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Research Update:

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

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Overview

- The Peru-based natural gas distribution company Gas Natural de Lima y Callao S.A (Calidda) has performed in line with our expectations by maintaining relatively 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. 26, 2017, S&P Global Ratings 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 in 2017, because the company posted debt to EBITDA of 2.8x and FFO to debt of 25%. Since the middle of last year, the company has been going through the revision of the Quinquennial Plan for 2018-2022, which includes projected tariffs according to the programmed connections and capex for the term. The publication of the new tariff for the plan will be announced on April 11 by the Energy and Mining regulator, Osinergmin (Organismo Supervisor de la Inversión en Energía y Minería) and applicable on May 2018. We don't foresee any impact on the rating since we believe that the company benefits from regulatory stability, given consistency in the regulatory framework, which recognizes efficient investments and costs.

Additionally, Calidda benefits from stable cash flow generation--stemming from very low industry risk--and its monopolistic position in the department of Lima and the 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, as electricity generators represent a higher portion in Calidda's client portfolio. Nevertheless, Calidda benefits from a diversified portfolio of customers with a residential and commercial client base, including installation services, representing 37% of revenue, followed by power generation (about 33%), industrial clients (around 15%), and natural gas stations (10%).

Our base-case scenario assumes the following factors:

- Revenues grow around 8% in 2018. Peru's solid economic growth prospects, favorable natural gas consumption trends, and an increase in its residential base all support the company's growth prospects.
- Gross margins to slightly improve in the next few years.
- Dividends of $50 million for 2018 and afterwards.
- Annual investments for network expansion are likely to remain at about $100 million. The company plans to reach Puente Piedra, Cañete, and Ventanilla, encompassing 23 districts in the residential & commercial segment for 2018.
- Calidda's main focus is on 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 2018 and 2019:

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

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 to be sold in the near term, it's important for the group's long-term strategy, and senior group management has made a long-term commitment to Calidda, which is 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.

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 capital expenditures (capex) to be flexible.

Principal Liquidity Sources:

- Cash and short-term investments for $35 million as of Dec. 31, 2017; and
- FFO generation of around $100 million in 2018.

Principal Liquidity Uses:

- Investment for network expansion of about $100 million in 2018; and
- Dividend payment in 2018.

Calidda isn't subject to financial covenants in its notes. We believe that the company has the ability to absorb high-impact, low probability events with limited need for refinancing. We believe that the company has satisfactory standing in credit markets and good relationships with banks.

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 were to 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 consistently lower than 23%. This could result from additional debt to fund capex or dividend payments.

Upside scenario

A positive rating action would depend on an upgrade of the parent, and would require an improvement in the company's key financial ratios--debt to EBITDA consistently below 2.5x and FFO to debt 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)

Issue 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.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- 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
- 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. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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.capitaliq.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.