

Research Update:

Finnish Power Generator Fortum Oyj Outlook Revised To Stable On Progress With Disposals; 'BBB' Rating Affirmed

July 5, 2021

Rating Action Overview

- On June 30, 2021, Finnish power generator Fortum Oyj announced the €2.9 billion sale of its 50% stake in Stockholm Exergi to a consortium led by APG. This adds to about the €2.2 billion of disposals already announced or executed since 2020. Fortum also has other assets under strategic review, and we expect that its S&P Global Ratings' adjusted debt to EBITDA will materially decrease to about to 2.0x compared to 3.3x in 2020.
- Fortum's operating performance is also supported by improved power prices in its key markets--notably Germany and the Nordics-- after record-low levels in 2020. This should lead to reported EBITDA above €3.0 billion in 2021 compared with about €2.7 billion in 2020.
- We revised the outlook to stable from negative to reflect our view that, following the Exergi sale, Fortum will post credit metrics commensurate with the current rating level in 2021, notably adjusted FFO to debt well above 35% and adjusted debt to EBITDA below 2.5x. We also expect the company to continue deleveraging. We are not incorporating a full takeover of Uniper into our analysis in the near term, but we will re-assess our base-case scenario if it happens.
- We also affirmed our 'BBB' long-term credit rating on Fortum.

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Rating Action Rationale

Fortum's sale of its 50% stake in Stockholm Exergi (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. 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, and that was the basis for the outlook revision.

Several other disposals have also supported the improvement, including:

- €710 million in proceeds from the sale of Baltic district heating assets in March 2021;

- The €280 million sale of 500 MW of Indian solar assets, announced in June 2021; and
- €1.2 billion of disposals in 2020.

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

Fortum carried out those 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. The company has still 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 signal a strong commitment from Fortum to protect the 'BBB' credit rating.

We expect credit-supportive operating performance for 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 for 2020 (with Uniper consolidated just for nine months). This was already demonstrated with strong first-quarter results, with recovery in volumes of power sold and increased power prices that led to EBITDA of €1,479 million. (This figure isn't comparable with that of first-quarter 2020, when Uniper hadn't yet been consolidated).

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 approximately 80% at €32/MWh for 2021 and 55% at €31/MWh for 2022. This protects cash flow for the year and supports our expectation of improving credit ratios. Uniper has hedged 85% of its Nordic production at €27/MWh, 80% at €24/MWh for 2022, and 35% at 21€/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).

A full takeover of Uniper is not expected 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. Within the current rating, Fortum would not have the financial flexibility for such a transaction under our base-case scenario, as its adjusted FFO to debt would decrease below 30% without any 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 of 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.

Outlook

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

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.

Company Description

Fortum is the third-largest power generator in Europe and Russia region. In addition to its strong position in generation, Fortum is the third-largest CO₂-free generator in Europe because of its zero-to-low carbon dioxide emission fleet, with 45% of its generation fleet being CO₂-free.

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 €2,687 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 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.

Our Base-Case Scenario

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

- Finland's GDP to rebound by 2.0% in 2021 after the contraction of 2.9% in 2020, followed by a 1.6% average growth over 2022-2023.
- The consolidation of Uniper in Fortum's accounts under the full consolidation method starting from March 31, 2020.
- Fortum's Nordic generation segment hedges: about 80% of the Nordic production has been hedged at €32/MWh (vs 75% at €33/MWh at FY20), and for 2022: 55% has been hedged at €31/MWh (compared to about 50% has been hedged at €31/MWh at FY20). For Uniper, for 2021: about 85% (of the Nordic production for the remaining months) has been hedged at €27/MWh (compared to about 90% hedged at €27/MWh at FY20), for 2022: about 80% has been hedged at €24/MWh (compared to about 65% hedged at €24/MWh at FY20) and for 2023: about 35% has been hedged at €21/MWh (vs. about 25% hedged at €22/MWh at FY20).
- Remedy measures to offset an 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

(Mil. €)	--Fiscal year ended Dec. 31--			
	2020a	2021f	2022f	2023f
EBITDA	2,955	2,900-3,200	2,400-2,700	2,400-2,700
Funds from operations (FFO)	2,480	2,400-2,700	2,000-2,300	2,000-2,300
Capital expenditure	1,101	1,300-1,500	1,200-1,500	1,200-1,500
Dividends	1,137	1,100-1,200	1,100-1,200	1,200-1,300
Debt	9,878	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.

Liquidity

As of March 31, 2021, we viewed Fortum's liquidity was strong. This is based on our estimate that its liquidity resources--including cash, FFO, and facility availability--will cover expected cash outflows by about 2.0x in the next 12 months and 1.2x in the next 24 months. Fortum's liquidity 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

- Cash and cash equivalents of about €3,598 million, excluding restricted cash;
- Access to undrawn committed facilities of €1.75 billion maturing in June 2023 and €1.8 billion maturing in September 2025; and
- Positive cash FFO, which we estimate will near €2.1 billion for the next 12 months.

Principal Liquidity Uses

- Debt of about €1,990 million maturing in the next 12 months and about €3,051 million in the 12 months after that;
- Annual capital expenditures of about €1,400 million; and
- Dividends of about €1.2 billion in the next 12 months.

Issue Ratings - Subordination Risk Analysis

Capital structure

Fortum's capital structure consists of senior unsecured debt issued at the parent level. After the consolidation of Uniper as a subsidiary, the priority debt ratio is 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 (Standard volatility table)

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

- Fortum's Management Changes At Uniper Show A Push To Accelerate Cooperation, With Debt Reduction Still Key, April 2, 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
- Fortum Oyj, Nov. 9, 2020
- Uniper SE, Aug. 31, 2020
- Fortum Oyj 'BBB' Rating Affirmed On Russian Regulatory Approval; Outlook Negative As Material Uncertainties Remain, March 19, 2020

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Fortum Oyj		
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2
Senior Unsecured	BBB	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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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