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EDP - Energias de Portugal S.A.

Primary Credit Analyst:
Massimo Schiavo, Paris + 33 14 420 6718; Massimo.Schiavo@spglobal.com

Secondary Contacts:
Renata Gottliebova, Dublin +353 1 568 0608; renata.gottliebova@spglobal.com
Pierre Georges, Paris (33) 1-4420-6735; pierre.georges@spglobal.com
Claire Mauduit-Le Clercq, Paris + 33 14 420 7201; claire.mauduit@spglobal.com
Pauline Pasquier, Paris (33) 1-4420-6771; pauline.pasquier@spglobal.com

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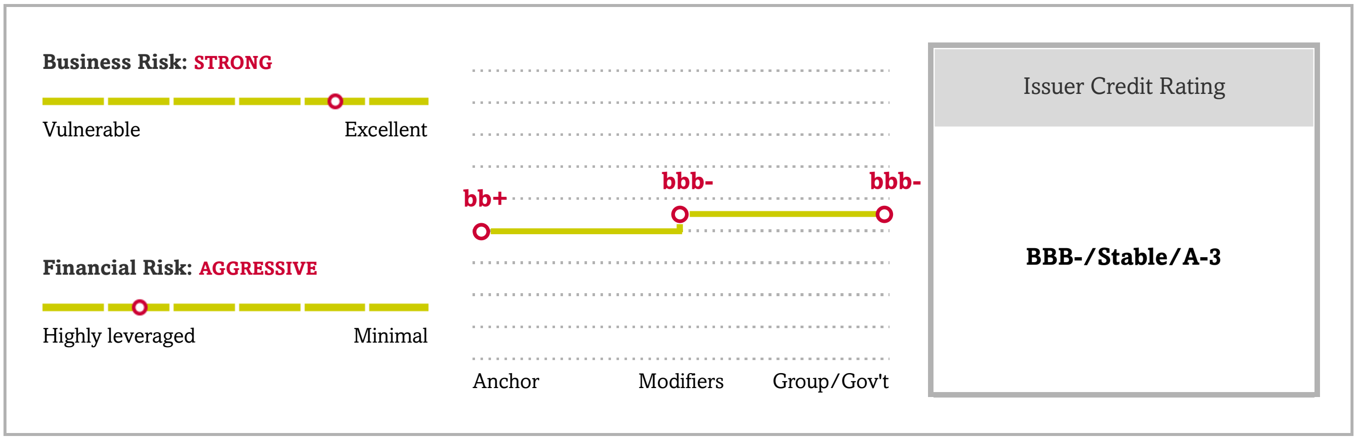
EDP - Energias de Portugal S.A.



Credit Highlights

Overview

Key strengths	Key risks
High share of cash flows (79% of 2019 EBITDA) stemming from networks (27% of 2019 EBITDA) and long-term contacted activities (52%), which will increase by about 5% following the reshape of the Iberian portfolio.	Relatively high leverage, with S&P Global Ratings-adjusted debt to EBITDA at 5.4x in 2019 and trending down to about 5.0x in 2020.
Dominant electric utility in Portugal and total regulated activities in Spain, Brazil, and Portugal (27% of 2019 EBITDA) in a still-supportive regulatory environment.	Exposure to regulation in Iberia (19% of 2019 EBITDA), which S&P Global Ratings sees as slightly less credit supportive than other European frameworks such as France, the U.K., or Germany.
Significant business and geographic diversification, with 67% of EBITDA generated outside of Portugal, mainly in Spain, Brazil, the U.S., and Canada.	Exposure--but gradually declining--to merchant risk (21% of EBITDA) mainly through power generation activities in Iberia.
A low-carbon and modern generation fleet, with about 75% of capacity coming from renewable sources (mainly wind and hydroelectric).	Exposure to foreign exchange risk in Brazil and the U.S, mitigated by the company's net investment hedge policy and by financial ring-fencing in Brazil.
Ongoing deleveraging, with adjusted debt to EBITDA expected to decline to about 5.0x in 2020 (consolidating Viesgo Holdco on a pro-forma basis) thanks to disposals, compared with 5.4x in 2019.	Presence of some minorities in subsidiaries, notably at EDP Brazil and EDP Renovaveis (EDPR), although mitigated by EDPR being almost fully funded internally.
Proactive liability management allowing reduced debt costs, with refinancing needs covered beyond 2022.	

A high share of EDP - Energias de Portugal S.A.'s (EDP)'s cash flow stems from networks, and long-term contracted asset-based operations, which will increase by about 5% with the acquisition of Viesgo. These activities represented 79% of 2019 EBITDA (with fully regulated activities representing 27% and long-term contracted generation operations 52%) and provide a stable and predictable source of cash flow generation. We see the acquisition of Viesgo, announced on July 15, 2020, as marginally improving EDP's business risk, as Viesgo's power network activities (about 75% of EBITDA) provide perpetual regulated licenses with good cash flow visibility for the next five years within the 2020-2025 regulatory period, and renewables operations (25%) are largely contracted. We view networks as slightly less risky than long-term contracted asset-based operations since they are less exposed to long-term technological risk, although we recognize the strength of EDP's renewable operations, which provide long-term visibility in earnings.

EDP had relatively high adjusted debt to EBITDA of 5.4x in 2019, with a deleveraging path, which will not be derailed by the acquisition of Viesgo. We view EDP's leverage as relatively high, since its adjusted debt to EBITDA has been sustainably well above 5.0x over the past five years.

That said, EDP has reshuffled its business portfolio, exited from merchant assets, and significantly reduced its leverage over the past six months. In particular:

- In December 2019, EDP agreed to sell six hydro plants in Iberia for €2.2 billion to a financial consortium led by ENGIE SA.
- In May 2020, EDP announced the sale of two combined-cycle gas turbine (CCGT) plants and a portfolio of business-to-consumer (B2C) clients to Total S.A. for €515 million.

Despite the acquisition of Viesgo, which is being partially funded with a €1.02 billion capital increase, these disposals, coupled with expected resilient performance, should lead to a significant reduction in adjusted debt to EBITDA to about 5.0x in 2020, compared with 5.4x in 2019. We note these disposals will also have a slightly positive impact on our business risk assessment because EDP is exiting some of its more volatile merchant business activities.

The exposure to merchant risk represented 21% of 2019 EBITDA, but is expected to decline to less than 20% in 2022. EDP's power generation activities--previously not vulnerable to merchant risk given the contractual equilibrium maintenance cost (CMEC) annual adjustment mechanism--became exposed to price and volume risks in July 2017. This created additional cash flow volatility that can somehow harm results, as seen over the past three years. EDP's hedging policy is a mitigating factor, which proved beneficial in its first-quarter 2020 results. Another mitigating factor is EDP's progress in selling its merchant activities, which are expected to represent less than 20% of EBITDA at year-end 2022 (from 21% in 2019).

We will be closely monitor the evolution of EDPR's merchant portfolio in the coming years. As of today, 90% of EDPR's revenue either comes from contracted activities and power purchase agreements (PPAs) or is hedged, versus 10% that is exposed to merchant power.

EDP has some minority shareholders in its subsidiaries, which will increase with the Viesgo acquisition. 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, 51.38% owned, and EDPR, 82.56% owned). This is mitigated by the fact that EDPR is almost fully funded internally. Financial leverage at EDPR is lower than consolidated leverage, meaning the consolidated debt mainly lies at the EDP level. We note that, with the Viesgo transaction, minorities for EDP will increase since it will own 75.1% of the power distribution networks of EDP and Viesgo. EDP's share of minority shareholders represented €3,774 million of noncontrolling interests at year-end 2019 (30% of the group's consolidated equity position as of year-end 2019).

Outlook: Stable

The stable outlook on EDP reflects our expectation that its financial risk profile will continue to improve over the next two years on stronger operating performance and the sale of merchant assets and retail B2C clients in the Iberian Peninsula, announced in the past six months, for more than €2.7 billion. Moreover, the Viesgo acquisition will not derail credit metric improvement since it is neutral from a cash flow perspective and slightly positive from a business risk perspective. The consolidation of Viesgo, which we started on Jan. 1, 2020, should lead to funds from operations (FFO) to debt of about 16% in 2020, and adjusted debt to EBITDA declining to about 5.0x, from 5.4x in 2019. Management's commitment to maintaining an investment-grade rating, as well as its policy to further reduce debt to EBITDA over 2020-2022, underpins the outlook.

Downside scenario

We could downgrade EDP if its FFO to debt does not improve as expected and stays materially below 16% over 2020-2022. We would also downgrade EDP if the company were unable to materially deleverage over 2020-2022, with adjusted debt to EBITDA remaining materially above 4.5x.

One or more of the following scenarios could prompt a downgrade:

- Continuously challenging conditions in the Iberian power generation market;
- Any deviation from the improvement in the leverage-reduction target presented in the 2019-2022 plan;
- A material heightening of Portuguese and (secondarily) Brazilian country risk (including adverse regulatory or fiscal effects);
- Larger-than-expected foreign exchange effects in 2020; and
- An inability to achieve its asset-rotation target over 2020-2022.

Upside scenario

Ratings upside over the next two years would require EDP to achieve FFO to debt above 20% under its current business risk profile.

Our Base-Case Scenario

Assumptions

In our base-case scenario for EDP over 2020-2022, we assume:

- Real GDP contraction in Portugal of 7.7% in 2020, followed by growth of 4.2% in 2021 and 4.0% in 2022. In Spain, we expect real GDP contraction of 9.8% in 2020, followed by growth of 6.8% in 2021, and 3.8% in 2022.
- Viesgo Holdco is consolidated pro forma from January 2020.
- A gradual recovery in economic growth and therefore electricity consumption in the Iberian Peninsula. This could minimize affordability issues, allow 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 €3.6 billion as of Dec. 31, 2019.
- Challenging conditions persist in the Iberian power market, with electricity prices expected to drop by about 20% compared with our previous assumptions. Although EDP has hedged 100% of its expected production for 2020 at about €55 per megawatt-hour (MWh), it could suffer declining power prices in 2021 for its portion of volumes that are not hedged. Over 2020-2022, we forecast prices of €43-€48 per MWh with EDP having hedged over 70% of its volumes at about €50 per MWh.
- Reported EBITDA at about €3.8 billion in 2020-2021, including Viesgo. EBITDA growth will be supported by capacity additions at subsidiary EDPR, new power transmission investments in Brazil, and resilient operating performance at EDP Brazil and in the Iberian power networks. The sale of hydro assets in Portugal and CCGTs and B2C supply in Spain will affect EBITDA by about €200 million in 2020. We expect a negative foreign exchange effect for 2020 of €100 million at most.
- A maximum working capital outflow of €500 million in 2020 due to a delay in collecting receivables.
- Cash taxes averaging €240 million over 2020-2021 and the rollover until 2022 of the €65 million extraordinary levy.
- Gross capital expenditure (capex) of about €3.0 billion over 2020-2022.
- Dividend payout (including dividends to minority shareholders) averaging €900 million over 2020-2021.
- Investment of 3.1 billion Brazilian reals for power transmission lines in the country over 2019-2022.
- Disposal of majority stakes in wind and solar assets, targeting €3 billion over 2020-2022. EDP has already realized about €1 billion in 2019. It expects to receive, on average, €1 billion annually over the next three years from the asset rotation deals. On Aug. 8, 2020, EDP announced a €0.5 billion asset rotation deal for wind farms in Spain that is expected to be completed in fourth-quarter 2020.
- Disposal of hydro assets in Portugal and thermal assets and retail clients in Spain for more than €2.7 billion, to be cashed in the next 12 months.

Key Metrics

	2019A	2020E	2021E	2022E
EBITDA (bil. €)	3.4	3.5-3.6	3.7-3.8	3.9-4.0
FFO (bil. €)	2.6	2.7-2.8	2.9-3.0	3.0-3.1
Capex (bil. €)	2.3	2.6-2.8	3.0-3.3	2.8-3.2

	2019A	2020E	2021E	2022E
Dividends (mil. €)	868	860-900	950-1,000	960-1,000
Debt (bil. €)	18.3	17.0-18.0	17.0-18.0	17.0-18.0
FFO to debt (%)	14.0	15.5-16.5	16.0-17.0	16.5-17.5
Debt to EBITDA (x)	5.4	4.5-5.0	4.5-5.0	4.5-5.0

A--Actual. Capex--Capital expenditure. E--Estimate. FFO--Funds from operations. All data is S&P Global Ratings-adjusted.

We expect organic debt reduction over 2020-2022 thanks to EBITDA growth led by renewables. As part of its 2019-2022 strategic update, EDP should significantly reduce reported net debt to EBITDA to about 3.2x (about 5.0x adjusted, according to our calculations) in 2020, and below 3.0x (about 4.5x adjusted) in 2022, from 4.0x (5.7x adjusted) in 2018. We see this target as challenging, given that EDP will partly finance its ambitious investment plan with the aforementioned asset-rotation strategy, and its adjusted debt to EBITDA has been sustainably above 5.0x over the past five years. That said, we note EDP's strong debt reduction efforts, as seen in its recent disposals of merchant and retail assets in Iberia for more than €2.7 billion.

EBITDA expansion will come from increasing capex, notably in renewables and power transmission in Brazil. The 2019-2022 strategic update, which dedicates €8 billion of investment in renewables, highlights EDP's ambition to accelerate expansion in this division. Over 2019-2022, EDP plans to finance part of this investment with €4 billion from asset rotation and €2 billion from disposals. We note that, as of May 2020, EDP had already secured about 65% of the aforementioned €6 billion from disposals and asset rotations. On Aug. 8, 2020, EDP announced a €0.5 billion asset-rotation deal for wind farms in Spain that is expected to be completed in fourth-quarter 2020.

The dividend payout ratio is relatively high. In last year's 2019-2022 strategic update, EDP increased the payout ratio to 75%-85% of net income (65%-75% in the previous plan), maintaining the floor of €0.19 per share (dividends paid in 2018). We note EDP's payout ratio is higher than that of Enel (70%) or Iberdrola (65%-75%), but we also understand from EDP that its dividend policy is intended not to hamper deleverage. However, we expect the company to increase dividends only if performance allows for it.

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 in the Iberian Peninsula, the U.S., Canada, Mexico, Brazil, France, Belgium, Italy, Poland, and Romania. It also generates solar photovoltaic 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:

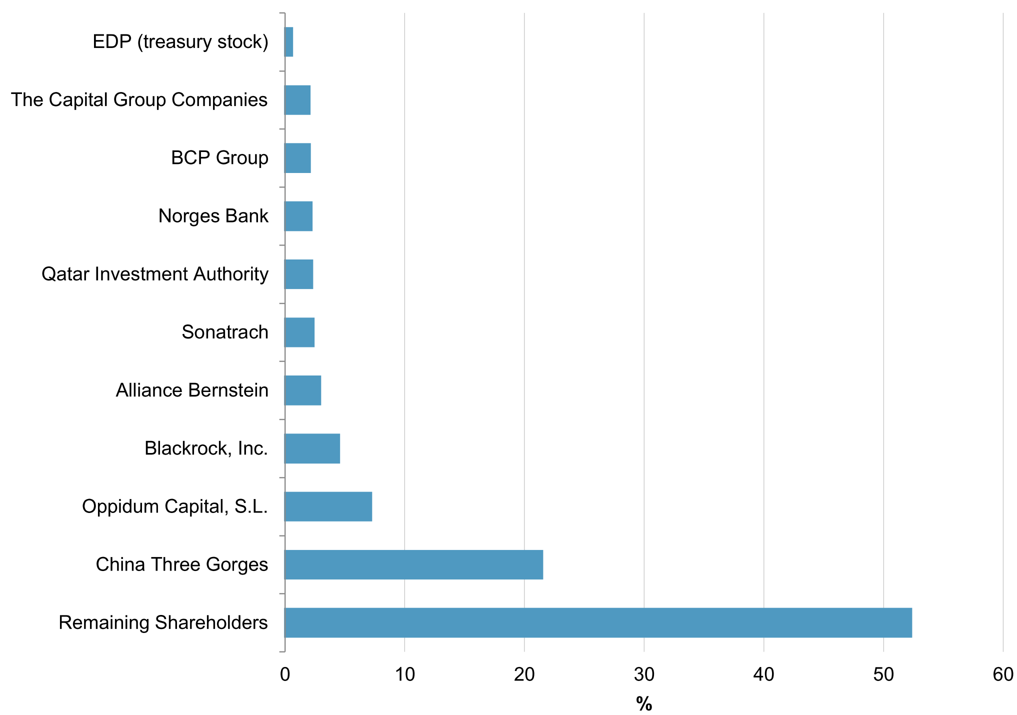
- Renewables (61% of 2019 EBITDA): This segment includes EDP's hydro, wind, and solar power assets across all geographies. EDP's renewables capacity accounts for 77% of total installed capacity, equivalent to 20.6 gigawatts (GW) (including Equity MW).

- Networks (27%): 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, 2019, EDP had an installed capacity of 26.7 GW and generated 66.7 terawatt hours of electricity over the previous 12 months, about 66% of which came from renewables.

Chart 1

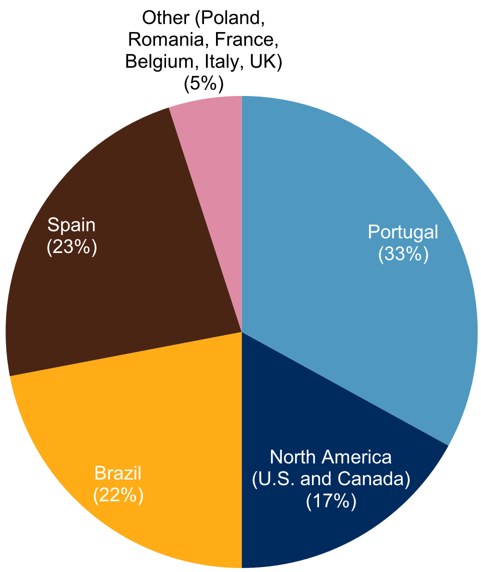
EDP-Energias De Portugal--Shareholding Structure



Source: S&P Global Ratings.

Chart 2

EDP-Energias De Portugal--Geographic Split As Of Year-End 2019
As a percentage of EBITDA



Source: S&P Global Ratings.

Peer Comparison

Table 1

EDP-Energias De Portugal S.A.--Peer Comparison

Industry sector: Energy

	EDP - Energias de Portugal S.A.	Naturgy Energy Group S.A.	Iberdrola S.A.	Enel SpA
Ratings as of Aug. 19, 2020	BBB-/Stable/A-3	BBB/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
(Mil. €)	**--Fiscal year ended Dec. 31, 2019--**			
Revenue	14,333.0	23,035.0	36,437.9	79,775.0
EBITDA	3,390.2	4,608.0	9,784.0	16,892.0
Funds from operations (FFO)	2,557.0	3,490.6	7,894.1	12,434.0
Interest expense	684.1	751.4	1,770.0	2,645.0
Cash interest paid	583.6	724.4	1,093.3	2,608.0
Cash flow from operations	1,741.8	4,082.6	5,610.9	11,356.0
Capital expenditure	2,300.7	1,835.0	5,360.0	9,259.0

Table 1

EDP-Energias De Portugal S.A.--Peer Comparison (cont.)				
Free operating cash flow (FOCF)	(559.0)	2,247.6	250.9	2,097.0
Discretionary cash flow (DCF)	(1,509.1)	(28.4)	(1,644.1)	(1,975.0)
Cash and short-term investments	1,481.7	2,658.1	2,119.5	8,880.3
Debt	18,290.7	17,191.3	42,870.7	54,866.5
Equity	13,507.0	13,115.0	45,920.4	49,166.5
Adjusted ratios				
EBITDA margin (%)	23.7	20.0	26.9	21.2
Return on capital (%)	6.3	9.4	7.0	11.0
EBITDA interest coverage (x)	5.0	6.1	5.5	6.4
FFO cash interest coverage (x)	5.4	5.8	8.2	5.8
Debt/EBITDA (x)	5.4	3.7	4.4	3.2
FFO/debt (%)	14.0	20.3	18.4	22.7
Cash flow from operations/debt (%)	9.5	23.7	13.1	20.7
FOCF/debt (%)	(3.1)	13.1	0.6	3.8
DCF/debt (%)	(8.3)	(0.2)	(3.8)	(3.6)

EDP 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 global leaders in renewables production. The company generates a higher proportion of its energy production from renewables than peers Enel and Naturgy. EDP will continue to invest in renewables, with onshore and offshore wind representing about 75% of expansion investments until 2022.

EDP is the smallest of the other global integrated utilities with a strong footprint in Iberia--adjusted EBITDA of €3.4 billion as of year-end 2019. EDP also receives a lower contribution from pure network activities (27% of 2019 EBITDA). For Iberdrola, Enel, and Naturgy this figure is above 50%. As a result, we view EDP's business risk profile as relatively weaker.

Business Risk: Strong

EDP's regulated and renewable segments have strong market positions. The earnings' contribution from power network activities in Iberia and Brazil and renewables operations in North America, Europe, and Latin America (87% in 2019) continue to support our assessment of EDP's business risk profile.

We expect regulated activities in Iberia will represent close to 22% of the company's EBITDA over 2020-2022, while electricity distribution and transmission in Brazil should represent close to 10%. The contribution to total EBITDA of EDP's subsidiary EDPR should increase to about 43%, with exposure to merchant generation in Iberia declining to less than 20% of total EBITDA in 2022, from 22% in 2019. We continue to see EDPR's portfolio as an additional strength for the business, with 90% of EDPR's revenue either coming from regulated activities and PPAs, or hedged, versus 10% that is exposed to merchant power. The average remaining life of these PPA contracts is 15 years in the U.S. and 11-12 years in Europe (for 100% of their renewable capacity), which provides significant cash flow visibility over the long term.

Table 2

EDP-Energias De Portugal S.A.--Assessments Of Regulatory Jurisdictions Where EDP Operates	
Strong/Adequate	Adequate
Portugal	Brazil
Spain	

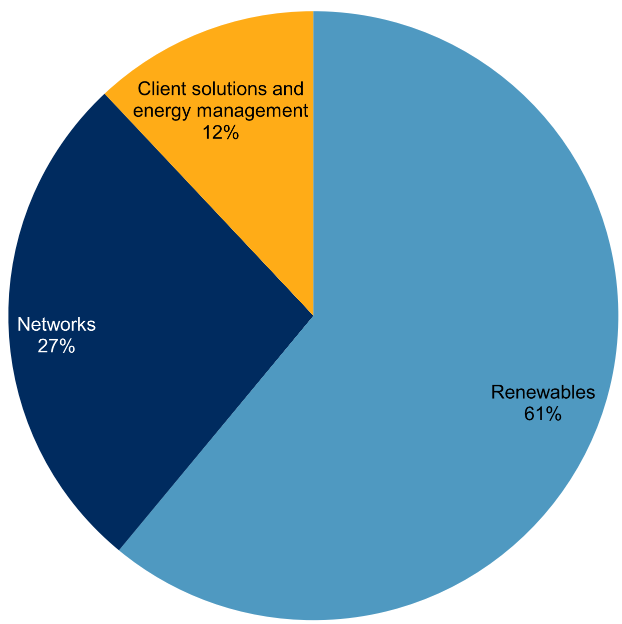
Source: S&P Global Ratings

EDP also has a strong position in its key markets as the largest generator, distributor, and supplier of electricity in Portugal, and the third-largest electricity generation company on the Iberian Peninsula. Our assessment also reflects EDP's cost discipline and solid operating performance, as well as the company's significant global scale and low-cost, low-carbon-intensive, and modern generation portfolio (including a leading global position in wind energy). Moreover, EDP benefits from significant diversification, with 67% of its 2019 EBITDA generated outside Portugal, mainly in Spain, Brazil, the U.S., and Canada.

Key relative weaknesses include EDP's exposure to uncertain and volatile power prices in Iberia, partially mitigated by its hedging policy, as well as its above-average country risk exposure to Brazil. We note EDP's merchant exposure has reduced following the sale of merchant assets in December 2019 and May 2020 for more than €2.7 billion.

Chart 3

EDP-Energias De Portugal--2019 EBITDA Split By Segment



Source: S&P Global Ratings.

The Viesgo acquisition will support EDP's business risk thanks to most of the EBITDA stemming from fully regulated or contracted activities. Viesgo generated reported (according to our definition) EBITDA of about €250 million in 2019, which we expect will decline to about €210 million in 2020 due to the new 2020-2025 regulation for power distribution, with a 50-basis-point remuneration decline in 2020, lower remuneration for renewables in Spain, and the negative impact on merchant renewables from lower power prices in the country. We note that 75% of Viesgo's EBITDA stems from fully regulated power distribution activities, and 25% from renewables, of which about half are fully contracted. Nevertheless, we see it as marginally improving EDP's business risk profile, because the majority of its EBITDA comes from fully regulated or contracted activities with visibility at least until 2025. In our base-case scenario, we do not assume any operating or financial synergies between EDP and Viesgo and have consolidated Viesgo within EDP starting from Jan. 1, 2020, on a pro-forma basis.

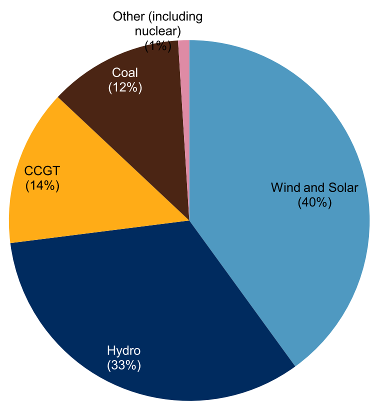
A high share of cash flows comes from regulated and long-term contracted asset-based operations. We expect EDP to generate more than 80% of 2020 EBITDA (including Viesgo) from regulated and long-term contracted asset-based operations. We also expect the remaining useful life of contracts--in excess of 10 years on average--should lead to above-average visibility on future earnings.

EDP has a strong standing in its key markets, being the largest generator, distributor, and supplier of electricity and the third-largest electricity generator in Iberia. This also underpins EDP's business risk position.

A low-carbon and modern generation fleet, with about 75% of capacity coming from renewable sources.

Chart 4

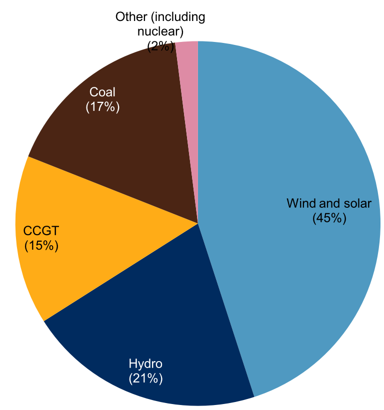
EDP-Energias De Portugal--Installed Capacity Breakdown By Technology (GW)
As of year-end 2019



CCGT--Combined cycle gas turbine. GW--Gigawatt. Source: S&P Global Ratings.

Chart 5

EDP-Energias De Portugal--Electricity Production Breakdown By Technology (TWh) As of year-end 2019



CCGT--Combined cycle gas turbine. TWh--Terawatt-hour. Source: S&P Global Ratings.

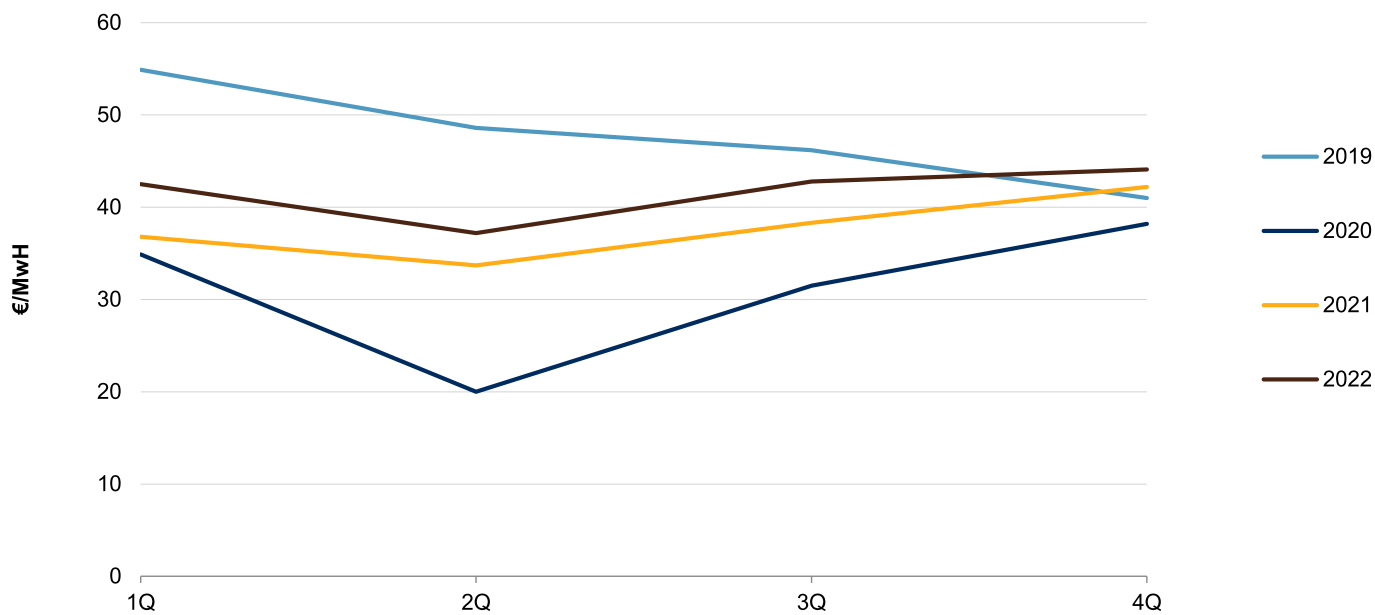
EDP benefits from a low-carbon and modern generation fleet, with about 73% of installed capacity and 66% of power production coming from renewables. We note that EDP, through its subsidiary EDPR, is the fourth-largest renewables operator in the world, with a geographical footprint in Europe--notably Iberia--North America, and Brazil. As of March 2020, EDP had 1.3 GW of wind and solar capacity under construction.

EDP has declining exposure to merchant risk, which represented 21% of 2019 EBITDA. Key weaknesses include EDP's exposure, although declining, to uncertain and volatile power prices in Iberia. This reflects that part of Iberian power capacity is fully exposed to market prices given the expiration of the CMEC annual adjustment mechanism in July 2017. The effect was particularly evident in 2017, when the recurring EBITDA for its Generation and Supply Iberia division declined 44% year-on-year, stemming mainly from lower hydro production and lower margins. We see EDP's progress in its sale of merchant activities as an increasingly important mitigating factor, with merchant activities expected to represent close to 15% of EDP's EBITDA at year-end 2022.

We expect declining power prices in Spain (see chart 6), with spot electricity prices remaining well below €40/MWh in 2020 (about 20% below the 2019 price level), will hurt EDP's power generation business in the Iberian Peninsula starting from 2021, since it is 100% hedged for 2020 and 70% for 2021.

Chart 6

EDP-Energias De Portugal--Electricity Power Prices In Spain



MwH--megawatt-hour. Source: S&P Global Platts.

There are some minority shareholders in EDP's subsidiaries. A credit consideration for EDP is its relatively complex group structure, with diverse minority shareholders in most of its foreign holdings (notably EDP Brazil, 51.38% owned, and EDP Renovaveis, 82.56% owned). We also note this is mitigated by EDPR being almost fully funded internally.

EDP's minority shareholders represented €3,774 million of noncontrolling interests at year-end 2019.

Financial Risk: Aggressive

EDP's 2019 results were credit supportive. Reported recurring EBITDA increased 13% year-on-year to €3,716 million. This was thanks to a stronger-than-expected performance in energy management and generation in Iberia, despite still-challenging hydro conditions; and in Brazilian networks, where the addition of power transmission lines contributed €44 million to EBITDA. Reported net debt increased by €300 million year-on-year, to €13.8 billion, owing to an 11% rise in capex to €2.3 billion. The increase in net debt, which was expected, was more than offset by EBITDA growth, with reported net debt to EBITDA that decreased to 3.6x compared with 4.0x in 2018.

EDP had relatively high adjusted debt to EBITDA of 5.4x in 2019. We view EDP's leverage as currently relatively high, noting that its adjusted debt to EBITDA has been sustainably well above 5.0x over the past five years. It is more leveraged than integrated utilities with strong business risk profiles.

There is now a credible path to deleveraging. Despite difficult operating conditions (such as weak hydro conditions in Iberia in the past three years) EDP has continued its deleveraging plan. In particular, over the past six months EDP has been active in reshuffling its business portfolio, exiting from merchant assets, and being able to significantly reduce its leverage. In particular we note:

- In December 2019, EDP sold six hydro plants in Portugal for €2.2 billion to a financial consortium led by ENGIE SA.
- In May 2020, EDP sold two CCGTs plants and a portfolio of B2C clients to Total S.A. for €515 million.
- These disposals, coupled with the expected resilient performance in 2020, should lead to a significant reduction in adjusted debt to EBITDA to less than 5.0x in 2020 compared with 5.4x in 2019.

The Viesgo acquisition will not derail EDP's credit metric improvement. In July, the company announced the acquisition of Spanish power network distributor and renewables company Viesgo for €2.7 billion. Viesgo's reported net debt was €1.1 billion in 2019. Once the transaction closes, expected before year-end 2020, EDP will own 75.1% of the Spanish distribution networks of EDP and Viesgo, EDP Renovaveis will own 100% of Viesgo's renewables business, and EDP will own 100% of Viesgo's soon-to-be-decommissioned coal power plants. In our base-case scenario, we consolidated Viesgo within EDP from Jan. 1, 2020, on a pro-forma basis. For more information, see "Viesgo Holdco's Financial Policy Likely To Remain Unchanged After Its Acquisition By EDP," published July 16, 2020, on RatingsDirect. As part of the transaction, EDP announced the following:

- In August, the company concluded a €1.02 billion capital increase, which was fully subscribed.
- It will transfer its Spanish power distribution networks to Viesgo and the networks will be 75.1% owned by EDP and 24.9% owned by Macquarie.
- EDP's 82.6%-owned subsidiary EDP Renovaveis will acquire 100% of Viesgo's renewables business and EDP will acquire Viesgo's two coal plants, which are expected to shut down in 2021.

Accounting for these, we expect the acquisition to be credit neutral for EDP, with adjusted debt to EBITDA expected to decrease to about 5.0x in 2020 from 5.4x in 2019 and adjusted FFO to debt to improve to close to 16% in 2020 from 14% in 2019.

Rating headroom is expected to recover over 2021-2022, with supportive performance expected in 2020. For 2020, we expect EDP's reported EBITDA to reach at least €3.6 billion (€3.8 billion considering Viesgo, according to our estimates), with COVID-19-related effects mainly stemming from:

- Foreign exchange, notably a devaluation of the Brazilian real, which we expect to have an impact on EBITDA of up to €100 million. Although having a negative profit-and-loss effect, we expect this local currency depreciation to reduce net debt, mitigating the impact on credit metrics.
- Lower electricity volumes sold and higher receivables, which would translate into an effect on working capital--expected to be a maximum of €500 million. Thanks to the aforementioned disposals and the resilient performance expected in 2020, adjusted FFO to debt should remain close to 16% on a pro-forma basis.

Over 2021-2022, we expect EDP will continue to focus on its large capex program, notably in renewables, which will lead to negative free cash flow after capex and dividends of about €300 million. EBITDA will increase, more so than adjusted debt, on the back of capacity additions. We forecast adjusted EBITDA (including Viesgo) will increase to more than €3.7 billion in 2021 and €3.9 billion in 2022, with adjusted debt remaining close to €17.5 billion. This will translate into an increase of adjusted FFO to debt to more than 17% in 2022, compared with close to 16% in 2020.

Proactive liability management has reduced debt, with refinancing needs covered beyond 2022. Liability management enabled EDP to proactively reduce its average cost of debt by 60 basis points to 3.4% in March 2020. Moreover, the recent debt issuances along with the company's comfortable liquidity position--mostly based on long-term revolving credit facilities (RCFs) fully committed and involving 27 international banks with high credit standing--will enable EDP to cover its refinancing needs beyond 2022.

Financial summary

Table 3

EDP-Energias De Portugal S.A.--Financial Summary			
Industry sector: Energy			
	--Fiscal year ended Dec. 31--		
(Mil. €)	**2019**	**2018**	**2017**
Revenue	14,333.0	15,278.1	15,746.0
EBITDA	3,390.2	3,207.0	3,462.0
Funds from operations (FFO)	2,557.0	2,455.1	2,001.5
Interest expense	684.1	708.6	847.4
Cash interest paid	583.6	686.9	851.0
Cash flow from operations	1,741.8	2,398.2	1,574.8
Capital expenditure	2,300.7	1,674.9	1,887.7
Free operating cash flow (FOCF)	(559.0)	723.3	(312.9)
Discretionary cash flow (DCF)	(1,509.1)	(156.1)	(1,164.7)
Cash and short-term investments	1,481.7	1,720.3	2,298.6
Gross available cash	1,543.2	1,913.2	2,343.9
Debt	18,290.7	18,147.4	18,454.4
Equity	13,507.0	13,275.3	13,855.3
Adjusted ratios			
EBITDA margin (%)	23.7	21.0	22.0
Return on capital (%)	6.3	5.5	6.2
EBITDA interest coverage (x)	5.0	4.5	4.1
FFO cash interest coverage (x)	5.4	4.6	3.4
Debt/EBITDA (x)	5.4	5.7	5.3
FFO/debt (%)	14.0	13.5	10.8
Cash flow from operations/debt (%)	9.5	13.2	8.5
FOCF/debt (%)	(3.1)	4.0	(1.7)
DCF/debt (%)	(8.3)	(0.9)	(6.3)

Reconciliation

Table 4

EDP-Energias De Portugal S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

	--Fiscal year ended Dec. 31, 2019--								
EDP - Energias de Portugal S.A. reported amounts (Mil. €)									
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
Reported	16,571.5	8,858.2	3,747.0	1,940.0	639.7	3,390.2	2,221.0	825.4	2,348.5
S&P Global Ratings' adjustments									
Cash taxes paid	--	--	--	--	--	(284.9)	--	--	--
Cash interest paid	--	--	--	--	--	(578.4)	--	--	--
Reported lease liabilities	837.7	--	--	--	--	--	--	--	--
Intermediate hybrids reported as debt	(875.0)	875.0	--	--	(42.6)	42.6	42.6	42.6	--
Postretirement benefit obligations/deferred compensation	825.6	--	(21.9)	(21.9)	32.7	--	--	--	--
Accessible cash and liquid investments	(1,543.2)	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	47.8	(47.8)	(47.8)	--	(47.8)
Share-based compensation expense	--	--	1.2	--	--	--	--	--	--
Dividends received from equity investments	--	--	45.8	--	--	--	--	--	--
Asset-retirement obligations	332.9	--	--	--	6.6	--	--	--	--
Nonoperating income (expense)	--	--	--	134.3	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(474.0)	--	--
Noncontrolling interest/minority interest	--	3,773.8	--	--	--	--	--	--	--
Debt: Guarantees	414.1	--	--	--	--	--	--	--	--
Debt: Fair value adjustments	(84.8)	--	--	--	--	--	--	--	--
Debt: Tax liabilities	1,286.9	--	--	--	--	--	--	--	--
Debt: Other	524.9	--	--	--	--	--	--	--	--
EBITDA: Business divestments	--	--	(313.5)	(313.5)	--	--	--	--	--
EBITDA: Other	--	--	(68.5)	(68.5)	--	--	--	--	--

Table 4

EDP-Energias De Portugal S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (cont.)

	Debt	Equity	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Dividends paid	Capital expenditure
Depreciation and amortization: Impairment charges/(reversals)	--	--	--	308.2	--	--	--	--	--
Funds from operations: Other	--	--	--	--	--	35.4	--	--	--
Total adjustments	1,719.2	4,648.8	(356.8)	38.7	44.4	(833.2)	(479.2)	42.6	(47.8)
S&P Global Ratings' adjusted amounts									
Adjusted	18,290.7	13,507.0	3,390.2	1,978.7	684.1	2,557.0	1,741.8	868.0	2,300.7

Liquidity: Strong

The short term rating on EDP is 'A-3'. 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.

Principal Liquidity Sources

We estimate that principal liquidity sources for the 12 months from March 31, 2020, include:

- Unrestricted cash of about €1.55 billion.
- About €6.1 billion in available committed lines maturing beyond 12 months. In particular, EDP has a €3.3 billion RCF maturing in 2024 and a €2.1 billion RCF maturing in 2025.
- Forecast cash FFO of about €2.9 billion.
- Asset disposals of about €3.1 billion expected, including €2.2 billion from the sale of Portuguese hydro assets to the consortium led by ENGIE SA (BBB+/Stable/A-2), and €515 million from the sale of gas plants and supply portfolio to Total S.A.
- A €1.02 billion capital increase related to the Viesgo

Principal Liquidity Uses

For the same period, we estimate that principal liquidity sources include:

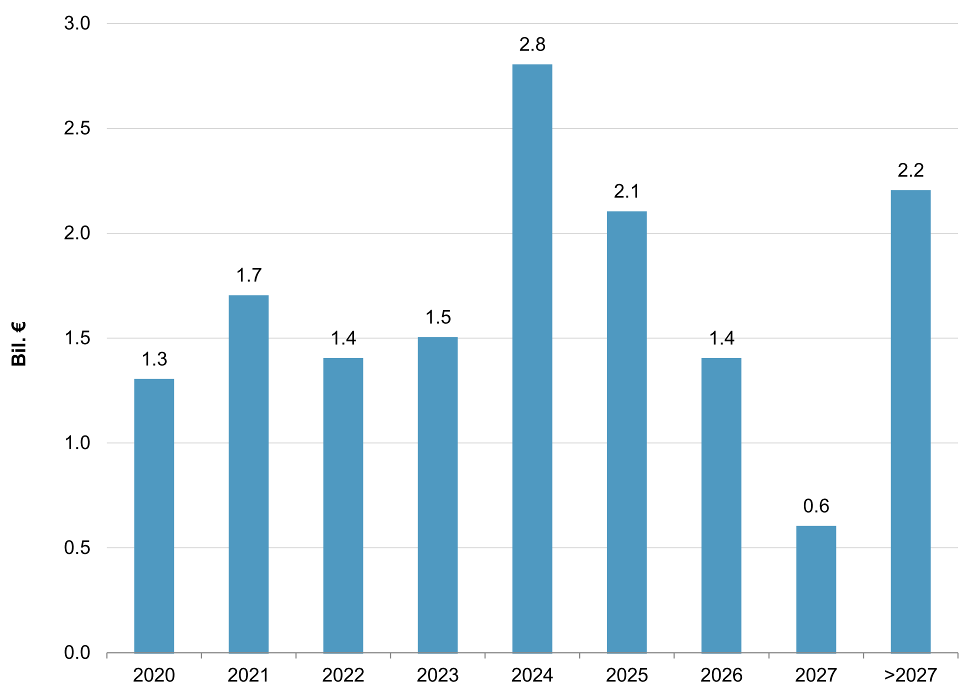
- Short-term debt of about €2.3 billion, including subsidiaries' short-term debt.
- Estimated working capital outflows of €425 million.
- An estimated €3.0 billion of gross capex.
- €2.7 billion enterprise value for the acquisition of Viesgo, including €1.1 billion of reported net debt in 2019.
- Dividends of about €870 million, including dividends to subsidiaries' minority shareholders.

acquisition, completed in August 2020.

Debt maturities

Chart 7

EDP-Energias de Portugal--Debt Maturities As Of March 31, 2020



Source: S&P Global Ratings.

Covenant Analysis

We understand that the documentation for EDP's outstanding debt includes no covenants.

Other Credit Considerations

EDP Brazil has its own independent management, a stand-alone funding model, and accounts for less than 20% of EDP's EBITDA. All debt issued in Brazil is completely ring-fenced and nonrecourse to EDP.

Environmental, Social, And Governance

From an environmental standpoint, EDP is a world leader in renewable energy generation and is better positioned than peers for energy transition, with 87% of EBITDA from renewable energies or networks.

About 73% of its 2019 installed capacity comes from renewables (wind and solar [40%] and hydro ([33%]), and it has a significant investment pipeline of further expansion in the coming years at its subsidiary EDPR. Only 12% of EDP's installed capacity is coal, which we expect the company will gradually phase out in Iberia over the next decade. Consequently, EDP is in the middle of the pack on carbon dioxide (CO2) emissions in Europe (including nuclear), as per our assessment, with 216 tCO2/GWh emissions in 2019, a decline of 16% compared with 2018. From a governance perspective, we note a judge has suspended the executive functions of EDP CEO António Mexia and executive director (and EDPR CEO) João Manso Neto. We are closely monitoring the outcome and the related possible negative impacts (for more details see "EDP's Strategy And Deleveraging Should Continue Despite CEO's Suspension," July 10, 2020).

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 29% because of the amount of debt at the subsidiaries, including Viesgo. We think EDP's size, diversity of cash flow generation, 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-3

Business risk: Strong

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

Financial risk: Aggressive

- **Cash flow/leverage:** Aggressive

Anchor: bb+

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Positive (+1 notch)

Stand-alone credit profile : bbb-

- **Group credit profile:** bbb-

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
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

- Portuguese Integrated Electric Utility EDP 'BBB-' Ratings Affirmed On Announced Acquisition Of Viesgo HoldCo, July 17, 2020
- Viesgo Holdco's Financial Policy Likely To Remain Unchanged After Its Acquisition By EDP, July 17, 2020
- EDP's Strategy And Deleveraging Should Continue Despite CEO's Suspension, July 10, 2020
- EDP's Stronger-Than-Expected 2019 Results Sustain 'BBB-' Rating, Feb. 21, 2020
- EDP Advances Deleveraging Plans With Hydro Disposal But Still Managing Limited Credit Headroom Through 2020, Dec. 20, 2019
- A Trio Of "Special Situations" M&A In European Utilities And Their Rating Implications, April 18, 2019
- Portuguese Power Utility EDP Affirmed At 'BBB-/A-3' With Limited Rating Headroom Through 2020; Outlook Stable, April 15, 2019
- Regulatory Support Is Powering Latin America's Utilities, March 8, 2019

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	Significant	**Aggressive**	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	**bb+**	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of August 19, 2020)*

EDP - Energias de Portugal S.A.	
Issuer Credit Rating	BBB-/Stable/A-3
Commercial Paper	
Local Currency	A-3
Junior Subordinated	BB
Senior Unsecured	BBB-
Short-Term Debt	A-3
Issuer Credit Ratings History	
08-Aug-2017	BBB-/Stable/A-3
30-Jan-2015	BB+/Positive/B
28-Jan-2014	BB+/Stable/B
Related Entities	
EDP Finance B.V.	
Issuer Credit Rating	BBB-/Stable/A-3

Ratings Detail (As Of August 19, 2020)*(cont.)	
Commercial Paper	
Local Currency	A-3
Senior Unsecured	BBB-
Short-Term Debt	A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.