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Research Update:

Electricite de France S.A. On CreditWatch Negative After Sharp Revision To Nuclear Output Amid COVID-19 Outbreak

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Rating Action Overview

- Electricite de France S.A. (EDF) has lowered significantly its French nuclear output for 2020-2022 because of lengthening maintenance outages amid the COVID-19 pandemic and anticipated lower power demand.
- The magnitude of the cut and the prolonged timeframe associated are deeply below our expectations and reflects increased operating weaknesses.
- We are placing our 'A-' long-term issuer credit, senior unsecured, and junior unsecured bond ratings on CreditWatch with negative implications, reflecting the sharp deterioration of the operating environment and credit metrics following significant pressure on earnings prospects.
- We are also placing our ratings on EDF's U.K. subsidiaries EDF Energy PLC and EDF Energy Customers PLC on CreditWatch negative, while our ratings on Edison are unaffected.
- We plan to resolve the CreditWatch placement after we assess the action plan of the group and the French state, EDF's majority shareholder, to protect its balance sheet.

Rating Action Rationale

Significantly lower nuclear output, coupled with lower power prices, will dent earnings and cash flows over 2020-2021. EDF announced on April 16 that it expects its French nuclear output to reach about 300 terawatt-hours (TWh) in 2020, while ranging from 330-360 TWh each year in 2021-2022. This compares with previous production estimates from EDF of 375-390 TWh in 2020 and with historical level of about 400 TWh in previous years. EDF commented on the phasing of the nuclear production, as planned in collaboration with French transmission system operator RTE, indicating that a number of nuclear reactors could be taken offline during this coming summer and autumn to save fuel on these power plants and help provide a continuous supply of power throughout the winter of 2020-2021. While we anticipated that the COVID-19 pandemic and extended lockdown in France was likely to delay scheduled necessary maintenance, we had undervalued the magnitude of the extended outages on EDF's existing fleet for 2020, but also for the subsequent years. We anticipate this might lower EBITDA generation by about €2.5 billion in 2020, €1 billion in 2021, and €700 million in 2022 compared with our previous earnings forecasts, absent any adjustment on variable costs resulting from these assets being taken offline. In addition, we believe the situation could bring additional operational disruption in the form of further delays in commissioning of EPR FLA-3 and on the U.K. new nuclear project HPC. This comes on top of our expectations that the group could suffer delayed collection on its supply business, particularly from its smaller and vulnerable client base. This will translate into increased working capital. We expect the financial drain to be manageable, with some recovery in 2021. At this stage, we do not factor a significant increase in default rates that could result in a material increase in bad debt provisions.

Lower earnings combined with upward pressure on economic debt will likely result in unsustainable credit metrics for the 'A-' rating. This announcement from the company adds to the financial pressure stemming from its continuing increase in economic debt. Increasing asset retirement obligation and pension deficits may also affect EDF's economic debt, as actuarial assumptions are likely to continue increasing liabilities, while dedicated and planned assets might underperform amidst disruptions in the financial markets in 2020 (for more information, see our report on EDF published April 3, 2020, on RatingsDirect). These deficits, combined with earnings significantly being lower than previously expected, could further stress EDF's adjusted credit metrics, with leverage spiking to 5.4x over 2020-2021. This compares to the 4.5x threshold we have set for the rating. Credit metrics improve from 2022 in our base-case scenario, on the back of higher nuclear output of about 360 TWh (albeit below historical levels) and more favorable power prices (above ARENH's level), supporting EDF's generation and supply earnings. Still the group will have no financial headroom for the 'A-' rating (4.8x in our base-case scenario and funds from operations to net debt at about 17%).

Timely measures are needed to support the 'A-' rating and the contemplated reregulation is likely to be delayed. A potential change of nuclear regulation in France has been so far a crucial element of our ratings on EDF, with a great emphasis put on the timing of its implementation. We believe that the COVID-19 pandemic will most likely delay advances on this structural regulatory reform for EDF, as both the French State and the European Commission are dealing with priorities of addressing the economic and social consequences of the pandemic. Furthermore, increasing the floor price (on the price corridor mechanism for a large part of the nuclear output) to a sustainable economic level is also politically sensitive because it raises affordability issues concerning electricity bills, especially given a weaker economy and lower power prices compared with the level when the public consultation was launched (about €48 per megawatt-hour).

The high likelihood of support from the French state provides three notches of uplift to the rating. EDF's highly strategic role as producer, distributor (through its concession Enedis), and supplier of electricity, and as provider of an essential public service, has been reinforced through the COVID-19 pandemic and its disruptive, restrictive measures. The rating benefits from high likelihood of support from the French state if needed. A downgrade of France (AA/Stable/A-1+) would have no impact on either the likelihood of support or the final rating on EDF. A downward revision to the utility's stand-alone credit profile will not affect per se the analysis of the likelihood of support.

CreditWatch

The CreditWatch placement indicates that we could downgrade EDF if the group could not provide clear remedy measures to address the weakening of its credit metrics arising from a sharp deterioration of its earnings prospects amidst disruptive COVID-19 crisis. At this stage, we anticipate the rating downside risk to be limited to one notch, assuming the high likelihood of support from the French state remains intact. Specifically, we will monitor the management's and French state's reaction to the unprecedented situation.

Absent proactive material measures to support the balance sheet and restore credit metrics, we will consider lowering the rating.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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: 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, 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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- COVID-19: Coronavirus-Related Public Rating Actions On Nonfinancial Corporations And Affected European CLOs, April 17, 2020

- COVID-19: Coronavirus- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date, April 15, 2020
- Electricite de France S.A., April 3, 2020
- EMEA Utilities Should Withstand COVID-19 Better Than Most Sectors, March 24, 2020
- COVID-19 Credit Update: The Sudden Economic Stop Will Bring Intense Credit Pressure, March 17, 2020
- COVID-19 Macroeconomic Update: The Global Recession Is Here And Now, March 17, 2020

Ratings List

Ratings Affirmed; CreditWatch Action

	To	From
Electricite de France S.A.		
Issuer Credit Rating	A-/Watch Neg/A-2	A-/Negative/A-2
EDF Energy Customers Ltd		
Issuer Credit Rating	BBB-/Watch Neg/--	BBB-/Negative/--
EDF Energy Limited		
Issuer Credit Rating	BBB-/Watch Neg/A-3	BBB-/Negative/A-3
Electricite de France S.A.		
Senior Unsecured	A-/Watch Neg	A-
Junior Subordinated	BB/Watch Neg	BB
Commercial Paper	A-2	A-2