Research Update:

Urenco Upgraded To 'A-' On Nuclear Industry Resurgence; Off CreditWatch; Outlook Stable

June 15, 2023

Rating Action Overview

- The push for energy security and lower carbon emissions in Europe will support healthy prices for Urenco's services and further increase its nuclear enrichment order backlog after years of shrinkage.
- In response to the changing environment, the company has recently reshuffled its business plan, addressing its capital expenditure needs, returns to shareholders, and managing its material decommissioning liabilities.
- With a robust capital structure, financial flexibility, and supportive credit metrics, the company's financial risk profile is stronger than ever.
- We therefore raised our long-term issuer credit rating on Urenco to 'A-' from 'BBB+', and removed the rating from CreditWatch positive, where we placed it on March 10, 2023.
- The stable outlook reflects the company's ability to enjoy the renaissance of the nuclear industry in the coming years, leading to a material increase in its backlog while building and executing its growth plan without jeopardizing its financials.

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Rating Action Rationale

Energy security discussions in Europe, prompted by the war in Ukraine, are already leading to improved prospects for the nuclear power generation industry. Urenco closed 2022 with a backlog of €10.8 billion (an increase of 24% compared with the previous year) after close to a decade of decline. This is the reverse of our projection of two years ago, which assumed a sharp decrease in the backlog to €5 billion-€6 billion by 2026. According to the company's updated market forecast, nuclear installed capacity is likely to increase by 10%-20% by 2040 (compared with a previous assumption of a more than 30% decline). The change in forecast may support our assessment of Urenco's business risk profile as strong for several years.

Higher capital expenditure (capex) and higher decommissioning liabilities. With higher demand for its services, Urenco is moving from scaling down its overall capacity to maintaining and planning for expansion. In 2022 the company's capex was about €175 million, mostly on maintenance, compared with about €5 billion expected over the coming decade (peak investment of about €0.7 billion in 2027). The capex program (excluding the expansion of the tail management facility [TMF]) is not linked to a single site, and the company will prioritize between the different sites. As of today, none of the projects were approved, and each one of them will be backed up by a long-term contract. The increase in the capacity will also mean that the company's decommissioning liabilities are set to increase (the company will produce more tails). Urenco now forecasts an increase in its decommissioning liabilities to about €5.4 billion by 2031 (with a further increase later on), compared with its previous forecast of an increase to about €4.1 billion.

Capital structure will remain under control, supported by a flexible financial policy. Urenco finished 2022 with reported excess cash of more than €600 million, after reaching a major milestone of being net debt-free as of year-end 2021. According to the company's recently revised financial policy, it aims to balance between its growth needs, managing its long-term €2.4 billion environmental liabilities, and delivering higher returns to its shareholders. Under our base case, we project discretionary cash flow (after capex and dividends) of €0.2 billion-€0.4 billion per year to be used to decrease decommissioning liabilities. Consequently, the company will be able to maintain its adjusted debt at a level of €1.9 billion-€2.0 billion in the coming three years, in line with the level as of December 2022. In our view, the nature of the debt, being a very long-term liability (rather than a financial liability), the flexibility around the dividend, and the high visibility given its backlog mean that the debt is very manageable. For example, a decision by the company to decrease its dividends by €100 million a year would eliminate its liabilities at a very rapid pace. Lastly, the company's liquidity remains strong with hefty cash on the balance sheet, no immediate maturities, and strong cash flows.

Urenco selected indicators: comparison of two periods

Period	**2014-2016**	**2021-2023**
Business risk profile	Strong	Strong
Financial risk profile	Intermediate	Modest
Backlog	€15.5 billion (Dec. 2016) – Expecting an gradual decline to €5 billion-€6 billion by 2026.	€10.8 billion (Dec. 2022) – Expecting a gradual increase toward €15 billion in by 2025.
EBITDA (mil. €)	1,150	860 *
Adj. debt	$4.0 billion (of which $2 bn of gross financial obligations)	$1.9 billion (of which $1 bn of gross financial obligations)
Adjusted FFO-to-debt	21%	35%-40%

*Projected EBITDA for 2023 doesn't include one-off contracts and the lag between spot prices and legacy contracts.

Outlook

The stable outlook reflects the company's ability to enjoy the renaissance of the nuclear industry in the coming years, leading to a material increase in its backlog while building and executing its growth plan without jeopardizing its financials.

Under our base case, we forecast adjusted EBITDA of about €800 million in 2023, which would translate into adjusted funds from operations (FFO) to debt of 30% or slightly better (with improvement toward 40% starting in 2024). We view a minimum level of 35% as commensurate with our 'A-' rating. Our rating also incorporates the company's ability to replenish its backlog toward €15 billion over the coming years.

Lastly, our rating factors in no changes in the company's ownership structure. Even if ownership changed, we expect a limited impact, if any, on the rating.

Downside scenario

We don't expect negative pressure on the rating in the coming 12-24 months. Downside to the rating could emerge in one of the following scenarios:

- A complete U-turn in market sentiment toward nuclear (for example due to a catastrophic nuclear accident resulting in a social pressure to curb existing and future use of nuclear). In this case, the company's backlog would shrink.
- A generous dividend policy on top of an extensive capex plan that led to an increase in the company's overall debt and its adjusted FFO to debt falling below 35% for an extended period.

Upside scenario

We believe that 'A-' is the maximum rating level for the company, based on its current business position. This would be the case even if the company had no financial debt (including decommissioning liabilities).

Company Description

Urenco is a leading uranium enrichment services supplier to the civil nuclear industry. It serves around 50 utilities across 19 countries, contributing to the provision of low carbon electricity through nuclear generation. More than 90% of earnings stem from uranium-enrichment tolling services using low-cost-to-use centrifuge technology.

Urenco has a production capacity of 17.9 million separative work units per year, compared with about 7.5 million for peer Orano. It operates four plants in four countries (Germany, the Netherlands, the U.K., and the U.S.), which gives it flexibility of supply. The U.K.-based TMF allows Urenco to treat depleted uranium "tails" prior to final disposal, effectively providing in-house de-conversion services.

In 2022, Urenco generated revenue of €1.7 billion and adjusted EBITDA of €0.82 billion.

One-third of Urenco's shares are held by the U.K. government, one-third by the Dutch government, and one-third by German utilities RWE and E.ON (the latter via its subsidiary PreussenElektra).

Our Base-Case Scenario

Under our base case, we project EBITDA of at least €0.8 billion in 2023, increasing to close to €1 billion in 2024. We note that the results in 2023 will continue to reflect legacy contracts (volumes and prices). Favorable new contracts will translate into higher profitability gradually over the coming years.

Assumptions

- Prices. After their peak in 2022, we expect uranium and enrichment spot market prices to gradually decrease over the next few years but remain higher than long-term average prices. The change in spot prices will have a limited effect on Urenco's results over the near term.
- Backlog. Gradual increase in enrichment services on back of a supportive environment for nuclear energy with the backlog reaching €15 billion over the coming three years. The backlog is also subject to foreign exchange changes.
- EBITDA margin of 55%-60% in 2023-2024 (before the potential impact of any noncash provisions). We understand that margins are subject to temporary changes in the mix of customers.
- Capex. In 2023, capex would be mostly driven by maintenance levels (about €150 million), with growth projects starting from 2024, in line with company's long-term objective of maintaining capacity of 18 million separative work units (SWU) per year. The assumption reflects the company's maximum spending, and would be closely linked to the increase in the backlog
- Dividends. In line with Urenco's financial policy and the previous few years' distributions.
- No acquisitions, disposals, or share buybacks.

Key metrics

Urenco Ltd.--Key metrics*

(Bil. €)	2022a	2023e	2024e
Backlog	10.8	11-12	12-14
Revenue	1.7	1.8-1.9	1.9-2.0
EBITDA*	0.8	0.8	1.0
Capital expenditure	0.17	0.3	0.4-0.45
Free operating cash flow (FOCF)*	0.4	0.5-0.6	0-(0.2)
Dividends	0.3	0.3	0.3
Discretionary cash flow (DCF)*	0.6	0.2-0.3	0.4-0.6
Funding decommissioning liabilities (FDC)	0.5	0.0	0.9
DCF post FDC	0.1	0.2–0.3	(0.4)–(0.5)
Reported net debt/(net cash)	(0.1)	(0.3)–(0.4)	0.1-0.2
Net decommissioning liabilities	2	2.2–2.3	1.5-1.6
Debt to EBITDA (x)*	2.7	About 2.5	< 2.0
FFO to debt (%)*	32.5	About 30	> 40

a--Actual. e--Estimated.

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Liquidity

We continue to assess the company's liquidity as strong, reflecting the cash on balance sheet, availability of funds under its committed credit facilities with maturity over 12 months (October 2027), and its plan to use positive discretionary cash flow to continue redeeming its debt. We calculate that liquidity sources cover uses by more than 1.5x for next 12 months and by more than 1.0x for subsequent 12 months starting Jan. 1, 2023.

Other factors supporting Urenco's liquidity include the absence of financial covenants, its strong relationship with key banks reflected in the sustainability-linked €500 million revolving credit facility (RCF) maturity, fully undrawn and committed. We also factor in management's willingness to maintain this healthy liquidity profile, which is commensurate with our strong assessment. The next material debt maturity is in December 2024.

Principal liquidity sources as of Jan. 1, 2023, for the next 24 months:

- Cash and liquid investments of €1.3 billion as of Jan. 1, 2023;
- Undrawn committed bank lines of €500 million expiring in October 2027;
- Cash FFO of more than €0.7 billion in next 12 months.

Principal liquidity uses as of Jan. 1, 2023, for the same period:

- No debt maturities until December 2024 when its €500 million Eurobonds come due;
- Seasonal working capital requirement of potentially up to €200 million in each year;
- Capex of €250 million in next 12 months, increasing to about €285 million in the subsequent 12 months;
- Dividend payment of €300 million in 2023 decreasing to €275 million in 2024;

- Limited working capital changes.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-3, G-2

Nuclear energy (currently about 10% of global electricity generation) remains an important tool to limit global carbon dioxide emissions and therefore could play an important role in the energy transition. In our view, the contribution of nuclear in the future will reflect different countries' aim to ensure energy security and address concerns (especially after the Fukushima accident in 2011). That said, no two countries have the same view on the future use of nuclear power:

- The U.S. (over 50% of Urenco's revenue) remains broadly supportive of nuclear power--including $6 billion of subsidies for nuclear plants earmarked as part of the 2021 Infrastructure Investment and Jobs Act.
- Europe (about 30% of Urenco's revenue) lacks a consistent approach to policy within the EU (taxonomy for sustainable finance), which is a key concern for Urenco's long-term business prospects. The U.K. remains a strong proponent of nuclear power. France is supportive and recently announced that it will restart building new nuclear reactors after a decades-long pause, given energy security needs and commitments to carbon emission neutrality by 2050. The Netherlands has also recently announced that about €500 million will support the development of the expansion plans for its nuclear energy fleet; two new units are planned that would be on-line by the end of the decade, and the lifespan extension for the Borssele reactor has been confirmed. The EU will need to approve any state support for building new nuclear plants. A key roadblock in this respect is that nuclear energy is not included in the EU taxonomy on sustainable finance, which means that it does not qualify for support from the EU's economic growth funds. However, compared to the past, nuclear energy is viewed as neutral rather than negative (as for coal and oil).

For full details, see "Urenco Ltd.," published May 11, 2022, on RatingsDirect.

Issue Ratings--Subordination Risk Analysis

Capital structure

Following the repayment of its €405 million notes at maturity in August 2022, Urenco's capital structure consists of:

- €500 million senior unsecured eurobonds due December 2024;
- Recently issued €500.0 million of Eurobonds due in June 2032 carrying effective interest rate of 3.25%. The bonds rank pari passu with other unsecured obligations.
- Japanese yen (¥) 20 billion unsecured loan at the Urenco Ltd. level maturing in April 2038 and fully drawn at end-2020.

In addition, Urenco maintains a fully available undrawn €500 million senior unsecured RCF at the parent level, maturing in October 2026. The instrument is pari passu with all other unsecured debt.

Analytical conclusions

There are no elements of subordination risk in Urenco's capital structure. We rate the senior unsecured Eurobonds in line with the 'A-' issuer credit rating on the company.

As of Dec. 31, 2022, Urenco had €2.2 billion of asset-retirement obligations, which we do not take into account in our subordination risk analysis.

We understand that the company will continue to reduce its gross debt over the coming years to address the structural changes in the market. This is unlikely to affect our subordination risk analysis.

Ratings Score Snapshot

Issuer Credit Rating	A-/Stable/--
Business risk:	Strong
Country risk	Low
Industry risk	Intermediate
Competitive position	Strong
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	a
Modifiers:	
Diversification/Portfolio effect	Neutral (No impact)
Capital structure	Neutral (No impact)
Financial policy	Neutral (No impact)
Liquidity	Strong (No impact)
Management and governance	Fair (-1 notch)
Comparable rating analysis	Neutral (No impact)
Stand-alone credit profile:	a-

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- 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 7, 2017
- General Criteria: Guarantee Criteria , Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions , March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global

Corporate Issuers , Dec. 16, 2014

- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology , Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities , Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating , Oct. 1, 2010

Ratings List

Upgraded

	To	From
Urenco Ltd.		
Issuer Credit Rating	A-/Stable/NR	BBB+/Watch Pos/NR
Senior Unsecured	A-	BBB+/Watch Pos
Urenco Finance N.V.		
Senior Unsecured	A-	BBB+/Watch Pos