FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades EDF to 'BBB+'; Places Rating on Negative Watch

Mon 17 Jan, 2022 - 11:11 ET

Fitch Ratings - Milan - 17 Jan 2022: Fitch Ratings has downgraded Electricite de France's (EDF) Long-Term Issuer Default Rating (IDR) to 'BBB+' from 'A-' and placed the rating on Rating Watch Negative (RWN). The UK subsidiaries of the group rated on a top-down from the parent basis have also been downgraded as detailed below.

Fitch has revised down EDF's Standalone Credit Profile (SCP) to 'bbb' from 'bbb+', following the announcement of political intervention in France to limit the increase of energy prices for households, with a material financial hit on EDF, and extended outages at some nuclear reactors, which will heavily erode margins at least for 2022. We estimate that this will leave 2022 Fitch-defined EBITDA at around EUR4 billion, 75% below our prior estimate, and a weakened financial structure for EDF.

The rating continues to factor in an uplift of one notch to EDF's SCP, reflecting the links with the stronger sovereign. We will reassess the links in light of potential support by the government to offset the impact related to the political intervention.

The RWN mainly reflects the uncertainty around the ultimate impact of the announced events, including the state of the reactor fleet, as well as measures to strengthen the company's financial structure. We may downgrade the ratings further if the credit metrics remain too weak after 2022, if we deem EDF's asset quality to be weaker in the long term or if the government's support does not materially offset the impact of the announced measures.

KEY RATING DRIVERS

Political Intervention Hits Cash Flows: The measures taken by the French government to limit the rise of electricity tariffs for 2022 include an additional ARENH allocation of 20TWh in 2022 and a postponement of a portion of the 2022 tariff increase over a 12-month period starting from 1 February. EDF has estimated that, based on market prices at end-2021, the total impact on 2022 cash EBITDA would be of around EUR8.4 billion, of which only EUR1.6 billion could be recovered in the future.

The final impact will depend on forward purchase prices - likely to be extremely high - of electricity related to the period of April-December 2022, while the purchased electricity will be sold at a regulated price of EUR46.2/MWh to alternative suppliers.

Extended Outage: Concurrently EDF has revised its French nuclear output estimate for 2022 to 300-330 TWh from 330-360 TWh. This is the result of the extension of the outage period for five of EDF's French nuclear reactors, since some problems were detected close to the welds on the pipes of the safety injection system circuit in a 10-yearly in-service inspection. A control programme is under development on the entire nuclear fleet. At present EDF has not revised the previous French nuclear production guidance of 340-370 TWh for 2023.

Large Financial Consequences: EDF has provided no estimate of the impact of the extended outage. The outage comes at a very unfavourable time for EDF, since it has largely hedged its production for 2022 and will have to buy on the market a relevant portion of the missing 30TWh to deliver it at hedged prices. Hedged prices are much lower than forward, as they also include old hedges. We expect the impact of this to be around EUR6 billion-EUR7 billion. Based on our preliminary estimate, around half of this amount could be offset by the actual production being sold in the market in 2022 at materially higher prices than in 2021.

Weakened Financial Structure: We expect a Fitch-defined EBITDA (ie post-leasing and non-cash items) of around EUR4 billion for 2022, which considering average annual capex of around EUR15 billion, is putting significant pressure on EDF's financial structure. We expect the company to announce a comprehensive package of measures to offset most of the increase in net debt of around EUR12 billion that we forecast for 2022.

Key Unknowns for the Medium Term: Several uncertainties are currently weighing on EDF's business profile, mainly the sustainable level of future nuclear production in France with an ageing fleet, the state's policy stance on the high electricity price environment from 2023 and, more generally, the role of EDF in the energy transition.

Links with the State: If not offset, the political intervention upends our view of the support for EDF derived from its links with the government, and we will thus revise it depending on the scope of potential supporting measures to be taken by the government (possibly including a capital increase for EDF). We also take into account the pivotal role of EDF in new nuclear development, the strong push of France to include nuclear in the EU taxonomy and the historical support shown by the government.

DERIVATION SUMMARY

We estimate regulated and contracted EBITDA at 40%-45% of EDF's total, well below that of peers Engie S.A. (A-/Stable), Enel S.p.A. (A-/Stable) and Iberdrola, S.A. (BBB+/Stable). The weaker business profile of EDF (also due to higher operational risk entailed in its investment plan and asset base) and the large negative free cash flow (FCF) expected across its business plan drive its lower debt capacity versus peers'. The FFO net leverage threshold between 'A-' and 'BBB+' is 4.2x for both Enel and Iberdrola, 4.2x (nuclear- adjusted) for Engie versus lower than 3.0x for EDF (on a Standalone Credit Profile (SCP) basis).

As a consequence, the SCP of EDF is weaker than Enel's, Engie's and Iberdrola's ratings. EDF's IDR benefits from a one-notch uplift, due to the application of the GRE Criteria.

The ratings of EDF's subsidiaries in the UK reflect the application of Fitch's Parent and Subsidiary Rating Criteria and our view of their strong links with EDF.

KEY ASSUMPTIONS

- Fitch-defined EBITDA (after non-cash items and IFRS 16 reversal) of around EUR4 billion in 2022, and around EUR15 billion for 2023-2024

- Annual capex of around EUR16 billion for 2022-2024

- No dividends to 2024

- Credit-enhancing measures of EUR10 billion cumulatively in 2022-2024, but with limited impact on EBITDA

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- The rating may be affirmed with the assignment of a Stable Outlook if the state will largely protect EDF from the impact of the political intervention and if management will put in place clear and visible measures to reduce FFO net leverage towards 4.5x from 2023

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Evidence of the state not compensating EDF for a large part of the earnings hit related to political intervention may result in the removal of the rating uplift

- Lack of visibility on deleveraging towards FFO net leverage of 4.5x by 2023

- Long-term reduction of available generation capacity from the existing fleet in France and weaker assessment of EDF's asset base

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Moderate Liquidity: At 30 June 2021, EDF had readily available cash comprising cash and cash equivalents of EUR5.9 billion, (Fitch-defined) liquid assets of EUR10.2 billion and committed undrawn facilities of EUR11.1 billion, including EUR1.8 billion that is maturing within a year. This means that EDF can cover scheduled debt maturities of EUR8.3 billion for the period of July 2021 to December 2022, and expected negative Fitch-defined FCF of about EUR15 billion for the same period without resorting to additional debt issuance.

ISSUER PROFILE

EDF is a leading electricity company and global leader for low-carbon energy production. It is particularly well established in Europe, especially France, the UK, Italy and Belgium, as well as North and South America. It covers all businesses spanning the electricity value chain - from generation to distribution - including energy trading activities. It has 37 million customer accounts and is particularly exposed to generation from nuclear sources.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍		PRIOR ⬍
EDF Energy Limited	LT IDR Downgrade	BBB- Rating Watch Negative	BBB Rating Outlook Negative

EDF Energy Customers Limited	LT IDR	BBB- Rating Watch Negative Downgrade	BBB Rating Outlook Negative
Electricite de France (EDF)	LT IDR	BBB+ Rating Watch Negative Downgrade	A- Rating Outlook Negative
	ST IDR	F2 Rating Watch Negative Rating Watch On	F2
senior unsecured	LT	BBB+ Rating Watch Negative Downgrade	A-
subordinated	LT	BBB- Rating Watch Negative Downgrade	BBB
EDF Energy Nuclear Generation Limited	LT IDR	BBB Rating Watch Negative Downgrade	BBB+ Rating Outlook Negative
EDF Energy Holdings Limited	LT IDR	BBB Rating Watch Negative Downgrade	BBB+ Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Antonio Totaro
Senior Director

Primary Rating Analyst
+39 02 879087 297
antonio.totaro@fitchratings.com
Fitch Ratings Ireland Limited Sede Secondaria Italiana
Via Morigi, 6 Ingresso Via Privata Maria Teresa, 8 Milan 20123

Djivan Torossian
Analyst
Secondary Rating Analyst
+44 20 3530 2617
djivan.torossian@fitchratings.com

Josef Pospisil, CFA
Managing Director
Committee Chairperson
+44 20 3530 1287
josef.pospisil@fitchratings.com

MEDIA CONTACTS

Tahmina Pinnington-Mannan
London
+44 20 3530 1128
tahmina.p-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

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

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021)

(including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

EDF Energy Customers Limited	EU Issued, UK Endorsed
EDF Energy Holdings Limited	EU Issued, UK Endorsed
EDF Energy Limited	EU Issued, UK Endorsed
EDF Energy Nuclear Generation Limited	EU Issued, UK Endorsed
Electricite de France (EDF)	EU Issued, UK Endorsed

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Corporate Finance Utilities and Power Europe France United Kingdom

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