



RATING ACTION COMMENTARY

Fitch Affirms Fortum Oyj on Uniper SE's Stabilisation Plan

Fri 05 Aug, 2022 - 9:39 AM ET

Fitch Ratings - Milan - 05 Aug 2022: Fitch Ratings has affirmed Fortum Oyj's Long-Term Issuer Default Rating (IDR) at 'BBB' with Negative Outlook and Short-Term IDR at 'F3'.

The affirmation mainly reflects our view that Fortum is now well-shielded from the losses incurred by its German subsidiary Uniper SE, following the latter's stabilisation package agreed with the German State. Although Fortum is still fully consolidating Uniper in its accounts, we now assess Fortum on a standalone basis (ie. excluding Uniper), given the complete absence of cash flows from/to Uniper over our forecast horizon to 2024 and the low visibility over the future shareholding structure of the subsidiary.

Fortum's rating is supported by its clean electricity generation business, which is benefitting from high electricity prices, as well as management's proven commitment to policies consistent with the current rating.

The Negative Outlook reflects Fitch's expectation of no headroom under Fortum's funds from operations (FFO) net leverage on a standalone basis for a 'BBB' rating (sensitivity of 3.5x). We estimate Fortum's leverage to significantly increase to 4.4x at end-2022, following considerable financial support it has provided to Uniper.

KEY RATING DRIVERS

Standalone Rating Approach: Fitch is taking a standalone approach in its assessment of Fortum, ie deconsolidating Uniper. We believe that the stabilisation package agreed between Uniper, Fortum and the German State protects Uniper from insolvency and above all clarifies the role of all the involved parties in the rescue of the German utility.

We expect no cash flows between Fortum and Uniper at least until 2024, while Fortum's permanence as a majority shareholder will mostly depend on its decision on the conversion of the EUR4 billion inter-company loan it granted to Uniper into new mandatory convertible instruments of up to EUR7.7 billion to be initially underwritten by the German State.

Equity Support for Uniper: Reduced gas volumes delivered by Gazprom since mid-June 2022 has resulted in significant losses for Uniper, which has turned to buying gas in the spot market at extremely high prices to meet its shortfall and honour its supply contracts. Total losses for mid-June to end-September could be in the range of EUR6 billion-EUR8 billion. Under the stabilisation package, the German State will provide EUR0.3 billion in return for a 30% equity stake in Uniper and up to EUR7.7 billion through the issue of mandatory convertible bonds. These will be issued when needed to cover losses resulting from gas curtailment.

Further Protection Measures from Package: From 1 October 2022, Uniper will be allowed to pass onto customers 90% of the extra costs related to the replacement of Russian gas. This should bring its finances back under control, even if not totally stabilised. Also under the package the German government will provide further support if replacement cost losses that cannot be offset by operating profits from Uniper's other businesses exceed EUR7 billion.

Uniper's Liquidity Tension Addressed: Under the stabilisation package, the German state bank KfW will provide additional liquidity support to Uniper of up to EUR7 billion, by increasing its existing EUR2 billion credit facility up to EUR9 billion. The KfW facility will become available in the next few weeks and is meant also as a bridge financing until the convertibles are issued starting from autumn 2022, and will thereafter remain as a back-up facility until the end of the stabilisation period.

Final Shareholding of Uniper Uncertain: Fortum's decision about the conversion of its EUR4 billion intercompany loan into mandatory convertibles will define its role in Uniper's shareholder structure. We believe that the company will convert and remain as majority shareholder only if it is fully confident about the business risk profile and future of Uniper. Until then no new money will be invested in Uniper.

High Starting Debt: Our estimate of Fortum's net debt on a standalone basis at end-2021 is around EUR6.4 billion, which includes EUR2.5 billion to fund the intercompany loan to Uniper. In 1Q22, Fortum had to fund the remaining EUR1.5 billion of the intercompany loan. To mitigate the debt increase, Fortum sold its stake in Oslo Varme for around EUR1.2 billion in 1Q22 and we expect it to sell its Russian assets by end-2022. Further, we expect 2022 to be a strong year for operating cash flow generation. We project net

debt of around EUR6.5 billion end-2022, without considering any cutbacks to capex or dividends.

Strong Fundamentals for Clean Generation: Fortum's generation business is mostly based on nuclear and hydro capacity in the Nordics, benefiting from current electricity prices that are not already hedged for 2022 and 2023 (20% and 45% at end-1Q22, respectively). Our rating case, which considers much lower prices than the forwards for unhedged volumes, includes a standalone EBITDA on average of around EUR1.85 billion for 2022-2024. As a result, we expect FFO net leverage to stabilise around 3.5x in 2023-2024, after its peak of 2022.

Debt Capacity Improvement: Deconsolidating Uniper has improved Fortum's debt capacity to 3.5x for 'BBB', from 3.0x, given the weaker profile of the German company. It reflects Fortum's profile as a large clean generation company, complemented by some defensive activities in its city solution business and a higher-risk consumer solution division. The deconsolidation of Uniper, if confirmed in the future, would also remove some long-term challenges for Fortum, especially related to the management of a large thermal generation fleet.

Commitment to Rating: A key factor for the rating affirmation is management's commitment to financial policies consistent with the rating. After Uniper's acquisition, Fortum's management has been proactive in reducing the company's leverage to within its rating sensitivities. Fortum has demonstrated a good ability to execute disposals and we believe it would be prepared to scale back capex and dividends, if needed.

DERIVATION SUMMARY

Fortum's closest peers are Statkraft AS (BBB+/Stable, including a single-notch uplift reflecting government links, which we view as stronger compared with that of Fortum and the Finnish government) and RWE AG (BBB+/Stable). Fortum's debt capacity at 'BBB' is in line with Statkraft's, given their clean asset base, which is mostly focused on the Nordics. Statkraft has a higher prominence of hydro (versus hydro and nuclear for Fortum), but is less integrated in activity than Fortum.

RWE has a higher share of quasi-regulated business (50%-60%), but unlike Fortum remains significantly exposed to thermal generation and its implied debt capacity would probably be slightly lower than Fortum's.

ERG S.p.A. (BBB-/Stable) benefits from much higher revenue visibility (generally through auctions or power purchase agreements), but it is smaller and lacks hydro generation and integration into supply. ERG has a slightly higher debt capacity than Fortum (positive sensitivity 3.6x).

KEY ASSUMPTIONS

- Deconsolidation of Uniper from our rating case since we now rate Fortum on a standalone basis
- Fortum's annual EBITDA averaging EUR1.85 billion in 2022-2024 (no contribution expected from Fortum Russia, which will be sold)
- Tax rate as communicated by the company
- Cash-in related to the settlement of margining receivables of EURO.6 billion on a cumulative basis
- Capex of around EURO.6 billion per year (excluding Uniper & Fortum Russia)
- Dividends at around EUR 1 billion p.a.
- Sizeable disposal proceeds in 2022

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- An upgrade is unlikely under current market conditions unless FFO net leverage falls below 1.5x on a sustained basis, assuming an unchanged business profile

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO net leverage above 3.5x and FFO interest coverage cover below 5.0x, both on a sustained basis
- Failure to implement Uniper's stabilisation package in its current form (ie. with no new money required from Fortum)
- Failure to implement the planned disposals, if not offset by sufficient cutbacks to capex and/or dividends
- New money injected into Uniper could lead us to rate Fortum on a consolidated basis and tighten its debt capacity
- Regulatory pressure on the generation division through, for example, introduction of windfall taxes, among others

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: We view the standalone liquidity position of Fortum as adequate. As per the last financial statement of March 2022, Fortum had a standalone cash balance of around EUR3 billion and undrawn committed credit lines of EUR3.9 billion to cover maturities of EUR3.6 billion in the following 12 months.

In June 2022 Fortum further reinforced its liquidity by signing new committed EUR3.1 billion liquidity facility with a 12 month maturity (plus two six-month extensions at the borrower's discretion) and EUR2.4 billion syndicated revolving credit facility (RCF) with a three-year maturity (plus two one-year extensions at the lenders' discretion). These facilities are mainly envisaged to repay its EUR 1.75 billion existing/drawn debt and to replace its undrawn RCF of EUR3 billion that expired in July 2022.

ISSUER PROFILE

Fortum is a Finnish state-owned energy company engaged in the generation and sale of electricity, heat, cooling, and power products and services.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Fitch has revised Fortum's ESG Relevance Score of energy management to '3' from '4', following the agency's deconsolidation approach. This is because the large scale of thermal generation, which had a negative impact on the credit profile, was entirely due to Uniper.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Fortum Oyj	LT IDR	BBB Rating Outlook Negative		BBB Rating Outlook Negative
	Affirmed			
	ST IDR	F3	Affirmed	F3
senior unsecured	LT	BBB	Affirmed	BBB

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)](#)
(including rating assumption sensitivity)

[Corporate Rating Criteria \(pub. 15 Oct 2021\)](#) (including rating assumption sensitivity)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 ([1](#))

ADDITIONAL DISCLOSURES

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Endorsement Policy

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Fortum Oyj

EU Issued, UK Endorsed

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Corporate Finance Utilities and Power Europe Finland
