Research Update:

Fortum Oyj And Uniper SE Ratings On CreditWatch Negative Following Fortum's Purchase Of Additional Stake In Uniper

October 9, 2019

Rating Action Overview

- On Oct. 8, 2019, Fortum Oyj agreed to acquire an additional stake in excess of 20.5% in Uniper SE from Elliot and Knight Vinke, increasing its total shareholding to over 70%. Closing Fortum expects by the end of first-quarter 2020 and is subject to regulatory approvals in Russia and the U.S.

- The transaction weakens Fortum's business risk profile to some degree (but still within the satisfactory category), assuming no change in Uniper's sizable exposure to carbon-intensive thermal power generation and commodities trading activities. It also delays Fortum's deleveraging, with adjusted debt to EBITDA expected to remain above 3.0x in 2020 compared to below 3.0x before the deal was announced.

- We understand Fortum's direct influence over Uniper is intended to increase significantly. As such, we will likely fully consolidate Uniper into Fortum and link the issuer credit rating on Uniper to that on Fortum upon antitrust approval.

- We placed our 'BBB' long-term ratings on Fortum and Uniper on CreditWatch with negative implications.

- The CreditWatch placement for Fortum reflects the significant likelihood of a one-notch downgrade once the deal closes, although the degree of downside risk will depend on possible remedy measures and market conditions.

- The CreditWatch placement for Uniper is associated to that of Fortum, depending on the link between both ratings post-transaction closing, subject to the level of Fortum's control over Uniper, its intended strategy and governance post-closing.

Rating Action Rationale

The CreditWatch negative placements follow Fortum Oyj's agreement to acquire an additional stake in excess of 20.5% in Uniper from Elliot and Knight Vinke, increasing its stake in Uniper to
over 70% from 49.99% currently. The transaction’s closing is subject to customary regulatory clearances in Russia and the U.S. which Fortum expects to achieve by the end of the first quarter of 2020.

Fortum intends to be represented on Uniper’s supervisory board commensurate with its ownership without delay, which will enable the company to have more control over Uniper than currently. Fortum rules out any domination and/or profit and loss transfer agreement (DPLTA) with Uniper or squeeze-out for at least two years.

Chart 1

Uniper Shareholding Structure

![Uniper Shareholding Structure](chart.png)

Source: S&P Global Ratings.
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Fortum Oyj

Fortum will pay about €2.3 billion for the combined shareholding, corresponding to €29.93 per share. The transaction will be cash-financed and we understand Fortum has already secured ample underwritten credit facilities, which gives us comfort in terms of liquidity. The CreditWatch negative placement reflects that a one-notch downgrade is likely once the transaction closes, although the degree of downside risk will depend on possible remedy measures and market conditions.

A downgrade could stem from a deterioration of Fortum’s business risk profile, still within the satisfactory category, because of Uniper’s sizable exposure to carbon-intensive thermal power generation and commodities trading activities. Given the business risk deterioration, we will need
stronger financial metrics to achieve the same rating level; for a ‘BBB’ rating, funds from
operations to debt would need to be above 35%, compared to 25% today. We also believe the
proposed transaction will delay Fortum’s deleveraging, with adjusted debt to EBITDA expected to
remain above 3.0x in 2020 instead of declining to below 3.0x from about 3.2x in 2019. The
higher-than-expected leverage compared with our previous base-case scenario is a result of the
€2.3 billion fully cash-financed acquisition. We will also start to fully consolidate Uniper in
Fortum’s accounts when the transaction closes.

The portfolio addition accentuates three main risks for Fortum:

- The addition of Uniper’s assets increases Fortum’s carbon footprint substantially. Previously,
  Fortum had been among the lowest carbon generators in Europe, but Uniper owns a significant
  fossil generation fleet (29 gigawatts of capacity). In our opinion, Fortum’s generation mix will
  shift to a higher share of coal and gas, comparing unfavorably with sizable generators such as
  Orsted (100% offshore wind) and EDP (39% wind and solar sources). This weakens Fortum’s
  competitive advantage somewhat, in terms of the energy transition.

- Fortum’s profile will evolve as a pure generator, as most of its earnings will be
  merchant-exposed, with inherent volatility risks associated with its predominantly thermal
  generation fleet (74% combined capacity estimated post-transaction) and its existing
  hydro/nuclear fleet. This leaves Fortum’s earnings exposed to fluctuating power prices in three
  main pools: the Nordics, Germany, and Russia. Although in Russia volatility is mitigated by
  capacity supply agreement contracts, Fortum is exposed to foreign exchange risk. Fortum’s
  profile as a pure generator compares unfavorably with European peers, notably CEZ and
  Verbund (which have higher shares of regulated activities, about 35% and 20%, respectively).

- Fortum will be exposed to Uniper’s sizable commodities business, which is inherently volatile,
  although we note Uniper’s significant progress in achieving cash flow stability.

All this being said, on the positive side, the transaction adds significant scale and could improve
operating efficiency because the combined group will have greater fleet optionality. The combined
generating capacity is now larger than all European peers except for EDF. We also understand that
the combined nuclear and hydro fleets, specifically, should improve the company's base load
capacity, with a favourable positioning in the merit order. Additionally, post-acquisition, Fortum
will have exposure to the midstream business, which provides some business line diversity in key
markets such as Russia, Sweden, and Germany.

We will continue to monitor the willingness of the Finnish government to support Fortum in case of
financial distress, which currently results in a one-notch uplift from the 'bbb-' stand-alone credit
rating.

Uniper SE

For Uniper, the acquisition could significantly reduce its independence which could result in
operational dependence of the two companies (driven by strategic alignment and shared
operations, for example regarding IT, administration, procurement, hedging, funding, liquidity,
etc.), even if Fortum owns less than the qualified majority ownership threshold of 75%.

Following the announced increase in ownership, Fortum aims to immediately increase
representation in Uniper’s supervisory board and expects to be more successful in achieving
operational and strategic alignment of the two companies.

The CreditWatch placement on Uniper is linked to that on Fortum. Given Fortum’s ambitions to
increase control of Uniper, we are likely to link both ratings and fully consolidate Uniper into
Fortum when the transaction closes. This being said, we could rate Uniper one notch above Fortum if there were sufficient elements of separation between the two companies post-closing.

CreditWatch

We expect to resolve the CreditWatch placement on Fortum when the transaction closes and after receiving clarity on potential remedy measures.

We expect to resolve the CreditWatch placement on Uniper in line with that on Fortum, when the transaction closes and after receiving more clarity on Fortum’s intended group strategy and implementation thereof, as well as on future Uniper’s governance and financial policy.

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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Will Fortum Become Uniper’s Majority Shareholder? Aug. 20, 2019
- Fortum Oyj, Aug. 14, 2019
- A Trio Of “Special Situations” M&A In European Utilities And Their Rating Implications, April 18, 2019
- Fortum Oyj, Dec. 5, 2018
- German Power And Gas Co Uniper Upgraded To ‘BBB’ On Reduced Event Risk And Strengthening Business Risk; Outlook Stable, April 27, 2018
## Ratings List

<table>
<thead>
<tr>
<th>CreditWatch Action</th>
<th>To</th>
<th>From</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fortum Oyj</td>
<td>Issuer Credit Rating</td>
<td>BBB/Watch Neg/A-2</td>
</tr>
<tr>
<td>Uniper SE</td>
<td>Issuer Credit Rating</td>
<td>BBB/Watch Neg/--</td>
</tr>
<tr>
<td>Rating Affirmed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fortum Oyj</td>
<td>Senior Unsecured</td>
<td>BBB</td>
</tr>
</tbody>
</table>

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. 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.