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

Primary Credit Analyst:
Vinicius Ferreira, Sao Paulo + 55 11 3039 9763; vinicius.ferreira@spglobal.com

Secondary Contact:
Marcelo Schwarz, CFA, Sao Paulo (55) 11-3039-9782; marcelo.schwarz@spglobal.com

Table Of Contents

Credit Highlights

Outlook

Our Base-Case Scenario

Company Description

Business Risk

Financial Risk

Liquidity

Covenant Analysis

Environmental, Social, And Governance

Group Influence

Issue Ratings - Subordination Risk Analysis

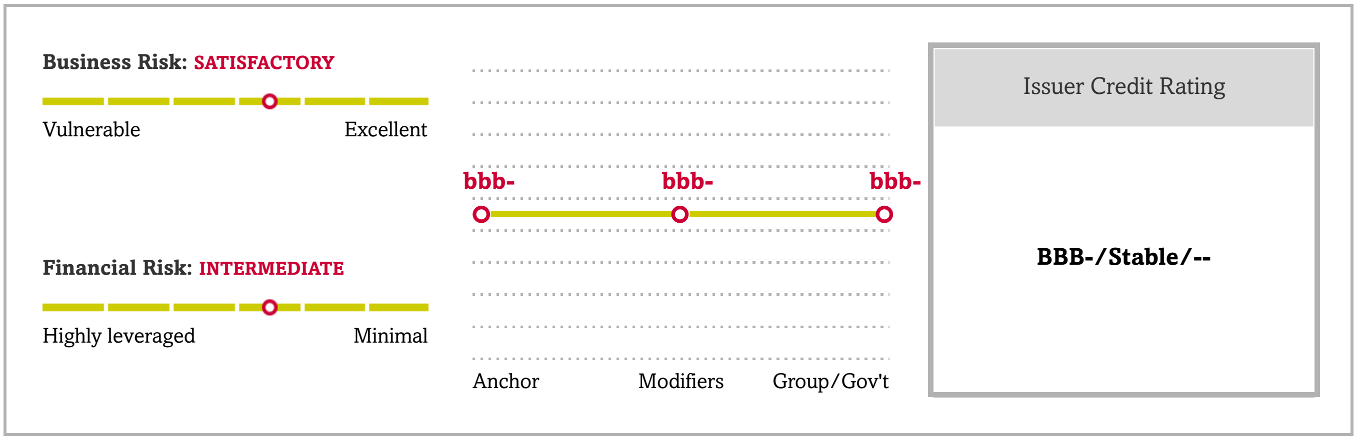
Reconciliation

Table Of Contents (cont.)

Ratings Score Snapshot

Related Criteria

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



Credit Highlights

Overview

Key Strengths	Key Risks
Natural monopoly in its specific concession area.	Increasing investments to expand client base.
Supportive regulatory framework.	Negative free operating cash flow indicating external funding needs.
Stable and predictable cash flow generation.	

Calidda will invest more to increase its footprint in the residential and commercial segments. Gas Natural de Lima y Callao S.A. (Calidda) plans to increase its investments in 2019 and 2020 to $100 million-$120 million annually, compared to the $100 million that we previously expected. This is mainly in order to increase its presence in the residential and commercial segments, which should make its cash flow even more predictable.

The company is taking advantage of the more flexible regulatory conditions for its expansion plan from the decree passed last December, which we believe will allow Calidda to accelerate its growth strategy in Peru. The decree lets Calidda make changes to the plan that the regulator approved throughout its execution.

Gross debt will increase to finance its investment plan. We don't expect Calidda's cash flow generation to be enough to fund its investment plan, given our expectation of negative free operating cash flow (FOCF) in the next two years. As a result, we believe the company will need to issue new debt. We believe that Calidda has good access to the local credit markets in Peru, through bank loans and bond issuances, and also to international markets.

After the investments, we expect cash flow generation to be even more predictable. Given that Calidda has a natural monopoly in its concession area (the Department of Lima and the Constitutional Province of Callao) and serves just 42 of the 160 districts there, it has room to grow its clients base. We believe the existing regulatory framework is consistent and investment-supportive, allowing the company to continue growing. Because Calidda's strategy is to expand operations mostly to the residential segment, which tends to have a more resilient consumption profile, we expect this strategy to make cash flows even more predictable, helping offset any potential slump from an economic downturn.

Outlook: Stable

We base the stable outlook on Calidda on our expectation that the company will maintain, in the next 12 to 24 months, debt to EBITDA at 3.0x-3.5x and funds from opreations (FFO) to debt between 18%-23%. Additionally, given the higher amount of investments, we expect the company to generate negative FOCF in the same period.

Downside scenario

We would lower the ratings on the company if we were to downgrade its controlling shareholder, Grupo Energia Bogota S.A.E.S.P. (GEB: BBB-/Stable/--).

In addition, we could lower the ratings and downwardly revise its 'bbb-' stand-alone credit profile (SACP) if Calidda generates consistently lower-than-expected cash flows while it continues expanding and maintains aggressive dividend distribution. These factors would pressure its financial metrics, resulting in debt to EBITDA consistently above 3.5x and consistently negative FOCF generation.

Upside scenario

An upgrade would first depend on an upgrade of GEB, which we currently rate at the same level as Calidda.

We could also revise Calidda's SACP upwards if the company consistently presents debt to EBITDA around 2.5x and positive FOCF, along with a conservative dividend policy that allows it to reduce debt.

Our Base-Case Scenario

Assumptions	Key Metrics
• Revenue growth between 5.0%-7.5% this year and between 10.0%-12.5% in 2020, due to the application of an extraordinary rate review to incorporate the company's larger investment plan in the second half of 2019. This also considers Peru's economic growth prospects, favorable natural gas consumption trends, and an increase in Calidda's residential clients. • Continued cost recovery through quarterly rate adjustments to pass through the gas costs. • Capital expenditures (capex) between $100 million-$120 million annually in 2019 and 2020, partially financed with new debt. • Dividend distribution of around $60 million this year, equivalent to the maximum distribution allowed, and potential reduction of the payout from 2020 on to accommodate the company's $600 million investment plan until 2023.	See table below

	2019E	2020E
EBITDA (Mil. $)	160-165	180-185
Debt to EBITDA (x)	3.0-3.5	3.0-3.5
FFO to debt (%)	18-23	18-23
FOCF to debt (%)	(5)-0	(5)-0

E--Estimated.

Base-case projections

We forecast negative FOCFin the next two years. Calidda has annual investments between $100 million-$120 million to expand its residential segment. It plans to add 125,000-150,000 clients annually to its client base. This indicates that Calidda will require new debt to finance part of its investment plan, which we already include in our base-case scenario.

Growing EBITDA will support credit metrics. Increases in EBITDA in 2019 and 2020 will come mostly from two factors. First, the application of the rate adjustment, which we expect to be in the second half of 2019, will let Calidda incorporate its larger investment plan into the approved rates. Previously, the company presented to the regulator a reduced investment plan of about $350 million until 2023, but now it plans to increase it to closer to $600 million.

Second, these expansion investments will increase its residential and commercial segment base, bringing it higher margins. Although these clients are only make up about 2% of invoiced volumes, they are responsible for almost 38% of the company's revenues.

Company Description

Calidda is a Peru-based natural gas distribution company. It has a 33-year concession contract that started in 2000 that can be extended up to 2060 to serve the Department of Lima and the Constitutional Province of Callao. Calidda serves 42 out of the 160 districts in the concession area (which represents only 3% of Peru's territory, but comprises 11 million people--35% of the country's population).

Currently, the distribution network has capacity for 420 million cubic feet per day (MMCFPD) of natural gas without considering the generators, and the company has more than 750,000 clients in the concession area with a network penetration ratio around 75%. Last year, Calidda invoiced 779 MMCFPD of natural gas in the concession area, including 569 MMCFPD for electricity generators. As of Dec. 31, 2018, the company reported revenues and EBITDA of $675 million and $159 million, respectively.

Calidda has two shareholders: GEB, with a controlling stake of 60%; and Promigas S.A. E.S.P. (not rated), with the remaining 40%. For further details on the relationship with the controlling shareholder, please refer to the Group Influence section.

Business Risk: Satisfactory

Calidda benefits from a stable regulatory environment in Peru and has monopoly rights to serve the provinces of Lima and Callao, which are the provinces that contribute most to Peru's GDP. OSINERGMIN (Organismo Supervisor de la Inversión en Energía y Minería), which we view as transparent, consistent, and predictable, regulates the company. Calidda has already achieved all the concession contract obligations and has been increasing its number of clients through new investments in the concession area, which are properly incorporated into rates, supporting its credit quality and adequate profitability levels.

Of Calidda's 779 MMCFPD invoiced volume in 2018, about 73% of that was related to power generation companies, 16% to industrial clients, 9% to NGV stations, and the remaining 2% to residential and commercial clients. However, in terms of revenue breakdown, given that approved tariffs vary by client's natural gas volume consumption levels, residential and commercial clients represent almost 38% of total revenues, giving greater stability to operating cash flows, while power generators are the second largest contributors, with around 30%.

Peer comparison

When we compare Calidda with other rated peers in Latin America, such as Companhia de Gas de Sao Paulo – Comgas (brAAA/Stable/--) and Naturgy Mexico S.A. de C.V. (Naturgy Mexico: mxAA+/Stable/--), we think that Calidda's scale is more comparable to Naturgy Mexico, since Comgas has the largest scale. At the same time, due to its expansion investments, Calidda has the most leveraged credit metrics.

Table 1

Peer Comparison

Industry Sector: Gas

	Gas Natural de Lima y Callao S.A. (Calidda)	**Companhia de Gas de Sao Paulo - Comgas**	**Naturgy Mexico S.A. de C.V.**
Ratings as of Feb. 25, 2019	BBB-/Stable/--	brAAA/Stable/--	mxAA+/Stable/--
	--Fiscal year ended Dec. 31, 2018--	--Fiscal year ended Dec. 31, 2018--	RTM ended Sept. 30, 2018
(Mil. $)			
Revenues	557.9	1,659.5	270.9
EBITDA	163.6	564.7	173.5
FFO	125.0	509.4	105.0

Table 1

Peer Comparison (cont.)

Industry Sector: Gas

	Gas Natural de Lima y Callao S.A. (Calidda)	Companhia de Gas de Sao Paulo - Comgas	Naturgy Mexico S.A. de C.V.
Net income from continuing operations	68.7	346.0	72.1
Cash flow from operations	81.9	344.3	91.8
Capital expenditures	119.0	134.8	109.7
Free operating cash flow	(37.2)	209.5	(17.9)
Discretionary cash flow	(89.9)	14.0	(28.1)
Cash and short-term investments	20.7	446.2	9.3
Debt	457.5	532.0	372.3
Equity	316.2	702.9	680.2
Adjusted ratios			
EBITDA margin (%)	29.3	34.0	72.9
Return on capital (%)	19.2	45.3	13.1
EBITDA interest coverage (x)	9.1	(157.4)	5.0
FFO cash interest coverage (X)	8.8	8.2	3.3
Debt/EBITDA (x)	2.8	0.9	2.1
FFO/debt (%)	27.3	95.8	28.4
Cash flow from operations/debt (%)	17.9	64.7	36.9
Free operating cash flow/debt (%)	(8.1)	39.4	15.1
Discretionary cash flow/debt (%)	(19.6)	2.6	15.1
Operational data			
Clients	761,216	1,905,455	1,799,649

FFO--Funds from operations.

Financial Risk: Intermediate

Although we expect in our base-case scenario that Calidda will have debt to EBITDA between 3.0x-3.5x in 2019 and 2020--which is in the middle-to-upper end of the range for its financial risk profile category--we believe the company remains committed to keeping debt to EBITDA consistently below 3.5x and its management could, for example, review the dividend policy on a yearly basis taking into consideration, according to the existing shareholders' agreement, the company's financial metrics and growth plan.

We already consider that Calidda will increase its debt, given our expectation that the company's FOCF generation will be negative in the next few years in order to finance its $600 million capex program until 2023.

Financial summary

Table 2

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

Industry Sector: Gas

	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
Rating history	BBB-/Stable/--	BBB-/Stable/--	BBB-/Stable/--	BBB-/Negative/--	BBB-/Stable/--
(000s $)					
Revenues	557,931.0	492,410.0	454,313.0	456,938.0	430,704.0
EBITDA	163,588.0	136,009.0	123,405.5	103,209.5	93,042.0
FFO	124,954.0	94,315.4	86,296.3	69,861.0	63,906.6
Net income from continuing operations	68,702.0	58,565.0	55,372.0	33,836.0	35,298.0
Cash flow from operations	81,862.0	101,135.4	57,356.3	87,445.0	65,383.6
Capital expenditures	119,041.0	87,007.0	80,543.0	77,622.0	80,103.0
Free operating cash flow	(37,179)	14,128.4	(23,186.7)	9,823.0	(14,719.4)
Discretionary cash flow	(89,887)	(35,706.6)	(53,639.7)	(21,945.0)	(14,719.4)
Cash and short-term investments	20,737.0	34,572.0	14,705.0	69,541.0	79,413.0
Debt	457,506.0	376,601.8	340,242.0	281,092.6	251,188.9
Equity	316,166.0	304,340.0	295,616.0	276,351.0	279,514.0
Adjusted ratios					
EBITDA margin (%)	29.3	27.6	27.2	22.6	21.6
Return on capital (%)	19.2	15.6	16.6	15.2	14.5
EBITDA interest coverage (x)	9.1	8.1	7.6	6.7	6.0
FFO cash interest coverage (x)	8.8	5.5	5.4	5.6	5.5
Debt/EBITDA (x)	2.8	2.8	2.8	2.7	2.7
FFO/debt (%)	27.3	25.0	25.4	24.9	25.4
Cash flow from operations/debt (%)	17.9	26.9	16.9	31.1	26.0
Free operating cash flow/debt (%)	(8.1)	3.8	(6.8)	3.5	(5.9)
Discretionary cash flow/debt (%)	(19.6)	(9.5)	(15.8)	(7.8)	(5.9)

FFO--Funds from operations.

Liquidity: Adequate

We assess Calidda's liquidity as adequate, which reflects our expectation that its sources of cash will cover its uses by around 1.2x over the next 12 months. We also project that the company's net sources will remain positive even if its EBITDA were to decline by 10% over the next 12 months. In addition, we believe the company has prudent risk management and that it will maintain its adequate liquidity profile, which is supported by its satisfactory standing in credit markets and good access to local and international capital markets. Furthermore, we believe the company could absorb high-impact, low-probability events (such as operational disruption that could result in reputational damage) with limited need for refinancing.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and short-term investments of $20.7 million as of Dec. 31, 2018; and • Expected cash flow generation of around $110 million in 2019.	• Debt maturities of $13 million in 2019; • Investments of around $120 million in 2019. • Dividend distribution equivalent to 90% of the previous year's net income.

Debt maturities

As of Dec. 31, 2018, Calidda had the following debt maturity schedule:

2019	2020	2021	2022	2023	Thereafter
$13 million	$26 million	$27 million	$14 million	$320 million	$61 million

Covenant Analysis

Calidda isn't subject to financial covenants in any of its debt obligations.

Environmental, Social, And Governance

We believe social, and to a lesser extent, environmental factors are relevant to Calidda's operations. Both social and environmental factors are reflected in the operational risk because for gas network companies, safety management is particularly important, since incidents that occur typically result in deaths. We believe that Calidda has been complying with safety standards, as there its operations haven't resulted in any deaths in the past two years, indicating its solid safety management. In addition, given the company's strategy to expand the network, mostly in the residential segment, it has been identifying the bypass areas in order to prevent social conflicts throughout the concession area. Since it started operating, Calidda estimates to have prevented around 60 million tons of carbon emissions into the atmosphere, replacing coal-powered electric services with gas ones, since the Peruvian electricity matrix is around 40% thermal.

Group Influence

We do not expect controlling shareholder GEB to sell Calidda in the short term, because the gas distributor is important for the group's long-term strategy. We expect GEB's support to Calidda will mainly come from GEB's management expertise and its commitment to prudent financial risk management.

Finally, we do not believe there are meaningful regulatory mechanisms or other structural barriers that restrict GEB's access to Calidda's assets and cash flows, so the rating on GEB could limit the rating on Calidda.

Issue Ratings - Subordination Risk Analysis

Capital structure

Calidda's debt consists of only senior unsecured debt. All debt was issued at Calidda's level, which is an operating company without subsidiaries, and therefore not subject to structural subordination. As of Dec. 31, 2018, its total debt was $461 million.

Analytical conclusions

Without material priority obligations ranking ahead of Calidda's senior unsecured bond of $320 million and bullet maturity in 2023, we rate this debt 'BBB-', the same as our long-term issuer credit rating.

Reconciliation

Table 3

Reconciliation Of Gas Natural de Lima y Callao S.A. (Calidda) Reported Amounts With S&P Global Ratings' Adjusted Amounts (000s $)

	Debt	Revenues	EBITDA	Operating income	EBITDA	Cash flow from operations
			--Fiscal year ended Dec. 31, 2018--			
Gas Natural de Lima y Callao S.A. (Calidda) reported amounts	478,243	674,938	146,870	119,190	146,870	98,158
S&P Global Ratings' adjustments						
Interest expense (reported)	--	--	--	--	(17,979)	--
Interest income (reported)	--	--	--	--	4,229	--
Current tax expense (reported)	--	--	--	--	(24,884)	--
Surplus cash	(20,737)	--	--	--	--	--
Non-operating income (expense)	--	--	--	4,229	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(16,296)
Revenues - Profit on disposals	--	(117,007)	(117,007)	(117,007)	(117,007)	--
COGS- Restructuring costs	--	--	117,007	117,007	117,007	--
SG&A- Other non-operating nonrecurring items	--	--	16,718	16,718	16,718	--
Working capital - Taxes	--	--	--	--	--	30,867
Working capital - Other	--	--	--	--	--	574
OCF - Taxes	--	--	--	--	--	(30,867)
OCF - Other	--	--	--	--	--	(574)
Total adjustments	(20,737)	(117,007)	16,718	20,947	(21,916)	(16,296)
	Debt	**Revenues**	**EBITDA**	**EBIT**	**Funds from operations**	**Cash flow from operations**
S&P Global Ratings' adjusted amounts	457,506	557,931	163,588	140,137	124,954	81,862

Ratings Score Snapshot

Issuer 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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (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 (no impact)

Related Criteria

- Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of April 18, 2019)*

Gas Natural de Lima y Callao S.A. (Calidda)	
Issuer Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-
Issuer Credit Ratings History	
29-Sep-2016	BBB-/Stable/--
03-Sep-2015	BBB-/Negative/--
14-Mar-2013	BBB-/Stable/--
Related Entities	
Grupo Energia Bogota S.A.E.S.P.	
Issuer Credit Rating	BBB-/Stable/--
Transportadora de Gas Internacional S.A. E.S.P.	
Issuer Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.