21 May 2021 | 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 25 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 liquefied natural gas, serving a wide range of industrial customers.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	13.6	14.4	>14	>14
Scope-adjusted debt (SaD)/EBITDA (x)	1.0	1.6	1.2	1.5
Free operating cash flow (FOCF)/SaD	75%	4%	~25%	~15%
Liquidity	>200%	>200%	>200%	>200%

Rating rationale

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

The affirmation is supported by Uniper's consistently strong financial risk profile and robust business profile that can withstand considerable market turbulence. Uniper continues to be rated as an independent company.

The issuer rating reflects Uniper's unchanged strong financial risk profile (A) and its significantly weaker business risk profile (BBB-). Uniper continues to be rated on a standalone basis given the sufficient level of independence from its majority shareholder Fortum, which does not control Uniper in our view.

We rate Uniper on a standalone basis, reflecting its continued financial and largely strategic independence from majority shareholder Fortum, which holds 76.1% (as of YE 2020) in the company. Despite its majority ownership, Fortum does not have direct control of Uniper. Both companies are strengthening their cooperation and aligned strategic direction. This is evidenced by the recent appointments of Klaus-Dieter Maubach as CEO and Tiina Tuomela as CFO and the formation of joint teams for the joint development of activities in: i) Nordic hydro; ii) renewables; and iii) hydrogen. Nevertheless, we believe that Uniper retains its independence for the time being. This is due to the absence of a domination or profit-and-loss transfer agreement, which Fortum has ruled out until YE 2021, or a supervisory board majority that can directly influence financial decisions, e.g. on investments/divestments or dividend pay-outs.

Ratings & Outlook

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

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Related methodologies

Rating Methodology: Corporate Ratings, Feb 2020

Rating Methodology: European Utilities, Mar 2021

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Outlook and rating-change drivers

Stable Rating Outlook

The Stable Outlook reflects Uniper's status as an independent company and strong ratings support from its financial risk profile, with a leverage of 1.5-1.8x. The Outlook assumes that Uniper is likely to balance its capex and dividend payments in order to keep its robust financial position.

Rating downside

A negative rating action could be considered if Uniper lost its status as an independent company and developed a more aggressive stance on leverage and dividends, leading to a persistently weaker financial position. A negative rating action could also be warranted if we expected Scope-adjusted debt (SaD)/EBITDA to reach above 1.8x for a prolonged period.

Rating upside

A rating upgrade remains a remote scenario, given the company's communicated financial strategy and investment plan, but could occur if SaD/EBITDA reached below 1.0x for a prolonged period.

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant European player in power and gas supply • Substantial cash flow contribution from regulated and quasi-regulated activities (more than 40% of recurring EBITDA), which can partly offset volatility from unregulated activities • Accelerated 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 underperformance in certain business segments • 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 SaD/EBITDA of below 1.8x and EBITDA interest cover of well above 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) which will consistently be reduced from about 30% to around 10% (based on capacity) over the next five years • Group profitability can heavily be impacted by external and non-controllable effects, e.g. achievable power prices, carbon emission allowances and foreign exchange rates, 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 SaD/EBITDA below 1.0x for a prolonged period	• Deterioration of financial risk profile as signalled by a SaD/EBITDA of above 1.8x on a sustained basis • Change in status as an independent company and development of a more aggressive stance on leverage and dividends

Financial overview

				Scope estimates		
Scope credit ratios	**2018**	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover (x)	13.9	13.6	14.4	>14	>14	>14
Scope-adjusted debt/EBITDA (x)	0.9	1.0	1.6	1.2	1.5	1.7
Free operating cash flow/Scope-adjusted debt (%)	-2%	75%	4%	~25%	~15%	~10%
Liquidity (internal + external)	>200%	>200%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA	**EUR m**			**EUR bn**		
Recurring EBITDA	1,543	1,561	1,657	1.75	1.5	1.5
Operating lease payments in respective year	0	0	0	0	0	0
Scope-adjusted EBITDA	1,543	1,561	1,657	1.75	1.5	1.5
Cash flows	**EUR m**			**EUR bn**		
Operating cash flow	1,241	932	1,241	1.5	1.2	1.2
Investing cash flow (net)	-1,263	221	-1,128	-0.9	-0.8	-0.9
Dividends to external shareholder	-302	-361	-449	-0.5	-0.5	-0.5
Discretionary cash flow	-324	792	-336	0.1	-0.1	-0.2
Scope-adjusted debt	**EUR m**			**EUR bn**		
Gross financial debt (including margining liabilities)	2,939	1,934	1,743	1.7	1.9	2.3
less: margining liabilities (Scope approach)	-976	-499	-193	-0.2	-0.2	-0.2
less: cash and cash equivalents	-1,400	-889	-289	-0.3	-0.5	-0.6
add: restricted cash	22	18	-	-	-	-
add: unfunded pension (Scope approach)	402	516	686	0.6	0.6	0.6
add: operating lease obligations (Scope approach)	-	-	-	-	-	-
add: unfunded asset retirement obligations (Scope approach)	438	468	630	0.4	0.4	0.4
Scope-adjusted debt (SaD)	1,425	1,548	2,577	2.2	2.3	2.6

Source: Uniper, Scope expectations

Business risk profile

Position as leading power and gas company partly constrained by higher-risk merchant business and rouble exposure

Uniper's business profile has proven very robust amid the pandemic. This is thanks to its: i) widely hedged exposure in power generation; ii) good support from robust regulated and quasi-regulated business activities; and iii) well-balanced position in commodity trading, with a solid and well-diversified customer base as well as gas storage capacities which offer good potential for arbitrage in gas trading . As such, Uniper demonstrates good resilience to adverse developments relating to volatile commodity pricing, temporary disruptions in power generation and adverse currency effects, primarily stemming from a further weakening of 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 25 GWp;
- its **leading position in gas trading in Germany and second position in the European gas supply market** (after Engie);
- a **strong competitive position in Russian power generation, with around 11 GWp of generation capacity**;
- full contraction for **UK gas power plants under a regulated reserve capacity scheme**;
- mitigation of pricing and volume risks though large hedging activities and long-term contracts with industrials;
- **balanced diversification** regarding market outreach, vertical and horizontal **diversification, and cyclical and non-cyclical activities**;
- a favourable position in the merit order system for parts of the power generation fleet, i.e. Swedish nuclear, German and Swedish hydro, which will benefit from a rising CO2 price;
- ongoing **de-risking strategy** (transformation of business model) towards defensive regulated and quasi-regulated infrastructure activities; and
- accelerated **decarbonisation** through the decommissioning/disposal of CO2-intense power generation assets in Europe.

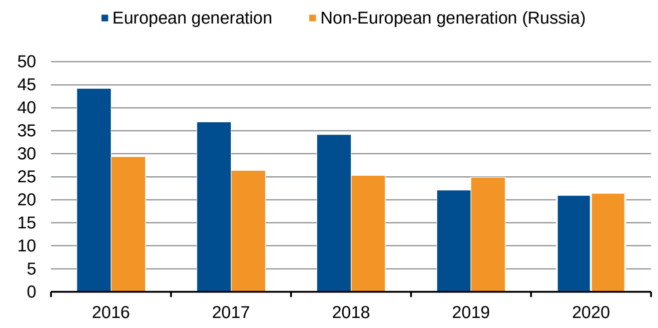
Nevertheless, Uniper's market position remains hampered by:

- **merchant risks for outright power production and commodity trading** e.g. gas, electricity, coal and liquified natural gas, partly mitigated 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
- **the significant impact on the company's average profitability** from the Global Commodity business with its exposure to trading, although it does contribute positive earnings.

ESG factor: decarbonisation of European generation is credit-positive

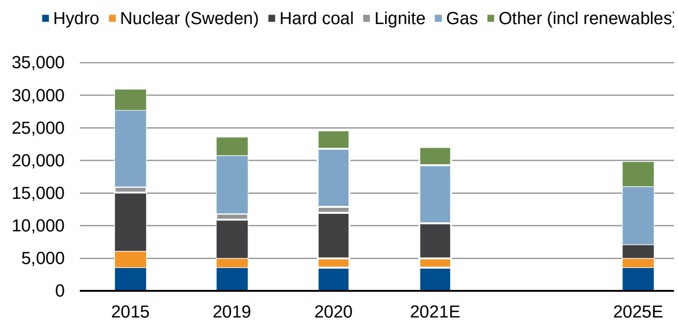
Following the formation and stabilisation of its business model in recent years, Uniper is gradually moving into an expansion and investment mode, targeting low-risk utility segments, such as low-carbon generation, hydrogen and the post-decommissioning utilisation of former power plant sites. Around 30% of Uniper's European generation capacity is currently related to power generation from hard coal and lignite, which exposes the company to environmental, reputational and cash flow risks (ESG: credit-negative risk factor). However, we view positively the accelerated decarbonisation strategy of its European generation portfolio amid rising CO2 prices and the fuel switch from coal to gas. With the earlier-than-expected decommissioning of the Heyden and Wilhelmshaven power plants at YE 2020 and in 2021 respectively, Uniper is likely to accelerate the reduction of CO2 output from its European generation assets beyond the more than 50% that was already saved from 2016 to 2020. As such, the company is well on the way to limiting its exposure to coal-based power generation to less than 10% by 2025 (Maasvlakte 3 and Datteln 4) after the scheduled disposal of Schkopau in Q4 2021 and the decommissioning of Scholven, Staudinger 5 and Ratcliffe by 2025 at the latest. At the same time, we see good opportunities for Uniper to accelerate the greening of its generation portfolio through investment in renewable generation capacities (with the aim of ramping up a renewables capacity ex hydro of around 1 GWp by 2025 and 3 GWP by 2030), which is among its top priorities for expansion capex. Overall, the accelerated transition towards lower-risk utility segments and the decarbonisation of Uniper's European power generation fleet is a positive ESG-related credit risk factor.

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



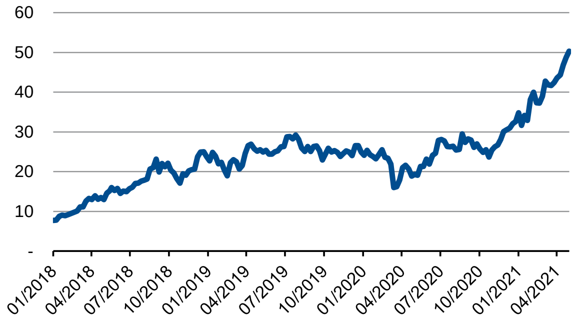
Source: Uniper, Scope

Figure 2 – Expected portfolio development of European power generation (MW)



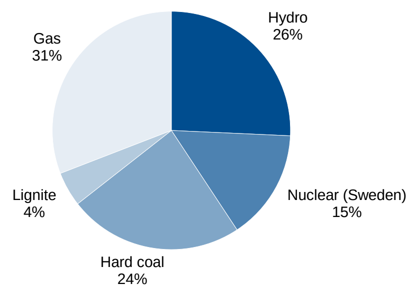
Source: Uniper, Scope

Figure 3 –Steep upwards price development of CO2 certificates (EUR/ton) driving fuel switch but also enlarging achievable margin for low-carbon generation



Source: Bloomberg, Scope

Figure 4 – Low-carbon hydro and nuclear generation volumes outpace generation from coal (based on 2020 generation), benefitting from rising CO2 prices



Source: Uniper, Scope

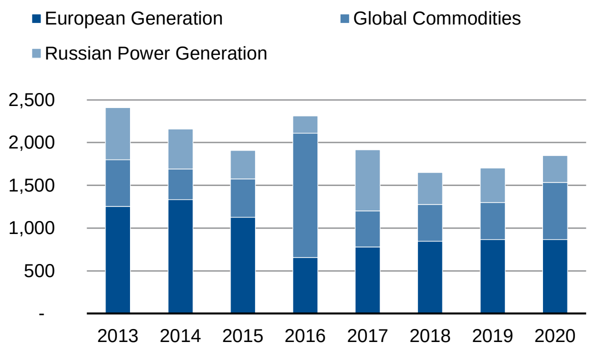
Rising CO2 price not detrimental to Uniper's cash flow profile overall

We are not overly concerned about potential cash flow risk from rising CO2 prices forcing a coal-to-gas switch, although this is negative for Uniper's remaining coal-fired generation exposure in the medium term. Based on Uniper's total power generation portfolio, we expect the company to benefit slightly from a rising CO2 price as: i) the hedged position for CO2 widens the achievable margin in outright unhedged power generation in the short term; ii) unneeded credits can be sold to the market thereby generating a material trading profit; iii) a rising CO2 price naturally boosts wholesale power prices, which will result in widened margins for power generation from hydro and nuclear capacities; and iv) a significant portion of contracts do not bear CO2 price risks for Uniper as such contracts are based on a cost-plus approach with rising prices passed on to the customer. In the medium-to-long term, we assume that a high CO2 price will be cash flow-accretive for the whole generation portfolio in Europe as Uniper's generation portfolio is dominated by hydro, nuclear and gas. Margins for hydro and nuclear volumes (more than 40% of generation volume) are widened, while margins for gas (more than 30% of generation volume) remain unchanged with the pass-through of increased costs.

Largely hedged generation volume provides solid earnings floor

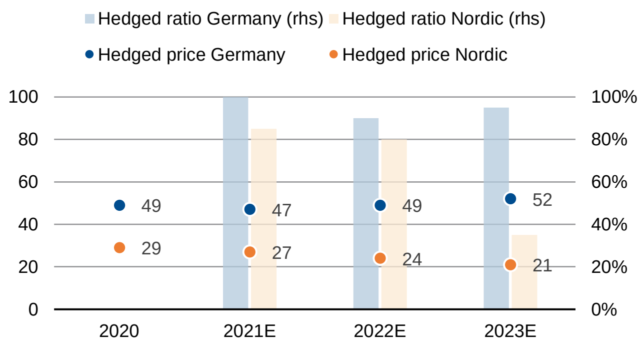
We regard a floor of about EUR 1.5bn on Uniper's group EBITDA with a high cash conversion of more than 75% into operating cash flow as sustained. While around 40% of recurring EBITDA is likely to be generated from regulated and quasi-regulated activities, downside risks for the more volatile unregulated generation business and commodity trading are mitigated by the wide extent of hedging. Generation volumes in Germany and the Nordpool are almost fully hedged for 2021 and 2022 at record prices in Germany of close to EUR 50/MWh and in the mid-twenty EUR/MWh range in the Nordics, which is at least higher than in the trough years of 2016/17.

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



Source: Uniper, Scope

Figure 6 – Achieved and hedged prices and hedged ratios for outright power generation (as of March 2021)



Source: Uniper, Scope

Financial risk profile

Adjustments

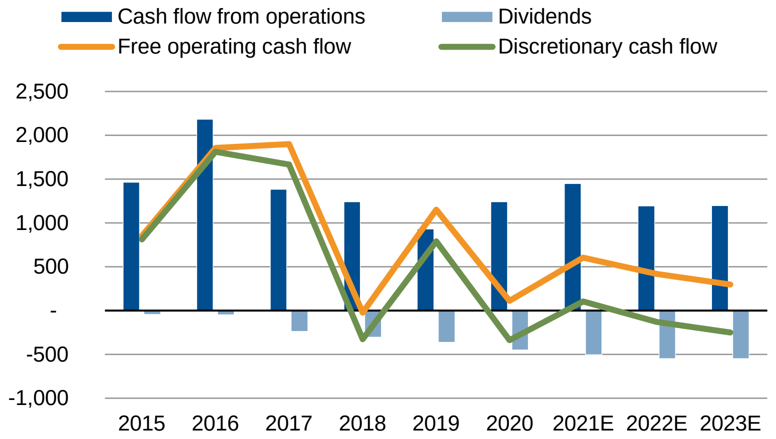
In order to assess Uniper's creditworthiness using key credit metrics such as leverage, debt protection and liquidity measures, we have adjusted for the following items:

- SaD is adjusted for: i) the 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 issuer rating remains strongly supported by its sound financial risk profile. The company's indebtedness of around EUR 3bn continues to be largely driven by debt-like provisions for pensions and asset retirement, which make up about 60% of the total gross debt exposure. The company's envisioned growth strategy earmarks annual capex of slightly below EUR 1bn per annum for a granular set of investment projects. Nevertheless, we believe that Uniper is likely to retain its financial profile, as displayed by a sustained Scope-adjusted leverage of below 1.8x. We anticipate that scheduled maintenance and growth capex are likely to be fully funded internally, bolstered by forecasts of a robust EBITDA level of about EUR 1.5bn and above per annum with good chances of some upside in 2021 (stemming from compelling opportunities for Uniper's gas midstream business in the US), and a high cash conversion. Dividends in the area of EUR 500-550m p.a., which we believe will be determined linked to the availability of potential extra investment opportunities, are expected to put little pressure on Uniper's leverage. With slightly negative discretionary cash flow, our rating case incorporates a gradually deteriorating leverage, measured by SaD/EBITDA of 1.5-1.8x between 2021 and 2023.

Figure 7 – Cash flow profile (EUR m)

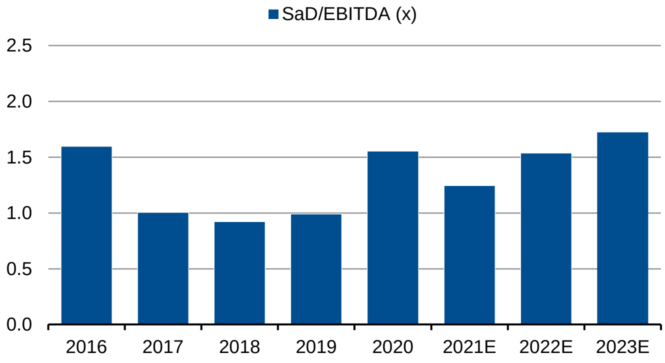


Source: Scope estimates

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

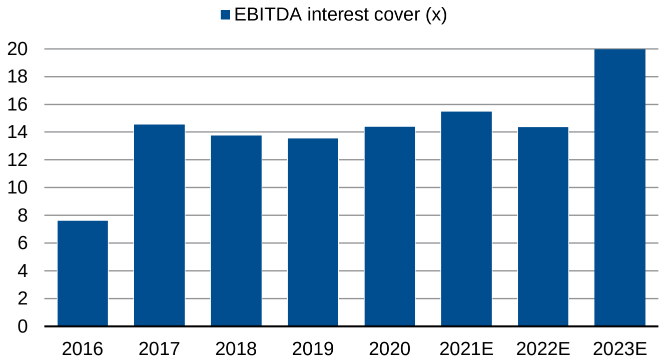
According to our sensitivity analysis, the company has ample headroom on both net debt and unexpected shortfalls in EBITDA before reaching our 1.8x threshold. All things being equal, the headroom for additional debt is around EUR 500m (which could be used for growth capex beyond the EUR 400-500m communicated), while EBITDA can fall short by around EUR 150-200m in 2020/21 (15%-20% against our estimates). We think this is unlikely in the short term, given Uniper's recent update of its 2021 guidance amid strong Q1 results and good visibility on the remainder of 2021. Debt protection, as measured by EBITDA/interest cover, remains comfortably above 10x. This is thanks to the limited need for external financing and fairly stable group EBITDA over the next three years but also reduced net interest payments going forward following increasing interest income from loans provided to finance Nordstream 2, which is nearing commercial operation.

Figure 8 – Leverage (Scope adjusted debt/EBITDA)



Source: Scope estimates

Figure 9 – Debt protection (EBITDA/interest cover)



Source: Scope estimates

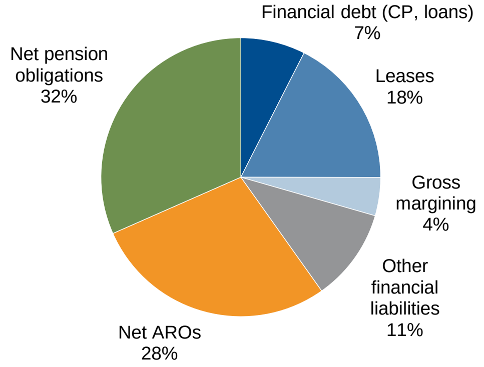
Financial policy strongly aligned with keeping leverage low

We regard Uniper as firmly committed to preserving its solid investment-grade rating of at least BBB, which is highly important for the company's commodity trading activities. This commitment is primarily demonstrated by the treasury's updated leverage ceiling of a maximum debt factor of 2.5x (economic net debt/EBITDA as per Uniper's definition). While this debt factor was raised against last year, it would still correspond to our leverage maximum of 1.8x. That is because our leverage definition (Scope-adjusted debt/EBITDA) results in a structurally lower number due to our adjustments and haircuts on long-term pension provisions, asset retirement obligations and margining to reflect their pay-out character and asset coverage. Moreover, we regard the company's dividend policy as being aligned with maintaining the current credit profile. While the company has pleased shareholders over the past few years with a steadily rising dividend payout, we believe that management would be likely to compromise on dividend payouts in the future if it required additional funding for investment opportunities to further stabilise the business profile or keep leverage low.

Solid liquidity

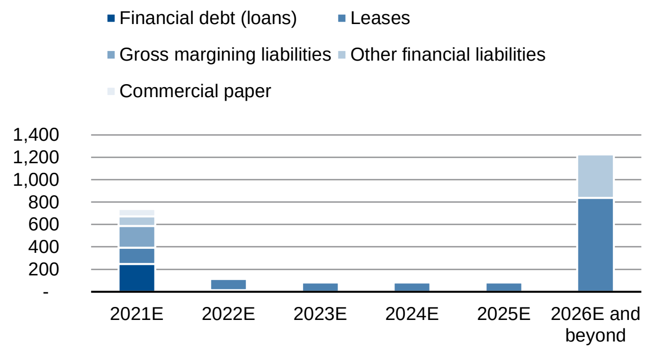
Uniper's liquidity remains very solid, as displayed by liquidity ratios above 200% (both internal and external sources) at all times. The company faces debt repayments adding up to roughly EUR 1,400m between 2021 and 2023, which includes about EUR 600m (as per Q1 2021) related to margining positions for electricity and gas trading. Whereas margining positions are widely balanced by similar receivables, the remaining debt maturities are expected to be comfortably covered by the company's unrestricted cash buffer of more than EUR 900m as of March 2021, an untouched volume of EUR 1.8bn from multi-year syndicated credit lines which are committed through to 2025 and consistently positive expected free operating cash flow.

Figure 10 – YE 2020 debt structure with little exposure to financial debt



Source: Scope estimates

Figure 11 – Maturity profile at YE 2020 (in EURm)



Source: Scope estimates

Long-term and short-term ratings

BBB+ senior unsecured rating

We have affirmed the BBB+ rating on senior unsecured debt in conjunction with the affirmation of the BBB+/Stable issuer rating.

S-2 short-term rating

Uniper's short-term rating is affirmed at S-2, based on consistently strong liquidity and good, unchallenged access to external funding channels.

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