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Research Update:

Gas Natural De Lima Y Callao S.A. And Its Notes Rated 'BBB-'; Outlook Stable

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Overview

- We are assigning our 'BBB-' corporate credit rating to Peru-based natural gas distribution company Calidda.
- At the same time, we are assigning our 'BBB-' rating to the company's proposed issuance of up to $320 million.
- The company's credit quality assessment is supported by Peru's promising economic growth initiatives and favorable natural gas consumption trends.
- The stable outlook reflects our expectation that Calidda's key financial ratios will improve over the next two years due to higher sales and operating revenue.

Rating Action

On March 14, 2013, Standard & Poor's Rating Services assigned its 'BBB-' corporate credit rating to Gas Natural de Lima y Callao S. A. (Calidda). We also assigned our 'BBB-' rating to its proposed senior unsecured notes for up to $320 million. The outlook is stable.

Rationale

The 'BBB-' corporate credit rating on Calidda reflects its "satisfactory" business risk profile due to its monopolistic position in the Lima and Callao provinces. The rating reflects Calidda's "adequate" liquidity. The rating also considers its status as 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. The rating is constrained by Calidda's "significant" financial risk profile.

The rating on the proposed notes reflects Calidda's issuer credit rating. The proceeds will be used to refinance Calidda's existing debt and capital expenditures in 2013 and part of 2014. The issuance will also extend the company's average debt life to 10 years.

We assess Calidda's business risk profile as "satisfactory." Calidda's primary economic activity is the distribution of natural gas in the department of Lima and the Callao province. The company holds a 33-year concession (extendable to a maximum of 60 years) from the government to build and operate the gas distribution network in the two provinces. During the concession period, the company is responsible for building, operating, and maintaining the natural gas distribution system, servicing residential, commercial, and industrial clients, electricity generators, and vehicle gas stations.

The company's growth prospects are supported by Peru's promising economic growth initiatives and favorable natural gas consumption trends. The rating on Calidda accounts for a less diverse client base compared to other distribution companies in the region due to the higher sales share that electricity generator clients represent (34% in terms of revenue). We believe the company will benefit from client diversification as it continues to expand its network in order to increase its residential and commercial customer base. In our opinion, EEB's investment in Calidda is significant, as we believe it will continue to support Calidda, mainly through its business expertise and its commitment to a moderate financial policy. Our rating is based on our expectations that EBITDA and operating revenues will grow at an average of 8% in the next five years.

Our view of Calidda's "significant" financial risk profile is evidenced in its key financial ratios. We estimate that Calidda will post a total debt-to-EBITDA ratio of 4.5 x, EBITDA interest coverage to debt of 2.8x, and funds from operations (FFO) to total debt of 13% in 2013. The expected debt increase is a result of the proposed issuance of up to $320 million of which $196.7 million the company will use to refinance existing debt and the remaining $123 million for capital expenditures. We believe that the company will begin to reduce its debt in 2014 as its residential and commercial customer base increases, improving its cash flow and margin.

Liquidity

We assess Calidda's liquidity as "adequate." The company's sources will exceed its uses by 1.21x in 2013. Available cash for the company as of Dec. 31, 2012, was $45.186 million, which compares favorably with its debt obligations of about $25.1 million (excluding the debt restructuring). Free operating cash flow (FOCF) generation is closely related to the company's expansion and capital expenditure program. Therefore, we expect negative FOCF in 2013, given increased capital expenditures of about $120 million and an increase in working capital needs. Moreover, we believe that in an economic downturn, Calidda has substantial flexibility to lower its capital expenditures.

Calidda benefits from flexibility in its capital expenditures which could shrink 80%-90% and still comply with its mandatory investment concession agreement with the government. The company also benefits from planned restrictions in dividend payments until 2016 and the potential support of its owners EEB and Promigas S.A. E.S.P. (not rated),which owns the rest of Calidda.

Outlook

The stable outlook reflects our expectation that Calidda's key financial ratios will improve over the next two years. In particular, we expect the company's EBITDA margins to remain between 45% and 55% and its total debt-to-EBITDA ratio will not exceed 4.5x in 2013 and will fall below 4.0x after 2014. We could lower the ratings if Calidda generates lower-than-expected cash flow that could pressure its financial metrics, or if debt ratios are higher than we expect driven by lower-than-expected EBITDA growth. A positive rating action could stem from a material improvement in its key financial ratios.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry, Nov. 26, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

New Rating

Gas Natural de Lima y Callao S.A. (Calidda)	
Corporate Credit Rating	BBB-/Stable/--
Senior Unsecured $320 Million Notes	BBB-

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.