

Research Update:

# Uniper 'BBB-' Rating Affirmed After Announcement Of German Government's Full Takeover; Outlook Remains Negative

October 12, 2022

## Rating Action Overview

- Energy market conditions led to a sharp financial deterioration for Uniper, proving the previous government support package agreed in July 2022 insufficient.
- On Sept. 21, 2022, a revised package followed, under which the German government stated plans to increase its ownership to 98.5% by injecting €8 billion cash equity into Uniper and purchasing the Fortum share in Uniper for €500 million.
- It also scrapped its plan to introduce a gas surcharge payable by retail gas consumers, which would have covered 90% of Uniper's costs in replacing missing Russian gas volumes.
- As a result, we estimate that Uniper by 2024 will suffer mid-double-digit billion euros of cash losses, which we expect Uniper to finance by a liquidity line from KfW, a German government-owned development bank, until a permanent solution is put in place.
- We deem these large losses as barely sustainable for the company on a stand-alone basis, despite the expected cash equity injection by the state, and we now view Uniper's stand-alone credit profile at 'b-', from 'bb-' before.
- We see the enhanced government support package as demonstrating the government's strong commitment to support Uniper and we have therefore re-assessed the likelihood of extraordinary government support to very high from high, given the state's ownership of almost 100% of Uniper will enable the government to provide timely and sufficient support to cover the losses on Uniper's long-term contracted gas business.
- We have therefore affirmed our 'BBB-' issuer credit rating on Uniper, reflecting its stronger link with and role for the German government, despite its much weaker stand-alone credit quality.
- The negative outlook reflects the government's support package being subject to several administrative and legal processes, including EU Commission Merger Control and State Aid approval; a lack of visibility on a sustainable solution to cover for Uniper's losses; and Uniper's significantly weakened business while it faces significant business transformation to support its long-term sustainability.

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## Rating Action Rationale

**We expect a very high likelihood of extraordinary government support to Uniper from the German government.** This is evidenced by the German government's recent support package provided to compensate the massive cost of reprocurring in full missing Russian gas volumes from the open market. The very volatile and rapidly deteriorating conditions of the German gas market have resulted in Uniper accumulating losses beyond the €7 billion backstop threshold included in the July 22, 2022, support package (see "Uniper 'BBB-' Ratings Affirmed Following German Government Support Package; Outlook Negative," published July 29, 2022, on RatingsDirect). Uniper's mounting losses led to further negotiations, which led to the German government's announcement on Sept. 21, 2022, that it would buy Fortum's share in Uniper for about €500 million and underwrite an €8 billion cash capital increase. We expect the government will own 98.5% of Uniper after the administrative and legal processes have been concluded, probably by the end of 2022. We also understand that Germany will provide funds for Uniper to repay the €4 billion credit line and absorb the outstanding €4 billion guarantees, both provided by Fortum, via state-owned development bank KfW (AAA/Stable/A-1+). Uniper will thereby have no financial obligations left toward Fortum.

**In our opinion, the package manifests the government's willingness to sufficiently and timely support Uniper, and its increasing commitment to Uniper.** In addition, 98.5% ownership enables the government to access a wider range of supporting tools, such as additional direct equity injections or loss grants. We expect the German government will be strongly represented in Uniper's supervisory board and will take an active role in directing Uniper's strategy according to the country's strategic energy goals. We believe these factors translate in a higher likelihood of timely and sufficient extraordinary support by the German government in the future, when needed. We have therefore revised our view of Uniper's link to the government to very strong, which coupled with the unchanged assessment of very important role to the government results in reviewing up our view of the likelihood of extraordinary government support to Uniper to very high from high previously, which is the primary support underpinning the 'BBB-' rating.

**Uniper's nationalization and our view of a very high likelihood of government support mitigate the effect of a weakening stand-alone credit quality, which we have revised to 'b-' from 'bb-'.**

In addition to nationalizing Uniper, on Sept. 29, Chancellor Olaf Scholz scrapped plans to introduce a gas surcharge mechanism payable by retail gas consumers, which was supposed to compensate gas importers for 90% of the costs of repurchasing the missing Russian gas volumes in the market. We estimate that this will result in cumulative losses for Uniper in the mid-double-digit billion euro range from June 14, 2022, until end-2024, by which time we expect prices under most of Uniper's long-term gas contracts will have caught up to market conditions. The total amount of actual losses largely depends on the evolution of gas prices and the ability to procure additional volumes from alternate sources, and we now forecast that Uniper will need substantially more support than under a scenario where the gas surcharge was implemented. These cumulative losses, which in our opinion make Uniper entirely dependent on government support to continue supplying gas to Germany, as well as the persistent uncertainties surrounding the disrupted German gas industry and lack of visibility of Uniper's long-term business prospects, have led us to revise the company's financial risk profile to highly leveraged from aggressive and our assessment of its SACP to 'b-' from 'bb-'. We believe Uniper plays a key role supplying Germany with gas, which is currently critical for households and the prevailing industry in the

country, as well as in building the infrastructure for LNG and hydrogen-compatible import infrastructure.

**The new support package for Uniper will need to be expanded and depends on regulatory approvals, which explains why our outlook on the issuer credit rating remains negative.** We believe the Sept. 21, 2022, support package anticipates government support. However, we estimate Uniper will need significantly more support, and we currently lack clarity on the mechanism that will cover for the remaining tens of billions of losses from June 2022 to end-2024. We expect Uniper will have sufficient liquidity support until a more permanent solution is in place. Furthermore, the necessary approval by EU Commission Merger Control and State Aid could be slow and lead to amending the expected form of support provided. Further areas of concern also may need to be addressed, for example the fate of Uniper's Russian assets.

**We lack visibility on Uniper's long-term business prospects, which continues to put downside pressure on the rating, but the government's intervention reveals the importance of the company in the German gas market.** Uniper is significantly more exposed to the ongoing European energy crisis resulting from the Russia-Ukraine war than any other European gas trader, in our understanding. In a tight global market, Uniper will need to find stable, additional sources to procure gas to sustain its market position from 2024. Price-driven demand destruction and the accelerated energy transition will likely reduce gas demand. This trend, although not translating into further losses, given we expect currently loss-making contracts to become profitable by then, could threaten Uniper's relevance for the German market, and hence its long-term prospects, as well as its role to the government's energy policies. In addition, while we expect Uniper's power generation portfolio will be relevant for supply security in the next 12-18 months, we believe Uniper's 22.5 gigawatt (GW) generation capacity as of Dec. 31, 2021, excluding Russia, is unfavorably positioned for the long term because close to two-thirds of it is thermal. Moreover, although we believe that the government would be willing to further support Uniper's investments for its green transformation, we expect security of supply concerns will be a priority in the short term, and expect it to slow this transformation.

**We expect ongoing liquidity support to Uniper from the German government, channeled through the promotional bank KfW.** Uniper will continue to require significant liquidity support in the short term to continue procuring gas at spot prices, and cope with the effect of volatile electricity, gas, and CO2 prices on its trading business. We understand the company upsized its committed credit lines with KfW to €18 billion as of Friday, Oct. 7, 2022, from €13 billion before, and that Uniper has flexibility to use part of those lines for margining; covering the cost of procuring missing gas volumes; to procure gas for the LNG facilities at Wilhelmshaven and Brunsbüttel, which are strategic to Germany's supply security and are expected to be operational during this winter; and other working capital purposes. As part of the updated support package, we expect KfW to continue providing sufficient liquidity to Uniper to bridge any gap at least until the takeover is complete. Importantly, we understand the German government has assigned to KfW the responsibility to provide the liquidity line to Uniper under a so-called mandated transaction ("Zuweisungsgeschäft"). We also understand that the government guarantees KfW's exposure to Uniper, and the government would be able to instruct KfW to further increase the amount of the liquidity line. Furthermore, following a recent change in legislation, it is the government itself that issues debt via the Economic Stabilization Fund, and it lends those funds to KfW to, among other things, provide for the Uniper liquidity line. These factors alleviate our short-term liquidity concerns and further support our view of likelihood of extraordinary government support.

**Uniper is no longer strategic for Fortum.** We are revising Uniper's status within Fortum to nonstrategic from moderately strategic, reflecting Fortum's divestment to the German state. This has no rating implications for Uniper.

## **Outlook**

The negative outlook reflects both that the support package is still subject to several administrative and legal hurdles, including EU Commission Merger Control and State Aid approval, and the lack of clarity on a solution to cover for Uniper's losses beyond the nearest-term €8 billion direct equity support. It also reflects our view that Uniper's business is significantly weakened by the ongoing market disruptions, and that the group will need to reshape it to ensure its long-term sustainability and importance to Germany's energy policy.

## **Downside scenario**

We could downgrade Uniper if we believe that the likelihood of the German government providing timely extraordinary support were to decrease. This could be the case, for instance, if the recent government support package were to be delayed or reduced materially, for example due to legal or political impediments. This could also be the case if Uniper continues to accumulate losses beyond the current support package, and the government does not step in to provide further support in such a scenario.

## **Upside scenario**

Revising the outlook to stable is unlikely in the coming year, because we expect Uniper to consistently require external support to sustain its operations, at least until early 2024. However, even beyond that, we would first need to gain clarity on the evolution of the company's business risk profile, and how strengthening stand-alone credit quality balances a potential reduction of government support.

## **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, the U.K., Sweden, the Netherlands, and North America. We expect Uniper will try to divest its operations in Russia in the next 12-18 months. The company owns and operates a well-diversified power generation portfolio, including facilities running on fossil fuels such as gas (15.2 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.

On Sept. 21, 2022, the German government reached an agreement with Fortum to take over 99% of the shares of Uniper.

## Ratings Score Snapshot

	To	From
<b>Issuer Credit Rating</b>	<b>BBB-/Negative/--</b>	<b>BBB-/Negative/--</b>
Business risk:	Weak	Weak
Country risk	Low	Low
Industry risk	Moderately High	Moderately High
Competitive position	Weak	Weak
Financial risk:	Highly Leveraged	Aggressive
Cash flow/leverage	Highly Leveraged	Aggressive
Anchor	b-	b+
Modifiers:		
Diversification/Portfolio effect	Neutral (No impact)	Neutral (No impact)
Capital structure	Neutral (No impact)	Neutral (No impact)
Financial policy	Neutral (No impact)	Neutral (No impact)
Liquidity	Adequate (No impact)	Adequate (No impact)
Management and governance	Fair	Fair
Comparable rating analysis	Neutral (No impact)	Positive (+1 Notch)
Stand-alone credit profile:	b-	bb-
Group credit profile	bbb-	bbb-
Entity status within group	Non-strategic	Moderately Strategic
Related government rating	AAA	AAA
Likelihood of government support	Very High	High

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

### Related Criteria

- 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

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

## Related Research

- Uniper 'BBB-' Ratings Affirmed Following German Government Support Package; Outlook Negative, July 29, 2022

## Ratings List

### Ratings Affirmed

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#### Uniper SE

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Issuer Credit Rating BBB-/Negative/--

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