Media Release:

Orsted A/S And Orsted Wind Power TW Holding A/S Downgraded To 'twAA-/twA-1+' On Higher Leverage And Industry Risk; Outlook Stable

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PRIMARY CREDIT ANALYST

James Hung, CFA
Taipei
+886-2-2175-6839
james.hung@spglobal.com
james.hung@taiwanratings.com.tw

SECONDARY CONTACT

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

Overview

- S&P Global Ratings recently lowered the long-term global scale rating on Danish offshore wind company **Orsted A/S** to 'BBB' from 'BBB+' and removed the ratings from CreditWatch with negative implications. The rating agency also lowered its assessment of Orsted's stand-alone credit profile (SACP) to 'bbb-' from 'bbb'.
- This followed the announcement by Orsted of its updated strategy which focuses on less ambitious growth and capital expenditure (capex), and no dividends for three years. The company reported impairment costs and cancellation costs of Danish krone (DKK) 36 billion (€4.8 billion) in 2023, primarily from its U.S. offshore projects.
- We perceive the offshore wind industry as riskier than before--particularly in the U.S. where we note Orsted's weak project management, but we expect the company will be able to successfully manage the substantial industry risks it faces thanks to its remaining investment and divestment plans.
- We have therefore lowered the long-term Taiwan scale issuer credit rating on Orsted A/S and **Orsted Wind Power TW Holding A/S** (Orsted TW) to 'twAA-' from 'twAA' and affirmed the short-term rating at 'twA-1+'. At the same time, we removed the ratings from CreditWatch with negative implications where we placed them on Nov. 6, 2023.
- The stable outlook reflects our view that Orsted's updated strategy should help improve its funding ratio (based on S&P Global Ratings ratio of adjusted funds from operations (FFO) to debt) to 23%-24% in 2024 and to 25%-30% from 2025. We forecast Orsted's EBITDA for 2024 in the range of DKK23 billion-DKK26 billion (excluding farm-downs) and we expect the company will benefit from a high share of contracted revenue, which should continue to support its business risk profile.

Rating Action Rationale

The downgrade reflects our view of Orsted and Orsted TW's higher leverage on its balance sheet and our view of increased industry risk. Weaker project management and tougher-than-expected local market conditions that triggered major impairments in 2023 have diluted Orsted's credit profile. We now view construction of offshore wind parks as riskier than in the past, notably in the U.S. In Europe, the key challenge facing the company is the effect of inflation on capex. We see Orsted's business risk profile as weaker than one year ago, albeit still satisfactory. Most impairments were related to U.S. offshore projects Ocean Wind 1 (DKK19.9 billion), Sunrise Wind (DKK2.1 billion), and Revolution Wind (DKK2.7 billion). Orsted's provision for cancellation fees of DKK9.6 billion, together with the total impairments of DKK26.8 billion, represent forgone investment. In effect, over 2023 Orsted has not produced any significant FFO. While we expect project management to considerably improve, the 'bbb-' SACP reflects our expectation that Orsted will have to rebuild its track record.

We view positively Orsted's plan to make substantial changes to its strategy, which now incorporates:

- Reduced build out ambitions, implying less capex and roughly stable S&P Global Ratings-adjusted debt at DKK65 billion-DKK75 billion over 2023-2026.
- Lower exposure to the U.S., as Orsted plans to keep only a minority stake in key offshore fields.
- Dividend cuts for three years.
- An increased farm-down program over 2024-2026 including Hornsea 3.

We view positively that Orsted will reduce its exposure to U.S. offshore, a riskier and less-mature market than that in the U.K. Virtually all of Orsted's 2023 impairments and cancellation costs were related to its U.S. business, primarily offshore. These losses are the largest that we know of in global offshore and approximate to Orsted's consolidated EBITDA over 2022 and 2023. For the longer term, keeping a footprint in U.S. offshore might allow Orsted to benefit from high growth if supply chain, pricing, and regulatory conditions evolve in line with the U.S. federal and state's ambitions for offshore wind.

We expect credit ratios to recover in 2024 and 2025 from a very low level in 2023. We now forecast Orsted will generate EBITDA of DKK24 billion-DKK26 billion in 2024, which is materially lower than our previous forecast of DKK33 billion-DKK37 billion, increasing further to DKK29 billion-DKK31 billion in 2025. This is the combined effect of lower power price assumptions for its merchant power generation exposure, less trading profitability, and slower ramp up of the Greater Changhua 1+2a, South Fork, and Gode wind farms. This is despite Orsted having a limited part of its EBITDA exposed to merchant power prices, which gives a good visibility into its earnings profile. We primarily expect growth from new fields coming on stream, as we exclude all farm-down profit from EBTIDA in our analysis. EBITDA generation in 2024 and 2025 should also be supported by the announced efficiency program, including some job cuts. Given Orsted did not meet our expectations for its core operations' 2024 EBITDA prospects (separate from U.S. offshore issues), we will monitor the extent to which contracting substantially protects it from commodity price variations in the future.

We expect the debt level to be relatively stable over 2024-2026.

This will depend on Orsted's ability to execute its farm-down strategy, which it plans to accelerate. Over 2024-2026 we assume farm downs of about DKK75 billion, which should reduce risk exposure to a single asset. This will support the credit ratios, together with the dividend pause. Orsted has a strong record of executing farm downs. In 2022 and 2023, it received cash inflow of DKK8.2 billion and DKK24 billion. Any delays or lower prices than assumed could pressure the rating. We perceive the three-year dividend cut as a strong commitment to supporting the credit profile. We now forecast FFO to debt at 23%-25% for 2024, just below our minimum expectation of 25%, before improving to 25-30% on average in 2025-2027, potentially slightly higher in some years depending on the timing of farm downs.

The new strategy is subject to execution risk. This is most notably because of its farm-down strategy in the U.S., where Orsted plans to divest majority stakes in its key offshore fields such as Revolution Wind, and South Fork over 2024 and 2025. Keeping only a minority stake (25%) is a departure from Orsted's previous strategy. We perceive this as a way to reduce the risk, because the acquirer of the majority stake will be responsible for the pro-rata share of capex as well as potential cost overruns. Furthermore, there is a risk of a DKK5.5 billion write down if Sunrise Wind does not receive a new offshore renewable energy contract, which is beyond Ortsed's control. This would be in addition to the existing DKK1.8 billion write down in 2023. We expect the outcome to come toward the end of first quarter 2024.

The change in strategy implies a material downward revision of Orsted's growth profile over 2024-2030, but it still includes material investments. In its new strategy, Orsted assumes a lower growth rate, so that its gross installed capacity would reach about 35-38GW compared with its Capital Markets Day 2023 aim of 50GW. However, on a net basis, Orsted expects this to be about 23GW--including some minorities. This will still require significant investments, and we expect gross investments of about DKK125 billion over 2024-2026. This is lower than the about DKK155 billion we previously assumed, but still significant. Orsted will still be exposed to construction risk, suppliers' ability to deliver equipment, and other parameters that might be outside of the group's control. We believe this is notable for Hornsea 3 in the U.K., on which Orsted took a financial investment decision in December 2023 and for which we expect a substantial farm down by 2025. This is one of the biggest renewable projects globally outside of China, with capex at 100% in the high single-digit billions (over three years of FFO), and capacity of 2.9 GW once completed in around 2027. We understand all major contracts for Hornsea 3 are in place but given the company's recent operational and management setbacks, we are closely monitoring its execution including a contract for difference rebid in round 6.

We continue to consider Orsted as a government-related entity (GRE) that benefits from a moderate likelihood of extraordinary government support from Denmark. We therefore include one notch of uplift to the ratings. This is based on our assessment of Orsted's strong link with the Danish government, which has a majority stake in the company of 50.1% currently, as well as its limited role for the government.

Outlook

The stable rating outlook reflects our expectation that adjusted FFO to debt will improve to 25%-30% by 2025 through a successful execution of Orsted's new strategy. This includes timely delivery of key projects under construction and proceeds from farm downs that do not materially deviate from our expectations. We forecast 2024 EBITDA in the range of DKK23 billion-DKK26 billion (excluding farm-downs) and expect Orsted will benefit from a high share of contracted revenue. Any further changes could very quickly lead to rating pressure. We expect Orsted's relationship with the Danish government to be unchanged, and that the company will not alter its strategy or financial policies.

Downside scenario

We could lower the rating if Orsted's operating performance did not considerably improve over the next two years, relative to its recent record. This could occur if it experienced delays in the implementation of its strategy, failed to execute on its farm downs, made more impairments, or if its capex exceeded our forecast. Also, we could downgrade the company if credit metrics weakened, such that FFO to debt did not recover to 25% or more by 2025, as it does in our base case.

We could also lower the rating by one notch if we believed that the likelihood of government support had weakened. We could take this view if the government seemed less willing or able to support Orsted, or if it no longer held a majority stake in the company. Again, we see this as unlikely over the next two years.

Upside scenario

In our view, a positive rating action is constrained by Orsted's rebuilding of its track record of successful strategic execution and fluid offshore industry developments. We would likely expect a period of proven project execution and durably stronger credit measures, such as FFO to debt sustainably above 30%, before we could consider a one-notch upgrade.

Company Description

Orsted A/S, previously known as DONG Energy, was founded in 1972. The group has been operating in the offshore wind sector since 1991 and is one of the global market leaders (excluding China) in the sector. It has 9.9 GW of constructed capacity as of third quarter 2023, 15.5GW on which a financial investment decision had been taken or was under discussion.

Orsted currently operates in three business segments:

- Offshore Wind: It contributed about 62% of total EBITDA in 2022, versus 87% in 2019. It is expected to remain the core business segment of Orsted.
- Onshore Wind: A new established business unit from fourth-quarter 2018 with the acquisition of Lincoln Clean Energy (LCE). This includes the development, ownership, and operation of onshore wind and solar farms in the U.S., Ireland and Germany. It contributed about 11% in 2022.
- Markets & Bioenergy: Contributed about 27% of total EBITDA in 2022.

Our Base-Case Scenario

Assumptions

Our base-case assumptions for 2024-2026 are:

- Successful rebidding of part of Hornsea 3 and Sunrise.
- No major acquisitions, although smaller bolt-on acquisitions may be included in capex.
- Capex of DKK48 billion-DKK55 billion in 2024 and DKK35 billion-DKK40 billion in 2025.
- No parent-company shareholder distributions over 2024-2026.
- Farm-down cash proceeds to total about DKK75 billion over 2024-2026.

Key metrics

Orsted A/S--Key Metrics

	--Fiscal year ended Dec. 31--				
BIL.DKK	**2021a**	**2022a**	**2023a**	**2024f**	**2025f**
EBITDA	16.4	21.1	13	23-26	29-33
FFO	12.5	16.5	~3	17-19	18-20
Capex	33.8	32.4	38	48-55	35-40
FOCF	(22.6)	(21.2)	(8-11)	(38-42)	(9-11)
Dividends	5.4	5.8	6.4	0	0
FFO/debt (%)	27.7	28.1	~5	23-25	25-30
Debt	45.3	52.8	68-70	75-80	65-75
Debt/EBITDA (x)	2.8	2.5	>5	2-2.5	1.8-2.3

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

The short-term rating on Orsted is 'twA-1+' We see the company's liquidity as adequate, balancing the group's prudent liquidity management with the potential adverse impact of the expected market volatility and continued negative discretionary cash flow.

We estimate that cash, committed credit facilities, and operating cash flow will cover anticipated cash outflows by about 1.9x over the next 12 months. We also expect that, overall, liquidity sources will exceed uses, even if EBITDA declines by 30%. The liquidity position is also supported by the absence of restrictive financial covenants in the group's loan documentation and its solid relationships with banks. We consider that management acted cautiously during 2022 and 2023, when rapid increases in gas and power prices heightened the need for cash collateral, which supports our view of prudent liquidity management. The group obtained several committed credit facilities to improve its liquidity.

The company has also frequently demonstrated that it has access to the international bond market, including during turbulence. That said, after the recent impairments and cost overruns, Orsted has not been active in the international capital market. Furthermore, Orsted's hedges expose it to gas and merchant power prices, which could quickly affect our liquidity calculation and ratio. Orsted's exposure to increasingly volatile prices could lead to more security postings and increase its working capital requirements over the next 12 months. Nevertheless, the exposure has reduced, compared with 2022, as prices have softened, and Orsted's hedging ratio is now lower.

We anticipate the company will have the following principal liquidity sources over the next 12 months:

- Cash and short-term securities of about DKK40 billion as of Dec. 31, 2023;
- Access to about DKK50 billion in undrawn committed credit facilities maturing after one year; and
- Cash FFO of DKK12 billion-DKK14 billion over the next 12 months.

We anticipate the company will have the following principal liquidity uses over the same period:

- No meaningful debt maturities;
- Annual net investments expected about DKK50 billion in the next 12 months and DKK35 billion-DKK40 billion in the following 24 months; and
- No major acquisition, no dividends

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

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: twa+

Modifiers

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

Stand-alone credit profile: twa+

- Likelihood of government support: Moderate (+1 notch from SACP)

Related Criteria & Research

Related Criteria

- Criteria | Corporates | General: Corporate Methodology - January 07, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities - January 07, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology - June 08, 2023
- 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
- 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
- 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

- Wind Giant Orsted A/S Downgraded To 'BBB'; Outlook Stable, www.capitaliq.com – February 8, 2024
- Taiwan Ratings' Ratings Definitions – Nov. 11, 2021

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

Ratings List

Downgraded; CreditWatch Action

	To	From
Orsted A/S		
Orsted Wind Power TW Holding A/S		
Issuer Credit Ratings	twAA-/Stable/twA-1+	twAA/Watch Neg/twA-1+