

**STANDARD  
& POOR'S**



## Interaction of Energy Security Risks and Credit Ratings

**Peter Kernan, Head of European Utilities  
London, April 2006**



# Agenda

- How is security risk factored into utility ratings?
- How do utilities mitigate security of supply risk?
- The challenge for policymakers
- Risk profile of Eastern and Western European utilities: levels and trends in ratings



## How does security of supply risk affect European utility ratings?

EU power supply has been overall secure (but import dependency is increasing). Supply risk not to be a significant *direct* mid-term risk driver

Security of supply will drive M&A, investment, which can impact ratings

EU 15 ratings trended down due to liberalisation, M&A (but still relatively strong) - these drivers are more directly relevant

Eastern European ratings generally on an improving trajectory – from low base



## European Utility Ratings

<b>Company</b>	<b>Country</b>	<b>Sector</b>	<b>Rating</b>
CEZ	Czech Republic	Vertically integrated	BBB+/Positive/--
POGC	Poland	Gas	BBB/Watch Pos/--
Turow	Poland	Generation	B/Developing/--
HEP	Croatia	Vertically integrated	BBB/Negative/--
Transelectrica	Romania	Transmission	BB/Positive/--
Hidroelectrica	Romania	Hydrogeneration	BB-/Positive/--
NEK	Bulgaria	Transmission	B/Developing/--
TPP	Bulgaria	Generation	BB/Stable/--
EDF	France	Vertically integrated	AA-/Negative/A-1+
RWE	Germany	Vertically integrated	A+/Negative/A-1
E.ON	Germany	Vertically integrated	AA-/Watch Neg/A-1+
SSE	U.K.	Vertically integrated	A+/Stable/A-1
Endesa	Spain	Vertically integrated	A/Watch Neg/A-1
Enel	Italy	Vertically integrated	A+/Negative/A-1



## Energy security risk and mitigants – market power is key

Financial strength, market power and capital market access are key

Tight global commodity supply, strong demand hits through prices

Generators with market power - in liberalised markets - can [partially] pass cost increases through, with a lag

In less-liberalised markets, margin squeeze is more likely



## **Energy security risk and mitigants – need for diversity to drive M&A**

Diversity of generation and fuel sourcing essential

Generation diversification to encompass gas, coal, renewables, hydro  
(nuclear?)

Fuel diversification to encompass multiple supply points and storage  
facilities



## The challenge for policymakers

**Security of Supply:** Increasing import dependency: generation and sourcing diversity key.

**Liberalisation:** Liberalisation boosts efficiency (but creates market risk). Regulatory certainty, competition framework key to encourage investment

**Climate Change Policy:** Favours CO<sub>2</sub> clean generation but there are policy uncertainties, which are delaying investment.



# European Utility Risk Drivers

## Western Europe

### REGULATION

Pressure to reduce tariffs  
Transparent

### MARKET

Strong but low growth  
High quality assets

### FINANCIAL RISK

Increasing investment needs  
Strong cash flows  
Moderate to high debt  
Sound access to funding

## Eastern Europe

### REGULATION

Regulated tariffs and prices too low  
Politicized and opaque regulation

### MARKET

Weak but improving market, strong growth  
Often weak asset base

### FINANCIAL RISK

High investment needs  
Weak cash flows and low debt  
Constrained access to funding



## Positive trends in Eastern European Sovereign Ratings

<b>Country</b>	<b>Rating</b>
Poland	BBB+/Positive/A-2
Hungary	A-/Negative/A-2
Czech republic	A-/Positive/A-2
Romania	BBB-/Stable/A-3
Bulgaria	BBB/Positive/A-3
Russia	BBB/Stable/A-2
France	AAA/Stable/A-1+
Germany	AAA/Stable/A-1+
UK	AAA/Stable/A-1+
Spain	AAA/Stable/A-1+
Italy	AA-/Negative/A-1+
Greece	A/Stable/A-1
Portugal	AA-/Stable/A-1+



## Conclusion

Energy security risk is not expected to be a significant direct risk driver

Security risk will drive M&A (E.ON/Gas Natural/Endesa, GDF/Suez)

Policy dexterity is key to avoid conflicting goals and uncertainty

Eastern European performance risk to further reduce as economies mature



## Contact Details

**Peter Kernan, Managing Director**

**Head of European Utilities**

**Tel. +44 207 176 3618**

**[peter\\_kernan@standardandpoors.com](mailto:peter_kernan@standardandpoors.com)**