FitchRatings

RATING ACTION COMMENTARY

Fitch Ratings Affirms EDF at 'A-'; Outlook Negative

Feedback

Mon 19 Jul, 2021 - 12:26 PM ET

Fitch Ratings - Milan - 19 Jul 2021: Fitch Ratings has affirmed Electricite de France's (EDF) Long-Term Issuer Default Rating (IDR) at 'A-' with a Negative Outlook. Fitch has also affirmed the ratings of EDF's UK subsidiaries.

The rating mainly reflects the group's strong market position and solid business profile, but also an ageing nuclear fleet in France and the UK, risks related to the new nuclear commissioning and structurally negative free cash flows (FCF). The IDR incorporates a one-notch uplift due to likely state support.

The Negative Outlook continues to reflect our expectations that funds from operations (FFO) net leverage will remain under pressure over the rating horizon, mainly due to the large negative FCF and lower nuclear output. Fitch forecasts a small breach of our leverage sensitivity over 2021-2023. However, we see potential upsides to our rating case, especially if the favourable price trend persists.

The potential nuclear reform in France remains a key issue for EDF, but we believe that an agreement is now unlikely before the French presidential elections in April 2022.

For a full list of rating actions please see below.

KEY RATING DRIVERS

Exhausted Leverage Headroom: We expect average FFO net leverage to reach 4.1x over 2021-2023, from 3.5x in 2020, slightly breaching our negative sensitivity of 4.0x. This is mainly related to heavily negative Fitch-defined FCF in the region of EUR6 billion-EUR8 billion a year. We expect the growth in EBITDA to be more than offset by rising capex, for which we see limited flexibility, driven by maintenance of existing nuclear, investments in new nuclear, and the development of renewables and a distribution grid.

Structurally Negative FCF: We expect the negative FCF to be only partially compensated by managerial actions. These include planned disposals of EUR3 billion in 2020-2022 and possible transactions needed to achieve the management's target of reported net debt/EBITDA of about 3x. We conservatively included dividends distributions in our rating case, however we see some upside related to the potential continuation of scrip dividends for the state beyond 2021 and the conversion into equity of the convertible bond in 2022. The structure of FCF and the sizeable exposure of the generation activity to price and volume risks are the key weaknesses of EDF's Standalone Credit Profile of 'bbb+'.

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Improving Price Environment: We believe EDF is one of the key beneficiaries of the improving power price environment, with one-year forward prices in France more than 50% higher than a year ago. This is mainly driven by the surge in CO2 prices, which would benefit EDF, given its clean asset base. We expect EDF to start seeing benefits from 2021, as the company recently upgraded its nuclear output estimates to 345TWh-365TWh from 330TWh-360TWh. The benefits will increase from 2022, as hedges made in less favourable price environment gradually roll off. We forecast on average higher EBITDA than the previous Fitch rating case (15% for 2021-2022), but this largely depends on electricity prices.

Uncertainties Around Market Reform: Negotiations with the EU about the nuclear market reform are continuing, particularly with regard to the price of nuclear generation and EDF's group structure. The French state and EDF intend to protect the full integration of the group, but we understand that the EU requires a stricter separation between businesses, which caused very long negotiations. An implementation of the reform before the presidential elections of April 2022 is now unlikely in our view. This creates additional uncertainties, also related to the approach of any new government.

Potential Benefits from Reform: The market reform should see the introduction of a higher and fixed remuneration for nuclear output. The reform should resolve key problems of the ARENH mechanism. This has a reference price at EUR42/MWh that is directly or indirectly applicable to most of EDF's French electricity sales and does not provide protection from a market downturn, while capping the price for most of the nuclear production sold.

Adequate Performance in 2020: Better-than-expected results for 2020 demonstrate EDF's satisfactory resilience to Covid-19. The group posted a 2.7% decline in EBITDA in 2020 on an organic basis (it would have grown without Covid-19). EDF estimates the pandemic shaved EUR1.5 billion off its 2020 EBITDA, of which EUR1.3 billion related to supply activity and nuclear generation in France. The remaining EUR0.2 billion related to distribution will be largely recovered in the following years. Fitch-defined FCF was negative for more than EUR5 billion in 2020, although FFO net leverage at 3.5x was substantially lower than our expectations.

UK Output to Remain Flat: EDF's nuclear generation in the UK decreased in 2020 by 10% to 45.7TWh, mainly due to the group's maintenance schedule. We expect generation to remain around this level, as a result of the recent closure of the Dungeness B power station, and additional closures scheduled at end-2021 for Hunterston and mid-2022 for Hinkley Point B. These account for about a quarter of the UK's nuclear capacity. The contribution of the UK to the consolidated EBITDA should fall below 5% over the plan.

New Nuclear Project Risk Remains: At the Flamanville power station in France, fuel loading would occur at best by end-2022. This implies an increase of construction costs by EUR1.5 billion (in 2015 real terms, excluding interest during construction) from previous estimates. Following a review in January 2021, Hinkley Point C, EDF's other key nuclear project, saw an increase in construction costs of GBP0.5 billion (2015 real terms) from previous estimates. Further delays and extra costs for these projects are likely and may further weaken the economics of new nuclear. The recent incident in Taishan may also have implications on other nuclear projects based on the same technology, if the investigation reveals any serious problems.

We expect new nuclear projects to be structured differently in terms of regulatory frameworks and EDF's financial involvement, with a much lower burden on the group's financial profile.

Healthy Nuclear Provision Coverage: In 2020, the value of assets dedicated to cover nuclear provisions increased by EUR1.2 billion to EUR33.8 billion. This represents 103.6% of the related provisions. Conservatively, we included some allocations to dedicated assets in our base case (which we deduct from FFO), but we do not expect significant cash-outs over the rating horizon.

Uplift due to GRE: The IDR reflects a one-notch uplift for the strength of its links with the sovereign under our Government-Related Entities (GRE) Rating Criteria. This is due to the French state's direct involvement in supporting the nuclear-market reform, triggering a

'Moderate' assessment for support track record. Other factors for the uplift are 'Strong' control, as well as 'Moderate' socio-political and 'Weak' financial implications of a default for the French state.

In the absence of an agreement with EU in the short term, we expect France to continue pursuing a solution to go beyond the ARENH mechanism and ensure a fair remuneration system for EDF's nuclear production. EDF is a key instrument for the country's ambitions in terms of energy transition, in our view. We could review our GRE assessment if the government's approach or commitment towards EDF were to be different from our expectations.

DERIVATION SUMMARY

We estimate EDF's regulated and contracted EBITDA at 40%-45% of the 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 (also due to higher operational risk entailed in the investment plan) and the large negative FCFs expected across the business plan drive the lower debt capacity for EDF compared to peers. For the FFO net leverage, the threshold between 'A-' and 'BBB+' is 4.2x for both Enel and Iberdrola, 4.2x (nuclear-adjusted) for Engie and 3.0x for EDF (on a standalone credit profile basis).

As a consequence, the standalone credit profile of EDF is lower than Enel and Engie's ratings, notwithstanding a broadly similar FFO net leverage, while Iberdrola has a BBB+ rating but with a higher leverage. EDF's IDR has 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

- French nuclear output at 350TWh-360TWh for 2021-2023

- French hydro output at 35TWh-40TWh for 2021-2023

- Market prices in France at EUR55-EUR60/MWh in 2021-2023

- French regulated activities' EBITDA to grow at a CAGR of about 6%, as indicated by the company

- UK nuclear output averaging 43TWh in 2021-2023

- Market prices in the UK and Italy broadly in line with forward levels, margins include hedging already in place

- Cash tax as per guidance; cost of new funding (senior unsecured) at 2% up to 2023

- Annual allocations to dedicated assets conservatively assumed during the period, even if not needed now

- Broadly neutral trend of working capital

- Annual net capex of about EUR17.0 billion in 2021-2023

- Cash dividends paid in 2022-2023, based on a pay-out of 50%

- Disposals and additional initiatives aimed at strengthening the balance sheet for a cumulative amount of about EUR3 billion in 2021-2023

RATING SENSITIVITIES

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

- Visibility on the introduction of the market reform for nuclear in France, with an increase in cash-flow predictability, and stronger credit metrics than those outlined in the negative sensitivities below may result in the Outlook being revised to Stable; and

- We do not anticipate an upgrade as reflected in the Negative Outlook. However, developments that may lead to an upgrade include FFO net leverage below 3.0x on a sustained basis; FFO interest cover above 6.0x on a sustained basis; sustained reduction in negative FCF and nuclear-market reform in France leading to higher cash-flow visibility, or stronger links with the government.

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

- FFO net leverage above 4.0x on a sustained basis;

- FFO interest cover below 5.0x on a sustained basis;

- A sustained decline in electricity prices in France, the UK and Italy and/or further cuts to production;

- Insufficient visibility on the implementation of nuclear-market reform in France, in the absence of any other measure enhancing earnings' visibility, and further delay and extra-costs in new nuclear development; and

- Weaker links with the French state.

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

Strong Liquidity: At 31 December 2020, EDF had readily available cash comprising cash and cash equivalents of EUR6 billion, (Fitch-defined) liquid assets of EUR13.5 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 EUR10 billion for 2021, and expected negative Fitch-defined FCF of about EUR6.6 billion for the same year without resorting to additional debt issuance.

ISSUER PROFILE

EDF group 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. The group covers all businesses spanning the electricity value chain - from generation to distribution - including energy trading activities. The company 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.

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RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
EDF Energy Limited	LT IDR	BBB Rating Outlook Negative	Affirmed	BBB Rating Outlook Negative
EDF Energy Customers Limited	LT IDR	BBB Rating Outlook Negative	Affirmed	BBB Rating Outlook Negative
Electricite de France (EDF)	LT IDR	A- Rating Outlook Negative	Affirmed	A- Rating Outlook Negative

ENTITY/DEBT	RATING			PRIOR
	ST	F2	Affirmed	F2

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

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

Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 30 Apr 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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