Research Update:

Uniper 'BBB-' Ratings Affirmed Following German Government Support Package; Outlook Negative

July 29, 2022

Rating Action Overview

- On July 22, 2022, German Chancellor Olaf Scholz announced a package to support German-based gas supplier Uniper, including the government taking a 30% equity stake (€267 million) in the company; the issuance of up to €7.7 billion of mandatory convertible bonds; and the upsizing of a KfW line to €9 billion from €2 billion currently. It also entails the ability of gas importers, including Uniper, to pass 90% of reprocurement costs for the missing Russian volumes to the final customer from Oct. 1, 2022, at the latest.
- The government support package includes an explicit promise to provide further government support if needed.
- We therefore affirmed our 'BBB-' long-term issuer credit and issue ratings on Uniper and removed the ratings from CreditWatch with negative implications, where they were placed July 5, 2022, while treating the company as a government-related entity with a high likelihood of support.
- At the same time, we lowered Uniper's stand-alone credit profile to 'bb-', reflecting our view that the losses at its long-term gas contracting (LTC) business will introduce major group profit volatility, significantly disrupting credit metrics, at least until market conditions stabilize. It also reflects our view that Uniper's LTC business requires significant contract restructuring to be sustainable.
- The negative outlook reflects our view that Uniper will continue to operate under an uncertain environment, because of the high volatility surrounding gas flows delivered through Nordstream 1, and our view that the government might need to expand its support to Uniper depending on gas flows and market prices.

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Rating Action Rationale

The support package reflects Uniper's importance to the German energy markets, and particularly to Germany's security of energy supply. The company supplies gas to gas distributors equivalent to the average annual consumption of about 35% to 40% of the German households, 50% of which heat with gas; and provides gas or electricity to over 420 of roughly 900 of the local municipalities' (Stadtwerke). It is also critical for the gas needs of German industry, which is highly energy intensive and relatively inflexible in the near term to move to alternative fuels. In addition, Uniper is the largest owner and operator of gas storage facilities in Germany, with 5.6 billion cubic meters (bcm), out of 22.9 bcm in total. We understand it will participate in a project to build a floating storage and regassification unit in Wilhelmshaven, planned by the German government to tackle security of supply concerns amid the ongoing energy crisis, and which will have a capacity of 7.5 bcm, equivalent to about 8% of Germany's annual gas needs. Since June 16, 2022, Uniper has received 40% or less of the volumes contracted with Gazprom, which we estimate is now resulting in losses of about €50 million-€80 million per day, depending on the volumes of gas flowing, gas prices, and the use of flexibility clauses on Uniper's remaining LTCs to procure gas. This, in addition to very volatile gas and power prices, which result in additional margin collateral needs, has led to significant liquidity needs for the company. As a result, it publicly requested government support on July 8, 2022.

In response, on July 22, the German government announced measures to support Uniper. The government package includes:

- Increasing a liquidity line by government-owned KfW to €9 billion from €2 billion, which we expect will happen in the next few days.
- A €267 million direct equity injection, whereby the government takes over 30% of Uniper's shares.
- €7.7 billion of mandatory convertible bonds, which the company can draw from as required to cover for the losses on the gas LTC business. This implies that equity will cover such losses.

In addition, the package provides for:

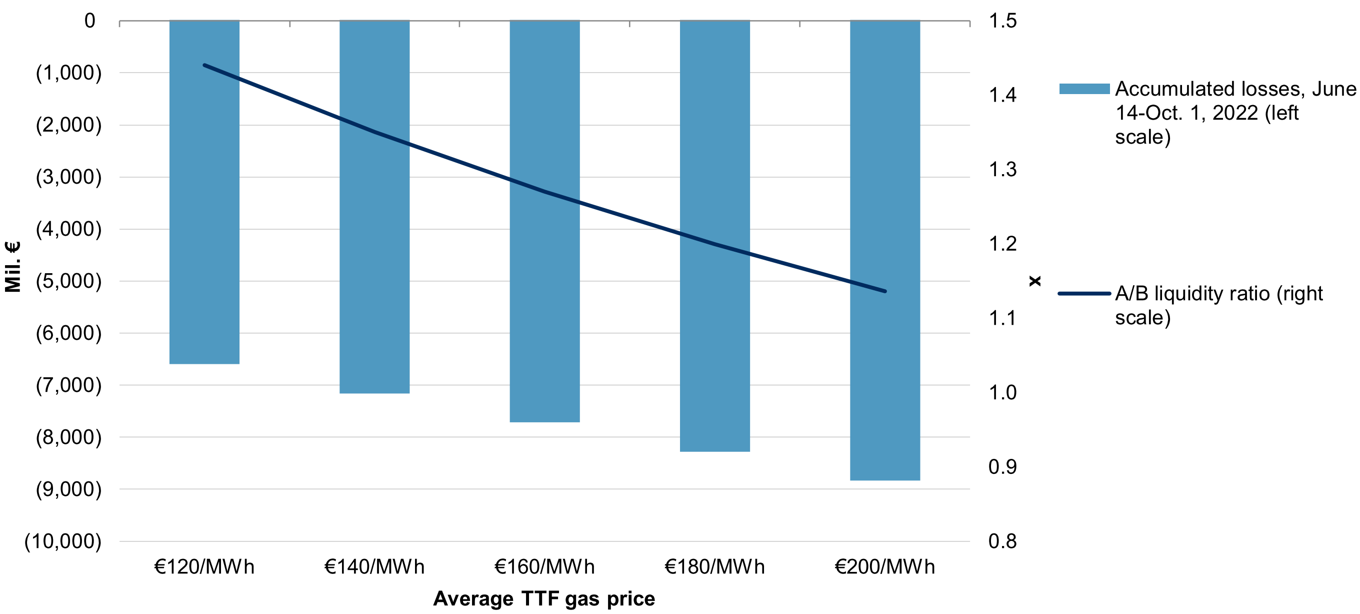
- A 90% pass through of reprocurement costs for the missing Russian gas volumes as of Oct. 1, 2022, according to the recently approved §26 of the Energiesicherungsgesetzt.
- Fortum's €4 billion shareholder loan remaining available during the stabilization process.

In our view, this package and, most notably, the increase of the KfW line to €9 billion, should address Uniper's current liquidity needs. Uniper's liquidity needs stem from the fact that the company's losses are accumulating rapidly. We understand the full support package could take one-to-four months to be approved and implemented, but since we understand the €9 billion KfW line will be in place shortly, the company will use it immediately until an equity-like support is in place. We believe execution risk is low considering the German government's track record in implementing bail-out packages and adopting the necessary laws in a timely manner.

We believe that the German government would increase the support package if needed. Beyond immediate issues, we believe Uniper will have significant liquidity needs over the next two years and we expect it will post significant losses, although both will depend on the gas flowing from Russia and prices for gas, electricity, and carbon dioxide. We believe that the package will help mitigate most of the cash flow losses but anticipate that under certain scenarios the support package might need to expand. For example, under a scenario in which gas flows through Nordstream 1 at 20% capacity and in which Title Transfer Facility (TTF) gas prices remain at €175 per megawatt-hour (/MWh)-€180/MWh until Oct. 1, 2022, we estimate that Uniper would incur losses of about €8.2 billion from June 14-and Oct. 1, 2022, thereby potentially exhausting the equity support under the package. However, this outcome depends on multiple factors, including the flexibility on alternative LTCs, use of Uniper's gas storage capacities (currently at 44%), and profits from other segments such as conventional power generation, which we understand is profitable for now.

Chart 1

Uniper's Losses Depend On TTF Gas Prices And Volumes
Assuming Nordstream 1 flows at 20% capacity until Oct. 1, and fixed margin calls



Source: S&P Global Ratings. *The chart does not assume incremental margin calls, which could further pressure liquidity.
TTF--Title Transfer Facility. /MWh--Per megawatt hour.

We believe the government has strong incentives to support Uniper because of the company's relevance for the German energy system and the highly energy consuming industrial base. We understand that the government believes that a Uniper default would materially disrupt the German energy market. The support package has been drafted assuming Gazprom curtails its gas supply by 60% and TTF prices at €160/MWh. Given the delivery of Russian gas at 20% of Nordstream 1 capacity since July 27, 2022, this assumption might not materialize. However, we nevertheless believe that the German government will adapt the support package to market conditions.

Gas importers, including Uniper, will be allowed to pass through 90% of additional costs to final consumers as of Oct. 1, 2022, at the latest. The company is by far the most exposed gas importer in Germany to Russian gas. Therefore, we assess the possibility of passing through 90% of incremental costs to the final consumer as credit positive for the company. We expect the levy to be managed by market operator Trading Hub Europe and charged to all gas consumers. Although the levy provides a mechanism to alleviate a significant share of Uniper's LTC business losses, we estimate that the company could incur costs of €800 million-€1.2 billion per year in 2022 and 2023, depending on gas volumes and prices. Under current conditions, we expect Uniper to post EBITDA of negative €6 billion in 2022 and close to break-even in 2023. We expect the company to return to profitability in 2024, when we expect LTC pricing to be closer to market levels.

We expect Uniper to return to profitability in 2024, albeit with significant uncertainty on its business model. In our view, the company's metrics will remain significantly exposed to geopolitical risks translating to gas volume and price fluctuations, which will be harmful because it will have to procure the shortfalls in the market until 2024, when we expect LTC pricing to be closer to market levels. In the interim, we anticipate that Uniper will seek to adapt its business model to the new market environment and will try to significantly overhaul its contract structure. However, there is uncertainty as to the extent that Russian volumes can be substituted over the medium term and we anticipate significant legal hurdles to be able to wind down its contracts with Gazprom, which means that for now the company remains heavily dependent on that supplier. Still, we believe Uniper will retain a central role in Germany on the gas market, for example in the liquefied natural gas (LNG) space. We also view positively that the company has a robust asset base outside the LTC business, which is currently profitable, including a thermal fleet in Germany, the U.K., and the Netherlands, and hydro and nuclear generation in the Nordic region.

With the government package, we now view Uniper as a government-related entity. We base this on our assessment of a high likelihood of extraordinary support from the German government in the event of further financial stress. This is based on our view of the company's:

- Very important role for the German government given the expressed view of Uniper's system-relevance for the effective functioning of the German energy market. Uniper is one of the largest energy companies in Europe, directly responsible for one-quarter of both import volumes and storage capacity of natural gas in Germany. It also is also of key importance for the government's investments into new LNG capacities.
- Strong link with the government. Through the announced support measures, the German government will acquire a significant equity share in Uniper for several years with further increases possible. This provides the German government with additional rights vis-à-vis the company and other shareholders, including the rights of a blocking minority and additional monitoring capabilities through its representation on the supervisory board.

We expect Uniper's position relative to its majority shareholder Fortum will weaken, resulting from the government presence. Fortum has indicated that it does not intend to further support Uniper with additional capital beyond the €8 billion in guarantees and shareholder loans. We believe that Uniper's relevance to Fortum has weakened with the market environment and government intervention. We therefore expect to revise our group status on Uniper, although this will not have a rating impact, given our assessment of the strength of government support.

Outlook

The negative outlook reflects our view that Uniper will continue operating under an uncertain environment because of the high volatility surrounding gas flows delivered through Nordstream 1, and our view that the government package would need to increase if gas flows remain at or below 20% and TTF prices are above €180/MWh. It also reflects that, while the package shows the government's willingness to support the company, there are details to be approved, including by the European Commission.

Downside scenario

We could downgrade Uniper if we believe that the German government support is insufficient to protect the company from market conditions or cannot be implemented sufficiently close to what was presented.

Upside scenario

The likelihood of a positive rating action is remote because we expect Uniper to operate under significant uncertainty while the Russia-Ukraine conflict continues.

Company Description

Uniper is an international, diversified energy company that operates in more than 40 countries and has about 11,500 employees. Its operations include power generation, commodity trading, energy storage, energy sales, and energy services. Its core markets are Germany, Russia, the U.K., Sweden, the Netherlands, and North America. The company owns and operates a well-diversified power generation portfolio, including facilities running on fossil fuels such as gas (15.2 gigawatts [GW] as of Dec. 31, 2021), coal (8.2 GW), hydroelectric (3.7 GW), Swedish nuclear (1.7 GW), and other (2.8 GW). It has a total generation capacity of 31.6 GW, of which one-third is in Russia. In 2021, Uniper produced 109.1 terawatt hours of electricity, of which 54% stemmed from gas and 24% from carbon-free hydroelectric and nuclear generation. Uniper was created in 2016 from the spinoff of the gas and power activities of E.ON SE. Fortum still owns about 80% of the company, but we expect this share to be diluted to about 55% once the government takes a 30% stake.

Liquidity

We view liquidity as adequate as of June 30, 2022, based on our view that the government will supply sufficient liquidity for Uniper to honor its commitments. This is backed by strong public statements, including from the German chancellor and Economic Ministry. We assume that the KfW line will increase to €9 billion within the next few days.

Principal liquidity sources include:

- Our assumption of cash and liquid investments of €2.7 billion-€3.2 billion as of June 30, 2022.
- The €2 billion liquidity line with KfW is assumed to be upsized to €9 billion, with the duration extended beyond 12 months.
- Margin backflows are netted against the use of the KfW line.

Principal liquidity uses' assumptions include:

- Negative cash funds from operations of €6.5 billion over the next 12 months.
- Negative working capital of €2.8 billion.
- Maintenance capital expenditure of €615 million over the next 12 months. No dividend payments.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Negative/--

Business risk: Weak

- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers

- Diversification/Portfolio effect: Neutral (No impact)
- Capital structure: Neutral (No impact)
- Financial policy: Neutral (No impact)
- Liquidity: Adequate (No impact)
- Management and governance: Fair
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bb-

- Group credit profile: bbb-
- Entity status within group: Core
- Related government rating: AAA
- Likelihood of government support: High

ESG credit indicators are: E-4, S-2, G-3

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Uniper SE		
Issuer Credit Rating	BBB-/Negative/--	BBB-/Watch Neg/--
Issue-Level Ratings Affirmed; Off CreditWatch		
Uniper SE		
Senior Unsecured	BBB-	BBB-/Watch Neg