

Fortum And Uniper 'BBB' Ratings Placed On CreditWatch Negative On Exposure To Russia-Ukraine Conflict

March 14, 2022

- Amid the Russia-Ukraine conflict, we see significant risks to Fortum group's financials from the heightened risk of disruption to its natural gas procurement from Russian gas giant Gazprom, which supplies about 50% of the company's annual total of about 370 terawatt-hours (TWh).
- If this unprecedented situation materializes, the group could be exposed to high market risk. The group may need to buy missing volumes on the energy market at very high prices to fulfill its gas sales commitments. The downside from this market price exposure is difficult to quantify, given the significant size of the operations, extremely volatile gas prices, and unknowns regarding potential government intervention to mitigate such risks.
- Furthermore, we believe the Russia-based subsidiaries of Germany energy company Uniper and its parent Fortum will be unable to transfer earnings outside of Russia, implying a 20% drop in EBITDA contributions. That said, both companies have ample headroom in their credit metrics and financial flexibility, which could buffer the loss of earnings contributions.
- As a result, 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 placements reflects the possibility that we could downgrade Fortum and Uniper in case of significant gas market disruptions. We aim to resolve the CreditWatch in the coming months, depending on the evolution of market and geopolitical conditions and how resilient both companies are to them.

NEW YORK (S&P Global Ratings) March 14, 2022--S&P Global Ratings today said it placed its 'BBB/A-2' long- and short-term ratings on Fortum Oyj and its 'BBB' long-term rating on Uniper SE on CreditWatch with negative implications.

We see potential downside pressure to the group's financials given the elevated risk that its long-term gas procurement contracts with Gazprom could be disrupted. The risk of disruptions to Fortum's subsidiary Uniper's gas procurement from Gazprom PJSC (CCC-/Watch Neg/--) has rapidly increased over the past few days. Disruptions to business could be significant, given that Gazprom supplies about 200TWh of Uniper's 370 TWh of annual natural gas procurement. Prices of natural gas, namely Dutch TFF spot prices, have been fluctuating between €100 and more than €200 per megawatt-hour (MWh) since the end of February, which compares with less than €25/MWh over past years up until mid-2021.

We expect that a severe disruption to Germany's gas import would trigger a state of emergency

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under the German legal framework, making the German regulator Federal Network Agency (BNetzA) the emergency authority for demand-side steering, in coordination with and monitored by EU authorities. But we lack visibility on how effectively and quickly this would mitigate pressure on Uniper's financials. Additionally, we don't have visibility on the extent to which this would invoke timely majeure/market disruption clauses on contract obligations with Western counterparties.

Meaningful disruption to gas import could have significant financial impact. Cash outflows for margin movements over recent months indicate the magnitude of this gas wholesale market exposure (consolidated Fortum margin receivables of €9.2 billion at the end of 2021). According to Fortum's management, the company received inflows in terms of unwinding of variation margins of €2.3 billion in January and February this year. In general, we consider risks associated with large volume hedging arrangements elevated in a volatile commodity market environment, in particular, access to liquidity is dependent on market sentiment and counterparty confidence in the credit quality of the company (see "Uniper Ratings Affirmed Following Commodity Price Surge, Increased Liquidity Needs In A Volatile Market; Outlook Stable," published Jan. 21, 2022, On RatingsDirect). Generally, we consider that risks associated with large volume hedging could include a rapid increase in margin requirements and reduced access to liquidity and funding.

In recent weeks, Uniper has been able to introduce measures to significantly reduce its exposure to margin postings whose effectiveness we are witnessing in the light of recent reduced margin posting requirements, despite the current gas-price surge. We are monitoring how the company's risk management reduces its exposure to margining requirements or procures sources of liquidity on a permanent basis.

We believe that the Russia-based operations of Fortum and Uniper will be unable to transfer earnings outside of Russia, implying a 20% drop in EBITDA contributions. Russia's military conflict with Ukraine has prompted a new round of G7 government sanctions, including targeting the foreign exchange reserves of The Central Bank of Russia (CBR); this has rendered a large part of these reserves inaccessible, undermining the CBR's ability to act as a lender of last resort and impairing what had been--until recently--Russia's key credit strength: its net external liquidity position. To mitigate the resulting high exchange rate and financial market volatility, and to preserve remaining foreign currency buffers, Russia's authorities have--among other steps--introduced capital controls that we understand could constrain nonresident government bondholders from receiving interest and principal payments on time. We also see a heightened risk of expropriation of any assets in Russia.

Consequently, we do not expect the Fortum group will receive any dividends from its Russian operations. A permanent exclusion of Russian exposure could lead us to revise the group's country risk exposure. We acknowledge that operations are still ongoing, but Fortum and Uniper have announced that no additional investments will be made in Russia and the sought-after divestment of Uniper's Russian operations Unipro (started in 2021) will be resumed as soon as feasible. Uniper also wrote down its €1.0 billion (non-cash effective) loan and accrued interest in Nord Stream 2 and announced it will no longer renew long-term gas contracts with Gazprom as these come due.

- Uniper's Russian subsidiary contributed to about 16% of its EBITDA in 2021 and has represented about 15%-20% of EBITDA historically. Uniper has installed coal and gas generation units in Russia of about 11 gigawatt (GW) that receive capacity payments.
- Fortum's reported comparable EBITDA amounted to €3.8 billion in 2021, and its Russian operations represented about 20% of EBITDA in 2021. While the share of earnings is relative

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low, we acknowledge that the operations are sizable, with in total 4.67 GW of installed capacity, constituting about 35% of Fortum's installed capacity generation fleet. That said, we expected earnings will decrease further to about €240 million by 2023, as Russian capacity supply agreement contracts related to thermal generation expire.

Fortum's and Uniper's recent operating performance and deleveraging have been above our previous base case, which could mitigate the abrupt stop in contributions from its Russian business. Fortum and Uniper both benefited from high commodity prices, especially power and gas in 2021, and their operating performance in 2021 was well above our previous expectations. To some extent, this mitigates the stop of contributions from the Russian operations, at least in the short term.

- Fortum's reported consolidated comparable EBITDA for 2021 amounted to about €3.8 billion, which is €0.7 billion-€1.0 billion above our previous expectations of €2.9 billion-€3.2 billion, which compares with €404 million in EBITDA from Fortum's Russian operation. Credit ratios, such as funds from operations (FFO) to debt at year-end therefore stood above our expected ratio of 35%-50% (netting the impact of margin receivables and collaterals).
- In 2021, Uniper generated EBITDA of about €1.9 billion compared with our previous expectation of above €1.5 billion--and adjusted debt was negative compared with about €2.0 billion anticipated previously (see "Full Analysis: Uniper," published Sept. 3, 2021). Next to the operating performance described above, the latter has benefitted by about €300 million from pension discount rate movement.

We believe electricity prices are likely to remain elevated, at least until the mid-2020s. Despite large parts of its generation being hedged, the group's nuclear and hydro generation units should benefit from favorable market prices and outperform our previous expectations. Additionally, we believe current market conditions are beneficial to Uniper's storage business, its non-Russian natural gas procurement business, and liquified natural gas business.

We believe that the commodity price surge and risk of disruptions could increase liquidity needs, and therefore revised our assessment of Fortum's liquidity to adequate from strong. In January, Fortum provided Uniper liquidity support as a result of extremely high and volatile gas prices and needed to provide additional margining payments for its hedging positions (see "Uniper Ratings Affirmed Following Commodity Price Surge, Increased Liquidity Needs In A Volatile Market; Outlook Stable," and "Finland-Based Power And Gas Company Fortum 'BBB/A-2 Ratings Affirmed; Outlook Stable," both published Jan. 21, 2022). As such, we cannot exclude the risk of increased working capital volatility to cover its positions as a result of the turbulent market situation and extreme changes in energy prices. As such, we now view Fortum's liquidity as adequate. This is based on our estimate that its liquidity resources, including cash, FFO, and facility availability, will cover expected cash outflow by more than 1.4x in the 12 months started Jan. 1, 2022, on a consolidated basis. In light of our liquidity assessment, we continue to monitor how the company's risk management reduces its exposure to margining requirements or procures sources of liquidity on a permanent basis.

We note that Fortum and Uniper have access to an additional €5.9 billion of short-term revolving credit facilities, of which €2.0 billion is from the German state-owned development bank KfW, which signals the importance of the group. However, since the facilities are maturing within 12 months, we do not incorporate them in our liquidity calculations, notwithstanding the current process with the German state to extend the KfW line.

S&P Global Ratings acknowledges a high degree of uncertainty about the extent, outcome, and consequences of the military conflict between Russia and Ukraine.

Irrespective of the duration of military hostilities, sanctions and related political risks are likely to remain in place for some time. Potential effects could include dislocated commodities markets--notably for oil and gas--supply chain disruptions, inflationary pressures, weaker growth, and capital market volatility. As the situation evolves, we will update our assumptions and estimates accordingly. See our macroeconomic and credit updates here: "[Russia-Ukraine Macro, Market, & Credit Risks](#)". Note that the timing of publication for rating decisions on European issuers is subject to European regulatory requirements.

Company Description

Fortum

Fortum is the third-largest power generator in Europe and Russia, with about 50 GW of installed capacity in total. Fortum has about 8,000 employees, and about 20,000 including Uniper. In addition to its strong position in generation, Fortum is the third-largest CO₂-free generator in Europe because of its zero-to-low CO₂emission fleet, with 45% of its generation fleet being CO₂-free. The remaining share of the fleet is geared toward gas, and carbon intensity from total energy production in Europe were 188 gram of CO₂ per kilowatt-kWh in 2020. Fortum engages in the generation and sale of electricity and heat in the Nordic countries, Russia, Poland, and Central Europe. It has the following five segments: Generation, 33% of 2021 EBITDA, City Solutions (8%), Consumer Solutions (3%): Russia (10%) and Uniper (45%).

Fortum held 78.0% of Uniper as of Dec. 31, 2021, increased from 76.1% at the end of 2020.

Uniper

Uniper is an international, diversified energy company that operates in more than 40 countries and has about 12,000 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 (17 GW as of Dec. 31, 2021) and coal (8.6 GW), as well as hydroelectric (3.6 GW) and Swedish nuclear (1.4 GW). It has a total generation capacity of 33.3 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 Uniper.

CreditWatch

We aim to resolve the CreditWatch within the coming months, depending on the evolution of market and geopolitical conditions and how resilient both companies are to them.

We expect to resolve the CreditWatch placement on both companies once we have clarity on the potential disruption of Russian gas flows and the corresponding full impact on the group. When we

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resolve the CreditWatch, we will also consider the extent of government support and legal remedies.

In case of a downgrade, we see a lowering of the rating by one-notch as most likely for both entities, but we cannot fully exclude a multi-notch downgrade, ultimately depending on how severely the market risk exposure materializes.

We could downgrade Fortum, if we expect its credit metrics to deteriorate such that FFO to debt falls below 35% or debt to EBITDA increases above 2.5x (excluding margin impact).

As per our assessment of Uniper's core group status within Fortum, our long-term issuer credit rating on Uniper is at the same level as our rating on Fortum, or one notch lower, depending on Uniper's stand-alone credit profile (SACP).

We could revise downward our assessment of Uniper's SACP of 'bbb', if we expect FFO to debt to deteriorate below 55% and debt to EBITDA above 1.7x (excluding margin impact and including lease income).

We could revise these ratios when we resolve the CreditWatch, depending on the evolving business mix, including how we expect the operating environment for the gas business in Europe to develop.

Liquidity

We view consolidated Fortum's liquidity as adequate. This is based on our estimate that its liquidity resources, including cash, FFO, and facility availability, will cover expected cash outflow by more than 1.4x in the 12 months started Jan. 1, 2022.

Fortum's liquidity, as of end-December 2021, continues to be supported by the group's access to in capital markets and sound relationships, which was proven over December 2021-January 2022 with the signing of new bank facilities with short notice. Our view of the group's sound banking relationship was further supported by our discussions with some of the group's banks. Alongside the long-term credit lines we weigh into our calculation, we note Fortum's access to shorter-term credit facilities. Its debt documents do not contain any financial covenants. We also note that Uniper has an committed revolving credit facility with KfW amounting to €2.0 billion. However, since the facilities are maturing within 12 months, we do not incorporate them in our liquidity calculations, notwithstanding the current process with the German state to extend the KfW line.

Principal liquidity sources for the group as per of end-December 2021:

- Our estimate of cash and cash equivalents of about €7.4 billion;
- Access to €400 million of undrawn facilities maturing after 12 months;
- Positive cash FFO, which we estimate will near €2.3 billion in the next 12 months; and
- Working capital inflows in terms of unwinding of variation margins of €2.3 billion (received in January and February).

Principal liquidity uses for the group as of the same date:

- Debt of about €6.6 billion maturing in the next 12 months;
- Maintenance capex of about €630 million;
- Dividends of about €1.2 billion in the next 12 months.

Environmental, Social, And Governance

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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

Related Research

- Russian Corporates Downgraded To 'CCC-' After Similar Action On Sovereign; Ratings Placed On CreditWatch Negative, March 8, 2022
- Russia Ratings Lowered To 'CCC-' And Kept On CreditWatch Negative On Increasing Risk Of Default, March 3, 2022

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- Uniper Ratings Affirmed Following Commodity Price Surge, Increased Liquidity Needs In A Volatile Market; Outlook Stable, Jan. 21, 2022
- The Energy Transition And What It Means For European Power Prices And Producers: February 2022 Update, Feb. 10, 2022
- Finland-Based Power And Gas Company Fortum 'BBB/A-2 Ratings Affirmed; Outlook Stable, Jan. 21, 2022
- Nuclear In Europe: Lessons Learned And Ways Ahead, Dec. 16, 2021
- ESG Credit Indicator Report Card: Power Generators, Nov. 18, 2021
- Price Tremors Threaten Europe's Gas Bridge, Oct. 5, 2021
- Fit for 55: The Gains (And Pains) For European Utilities, Sept. 29, 2021
- Uniper SE, Sept. 3, 2021
- Fortum Oyj, Sept. 1, 2021
- Outlook On German Energy Co. Uniper Revised To Stable Following Similar Action On Fortum; 'BBB' Ratings Affirmed, July 6, 2021
- The Hydrogen Economy: Storage Is Paramount For Utilities In The Long Term, April 22, 2021

Ratings List

***** Fortum Oyj *****

Ratings Affirmed; CreditWatch/Outlook Action		
	To	From
Fortum Oyj		
Issuer Credit Rating	BBB/Watch Neg/A-2	BBB/Stable/A-2
Senior Unsecured	BBB/Watch Neg	BBB

***** Uniper SE *****

Ratings Affirmed; CreditWatch/Outlook Action		
	To	From
Uniper SE		
Issuer Credit Rating	BBB/Watch Neg/--	BBB/Stable/--
Senior Unsecured	BBB/Watch Neg	BBB

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