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Research Update:

French Nuclear Company Orano Upgraded To 'BBB-' On Lower Leverage And Improved Business Prospects; Outlook Stable

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Rating Action Overview

- We expect nuclear market pricing to benefit from previous capacity curtailments and this will become more pronounced if the current European energy crisis translates into increased demand for nuclear over the medium and long term.
- Debt reduction has been ongoing at Orano since 2017. In addition, the sizable end-of-lifecycle liabilities have become less volatile. We understand that the company is aiming to use its free cash flows in the coming years to further improve its capital structure, as well as invest in its business.
- In our view, major milestones (including key projects and contracts) will now move into the spotlight, and this could further de-risk the company's business model.
- We therefore raised to 'BBB-' from 'BB+' our long-term ratings on Orano and its senior unsecured bonds.
- The stable outlook reflects our expectation of robust results in the next 12-18 months, positive momentum in the nuclear industry, and deleveraging at Orano.

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Rating Action Rationale

The rating action is based on stronger market fundamentals coupled with Orano's continued balance sheet strengthening. The nuclear energy market currently benefits from previous capacity curtailments (including shutting down uranium mines and phasing out enrichment facilities) which have supported a steady recovery of prices. The positive trend could get a material boost if the current European energy crisis translates into increased demand for nuclear over the medium and long term. We note that several governments in Europe have changed their plans regarding their aging nuclear power plants and may even approve new nuclear power plants. For example, France announced that it would build six new nuclear reactors as well as extend the operation lifetime of the existing fleet. Construction will start in 2028. Furthermore, nuclear energy has recently been admitted in the EU Taxonomy for green energy, albeit as a transitional energy source, allowing for investments in the sector to be marketed with a green label. We believe this will further strengthen Orano's business prospects. In addition, utility companies will seek to replace the enriched uranium coming from Russia (about 35% of the global market share).

Slow and steady deleveraging will continue until 2025 when the company is expected to meet its financial objectives. Moreover, since Orano's creation as a spin-off of Areva in 2017, Orano has built a track-record of stable earnings and deleveraging. On a multiyear average, the company reported EBITDA of over €1 billion a year, translating into a cumulative free cash flow of €1.2 billion (2018-2021). As of June 30, 2022, the company's adjusted debt was €3.5 billion compared with €5.0 billion as of Dec. 31, 2017. Under our base case, we expect Orano to post average EBITDA of €1.0 billion-€1.2 billion in 2022-2024, and if assuming capital expenditure (capex) at historical levels of about €550 million, the company has the capacity to further drive down total debt by more than €1 billion. In practice, the company's growth plans (additional capex and potentially M&A) could raise debt to about €4.5 billion-€5.0 billion. However, we view such an increase, which will be supported by higher EBITDA over time, as much more sustainable than in the past.

Orano's sizable provisions shrank and became less volatile. As part of our adjustments, we added €760 million in relation to the company's end-of-lifecycle commitments and €516 million in relation to its pension liabilities (as a reference, in late 2017, the two provisions amounted to about €1.7 billion). The allocation of some cash toward the provisions and higher interest rates were the two main reasons for the reduction. In our view, the reduction will also mean the liabilities will be less volatile. In addition, the expectation for higher interest rates is not fully factored into the figures above, and could result in another €100 million drop.

Successful delivery of key projects and contracts should de-risk the company's business model. EDF, the French utility company, is one of Orano's key clients, accounting for about 50% of the back-end business, and is currently experiencing operational and financial challenges (see "Electricite de France Placed On CreditWatch Negative On Further Nuclear Issues And Increase In Debt," published May 24, 2022, on RatingsDirect). We understand that a key contract between the two is due for renegotiation. We will continue to monitor the negotiations, including the potential involvement of the French government as the ultimate client. The two related plants, La Hague and Melox, are currently undergoing production ramp-up, notably due to switching from old to new equipment (at La Hague) and restoring production due to quality problems (at Melox). We expect the production hiccups as well as the contract renewal to be resolved by 2025.

Opportunities to grow the business will be limited only by the company's financial policy. With potentially higher demand for nuclear power over the medium and long term, the company will likely consider potential investments, including an increase in its mining and/or enrichment capacity or other recycling services capabilities. Each project will come with a very costly price tag, and with a lengthy timeline between the approval and commissioning. We understand that the company's ultimate decision will rely on its ability to secure long-term contracts (and even pre-funding). Under our base case, we include capex of about €800 million-€1.0 billion over 2023-2025 (partly be funded by clients, share to be determined), compared with a historical average of €500 million-€600 million. About 60% of the investments are growth projects and include the production ramp-up of recycling sites La Hague and Melox.

Free cash flow generation should remain above €200 million, including changes in working capital, as part of the company's capex is financed by one of Orano's major clients, EDF, with the counterpart included in working capital.

Outlook

The stable outlook reflects the expectation for robust results in the next 12-18 months and positive momentum in the nuclear industry, which could become even more pronounced if the current energy crisis in Europe lasts for an extended period.

Under our base case, we project EBITDA of about €1.0 billion-€1.2 billion in 2022 and 2023 and free operating cash flow (FOCF) of about €200 million in each of the two years (this figure could turn to be more positive if the company decided to delay some growth capex which is currently included in the budget). Based on the current capital structure (chiefly, no changes in the provisions), we expect our adjusted debt-to-EBITDA ratio to be in a range of 3x-4x, which we consider commensurate with the current stand-alone credit profile (SACP) of 'bb-' and the 'BBB-' rating.

Our rating factors in no changes in the company's ownership structure.

Downside scenario

We view downside pressure as remote in the coming 12-24 months. The two drivers that could trigger pressure on the rating are:

- Major operational disruptions
- Diversion from the existing financial policy--increasing reported net debt to EBITDA, by being more aggressive with debt-funded acquisitions or due to a significant increase in the capex budget or distribution to shareholders.

Upside scenario

In our view the current positive momentum in the nuclear industry, which has already translated into higher prices (for uranium, separative work units [SWU], and other services), would support higher profitability in the medium term, and later, higher demand for the company's services. As a result, we may see some buildup of positive pressure on the rating.

Some of the triggers which could support such an action include:

- Maintaining projected profitability, cash conversion, and credit metrics. Meaning EBITDA in the range of €1.0 billion-€1.2 billion, positive FOCF of €100 million or more and adjusted debt to EBITDA in the range of 3x-4x. Given the fact that the credit metrics could be subject to changes in our sizable adjustments, we will continue to monitor the company's ability to meet the objectives on a multiyear average basis.
- The company's ability to meet important milestones with its two recycling projects (La Hague and Melox). We understand that the projects are expected to be fully completed in 2024.
- Better visibility on its medium-term growth strategy, including embarking on new capacity increases.
- Progress in the discussion between the company, EDF, and the government regarding some of its key contracts.

Company Description

France-headquartered Orano is a spinoff of former nuclear services provider Areva. Orano offers products and services for the entire nuclear fuel cycle, from raw materials to waste processing. Its activities--ranging from mining to decommissioning and including conversion, enrichment, recycling, logistics, and engineering--contribute to the production of low-carbon electricity. The company has about 16,500 employees worldwide. At year-end 2021, Orano's revenue totaled €4.7 billion, with adjusted EBITDA of €1.3 billion.

Orano operates mainly through three business divisions:

- Mining (23% of sales and 31% of EBITDA in 2021): Operates uranium mines in Canada, Niger, Kazakhstan, Namibia, Mongolia, Uzbekistan, and France. The mineral reserves in Orano's deposits amounted to 207,789 metric tons as of Dec. 31, 2021 (Orano's equity share).
- Front end (20% of sales and 14% of EBITDA in 2021): This combines all the operations required to convert natural uranium into enriched uranium to be used in nuclear fuel assemblies designed to generate electricity. Customers are primarily nuclear power plant operators.
- Back end (57% of sales and 55% of EBITDA in 2021): This includes treating and recycling used fuel for reuse in the reactor, developing storage systems, organizing the transportation of radioactive materials, and cleaning up and dismantling nuclear facilities. Orano is the main global player in this space.

The main peers for both the mining and front-end divisions are the Rosatom State Atomic Energy Corp. (not rated); China General Nuclear Power Corp. (A-/Stable/--); Cameco Corp. (BBB-/Stable/A-3); and, for mining only, Kazatomprom (not rated).

Our Base-Case Scenario

Under our current base case, we project adjusted EBITDA of about €1.1 billion-€1.2 billion in 2022 and 2023, equivalent to underlying EBITDA of about €1.0 billion-€1.1 billion. Orano's recent public guidance points to underlying EBITDA of about €1.0 billion. We understand Orano is currently fully booked for the next few years.

Looking beyond 2023, we expect the company's EBITDA to increase gradually, on the back of higher volumes and prices as well as a return to nameplate production in recycling and in the front end.

Assumptions

- Prices. The company's results are less influenced by spot prices. However, the ongoing recovery in uranium and SWU prices over the past few years will replace some less attractive legacy prices, supporting higher prices.
- Backlog. Despite the current push toward nuclear energy, we don't assume that the company will secure material new contracts, resulting in order-to-book ratios remaining below 1.0x. However, even if it does secure new contracts, this will support higher EBITDA beyond our rating horizon.
- Mining. The division's results will be driven by higher prices and full resumption of production at KATCO in 2024-2025.

- Front-end division will improve due to a price effect in enrichment and conversion.
- Back-end division. Better cost absorption as recycling plants La Hague and Melox ramp up, driving EBITDA in the back-end division. Our forecast takes into account potential ad hoc benefits from one-off contracts (similar to the one in 2021).
- Capex will increase on the back of required investments to ramp-up production in recycling, as well as the new uranium deposit development in Kazakhstan.
- Higher working capital inflows to be driven by a reduction in SWU inventories in the front end and uranium destocking in the mining division.
- In our base case we conservatively assume capex of about €300 million-€350 million per year from 2023 in the mining divisions, as the company looks to extend its production well into 2030. No budget has been committed by the company yet.
- No changes in the company's provisions, including decommissioning and pension liabilities.
- The company is envisaging paying dividends at the earliest in 2025, once important contracts with EDF are renegotiated and begin contributing positively to EBITDA. Dividend payments will also be subject to net leverage remaining below 3x.

Key metrics

Orano - Key metrics

	2021a	2022e	2023e
Uranium price ($/lb)	36	49	55
Euro per U.S. dollar (€/$)	0.85	0.92	0.89
Revenues (bil. €)	4.7	4.2-4.5	4.0-4.4
Underlying EBITDA (mil. €)	1,349	1,000-1,200	900-1,100
Adjusted EBITDA (mil. €)*	1,356	1,000-1,200	900-1,100
-- Mining EBITDA (mil. €)	429	400-500	400-500
-- Front end EBITDA (mil. €)	204	450-550	350-450
-- Back end EBITDA (mil. €)	764	150-250	200-300
Capex (mil. €)	592	800-900	900-1100
Change in working capital (mil. €)	217	300-400	300-400
Dividends to minority shareholders(mil. €)	5	40-50	70-90
Free cash flow (mil. €)	507	280-300	100-200
Adjusted debt (bil. €)	3.5	3.0-4.0	4.0-4.5
Cash (bil. €)	1.2	0.5-0.6	About 0.5
Adjusted debt/EBITDA (x)	2.6	2.5-3.5	3.5-4.5
Net debt/EBITDA (x)**	1.7	1.5-2.5	2.0-2.5

a--Actual. e--Estimate. FFO--Funds from operations. mt--metric ton. *S&P Global Ratings-adjusted EBITDA includes provisions and other costs related to end-of-lifecycle operations. **Based on reported net debt and underlying EBITDA.

Liquidity

We assess Orano's liquidity as strong. This is supported by our estimate that the company's liquidity sources will cover uses by more than 1.5x in the 24 months started June 30, 2022. We also factor in the company's prudent liquidity management and solid bank relationships.

We expect the company to refinance its upcoming bond maturity (€730 million in March 2023) as and when market conditions permit. If, however, the company decided to repay the bond from its cash balance, this would not affect our liquidity assessment of strong.

We estimate that liquidity sources for the 12 months started June 30, 2022, include:

- About €1.4 million of unrestricted cash on the balance sheet, including about €300 million of highly liquid marketable securities;
- €880 million available under a syndicated credit revolving facility maturing in May 2027;
- Working capital inflows of about €350 million, and
- Cash funds from operations of about €700 million-€800 million.

We estimate that liquidity uses for the same period include:

- €730 million bond due in March 2023;
- Some moderate intrayear working capital swings that we don't expect will exceed €200 million;
- Capex of €800 million-€900 million, and
- Dividends to minority shareholders of about €60 million.

Under certain circumstances, the company may be required to use its cash to balance its end-of-cycle liabilities deficit, which was about €122 million on Dec. 31, 2021 (on a regulatory basis). We understand that the company will not need to make such deposits before 2026.

Covenants

There are no covenants in the debt documentation.

Issue Ratings--Subordination Risk Analysis

Capital structure

- €2.7 billion senior unsecured notes.
- Fully undrawn RCF of €880 million, which is unsecured and ranks pari passu with the unsecured notes.
- About €260 million of secured debt.

Analytical conclusions

We rate the unsecured notes 'BBB-', the same level as our long-term issuer credit rating on Orano, since no significant elements of structural or contractual subordination risks are present in the capital structure, in our view.

Ratings Score Snapshot

Issuer Credit Rating	**BBB-/Stable/--**
Business risk:	Satisfactory
Country risk	Low
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb
Modifiers:	
Diversification/Portfolio effect	Neutral/Undiversified (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bb-
Related government rating	AA
Likelihood of government support	High (+3 notches from SACP)

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

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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
Orano		
Issuer Credit Rating	BBB-/Stable/--	BB+/Stable/--
Senior Unsecured	BBB-	BB+
Recovery Rating	NR	3(65%)