FITCH UPGRADES CALIDDA'S IDRS TO 'BBB'; OUTLOOK REVISED TO STABLE

Fitch Ratings-New York-17 March 2017: Fitch Ratings has upgraded Gas Natural de Lima y Callao S.A.'s (Calidda) long-term local and foreign currency issuer default rating (IDR) to 'BBB' from 'BBB-'. The upgrade affects USD320 million of senior unsecured notes due in 2023. The Outlook has been revised to Stable from Positive.

KEY RATING DRIVERS
The upgrade to Calidda's ratings reflects the company's improving capital structure supported by its naturally monopolistic market position as Lima and Callao's sole natural gas (NG) distributor. It is further underpinned by the sustained cash flow stability provided by its transparent, regulated tariff scheme designed to ensure adequate return on investment. Calidda's cash flow generation also continues to benefit from expected demand growth of 100,000 client additions per year going forward, based on Fitch's estimates.

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 concentrates more than 35% of the country's population and over 50% of its GDP. The concession term lasts through 2033, and may be renewed upon request from Calidda in 10-year increments up to 2060. As of today, Calidda has complied with all the commitments established under the concession.

Predictable and Stable Cash Flow
The vast majority of Calidda's revenues are derived from its NG distribution clients (such as natural gas for vehicles [NGV], commercial and residential, industrial, and generation), providing the company with stable and predictable cash flow generation. The company's regulated tariff scheme, which assures cost recovery and an adequate return over 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 2016, the company generated USD125 million of EBITDA, up from USD104 million recorded in 2015 mainly due to higher volumes sold. EBITDA margins also improved to 23% from 19% in 2014, reflecting the higher proportion of distribution revenues relative to connection/installation revenues. 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 51% 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 2.7x in 2016 from 4.4x in 2013, in line with Fitch's expectations. Fitch's forecast incorporates expectations for a substantial capex program in the near- to medium-term. Additionally, the company started paying dividends to its 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 between 3.0x and 3.5x during the 2016-2019 period.

Concentration on Natural Gas Supply

In order to serve the regulated demand, Calidda needs to negotiate its NG supply contract. Beginning in 2018, Calidda will increase its contracted volume from the Camisea consortium by almost 40% versus 2016. Moreover, it will rebalance its interruptible capacity to 20% of total (versus 78% of total, 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 has recently renewed the agreement until 2021.

Shareholders with Proven Track Record in the Sector
Fitch considers it positive 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 additional international presence in Peru.

KEY ASSUMPTIONS
Fitch's assumptions for Calidda's rating case include:

-- The company will add an average of 100,000 clients per year;
-- Annual volumes increase by around 2% on average over the next four years.
-- Lower power volumes starting by the end of 2017 as a result of an increase in hydro projects;
-- Average tariffs per customer segment increasing by CPI;
-- 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 between USD30 and USD40 million annually

RATING SENSITIVITIES
Although a positive rating action is considered unlikely, positive rating triggers could include significant and sustained deleveraging to about 2.0x along with the growth and consolidation of the regulated supply and demand (NGV and residential and commercial segments) including a major increase in network penetration rates.

A negative rating action could be taken if leverage, as measured by total debt/EBITDA, increased and remained at a level of more than 3.5x for a prolonged period of time due either to operational deterioration or unexpectedly large dividend distributions.

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

LIQUIDITY
In 2013, Calidda issued USD320 million in unsecured bonds to finance its CAPEX program in 2013 - 2014 and to repay all its outstanding debt at that date (USD150 million in bank debt plus USD47 million shareholders' debt). The bonds have a 10-years bullet payment and fixed interest rate. The transaction allowed the company to reduce interest rates, extend debt average life to 10 years from 3, match debt maturity profile with long-term revenues and remove restricted covenants and overcollateralization (i.e. concession mortgage, revenues trustee, shares pledge and debt service reserve account).

As a result of the transaction, total debt/EBITDA grew from 3.0x in December 2012 to 4.4x in December 2013. As of year-end 2016, Calidda showed gross leverage of 2.7x and interest coverage of 6.6x. Fitch expects the company's leverage will remain around 3.0x through the medium term.

The bulk of Calidda's debt (93%) is USD-denominated and its tariff is calculated in USD. Exchange rate risk is limited to the collection period (approximately 30 days). Hedging is based on the exchange rate forecast, and is reviewed on a monthly basis.

Calidda plans to finance future investments mainly with its operating cash generation. Since 2015, the company has been adding medium-term local-currency-denominated debt to fund its annual dividends of around USD30 million as well as provide a hedge on accounts receivable. This debt amortizes over four years, and Fitch expects future debt increases of this nature to follow a similar amortization structure.

Calidda's policy is to maintain a minimum cash of USD6 million. Liquidity is supported by Calidda's local uncommitted credit lines from banks available for working capital needs.

FULL LIST OF RATING ACTIONS

Fitch has upgraded the following ratings:

Gas Natural de Lima y Callao S.A (Calidda)
--Long-Term Foreign Currency IDR to 'BBB' from 'BBB-';
--Local Currency Long-Term IDR to 'BBB' from 'BBB-';
--USD320 million due 2023 senior unsecured notes upgraded to 'BBB' from 'BBB-'.

The Rating Outlook is Stable.

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Date of Relevant Rating Committee: March 16, 2017.

Additional information is available on www.fitchratings.com

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)
https://www.fitchratings.com/site/re/895493
Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016)
https://www.fitchratings.com/site/re/886557