23 AUG 2023

Fitch Affirms Comision Federal de Electricidad's IDRs at 'BBB-'; Outlook Stable

Fitch Ratings - Monterrey - 23 Aug 2023: Fitch Ratings has affirmed Comision Federal de Electricidad's (CFE) Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BBB-', National Long-Term Rating at 'AAA(mex)' and National Short-Term Rating at 'F1+(mex)'. The Rating Outlooks for the FC and LC IDRs and the National Long-Term Rating are Stable.

CFE's ratings remain equalized with Mexico's sovereign rating based upon Fitch's application of its Government-Related Entities Ratings Criteria (GRE Criteria); Fitch maintained its assessment of CFE's Standalone Credit Profile (SCP) at 'bb-'.

Key Rating Drivers

Government Linkage: CFE's ratings are equalized with the Mexican sovereign rating, based on Fitch's GRE Criteria. The strength of the linkage is considered very strong to strong due to the assessment of "very strong" to the status, ownership and control by the government of Mexico and the "strong" assessment to the support track record. The Incentive to Support is considered strong as the assessment of financial implications for the government in the event of a default by CFE and the socio-political implications of a default are considered "strong". CFE's SCP is 'bb-'.

The overall GRE support score is 35 and the SCP continues to justify the equalization of the ratings. CFE is highly important to Mexico as its largest integrated electric utility, and it is the only domestic entity allowed to both transmit and distribute electricity. If Fitch were to lower the SCP to 'b+', a support score of 35 would result in a top down minus one rating approach and CFE would be downgraded to 'BB+'.

Reliance on Government Support: CFE's credit profile is reliant on receiving timely financial support from the federal government. Fitch expects total government transfers to CFE in 2023 will be approximately MXN100 billion and EBITDA margin will reach 24.3%. FCF is estimated to be negative over the next three years due to high capex needs given its expansion plans. Fitch's rating case is assuming negative FCF will be funded with incremental debt, elevating its leverage metrics.

Leverage Profile: Fitch forecast CFE´s total adjusted financial leverage should be near 3.7x at YE 2023, an improvement from YE 2022 leverage level of 8.4x. The leverage metrics improvement is mainly due to a stronger EBITDA benefited by higher government transfers, the Mexican peso appreciation against the USD and lower fuel prices. Fitch expects that for 2024 and 2025 CFE's leverage levels should remain around 5.1x and subsidy to be lower at around MXN80 billion (level consistent with previous years). Annual capex is expected to remain below MXN100 billion during 2023-2025. Fitch's calculations add back the estimated actuarial cost of labor obligations.

Increase in Energy Demand: Fitch expects that electricity demand will continue growing as a result of the acceleration of the Mexican economy, mainly due to the nearshoring. Mexico's energy consumption in the first half of 2023 has exceeded in 4.6% the levels registered in the same period of 2022 and according to the Program Development of National Electric System (PRODESEN) 2023-2027, during the next 15 years, electricity demand in Mexico will increase by at least 2.5% on an annual average. The energy generation matrix in Mexico will continue being mainly thermal, and the energy demand will continue being served mainly through new combined cycles that are more efficient and less polluting that the conventional ones, with natural gas remaining as the primary fuel source of power generation. Gas based power plants accounted for around 62% of the total energy generation mix in 2022.

Natural Gas Price Exposure: Mexico imports around 70% of its natural gas needs from the U.S. This exposes CFE to shortages and fluctuations in natural gas prices and FX rates, as more than 60% of CFE's installed capacity requires natural gas for electricity generation. Mexico's domestic natural gas production does not satisfy internal demand, and storage facilities are limited. Texas represents around 86% of total natural gas imports by pipeline from the U.S. to Mexico. CFE implemented a Commodities Hedging Program to reduce this exposure; as of June 2023, 32.6% of its fuel requirements were hedged, though the company plans to increase that coverage substantially by 2024 depending on commodities market conditions.

Strategically Important for the Country: CFE's scale of operations, position as sole electricity marketer to unqualified users and unique position on transmission and distribution activities make the company strategically important for the country. As of June 2023, the company had a total installed capacity of 69,149MW, including the capacity from independent power producers (IPP) that generate electricity for CFE and is the only responsible for the transmission and distribution of electricity, as those activities are reserved to the Mexican state. Through the Energy Regulatory Commission (CRE), the government directly sets electricity tariffs to high consumption users (more than 1MW) while the Ministry of Finance and Public Credit (SHCP) determines user subsidies for low consumption users (less than 1MW).

Derivation Summary

CFE's 'BBB-' rating mirrors those of the Mexican sovereign, given the company's strong linkage with the government and high importance to the country. Compared with other state-owned companies in Latin America, CFE's IDR is higher than the Colombian group Ecopetrol S.A. (BB+/Stable). CFE's ratings are fully supported by the Mexican sovereign rating of 'BBB-'/Outlook Stable due to its exclusively reserved transmission and distribution activities in the country.

Ecopetrol's ratings reflect the close linkage with the Republic of Colombia (FC and LC IDRs BB+/Stable), which currently owns 88.5% of the company. Ecopetrol's ratings also reflect the company's strategic importance for the country, as well as its ability to maintain a solid financial profile. Ecopetrol supplies virtually all liquid fuel demand in Colombia and owns 100% of the country's refining capacity.

CFE's IDR is also rated higher than Brazilian company Centrais Eletricas Brasileiras S.A. (Eletrobras; BB-/Negative). Eletrobras' linkage with the Brazilian sovereign rating (BB/Stable) has weakened following the privatization of the company's shares. Fitch rates Eletrobras on a standalone basis.

Key Assumptions

--Revenues to increase 6.9% in 2023 driven by higher government support;

--EBITDA margins improving to around 24% in 2023 (adding the estimated actuarial cost of labor obligations into EBITDA);

--Annual capex below MXN100 billion during the next two years;

--Total government support near MXN100 billion in 2023;

--Total debt/EBITDA ratio near 3.7x at YE 2023.

RATING SENSITIVITIES

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

--An upgrade of the Mexican sovereign rating.

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

--A downgrade of Mexico's sovereign rating; Fitch outlined the following negative rating sensitivities in its press release on the sovereign on June 16, 2023:

--Macro: A weakening in the consistency and credibility of the macroeconomic policy framework, for example if unorthodox policy interventions become more widespread, negatively affecting growth prospects and/or leading to a reassessment of the upward notching in our rating adjustment for tis factor;

--Public Finances: A marked upward trajectory in the gross general government debt/GDP ratio, for example due to fiscal deterioration or weaker economic growth;

--Structural: deterioration in governance that results in political instability or undermines policy-making and business climate;

--A deterioration of the SCP to a 'b+' level due to total debt to EBITDA of 5.0x or higher, EBITDA to interest coverage of 3.0x or below, and/or weakened liquidity;

--Government support at a level that does not allow CFE to be FCF neutral.

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

Liquidity Profile: As of June 2023, CFE reported total cash on hand of MXN78.8 billion compared with short-term debt of MXN70.5 billion. On the same date, total debt amounted to MXN471.4 billion (excluding the recognition of the liability for the right of usage of assets of MXN470.8 billion) and is mainly composed of MXN265.1 billion of documented debt, MXN103.3 billion of PIDIREGAS, and MXN68.9 billion related to capital leases. The company has undrawn committed credit lines for almost USD2 billion and MXN15 billion that supports its liquidity position. Fitch expects CFE to continue refinancing its short-term debt.

Issuer Profile

CFE is the largest electricity generator in Mexico with a total installed generation capacity as of June 2023 of 69,149 MW, including from independent power producers. The company has exclusively reserved the transmission and distribution activities in the country.

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.

Public Ratings with Credit Linkage to other ratings

CFE's ratings are linked to Mexico's sovereign rating.

ESG Considerations

Comision Federal de Electricidad (CFE) has an ESG Relevance Score of '4' for Governance Structure due to ownership concentration as a wholly government-owned entity and due to board independence and effectiveness, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Fitch Ratings Analysts

Velia Patricia Valdes Venegas
Director
Primary Rating Analyst

+52 81 4161 7049
Fitch Mexico S.A. de C.V. Prol. Alfonso Reyes No. 2612, Edificio Connexity, Piso 8, Col. Del Paseo Residencial, Monterrey 64920

Julieta Seebach
Director
Secondary Rating Analyst
+1 512 215 3743

Saverio Minervini
Senior Director
Committee Chairperson
+1 212 908 0364

Media Contacts

Elizabeth Fogerty
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Comision Federal de Electricidad (CFE)	LT IDR	BBB-	Affirmed		BBB-
	LC LT IDR	BBB-	Affirmed		BBB-
	Natl LT	AAA(mex)	Affirmed		AAA(mex)
	Natl ST	F1+(mex)	Affirmed		F1+(mex)
• senior unsecured	LT	BBB-	Affirmed		BBB-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	Natl LT	AAA(mex)	Affirmed		AAA(mex)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.28 Oct 2022) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub.30 Sep 2020)

National Scale Rating Criteria (pub.22 Dec 2020)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub.12 May 2023)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Comision Federal de Electricidad (CFE)	EU Endorsed, UK Endorsed

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