MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Baa3 rating to Calidda's proposed senior unsecured notes; Outlook Stable

Global Credit Research - 14 Mar 2013

Approximately US$320 million of debt securities affected

New York, March 14, 2013 -- Moody's Investors Service has assigned a Baa3 foreign currency senior unsecured rating to the proposed issuance of up to US$320 million 10-year senior unsecured notes by Peruvian Gas Natural de Lima y Callao S.A. (Calidda) due in 2023 (bullet). This is the first time Moody's has assigned a rating to Calidda. The rating outlook is stable.

Proceeds from the offering will be used to fund the prepayment of Calidda's outstanding senior and subordinated indebtedness aggregating US$196.7 million, including the $47 million subordinated shareholders' loan due in 2014 (which at year-end 2012 had accrued interest of around $9.1 million), as well as for general corporate purposes including funding the issuer's capital expenditure (capex) program.

RATINGS RATIONALE

The Baa3 senior unsecured rating reflects the fact that the bulk of Calidda's revenues are derived from its regulated natural distribution operations. "It further captures the cash flow visibility that is underpinned by the terms of the build, operate, own and transfer (BOOT) concession agreement that will expire not earlier than 2033 which is after the notes' maturity," said Moody's Assistant Vice President Natividad Martel. "Even though the rating further considers the overall credit supportive regulatory framework under which the issuer operates, the rating also captures the limited track-record and some inconsistency in the application of some of the regulatory mechanisms."

"While the rating also acknowledges the merits of growing its residential customer base, Calidda's exposure to unregulated customers will remain significant, a credit negative," said Martel. This exposure in terms of gross margins ranks among the highest across Moody's rated universe of regulated natural gas distribution companies in the Americas. Somewhat offsetting this credit concern is the growing contribution to Calidda's cash flows of the revenues generated under firm contracts that currently represent around 46% of its regulated distribution revenues. Furthermore, Moody's also notes that concerns about the negative impact on the variable portion of Calidda's operating distribution margins resulting from fluctuations in natural gas demand from the thermal generation companies are somewhat mitigated by the relevant role that natural gas fired generation facilities play in the Peruvian energy mix such that their output has historically accounted for at least 30% of the total output regardless of the season.

The rating is also tempered by the expected increase in the contribution to Calidda's cash flows of unregulated ancillary services, largely associated with the connection services. However, it also recognizes that Calidda has a competitive advantage over other potential service providers. The rating further captures the anticipated deterioration in Calidda's credit metrics over the short term amid the increased leverage associated with the new notes to refinance existing indebtedness but also to fund its material capex program earmarked to add new end-users; however, it also assumes that the weakening of its metrics is temporary and, over the medium to long term, Calidda's cash flow generation will improve such that it will again report credit metrics that are well positioned within Moody's Baa-rating category.

The rating is also capped by some currency risk exposure associated with the payments received from Calidda's regulated customers. These revenues are invoiced in nuevos soles after monthly adjustments of the charges that are initially calculated in US$. This is a credit negative since the bulk of Calidda's cost structure is largely in US-dollars; however, Moody's also believes that the monthly adjustment process helps to reduce the impact of any potential nuevos soles devaluation which somewhat lessens our credit concerns. The rating is further tempered by the anticipated deterioration over the medium-term of Calidda's liquidity profile. Similar to the vast majority of issuers in Latin America, Calidda has no committed bank credit facility in place (only non-committed) which results in a significant dependence on the capital markets for any future working capital and liquidity needs, a credit negative. The rating assumes that, in the absence of such committed facilities, the issuer will maintain robust cash balances that will allow it to meet unexpected cash flow shortfalls, particularly considering its significant capex program. Moreover, our credit concerns are further mitigated by the expectation that the issuer will not make dividend distributions until a substantial portion of its ongoing expansion program is completed in 2016 and by the little reliance of its shareholders on Calidda's dividend distributions to meet their own funding requirements. Further consideration is given to the proven track-record of Calidda's majority shareholder, EEB, of forgoing dividend distributions and providing subordinated shareholder loans to its other controlled subsidiaries in Colombia and abroad.

The stable outlook reflects our expectation that Calidda will successfully implement its expansion plans within the residential segment along with a fairly credit-supportive outcome of the next tariff review, due in May 2014. The review will enhance Calidda's ability to generate cash flows such that its reported credit metrics will improve over the medium term. The stable outlook further considers management's target for Calidda to report over the medium term a 3.0x Debt/EBITDA. It also reflects our expectation that, in the absence of committed credit facilities, the company will maintain robust 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 rating could be upgraded if the Peruvian government's sovereign rating is upgraded, if Moody's observes a more consistent application of all the regulatory mechanisms embedded in the framework, and if, upon completion of its current ongoing investment program, Calidda's liquidity profile over the medium term is very strong along with a significant improvement in its credit metrics such that its cash flow from operations pre W/C (CFO pre-W/C) interest coverage and CFO-to-debt metrics exceed 4x and 16%, respectively, on a sustainable basis.

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 momentum could also result from unexpected changes in the regulatory framework and/or a less credit-supportive outcome of future tariff reviews. 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 more commensurate with the Baa-rating category, such that its interest coverage ratio and the CFO pre-W/C-to-debt remains below 3x and 13%, respectively, for an extended period, would likely trigger a downgrade. Dividend distributions that start before the completion of the ongoing capex program and improvement of Calidda's cash flows, and/or an aggressive future dividend distribution policy that results in the issuer reporting Retained Cash flows (RCF)-to-debt below 9% on a sustainable basis, could also trigger a downgrade.

The principal methodology used in this rating was the Regulated Electric and Gas Utilities published in August 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Headquartered in Lima, Gas Natural de Lima y Callao S.A. (Calidda) started commercial operations in 2004 after a two year construction period and is currently the largest Local Distribution Company (LDC) of Natural Gas in Peru with a 2,455 km natural gas distribution network. Calidda operates under a 33-year BOOT concession agreement that will not expire before 2033. Calidda's concession area comprises the Department of Lima and the Constitutional Province of Callao, which accounts for around 50% of the Peruvian GDP and around 30% of the country's total population of approximately 30 million. The bulk of the country's natural gas fired power generation facilities are also located in the same area. As part of Calidda's ongoing expansion program, its network capacity is expected to increase to 420 MMCFD (currently 255 MMCFD) before the middle of this year, while its residential customer base is anticipated to also grow significantly over the next several years. At year-end 2012, its total customer base of over 101,000 already exceeded the goals set under the BOOT agreement that included 91,000 customers by 2015.

Calidda's tariffs are subject to regulatory purview of the Peruvian regulatory body, Organismo Supervisor de la Inversión en Energía y Mineria (OSINERGMIN), while it pre-agrees its five year capex program with the Ministry of Energy and Mines (MEM).

Calidda's majority shareholder is Empresa de Energia de Bogota (EEB; Baa3, stable) with a indirect and direct ownership stake of 66.2% given that it also holds a 15.6% equity interest in the other shareholder, Promigas S.A. E.S. (not rated; 40% interest).

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