S&P Global
Ratings

Environmental, Social, And Governance Evaluation

EP Infrastructure

Summary

EP Infrastructure (EPIF) is a Czech Republic-based diversified energy infrastructure group operating across four core business segments: gas transmission, gas and electricity distribution, gas storage, and heat generation and distribution. It also has interests in Slovakia and Germany. Its subsidiaries have long operational histories, although the group in its current form was founded in 2013. EPIF is majority-owned (69%) by EPH, a vertically integrated energy company. Macquarie Infrastructure and Real Assets (MIRA) acquired a 31% interest in the group in 2016.

EPIF's ESG Evaluation of 63 reflects a governance structure that has enabled the group to realize its strategy despite a lack of formal independence. It also reflects our view that the company is adequately prepared for potential disruptions despite its exposure to the geopolitical situation that weakens the strategic resilience of some of EPIF's business segments. While the group's handling of environmental risk focuses largely on regulatory compliance, EPIF has set decarbonization targets, which it has maintained despite the situation in the European energy sector, and will likely continue to fuel improvements in its environmental performance. As for social risk, in our opinion, the group lacks a clear, long-term approach to talent development and places limited emphasis on improving diversity. However, we view positively EPIF's role in maintaining energy supply in the regions where it operates.

The governance framework reflects a strong shareholder agreement between EPIF and MIRA. In our view, the group has made concerted progress on mitigating the key-person risk that came from the dual chairman-CEO role that EPIF's majority owner, Daniel Kretinsky, had held by separating these roles in 2021. Nevertheless, we believe that the board, despite its strong industry and regional expertise, lacks independence, diversity, and an effective system of checks and balances. Still, the group has demonstrated its proficiency in deal due diligence and execution, and more recently in steering the company through disruptive times, having become a prominent feature in gas transmission and heat infrastructure in Central Europe.

PRIMARY ANALYST

Anna Liubachyna
London
+ 44 7971 362293
anna.liubachyna@
spglobal.com

SECONDARY ANALYST

Pauline Pasquier
Paris
+ 33 14 420 6771
pauline.pasquier@
spglobal.com

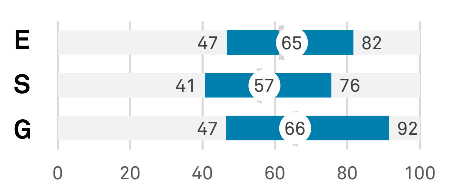
Luisina Berberian
Madrid
+34 917-78872
luisina.berberian@
spglobal.com

RESEARCH CONTRIBUTOR

Anirban Bandyopadhyay
Pune,
CRISIL Global Analytical Centre an
S&P Affiliate

ESG Profile Components (figures subject to rounding)

Entity-specific assessment			Sector/region analysis			Achieved and attainable scores
E (30%)	33	+	E (30%)	32	=	E
S (30%)	32	+	S (30%)	26	=	S
G (40%)	39	+	G (40%)	27	=	G

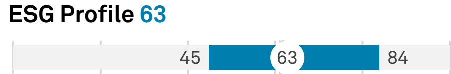


Entity within its primary sector/region

Entity's sectors/ regions versus all sectors/ regions

Min and max scores possible given sectors/regions. The grey line represents performance in line with industry standards.

ESG Profile 63



Preparedness No Impact

Low	Emerging	**Adequate**	Strong	Best in class

ESG Evaluation

63

A higher score indicates better sustainability. Figures subject to rounding.

Component Scores

Environmental Profile		Social Profile		Governance Profile	
Sector/Region Score	**32/50**	**Sector/Region Score**	**26/50**	**Sector/Region Score**	**27/35**
Greenhouse gas emissions	**Good**	Workforce and diversity	**Lagging**	Structure and oversight	**Good**
Waste and pollution	**Good**	Safety management	**Good**	Code and values	**Good**
Water use	**Good**	Customer engagement	**Good**	Transparency and reporting	**Good**
Land use and biodiversity	**Good**	Communities	**Good**	Financial and operational risks	**Neutral**
General factors (optional)	**3**	General factors (optional)	**3**	General factors (optional)	**0**
Entity-Specific Score	**33/50**	**Entity-Specific Score**	**32/50**	**Entity-Specific Score**	**39/65**
E-Profile (30%)	**65/100**	**S-Profile (30%)**	**57/100**	**G-Profile (40%)**	**66/100**

ESG Profile (including any adjustments) **63/100**

Preparedness Summary

EPIF's strategy is rooted in acquiring and operating high-quality regulated or midstream companies in Central European countries with supportive regulatory and structural factors. The group has effectively established itself as a leading player in the markets where it operates with assets that are strategically important for the region. However, the Russia-Ukraine conflict and consequent energy crisis bring a high level of uncertainty on the strategic resilience of some of EPIF's business segment, mainly eustream (49% owned by EPIF). In addition, its assets being predominately gas oriented face long-term climate-related risks as the EU accelerates its decarbonization agenda. Still, the group has accelerated its transition to hydrogen and is gradually reducing its footprint through fuel-switching its heat infrastructure assets to biomass, municipal waste, and natural gas.

Capabilities	
Awareness	**Excellent**
Assessment	**Good**
Action plan	**Good**
Embeddedness	
Culture	**Developing**
Decision-making	**Good**

Preparedness Opinion (Scoring Impact) **Adequate (No Impact)**

ESG Evaluation **63**

Note: Figures are subject to rounding.

Environmental Profile

65/100

Sector/Region Score (32/50)

EPIF operates mainly in gas and electricity distribution (52% of assets as of June 2022), gas transmission and storage (41%), and predominantly coal-based heat generation and distribution (7%). The energy transition is the most material environmental risk for these sectors given toughening greenhouse gas (GHG) regulations globally. They also face waste impacts, such as air emissions from burning fossil fuels, along with land and biodiversity impacts as biomass becomes a greater part of the power generation sector's fuel mix.

Entity-Specific Score (33/50)

Note: Figures are subject to rounding.

Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Good	**Good**	**Good**	**Good**	**3**

EPIF is progressing well in its energy transition strategy. The group has implemented targets to gradually fuel switch from coal to gas, biomass, and waste to energy sources by 2030, and to become carbon-neutral across its direct operations by 2040. However, these targets lag those of stronger peers whose net-zero targets include scope 3. But the company shows solid progress in preparing its assets for the hydrogen transition, in line with its decarbonization strategy, which we view as the ultimate decarbonization path for the sector. We also factor in EPIF's modern gas infrastructure--50% of its distribution network pipes in Slovakia are plastic--which should enable a swift incorporation of hydrogen into the fuel mix. In its gas storage, transmission, and distribution operations, EPIF uses predictive maintenance to gauge leaks and has policies to avoid venting, which is aligned with advanced peers. Despite its decarbonization aims, EPIF underperforms its power generation and district heating sector peers on scope 1 emissions intensity given its reliance on coal (primary fuel for power in the Czech Republic). Although the group is committed to phasing out lignite in its generation assets by 2030, this target lags more advanced peers that have already phased out coal. The targets have been maintained this year, but we anticipate the group's scope 1 emissions will rise in 2022-2023 due to the increase in coal-based generation in response to the energy crisis, in line with European peers.

We observe EPIF is reducing its air emissions in absolute terms and planning to use biomass and municipal waste for heat generation. We expect the group will continue to improve its air emissions performance as it moves away from coal as a primary energy source, but its current and historical nitrogen oxide, sulphur dioxide, and dust emissions on a revenue-intensity basis are demonstrably higher than those of peers. EPIF is investing in projects to reduce emissions further, including desulphurization and denitrification. Its actions on air emissions are primarily in response to regulatory requirements, which lags some more proactive peers. The group has yet to track mercury emissions and will do so in line with incoming regulations, but strong peers have tracked both mercury and cadmium emissions for some time now.

EPIF's actions to preserve biodiversity remain in line with regulatory requirements. The group's strategy involves acquiring and refurbishing operational assets, and it typically does not develop greenfield sites, so carries minimal risk to nature. Still, as the group transitions to using biomass as a primary energy source, we believe that its impact on land use and biodiversity could increase although we understand it's primarily sourced from wood residues from logging activities in local forests. EPIF reduced its water withdrawal 71% in 2021 from 2017 levels. This is due to efficient water management, including measures such as rainwater harvesting and water reuse.

Social Profile

57/100

Sector/Region Score (26/50)

The most material social risks for the gas storage, transmission, and distribution sectors involve maintaining reliable and affordable networks. Community relations can also be a material risk, especially during network upgrades. Safety is generally well managed, but high-impact events, such as gas leaks or explosions, can have financial and reputational consequences. Strikes from largely unionized workforces, aging talent, and skill shortages also pose risks to the sector.

Entity-Specific Score (32/50)

Note: Figures are subject to rounding.

Workforce and diversity	Safety management	Customer engagement	Communities	General factors
Lagging	**Good**	**Good**	**Good**	**3**

Although EPIF has a highly skilled workforce, it lags peers on diversity metrics and initiatives. A material risk for the group and sector more generally is an aging workforce, with 44% of the workforce above the age of 49. EPIF has yet to implement strategies to attract younger talent, unlike sector peers, which suggests their metrics are unlikely to improve materially in the near term. Similarly, the company still lags stronger peers in its total share of women in the workforce, with the figure remaining flat at 20% since 2018. We believe this is unlikely to improve materially given the absence of initiatives to attract female talent or targets to increase the number of women at various levels of seniority but note its recent appointment of two female CEOs in its Opatovice Power Plants and renewables divisions. Similarly, EPIF has yet to implement a formal employee engagement survey, which lags that of stronger performing peers.

Safety management is top priority for EPIF management, and its procedures are in line with the sector. The group's long-term injury frequency rate has fluctuated in recent years but remained constant in 2020 and 2021, although it remains high compared with that of sector peers. We view EPIF's integration of health and safety into its incentive schemes as being a notable strength compared with its peers. Although we see steps being made to enhance the group's safety performance, such as through a procurement policy that addresses supplier safety performance and work with external consultants to inculcate the best practice among its workforces, EPIF lacks qualitative targets on safety management that go beyond a goal of zero harm. The group's number of fatalities is comparatively on par with its peers.

EPIF has good links with the communities it operates in. The group showcased its commitment to the regions where it operates through donations during the COVID-19 pandemic and assistance to refugees from Ukraine. The company, via its Nafta subsidiary, has experienced issues with local environmental lobbies, which could lead to reputational risk for EPIF, especially as decarbonization becomes a more mainstream concern. Although Nafta has not breached any regulation, this is an ongoing dispute that we will monitor.

EPIF has consistently exceeded regulatory requirements for system reliability. The group's electricity distribution subsidiary has delivered a consistent supply of power and communicated with consumers regarding potential disruptions, which we view as positioning EPIF in line with its sector peers. We view positively the company's contribution to the reliable supply of energy to its customers during the energy crisis.

Governance Profile

66/100

Sector/Region Score (27/35)

EPIF is headquartered in the Czech Republic, and also operates across Slovakia and Germany. Czech governance standards are somewhat behind the EU's generally high standards. About 90% of the group's assets in 2022 are in Slovakia, which has a higher level of perceived corruption and weaker political institutions.

Entity-Specific Score (39/65)

Note: Figures are subject to rounding.

Structure and oversight	Code and values	Transparency and reporting	Financial and operational risks	General factors
Good	**Good**	**Good**	**Neutral**	**0**

EPIF is a private group with a strong shareholder agreement and a management board that demonstrates a good balance of skills and expertise. The group has separate the chair and CEO roles, which, paired with an effective shareholder agreement between MIRA and EPH, lessens the key-person risk at EPIF. However, the group lacks a formal effective system of checks and balances. The company's governance consists of a two-tier structure, with a board of directors in charge of management and the true driver of the group, and a non-independent supervisory board primarily tasked with approving the dividends and the accounts, but with an ultimately limited oversight function. The seven-person management board has an effective blend of regional expertise and infrastructure knowledge, provided by two representatives from MIRA and five directors from EPH. Strategic decision-making rests in the hands of the two shareholders, and EPIF's strong shareholder agreement requires unanimous consent for major decisions. The appointment of Gary Mazzotti as CEO of EPIF somewhat mitigates the key-person risk that came with Daniel Kretinsky, the majority owner, previously holding a dual role as CEO and chair of the management board. Despite this lessened risk, Mr. Kretinsky still has a prominent role in the group. We recognize the management team's solid track record in helping EPIF navigate through the energy crisis. However, the lack of a formalized institutional system of independent checks and balances weighs on our assessment.

EPIF has shown solid progress in embedding a unified set of codes and values across the group. The policy framework covers its core values, such as offering a reliable service that is in line with regulatory requirements and has clauses for all its major stakeholders. EPIF progressed toward the implementation of policies, including anticorruption and antibribery, across the group in 2021. The company trains employees on policies and has an established whistleblower channel. In addition, it has different internal bodies such as a health, safety, and environmental committee to ensure internal compliance with policies, overseen by the ESG officer. A third part of the CEO's variable pay is linked to ESG performance and safety, which we believe is comparable with that of sector peers.

The disclosure of nonfinancial information is improving. This improved transparency is typified by the group's announcement of a set of decarbonization targets, and the actions it seeks to take to achieve those targets, which collectively compare well with those of peers. Although EPIF's level of disclosure of nonfinancial data is broadly aligned with its sector peers', considering that it is a private group, we see EPIF as demonstrating a commitment to transparency and disclosure.

Preparedness Opinion

Adequate
(No Impact)

Preparedness	Low	Emerging	Adequate	Strong	Best in class

EPIF's strategy is rooted in acquiring and operating high-quality regulated or midstream companies in Central European countries with supportive regulatory and structural factors. The group has effectively established itself as a leading player in the markets where it operates with assets that are strategically important for the region. However, the Russia-Ukraine conflict and consequent energy crisis bring a high level of uncertainty on the strategic resilience of some of EPIF's business segment, mainly eustream (which is 49% owned by EPIF). Eustream is a key gas corridor for Russian gas into Europe, and its transit volumes and long-term business model would suffer if Russian gas flows decrease or stop. In addition, its assets, being predominately gas-oriented, face long-term climate-related risks as the EU accelerates its decarbonization agenda. The group is gradually reducing its footprint through switching its heat infrastructure fuel to biomass, municipal waste, and natural gas, and has accelerated its transition to hydrogen. However, in our view, it is not clear how the company explicitly integrates long-term sustainability objectives into its strategic decision-making.

The blend of considerable regional and deep industry knowledge from EPIF's board provides a balanced understanding of the unique risks of the regions and assets it operates. The board views the Russia-Ukraine conflict and its wider geopolitical implications, decarbonization (including the introduction of hydrogen into gas networks), and the future of gas in Europe as material risks, and its members showcase a strong awareness of the complicated nuances underpinning these risks. Board members show strategic flexibility in their thinking and while they use an informal approach to analyze scenarios, in-depth strategic discussions at the board level support resilience in their thinking about the impact of risks from major projects on the group's performance, and the long-term viability of potential acquisition targets. Still, the board views the conflict as a black swan event. Therefore, the eustream's strategic resilience will be challenged should Russian gas completely stop. EPIF is well prepared to use its infrastructure for the transit of gas sourced from other countries, although we don't see this as an immediate solution.

The group's management team has a track record of executing strategic acquisitions of operational and regulated assets in Central Europe in response to evolving market dynamics and contingency plans that mitigate potential disruptions. Through acquisitions, it has positioned itself among the key utility players in Central Europe. In addition, the company's networks are generally new and efficient, resulting in a relatively long-remaining useful life, low capital expenditure, and high cash flow conversion for the foreseeable future, in our view. The group has a rigorous and disciplined approach to deal due diligence and applies strict investment criteria to ensure deals are suitable for the risk appetite of EPIF's key shareholders and aligned with the long-term strategy, although sustainability is yet to be a core feature of this process.

The desired culture is still being shaped across the group's subsidiaries. It is largely influenced by its ultimate owner, Daniel Kretinsky, who promotes the strategy and vision of both of EPIF's shareholders that emphasizes entrepreneurship and innovation. While the group has a strong team and has effectively improved efficiency and communicated its goals for middle management and employees at all its acquired subsidiaries in the past few years, it is unclear the extent to which communications focus on the desired culture and efforts to track whether that culture is well understood are lacking. In addition, EPIF's efforts to integrate long-term sustainability objectives into its decision-making are relatively nascent, and it faces unique challenges as a relatively new group composed of subsidiaries with long operating histories, as it seeks to meet increasingly prescriptive regulatory requirements and to transition from fossil fuels.

Appendix

Sector And Region Risk

Primary sector	Utility Networks
Primary operating regions	Slovakia Czech Republic Germany

Sector Risk Summary

We base our sector analysis on EPIF's operations in the utility networks and oil and gas infrastructure (midstream) sectors, and we split exposure across these sectors according to the company's assets in 2022.

Environmental exposure

The regulated utility network sector's exposure to environmental risks stems from its infrastructure assets and exposure to the environmental characteristics of entities across value chains. These networks are generally viewed as having high responsibility for ensuring clean water and air and helping to transition to a lower carbon economy. While electric, gas, and water networks each have unique environmental risk drivers, the most material environmental risks facing these subsectors are the physical effects of climate change and mitigation policies. Each subsector also faces some land-use risk; as they grow, they risk encroaching on habitable or undeveloped lands that are more exposed to biodiversity issues in some parts of the world. Electric and gas utilities are exposed to significant energy transition risks, indirectly, through their upstream partners. These risks to networks are moderated, at least financially, by the regulatory support they enjoy and their ability to absorb costs through rate increases. However, less direct reputational effects can be significant given utilities' strong brand recognition. For electric transmission and distribution networks, the physical effects of climate change, including more frequent and severe wildfires, storms, hurricanes, and tornadoes, have the potential to disrupt the functioning of critical equipment and processes. Battery storage has its own set of environmental risks, stemming from mining and end-of-life disposals of materials used in battery units. For natural gas networks, we focus on gas explosions and leaks that emit highly potent greenhouse gases and may adversely affect local biodiversity, leading to costly penalties and reputational damage. For water networks, environmental risks are mainly water quality and availability, sometimes because of inefficient and aging infrastructure. Both water quality and availability--essential for this sector--can be impaired by climate-related factors, including droughts and floods.

Social exposure

The regulated utility network sector plays a crucial community role by providing essential services that must remain affordable and reliable to ensure conciliatory regulatory and customer relationships. This is the essence of utilities' social license to operate. However, as infrastructure ages, utilities must also ensure safety as leaks, explosions and fires can yield very material financial and reputational consequences. Water utilities may also face public health risks if they are unable to avoid drinking water contamination or stop wastewater from polluting supplies. Governments and regulators focusing increasingly on affordability, which we believe could create barriers to regulated networks' cost recovery. This is especially so in areas facing upward cost pressures from ongoing high investments in renewables and grid strengthening. Longer term, increased costs and improved solar and battery technology could result in some downstream residential, commercial, and industrial customers partially defecting from electric utilities. Utilities also face significant workforce issues. Amid an unrelenting energy transition, electric utilities, specifically, must develop employee bases with appropriate skills to operate the grid of the future, as well as retain employees. Given the sector's high unionization, companies have to focus on labor-relations management to avoid labor disruptions and related costs. Given that utilities are local in nature, they play a prominent role in communities and have large numbers of local employees. This can often result in regulatory support, but also carries a responsibility to contribute to the community and support low income customers, as well as tactfully mitigating disputes around land use as they expand. Finally, given the social responsibility of providing continuous electricity, gas, and water supply, preventing any risk that could lead to a power blackout or water shortage is an important consideration. Cyber-attacks are therefore increased threats for the sector, more so than in many other sectors.

Regional Risk Summary

Slovakia

Corporate governance legislation in Slovakia is primarily based on the Securities Act, the Accounting Act, and the Commercial Code. In 2002, the Stock Exchange and the Financial Market Authority adopted a first version of a corporate governance code. It was then adapted by the Central European Corporate Governance Assn., which released the latest version in 2016. Mostly principles-based, the code works on a comply-or-explain basis. Although companies are required by law to report annually on their compliance with the code, the level of adoption and quality of disclosures are low. Companies operate under a dual-board system with a supervisory board overseeing a management board. However, the supervisory board's role is ill-defined by the law and shareholders can still elect and remove members of both boards. This takes an important responsibility away from the supervisory board of directors. Boards often lack independence--there is no independence requirement--and female participation is significantly lower than for the rest of Europe. Perceived corruption is relatively high, and the country ranks in the weaker half of EU countries (56 of 180 on Transparency International's 2021 Corruption Perceptions Index).

Czech Republic

The country's key political and economic institutions have a good track record of independence and effectiveness despite the greater instability of Czech governments, historically. Based on OECD principles, the 2018 Czech corporate governance code is the reference document for best practices. It operates on a comply-or-explain basis, but companies are required to publish an annual statement on their alignment with it. Companies can choose between one- or two-tiered governance structures where a supervisory board oversees the executive board. At companies with over 500 employees, employees can elect one-third of the supervisory board. While the stock exchange doesn't have specific ESG requirements in its listing rules, larger companies are implementing the EU Non-Financial Reporting Directive's recommendations, which mandate disclosing ESG risks. The Czech Republic's perceived corruption levels are higher than other developed EU countries and it ranks 49 of 180 on Transparency International's 2021 Corruption Perceptions Index.

Germany

Germany has strong institutional and governance effectiveness. Rule of law is strong, the judiciary is independent, and corruption is viewed as a minor issue. Germany ranks 10 of 180 on Transparency International's 2021 Corruption Perceptions Index. The German Corporate Governance Code (Kodex) is the reference document for best practices and works on a comply-or-explain basis. Its last iteration came into effect in 2020 when the EU Shareholder Rights Directive II was transposed into German law. Notable improvements include recommendations on board independence and board oversight of related-party transactions and executive pay, with a shareholder vote on the remuneration report becoming mandatory in 2022. While the recommendations are less specific than most European codes, companies exhibit strong governance practices. Companies are typically governed by a two-tier board system: a management board overseen by a supervisory board comprising non-executives including shareholder and employee representatives. The 2021 Act on Strengthening Financial Market Integrity (FISG) is an important milestone aimed at strengthening financial oversight at German companies. Besides requiring a minimum number of financial experts on boards, since January 2022 all listed companies must also form an audit committee.

Appendix

Related Research

- "Environmental, Social, And Governance Evaluation: Analytical Approach," Dec. 15, 2020
- "The ESG Risk Atlas: Sector And Regional Rationales And Scores," July 22, 2020
- "Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide," July 22, 2020
- "How We Apply Our ESG Evaluation Analytical Approach: Part 2," June 17, 2020

This report does not constitute a rating action.