Research Update:

French Utility Engie Affirmed At 'BBB+/A-2' On Solid Financial Ratios, Supportive Financial Policy; Outlook Stable

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Rating Action Overview

- Engie S.A. is transitioning its business via a major increase in capital expenditure (capex) on renewables, networks, and energy solutions, while delivering its sizeable asset disposal plan ahead of schedule.
- The group has entered the current energy crisis with restored rating headroom and is reasonably well positioned to manage its Russian gas exposure thanks to a diversified and integrated power and gas assets portfolio.
- We revised our liquidity assessment to strong from exceptional to reflect the increased buffers needed amid current market volatility, exposing the group to a potential sizeable margin call and working capital requirements. But we expect 2022 EBITDA to see strong upside from trading profits and structurally higher power prices, which should ensure 2022-2024 adjusted funds from operations (FFO) to net debt remains comfortably above the 18% minimum rating threshold.
- We therefore affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings on Engie.
- The stable outlook indicates that we expect Engie will manage the effects of extremely volatile prices thanks to a strong liquidity position, while higher commodity prices and the sizeable share of stable regulated cashflows should support profitability.

Rating Action Rationale

Engie entered the 2022 energy crisis with restored rating headroom. Operating performance sharply rebounded last year versus 2020, which was heavily affected by the COVID-19 pandemic. This was notably supported by more favorable power prices and the continued delivery of strategic and financial plans. EBITDA, excluding the contribution from Equans, was €10.6 billion in 2021, up 19% year over year with contributions from all divisions, including particularly strong nuclear performance--EBITDA plus €1 billion year over year, boosted by a higher availability rate of 92%

and higher power prices. Net adjusted debt was almost stable at €43 billion, despite the €1.4 billion increase in working capital, mostly related to €2.2 billion of margin call requirements. As a result, Engie's FFO to net debt reached 20.4% in 2021, up from 17.5% in 2020, and adjusted debt to EBITDA improved to 4.2x versus 4.8x a year ago.

Engie's transition is on track with the successful execution of its disposal program. This improvement in credit metrics was accompanied by strong execution of its sizeable disposal plan, with an at least €8 billion positive impact on net debt expected this year. This includes the sale of Equans expected to close in second-half 2022 for a net debt reduction of €6.6 billion. In addition, the group should receive about €1.4 billion from asset disposals in 2022, notably by selling its remaining stake in Suez and reducing its stake in GTT to 21% from 30%. The group is pursuing its transformation with a strategic refocus on infrastructure, allocating growth capex of €16 billion-€18 billion on renewables (€7.3 billion, the bulk of the investment program), networks, and asset-backed energy solutions over 2022-2024. Engie targets 50 gigawatts (GW) of renewables capacity in 2025 (full consolidation) and 80 GW in 2030, from 34.2 GW currently, and has a global pipeline of 34 GW over 2023-2025. As a result, we expect the renewables business will account for 23% of total EBITDA in 2024 from 16% in 2021.

Engie's exposure to Russian long-term contracted gas is relatively high but set to structurally decline over the decade. The group has no direct operational exposure to Russia, with no industrial activity (only 45 employees) or investments in the country. However, it has relatively large exposure to long-term contracts with Gazprom. In 2021, these take-or-pay contracts represented 20% of the group's overall gas sales and consumption, totaling about 120 terawatt hours (TWh)-130 TWh, equivalent to about 12 billion cubic meters (bcm) of gas. The maturity profile of these contracts indicates a progressive and constant reduction over the decade. We understand that Engie has already taken some actions to reduce its Russian gas exposure, by notably securing extra Norwegian medium-term capacity and contracting longer-term liquefied natural gas (LNG) deliveries from different sources. In addition, the group has some flexibility to attract more LNG capacity in the medium term. Although Engie is more exposed to gas procured from Russia than most of its European utility peers, due its significant gas retail business, its exposure is lower than gas players such as Uniper (about 50% exposure or 20 bcm) and we believe the group has flexibility to diversify thanks to its LNG import capacities.

Trading risks are partly mitigated by the group's prudent hedging and very high liquidity. The Russia-Ukraine conflict and energy crisis increase Engie's market, counterparty, and cash risks. In our view, these risks are manageable, absent a gas curtailment scenario for which the outcome is largely unpredictable. This is because the group has sophisticated commodity risk management, inherited from its longstanding energy management operations, and strong banking relationships.

- Market risk: We understand Engie's exposure to price increases is limited to short-term deliveries that are fixed one month-ahead and hedged. Engie buys its gas at variable prices then sells it to its residential and industrial customers, largely at variable prices. The company manages this maximal exposure with a flexible approach depending on market conditions and the environment. Its agile approach should reduce the negative effect of buying these extra volumes on a higher gas spot market.
- Cash risk: The group has been proactive in protecting its liquidity position ahead of the current energy crisis to limit the volatility of its cash balance linked to margining in hedging contracts. Three years ago, Engie implemented a liquidity swap program and negotiated a margin calls' substitution with stand-by letters of credit (SBLC) through its core banks. These two levers

allowed Engie to pass on part of the cash risk to the core banking partners at Dec. 31, 2021. For instance, the €1.1 billion SBLC reduced the group's need for initial margins, which have increased drastically for the sector to reflect the intraday volatility of commodity prices, limiting the initial margin impact to €4.4 billion at Dec. 31, 2021.

- Counterparty risk: This cannot be entirely mitigated and remains high in the context of increased liquidity pressure for all gas traders due to a spike in margin calls and collateral posting. However, Engie's very high liquidity over the next 12 months acts as a robust mitigant, demonstrating the group's risk management standards. For instance, the group secured an additional €1.5 billion swingline over the past month and has maintained a very high liquidity buffer (cash and available credit lines of about €25 billion) to address the current crisis.

In the unlikely but possible scenario of a complete halt to Russian gas flows, we believe that European governments will step in to prevent systemic risk. In a gas curtailment scenario, which we still view as possible but unlikely and not part of our base case, we anticipate a wide effect on the utilities sector as a whole and on Engie as the largest French gas retailer. This includes a possible spike in margin calls, heightened trading risks, and the use of force-majeure clauses; state measures to tax windfall profits to contain unsustainable energy bills; and most likely adverse macroeconomic impacts. We have received some guidance regarding French state intervention in case of an energy shortage. An April decree named Délestage details a legally binding protocol to manage potential gas scarcity, with industrial customers interrupted in a predefined manner. Therefore, we understand that state intervention will supersede Engie's contractual engagements for all physical gas deliveries. Even though this could significantly hit Engie, especially its trading activity, we expect downside to remain manageable, although it is difficult to predict.

Medium-term uncertainties on the role of gas in France continue, although the current energy crisis could accelerate the transition to green gases. French energy policy does not include a central role for gas, but the current focus on security of supply and nuclear woes emphasize the key role of gas infrastructure for the energy transition and the need to transition to renewable gases to meet decarbonization targets. This could support the long term repositioning of Engie's French gas networks, and notably its distribution grids to support the integration of biomethane. We believe there is increasing momentum to produce biomethane and connect it to the grid, as evidenced by the validation of domestic investments by French regulator the Energy Regulatory Commission based on 100 TWh of available potential. With the REpowerEU plan, the European Commission is also doubling targets for biomethane production to 35 bcm by 2030 as a key proposal to reduce reliance on Russian gas sooner.

The group's Belgian nuclear operations remain a balance sheet constraint to accelerating its strategic transition. despite the planned phase-out by 2025. Engie is preparing to progressively phase-out its nuclear operations according to the legal schedule, starting in October 2022 with the Doel 3 reactor closure, followed by the Tihange 2 closure (both 0.9 GW capacity) in February 2023. Further closures will then happen throughout 2025. The group will contribute €6.5 billion of funding over 2022-2024 ahead of the nuclear plant closures, including the impact of the upcoming law amendment to increase dismantling provisions funding. As such, we expect the scheduled phase-out and decommissioning to reduce the EBITDA contribution and squeeze cash flows from 2023. We expect nuclear provisions to be revised upward at year-end 2022 by the regulatory triennial revision, affecting the decommissioning and dismantling and fuel and waste management provisions. The decision is expected in mid-December 2022 and we factor into our 2022 adjusted net debt an increase of provisions, which could be higher than €1.5 billion

depending on final decisions on costing and discount rate assumptions. Prompted by the current geopolitical context and increased tensions related to power supply in the country, the Belgian government has publicly indicated that a life extension until 2035 is required for the two newest reactors. This will mean a revision to the maintenance work at the two plants, prompting lower availability and lower production levels as early as 2023. In addition, the life extension would prompt a revision to the nuclear provisions. This could be credit positive and earnings accretive for the group in the medium term provided operational and financial risks are shared with the state. At this stage, we do not factor into our base case the EBITDA loss or a change in nuclear provisions profile, since there remain a lot of uncertainties regarding the conditions of this extension and the risk-sharing mechanism between the state and Engie.

Credit metrics should remain strong until 2024, with EBITDA growth fueled by high commodity prices, even if we lack visibility on likely adverse regulatory measures. EBITDA growth over 2022-2024, guided at 1.5%-3.5% per year, should be fueled primarily by the group's performance and efficiency plan (about €500 million of savings remaining), high commodity prices, and investment in renewables. Together, this will mitigate the loss of earnings from disposed businesses and the progressive nuclear phase-out in Belgium. Engie is hedged 80% for 2022 at €60 per megawatt-hour (/MWh) for its outright merchant generation, compared with an average realized price of €59/MWh in 2021. For 2023, the group is hedged 64% at €55/MWh, leaving significant merchant exposure to capture higher wholesale power prices observed since the beginning of the year. At the same time, we anticipate Engie will generate negative cash flows (on average €3 billion per year before disposals) due to the narrower business scope, gradual increase in investments, including the nuclear funding mentioned above, and dividend distributions. Compensating for this, disposal proceeds have exceeded our expectations and we now forecast reported net financial debt will only exceed 2021 levels in 2024 (about €28 billion). Considering the increase in nuclear provisions, we project Engie will post adjusted FFO to net debt of about 21% in 2022, with similar levels in 2023-2024. The higher sales cash-in does not come with an acceleration of investments (over 2022-2024 compared to 2021-2023) resulting in increased balance sheet headroom. However, we believe that this extra headroom might be at risk from adverse regulatory measures in France, notably to tax windfall profits arising from high commodity prices, and general uncertainties amid current market conditions.

Financial policy continues to support a solid investment-grade rating. An important factor for our 'BBB+' remains the group's financial policy. In its 2022-2024 strategic update, Engie reiterated its commitment to a strong investment-grade rating, with a target to keep net debt to EBITDA at 4.0x or lower. This ratio reached 3.6x at year-end 2020 and it compares with our adjusted leverage metric FFO to net debt of 20.4%. The dividend policy of a 65%-75% net profit payout ratio with a floor at €0.65 per share is in line with the sector. We note the group's financial flexibility in 2020 when it withdrew a dividend distribution amid poor operating performance. Uncertainties on governance have eased with the nomination of new CEO Catherine McGregor in early 2021, who worked with the chairman of the board on the new strategic plan. The successful execution of the group's disposals and strategy signals alignment of interests between the senior management team and board of directors.

Outlook

The stable outlook reflects our expectation that Engie will manage the effects of extreme market volatility linked to the Russia-Ukraine conflict thanks to its strong liquidity position, but also

benefit from structurally higher power prices.

Execution risk has significantly reduced through the completion of a large part of its disposal program, which should result in some debt reduction this year and ensure adjusted FFO to net debt ratio remains comfortably above 18%.

Downside scenario

We could lower the rating if FFO to debt sustainably falls below 18% or if the group's market or business strengths reduce.

Downside could also arise from a sudden Russian gas embargo, resulting in extreme price volatility and a hard-to-predict sequence of adverse financial effects for the group. We currently see Engie as prepared for such a scenario but equally assume some regulatory or governmental intervention. For instance, an uncontained surge in margin-call requirements, the lack of timely mitigating measures by the states and/or the EU to manage gas scarcity, and extra costs related to securing LNG imports, could materially hamper the group's earnings.

In addition, high energy prices expose the group to adverse regulatory measures, such as an extension to the French gas regulated-tariff freeze, limiting its ability to capture extra profits and most likely leading to additional negative working capital movements.

Other downside risks could stem from increased risk exposure in its Belgian nuclear operations and related failure to transition its earnings profile away from nuclear generation by 2025 and offset the loss of Equans.

In the longer term, increased uncertainty on the role of gas infrastructure in France through an unsupportive public policy and regulatory framework could also pressure the rating.

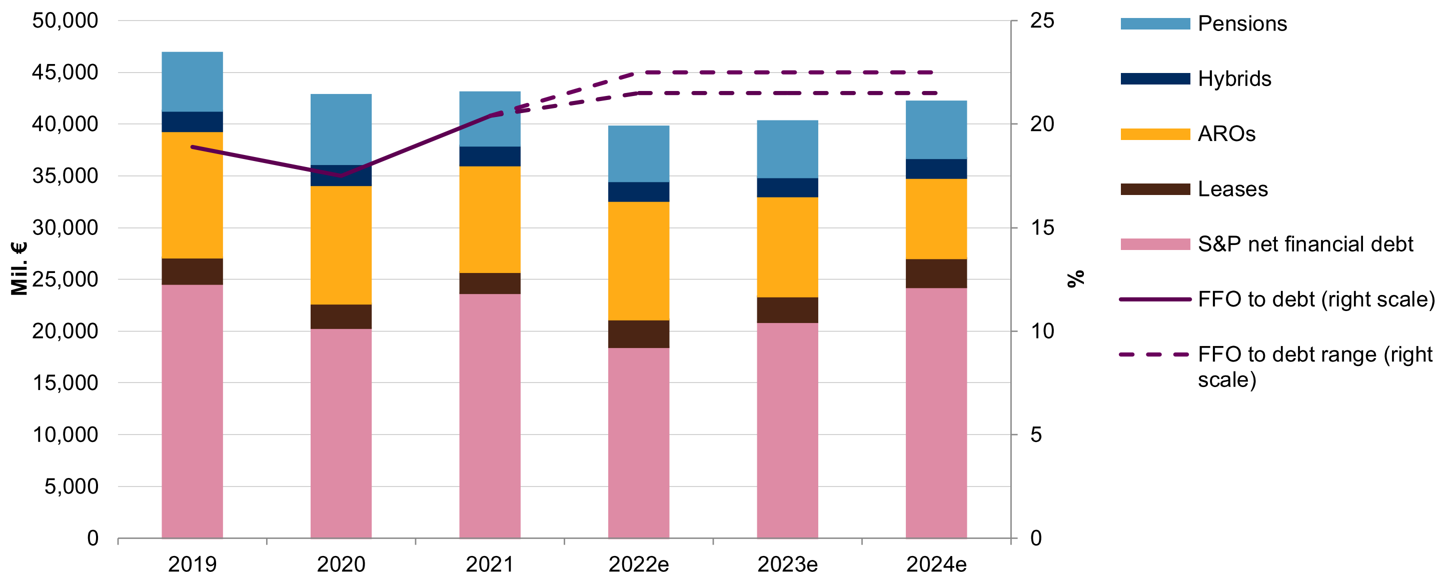
Upside scenario

We see rating upside as less likely given the increased market risks but also the need to gain more visibility on Engie's future business mix and profitability in 2025, and the continued role of gas in France.

Reduced responsibility for nuclear liabilities and a clear strategy for its Belgian nuclear activities, including benefits and risk sharing for any life extensions on two of the five reactors with mechanisms, could also benefit the group's credit quality.

These scenarios would need to combine with stronger credit metrics, specifically FFO to net debt staying comfortably above 21%.

Leverage And FFO-To-Debt Evolution
2019a-2024e



e--Estimate. AROs: asset-retirement obligations. Source: S&P Global Ratings.
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Company Description

With the disposal of its upstream activities in oil and gas exploration and production and LNG, Engie is now focusing on renewable power generation, gas and power infrastructure, and asset-backed energy services. The group's strategic plan is to increase the share of long-term contracted energy activities, while maintaining a stable share of regulated business. Engie notably operates the regulated French gas distribution and transmission networks, as well as downstream storage infrastructures.

At Jan. 1, 2022, the group had a total French regulated asset base of close to €29 billion and about €3.8 billion of international gas and power networks (capital employed). In addition, Engie had installed generation capacity of 100 GW at year-end 2021, or 63 GW in percentage of consolidation, of which half is in Europe (50%), 25% in Latin America, 19% in the Middle East, Asia, and Africa, and 6% in North America. The generation portfolio is mostly gas (39% in percentage of consolidation), hydro (26%), nuclear (10%), wind (13%), solar (5%), and coal (3%).

Engie also benefits from a large and broad customer base, including 6.2 million residential gas contracts (60% market share) and 5 million electricity contracts in France (roughly 15% market share) at year-end 2021. The group is a world leader in energy services, mainly through the Axima and Cofely brands. It generated almost €800 million of EBITDA in energy solutions in 2021 and €445 million in supply.

Engie reported revenue of €57.9 billion and EBITDA of €10.6 billion for the year to Dec. 31, 2021. The company is listed on the Paris Stock Exchange and is part of the CAC 40, a benchmark French stock market index. It had a total market capitalization of more than €28 billion as of April 2022. The French government owns 23.64% of the company and holds 33.39% of the voting rights.

Our Base-Case Scenario

Assumptions

- The group will suffer earnings dilution from the carve-out of Equans in 2022 (deconsolidation of about €800 million of EBITDA), which should be offset by strong results from outright production, benefiting from higher power prices and an increasing renewables contribution.
- For nuclear, we currently do not include a potential extension of the Doel 4 and Tihange 3 reactors (total capacity of 1.8 GW) up to 2035, but still consider the legal closure schedule, with 3.2 GW of capacity remaining operational until year-end 2024. We expect a sustained contribution from Engie's nuclear generation fleet thanks to availability rates above 80% on average over 2022-2024.
- EBITDA growth is led by a step-up in renewables commissioning to 4 GW per year, the performance plan targeting €0.6 billion of additional EBIT by 2023, and higher achieved power prices from the merchant-exposed thermal and nuclear generation fleet.
- Total disposal proceeds of €11 billion-€12 billion over 2022-2024. This includes the sale of the asset-light client solutions division Equans (€6.6 billion cash to be received in second-half 2022), and the sale of nonstrategic assets in noncore geographies including thermal generation capacities. We expect the bulk of these proceeds to be cashed in during 2022 (€8 billion-€9 billion).
- Total annual average investments of €10 billion over 2022-2024 including €5.0 billion-€5.5 billion for growth, €2.5 billion for maintenance, and €2.2 billion related to Synatom funding (including additional dismantling provisions funding).
- Working capital outflows of €500 million in 2022, mainly stemming from higher margin-call requirements spurred by power and gas price volatility and delayed payments from customers, followed by a significant cash inflow in 2023. This comes as the company recovers the initial margin posted for derivatives this year and the effect of the regulated gas price freeze is unlocked.
- A dividend payout of 65%-75% of net profit as defined publicly, with a floor at €0.65 per share translating into cash outflows of €8 billion over 2022-2023.
- A material increase of nuclear asset-retirement obligations (AROs) as part of the Belgian nuclear provisions triennial revision (on top of the ONDRAF tariffs revision) expected by year-end 2022.
- Flat to slightly increasing pension provisions.

Key metrics

Engie S.A.--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. €)	2020a	2021a	2022f	2023f	2024f
EBITDA	8.9	10.2	10.2-10.5	10.2-10.5	10.5-11
Funds from operations (FFO)	7.5	8.8	8.5-9.0	8.8-9.3	9.0-9.5
Capital expenditure	5	5.9	9.5-10	10.0-10.5	9.8-10.3
Dividends	0.6	1.8	2.5-3.0	2.5-3.0	2.5-3.0
Debt	42.8	43	38.0-42.0	39.0-43.0	41.0-45.0
Debt to EBITDA (x)	4.8	4.2	3.7-3.9	3.8-4.0	3.8-4.0
FFO to debt (%)	17.5	20.4	21.5-22.5	21.5-22.5	21.5-22.5

*All figures adjusted by S&P Global Ratings. 2021 year-end debt consists of net financial debt of €24.7 billion with key adjustments being €10.3 billion in asset-retirement obligations, €5.1 billion in pensions, €1.8 billion in hybrids, and €1 billion in derivatives. a--Actual. e--Estimate. f--Forecast.

Liquidity

We have revised our liquidity assessment to strong from exceptional to reflect the increased buffers needed amid current high commodity prices and heightened market volatility, exposing the group to potential sizable margin calls and working capital requirements. That said, we still view Engie's proactive liquidity management as well as ample cash and available committed facilities as a differentiating factor compared to peers in the sector. As of March 31, 2022, projected sources of funds exceeded projected uses by slightly less than 2.0x over the next 12 months. Our assessment is further supported by the group's solid relationships with banks, and proven access to the capital markets, even under dire market conditions.

Principal liquidity sources as of March 31, 2022, include:

- About €16 billion in available cash and marketable securities at the group level.
- About €8.9 billion in available committed credit lines maturing beyond 12 months, of which €5 billion and €4 billion relate to two syndicated facilities maturing in December 2025 and December 2026, respectively.
- Our forecast of cash FFO of about €8.9 billion over the next 12 months.
- Asset disposals, signed or at very advanced stages, of €8.2 billion over the next 12 months, of which €6.6 billion stems from the sale of Equans, which will be cashed in by second-half 2022.

Principal liquidity uses as of March 31, 2022, include:

- Long- and short-term debt maturities of about €9 billion.
- Our estimate of about €9.8 billion in annual capex, including Synatom funding.
- Dividend cash payments of about €2.5 billion, including subsidiaries' minority shareholders and hybrid debtors.

Debt maturities include:

- 2022: €4.3 billion (net of commercial paper)
- 2023: €3.5 billion

- 2024: €1.5 billion
- 2025: €2.5 billion
- Thereafter: €21 billion

Environmental, Social, And Governance

ESG credit indicators: E-3, S-2, G-2

Environmental factors are a moderately negative consideration in our credit rating analysis of Engie, although we note the company's progress in managing its environmental risks since 2015 through an in-depth transformation. On its path to net-zero emissions by 2045 across all scopes, Engie plans to reduce its carbon intensity to 168 grams per kilowatt hour (g/KWh) in 2030 from 240g/KWh in 2021 (excluding Equans) and its greenhouse gas (GHG) emissions from energy production to 43 million tons of carbon dioxide (MtCO2) equivalent in 2030 from 67 MtCO2 equivalent in 2021. These targets should be facilitated by the group's coal exit plan and larger share of renewables in the mix, even if they remain ambitious given Engie's carbon intensity remains higher than best-in-class peers, such as Iberdrola and EDP. The company's nuclear operations in Belgium also pose several challenges related to the future of long-term nuclear waste storage, with increasing liabilities net of dedicated assets (€9.5 billion at year-end 2021) to reflect the regulatory triennial revision in Belgium. Social risks are increasing in France in the context of affordability pressures building on rising energy prices. The government announced a gas tariff freeze to retail customers under fixed price contracts or regulated tariffs applied between Jan. 1, 2022, and June 30, 2022. Although this will entail a working capital burden for the group, it will not trigger a loss and it should be recovered progressively by subsequent tariff increases in second-half 2022, therefore limiting the financial impact. Governance, which we assess as satisfactory, is a neutral consideration as uncertainties have eased with the nomination of new CEO Catherine McGregor at the beginning of 2021. She worked with the chairman of the board on the new strategic plan.

Issue Ratings - Subordination Risk Analysis

Capital structure

At year-end 2021, Engie's capital structure comprised about €39 billion of senior unsecured debt and about €3.8 billion of hybrid securities issued by Engie S.A. and its financing subsidiaries. The group has debt of about €7.2 billion under local subsidiaries.

Analytical conclusions

We do not see any material structural subordination risk for the senior unsecured debt instruments and rate them 'BBB+', in line with the issuer credit rating on Engie.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Strong

- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bbb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

- Group credit profile: bbb+
- Likelihood of government support: Low (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Affirmed	
Engie S.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Subordinated	BBB-
Junior Subordinated	BBB-
Commercial Paper	A-2
GIE ENGIE Alliance	
Issuer Credit Rating	BBB+/Stable/--
Senior Unsecured	BBB+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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