FITCH AFFIRMS CALIDDA'S IDR AT 'BBB-'; REVISES OUTLOOK TO POSITIVE

Fitch Ratings-Chicago-14 March 2016: Fitch Ratings has affirmed the local and foreign currency long-term Issuer Default Rating (IDR) of Gas Natural de Lima y Callao S.A (Calidda) at 'BBB-', and revised the Rating Outlook to Positive from Stable. Additionally, Fitch has affirmed the 'BBB-' rating assigned to the USD320 million senior unsecured notes.

KEY RATING DRIVERS

The Positive Outlook reflects the company's improving credit metrics which are due to an increase in number of customers, higher volumes, additional revenues from relocation services, and a favorable natural gas distribution tariff revision. The company was able to decrease its leverage to levels below Fitch's expectations. We project gross leverage could further decline within the next two years and stabilize in the 3.0x - 3.5x range. The company's ability to maintain gross leverage below 3.5x on a sustained basis could result in a positive rating action.

Calidda's investment-grade ratings reflect the company's strong market position due to its exclusive right to distribute natural gas (NG) in Lima and Callao, the largest market in Peru with a high potential for growth. The ratings also factor in the issuer's diversified client base and predictable and stable cash flow generation. The company's stable cash flow is supported by a regulated tariff scheme that aims at ensuring an adequate return on investment; the NG distribution tariffs were increased during 2014 by Peru's energy & mining regulator, OSINERGMIN, improving the company's financial results. Calidda's cash flow generation also benefits from expected demand growth and installation service revenues from residential client additions of approximately 100,000 per year.

-- Strong Market Position
Calidda is the largest NG distribution company in Peru. It has exclusive rights to distribute NG in Lima and Callao, an area that contains more than 35% of the country's population and over 50% of its GDP. The concession may be renewed upon request from Calidda after 2033 in 10-year increments, up to 2060. As of today, Calidda has complied with all the commitments established in the concession. The company's penetration rate has grown consistently, increasing to 57% in 2015 from 42% observed in 2012 and it is expected to further increase within the next two to three years.

--Predictable and Stable Cash Flow
The vast majority of Calidda's revenues are derived from its regulated NG distribution clients, such as natural gas for vehicles (NGV), commercial and residential, providing the company with stable and predictable cash flow. Its regulated tariff scheme, which assures cost recovery and an adequate return on total capital investments, further supports cash flow predictability. Additionally, 78% of the invoiced distribution volumes are through firm take-or-pay contracts with an average life of 15 years with top-tier power generators and large industrial companies, adding to the visibility of the cash flows.

As of year-end 2015, the company generated USD104 million of EBITDA, up from USD92 million recorded in 2014, mainly due to an increase in the distribution tariff, coupled with slightly higher volumes and additional revenues from relocation services. EBITDA margins also improved to 19% from 18% observed in 2014. Over 65% of the company's revenues are from pass-through services that carry no profit margin. The remaining revenues (adjusted revenues) are divided primarily between gas distribution and connection fees, with 52% of the distribution revenues associated with power generators.

--Improving Credit Metrics
Calidda's credit metrics have improved significantly since 2013. Leverage, measured as total debt/EBITDA, decreased to 3.3x from 4.4x in 2013, in line with Fitch's expectations. Our forecast incorporates expectations for a substantial capex program in the near- to medium-term. Additionally, the company started paying dividends to shareholders during 2015. Fitch expects that the company will finance its capex needs with its internal cash flow generation and that dividend payments will continue to be moderate, allowing the company to maintain leverage below 3.5x.

--Concentration -of Natural Gas Supply
In order to serve the regulated demand, Calidda needs to negotiate its NG supply contract. Over the course of 2017 and 2018, Calidda will gradually increase its contracted volume from the Camisea consortium by almost 40%. Moreover, it will rebalance its interruptible capacity to 20% of the total (versus 78%, currently). Single-source exposure is mitigated by the fact that Pluspetrol, the consortium operator, is obliged to prioritize NG supply to cover local demand, according to its concession agreement. The company recently renewed the agreement until 2021. Calidda has reached out to other producers to diversify NG supply and improved its commercial agreement terms, including lengthening the contract term and taking additional firm capacity.

--Shareholders with Proven Track Record in the Sector
Fitch considers positively that the company is part of Empresa de Energia de Bogota (EEB; 'BBB'/Stable Outlook), which maintains a 60% ownership. The remaining 40% is owned by Promigas ('BBB-'/Stable Outlook). EEB is a leading energy holding company with interests across the electricity and natural gas sectors in Colombia, Peru and Guatemala while Promigas is one of the largest NG transportation and distribution companies in Colombia, with international presence in Brazil, Panama, Peru and Costa Rica.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for Calidda include:

-- An average of 100,000 additional clients per year
-- Average annual volume per client per month in line with historical volumes
-- Lower power generators volumes starting by the end of 2017 as a result of an increase in hydro projects.
-- Tariffs per customer segment according to 2014-2018 review, then reset in 2019 by 4% for residential clients and an average of 8% for the industrial customers
-- Pass-through of costs and inflation in the tariffs
-- Manageable annual capex of approximately $80 million on average for the next five years
-- Dividend distribution of 100% of net income

RATING SENSITIVITIES
A negative rating action could be taken if leverage, as measured by total debt/EBITDA, increased and remained at more than 4.0x for a prolonged period of time due either to operational deterioration or unexpectedly large dividend distributions.

Material changes in the BOOT agreement, tariff scheme and applicable regulations would also be considered in future rating actions.

For a positive rating action, Fitch has revised its leverage trigger to 3.5x due to Calidda's stable and predictable cash flow generation and balanced regulatory framework. A positive rating action could be triggered if the company maintains leverage measured as total debt/EBITDA below 3.5x on a sustained basis and net leverage below 3.0x, along with the growth and consolidation of the regulated supply and demand (NGV and residential and commercial segments) including a higher penetration rate and a favorable balanced regulatory framework.

LIQUIDITY
Fitch considers Calidda's liquidity position as sufficient with manageable debt amortizations over the next 24 months. As of year-end 2015, Calidda had cash and short-term investments of USD69.5 million. These liquidity sources compare with debt amortizations of USD9 million in 2016 and no significant maturities until 2023.

Fitch expects the company to remain free cash flow negative during the next two years as a result of significant capex investments and dividend payments. We consider the dividend payment policy and capex investment plan to be flexible and commensurate with the company's ratings.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings:

Gas Natural de Lima y Callao S.A (Calidda)
--Foreign currency long-term Issuer Default Rating (IDR) at 'BBB-'

--Local currency long-term IDR at 'BBB-';
--USD320 million due 2023 senior unsecured notes at 'BBB-'.

The Rating Outlook is Positive.

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Date of Relevant Rating Committee: March 11, 2016.

Additional information is available at www.fitchratings.com

Applicable Criteria