MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Calidda to Baa2, outlook stable

10 Jul 2018

New York, July 10, 2018 -- Moody's Investors Service ("Moody's") upgraded today the foreign currency senior unsecured rating of Gas Natural de Lima y Callao S.A. (Calidda) to Baa2 from Baa3. At the same time, the outlook was revised to stable from positive.

The upgrade recognizes the successful implementation of the company's capital investment plan and business model, while at the same time maintaining strong credit metrics. It further considers the timely conclusion of the tariff review process in June 2018 at adequate returns, reflecting the strength of the regulatory framework.

The stable outlook reflects our expectation that the company will be successful in executing the capex plan approved during the more recent regulatory cycle efficiently, in accordance with its track record, and that the company will prudently manage its liquidity profile.

Upgrades:

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

.Senior Unsecured Global Notes, Upgraded to Baa2 from Baa3

Outlook Actions:

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

.Outlook revised to stable from positive

RATINGS RATIONALE

The rating upgrade recognizes the successful implementation of the company's investment program and business model, which have led to increased cash flow and operating margins. It further considers the timely conclusion of the tariff review process in June 2018, despite the recent political turmoil in the country which included the replacement of senior personnel at both the Ministry of Energy and Mining and related agencies, which speaks to the strength and stability of the regulatory framework. The tariff framework recognizes the investments previously made through a replacement value approach, as well as the capex plans for the 2018-2022 period. It further allows for quarterly adjustments to incorporate variability in costs and expenses. In light of the smooth tariff review process, we have revised our subfactor score for 'Timeliness of Recovery of Operating and Capital Costs' to 'Baa' from 'Ba'.

The capex plan for the 2018-2022 cycle incorporates the expected deceleration in the expansion growth rate, which will ultimately lead to lower ancillary installation revenues. CFO pre WC to Debt and Interest Coverage are expected to deteriorate to 20% and 5.5x, respectively, from the past three year average of 24% and 6.5x, respectively, but remain robust for the rating category. The strong metrics offset the risks associated with the still relevant portion of revenues deriving from installation services, high concentration of power generators in the offtake base, and single market operations.

The credit view recognizes the stability of the company's organic cash flow profile in light of its regulated utility business, and the strategic importance of the infrastructure to the distribution of natural gas to the metropolitan region of Lima.

Calidda's network continues to grow rapidly, and extends for the metropolitan region of Lima, reaching a total 8,347 km of underground pipelines. The expectation is that the company will continue to grow, however at a slower pace. The approved business plan considers capex and client growth at a CAGR of 11% and 15%, respectively, for the 2017-2020 period in contrast to 21% and 31%, respectively for the 2014-2017 period. As a result of a lower number of new installations, total adjusted revenues are likely to stabilize around $230 million over the medium term.

The company has maintained a relatively low cash balance historically, ranging between $15-$30 million over the past two years, although faces fairly limited debt maturities over the short to medium run, restricted to a bank loan with annual amortizations averaging $20 million. In light of the capex plan for the next three years, estimated at around $240 million, the company will remain free cash flow negative, and is likely to have net debt needs of around $70 to $80 million.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Calidda's rating could experience positive momentum should the company be able to record more robust credit metrics that further offset the risks related to the still important contribution from ancillary installation services revenues, concentration of unregulated power generation companies in the offtake base, and single-market concentration. Specifically, we could upgrade the rating if CFO pre WC to debt and Interest Coverage exceed 25% and 6.5x respectively.

Downwards rating pressure could result upon deterioration of business fundamentals or weakening of the regulatory environment leading to a perception of lower credit metrics, specifically if CFO pre WC to debt and Interest Coverage decline to below 15% and 4.5x, respectively.

The principal methodology used in this rating was Regulated Electric and Gas Utilities published in June 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Lima, Gas Natural de Lima y Callao S.A. (Calidda) started commercial operations in 2004 in the Department of Lima and the Constitutional Province of Callao. It is currently the largest natural gas distribution company in Peru, serving 612,132 customers as of March 2018. Calidda operates under a 33-year Build Operate Own and Transfer (BOOT) concession agreement and its May 2010 Addendum, expiring in 2033, although subject to potential extensions. Calidda's tariffs are subject to the regulatory purview of the Peruvian regulatory body, Organismo Supervisor de la Inversión en Energía y Mineria (OSINERGMIN), which also monitors its pre-agreed five year capex program.

Calidda's majority shareholder is Grupo de Energia de Bogota (GEB) with an indirect and direct ownership stake of 66.2% given its 15.6% equity interest in Calidda's minority shareholder, Promigas S.A. E.S., which holds a direct 40% interest.

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