6 May 2019

Corporates

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. 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.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019E**	**2020E**
EBITDA/interest cover (x)	15.0	13.9	>10	>10
SaD/EBITDA (x)	1.0	0.9	1.5	1.6
FOCF/SaD	102%	-2%	5-15%	0-10%
Liquidity	>200%	>200%	193%	>200%

Rating rationale

Scope has today affirmed Uniper SE's issuer rating of BBB+ with Stable Outlook. The S-2- short-term rating and BBB+ senior unsecured debt rating were also affirmed.

The issuer rating continues to be constrained by the business risk profile (BBB-), weakened by significant merchant risks from the company's dominant position in power generation and gas supply, and by increasing political risks regarding the phase-out of coal in different markets. This is partly offset by the gradual and ongoing expansion of EBITDA contributions from regulated and quasi-regulated segments. Moreover, Uniper's credit quality is strongly supported by its financial risk profile (A) and sound financial policy which aims at preserving the rating level.

The Stable Outlook reflects the status quo of Uniper. Scope-adjusted leverage (Scope-adjusted debt/EBITDA) at up to 1.7x remains commensurate with the current rating, assuming business risks do not increase significantly. The Outlook further incorporates that Uniper will keep its current stance on financial policy with i) a focus on positive free operating cash flows; ii) gradual dividend increases; and iii) a commitment to a target economic net debt/EBITDA of around 2.0x.

A negative rating action could be required if at one point Uniper loses its status as an independent company and altered its financial policy towards a more aggressive stance on leverage and dividends. Uniper's future as an independent company will be more clear following the AGM on 22 May 2019 should shareholders vote to instruct Uniper's management to implement some of the proposals by Elliot and Knight Vinke. Scope would reassess its rating, should Fortum or any other shareholder obtain a controlling stake in Uniper. Scope keeps the trigger for a potential negative rating action if it expected that Uniper's financial risk profile will weaken, as measured by a Scope-adjusted debt/EBITDA of at least 1.8x over a prolonged period.

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

Ratings & Outlook

Corporate rating	BBB+/Stable
Short-term rating	S-2
Senior unsecured rating	BBB+

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Related methodology/research

Rating Methodology: Corporate Ratings

Rating Methodology: European Utilities

Germany's coal exit: Mixed medium to-long term implications, Jan 2019

European utilities outlook 2019: Political, regulatory risk moves centre stage, Dec 2018

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

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Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant European player in power and gas supply • Ongoing transformation of business profile towards a higher cash flow contribution from regulated and quasi-regulated activities, which can to some extent offset the volatility from unregulated activities • Strong diversification regarding markets, technologies, and some integration across the utilities' value chain, thereby limiting the incremental effect of an underperformance in particular business segments • Cash flow rebound beyond 2019 bolstered by hedges and better market fundamentals (commodity prices) • Well-shielded market position in the regulated Russian power market • Strong financial risk profile, supported by conservative financial policy as an independent company and sound liquidity profile, with a SaD/EBITDA of below 1.7x and EBITDA interest cover of >10x in our rating case	• Overall business risk profile significantly weaker than financial risk profile • Industry-inherent merchant risks under adverse market conditions in non-regulated power generation and commodity trading and resulting cash flow volatility • Increasing political headwinds regarding power generation from coal-fired power plants • Profitability heavily impacted by external non-controllable effects and overall margin dilution due to high share of trading business • Significant exposure to the volatile Russian rouble, with hedged dividend but unhedged translation risks

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Further stabilisation of BRP and maintenance of a SaD/EBITDA of below 1.0x for a prolonged period	• Deterioration of Uniper's financial risk profile above a Scope-adjusted debt/EBITDA above 1.8x • Changes in Uniper's shareholder structure which could alter the company's independent financial policy

Financial overview

				Scope estimates		
Scope credit ratios	**2016**	**2017**	**2018**	**2019E**	**2020E**	**2021E**
EBITDA/interest cover (x)	7.6	15.0	13.9	>10	>10	>10
Scope-adjusted debt/EBITDA (x)	1.6	1.0	0.9	1.5	1.6	1.5
Free operating cash flow/Scope-adjusted debt (%)	53%	102%	-2%	5-15%	0-10%	5-15%
Liquidity (internal + external)	>200%	>200%	>200%	193%	>200%	>200%
Scope-adjusted EBITDA	**EUR m**			**EUR bn**		
Recurring EBITDA	2,122	1,741	1,543	1.4	1.5	1.7
Operating lease payment in respective year	83	115	-	-	-	-
Scope-adjusted EBITDA	2,205	1,856	1,543	1.4	1.5	1.7
Cash flows	**EUR m**			**EUR bn**		
Operating cash flow	2,184	1,385	1,241	1.0	1.0	1.2
Investing cash flow (net*)	-328	517	-1,263	-0.8	-1.0	-0.9
Dividends to external shareholder	-44	-236	-302	-0.3	-0.4	-0.4
Discretionary cash flow	1,812	1,666	-324	-0.1	-0.4	-0.1
Scope-adjusted debt	**EUR m**			**EUR bn**		
Gross financial debt (including margining liabilities)	2,870	1,923	2,939**	2.1**	2.4**	2.8**
deduct: margining liabilities (Scope approach)	-312	-297	-976	-0.5	-0.5	-0.5
deduct: cash and cash equivalents	-341	-1,027	-1,400	-0.4	-0.4	-0.6
add: restricted cash	10	112	22	0.1	0.1	0.1
add: unfunded pension (Scope approach)	393	338	402	0.4	0.4	0.4
add: operating lease obligations (Scope approach)	386	368	-	-	-	-
add: unfunded asset retirement obligations (Scope approach)	514	451	438	0.5	0.5	0.5
Scope-adjusted debt (SaD)	3,520	1,868	1,425	2.1	2.5	2.6

* For 2016-2018 investing cash flow includes realised asset disposals

** Including operating lease obligations acc to IFRS 16

Source: Uniper, Scope expectations

AGM could set the stage for changing Uniper's future as an independent company

Activist shareholders put pressure on Uniper's future as an independent company

Scope's rating case is based on Uniper being an independent company. Decisions taken at the AGM on 22 May 2019 could alter this status in the medium to long-term if proposals of activist shareholders Knight Vinke (KVIP International V L.P.) and Elliott (Cornwall GmbH & Co. KG) were to be implemented at some point. Fortum which has bulked up its share in Uniper to 49.99% after the end of the tender period in 2018, has not been able to take control due to restrictions in Russian Strategic Investment Law if it wanted to do so. In case Fortum truly wanted control over Uniper, it would have the chance to set the stage for a potential implementation of measures that could lead to obtaining control in the medium to-long term as Fortum and activist shareholders will have a combined share of 72.84% at the AGM (Fortum: 49.99%; Paul E. Singer and related entities [Elliott]: 17.84%; Eric Knight [Knight Vinke]: 5.02%).

Conclusions at AGM could alter status of Uniper

While the further stocking up of Fortum's share in Uniper signals the general intention, the question remains, however, as to whether Fortum actually intends on taking control of Uniper. This is given the so-called 'fresh start' between the two companies for future co-operation and the implied financial consequences for Fortum. At the AGM, all proposals of the activist shareholders could eventually lead to Fortum either taking full control in the following months or taking over a significant part of Uniper's assets, the latter of which would be more complementary to Fortum's asset portfolio and ESG profile. However, Scope will wait for the conclusions from the AGM before assessing any rating impact, also taking into account that – if agreed by the shareholders – the implementation of the proposals will require a significant amount of time.

The three proposals are:

- **Prepare the conclusion of a legally valid domination agreement (Elliott proposal).** A positive decision on this point requires 75% of shareholder votes at the AGM. If such domination agreement was concluded at some point, it would theoretically result in full control by Fortum as either it or one of its subsidiaries would be the dominating company, with Uniper losing its independence on dividends, financing structure, investments etc.. However, the implementation of domination agreement will not alter the legal situation in Russia and Scope deems it likely that Russian Authorities would again veto such transaction to prevent Fortum and its controlling shareholder from controlling strategic assets in Russia. Moreover, full consolidation is likely to have significant impact on Fortum's business risk and financial risk profiles, potentially adding further rating pressure. From our perspective, Fortum's business risk profile and ESG would be weakened when incorporating Uniper's business risks, and the financial risk profile would likely be impacted negatively by a closure of a domination agreement under the German Aktiengesetz. Moreover, Fortum would likely be required to pay remaining shareholders the 'full real value' based on IDW S-1, a German accounting standard, which would stretch Fortum's indebtedness any further.
- **Spin off the International Power segment (Knight Vinke proposal).** This would eventually pave the way for a takeover of the remaining parts of Uniper (European Generation and Global Commodities). While such spin-off would require a lengthy process, it would be one realistic scenario for Uniper to lose its independent status as this would eliminate the obstacle to the takeover, a veto from Russian authorities. However, the credit impact on Fortum's business risk profile is likely to be even more negative than under the first option, as Scope deems the regulated Russian business activities as an overall strength. The impact on the overall financial risk profile will then depend on the financial structuring for the spun-off segment and the

conditions for a new tender offer that Fortum could make for Uniper following such spin-off.

- **Spin off the European Generation segment in Sweden (Knight Vinke proposal).** From our perspective, this would rule out any option that would enable Fortum to take control of Uniper at some point, but would be more satisfactory advantageous for Fortum as it would enable it to acquire Uniper's hydro, nuclear and gas-fired generation capacities in Sweden (totalling 4.6 GW) – assets which complement Fortum's business and ESG profiles.

Business risk profile

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

Under the current status quo, Uniper's business risk profile (BBB-) continues to constrain the overall rating. Although Uniper dominates in power generation in major Western European markets, ranking first in gas trading in Germany and second in Europe, its overall business risks remain affected significantly by industry-inherent and non-controllable factors acting on commodity prices, by generation disruptions, and unhedged currency translation risks, particularly regarding 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 of around 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:

- **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;
- **political headwinds** for part of Uniper's European power generation fleet (hard coal and lignite in Germany, France and the Netherlands);
- a **significant exposure to the Russian rouble**; and
- **significant impact on the company's average profitability** from Global Commodity business with its exposure to trading, albeit contributing positive earnings.

Coal phase out affecting significant share of generation fleet, but likely accompanied by adequate compensation

Uniper's European generation business is also increasingly under political/regulatory pressures to phase out coal. Germany aims for this by 2038 (see also Scope's commentary: Mixed medium to-long term implications from Germany's coal exit, January 2018); France envisages accelerated phase-out by 2021; the Netherlands intends it by 2030. This would have a significant impact on Uniper's medium-to-long-term business risk profile, as around 20% of its European power generation relates to lignite and hard coal in these markets (adding up to around 6 GW). For its French generation activities, which include two hard coal power plants (1.2 GW), Uniper has already received a binding offer from Czechia's Energetický a průmyslový holding, a.s. in December 2018.On the other hand, the coal exit is likely to be accompanied by adequate compensation payments. These could be reinvested in markets less exposed to such risks, invested in assets which fulfil Uniper's current investment focus on regulated and quasi-regulated assets, or simply used to keep indebtedness low.

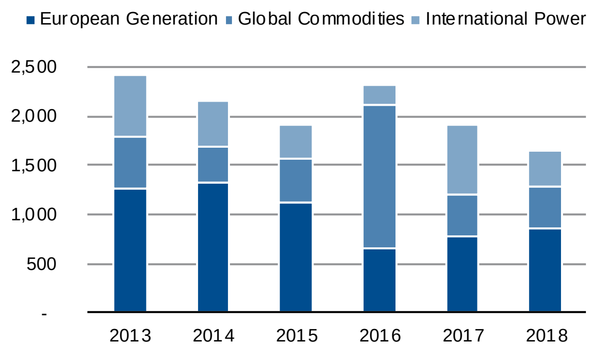
Gradual growth of EBITDA contribution from robust activities

In this context, Scope's assumptions of Uniper's gradual transformation towards lower-risk utility segments and gradually increasing stabilisation of the business risk profile still hold. The assumption of a growing relative EBITDA contribution from regulated and quasi-regulated activities to more than 60% in 2020E no longer applies given the better-than-expected developments for unregulated merchant business. Instead, Scope expects EBITDA contributions from lower-risk utility segments (power generation in capacity markets as well as power generation under long-term contracts with industrials) to grow to above EUR 800m by 2020, which would correspond to around 50% of group EBITDA.

EBITDA recovery beyond 2019

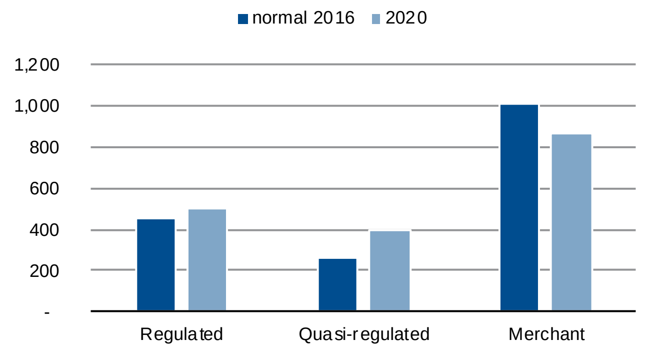
Scope expects Uniper's EBITDA to reach a trough of around EUR 1.4bn in 2019E. This reflects Uniper's hedge ratios and hedged prices in its main markets, Germany and Sweden, as well as the general commodity price rebound, which is expected to lead to a recovery in EBITDA beyond 2019 (Scope's forecasts: 2020E: EUR 1.5bn; 2021E: 1.7bn). This is due to the hedged price secured at 22-26 euros/MWh in 2019 for 80% of outright power generation in Germany against 35 euros/MWh in 2020; the largely hedged price of 22-26 euros/MWh for outright power generation in the Nordpool against 24-28 euros/MWh in 2020; and the positive effect from the absolute pricing level of gas. Scope does not anticipate significant risks for deteriorating market fundamentals (achievable prices and margins) over the next three years in light of the shifts in the merit order system with the phase-out of nuclear and coal in Germany, and with CO2 pricing seeming to have found a floor at 20 euros/metric tonne.

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

Adjustments

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 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. Scope notes that adjustments for off-balance sheet leases are not required as Uniper has disclosed the debt burden of operating leases in line with IFRS 16 in its 2018 accounts already.

- disclosed in line with IFRS 16 together with finance leases
- Interest is adjusted for the (estimated) interest component of pension provisions, operating leases and asset retirement obligations.

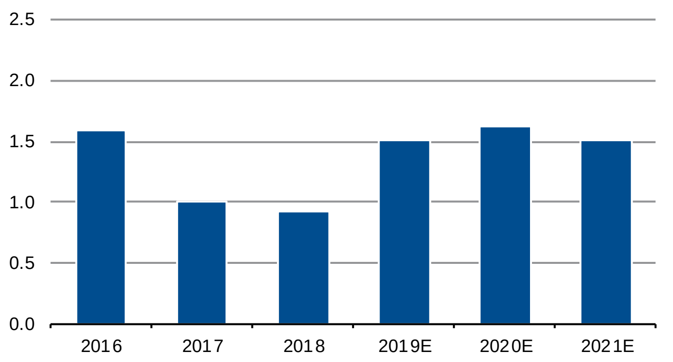
Issuer rating strongly supported by financial risk profile

Uniper's financial risk profile (A) still strongly supports the rating. Debt protection, as measured by EBITDA/interest cover, remains comfortably above 10x in light of the limited need for expansion capex, new financing and the gradual improvement expected for group EBITDA beyond 2019. More importantly, Scope-adjusted debt/EBITDA, which includes Scope's adjustments to long-term obligations for pensions and asset retirements but excludes margining liabilities, remains low at below 1.7x and forms the basis for the rating case (2018: 0.9x; 2017: 1.0x; 2016: 1.6x). Incorporating our assumptions about a strong reduction of margining liabilities (gross) as well as the partial usage of external bank financing related to growth capex, Uniper's leverage is expected to stand at a higher level over the next three years. However, Scope does not expect Uniper to exceed the leverage threshold mentioned above over the next few years, based on envisaged needs for maintenance and growth capex as well as on dividend payouts, which grow gradually in line with policy. Scope's underscores that our adjusted leverage is structurally lower than Uniper's communicated leverage as net economic debt/EBITDA due to the agency's adjustments and haircuts on long-term pension provisions, asset retirement obligations and margining, thereby reflecting the payout character and asset coverage of such debt obligations.

Significant headroom for debt and EBITDA until reaching our quantitative downgrade trigger

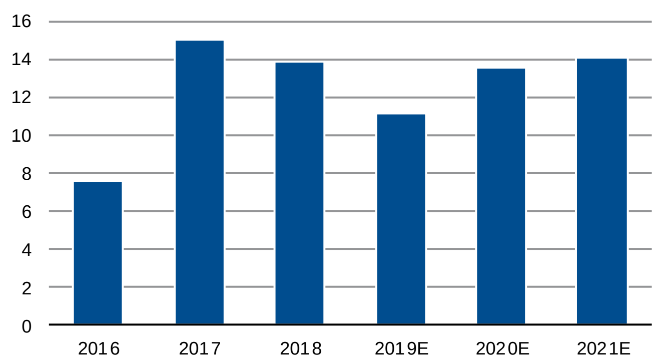
According to Scope's sensitivity analysis, the company has headroom on both net debt and unexpected shortfalls in EBITDA before reaching the maximum leverage of 1.7x, the trigger for a negative rating action. All things being equal, Scope calculates Uniper's potential headroom for additional debt (which could be used for growth capex beyond the EUR 400m communicated) to be around EUR 300m, based on the agency's maximum leverage threshold of 1.8x. Similarly, the company's EBITDA can fall short by around EUR 150m in 2019/20 (10% against our estimates) before reaching the agency's leverage-based trigger for a negative rating action. Such decline in EBITDA is deemed unlikely given the aforementioned positive effects from commodity prices, hedged volumes for 2019 and 2020 in power generation, and price indications from oil and gas futures.

Figure 3: Leverage (Scope adjusted debt/EBITDA)



Source: Scope estimates

Figure 4: Debt protection (EBITDA/interests cover)



Source: Scope estimates

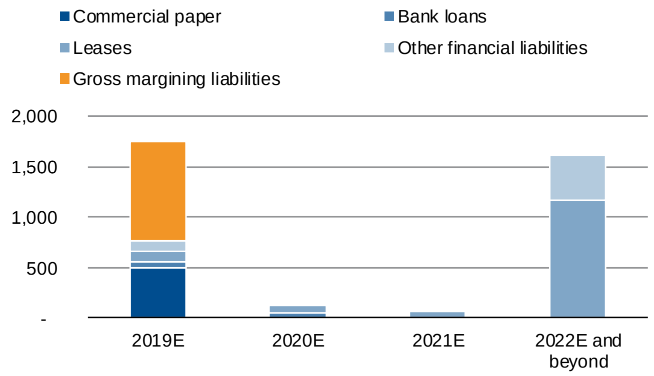
Conservative financial policy as an independent company

The rating is also supported by Uniper's communicated target leverage of around 2.0x as it implies the company will not engage in growth projects that result in more volatile cash flow. Fluctuations around this level would predominantly be due to margining positions as at YE 2018 (excluded in Scope-adjusted leverage), when leverage as defined by Uniper stood at 2.1x. Furthermore, Scope's opinion of a sustainably strong financial risk profile is further based on Uniper's rating commitment, dividend payouts linked to free cash from operations (funds from operations minus maintenance or replacement capex).

Robust liquidity

Liquidity remains sound with ratios of consistently above 110% (both internal and external sources) at all times. After redeeming its EUR 500m corporate bond in December 2018, Uniper has outstanding debt totalling around EUR 1.9bn that needs to be covered between 2019-21, which includes the settlement of gross margining liabilities related to Uniper's electricity and gas trading of about EUR 1.0bn as at YE 2018 (see figure 5). While the margining liabilities are widely balanced by receivables, the remaining debt exposure from commercial paper, leases and bank loans is expected to be covered by the combination of an unrestricted cash cushion (EUR 1.4bn at YE 2018), free operating cash flows (consistently at least at breakeven), and the unused EUR 1.8bn syndicated credit facility committed until 2023. From Scope's perspective, Uniper's internal liquidity sources are expected to be sufficient to cover funding needs without needing to extent the usage of the EUR 1.8bn commercial paper beyond the current level (usage of around EUR 500m at YE 2018) or exploiting its EUR 2bn unused debt issuance programme, unless Uniper intended to pursue larger than expected growth opportunities.

Figure 5: Maturity profile at YE 2018 (in EURm)



Source: Uniper, Scope

S-2 short-term rating affirmed

Based on the sound 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 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 at well above 110%.

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