

4.2.2015

FORTUM IN RUSSIA

How would you describe Fortum's business environment in Russia at the moment?

Fortum operates in the Urals and Western Siberia in the Tyumen and Khanty-Mansiysk area, where industrial production is dominated by the oil and gas industries, and in the Chelyabinsk area, which is dominated by the metal industry. In 2014, the demand for electricity was stable: Electricity consumption in Fortum's operating area in the First price zone (European and Urals part of Russia) was 777 (772) TWh.

In Russia, we buy fuels and pay salaries in roubles, and our customers pay in roubles. The euro-denominated result level will be volatile, mainly due to the translation effect.

Our investment programme is nearly completed. The programme was started in 2008, when Fortum acquired TGC-10 (OAO Fortum). The programme comprises eight new units, of which six are now ready and in commercial use. The remaining two units are estimated to be commissioned during the first half of 2015.

What was the financial result of the Russian operations in 2014?

In January-December, Russia contributed positively to Fortum's results: comparable EBITDA was EUR 304 million (2013: 258) due to:

- new units receiving capacity payments (CSA) based on the Russian Government's capacity supply agreements to power generation capacity built after 2007
- better electricity and heat spreads and income from heat connections
- improved bad-debt collections
- increased efficiency of our operations

The weakened Russian rouble affected the result negatively by approximately EUR 34 million.

The Russian operations have an important role in Fortum's strategy, and the company's goal is to achieve solid earnings growth in the segment. In 2014, sales by Fortum's Russian business were approximately EUR 1.1 billion (~22% of Fortum's sales) and the comparable operating profit was EUR 161 million (~12% of Fortum's comparable operating profit). At the end of December 2014, Russia's share of Fortum's net assets was about 20%. Fortum has approximately 4,200 employees in Russia.

Fortum has had diverse business relations with the country for more than five decades.

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What is the status of the Russian investment programme in Western Siberia?

We started an ambitious investment programme in 2008 to build a total of 8 new production units and to modernise existing capacity and connections. The programme is now nearly concluded, with six of the new units in commercial operation. The remaining two units are estimated to be commissioned during the first half of 2015.

The run-rate operating profit (EBIT) target for the Russia Segment, RUB 18.2 billion, is to be reached during 2015. The euro-denominated result level will be volatile, mainly due to the translation effect.

What is the rationale behind the plan to restructure TGC-1 in Russia and to participate in Fennovoima nuclear project in Finland?

We see this as a great opportunity to increase our CO₂-free hydropower capacity, optimise our production portfolio in Russia and increase the flexibility that hydropower offers. Once the transaction is completed, Fortum's hydropower capacity will be increased by 60%.

Gazprom Energoholding (51.8%) and Fortum (29.5%) are currently the main owners of TGC-1, which is listed on the Moscow Exchange (MOEX). The company owns and generates hydro and thermal power plants in North-western Russia as well as heat distribution networks in St. Petersburg. In line with our strategy, we are interested in obtaining the hydro assets of TGC-1 and more than 75% ownership in the hydro company.

Participating with a minor stake in Fennovoima is part of the package that enables the restructuring of TGC-1 and Fortum obtaining more than 75% ownership of its hydropower assets.

Our core competencies are in CO₂-free hydro and nuclear power and efficient CHP production.

How is the restructuring process proceeding?

In December the parties signed a protocol to start the restructuring process of TGC-1. Now we are working to complete detailed structuring, practical arrangements and final commercial terms.

Provided that Fortum obtains a more than 75% ownership in TGC-1 hydro assets, Fortum would be ready to participate with a minority stake (max. 15%) in the Finnish Fennovoima nuclear power project on the same terms and conditions as the other Finnish companies currently participating in the project.

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How much will this restructuring cost?

By utilising our present stake in TGC-1 (29.5%), Fortum intends to obtain more than 75% ownership in the hydropower business. Rosatom would have a less than 25% minority holding in the hydropower company. We are working to complete detailed structuring, practical arrangements and final commercial terms.

What is the outlook for your operations in Russia?

The Russia Segment's new capacity will be a key driver for earnings growth in Russia, as it is expected to bring income from new volumes sold and to receive considerably higher capacity payments than the old capacity. CSA payments can vary somewhat annually because they are linked to Russian Government long-term bonds with 8 to 10 years maturity. In addition, the regulator will review the earnings from the electricity-only market three years and six years after the commissioning of a unit and could revise the CSA payments accordingly.

In 2014, the Ministry of Energy proposed a new heat market model (for public discussion), which is supposed to ensure a transition to economically justified heat tariffs by 2020 and attract investments into the heat sector. In September 2014, the heat market reform roadmap was approved by the Russian Government. According to the roadmap, the reform shall give heat market liberalisation by 2020 or, in some specific areas, by 2023.

Our plans to restructure TGC-1 would optimise our production portfolio, balance our geographical presence and increase our flexibility in Russia.