

Credit rating agency Standard & Poor's (S&P) said that it has upgraded its long-term issuer credit rating of Croatian state-owned power utility HEP to BB+ from previous BB.

S&P said in a statement that the outlook is stable and reflects its expectation that HEP's stand-alone performance will be solid, with funds from operations (FFO) to debt ratio above 60 % in the next 12 months. The raising of the rating follows the recent upgrade of Croatia to BBB- from BB+, as S&P believes the country now has greater capacity to support the power utility.

HEP plays a very important role for the Croatian Government, because its transmission and distribution operations are crucial for the security of the country's energy supply, which in turn is a fundamental input for Croatia's resilience. In addition, the Croatian Government's 100 % ownership of HEP, and the alignment between the Government's energy strategy and that of HEP, reinforces the view that there is a strong link between both entities.

HEP's monopoly ownership and operation of the transmission and distribution networks in Croatia, which account for about 50 % of EBITDA generation, are key strengths for the business. Moreover, HEP's low-carbon generation fleet could provide significant competitive advantages in light of increasing carbon costs and the EU's low-carbon energy directives. These strengths are counterbalanced by HEP's limited geographic diversification, which is mostly constrained to a small market, with uncertain long-term growth prospects and weaker regulatory support than in other European countries. Although HEP has posted FFO to debt consistently between 100 and 110 % over the past three years, S&P still believes that the company's credit metrics are exposed to volatility because of its dependence on hydropower activity, and the risk of procurement that would arise under poor hydro-logical conditions in a given year, as observed in 2011 and 2012.

The stable outlook on HEP mirrors that on Croatia, and reflects the assumption that HEP will continue to enjoy a high likelihood of extraordinary government support. It also captures the expectation that HEP will continue posting sound financial performance, as a result of stable and monopolized transmission and distribution operations, coupled with its position as the largest electricity provider in Croatia.