



RATING ACTION COMMENTARY

Correction: Fitch Revises Outlook on Fortum to Stable; Affirms at 'BBB'

Wed 30 Jun, 2021 - 10:06 AM ET

Fitch Ratings - Milan - 30 Jun 2021: This is a correction of a rating action commentary published on 28 June. It includes additional information in the Summary of Financial Adjustments.

Fitch Ratings has revised the Outlook on Fortum Oyj's Long-Term Issuer Default Rating (IDR) to Stable from Negative and affirmed the IDR and senior unsecured rating at 'BBB'.

The revision of the Outlook mainly reflects Fortum's good performance in 2020 despite the challenges brought about by the pandemic. It also reflects the progress in integration with Uniper, asset disposals and the group's strategic guidelines, which include financial commitments commensurate with current rating as a key pillar.

The rating reflects Fortum's solid market positioning, focus on cash flow protection and moderate funds from operation (FFO) net leverage that we forecast until 2023. It also reflects the large exposure to merchant businesses, the significant role of thermal generation after Uniper's consolidation and a generous dividend policy.

KEY RATING DRIVERS

Feedback

Healthy 2020 Performance: Fortum achieved good results in 2020, considering the challenging market conditions. With Uniper consolidated from April 2020, the group reported EBITDA of around EUR2.4 billion. Hedging in the Nordics proved effective, with achieved prices in the region down by 5% year-on-year, while the spot price declined by 72%. Fitch-defined net debt rose only by EUR1.1 billion to EUR6.1 billion, as the group's operating cash flow and EUR1.3 billion divestments compensated for a large part of the outflow related to the Uniper transaction. The resulting FFO net leverage of 2.7x was substantially lower than our expectations.

Focus on Deleveraging: The company has communicated to the market that its focus in 2021-2022 will be on strengthening the balance sheet. Consequently, we expect that activities currently under strategic review, including the district heating businesses in Poland and Baltics, the consumer solution business and the 50% stake in Stockholm Exergi, will eventually be sold. Based on our estimates, this would imply a large cash-in for Fortum, bringing FFO net leverage well below our rating sensitivity of 3.0x for 'BBB' for the rating horizon until 2023.

Growth From Sustainable Activities: Fortum has indicated cumulative growth capex of EUR3 billion for 2021-2025, mainly focused on renewables, hydrogen and clean gas and environmental solutions. Our rating case does not include a material earnings contribution from these investments until 2023. We understand that Fortum will retain flexibility in terms of the development model applied to renewables, opting for consolidation or sale of assets depending on strategic priorities and market conditions. We view a step-up of the investment plan as highly likely if the assets currently under strategic review are entirely sold.

Challenges From Energy Transition: The consolidation of Uniper has brought some challenges for the group, mainly related to the phase out of coal and the management of a very large gas fleet. Uniper's coal fleet has a capacity of almost 8GW excluding Russia. Coal-fired electricity production represents around 12% of Fortum's total production and the group has committed to becoming carbon neutral in European generation by 2035 at the latest and at a group level (ie. mainly including Russia) by 2050. The role of the gas fleet will remain important in the medium term, as decarbonisation gradually occurs. However, its profitability is subject to merchant risk, exacerbated by the recent high volatility in the commodities and CO2 markets.

Gradually Evolving Business Mix: We estimate that around 50-60% of Fortum's earnings is subject to merchant risk, with the remaining part quasi-regulated. The quasi-regulated portion includes a mix of activities, such as the capacity supply agreements (CSA) in Russia,

some capacity payments in the UK, the city solutions business (mainly waste and district heating) and other activities and services provided by Uniper.

We assign higher debt capacity to quasi-regulated activities related to renewables with long residual life of the incentives (or power purchase agreements) compared with most of Fortum's quasi-regulated activities. We expect the business mix to gradually change under the opposing pressures of expiring CSAs in Russia and additional renewables capacity.

Buyout of Uniper Minorities: Fortum currently owns 76.1% of Uniper and has committed to not buy out the minorities until the end of 2021. Based on the current market conditions, the buyout would imply a cash-out of around EUR2.7 billion, with a FFO benefit deriving from the absence of the dividend currently paid to Uniper's minorities (we assume around EUR170 million). This transaction would be largely negative for the company's credit ratios, and we expect it to be done only with mitigation measures, and consistently with the commitment to preserve the current rating.

DERIVATION SUMMARY

Fortum's closest peers are Statkraft AS (BBB+/Stable, including one notch uplift reflecting government links) and RWE AG (BBB+/Stable). The group's debt capacity at 'BBB' is 0.5x lower than both peers (3.0x vs. 3.5x). Statkraft has a similar share of quasi-regulated business, but benefits from a substantially cleaner asset base dominated by low-cost hydro. RWE has a higher share of quasi-regulated business (50-60%), but is also significantly reliant on thermal generation, like Fortum.

Other gencos mostly focused on renewables like ERG S.p.A. (BBB-/Stable) and Orsted A/S (BBB+/Stable) benefit from the higher revenue visibility of this business (generally through auctions of power purchase agreements) and have higher debt capacity than Fortum (negative sensitivity at 'BBB' is 3.4x for ERG, 3.5x at 'BBB+' for Orsted).

KEY ASSUMPTIONS

- Power price assumptions considered for Fortum and Uniper based on forwards and hedging levels of 1Q21.

- Group EBITDA averaging EUR2.4 billion in 2021-2023 (including full-year Uniper consolidation).
- Annual capex at around EUR1.3 billion per year.
- Dividend payments remaining around EUR1 billion based on the announced dividend policy.
- Cash-in for disposals of EUR 4.5 billion in 2021-2022, related to announced divestments and companies set under strategic review.

RATING SENSITIVITIES

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

- FFO net leverage under 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 3.0x on a sustained basis, FFO interest coverage cover below 5.0x on a sustained basis.
- Significant deterioration of the political, economic or regulatory environment in Russia or significant structural decline in Nord Pool power prices.

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: Fortum's liquidity position was EUR7.3 billion at end-December 2020, mainly including:

- EUR1.9 billion cash and cash equivalents
- EUR363 million deposits and commercial papers with maturity over three months
- Around EUR5 billion committed undrawn credit lines (out of which EUR1.45 billion matures in November 2021 and EUR1.75 billion matures in June 2023).

Fortum's EUR1.3 billion short-term maturities as of end-December 2020, as well as major repayments due in 2022 and 2023 (EUR3 billion and EUR1.1 billion, respectively) can be fully covered by the liquid assets.

ISSUER PROFILE

Fortum is a Finnish energy company majority-owned by the state engaged in the generation and sale of electricity, heat, cooling, and power products and services. The company is the third-largest power generator in Europe and Russia and the third-largest nuclear generator in Europe.

SUMMARY OF FINANCIAL ADJUSTMENTS

Fitch adjusts the financials in order to treat Fortum's margining asset and liabilities as cash and financial debt, respectively. This choice considers the high quality of the clearing house counterparty and the artificial volatility of cash flows and net debt which would derive from considering these items as working capital. This adjustment reduces FY20 net debt by around EUR800 million, with a reduction of FFO net leverage by around 0.4x.

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

Fortum Oyj has an ESG Relevance Score of '4' for Energy Management due to increased share of coal-fired power generation subject to ETS and commodities price, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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		
Fortum Oyj	LT IDR	BBB Rating Outlook Stable	Affirmed
	ST IDR	F2	Affirmed
● senior unsecured	LT	BBB	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)[Corporate Rating Criteria \(pub. 21 Dec 2020\) \(including rating assumption sensitivity\)](#)[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)
\(including rating assumption sensitivity\)](#)[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub. 30 Apr 2021\)](#)**APPLICABLE MODELS**

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Fortum Oyj

EU Issued, UK Endorsed

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