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Research Update:

Gas Natural de Lima y Callao S.A. (Calidda) 'BBB-' Corporate Credit Rating Affirmed; Outlook Remains Stable

Primary Credit Analyst:
Maria del Sol S Gonzalez, CFA, New York (1) 212-438-4443; maria.gonzalezcosio@standardandpoors.com

Secondary Contact:
Jose Coballasi, Mexico City (52) 55-5081-4414; jose.coballasi@standardandpoors.com

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Overview

- During 2014, the Peruvian regulator raised Peru-based natural gas distributor Calidda's rates. As a consequence, the company's performance was better than we expected.
- We are affirming our 'BBB-' corporate credit rating on Calidda.
- The stable outlook reflects our expectation that the company's net debt to EBITDA will approach 2.9x by year-end 2015 and remain around 3.0x in the next few years as it finances its capital expenditures (capex) with its own cash flow generation.

Rating Action

On April 28, 2015, Standard & Poor's Ratings Services affirmed its 'BBB-' corporate credit rating on Gas Natural de Lima y Callao S.A. (Calidda). The outlook remains stable.

Rationale

The 'BBB-' corporate credit rating on Calidda reflects its "satisfactory" business risk profile due to its stable cash flow generation--stemming from very low industry risk--and its monopolistic position in the department of Lima and Callao province in Peru. The rating also considers its status as a "strategically important" 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 also reflects Calidda's "intermediate" financial risk profile.

Calidda's primary economic activity is the distribution of natural gas in Lima and the Callao province through a 33-year concession with the government (signed in 2000) to build and operate the gas distribution network. The contract can be extended up to 60 years. 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 gas stations in the province.

Calidda's competitive position is "satisfactory," primarily reflecting its strong to adequate regulatory advantage due to the company's monopolistic position in Lima and Callao, the province that generates the most GDP in Peru.

The company's growth prospects are supported by Peru's promising economic growth initiatives and favorable natural gas consumption trends. The rating on Calidda incorporates a less diverse client base compared with other distribution companies in the region, due to the higher sales share that electricity generator clients represent in Calidda's portfolio. The company distributes gas to 16 power generators in its concession area. Power generator revenue share increased to 32% by year-end 2014 from 27% in 2013 due to the rate hike, which increased power generators' rates higher than rate increases for residential customers. During 2014, Calidda's residential and commercial client base grew 56% while industrial clients increased 5%, and the number of natural gas stations it supplies rose 7%. We would expect the share of revenues from power generators to decline to levels below 30% in the next five years as Calidda increases other customer bases.

Our view of Calidda's "intermediate" financial risk profile considers the stability of the company's cash flows and its current and expected key financial ratios. Our base case considers the hike in distribution rates by a weighted average by revenue component of around 20% or an overall 6.4% higher tariff (simple average) during the current review cycle. This should allow Calidda to post a debt-to-EBITDA ratio of less than 3.0x. Our debt to EBITDA ratio considers 75% of available cash and short term investments in our debt to EBITDA calculations.

The rate hike will likely lead to EBITDA interest coverage to debt of 7.0x, and funds from operations (FFO) to total debt of 24% by year end 2015, reflecting the increase for the full 12 months. We expect the company's leverage to remain stable, at about 3.0x, as its EBITDA continues to increase following revenue and slight margin growth while financing additional capex with small potential debt issuances.

Group Influence

We consider Calidda a "strategically important" subsidiary of EEB because it's unlikely that EEB would sell Calidda in the near term, the company is important for the group's long-term strategy, senior group management has made a long-term commitment to Calidda, and the company is successful in its business line. In our opinion, EEB will continue to support Calidda, mainly through its business expertise and its commitment to prudent financial management.

Liquidity

Calidda's liquidity is "adequate." We expect sources to exceed uses by at least 1.2x in the next two years. We consider the company's dividend payment and capex to be highly flexible.

Principal Liquidity Sources:

- Cash and short term investments for $79.4 million as of year-end 2014
- FFO generation of around $65 million in 2015

Principal Liquidity Uses:

- Capex of $85 million in 2015
- Dividend payment of $31 million in 2015

Outlook

The stable outlook on Calidda reflects our expectation that the company's key financial ratios will continue to improve over the next two years following its continued network expansion. We expect that as the company's residential business continues to grow, its exposure to electricity generators will decrease. In particular, we expect the company's adjusted net debt-to-EBITDA ratio will drop to around 3.0x by the end of 2015 and its FFO to debt will reach 24%.

Downside scenario

We could lower the rating if Calidda generates lower-than-expected cash flow that could pressure its financial metrics, or if leverage ratios weaken to debt-to-EBITDA ratios more than 3.5x or FFO to debt lower than 23% due to additional debt acquisition to fund additional capex or dividend payments.

Upside scenario

A positive rating action could follow a material improvement in the company's key financial ratios and a significant increase in client diversity stemming from a higher contribution from residential customers and if we upgrade its parent company, EEB.

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)

Related Criteria And Research

Related Criteria

- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013

Related Research

- Research Update: Empresa de Energia de Bogota Debt Rating Raised To 'BBB-' From 'BB+'; 'BBB-' Corporate Credit Rating Affirmed, Aug. 28 2014

Ratings List

Ratings Affirmed

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

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