Research Update:

Orsted A/S And Orsted Wind Power TW Holding A/S 'twAA/twA-1+' Ratings Affirmed On Steady Performance; Liquidity Revised To Adequate; Outlook Stable

December 5, 2022

PRIMARY CREDIT ANALYST

Irene Lai
Taipei
+ 886-2-2175-6825
irene.lai
@spglobal.com
irene.lai
@taiwanratings.com.tw

SECONDARY CONTACT

Raymond Hsu, CFA
Taipei
+886-2-2175-6827
raymond.hsu
@spglobal.com
raymond.hsu
@taiwanratings.com.tw

Rating Action Overview

- Danish Wind Offshore Giant Orsted A/S should be able to continue its 2023-2025 growth strategy for offshore and onshore wind globally thanks to continued strong results for the first nine months of 2022, with a 34% increase in reported EBITDA year on year to Danish krone (DKK) 14.4 billion (€1.9 billion excluding farm downs).
- Although Orsted will likely report stronger-than-anticipated EBITDA this year, of DKK21 billion-DKK23 billion, higher power and gas prices collateral requirements related to hedges suggest that a higher debt level will lower adjusted funds from operations (FFO) to debt to 35%-40% at end-2022 from our previous expectation of 43%-48%. Our updated FFO to debt estimate is still well within the thresholds for the 'twAA' rating.
- We now view Orsted's liquidity as adequate, due to the volatility in the market, although we acknowledge the very prudent financing lines in place.
- We affirmed our 'twAA/twA-1+' issuer credit ratings on Orsted. We equalize the ratings on Orsted Wind Power TW Holding to those on Orsted because the parent guarantees all obligations of the Taiwan holding company irrevocably and unconditionally, and that all clauses of the guarantee remain unchanged and valid.
- The outlook remains stable, reflecting our expectation that adjusted FFO to debt will remain rating commensurate at well above 25% over 2023-2024. More volatile energy prices and discussions on windfall taxes create some uncertainties, but we expect supporting industry fundamentals, alongside the benefits of Orsted's high proportion of secured profit in its offshore segment during 2022-2026, to sustain credit metrics within our 'twAA' category.

Rating Action Rationale

We think that Orsted's underlying performance will remain steady. The group's strong first-nine-months results prompted us to adjust up our EBITDA expectations for 2022 to DKK22 billion-DKK23 billion (€2.9 billion-€3.1 billion) from DKK19 billion-DKK21 billion previously. We considered the increased earnings from the group's division Bioenergy & Other, which benefits from higher power and gas prices. This segment's EBITDA rose 115% in the first nine months 2022 to DKK5 billion, and we believe earnings will stay on this upward trend on the back of higher prices in 2023-2024. Earnings from wind and solar assets in operation decreased DKK0.6 billion to DKK9.7 billion year on year. This was mainly volume related, i.e. wind speed, which then resulted in a hedge ratio so high that it forced the company to buy power in the market to compensate for loss volumes.

Industry fundamentals will likely support Orsted's expansion. We believe Orsted is in a very good position to continue its growth path. We view the fundamentals for wind offshore globally as strong, particularly in Europe. We anticipate European developments to accelerate on the back of the EU's policy target of massively upping installed capacity from about 20GW today. We view Orsted's business as resilient, and its reported figures are unlikely to weaken materially or for a prolonged period. The setbacks from lower production and hedges are unlikely to last long. About 95% of the company's EBITDA stems from offshore and onshore wind activities in Europe and the U.S., making Orsted more prepared to handle potential economic downturns and price volatility than conventional power generators. Furthermore, a high share of future profit is secured by guaranteed fixed tariffs and guaranteed minimum prices--about 83% before hedges in its offshore segment and 75% of its onshore segment during the 2022-2026 period.

New projects coming on stream in the next two years will sustain operating performance improvements but increasing capital expenditure (capex) will likely weigh on credit ratios. We expect annual capex to ramp up to DKK38 billion-DKK50 billion over 2022-2024, from about DKK27 billion in 2020 and DKK34billion in 2021. That said, this year's FFO to debt should stay at 35%-40%, well above our 23% threshold for the rating. This is thanks to increased EBITDA as well as Orsted's "farm down" model, a common industry practice of rotating assets by selling stakes, typically to institutional investors seeking stable yield over the long term. Since 2018, Orsted has completed nine large asset rotations, raising more than DKK60 billion in disposal proceeds. This somewhat offsets Orsted's constant negative discretionary cash flow, although there will always be uncertainty about timing and pricing of the disposals. This strategy increases the company's investment headroom substantially, as long as assets are divested in a timely manner and enable Orsted to manage its financial ratios, such that they are commensurate with the rating. As such, success of the "farm down" strategy is key to safeguarding Orsted's balance sheet during the company's pursuit of accumulated renewable capacity of approximately 50GW by 2030. By end-October 2022, Orsted had divested 50% stakes in the onshore wind farms Lincoln Land Wind, Plum Creek Wind, and Willow Creek Wind, as well as the solar farm Muscle Shoals with a total capacity of 862 MW; the total consideration was US$410 million. We will likely pro-rata consolidate Orsted's remaining interest in those assets, as we do with the European assets.

We believe Orsted's credit metrics provide enough rating headroom to withstand market volatility. Unrealized hedges and windspeeds have created temporary volatility in reported earnings during 2022, excluding impact from farm downs. However, in our EBITDA and FFO calculations, we eliminate from EBITDA the unrealized gains and losses on various hedging contracts, which somewhat reduces this volatility. Given Orsted's recently announced intention to reduce hedging, we expect hedges to have less of an impact 2023-2024. Also, considering Orsted's high share of income is fixed with tariffs over the 2022-2026 period and the current high power prices, we don't expect tariffs to lead to any major increase in earnings volatility over time. However, collateral requirements may affect debt levels, since the energy market has become more volatile. The collateral requirement has increased to DKK33.5 billion as of end-September 2022 from DKK12.3 billion at end-2021, but we anticipate a decrease toward year-end since both power and gas prices have declined since the end of the third quarter and since the hedges are rolling off. Nevertheless, collateral requirement will continue to affect debt levels in the short term, making it somewhat more difficult to precisely forecast credit ratios. We note that Orsted's decision to reduce hedging leads us to believe the collateral requirement will steadily have less of an impact over the coming few quarters.

Orsted's strategy will support the energy transition in Denmark, confirming the company's importance to the Danish government. Orsted has a strong link with the state, which has maintained its overall majority stake (50.1%) in the company. This is because of the Danish government's commitment to energy transition, and the company's dominant domestic position, despite operating in a liberalized market. As a result, we include a one-notch uplift in the ratings for potential support in extraordinary circumstances.

Outlook

The stable outlook on Orsted reflects our assumption that the wind power segment's operating performance will remain credit supportive over the next two years, thanks to the stable and predictable nature of the segment's operations. We expect that the company's relationship with the Danish government will remain the same, and that there will be no significant changes to Orsted's strategy or financial policies. This underpins our view that the company will report FFO to debt above 25%. We expect the company will have ample headroom in 2022, with adjusted FFO to debt at 35%-40%, declining to 27%-32% in 2023.

Downside scenario

We could lower the rating if Orsted's operating performance deteriorated significantly over the next two years. This could occur due to delays in commissioning new projects, sizable acquisitions, cost overruns, or greater-than-forecast capex. We could also lower the rating by one notch if credit metrics weakened, with FFO to debt below 23% over the next two years. However, this is not our base case.

Nevertheless, we could lower the rating by one notch if we believed that the likelihood of government support had weakened. This could happen, for example, if the government showed less willingness or decreased ability to support its investment in Orsted, or it no longer held a majority stake in the company. We also see this as unlikely over the next two years.

Upside scenario

We see rating upside as constrained by Orsted's existing financial policy. However, we could upgrade the company if it revised its financial policy, leading to stronger, durable credit measures, such as FFO to debt sustainably at 35%-40%. We see this as a remote possibility during the outlook period.

Our Base-Case Scenario

Assumptions

Our base-case assumptions for 2021-2023 are:

- Denmark's real GDP expected to about 2.24% in 2022 after 2.8% in 2021.
- No major acquisitions.
- Offshore and onshore production of about 31-33 terawatt hours (TWh) in 2022, up from 22TWh in 2021, and power production from its bioenergy, power, and heat division at about the same level as in previous years of 5.5TWh-7.0TWh.
- Capex of about DKK36 billion-DKK38 billion in 2022 and DKK42 billion-DKK47 billion in 2023.

Key metrics

Orsted A/S—Key Metrics

BIL.DKK	2020	2021a	2022f	2023f
EBITDA	17,265.0	16,396.0	22.0-23.0	24.5-26.5
Capex	26,508	33,787	36,000-38,000	42,000-47,000
Dividends	5,015	5,394	5,800	6,200-6,500
FFO/debt (%)	54.6	27.7	35.0-40.0	28-35
Debt	24,482	45,251	46,000-55,000	60,000-70,000
Debt/EBITDA (x)	1.4	2.8	1.9-2.5	2.3-3.2

Note: All figures are adjusted by S&P Global Ratings. Capex--Capital expenditure. FFO--Funds from operations. DKK--Danish krone. a--Actual. f--Forecast.

Liquidity

We reassessed Orsted's liquidity as adequate from strong previously, balancing the group's prudent liquidity management with the potential adverse impact of anticipated market volatility. We believe that cash, committed credit facilities, and operating cash flow will cover anticipated cash outflows by about 2.3x over the next 12 months. We also expect that overall liquidity sources will exceed uses even if EBITDA declines by 30%. An absence of restrictive financial covenants in the group's loan documentation and solid relationships with banks further support its liquidity position, in our view. We believe management has acted cautiously during 2022, when rapidly increased gas and power prices heightened the need for cash collaterals, by obtaining several committed credit facilities to improve its liquidity. The amount of undrawn credit facilities rose to about DKK62 billion at end-September from DKK18 billion in March. Furthermore, Orsted has demonstrated good access to international markets; in September 2022 the group issued three bonds totaling approximately €2 billion, on good terms despite market turbulence.

Orsted's hedges, however, expose the company to gas and power price volatility. Because prices have become more volatile, this exposure could result in more security postings and working capital requirement over the next year. This prompts us to project that the group's liquidity sources to uses ratio could go below 1.5x during times of market spikes and underpins our adequate liquidity assessment.

Principal Liquidity Sources:

- Cash and short-term securities of about DKK25 billion as of Sept. 30, 2022;
- Access to about DKK62 billion in undrawn committed credit facilities maturing after one year;
- Cash FFO, which we expect to be DKK 19 billion-DKK21 billion over the next 12 months; and
- Contracted fixed asset sale of DKK1.5 billion-DKK2.0 billion expected over the next 12 months.

Principal Liquidity Uses:

- Debt maturities of about DKK2 billion in next 12 months;
- Anticipated annual net investments of about DKK40 billion in the next 12 months and DKK50 billion in next 24 months; and

- Dividends of DKK6 billion-DKK7 billion to principal and minority shareholders over the next 12 months.

Ratings Score Snapshot

Issuer Credit Rating: twAA/Stable/twA-1+

Note: The descriptors below are on a global scale.

Business risk: Satisfactory

- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: twaa-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twaa-

- Group credit profile: twaa-
- Sovereign rating: AAA
- Likelihood of government support: Moderate (+1 notch from SACP)

ESG credit indicators: E-1, S-2, G-1

Related Criteria & Research

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions - March 02, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings - March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry - March 28, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Principles Of Credit Ratings - February 16, 2011

- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Guarantee Criteria - October 21, 2016

Related Research

- Taiwan Ratings' Ratings Definitions – November 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed	
Orsted A/S	
Orsted Wind Power TW Holding A/S	
Issuer Credit Rating	twAA/Stable/twA-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.taiwanratings.com for further information. Complete ratings information is available to subscribers of Rating Research Service at rrs.taiwanratings.com.tw. All ratings affected by this rating action can be found on Taiwan Ratings' public website at www.taiwanratings.com.