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Research Update:

Gas Natural de Lima y Callao S.A. (Calidda) 'BBB-' Ratings Affirmed, Outlook Remains Negative

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Overview

- The 2015 financial performance of Peru-based natural gas distribution company, Calidda, was in line with our expectations, with sound financial metrics and increasing client base and network system.
- We're affirming our 'BBB-' corporate credit rating on Calidda.
- The negative outlook on the company mirrors that on its parent, EEB.
- We expect Calidda to maintain its key credit metrics with debt to EBITDA around 3.0x and funds from operations (FFO) to debt above 23% for the next two years.

Rating Action

On March 30, 2016, Standard & Poor's Ratings Services affirmed its 'BBB-' corporate credit and senior unsecured ratings on Gas Natural de Lima y Callao S.A. (Calidda). The outlook remains negative.

Rationale

Our rating on Calidda considers its 'bbb-' stand-alone credit profile, which reflects the company's satisfactory business risk profile, intermediate financial risk profile, and adequate liquidity.

The company is a subsidiary of Empresa de Energia de Bogota S. A. E. S. P. (EEB; BBB-/Negative/--), a Colombia-based, diversified energy holding company that owns 60% of Calidda. We consider the company a strategically important subsidiary of EEB because it's unlikely that the latter would sell Calidda in the near term, it's important for the group's long-term strategy, senior group management has made a long-term commitment to the company, and it's 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.

On Sept. 3, 2015, we revised our outlook on EEB to negative from stable, reflecting its weaker leverage ratios due to the depreciation of the Colombian peso. Because there are no meaningful regulatory mechanisms or other structural barriers that restrict EEB's access to Calidda's assets and cash flow, the latter's outlook is aligned with that of its parent.

Calidda's focus is on the distribution of natural gas in the department of Lima and the Callao province in Peru through a 33-year concession contract with the government since 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 and servicing residential, commercial, and industrial clients, electricity generators, and gas stations in the province.

Calidda's satisfactory business profile is based on its stable cash flow generation--stemming from very low industry risk--and its monopolistic position in the department of Lima and the Callao province, which contributes the highest share to national GDP. The rating on Calidda incorporates a narrower client base than those of other distribution companies in the region, due to the higher sales share that electricity generators represent in Calidda's client portfolio. The company distributes gas to 16 power generators in its concession area. Revenue share from these entities increased to 34% by the end of 2015 from 32% in 2014 due to higher firm contracted capacity (take or pay) of three power generators. During 2015, Calidda's residential and commercial client base grew 35%, while industrial clients increased 4%, and the number of natural gas stations it supplies rose 5%. As a result, the company's adjusted EBITDA margin increased to 52.5% in 2015 from 50.1% in 2014. Calidda has to comply with investments and connections to maintain its actual tariff with the regulator. As of this report's date, the company has successfully completed them, and we expect that it will continue to fulfill its commitments.

Our view of Calidda's intermediate financial risk profile incorporates the stability of the company's cash flow generation and its current and expected key financial ratios. In 2015, the company performed according to our expectations. Calidda reported debt to EBITDA and FFO to debt of 2.7x and 24.9%, respectively.

Our base-case scenario assumes the following factors:
- Revenue to grow around 5.2% in 2016 and 9.6% in 2017. Peru's solid economic growth prospects and favorable natural gas consumption trends support the company's growth prospects.
- Gross margins to slightly improve in the next few years as costs will remain fixed while revenue rises.
- Dividends of $30 million for 2016 and afterwards.
- Annual investments for network expansion are likely to remain at $80 million - $90 million.

Based on these assumptions, we arrive at the following credit measures for 2016 and 2017, respectively;
- Debt to EBITDA of 2.9x and 2.8x; and
- FFO to debt of 23.6% and 24.7%.

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 $70 million as of Dec. 31, 2015
- FFO generation of around $77 million in 2016

Principal Liquidity Uses:

- Investment for network expansion of about $90 million in 2016
- Dividend payment of $30 million in 2016.

Outlook

The negative outlook on Calidda reflects the one on its parent, EEB. The negative outlook on the latter reflects our view that its key financial ratios could remain weak relative to its current rating category in the next few years. This could be the result of further depreciation of the Colombian peso and the company's lower EBITDA generation amid economic weakness in its key markets.

We also expect Calidda to 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 downgrade 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 lower than 23%. This could result from additional debt to fund additional capex or dividend payments.

Upside scenario

An outlook revision to stable would depend on a same action on EEB, which could stem from its 2016 financial performance aligning with our expectations.

Additionally, a positive rating action would depend on the parent's upgrade and would require an improvement in the company's key financial ratios particularly if debt to EBITDA is consistently below 2.5x and FFO to debt is above 35%.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Negative/--

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

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology: 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
- 2008 Corporate Criteria: Rating Each Issue, April, 15, 2008

Ratings List

Ratings Affirmed

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

Corporate Credit Rating	BBB-/Negative/--
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.globalcreditportal.com and at www.spcapitaliq.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.