Creditreform Corporate Issuer / Issue Rating

Naturgy Energy Group, S.A.

Creditreform Rating

Rating object	Rating information	
Naturgy Energy Group, S.A.	Corporate Issuer Rating: **BBB+ / stable**	Type: Update unsolicited
Creditreform ID: 2000000652 Incorporation: 1843 Based in: Madrid Main (Industry): Natural gas and electricity utilities company CEO: Francisco Reynés	LT LC Senior Unsecured Issues,: **BBB+ / stable**	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: 29 May 2020 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 the Group, Naturgy, or the Company – is a public company incorporated in 1843 and located in Madrid, Spain. The Group is the biggest integrated natural gas and electricity company in Spain and overall a leading multinational group in the energy sector. Its core businesses are the distribution and commercialization of natural gas as well as the generation, distribution and commercialization of electricity. Naturgy disposes of 16.9 GW of installed power generation capacity, 133,917 km of gas distribution network, and 218,831 km of electricity distribution network. The Company serves more than 18 million customers in 28 countries. Nearly 50% of its over 12,000 employees work outside of Spain.

In 2019, due to the decline in commodity prices, revenues of Naturgy Energy Group, S.A. decreased by 5.4%%, amounting to EUR 23,035 million (2018: EUR 24,339 million). The Group achieved an EBITDA of EUR 4,562 million (2018: EUR 4,019 million) and a net profit of EUR 1,796 million (2018: EUR -2,596 million). Net income in 2018 was marked by large impairments related to the new strategy for 2018-2022 and the revaluation of the Company's conventional electricity generation plants in Spain. Approx. 70% of Naturgy's EBITDA comes from regulated or quasiregulated activities. In 2019, 48.5% of its EBITDA was achieved in Spain.

Rating result

The current rating attests a highly satisfactory level of creditworthiness to Naturgy Energy Group, S.A. (Group), which represents a low to medium default risk. The Group's high proportion of regulated and contracted activities - reflected in a large proportion of stable and predictable EBITDA - its scale and its geographical and product diversification attest a strong credit rating. The Company has a solid earnings capacity and strong financial metrics, which have improved in the course of the implementation of the cost efficiency program introduced in 2018. Its proved access to financial markets, solid liquidity, controlled investment policy and commitment to financial discipline underpin our rating assessment. Naturgy aims to reduce its exposure to commodity-linked earnings; however, a significant part of its business is negatively affected by volatile power demand and prices. The Company's generous dividend policy, with envisaged further annual increase in distribution payments and share buyback program, particularly against the backdrop of the overall economic slowdown resulting from the health crisis, as well as a drop in energy demand and aggravated counterparty and liquidity risks, have a dampening effect on the 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 proved access to financial markets, we do not expect liquidity shortages or a deterioration of Naturgy's financial metrics following the expected decrease in earnings resulting from the implications of the health crisis, which would lead to a rating downgrade in the short-term perspective. However, at this point in time it is difficult to assess how long the health crisis, the economic slowdown and the subsequent recovery period will last. These events might have a more severe negative effect on energy demand and therefore the business development of Naturgy. Should our assessment of the implications of COVID-19 pandemic on the business of Naturgy change, then we might change the outlook of the rating.

Reference:

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

Excerpts from the financial key figures analysis 2019:
+EBITDA, EBIT, EAT
+Net total debt / EBITDA adj.
+Return on investments

-Sales
-Equity ratio
-Capital lock-up period

Relevant rating factors

Table 1: Financials I Source: Naturgy Energy Group, S.A. Consolidated Financial Statements 2019, standardized by CRA

Naturgy Energy Group, S.A. Selected key figures of the financial statement analysis Basis: Consolidated Financial Statements as of 31.12. (IFRS)	CRA standardized figures[1]	
	2018	2019
Sales (EUR million)	24,339.00	23,035.00
EBITDA (EUR million)	3,840.00	4,523.00
EBIT (EUR million)	2,103.00	2,903.00
EAT (EUR million)	-2,596.00	1,796.00
EAT after transfer (EUR million)	-2.822.00	1,401,00
Total assets (EUR million)	35,718.00	36,107.00
Equity ratio (%)	33.43	31.36
Capital lock-up period (days)	48.99	49.41
Short-term capital lock-up (%)	13.99	13.73
Net total debt / EBITDA adj. (Factor)	5.78	4.92
Ratio of interest expenses to total debt (%)	3.39	3.38
Return on investment (%)	-5.30	6.86

[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.

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

General rating factors

\+ High proportion of regulated and contracted EBITDA
\+ Geographically well-diversified
\+ High entry barriers
\+ Plausible and future-oriented strategy
\+ Stable business development in recent years
\+ Proved access to financial markets

– Exposure (though limited) to volatile electricity and gas prices
– Exposure to higher-risk international gas procurement and supply contracts
– Changes in regulation
– Country risks
– Very capital-intensive business areas (high fixed costs and maintenance capex)

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

Current rating factors

\+ Still solid equity ratio and capital structure
\+ Stable net financial debt and improved net financial debt / EBITDA ratio
\+ Improved operational efficiency
\+ Controlled capex

– Low commodity prices that put pressure on cash flows
– Decrease in equity ratio
– Improvable asset coverage ratio
– High dividend distribution

Prospective rating factors are factors and possible events that – according to the analysts as of the date of the rating – would most likely have a stabilizing or positive effect (+) and a weakening or negative effect (-) on future ratings, if they occurred. This is not a full 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

\+ Successful realization of the operational improvements and synergies
\+ Positive effects from the targeted product policy and geographical optimization
\+ Development of renewables

– Deterioration of earnings capacity and intensification of liquidity risks resulting from the health crisis
– Negative changes in regulatory environment
– Relatively high cash outflows due to commitments to shareholders

ESG factors are factors related to environment, social issues and, governance. For more information, please see the "Regulatory requirements"section. 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 considers ESG factors (environment, social and governance) within its rating decisions. In the case of Naturgy Energy Group, S.A. we have not identified any ESG factor with significant influence.

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:

https://creditreform-rating.de/en/about-us/regulatory-requirements.html?file=files/content/downloads/Externes%20Rating/Regulatorische%20Anforderungen/EN/Ratingmethodiken%20EN/The%20Impact%20of%20ESG%20Factors%20on%20Credit%20Ratings.pdf

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.

Best-case scenario: BBB+

In our best-case scenario for one year, we assume a rating of BBB+. Given the implications of the COVID-19 pandemic, we expect a temporary deterioration of the Company's earnings and its financial metrics with subsequent recovery, taking into consideration its resilient business model and currently strong liquidity position; therefore, we do not expect a rating upgrade in the short term.

Worst-case scenario: BBB

In our worst-case scenario for one year, we assume a rating of BBB. The Company's financials worsen following a significant drop in energy demand and subsequent deterioration of cash flows combined with an extension of debt resulting from the implementation of its investment strategy and further considerable cash outflows for commitments to the shareholders.

Business development and outlook

In 2019, amidst overall challenging market conditions, Naturgy managed to enlarge its international activities and further improve its operational efficiency. The Company generated revenues of EUR 23,035 million (2018: EUR 24,339 million), a decrease of 5.4% in comparison to last year, due to the decline in energy prices and volumes sold in the liberalized businesses, partly offset by growth in the infrastructure businesses. The Company's EBITDA grew by 13.5% to EUR 4,562 million on a reported basis (2018: EUR 4,019 million), and the adjusted EBITDA grew by 5.8% to EUR 4,668 million (2018: EUR 4,413 million). The adjustments on the EBITDA level were mainly associated with restructuring costs and other one-off and extraordinary effects, totaling EUR -106 million in 2019 and EUR -394 million in 2018. The consolidated net income improved significantly from EUR – 2,596 million in 2018 to EUR 1,796 million in 2019. Net income in 2018 was negatively affected by a range of non-recurring expenses at a total amount of EUR 4,067 million, particularly by the asset whrite-downs. As a result of the reassessment of future cash flow estimates based on the new strategic plan for 2018-2022, and after requesting permission to shut down its coal plants in Spain in 2018, the Company recognized impairments of Spanish conventional electricity generation plants in the amount of EUR 3,824 million.

The performance of the Group is broken down as follows.

Table 2: The development of corporate divisions in 2019 (reported figures) I Source: Consolidated Financial Statements 2019

EUR million	Net sales		EBITDA	
	2018	2019	2018	2019
Gas & Power	19,560	17,060	1,360	1,441
Infrastructures EMEA	2,419	2,451	1,802	1,923
Infrastructures LatAm South	5,076	5,468	791	938
Infrastructures LatAm North	1,367	1,526	232	376

In the Gas & Power division, strong performance in the supply of gas, electricity and services, as well as in international power generation, was partly offset by the weak performance in International LNG and power Generation in Europe, resulting from low margins and a decrease in sales.

In Infrastructure EMEA, the EBITDA increased by 6.7% based on stable performance across all businesses (gas and electricity distribution in Spain and infrastructure in the Maghreb countries) together with operational improvements.

The positive development in Infrastructure in Latin America South (Chile, Brazil and Argentina) was mainly driven by the stable regulatory environment and operative efficiency, and partly offset by negative effects of currency rates, particularly in Argentina as a hyperinflationary economy.

Good operational performance, higher demand and efficiency improvements, as well as positive exchange rate effects in the business units Gas distribution Mexico and Electricity distribution Panama were the main performance drivers in Infrastructures LatAm North.

In June 2018, Naturgy presented its new strategy for the period 2018-2022, which was designed to create additional value in all the Company's divisions and activities against the backdrop of the energy transition requirements and related market trends. The business model focuses on proximity to customers, intensifying renewable energy and energy efficiency services in order to strengthen its market position, while introducing modern digital solutions and enhancing operating efficiency. The Company plans to develop renewable gas, amplify the use of gas in transportation, and to triple its renewable energy capacities by 2022. A range of measures aimed at simplifying the Group's structure were implemented, such as reducing the number of members on the Board of Directors, introducing a new organizational structure with four business segments, and adopting a leaner corporate structure. In its investment policy, Naturgy is poised to focus on contracted and regulated activities, notably gas and electricity infrastructure, as well as on energy services. New investments should have synergy potential with its current activities. Geographically, big markets with strong growth opportunities and a stable legal environment represent potential investment priorities.

The financial strategy is based on the optimization of operational costs and controlled capital expenditure with tightened investment discipline, and focus on organic growth. The Company strives to achieve savings of EUR 500 million by 2022 through optimization of its non-core activities, digitization and enhancing operational efficiency. The annual capex should be reduced by EUR 200 million compared to 2015-2017, with cumulated total investments of EUR 8.4 billion within five years, of which EUR 5.3 billion should be allocated to growth, according to targeted aim of 63% growth capex (54% in 2015-2017). Naturgy plans to increase dividend payments by 5% yearly, achieving cumulated dividends of EUR 6.9 billion over the period 2018-2022, and announced a share buyback program of up to EUR 2 billion, capped at EUR 400 million per year. Until 2022, the Company aims to achieve an EBITDA of EUR 5.0 billion, net income and free cash flow of EUR 1.8 billion, and to maintain its net financial debt on the level of 2017 (EUR 16.4 billion).

Corresponding to its strategy, in 2019 the Company managed to decrease its maintenance capex through optimisation of capex processes by 7.3% to EUR 633 million (2018: 683 million)and invested EUR 573 million in renewable energy projects, the majority of which wind and solar projects in Spain. The growth capex totaled EUR 1,052 million, down by 35.8% compared to 2018 (EUR 1,638 million). The Group divested a few of its international activities, considering them as non-core; among others, its interest in a Moldavian electricity distribution entity and in Transemel, an electricity transmission subsidiary in Chile. During 2019, the Company realized additional savings of EUR 270 million as part of its cost optimization program, achieving cumulated savings of EUR 380 million since 2018. According to a recent announcement, further EUR 120 million on savings have been envisaged for 2020, with the implementation of a targeted EUR 500 million savings two years ahead of plan.

The results of the first quarter 2020 were marked by the implications of COVID-19 pandemic and the overall economic slowdown. As of 31 March 2020, net sales decreased by 20.2% to EUR 5,067 million (March 2019: EUR 6,349 million), mainly due to lower energy prices and a drop in sales volumes in the liberalized business. The reported EBITDA decreased by 15.6% from EUR 1,119 million in 2019 to EUR 944 million against the backdrop of unfavorable market conditions in LNG, due to weak global spot prices and an expected lower contribution from EMPL[2] and Spanish electricity distribution. This result was negatively affected by non-recurring capture costs related to the implementation of the efficiency program (EUR 158 million) as well as by currency effects. Adjusted EBITDA decreased by 5.6%. Net income stood at EUR 199 million (2018: EUR 341 million), a drop of 41.6%. Total capex amounted to EUR 201 million in the quarter, down 33.2% from the previous year. This reduction is mainly due to lower growth investments in Spanish gas networks and a slowdown in renewable developments in Spain. As of 31 March 2020, net debt amounted to EUR 15,010 million, EUR 258 million less than in December 2019, after the EUR 755 million used for shareholder remuneration during the quarter.

Naturgy has a strong liquidity position of EUR 10,002 million as of May 2020, consisting of EUR 4,468 cash and cash equivalents and EUR 5,534 million undrawn credit lines, enhanced by the issuance of EUR 1.0 billion EMTN-bond in April 2020. Despite the adverse effects of the crisis, the Company confirms its commitment to dividend payments and plans to continue with its investments in renewables and scheduled maintenance capex in networks.

With a view to the COVID-19 outbreak, we expect a deterioration of the Company`s earnings and heightened counterparty risks followed by negative effects on the Company's liquidity in 2020. However, taking into consideration the Company's resilient business model with a concentration on regulated and contracted activities, amounting to roughly 70% of the Group's revenues, along with its currently strong liquidity position and favorable debt maturity profile, we expect a rather quick recovery in the next year.

The strategy of Naturgy towards fostering regulated and contracting businesses, and its focus on developing renewables, operational optimization and disciplined capex, as well as its commitment to maintain its strong financial metrics is, in our opinion, plausible and forward-looking.

[2] Europe Maghreb Pipeline Limited

Structural risk

The Company has more than 70,000 shareholders. As of December 2019, the main shareholders of Naturgy were Criteria Caixa (24.4%), Global Infrastructure Partners (20.3%), Rioja Acquisitions (20.4%), and Sonatrach (4.1%). The remaining shares were held by institutional (23.2%) and retail shareholders (7.6%). 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.

On 22 February 2018, Repsol, S.A. reached an agreement to sell its 20.072% stake in the capital of the Company to Rioja Bidco Shareholdings, S.L.U. The transaction was completed in May 2018, with the result that Repsol, S.A. ceased to be a shareholder of the Company.

Following the changes in the ownership structure, there were significant changes in thestructure of the Board of Directors in 2018. In June 2018, the General Shareholders' Meeting approved the reduction in the number of members on the Board of Directors from 17 to 12. In addition, the Executive Committee was eliminated, along with changes in the number of members on the Audit and Remuneration Committees. The senior management of Naturgy comprises executives heading the four business units and eight corporate units, who report directly to the Executive Chairman.

The Company's new strategic plan for 2018-2022 defined a new segment model with full management responsibility and independence, which comprises the following segments:

- Gas and Electricity: supply of gas, electricity and services, LNG supply and transport, electricity generation in Europe, Latin America and Australia
- EMEA Infrastructures: gas and electricity distribution in Spain and the management of the Maghreb-Europe gas pipeline
- Latin America South Infrastructures: gas and electricity distribution in Argentina, sale of gas and electricity and gas distribution in Chile, gas distribution in Brazil and Peru
- Latin America North infrastructures: gas distribution in Mexico and electricity distribution in Peru

The Company operates in 28 countries. The majority of its revenues are generated in Spain (44% in 2019), followed by Latin American countries (36.9%), the rest of Europe (11.5%), and other countries (7.6%).

The widespread geographical diversification of the Group requires a high degree of organization and entails risks associated with local legal, political, cultural and social particularities. We assume that the Group's structure supports the implementation and monitoring of its strategy in accordance with the specific legislation and regulatory frameworks in the countries in which the Group operates. 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. The new initiatives for optimizing geographical presence and the concentration on core activities should enhance operative efficiency. The Company's acquisition activities entail integration risks and the risk of non-realization of expected gains and synergies.

Business risk

Naturgy Energy is an integrated Group whose main activities are the supply, liquefaction, re-gasification, transport, storage, distribution and commercialization of natural gas, as well as the generation, transport, distribution and commercialization of electricity. The Company is one of the three major players in the Iberian power and gas markets.

The Group manages 133,917 km of gas distribution networks in Spain and Latin America, servicing 11.1 million distribution connections. Naturgy dominates the gas distribution business in Spain, holding 69% of the market share, and is one of the leading companies in Argentina, Brazil, Chile, Mexico and Peru. The Company has eight LNG carriers and services two transportation pipelines connecting Algeria and Spain (EMPL and Medgaz). Naturgy supplies gas both in Spain and internationally. Its market share in gas supply in Spain amounts 26%.

Naturgy services 218,831 km of electricity distribution networks and 7.7 million supply connections, being a third-largest operator in Spain and having a strong market position in Argentina, Chile and Panama. The Company has a 16.9 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 17.4% in non-renewable and 2.1% in renewable generation. Naturgy is one of the main Spanish electricity trade leaders, with a market share of 10%.

The Group disposes of a number of concessions, authorizations, licenses, specific rights and allowances to exercise its activities. The Company is increasingly exposed to regulatory risks due to an increased contribution from the 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 (a potential revision of criteria and levels of return recognized for regulated activities, gaps in gas and/or electricity volumes, and other operational risks), which could have potentially severe impacts on the Company. We expect lower profitability from regulated activities in Spain and Chile following the modified tariff systems in these countries for gas and electricity distribution for the next regulatory periods, with tightened remuneration mechanisms.

The Company faces gas and electricity raw material price risks for approx. 30% of its EBITDA. Supply contracts mitigate exposure to commodity risks with flexible and diversified indexing. Moreover, the Company hedges (physically and financially) against raw material prices in order to minimize the impact of commodity risks.

The Group faces credit risk in the countries it operates in due to the current macroeconomic situation and potential increase in defaults. The global demand for power has decreased as a result of the health crisis and its recovery will depend on the duration of the crisis, the willingness of society and governments to lift the restrictions, and the extent of governmental support.

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.

The business model of Naturgy 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 its vertically integrated model along the gas and power value chain, we consider the Company as 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 volatility of commodity prices and exchange rates, which will challenge the adaptation capacity of the Group.

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.

The Company is capital intensive. Seventy-five percent of its balance sheet is invested in long term assets. This high capital intensity is partly offset due to the capital structure of Naturgy. Creditreform adjusted equity for 2019 stood at EUR 11,323 million (2018: EUR 11,941 million), i.e. a 31.4% equity ratio (2018: 33.4%). The main reasons for the decrease in equity were dividend payments (EUR 1,895 million), trading in treasury shares and share capital reduction.

Gross financial debt amounted to EUR 17,987 million at the end of 2019. Naturgy finances itself predominantly by means of bonds (54%) and borrowings from financial institutions (36%), as well as derivative and other financial instruments. Following the application of IFRS 16, lease liabilities totaling EUR 1,644 million were balanced. The gross financial debt has a comfortable maturity profile with 12.7% current liabilities, 43.8% payable in 2021-2024, and 43.5% due after 2024. 85.5% of financial debt has a fixed-rate and 65.8% denominate in EUR.

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 8,725 million has been drawn down as of December 2019. Naturgy also has a Euro Commercial Paper Program (ECP) amounting to EUR 1,000 million, fully available as of December 2019.

Net financial debt was stable compared to the previous year, standing at EUR 15,268 million (2018: EUR 15,309 million). The Creditreform adjusted net total debt/EBITDA has improved in comparison with 31 December 2018 to 4.7x (2018: 5.78x) due to the improved earnings capacity and EBITDA. The Company's original calculation of the net financial debt / EBITDA is solid at 3.3x.

The Company shows good liquidity with an improved cash flow from operating activities due to the strengthened earnings and optimized working capital of EUR 4,021 million (2018: EUR 2,881 million), which are generally sufficient to cover the Company's investments and dividend payments, including minorities. As of the end of May 2010, the Company had solid liquidity of EUR 10,002 million, consisting of EUR 4,468 cash and cash equivalents and EUR 5,534 million undrawn credit lines.

The Group is exposed to exchange rate risks, especially in Latin America, which are mitigated by diversification and natural hedging (financing in local currencies and derivative financial instruments). Interest rate risks are financially hedged and mitigated by diversification in financing sources, with a majority of fixed-rate debts.

The Company's trend toward higher dividend payments with an envisaged 5% payout increase per year for the period until 2022, especially with a view of the COVID-19 effects, has a dampening effect on our assessment.

Overall, we see no significant short or medium-term financial risks for Naturgy Energy Group S.A. that could endanger the Company's sustainability. The Group disposes of diversified funding sources as well as a comfortable debt maturity profile and liquidity. Furthermore, Naturgy has a strong capital structure, generates solid operating cash flows and disposes of diversified funding that should allow the Company to withstand the implications of the health crisis and to finance its strategic plan, while maintaining strict financial discipline.

Issue rating

Further issuer ratings

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

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

Naturgy Energy Group, S.A. is guarantor of the above group companies and the issues that have been issued under the EMTN program, with the last base prospectus of 3 April 2020 and the last supplement dated 11 May 2020. 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+ with stable outlook.

Naturgy Capital Markets, S.A. ("the Issuer") is a wholly-owned subsidiary (with exception of one share hold 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+ with stable outlook.

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 3 April 2020 and the supplement from 11 May 2020. This EMTN program amounts to EUR 12.0 billion. The notes and coupons under the EMTN programme 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 mainly 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 of 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)	29.05.2020	BBB+ / stable
Naturgy Finance B.V. (Issuer)	29.05.2020	BBB+ / stable
Naturgy Capital Markets, S.A. (Issuer)	29.05.2020	BBB+ / stable
Long-term Local Currency (LC) Senior Unsecured Issues	29.05.2020	BBB+ / stable
Other	--	n.r.

Table 4: Overview of 2020 Euro Medium Note Program I Source: Base Prospectus dated 3 April 2020

Overview 2020 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	Currency	Depending on respective bond
Credit enhancement	none	ISIN	Depending on respective bond

All future LT LC senior unsecured notes that will be issued by Naturgy Energy Group, S.A., Naturgy Finance B.V., and Naturgy Capital Markets, S.A. and that 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.

Creditreform Rating

Financial ratio analysis

Table 4: Financial key ratios |Source: Naturgy Energy Group, S.A. Consolidated Financial Statements 2019, standardized by CRA

Asset structure	2016	2017	2018	2019
Fixed asset intensity (%)	81.32	73.11	75.77	74.90
Asset turnover	--	0.55	0.63	0.64
Asset coverage ratio (%)	67.84	77.95	75.62	71.75
Liquid funds to total assets	4.73	7.72	4.80	7.44
Capital structure				
Equity ratio (%)	41.38	36.44	33.43	31.36
Short-term debt ratio (%)	18.36	19.86	21.73	20.56
Long-term debt ratio (%)	13.79	20.55	23.87	22.38
Capital lock-up period (in days)	54.55	45.38	48.99	49.41
Trade-accounts payable ratio (%)	7.50	6.91	9.15	8.64
Short-term capital lock-up (%)	16.92	19.37	13.99	13.73
Gearing	1.30	1.53	1.85	1.95
Leverage	--	2.57	2.85	3.09
Financial stability				
Cash flow margin (%)	--	11.69	13.89	15.00
Cash flow ROI (%)	--	6.53	9.51	9.61
Total debt / EBITDA adj.	5.79	7.13	6.23	5.51
Net total debt / EBITDA adj.	5.32	6.26	5.78	4.92
ROCE (%)	8.12	6.93	8.13	11.53
Total debt repayment period	--	19.86	-39.89	5.70
Profitability				
Gross profit margin (%)	33.81	28.87	27.66	29.65
EBIT interest coverage	2.95	2.64	2.61	3.47
EBITDA interest coverage	4.77	4.65	4.76	5.40
Ratio of personnel costs to total costs (%)	4.92	4.85	4.60	4.45
Ratio of material costs to total costs (%)	66.36	71.28	72.47	70.49
Cost income ratio (%)	88.13	91.47	91.91	88.03
Ratio of interest expenses to total debt (%)	3.66	3.04	3.39	3.38
Return on investment (%)	5.78	5.76	-5.30	6.86
Return on equity (%)	--	10.20	-19.12	15.44
Net profit margin (%)	7.77	7.27	-10.62	7.76
Operating margin (%)	12.55	9.12	8.60	12.55
Liquidity				
Cash ratio (%)	25.78	38.88	22.11	36.18
Quick ratio (%)	92.30	125.60	96.28	103.57
Current ratio (%)	101.76	135.44	111.53	122.12

Appendix

Rating history

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

Table 5: 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
Update	29.05.2020	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Table 6: Corporate Issuer Rating of Naturgy Finance B.V.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.08.2018	24.08.2018	28.05.2020	BBB+ / stable
Update	29.05.2020	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Table 7: Corporate Issuer Rating of Naturgy Capital Markets, S.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.08.2018	24.08.2018	28.05.2020	BBB+ / stable
Update	29.05.2020	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Table 8: LT LC Senior Unsecured Issues Issued of Naturgy Finance B.V.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.08.2018	24.08.2018	28.05.2020	BBB+ / stable
Update	29.05.2020	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Table 10: LT LC Senior Unsecured Issues Issued of Naturgy Capital Markets, S.A.

Event	Rating created	Publication date	Monitoring until	Result
Initial rating	17.08.2018	24.08.2018	28.05.2020	BBB+ / stable
Update	29.05.2020	www.creditreform-rating.de	Withdrawal of the rating	BBB+ / stable

Regulatory requirements

The present rating is an unsolicited rating in the regulatory sense. 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.

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

The rating was conducted based on the following information.

List of documents
Accounting and controlling
▪ Annual Consolidated Financial Report 2019
▪ Annual Consolidated Financial Report 2018
▪ 1Q20 Results, report and presentation dated 29 April 2020
Finance
▪ Base Prospectus dated 3 April 2020
▪ Base Prospectus Supplement dated 11 Mai 2020
▪ Final Terms oft he issues
Additional documents
▪ Integrated Annual Report
▪ Corporate Responsibility Report 2019
▪ Naturgy’s presentations and press-releases

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

The documents 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	Website
Corporate Ratings	2.3	29.05.2019	https://www.creditreform-rating.de/pub/media/global/page_document/Rating_Methodology_Corporate_Ratings_2.3.pdf
Non-financial Corporate Issue Ratings	1.0	October 2016	https://www.creditreform-rating.de/pub/media/global/page_document/Rating%20Methodology%20Non-Financial%20Corporate%20Issue%20Ratings.pdf
Rating Criteria and Definitions	1.3	January 2018	https://www.creditreform-rating.de/pub/media/global/page_document/CRAG_Rating_Criteria_and_Definitions_v1_3_01-2018.pdf

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	Email-Address
Elena Damijan	Lead analyst	E.Damijan@creditreform-rating.de
Rudger van Mook	Analyst	R.vanMook@creditreform-rating.de

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

Name	Function	Email-Address
Holger Becker	PAC	H.Becker@creditreform-rating.de

On 29 Mai 2020, the analysts presented the rating to the rating committee and the rating was determined. The rating result was communicated to the company on 2 June 2020. 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:

https://creditreform-rating.de/en/about-us/regulatory-require-ments.html?file=files/content/downloads/Externes%20Rating/Regulatorische%20Anforderungen/EN/Rating-methodiken%20EN/The%20Impact%20of%20ESG%20Factors%20on%20Credit%20Ratings.pdf

Conflict of interests

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.

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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.

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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".

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