Research Update:

Uniper And Fortum Ratings Placed On CreditWatch Negative As Earnings And Liquidity Are Hit By Russian Gas Import Cut

July 5, 2022

Rating Action Overview

- Gazprom's cut of Nordstream 1 pipeline flows to 40% of capacity since mid-June is forcing Uniper SE to procure missing volumes in the market. Absent a specific cost pass through mechanism, Uniper faces significantly higher prices, which we estimate is currently leading to losses in the low- to mid-double-digit million area per day and likely to increase in case of further reductions or significant gas price movements.
- As a result, Uniper withdrew its financial guidance for 2022 on June 29, 2022, and we believe the financial hit could be very material for the company and its parent Fortum Oyj, given Uniper normally contributes about 50% to Fortum's consolidated EBITDA.
- We understand Uniper is exploring support mechanisms with the German government, which could lead us to capture extraordinary government support in our rating when we obtain sufficient clarity on the magnitude and scope of such a plan. We still assume Uniper will have sufficient support through government committed credit lines to cover its liquidity needs beyond resources provided by Fortum, if needed.
- We placed our 'BBB/A-2' long- and short-term ratings on Fortum and our 'BBB-' long-term rating on Uniper on CreditWatch with negative implications.
- The CreditWatch negative on both companies reflects our view that Uniper is dependent on external factors, including government support, to sustain its financial position so long as the situation continues. In our base case, a government mechanism will soon be in place to support Uniper and possibly the broader sector, reinforcing the 'BBB-' rating. The CreditWatch also reflects our view that incremental costs at Uniper will weigh on Fortum's already tight credit metrics, potentially putting significant pressure on the group's credit quality in the short term.

PRIMARY CREDIT ANALYSTS

Daniel Annas
Stockholm
+46 (8) 4405925
daniel.annas
@spglobal.com

Gerardo Leal
Frankfurt
+ 49 69 33 999 191
gerardo.leal
@spglobal.com

SECONDARY CONTACTS

Per Karlsson
Stockholm
+ 46 84 40 5927
per.karlsson
@spglobal.com

Emmanuel Dubois-Pelerin
Paris
+ 33 14 420 6673
emmanuel.dubois-pelerin
@spglobal.com

Rating Action Rationale

Reduced Russian exports are forcing Uniper to procure gas on the market, leading to a rapidly expanding financial burden. Since June 14, 2022, Gazprom has reduced flows through the key Nordstream 1 pipeline to 40% of its about 150 million cubic meters (mcm) per day capacity. Since then, Uniper has received only 40% of its contracted gas supply from Gazprom. Gazprom contracts normally represent more than 50% of its 370 terawatt hours (TWh) of annual gas procurement, making it the most exposed gas importer in Germany to Russian gas. Because Uniper has sold gas forward against its Russian supply, the company is currently forced to use flexibility clauses in its existing contracts with alternative suppliers and procure the remaining deficit on the market at significantly higher prices to compensate for the imbalances. This is leading to losses in the low- to mid-double-digit million area per day for Uniper at current gas prices. Also, because a mechanism to calculate and transfer the costs is yet to be enforced. The recent amendment to the Energiesicherungsgesetz (EnSiG) that includes a clause (paragraph 24), which, if activated, would allow gas importers to pass incremental procurement costs to customers from the second stage of the Gas Emergency Plan (Notfallplan Gas, triggered on June 23), has not hindered these developments because paragraph 24 of the EnSiG has not been triggered since the German regulator, the BNetzA, has not declared a significant shortage of gas in the German gas market yet, which is the second prerequisite to trigger paragraph 24 in addition to declaring the second stage of alarm. Additionally, in our view, Uniper's daily costs could significantly increase if the situation persists. For now, it has withdrawn financial guidance of €1.0 billion-€1.3 billion of EBIT for 2022 and publicly requested support from the German government, potentially including guarantees, further credit lines, and equity contributions.

We believe Uniper is dependent on external factors to sustain its financial position, with the burden likely to spread to the Fortum group if the situation persists. Current intense price volatility in the European gas market exposes further vulnerabilities in Uniper's business risk profile beyond those we captured in our last rating action. The situation is also rapidly deteriorating the company's financial position and putting material pressure on the 'bbb-' stand-alone credit profile (SACP). The support Uniper needs will largely depend on the length of gas curtailments and how supportive legislative add-ons are for gas importers' operating framework, like a mechanism to transfer additional procurement costs to gas users. We understand Uniper is working closely with the German government to implement a company-specific support mechanism to ease its financial burden and contribute to the public goal of continuity of gas supply. However, the losses that Uniper may face if the situation continues are difficult to quantify and depend on whether gas volumes are restored at the planned end of the pipeline's regular annual maintenance on July 21. We estimate Uniper's net margining position as of July 1, 2022, has not materially changed compared to the negative €4.5 billion as of end of the first quarter of 2022. In addition, Uniper is also posting guarantees in lieu of collateral, but we estimate these are less than €500 million as of today.

If gas volumes are not restored, Uniper will depend on the German government implementing a cost transfer mechanism or declaring the third stage of its Emergency Plan which would relieve gas importers from their contractual obligations to deliver gas, since regulator Bundesnetzagentur would take over the matching of gas demand and supply. Until the third stage is triggered, and without any supporting mechanism, we don't have clarity on how long Uniper can serve all its customers and, if not, whether this could trigger any guarantees or collateral calls. Furthermore, even if the third stage is triggered under a gas curtailment scenario, the timing and circumstances under which Uniper would be able to recover such margin positions are unclear to us if the underlying gas is not delivered. In our view, Uniper is even more exposed to developments than the rest of the sector because of the size of these positions relative to its balance sheet, although we acknowledge that other utility companies are similarly exposed to contracts subject to margin calls.

These burdens come on top of high liquidity needs, and capital control mechanisms that prevent earnings repatriation from Russia. Uniper's liquidity needs are significant given extremely volatile gas prices leading to large working capital swings and power prices that have led to multi-billion euro margin collateral postings. In addition, because of capital control mechanisms imposed by Russia, Uniper and Fortum are unable to repatriate cash from Russian-based activities, which reduces the company's available resources. We do not factor support to Uniper or Fortum from a potential divestment of their Russian operations given the adverse geopolitical environment. Fortum's fossil-free generating portfolio is benefitting from elevated electricity prices, which partly offset Uniper's losses. About 80% of Fortum's Nordic generation is hedged at €35 per megawatt hour (/MWh) for the remainder of 2022, and therefore the upside from current higher electricity prices of €122/MWh on average is limited. However, the hedge ratio is substantially lower in 2023. Uniper might also capture higher prices in its generation portfolio, particularly as clean dark spreads (profitability of coal-fired electricity) are currently positive. However, we believe currents risks related to gas supplies largely outweigh these benefits in the short term.

We assume Uniper will have sufficient support from government credit lines to cover its liquidity needs. Although Uniper faces considerable and volatile calls on its liquidity, it currently has significant resources. These include a €2 billion committed credit line from German state investment bank KfW maturing in April 2023, which remained undrawn at July 1, 2022, and €8 billion from Fortum--both of which support its SACP--as well as potential emergency German government lines that could be provided via KfW. We also note that last month Fortum signed two long-term revolving credit facilities (RCFs) totaling €5.5 billon, which replaced existing RCFs totaling €4.75 billion. The first €2.4 billion RCF matures in June 2025 and the second €3.1 billion RCF in June 2024 (including optional extensions of up to a year).

CreditWatch

We expect to resolve the CreditWatch on both companies once we gain sufficient clarity on the impact of existing and future potential disruptions of Russian gas flows on Uniper's creditworthiness (including its medium-term business prospects) and on the magnitude and scope of any very near-term government support mechanism--a key consideration for our rating remaining 'BBB-'. We understand that the government is aware of the potential consequences of a downgrade to speculative grade on Uniper's trading activities and that counterparties would have the right to demand significant additional cash or non-cash collateral in such a scenario.

The CreditWatch negative also reflects our view that incremental costs at Uniper weigh on Fortum's already tight credit metrics, putting significant pressure on the group's credit quality in the short term. We cannot fully exclude a multi-notch downgrade of Uniper, although this will ultimately depend on our assessment of German government support.

Company Description

Fortum

Fortum is the third-largest power generator in Europe and Russia, with about 50 gigawatts (GW) of installed capacity. In 2021, Fortum reported EBITDA of €3,817 million. The company was founded in 1998 and is headquartered in Espoo, Finland. At Dec. 31, 2020, the main shareholder was the Finnish government, with 50.76% of the share capital. Fortum had about 8,000 employees and about 20,000 including Uniper before the announced divestment of Russian assets. In addition to its strong position in generation, Fortum is the third largest carbon dioxide (CO_2)-free generator in Europe because of its zero-to-low CO_2-emission fleet, with 45% of its generation assets being CO_2-free. Fortum engages in the generation and sale of electricity and heat in the Nordic countries, Poland, and Central Europe. It operates under five segments: Generation (34% of 2021 EBITDA), City Solutions (8%), Consumer Solutions (3%), Russia (10%), and Uniper (45%).

Uniper

Uniper is an international, diversified energy company that operates in more than 40 countries and has about 11,500 employees. Its operations include power generation, commodity trading, energy storage, energy sales, and energy services. Its core markets are Germany, Russia, the U.K., Sweden, the Netherlands, and North America. The company owns and operates a well-diversified power generation portfolio, including facilities running on fossil fuels such as gas (15.2 GW as of Dec. 31, 2021), coal (8.2 GW), hydroelectric (3.7 GW), Swedish nuclear (1.7 GW), and other (2.8 GW). It has a total generation capacity of 31.6 GW, of which one-third is in Russia. In 2021, Uniper produced 109.1 TWh of electricity, of which 54% stemmed from gas and 24% from carbon-free hydroelectric and nuclear generation. Uniper was created in 2016 from the spinoff of the gas and power activities of E.ON SE. Fortum owns about 78% of the company and the German government does not have a stake.

Fortum ESG credit indicators: E-4, S-2, G-3

Uniper ESG credit indicators: E-4, S-2, G-3

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March

25, 2015

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Placed On CreditWatch

	To	From
Fortum Oyj		
Issuer Credit Rating	BBB/Watch Neg/A-2	BBB/Negative/A-2
Fortum Oyj		
Senior Unsecured	BBB/Watch Neg	BBB

Ratings Placed On CreditWatch

	To	From
Uniper SE		
Issuer Credit Rating	BBB-/Watch Neg/--	BBB-/Negative/--
Uniper SE		
Senior Unsecured	BBB-/Watch Neg	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914