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

Global Credit Research - 06 May 2015

Peru

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Baa3
Parent: Empresa de Energia de Bogota S.A. ESP. (EEB)	
Outlook	Positive
Senior Unsecured	Baa3

Contacts

Analyst	Phone
Natividad Martel/New York City	212.553.4561
William L. Hess/New York City	212.553.3837

Key Indicators

[1]**GasNaturaldeLimayCallaoS.A.(Calidda)**

	12/31/2010	12/31/2011	12/30/2012	12/31/2013	12/31/2014
CFO pre-WC + Interest / Interest	**3.6x**	**5.0x**	**4.4x**	**3.6x**	**6.0x**
CFO pre-WC / Debt	**15.9%**	**22.2%**	**19.7%**	**10.2%**	**21.8%**
CFO pre-WC - Dividends / Debt	**15.9%**	**22.2%**	**19.7%**	**10.2%**	**21.8%**
Debt / Capitalization	**50.6%**	**54.8%**	**49.6%**	**57.3%**	**54.4%**

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

-Cash flow visibility enhanced by the terms of the BOOT agreement and its May 2010 addendum

- Low business risk LDC profile albeit exposure to unregulated customers is material

- Overall credit supportive regulatory environment

- Credit metrics expected to remain commensurate with the Baa-rating category despite material capex during ramp-up of services

- Expected prudent dividend policy will allow for maintaining an adequate liquidity profile

Corporate Profile

Headquartered in Lima, Gas Natural de Lima y Callao S.A. (Calidda; Baa3, stable) started commercial operations in 2004 after a two year construction period.

Calidda is currently the largest Local Distribution Company (LDC) of natural gas in Peru (A3 stable) as measured by number of customers (year-end 2014 around 255,000) and volume of natural gas supplied. With around 4,700 km natural gas distribution network with a 420 million cubic feet per day (MMCFD) system capacity Calidda currently provides its services to residential end-users in 15 out of the 49 districts in the Department of Lima and the Constitutional Province of Callao, while its natural gas vehicle (NGV) stations and industrial customers extend over 34 districts.

Calidda operates under a 33-year Build Operate Own and Transfer (BOOT) concession agreement and its May 2010 Addendum. Calidda's tariffs are subject to regulatory purview of the Peruvian regulatory body, Organismo Supervisor de la Inversión en Energía y Mineria (OSINERGMIN), while its pre-agreed five year capital expenditure (capex) program is monitored by the Ministry of Energy and Mines (MEM).

Calidda's non-regulated revenues consists of fees for rendering services ancillary to its LDC operations which are mainly related with installation and connections as well as the interest received for providing financing to new residential end-users for funding connection devices.

Calidda's majority shareholder is Empresa de Energia de Bogota (EEB; Baa3, positive) 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. (not rated; 40% interest).

For more details about the company, the terms of the BOOT concession agreement and 2010 Addendum and/or the key Peruvian natural gas provisions underpinning Calidda's operations please refer to the March 2013 Presale-Report available on our website.

SUMMARY RATING RATIONALE

Calidda's Baa3 rating factors its overall low business risk profile and that the bulk of its revenues are derived from its regulated NG distribution operations. It further considers that the company's cash flow visibility is enhanced by the terms of its concession and tax stability agreements as well as the overall credit supportive regulatory environment under which it operates. The rating is tempered by Calidda's overall modest albeit growing footprint, its significant exposure to unregulated end-users despite its growing residential customer base, and the increasing contribution to Calidda's cash flows of unregulated ancillary services. Importantly, the rating assumes that Calidda's credit metrics will remain commensurate with the Baa-rating category while its total debt to EBITDA ratio is limited to a maximum 3.5x. The rating assumes the continuation of a prudent financial policy to fund its planned material capex as well as responsible dividend distributions over the medium term, and acknowledges Calidda's hedging program to offset some cash flows mismatching due to some foreign exchange risk exposure.

DETAILED RATING CONSIDERATIONS

CREDIT SUPPORTIVE BOOT-CONCESSION TERMS

The terms of Calidda's BOOT-agreement and 2010-addendum are a key rating consideration. The initial expiration is scheduled after the maturity of the US$320 million Yankee notes (Baa3 stable) due in 2033. The BOOT-agreement is subject to 10-year extensions until 2060 further diminishing the refinancing risk, another credit positive. We consider the risk of an early termination of the BOOT agreement as low given the LDC's operational performance to-date and our understanding of the overall constructive relationship with the MEM. Calidda's cash flow visibility is further enhanced by the terms of its Tax Stability Agreement which limits its exposure to changes in taxation.

MODEST SIZED LDC BUT GROWING FOOTPRINT

Calidda's service territory accounts for around 34% of the country's total population (around 30 million) and around 45% of GDP. A key rating consideration is Calidda's multi-year aggressive expansion strategy. This targets growing the LDC's customer base to 600,000 by 2017. This equates to adding over the next couple of years around 100,000 connections p.a.; however, this seems manageable after Calidda added almost 91,200 new connections in 2014, a material increase over 2013 (+56%) and compared to 144,000 total new connections added in the 2010-2013 period. Failure to implement that goal would not negatively impact its BOOT-agreement as its customer base already exceeds the expansion target agreed under the 2010 BOOT (91,000 additional customers

to the already connected as of May, 2010 which approximated 30,000). That said, we believe it could negatively impact its relationship with OSIGNERGMIN. We understand that the regulator would like Calidda's expansion program to progress at a faster pace amid the Government various initiatives to extend the use of NG throughout the country.

For the 2014-2017 period OSINERGMIN has approved the recovery in rates of capital outlays aggregating US$428 million (2014: around US$80 million). Nevertheless, this expansion is not without risks including performing construction work in densely populated areas; however, we note that Calidda has discretion over the areas for growing its customer base. This has resulted in its commercial strategy being primarily focused on those areas where end-users have higher incentives for switching to natural gas, particularly the low to medium income residential end-users. In addition to the country's low regulated NG prices customers also benefit more from promotional discounts and the installation financing arrangements also provided by Calidda. OSIGNERMIN set in the 2014-2018 Promotion Plan a discount at S/322 (before: S/315 per customer) and estimated that a total 371,379 customers would benefit from this discount by the end of period (2013: 119,814). It also concluded that the savings from NG compared to using Liquefied Petroleum Gas (the most direct alternative fuel source) could average 20%. Calidda further expects that its growth strategy will benefit from the recent simplifications of the building standards and the requirements that new multifamily buildings include natural gas installations.

Calidda will continue growing its networks (2014: +1,274km), mainly its secondary ducts. This consists currently of 428km of high pressure steel pipes (2014: +20km) to serve NG vehicle (NGV) stations and industrial customers as well as almost 4,250km of polyethylene network pipe. This expansion provides the LDC access to potential new customers which Calidda has estimated aggregate 466,000 at year-end 2014 (2013: 331,000). Compared with its current customer base this results in a penetration rate of 55% (2013: 50%; 2009: 20%) and economies of scale, another credit positive. According to OSIGNERGMIN's estimations in 2013 Calidda's clients were located every 21m (or around 10m according to Calidda's calculations) compared to 150 meters in 2005. Calidda's goal is to achieve a 80% penetration rate by 2019.

Calidda's system capacity of 420MMCFD is sufficient to meet this growing customer base (current peak at 300MMWCFD) while it is currently negotiating with the Camisea consortium the extension of its NG supply agreement (scheduled to expire in 2016). According to the last estimates available from the authorities (published in 2013) the proven NG reserves in the country were estimated to remain sufficient for least 30 years considering 2013 production levels and transportation capacity. Calidda has also transportation contracts in place with Transportadora de Gas del Peru (TgP; Baa1 stable) that secure its access to sufficient NG pipeline capacity. Calidda is considering participating in TgP's next open season for the capacity (around 20MMCF) that was not allocated last year. Total of around 80MMCF incremental capacity was allocated mainly to Calidda's customers which somewhat mitigates the risk for the LDC of limited access to transportation capacity.

MATERIAL EXPOSURE TO NON-RESIDENTIAL CUSTOMERS AND UNREGULATED ANCIALLIARY REVENUES

The rating is tempered by the significant exposure of Calidda's cash flows from unregulated ancillary services, largely associated with connecting new customers. We acknowledge that the issuer benefits from a competitive advantage over other potential service providers such that these services are expected to remain a key component of its gross profit margin (currently over 30%) defined as revenues after the pass-through of related cost components. The importance of NG for the end-users' quality of life and the costs associated with connecting to an alternative fuel source after a disconnection provides incentives to make their payments on time. This is evidenced by the low bad-debt recorded by Calidda's financing operations (less than 1%).

We consider credit positive Calidda's current focus on growing its residential and commercial customer base (2014: <1% of its distributed volumes and 4.5% of its revenues); however the issuer's exposure to its unregulated customers is expected to remain material. This exposure ranks among the highest across Moody's rated universe of regulated LDCs in the Americas, a credit negative. This considers that the bulk of the country's natural gas fired power generation facilities are located in Calidda's service territory. These accounted for around 32% of Calidda's adjusted revenues at year-end 2014 (for 2014: 74.2% of distributed volumes). Industrial end-users represented the next largest segment (2014: 16% of volumes and and 15.3% of adjusted revenues) followed by NGV stations (2014: 9.0% of volumes and 11.2% of adjusted revenues).

On a positive note, the bulk of Calidda's total adjusted revenues (2014: 63%) are not volumetric, including those related to the installation services (2014: 37%) as well as services rendered under firm contracts (take-or-pay agreements). These contracts (51.1MMCFD or 80% of Calidda's distributed volumes) will expire in 2033, and have been mainly executed with the NG-fired power generation companies. The credit concerns associated with this large exposure to the power generation sector is offset by their importance in the Peruvian energy mix (historically

at least 30% of the total output regardless of the season). Also this results in power generator's NG-demand in Peru being less volatile than in other countries in the region where the contribution of hydro-electric plants are significantly higher, causing the dispatch of NG-fired plants to be more seasonal and unpredictable. No new NG-fired facilities are expected to start operations over the next several years in Calidda's service territory after the 534MW Fenix (albeit off-line for some time) and 200MW Termochilca were commissioned in 2013 (+126MMCFD).

OVERALL CREDIT SUPPORTIVE REGULATORY ENVIRONMENT

Calidda's rating also reflects our opinion that the Peruvian regulatory environment is overall credit supportive albeit it also captures its limited historical track-record and some inconsistency in the application of some of the existing regulatory mechanisms.

Our opinion considers the outcome of the 2014-2018 tariff review. This progressed significantly smoother than the previous review (due in 2008 but completed in May 2010) and was completed in around eight months, a credit positive. Following Calidda's motion in its final decision published in June (rates became effective in July) the OSINERGMIN agreed to review upward slightly some of the key variables considered in setting rates, namely capex (+US$1 million to US$306.6 million) and OPEX (+US$10 million to US$109.6 million). As a result, rates averaged $22/m3, a 6.4% increase compared to the average tariff applicable during the 2009-2014 period and a 2.2% hike over the average tariffs decided in May 2014. That said, the impact varied by customer class with the more significant increase for very large demand customers (large industrial: +71% and power generators: +40%) while the tariffs for those residential customers with the lowest demand and for NG stations dropped by (0.6%) and (1.3%), respectively. Moody's calculates that after considering volumes the new tariffs resulted in a 20% increase in revenues.

The final outcome compares relatively well with Calidda's proposed tariffs. Some of the items that drove the difference (the gap averaged around 5% as the rate-increase for some customers was larger than requested) included OSINERGMIN's lower approved investments related to the promotional discounts in order to expand services among the low and mid-income categories also contributed to the difference. Also, the recovery of a lower authorized operational expenses (opex) as OSINERMIN's tariffs reflect higher efficiencies than assumed by the LDC. In addition OSINERGMN's approved a higher capex program (gap aggregates around US$25 million) albeit additional investments are fully recoverable in rates, credit neutral.

We consider credit positive the LDC's ability to adjust tariffs quarterly to reflect changes in the US Producer Price Index (US-PPI), the Peruvian Wholesale Prices Index, the Steel and the polyethylene indexes; however, OSINERGMIN's decision places a higher weight on the local (79%) and US-PPI (13.1%) rates compared to Calidda's proposed actualization weights for those same factors of 53.3% and 9.5%, respectively. The regulator also reduced the relative weight of the polyethylene (1.4% versus Calidda's proposed 2.7%) and steel-index (34.3% versus Calidda's submitted 6.5%). The latter is a credit negative considering that polyethylene and steel are some of the key components of Calidda's capex program; however, we also acknowledge that changes in steel prices are a component included in the US-PPI-index calculations, slightly offsetting our concerns.

Our view about the regulatory framework's credit supportiveness further factors other features including the LDC's ability to adjust annually the bills of the captive regulated customers with demand under 30,000 Standard cubic meter (SCM) for which it procures NG and transportation services. The latter includes not only residential, commercial end-users but also small and medium size industries as well as NG stations. This annual frequency matches the suppliers' contractual adjustments reducing the LDC's cost recovery lag and enhancing its cash flow visibility. Another credit positive is Calidda's ability to recoup and to generate returns (based on a 12% annual rate and a 30-year recovery period of the capital investments) not only on its past but also on those capital outlays earmarked for the next four years.

The five-year capex program pre-agreed with the MEM and subject to OSINERGMIN's consideration during the tariff review process should theoretically help mitigate the risk of investment disallowances, another credit positive. While OSINERGMIN's biannual review of Calidda's actual investments, operating costs and demand assumptions versus forecasted amounts used in setting the tariffs increases regulatory scrutiny; we believe it also helps to smooth the tariff review setting process that takes place every four years. The next biannual review should take place next year. During the 2012 biannual review tariffs were adjusted (effective in 2013) to reflect higher than anticipated volumes (used in setting the 2008 tariffs).

Calidda's cash flows are exposed to some currency risk associated with the payments received from its regulated customers. While the charges are initially calculated in US$-dollars the revenues are invoiced in nuevos soles after monthly adjustments of the charges. This is a credit negative since the bulk of Calidda's cost structure and indebtedness is in US-dollars (not converted into nuevos soles); however, we also believe that the monthly

adjustment process helps to reduce the impact of any potential nuevos soles devaluation which somewhat lessens our credit concerns. That said, we consider Calidda's hedging program (in place since last year) to fully eliminate this risk, a credit positive.

CREDIT METRICS COMMENSURATE WITH THE Baa-RATING CATEGORY

As depicted in the tables above, during 2014 Calidda's credit metrics improved significantly compared to the year before. Growing demand (new customers) and almost a half-year of higher tariffs (July) aided the issuer to record an improvement in its cash flows compared to the year before.

Moreover, Calidda's financial performance and cash flows were not impacted by several negative one-time off items registered in 2013. These included (i) fees related to the debt prepayment and the Yankee bonds issuance, (ii) accrued interest (2010-May 2013: around US$10.4 million) under its shareholders' loans (payment was subject to restrictions) and in arrears (payable for the period October-December 2013: around US$4.7 million) and (ii) higher outflows associated with prepaid taxes ($22.5 million; 2014: $6.5 million). During 2014, Calidda's EBITDA margin approximated 17% which was more aligned with its historical levels after the significant drop registered the year before due to an increase in the expenses related to the outsourced construction works.

Calidda's 2012-2014 cash flow from operations (CFO) pre W/C (CFO pre-W/C) to debt and interest coverage averaged 17% and 4.7x, respectively. These are commensurate with the lower end of the Baa-rating category according to the guidelines provided for low business risk in the Regulated Electric and Gas Utility Methodology published in December 2013. Given the absence of dividend payments Calidda's 2012-2014 average Retained Cash Flow (RCF) to debt of around 17% is robust for the rating category.

Importantly, Calidda was also able last year to meet management's target to limit total debt to EBITDA at 3.5x (2013: 4.4x), a credit positive.

Going forward, we expect Calidda's credit metrics will remain commensurate with the Baa-rating category. This year its cash flows should benefit from a full-year of the July 2014-tariffs while growing demand (new customers) will further drive its financial performance. This also assumes that Calidda will be able to adjust its cost structure to closely reflect the OPEX considered by OSINERGMIN when setting the 2014 final rates. Also, some uncertainty remains regarding the indebtedness to be incurred by Calidda to fund its capex and possible dividend distributions. That said, we gain comfort from management's prudent commitment to limit Calidda's total debt/EBITDA to 3.5x.

Calidda's rating assumes that despite the increased indebtedness to fund its ongoing capex program the LDC will be able to record 3-year average CFO pre-W/C to debt and interest coverage of at least 11% and 3.0x, respectively. Importantly, we assume a prudent dividend policy will be sized to allow the company to record a RCF to debt of at least 7% while also allowing the company to maintain adequate cash balances in the absence of any committed credit facilities to meet any unanticipated cash shortfalls.

Liquidity Profile

Calidda has currently no material debt maturity before 2023 when the Yankee notes become due. Calidda used a portion of the proceeds (increased indebtedness by US$120 million) to fund its material capex program. At year-end 2014, Calidda's cash balance approximated US$79 million. In the absence of any further shareholders' equity contributions we anticipate Calidda will be required to issue new debt to further finance its planned investments (around US$80 million p.a.). While Calidda's shareholders expect the utility to start making dividend distributions over the medium term, we acknowledge EEB's historical proven track-record of forgoing dividend distributions and providing subordinated shareholder loans to its other controlled subsidiaries. Another important rating consideration is that in the absence of a multi-year committed credit facility Calidda is expected to maintain a prudent cash balance that will allow it to meet any unexpected cash flow shortfalls.

Rating Outlook

The stable outlook reflects our expectation that Calidda will continue to successfully implement its expansion plans within the residential segment and that the regulatory environment will remain overall credit supportive. The stable outlook further considers management's target for Calidda to report over the medium term a Debt/EBITDA ratio below 3.5x. It also reflects our expectation that, in the absence of committed credit facilities, the company will maintain adequate cash balances amid a responsible dividend policy so as to remain in a position to cope with any external shocks, particularly given its substantial capex program. The stable outlook assumes that Calidda will record credit metrics (mentioned earlier) that are appropriate for the rating category.

What Could Change the Rating - Up

The rating could be upgraded if Calidda's liquidity profile over the medium term improves significantly along with a significant improvement in its credit metrics such that it records CFO pre-W/C to debt, interest coverage and RCF to debt in the very high teens, above 4x, and mid teens, respectively, on a sustainable basis.

What Could Change the Rating - Down

Calidda's rating could be downgraded if Moody's perceives that the issuer's liquidity profile is insufficient to comfortably cope with potential external shocks. Negative rating pressure could also result from unexpected changes in the regulatory framework that negatively impacts its ability to generate sufficient cash flows to help carry-out its planned capital investment program . Other negative events would include a downgrade of the Peruvian sovereign ratings, and/or if Calidda's majority shareholder, EEB, were to experience a multi-notch downgrade. Failure over the medium term to report credit metrics that are commensurate with the Baa-rating category, such that its CFO pre-W/C-to-debt and interest coverage that remain below 11% and 3x for an extended period, would likely trigger a downgrade. An aggressive future dividend distribution policy that results in the issuer reporting RCF to-debt below 7% on a sustainable basis, could also trigger a downgrade.

Other Considerations

The rating considers that Calidda's functional currency is the US$. This provides a natural hedge given that the bulk of its payables and 100% of the company's currently outstanding indebtedness is also denominated in that currency. However, as mentioned earlier, the company is exposed to some currency risk because of the mechanics of the payments of the residential customers bills. That said, we consider credit positive that a new hedging program using 30-day forwards based on the forecasted exchange rate Nuevos Solese/US$ (reviewed on a monthly basis) was approved and implemented last year.

As mentioned earlier, Moody's evaluates Calidda's financial performance relative to the low business risk option under the updated Regulated Electric and Gas Utility Methodology published in December 2013. As depicted in the grid below the company's indicated rating based on historical and projected credit metrics is Baa3 which is the same as the currently assigned senior unsecured rating.

Rating Factors

GasNaturaldeLimayCallaoS.A.(Calidda)

Regulated Electric and Gas Utilities Industry Grid [1][2]	**Fiscal Year 12/31/2014**		[3]**Moody's 12-18 Month Forward ViewAs of May 2015**	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	Baa	Baa	Baa	Baa
b) Consistency and Predictability of Regulation	Baa	Baa	Baa	Baa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Ba	Ba	Ba	Ba
b) Sufficiency of Rates and Returns	Baa	Baa	Baa	Baa
Factor 3 : Diversification (10%)				
a) Market Position	Ba	Ba	Ba	Ba
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.7x	Baa	3x-4.5x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	16.9%	Baa	11%-19%	Baa
c) CFO pre-WC - Dividends / Debt (3 Year Avg)	16.9%	Baa	7% - 15%	Baa
d) Debt / Capitalization (3 Year Avg)	54.4%	Baa	50% - 59%	Baa

Rating:				
Grid-Indicated Rating Before Notching Adjustment		Baa3		Baa3
HoldCo Structural Subordination Notching		0		0
a) Indicated Rating from Grid		Baa3		Baa3
b) Actual Rating Assigned		Baa3		Baa3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014 (LTM); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

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