



Fitch Maintains EDP and Hidrocantabrico's 'BBB+' Rating on RWN Ratings

14 Nov 2011 8:52 AM (EST) Fitch Ratings-Barcelona/London-14 November 2011: Fitch Ratings has maintained EDP- Energias de Portugal, S.A.'s (EDP) and EDP Finance B.V.'s Long-term Issuer Default Ratings (IDR) and senior unsecured ratings of 'BBB+' on Rating Watch Negative (RWN). Both entities' Short-term IDRs of 'F2' also remain on RWN. Additionally, the agency has maintained Hidroelectrica del Cantabrico, S.A.'s (HC) Long-term IDR of 'BBB+' and its Short-term IDR of 'F2' on RWN.

The RWNs reflect the possibility of a downgrade in the near term as a result of a potential downgrade of Portugal's sovereign rating ('BBB-/RWN). However, the agency notes that the notching difference between EDP and the sovereign may widen beyond the current two notches in the case of a further sovereign downgrade, provided that the standalone profile remains commensurate with the current rating level. The maximum potential difference between EDP's rating and that of the sovereign also depends on the drivers for sovereign rating pressure. A one-notch sovereign downgrade to 'BB+' would not result in an automatic downgrade of EDP's rating to 'BBB'.

Fitch takes a negative view of the proposal by ERSE (the Portuguese Energy Services Regulator) regarding the deferral in the collection by EDP of the over-costs from the special regime generation for 2012. It is expected that amounts related to this will total EUR1.2bn in 2012 but that only EUR259m will be recovered through the tariff in that year. The remainder (EUR939m) plus associated interest will be recognised in the 2013-2016 period. On a positive note, EDP has already financed EUR0.6bn that will be recovered in 2012, as per ERSE's proposal.

Additionally, Fitch notes that deviations produced in the CMEC mechanism in 2010 (EUR141m) that were to be recovered in 2012, will be postponed to 2013. The deviations produced in 2011 (EUR0.1bn) will nevertheless be received in 2012 as usual.

The creation of an additional tariff deficit of around EUR0.4bn as a result of these measures puts pressure on funds from operations (FFO)-based leverage, which Fitch estimates at around 5x at YE11, leaving the company with little headroom at the 'BBB+' rating level. However, the agency also continues to calculate ratios excluding the tariff deficit if the near-term recovery of these amounts is likely.

ERSE also recently proposed new parameters for the return on the regulated distribution assets in 2012-2014. The formula to calculate these returns will switch from 10-year Portuguese bonds+400b.p. to an indexation to the five-year Portuguese CDS, which resulted in a preliminary return on assets of 9.5% for 2012 (based on an average five-year Portuguese CDS of 780 bp). A cap and a floor have been established within this updated remuneration framework allowing for a minimum return of 8% and a maximum return of 11%. Fitch views the latter positively as well as the reduction of the variable component of allowed revenues, resulting in a lower sensitivity of the remuneration to electricity consumption. These two changes contribute to EDP's earnings stability and visibility and ensures a minimum return on the distribution activity that compares well with a number of other European countries. In the nine months to end-September 2011, EDP's performance also demonstrated a good degree of resilience to macro-economic conditions with an EBITDA improvement of close to 5%.

Final electricity tariffs for 2012 will be published by mid-December 2011 and Fitch will closely assess them. The agency will also follow the privatisation process of up to 21.35% of the Portuguese government's stake in EDP. While proceeds from this process are anticipated to go to the government, the presence of a new shareholder may have an impact on the company's business and financial strategy and on its access to liquidity.

EDP had adequate liquidity of over EUR4bn at end-September 2011, including cash and available bank facilities. This largely covers the company's refinancing needs in the next 18 months, but the company will have to tap the market to cover 2013 maturities. Progress on refinancing, including successful issuance of a EUR200m domestic bond issue that EDP is currently launching, would be viewed positively by Fitch

EDP's senior unsecured rating is currently constrained at 'BBB+', lacking the uplift above the IDR which Fitch typically accords to the senior unsecured debt of utilities with a large portion of regulated earnings, to reflect the higher than expected recoveries in a default scenario. This constraint reflects the concern that in the context of a utility with a higher standalone creditworthiness than its sovereign, free market liquidity in EDP's core Portuguese network assets would be less predictable if the sovereign's weakness indirectly creates a utility default than if the utility defaulted for reasons unrelated to sovereign financial distress.

HC's ratings (which is wholly owned by EDP) remain aligned with those of EDP according to Fitch's "Parent and Subsidiary Rating Linkage Methodology", reflecting the close integration of the two companies. HC is strategically and operationally important to EDP as it provides the parent with a strong platform in Spain, enabling the group to optimise its positioning in the Iberian market.

Contact:

Primary Analyst
Borja Monforte

Associate Director
+34 93 467 87 47
Fitch Ratings Espana S.A.U.
Paseo de Gracia, 85, 7th Floor
08008 Barcelona

Secondary Analyst
Francesca Fraulo
Director
+39 02 87 9087 237

Committee Chairperson
Erwin van Lumich
Managing Director
+93 323 84 03

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Corporate Rating Methodology', dated 13 August 2011, is available at www.fitchratings.com.

Applicable Criteria and Related Research:

Corporate Rating Methodology

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