

Research Update:

# Portuguese Electric Utility EDP Upgraded to 'BBB/A-2' On Stronger Metrics; Outlook Stable

March 16, 2021

## Rating Action Overview

- We view positively EDP's new strategic plan, which focuses on materially improving financial leverage while accelerating growth in lower risk renewables and regulated networks--mostly in Europe and the U.S.--with an ambitious €24 billion aggregate investment target over 2021-2025.
- On March 2, 2021, EDP's main subsidiary EDPR announced a €1.5 billion capital increase while EDP raised a €750 million hybrid in January 2021. These measures were not in our base case. They significantly improve EDP's balance sheet and partly secure its sources of funding for its upcoming plan. Capital expenditure (capex) will be also funded by targeted €8 billion of asset rotations, other flexible sources of funding such as disposals, and about €2 billion of additional debt.
- The reduced leverage and additional EBITDA from return on capex lead us to expect a material and sustainable improvement in EDP's credit metrics. The above-mentioned measures also demonstrate the company is clearly committed to a 'BBB' rating.
- We have therefore raised our long- and short-term issuer credit ratings on EDP to 'BBB/A-2' from 'BBB-/A-3' and upgraded the hybrid instrument to 'BB+' from 'BB'.
- The stable outlook reflects our expectations that EDP's funds from operations (FFO) to debt will remain above 19% and debt to EBITDA close to 4.0x in 2021, improving to above 20% from 2022.

## Rating Action Rationale

**Several credit protective measures significantly improved EDP's balance sheet and has partly secured funding for the upcoming challenging growth plan.** EDP has taken various actions since July 2020 to significantly strengthen its balance sheet, which have resulted in better than expected cash flow and leverage metrics. These include a €1 billion capital increase at the EDP level in August 2020, a €1.5 billion capital increase the EDPR level announced in March 2021, and a €750 million hybrid issuance in January 2021. We notably forecast FFO to debt to reach above 19% and debt to EBITDA decreasing close to 4.0x in 2021 from close to 17% and 4.6x, respectively,

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in 2020. We have recently lowered our upside rating threshold for a 'BBB' rating to 19% from 20% to reflect evolving business risk amid the accelerated energy transition we foresee in Europe (see "Ratings On Six European Integrated Utilities Affirmed Amid Accelerated Energy Transition; One Outlook Now Negative," published on Feb. 17, 2021).

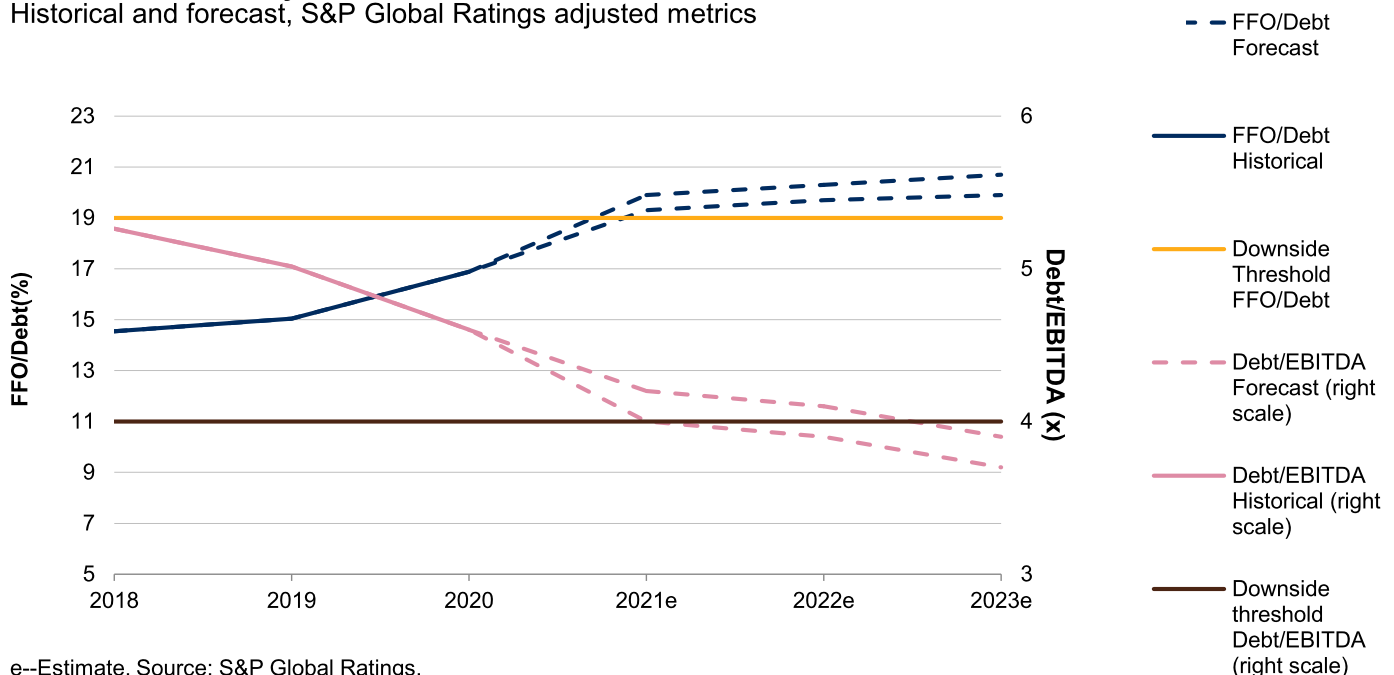
The following have contributed to EDP's improved credit metrics:

- EDP raised €1.02 billion for the Viesgo acquisition in July 2020 (see "Portuguese Integrated Electric Utility EDP 'BBB-' Ratings Affirmed On Announced Acquisition Of Viesgo HoldCo" published on July 17, 2020).
- €2.7 billion cash garnered from asset sales concluded in December 2020.
- On Jan. 25, 2021, EDP issued a non-callable 5.25-year €750 million green hybrid with interest of 1.875% to further finance its green project portfolio, which we assessed as having intermediate equity content.
- On March 2, 2021, EDP announced a capital increase of €1.5 billion at the EDPR level to partially finance EDPR's capex plan presented in the strategic plan. The company launched an offering of EDPR shares via an accelerated bookbuild targeting gross proceeds of around €1.5 billion, issuing 80 million shares or 9% of existing shares.

We highlight that, taking into account the above-mentioned credit protective measures already implemented the past 12 months, pro-forma FFO to debt is already above 19%.

Chart 1

**EDP Evolution Of Key Ratios**  
Historical and forecast, S&P Global Ratings adjusted metrics



e--Estimate. Source: S&P Global Ratings.

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**EBITDA growth will be supported by additional renewable capacity additions.** For 2020, EDP's reported recurring EBITDA decreased by 2% year-on-year (YoY) to €3,657 (corresponding to around €3.4 billion S&P Global Ratings-adjusted EBITDA). This is slightly below our previous assumptions, notably due to the COVID-19 pandemic and depreciation of the Brazilian real, which together hit reported EBITDA by around €305 million. On the other hand, reported debt decreased by about €1.6 billion YoY to about €12.2 billion on the back of successful disposals and EDP's asset rotation program. This led to a lower reported net debt to EBITDA of 3.2x (around 4.6x S&P Global Ratings-adjusted) compared with 3.6x in 2019 (adjusted: 5.0x). For 2021, we expect EDP to achieve a reported recurring EBITDA of about €3.7 billion (€3.5 billion S&P Global Ratings-adjusted EBITDA), with around €200 million coming from Viesgo but a reduced perimeter in Generation Iberia due to 2020 disposals. These notably relate to six hydro power plants in Portugal that contributed around €150 million EBITDA a year. Over 2021-2023, we expect EDP to focus on its high capex program, notably in renewables, which will lead to negative cash flow after capex and dividends of about €2 billion, and €400 million-€500 million of negative free cash flows after asset rotations. We expect EBITDA to increase more than adjusted debt on the back of renewable capacity additions.

**The upgrade is further underpinned by EDP's strong commitment to the current rating and unchanged financial policy.** During its capital markets day, EDP committed to improve its financial metrics to reach a solid investment-grade rating while maintaining sustainable leverage. We note that it reached FFO to debt above 19% in 2020 (EDP's definition) and strengthened cash flow generation. Various credit protective measures resulted in S&P Global Ratings-adjusted FFO to debt increasing to above 19%, which reinforced its commitment to the 'BBB' rating, in our view. We understand that EDP still had some flexibility to further reinforce its balance sheet (that is, additional hybrid issuance, portfolio optimization), which are not currently in our base case. If EDP encounters any operational or financial underperformance in its current plan, we would expect these credit supportive measures to be implemented in such a way that FFO to debt remains above 19% and debt to EBITDA below 4.0x.

We also understand that EDP's financial policy is unchanged, with a target payout ratio of 75%-85%, staying at €0.19 per share. We expect total dividends to average between €850 million and €920 million for the next two-to-three years.

**EDP's 2021-2025 strategic plan entails ambitious acceleration of investments in renewables and networks and should bring credible growth.** On Feb. 25, 2021, EDP presented its plan to make gross investments of €24 billion in energy transition over 2021-2025. Of this, €21 billion is aimed for expansion and €3 billion relates to maintenance, mostly in networks. S&P Global Ratings expects capex will average €4.6 billion over 2021-2022, increasing to €4.9 billion on average over 2023-2025. As a result, EDP expects EBITDA to increase by 6% over 2020-2025 to €4.7 billion. The accelerated growth predominantly focuses on renewable generation. EDP aims to double its build out renewable capacity by 2025 with an additional 20 gigawatts (GW; mainly wind onshore, with 9GW deployed and 8GW solar PV), resulting in a net added capacity of 13GW (post asset rotation).

**EDP's solid experience should mitigate the risks associated with the plan.** EDP also plans to install around 3.5 GW of renewables per year over 2021-2023, increasing to 4.6GW per year over 2024-2025, up from about 1.6GW per year as per its previous 2019-2021 plan. This is ambitious and entails some execution risks, in our view; mainly the authorization process slowing the deployment of renewables capacity. EDP has a good execution track record so far and a relatively

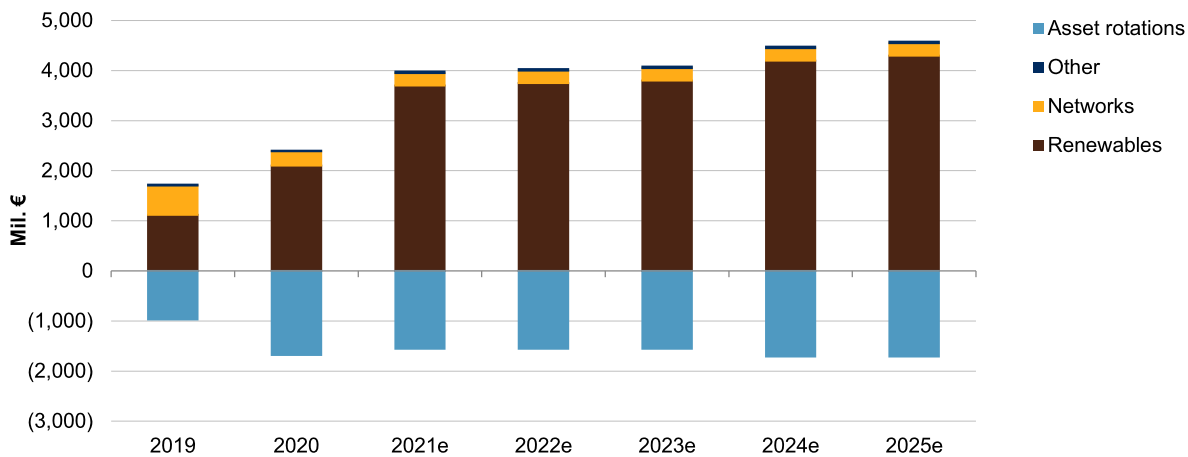
high amount of already-secured pipeline. We understand that around 60% of the capex has been secured or is expected to be secured in the short term, while the remaining 40% is in the pipeline. In addition, the bulk of capex is concentrated on increasingly mature technologies with 45% on solar and 40% on onshore wind, where the group has built a solid track record, limiting operational risks. Remaining capacity (3GW) will be allocated to offshore wind, solar distributed generation, and storage.

**In our view, the plan supports EDP's business risk profile.** This is because growth should stem mainly from renewables and, to a lesser extent, networks mostly in highly rated countries, notably the North America and Europe. Details of the plan include:

- About 80% of total capex will be allocated to renewables, 14% to networks, and 6% to conventional generation and supply. The EBITDA contribution from networks will increase from 23% in 2020 to 30% on 2021-2025 with the integration of the Viesgo distribution network, while EBITDA from renewables will stay relatively unchanged at about 60% on 2021-2025 (from 66% in 2020, due to hydro sale) with a slight dilution in EBITDA contribution from conventional generation and supply activities, to 10% from 12% in 2020.
- EDP will direct most of its investments to Europe and the North America. Renewables capex will focus on North America (about 45%) and Europe (about 35%) with a remaining 15% in Latin America, and will be concentrated in wind onshore and solar technologies. Of the networks' organic capex, 70% will be directed in core markets Portugal (50%) and Spain (20%), while the remaining 30% will be invested in Brazil.

Chart 2

**EDP Evolution Of Expansion Capex And Asset Rotation**



Note: Expansion capital expenditure (capex) includes financial investments. e--Estimate. Source: S&P Global Ratings.

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**EDP has some minority shareholdings in its subsidiaries, which will increase after the recent capital increase on EDPR.** A credit consideration for EDP is its relatively complex group structure, with significant and diverse minority shareholders in most of its foreign holdings

(notably EDP Brazil, 53.4% owned; EDPR, 75% owned, pro forma the 2021 capital injection; and electricity distribution business in Spain, 75.1% owned). This is mitigated by EDPR being almost fully internally funded, with low dividend payments, and by EDP Brasil being ring-fenced. Financial leverage at EDPR is lower than consolidated leverage, meaning the consolidated debt mainly lies at the EDP level. We note that, with the recent capital increase at EDPR, EDP's minority holdings slightly increase since it will now own 75% from 82.56% previously. EDP's share of minority shareholders represented €3,496 million of noncontrolling interests at year-end 2020 (27% of the group's consolidated equity position as of year-end 2020). We'll keep monitoring this source of cash flow leakage.

## Outlook

The stable outlook reflects our expectation that our adjusted FFO to debt for EDP will remain above 19% and adjusted debt to EBITDA close to 4.0x, down from around 5.0x in 2020. We believe the company's financial risk profile will further improve from 2022 with adjusted FFO to debt above 20%. Our rating on EDP factors in that its financial policy supports remaining at the current rating level.

## Downside scenario

We could lower the ratings if, over 2021-2022, EDP's FFO to debt drops below 19% or the company were unable to reduce leverage, with adjusted debt to EBITDA remaining above 4.0x. One or more of the following scenarios could lead us to take a negative rating action:

- EDP experiences any operational setback, such as lower-than-expected profitability from installed assets or material delays in construction that are not compensated by supportive credit remedy measures;
- Underperformance of the leverage-reduction target in the company's 2021-2025 plan;
- Increased presence of minorities, which would result in higher-than-expected cash flow leakage;
- A material heightening of country risk in Portugal and (secondarily) Brazil, including adverse regulatory or fiscal effects); and
- Inability to achieve the €8 billion asset rotation target over 2021-2025.

## Upside scenario

We view an upgrade as unlikely, given the company's current financial policy and ambitious investment plan. That said, rating upside would require EDP to achieve FFO to debt above 25% under its current business risk profile.

## Company Description

EDP is a vertically integrated utility company. It is the largest generator, distributor, and supplier of electricity in Portugal, and the third-largest electricity generator on the Iberian Peninsula.

EDP is one of the largest wind power operators worldwide, with wind farms for energy generation

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in the Iberian Peninsula, the U.S., Canada, Mexico, Brazil, France, Belgium, Italy, Poland, and Romania. It also generates solar photovoltaic (PV) energy in Portugal, Romania, and the U.S.

In Brazil, EDP is the fifth-largest private operator in electricity generation, with two electricity distribution concessions (EDP São Paulo Distribuição de Energia and EDP Espírito Santo Distribuição de Energia). It is Brazil's fourth-largest private supplier in the liberalized market, and recently entered into power transmission there.

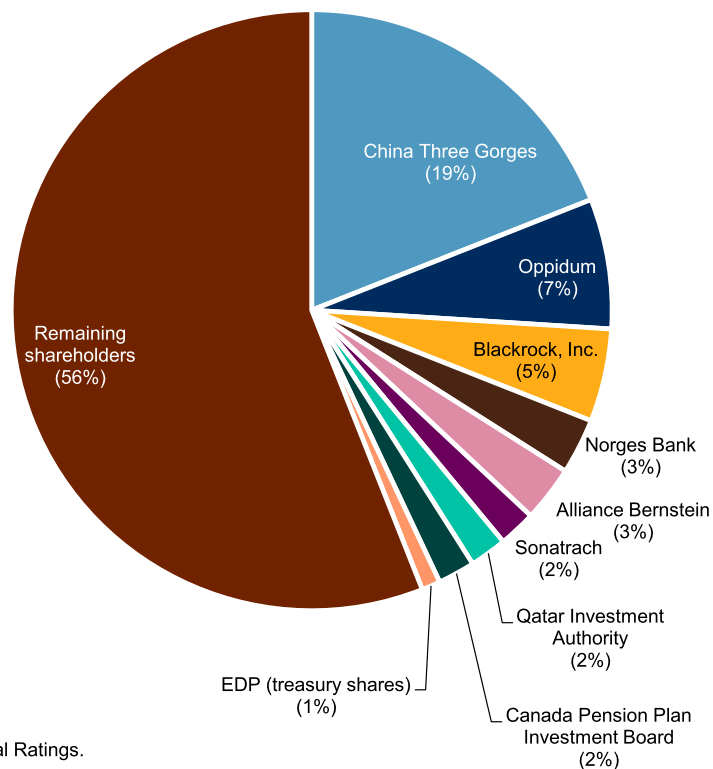
EDP reports its operations under the following three business segments:

- Renewables (65% of 2020 EBITDA). This segment includes EDP's hydro, wind, and solar power assets across all geographies. EDP's renewables capacity accounts for 78% of total installed capacity, equivalent to 18.6GW (including equity MW).
- Networks (23%). This segment includes EDP's electricity distribution activities in the Iberian Peninsula (17%) and Brazil, electricity transmission lines in Brazil, and electricity last resort supply activity in Portugal.
- Client Solutions and Energy Management (12%). This segment includes EDP's supply activities in Iberia and Brazil, thermal generation, and energy management businesses.

As of Dec. 31, 2020, EDP had an installed capacity of 23.7GW and generated 64.3 terawatt hours of electricity over the previous 12 months, about 73% of which came from renewables.

Chart 3

### EDP Shareholding Structure



e--Estimate. Source: S&P Global Ratings.

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## Our Base-Case Scenario

### Assumptions

In our base-case scenario for EDP over 2021-2023, we assume:

- Viesgo Holdco is consolidated from Dec. 16, 2020 and from as full year 2021.
- A gradual recovery in economic growth and therefore electricity consumption in the Iberian Peninsula. This could minimize affordability issues, enable a cut in electricity system costs, and see a moderate increase in system revenues. Moreover, it would reduce the tariff deficit in Portugal, which was €3.5 billion as of Dec. 31, 2020.
- Improved price conditions in the Iberian power market, with electricity prices expected to increase by about 35% compared with the 2020 low point. Over 2021-2022, we forecast prices of €45-€55 per megawatt hour (MWh). EDP would not benefit from increasing prices in 2021 as its volumes are fully hedged. 100% of expected hydro and nuclear production are hedged at prices close to €45/MWh (base-load price excluding ancillary services) and 100% of expected CCGT production at mid-single digit average spread.
- Reported EBITDA at about €3.7 billion-€3.9 billion in 2021-2022, including Viesgo. EBITDA growth will be supported by capacity additions at subsidiary EDPR, resilient operating performance at EDP Brazil, and in the power networks. The Client Solutions and Energy Management activities are expected to be slightly lower than 2019-2020 where it included several one-offs.
- We do not include any foreign exchange hit.
- A maximum working capital outflow of €300 million in 2021 and 2022.
- Cash taxes averaging €280 million over 2021-2023 and the rollover until 2022 of the €65 million extraordinary levy.
- Expansion capex including financial investments of about €4.0 billion per year over 2021-2023 and maintenance capex of about €600 million per year in the same period.
- Dividend payout (including dividends to minority shareholders) averaging €850 million over 2021-2023.
- Disposal of majority stakes in wind and solar assets, targeting €1.5 billion-€1.6 billion per year over 2021-2023 (35% of 20GW added capacity aimed at asset rotation) .
- Disposal of about €150 million per year in 2021 and 2022, with the €1 billion disposal plan being back-loaded.
- Capital injection within EDPR to be cashed-in during 2021 for €1.5 billion.
- New €750 million hybrid issued on January 2021 and considered as intermediate equity content with 50% adjusted to debt.

### Key metrics

## Key Metrics

	2019A	2020P	2021E	2022E	2023E
EBITDA (bil. €)	3.4	3.4	3.4-3.5	3.6-3.7	3.9-4.0
FFO (bil. €)	2.6	2.7	2.6-2.7	2.8-2.9	2.9-3.0
Capex and Inv. (bil. €)	2.6	3.7	4.4-4.5	4.5-4.6	4.6-4.7
Dividends (mil. €)	868	832	850-900	900-950	900-950
Debt (bil. €)	17.0	15.8	14.0-15.0	14.0-15.0	15.0-15.5
FFO/debt (%)	15.0	16.9	19.0-20.0	19.5-20.5	20.0-21.0
Debt/EBITDA (x)	5.0	4.6	4.0-4.5	3.8-4.3	3.8-4.3

A--Actual. P-- Preliminary. E--Estimate. Capex and Inv.--Capital expenditure, includes financial investments. FFO--Funds from operations. All data is adjusted by S&P Global Ratings.

## Liquidity

We view EDP's liquidity as strong, reflecting the company's proactive financing and healthy cash flow. In particular, projected sources of liquidity (predominantly operating cash flow and available bank lines) exceed projected uses (mainly necessary capex, debt maturities, and dividends) by more than 1.5x for the next 12 months and more than 1.0x in the following 12 months. EDP's strong bank relationships, prudent financial discipline, and proven access to the debt capital markets support our assessment of the company's liquidity position as strong.

We estimate the following principal liquidity sources for the 12 months from Dec. 31, 2020:

- Unrestricted cash of about €3.0 billion;
- About €5.5 billion in available committed lines maturing beyond 12 months. In particular, EDP has a €3.3 billion revolving credit facility (RCF) maturing in 2024 and a €2.1 billion RCF maturing in 2025.
- Forecast cash FFO of about €3.4 billion;
- Capital injection of €1.5 billion within EDPR, announced in the first quarter of 2021;
- €750 million for hybrid issuance in January 2021.

For the same period, we estimate that principal liquidity uses:

- Short-term debt of about €1.4 billion, including subsidiaries' short-term debt.
- Estimated working capital outflows of €300 million.
- An estimated €4.5 billion of gross capex.
- Dividends of about €810 million, including dividends to subsidiaries' minority shareholders.

## Issue Ratings - Subordination Risk Analysis



## **Capital structure**

EDP's policy is to issue most of its debt at the parent company directly, or via its financial subsidiary EDP Finance BV, and lend the proceeds to its operating companies. However, we calculate structural subordination to be 20% because of the amount of debt at the subsidiaries, including Viesgo. We think EDP's size, diversity of cash flow generation, and financial ring-fencing of its Brazilian subsidiary and direct ownership of a fair amount of operating assets strongly mitigate structural subordination issues.

## **Analytical conclusions**

The issue rating on EDP's senior unsecured debt is 'BBB', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure. We rate the hybrid bonds 'BB+', two notches below EDP's 'bbb' stand-alone credit profile.

## **Ratings Score Snapshot**

Issuer Credit Rating: BBB/Stable/A-2

Business risk: Strong

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Significant (medial volatility table)

- Cash flow/Leverage: Significant

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

- Group credit profile: bbb

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- 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
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Ratings List

### Upgraded

	To	From
<b>EDP - Energias de Portugal S.A.</b>		
<b>EDP Finance B.V.</b>		
Issuer Credit Rating	BBB/Stable/A-2	BBB-/Stable/A-3
<b>EDP - Energias de Portugal S.A.</b>		
Senior Unsecured	BBB	BBB-
Junior Subordinated	BB+	BB
Commercial Paper	A-2	A-3
<b>EDP Finance B.V.</b>		
Senior Unsecured	BBB	BBB-
Commercial Paper	A-2	A-3

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,

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have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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