

Credit FAQ:

Will Fortum Become Uniper's Majority Shareholder?

August 20, 2019

Uniper SE's future ownership structure remains unclear. The German utility's management board is already reshuffling in the wake of Finnish state-owned Fortum Oyj's acquisition of the largest stake in the company. Because Uniper's subsidiary Unipro has water-testing operations in Russia, it is subject to the Russian Strategic Investment Act, which bars Fortum from taking majority ownership. If and when this barrier is removed, what would Fortum's intentions be? S&P Global Ratings believes that if Fortum adopts an accelerated acquisition strategy, it could be negative for the ratings on both companies.

Fortum's management is publicly pushing for a resolution to the Russian legal obstacle, yet has not communicated its plans for what would happen afterward. Recent moves by activist shareholders to accelerate Fortum's control have added to the drama--and the uncertainty. Talks between both companies resumed at the highest management level after Fortum's CEO, Pekka Lundmark, met with Uniper's supervisory board in July 2019.

We address investors' questions, including whether Fortum is in a position to take a majority ownership in Uniper and what firm control of Uniper means for the credit standing of both companies.

Frequently Asked Questions

How much influence does Fortum currently have over Uniper?

In our base-case scenario, we continue to view Fortum's stake (at 49.99%) in Uniper as a strategic investment, in line with Fortum's own representation of its investment. We take this approach because Fortum's current stake does not give it significant control of Uniper. As long as ownership remains below 50%, Fortum's formal power to influence Uniper's strategic decisions is limited, since many actions, such as an approval of dividends, require at least a 50% majority at Uniper's annual meeting.

Under German law, immediate full control of Uniper's supervisory board can only be secured with a qualified majority of 75%. We note, however, that Fortum could gain a more meaningful ability to influence Uniper's management by nominating a new supervisory board upon its scheduled renewal in 2022. Fortum can do this even if its stake in Uniper remains below 50%. Fortum's chief financial officer (CFO), Markus Rauramo, has already taken on the supervisory position held by a member of E.ON S.E. before it sold its stake in Uniper to Fortum in 2018.

Fortum is unlikely to gain significant influence over Uniper before 2022 without its cooperation.

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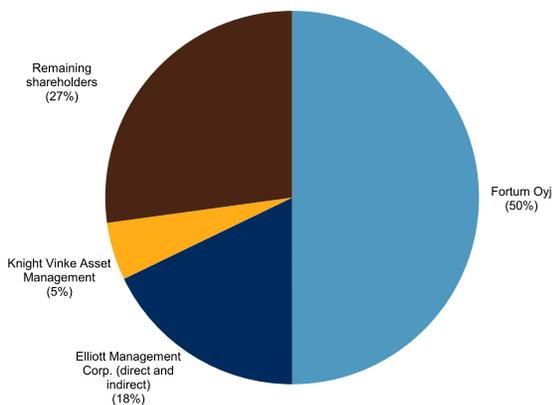
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Under German law, full control (that is, giving binding instructions to management) can only occur by implementing a domination agreement and/or a profit-and-loss pooling agreement. The prerequisite for this is a majority vote of 75% at the general meeting. Moreover, any such agreement could still be subject to legal challenges by minorities, and implementation of post-offer integration measures are typically time-consuming and costly. A domination agreement would force Fortum to offer Uniper's remaining minority shareholders a mandatory exit compensation based on Uniper's assets as valued under the German accountancy standard IDW-S1; in our view, this results in a materially higher value than its market value. That said, even at market price, acquiring another major share into Uniper would put Fortum's financial metrics under significant pressure for the current rating.

As long as none of Uniper's shareholders has a controlling stake, we will continue to analyze Uniper on a stand-alone basis.

Chart 1

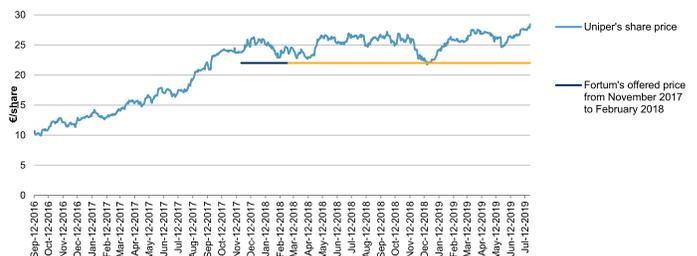
Uniper Shareholding Structure



Data as of report publication date. Source: S&P Global Ratings.
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Chart 2

The Evolution In Uniper's Share Price



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Will Fortum reach an agreement with significant minority shareholders Elliott Management (18%) and Knight Vinke (5%) to exert more control on Uniper?

In our opinion, this is unlikely, given their different investment time horizons and strategies. On May 22, 2019, Elliott Management called for a shareholder vote to instruct Uniper's management to enter into negotiations with Fortum over a domination agreement; however, the motion was pulled back ahead of the annual general meeting. Further, Fortum is a state-owned company, with the Finnish government owning 50.8% of its capital. This in our view affords the company more time and less pressure to manage its investment in Uniper, compared with hedge funds, which tend to be more focused on the short-to-medium term outcomes.

Will Fortum further increase its stake in Uniper?

We don't see Fortum increasing its stake above 50% without the cooperation of Uniper in the short term. This is because it still needs to resolve the barrier relating to Russian assets, which we estimate could take at least until 2022 if the two companies don't find common ground. In 2022,

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Fortum could enforce management rotation via the supervisory board, which comes up for renewal at that time. Moreover, in our view, the cost of acquiring a substantially higher stake would stretch Fortum's financials, and thereby undermine the company's credit profile. We believe Fortum won't want to risk a downgrade.

That said, we view as likely that as soon as Russian restrictions are lifted, Fortum will gradually increase its stake in Uniper, while striving to preserve the group's credit quality. We base our view on Fortum's public efforts for the Russian bar to be lifted even though the company remains unclear about its investment intentions.

Fortum's key obstacle in considering an increase in its stake in Uniper is that Russian authorities have limited Fortum's stake in Uniper at below 50% (also refer to "A Trio Of "Special Situations" M&A In European Utilities And Their Rating Implications" published on RatingsDirect on April 18, 2019). Both Uniper and Fortum have operations in Russia, and Russian law restricts control of strategic activities such as water supply by state-controlled foreign companies. Fortum is majority owned by the Finnish government, and Uniper holds 83.7% in the Moscow-listed company Unipro, which mainly produces electricity from gas- and coal-fired power plants. However, Unipro is considered by Russia's Federal Antimonopoly Service to be a company conducting strategic activities in the area of water supply and licensed activities linked to the analysis of drinking water. We understand this relatively small water-testing activity is legally integrated into Unipro's generation business. For that reason, resolving the issue is more complex than disposing of or outsourcing these water-testing operations. Unipro's management has shown no intention of selling the related assets, and there appears little business incentive to do so.

What is Uniper's view about a closer relationship?

We consider it unlikely that Uniper will seek to get closer to Fortum without knowing its investment strategy and getting assurances about workforce arrangements and the company's credit strength after the takeover. By now, the differences between both company's management teams have led to a reshuffle of Uniper's executive board. The former CEO Klaus Schäfer and CFO Christopher Debrück resigned from their positions earlier in 2019, followed by the two remaining executives: Chief Operating Officer Eckhardt Rümmler and Chief Commercial Officer Keith Martin followed suit after Uniper's annual general meeting on May 22, 2019, due to Fortum postponing the discharge of the management board for the 2017 and 2018 financial years. Uniper's labor union officials are calling for the German and Finnish governments to intervene.

Why does S&P Global Ratings think Fortum would increase its stake only after resolution of the Russian hurdle?

Any material acquisition of shares would mean Fortum may not be able to sustain financial metrics in line with the current rating. Fortum has said that it prioritizes the return on its strategic investment in Uniper over further expanding its stake. In addition, Uniper's profitability is strongly linked to its trading and contracting capabilities, which in turn is dependent on the rating.

That said, a lifting of the Russian restriction could still be some time off, even if a common ground is found between Uniper and Fortum. In that case, Uniper would have no formal control over Unipro's management, given legal considerations to protect Unipro's minority shareholders. Therefore, its ability to force Unipro to dispose of related Russian assets is limited. Further, we have no indication that Fortum is able to convince Russia to lift restrictions.

As long as Russian restrictions limit Fortum's ownership, our base-case assumption is that Uniper

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would continue operating as an independent company, and that Fortum's current influence would not materially impair Uniper's credit quality. We also do not factor in our base case any synergies that could emerge from an industrial partnership with Fortum. But we acknowledge that the companies' business mix is somewhat complementary.

How would S&P Global Ratings assess Fortum if its stake in Uniper rose?

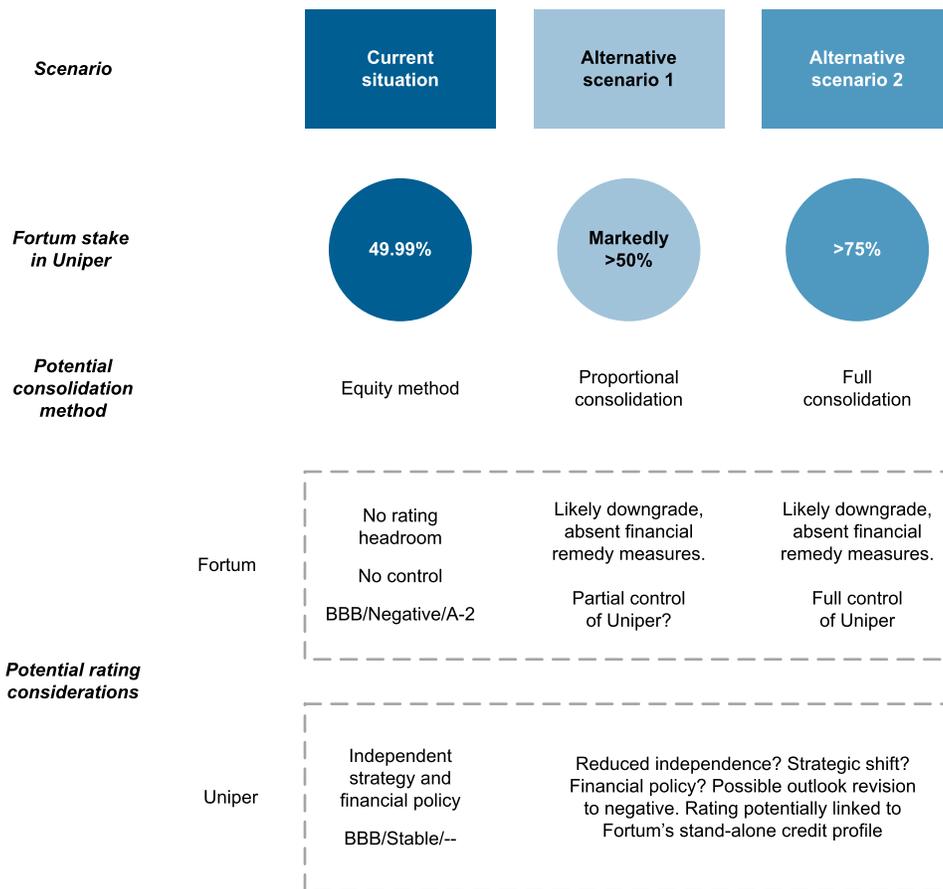
A higher stake in Uniper could lead to a downgrade for Fortum. This is because Uniper's exposure to carbon-intensive thermal power generation would likely weaken our assessment of Fortum's business risk profile. If Fortum's stake remains close to 50%, proportional credit metrics could be slightly better, given Uniper's low leverage, but this is unlikely to prevent a downgrade unless it takes remedial measures.

For a more detailed overview of the credit approaches we might consider in the different scenarios mentioned in the chart 3 below, see "The Fortum-Uniper-E.ON Deal And Its Credit Consequences," published on Feb. 23, 2018.

How would S&P Global Ratings assess Uniper if Fortum's shareholding increased?

We would likely reassess the status between the two companies and might proportionally or fully consolidate Uniper into Fortum.

Fortum-Uniper "What If" Scenarios



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In line with our criteria, we most often use the same scope of consolidation as in the parent's International Financial Reporting Standards (IFRS) statements (see "Corporate Methodology: Ratios And Adjustments," published on April 1, 2019). We would expect to link the rating on Uniper to the stand-alone credit profile on Fortum with a difference of between zero to two notches depending on operational and funding dependence as well as the structural safeguards in place limiting Fortum's control. Namely, the triggers for our reassessment are:

- Fortum's stake increases markedly above 50%.
- We see signs of increasing cooperation between Fortum and Uniper (such as a strategic alignment, asset disposals, IT, administration, procurement, hedging, funding, and liquidity).

The degree and nature of cooperation is a driving factor for our assessment on Uniper as an insulated entity and accounts for the potential notching difference between the two companies. Fortum has declared its intention to support Uniper management's stated strategy, while also seeking cooperation between the two companies for value creation opportunities. That said, Fortum has no incentive to materially dilute its own or Uniper's credit strength, and as such would likely seek to preserve Uniper's operational and financial independence. As previously mentioned,

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we understand that is because achieving a sustainable return on its investment has a higher priority than ownership of Uniper.

Deviations from our expectation about Uniper's independence and strategy could take the form of Fortum trying to influence daily operational business or funding or include signs of a higher growth rate in net investments or larger dividends than we currently envisage for Uniper's modest financial risk profile.

Related Research

- Fortum Oyj, Aug. 14, 2019
- A Trio Of "Special Situations" M&A In European Utilities And Their Rating Implications, April 18, 2019
- Fortum Oyj, Dec. 5, 2018
- German Power And Gas Co Uniper Upgraded To 'BBB' On Reduced Event Risk And Strengthening Business Risk; Outlook Stable, April 27, 2018
- The Fortum-Uniper-E.ON Deal And Its Credit Consequences, Feb. 23, 2018
- Fortum Affirmed At 'BBB' Following Final Outcome Of Takeover Offer For Uniper; Outlook Remains Negative, Feb. 16, 2018
- German Energy Company Uniper 'BBB-' Ratings Affirmed; Outlook Remains Positive, Jan. 18, 2018

This report does not constitute a rating action.

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