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Research Update:

Gas Natural de Lima y Callao S. A. (Calidda) 'BBB-' Ratings Affirmed, Outlook Remains Stable

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Overview

- The Peru-based natural gas distribution company, Calidda, has performed in line with our expectations by maintaining sound financial metrics.
- We're affirming our 'BBB-' corporate credit and debt ratings on Calidda.
- The stable outlook reflects our expectations that Calidda will maintain its debt to EBITDA at around 3.0x and funds from operations (FFO) to debt above 23% for the next two years.

Rating Action

On Feb. 24, 2017, S&P Global Ratings Services affirmed its 'BBB-' corporate credit and senior unsecured ratings on Gas Natural de Lima y Callao S.A. (Calidda). The outlook remains stable.

Rationale

The ratings affirmation reflects Calidda's operating and financial performance, which remained in line with our expectations. We view the company as having a satisfactory business risk profile and intermediate financial risk profile, while it maintained an adequate liquidity. For the 12 months ended Sept. 30, 2016, debt to EBITDA was 2.9x and FFO to debt was 24.3%. The company was able to generate higher EBITDA thanks to lower operating expenses and higher sales amid an increase in distribution services. Our view of Calidda's intermediate financial risk profile incorporates the stability of the company's cash flow generation and its current and expected key financial ratios.

Calidda's satisfactory business risk profile is based on stable cash flow generation--stemming from very low industry risk--and its monopolistic position in the department of Lima and Callao province, which contribute the highest share to Peru's GDP. The rating on Calidda incorporates a narrower residential client base than those of other gas distribution companies in the region, due to the higher sales share that electricity generators represent in Calidda's client portfolio. Calidda benefits from a diversified portfolio of customers with residential and commercial client base, including installation services, representing 35% of revenue, followed by power generation (about 33%), industrial clients (around 14%), and natural gas stations (11%).

In May 2016, the company had a mid-plan review on its approved tariffs under its quinquennial plan. Calidda complied with its required investments and connections; therefore, its actual tariff will be valid until the next tariff review in May 2018.

Our base-case scenario assumes the following factors:

- Revenue to grow around 7.6% in 2017. Peru's solid economic growth prospects and favorable natural gas consumption trends support the company's growth prospects.
- Gross margins to slightly improve in the next few years given that costs will remain under control while revenue rises.
- Dividends of $40 million for 2017 and afterwards.
- Annual investments for network expansion are likely to remain at $80 million - $90 million.
- Calidda's main focus is the expansion of its existing business portfolio; therefore, we don't expect acquisitions in the next few years.

Based on these assumptions, we arrive at the following credit measures for 2017 and 2018;

- Debt to EBITDA of around 3x; and
- FFO to debt of around 23%.

Calidda's focus is the distribution of natural gas in the department of Lima and the Callao province in Peru through a 33-year concession contract with the government since 2000 to build and operate the gas distribution network. The contract can be extended up until 2060. During the concession period, the company is responsible for building, operating, and maintaining the natural gas distribution system and servicing residential, commercial, and industrial clients, electricity generators, and gas stations in the province.

Liquidity

Calidda's liquidity is adequate, in our view. We expect sources to exceed uses by at least 1.2x in the next two years. We consider the company's dividend payment and capex to be highly flexible.

Principal Liquidity Sources:

- Cash and short-term investments for $19.3 million as of Sept. 30, 2016; and
- FFO generation of around $90 million in 2017.

Principal Liquidity Uses:

- Investment for network expansion of about $70 million in 2017; and
- Dividend payment in 2017.

Calidda isn't subject to financial covenants in its notes. Our view of the uses of liquidity incorporates the flexibility in the company's capex in a stress scenario. Therefore, Calidda's capex figure under our liquidity analysis is lower than in our base-case assumption.

We believe that the company has the ability to absorb high-impact, low probability events with limited need for refinancing. Calidda's next major debt maturity is 2023. We believe that the company has satisfactory standing in credit markets and relationship with banks.

Group rating methodology

The company is a subsidiary of Empresa de Energia de Bogota S. A. E. S. P. (EEB; BBB-/Stable/--), a Colombia-based, diversified energy holding company that owns 60% of Calidda. We consider Calidda a strategically important subsidiary of EEB because it's unlikely that the latter would sell its subsidiary in the near term, it's important for the group's long-term strategy, senior group management has made a long-term commitment to Calidda, and it's successful in its business line. In our opinion, EEB will continue to support Calidda, mainly through its business expertise and commitment to prudent financial management.

On Sept. 29, 2016, we revised our outlook on EEB to stable from negative, reflecting its stronger financial performance given a normalized dividend flow, debt reduction, and stronger Colombian peso. Because there are no meaningful regulatory mechanisms or other structural barriers that restrict EEB's access to Calidda's assets and cash flow, the latter's outlook is aligned with that of its parent.

Issue-level ratings

The 'BBB-' rating on Calidda's senior unsecured debt is the same as the company's corporate credit rating. Calidda doesn't have subsidiaries, thus we don't consider the debt to be structurally subordinated.

Outlook

The stable outlook on Calidda is based on our expectations that it will maintain its key credit metrics, with debt to EBITDA around 3.0x and FFO to debt above 23% for the next two years.

Downside scenario

We would lower the ratings on the company if we downgrade its parent, EEB. We could also lower the ratings if Calidda generates consistently lower-than-expected cash flow that could pressure its financial metrics, particularly if debt to EBITDA is higher than 3.5x or FFO to debt is lower than 23%. This could result from additional debt to fund additional capex or dividend payments.

Upside scenario

A positive rating action would depend on the parent's upgrade and would require an improvement in the company's key financial ratios particularly if debt to EBITDA is consistently below 2.5x and FFO to debt is above 35%.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--
Business risk: Satisfactory
- Country risk: Moderately high
- Industry risk: Very low
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb-
Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-
Group Credit profile: bbb-
- Entity status within group: "Strategically important" subsidiary (No impact)

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Gas Natural de Lima y Callao S.A. (Calidda)

Corporate Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.