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Corporates

Electric-Corporate
Mexico
Credit Analysis

Comisión Federal de Electricidad (CFE)

Ratings

Security Class	Current Rating
National Scale	AAA(mex)

Outlook

Stable

Financial Data

Comisión Federal de Electricidad
(USD Mil.)

	12/31/08	12/31/07
Revenues	24,158	20,656
EBITDA	5,758	9,643
Total Debt	9,821	9,512
Short-Term Debt	1,401	1,340
Cash and Equivalents	3,603	2,780
Debt/EBITDA (x)	1.7	1.3
Adjusted Debt/ Adjusted EBITDA (x)	3.3	3.4
EBITDA/Interest (x)	14.1	22.2

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Related Research

- *Latin America Corporate Sector Outlook, July 21, 2009*
- *Comparative Statistics Book 2009, June 9, 2009*
- *Latin American Power 2009, Jan. 29, 2009*
- *Comisión Federal de Electricidad, Feb. 11, 2008*
- *Parent and Subsidiary Rating Linkage, June 19, 2007*

Rating Rationale

- Comisión Federal de Electricidad's (CFE) rating reflects the company's position as the largest electric energy generator in Mexico, its exclusive transmission and distribution rights, and its strategic importance to the country's economy. The rating also incorporates CFE's high exposure to political interference, given its status as a wholly owned, decentralized entity of the Mexican government, along with budgetary constraints and a weak tariff structure.
- CFE operates as a virtual monopoly and has exclusive rights to provide electric services throughout Mexico. The company's monopoly status is embedded in the Mexican Constitution and is defined by the Electric Energy Public Service Law. CFE's budget is incorporated into the government's budget and is approved by the Mexican Congress. While CFE's monopoly status lowers competitive and other business-related risks, the company's operating and financial performance is highly linked to the United Mexican States (UMS). CFE's debt is not guaranteed by the Mexican government.
- CFE's tariffs are set annually by the Secretaria de Hacienda y Credito Publico (SHCP), which exposes the company to political interference and regulatory risk. The weak regulatory and tariff structure includes subsidies to the residential and agricultural sectors. These subsidies are generally paid by the government to CFE through non-cash governmental transfers, which are offset against taxes, duties, and royalties owed to the government.
- CFE is also partially exposed to fuel prices and operating cost fluctuations as the current tariff structure does not pass through 100% of the changes in fuel and operating costs on approximately 24% of its total revenues associated to the residential and agricultural customers. The lack of cost pass through is somewhat offset through increased subsidies funded by the government. Also, operating costs are high when benchmarked against comparable private sector electric companies.
- The company generates relatively stable cash flows with funds from operations averaging USD3.15 billion in the past three years. With average capex of about USD2.7 billion per year, the CFE was able to generate USD125 million in accumulated free cash flow during this period. However, credit protection measures are weak for the rating category when adjusted for USD22.1 billion unfunded pension plan and USD15.7 billion payments to IPPs for capacity availability over the next 25 years.

Key Rating Drivers

- Catalysts for a downgrade include UMS' ratings downgrade, a substantial increase in leverage to finance capex and/or sharp and extended equity erosion due to lack of government support.
- Catalysts for an upgrade include UMS' ratings upgrade, increased financial support from the government, significant improvement in credit profile, and/or a sharp and extended generation of positive FCF.

Recent Events

On Oct. 11, 2009, the president of Mexico issued a decree dissolving Luz y Fuerza del Centro (LyFC), the state-owned entity in charge of distributing electricity in Mexico City and the metropolitan area. As a result, the CFE will take over the operations of LyFC and become the sole transmission and distribution company in Mexico. In power generation, the CFE increases its market share to 91% from 90%, while Pemex and the private sector maintain 5% and 4%, respectively. Fitch believes that this action increases the linkage of the CFE to the UMS, and due to the LyFC inefficiencies, the company will receive more subsidies from the government until operating metrics improve at the liquidated entity in line with CFE's over time. Other risks arising include the disruption of operations caused by the more than 44,000 former LyFC employees, which has diminished substantially due to lack of support from other unions and the fact that close to 62% of them have accepted their rich severance packages.

On Oct. 28, 2008, the Mexican Congress approved a comprehensive reform of the energy sector with little impact to the CFE. This reform creates commitments for the CFE to generate electricity from renewable sources, which are quite manageable. Also, the Mexican government announced the Program to Promote Growth and Employment, which included a 10% reduction in natural gas prices as well as a price freeze for gasoline. These announcements highlight the risk of political intervention. Since approximately 50% of the CFE electric plants are fired with natural gas, the company saw margins improve for two months after this price decrease went into effect on Jan. 1, 2009 due to a time lag of 60 days for the pass through.

CFE posted weak results in 2008 with total revenues down 4.1% to USD19.9 billion and EBITDA down 75% to USD629 million. The revenue decline was the result of the devaluation of the MXN, partially offset by 1.6% increase in volumes and 17.2% increase in average prices in MXN terms. The EBITDA margin declined to 3.2% from 12% due to higher fuel costs and an accounting change that increased pension expense to USD3.6 billion from USD2.1 billion in 2007. Excluding pension expense, the EBITDA margin increased by 54 bps to 22.5%. FCF was negative USD62.2 million as the company financed its USD2.1 billion in capex primarily with CFO. CFO would have been higher if the government had paid the USD1.9 billion in subsidy refunds that exceeded taxes on CFE's net assets. Total debt increased to USD9.9 billion from USD9.5 billion in 2007 and cash on hand closed the year at USD3.6 billion compared to USD1.4 billion in short-term maturities.

Liquidity and Debt Structure

As of December 2008, the CFE had cash balances of approximately USD3.6 billion compared to short-term debt maturities of USD1.4 billion. Adjusted debt of USD31.95 billion consisted of USD5 billion related to Pidiregas projects, USD3.5 billion to bank loans in foreign currency, USD570 million to derivative liabilities, USD490 million to asset retirement liabilities, USD22.1 billion to underfunded pension plans, while the remaining balance was bank loans in pesos and capital leases.

Adjusted leverage was 3.3x at the end of 2008 compared to a range of 3.0x–3.4x over the past four years. The CFE relies primarily on its internally generated funds for liquidity purposes with average CFFO over the last three years of USD2.75 billion, while capex averaged USD2.71 billion over the same period resulting in accumulated FCF of only USD106 million.

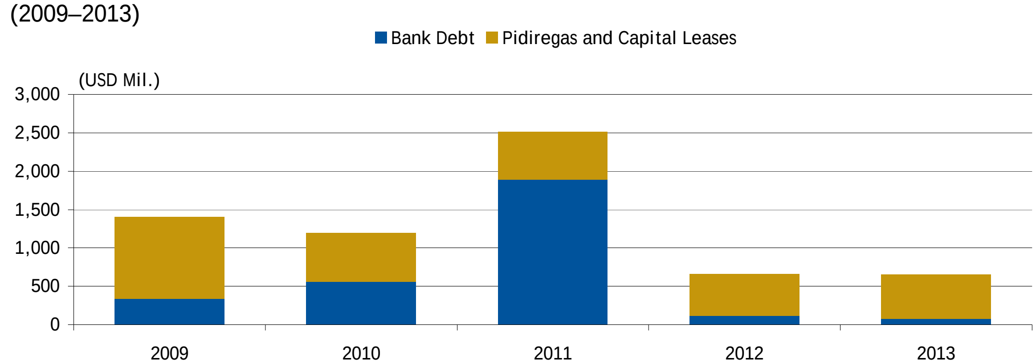
CFE finances investments with its own resources, private investments as well as through loans from national and international banks or exim institutions. CFE's budget, which has to be approved by Congress, defines the company's own resources to be used to finance projects. Private investments are made through Pidiregas under two schemes: direct investments in financed public works (FPW) and conditioned investments by independent power producers (IPP). Under FPW, CFE gets the ownership of the infrastructure project at the end of the construction while under IPP the private investor keeps ownership of the assets.

Pidiregas is a form of deferred financing created in 1995 to allow private investment in the power sector. Under FPW, the constructor makes all the necessary investments, and when the project is finished the CFE pays for the projects through long term loans. Under IPP the constructor makes all the necessary investments and keeps both the ownership of the assets and the responsibility to operate and maintain the infrastructure project. The CFE does not record any liability on its balance sheet under IPP but commits to buy capacity and power for 25 years. As of December 2008, CFE's commitments under IPP amounted to USD15.7 billion.

To finance FPW (Pidiregas) the company has structured the issuance of CEBURES (Certificados Bursatiles) through a trust. The trust gets a loan and securitizes the rights to the credit. The funds from the issuance are used to pay the contractor while the CFE will be responsible for paying the CEBURES interest and principal. Upon completion of the project the contractor transfers the ownership of the asset to the CFE.

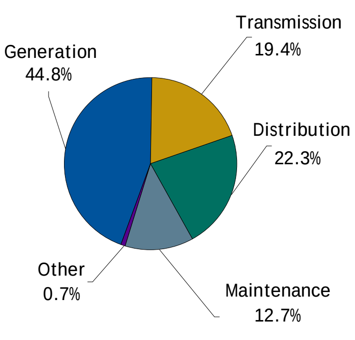
In 2009, CFE has been very active in the domestic capital markets, having issued about USD1 billion of senior unsecured CEBURES, including: MXN1.1 billion floating notes due 2012, MXN4 billion real interest rate notes due 2021, MXN4 billion fixed rate notes due 2021, and MXN2.6 billion real interest rate notes due 2024. The company continues to have strong access to the domestic capital markets at yields below Cetes + 50 bps.

Debt Maturities
(2009–2013)



Source: CFE.

Required Investments 2009–2018
(USD58.1 Bil.)



Source: CFE.

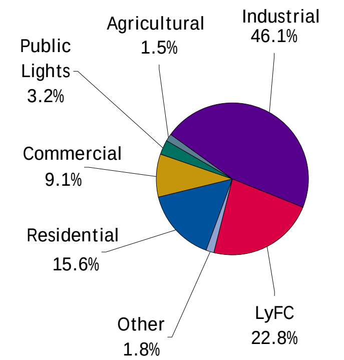
Key Projects and Capex Plan

CFE's capital expenditure program consists of USD58.1 million from 2009 to 2018. The company expects to spend USD6 billion in 2009, USD6.5 billion in 2010, USD6 billion in 2011, and USD5.1 billion in 2012. Forty-three percent of this 10-year investment plan is expected to be funded with CFE's budgeted funds, 35% through FPW schemes, and 11% via IPPs while the remaining balance funding scheme is still to be defined. As a result of these investments, over the next 10 years generation capacity is expected to increase by approximately 17,942 MW and transmission lines by about 27,150 km, including capacity increases over the next three years of 3,520 MW and 9,140 km, respectively.

Significant projects under construction include La Yesca 750 MW hydroelectric plant, Carboelectrica del Pacifico 678 MW plant, La Trinidad (Norte) 466 MW combined cycle plant and Laguna Verde nuclear plant expansion. The estimated investment in these projects is USD2.4 billion including USD800 million for La Yesca, which becomes operational in 2012 while the others in 2010. La Yesca and Carboelectrica del Pacifico are being constructed under the FPW Pidiregas, La Trinidad by an IPP, and the Laguna Verde expansion with CFE's resources.

At any given time, CFE has a number of substation, transmission line, and other PIDIREGAS-designated generation projects for which it seeks outside investment via a competitive bid process. This process is fairly transparent and, in general, is a vehicle by which the company has invited external participation.

2008 Revenues by Group
(USD24.2 Bil.)



LyFC – Luz y Fuerza del Centro.
Source: CFE.

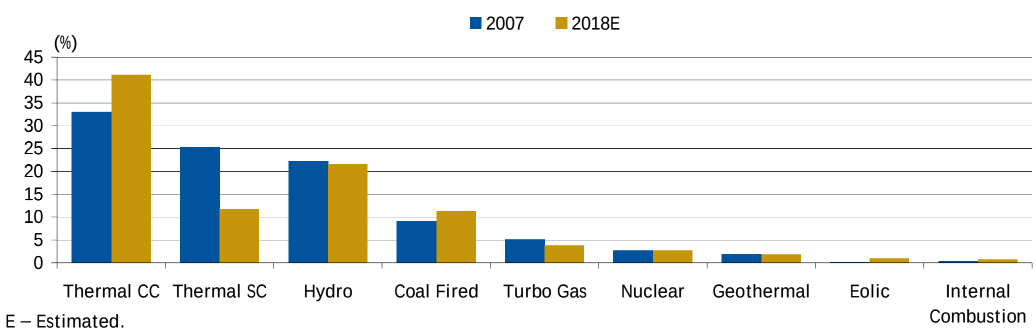
Company Overview

The company was created in 1937 by presidential decree. Since then, CFE has the exclusive right to generate, transmit, distribute, and commercialize electric power in Mexico. LyFC, another government entity, focused primarily in the Mexico City metropolitan until Oct. 11, 2009 when it was liquidated by presidential decree and the CFE took over its operations. Private sector participation in generation was allowed in 1992.

Mexican law allows for the operation of IPPs; however, IPPs must sell all of their power to CFE. The creation of the IPP segment in Mexico has generally resulted in the addition of lower cost generation capacity due to the public bidding process. Competitive threats generally are limited to self-generation projects by large industrials.

As of December 2008, CFE had 26.3 million clients with sales volumes of 200,929 GWh, while total installed capacity was 49,931 MW. The number of clients CAGR in the last six years was 4.4%. Most of CFE sales are made in Mexico as the company's export revenues represent only 0.3% of the total. LyFC used to be CFE's key client, representing about 20% of sales and 11% of accounts receivables. The residential sector represents 88.1% of the number of users, while the industrial sector represents 70.1% of revenues.

Power Generation Capacity in Mexico by Source
(51,029 MW in 2007 Versus 63,184 MW in 2018)



E – Estimated.
Source: CFE.

Financial Summary — Comisión Federal de Electricidad (CFE)

(USD 000, Years Ended Dec. 31)

	2008	2007	2006	2005	2004
Profitability					
Operating EBITDA[a]	5,758,215	7,568,255	7,420,007	7,278,661	6,926,467
Operating EBITDAP[b]	9,619,650	9,643,511	9,485,103	9,026,674	8,357,222
Operating EBITDA Margin (%)	24	37	38	41	48
Operating EBITDAP Margin (%)	40	47	49	51	58
FFO Return on Adjusted Capital (%)	10	0	9	7	6
Free Cash Flow Margin (%)	(0)	(1)	2	1	(6)
Coverage (x)					
FFO Interest Coverage	8.9	9.5	8.9	4.7	4.3
Operating EBITDA/Interest Expense	14.1	22.2	17.5	14.6	16.8
Operating EBITDA/Debt Service Coverage	3.2	4.5	5.5	4.8	4.8
FFO Fixed Charge Coverage	1.8	2.2	2.3	1.8	1.7
FCF Debt Service Coverage	0.2	0.1	0.5	0.4	(0.4)
(FCF + Cash and Marketable Securities)/Debt Service Coverage	2.2	1.8	1.8	1.2	0.2
Cash Flow from Operations/Capital Expenditures	1.0	1.0	1.1	1.1	0.6
Capital Structure and Leverage (x)					
FFO Adjusted Leverage	4.3	6.3	5.0	6.6	7.3
Total Debt with Equity Credit/Operating EBITDA	1.7	1.3	1.2	1.2	1.1
Total Net Debt with Equity Credit/Operating EBITDA	1.1	0.9	0.9	1.0	0.9
Total Adjusted Debt/Operating EBITDAP	3.3	3.4	3.1	3.0	2.8
Total Adjusted Net Debt/Operating EBITDAP	2.9	3.2	2.9	2.9	2.7
Implied Cost of Funds (%)	4.2	3.8	4.9	6.2	4.9
Short-Term Debt/Total Debt	0.1	0.1	0.1	0.1	0.1
Balance Sheet					
Total Assets	57,307,700	70,033,516	66,324,347	63,693,451	56,610,311
Cash and Marketable Securities	3,602,657	2,780,092	1,676,447	1,095,116	844,194
Short-Term Debt	1,400,817	1,340,588	936,545	1,022,151	1,041,295
Long-Term Debt	8,420,223	8,171,770	7,632,677	7,682,611	6,247,322
Total Debt	**9,821,040**	**9,512,358**	**8,569,222**	**8,704,762**	**7,288,617**
Equity Credit	—	—	—	—	—
Total Debt with Equity Credit	**9,821,040**	**9,512,358**	**8,569,222**	**8,704,762**	**7,288,617**
Off-Balance-Sheet Debt	22,127,950	23,658,698	20,750,901	18,414,107	16,015,520
Total Adjusted Debt with Equity Credit	**31,948,990**	**33,171,056**	**29,320,123**	**27,118,869**	**23,304,137**
Total Equity	30,385,981	34,593,807	35,410,271	34,506,867	32,218,345
Total Adjusted Capital	**62,334,971**	**67,764,863**	**64,730,394**	**61,625,736**	**55,522,482**
Cash Flow					
Funds from Operations	3,222,736	2,879,172	3,345,906	1,831,362	1,370,247
Change in Operating Working Capital	(761,579)	110,503	(560,160)	(138,296)	(98,201)
Cash Flow from Operations	**2,461,157**	**2,989,675**	**2,785,746**	**1,693,066**	**1,272,046**
Total Non-Operating/Non-Recurring Cash Flow	—	—	—	—	—
Capital Expenditures	(2,536,554)	(3,122,067)	(2,471,855)	(1,518,750)	(2,201,834)
Dividends	—	—	—	—	—
Free Cash Flow	**(75,397)**	**(132,391)**	**313,891**	**174,316**	**(929,788)**
Net Acquisitions and Divestitures	—	—	—	—	—
Other Investments, Net	(437,333)	(28,199)	(13,819)	(671,337)	84,152
Net Debt Proceeds	366,907	782,445	(158,579)	(364,127)	(286,025)
Net Equity Proceeds	—	—	—	—	—
Other Financing, Net	1,848,582	431,191	429,678	1,027,705	301,958
Total Change in Cash	**1,702,759**	**1,053,045**	**571,170**	**166,556**	**(829,703)**
Income Statement					
Net Revenues	24,157,511	20,656,482	19,395,846	17,744,455	14,462,588
Revenue Growth (%)	16.9	6.5	9.3	22.7	6.2
Operating EBIT	(1,580,716)	156,647	591,762	(1,080,816)	(279,530)
Gross Interest Expense	408,887	340,380	423,843	498,910	412,117
Pension Expense	3,861,435	2,075,256	2,065,095	1,748,014	1,430,755
Net Income	(1,747,691)	(682,408)	190,756	468,001	(736,440)

[a]EBITDA includes transfers from the government up to amount owed to the government equivalent to 9% of net fixed assets. [b]EBITDAP = EBITDA + pension expense.
Source: CFE.