FitchRatings

RATING ACTION COMMENTARY

# Fitch Revises EDF's Outlook to Stable; Affirms at 'BBB+'

Tue 06 Sep, 2022 - 04:27 ET

Fitch Ratings - Milan - 06 Sep 2022: Fitch Ratings has revised the Outlook on Electricite de France's (EDF) Long-Term Issuer Default Rating (IDR) to Stable from Negative and affirmed the IDR at 'BBB+'. A full list of rating actions is below.

EDF's IDR now incorporates a two-notch uplift for state support. The additional uplift mainly reflects the announced nationalisation of the group, along with expected additional support measures, including the buyout of convertible bonds by the state. It also reflects the growing strategic importance of EDF for the country's energy transition and security, which enhances the state's incentive to support EDF's financial health, in our view.

Fitch has revised EDF's Standalone Credit Profile (SCP) to 'bbb-' from 'bbb'. This mainly reflects the expected breach of the funds from operations (FFO) net leverage sensitivity of 4.0x in 2023, with limited visibility thereafter.

The Stable Outlook mainly reflects the clearing received from the Autorité de Sûreté Nucléaire (ASN) about the fleet repair programme and the increased headroom under the revised SCP, under which EDF could accommodate further limited nuclear outages. We also expect that the state will intervene if the financial structure become structurally more aggressive than our negative threshold (4.7x).

## KEY RATING DRIVERS

**Nationalisation is Credit Positive:** In July 2022 the French government announced its intention to nationalise EDF (current ownership is around 84%). Our assumption is that the process will be completed in autumn 2022. No new money will be injected into the company in this phase. Based on the announced offer price, the cash-out for the state will be around EUR9.7 billion, including the takeover of EUR1.4 billion convertible bonds (Fitch-defined net debt will reduce by EUR2.4 billion, including EUR1 billion already held by the state. The state has also set aside further funds of around EUR3 billion for potential additional support, although not only for the benefit of EDF.

In our view, the transaction, together with the bold statements about nuclear renaissance in France, highlights EDF's strategic importance for energy transition and security, ultimately enhancing the links with the state.

**Stronger GRE Links:** We now assign a two-notch uplift to EDF, reflecting stronger links with the sovereign under our Government-Related Entities (GRE) rating criteria. This reflects a change in our assessment of status, ownership and control to 'very strong' from 'strong', due to the upcoming nationalisation which would represent a tangible sign of the company's importance for the State. The takeover of the convertible bonds and our expectations of further support measures if needed also contributed to the revised assessment.

The assessment of the remaining GRE factors is unchanged, with 'moderate' support record and expectations and socio-political impact of default and 'weak' financial implications of a default for the French state.

**Operational Risk Remains Key:** The state of the fleet remains the key risk for EDF, in our view. Currently, 12 reactors (among the newest of the fleet) will need outages to repair stress corrosion close to the welds on the pipes of the safety injection system (a back-up system needed to cool the reactor in an emergency). The company estimates that 16 reactors have high sensitivity to the corrosion, while the others should have low or very low sensitivity to it. All the fleet will be inspected by 2025. ASN has assessed EDF's strategy for investigation and repair as appropriate, which is an important factor for the rating.

The company has further reduced its expectation of French nuclear production for 2022 to 280TWh-300TWh from 295TWh-315TWh, keeping 2023 unchanged (300TWh-330TWh) with our rating case assumption at the low end of these ranges. Further material downside risk remains, and we cannot rule out similar problems emerging in other parts of the plants.

**Worsened 2022 Expectations:** EDF has worsened the estimated impact from state intervention and nuclear outages by EUR10 billion to around EUR34 billion for 2022 (EUR10 billion due to regulatory measures and EUR24 billion due to nuclear outage), only partially compensated by price effect for EUR8 billion. Hydro production has also been affected by a severe drought. For 2022, we assume negative Fitch-defined EBITDA of around EUR12 billion and net debt of EUR67 billion, up from EUR49 billion at end-2021.

**Leverage Breaching Negative Sensitivity:** EDF has confirmed its leverage (reported net financial debt / EBITDA) target for 2023 at around or slightly above 3.0x for 2023, which is equivalent to around 4.0x in terms of Fitch-calculated FFO net leverage. This corresponds to a SCP on the cusp between 'bbb' and 'bbb-'. We expect French nuclear production of 300TWh (the lower end of the guided range), no repeated state intervention on Arenh volumes and very limited sales (in terms of volumes) of French nuclear electricity at the merchant price in 2023. Fitch-defined EBITDA would recover to around EUR17 billion, with FFO net leverage of 4.7x, more consistent with a 'bbb-' SCP.

**Favourable Mid-Term Perspectives:** If the company will be able to sustainably restore a French nuclear production of at least 350TWh from 2024, it could be on a positive path in terms of cash flow generation in the medium term. Even without considering the current huge price spikes, it is reasonable to expect some benefits deriving from the market environment for EDF, also when it comes to defining a new system to follow the ARENH, which will expire in 2025 and still foresees a selling price of EUR42/MWh for the company.

We forecast a Fitch-defined EBITDA of around EUR20 billion for 2024, mainly due to a production assumption of about 345TWh, while assuming 'normalized' prices of around EUR75/MWh for the merchant sales. This leads to an FFO-net leverage of 4.2x. We see material upside in terms of prices, but further outages, not factored in at the moment, represent a key downside risk to our rating case.

**Nuclear Reform Remains Important**: We believe that recent market and political events have confirmed the very high importance of a nuclear reform for EDF. The current exposure to price volatility can be detrimental for EDF, even when the market environment is theoretically favourable, as in 2022. We expect France's dialogue with the EU to resume after the nationalisation. An agreement granting a healthy price level with good visibility would be positive for the company's debt capacity.

**Nuclear Plants Burdens Balance Sheet:** Based on our estimate, more than half of EDF's reported net debt in 2021 was related to the new nuclear plants of Flamanville and Hinkley Point C (HPC), both burdened by massive delays and extra costs.

Following another cost review in May 2022, HPC saw an estimated construction cost increase of GBP3 billion (2015 real terms) compared with previous estimates, while the commissioning of Unit 1 was further postponed by a year to mid-2027. Flamanville should start its production within the rating horizon (full-year contribution would be about 12TWh). The commissioning of these assets would give a better picture of the company's financial structure.

## DERIVATION SUMMARY

We estimate regulated and contracted EBITDA at 30%-40% of EDF's total under normal business conditions, well below that of peers Engie S.A. (A-/Stable), Enel S.p.A. (BBB+/Stable) and Iberdrola, S.A. (BBB+/Stable). EDF's weaker business profile (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 'BBB+' and 'BBB' is 4.9x for Enel, Iberdrola and Engie (nuclear-adjusted), while EDF has a threshold of 4.7x between 'bbb-' and 'bb+' (on a SCP basis).

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

## KEY ASSUMPTIONS

A Fitch's Key Assumptions Within Our Rating Case for the Issuer

Absence of further state intervention on ARENH from 2023; 4% increase in regulated tariff annually.

French nuclear output at 290TWh for 2022, 300TWh for 2023, 345TWh for 2024; French hydro output at 40TWh for 2022-2024

100% hedging for a given year in December of the previous year; for 2024 we assumed that the state will only allow the company to retain a 'fair' price on the portion of electricity sold at market prices (i.e. it will tax the so-called extra-profits)

French regulated activities' EBITDA CAGR of about 5%

UK nuclear output declining, with an average of 33TWh in 2022-2024

Cash tax rate as per guidance; cost of new funding (senior unsecured) at 3.0% in 2022 and 3.5% from 2023

No regulatory allocations to dedicated assets across the period

Annual net capex of about EUR17 billion for 2022-2024

Scrip dividends for the state for 2022-2023, but not 2024

Cumulative disposals of about EUR3 billion in 2022-2024

Reclassification of the EUR2.4 billion convertible bonds from Fitch-defined debt to equity

Broadly neutral working capital cumulatively over 2022-2024, in line with the company's expectations

## RATING SENSITIVITIES

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

--Sustained record of stabilised nuclear production in France;

--Stronger links with the state;

--FFO net leverage below 4.0x on a sustained basis.

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

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

--FFO net leverage above 4.7x on a sustained basis;

--Unexpected political measures similar to those taken in 2022 would be negative for the rating;

--Failure to implement the nationalisation.

## 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

**Adequate Liquidity:** As of 30 June 2022, EDF had readily available cash comprising cash and cash equivalents of EUR7.4 billion, (Fitch-defined) liquid assets of EUR19.6 billion and committed undrawn facilities of EUR12 billion. This means that liquidity is almost sufficient to cover scheduled debt maturities of EUR12.7billion for July 2022 to December 2023, and expected negative Fitch-defined FCF of about EUR29.6 billion for the same period without resorting to additional debt issuance. Since the beginning of 2022 EDF has raised around EUR15.4 billion of debt and EUR3.1 billion of equity.

## ISSUER PROFILE

EDF is a leading electricity company and global leader for low-carbon energy production. It is particularly well established in Europe, especially in France, the UK, Italy and Belgium, as well as North and South America. It covers all businesses spanning the electricity value chain, 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 |
| --- | --- | --- |

| | | | | |
|---|---|---|---|---|
| Electricite de France (EDF) | LT IDR | BBB+ Rating Outlook Stable Affirmed | | BBB+ Rating Outlook Negative |
| | ST IDR | F3 | Downgrade | F2 |
| senior unsecured | LT | BBB+ | Affirmed | BBB+ |
| subordinated | LT | BBB- | Affirmed | BBB- |

VIEW ADDITIONAL RATING DETAILS

## FITCH RATINGS ANALYSTS


**Antonio Totaro**
Senior Director
Primary Rating Analyst
+39 02 9475 8280
antonio.totaro@fitchratings.com
Fitch Ratings Ireland Limited Sede Secondaria Italiana
Via Morigi, 6 Ingresso Via Privata Maria Teresa, 8 Milan 20123

**Djivan Torossian**
Senior 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.pinnington-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

## PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## 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)

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

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 15 Jul 2022)

## APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Electricite de France (EDF) | EU Issued, UK Endorsed |

## DISCLAIMER & DISCLOSURES

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.



**READ LESS**

## SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

## ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Corporate Finance Utilities and Power Europe France United Kingdom