25 May 2020

Corporates

Uniper SE
Germany, utilities

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 around 24 GWp in major European markets (Germany, Sweden and the UK, among others) as well as a thermal generation portfolio of around 11 GWp 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	2018	2019	2020E	2021E
EBITDA/interest cover (x)	13.9	13.3	>10	>10
Scope-adjusted debt (SaD)/EBITDA (x)	0.9	1.0	1.4	1.5
Free operating cash flow (FOCF)/SaD	-2%	75%	-5 to 5%	10 to 15%
Liquidity	>200%	>200%	>200%	>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 affirmation is driven by Uniper's status as an independent company and its consistently strong credit metrics supported by an extensive use of hedging and robust regulated and quasi-regulated activities.

The issuer rating remains constrained by Uniper's business risk profile (BBB-) but supported by its strong financial risk profile (A) and sound financial policy, which aims at preserving the rating level. Uniper is still rated as an independent company, despite Fortum's takeover with a 73.4% majority share, given our continued view that Fortum does not control Uniper.

The Stable Outlook reflects Uniper's status as an independent company. A Scope-adjusted debt/EBITDA of up to 1.7x remains commensurate with the current rating, assuming business risks do not increase significantly. The Outlook further incorporates Uniper's maintenance of its financial policy, namely i) positive free operating cash flows; ii) gradual dividend increases; and iii) commitment to a maximum economic net debt/EBITDA of around 2.0x (as per Uniper's definition).

A negative rating action could be required if Uniper lost its status as an independent company and developed a more aggressive stance on leverage and dividends. A potential negative rating action is also possible if Scope-adjusted debt/EBITDA was anticipated to reach above 1.8x for a prolonged period, driven, for example, by much lower operating cash flows without measures to counteract the weaker earnings.

A rating upgrade remains a remote scenario, given the company's communicated financial leverage and dividend policies, but could occur if Scope-adjusted debt/EBITDA reached below 1.0x for a prolonged period.

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, Feb 2020

Rating Methodology: European Utilities, Mar 2020

European utilities' credit outlook stable amid Covid-19; industry disruption poses longer-term threat, Mar 2020

2020 European Utilities Outlook, Feb 2020

European electricity: Renewables-based PPAs transform sector, Oct 2019

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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 • Ongoing decarbonisation of European power generation fleet (ESG: credit-positive environmental risk factor) with expected proceeds from asset disposal and compensation payments to be reinvested in low-risk assets • 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 • Limited short-term expected impact from Covid-19, thanks to largely hedged generation exposure and long-term contracts in energy supply • 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 • Still significant exposure to power generation from coal-fired power plants (ESG: credit-negative environmental risk factor) • Profitability heavily impacted by external and 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 business risk profile 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 of above 1.8x on a sustained basis • Changes in the status as an independent company and development of a more aggressive stance on leverage and dividends

Financial overview

				Scope estimates		
Scope credit ratios	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
EBITDA/interest cover (x)	15.0	13.9	13.3	>10	>10	>10
Scope-adjusted debt/EBITDA (x)	1.0	0.9	1.0	1.4	1.5	1.5
Free operating cash flow/Scope-adjusted debt (%)	102%	-2%	75%	-5 to 5%	10 to 15%	15 to 20%
Liquidity (internal + external)	>200%	>200%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA	**EUR m**			**EUR bn**		
Recurring EBITDA	1,741	1,543	1,561	1.4	1.5	1.6
Operating lease payments in respective year	115	0	0	0	0	0
Scope-adjusted EBITDA	1,856	1,543	1,561	1.4	1.5	1.6
Cash flows	**EUR m**			**EUR bn**		
Operating cash flow	1,385	1,241	932	1.1	1.1	1.2
Investing cash flow (net)	517	-1,263	221	-1.1	-0.8	-0.8
Dividends to external shareholder	-236	-302	-361	-0.5	-0.5	-0.6
Discretionary cash flow	1,666	-324	792	-0.5	-0.3	-0.2
Scope-adjusted debt	**EUR m**			**EUR bn**		
Gross financial debt (including margining liabilities)	1,923	2,939	1,934	2.2	2.7	3.2
less: margining liabilities (Scope approach)	-297	-976	-499	-0.5	-0.5	-0.5
less: cash and cash equivalents	-1,027	-1,400	-889	-0.7	-0.9	-1.3
add: restricted cash	112	22	18	0.1	0.1	0.1
add: unfunded pension (Scope approach)	338	402	516	0.5	0.5	0.5
add: operating lease obligations (Scope approach)	368	-	-	0.0	0.0	0.0
add: unfunded asset retirement obligations (Scope approach)	451	438	468	0.5	0.5	0.4
Scope-adjusted debt (SaD)	1,868	1,425	1,548	2.1	2.3	2.5

Source: Uniper, Scope expectations

Uniper is rated on a standalone basis as an independent company

Majority shareholder Fortum does not control Uniper

Uniper's majority shareholder, Fortum (holding increased to 73.4% in May 2020), continues to rule out a domination and/or profit-and-loss transfer agreement or a squeeze-out until the end of 2021 at least. In Uniper's supervisory board, Fortum occupies four of the six seats (including chairperson) representing shareholders but is not linked to the other six seats representing workers. From Scope's perspective, Uniper will remain an independent company in the absence of a domination or profit-and-loss transfer agreement or a supervisory board majority that can directly influence financial decisions, e.g. on investments/divestments or dividend pay-outs. Hence, Uniper remains rated on a standalone basis.

Business risk profile

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

Under the current status quo, Uniper's business risk profile (assessed at 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 our view, by:

- a strong placing among the **top 10 European power generators,** with a production capacity of around 24 GWp and total output of around 60 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**;
- the **balanced diversification** regarding market outreach, vertical and horizontal **diversification, and cyclical and non-cyclical activities;**
- Ongoing **de-risking strategy** (transformation of business model) towards defensive regulated and quasi-regulated infrastructure activities; and
- Ongoing **decarbonisation** through mothballing/disposal of CO2-intense power generation assets in Europe.

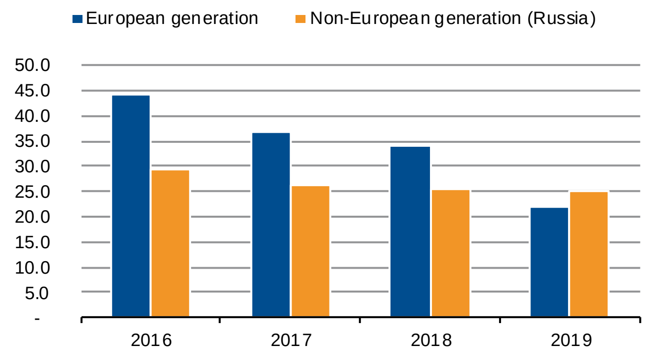
Nevertheless, Uniper's market position remains hampered by:

- **merchant risks for outright power production and commodity trading** e.g. gas, electricity, coal and LNG, mitigated to some extent by extensive hedging of outright production volumes and long-term contracts with industrial customers;
- comparatively high CO2-intensity of European power generation fleet despite huge decarbonisation efforts over the past few years; however, coal exit is planned over the next few years in key German and UK markets;
- 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.

ESG factor: Decarbonisation of European generation is credit-positive

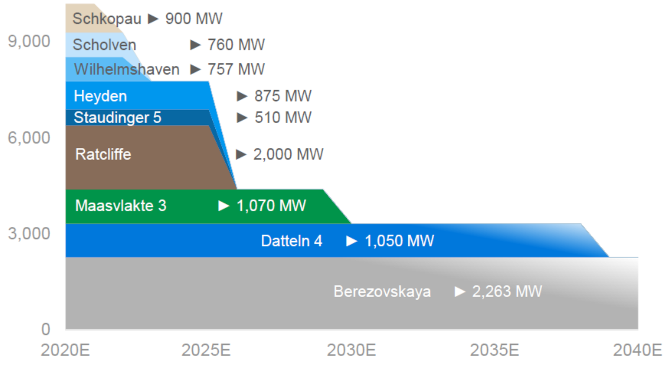
We highlight the company's consistent execution of its de-risking strategy. This encompasses the gradual transition towards lower-risk utility segments and the decarbonisation of its European power generation fleet. The latter is implemented via asset sales (e.g. recent disposal of French hard-coal plants) and gradual mothballing (exit strategy) of the remaining coal-fired power plants in Germany and the UK against compensation via auctions organised by the Federal Network Agency (BNetzA). This has already yielded results, with CO2 output of its European generation fleet down by more than 30% since 2016. Even so, 30% of its European power generation capacity remains exposed to lignite and hard coal (ESG: credit-negative environmental risk factor). By 2025, this figure is likely to reduce to around 10% of its European generation fleet – a positive ESG credit risk factor – through the disposal of Schkopau and mothballing of Scholven, Wilhelmshaven, Heyden, Staudinger 5 and Ratcliffe power plants. The gradual decarbonisation will further reduce non-controllable pricing risks on CO2 emissions and mitigate regulatory and reputational risks. Further, compensation payments for shutting down coal-fired capacities in Germany are likely reinvested into assets that are less exposed to pricing and volume risks and align with Uniper's focus on regulated and quasi-regulated activities, or simply used to keep indebtedness low.

Figure 1 – Strong reduction of direct CO2 emissions in European generation (in million metric tons)



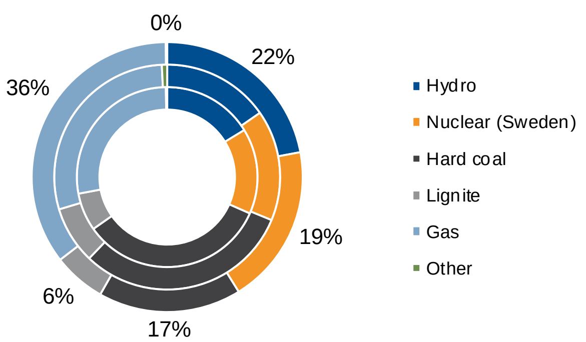
Source: Uniper, Scope

Figure 2 – Coal exit plan for European generation



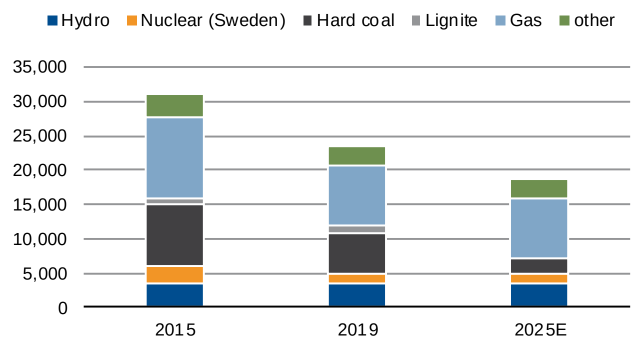
Source: Uniper

Figure 3 – European generation portfolio measured by output (inner circle 2017; middle circle 2018, outer circle 2019)



Source: Uniper, Scope

Figure 4 – Decarbonising the European generation portfolio (capacity)



Source: Uniper, Scope

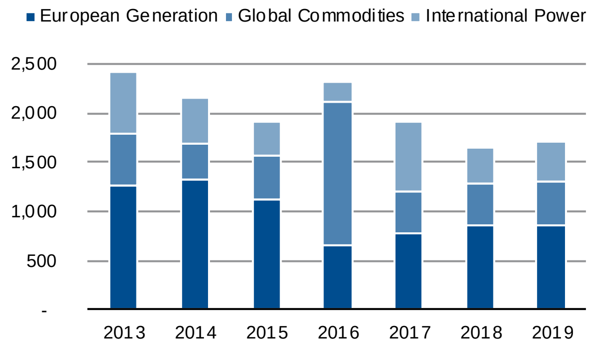
Gradual growth of EBITDA contribution from robust activities

In this context, our view on a gradual stabilisation of Uniper's business risk profile still holds, with lower-risk utility segments (power generation in capacity markets as well as power generation under long-term contracts with industrials) expected to contribute roughly 50% of group EBITDA over the next few years.

EBITDA expected to remain above EUR 1.4bn

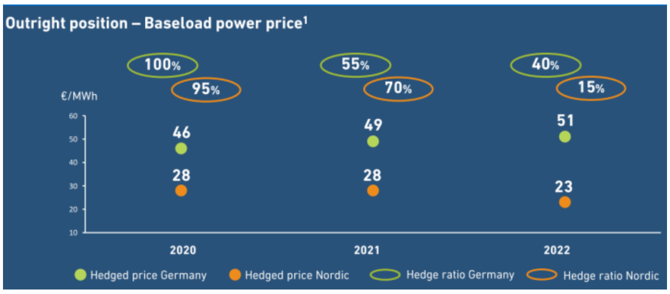
Amid the Covid-19 health crisis, we remain confident that Uniper's EBITDA will remain in a range of EUR 1.4bn-1.6bn between 2020 and 2022. The company faces little pricing and cash flow risks for 2020 and 2021 despite the volatility of spot and forward prices for outright electricity production in its relevant markets. This is largely due to its extensive hedging of outright generation volumes: for 2020, 100% is hedged at EUR 46/MWh in Germany and 95% at EUR 28/MWh in the Nordic region; for 2021, 55% at EUR 49/MWh in Germany and 70% at EUR 28/MWh in the Nordic region – all above prices seen over the past three years. With the company's European and Russian power generation largely secured by regulation, long-term contracts and/or extensive hedging, the only likely sources of volatility are trading volumes in global commodities, primarily natural gas, and the Russian rouble.

Figure 5 – Segment split based on EBITDA (EUR m)



Source: Uniper, Scope

Figure 6 – Largely hedged position in European power generation (as of May 2020) with hedged prices above the 3-year average



Source: Uniper

Financial risk profile

Adjustments

To assess Uniper's creditworthiness through key credit metrics such as leverage, debt protection and liquidity measures, we have 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 iv) 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.

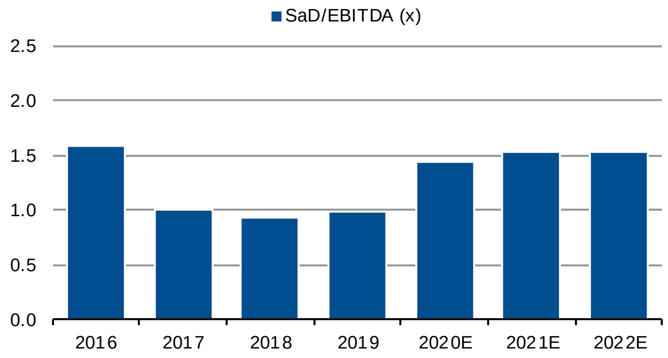
Issuer rating strongly supported by financial risk profile

Uniper's financial risk profile (A) strongly supports the overall rating. Of the EUR 3bn gross debt balance, only EUR 0.9m bears interest (mostly from leases), with the remainder relating to economic debt such as unfunded pensions and asset retirement obligations. As expansion capex is expected to be limited and to be largely financed internally, we expect no significant external financing over the next few years. Debt protection, as measured by EBITDA/interest cover, is expected to remain comfortably above 10x in light of the limited need for external financing and the roughly stable group EBITDA over the next three years. More importantly, leverage as measured by Scope-adjusted debt/EBITDA which includes Scope's adjustments to long-term obligations for pensions and asset retirements but excludes margining liabilities, is expected to remain low, at below 1.7x, forming the basis for the rating case (2019: 1.0x; 2018: 0.9x; 2017: 1.0x). Scope-adjusted leverage is forecasted to increase to around 1.5x by 2022, reflecting expected negative discretionary cash flows of minus EUR 200m-500m expected during that period, but is unlikely to surpass Scope's 1.8x threshold for a downgrade.

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

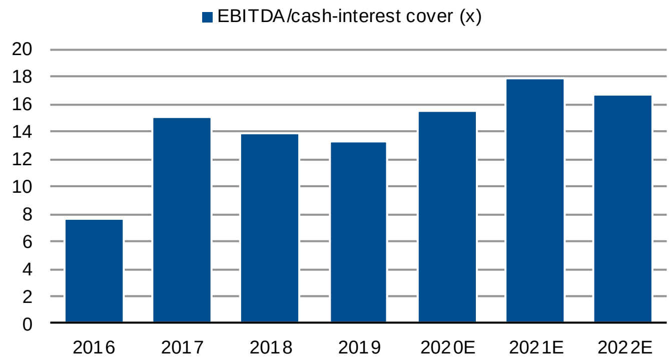
According to Scope's sensitivity analysis, the company has ample headroom on both net debt and unexpected shortfalls in EBITDA before reaching this 1.8x threshold: All things being equal, the headroom for additional debt is around EUR 500m (which could be used for growth capex beyond the EUR 400m communicated), while EBITDA can fall short by around EUR 150-200m in 2020/21 (15-20% against Scope's estimates), which is deemed unlikely in the short term given Uniper's recent confirmation of its 2020 guidance amid strong Q1 results and good visibility on the remainder of 2020. The same applies to Scope's 2021 forecasts, with Uniper's revenues partly secured by hedged volumes and prices in European power generation, as well as largely contracted business in global commodities and power generation in Russia.

Figure 7 – Leverage (Scope adjusted debt/EBITDA)



Source: Scope estimates

Figure 8 – Debt protection (EBITDA/interest cover)



Source: Scope estimates

Financial policy strongly aligned with keeping leverage low

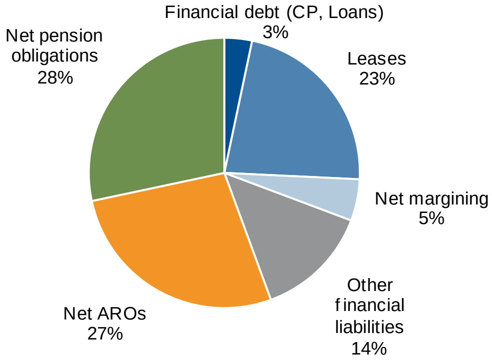
Uniper is committed to keeping a credit rating of at least BBB, which corresponds to the company's aspired debt factor (economic net debt/EBITDA as per Uniper's definition) of 2.0x maximum. Scope underscores that the Uniper's leverage figure is structurally slightly higher than Scope-adjusted debt/EBITDA, due to Scope's adjustments and haircuts on long-term pension provisions, asset retirement obligations and margining to reflect their pay-out character and asset coverage. Given Uniper's maximum leverage threshold and its rating commitment Scope understands that the company is likely to forego capex and dividends or seek adequate recapitalisation should leverage come close to the internal limit. Consequently, Scope has good comfort on the affirmed BBB+/Stable.

Robust liquidity

Uniper's liquidity remains sound, with ratios of consistently above 200% (both internal and external sources) at all times. Uniper has to cover around EUR 1.0bn of debt in 2020-22, which includes margining positions related to electricity and gas trading of about EUR 0.5bn as at YE 2019. Margining liabilities are already largely balanced by receivables, while the remaining exposure can be covered comfortably by the large unrestricted cash buffer of EUR 1.3bn as of March 2020, free operating cash flows (consistently at least at breakeven), and the unused EUR 1.8bn multi-year syndicated credit facility (committed until 2024 with an extension option of one year).

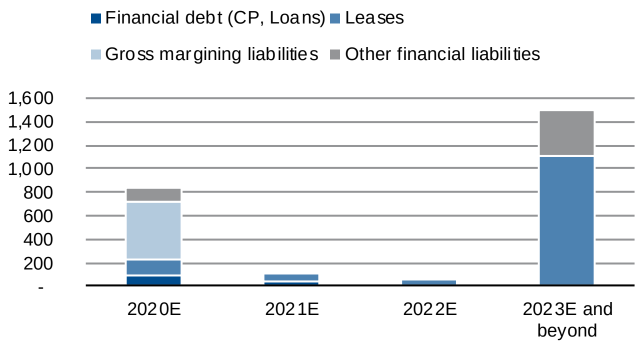
We expect Uniper's internal liquidity sources to sufficiently cover funding needs without the need to extend the use of the EUR 1.8bn commercial paper beyond the current level (around EUR 500m at YE 2018) or resort to using its EUR 2bn unused debt issuance programme, unless Uniper decided to pursue larger-than-expected growth opportunities.

Figure 9 – YE 2019 debt structure with little exposure to financial debt



Source: Scope estimates

Figure 10 – Maturity profile at YE 2019 (in EURm)



Source: Scope estimates

Long-term and short-term ratings

BBB+ senior unsecured rating

In conjunction with the affirmation of the BBB+/Stable issuer rating, we have affirmed the BBB+ rating on senior unsecured debt.

S-2 short-term rating

Based on the sound liquidity and Uniper's BBB+ issuer rating, we have affirmed the short-term rating of S-2. The short-term rating mirrors our perception of the company's sustainable and robust 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 at well above 200% over the next three years.

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