Creditreform Corporate Issuer / Issue Rating

Naturgy Energy Group, S.A.

Creditreform Rating

Rating object	Rating information	
Naturgy Energy Group, S.A. Creditreform ID: 2000000652 Incorporation: 1843 Based in: Madrid Main (Industry): Natural gas and electricity utilities company CEO: Francisco Reynés	Corporate Issuer Rating: **BBB+ / stable** LT LC Senior Unsecured Issues: **BBB+ / stable**	Type: Update Unsolicited Public rating Other: **n.r.**
Rating objects: Long-term Corporate Issuer Rating: Naturgy Energy Group, S.A. Long-term Corporate Issuer Rating: Naturgy Finance B.V. Long-term Corporate Issuer Rating: Naturgy Capital Markets, S.A. Long-term Local Currency (LT LC) Senior Unsecured Issues	Rating date: 24 January 2023 Monitoring until: withdrawal of the rating Rating methodology: CRA "Corporate Ratings" CRA "Non-Financial Corporate Issue Ratings" CRA "Rating Criteria and Definitions" Rating history: www.creditreform-rating.de	

Content

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Summary

Company

Naturgy Energy Group, S.A. and its subsidiaries – hereafter referred to as Naturgy, the Group, or the Company – is a public limited company incorporated in 1843 and headquartered in Madrid, Spain. The Group is a multinational integrated gas and electricity utility engaged in the procurement, liquefaction, regasification, transportation, storage, distribution and commercialization of natural and renewable gas. The Company is also active in the generation, transmission, distribution and commercialization of electricity. Naturgy has 15.8 GW installed power generation capacity, 135,640 km of gas distribution network, and 153,981 km of electricity distribution network at its disposal. The Company serves more than 16 million customers in over 20 countries and enjoys a strong market position in Spain.

The Company's business performance in 2021 benefited from a general economic recovery, including a significant increase in commodity prices, despite the ongoing impact of the pandemic. As a result, the Naturgy Group achieved a considerable increase in sales by 44.3% to EUR 22,140 million (2020: EUR 15,345 million) and in EBIT by 20.6% to EUR 2,225 million (2020: EUR 1,845 million), as well as more than quadrupling its EAT amount after transfer to EUR 1,214 million (2020: EUR -347 million). Also, in the first nine months of 2022, Naturgy was able to continue its positive sales and earnings development compared to the same period of the previous year despite a persistently volatile and challenging market environment.

Rating result

The current rating of BBB+ attests Naturgy Energy Group, S.A. a highly satisfactory level of creditworthiness, representing a low to medium default risk. Against the backdrop of the global market recovery and commodity prices in 2021, the rating result reflects an improved economic situation for Naturgy in line with our expectations. Compared to 2020, Naturgy showed a significant recovery in earnings for the 2021 financial year, although the result of the financial key figure analysis showed a moderate improvement overall. Moreover, the strong operational performance in the first nine months of 2022, despite challenging market conditions, high volatility in commodity prices and increased regulatory risks, has a stabilising effect on the rating. The updated strategic plan 2021-2025, which focuses on organic and energy transition growth while maintaining financial discipline, contributes positively to the rating assessment. The high proportion of regulated and contractually agreed activities, as well as the geographical and product-related diversification of the Group, also stabilise the rating. Proven access to financial markets, solid liquidity, a controlled investment policy and commitment to financial discipline underpin our rating assessment.

On 14 July 2022, due to insufficient transparency regarding the separation process, Naturgy's rating was assigned "Watch UNW" (Watch Uncertain). As the implementation of the Gemini project has been postponed indefinitely, we have withdrawn the "Watch UNW" addition. Nevertheless, we maintain the view that uncertainty associated with the split-up of the Company remains in terms of the breakdown of total debt and investments, as well as its strategic direction, which limits Naturgy's rating.

Outlook

The yearlong outlook of the rating is stable. Taking into consideration the resilient business model of the Company with its stable and strong cash flows, generated predominantly in regulated activities, as well as its solid liquidity position and proven access to financial markets, we do not expect any liquidity shortages for Naturgy, despite the Company's announcement to redeem its hybrid bond, as well as windfall taxes planned by the Spanish government for 2023-2024. Given the significant improvement in revenue and earnings in the nine months of 2022 compared to the previous year, we expect the Company to be able to maintain its solid financial ratios despite the ongoing complex macroeconomic environment. Nevertheless, risks from exogenous factors also remain high in the current year 2023 in view of the tense geopolitical situation worldwide.

Relevant rating factors

Reference:

The relevant rating factors (key drivers) mentioned in this section are predominantly based on internal analyses, evaluations from the rating process, the derived valuations of the analysts participating in the rating and, if applicable, other rating committee members. The fundamental external sources used are specified in the sections "Regulatory requirements" and "Rules on the presentation of credit ratings and rating outlooks".

Excerpts from the financial key figures analysis 2021:

+ Increased sales
+ Increased EBITDA, EBIT and EAT
+ Improved net total debt / EBITDA adj
+ Reduction of short-term capital lock-up
+ Raising the return on investment

- Low equity ratio
- Decreased EBITDA margin
- High level of net total debt / EBITDA adj.

Table 1: Financials I Source: Naturgy Energy Group, S.A. Annual Consolidated Financial Report 2021, standardized by CRA

Naturgy Energy Group, S.A. Selected key figures of the financial statement analysis Basis: Annual consolidated financial report of 31.12. (IFRS)	CRA standardized figures[1]	
	2020	2021
Sales (million EUR)	15,345.0	22,140.0
EBITDA (million EUR)	3,321.0	3,670.0
EBIT (million EUR)	1,845.0	2,225.0
EAT (million EUR)	-31.0	1,556.0
EAT after transfer (million EUR)	-347.0	1,214.0
Total assets (million EUR)	36,800.0	37,247.0
Equity ratio (%)	26.3	24.2
Capital lock-up period (days)	59.9	56.2
Short-term capital lock-up (%)	42.1	26.2
Net total debt / EBITDA adj. (Factor)	7.1	6.5
Ratio of interest expenses to total debt (%)	2.3	2.1
Return on investment (%)	1.4	5.3

[1] For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. For example, when calculating the analytical equity ratio, deferred tax assets, goodwill (entirely or partly), and internally generated intangible assets are subtracted from the original equity, whilst deferred tax liabilities are added. Net total debt considers all balance sheet liabilities. Therefore, the key financial figures shown often deviate from the original values of the company.

In contrast to previous years, the CRA has reclassified subordinated perpetual bonds of EUR 750 million as financial debt (see "Financial risks").

General rating factors summarize the key issues which – according to the analysts as of the date of the rating – have a significant or long-term impact on the rating, whether positive (+) or negative (-).

General rating factors

+ High proportion of regulated and contracted EBITDA
+ Geographically well-diversified
+ High entry barriers
+ Future-oriented strategy (2021-2025)
+ Proved access to financial markets

– Exposure (though limited) to volatile electricity and gas prices
– Exposure to higher-risk international gas procurement and supply contracts
– Country risks
– Very capital-intensive business areas (high fixed costs and maintenance capex)
– Market conditions can be influenced significantly by government

Current rating factors are the key factors which, in addition to the underlying rating factors, have an impact on the current rating.

Current rating factors

+ Postponement of Naturgy split indefinitely
+ Increase in sales and earnings in 2021 as well as in first nine months of 2022 due to global demand recovery and significantly higher energy prices
+ Strong liquidity
+ Expansion of renewable energies

– Declining development of the EBITDA margin
– Price cap for electricity and gas at a fixed price of €65/MWh and €55/MWh, respectively, until the end of 2025 and without conditions
– Company's intention to terminate its 4.125% subordinated bond with early redemption option 2022
– High dividend distribution
– Uncertainty regarding the price negotiations for gas procurement with Algeria's Sonatrach
– Energy windfall tax in 2023 and 2024
– Lack of transparency regarding timeline of the demerger process
– Continued economic and political uncertainty

Prospective rating factors are factors and possible events which – according to the analysts as of the date of the rating – would most likely have a stabilizing or positive effect (+), or a weakening or negative effect (-) on future ratings if they occurred. This is not an exhaustive list of possible future events with potential relevance for future ratings. Circumstances can arise that are not included in the list of prospective factors, whose effects are impossible to assess at the time of the rating, either because these effects are uncertain or because the underlying events are deemed unlikely to occur.

Prospective rating factors

+ Persistently high energy prices
+ Successful implementation of the transformation strategy
+ New business opportunities through the energy transition
+ Stabilisation and improvement of the global economy and geopolitical situation

– Persistent uncertainty with regard to political framework conditions and geopolitical tensions
– Significant price decline
– Imbalances between generation and commercialization
– Relatively high cash outflows due to commitments to shareholders
– Deviation from the strategy or failure in its implementation
– Increase in investments in connection with the energy transition

ESG factors are factors related to environment, social issues and governance. For more information, please see the section "Regulatory requirements". CRA generally takes ESG relevant factors into account when assessing the rating object and discloses them when they have a significant influence on the creditworthiness of the rating object, leading to a change in the rating result or the outlook.

ESG-factors

CRA generally takes ESG factors (environment, social and governance) into account within its rating decisions. In the case of Naturgy Energy Group, S.A., we have not identified any ESG factors with significant influence.

As a result of global events in 2020, a number of energy companies suffered significant impairments on oil and gas reserves in the face of low crude oil and natural gas prices, as some oil and gas reserves were no longer economically viable due to the price decline. As this is a general risk present in the fossil fuel industry, we considered in the 2021 rating of Naturgy that this risk may also exist for Naturgy and classified this as a significant ESG factor. In the 2022 rating of Naturgy we no longer considered this risk to be significant, as prices for oil and natural gas have risen sharply and, in particular, because gas has also been included as an energy source in the EU taxonomy.

By commissioning 562 MW in new renewable energy projects (wind and photovoltaic), Naturgy increased its installed renewable energy capacity to 33% in 2021. With the renewable generation already installed, the Company is expected to reach a capacity of 14 GW in 2025, reinforcing Naturgy's strategic importance for the energy transition. In 2021, Naturgy was the first company in Spain to inject gas from renewable energy sources into the gas distribution network. Currently, 95% of Naturgy's gas distribution networks are prepared for renewable gas and hydrogen, which will help to decarbonize the energy system, reduce CO_2 emissions and promote a circular economy.

The energy sector in Europe as a whole is facing a major transformation linked to the EU goals of climate neutrality by 2050, which may entail significant risks for individual companies. Nevertheless, Naturgy aims to play a key role in the energy transition and climate protection in Spain. Accordingly, Naturgy's Strategic Plan 2021-2025 is in line with the EU's "Net Zero CO_2" target by 2050. As an interim step, the Company has set out to reduce total emissions, scopes, in categories 1, 2 and 3 by 24% by 2025 compared to the 2017 baseline, with noticeable progress already made in 2021. Absolute greenhouse gas emissions (Scope 1 and 2) of 13.5 $MtCO_2eq$ and the total CO_2 balance, which also includes indirect emissions of 150 $MtCO_2$, were reduced by 37% and 9% respectively compared to the base year 2017. The Company also performs well in our peer comparison in terms of emissions.

With regard to the acceleration of the energy transition, we do not see any risk for Naturgy's business model. However, the realization of these goals requires significant investment that could lead to higher leverage, which may negative affect the rating. Naturgy plans to invest EUR 14 billion by 2025, two-thirds of which is to go towards the promotion of renewable energy. In addition, 80% of the Group's planned investments are envisaged to comply with the EU taxonomy for sustainable finances and thus be geared towards the energy transition. In 2021, a total of EUR 579 million was invested in the construction of various renewable projects. Moreover, Naturgy has entered into several agreements for further growth of renewable energies.

Social and governance issues are also important to the Company. Naturgy is committed to developing a diverse and inclusive corporate culture. We do note, however, that in 2021 the proportion of women in management positions was only 21.2%. Nevertheless, the Company intends to increase this share to more than 40% by 2025.

Overall, we see Naturgy as solidly positioned in terms of ESG criteria, which has a stabilizing effect on the rating in view of the increasing sustainability requirements in the market.

A general valid description of Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found here.

Best-case scenario: BBB+

Please note:

The scenarios are based on information available at the time of the rating. Within the forecast horizon, circumstances may occur that could lead to a change of the rating out of the indicated range.

In our best-case scenario for one year, we assume a rating of BBB+. We do not see an upgrade within one year as likely, due to the investment requirements related to the Group's strategic plan combined with the impact of regulatory measures to combat high energy prices, as well as the pending price negotiations with Sonatrach, which could dampen potential improvements in credit metrics in the short term. The uncertainty surrounding the planned demerge also limits the likelihood of a rating upgrade.

Worst-case scenario: BBB

In our worst-case scenario, we assume a rating of BBB. For this scenario, we assume a significantly worsened operating environment, which could have a negative impact on the Company's earnings situation as a result of the political influence measures, an unsatisfactory outcome of the price negotiation for gas procurement, as well as a sharp decline in energy demand. In combination with high investment requirements and further considerable cash outflows for commitments to the shareholders, this could lead to a significant deterioration of the Company's financial and liquidity position, necessitating a downgrade of Naturgy's rating.

Business development and outlook

The 2021 business year showed a recovery compared to the 2020 business year. During the year, Naturgy generated sales of EUR 22,140 million (2020: EUR 15,345 million), an increase of 44.3% compared to the previous year due to higher demand and energy prices. As EBITDA growth to EUR 3,670 million (2020: EUR 3,321 million) was just 10.5%, this impacted the EBITDA margin, which fell from 21.6% to 16.6% year-on-year. This is mainly attributable to the Supply segment, which was adversely affected by higher gas procurement costs and pool prices. The Group's EAT after transfer increased from EUR -347 million to EUR 1,214 million. Compared to the previous year, this is primarily due to the absence of impairment effects, which burdened the year 2020 in the amount of EUR 1,363 million. Even though 2021 was characterized by volatility in the international gas markets, especially in the second half of the year, Naturgy recorded a significant recovery in earnings compared to 2020, enabling it to meet its forecasts.

Following its strategic objectives, in 2021 Naturgy continued to simplify its business and reduce the risk of its commercial positioning by reaching an agreement in March 2021 to amicably settle the disputes with ENI and the Arab Republic of Egypt concerning Unión Fenosa Gas (UFG). As a result, Naturgy received a capital gain of EUR 127 million and acquired the remaining 50% of UFG's stake for EUR 466 million, increasing its shareholding to 100% and gaining full control. Moreover, in July 2021 the 96.04 % stake in Compañía General de Electricidad S.A. (CGE) in Chile, the Company operating the electricity network business in Chile, was sold to State Grid International Development Limited (SGID) for a total purchase price of Euro 2,570 million (equity value).

In July 2021, Naturgy presented its new strategic plan 2021-2025, which emphasizes ESG obligations in addition to investments in networks and renewable energy growth in stable regions. This plan is to be realized with a cumulative net investment of EUR 14 billion, of which 60% will be dedicated to the promotion of renewable energies, 30% for gas and electricity grids and 10% for energy management and marketing. In addition, Naturgy intends to become the leading electricity grid operator in Spain through the optimization, digitalization and automation of its processes. In terms of gas grids, the Company aims to significantly boost the implementation of renewable gas in order to contribute to decarbonization and commercial repositioning. It has also set profitability targets to achieve EBITDA of EUR 4.8 billion and net profit of EUR 1.6 billion by 2025. With regard to its dividend policy, this is subordinated to the achievement of financial targets. The dividend per share is set at EUR 1.2 until 2025, subject to adjustment until 2023 if necessary to maintain the key figures. An average dividend pay-out ratio for the reporting period is expected to be around 85%. Over and above the strategic plan, Naturgy has earmarked a further EUR 13.8 billion for investments in almost a hundred energy transition projects as part of the European Union's economic recovery plan.

Despite a challenging macroeconomic environment, particularly impacted by heightened geopolitical tensions following Russia's invasion of Ukraine, high inflation and the impact of the coronavirus pandemic, Naturgy recorded an increase in revenue of 85.5% to EUR 27,011 million as of 30 September 2022 (9m 2021: EUR 14,558 million). Reported EBITDA grew by 36.8% to EUR 3,502 million (9m 2021: EUR 2,560 million) and reported EBIT by 44.4% to EUR 2,161 million (9m 2021: EUR 1,497 million). Likewise, consolidated net income rose significantly from EUR 777 million to EUR 1,061 million, an increase of 36.6%. This positive development of results was mainly driven by Energy Marketing and Management activities, including a significant contribution from global operations, which accounted for almost 60% of the recorded EBITDA growth. The growth of the Group's activities in Spain led to an increase in EBITDA of EUR 407 million euros, whereas its global activities provided a further EUR 535 million.

At the same time, earnings were diminished by the retroactive effect of the new purchase price agreement with the Algerian state-owned Sonatrach, as well as the estimated impact of the decoupling of final gas sales prices from their current hedging. Sonatrach delivers roughly 5 billion cubic meters of gas to Spain annually under contracts that provide for regular price reviews and are valid until 2030. Due to the high volatility and uncertainty of global gas prices, which do not allow high visibility in the medium term, a new price was set for the supply volume until the end of 2022. So far, no detailed information about this price negotiation has been published. The next price agreement is scheduled for 2023.

Table 2: The development of accumulated EBITDA and Capex by business unit I Soruce: Naturgy Energy Group Q3 2022 Results, reported information

Naturgy Energy Group, S.A.						
In million EUR	**EBITDA**			**CAPEX**		
	9m 2021	**9m 2022**	**Δ %**	**9m 2021**	**9m 2022**	**Δ %**
Networks Spain	1,043	1,207	15.7	217	249	14.7
Networks LatAm	635	716	12.8	157	219	39.5
Energy management	687	1,024	49.1	61	117	91.8
Renewables and New businesses	175	254	45.1	361	429	18.8
Supply	130	373	--	80	93	16.3
Rest	-110	-72	-34.5	14	12	-14.3
Total	**2,560**	**3,502**	**36.8**	**890**	**1,119**	**25.7**

In the first nine months of 2022, investments rose to EUR 1,119 million, an increase of 26% compared to the same period last year. The investments were mainly related to the expansion of Naturgy's gas and electricity distribution network, electricity generation from renewable energy sources and the development of renewable gases. In this regard, the Company is adhering to its strategic plan for 2021-2025, which allocates EUR 14 billion for organic development by the end of the period. Thus, more than 65% of the total investment between 2021 and 2022 has been allocated to the growth and development of industrial activities in the networks and renewable energy sectors.

The global energy crisis triggered by Russia's invasion of Ukraine has led to new highs in natural gas prices and a tight market in 2022. To increase security of supply and market resilience ahead of the coming winter, the European Union and its member states have undertaken a number of market adjustments and policy measures. Currently, mild temperatures and gas stocks in the EU, which are now well above the five-year average, are causing weak demand and thus a significant drop in prices. Conversely, a cold snap is likely to lead to an increase in demand for gas and thus to a new price spike. It is difficult to estimate how gas prices will develop in 2023. We tend to expect gas prices to remain volatile and at high levels, although possibly below last year's levels. In contrast, we expect electricity prices to fall in 2023, primarily due to the effects of government intervention. In addition, unplanned, lengthy maintenance work at several French nuclear power plants should be completed by spring 2023 at the latest and more electricity from hydropower plants should be available again. These factors could slow down or even reverse the rise in electricity prices. We nevertheless see good opportunities for the Naturgy Group to either mitigate or partially offset the risks associated with highly volatile energy prices, as well as adverse regulatory conditions, thanks to its vertically integrated business model operating across the entire value chain in the gas and energy sector. Furthermore, the Company's increasing commitment to the expansion of renewable energies, as well as to new business areas such as renewable gas, hydrogen and distributed generation, helps to ensure sustainable growth and profitability in the medium and long term.

Structural risk

Naturgy Energy Group, S.A. has more than 55,000 shareholders. As of January 2023, the main shareholders of Naturgy were Criteria Caixa, S.A.U. (26.7%), Rioja Acquisitions S.à.r.l. (20.7%), GIP III Canary 1 S.à.r.l. (20.6%), Global InfraCo O (2) S.à.r.l. (14.0%), and Sonatrach (4.1%). The remaining shares (13.9%) represent free float shareholding. The shares of Naturgy Energy Group, S.A. are listed on the four official Spanish stock exchanges, are traded on the continuous market, and form part of the Ibex35 and in particular the Ibex Utilities index.

The Board of Directors of Naturgy Energy Group, S.A. consists of 12 members, three of whom are female. The Group's senior management comprises executives heading the three business units, as well as the corporate units for central control, who report directly to the Executive Chairman. At the end of the business year 2021, the Group employed 7,366 staff (2020: 9,335).

The Naturgy Group operates in over 20 countries. The majority of its sales are generated in Spain (51.6% in 2021), followed by Latin American countries (26.6%), the rest of Europe (14.8%), and other countries (7.0%). The Company is active in regulated and liberalized gas and electricity markets in both Spain and Latin America. In 2020, the Company reorganized its businesses into three strategic areas:

- Energy and Network Management:
  - Iberia Networks, which includes gas and electricity distribution businesses in Spain
  - Latin American Networks, which includes the gas network businesses in Argentina, Chile, Brazil and Mexico, and the electricity network businesses in Argentina and Panama
  - Energy Management, which includes the businesses of International LNG Commercialization, Markets & Procurement, the Maghreb-Europe[2] and Medgaz Gas pipelines management, thermal power generation in Spain and Latin America (Mexico, Dominican Republic and Puerto Rico)
- Renewables and New Business:
  - Renewable Energies Spain and the United States, which includes the management of wind, mini-hydro, solar and cogeneration assets and generation projects, additionally incorporating hydroelectricity generation
  - Renewables Latin America, which includes the management of GPG's[3] renewable energy assets and generation projects
  - Renewables Australia, which includes the management of GPG's renewable energy assets and generation projects
- Commercialization:
  - Manages the commercial model for end customers in the areas of gas, electricity and services, incorporating new technologies and services

[2] The concession for the exclusive use of the Moroccan section of the Maghreb-Europe gas pipeline ended on 31 October 2021 and ownership of the assets reverted to Morocco

[3] Global Power Generation

In February 2022, Naturgy announced Gemini project to reorganise the Company. The segregation will create two listed companies that will maintain the same shareholding structure. One of the two companies (MarketsCo) will manage Naturgy's liberalized businesses, which include renewable energy development, the energy customer portfolio and related services, conventional power generation and wholesale energy market management. The other company (NetworksCo) will manage the regulated power distribution and transmission infrastructure. The project should aim to drive growth beyond the strategic plan and break new ground for a pragmatic approach to the energy transition. Due to the insufficient transparency of the separation process, Naturgy's rating was assigned with "Watch UNW" (Watch Uncertain) on 14 July 2022. Against the backdrop of volatile market conditions, the ongoing European energy crisis and numerous regulatory uncertainties, the implementation of the project has been postponed indefinitely. In particular, given the Spanish government's plan announced on 12 December 2022[4] to extend until the end of 2024 the restrictions imposed during the pandemic on foreign takeovers of companies which it considers strategic, we assess the likelihood of Naturgy splitting before 2024 as low. As a result, we have withdrawn the supplement "Watch UNW". It remains to be seen when the final decision on the separation of Naturgy will be made.

Based on publicly available information, we assume sufficiently developed structures with regard to risk management, accounting and controlling, as well as other administrative and operational functional areas, and see no core risks associated either with the organizational or shareholder structure of the Company.

Nevertheless, in our view, the uncertainty associated with the split, particularly with regard to business operations, the breakdown of total debt and investments, as well as the strategic direction of the two new companies NetworksCo and MarketsCo within the new structures, remain and limit Naturgy's rating. In addition, lack of transparency as to the timeline for the implementation of the Group's demerger process has a dampening effect on rating.

Business risk

Naturgy Energy is an integrated group whose main activities are the supply, liquefaction, regasification, transport, storage, distribution and commercialization of natural gas, as well as the generation, transport, distribution and commercialization of electricity. The Company is a main player in the Iberian electricity and gas markets.

The Group manages 135,640 km of gas distribution networks in Spain and Latin America, servicing 11.0 million distribution connections. Naturgy dominates the gas distribution business in Spain, holding 68% of the market share, and is one of the leading companies in Argentina, Brazil, Chile and Mexico. The Company has nine LNG carriers and services a Medgaz transport pipeline connecting Algeria and Spain. Naturgy supplies gas both in Spain and internationally. Its market share of gas supply in Spain amounts 23%.

The Company services 153,981 km of electricity distribution networks and 4.7 million supply connections, making it the third-largest operator in Spain and with a strong market position in Argentina and Panama. The Company has a 10.6 GW power generation capacity consisting of CCGT, hydro, renewable, coal, nuclear and oil-fired power plants. Its market share in electricity generation in Spain is 17.5%. Naturgy is one of the main Spanish electricity traders, with a market share of 10%.

[4] Spain to extend restrictions on foreign takeovers until end of 2024 | Reuters

The Group has a number of concessions, authorizations, licenses, special rights and allowances to exercise its activities. Naturgy is increasingly exposed to regulatory risks due to a solid contribution from its regulated business to its EBITDA. This confers stable and predictable revenues to the Group while reducing its exposure to the energy market price environment. However, Naturgy is exposed to changes in regulatory frameworks as well as significant political influence. In view of the strong increase in electricity and gas prices in 2021 and 2022, a number of royal decree-laws were passed introducing temporary measures to protect consumers and the real economy. This includes a mechanism consisting of a cap on the reference price for gas when selling to the electricity system. Naturgy therefore introduced a fixed electricity price of EUR 65/MWh for three years for all types of consumers in Q4 2021, followed by a fixed tariff of EUR 55/MWh until the end of 2025 for its industrial gas customers in Q1 2022. As a further measure, temporary taxes ("windfall taxes") for large energy companies on high profits generated due to unusually favorable market factors have been inserted. The levy will comprise a tax of 1.2% on aggregate turnover in the years 2023-2024; regulated activities are excluded from this tax. The tax is not deductible for corporate tax purposes and cannot be passed on to customers. These measures may reduce profit margins and put pressure on cash flow generation, which could have a negative impact on Naturgy's financial stability.

High global energy demand, triggered by a rapid economic recovery from the COVID 19 pandemic and combined with limited supply, has led to a continuous increase in gas prices since autumn 2021. The situation has been further exacerbated by escalating geopolitical tensions related to Russia's invasion of Ukraine. A significant portion of the Group's operating costs relates to the purchase of natural gas and liquefied natural gas ("LNG") for marketing in the regulated and non-regulated markets and to provide fuel for combined cycle power plants. Therefore, in addition to increasing costs in the natural gas business, higher gas prices can also drive up the Group's electricity generation costs. Long-term supply contracts mitigate commodity risk through flexible and diversified indexation. In addition, the Company hedges (physically and financially) against raw material prices in order to minimize the impact of commodity risks.

The Group is exposed to credit risk in the countries in which it operates due to the current macroeconomic situation and to a potential increase in defaults. The concentration of credit risk is minimized through diversification, management and a combination of different impact areas: an internationally diversified customer base; a diverse product range; different types of customers in both the public and private sectors in different industries.

Gas supply is exposed to international political risks: potential problems in the Maghreb countries or the Middle East could affect gas procurement. This risk is mitigated by gas supply contracts and by an increased number of gas supply points, as well as by specific insurance policies.

Naturgy's business model is solid and profitable. The Group offers a well-balanced mix of activities and is geographically well-diversified, globally mitigating business risks. Given its leading position and vertically integrated model along the gas and power value chain, we consider the Company to be well-placed to face the energy transition. Concluding new contracts with other suppliers and obtaining new concessions could increase the Group's portfolio flexibility. Critical issues in the future will be the high volatility of commodity prices, significant regulatory changes and increased geopolitical tensions, which will challenge the Group's adaptability.

Financial risk

For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. Contrary to our usual practice, we deducted the goodwill shown on the balance sheet from equity by only 50%, suggesting a certain recoverability of goodwill. The following descriptions and indicators are based solely on these adjustments.

Contrary to previous years, a reclassification of the subordinated perpetual notes was made by CRA due to Naturgy's decision (s. Naturgy 9M 2022 results) to redeem and not replace the EUR 500 million 4.125% subordinated perpetual bond. Consequently, this bond was fully reclassified to short-term financial debt along with half of the EUR 500 million 3.375% subordinated perpetual bond to medium-term financial debt. This reclassification has led to some unfavorable, but not significant, changes in the key figures. This has mainly affected the equity ratio, which currently shows a lower level of 24.2% (2020: 26.3%), as Creditreform's adjusted equity after reclassification now amounts to EUR 9,008 million instead of EUR 9.760 million. Notwithstanding this, the overall result of the analysis of the structured financial key ratios has remained the same, albeit at a somewhat weakened level.

The Company is capital intensive, with 62.0% of its balance sheet invested in long-term assets. This capital intensity, which remains high but has decreased significantly since the last four years, is partly offset due to the capital structure of Naturgy.

The Group issues bonds via its subsidiaries Naturgy Capital Markets, S.A. and Naturgy Finance BV through a European Medium Term Notes (EMTN) program established in 1999, with a limit of EUR 12,000 million, of which EUR 8,110 million has been drawn down as of December 2021. Naturgy also has a Euro Commercial Paper Program (ECP) amounting to EUR 1,000 million, fully available as of December 2021.

As of 30 September 2022, the reported gross debt amounted to EUR 16,741 million (31.12.2021: EUR 16,812 million). The gross debt has a comfortable maturity profile with 12.8% current liabilities, 55.8% payable in 2023-2026, and 31.4% due after 2027. 80% of financial debt has a fixed-rate and 90% denominate in EUR.

At the end of September 2022, the reported net financial debt decreased by EUR 2,579 million to EUR 10,252 million (31.12.2021: EUR 12,831 million), mainly due to the strong increase in cash and cash equivalents during the year. The Company’s original calculation of the net financial debt / EBITDA has improved to 2.3x (31.12.2021: 3.6x). As of 30 September 2022, total liquidity increased to EUR 11,797 million, consisting of EUR 6,244 million cash and cash equivalents and EUR 5,553 million undrawn credit lines. We therefore consider the Company's liquidity position to be solid.

Overall, we assess Naturgy's financial risks to be moderate and manageable despite its high and increasing investment needs. The Company has diversified funding sources and solid liquidity, which should enable it to pursue its strategic plan. The Group also has a healthy capital structure and generates stable operating cash flows, which are mainly generated from regulated activities. Moreover, the Company benefits from proven access to capital markets.

Issue rating

Further issuer ratings

In addition to the rating of Naturgy Energy Group, S.A. the following Issuers and its issues (see below), have been rated.

- Naturgy Finance B.V.
- Naturgy Capital Markets, S.A.

Naturgy Energy Group, S.A. is the guarantor of the above Group companies and the notes that were issued under the EMTN program, with the last base prospectus of 15 December 2022. These subsidiaries have also been assessed in this rating report.

Naturgy Finance B.V. ("the Issuer") is a wholly-owned subsidiary of Naturgy Energy Group, S.A., which was incorporated in the Netherlands as a private limited company on 26 November 1993 under the name Union Fenosa Finance B.V. and is governed under the laws of the Netherlands. The Issuer's principal business is to facilitate the raising of financing for the Company. The business development of Naturgy Finance B.V. is largely determined by the financial requirements of the Group's companies worldwide. As a wholly-owned subsidiary of Naturgy Energy Group, S.A., the Issuer is dependent on the performance of the Group and the ability of its members to generate sufficient income to satisfy its payment obligations to other capital market participants. The Issuer's financial statements are fully consolidated in the financial statements of the Group. For these reasons, we derive the rating of Naturgy Finance B.V. from the unsolicited corporate issuer rating of Naturgy Energy Group, S.A., i.e. BBB+ / stable.

Naturgy Capital Markets, S.A. ("the Issuer") is a wholly-owned subsidiary (with exception of one share held by La Propagadora del Gas, S.A.) of Naturgy Energy Group, S.A., which was incorporated in Spain as a limited liability company on 23 May 2005 under the name Gas Natural Capital Markets, S.A. and is governed under Spanish law. The Issuer's principal business is to facilitate the raising of financing for Naturgy Energy Group, S.A. The business development of Naturgy Capital Markets, S.A. is largely determined by the financial requirements of the Group's companies worldwide. As a wholly-owned subsidiary of Naturgy Energy Group, S.A., the Issuer is dependent on the performance of the Group and the ability of its members to generate sufficient income to satisfy its payment obligations to other capital market participants. The Issuer's financial statements are fully consolidated in the financial statements of the Group. For these reasons, we derive the rating of Naturgy Capital Markets, S.A. from the unsolicited corporate issuer rating of Naturgy Energy Group, S.A., i.e. BBB+ / stable.

Issue rating details

The rating objects of this issue rating are exclusively the long-term senior unsecured notes, denominated in euro, issued by Naturgy Finance B.V., Naturgy Capital Markets, S.A. and Naturgy Energy Group, S.A. (Issuers), which are included in the list of ECB-eligible marketable assets. The ECB list of eligible marketable assets can be found on the website of the ECB.

The notes have been issued under the EMTN program with its latest prospectus from 15 December 2022. This EMTN program amounts to EUR 12.0 billion. The notes and coupons under the EMTN program constitute unsubordinated, unsecured obligations of the issuers, and rank pari passu with all other present and future unsecured obligations of the issuers.

Result corporate issue rating

We have provided the debt securities issued by Naturgy Finance B.V. and Naturgy Capital Markets, S.A. with a rating of BBB+ / stable. This decision is based on the corporate rating of

Naturgy Energy Group, S.A. and takes into account the specific credit enhancement of the notes, namely the guarantee by Naturgy Energy Group, S.A., which has unconditionally and irrevocably guaranteed the due payment of all sums expressed to be payable by Naturgy Finance B.V. and Naturgy Capital Markets, S.A. under the notes, receipts and coupons. Other types of debt instruments or issues denominated in other currencies have not been rated by CRA. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG.

Overview

Table 3: Overview of CRA Ratings I Source: CRA

Rating Category	Details	
	Date	Rating
Naturgy Energy Group, S.A. (Issuer)	14.07.2022	BBB+ / stable
Naturgy Finance B.V. (Issuer)	14.07.2022	BBB+ / stable
Naturgy Capital Markets, S.A. (Issuer)	14.07.2022	BBB+ / stable
Long-term Local Currency (LC) Senior Unsecured Issues	14.07.2022	BBB+ / stable
Other	--	n.r.

Table 4: Overview of 2022 Euro Medium Term Note Program I Source: Base Prospectus dated 15.12.2022

Overview of 2022 EMTN Program			
Volume	EUR 12,000,000,000	Maturity	Depending on respective bond
Issuer / Guarantor	Naturgy Energy Group, S.A. (Guarantor) Naturgy Finance B.V. Naturgy Capital Markets, S.A.	Coupon	Depending on respective bond
Arranger	Citigroup Global Markets Europe AG	Currency	Depending on respective bond
Credit enhancement	none	ISIN	Depending on respective bond

All future LT LC senior unsecured notes issued by Naturgy Energy Group, S.A., Naturgy Finance B.V., and Naturgy Capital Markets, S.A. which have similar conditions to the current EMTN program, denominated in EUR and included in the list of ECB-eligible marketable assets will, until further notice, receive the same ratings as the current LT LC senior unsecured notes issued under the EMTN program. Notes issued under the program in any currency other than EUR, or other types of debt instruments, have not yet been rated by CRA. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG. For the time being, other emission classes or programs (such as the Commercial Paper Program) and issues that do not denominate in EUR will not be assessed.

Financial ratio analysis

Table 5: Financial key ratios |Source: Naturgy Energy Group, S.A. Consolidated Financial Statements 2021, structured by CRA

Asset structure	2018	2019	2020	2021
Fixed asset intensity (%)	76.81	75.96	62.01	62.02
Asset turnover	0.62	0.56	0.41	0.60
Asset coverage ratio (%)	75.24	71.58	76.57	65.88
Liquid funds to total assets	4.60	7.12	10.67	10.65
Capital structure				
Equity ratio (%)	34.95	32.94	26.26	24.18
Short-term debt ratio (%)	20.80	19.69	27.23	28.49
Long-term debt ratio (%)	22.84	21.43	21.22	16.67
Capital lock-up period (in days)	48.99	54.82	59.89	56.17
Trade-accounts payable ratio (%)	8.75	8.27	6.84	9.15
Short-term capital lock-up (%)	14.00	15.24	42.12	26.21
Gearing	1.73	1.82	2.40	2.69
Leverage	2.80	2.95	3.37	3.97
Financial stability				
Cash flow margin (%)	13.89	15.62	17.16	12.86
Cash flow ROI (%)	9.10	8.63	7.19	7.67
Total debt / EBITDA adj.	6.36	6.09	8.28	7.53
Net total debt / EBITDA adj.	5.91	5.45	7.08	6.48
ROCE (%)	7.38	9.64	7.80	10.59
Total debt repayment period	-40.74	5.98	-35.15	7.10
Profitability				
Gross profit margin (%)	27.66	30.08	34.43	25.69
EBIT interest coverage	2.61	3.56	2.97	3.72
EBITDA interest coverage	4.76	5.56	5.34	6.14
Ratio of personnel costs to total costs (%)	4.60	4.29	5.67	4.58
Ratio of material costs to total costs (%)	72.47	70.05	65.74	74.40
Cost income ratio (%)	91.91	87.69	88.67	90.48
Ratio of interest expenses to total debt (%)	3.32	2.97	2.29	2.12
Return on investment (%)	-5.07	6.59	1.36	5.25
Return on equity (%)	-18.37	14.10	-0.28	16.67
Net profit margin (%)	-10.62	8.61	-0.20	7.00
Operating margin (%)	8.60	12.82	11.96	10.01
Liquidity				
Cash ratio (%)	22.11	36.17	39.19	37.37
Quick ratio (%)	96.25	103.54	127.44	121.14
Current ratio (%)	111.50	122.09	139.52	133.33

Appendix

Rating history

The rating history is available under https://www.creditreform-rating.de/en/ratings/published-ratings.html.

Table 6: Corporate Issuer Rating of Naturgy Energy Group, S.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.05.2017	26.05.2017	28.05.2020	BBB+ / stable

Table 7: Corporate Issuer Rating of Naturgy Finance B.V.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.05.2017	26.05.2017	28.05.2020	BBB+ / stable

Table 8: Corporate Issuer Rating of Naturgy Capital Markets, S.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.05.2017	26.05.2017	28.05.2020	BBB+ / stable

Table 9: LT LC Senior Unsecured Issues issued by Naturgy Finance B.V.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.05.2017	26.05.2017	28.05.2020	BBB+ / stable

Table 10: LT LC Senior Unsecured Issues issued by Naturgy Capital Markets, S.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.05.2017	26.05.2017	28.05.2020	BBB+ / stable

Regulatory requirements

The rating[5] was not endorsed by Creditreform Rating AG (Article 4 (3) of the CRA-Regulation).

The present rating is, in the regulatory sense, an unsolicited rating, that is public. The analysis was carried out on a voluntary basis by Creditreform Rating AG, which was not commissioned by the Issuer or any other third party to prepare the present rating.

The rating is based on the analysis of published information and on internal evaluation methods for the assessment of companies and issues. The rating object was informed of the intention of creating or updating an unsolicited rating before the rating was determined.

[5] In these regulatory requirements the term "rating" is used in relation to all ratings issued by Creditreform Rating AG in connection to this report. This may concern several companies and their various issues.

The rating object participated in the creation of the rating as follows:

Unsolicited Corporate Issuer / Issue Rating	
With rated entity or related third party participation	No
With access to internal documents	No
With access to management	No

A management meeting did not take place within the framework of the rating process.

The documents submitted and information gathered were sufficient to meet the requirements of Creditreform Rating AG's rating methodologies.

The rating was conducted based on the following rating methodologies and the basic document.

Rating methodology	**Version number**	**Date**
Corporate Ratings	2.4	July 2022
Non-financial Corporate Issue Ratings	1.0	October 2016
Rating Criteria and Definitions	1.3	January 2018

The documents contain a description of the rating categories and a definition of default.

The rating was carried out by the following analysts:

Name	**Function**	**Mail-Address**
Natallia Berthold	Lead-analyst	N.Berthold@creditreform-rating.de
Christina Sauerwein	Analyst	C.Sauerwein@creditreform-rating.de

The rating was approved by the following person (person approving credit ratings, PAC):

Name	**Function**	**Mail-Address**
Stephan Giebler	PAC	S.Giebler@creditreform-rating.de

On 24 January 2023, the analysts presented the rating to the rating committee and the rating was determined. The rating result was communicated to the company on 25 January 2023. There has not been a subsequent change to the rating.

The rating will be monitored until Creditreform Rating AG withdraws the rating. The rating can be adjusted as part of the monitoring, if crucial assessment parameters change.

In 2011, Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on this registration, Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

ESG-factors

You can find out whether ESG factors were relevant to the rating in the upper section of this rating report "Relevant rating factors".

A general valid description for Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found here.

Conflicts of interest

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or in approving credit ratings and rating outlooks.

In the event of providing ancillary services to the rated entity, Creditreform Rating AG will disclose all ancillary services in the credit rating report at this point:

No ancillary services in the regulatory sense were carried out for this rating object.

Rules on the presentation of credit ratings and rating outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our "Rating Committee Policy", all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, Creditreform Rating AG has used following substantially material sources:

Corporate issuer rating:

1. Annual report

2. Website

3. Internet research

Corporate issue rating:

1. Corporate issuer rating incl. information used for the corporate issuer rating

2. Documents on issues / instruments

There are no other attributes and limitations of the credit rating or rating outlook other than those displayed on the Creditreform Rating AG website. Furthermore, Creditreform Rating AG considers as satisfactory the quality and extent of information available on the rated entity. With respect to the rated entity, Creditreform Rating AG regarded available historical data as sufficient.

Between the time of disclosure of the credit rating to the rated entity and the public disclosure, no amendments were made to the credit rating.

The Basic Data Information Card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In cases where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating report and indicates how the different methodologies or other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings and best-case scenario credit ratings are explained.

The date at which the credit rating was initially released for distribution and the date when it was last updated, including any rating outlooks, is indicated clearly and prominently in the Basic Data Information Card as a "rating action"; initial release is indicated as "initial rating", other updates are indicated as an "update", "upgrade" or "downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the Basic Data Information Card.

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009, a registered or certified credit rating agency shall make available, in a central repository established by ESMA, information on its historical performance data including the rating transition frequency and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website.

An explanatory statement of the meaning of Creditreform Rating AG's default rates are available in the credit rating methodologies disclosed on the website.

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