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RATING ACTION COMMENTARY

Fitch Downgrades Engie S.A. to 'A-'; Outlook Stable

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Fitch Ratings - Warsaw - 24 Mar 2021: Fitch Ratings has downgraded Engie S.A.'s Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'A-' from 'A' and subordinated debt rating to 'BBB' from 'BBB+'. Fitch has affirmed the Short-Term IDR at 'F1'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is below.

The downgrade reflects Engie's announcement that the operating life extension of its two second-generation nuclear reactors in Belgium to 2045 from 2025 is unlikely, given technical and regulatory constraints. Consequently, Fitch has made an additional adjustment to Engie's unfunded portion of Belgian nuclear dismantling provisions in its leverage ratio, due to the shorter time to decommissioning of the nuclear power plants than previously assumed.

As a result, our nuclear-adjusted funds from operations (FFO) net leverage ratio for Engie is commensurate with a 'A-' instead of a 'A' rating. The Stable Outlook reflects credit metrics' headroom at the new rating and our expectation that the strategy update due later this year will reposition Engie's business profile for the energy transition.

KEY RATING DRIVERS

Nuclear Lifetime Extension Unlikely: Engie announced in late February 2021 that following the announcements made by the Belgian government in autumn 2020 and subsequent talks, the company was stopping all preparation works that would allow a 20-year extension of two second-generation nuclear reactors (Doel 4 and Tihange 3 (each with 1GW of capacity)) beyond 2025. This was due to technical and regulatory constraints, and together with changes in the commodity price scenario, resulted in an impairment of EUR2.9 billion for nuclear assets.

Treatment of Nuclear Dismantling Provisions: Engie does not plan to fully fund the dismantling provisions with dedicated assets by 2025, by when all its nuclear reactors are now to be decommissioned. Currently only about 25% of Belgian nuclear provisions for dismantling are funded with dedicated assets at the Engie group level. As a result, we are adding the unfunded portion of these provisions (EUR4.9 billion) to Fitch-adjusted debt and also increasing the cash flow divider in the FFO net leverage ratio by the annual cash flow impact related to them.

Adjustment Improves Comparability with Peers: The adjustment is in line with our approach to EMEA utilities, under which companies with nuclear generation assets may be subject to a further leverage adjustment that serves as a basis for comparison with peers, to reflect that obligations under the nuclear provisions will reduce capacity to service debt, especially where near-term decommissioning is an issue.

We apply a comparable additional adjustment to the FFO net leverage of German utilities E.ON SE (BBB+/Stable) and RWE AG (BBB/Stable).

Treatment of Nuclear Waste Provisions: We continue to reflect the impact of provisions for nuclear waste in our cash flow projections by 2025, as the company gradually increases funding for these provisions, in line with the commitment by Engie's subsidiary Electrabel S.A. (A-/Stable) towards Belgian nuclear authorities to fully fund them by 2025. Engie expects cash outflows of about EUR2.7 billion in 2021-2022 on top of EUR1.3 billion cash outflow in 2020, and additional cash outflows in 2023-2025 to meet this target.

Nuclear-Adjusted Leverage: Nuclear-adjusted FFO net leverage was 3.8x at end-2020 reflecting the additional adjustment, compared with FFO net leverage of 3.1x. We project this ratio will remain around this level in 2021-2022, providing some rating headroom below the negative sensitivity of 4.2x.

Covid-19 Impact: Engie posted a 6.5% decline in reported EBITDA in 2020 (on an organic basis), on the back of the pandemic and economic recession. The Covid-19 impact in 2H20 was smaller than in 2Q20 as the company adapted its operations, reduced costs and restrictions in France were eased. The two main segments affected by the pandemic 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, demonstrated resilience in 2020.

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 including urban district heating and cooling networks and on-site power generation and we view both investment areas as credit positive.

More than 90% of investments in 2021 will be allocated to renewables, networks and asset-based client solutions.

Asset Disposal Plan On Track: In June 2020, Engie announced it was more than doubling its divestment programme of EUR4 billion to fund growth in renewables and infrastructure assets. Disposals include the sale of 29.9% in SUEZ S.A. to Veolia Environnement S.A. (BBB/Stable) for EUR3.4 billion in October 2020 and may include part of the client solutions business, non-core businesses and minority stakes. We will reflect additional divestments (and capex) in our rating case once details of the updated disposal plan are made available at the strategic update in May 2021.

Strong Business Profile: The ratings reflect Engie's large scale, diversification and low carbon footprint of power generation activities, together with a large share of regulated, quasi-regulated and contracted EBITDA.

Prudent Financial Policy: Engie continues to target net economic debt-to-EBITDA of up to 4x over the long-term and a strong investment grade rating. Net economic debt-to-EBITDA includes interest-bearing debt and also pensions and unfunded nuclear provisions. This ratio was 4x at-2019 and at-2020. In 2020 Engie cancelled a EUR1.9 billion dividend and also cut expenditure to mitigate the negative impact of the pandemic on cash flows.

Stable Outlook Reflects Expected Improvement: The Stable Outlook reflects expected improvement in financial performance in 2021, assuming a gradual easing of restrictions this year. Engie will provide a strategic update in May 2021 including additional capex for the two growth areas, renewables and infrastructure, an updated disposal plan, and medium-term guidance.

Short-Term IDR Affirmed: The Short-Term IDR has been affirmed at 'F1' given that Engie's strong financial flexibility, in particular liquidity position, supports the higher short-term rating of the two options available.

DERIVATION SUMMARY

Engie's business mix (about 75%-80% regulated, quasi-regulated or contracted) compares well with that of Enel S.p.A. (A-/Stable) and Iberdrola, S.A. (BBB+/Stable), which are the closest peers, in our view. However, 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 and Enel have the same rating as Electricite de France (EDF, A-/Negative), but higher debt capacity on a standalone basis. EDF's Standalone Credit Profile (SCP) is 'bbb+' as the rating includes a one-notch uplift reflecting tighter links with the government. EDF's threshold between the SCP of 'bbb+' and 'a-' is at 3.0x vs. 4.2x for Engie and Enel. This mainly reflects EDF's ageing nuclear fleet, exposure to large nuclear projects with higher execution and operational risks and structurally sizable, negative free cash flow, partially offset by the very strong market position domestically and a focus on stronger countries, compared with Enel.

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

Fitch aligns the ratings of Engie's two subsidiaries, Engie Invest International S.A. (A-/Stable) 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. 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 2020 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:

- Recovery of EBITDA in 2021 (reported EBITDA at EUR10.0 billion in 2021 up from EUR9.3 billion in 2020), close to the lower range of the 2021 company guidance of EUR9.9 billion-EUR10.3 billion on expectations of substantially lower pandemic impact than in 2020, assuming no additional stringent lockdowns and gradual easing of restrictions over 2021.

- EBITDA in networks in France based on new reduced allowed returns for 2020-2024, in line with the regulator's decision reflecting lower interest and tax rates. The impact of warm weather on lower network volumes in France in 2020 will be compensated in 2021-2022 due to the claw-back accounts mechanism.

- Growing EBITDA in renewables fuelled by large capex.

- Growth capex of about EUR10 billion and maintenance capex of about EUR8 billion in 2020-2022. Our assumptions for capex will be updated after the strategic update in May 2021.

- Funding of nuclear provision for waste of about EUR4 billion in 2020-2022 and about EUR1.3 billion in 2023.

- Disposals of about EUR4 billion in 2020-2022, excluding proceeds from DBSO (develop, build, sell and operate). Our assumptions for disposals will be updated after the strategic update in May 2021.

- 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. Only the disposal of a 29.9% stake in SUEZ for EUR3.4 billion completed in October 2020 is included in projections, with most of the proceeds to be spent on capex for renewables and infrastructure assets in 2021-2022.

- Dividends reinstated at 75% payout ratio in 2021 and then 10% annual growth in 2022-2023.

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RATING SENSITIVITIES

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

- Reduction of nuclear-adjusted FFO net leverage to below 3.2x on a sustained basis.

- Positive free cash flow amid sustained EBITDA growth.

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

- Nuclear-adjusted FFO net leverage above 4.2x on a sustained basis.

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

- Adverse regulatory or fiscal changes affecting the predictability of cash flows.

- 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 EUR13.6 billion at end-2020. Unused committed liquidity facilities at the same date were an additional EUR12.7 billion excluding facilities expiring in 2021. Fitch believes that liquidity is sufficient to meet Engie's operating needs and debt maturities at least in the next 24 months.

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 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 by nuclear plants, the remaining part is shown in 'other investing and financing cash flow items'.

- Nuclear-adjusted FFO net leverage is calculated in the following way: Fitch-calculated net debt is increased by nuclear provisions related to dismantling, net of associated, unencumbered assets. The

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cash flow divider is increased by the cash flow impact of nuclear provisions for dismantling included in FFO for that year.

As a result, the formula for nuclear-adjusted FFO net leverage is the following: (Fitch-calculated net debt excluding lease liabilities + nuclear provisions for dismantling net of associated, unencumbered assets) / (FFO + net cash interest paid + the cash flow impact of nuclear provisions for dismantling included in FFO).

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. 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-	Downgrade	A
Engie S.A.	LT IDR	A-	Downgrade	A
	ST IDR	F1	Affirmed	F1
• senior unsecured	LT	A-	Downgrade	A
• subordinated	LT	BBB	Downgrade	BBB+
• senior unsecured	ST	F1	Affirmed	F1
Engie Invest International S.A.	LT IDR	A-	Downgrade	A
Electrabel S.A.	LT IDR	A-	Downgrade	A

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

- Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)
- Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)
- Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)
- Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 21 Dec 2020)
- Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)
- Country-Specific Treatment of Recovery Ratings Criteria (pub. 05 Jan 2021)

APPLICABLE MODELS

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

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

ADDITIONAL DISCLOSURES

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

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ENDORSEMENT STATUS

Electrabel S.A.	EU Issued, UK Endorsed
Engie Alliance GIE	EU Issued, UK Endorsed
Engie Invest International S.A.	EU Issued, UK Endorsed
Engie S.A.	EU Issued, UK Endorsed

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