FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Engie S.A. to 'BBB+'; Outlook Stable

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Fitch Ratings - Barcelona - 15 Jul 2024: Fitch Ratings has downgraded Engie S.A.'s Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'BBB+' 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 mainly reflects an expected rise in Engie's leverage in the medium term to beyond our negative sensitivity of 4.0x, and to a level more commensurate with the new ratings. Specifically, our rating case forecasts nuclear-adjusted funds from operations (FFO) net leverage to increase to 3.8x in 2024 (from 2.9x in 2023) and to average 4.3x in 2025-2026, driven by a large capex plan and cash payments for the transfer of nuclear waste liabilities.

The Stable Outlook reflects Engie's comfortable headroom within the new rating to accommodate possible further investments arising from energy transition. We continue to see Engie's business profile as robust, with a large scale and diversification, and a significant share of regulated, quasi-regulated or contracted EBITDA supporting cash flow predictability. The rating also considers Engie's low carbon power generation and its investment plan focused on energy transition, while targeting reported economic net debt of up to 4.0x EBITDA.

KEY RATING DRIVERS

Expected Financial Trajectory Drives Downgrade: Fitch projects nuclear-adjusted FFO net leverage to rise to 3.8x in 2024 and to above our previous sensitivity of 4.0x from 2025. This is mainly driven by a large capex plan and cash payments for the transfer of nuclear waste to the Belgian state. We expect leverage to remain comfortably within its sensitivities under the new rating, and believe that Engie will adhere to its current financial target of economic net debt-to-EBITDA of up to 4x over the long term.

Large Capex Pressures Free Cash Flow: Engie's 2024-2026 business plan includes EUR22 billion-EUR24 billion of growth capex, a sharp increase from the EUR15 billion-

EUR16 billion in 2021-2023. The investment plan is consistent with the group's focus on energy transition, with about half of it allocated to renewable growth capacity. This is aimed at increasing installed renewable capacity to 54GW by 2026 from 41GW at end-2023 (at 100% ownership), through investments in onshore and offshore wind and solar, with largely contracted and predictable earnings.

The remainder will be spent mainly on networks, other infrastructure assets and flexible generation. Around 75% of growth capex is aligned with EU taxonomy.

Higher Visibility on Nuclear Waste: The transfer of EUR16 billion nuclear waste provisions to the Belgian state includes an estimated EUR7 billion-EUR8 billion of cash outflows in 2024-2025 (on top of designated assets to cover the provisions), which we factor into the rating case after free cash flow (FCF). This cash outflow will contribute to the expected increase in leverage, together with projected moderately negative FCF for 2024-2026. As a result, we expect Fitch-adjusted net debt to increase to EUR48 billion at end-2026 from EUR28.4 billion at end-2023. Positively, Engie will no longer be liable for the nuclear-waste storage of its Belgian fleet.

Limited Residual Exposure to Nuclear: We expect Engie to cease nuclear production in Belgium by end-2025, except for two units in its joint venture (JV) with the Belgian state, which should receive approval for a 10-year extension to 2035 by end-2024. The partnership should limit operational risks for the group, while its production will be sold under a contract-for-difference mechanism. The extension capex, estimated at EUR1.6 billion-EUR2 billion, will be equally funded by Engie and the government.

Solid Business Profile: Engie's plan to accelerate growth in renewables and infrastructure assets with largely predictable cash flows is consistent with the group's increasing focus on energy transition and should bring its business mix closer to peers'. We expect the share of regulated, quasi-regulated or contracted EBITDA to increase to more than 70% by 2026 from around 60% in 2023, when the contribution of merchant activities was inflated by high market prices. Engie remains more exposed to the gas value chain than other large European utilities.

Engie remains mostly focused on France (34% of reported EBITDA in 2023), followed by other European countries (22%), with LatAm (16%) and other regions accounting for the remainder.

Good Performance Extends in 1Q24: After a record EBITDA and operating cash flow in 2023, Engie posted a good performance in 1Q24, with only a modest 0.7% EBITDA decline. Lower contribution from networks, retail, and global energy management & sales (GEMS), due to a mix of mild weather, lower volumes and normalising market conditions, was offset by a strong result in nuclear (due to the end of the infra-marginal tax in Belgium), renewables hydro and new capacity, and improved profitability for flexible generation. Reported economic net debt improved to 2.9x EBITDA at end-March 2024 from 3.1x at end-2023 due to working-capital inflows.

Regulated Business: We expect regulated activity to reach 35% of total EBITDA in 2026, from 28% in 2023. France should account for about 80%, which benefits from a mature and stable regulatory framework, in our view. The new regulatory frameworks for gas distribution, transmission and storage, introduced in France in 2024, contain credit-enhancing features including a revised weighted average cost of capital (WACC) formula, resulting in higher earnings versus the previous approach, and a higher recovery cap, which will allow the group to recover about EUR1 billion in unrecovered revenue from the previous regulatory period.

Nuclear-Adjusted Leverage: We continue to adjust our leverage ratio for the unfunded portion of Belgian nuclear dismantling provisions, except for two reactors that will be transferred to its JV with the Belgian state. In our view this improves comparability with peers, as Engie does not plan to fully fund these provisions by 2025, when the last nuclear plants are due to be decommissioned (Engie plans to fully fund dismantling provisions by 2030).

DERIVATION SUMMARY

Engie's business mix (more than 70% regulated, quasi-regulated or contracted EBITDA by 2026) compares well with that of Enel S.p.A. (BBB+/Stable) and Iberdrola, S.A. (BBB+/Stable), which are its closest peers, in our view. Enel and Iberdrola benefit from a higher share of regulated networks in EBITDA and larger operations in renewables leading to better earnings predictability.

In addition, Engie is more exposed to the gas industry, which we view as a weakness in light of its higher long-term climate risks than for electricity. Engie's growth in renewables and infrastructure assets will bring its business mix closer to those of Enel and Iberdrola, which are leading the energy transition. We view Engie's geographic mix as stronger than Enel's due to a lower exposure to higher-risk countries, including in LatAm. Overall, we view Engie's debt capacity in line with Enel's and slightly lower than Iberdrola's.

Engie's higher debt capacity than Electricite de France's (EDF, BBB+/Stable, SCP: bbb-) reflects the latter's weaker business profile (due also to higher operational risk entailed in its investment plan and asset base) and deeply negative FCF expected across its business plan. EDF's IDR benefits from a two-notch uplift from its Standalone Credit Profile, under Fitch's Government-Related Entities (GRE) Rating Criteria.

We rate Engie on a standalone basis because the French state, with 23.6% of its share capital and 33.6% of voting rights, does not have economic or voting control over Engie.

Fitch aligns the ratings of Engie's subsidiary, Engie Invest International S.A. (A-/Stable), with the ratings of Engie based on the parent's guarantees of its debt. Another subsidiary Electrabel S.A. is rated at the same level as Engie, reflecting strong operational and strategic ties, including Electrabel's about 40% contribution to group EBITDA, 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:

- Reported EBITDA, excluding nuclear, close to the mid-points of Engie's guidance range of EUR12.2 billion-EUR13.2 billion in 2024; EUR12.9 billion-EUR13.9 billion in 2025 and EUR13.5 billion-EUR14.5 billion in 2026

- EBITDA in networks in France based on allowed returns for the current regulatory period

- Growing EBITDA in renewables and energy solutions in 2024-2026, fueled by large capex

- Growth capex of around EUR22 billion-EUR24 billion for 2024-2026, with renewables accounting for around 50%-55%, networks 15%-20%, energy solutions 10%-15% and flexible generation 10%

- Maintenance capex totaling EUR8 billion for 2024-2026

- Dividends in 2024-2026 in line with Engie's dividend policy (65%-75% of group net result, with a floor of EUR0.65 per share)

- Asset disposals totaling EUR4 billion in 2024-2026

- Net funding of nuclear provisions of about EUR12 billion cumulatively in 2024-2026, in line with management's assumptions, including funding as part of an agreement with the Belgian government

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Nuclear-adjusted FFO net leverage sustained below 4x, supported by a consistent financial policy

- Positive FCF on sustained EBITDA growth

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Nuclear-adjusted FFO net leverage above 4.7x 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

LIQUIDITY AND DEBT STRUCTURE

Sufficient Liquidity: Fitch-calculated readily available cash and cash equivalents amounted to EUR17.2 billion as of end-2023. Unused committed liquidity facilities at the same date were an additional EUR12.2 billion. Engie's two main committed facilities are syndicated lines amounting to EUR4 billion and EUR4.5 billion and both maturing in 2028. Fitch believes that liquidity is sufficient to meet Engie's operating needs and debt maturities at least in the next 24 months.

ISSUER PROFILE

Engie is a large international utility based in France, with networks (28% of 2023 reported EBITDA), global energy management & sales and others (22%), renewables (18%), flexible generation (13%), nuclear (9%), energy solutions (6%) and retail (5%).

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process;

they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Engie S.A.	LT IDR	BBB+ Rating Outlook Stable	Downgrade	A- Rating Outlook Stable
	ST IDR	F1	Affirmed	F1
senior unsecured	LT	BBB+	Downgrade	A-
subordinated	LT	BBB-	Downgrade	BBB
senior unsecured	ST	F1	Affirmed	F1
Engie Invest International S.A.	LT IDR	BBB+ Rating Outlook Stable	Downgrade	A- Rating Outlook Stable
Electrabel S.A.	LT IDR	BBB+ Rating Outlook Stable	Downgrade	A- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

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

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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

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