

ISSUER COMMENT

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Vattenfall AB

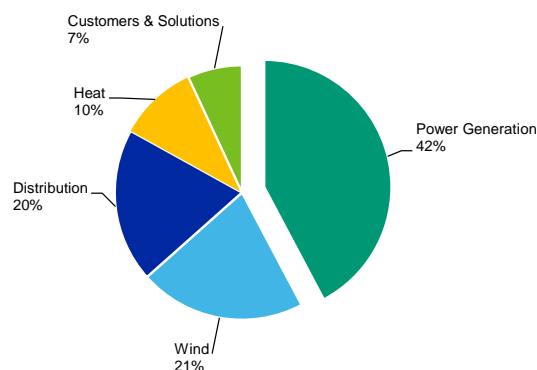
Strong operating performance in 2020, but credit metrics will likely weaken this year

On 4 February 2021 Vattenfall (A3 negative) reported full year results for 2020. Despite a very challenging operating environment in the Nordics – where average spot electricity prices decreased by around 65% - Vattenfall's underlying EBITDA held up very well at SEK44 billion, slightly above what the company recorded during 2019. The stronger than expected EBITDA further translated into solid cash flow generation with our estimated Funds from operations (FFO) / Net Debt ratio being in the high 20s. However, given the power segment's importance to Vattenfall – representing 42% of underlying EBITDA in 2020 – we expect lower prices to hit Vattenfall's operating performance during 2021 and weigh on credit metrics.

Exhibit 1

Power generation accounts for a significant share of Vattenfall earnings

Share of FY2020 underlying EBITDA



Shares calculated based on underlying EBITDA excluding eliminations and others
 Source: Vattenfall FY2020 annual report

Most of Vattenfall's operating segments were overall stable and the company showed a high degree of resiliency throughout 2020.

Exhibit 2

Vattenfall earnings showed resiliency in 2020

In SEK million

	FY2020 underlying EBITDA	% change compared to FY2019
Power Generation	18,796	-2.1%
Wind	9,426	-2.0%
Distribution	8,725	5.8%
Heat	4,462	1.2%
Customers & Solutions	3,083	2.1%

Source: Vattenfall FY2020 annual report

Underlying EBITDA in the power generation declined following pressure on power prices and lower nuclear output. The overall decline was nonetheless modest at 2% compared to 2019 and was tempered by a much stronger performance of Vattenfall's trading operations – adding roughly SEK1 billion to the division's underlying operating profit – as well as higher hydro output. Equally, the wind segment also saw a 2% decline reflecting a combination of the pricing environment and increased maintenance work affecting load factors, outpacing incremental capacity additions. Whereas the underlying EBITDA in distribution increased by close to 6%, this essentially reflects the non-recurring event of a storm during 2019 where Vattenfall had to record extraordinary costs of around SEK800 million. Adjusted for these costs, underlying EBITDA would have been down by approximately 3.5%, mainly due to the impact of reduced WACC in the current regulatory period (reduction to 2.35%, down from 5.85% in the prior period. The decision is appealed and legal process is still ongoing in the courts). Vattenfall's heat segment slightly increased as lower maintenance costs offset reduced capacity and deterioration in clean spark and clean dark spreads. As for customers & solutions, Vattenfall maintained a stable customer base (10.1 million) during the year and cost control supported an EBITDA growth of 2%.

Vattenfall reported an adjusted FFO/Net debt (company definition) of 28.8% for 2020. The company's overall solid credit metrics were supported by a combination of (1) resiliency in its EBITDA generation (2) the company's decision to halve its dividend payment last year (3) a very favorable movement in margins calls affecting working capital, which subsequently improved the company's reported net debt figure (inflow of SEK12.6 billion during last year, whereas 2019 saw an outflow of SEK20.7 billion).

We expect Vattenfall's credit metrics to weaken in 2021 as power prices remain at low levels and with the company having locked in 69% of its Nordic output for the year at €28/ MWh (against achieved prices of €31/ MWh during 2020). In addition, Vattenfall's heavy capital expenditure programme - amounting to net expenditures of SEK57 billion over 2021 and 2022 - will weaken free cash flows in the current year. Increased output in wind will only partly mitigate these negative drivers. However, Vattenfall could strengthen its balance sheet through an eventual disposal of its stake in the electricity grid company, Stromnetz Berlin GmbH, an asset that the company has offered to sell to the city of Berlin and which could be sold during the first half of this year.

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