Uniper SE
Germany, Utilities

SCOPE BBB+ STABLE

Corporate profile

Uniper SE ('Uniper' or 'the company') is a major European power and gas company with a wide reach across the different segments of its industry. The company was spun off from E.ON SE in September 2016. Uniper operates a diversified generation portfolio of more than 25 GWp in major European markets (Germany, Sweden and the UK, among others) as well as around 11 GWp thermal generation portfolio in Russia. The company is also a major player in commodity supply, i.e. gas, electricity, coal and LNG, serving a wide range of industrial customers.

Ratings

Corporate Rating	BBB+
Outlook	Stable
Senior Unsecured Debt Rating	BBB+
Short-Term Rating	S-2

Rating rationale

Scope Ratings affirms BBB+/Stable issuer rating and S-2 short-term rating to German utility Uniper SE. Senior unsecured debt under the debt issuance programme is rated BBB+.

The rating affirmation reflects Scope's view of Uniper's business risk profile (assessed at BBB-) which remains constrained by significant merchant risks despite the company's dominant position in power generation and gas supply. However, Scope believes that the company's gradual and still ongoing shift towards regulated and quasi-regulated business segments strengthens the defensive character of its business model. Overall creditworthiness is strongly supported by Uniper's improved financial risk profile (assessed at A) but also its sound financial policy in terms of dividend distributions and a leverage-driven M&A strategy which aims at preserving credit quality.

The Stable Outlook reflects Scope's expectations that Uniper will retain its strong financial risk profile in line with the publicly communicated maximum leverage target of below 2.0x (as per Uniper's definition of economic net debt/EBITDA). This corresponds to a leverage as per Scope's definition (Scope-adjusted debt/EBITDA) of around 1.7x. Moreover, Scope's Stable Outlook incorporates the further stabilisation of Uniper's business risk profile through the gradual transition towards a higher contribution from regulated and quasi-regulated segments. The Stable Outlook also reflects the status quo regarding shareholder structure and the fact that no significant changes have been made to Uniper's communicated financial policy. Scope would reassess its rating, should Fortum or any other shareholder obtain a controlling stake in Uniper.

Scope believes that the possibility of a rating upgrade is remote, given the company's communicated financial leverage and dividend policy. Scope could consider a rating upgrade if Uniper's leverage, as measured by its Scope-adjusted debt/EBITDA, stabilised at below 1.0x over a prolonged time horizon.

Scope maintains its downgrade trigger for a negative rating action. A negative rating action could be required if Scope expected that Uniper's financial risk profile was likely to deteriorate to Scope-adjusted debt/EBITDA above the rating case, i.e. to 1.8x, over a prolonged period as a result of consistently low achievable wholesale prices in power generation or persistently low commodity prices in the trading business.

Analyst

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Related Research // Methodology

Rating Methodology: Corporate Ratings, January 2018

Rating Methodology: European Utilities, Jan 2018

Uniper's solid FY 2017 figures in line with rating case, Mar 2018

Uniper's BBB+/Stable issuer rating unaffected by final outcome of Fortum tender, Feb 2018

Scope rates German power and gas company Uniper SE at BBB+, Stable Outlook, Jun 2018

European Utilities: Commodity Rebound – Past the Trough, Nov 2017

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Bloomberg: SCOP

Rating drivers

Positive	Negative
• Ongoing shift towards more cash flow from regulated and quasi-regulated activities, which can partly offset the volatility from non-regulated activities	• Overall business risk profile significantly weaker than financial risk profile
• Dominant player in European power and gas supply	• Industry-inherent merchant risks under adverse market conditions in non-regulated power generation and commodity trading and resulting cash flow volatility
• Strong diversification regarding markets, technologies, and some integration across the value chain, thereby limiting the incremental effect of underperformance in particular business segments	• Profitability heavily impacted by external non-controllable effects and overall margin dilution due to high share of trading business
• Well-shielded market position in the regulated Russian power market	• Significant exposure to the volatile Russian rouble, with hedged dividend but unhedged translation risks
• Strong financial risk profile following deleveraging efforts, supported by the conservative financial policy and comfortable liquidity profile	

Rating-change drivers

Positive	Negative
• Further stabilisation of business risk profile and maintenance of a Scope-adjusted debt/EBITDA of below 1.0x for a prolonged period	• Deterioration of Uniper's financial risk profile above a Scope-adjusted debt/EBITDA of above 1.8x

Table 1 – Financial overview

			Scope estimates		
Scope credit ratios	**2016**	**2017**	**2018E**	**2019E**	**2020E**
EBITDA/interest cover (x)	7.6	15.0	>10	>10	>10
Scope-adjusted debt/EBITDA	1.6	1.0	1.2	1.6	1.6
Free cash flow/Scope-adjusted debt	53%	102%	0-10%	0-10%	0-10%
Liquidity (internal + external)	>200%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA	**EUR m**		**EUR bn**		
EBITDA	2,122	1,741	1.5	1.3	1.5
Operating lease payment in respective year	83	115	0.1	0.1	0.1
Scope-adjusted EBITDA	2,205	1,856	1.6	1.4	1.6
Cash flows	**EUR m**		**EUR bn**		
Operating cash flow	2,184	1,385	0.9	1.0	1.1
Investing cash flow (net*)	-328	517	-0.9	-0.9	-0.9
Dividends to external shareholders (incl minorities)	-44	-236	-0.3	-0.3	-0.4
Discretionary cash flow	1,812	1,666	-0.2	-0.3	-0.2
Scope-adjusted debt	**EUR m**		**EUR bn**		
Gross financial debt	2,870	1,923	2.4**	2.5**	2.6**
Deduct: margining positions (Scope approach)	-312	-297	-0.3	-0.3	-0.3
Deduct: cash, cash equivalents	-341	-1.027	-0.9	-0.8	-0.6
Cash not accessible	10	112	0.1	0.1	0.1
Add: pension obligation (Scope approach)	393	338	0.3	0.3	0.3
Add: operating lease obligations (Scope approach)	386	368	Already included in gross financial debt		
Add: asset retirement obligations (Scope approach)	514	451	0.5	0.5	0.5
Scope-adjusted debt (SaD)	3,520	1,868	2.0	2.3	2.6

* For 2016/17 investing cash flow includes realised asset disposals

** Including operating lease liabilities acc to IFRS 16

Source: Uniper, Scope expectations

Uniper remains independent company

No rating impact from Fortum's minority stake in Uniper

Scope notes that Uniper remains an independent company for the time being, after Fortum Deutschland SE, a subsidiary of Finnish Fortum Oyj (not rated by Scope), was only able to convince 0.47% of shareholders in addition to E.ON's 46.65% share of Uniper to tender their shares in Fortum's public tender offer. Fortum expects to finalise the transaction in mid-2018, upon obtaining all required regulatory approvals. While it remains to be seen whether Fortum will acquire additional shares in Uniper on the market over the next months, Scope believes that Fortum will stick to a minority share given the Finnish utility's publicly announced strategy of establishing co-operation with Uniper as well as the potential pressure on Fortum's financial risk profile.

Business risk profile

Uniper's position as leading power and company partly constrained by higher-risk merchant business and rouble exposure

Scope continues to consider Uniper's business risk profile to be a constraint on the overall rating. While Uniper clearly ranks among the dominating power generators and gas traders in major Western European markets, its overall business risks remain affected by industry-inherent and non-controllable factors acting on commodity prices, generation disruptions or unhedged translation risks, particularly with regard to the Russian rouble.

Uniper's position in its market segments is supported, in Scope's view, by:

- a strong placing among the **top 10 European power generators,** with a production capacity of more than 25 GWp and total output in 2017 of more than 70 TWh;
- its **leading position in gas trading in Germany and second position in the European gas supply market** (after Engie);
- the **strong competitive position in Russian power generation with around 11 GWp of generation capacity**; and
- the **balanced diversification** regarding market outreach, vertical and horizontal diversification, and cyclical and non-cyclical activities.

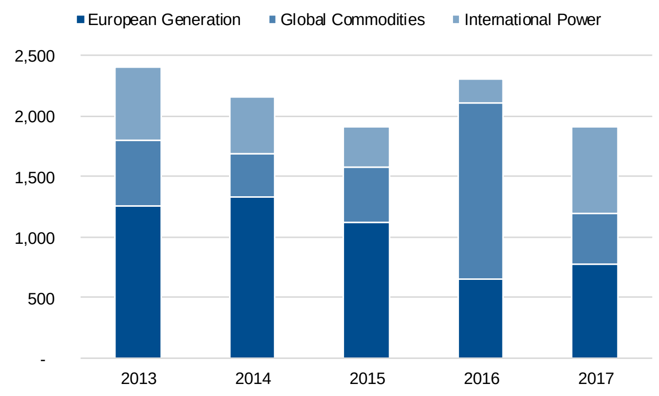
Nevertheless, Uniper's market position is hampered by:

- **full merchant risks for outright power production and commodity trading** e.g. gas, electricity, coal and LNG, mitigated to some extent by large hedging activities for outright production volumes and long-term contracts with industrial customers;
- the risk on some power generation assets due to their unfavourable positions in the relevant markets' merit order system;
- a **significant exposure to the Russian rouble**; and
- **strong impact on the company's average profitability** from a large trading exposure, albeit contributing positive earnings.

Ongoing transformation of the business model towards robust regulated and quasi-regulated activities

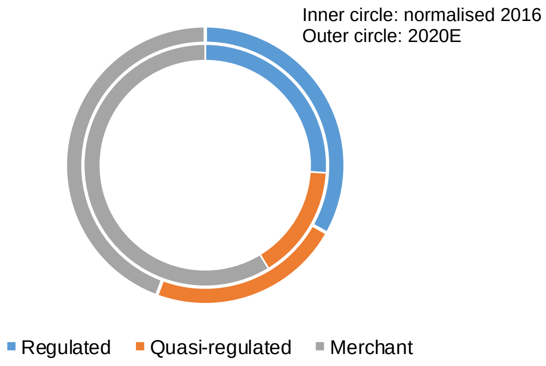
However, Scope believes that Uniper's business risk profile justifies the affirmed rating given the company's gradual transition towards lower-risk business segments (power generation in capacity markets such as Russia, France and the UK but also power generation under long-term contracts with industrial customers), which Scope believes will make up around 60% of the company's EBITDA by 2020. Scope sees the company as being largely on track despite the delayed commercial operation date for power plant Datteln IV.

Figure 1 – Segment split based on EBITDA (EUR m)



Source: Uniper, Scope

Figure 2 – Scope's expectations on growing share of regulated and quasi-regulated activities (based EBITDA expectations)



Source: Scope

Financial risk profile

Issuer rating strongly supported by financial risk profile

From Scope's perspective, the company's financial risk profile remains the supportive driver for Uniper's issuer rating, further backed by the strong deleveraging efforts, very comfortable debt protection measures, and the very limited refinancing needs over the next 2.5 years. Scope assesses Uniper's financial risk profile in conjunction with the company's financial policy, particularly the guidance on leverage.

Adjustments and projections

To assess Uniper's creditworthiness through key credit metrics such as leverage, debt protection and liquidity measures, Scope has adjusted for the following items:

- Scope-adjusted debt is adjusted for i) unrestricted cash position; ii) half of the company's unfunded pension provisions, given the high coverage of annual pension payments through dedicated pension assets; iii) the net present value of operating leases, iv) the deduction of margin payments for stock exchange futures; and v) the expected burden from asset retirement obligations which also reflects deferred tax assets relating to such provisions.
- Interest is adjusted for the (estimated) interest component of pension provisions, operating leases and asset retirement obligations.

EBITDA bottoming out in 2019

Uniper's operating result in terms of Scope-adjusted EBITDA (including operating leases) is expected to remain depressed compared to 2016/17 (Scope's forecasts: 2018E: EUR 1.6bn, 2019E: EUR 1.4bn) due to the lack of positive effects from gas price renegotiations, the lapse of cash flow contributions following the sale of its gas exploration and production (Yuzhno Russkoye) and the effect from lower average prices for power generation volumes compared to the previous two years. Regarding the latter, Scope believes that forward power prices in Uniper's core markets of Germany and Sweden will remain well above the low levels seen in 2015-16 due to the rebound of commodity prices and gradual shifts in the markets' merit order systems. These shifts involve the phasing-out of nuclear in Germany and coal as well as a sustainably higher price for CO_2 emissions which is favourable for Uniper's nuclear, hydro and gas-fired plants in Europe (see also Scope's research 'European Utilities: Commodity Rebound Past the Trough').

Uniper to benefit from price rebound after 2019

Over the next 2.5 years, Scope believes that Uniper will have upside rather than downside as displayed by current forward prices in Germany and Sweden which are well above the company's hedged prices for 2018 and 2019 (1y forward Germany baseload YTD at around 36 EUR/MWh against hedged price of between 20-24 EUR/MWh; 1y forward Nordpool baseload YTD currently at around 29 EUR/MWh against hedged price of between 20-24 EUR/MWh). Reflecting Scope's expectations of net capex of less than EUR 1bn per annum, free cash flows are expected to remain in positive territory despite the delayed EBITDA contribution from Datteln IV, thereby allowing Uniper's envisaged dividend growth, in Scope's view.

Financial policy supports robust Financial Risk Profile

Scope acknowledges Uniper's prudent financial policy which focusses on: i) communicated maximum leverage of less than 2.0x (as per Uniper's definition of net economic debt including operating leases, full asset retirement obligations, full pensions and margining positions divided by adjusted EBITDA); ii) dividend payouts linked to free cash from operations (funds from operations minus maintenance or replacement capex); and iii) a commitment to small-scale M&A activities only, in conjunction with low-risk targets. Scope expects that this combination will lead to a robust financial risk profile, supporting the agency's rating case.

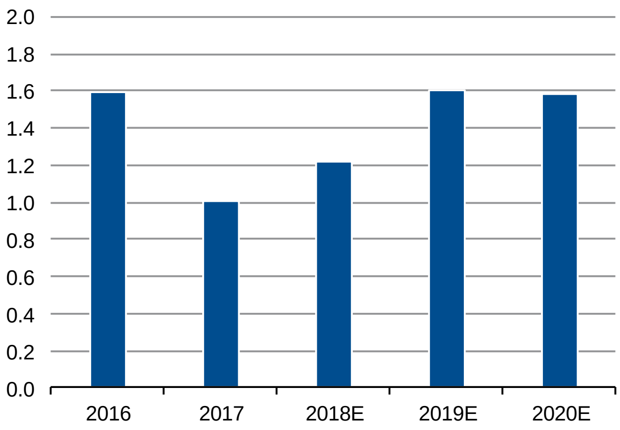
Interest coverage well above 10x

Uniper's financial risk profile is considered to strongly support the affirmed rating. Uniper's debt protection – as measured by EBITDA/interest cover – comfortably stands above 10x (15.0x in 2017 vs 7.6x in 2016), thanks to the cash-financed redemption of bank loans in Q1 2017, the lapse in 2017 of interest one-off effects from the spin-off from E.ON in 2016 and limited needs for additional external financing.

Rating case incorporates SaD/EBITDA of 1.5-1.7x

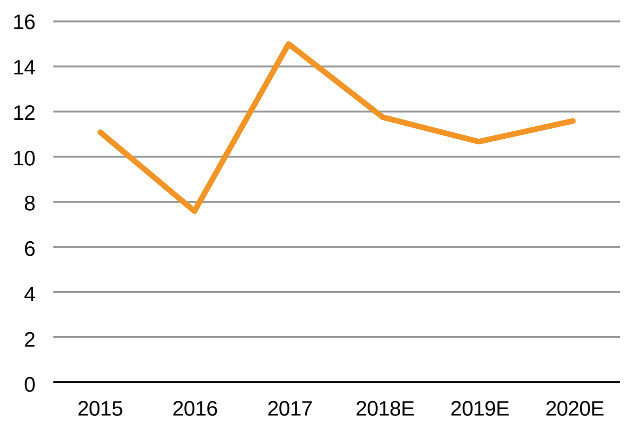
Scope-adjusted debt/EBITDA, which includes Scope's adjustments to long-term obligations for pensions and asset retirements but also margining positions and leases, is fully in line with Scope's financial risk profile assessment (2017: 1.0x vs 1.6x in 2016). The agency notes that Scope's leverage is slightly lower than the company's calculated leverage in terms of net economic debt/EBITDA due to Scope's adjustments/haircuts on long-term pension provisions and asset retirement obligations, thereby reflecting the payout character of such debt obligations.

Figure 3 – Leverage (Scope adjusted debt/EBITDA)



Source: Uniper, Scope

Figure 4 – Debt protection (EBITDA/interests cover)



Source: Uniper, Scope

Headroom to rating triggers

The company has retained sufficient headroom for relatively small investments or minor disposals before reaching the leverage range of between 1.5-1.7x upon which Scope's rating case is based. All things being equal, Scope calculates Uniper's potential headroom for additional debt (which could be used for additional growth capex beyond Uniper's communicated EUR 500m growth investments) to be around EUR 400m based on the agency's leverage maximum of 1.8x. Similarly, Scope calculates that the company's EBITDA could fall short by around EUR 250m in 2018/19 before reaching the agency's leverage-based rating trigger for a negative rating action. Such headroom will increase in case Uniper will conduct further asset disposals which are not reflected in Scope's rating case. Moreover, Scope believes that the company's debt profile can largely absorb the anticipated downturn (compared to 2016/17 levels) in the company's EBITDA profile in 2018 and, particularly, 2019 (when lower EBITDA contributions from Global Commodities and International Power are anticipated).

Liquidity

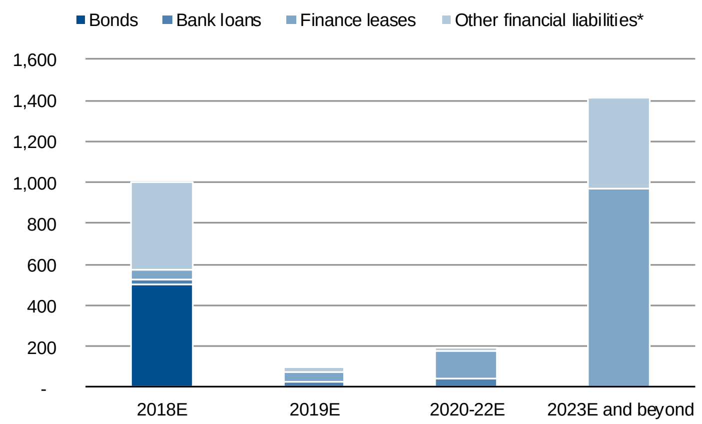
Robust liquidity profile

In light of Scope's expectation of continued positive free cash flows at least at breakeven, and in conjunction with Uniper's continued access to its EUR 2bn debt issuance programme on top of its EUR 2.5bn undrawn credit facilities (committed until June 2021), the company is expected to comfortably cover the upcoming sizeable maturity of EUR 500m from its corporate bond in December 2018 as well as minor positions from bank loans and finance leases. For 2019 and 2020 Scope expects debt repayments of less than 200m per annum, which is expected to be covered from internal cash flows.

S-2 short-term rating affirmed

Based on our positive assessment of liquidity and Uniper's BBB+ issuer rating, Scope affirms its short-term rating of S-2. This rating reflects Scope's perception of the company's sustainable liquidity profile in terms of short-term debt coverage and access to external corporate funding. Including all internal and external sources of liquidity, coverage of short-term debt is projected to stand well above 2x, a level Scope considers to be commensurate with the rating.

Figure 5 – Maturity profile at YE 2017 (in EURm)



* 2018E includes EUR 0.3bn from margining positions

Source: Uniper, Scope

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