Uniper Exit Is Credit Positive for Fortum

Transaction Improves Financial Profile, Eliminates Contagion Risk; New Strategy Will Be Fundamental for Rating

"The divestment of its stake in Uniper will allow Fortum to recover only a small part of the investment made. However, from a rating perspective the deconsolidation of Uniper improves Fortum's business risk profile and the cash-in of the intercompany loan materially reduces its leverage. The company's updated strategy, especially in relation to the use of the financial headroom originated by the transaction, will be very important for the rating, but we assume the commitment to the 'BBB' rating will remain."

Antonio Totaro, Senior Director, Fitch Ratings

Fitch has rated Fortum Oyj (BBB/Negative) on a standalone basis (i.e. deconsolidating Uniper SE) since the announcement of the stabilisation plan agreed between Fortum and the German state in July 2022. We see the recent agreement by the German state to buy Fortum's stake in Uniper as credit positive for the company, as it would improve its financial profile, while eliminating any residual contagion risk from Uniper's gas business losses.

The transaction is subject to regulatory clearances and approval by Uniper's Extraordinary General Meeting. We expect to update our rating case after the transaction closes in a few months and we gain visibility on Fortum's new strategy.

Definitive Exit from Uniper Is Credit Positive

The amendment of the stabilization plan agreed in September 2022 implies the full acquisition by the German state of Fortum's shares in Uniper for EUR0.5 billion. The agreement also entails the repayment of Fortum's EUR4 billion intercompany loan to Uniper, which would lead to a strong de-leveraging of Fortum and improve its liquidity position.

Assuming that both the exit from Uniper and the sale of the Russian assets would close in 2022, we estimate funds from operations (FFO) net leverage around 1.5x at end 2022. This compares with Fortum's negative sensitivity of 3.5x for a 'BBB' rating and is well below our previous FY22 estimate of 4.4x. In addition, the transaction brings visibility to Fortum's final configuration, ruling out any potential re-consolidation of Uniper for rating purposes.

Standalone Business Profile Is Stronger

In August 2022 Fitch increased Fortum's debt capacity to 3.5x, from 3.0x, as the deconsolidation of Uniper improves the group's business risk profile as a pure clean generator.

Fortum standalone benefits from the strong fundamentals for clean generation. The extremely high prices represent an upside to our rating case, as Fitch considers much lower prices than the forwards for unhedged volumes. Price caps or windfall taxes would be neutral to our rating case, given our conservative price assumptions.

New Strategy Will be Fundamental

The de-leveraging resulting from the transaction would allow the company to capture more growth opportunities related to the energy transition. The impact on geographical diversification and contracted share of earnings will be important for debt capacity.

The capex and dividend policy will be updated later, but we expect the commitment to the current rating to remain. The company has reiterated its need – as a capital-intensive utility – to maintain a solid investment-grade rating, which also underpins its solid position as a trading counterparty, which is key in the current volatile price environment.

Related Research

Fitch Affirms Fortum Oyj on Uniper SE's Stabilisation Plan (August 2022)

Mixed Hit on EU Utilities from Extreme Market Conditions (September 2022)

Spotlight: European Utilities Resilient to Windfall Tax, Political Risk Remains (June 2022)

Spotlight: The Challenge of Replacing Russian Gas in the EU (May 2022)

EU Can Withstand Russian Gas Crisis But Not Without Pain (September 2022)

Fitch Rtgs: Russian Gas Replacement Only Feasible in Medium Term in Europe (April 2022)

Analysts

Antonio Totaro
+39 02 94758280
antonio.totaro@fitchratings.com

Jaime Sierra
+49 69 768076 275
jaime.sierrapuerta@fitchratings.com

Agreed Transaction Improves Visibility

Fitch affirmed Fortum's IDR at 'BBB'/Negative in August 2022 in light of the stabilisation package presented in July 2022 by Fortum and the German state. We also moved to a standalone approach in our assessment of Fortum (i.e. deconsolidating Uniper), since in our view the stabilization plan sufficiently shielded Fortum from the losses incurred by its German subsidiary Uniper.

Uniper has accumulated higher economic losses than envisaged in July 2022, totalling EUR8.5 billion at 16 September 2022. This is mainly due to Gazprom's indefinite shutdown of Nord Stream 1 at the beginning of September 2022 and the extremely high spot prices of gas across Europe. As a result, the parties have amended the stabilization plan and have agreed on the full acquisition by the German State of Fortum's shares in Uniper for EUR1.70 per share, valuing Fortum's stake at EUR0.5 billion. The agreement also entails the repayment of Fortum's EUR4 billion intercompany loan (IC loan) to Uniper and the release of the EUR4 billion parent guarantee provided to Uniper, which we expect immediately after closing.

The transaction would represent a large investment loss for Fortum, as it spent almost EUR7 billion to build up its stake in Uniper and is now recovering only a small part of the investment. However, in the current circumstances we see the deal as credit positive for Fortum.

In our latest rating case of August 2022 (which assumed the disposal of the Russian business, but not the Uniper divestment nor the recovery of the IC loan) we estimated Fortum's standalone FFO net leverage at 4.4x for FY22. The disposal of Uniper for EUR 0.5 billion and the recovery of the EUR4 billion IC loan would bring FFO net leverage around 1.5x by end-2022, all else being equal. This would imply substantial rating headroom given our negative sensitivity set at a maximum FFO net leverage of 3.5x for Fortum's 'BBB' IDR.

Impact of EUR4.5 billion Inflow from the German State on Fitch's Rating Case

	2022	2023
Fitch Rating Case		
Net Debt (Fitch-defined)	6,587	5,871
FFO net leverage (x)	4.4	3.4
Fitch Rating Case assuming EUR4.5bn inflow		
Net Debt (Fitch-defined)	2,089	1,373
FFO net leverage (x)	1.4	0.8

Source: Fitch Ratings

In addition, the transaction also brings visibility to the final configuration of Fortum, ruling out any potential re-consolidation of Uniper for rating purposes and eliminating any residual contagion risk from Uniper's gas business losses. We expect the deal to close by end-2022. It is subject to regulatory clearances (including from the European Commission), and approval by Uniper's Extraordinary General Meeting.

Fortum Becomes (Again) a Clean Genco

In our view the definitive sale of the stake in Uniper would be beneficial for Fortum's business profile. When Fortum acquired the majority of Uniper, we tightened the group's debt capacity for a 'BBB' rating by 0.6x (based on FFO net leverage).

This was mainly due to the increasing exposure to CO2 prices, and Uniper's volatile gas midstream and commodity trading business, for which we did not assign any debt capacity at investment grade (see Fitch Places Fortum's 'BBB' Rating on Rating Watch Negative). Moreover, we assigned an ESG Relevance Score of '4' for Energy Management due to increased share of coal-fired power generation subject to ETS and commodities price.

Conversely, the deconsolidation of Uniper, which we implemented for rating purposes in August 2022, implied a relaxation of the debt capacity for a 'BBB' rating by 0.5x to 3.5x.

Moreover, the Russian invasion of Ukraine has triggered the decision by Fortum to sell its Russian business, which we expect to materialize in the coming quarters.

As a result, and also considering the sale of various district heating assets implemented in the context of the strategic review done in 2020-2021, Fortum will have the profile of a clean genco, with some additional activities (City Solutions and Consumer Solutions) representing in total around 15% of the EBITDA based on our estimates.

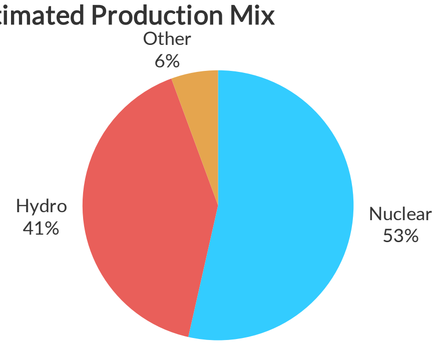
Fortum Divisional EBITDA Without Russian Assets and Uniper

(EURm)	Company figures		Fitch conservative estimates	
Divisional EBITDA	**2020**	**2021**	**2022**	**2023**
Nordic Generation	886	1299	1,535	1,959
City Solutions	239	317	200	200
Consumer Solutions	153	123	140	140

Source: Fitch Ratings

On average, we expect Fortum to generate between 50-55 TWh/year of electricity in the Nordics, entirely from clean generation, on the basis of the split shown in the chart below.

Fortum Estimated Production Mix



Source: Fitch Ratings

Fortum is now well placed to benefit from the strong fundamentals for clean generation. The extremely high electricity prices will boost revenues of unhedged volumes in 2022, whereas the higher hedged prices (and still very high forward prices) will support revenues in 2023-2024.

The recent price levels represent an upside to our rating case, as Fitch considers much lower prices than the forwards for unhedged volumes, resulting in a standalone EBITDA of close to EUR2 billion on average in during 2022-2024. By contrast, price caps or windfall taxes would be rather neutral to our rating case, given our conservative price assumptions.

Fitch's Conservative Assumptions vs. Forward Prices

	2022	2023
Fortum's unhedged electricity volumes in Nordic generation in 1H22 (%)	20	40
Fitch's assumed electricity prices for Fortum's unhedged volumes in Nordic generation (MWh)	120	90
Nordic electricity forward prices as of 1 July 2022 (MWh)	188	113
Nordic electricity forward prices as of 1 Sep 2022 (MWh)	275	188

Source: Fitch Ratings, Bloomberg

Fortum has also the right of first offer until end-2026 if Uniper decides to sell all or parts of its Swedish assets. This could be an interesting expansion opportunity for Fortum, as we estimate that the Nordic assets of Uniper generate around 20TWh/year from nuclear and hydro, substantially in line with the asset base of Fortum itself.

New Strategy Is Fundamental for Assessing How Fortum Will Use Financial Headroom

We estimate an FFO net leverage around 1.5x for Fortum in FY22, based on our conservative assumptions, and assuming a cash-in of EUR4.5 billion from the German state at end-2022. Leverage would reduce further in 2023, assuming the current capex policy and dividends in line with the historical level.

We believe that the company will have to elaborate a new strategic plan given the completely new scenario compared to only a few months ago. This would explain how it wants to use the financial headroom created by the transaction and the healthy expected profits.

We expect Fortum to focus firmly on clean generation and energy efficiency solutions, although external growth for these asset classes could be very expensive.

We will have to assess the strategic direction (eg potential diversification, merchant or contracted activities) and the financial policy of the company, and whether it might favour dividends over growth or vice versa.

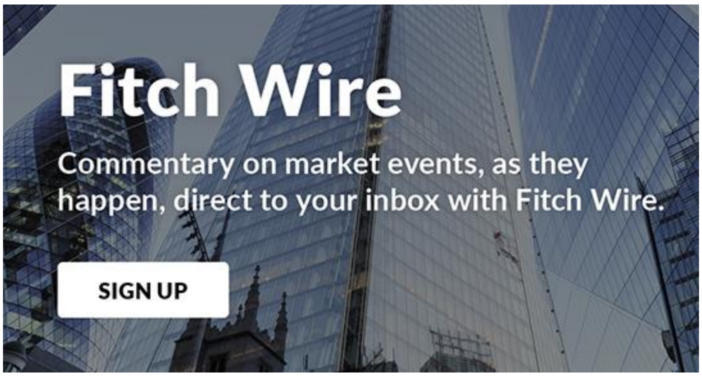
We assume that the commitment for the ‘BBB’ rating will remain, as publicly stated by the management and demonstrated in the past, and that any strategic update would take that into account.

Liquidity Still Has to be Monitored, but Should Improve in the Short Term

Fortum standalone had a cash balance of around EUR1 billion and undrawn committed credit lines of EUR3.6 billion to cover fixed maturities of EUR2.7 billion in the following 12 months, according to the most recent financial statement of June 2022.

Fortum, like many other utilities in Europe, has been facing significant margin payments during 2022 (with a EUR1 billion weekly increase in collateral requirements at end-August 2022), which were covered with own funds. Liquidity remains adequate, in our view, and Fortum has also obtained liquidity support from the Finnish state, in the form of a one-year, incremental liquidity facility of EUR2.35 billion signed in September 2022. Fortum has recently drawn a EUR350 million tranche under this facility, as this was a condition required for the loan to remain effective.

The repayment of the EUR4 billion intercompany loan by end-2022 and the disposal of Uniper’s stake and Russian assets would further enhance Fortum’s liquidity position.



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