Creditreform corporate rating, unsolicited

ENGIE S.A. (Group)

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Rating object		Rating information			
Engie S.A. (Group)		Rating: **A-**		Outlook: **stable**	
Creditreform ID:	2000000610	Prepared on:	**December 30, 2016**		
Incorporation:	2004	Monitoring until:	withdrawal of the rating		
(Main) Industry:	electricity, gas and energy services	Publication:	January 6, 2017		
Management:	Isabelle Kocher, CEO	Rating type:	**unsolicited**		
		Rating systematic:	corporate rating		
		Rating history:	www.creditreform-rating.de		

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Abstract

Company

Engie S.A. (Group) was created in 1946 with EPIC status and was transformed in an S.A. in 2004 for a period of 99 years. The Group is a result of the merger in 2008 of SUEZ and Gaz de France (GDF Suez). The new name of the Group, Engie, was adopted on July 2015. The Group buys, produces and sells natural gas and electricity; transports, stores, distributes, develops and operates large gas infrastructures; and provides energy services. Engie operates in 70 countries, is the first importer of liquefied gas in Europe and the first independent power producer in the world. Engie employed 154,950 people in 2015 and is listed on the Euronext Paris and Euronext Brussels (ENGI – FR0010208488).

Engie's revenues amounted to EUR 69.9 billion in 2015, which represents a decline in revenues of -6.4% in absolute terms in comparison with 2014 (EUR 74.7 billion) due to an unfavourable market environment. With an EBITDA amounting to EUR 11.3 billion (2014: EUR 12.1 billion) and an EBIT of EUR 6.3 billion (2014: EUR 7.1 billion), the company recorded a net loss of EUR -5.1 billion (2014: net profit EUR 3.1 billion), mainly due to asset impairments of EUR 8.7 billion. The company shows sufficient liquidity with a positive operating cash flow. As of December 31, 2015, total financial debt amounted to EUR 52.0 billion (previous year: EUR 47.2 billion), mostly composed of bond issues (EUR 23.9 billion) within the framework of its EMTN Program of EUR 25.0 billion. The adjusted ratio Net Debt / EBITDA has increased to 8.6 as of December 31, 2015.

Rating Result

The current rating attests a good credit quality to Engie, which represents a low default risk in comparison with the sector and the overall economy. The Group is currently facing an unfavorable market price environment, putting pressure on cash flow generation. The strategy followed by Engie could offset this negative development by an asset portfolio rotation in line with the current environmental trends (low CO2, more renewables) as well as a reduction of the Group's exposure to commodities prices. Capex in the digitalization will allow the Group to reduce its costs and offer efficient services to its clients. The shareholdership of the French Government (32.8% of the shares) has a positive impact on the rating note.

Outlook

The yearlong outlook of the rating is stable. This appraisal is based on our expectations that the company will successfully achieve its strategic financial plan and that the currently low power-prices will not further deteriorate.

Relevant rating factors

Excerpts from the financial ratios analysis 2015

+ Better financing costs
+ Shorter capital lock-up
+ Increasing operating margin

- Decreasing equity level
- Higher short term capital lock-up
- High ratio net debt / EBITDA
- Negative profitability because of impairments

Financial ratios' extract Basis: consolidated annual statement per 31.12 (IFRS)	Standardized balance sheet	
	2014	2015
Total assets	EUR 135,218 million	EUR 129,497 million
Turnover	EUR 74,686 million	EUR 69,883 million
EBITDA	EUR 11,511 million	EUR 10,861 million
EBIT	EUR 6,714 million	EUR 5,854 million
EAT	EUR 3,106 million	EUR -5,112 million
Equity ratio	25.84%	19.86%
Capital lock-up period	91.87 days	89.32 days
Short-term capital lock-up	41.26%	49.22%
Net Debt / EBITDA adj.	7.84	8.60
Return on investment	3.68%	-2.75%
Ratio of interest expenses to debt	2.67%	2.33%

General rating factors

+ Second electricity leader and first power producer with renewable energies in France
+ First importer of liquefied natural gas in Europe
+ Geographic diversification and scale
+ Mainly regulated and contracted activities
+ System relevance and shareholdership of the French Government

- Capital-intensive business with high investments required
- Exposure to commodity prices
- Weather-dependent

Current factors (rating 2016)

+ Good liquidity and cash flow generation
+ Sufficient financing possibilities and access to the capital market

- Significant assets impairments
- Currently unfavorable commodity-price environment in Europe
- Decreasing revenues and planned EBITDA 2016 lower than in 2015
- High payout ratio

Prospective rating factors

+ Transparent financial strategy (three-year transformation plan)
+ Asset portfolio rotation to shift towards more contracted and regulated activities
+ Less exposure to commodity prices
+ Opex reduction program

- Further negative evolution of the commodity prices in Europe
- Significant capex with an expected negative trend in financial ratios
- Portfolio rotation linked to operational risks

Best case scenario:	A
Worst case scenario:	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 A. It is assumed that the Group successfully achieves its transformation plan (portfolio rotation, capex program and cost-reduction), which have a favorable impact on the company's operating activities and capital structure.

Worst-case scenario

In our worst case scenario for one year, we assume a rating of BBB+. It is assumed that the portfolio rotation towards more regulated and contracted activities does not compensate the pressure on cash flows resulting from the lower commodity and power-price environment. The planned capex program of EUR 22.0 billion has a negative impact on the Group's financials and on the credit quality of the company.

Business development and outlook

During the business year 2015, the Group registered an absolute and organic decline in revenues of respectively -6.4% and -8,8% in comparison with 2014 as well as an EBITDA decline of -7.2% (organically -9.1%) down to EUR 11.3 billion. This is due to the lower commodity price environment, the contraction of LNG activities as well as the unavailability of the Doel 3 and Tihange 2 nuclear power plants and the shutdown of the Doel 1 reactor in Belgium. This was partially offset by the appreciation of the USD against the EUR (positive impact on revenues of EUR 1.9 billion) and a more favorable climate for gas sales in France in comparison with 2014. The company had to impair assets in the amount of EUR 8.7 billion. The impairments mainly concerned E&P activities and LNG commercialization (EUR 4.3 billion), which have been strongly impacted by the major and prolonged drop in natural gas and oil prices. Impairments also relate to power production activities in merchant markets (EUR 3.2 billion) and other assets, mainly intangibles in France (EUR 1.2 billion), where the market was impacted in 2015 by the termination of regulated tariffs for professional clients and the subsequently intensified competitive pressure.

Geographically, the Group realized 35.8% of its revenues in France, where the Group is the second largest electric company, 12.9% in Belgium, 26.5% in UE, 3% in other European countries, 6.6% in North America, 8.8% in Asia, Middle East and Oceania, 5.8% South America and 0.4% Africa. The electricity business accounted for 71% of sales in 2015, gas for 6% and services 23%. The installed power production capacity of Engie amounts to 117.1 GW, among which 56.2% is natural gas, 18.3% renewables, 12.8% coal, 5.3% nuclear and other sources. Furthermore, Engie operates 228 urban networks for heating and cooling in 13 countries. The company invested EUR 7.2 billion in 2015. Dividends amounting to EUR 2.4 billion have been paid to Engie shareholders as well as EUR 0.5 billion to non-controlling interests.

During the first nine months of 2016, revenues of the Engie Group decreased by -11.1% (organic -10.3%) in comparison to Q3-2015 due to the unfavorable environment in Europe and to mild weather conditions. Furthermore, the termination of regulated tariffs for large and mid-size companies in France from January 1, 2016 (green and yellow tariffs) exposes Engie to market prices and to increased competition. Nevertheless, net debt decreased by EUR 2.0 billion in comparison with the end of 2015 thanks to positive cash flow generation. As of September 30, 2016 the average maturity of the Group's net debt was 9.1 years. Investments amounted to EUR 4.7 billion (2015: EUR 4.6 billion). The transformation plan is on track to reach its objective for 2018. Nevertheless, the Group should achieve a net recurring income in 2016 at the lower end of the estimated range of EUR 2.4 and 2.7 billion.

The Group's strategy is a portfolio rotation of EUR 15.0 billion in 2016-2018 in order to reduce the exposure of the Group to activities exposed to commodity price risk by selling assets or closing down sites. These activities accounted for 30.0% of Engie's EBITDA. In addition, Engie put in place an investment program of EUR 22.0 billion in 2016-2018 of which EUR 7.0 billion are for investments in maintenance and at least EUR 500 million for innovation, financed principally by operating cash flow generation. Moreover, a development program comprising new activities and digitalization amounting to 1.5 billion EUR should generate an organic growth from 2018 onwards. In addition, a performance program ("Lean 2018") has been implemented to achieve recurring savings on operating costs, which should have a cumulated impact of EUR 1.0 billion on EBITDA up to 2018. Concretely, the net recurring income should be in the area of EUR 2.4-2.7 billion and the net debt/ EBITDA ratio should be lower than 2.5x (Engie calculations). These expectations are based on EBITDA previsions of EUR 10.8-11.4 billion, which are lower than in 2015.

The year 2016 will be negatively impacted by the additional provisions amounting to EUR 1.8 billion to be booked in group accounts for the decommissioning of nuclear installations and the long term nuclear waste storage, due to the decrease of their discount rate. This will have a negative impact on the non-recurring EAT and therefore on its balance sheet structure. From 2017 onwards, the higher nuclear provisions will have an impact of approx. EUR 110.0 million on the recurring EAT per year until shutdown of the plants (2022-2025). Engie, however, assumes that nuclear power plants will still be needed to guarantee the energy equilibrium in Belgium after 2025.

Structural risks

The company prepares financial statements in accordance with IAS and IFRS. The Group comprises approx. 70 significant subsidiaries worldwide.

Until December 31, 2015, the company was structured in 5 operational units (Branche Energy Europe, Branche Energy International, Branche global gas and LNG, Branche Infrastructure, Branche Energy Services). Since January 1, 2016, the Group functions with 24 business units and 5 business lines. A risk management system is in place.

The largest shareholder of the company, with 32.8% of shares, is the French Government. Other shareholders are employees (2.7%), GBL (2.3%), Groupe CDC (1.9%), CNP Assurances (1.8%), Sofina (0.4%), treasury shares (0.1%) as well as the public (56.6%).

There are, in our opinion, no core risks associated either with the organizational or with the shareholder structure of the company. The new internal structure nevertheless needs to demonstrate its effectiveness. The asset portfolio rotation strategy of Engie entails integration risks and the risk of non-realization of expected gains and synergies.

Business risks

Overall, Engie' business is weather-dependent and faces risks related to climatic changes. Furthermore, variations in supply or demand of electricity affect commodity prices (gas, oil, coal, electricity, etc.), which has an impact on the Group's margin.

In OCDE countries, power demand has slowed down structurally due to more efficient energy utilization, supportive regulations and an eco-friendly attitude on the part of consumers, whereas in other countries, demand has grown steadily. In Europe, Engie currently faces an overproduction capacity in thermal power stations due to the low increase in demand, the rise of renewables and the competitive coal business. In 2015, the Group either closed or cocooned several thermal power stations.

The decentralization of power production following the energy transition has broken down the entry barriers for a lot of competitors (photovoltaic, services). Any changes in the support structures to renewables could hamper the profitability of the Group.

Engie is subject to several laws and regulations regarding environmental issues, promotion of zero or low greenhouse gas emission production systems, energy consumption reduction, health protection and security standards. Changes in these could affect the strategy and the results of Engie.

In France, gas transportation and distribution networks are regulated. Engie, via its subsidiary GRTgaz (majority of voting rights), has a dominant position on the gas transportation market in France. GRDF (fully-owned company) operates gas distribution networks in France under long-term concessions arrangements, most of which are mandatorily renewed upon expiration. Tariffs are determined by the *Commision de Régulation de l'Énergie* (CRE).

In other countries, price control mechanisms for energy production, distribution, and sales are in place. Any changes in the regulatory environment in all countries where Engie operates would have implications for the Group. New regulatory or fiscal initiatives could have an impact on the Group's results. The Group faces also country risks.

Operational risks in the purchase/sale of natural gas are partially mitigated by long-term take-or-pay contracts. Industrial risks, commodity price risks, counterparty risks, currency risks, interest rate risks, and liquidity risks are also present.

Permits and authorizations are needed to carry out Engie's operations, e.g. Engie has been granted hydropower concessions agreements, among which one will expire in 2023. The non-renewal of such concessions contracts would negatively affect the company.

To mitigate market risks, Engie has put in place a technological monitoring mechanism, as the industry is a rapidly evolving one with regard to technologies as well as consumer needs and demand, in a competitive and increasingly digitalized sector. The rise of digital technology and smart energy impacts the cost structure of the Group.

Overall, we assess the company as having a low to moderate business-risk profile as the company operates system-relevant assets. Part of the business is regulated. Engie's activities are well-diversified, both with regard to its business operations and geographically. Nevertheless, its business requires intensive capex to adapt to the energy transition, which entails high operating risks. We also see operational risks in the planned asset portfolio rotation.

Financial risks

For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. The following descriptions and indicators are based solely on those adjustments.

As of December 31, 2015, gross debt amounted to EUR 103.8 billion and total financial debt amounted to EUR 52.3 billion (previous year: EUR 47.5 billion), among which bond issues for EUR 23.9 billion (including green bonds amounting to EUR 2.5 billion). Liquidity is cash-pooled, cash and cash equivalents of the Group amounted to EUR 9.2 billion at December 31, 2015.

As of December 31, 2015, 67.0% of net debt was denominated in euros, 17.0% in US dollars and 7.0% in pounds sterling. The average maturity of the Group's net debt is 9.5 years. The ratio net debt / EBITDA has increased to 8.6 as of December 31, 2015 (Creditreform Rating's calculation). Following Engie's calculations, the Group ratio net financial debt to EBITDA decreased as of September 30, 2016 to 2.38x compared to 2.46x on December 31, 2015.

Furthermore, the Group possesses EUR 14.0 billion undrawn confirmed credit lines (notably covering outstanding US commercial papers and French *billets de trésorerie* amounting to EUR 5.4 billion) as of December 31, 2015.

The overall capital structure of the company has deteriorated as the company shows an adjusted equity ratio of 19.9% against a 25.8% in 2014 (when redrawing 100% of goodwill from original equity). This is essentially due to the loss recorded in 2015 as well as to the payment of cash dividends amounting to EUR 2.9 billion. The company shows high equipment intensity and an assets cover ratio at 71.8%.

Engie is exposed to commodity prices risks, FX-risks and interest rate risks. Therefore, the Group uses derivative financial instruments to manage and reduce its exposure to market risks.

Despite its favorable business model and because of its high leverage as well as its low EBITDA interest coverage, we assess the financial risk of Engie as moderate. The company's investment program is nevertheless significant and the credit risk position of the company could deteriorate in the long term. These future investments will put pressure on the cash flow, and a further increase of the net debt / EBITDA ratio could have a negative impact on the rating outlook and / or on the rating on a long-term perspective.

Financial ratio analysis

Appendix : key ratios

Asset Structure	2013	2014	2015
Fixed asset intensity (%)	64,72	64,93	62,47
Asset turnover	--	0,56	0,53
Asset coverage ratio (%)	82,18	76,66	71,83
Liquid funds to total assets (%)	7,40	7,39	8,00
Capital Structure			
Equity ratio (%)	29,26	25,84	19,86
Short-term-debt ratio (%)	43,17	45,79	49,84
Long-term-debt ratio (%)	23,93	23,94	25,01
Capital lock-up period (in days)	68,09	91,87	89,32
Trade-accounts-payable ratio (%)	12,50	13,90	13,21
Short-term capital lock-up (%)	32,45	41,26	49,22
Gearing	2,17	2,58	3,63
Financial Stability			
Debt / EBITDA adj.	6,58	8,71	9,56
Net Debt / EBITDA adj.	5,89	7,84	8,60
ROCE (%)	0,10	0,09	0,09
Debt repayment period (years)	--	8,99	-33,04
Profitability			
Gross profit margin (%)	42,67	40,87	43,75
EBIT interest coverage	3,15	2,51	2,43
EBITDA interest coverage	5,78	4,31	4,50
Ratio of personnel costs to total costs (%)	13,21	13,09	14,55
Ratio of material costs to total costs (%)	57,33	59,13	56,25
Cost income ratio (%)	91,46	91,22	91,81
Ratio of interest expenses to debt (%)	2,63	2,67	2,33
Return on investment (%)	-5,21	3,68	-2,75
Return on equity (%)	--	8,47	-16,85
Net profit margin (%)	-9,99	4,16	-7,32
Operating margin (%)	8,74	8,99	8,38
Liquidity			
Cash ratio (%)	15,37	13,80	14,23
Quick ratio (%)	55,95	50,96	53,16
Current ratio (%)	81,73	76,58	75,29

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 2015, intermediate reports, 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 (lead analyst) and Rudger van Mook (co-analyst).

A Rating Committee of highly qualified analysts of Creditreform Rating AG was called on December 30, 2016. 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 Engie on the same day. The final version of the rating report has been sent to Engie on January 5, 2017.

The rating will be monitored as long as CRA removes the rating and sets 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.

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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.

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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.

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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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