CRA

Latvenergo AS Selected key figures of the financial statement analysis Basis: Annual report of 31.12. (IFRS, etc.)	CRA standardized figures ¹	
	2021	2022
Sales (million EUR)	1,065.2	1,841.8
EBITDA (million EUR)	198.8	360.2
EBIT (million EUR)	81.9	193.3
EAT (million EUR)	71.6	183.9
EAT after transfer (million EUR)	70.7	183.4
Total assets (million EUR)	3,472.6	3,851.8
Equity ratio (%)	65.1	64.1
Capital lock-up period (days)	47.6	11.8
Short-term capital lock-up (%)	20.4	26.1
Net total debt / EBITDA adj. (Factor)	6.5	3.5
Ratio of interest expenses to total debt (%)	0.8	0.8
Return on investment (%)	2.3	5.1

General rating factors

- + Strategic importance for the country
- + Government-related company, 100% state-owned
- + Overall supportive regulatory framework covers substantial part of earnings
- + Monopoly status as a distribution network operator
- + Earnings differentiation
- + Proven access to financial markets
- + Major share of electricity sold is covered by own generation
- Generation business highly dependent on exogenous factors (weather conditions, water inflow)
- High capital intensity
- Exposure to price and demand fluctuations on the energy markets
- Dependency on energy imports
- Geopolitical risks
- So far limited growth possibilities, small geographical presence

Current rating factors

- + Increased revenues and solid annual result in 2022, driven by positive price environment on energy markets
- + Secured funding
- + Adequate electricity generation
- + Growing customer base in trading activities

¹ For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. For example, when calculating the analytical equity ratio, deferred tax assets, goodwill (entirely or partly), and internally generated intangible assets are subtracted from the original equity, whilst deferred tax liabilities are added. Net total debt considers all balance sheet liabilities. Therefore, the key financial figures shown often deviate from the original values of the company.

- + Substitution for supplies of natural gas from Russia ensured
- + Further growth in revenues and result in Q1 2023
- Initial disruptions in the supply of natural gas
- Increase in purchase prices of energy in 2022
- Geographical proximity to Russia and Belarus with a view to the currently tense geopolitical situation

Prospective rating factors

- + Development of wind energy, also in cooperation with RWE, and other renewables
- + Diversification of gas supplies and dispensation with Russian gas
- + Opportunities arising from expansion of trading activities in other Baltic countries
- Risks related to delays in construction or cost overruns
- Expected increase in capex due to ambitious plans regarding renewables
- Risks associated with expanding international operations
- Overall increase in interest rates and inflationary environment
- Persisting economic downturn

ESG-factors

CRA generally takes ESG factors (environment, social and governance) into account within its rating decisions. In the case of Latvenergo AS we have not identified any ESG factors with significant influence.

We believe that Latvenergo, as a distribution system operator, plays an important role in the decarbonization of the energy market of Latvia and Baltic countries by integrating the increasing amount of renewables into its system. The complexity of grid networks will increase as new wind and solar power generation capacity is installed, with the energy system shifting from large-scale and centralized power plant generation to smaller-sized and more widely-distributed energy facilities located closer to points of consumption. Another challenge to be addressed during this transition is the intermittent generation of wind and solar energy, since it cannot be stored or transported easily, and the stability of energy distribution can vary significantly according to the climate characteristics of each geographic region. All of this will require grid operators to raise investments significantly over the next few years, with the objective of not only expanding their network infrastructure, but also increasing digitization of operations and energy efficiency through new technologies.

The main focus of Latvenergo's strategy 2022-2026, approved by the Cabinet of Ministers of the Republic of Latvia, lies in a substantial increase the share of renewable energy sources in electricity generation, by complementing the existing generation capacity with solar and wind power parks, thus contributing to the energy independence of Latvia. The Company is committed to doubling the generation capacity of renewable electricity by 2030, reaching 2,300 MW by this time. On this path, Latvenergo has initiated a range of major joint projects aimed at development, building and management of on-shore and offshore wind parks with Latvian (Latvijas valsts meži AS) and international partners (RWE). In the distribution segment, the strategy aims at improving the quality and security of electricity supply and envisages the creation of a two-way network for the development of microgeneration and the implementation of digital transformation and efficiency measures. Latvenergo is engaged in the building of the electromobility

Prospective rating factors are factors and possible events which – according to the analysts as of the date of the rating – would most likely have a stabilizing or positive effect (+), or a weakening or negative effect (-) on future ratings if they occurred. This is not an exhaustive list of possible future events with potential relevance for future ratings. Circumstances can arise that are not included in the list of prospective factors, whose effects are impossible to assess at the time of the rating, either because these effects are uncertain or because the underlying events are deemed unlikely to occur.

ESG factors are factors related to environment, social issues and governance. For more information, please see the section "Regulatory requirements". CRA generally takes ESG relevant factors into account when assessing the rating object and discloses them when they have a significant influence on the creditworthiness of the rating object, leading to a change in the rating result or the outlook.

infrastructure in the Baltics and aims to significantly increase the number of charging points by 2030. By increasing its customer portfolio within its trade activities, the Company is committed to promoting microgeneration, electrification and energy efficiency. In order to align its financial policy with its sustainability strategy, Latvenergo has developed its Green Bond Framework, under which financing instruments issued are linked to the environmental objectives defined in the EU taxonomy.

We believe that Latvenergo is well-positioned to address the challenges associated with its medium-term strategic objectives, partly due to its proximity to the Latvian Government and its strategic importance for the country's economy. Moreover, we think that the Group plays a central role in Latvian energy and climate policy, and thus see the energy transition as a potential key growth driver for the Company's performance in the long term. In this context, we assess the business model of Latvenergo as future-oriented.

A general valid description of Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found [here](#).

Best-case scenario: A-

In our best-case scenario for one year, we assume a rating of A-. This could be the case if the Company is able to maintain its currently sound financials and the currently adequate earnings situation persists at a level commensurate with the increase in liabilities and sufficient to maintain its profitability, despite an elevated interest burden partly resulting from elevated interest rates. The rating could also be upgraded following an improvement of the sovereign rating of the Republic of Latvia

Worst-case scenario: BBB

In our worst-case scenario for one year, we assume a rating of BBB. This could be the case if the Group's financials deteriorate following a decline in its earnings capacity due to unfavorable exogenous factors, such as weather conditions affecting the Company's generation business, or negative market developments affecting its trading activities, or following a substantial increase in debt due to cost overruns and/or a substantial increase in capex, as well as significant delays in construction works. Another factor could be the downgrade of the sovereign rating of the Republic of Latvia.

Please note:

The scenarios are based on information available at the time of the rating. Within the forecast horizon, circumstances may occur that could lead to a change of the rating out of the indicated range.

Business development and outlook

The development of Latvenergo Group in the 2022 financial year was in particular marked by the surge in energy prices resulting from overall disruptions in energy supply, especially in the supply of natural gas from Russia, and an increase in demand for energy in the course of the recovery from the consequences of the COVID-19 pandemic. A significant share of European power plants uses natural gas, which contributed to the increase in electricity prices. According to the Company, the average electricity price in Latvia surged by 2.5 times against 2021 with a peak in August 2022 (EUR 467/MWh). The Group's revenue improved significantly by 73% to EUR 1,841.8 million (2021: EUR 1,065.2 million). This growth was largely driven by EUR 711.2 million higher energy sales revenues due to higher energy prices.

Table 2: The development of business of Latvenergo AS | Source: Annual Report 2022, reported information

Latvenergo AS				
In million EUR	2021	2022	Δ	Δ %
Revenue	1,065.2	1,841.8	776.6	72.9
EBITDA	198.8	360.2	161.4	81.2
Operating profit	81.9	194.0	112.1	136.9
EBT	74.9	184.5	109.6	146.3
EAT	71.6	183.9	112.3	183.9

In the 2022 financial year, the Company generated 3,822 GWh of electricity (2021: 4,517 GWh). Due to the slightly higher water inflow in the Daugava river, the generation at Daugava HPPs was stable at 2,670 GWh, whereas the generation at the Company's CHPPs (1,123 GWh) was 39% lower than in 2021 against the backdrop of the surge in prices for their main fuel, natural gas, as well as a significant increase by 53% in prices for CO₂ emissions allowances. Due to favorable weather conditions during the heating season, thermal energy generation decreased by 14% to 1,777 GWh. Against the backdrop of a decrease in electricity production on CHPPs, the share of electricity generated from renewable sources reached a historically high level of 70% (2021: 59%) in 2022.

During the year, the Company was able to increase the number of its electricity customers by 8% to more than 818 thousand, mainly due to an increase in the number of household customers in Lithuania. Nevertheless, the amount of electricity supplied dropped by 20% to 7,346 GWh, largely due to an overall decrease in consumption against the backdrop of high prices, as well as an adjustment to the Company's electricity sales strategy for large business customers. According to the Company, household consumption saw a reduction as a result of a drop in remote work in 2022. Despite the fall in the demand for gas, natural gas sales edged up by 1.3% to 1,040 GWh due to the increase in the number of customers.

The Company distributed 4% less electricity in 2022 with 6,241 GWh, due to high electricity prices and a warm winter. The segment result was negatively impacted by an increase in the costs of maintaining its distribution network due to disruptions in the supply of materials, and stormy weather conditions resulting in a need for repairs during the year.

Table 3: The development of business segments in 2022 | Source: Latvenergo AS Annual Report 2022

Latvenergo AS according to individual segments in 2022				
in million EUR	Generation and Trade		Distribution	
	2021	2022	2021	2022
Sales to third parties	754.4	1,533.2	303.3	300.6
EBITDA	80.4	275.2	105.7	71.3
Segment profit before tax	55.2	202.0	24.9	(9.8)
Segment assets at the end of the year	1,473.3	1,833.1	1,801.1	1,791.7

The Group's EBITDA increased by 81% to EUR 360.2 million (2021: EUR 198.8 million). The negative effects of the surge in prices for natural gas and for purchased electricity were overcompensated by the effects of adjustments of electricity sale prices, as well as by the effects of derivative instruments aimed at limiting the negative impact of the increase in costs. The Group's annual result reached EUR 183.9 million, an increase of 184% (2021: EUR 71.6 million).

The tense geopolitical situation in Europe and sanctions against Russia had a direct impact on the Group's operations, leading to the termination of several contracts with suppliers. On the other hand, Latvenergo had no significant direct contracts with Russian companies and was able to ensure a continuous gas supply to its power plants and to the state reserves (the latter according to the amendment to the Latvian Energy Law from 22 April 2022, which stipulates that the purchase and storage of natural gas to ensure energy supply reserves on behalf of the state is to be organized by Latvenergo AS). Natural gas supplies from Russia were replaced by Norwegian gas and LNG from the USA and Qatar.

In the first three months of the 2023 financial year, the Group saw further positive development driven largely by a significant increase in electricity generation. Its electricity output reached 2,179 GWh (2021: 1,140 GWh). Due to favorable weather conditions and a higher water inflow, power generation on the Company's HPPs increased by 77% compared to Q1 2021. Electricity generation on CHPPs increased by 146% after its lows in the previous year, largely due to elevated gas prices, and in line with market conditions, while generation of thermal energy was largely stable. The amount of electricity supplied to retail customers increased to 1,635 GWh, +15%, partly due to an increase in the number of retail customers in the entire Baltics region. The electricity generated was sufficient to meet the electricity needs of all of the Company's customers, with the residual amount being exported. The Group's sales reached EUR 729 million, up 79%, mainly due to larger electricity sales volumes, higher sales prices, and improved generation figures. The Group's profit for this period increased by 33% to EUR 108.4 million.

Table 4: Figures of current financial year | Source: Q1 report 2023

Latvenergo AS Q1 figures		
in EUR mln	Q1 2022	Q1 2023
Sales	407.7	729.4
EBITDA	123.6	155.7
Profit	81.8	108.4

The Group's medium-term strategy for 2022-2026 was approved by the Supervisory Board in March 2022. In line with the Sustainable Development Strategy of the Republic of Latvia – Latvia 2030 - Latvenergo's strategy is in particular aimed at intensifying the development of sustainable energy generation, thus contributing to the country's energy independence. The electrification of transport, an increase in the efficiency of the distribution network and services, as well as a further expansion of Elektrum's market share (of trade activities) in the Baltic countries are further key themes of the middle-term strategy. Financial targets comprise the maintaining of an annual profitability at over 7% (excluding regulated business), in line with the average benchmark companies in the European energy sector, and maintaining a sound capital structure with adjusted FFO/net financial debt of over 25%, a prudent dividend policy, and an investment-grade rating.

We consider the strategy of Latvenergo to be future-oriented and sound, and its financial targets to be realistic from the current perspective, taking into consideration the Company's sufficient earnings and cash flows, which are commensurate with its financing structure. The Company plays a key role in the energy supply in Latvia and is increasing its market share in the retail electricity and natural gas business, as well as in the development of renewable energy sources in the whole Baltics region. Stable and rather predictable revenues from regulated activities form a substantial part the Company's earnings and are generated within an overall supportive regulatory framework. With a view to a strategic importance of Latvenergo for the infrastructure and economy of the Republic of Latvia, we assume state support in any critical event, which underpins our rating assessment.

Structural risk

Latvenergo AS is a private limited liability company registered on 8 October 1991 in the Republic of Latvia and located in Riga. As of 31 December 2022, the Company's share capital amounted to EUR 790,368 thousand and was divided into 790,368 thousand fully-paid ordinary shares. The Company's sole shareholder is the Republic of Latvia. The shares are held by the Ministry of Economics of the Republic of Latvia.

The main governance bodies of Latvenergo are the Shareholder Meeting and the Supervisory Board. The interests of the shareholder are represented at the Shareholder Meeting by the State Secretary of the Ministry of Economics, or an authorized delegate. The Supervisory Board is composed of five members with a five-year term of office. All members of the Supervisory Board are independent, do not hold other positions in the Company and are not involved in the Group's operations. The Management Board currently consists of five Chief Officers, whose responsibilities are divided according to the Group's strategic alignment.

The business activities of Latvenergo are divided into two operating segments:

- **Generation and Trade:** generation of electricity and thermal energy, conducted by the Latvenergo AS and Liepājas enerģija SIA, as well as electricity and natural gas trade in the Baltics carried out by the Company and its subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva, UAB and administration of the mandatory electricity procurement process in Latvia handled by the Company's subsidiary Enerģijas publiskais tirgotājs SIA.
- **Distribution:** electricity distribution services in Latvia. The services are provided by the Company's subsidiary Sadales tīkls AS – the largest distribution system operator in Latvia, covering approximately 99% of the country's territory.

At the end of 2022, the Latvenergo Group consisted of seven companies: the Parent Company Latvenergo AS and six directly-controlled subsidiaries. The Company's subsidiaries also provide

services related to electricity consumption and energy efficiency, such as the construction of solar parks for customers and the development of charging networks for electric cars. The Group has trading and service activities in other Baltic countries, with more than 20% of electricity consumers and more than one-third of revenues outside Latvia.

Based on publicly available information, we assume sufficiently developed structures with regard to risk management, accounting, and controlling, as well as other administrative and operationally functional areas. Most of the Group's activities, including corporate governance, its dividend policy, as well as its distribution activities and part of generation business, are subject to regulation and laws concerning activities of state-owned companies, which brings in our view additional stability and transparency into its operations and structure. Given the systemic importance of the Group as the major electricity generation company in the Republic of Latvia and as its distribution system operator, its key role in ensuring energy security of the Latvian State, and bearing in mind the tight organizational and ownership links between the Group and the state, no core risks can, in our opinion, be associated with the structure of the Group. On the other hand, certain decisions of the Company's sole shareholder could possibly have an adverse effect on its profitability and financials.

Business risk

The majority of the Group's revenues (83% in 2022, 71% in 2021) are generated in the segment **Generation and Trade**. The majority of the revenues in this segment (except for payment for the installed electrical capacity and generation of thermal energy at the Company's CHPPs, generation of electricity and thermal energy at the Liepaja generation facilities and Aiviekste HPP) are unregulated. The Company operates hydro power plants (HPP) on the Daugava river with a total capacity of 1,558 MW, making up approximately 60% of its total installed electrical capacity (2,606 MW). Additionally, the Company operates two combined heat and power plants (CHPP) with a total capacity of 1,039 MW, and a range of small power plants with combined capacity of 9 MW. The two CHPPs cover a significant part of the heating needs of the city of Riga and, together with the small power plants of Latvenergo, have a total thermal energy capacity of 1,793 MW. The Group sells the electricity it generates, and at the same time procures electricity for its customers on the Nord Pool power exchange. According to Latvenergo, its market share in electricity trading in the entire Baltics region amounts to 20%. In Latvia, the Group estimated its market share at 50% in 2022, while in Estonia and Lithuania it was 9% and 10%, respectively. Within the segment Generation and Trade, the Company is responsible for the administration of mandatory procurement of electricity generated from renewable energy sources, or from efficient cogeneration power plants, a state-regulated support mechanism for sustainable electricity generators in Latvia. In compliance with the Electricity Market Law, the functions of the public trader in Latvia are performed by Latvenergo's subsidiary Enerģijas publiskais tirgotājs SIA. The public trader is compensated for expenditure associated with the mandatory procurement and support for energy-intensive processing industry companies by the Latvian state.

The 100% subsidiary of Latvenergo, Sadales tīkls AS, is the largest distribution system operator in Latvia, covering over 99% of the country's territory and providing electricity distribution services to more than 790 thousand customers. The distribution network consists of low-voltage and medium-voltage lines formed by cables and overhead lines with a total length of 92,407 km. Revenues from electricity distribution services are based on regulated tariffs that are subject to approval by the Public Utilities Commission (PUC) and regulations by the Cabinet of Ministers of the Republic of Latvia's "Regulations on Electricity Trade and Usage". This segment generates a substantial share of EBITDA. About half of the Group's assets and the majority of the its capex

(EUR 85 million out of EUR 122 million in 2022) are allocated to this segment. The PUC approved the Group's development plan for the next ten years, beginning with 2023, comprising the reconstruction and modernization of the distribution system in accordance with the development trends of the industry and public demand, including growing numbers of renewable power plants which need to be connected. Starting on 1 July 2023, a new distribution tariff system comes into force according to previously submitted suggestions of Sadales tīkls AS, which includes an average increase in tariffs by 31%.

Russia's invasion of Ukraine led to supply chain disruptions, instability, volatility in global commodity markets, an overall inflationary situation, and restrained economic sentiment, especially in Europe. The overall economic activity in Latvia, the Baltic countries, and Europe, and the resulting energy consumption, have a direct influence on the development of Latvenergo. The Company is exposed to general weather conditions and water inflow during the year, which are critical for the electricity production on the HPPs. The demand for thermal energy also directly depends on weather conditions. Significant are operational risks including technical disruptions, physical damage, and environmental issues with regard to hydro and combined power plants.

Latvia is fully integrated in the Nordic electricity market through transmission interconnectors, so that electricity prices in Latvia depend on the overall trends on these markets. Latvenergo is exposed to heightened risks associated with the volatility of different commodity prices, especially for diesel fuel, natural gas, and woodchips, which are necessary for the operation of its CHPPs, as well as to the risk of disruption in their supply, which have increased since the outbreak of the war in Ukraine, in particular with regard to natural gas. Roughly two-thirds of the electricity sold to customers and consumed for technological needs is generated by the Group's plants. The remaining share has to be purchased on the market, potentially at higher prices than stipulated in the Company's contracts with its customers. Additionally, there are deviations in the electricity production and consumption profiles, creating seasonal energy purchase peaks. In general, a significant share of the Group's annual electricity supply to its customers remains subject to market price risks. In its consumer supply segment, the Group is exposed to a high level of competition and retail price fluctuations due to the fully liberalized electricity supply market. Additionally, the prices for CO₂ allowances increase from year to year, which in particular has a direct impact on the profitability of CHPPs.

Latvenergo ceased purchasing natural gas from Russia as of 24 February 2022, switching to LNG supplies from other countries. In January 2023, the Latvian Government prohibited natural gas purchases from Russia, which did not have any negative impact on Latvenergo's activities. Latvenergo acquired rights to use the capacities of LNG terminal in the port of Klaipeda (Lithuania) for the next ten years, and concluded contracts for LNG supply from the USA and Norway.

The EU electricity market is subject to increasingly stringent regulation according to the general energy guidelines of the EU, which have intensified since the outbreak of the war in Ukraine, including price caps, and stipulating the allocation of investments. Generally, the Company's strategy has been developed in accordance with EU-wide policies aimed at developing decarbonization technologies, renewable energy resources, and fostering energy efficiency.

Revenues from the Group's regulated business activities are directly dependent on the current regulatory framework and tariffs, which are subject to approval by the Public Utilities Commission. These activities, contributing substantially to the Group's EBITDA, are subject to risks of unfavorable changes in legislation, with insufficient rates of return on capital included in the calculation of the price of the electricity distribution, or other parameters that may not be sufficient to ensure the sound financials and strong competitive profile of the Company.

Even though Latvia is a member of both the NATO block and the European Union, the risk of Russian military aggression cannot be completely ruled out, in particular given the considerable proportion of ethnic Russians in the population (24.5%)² and its common borders with Russia and Belarus.

Overall, we assess the business risk profile of Latvenergo Group as moderate. A considerable part of its cash flows is generated in its overall supportive regulated business and is fairly stable and predictable. As far as we can assess, based on publicly available information, the Company has a well-developed risk management and controlling system. The Company uses hedging and financial derivative contracts, as well as insurance coverage, which help to partly mitigate price and operational risks. Latvenergo is systemically important for the Republic of Latvia as its substantial electricity producer and local electricity and gas supplier. Additionally, it is entitled for the maintenance and development of the country's strategically important infrastructure as its distribution system operator, which is in particular relevant with a view to the energy transition, and for other processes (insuring of natural gas reserves, mandatory procurement of electricity), crucial for the country's economy and social environment. Consequently, we assume that the state will give systemic support to the Group if needed.

Financial risk

For analytical purposes, CRA adjusted the original values in the financial statements in the context of financial ratio analysis.

The Group's operations are capital intensive, with fixed assets representing nearly 80% of the consolidated total assets. The Group's business, focusing on the production and distribution of electricity, requires a high level of capex in connection with enlargement and maintenance of the power grid and generating facilities to ensure adequate and reliable infrastructure compatible with the ubiquitous digitalization and decarbonization efforts. In the 2022 financial year, roughly 70% of the total capex (EUR 84 million out of EUR 122 million; 2021: EUR 85 million out of EUR 125 million) was allocated to the distribution segment, which is currently subject to a rolling modernization process. The hydropower units on the Daugava river have been under reconstruction during recent years, which should facilitate continuous operations over the next 40 years and whose total investments amount to EUR 260 million. Work on 8 of the 11 hydro units subject to reconstruction has already been finished, with cumulated costs of approximately EUR 200 million. According to the Group's Strategy for 2022-2026, in the future, the Group's investments in renewable energy sources will increase significantly, which will reduce GHG emissions and facilitate the climate neutrality of Latvia by 2050.

Adjusted equity, which includes non-current deferred income on grant for installed electrical capacity of CHPPs (EUR 113.5 million; 2021: EUR 137.4 million) edged up to EUR 2,467 million (2021: EUR 2,261 million) as of 31 December 2022, mainly due to positive annual result. Nevertheless, the adjusted equity ratio sank slightly (64.05%, 2021: 65.10%), which was enhanced by the increase in total assets and the reduction in the residual amount of equity-related grants. The equity ratio remains very solid in our view.

Along with its internal financing capacity, the Company has a variety of external long-term financing sources in place to finance its investments. Within its third bond issuance programme, Latvenergo issued three bonds in the format of green bonds with a total amount of EUR 200 million, the last of which was issued in February 2023. In 2022, the Company attracted new long-

² as at the beginning of 2021, according to the government of Latvia's 2021 Demography Report

term loans from commercial banks in the amount of EUR 200 million to finance and refinance its green investments, which remained undrawn as of the end of 2022. Additionally, the Group had seven overdraft agreements with a total amount of EUR 296 million, of which EUR 123 million were unused. The financial debt of Latvenergo increased from EUR 792 million to EUR 876 million as of 31 December 2022 as a result of increased current financial liabilities, and especially due to a bank overdraft amounting EUR 119.5 million. In the reporting year, according to the Company, all the binding financial covenants set in Latvenergo Group's loan agreements were met.

Against the backdrop of the Group's positive operative development, the Group's cash flow from operations before changes in working capital increased significantly by 60% to EUR 414 million (2021: EUR 258 million). Taking into consideration the increase in inventories, especially natural gas reserves, net cash flow from operating activities edged up to EUR 173 million (2021: EUR 132 million).

As of 31 March 2023, the Group's borrowings amounted to EUR 800.9 million (31 March 2022: EUR 792.0 million), including long-term loans from commercial banks and international financial institutions, as well as green bonds in the amount of EUR 200 million. All borrowings were denominated in EUR and have a weighted average long-term loan repayment period of 3.8 years (31 March 2022: 3.5 years).

As of 31 March 2023, the Company had a strong liquidity position with EUR 432.2 million cash and cash equivalents, covering operating expenses, dividend payouts, repayment of the outstanding current borrowings (EUR 188 million), as well as for scheduled investments. The dividends, in the amount of EUR 134 million, were paid out in May 2023.

The financing structure of the Group is currently appropriate, taking into consideration the adequate maturity profile of its financial debt and its net total debt / EBITDA adj. of 3.49 (2021: 6.46). However, according to the Group's strategy, we expect a substantial increase in capex in the coming years, which could put pressure on its liquidity. For the time being, the Company has a sound internal financing capacity, underpinned by overall stabilized prices for energy sold, as well as by its growing customer base in the Baltics. Further disruptions in energy supplies, unfavorable weather conditions, or an overall increase in operating expenses and financing costs cannot be ruled out for the future. Also, persistently restrained economic sentiment would have a negative impact on the Group's operative cash flows. The strategy of expanding a renewable energy source-based generation portfolio would help to enhance the Company's independence from energy supplies from third parties and from exogenous factors like water inflow, which currently remain a key factor of the Group's operating performance. Growth possibilities also arise from its trading activities, although inherently vulnerable to market fluctuations. It remains to be seen how the Group's financials will change in the course of implementing its strategy, and whether its operating cash flows will remain commensurate with in the course of ambitious investments growing indebtedness. The Company's affiliation with the Latvian government resulting from its strategic importance for the country's economy, as well as its declared sound financial strategy with a focus on a balanced financing structure and moderate dividend policy, underpin our positive rating assessment.

Further ratings

Based on the unsolicited long-term issuer rating and taking into account our liquidity analysis, the short-term rating of the Latvenergo AS was set at **L3** (standard mapping), which corresponds to an adequate level of liquidity for one year.

The rating objects of this issue rating are exclusively the long-term senior unsecured issues, denominated in euro, issued by Latvenergo AS (Issuer) and which are included in the list of ECB-eligible marketable assets. The ECB list of eligible marketable assets can be found on the website of the ECB. The issues have been issued under the Third Programme for the Issuance of Notes with its latest prospectus from 20 April 2022 and the supplement to it dated 20 September 2022. This programme amounts to EUR 200 million. The notes under the programme constitute direct, unsecured and unguaranteed obligations of the Issuer ranking pari passu without any preference among each other and with all other unsecured, unguaranteed and unsubordinated indebtedness of the Issuer.

We derive the unsolicited corporate issue rating of the in euro denominated bonds of the issuer from the unsolicited corporate issuer rating of Latvenergo AS. The ratings of the issues are set equal to the corporate rating of the issuer. The rating result is **BBB+/Stable**. Other types of debt instruments or issues denominated in other currencies of the issuer have not been rated by CRA. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG.

Long-term local currency senior unsecured notes issued by Latvenergo AS, which have similar conditions to the current issuance programme, denominated in Euro and included in the list of ECB-eligible marketable assets, generally receive the same ratings as the current LT LC senior unsecured notes issued under the issuance programme. Notes issued under in any currency other than euro, or other types of debt instruments, have not yet been rated by CRA. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG.

Table 5: Overview of CRA Ratings | Source: CRA

Rating Category	Details	
	Date of rating committee	Rating
Latvenergo AS	4 July 2023	BBB+ / stable / L3
Long-term Local Currency (LC) Senior Unsecured Issues issued by Latvenergo AS	4 July 2023	BBB+ / stable
Other	--	n.r.

Financial ratio analysis

Table 6: Financial key ratios |Source: Latvenergo AS Sustainability and Annual Report, structured by CRA

Asset structure	2019	2020	2021	2022
Fixed asset intensity (%)	71.97	88.51	83.18	79.61
Asset turnover	--	0.21	0.31	0.50
Asset coverage ratio (%)	97.65	83.07	85.74	86.55
Liquid funds to total assets	3.17	3.00	2.80	2.93
Capital structure				
Equity ratio (%)	63.63	68.06	65.10	64.05
Short-term debt ratio (%)	13.75	7.90	12.57	16.94
Long-term debt ratio (%)	6.65	5.47	6.23	4.86
Capital lock-up period (in days)	35.00	29.31	47.63	11.77
Trade-accounts payable ratio (%)	2.09	1.85	4.00	1.54
Short-term capital lock-up (%)	45.84	17.29	20.38	26.06
Gearing	0.52	0.43	0.49	0.52
Leverage	--	1.52	1.50	1.55
Financial stability				
Cash flow margin (%)	--	33.28	14.77	18.81
Cash flow ROI (%)	--	7.66	4.53	9.00
Total debt / EBITDA adj.	5.73	3.86	7.03	3.80
Net total debt / EBITDA adj.	5.23	3.50	6.46	3.49
ROCE (%)	3.18	4.14	2.80	6.14
Total debt repayment period	--	1.47	61.83	6.02
Profitability				
Gross profit margin (%)	43.25	52.25	30.52	27.59
EBIT interest coverage	11.35	12.11	8.90	17.95
EBITDA interest coverage	26.03	26.57	18.62	33.34
Ratio of personnel costs to total costs (%)	12.04	13.70	9.92	6.35
Ratio of material costs to total costs (%)	56.75	47.75	69.48	72.41
Cost income ratio (%)	87.42	83.91	92.70	89.65
Ratio of interest expenses to total debt (%)	0.69	1.01	0.76	0.78
Return on investment (%)	2.66	3.72	2.28	5.05
Return on equity (%)	--	4.90	3.15	7.78
Net profit margin (%)	11.21	15.04	6.72	9.98
Operating margin (%)	13.15	16.95	7.69	10.53
Liquidity				
Cash ratio (%)	23.04	37.96	22.23	17.28
Quick ratio (%)	180.92	117.11	83.59	68.88
Current ratio (%)	203.94	145.51	133.73	120.37

Appendix

Rating history

The rating history is available under <https://www.creditreform-rating.de/en/ratings/published-ratings.html>.

Table 7: Corporate Issuer Rating of Latvenergo AS

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	04.07.2023	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Table 8: LT LC Senior Unsecured Issues issued by Latvenergo AS

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	04.07.2023	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Table 9: Short-term issuer rating of Latvenergo AS

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	04.07.2023	www.creditreform-rating.de	Withdrawal of the rating	L3

Regulatory requirements

The rating³ was not endorsed by Creditreform Rating AG (Article 4 (3) of the CRA-Regulation).

The present rating is, in the regulatory sense, an unsolicited rating, that is public. The analysis was carried out on a voluntary basis by Creditreform Rating AG, which was not commissioned by the Issuer or any other third party to prepare the present rating.

The rating is based on the analysis of published information and on internal evaluation methods for the assessment of companies and issues. The rating object was informed of the intention of creating or updating an unsolicited rating before the rating was determined.

The rating object participated in the creation of the rating as follows:

Unsolicited Corporate Issuer / Issue Rating	
With rated entity or related third party participation	No
With access to internal documents	No
With access to management	No

A management meeting did not take place within the framework of the rating process.

³ In these regulatory requirements the term "rating" is used in relation to all ratings issued by Creditreform Rating AG in connection to this report. This may concern several companies and their various issues.

The documents and information gathered were sufficient to meet the requirements of Creditreform Rating AG's rating methodologies.

The rating was conducted based on the following rating methodologies and the basic document.

Rating methodology	Version number	Date
Corporate Ratings	2.4	July 2022
Corporate Short-Term Ratings	1.0	June 2023
Government-related Companies	1.1	May 2023
Non-financial Corporate Issue Ratings	1.0	October 2016
Rating Criteria and Definitions	1.3	January 2018

The documents contain a description of the rating categories and a definition of default.

The rating was carried out by the following analysts:

Name	Function	Mail-Address
Elena Damijan	Lead-analyst	E.Damijan@creditreform-rating.de
Christina Sauerwein	Analyst	C.Sauerwein@creditreform-rating.de

The rating was approved by the following person (person approving credit ratings, PAC):

Name	Function	Mail-Address
Philip Michaelis	PAC	P.Michaelis@creditreform-rating.de

On 4 July 2023, the analysts presented the rating to the rating committee and the rating was determined. The rating result was communicated to the company on 4 July 2023. There has not been a subsequent change to the rating.

The rating will be monitored until Creditreform Rating AG withdraws the rating. The rating can be adjusted as part of the monitoring, if crucial assessment parameters change.

In 2011, Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on this registration, Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

ESG-factors

You can find out whether ESG factors were relevant to the rating in the upper section of this rating report "Relevant rating factors".

A general valid description for Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found [here](#).

Conflict of interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services

are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or in approving credit ratings and rating outlooks.

In the event of providing ancillary services to the rated entity, Creditreform Rating AG will disclose all ancillary services in the credit rating report at this point:

No ancillary services in the regulatory sense were carried out for this rating object.

Rules on the presentation of credit ratings and rating outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our "Rating Committee Policy", all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, Creditreform Rating AG has used following substantially material sources:

Corporate issuer rating:

1. Annual report
2. Website
3. Internet research

Corporate issue rating:

1. Corporate issuer rating incl. information used for the corporate issuer rating
2. Documents on issues / instruments

There are no other attributes and limitations of the credit rating or rating outlook other than those displayed on the Creditreform Rating AG website. Furthermore, Creditreform Rating AG considers as satisfactory the quality and extent of information available on the rated entity. With respect to the rated entity, Creditreform Rating AG regarded available historical data as sufficient.

Between the time of disclosure of the credit rating to the rated entity and the public disclosure, no amendments were made to the credit rating.

The Basic Data Information Card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In cases where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating report and indicates how the different methodologies or other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings and best-case scenario credit ratings are explained.

The date at which the credit rating was initially released for distribution and the date when it was last updated, including any rating outlooks, is indicated clearly and prominently in the Basic Data Information Card as a "rating action"; initial release is indicated as "initial rating", other

updates are indicated as an “update”, “upgrade” or “downgrade”, “not rated”, “confirmed”, “selective default” or “default”.

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the Basic Data Information Card.

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009, a registered or certified credit rating agency shall make available, in a central repository established by ESMA, information on its historical performance data including the rating transition frequency and information about credit ratings issued in the past and on their changes. Requested data are available at the [ESMA website](#).

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