

Bulletin:

Vattenfall's Improved Financials Are Likely To Fade Given Investments

February 4, 2021

STOCKHOLM (S&P Global Ratings) Feb. 4, 2021--S&P Global Ratings today said that Swedish power company Vattenfall AB's (BBB+/Stable/A-2) better-than-anticipated financial performance in 2020 has improved rating headroom, but will likely not be sustainable. This due to the company's acceleration of investments over 2021 and 2022, and the volatile nature of its margin calls.

For the full-year 2020, we estimate Vattenfall's preliminary S&P Global Ratings-adjusted funds from operations (FFO) to debt at about 28%-32%, which is well above the upside rating trigger of 25%. This is mainly because a large working capital inflow--mostly related to margin calls of Swedish krona (SEK) 12 billion (about €1.2 billion)--resulted in meaningfully lower debt than anticipated at year-end. We note that these inflows, however, are temporary to some extent. Vattenfall's reported underlying EBITDA of SEK44 billion and FFO of SEK35 billion are in line with our expectations.

Vattenfall managed to keep its operating performance relatively unchanged in 2020 compared with 2019, despite record low power prices, which we view as a support for the current rating. Profitability continues to be underpinned by its diversified earnings base, with increased contributions from the heat business divisions partly offsetting the lower contribution from its power generation segment, which was also supported by hedges in place. On the negative side, we note that the SEK11.3 billion write-down of its coal plant Moorburg weighed heavily on net profits, which was largely in line with our assumptions, but we don't expect any further write-downs. For 2021, Vattenfall has hedged about 69% of its output at €28 per megawatt hour (/MWh), which prudently secures a certain level of cash flow, but at the same time limits the upside.

We anticipate that Vattenfall will gradually benefit from a recovery of Nord pool system spot prices in the Nordic region. We expect improved prices at about €25/MWh-€35/MWh on average compared with a record low of €11/MWh in 2020, because of very strong hydrological conditions (see "The Energy Transition And What It Means For European Power Prices And Producers: January 2021 Update," published Jan. 27, 2021, on RatingsDirect).

Although a continued stronger-than-expected financial risk profile could lead to upside rating pressure, we believe that Vattenfall's credit ratios will soften over 2021-2022. This is because investments are set to increase to about SEK57 billion over 2021 and 2022, up from SEK23.6 billion in 2020. The increase in capital expenditure is primarily spurred by Vattenfall's investments in large offshore wind projects, namely Hollandse Kust Zuid 1-4 (1,500 megawatts), which are set to be commissioned in 2023 and likely to boost revenue and cash flow from 2023. In addition, we

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are also monitoring any potential changes to Vattenfall's dividend or acquisition strategy.

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