Creditreform Corporate Rating

Gas Natural SDG, S.A. (Group)

Creditreform Rating
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Rating object	Rating information	
Gas Natural SDG, S.A. (Group)	Rating: **BBB+**	Outlook: **stable**

Creditreform ID:	2000000652
Incorporation:	1843
(Main) Industry:	power and gas
Management:	Rafael Villaseca Marco, CEO

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Rating systematic:	corporate rating
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Content

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Abstract

Company

Gas Natural SDG, S.A. and its subsidiaries – hereafter referred to as the Group, Gas Natural Fenosa, GNF, or the company – is a public company incorporated in 1843 and located in Barcelona, Spain. The Group is the biggest integrated gas and electricity company in Spain and overall a leading multinational Group in the energy sector. Its core businesses are the complete gas life cycle as well as the generation, distribution and commercialization of electricity. Gas Natural Fenosa disposes of 15.5 GW of installed power capacity and 142,187 km of gas distribution network that serve 22 million customers in more than 30 countries. The Group offers also other lines of business, such as energy services.

In 2016, due to the decline in commodity prices, revenues of Gas Natural Fenosa decreased by 10.9%, amounting to EUR 23,184 million (2015: EUR 26,015 million). The Group achieved an EBITDA amounting to EUR 4,970 million (2015: EUR 5,264 million) and a net profit of EUR 1,347 million (2015: EUR 1,502 million). The Group employed 17,229 people as of December 31, 2016 (2015: 19,939). Approx. 75% of Gas Natural Fenosa's EBITDA comes from regulated or quasi regulated activities. In 2016, 56% of its EBITDA was achieved in Spain in (2015: 52%) and 44% internationally.

Rating result

The current rating attests a good level of creditworthiness to Gas Natural SDG, S.A. (Group), which represents a low to medium default risk in comparison with the sector and the overall economy.

The group's high proportion of regulated and contracted activities, reflected in a large proportion of stable and predictable EBITDA, its scale as well as its geographical and product diversification attest a strong credit rating. The capital structure of the Group is solid with a high equity ratio. In our opinion, the realization of the company's 2016-2020 Strategic Vision plan is plausible. Even though the company aims at reducing its exposure to commodity-linked generation earnings, the still current unfavorable energy prices have a dampening effect on the rating.

Outlook

The yearlong outlook of the rating is stable. We expect a stable development of the company with a favorable economic outlook in Spain (moderate growth), further strong cash flow generation and moderate increase in debt. This outlook is based on the assumption of stable regulatory frameworks in the countries where Gas Natural Fenosa operates and on the expectation that the commodity prices will not further deteriorate.

Relevant rating factors

Excerpts from the financial ratios analysis 2016

+ Improved operating performance
+ Good overall profitability and cash flow generation
+ High equity ratio

- Decreasing revenues
- Low asset coverage ratio

Financial ratios´ extract Basis: consolidated annual statement per 31.12 (IFRS)	Standardized balance sheet	
	2015	2016
Revenues	EUR 26,015 million	EUR 23,184 million
EBITDA	EUR 5,264 million	EUR 4,970 million
EBIT	EUR 3,261 million	EUR 3,006 million
EAT	EUR 1,824 million	EUR 1,711 million
Total assets adj.	EUR 44,696 million	EUR 43,670 million
Equity ratio adj.	39.4 %	41.4 %
Capital lock-up period	43.4 days	51.5 days
Short-term capital lock-up	17.0 %	16.0 %
Return on investment	6.1 %	5.8 %
Net debt / EBITDA adj.	4.9	5.0
Ratio of interest expenses to debt	3.8 %	3.7 %

General rating factors

+ High proportion of regulated and contracted EBITDA
+ Geographically well-diversified outside Iberia
+ High entry barriers
+ Very stable business development in recent years

- Exposure (even though limited) to wholesale prices of electricity and gas
- Exposure to higher risk international gas procurement and supply contracts
- Volume risk in the Spanish gas distribution business
- Very capital-intensive businesses (high fixed costs, low variable costs)
- Market conditions can be influenced largely by government (e.g. CO_2 emission regulations)

Current factors (rating 2017)

+ Solid equity ratio and capital structure
+ Well-defined business plan (2016-2020)
+ Flexible financial profile and low net financial debt / EBITDA ratio

- Low commodity prices that put pressure on cash flows
- Improvable asset coverage ratio

Prospective rating factors

+ Successful realization of the planned further internationalization
+ Further improved operating performance based on synergies
+ Growth of regulated and contracted businesses

- Gas oversupply risk in Spain that could put pressure on margins
- Increased electricity supply risk by fostering power generation with renewables

Best case: BBB+

Worst case: BBB

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

Best case scenario

In our best case scenario for one year, we assume a rating of BBB+. Given the difficult energy context and the stability of the business development of GNF over recent years, we therefore expect a further stable development of the company and do not expect a rating upgrade in the short term.

Worst case scenario

In our worst case scenario for one year, we assume a rating of BBB. The company's financials deteriorate following significant debt increase to finance the strategy and/or the commodity prices plummet and the company cannot acquire new regulated businesses.

Business development and outlook

Gas Natural Fenosa achieved revenues of EUR 23,184 million in 2016 (2015: EUR 26,015 million), which is a decrease of 10.9% in comparison to last year, due to the decline in commodity prices. Also, EBITDA decreased by 4.9% to EUR 4,970 million (2015: EUR 5,264 million), after discontinuation of the liquefied petroleum gas business in Chile. Net profit was EUR 1,711 million (2015: EUR 1,824 million). The results 2016 were affected by the very demanding macroeconomic and energy situation. Despite the difficult economic and energy situation in 2016, the Group reached the objectives in terms of EBITDA (approx. EUR 5,000 million) and net income (between EUR 1,300 million and EUR 1,400 million) of its 2016-2020 Strategic Vision plan. The Group realized 56% of its EBITDA in Spain and 44% internationally.

The Group has developed stably over recent years. The performance of Gas Natural Fenosa is broken down as follows (in percentage of total):

In % of total	Revenues		EBITDA		Investments		EBIT	
December 31	2015	2016	2015	2016	2015	2016	2015	2016
Networks (gas and electricity distribution)	41.5	45.0	58.8	61.6	79.3	67.3	63.5	65.2
Gas (infrastructure and supply)	36.5	33.0	20.5	17.0	2.8	18.8	27.7	22.7
Electricity (generation)	21.0	21.5	19.1	19.6	9.2	7.7	9.4	9.3
Others	1.0	0.5	1.6	1.8	8.7	6.2	-0.6	2.8

In 2016, the Group invested EUR 2,901 million (2015: EUR 2,082 million), mainly in the acquisition of new gas tankers, in the improvement of the gas distribution infrastructure in Spain, and in the acquisition of LPG distribution points from Repsol as well as a number of investees. Disposals amounting to EUR 676 million mainly relate to the sale of shares in Gasco, S.A., GNL Quintero and the sale of buildings in Madrid.

Gas Natural Fenosa developed a 2016-2020 Strategic Vision Plan that is as follows:

- Distribution networks: improve and expand the distribution network business, entry in new geographical markets (concessions), purchase of companies and of new supply points
- Gas commercialization: boost the liquefied natural gas business, acquire new gas supply contracts and double the capacity of the methane tanker fleet
- Electricity generation: generate new capacity, mainly from renewable energies

A special emphasis will be put on the further internationalization of the company. 2016 and 2017 will serve to put in place the plan. The full effect of the plan should be materialized in 2018.

This plan should be realized with a cumulative net investment of EUR 14 billion over the period 2016-2020, of which 80% will be allocated to regulated and contracted activities. GNF aims at reaching cost optimization of EUR 220 million until 2018. The targets 2018 are reaching an EBITDA of EUR 5,400 million, net profit of EUR 1,600 million with a ratio of net financial debt / EBITDA of 3.0x and a dividend payout of approx. 70%.

For 2017, Gas Natural Fenosa confirmed its guidance for net profit to be between EUR 1,300 and 1,400 million, as well as the continuity of its dividend policy in accordance with the Strategic Vision 2016-2020.

In an unfavorable context of low power prices and globally growing demand of energy, the non-regulated and non-contracted activities, exposed to commodity-linked generation earnings, are putting pressure on utilities companies' cash flows. Therefore, the strategy of GNF towards fostering regulated and contracting businesses, with a focus on developing networks and renewables as well as the planned further internationalization of the company, mainly in emerging markets, is in our opinion plausible.

Structural risks

In 2016, the shareholder structure of the Group was profoundly modified with the North American Fund, Global Infrastructure Partners (GIP) entering the capital of the Group. GIP acquired 20% of the shareholdership bought from Criteria Caixa and Repsol, the two main shareholders. This change in the shareholdership generated changes in the corporate governance of GNF.

The shareholders of Gas Natural Fenosa are therefore 20% GIP, 24.4% "la Caixa" Group, 20% Repsol Group, 21.5% international institutional investors, 8.1% minority shareholders, 4% Sonatrach and 2% Spanish institutional investors. The shares are listed on the four Spanish stock markets (Madrid, Barcelona, Bilbao and Valencia).

At the end of the business year 2016, Gas Natural Fenosa employed 17,229 people (2015: 19,939).

We see no core risk associated with either the structural or organizational framework of the group, although the impacts of the entry of GIP in the capital of GNF on the strategic positioning of the company remain to be seen. Gas Natural Fenosa aims at achieving a sustainable growth trajectory with an internationalization plan that should strengthen its leadership position worldwide. This strategy entails integration risks and the risk of non-realization of expected gains and synergies by the new acquisitions.

Business risks

Gas Natural Fenosa 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 Group is mainly active in Spain but also in Latin America (mainly in Chile), the rest of Europe, and Africa. Gas Natural Fenosa is one of the three major players in the Iberian power and gas markets.

The activities of the group can be divided into 4 segments:

Gas distribution

Gas Natural Fenosa manages 142,187 km of gas distribution network (medium and lower pressure transport pipeline) and 13.6 million supply points. The Group is the leader in Spain and in Latin America (Mexico, Chile, Colombia, Brazil, Argentina and Peru) and has a solid presence in Italy. In Spain, the natural gas distribution is a regulated business, based on a system of administrative authorizations (no concessions) that are granted for an indefinite period and carry no exclusive use rights.
The company operates in countries with stable regulatory and tariff frameworks. In this sector, GNF is not affected by changes in the commodities prices, transport or inflation, but only by gas volumes. The strategy of the Group in this segment is the development of new concessions in Spain and Latin America as well as the acceleration of the gasification process in Chile.

Electricity distribution

The electricity distribution business disposes of 8.2 million supply points and 250,886 km of network (electricity distribution and transportation lines). This segment is regulated and the Group operates in markets with stable regulatory and tariffs frameworks. It ranks third on the Spanish market and is the leader in Moldova. Gas Natural Fenosa also operates in Latin America (Chile, Argentina, Panama and Colombia).

Gas

The Group has an integrated gas infrastructure that allows it to transport and supply gas in Spain and in other countries. In order to ensure the gas supply, long-term contracts (20-25 years) with the suppliers are concluded. The gas supply business of Gas Natural Fenosa is based on a 30 billion cubic meters (bcm) portfolio, comprising 36% natural gas and 64% liquefied natural gas. The Group supplied 325,384 GWh in 2016.

In Spain, the production, the supply and the commercialization of natural gas are non-regulated activities and are therefore subject to variations in commodity prices. 99.9% of the natural gas supply in Spain is imported from abroad. The LNG (60% of gas supply) comes from Qatar, Trinidad and Tobago, Nigeria, Egypt, and Oman and is transported by a fleet of nine methane tankers. The NG (40% of gas supply) comes from Norway and Algeria and is transported by two gas pipelines (Maghreb-Europe and Medgaz). These enable Gas Natural Fenosa to offer a steady supply of gas, avoiding the impact of seasonal changes and demand peaks. The company acquired two new tankers in 2016 and aims at incorporating four new tankers by 2018 to enlarge the fleet by 2 million cubic meters. The Group commercialized 325 TWh of gas in 2016.

Electricity

Regarding electric power, the Group disposes of a total installed generation capacity of 15,418 MW and produced 46,552 GWh in 2016. The group produces electricity in ordinary regime (nuclear plants, hydroelectric plants, coal plants (national and imported), fuel gas, combined cycles) and in special regime (wind parks, mini hydraulic, cogeneration installation). The group distributes and trades power on the Spanish market and cross-border (on the free and on the regulated market).

Each segment of Gas Natural Fenosa faces its own business and operating risks. Without being exhaustive, the principal elements are described below.

The Group disposes of a number of concessions (12 concession contracts for the construction, operation and maintenance of facilities), authorizations, licenses, specific rights and allowances to exercise its activities. The company is increasingly exposed to regulatory risks due to a solid contribution from the regulated business to its EBITDA 2016. This confers stable and predictable revenues to the Group while reducing its exposure to the energy market price environment. However, GNF 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 risk), which could have potential severe impacts on the company.

The company faces gas and electricity raw material prices risks for approx. 40% of its EBITDA. The supply contracts mitigate exposure to the commodities risk with flexible and diversified indexing. Moreover, the company hedges (physically and financially) against raw materials prices in order to minimize the impact of commodities risks.

The Group faces credit risk in the countries it operates because of the current macroeconomic situation and potential increase in defaults. The current demand for gas in Spain is low, creating a gap between the gas supply and demand. The demand for electricity is stable and the company is trying to optimize the commercialization-generation gap given the increased participation of renewable energies with zero marginal costs but also intermittent production.

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 new gas supply contracts and by an increased number of gas supply points as well as by specific insurance policies.

The business model of Gas Natural Fenosa is designed to be 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 well-placed to face the energy transition. Concluding new contracts with other suppliers and obtaining new concessions could increase the Group's portfolio flexibility, also against the background of some concessions expiring in 5 and 6 years. Critical issues in the future will be the volatility of the commodity prices and exchange rates, which will challenge the adaptation capacity of the Group.

Financial risks

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 the 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. Approximately 80% of the company's balance sheet is invested in long term assets. This high capital intensity is partly offset due to the capital structure of Gas Natural Fenosa. Creditreform adjusted equity for 2016 stood at EUR 18,070 million (2015: EUR 17,625 million), which in relative terms means 41.4% of the balance sheet (2015: 39.4%).

Gross financial debt amounted to EUR 17,602 million at the end of 2016. Gas Natural Fenosa finances itself predominantly by means of bonds (66.3% of gross financial debt) and bank loans (32.3%), as well as derivative and other financial instruments (1.4%). Approx. 75.9% of financial debt has a fixed-rate and 79.4% is libeled in EUR.

The Group issues bonds via its subsidiaries Gas Natural Capital Markets, S.A. and Gas Natural Fenosa Finance BV through a European Medium Term Notes (EMTN) Program established in 1999 with a limit of EUR 14,000 million, of which EUR 10,205 million has been drawn down as of December 31, 2016. Gas Natural Fenosa has furthermore a Euro Commercial Paper Program (ECP), amounting to EUR 1,000 million and draw down for EUR 100 million as of December 31, 2016. The European Investment Bank has granted financing to the Group in the amount of EUR 1,835 million. Gas Natural SDG, S.A. has given guarantees to its subsidiary for debt issued by Gas Natural México S.A. de C.V. amounting to EUR 67 million as of December 31, 2016.

Net financial debt amounted to EUR 15,423 million (2015: EUR 15,648 million), of which 12,307 million are due in and after 2019. Net debt has an average length of 5.2 years. The Creditreform adjusted net debt/EBITDA is stable in comparison with December 31, 2015 at 5.0x. Original calculation of the ratio of net financial debt / EBITDA is low at 3.1x.

The company shows good liquidity with a positive cash flow from operating activities of EUR 3,375 million (2015: 3,500 million), which can cover the debt maturities of the Group for more than 24 months. At the end of 2016, the company had cash and cash equivalents of EUR 2,067 million and available committed credit lines, uncommitted credit lines and undrawn loans amounted to EUR 8,544 million.

The Group is exposed to exchange rate risks, especially in Latin America, which are mitigated by a 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.

From 62.1% payout ratio in 2014, 66.6% in 2015, the payout ratio amounted to 74.3% in 2016. The company's trend toward a high payout ratio of 70% has a dampening effect on our assessment.

Overall, we see no significant short or medium-term financial risks for Gas Natural Fenosa that could endanger the company's sustainability. The Group disposes of diversified funding sources as well as comfortable debt maturities profile and liquidity. Furthermore, GNF has a strong capital structure, generates solid operating cash flow and disposes of diversified funding that should allow the company to finance its strategic plan, while maintaining strict financial discipline.

Financial ratios analysis

Appendix: key ratios

Asset Structure	2013	2014	2015	2016
Fixed asset intensity (%)	76.93	75.87	77.98	81.32
Asset turnover	--	0.52	0.57	0.52
Asset coverage ratio (%)	69.60	71.40	70.22	67.84
Liquid funds to total assets (%)	8.62	8.55	5.35	4.73
Capital Structure				
Equity ratio (%)	37.10	37.62	39.43	41.38
Short-term-debt ratio (%)	21.48	21.30	20.10	18.36
Long-term-debt ratio (%)	16.45	16.55	15.33	13.79
Capital lock-up period (in days)	56.43	56.53	43.44	51.54
Trade-accounts-payable ratio (%)	8.15	8.08	6.93	7.50
Short-term capital lock-up (%)	18.07	18.10	17.00	15.99
Gearing	1.46	1.43	1.40	1.30
Financial Stability				
Cash flow margin (%)	--	15.17	16.48	13.52
Cash flow ROI (%)	--	7.92	9.59	7.18
Debt / EBITDA adj.	6.14	6.15	5.40	5.43
Net Debt / EBITDA adj.	5.30	5.30	4.93	4.99
ROCE (%)	9.41	9.29	9.72	8.85
Debt repayment period	--	11.02	7.53	5.79
Profitability				
EBIT interest coverage	3.40	3.40	3.16	3.14
EBITDA interest coverage	5.13	5.13	4.85	4.98
Ratio of personnel costs to total costs (%)	3.36	3.35	3.74	4.37
Ratio of material costs to total costs (%)	0.00	0.00	0.00	0.00
Ratio of interest expenses to debt (%)	3.18	3.17	3.82	3.73
Return on investment (%)	6.25	5.19	6.11	5.84
Return on equity (%)	--	9.42	10.30	9.59
Net profit margin (%)	8.62	6.71	7.01	7.38
Interest burden (%)	74.89	74.91	72.48	69.29
Operating margin (%)	12.89	12.90	12.53	12.97
Liquidity				
Cash ratio (%)	35.45	35.45	26.60	25.78
Quick ratio (%)	87.20	94.60	100.33	92.30
Current ratio (%)	107.40	113.32	109.53	101.76

Regulatory requirements

The present rating is an unsolicited corporate rating. Creditreform Rating AG was not commissioned by the company with the preparation of the rating. The present analysis was prepared on a voluntary basis.

The rating is based on the analysis of published information and on internal evaluation factors. The quantitative analysis is primarily based on the annual report for 2016 and on press releases of the company. The information and documents meet the requirements and are in accordance with the published Creditreform Rating AG's rating methodology. An electronic version of our rating methodology can be found on our website www.creditreform-rating.de.

The rating was prepared by analysts Marie Watelet (m.watelet@creditreform-rating.de) and Rudger van Mook (r.vanmook@creditreform-rating.de).

A Rating Committee of highly qualified analysts of Creditreform Rating AG was called on May 17, 2017. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant risk factors, the Rating Committee arrived at a unanimous rating decision.

The rating result and a draft of the present rating report were communicated to Gas Natural SDG, S.A. (Group) on May 19, 2017. The final version of the rating report has been sent to the company on May 23, 2017. GNF participated in the credit rating process by providing some comments on the report on May 22, 2017. No further or confidential information about the company has been provided to Creditreform Rating AG.

The rating will be monitored as long as CRA removed the rating and set it to non-rated (n.r.).

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

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 approving credit ratings and rating outlooks.

In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

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 policy "Rating Committee," all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, CRAG has used following substantially material sources:

1. Annual Report

2. Website

3. Internet research.

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

Between the 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 case 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 and indicates how the different methodologies or these 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 as well as best-case scenario credit ratings are explained.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the “Basic data” card as a “Rating action”; first 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 „Basic data“ information card.

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

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

Please note:

This report exists in an English version only. This is the only binding version.

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