FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Engie S.A. at 'A-'; Outlook Stable

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Fitch Ratings - Warsaw - 01 Oct 2021: Fitch Ratings has affirmed Engie S.A.'s Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'A-', subordinated debt rating at 'BBB' and Short-Term IDR at 'F1'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is below.

The affirmation reflects Engie's robust business profile, with a large scale and diversification, and a significant share of regulated, quasi-regulated or contracted EBITDA supporting cash-flow predictability. The rating also incorporates the low carbon footprint of Engie's power generation, planned decommissioning of the group's nuclear fleet in Belgium by 2025 and related decommissioning costs.

The rating also considers Engie's strategic plan to refocus on core markets and activities, streamline the organisation and accelerate growth in more resilient renewables and infrastructure assets, while maintaining a conservative financial policy with economic net debt to EBITDA of up to 4.0x.

The Stable Outlook reflects our expectations that credit metrics will remain within our rating sensitivities in 2021-2023, although with modest rating headroom.

KEY RATING DRIVERS

Strategic Update Credit-Supportive: Engie's plan to accelerate growth in renewables and infrastructure assets and simplify the group's operations supports the 'A-' rating and Stable Outlook. The strategic update in May 2021 also confirmed its prudent financial policy regarding maximum leverage, funding of increased capex, dividends, and an upsized asset disposal plan.

Renewables Growth: Engie plans to accelerate its growth in renewables and reach 50GW by 2025 and 80GW by 2030, from 31GW currently (at 100% ownership, 22GW consolidated). It will also boost its average annual growth in renewable capacity (currently 3GW) to 4GW in 2022-2025 and 6GW in 2026-2030, through investments in onshore and offshore wind and solar, with largely contracted and predictable earnings.

Investments in Infrastructure Assets: Engie also aims to add 8GW of capacity to reach 32GW of low-carbon distributed-energy infrastructure assets with predictable cash flows by 2025, covering district heating and cooling networks, distributed generation and low-carbon mobility, and related services.

Predictable Cash Flow Component: We expect the two remaining key business units - regulated networks and thermal generation, the latter with largely contracted earnings and focused on gas - to continue to provide predictable cash flows.

Increased Regulatory Risk in Gas Supply: We see an increased regulatory risk in Engie's gas supply business in the current environment of record high gas prices. The French government has recently announced plans to introduce a tariff shield for gas and electricity, which would effectively freeze gas prices for those households that are subject to regulated tariffs until spring 2022. Engie would be able to recover losses on this customer group thereafter, assuming market gas prices decrease, which would be in line with Fitch's gas price deck

We will update our projections when more details on the tariff shield and its impact on Engie are available. We do not expect this factor to drive a rating change, but lower profitability in gas supply may reduce Engie's rating headroom in the next 12-18 months depending on the development of gas prices.

Simplification of Operations: Engie will simplify its operations by focusing on core activities and reducing its geographic footprint to fewer than 30 countries by 2023 compared with 70 in 2018. The group has streamlined its organisation to four global business units from 25 business units. Engie targets a net EBIT contribution of EUR0.6 billion in 2021-2023, by enhancing efficiencies across businesses and support functions.

Solid Business Mix: We expect Engie's capex plan, assets disposals and the decreasing electricity production from nuclear power plants to moderately increase the share of regulated, quasi-regulated or contracted EBITDA to slightly above 80% in 2023 from around 75% in 2021, supporting Engie's business profile.

Engie has allocated EUR15 billion-EUR16 billion of cumulative growth capex for 2021-2023, with renewables accounting for 40%-45%, networks 30%-35% and energy solutions 15%-20%.

Assets Disposal Plan: The group plans EUR9 billion-EUR10 billion of disposals in 2021-2023 through strategic reviews of non-core activities, country exits, a net-zero carbon commitment and reducing its exposure to French gas networks.

Engie has also separated the asset-light part of the client solutions business, which underperformed in 2020 and is no longer viewed as strategic. These operations, entirely merchant, relate to multi-technical services and are managed independently from Engie from July 2021 under the newly-created EQUANS and should be disposed of by 2022.

Conservative Financial Policy: Engie expects to fund its capex plan and dividends with operating cash flow and asset disposals to ensure its economic net debt remains stable. It continues to target economic net debt-to-EBITDA of up to 4x over the long term and a strong investment-grade rating.

Nuclear-Adjusted Leverage: Following the announcement in March 2021 that Engie was unlikely to extend the operating life of its two second-generation nuclear reactors in Belgium to 2045 from 2025, Fitch had adjusted its leverage ratio to consider the unfunded portion of Belgian nuclear dismantling provisions. This was due to the shorter time to decommissioning of the nuclear power plants than previously assumed and contributed to the downgrade of the Long-Term IDR to 'A-' from 'A'.

Nuclear-adjusted funds from operations (FFO) net leverage was 3.8x at end-2020, compared with 3.1x before adjustment. We project this ratio will remain on average around this level in 2021-2023, providing some rating headroom below the negative sensitivity of 4.2x.

Strong Performance in 1H21: Engie posted solid results in 1H21, with reported EBITDA showing an organic growth of 23%. This was mainly driven by a recovery in client solutions and supply - which were heavily affected by the pandemic in 1H20 - and stronger results in networks and in the nuclear segment. Engie upgraded its EBITDA guidance for 2021 by EUR0.3 billion to EUR10.2 billion-EUR10.6 billion on the back of strong 1H21 results. Reported net debt/EBITDA remained stable at 2.4x as of end-1H21 from end-2020, while economic net debt to EBITDA improved to 3.7x from 4x.

DERIVATION SUMMARY

Engie's business mix (about 75%-80% regulated, quasi-regulated or contracted EBITDA) 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. Enel and Iberdrola benefit from a higher share of regulated networks in EBITDA and larger operations in renewables. This results in their better cash-flow predictability, with better performance than Engie in 2020. Engie's growth in renewables and infrastructure assets will make its business mix closer to those of Enel and Iberdrola, which are leading the energy transition. The three peers have similar debt capacity at their respective ratings.

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 to reflect tighter links with the government. EDF's leverage threshold between an SCP of 'bbb+' and 'a-' is 3.0x vs. 4.2x for Engie and Enel. This mainly reflects EDF's weaker business profile, due to a lower share of regulated and contracted EBITDA and higher operational risk entailed in the company's investment plan and also large negative free cash flows (FCF) expected across the business plan.

We rate Engie on a standalone basis because the French state, with 23.64% of the share capital and 33.44% 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 parent'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 (projected reported EBITDA at EUR10.3 billion in 2021, up from EUR9.3 billion in 2020), close to the lower range of the 2021 company guidance of EUR10.2 billion-EUR10.6 billion, on expectations of substantially lower pandemic impact than in 2020.

- 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 and client solutions (excluding EQUANS) in 2021-2023, fuelled by large capex.

- Lower EBITDA in the thermal segment from 2021, mainly due to asset disposals.

- Strong improvement in EBITDA in the nuclear segment in 2021, due to better prices and plant availability; EBITDA in 2022-2023 negatively affected by gradual decommissioning of the nuclear fleet in Belgium by 2025.

- Growth capex of EUR15 billion-EUR16 billion for 2021-2023, with renewables accounting for 40%-45%, networks 30%-35% and energy solutions 15%-20%.

- Maintenance capex of EUR7 billion-EUR8 billion for 2021-2023, half of which will be allocated to regulated networks.

- Dividends in 2021-2023 in line with Engie's dividend policy (65%-75% pay-out ratio of net recurring result group share, with a floor of EUR0.65 per share).

- Funding of nuclear provisions of about EUR4 billion in 2021-2023.

- Asset disposals of EUR9 billion-EUR10 billion in 2021-2023

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.

- FCF on 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 EUR12.8 billion as of 30 June 2021. Unused committed liquidity facilities at the same date were an additional EUR13.1 billion. Fitch believes that liquidity is sufficient to meet Engie's operating needs and debt maturities at least until end-2022.

Engie has solid access to the debt-capital market as a frequent bond issuer and a large issuer of green bonds.

ISSUER PROFILE

Engie is a large international utility based in France. Its largest business segments by EBITDA are networks, renewables, thermal generation (focused on natural gas) and client solutions. In 2020 reported EBITDA was EUR9.3 billion.

SUMMARY OF FINANCIAL ADJUSTMENTS

- 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 cash flow component in the ratio 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 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).

- 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'.

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-	Affirmed	A-
Engie S.A.	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
	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- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
Electrabel S.A.	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria - Effective from 26 August 2020 to 1 December 2021 (pub. 26 Aug 2020)

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporate Rating Criteria -- Effective from 21 December 2020 to 15 October 2021 (pub. 21 Dec 2020) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 05 Jan 2021)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria - Effective from 30 April 2021 to 15 October 2021 (pub. 30 Apr 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

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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