

Fortum

Company report

12/7/2022



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This report is a summary translation of the report "Sähkö kallistuu ja verot nousee" published on 12/7/2012 at 7:45 am.

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Electricity costs more and taxes go up

We raise Fortum's target price to EUR 18.0 (was EUR 16.5) and reiterate our Accumulate recommendation. Although the Finnish tax proposal was bad news for next year's results, the sharp rise in electricity prices compensated for this and improves the outlook for the coming years. Outside Russia, Fortum's profile is favorable following the completion of the Uniper transaction, against which the valuation (2023e P/E 9x) remains low.

Electricity prices on another sharp rise

Much is happening around Fortum and the whole energy sector at the moment. The most significant event for earnings estimates of the coming years is the resumption of a sharp rise in electricity prices, which is also reflected in futures. At the time of Fortum's Q3 earnings call (November 10), for example, Nordic electricity futures for 2023 were hovering around €120/MWh, but now the level is already well above €200/MWh. Prices have risen both in the spot market and further into the future. We have significantly raised our estimates for the Generation segment to better reflect current levels and now expect the segment to generate an operating profit of just under EUR 2.7 billion (was EUR 2.3 bn). We believe that the average wholesale price expected by the Vara consensus (2023e: 66 €/MWh) is conservative based on recent movements, and our own estimate is around 80 €/MWh. At the end of Q3, Fortum had hedged around 65% of its production at €49/MWh for 2023, which limits the upside. Significant uncertainty in the estimates is caused by the highly volatile electricity market and the fate of Olkiluoto 3, which may have a significant impact not only on Fortum's performance but also on the Finnish electricity market as a whole.

Likely windfall tax, dilution of the stock and the Uniper solution

The "windfall tax" proposal announced by the Finnish government on Friday was tighter than anticipated and, according to our preliminary estimate, could lead to an additional EUR 400-500 million in taxes for Fortum in 2023. This will of course depend on the actual result in Finland, especially in the Generation segment. We have added EUR 400 MEUR of additional taxes to our estimates, resulting in a lower 2023 EPS forecast despite the otherwise positive changes. The impact should be limited to 2023 and we have assumed this to be the case, although in Finland temporary taxes have sometimes remained permanent. We have also now considered the 1% increase in Fortum's share capital following the free share issue to Solidium. On the other hand, there are positive indications for the completion of the Uniper transaction, as Uniper convened an Extraordinary General Meeting on December 19, and the company expects to have received the other necessary approvals for the transaction (e.g. from the EU) before then. The completion of the Uniper transaction and the repatriation of EUR 4.5 billion will, in our view, remove Fortum's liquidity concerns.

Valuation still attractive as the situation gradually becomes clearer

Fortum's 2023e P/E is around 9x next year's earnings, supported by very high electricity prices but weighed down by an exceptional tax burden. We estimate that normalized earnings per share will be at the level of EUR 1.3-1.6 (was EUR 1.2-1.5), which would result in a P/E of around 10-12x. We believe this is also very moderate in the longer term. Dividend yields are also set to rise again in the coming years thanks to strong cash flows. Although Russia will continue to weigh on Fortum for a long time, we believe the risk/reward ratio of the stock is good if the Uniper deal goes through. Although the Uniper adventure was a disaster, in a favorable market environment, we believe that these bumps on the road will be quickly overcome if energy policy (new additional taxes and the like) doesn't make the situation significantly more difficult.

Recommendation

Accumulate

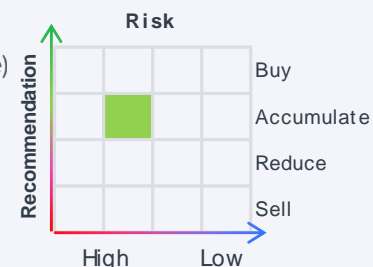
(previous Accumulate)

EUR 18.00

(previous EUR 16.50)

Share price:

15.87



Key figures

	2021	2022e	2023e	2024e
Revenue	6422	8725	9785	9551
growth-%	-87%	36%	12%	-2%
EBIT adj.	1429	1718	2936	2300
EBIT-% adj.	22.3 %	19.7 %	30.0 %	24.1 %
Net Income	3985	2043	1660	1576
EPS (adj.)	-2.43	-2.44	1.85	1.76

P/E (adj.)	neg.	neg.	8.6	9.0
P/B	2.0	2.1	1.8	1.7
Dividend yield-%	4.2 %	2.4 %	7.2 %	7.2 %
EV/EBIT (adj.)	22.9	10.1	5.1	6.2
EV/EBITDA	6.7	5.6	4.3	5.0
EV/S	5.1	2.0	1.5	1.5

Source: Inderes

Guidance

(Unchanged)

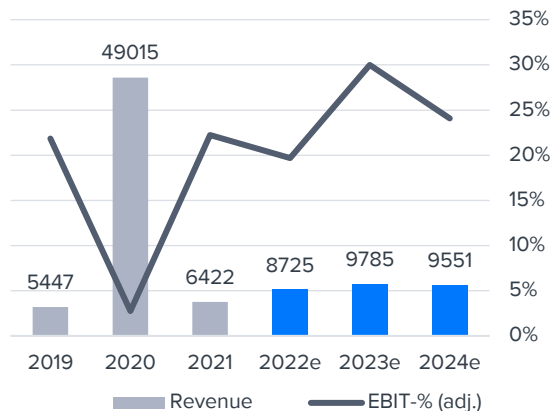
Generation segment's Nordic generation hedges: approximately 80% at EUR 49 per MWh for the remainder of 2022, approximately 65% at EUR 49 per MWh for 2023, and approximately 40% at EUR 38 per MWh for 2024.

Share price



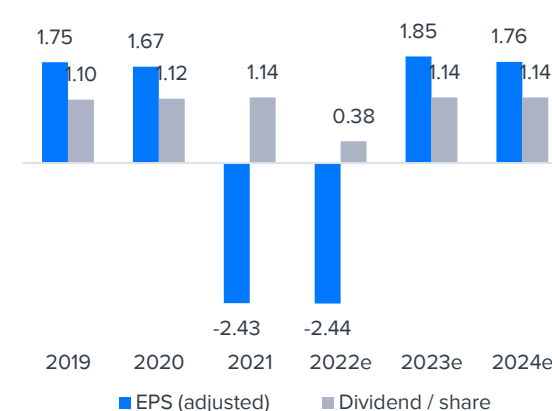
Source: Millstream Market Data AB

Revenue and EBIT %



Source: Inderes

EPS and dividend



Source: Inderes



Value drivers

- Successful exit from Uniper and Russia
- Improved investment profile and lower risk profile as the situation becomes clearer
- Very high electricity prices enables wild earnings levels if they persist
- Improving operational efficiency
- Successful investments and divestments in accordance with the strategy



Risk factors

- Completing the nationalization of Uniper
- Write-down risks associated with Russian business, which may also result in balance sheet problems
- Possible windfall taxes and developments in energy policy
- A drop in electricity prices would ultimately be reflected in the result, despite hedging
- Unfavorable regulatory developments in the Nordic countries, Europe or Russia
- Risks related to the state owner

Valuation	2022e	2023e	2024e
Share price	15.9	15.9	15.9
Number of shares, million:	897.3	897.3	897.3
Market cap	14235	14235	14235
EV	17287	15102	14177
P/E (adj.)	neg.	8.6	9.0
P/E	neg.	8.6	9.0
P/FCF	2.5	5.2	6.6
P/B	2.1	1.8	1.7
P/S	1.6	1.5	1.5
EV/Sales	2.0	1.5	1.5
EV/EBITDA	5.6	4.3	5.0
EV/EBIT (adj.)	10.1	5.1	6.2
Payout ratio (%)	neg.	61.6 %	64.9 %
Dividend yield-%	2.4 %	7.2 %	7.2 %

Source: Inderes

Rising electricity prices support earnings outlook

Estimate revisions 2022e-2024e

- Electricity prices have risen sharply since our last update, which is why we have raised our forecasts, especially for the Generation segment.
 - Nordic electricity futures are now: 2023 216 €/MWh, 2024 96 €/MWh and 2025 78.5 €/MWh
 - Prices fluctuate strongly and the more significant regional prices for Fortum differ significantly from these
 - We haven't used futures prices directly in our estimates but have tried to soften the impact with smaller changes (to reduce the volatility of estimates in a volatile market).
 - The Generation segment hedges for Nordic generation at the end of Q3 were as follows: for the rest of 2022 around 80% at €49/MWh, for 2023 around 65% at €49/MWh and for 2024 around 40% at €38/MWh.
- In the other segments, we made mainly minor downward revisions, but these were of little importance for the overall picture.
- We have added an additional tax of EUR 400 million to our 2023 estimates based on the Finnish government's tax proposal.
 - The new law is currently being consulted and may still undergo significant changes
 - The final tax will depend in particular on the result of the Generation segment
- In our estimates, we have considered the 1% dilution of the stock.

Estimate revisions MEUR / EUR	2022e			2023e			2024e		
	Old	New	Change %	Old	New	Change %	Old	New	Change %
Revenue	8820	8725	-1%	9543	9785	3%	9305	9551	3%
EBITDA	3093	3081	0%	3259	3512	8%	2585	2855	10%
EBIT (exc. NRIs)	1730	1718	-1%	2683	2936	9%	2038	2300	13%
EBIT	2534	2522	0%	2683	2936	9%	2038	2300	13%
PTP	2593	2581	0%	2423	2651	9%	1783	2035	14%
EPS (excl. NRIs)	-2.45	-2.44	1%	2.12	1.85	-13%	1.55	1.76	13%
DPS	0.38	0.38	0%	1.14	1.14	0%	1.14	1.14	0%

Source: Inderes

Valuation continues to attract

A valuable core in the Nordic countries

The value of Fortum's core business has been clear throughout the crisis. The current market value of the company's Nordic hydro and nuclear assets of more than EUR 14 billion is still very low. Following the completion of the Uniper transaction, we estimate that the liquidity position is good, even under exceptional circumstances, and the balance sheet is largely in order - although any further write-downs in Russia could further weaken it. Fortum's Generation segment alone will generate over EUR 2 billion in operating profits in the coming years thanks to high electricity prices, which will significantly strengthen the balance sheet in the short term.

However, the sector is priced very moderately, which is understandable as Europe wrestles with the energy crisis. In addition, Fortum is still burdened by the Russia segment, which is included in our estimates. We expect the segment's profit to be on a downward curve, and in 2023 it will account for under 8% of operating profit. The business is unlikely to have a significant value, and the result will be eliminated from the valuation multiples if you wish.

Fortum's risk profile is also generally elevated until it has normal access to debt markets. We expect this to be possible in 2023, when the Uniper deal is completed, and the financial situation is stable again. After the exit from the Russia business, the way is certainly open, but it may take a long time.

Stock is cheap with the result of the next few years

Fortum is well positioned to deliver excellent results in the coming years thanks to high electricity prices, even though the 2023 result will be burdened by significant additional taxes. Fortum's 2023e P/E is around 9x and, after estimate revisions, not significantly different from the 2024 level. We estimate

normalized earnings per share to be in the range of EUR 1.3-1.6 (was EUR 1.2-1.5), which would put the P/E in the range of 10-12x, which we believe is a very moderate level in the longer term. Although risks and uncertainties remain, we believe Fortum's risk/return ratio is still good. If Fortum were able to return to both the debt market and as a dividend payer, the company's risk profile would fall further. Following this, we believe the new profile of the company would support a significantly higher valuation, but this will likely require an exit from Russia.

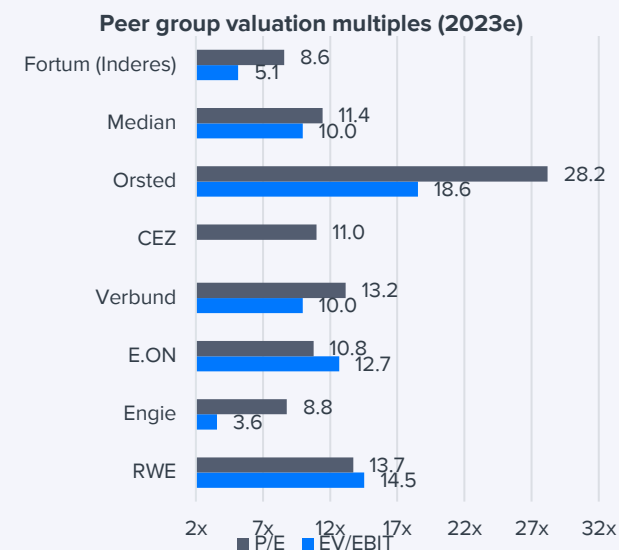
Uncertainty remains high

Although the Uniper mess seems to be resolved and we are confident that the arrangement will be completed during the rest of the year, nothing is certain until the money is in the account. The bigger problem, however, is the exit from Russia, which in this market environment seems to be very difficult, even at reasonable prices. In addition, there are significant risks associated with regulation of the whole sector and the energy policy throughout Europe. In Finland, too, taxing "excess profits" of electricity companies has been politically attractive, but we believe that the current proposal has now been taken on board.

The concern, of course, is that the temporary tax will become permanent and continue to burden the sector, or that Sweden will also adopt a solution that will significantly increase Fortum's tax burden. To our understanding, so far, the debate in Sweden has revolved around taxing fossil fuel production, which we don't believe would have a material impact on Fortum. However, the situation is uncertain. In addition, an obvious risk for Fortum's earnings development is the longer-term sustainability of very high electricity prices, which may be hampered by challenges on the futures market.

Valuation	2022e	2023e	2024e
Share price	15.9	15.9	15.9
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Market cap	14235	14235	14235
EV	17287	15102	14177
P/E (adj.)	neg.	8.6	9.0
P/E	neg.	8.6	9.0
P/FCF	2.5	5.2	6.6
P/B	2.1	1.8	1.7
P/S	1.6	1.5	1.5
EV/Sales	2.0	1.5	1.5
EV/EBITDA	5.6	4.3	5.0
EV/EBIT (adj.)	10.1	5.1	6.2
Payout ratio (%)	neg.	61.6 %	64.9 %
Dividend yield-%	2.4 %	7.2 %	7.2 %

Source: Inderes

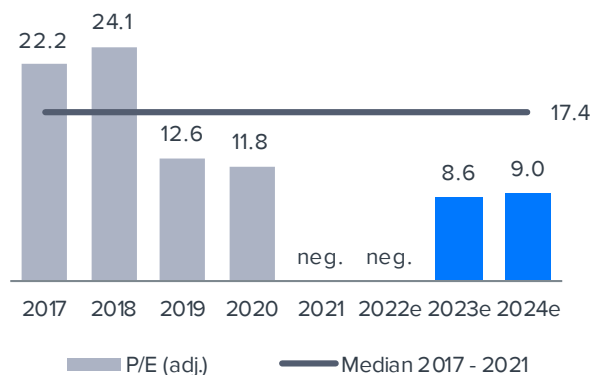


Valuation table

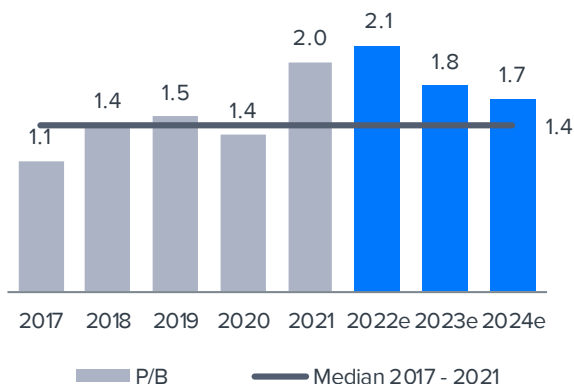
Valuation	2017	2018	2019	2020	2021	2022e	2023e	2024e	2025e
Share price	16.5	19.1	22.0	19.7	27.0	15.9	15.9	15.9	15.9
Number of shares, millions	888.4	888.4	888.3	888.4	888.3	897.3	897.3	897.3	897.3
Market cap	14658	16968	19542	17501	23975	14235	14235	14235	14235
EV	13955	16805	18665	25567	32676	17287	15102	14177	13346
P/E (adj.)	22.2	24.1	12.6	11.8	neg.	neg.	8.6	9.0	9.6
P/E	16.9	20.1	13.2	9.6	32.4	neg.	8.6	9.0	9.6
P/FCF	neg.	10.0	46.5	neg.	25.8	2.5	5.2	6.6	7.1
P/B	1.1	1.4	1.5	1.4	2.0	2.1	1.8	1.7	1.6
P/S	3.2	3.2	3.6	0.4	3.7	1.6	1.5	1.5	1.5
EV/Sales	3.1	3.2	3.4	0.5	5.1	2.0	1.5	1.5	1.4
EV/EBITDA	8.6	10.0	11.0	9.5	6.7	5.6	4.3	5.0	5.0
EV/EBIT (adj.)	16.9	17.0	15.7	19.0	22.9	10.1	5.1	6.2	6.4
Payout ratio (%)	112.8 %	115.9 %	66.0 %	54.6 %	137.0 %	neg.	61.6 %	64.9 %	69.1 %
Dividend yield-%	6.7 %	5.8 %	5.0 %	5.7 %	4.2 %	2.4 %	7.2 %	7.2 %	7.2 %

Source: Inderes

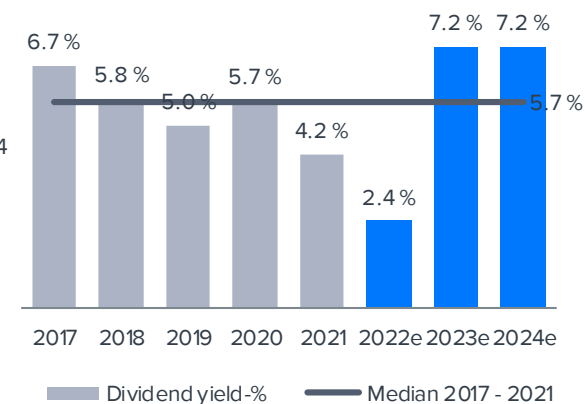
P/E (adj.)



P/B



Dividend yield-%



Peer group valuation

Peer group valuation	Market cap	EV	EV/EBIT		EV/EBITDA		P/E		Dividend yield-%		P/B
Company	MEUR	MEUR	2022e	2023e	2022e	2023e	2022e	2023e	2022e	2023e	2022e
RWE	28077	48966	12.3	14.5	8.8	9.2	10.5	13.7	2.2	2.2	1.6
Engie	35161	26651	3.1	3.6	2.0	2.2	7.4	8.8	8.4	7.7	1.0
E.ON	24390	57333	12.3	12.7	7.4	7.7	10.1	10.8	5.5	5.7	1.8
Verbund	29548	34712	14.0	10.0	11.4	8.3	18.1	13.2	4.4	4.4	4.3
EDF	46639	43183	5.5	7.1	3.6	2.4		11.9	2.5	4.5	0.9
CEZ	17093						6.5	11.0	9.4	9.8	2.1
Enel	53660	98924	8.5	7.8	5.1	4.9	10.0	9.1	7.5	8.0	1.4
Uniper	1335	10771						9.2			0.5
Orsted	37188	39099	13.1	18.6	9.7	11.2	17.1	28.2	2.0	2.2	3.6
Fortum (Inderes)	14235	17287	10.1	5.1	5.6	4.3	neg.	8.6	2.4	7.2	2.1
Average			9.8	10.6	6.9	6.9	11.4	13.3	5.2	5.6	1.9
Median			12.3	10.0	7.4	8.0	10.1	11.4	4.9	5.1	1.6
Diff-% to median			-18%	-48%	-25%	-46%		-25%	-52%	41%	32%

Source: Refinitiv / Inderes. NB: The market cap Inderes uses does not consider own shares held by the company.

Income statement

Income statement	2020	Q1'21	Q2'21	Q3'21	Q4'21	2021	Q1'22	Q2'22	Q3'22	Q4'22e	2022e	2023e	2024e	2025e
Revenue	49015	1721	1234	1296	2171	6422	2162	1754	2152	2657	8725	9785	9551	9461
<i>Generation</i>	2006	669	570	677	953	2869	701	715	894	1027	3337	4856	4340	4032
<i>City Solutions</i>	1075	418	256	202	426	1302	390	229	254	416	1289	1366	1395	1425
<i>Consumer Solutions</i>	1267	661	424	485	1052	2622	1168	856	1094	1256	4374	4004	4090	4178
<i>Russia</i>	929	264	182	193	267	906	223	218	261	322	1024	949	949	949
<i>Uniper</i>	44514	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Other</i>	140	34	36	33	35	138	35	34	34	36	139	137	141	144
<i>Eliminations</i>	-916	-325	-234	-294	-562	-1415	-355	-298	-385	-400	-1438	-1527	-1364	-1267
EBITDA	2689	675	394	3142	702	4913	386	901	1058	736	3081	3512	2855	2654
Depreciation	-1090	-145	-146	-142	-154	-587	-140	-134	-141	-144	-559	-576	-555	-565
EBIT (excl. NRI)	1344	459	207	243	520	1429	388	318	420	592	1718	2936	2300	2089
EBIT	1599	530	248	3000	548	4326	246	767	917	592	2522	2936	2300	2089
<i>Generation</i>	722	268	190	237	428	1123	275	300	375	456	1406	2666	2051	1847
<i>City Solutions</i>	47	86	-4	-20	73	135	48	-36	-16	57	53	65	60	63
<i>Consumer Solutions</i>	90	36	19	13	-16	52	35	21	17	19	92	108	106	108
<i>Russia</i>	251	100	37	45	79	261	61	57	67	90	275	216	203	191
<i>Uniper</i>	363	0	0	0	0	0	0	0	0	0	0	0	0	0
<i>Other</i>	-129	-31	-35	-32	-44	-142	-31	-24	-23	-30	-108	-120	-120	-120
<i>Items affecting comparability</i>	255	71	41	2757	28	2897	-142	449	497	0	804	0	0	0
<i>Share of associates' profit or loss</i>	656	80	60	7	21	168	-215	-79	-39	25	-308	20	20	20
Net financial items	-56	-42	-47	-46	-26	-161	59	499	-141	-50	367	-305	-285	-197
PTP	2199	568	261	2961	543	4333	90	1187	737	567	2581	2651	2035	1912
Taxes	-344	-91	-46	-73	-115	-325	-104	-150	-137	-127	-518	-966	-433	-407
Minority interest	-32	-15	-1	4	-11	-23	-7	2	1	-15	-19	-25	-26	-26
Net earnings	1823	1092	-474	-721	842	739	-2222	-5686	6099	424	-1385	1660	1576	1479
EPS (adj.)	1.67	1.15	-0.58	-3.92	0.92	-2.43	-2.32	-6.84	6.24	0.47	-2.44	1.85	1.76	1.65
EPS (rep.)	2.05	1.23	-0.53	-0.81	0.95	0.83	-2.48	-6.34	6.80	0.47	-1.54	1.85	1.76	1.65

Source: Inderes

Balance sheet

Assets	2020	2021	2022e	2023e	2024e
Non-current assets	35604	49399	14922	15046	15191
Goodwill	1069	1021	248	248	248
Intangible assets	1739	1146	646	646	646
Tangible assets	19367	19049	8290	8414	8559
Associated companies	2912	2461	1586	1586	1586
Other investments	7959	6477	0.0	0.0	0.0
Other non-current assets	2402	17096	3308	3308	3308
Deferred tax assets	156	2149	844	844	844
Current assets	22206	100262	15390	14509	12835
Inventories	1396	2275	305	342	334
Other current assets	8998	65500	6360	5360	4860
Receivables	9504	24895	1745	1957	1910
Cash and equivalents	2308	7592	6980	6850	5731
Balance sheet total	57810	149661	30312	29555	28026

Source: Inderes

Liabilities & equity	2020	2021	2022e	2023e	2024e
Equity	15577	13665	6788	8107	8660
Share capital	3046	3046	3046	3046	3046
Retained earnings	10149	10062	7665	8984	9537
Hybrid bonds	0.0	0.0	0.0	0.0	0.0
Revaluation reserve	0.0	0.0	0.0	0.0	0.0
Other equity	-242.0	-977.0	-4000.0	-4000.0	-4000.0
Minorities	2624	1534	77.0	77.0	77.0
Non-current liabilities	22356	38070	10561	10050	8739
Deferred tax liabilities	952	827	514	514	514
Provisions	8098	10298	1070	1070	1070
Long term debt	8785	8701	7727	7216	5905
Convertibles	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	4521	18244	1250	1250	1250
Current liabilities	19877	97926	12963	11398	10627
Short term debt	1877	8519	3727	1950	1226
Payables	9525	17462	1745	1957	1910
Other current liabilities	8475	71945	7491	7491	7491
Balance sheet total	57810	149661	30312	29555	28026

Summary

Income statement	2019	2020	2021	2022e	2023e	Per share data	2019	2020	2021	2022e	2023e
Revenue	5447	49015	6422	8725	9785	EPS (reported)	1.67	2.05	0.83	-1.54	1.85
EBITDA	1693	2689	4913	3081	3512	EPS (adj.)	1.75	1.67	-2.43	-2.44	1.85
EBIT	1118	1599	4326	2522	2936	OCF / share	1.51	1.75	1.23	4.13	3.84
PTP	1728	2199	4333	2581	2651	FCF / share	0.47	-8.69	1.05	6.46	3.06
Net Income	1482	1823	739	-1385	1660	Book value / share	14.62	14.58	13.66	7.48	8.95
Extraordinary items	-72	255	2897	804	0	Dividend / share	1.10	1.12	1.14	0.38	1.14
Balance sheet	2019	2020	2021	2022e	2023e	Growth and profitability	2019	2020	2021	2022e	2023e
Balance sheet total	23364	57810	149661	30312	29555	Revenue growth-%	4%	800%	-87%	36%	12%
Equity capital	13235	15577	13665	6788	8107	EBITDA growth-%	1%	59%	83%	-37%	14%
Goodwill	612	1069	1021	248	248	EBIT (adj.) growth-%	21%	13%	6%	20%	71%
Net debt	5255	8354	9628	4475	2317	EPS (adj.) growth-%	120%	-4%	-245%	0%	-176%
Cash flow	2019	2020	2021	2022e	2023e	EBITDA-%	31.1 %	5.5 %	76.5 %	35.3 %	35.9 %
EBITDA	1693	2689	4913	3081	3512	EBIT (adj.)-%	21.8 %	2.7 %	22.3 %	19.7 %	30.0 %
Change in working capital	-240	-785	-1365	4089	963	EBIT-%	20.5 %	3.3 %	67.4 %	28.9 %	30.0 %
Operating cash flow	1340	1556	1092	3709	3442	ROE-%	11.9 %	14.1 %	5.9 %	-14.7 %	22.5 %
CAPEX	-617	-20567	-12840	31738	-700	ROI-%	9.9 %	10.3 %	15.8 %	9.0 %	16.6 %
Free cash flow	420	-7721	929	5797	2742	Equity ratio	56.6 %	26.9 %	9.1%	22.4 %	27.4 %
Valuation multiples	2019	2020	2021	2022e	2023e	Gearing	39.7 %	53.6 %	70.5 %	65.9 %	28.6 %
EV/S	3.4	0.5	5.1	2.0	1.5						
EV/EBITDA (adj.)	11.0	9.5	6.7	5.6	4.3						
EV/EBIT (adj.)	15.7	19.0	22.9	10.1	5.1						
P/E (adj.)	12.6	11.8	neg.	neg.	8.6						
P/E	1.5	1.4	2.0	2.1	1.8						
Dividend-%	5.0 %	5.7 %	4.2 %	2.4 %	7.2 %						

Source: Inderes

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Accumulate	The 12-month risk-adjusted expected shareholder return of the share is attractive
Reduce	The 12-month risk-adjusted expected shareholder return of the share is weak
Sell	The 12-month risk-adjusted expected shareholder return of the share is very weak

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Recommendation history (>12 mo)

Date	Recommendation	Target price	Share price
3/17/2020	Buy	15.00 €	13.31 €
4/27/2020	Buy	17.00 €	14.86 €
5/18/2020	Buy	17.50 €	14.92 €
7/21/2020	Buy	20.00 €	17.84 €
8/20/2020	Buy	20.00 €	17.02 €
11/18/2020	Buy	20.00 €	17.63 €
12/4/2020	Buy	20.00 €	18.30 €
2/15/2021	Accumulate	22.50 €	21.97 €
5/14/2021	Accumulate	24.00 €	22.74 €
8/18/2021	Accumulate	26.50 €	24.49 €
11/15/2021	Reduce	25.00 €	25.30 €
2/28/2022	Reduce	19.00 €	19.47 €
3/7/2022	Accumulate	16.00 €	15.26 €
4/27/2022	Reduce	16.00 €	15.63 €
5/13/2022	Reduce	16.00 €	15.31 €
6/21/2022	Accumulate	18.00 €	16.31 €
7/25/2022	Accumulate	13.00 €	11.36 €
8/18/2022	Reduce	11.00 €	11.41 €
8/23/2022	Reduce	11.00 €	10.47 €
8/26/2022	Reduce	11.00 €	10.32 €
9/22/2022	Accumulate	14.50 €	13.25 €
10/13/2022	Accumulate	14.50 €	12.73 €
11/11/2022	Accumulate	16.50 €	14.38 €
12/7/2022	Accumulate	18.00 €	15.87 €



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