Research Update:

Uniper Outlook Revised To Stable On Return To Profitability; ‘BBB-’ Rating Affirmed

June 19, 2023

Rating Action Overview

- Uniper successfully mitigated its exposure to additional gas curtailment losses under its Gazprom contracts by hedging all missing gas volumes already sold, and therefore initiating its way to financial recovery. As a result, we revised upward Uniper's stand-alone credit profile (SACP) to 'b' from 'b-'.
- Uniper's stand-alone credit quality remains constrained by a business mix that mostly depends on carbon dioxide-heavy assets. For now, we have limited visibility on Uniper's strategic plan which could lead it to achieve a more sustainable asset mix.
- We still believe there is a very high likelihood that the German government would provide sufficient and timely support in case of need. However, we expect that the government's propensity to provide further extraordinary support could decline as Uniper's own financial strength improves.
- Therefore, we revised our outlook on Uniper to stable from negative and affirmed our 'BBB-' long-term issuer credit rating.
- The stable outlook reflects our expectation that Uniper will not incur in further losses related to gas curtailments, and that the company is starting a recovery process. It also captures our view of a very high likelihood that the German government will continue to provide extraordinary support to Uniper, if needed.

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Rating Action Rationale

Uniper has mitigated its exposure to further gas curtailment losses amid a more favorable gas price environment, thereby commencing its financial recovery. The drop in gas prices to €30 per megawatt-hour (/MWh)-€40/MWh from about €300/MWh at the peak of the energy crisis, coupled with recovering market liquidity, allowed Uniper to hedge volumes sold before Gazprom interrupted its contractually agreed gas supply. Uniper is contractually obliged to deliver these volumes to its customers during 2023 and, to a minor extent, in 2024. This transaction is credit positive, in our view, as it fully mitigates the company's exposure to further losses from replacing missing Russian gas volumes. As Uniper sold these volumes at higher prices, it locked pre-tax profits of more than €2 billion when closing the hedging transaction, which will be realized in 2023 and 2024. However, it is currently unclear to which extent the company will be allowed to reinvest such proceeds in the business. As a comparison, Uniper realized losses of about €13.2 billion in 2022 due to procurement costs.

We raised Uniper's SACP to 'b' from 'b-' because we expect the company will return to profitability in 2023. However, we believe its financial performance to a large degree remains exposed to commodity price swings. Our view of Uniper's financial risk profile has improved because we expect the company's profitability will be boosted mostly by the profits realized through the gas hedging transaction, and by very profitable coal and gas power generation, which benefit from locking in favorable market conditions. However, while these segments provide good visibility in 2023, we think Uniper's financial performance remains subject to volatility. For instance, Uniper generates about two-thirds of its power from coal and gas-fired power plants, which depend heavily on clean spark spread and clean dark spread prices. In addition, as Uniper lost over 180 terawatt-hours of stable gas flows provided by Gazprom annually, it will be forced to overhaul its long-term gas contract structure to defend its market position while remaining profitable in the gas segment. The forced disposal by 2026 of Uniper's European gas pipeline infrastructure, several thermal power plants, and its North American power business, among other assets introduce a further layer of uncertainty because of the evolving operating perimeter. This said, we understand Uniper will release an updated strategic plan during 2023, which could give us more visibility on how it can deliver a sustained solid financial performance.

In our assessment we incorporate the German government's ongoing commitment to support Uniper in a hypothetical stress scenario. However, we believe this could diminish as Uniper regains its financial strength. We expect the German government to remain committed in supporting Uniper as the company recovers from exceptionally adverse conditions in 2022. At the same time, Uniper's improved financial performance reduces its dependency on government support. Against this backdrop, the company is developing a strategic plan that provides visibility on its long-term business prospects. We believe the government will roll back some of the support it extended to Uniper if and when the company regains its own credit quality. This leads to our assumption that the likelihood of extraordinary support will progressively diminish until 2028.

We believe the terms under the approved package provide sufficient support to stabilize Uniper's ongoing operations; although this could limit an accelerated asset portfolio transformation, which weighs on its business risk profile due to its heavy carbon footprint. We believe the EU Commission's approval of the support package focuses on Uniper's financial stabilization while preventing state support that aims to provide the company with an advantage over competitors. As such, the terms under the stabilization agreement include mechanisms such as asset disposals. The package also includes equity clawbacks, which require Uniper to cover part of the curtailment losses with 30% of its EBIT after adjusting for, among other things, mark-to-market derivative fluctuations from 2022 to 2024, and return all equity in excess of Uniper's pre-crisis equity level accumulated until 2024 to the German government. These measures are unlikely to weaken Uniper's financial position because they are dependent on the company's performance and not a lump-sum payment. However, they could limit the resources Uniper can allocate to its portfolio transformation, which we believe will require significant investments to support a stronger business risk profile.

Outlook

The stable outlook reflects our expectation that Uniper will not incur further losses related to gas curtailments, and that the company's financial recovery will likely accelerate over 2023 and 2024. It also captures our view that the German government's commitment to support Uniper could decrease as the company gradually regains its financial strength and develops a comprehensive strategic plan that provides visibility on the company's long-term business prospects, which we expect Uniper will release during 2023.

Downside scenario

We could downgrade Uniper if we believe the decline in the likelihood of the German government providing timely extraordinary support accelerates beyond our current expectations, outpacing the potential improvements in Uniper's SACP.

Upside scenario

We expect rating upside will remain limited over the next two years, because we expect German government support will decline should Uniper's own credit quality improve.

We also view any upgrade as unlikely as the conditions under the approved support package will constrain Uniper's ability to accelerate its business transformation. This is because we believe it is geared toward the company regaining its financial strength, instead of accelerating growth. For instance, the approved package could reduce Uniper's scale of operations, as it will force the company to divest a portfolio of assets. It also includes equity clawback and yearly EBIT contribution clauses that constrain Uniper's ability to accumulate capital until the end of 2024.

Company Description

Uniper is an international, diversified energy company that operates in more than 40 countries. Its operations include power generation in Europe, energy trading, and a broad gas portfolio, including long-term gas procurement, sale, and storage. Its core markets are Germany, the U.K., Sweden, the Netherlands, and North America.

As of end-2022, the company owned and operated a well-diversified power generation portfolio in Europe totaling about 22.5 gigawatts (GW), including facilities running on fossil fuels such as gas (8.5 GW), coal (6.3 GW), hydroelectric (3.6 GW), Swedish nuclear (1.4 GW), and other (2.8 GW). On Dec. 20, 2022, the European Commission approved a support package that allowed Germany to take over 99% of Uniper's shared capital, after injecting equity in the company and purchasing all of Fortum's shares. The approved package requires Uniper to divest its Russian operations by 2026 (about 9 GW of power generation capacity at Unipro, currently under Russian state administration), its European gas pipeline infrastructure, several thermal power plants, and its North American power business, among other assets. We believe this will reduce its scale of operations initially, but that the proceeds will ultimately be reinvested in the business.

Liquidity

We view liquidity as adequate as of March 31, 2023, based on our view that the government will supply sufficient liquidity for Uniper to honor its commitments. This is backed by available credit lines from German development bank KfW, of which €9.5 billion are available until 2026.

Despite Uniper hedging its exposure to gas curtailment losses, and the somewhat stabilized commodity prices, the company's trading activities are exposed to large amounts of margin collateral, which can prompt unexpected liquidity needs. In addition, we believe the company has yet to regain its status in the capital markets or demonstrate that it can diversify its funding sources, given that it currently almost entirely relies on KfW lines to finance its needs. For this reason, we do not view Uniper's liquidity as strong, despite its very robust cash position.

Principal liquidity sources for 12 months starting March 31, 2023, include:

- €4.5 billion of cash and liquid investments;
- €8 billion available credit lines maturing beyond 12 months, most of which correspond to KfW financing; and
- Positive funds from operations over the next 12 months.

We assume principal liquidity uses for the same period will include:

- Debt maturities of €150 million;
- Simulated negative working capital of €1.5 billion;
- Capital expenditure of about €1 billion; and
- Any sudden margin collateral needs for Uniper's trading activities.

Covenants

We understand Uniper has no financial covenants on its loan documentation. However, the company's trading contracts require it to post different amounts of collateral depending on the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating	**BBB-/Stable/--**
Business risk:	Weak
Country risk	Low risk
Industry risk	Moderately high risk
Competitive position	Weak
Financial risk:	Aggressive
Cash flow/leverage	Aggressive
Anchor	b+
Modifiers:	

Issuer Credit Rating	BBB-/Stable/--
Diversification/Portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Adequate
Management and governance	Fair
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	b
Group credit profile	b
Related government rating	AAA
Likelihood of government support	Very high (+5 notches)

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

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Uniper SE		
Issuer Credit Rating	BBB-/Stable/--	BBB-/Negative/--