MOODY'S
INVESTORS SERVICE

Rating Action: Moody's Downgrades Comision Federal de Electricidad's ratings to Baa2; outlook changed to stable

12 Jul 2022

New York, July 12, 2022 -- Moody's Investors Service ("Moody's") today downgraded Comision Federal de Electricidad's ("CFE") senior unsecured ratings to Baa2 from Baa1 and downgraded the baseline credit assessment (BCA) to ba3 from ba2. The outlook changed to stable from negative.

This follows Moody's rating action in which the agency downgraded the Government of Mexico's rating to Baa2 from Baa1 and changed the rating outlook to stable from negative. For more information on the Government of Mexico please visit ratings.moodys.com.

Downgrades:

..Issuer: Comision Federal de Electricidad

.... Baseline Credit Assessment, Downgraded to ba3 from ba2

....Senior Unsecured Regular Bond/Debenture, Downgraded to Baa2 from Baa1

Outlook Actions:

..Issuer: Comision Federal de Electricidad

....Outlook, Changed To Stable From Negative

RATINGS RATIONALE

CFE's rating downgrade reflects the rating downgrade of the Government of Mexico (Baa2 stable), the support provider, which provides rating uplift under our analytical framework for Government Related Issuers (GRIs). The BCA reflects our opinion of CFE's standalone intrinsic strength, absent any extraordinary support from Mexico's federal government. The BCA adjustment to ba3 from ba2 reflects the expected weaker intrinsic credit strength amid Mexico's energy policies and a high natural gas price environment.

CFE's Baa2 rating reflects the application of Moody's joint default analysis (JDA) framework for Government Related Issuers (GRIs), which takes into account i) the Baa2 rating of the Government of Mexico as CFE's support provider, ii) an expectation of "very strong" implied government support to the utility in the case of financial distress and iii) an assessment of "very high" default dependence between CFE and the Mexican government, resulting in the senior unsecured rating four notches above CFE's standalone credit quality as reflected in its Baseline Credit Assessment (BCA) of ba3.

CFE's BCA of ba3 reflects that its stand-alone financial performance will likely remain weak in the next 18-24 months amid a high natural gas price environment and challenges related to its large capital spending program that will require debt financing. CFE's may recover costs through tariffs over time or through extraordinary government transfers, although size and timing is highly uncertain.

Since the military conflict in Ukraine started in late February, gas prices have surged reflecting uncertainty around global energy security and pushed up CFE's operating costs. Moody's baseline scenario assumes higher natural gas prices to remain well above the historical prices in 2022, improving as the supply disruptions gradually ease in 2023. The company has some flexibility to adjust rates to large industrial and commercial customers registered as qualified users, but the adjustments do not fully mitigate continued losses from cost pressures, given tariff caps and subsidies in place to captive customers. As such, the company will remain dependent on government support through direct transfers or allowances for higher tariff increases. These pressures build on top of an already weakened CFE as a result of the impact of the natural gas price volatility that occurred due to the polar vortex event in February 2021. The event resulted in a temporary increase in generation costs that contributed to a net income loss of approximately MXN 90 billion, since CFE was not fully compensated for the cost overrun. According to CFE, the full impact is around MXN 84 billion and Mexico's energy regulator – Comisón Reguladora de Energía (CRE) - only recognized MXN 38 billion that would recovered via tariffs over 24 months, from which close to MXN 30 billion are expected to be recovered in 2022. While the company expects an extraordinary transfer of at least MXN 45 billion from the Ministry of Finance to offset the excess cost incurred in 2021 timing remains uncertain.

CFE receives yearly recurrent transfers from the of approximately MXN 70 billion to compensate for tariff subsidies, which are included in the Federal Budget ("Presupuesto de Egresos de la Federación") and transferred to the company in monthly payments. In 2021, those transfers amounted MXN 70.3 billion and for 2022, the approved Federal Budget considers transfers to CFE for MXN 73 billion. The rating considers that CFE will continue to benefit from these transfers, albeit with extended delays, especially in a high natural gas price environment.

In addition, the rating's baseline scenario considers that the MXN 582.3 billion capital investment plan for 2022-26 included in the company's Business Plan will likely create additional pressures in terms of leverage and capital investment recovery.

According to our projections, amid the high natural gas price environment, CFE could record a negative cash flow from operations that in conjunction with the substantial capital program would lead to financing requirements beyond the original budgeted amount by year-end. The additional costs are not expected to be passed-through to consumers via tariffs this year, but according to the company the regulator will allow tariffs to be adjusted over a 24 month period. CFE is also seeking additional transfers from the government, but the outcome and timing is uncertain. Notwithstanding, CFE maintains adequate liquidity with a cash balance of MXN 127.8 billion (as of March, 2022) and unused amounts of committed credit facilities of MXN 10 billion and $1.8 billion while the amount of uncommitted credit facilities was MXN 27.5 billion and $0.5 billion (as of December 2021).

While the Government of Mexico does not directly guarantee CFE's debt obligations, Moody's believes that there is a significant likelihood of governmental support given the company's status as a wholly government-owned entity, and its strategic importance to the country's overall economy due to its essential business nature. Moody's also considers a very high default dependence between the two entities, given that CFE shares several common risk factors with the government.

RATING OUTLOOK

The outlook is stable, reflecting Government of Mexico's, the support provider, stable rating outlook. The stable outlook also incorporates our expectation that CFE's financial performance will gradually improve in 2023, once natural-gas prices stabilize and tariffs are adjusted to compensate cost overruns expected for 2022.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

CFE's ratings could face upward rating pressure if CFO pre-WC/debt and CFO pre-WC/interest coverage improve above 8.0% and 2.5x, respectively, on a sustained basis. Given the strong linkages with the Government of Mexico, a rating upgrade for CFE would likely require that Mexico's rating is upgraded.

The ratings could be downgraded if our view of implied government support diminishes. The ratings could also be downgraded if CFE's adjusted leverage increases or its ability to generate adequate cash flow is impaired, leading credit metrics to remain weak for a prolonged period. Specifically, if CFO pre-WC/debt and CFO pre-WC/interest coverage remain below 4% and 2x, respectively, on a sustained basis, the ratings could be downgraded.

PROFILE

CFE is Mexico's dominant electric utility and one of the largest electric utilities in Latin America, with installed generation capacity of 59.6 GW (as of December 31, 2021) when including the generation capacity of independent power producers (27% of the 59.6 GW). CFE has 110,347 kilometers of transmission and sub-transmission lines (medium and high voltage) and a distribution network of more than 878,049 kilometers (low voltage). In 2021, CFE generated 217 terawatt/hour (TWh) of energy, including the IPPs. The company accounts for 67% of the electricity generated in Mexico (including IPPs), providing service to almost 99% of the population.

The methodologies used in these ratings were Regulated Electric and Gas Utilities published in June 2017 and available at https://ratings.moodys.com/api/rmc-documents/68547 and Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/api/rmc-documents/64864. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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