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Fortum Oyj

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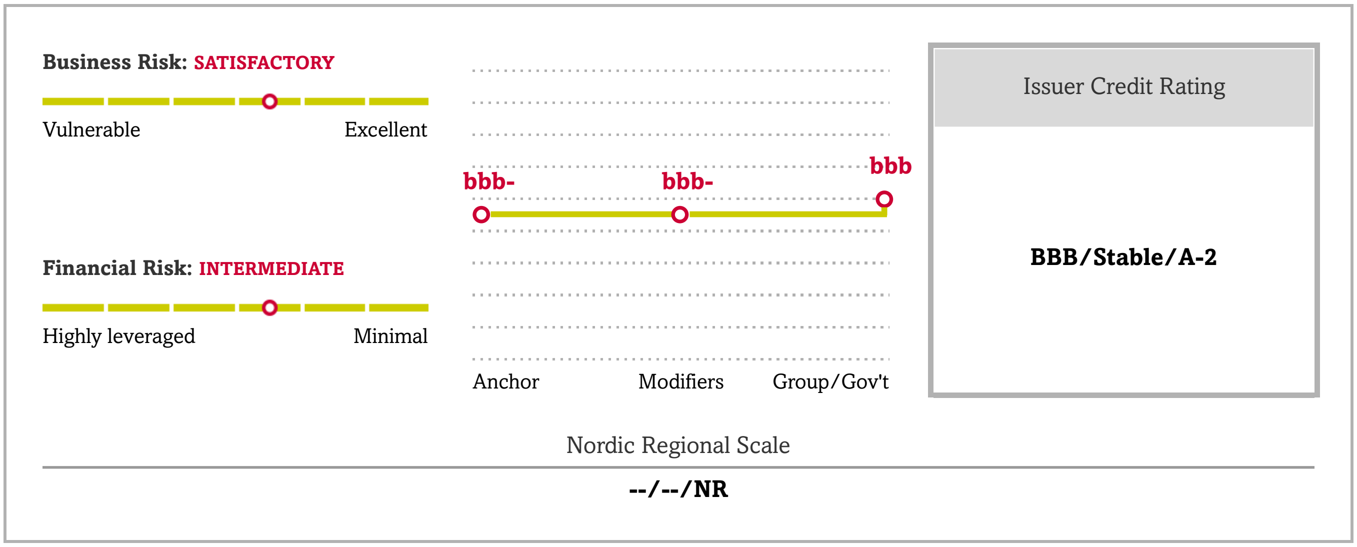
Fortum Oyj



Credit Highlights

Overview

Key strengths	Key risks
Third-largest power generator in the Europe and Russia region after the Uniper acquisition, with a strong market position in the Nordic countries, Germany, and Russia.	Unclear strategy on full takeover of Uniper.
Diversified generation fleet providing baseload in the Nordics and Germany.	Increased leverage following Uniper's acquisition, partially tempered by commitment to the rating and remedy measures, including disposals, to reduce leverage.
Hedging strategy providing short-term support to cash flow generation. For the remainder of 2021, Fortum has hedged 75% of its planned Nordic production at €33 per megawatt-hour (/MWh) and 60% for 2022 at €31/MWh.	Significant increase in carbon dioxide emissions exposure after Uniper's acquisition, as about 75% of the combined power generation capacity split now stems from gas and coal, compared with less than 50% before the acquisition. Fortum's carbon intensity is thereby among the highest in the peer group, although CO_2 emissions are on a declining trend in the medium term.
Prudent risk management and commitment to the rating, with strong remedy measures in place to maintain the current rating.	High exposure to volatile power generation activities (35% of 2020 EBITDA), with generation exposure increased by sale of credit-supportive district heating businesses. The price volatility is partially mitigated by hedging and bilateral supply contracts.
Support from the Finnish government, providing a one-notch uplift from Fortum's stand-alone credit profile (SACP).	Exposure to Russian ruble foreign exchange risk (about 25% of 2020 EBITDA generated in Russia).

Fortum's sale of its 50% stake in Stockholm Exergi Holding AB (publ) (BBB+/Stable/A-2) for €2.9 billion will lower leverage in 2021. Fortum expects the Exergi transaction to close by the end of 2021, which is factored into our base case. We see this transaction as a key milestone for management to improve Fortum's financial risk profile, as it will speed up the improvement of its credit ratios. We now expect credit ratios to be in line with the rating by year-end 2021, with notably S&P Global Ratings adjusted funds from operations (FFO) to debt above the 35% threshold for the current rating. This was the basis for our outlook revision to stable from negative on July 5, 2021 (see "Finnish Power Generator Fortum Oyj Revised To Stable On Progress With Disposals; 'BBB' Rating Affirmed,," published on RatingsDirect on July 5, 2021).

Several other disposals (€5.2 billion in total announced in the last 18 months) have also supported the improvement, including:

- €710 million in proceeds from the sale of Baltic district heating assets in March 2021 (transaction closed in July 2021);
- The €280 million sale of 500 megawatts (MW) of Indian solar assets, announced in June 2021 (transaction that will be closed partially during the second half of 2021 and partially in the first half of 2022); and
- €1.2 billion of disposals in 2020.

These will all reduce Fortum's leverage, with adjusted debt to EBITDA decreasing well below 2.0x in 2021 from 3.3x in 2020. We expect adjusted FFO to debt will rebound to well above 40% in 2021 from 25.1% in 2020.

The credit remedy measures signal a strong commitment to protect the current rating. Fortum carried out these transactions to offset the increase in leverage and as part of the strategic asset rotation and portfolio optimization following the purchase of a 76.1% stake in Uniper SE for €6.9 billion between 2018 and 2020 (chart 1). As part of its active portfolio rotation, the company still has some assets under strategic review, notably its consumer solutions business and its Polish district heating assets, which we expect will be sold this year. In our view, these transactions together signal a strong commitment from Fortum to protect the 'BBB' credit rating.

A full takeover of Uniper is not expected to be announced until the end of 2021 at the earliest, in line with the company's publicly stated communication. A 23.9% minority buyout would cost Fortum more than €2.6 billion. Fortum would not have the financial flexibility for such a transaction within the current rating, under our base-case scenario, as its adjusted FFO to debt would decrease below 30%, assuming no remedy measures. However, in recent years Fortum has demonstrated a strong commitment to maintaining the current rating, with more than €5.2 billion of proceeds from announced assets sales supporting credit metrics. We expect that Fortum will make a full takeover bid for Uniper at some point. However, we believe that management would either wait until the company has more financial flexibility or offset the financial impact of the transaction with further disposals within a relative short timeframe.

In the first six months of 2021, Fortum reported supportive results, driven by an increase in power and commodity prices across Europe, while leverage remains above the target with recently announced disposals not yet cashed in. EBITDA in the first half of the year was €1,827 million compared with €1,055 million in the first half of 2020. This was mainly thanks to the particularly strong performance of Uniper (fully consolidated since second-quarter 2020) and of the generation division, which contributed €588 million EBITDA, compared with €485 million in the same period last year. Fortum's generation business' achieved power prices were up by €3.8/MWh on average to €38.1/MWh amid post-pandemic market conditions, more normal precipitation in the Nordic region, and higher gas and carbon prices outside the region, which supported power prices' return to normality.

We expect credit-supportive operating performance for the rest of 2021. Recovery in credit metrics will also be supported by strong operating performance in Fortum's core power generation operations, notably due to increasing power prices in its core markets: the Nordics and Germany. This should lead to a recovery in reported EBITDA to above €3.0 billion, well above the €2.7 billion reported in 2020 (with Uniper consolidated just for nine months). This was already demonstrated with strong first-semester results, with recovery in volumes of power sold and increased power prices. We assume Nordpool power prices will improve to the €25/MWh-€35/MWh range in 2021-2022 from the record low of about €11/MWh in 2020, supported by a better hydro balance in the region. We then expect that it will average €30/MWh-€40/MWh in 2023 (for more details, see "The Energy Transition And What It Means For European Power Prices And Producers: January 2021 Update," Jan. 27, 2021). This will continue to support price realization and earnings. Fortum's generation segment hedged 75% for the remainder of 2021 at €33/MWh for 2021 and 60% at €31/MWh for 2022. This protects cash flow for the year and supports our expectation of improving credit ratios. Uniper has hedged 90% of its Nordic production at €26/MWh for the remainder of 2021, 85% at €24/MWh for

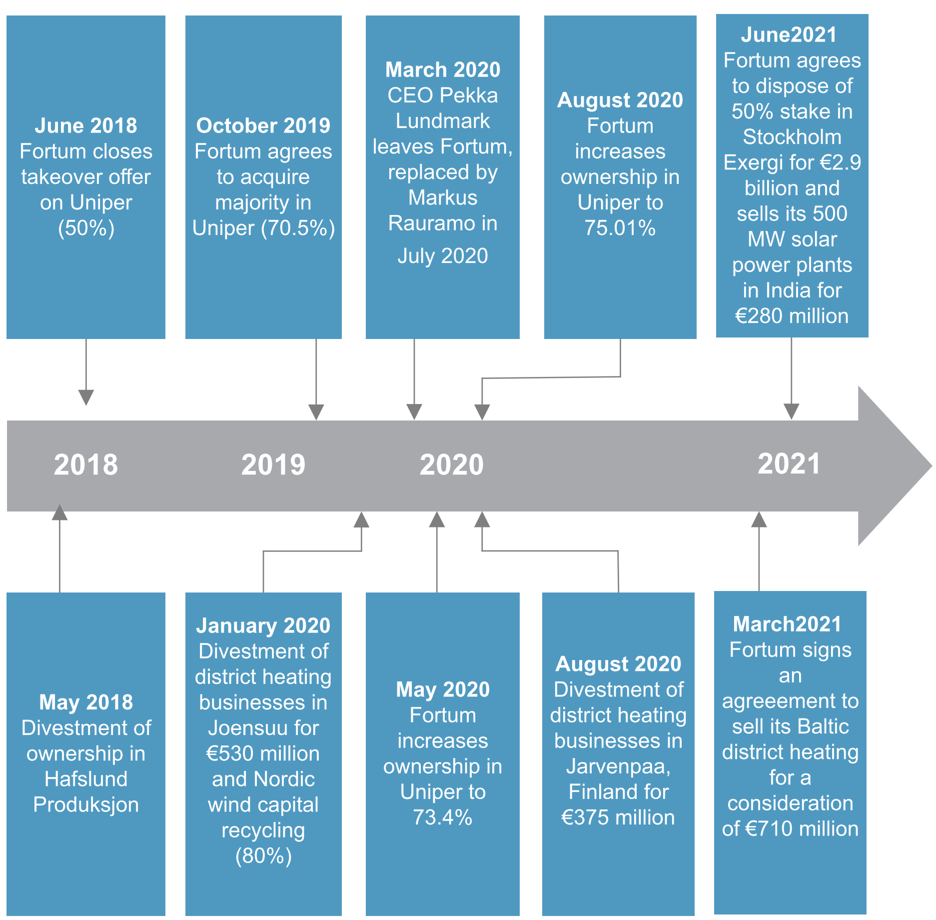
2022, and 45% at €22/MWh for 2023.

We expect a push in cooperation with Uniper after recent management changes. The abrupt management-level changes at Uniper in April 2021, driven by Fortum, will likely support the delivery of outlined synergies of €50 million by 2023 and €100 million by 2025. These changes demonstrate that the integration process has not been as smooth as previously outlined. We think it also signals Fortum's move to accelerate the process of strategy execution between the two companies (for more details, see "Fortum's Management Changes At Uniper Show A Push To Accelerate Cooperation, With Debt Reduction Still Key," April 2, 2021).

Fortum enjoys support from the Finnish government. The Finnish government is Fortum's major shareholder with a 50.8% share. We view Fortum as important for the country because it is the largest power producer, and we incorporate one notch into the stand-alone rating to reflect support from the Finnish government.

Chart 1

Fortum's Evolution And Strategic Route



CEO--Chief executive officer. Source: S&P Global Ratings.

Outlook: Stable

The stable outlook reflects our view that Fortum, after the Exergi disposal, should post credit metrics commensurate with the current rating in 2021, with adjusted FFO to debt above 35% and adjusted debt to EBITDA below 2.5x. Fortum still has some assets under strategic review, notably its consumer solution business and district heating assets in Poland, and we expect the company will continue deleveraging in 2021.

The stable outlook takes into account the improving operating conditions in Fortum's key markets, Germany and the Nordics, where power prices and demand are improving. We have conservatively factored in EBITDA declines of about €100 million in both 2021 and 2022 to reflect potential higher-than-expected negative movements in power prices. While benchmarking Fortum's credit metrics against the threshold for the rating, we net the adjusted debt of Fortum for the impact of margin receivables and collaterals.

We do not expect Fortum to launch a domination agreement on Uniper before the end of 2021. We will continue to monitor the Finnish government's willingness to support Fortum in case of financial distress; this support currently results in one notch of uplift from the 'bbb-' stand-alone credit rating.

Downside scenario

We could lower the ratings if Fortum's credit metrics were to weaken below our expectations, notably if we believe there's a risk that FFO to debt will decrease below 35% or debt to EBITDA will increase above 2.5x in 2021. This could stem from declining power prices in Europe and Russia. This could also occur if Fortum were to increase its stake in Uniper to well above 75%, which would markedly increase its leverage, absent any significant financial remedies.

Upside scenario

Any rating upside potential is limited for the time being, as we expect Fortum to use its financial flexibility to increase investments, including its stake in Uniper.

Our Base-Case Scenario

Assumptions

In our base case for Fortum through 2023, we assume:

- Finland's real GDP to rebound by 2.5% in 2021 after the contraction of 2.77% in 2020, followed by 2.25% average growth over 2022-2023.
- Fortum's Nordic generation segment hedges: 75% of the Nordic production hedged at €33/MWh for the remainder of 2021; for 2022, 60% hedged at €31/MWh.
- Uniper's Nordic generation segment hedges: 90% for 2021 hedged at €26/MWh for the remainder of 2021. For 2022: 85% has been hedged at €24/MWh. For 2023: 45% has been hedged at €22/MWh (versus about 25% hedged at €22/MWh in 2020).
- Remedy measures to offset any additional stake increase in Uniper executed on time and with proceeds not affected by volatile market conditions.
- Divestment of consumer solution business in 2021.
- Divestment of Stockholm Exergi for €2.9 billion to be completed by the end of 2021.
- No impact from EU classification system for sustainable activities (EU taxonomy).
- A 1% increase in dividends per share over 2021-2025, starting at €1.12 in 2021.

Key metrics

Fortum Oyj--Key Metrics*

	--Fiscal year ended Dec. 31--			
(Mil. €)	**2020a**	**2021f**	**2022f**	**2023f**
EBITDA	2,955.0	2,900-3,200	2,400-2,700	2,400-2,700
Funds from operations (FFO)	2,480.0	2,400-2,700	2,000-2,300	2,000-2,300
Capital expenditure	1,101.0	1,300-1,500	1,200-1,500	1,200-1,500
Dividends	1,137.0	1,100-1,200	1,100-1,200	1,200-1,300
Debt	9,878.0	5,000-6,000	5,000-6,000	5,000-6,000
Debt-to-EBITDA (x)	3.3	1.5-2.3	2.0-2.5	2.0-2.5
FFO-to-debt (%)	25.1	35.0-50.0	35.0-40.0	35.0-40.0

*All figures are adjusted by S&P Global Ratings. The full consolidation of Uniper is from fiscal-year 2020. We didn't adjust 2020 figures for the impact of margin liabilities; if we had, the FFO to debt would have been 28.7%. a--Actual. f--Forecast.

2020 results suffered from very low power prices in the Nordics and the increased leverage following Uniper's acquisition, therefore leaving Fortum with very limited rating headroom. Reported EBITDA in 2020 increased to €2,434 million from €1,766 million in 2019. Uniper was consolidated as a subsidiary as of March 31, 2020, and represented €856 million of the total EBITDA. Fortum's reported EBITDA of €1,578 million excluding Uniper was slightly above our projections, mostly thanks to a stronger-than-expected performance in the generation division.

Fortum's achieved power price was supported by a prudent price hedge, which effectively mitigated the exposure to the historical low power prices in the Nordics. Although the group's credit metrics remained below the target for the current rating, with S&P adjusted FFO to debt at 25% and debt to EBITDA at 3.3x, we also believe Fortum is making good progress on its remedy plan, as captured in our recent outlook revision to stable from negative. Nord Pool spot prices averaged a mere €10.9/MWh in 2020 versus €38.9/MWh in 2019. The group's 2020 reported net debt to EBITDA increased to 2.9x from 2.7x in 2019; this is still above the company's commitment of financial net debt to EBITDA below 2.0x. Total gross debt increased to €10.6 billion from about €6.7 billion in 2019. The jump stemmed from the consolidation of Uniper, given the stake increased by 26.11% to 76.1% for approximately €2.9 billion.

The group's FFO to debt, as adjusted by S&P Global Ratings, stood at 25.1% for 2020. This is lower than the 35% threshold for the current rating, but in line with our expectations for the year.

2021 remains a key transition year for the company, with leverage decreasing following the announced disposals. We believe adjusted debt reached a peak in 2020, following the increase in the Uniper stake, and we expect it will start to decrease from this year, thanks to the cash-in from the disposal plan. The 50% stake disposal in Stockholm Exergi for €2.9 billion is expected to close in second-half 2021; the Baltic district heating disposal for a total amount of €710 million was completed in July 2021, and the 500 MW divestment in India for a total consideration of €280 million, is expected either in second-half 2021 or first-half 2022 at the latest. These are the main reasons why we project debt will decrease to the €5 billion-€6 billion range, from about €10 billion at year-end 2020. In addition to the improving power prices in the Nordics compared with last year (chart 6), we view positively that Fortum's Nordic generation business is 75% hedged at €33/MWh for the remainder of 2021 and 60% hedged at €31/MWh for 2022. Uniper's Nordic generation portfolio is 90% hedged at €26/MWh for the remainder of 2021, 85% at €24/MWh for 2022 and 45% at €22/MWh for 2023, as this provides good visibility and cash flow stability in the shorter term.

The first-half 2021 operating performance showed a promising recovery, while the effect of announced disposals on leverage is expected for the second half of the year. Strong generation volume and achieved power prices for the Nordic environment were the driver of the supportive results in first-half 2021. However, reported net debt to EBITDA remained at 2.4x, still above the company's 2.0x target. We expect leverage will materially decrease after the cash-in of the significant announced disposals, which is expected for later this year.

Company Description

Fortum is the third-largest power generator in the Europe and Russia region, with in total 50.3 gigawatts (GW) of installed capacity. In addition to its strong position in generation, Fortum is the third-largest CO_2-free generator in Europe because of its zero-to-low carbon dioxide emission fleet, with 45% of its generation fleet being CO_2-free. However, the remaining share of the fleet is geared toward gas, and carbon intensity of 375g per kilowatt-hour (/kWh) is therefore materially higher than the average of the rated European utilities, which we estimate at about 250g/kWh.

Fortum engages in the generation and sale of electricity and heat in the Nordic countries, Russia, Poland, India, other parts of the Baltic Rim area, and elsewhere. It has the following five segments, including Uniper:

- Generation (36% of 2020 EBITDA): produces power through nuclear, hydro, wind, and thermal resources;
- City Solutions (about 10%): develops heating, cooling, waste-to-energy, biomass, and other circular economy solutions as well as solar power production;
- Consumer Solutions (about 6%): engages in electricity and gas retail businesses in the Nordics and Poland, including the provision of invoicing, debt collection, and customer services, and electricity and related value-added products,

as well as digital services;

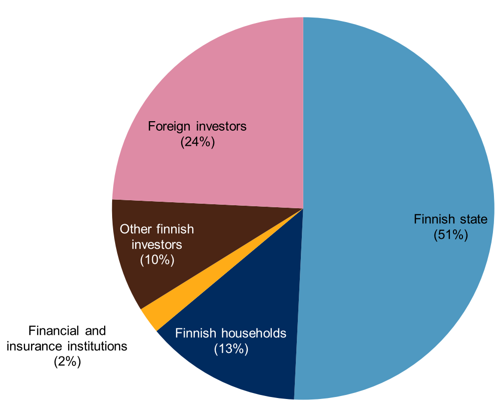
- Russia (16%): generates and sells power and heat; and
- Uniper (35%): Fortum holds 76.1% of Uniper as of Dec. 31, 2020. Uniper was created in 2016 from the spinoff of the gas and power activities of E.ON SE. It is an international, diversified energy company that operates in more than 40 countries and has about 11,000 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. With more than 35 GW of installed generation capacity, Uniper is among the largest global power generators. Approximately 50% of the power generating capacity is gas-based, 30% is coal-based, and 20% is hydro- or nuclear-based.

In 2020, Fortum reported EBITDA of €2,689 million. The company was founded in 1998 and is headquartered in Espoo, Finland. As of Dec. 31, 2020, the main shareholder is the Finnish state, with 50.76% of the share capital.

Fortum owns and operates a well-diversified power generation portfolio, including facilities running on fossil fuels such as gas (45% of the total 142.1 terawatt hours (TWh) power generation in 2020) and coal (9% of power generation) as well as hydroelectric (32.7 TWh; 23% as of end-2020) and nuclear (28.4 TWh; 20%). It has a total generation capacity of 50.3 GW based in Europe and Russia. Its renewables and CO2-free power generation capacity amounts to 14.6 GW, including hydro (8.4 GW), wind and solar (1.7 GW), and nuclear (4.5 GW). Fortum has also committed to reducing its coal-fired generation capacity by more than 50% by the end of 2025, to approximately 5 GW.

Chart 2

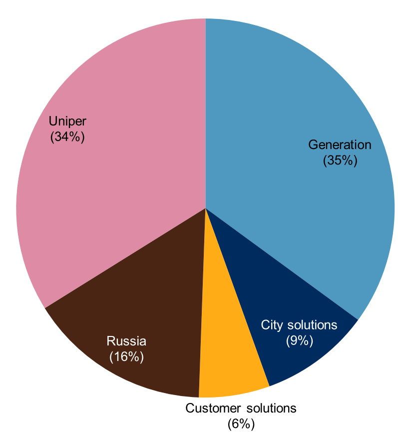
Shareholding Structure
As of Dec. 31, 2020



Source: S&P Global Ratings.

Chart 3

2020 EBITDA Split By Segment



Source: S&P Global Ratings.

Peer Comparison

Table 1

Fortum Oyj--Peer Comparison

Industry sector: Energy

	Fortum Oyj	CEZ a.s.	Vattenfall AB	Verbund AG	Statkraft AS	Orsted A/S
Ratings as of Aug. 18, 2021	BBB/Stable/A-2	A-/Stable/--	BBB+/Stable/A-2	A/Stable/--	A-/Stable/A-2	BBB+/Stable/A-2
	--Fiscal year ended Dec. 31, 2020--					
(Mil. Mix currencies)	€	CZK	SEK	€	NOK	DKK
Revenue	49,015.0	209,522.0	158,847.0	3,208.8	34,560.0	52,601.0
EBITDA	2,955.0	75,482.0	41,627.0	1,284.5	13,148.0	17,265.0
Funds from operations (FFO)	2,480.0	65,808.0	36,396.5	1,182.4	6,377.0	13,358.0
Interest expense	276.0	5,942.2	3,633.0	79.5	325.0	3,513.0
Cash interest paid	208.0	5,926.0	2,511.5	33.6	509.0	2,789.0
Cash flow from operations	2,555.0	71,880.0	41,768.5	1,051.7	11,414.0	15,773.0
Capital expenditure	1,101.0	31,281.0	21,204.0	717.7	7,535.0	26,508.0
Free operating cash flow (FOCF)	1,454.0	40,599.0	20,564.5	334.0	3,879.0	(10,735.0)
Discretionary cash flow (DCF)	317.0	22,460.0	14,910.0	42.7	(2,621.0)	(15,808.0)
Cash and short-term investments	2,308.0	8,819.0	56,222.0	39.2	11,730.0	29,866.0
Debt	9,878.0	210,890.5	116,016.8	1,453.7	24,915.6	24,482.0
Equity	15,577.0	238,563.0	120,844.0	6,873.9	98,028.0	90,713.0
Adjusted ratios						
EBITDA margin (%)	6.0	36.0	26.2	40.0	38.0	32.8
Return on capital (%)	11.1	9.5	9.9	11.7	7.9	8.8
EBITDA interest coverage (x)	10.7	12.7	11.5	16.2	40.5	4.9
FFO cash interest coverage (x)	12.9	12.1	15.5	36.2	13.5	5.8
Debt/EBITDA (x)	3.3	2.8	2.8	1.1	1.9	1.4
FFO/debt (%)	25.1	31.2	31.4	81.3	25.6	54.6
Cash flow from operations/debt (%)	25.9	34.1	36.0	72.3	45.8	64.4
FOCF/debt (%)	14.7	19.3	17.7	23.0	15.6	(43.8)
DCF/debt (%)	3.2	10.7	12.9	2.9	(10.5)	(64.6)

CZK--Czech koruna. SEK--Swedish krona. NOK--Norwegian krone. DKK--Danish krone.

We see Fortum's business risk profile as weaker than that of its more regulated peers such as CEZ a.s. (about 30% of full-year 2020 EBITDA from regulated activities), Verbund AG (20%), and Vattenfall AB (19%). Statkraft AS has a better generation mix than Fortum, due to its large, low-cost, and flexible Nordic hydropower assets. Emission intensity is also much lower compared with Fortum, below 100 g/kWh, compared with Fortum's around 375 g/kWh. Hydro generation is 76% of Statkraft's 19 GW installed capacity. About 73% of Vattenfall's 29.3 GW installed capacity is low-carbon dioxide generation such as nuclear, hydro, wind, biomass, and solar and therefore emission intensity is also lower than Fortum's, at about 125g/kWh.

Fortum's SACP is 'bbb-', which assumes it maintains adjusted FFO to debt of about 35%. This compares our threshold metrics for the following peers:

- Orsted A/S (SACP 'bbb'): adjusted FFO to debt above 23%

- Statkraft ('bbb'): adjusted FFO to debt above 20%
- Vattenfall ('bbb'): adjusted FFO to debt above 20%
- Verbund ('a-'): adjusted FFO to debt above 40%

Business Risk: Satisfactory

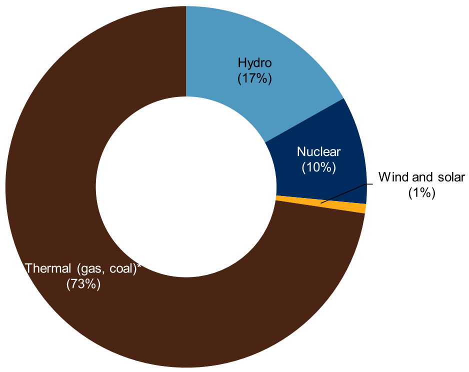
Strong market position in the Nordics and Russia, and one of the largest European power generators. Following the Uniper acquisition, Fortum is the second-largest power generator in the Nordic countries, after Vattenfall and before Statkraft, and the largest electricity retailer. In Europe it is the third-largest power generator in terms of installed capacity, with 50.3 GW, after EDF (128 GW) and Engie (63.3 GW). Fortum benefits from its diverse generation portfolio, as well as its exposure to different markets, mainly in the Nordics, Russia, and Germany, and complemented by much smaller activities in Poland, the Baltics, the Netherlands, the U.K., and Hungary.

Fortum's generation mix remains relatively less well positioned for the energy transition compared with peers. The generation portfolio is still a key diversification strength for Fortum, both in terms of geographic location and power sources. Since last year, we view negatively Fortum's increased carbon footprint following the addition of Uniper's assets, although we note Uniper's decarbonization strategy--for example, closing down the majority of coal plants by 2025. Previously, Fortum had been among the lowest carbon generators in Europe, but with Uniper it has taken over a significant fossil generation fleet (about 35 GW of capacity). Of Fortum's 2020 power production, 45% was carbon dioxide-free, thanks to the presence in its generation mix of nuclear (4.8 GW, 9.6% of total capacity), hydro (8.4 GW, 16.8%), and other renewables (0.4 GW, around 1%). Combined heat and power and condensing power represented 16% and 56%, respectively (chart 5). Fortum's generation mix compares unfavorably with sizable generators such as Orsted (100% offshore wind) and EDP (79% renewable energies). While this weakens Fortum's competitive advantage within the energy transition, the combined nuclear and hydro fleets also improve Fortum's outright capacity and therefore its positioning in the merit order, because they maintain greater priority in power dispatching. Furthermore, the Uniper acquisition, while significantly increasing Fortum's size, has also weakened its profitability, with adjusted EBITDA margin decreasing to 6% in 2020 compared with 37% in 2019 (mainly for the consolidation of Uniper's global commodity business).

In Germany, policy decisions have accelerated Uniper's coal phase out in the coming years, with almost all coal plants to shut by 2025. In July 2020, the German parliament passed a law to ensure that the country would stop using coal no later than 2038. Following this decision, Uniper announced its own accelerated coal exit plan, which includes closing nearly all of its coal-fired power plants in Germany by 2025. The exceptions are the newly built, highly efficient 1.1 GW Datteln 4 plant, which contributes about €100 million a year to EBITDA, and the 2015 Dutch-built 1.1 GW Maasvlakte 3. We expect the latter to run at least until 2030, and Datteln 4 to run until at least 2035. The hard coal plants, Wilhelmshaven and Scholven, which have a combined capacity of 1.5 GW, are expected to go offline in 2022. A further 1.4 GW in hard coal capacity (Staudinger and Heyden) is scheduled to close by 2025.

Chart 4

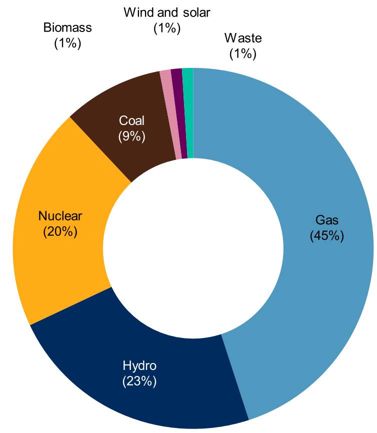
Power Generation Capacity By Source
As of Dec. 31, 2020



*Also includes a minimal part of biomass and energy from waste. Source: S&P Global Ratings.

Chart 5

Generation Split By Source
As of Dec. 31, 2020

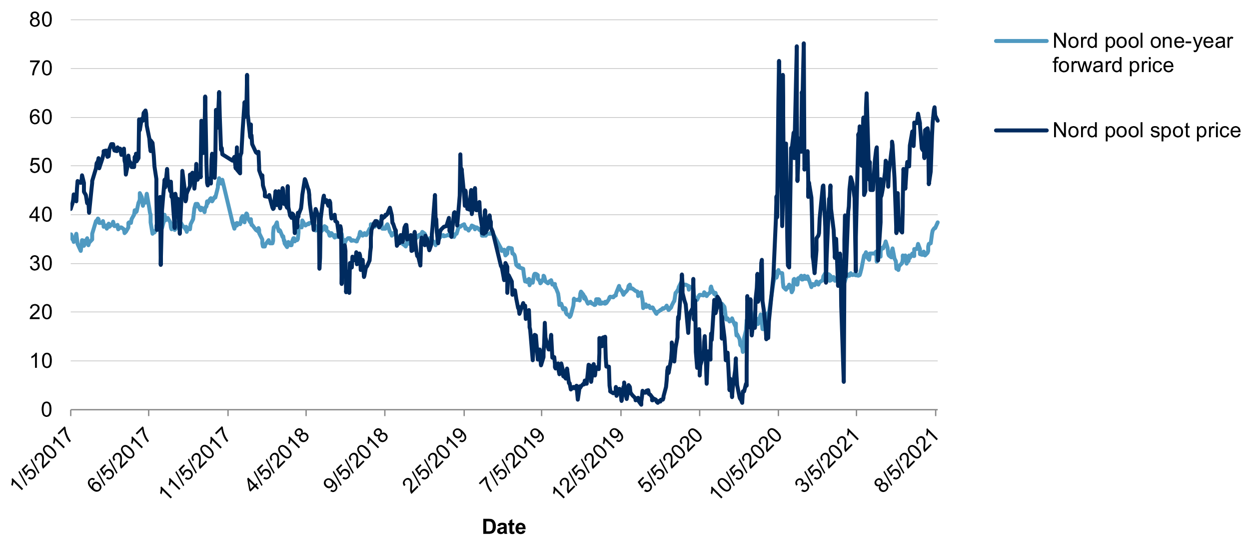


Source: S&P Global Ratings.

As an almost pure generator, Fortum remains highly exposed to volatile merchant power generation, which constitutes a weakness of its business risk. Over the past years, Fortum's profile has transformed into a pure generator. Most of its earnings are merchant-exposed, with inherent volatility risks associated with the thermal and hydro/nuclear fleet. This leaves Fortum's earnings exposed to fluctuating power prices in two main pools: the Nordics, and Russia. In Russia, volatility is mitigated by capacity supply agreement (CSA) contracts, but these should expire in the coming years, and Fortum is also exposed to foreign exchange risk and to changes in the CSA framework itself, as shown recently in the first six months of 2021. Fortum's profile as a pure generator compares unfavorably with European peers, notably CEZ and Verbund (which have higher shares of regulated activities; about 30% and 20%, respectively). In our assessment, we take into account the announced disposals of district heating assets in the Nordic region that, despite the relatively small size compared with Fortum and Uniper's combined EBITDA, were stable and predictable sources of cash flow.

Chart 6

Nord Pool Power Prices 2017-YTD



Source: S&P Global Platts.

Financial Risk: Intermediate

We expect Fortum's credit remedy measures will decrease leverage starting from 2021, after the peak reached in 2020, thereby improving rating headroom. Our 2020 credit ratios for Fortum were below the thresholds for the 'BBB' rating as Uniper's acquisition fully eroded Fortum's financial headroom between 2018 and 2020. This is mitigated by Fortum's sale of its 50% stake in Stockholm Exergi for €2.9 billion announced in July 2021, which will significantly lower leverage in 2021. Fortum expects the Exergi transaction to close by the end of 2021. We see this transaction as a key milestone for management to improve Fortum's financial risk profile, as it will speed up the improvement of its credit ratios. We now expect credit ratios to be well in line with the rating by year-end 2021, with S&P Global Ratings' adjusted FFO to debt trending toward 35%-40% and reported debt to EBITDA nearing the company's 2.0x target. The Exergi disposal is part of the company's pledged material asset disposals to strengthen its balance sheet to a level required to maintain the current rating, which was also the basis for the recent outlook revision to stable.

Despite only slightly increasing dividends and capex, credit metrics recovery remains partially dependent on power prices and foreign exchange volatility. In our current base case for Fortum, we include a 1% increase in dividends per share over 2021-2025, starting at €1.12 in 2021. Investments are estimated at about €1,200-1,500 million per year, including Uniper. However, improvement in profits is subject to a reduction in volatility in the power generation markets, both for price and volume generated, in the Nordics and Russia, and no substantial devaluation of the Russian ruble. While the first-half 2021 results were promising, Fortum is still sensitive to foreign-exchange movements, notably in Russia, with a negative foreign-exchange impact of €23 million on the comparable EBITDA generated in the region in the first six months of the year.

Starting from this year, we no longer consolidate TVO's net reported debt in Fortum's adjusted debt. Fortum has a 26% stake in Finland-based nuclear producer Teollisuuden Voima Oyj (BB/Positive/B), from which it will buy electricity at cost, once the plant comes into operation, now planed for first-half 2022. Since Fortum is one of the largest shareholders in TVO, and given the shareholding-funding in TVO, in the past we have proportionally consolidated TVO's reported debt in Fortum, with an impact of about €1.1 billion on Fortum's adjusted debt in 2019 (about €6.5 billion). Starting from this year and in our current base case, we no longer consider TVO's debt. This is because we acknowledge there is now diminishing risk related to TVO's Olkiluoto 3 (OL3) reactor. 12 years behind the original plan, fuel has finally started to be loaded, signaling good progress on the project, which also resulted in our recent outlook revision for TVO (see "Nuclear Producer Teollisuuden Voima Oyj Outlook Revised To Positive; 'BB' Rating Affirmed On Fuel Loading Completion," published April 1, 2021). Furthermore, we do not expect any major shareholder support from Fortum to TVO. At the same time, we will continue to monitor the benefit arising for Fortum from its direct shareholding in TVO versus its obligations and factor into our analysis the cost of its electricity, which we expect will increase once the new reactor comes into operation.

Financial summary

Table 2

Fortum Oyj--Financial Summary

Industry sector: Energy					
	--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**
(Mil. €)					
Revenue	49,015.0	5,447.0	5,242.0	4,520.0	3,632.0
EBITDA	2,955.0	2,008.0	1,566.5	1,358.5	1,072.0
Funds from operations (FFO)	2,480.0	1,666.0	1,292.0	1,082.3	638.5
Interest expense	276.0	210.0	207.5	233.2	224.5
Cash interest paid	208.0	177.0	180.5	193.2	217.5
Cash flow from operations	2,555.0	2,015.0	821.0	1,006.3	632.5
Capital expenditure	1,101.0	695.0	579.0	657.0	599.0
Free operating cash flow (FOCF)	1,454.0	1,320.0	242.0	349.3	33.5
Discretionary cash flow (DCF)	317.0	320.0	(735.0)	(627.7)	(943.5)
Cash and short-term investments	2,308.0	1,432.0	586.0	3,897.0	5,154.0
Gross available cash	2,406.0	1,432.0	586.0	3,897.0	5,154.0
Debt	9,878.0	6,477.7	6,803.4	2,439.2	1,355.3
Equity	15,577.0	13,234.0	12,077.0	13,287.0	13,542.0
Adjusted ratios					
EBITDA margin (%)	6.0	36.9	29.9	30.1	29.5
Return on capital (%)	11.1	10.1	5.9	6.5	5.5
EBITDA interest coverage (x)	10.7	9.6	7.5	5.8	4.8
FFO cash interest coverage (x)	12.9	10.4	8.2	6.6	3.9
Debt/EBITDA (x)	3.3	3.2	4.3	1.8	1.3
FFO/debt (%)	25.1	25.7	19.0	44.4	47.1
Cash flow from operations/debt (%)	25.9	31.1	12.1	41.3	46.7
FOCF/debt (%)	14.7	20.4	3.6	14.3	2.5
DCF/debt (%)	3.2	4.9	(10.8)	(25.7)	(69.6)

Reconciliation

Table 3

Fortum Oyj--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2020--					
Fortum Oyj reported amounts						
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**
Reported	9,607.0	12,953.0	2,687.0	1,599.0	170.0	2,955.0
S&P Global Ratings' adjustments						
Cash taxes paid	--	--	--	--	--	(267.0)
Cash interest paid	--	--	--	--	--	(208.0)
Reported lease liabilities	1,055.0	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	977.0	--	10.0	10.0	14.0	--
Accessible cash and liquid investments	(2,406.0)	--	--	--	--	--
Capitalized interest	--	--	--	--	27.0	--
Share-based compensation expense	--	--	9.0	--	--	--
Dividends received from equity investments	--	--	117.0	--	--	--
Asset-retirement obligations	645.0	--	--	--	65.0	--
Nonoperating income (expense)	--	--	--	767.0	--	--
Noncontrolling interest/minority interest	--	2,624.0	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	(765.0)	(765.0)	--	--
EBITDA: Derivatives	--	--	675.0	675.0	--	--
EBITDA: Other income/(expense)	--	--	222.0	222.0	--	--
Total adjustments	271.0	2,624.0	268.0	909.0	106.0	(475.0)
S&P Global Ratings' adjusted amounts						
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**
Adjusted	9,878.0	15,577.0	2,955.0	2,508.0	276.0	2,480.0

Liquidity: Strong

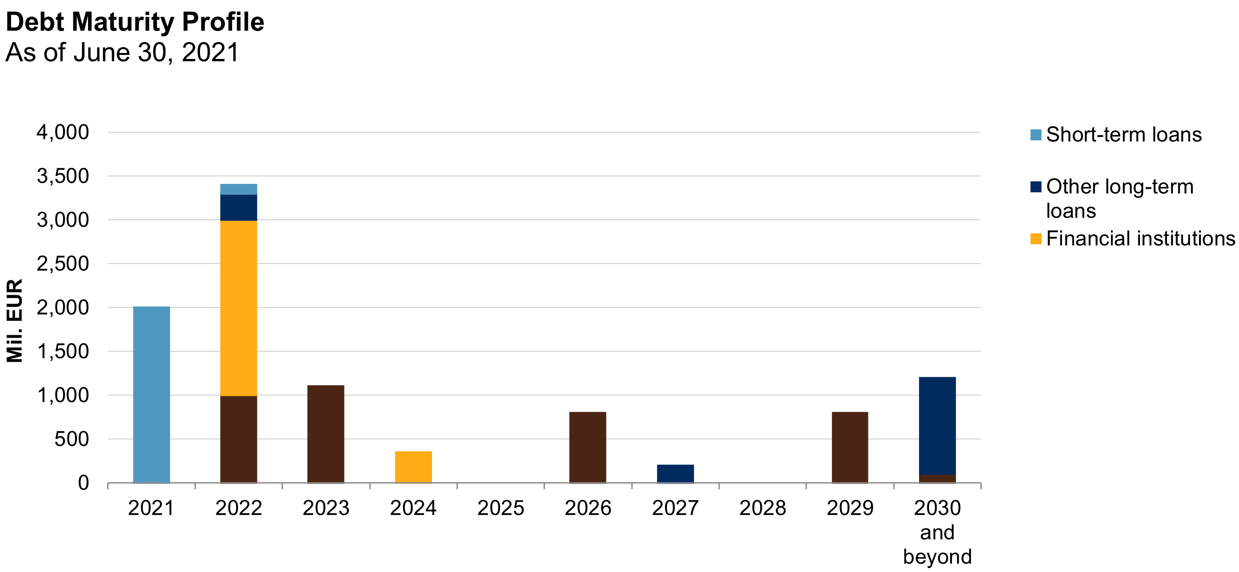
As of June 30, 2021, we view Fortum's liquidity as strong. This is based on our estimate that its liquidity resources, including cash, FFO, and facility availability, will cover expected cash outflows by about 2.5x in the next 12 months and 1.0x in the next 24 months.

Fortum's liquidity, as of June 30, 2021, continues to be supported by the group's strong standing in capital markets and sound banking relationships. Its debt documents do not contain any financial covenants.

Principal liquidity sources	Principal liquidity uses
• Cash and cash equivalents of about €1,703 million, excluding restricted cash; • Access to an undrawn long-term committed facility of €1.45 billion maturing in November 2021; • Access to €3.6 billion of undrawn facilities maturing after 12 months; • Positive cash FFO, which we estimate will near €2.2 billion in the next 12 months; • Announced disposals that will be cashed in by the end of the year, including the Exergi sale, for a total consideration of about €3.9 billion (the Exergi sale alone will account for about €2.9 billion); and • Working capital inflows in the amount of about €40 million in the next 24 months.	• Debt of about €2,278 million maturing in the next 12 months, and €1,353 in the following 12 months; • Annual capex of about €1,500 million; • Dividends of about €1.2 billion in the next 12 months.

Debt maturities

Chart 7



Source: S&P Global Ratings.

Environmental, Social, And Governance

Fortum's environmental risks are broadly in line with those of peers. On one hand, its European capacity has a zero to low-carbon dioxide emission fleet (mostly hydro and nuclear), generating scope 1 emission of 287 grams of carbon dioxide per gigawatt hour (gCO2/GWh) in 2020, of which less than 20 megatonnes (Mt) is generated in Europe. Nuclear risks and waste management, however, represent environmental and financial concerns. At the same time, nuclear companies in Finland are overfunded in terms of future waste management, and they are also well provided for in Sweden.

Russian operations (about 16% of 2020 EBITDA) rely mostly on thermal generation, and as a result have higher carbon dioxide emissions than the European fleet, with more than 30 Mt direct carbon dioxide emissions generated in 2020, out of a total of 48.8 Mt.

Fortum's approximately 76% stake ownership of German company Uniper exposes it to more thermal generation and environmental risks in the rapidly evolving German market.

We revised Fortum's management and governance assessment to fair following the Uniper acquisition in 2018, because we find it difficult to reconcile the transaction with Fortum's plan to be one of the leading green generators. This could be mitigated in part by Fortum's increasing scale and diversity, as well as scope for material synergies between the two companies. On the governance side, the abrupt management-level changes at Uniper in April 2021, driven by Fortum, will likely support the delivery of outlined synergies of €50 million by 2023 and €100 million by 2025. These changes demonstrate that the integration process has not been as smooth as previously outlined. We think it also signals Fortum's move to accelerate the process of strategy execution between the two companies.

Government Influence

Our rating on Fortum continues to incorporate a one-notch uplift for our view of a moderate likelihood of extraordinary government support if needed, based on Fortum's:

- Strong link with the government, given Finland's 50.8% ownership of the company. We believe that the government is likely to retain its majority stake in Fortum because the government has categorized the group as a strategically important entity; and
- Limited role for the government. Notwithstanding Fortum's position as the owner and operator of a sizable share of Finland's nuclear power capacity, we consider that the group operates in a liberalized electricity market, and that many of its services could be provided by a private-sector entity or another government-related entity.

A negative reassessment of the likelihood of extraordinary government support would likely lead to a one-notch downgrade of Fortum. This could occur if the government of Finland reduces its stake below 50.1% (currently at 50.8%), which we consider unlikely at this stage, and which would require parliament's approval.

Issue Ratings - Subordination Risk Analysis

Capital structure

Fortum's capital structure consists of senior unsecured debt issued at the parent level. After consolidation of Uniper as a subsidiary, the priority debt ratio is well below 30%.

Analytical conclusions

The issue rating on Fortum's senior unsecured debt is 'BBB', in line with the issuer credit rating, as no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Moderately high
- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb-

- **Related government rating:** AA+
- **Likelihood of government support:** Moderate (+1 notch from SACP)

Related Criteria

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

Related Research

- Outlook On German Energy Co. Uniper Revised To Stable Following Similar Action On Fortum; 'BBB' Ratings Affirmed, July 6, 2021
- Finnish Power Generator Fortum Oyj Revised To Stable On Progress With Disposals; ‘BBB’ Rating Affirmed, July 5, 2021
- Fortum's Management Changes At Uniper Show A Push To Accelerate Cooperation, With Debt Reduction Still Key, April 2, 2021
- Nuclear Producer Teollisuuden Voima Oyj Outlook Revised To Positive; 'BB' Rating Affirmed On Fuel Loading Completion, April 1, 2021
- Finnish Power Generator Fortum Delivers Solid 2020 Results Despite Challenging Operating Environment, March 12, 2021
- The Energy Transition And What It Means For European Power Prices And Producers: January 2021 Update, Jan. 27, 2021
- Finnish Power Generator Fortum Oyj 'BBB' Rating Affirmed; Outlook Negative, Dec. 18, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of September 1, 2021)*

Fortum Oyj		
Issuer Credit Rating		BBB/Stable/A-2
Nordic Regional Scale		--/--/NR
Senior Unsecured		BBB
Issuer Credit Ratings History		
05-Jul-2021		BBB/Stable/A-2
19-Mar-2020		BBB/Negative/A-2
09-Oct-2019		BBB/Watch Neg/A-2
18-Jan-2018		BBB/Negative/A-2
22-Sep-2017		BBB+/Watch Neg/A-2
05-Jun-2015	*Nordic Regional Scale*	--/--/NR
13-Jan-2003		--/--/K-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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