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RATING ACTION COMMENTARY

Fitch Revises Engie S.A.'s Outlook to Negative; Affirms at 'A'

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Fitch Ratings - Warsaw - 24 Sep 2020: Fitch Ratings has revised Engie S.A.'s rating Outlook to Negative from Stable and affirmed the utilities company's Long-Term Foreign-Currency Issuer Default Rating (IDR) and senior unsecured rating at 'A'. A full list of rating actions is below.

The Negative Outlook reflects the impact of COVID-19 and economic recession on Engie's cash flows and our revised assessment of its business profile positioning among peers. We view Engie as one of the most affected among large European utilities, although the pandemic impact is manageable for the sector.

Next to a EUR1.9 billion dividend cancellation in 2020 and expenditure cut, Engie announced a strategic refocus in July 2020. This is to accelerate growth in renewables and infrastructure assets, and increase disposals possibly including part of its client solutions business, which under-performed in 1H20. These would support Engie's credit profile, but carries significant execution risk, which is reflected in the Outlook revision.

KEY RATING DRIVERS

Material COVID-19 Impact: We expect about 13% decline in reported EBITDA for 2020 after Engie posted a 14% decline in reported EBITDA in 1H20 (on an organic basis), driven by the impact of COVID-19 and economic recession. This is one of the largest hits among large European utilities.

Underperformance of Client Solutions and Supply: The main two segments impacted by the pandemic and recession are client solutions (mainly the asset-light part of the segment) and supply. The remaining segments generating most of Engie's EBITDA, including networks, renewables, thermal and nuclear generation, reported solid EBITDA in 1H20. Engie saw some recovery in client solutions in 3Q20 after lockdowns were lifted in most of its markets, but we do not expect near-term EBITDA recovery to pre-pandemic levels.

Growth in Renewables and Infrastructure: In July 2020 Engie announced a strategic refocus with increased target for renewables capacity commissioned to 4GW from 3GW a year on average over the medium term, while increasing the number of renewables projects retained on its balance sheet. Engie will also accelerate its growth in decentralised infrastructure assets such as urban district heating and cooling networks and on-site power generation and we view both investment areas as rating-positive.

Upsized Asset Disposal Plan: Engie now also aims to more than double its divestment programme of EUR4 billion to fund future growth in renewables and infrastructure assets. Disposals may include part of the client solutions business, non-core businesses and minority stakes, such as a 32% stake in SUEZ S.A. for which Veolia Environnement S.A. (BBB/Stable) has recently made an offer (EUR2.9 billion for a 29.9% stake). Considering the execution risk, we do not assume additional divestments (or capex) in our rating case.

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Strong Business Profile: The ratings reflect Engie's large scale, diversification and low carbon footprint of power generation activities, which together with a large share of regulated, quasi-regulated and contracted EBITDA result in a business profile that we regard as one of the strongest of European utilities.

Revised Leverage Guideline: We have revised Engie's negative sensitivity for net leverage to 3.2x from 3.7x. This is due to a change in Fitch's approach towards leases (now fully considered as operating spending with no capitalisation, versus rent capitalisation through a multiple previously), which reduces net leverage by about 0.3x (but does not reduce rating headroom). In addition, we tightened the sensitivity by 0.2x to reposition Engie's debt capacity compared with its peers such as Enel S.p.A. (A-/Stable) and Iberdrola, S.A. (BBB+/Stable).

Deteriorated Net Leverage: We forecast Engie's funds from operations (FFO) net leverage to be above our revised negative sensitivity in 2020 (3.6x up from 3.1x in 2019) and in 2021 (3.3x) before recovering to 3.2x in 2022. This is reflected in the Negative Outlook.

Prudent Financial Policy: Engie continues to target net economic debt-to-EBITDA of up to 4x. This ratio includes interest-bearing debt and also pensions and nuclear provisions. The company expects this ratio to be above its target in 2020 but within the target in the long term. While Engie's financial policy remains conservative, in our view, the target ratio may no longer support the rating at 'A' given our revised assessment of the company's business profile positioning among peers and resulting tighter leverage sensitivity.

Increased Nuclear Provisions Funding: The rating case includes increased funding for nuclear provisions in 2020-2025, in line with the commitment by Engie's subsidiary Electrabel S.A. (A/Negative) towards Belgian nuclear authorities to fully fund the provisions for nuclear waste by 2025. Engie expects cash outflows of EUR4 billion in 2020-2022 and additional cash outflows in 2023-2025 to meet this target. Historically only 25% of nuclear provisions for Belgian power plants were funded with dedicated assets at the Engie group level. These payments will reduce cash flow generation and lower financial flexibility, although the latter will remain solid. The first two out of seven operational nuclear reactors are due to be decommissioned in 2022-2023.

DERIVATION SUMMARY

Engie's business mix (about 75% regulated, quasi-regulated or contracted) compares well with that of Enel (A-/Stable) and Iberdrola (BBB+/Stable), which are the closest peers in our view. Enel and Iberdrola benefit from a higher share of regulated networks in EBITDA and larger operations in renewables than Engie, which results in better cash flow predictability (and recent performance). Engie's strategic refocus and accelerated growth in renewables and infrastructure assets will likely narrow the gap and we view the debt capacity of the three peers as comparable (at their respective rating levels).

Engie's higher rating is supported by lower FFO net leverage than most peers' and also solid FFO interest coverage.

We rate Engie on a standalone basis because the French State owning 23.64% of the share capital and 34.3% of the voting rights does not have majority economic or voting control over Engie.

Electricite de France's (EDF) IDR of 'A-'/Negative incorporates a one-notch uplift for state support, while the company's Standalone Credit Profile (SCP) has been recently revised downward to 'bbb+' from 'a-'. The uplift mainly reflects the direct involvement of the French State in the potential reform of the nuclear generation market, while the lower SCP is due mainly to the company's results' volatility, especially in the generation segment, and structurally negative free cash flow (FCF). EDF's Negative

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Outlook mainly reflects weaker operating results due to COVID-19, and in particular, our expectation of much lower nuclear production for 2020-2022 and large negative FCF over the medium term.

Fitch aligns the ratings of Engie's two subsidiaries, Engie Invest International S.A. (A/Negative) and Engie Alliance GIE (senior unsecured rating of A), with the ratings of Engie based on the latter's guarantees of their debt. Electrabel S.A. (A/Negative) is rated at the same level as the parent, reflecting strong operational and strategic ties including Electrabel's about 40% contribution to group EBITDA (based on 2019 results), and despite the absence of guarantees and a less predictable business mix.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- EBITDA in networks in France based on new reduced allowed returns for 2020-2024, in line with the regulator's decision (4.1% for gas distribution, 4.25% for gas transport and 4.75% for gas storage) reflecting lower interest and tax rates.

- Gradual recovery of EBITDA in client solutions in 2021-2022 on assumption of no further lockdowns.

- Growth capex of about EUR10 billion in 2020-2022.

- Maintenance capex of about EUR8 billion in 2020-2022.

- Funding of nuclear provision of about EUR4 billion in 2020-2022.

- Disposals of about EUR4 billion in 2020-2022, excluding proceeds from DBSO (develop, build, sell and operate).

- Additional disposals and capex considered in the strategic refocus in July 2020 are not included, pending further details of the strategic plan expected in 1H21.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-We do not anticipate an upgrade as reflected in the Negative Outlook. However, developments that may lead to an upgrade include reduction of FFO net leverage to below 2.2x and FFO interest coverage above 7.5x on a sustained basis. Credit metrics sustainably stronger than outlined in the negative sensitivities below would support rating affirmation and Outlook revision to Stable.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-FFO net leverage above 3.2x on a sustained basis

-FFO interest coverage below 6x on a sustained basis

-Major debt-funded acquisition

-Substantial reduction in the share of regulated, quasi-regulated and contracted EBITDA

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-For Electrabel and other subsidiaries, materially weaker ties with Engie.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Sound Liquidity: Fitch-calculated readily available cash and cash equivalents amounted to EUR11 billion at end-2019. Unused committed liquidity facilities at the same date were an additional EUR11.8 billion excluding facilities expiring in 2020. Fitch believes that liquidity is sufficient to meet Engie's operating needs and debt maturities until at least 2022.

Liquidity remained strong at end-June 2020 following bond issues in March 2020 (EUR2.5 billion) and June 2020 (EUR750 million).

SUMMARY OF FINANCIAL ADJUSTMENTS

- 50% equity credit assigned to hybrid bonds

- lease liabilities excluded from debt and lease expenses treated as operating expenditure (reducing reported EBITDA and also FFO accordingly)

- debt adjustments for derivatives hedging borrowings

- capitalised borrowing costs moved from capex to interest paid

- out of cash outflows for nuclear provisions funding we deduct from FFO the recurring annual part related to actual electricity generation, the remaining part is shown in 'other investing and financing cash flow items'.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

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The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Engie Alliance GIE				
• senior unsecured	LT	A	Affirmed	A
Engie S.A.	LT IDR	A ⊖	Affirmed	A ○
	ST IDR	F1	Affirmed	F1
• senior unsecured	LT	A	Affirmed	A
• subordinated	LT	BBB+	Affirmed	BBB+
• senior unsecured	ST	F1	Affirmed	F1
Engie Invest International S.A.	LT IDR	A ⊖	Affirmed	A ○
Electrabel S.A.	LT IDR	A ⊖	Affirmed	A ○

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

- Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)
- Corporate Hybrids Treatment and Notching Criteria (pub. 11 Nov 2019)
- Country-Specific Treatment of Recovery Ratings Rating Criteria (pub. 27 Feb 2020)
- Short-Term Ratings Criteria (pub. 06 Mar 2020)
- Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)
- Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 26 Jun 2020)
- Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

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- Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

- Dodd-Frank Rating Information Disclosure Form
- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

Electrabel S.A.	EU Issued
Engie Alliance GIE	EU Issued
Engie Invest International S.A.	EU Issued
Engie S.A.	EU Issued

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