FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms RWE at 'BBB+'; Outlook Stable

Wed 28 Feb, 2024 - 12:19 ET

Fitch Ratings - Frankfurt am Main - 28 Feb 2024: Fitch Ratings has affirmed RWE AG's Long-Term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook. A full list of rating actions is below.

The affirmation reflects RWE's resilient business profile and strong position as a large and increasingly clean generation company. RWE has fairly predictable cash flows, supported by a good share of quasi-regulated EBITDA in high-quality jurisdictions. We view the focus on clean technologies in the medium term as positive for the company's business profile, while the coal business will be phased-off by 2030 and has been reclassified as non-operating by the company.

We expect heavily negative free cash flow (FCF) in 2024 and 2025 due to very high capex, which would lead to an increase in nuclear-adjusted funds from operations (FFO) net leverage to 2.7x by end-2025, above the negative rating sensitivity of 2.5x. However, RWE has various tools to maintain leverage within its rating sensitivities, albeit not included in our rating case, and targets to maintain the current rating, which supports the Stable Outlook.

KEY RATING DRIVERS

Investments in Renewables Accelerated: RWE has an ambitious target of EUR55 billion net capex over 2024-2030, of which 75% relates to renewables expansion. It aims to add more than 30GW of net capacities to reach more than 65GW in 2030. In 2030, solar should represent 25% of the portfolio, followed by onshore wind (20%) and offshore wind (15%). We expect total installed capacity in 2030 to be spread mainly across the US (30%), Germany (25%) and the UK (25%).

Increasing Leverage, No Headroom: Fitch expects leverage to increase due to the accelerated capex plan. We forecast nuclear-adjusted FFO net leverage (excluding variation margins) to rise to 2.7x in 2025 from 0.2x in 2022, above the 2.5x negative sensitivity. RWE has also revised its own leverage target (company-defined net debt/adjusted EBITDA) to 3.5x post-2025 from 3.0x currently. We estimate the company's new target of 3.5x to translate into Fitch-defined nuclear-adjusted FFO net leverage of around 2.5x-3.0x.

Target to Maintain Rating: The Stable Outlook factors in RWE's target to maintain the current rating and the various tools available for management to control leverage, including issuing hybrids and increasing asset rotation. None of these measures are currently included in our rating case. A sustained nuclear-adjusted FFO net leverage above 2.5x without any visible mitigating measure would result in a negative rating action.

Flexible Generation Still Key: Flexible generation (FlexGen) plays an important role in RWE's strategy, according to management, complementing its renewables portfolio and ensuring supply security. It will account for 15% of investments in 2024-2030 and should account for 30% of installed capacity in 2030. Batteries account for 10% of planned capex in 2024-2030 with an installed capacity of 6GW in 2030, from less than 1GW currently. We expect EBITDA from FlexGen to normalise after a peak in 2023 on high energy prices, but to remain above historical levels in 2024-2026.

Non-core Business to Diminish: RWE phased out nuclear in April 2023 and targets to exit coal in 2030. It expects the share of coal capacity to decline to below 10% by end-2027. Starting from 2024, the non-core business (coal/nuclear) will be reported under non-operating result. This supports RWE's strategy for energy transition and is positive for its business profile in the medium term. Exposure to coal is still a weakness on the company's debt capacity, especially compared with 'BBB' category peers that mostly have a cleaner asset base.

Quasi-regulated Earnings to Increase: Higher energy prices in recent years have resulted in a dilution of quasi-regulated businesses in their EBITDA share, which fell below 40% in 2021-2023. However, we expect the share to rise to 54% in 2025, with the normalisation of energy prices and the expansion of renewables. RWE derives about 70% of earnings from wind and solar under secured support schemes with a remaining support tenor of 14 years on average. RWE also benefits from capacity payments in the UK gas segment, which represent about 25% of FlexGen earnings.

The increase in the share of quasi-regulated earnings and the gradual decrease of coal exposure will improve the business profile of RWE and could lead to a marginally higher debt capacity.

High Capex Drives Negative FCF: We expect RWE's ambitious capex plan to translate into deeply negative FCF of an estimated EUR9 billion on average in 2024-2025. We forecast a cumulative capex of EUR23.1 billion over 2024-2025, the majority of which will be on renewables. We also forecast a steady increase in dividends, in line with management's public commitment. The higher capex and dividends will lead to a gradual increase in net debt (excluding nuclear liabilities) to almost EUR9 billion by end-2025, from a net cash position of EUR4 billion in 2022.

Ambitious Investment Strategy: RWE has clear investment criteria, as it targets a spread of 100bp-300bp over weighted average cost of capital and an average investment return rate of 8%, which could become more challenging to achieve under recently lower electricity forward prices. RWE has 7.8GW of capacity under construction and a development pipeline of more than 100GW, ensuring flexibility in investment choices. Fitch believes that M&A is not central to the investment strategy, but it may help RWE to achieve its EUR55 billion net investments in 2030.

DERIVATION SUMMARY

RWE is one of the largest German utilities focusing on generation from renewable sources as well as FlexGen (hydro, biomass and gas). RWE's closest peers are European generation companies, like Fortum Oyj (BBB/Stable), Statkraft AS (A-/Stable; Under Criteria Observation), and Orsted A/S (BBB+/Stable). RWE has a materially higher share of quasi-regulated business than Fortum, but remains more exposed to thermal generation, which ultimately leads to a broadly similar debt capacity.

RWE's rating is at the same level as the Standalone Credit Profile of Statkraft (bbb+). While both companies have comparable size in revenue, the Nordic utility has a better generation mix due to its low-cost, flexible hydro-asset base and lower exposure to thermal generation. However, RWE has higher share of quasi-regulated earnings and no emerging-market exposure, which drives an overall similar debt capacity.

Orsted has a higher debt capacity of 3.2x versus RWE's 2.5x for the same rating. This reflects Orsted's 80% quasi-regulated cash flow, a greater proportion of renewables in its generation mix and long-term price support mechanisms for its offshore wind power business, which are partially offset by its higher concentration.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Installed capacity to increase to 52GW in 2025, including 22.4GW from wind and solar, 22GW from FlexGen, and 8GW from coal

- Fitch-defined EBITDA to decline in 2024-2025 compared with 2023, but to remain above historical levels on average at EUR4.5 billion per year

- Average capex of EUR11.6 billion a year in 2024-2025

- Total disposals of EUR5.1 billion in 2024-2025

- Average dividends about EUR780 million a year in 2024-2025

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- We currently do not anticipate an upgrade to the 'A' category. Upside is limited by RWE's business profile as an electricity generation utility with no networks and its sizeable thermal exposure. However, signs of a quicker shift to renewables, for example with over 75% contribution from quasi-regulated activities to EBITDA, while keeping leverage low, could lead to positive rating action.

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Deterioration of the business profile, for example due to delays in execution of investments in renewables, lower-than-expected profitability of new assets or persistently depressed electricity prices

- Nuclear-adjusted FFO net leverage above 2.5x on a sustained basis

LIQUIDITY AND DEBT STRUCTURE

Strong liquidity: We estimate RWE had about EUR16 billion of cash and marketable securities at end-2023, and available revolving credit facilities of around EUR10 billion. This compares with no bond maturities and forecast negative FCF of EUR6.7 billion in 2024.

In July 2023, RWE signed a EUR5 billion syndicated credit facility with a consortium of 28 banks to support its commodity-hedging activities. The facility has a maturity of one year (with extension options). The company also has credit lines of EUR3 billion and EUR2 billion, which run until April 2026. In addition, RWE's 15% stake in E.ON (around EUR4.5 billion) is a source of financial flexibility if it decides to divest the stake in full or in part.

ISSUER PROFILE

RWE is a power generation and trading company. It is one of the largest utilities in Germany with operations in several other European markets and worldwide.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

RWE has an ESG Relevance Score of '4' for 'GHG Emissions & Air Quality' and 'Energy Management'. ESG issues affect the ratings primarily through the presence of coal in RWE's generation fuel mix. These factors have a negative impact on the credit profile, and are relevant to the ratings in conjunction with other factors. However, RWE has been reducing its carbon footprint and is on a decarbonisation path with the CO2 neutrality goal set for 2040. In addition, the company agreed to exit coal in 2030.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
RWE Finance US, LLC				
senior unsecured	LT	BBB+	New Rating	
RWE AG	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable

	ST IDR	F1	Affirmed	F1
senior unsecured	LT	BBB+	Affirmed	BBB+
subordinated	LT	BBB-	Affirmed	BBB-
senior unsecured	ST	F1	Affirmed	F1

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Yesmine Arousse
Senior Analyst
Primary Rating Analyst
+49 69 768076 148
yesmine.arousse@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Jad Salem
Director
Secondary Rating Analyst
+971 4 424 1245
jad.salem@fitchratings.com

Antonio Totaro
Senior Director
Committee Chairperson
+39 02 9475 8280
antonio.totaro@fitchratings.com

MEDIA CONTACTS

Isobel Burke
London
+44 20 3530 1499
isobel.burke@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

RWE AG	EU Issued, UK Endorsed

DISCLAIMER & DISCLOSURES

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s Regulatory Affairs page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.