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Research Update:

French Integrated Utility Engie S.A. Affirmed At 'BBB+', Guidance Raised On More Volatile Cash Flows; Outlook Stable

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(Editor's note: We republished this article on Nov. 20, 2024, for clarification on regulated EBITDA.)

Rating Action Overview

- By 2026, we forecast the group's regulated and strongly protected activities to contribute more than 50% to its EBITDA, supporting its strong business profile. However, we observe a declining share of strongly regulated activities, mainly French gas networks, to about 29% compared to the historical level of about 35%.
- In addition, we think that Engie S.A.'s high gas exposure in France, transitioning to a low-carbon economy, will lead to subdued growth from regulated EBITDA in the medium to long term compared with key peers Enel SpA and Iberdrola S.A. that are more exposed to the electricity grid. Therefore, we apply the standard volatility table to benchmark the group's financial metrics and revise upward the guidance of funds from operations (FFO) to debt to about 20% for the current rating level. The guidance factors in that most of the earnings come from regulated and strongly protected activities.
- We expect Engie to generate an adjusted EBITDA of €15 billion on average over 2024-2026, as energy prices moderate stable compared to 2023. The growth in renewable generation and network remuneration should compensate for normalized earnings from the trading business and loss of EBITDA contribution from nuclear generation related to the gradual phase out by 2025.
- While we forecast that adjusted debt will increase to €59 billion by the end of 2026, driven by high capital expenditure (capex; €10 billion-€11 billion annually) and dividends (€3.5 billion-€4 billion annually), we expect it will post FFO to debt at about 21% on average over 2024-2026. This will mitigate the cumulative negative discretionary cash flow (DCF) of €7 billion.
- We therefore affirmed our long-term issuer credit rating and ratings on senior unsecured debt of Engie at 'BBB+', our short-term issuer credit rating at 'A-2', and our rating on junior subordinated debt at 'BBB-'.
- The stable outlook indicates that we anticipate Engie to post on average FFO to debt above 20% on 2024-2026 and to keep a large majority of EBITDA from regulated and strongly protected

operations.

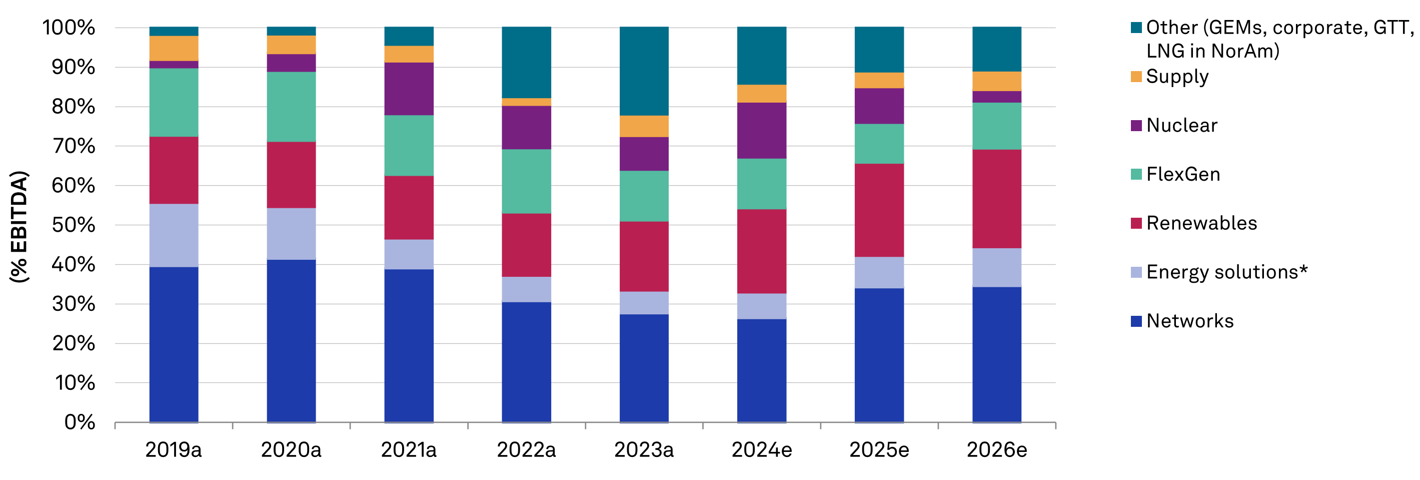
Rating Action Rationale

We expect Engie to maintain an about 55%-60% share of regulated and strongly contracted activities within its EBITDA mix. Over 2022-2024, EBITDA generation of trading activities (Global Energy Management Services [GEMS]) was unusually strong. From 2025, as energy market prices normalize and merchant nuclear is partially phased out, we expect the contribution from strongly regulated activities to be about 29% of EBITDA mix (on a full consolidation basis) although this is dampened by the presence of large minorities in GRTGaz and Elengy and translates to 26% on a proportionate basis, compared to 30%-35% in 2019-2021. We anticipate that this will be driven by the structurally increasing contribution from renewables and continued solid performance from trading services.

Based on the information we have received; we understand the group has a share of regulated and strongly protected revenues of about 55%-60%. Engie's long-term growth will mostly stem from renewables and energy solutions activities, which are heterogeneous in volatility of remuneration. We view Engie's long-term purchased price agreements in generation activities as credit supportive when it is 'as produced' and signed with an investment-grade counterparty. We consider Brazil-based hydro generation and power transmission lines as benefitting from regulated fixed tariffs and the European district heating and cooling business as supportive given 30-40 years of long-term concessions representing about half of energy solution EBITDA. We will closely monitor the potential disposal of asset light energy solutions in the U.S. and Engie's ambitions in power grid.

Chart 1

EBITDA from low-risk activities diluted compared to pre-energy crisis levels
2025-2026



*Equans sold in 2022. a--Actual. e--Estimate. Source: S&P Global Ratings.
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We are revising the guidance to maintain a 'BBB+' rating to about 20% from 18% to reflect the higher exposure of Engie to gas infrastructure compared with peers and its slightly higher volatility of earnings over time. The group's historical focus on gas infrastructure contributes additional risk in the long-term compared to the closest, more power-geared peers. Of Engie's €40 billion regulated asset base, 80% is French gas distribution, transmission, storage, and liquefied natural gas (LNG) terminals infrastructures. With France's 2050 carbon neutrality targets, the gas infrastructure faces high transition risk as demand for natural gas is expected to shrink progressively. Uncertainties remain on scalability of the new type of low-carbon molecules despite French ambitions. Compared to its closest peers Enel and Iberdrola, Engie has little exposure to electricity networks (less than 3% of total EBITDA), which presents a strong growth profile due to the high investment needed to upgrade the grid to integrate renewables.

For 2024-2027, this risk is partially compensated by the strength of the regulatory frameworks on gas networks in France with a €2 billion EBITDA growth expected in 2024-2027, as the new regulatory period's tariffs catch up on cost inflation and claw-back mechanism. We view this mechanism as supportive as it protects the group's margin, with cost inflation fully recovered through remuneration. The ATRT8 transmission period tariff introduced on April 1, 2024 a 19% average increase in tariff for 2024. For the ATRD7 tariff distribution period, the average increase in various tariff components as of July 1, 2024 was 27.5%.

Uncertainties remain on regulated asset base (RAB) expansion, ultimately weighing on regulated EBITDA growth. Engie's strategic plan, networks' expected capex will increase by €3.2 billion over 2023-25 with €1.6 billion for GRdF, €0.24 billion for GRTgaz, €0.9 billion for power transmission lines, and €0.6 billion for biogas. The ATRT8 tariff includes provisions for necessary investments to accommodate increased biomethane injections, aligning with the government's plan to reach 14 terawatt-hour (TWh)-22 TWh of renewable gas by 2028. However, this remains minimal compared to natural gas consumption levels and hurdles faced by scalability notably in energy sources and price incentives.

Engie is diversifying in power transmission lines in Brazil with 1000 kilometer of lines contract obtained in 2024. However, we view the supportiveness of the regulatory framework in Brazil as weaker than the one in France and this diversification remains marginal on proportionate EBITDA contribution due to large minorities present in Engie's Brazilian subsidiary Engie Brasil Energia S.A.

We forecast Engie will maintain limited headroom from 2025 due to large negative DCFs in 2025 driven by capex acceleration and high dividends. We expect Engie to reach a strong 24% FFO to debt in 2024, reducing to about 20% in 2025 and 2026 as GEMS' EBITDA reduces to a more sustainable level and capex (€11 billion annually) and dividends (€3.6 billion including to minorities; 65%-75% of net recurring income) remain heavy. The 2024-2026 capex plan focuses on renewables (about 50% of growth capex) and energy solutions (15%). We forecast a €1 billion increase in unfunded asset retirement obligations in 2025-2026 based on new provisions and plan performance. This is independent from the agreement with the Belgian state on nuclear waste liabilities which led to unfunded asset-retirement obligations (AROs) of about €4.5 billion in 2026 after the €16 billion transfer to the Belgian state in 2024 and 2025. The transfer of waste nuclear liabilities to the Belgian state, while costly with €5 billion provision increased in 2023, has reduced uncertainty on Engie's balance sheet.

To mitigate for the increase in adjusted debt, we forecast Engie to post solid 2024 performance with €15.5 billion reported EBITDA, before it stabilizes at €14.6 billion over 2025-2026. Engie guided toward the upper range of its 2024 guidance (€12.8 billion-€13.8 billion EBITDA excluding nuclear) after solid third quarter results and we expect a strong €15.3 billion adjusted EBITDA in 2024, slightly up from 2023. This increase is supported by the strong growth in renewables, with additional installed capacity in Latin America, North America, and Europe of 2.3 gigawatt (GW) in the first nine months of 2024, on track to reach Engie's 4 GW annual additional installed capacity target, and thanks to good hydro conditions in France and Portugal. We forecast €2.2 billion of nuclear generation EBITDA, a steep improvement compared with €1.3 billion EBITDA in 2023 due to the termination of the inframarginal tax in Belgium in June 2023.

We expect GEMS to stabilize at a more sustainable EBITDA level from 2025, S&P Global Ratings' assumption of €1.0 billion-€1.5 billion, as energy prices stabilize and contracts signed in previous years are rolled out. This is still higher than €500 million historical level, as the need for hedging services increase with higher penetration of renewables and an increase in price volatility. Renewables will increase with a target pace of 4 GW additional capacity installed in 2025 and 6 GW from 2026. We anticipate the Energy solution segment to increase toward €1.2 billion-€1.4 billion of EBITDA by 2026. From 2026, we expect nuclear contribution to adjusted EBITDA to reduce materially to about €400 million, driven by drawing rights in French nuclear, as three of the five Belgian nuclear reactors are closed and Engie will operate the remaining two reactors over 2026-2035 on a 50/50 joint venture with the Belgian state. Over 2025-2026, the remuneration of French networks will catch up on cost inflation as new regulatory periods started in April and July 2024. We forecast a flat contribution from the flexible generation segment as thermal units are displaced in the merit order with exposure to carbon allowance price, clean spark spread evolution, and utilization hours bringing some volatility in our forecast.

Outlook

The stable outlook reflects our expectation that Engie will maintain adjusted FFO to net debt at about 21%. We expect the execution risk of renewable growth to be mitigated by Engie's large pipeline of projects and we will closely monitor the long-term transition risk on gas operations.

Downside scenario

We could lower the rating if FFO to debt sustainably falls below 20% or if business strengths reduce. This could occur if the group was unsuccessful in executing its renewable deployment program at attractive profitable levels or due to a deterioration in free cash flow generation to negative DCFs of €3 billion-€4 billion, with inflexible and high dividends. This could also happen if faced with a major energy market shock that prompted acute price volatility and potentially hard-to-predict adverse financial effects.

We could also lower the rating should we perceive a further dilution of the regulated and strongly protected businesses within the group. In the longer term, increased uncertainty about 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 remote; this would be conditional on higher free cash flow generation and a material increase in contribution from regulated activities or strongly protected earnings while gaining more visibility on Engie's future business mix and profitability, and on the continued role of gas in France.

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 following the 2022 disposal of asset-light client solutions activities of Equans SAS. The group's strategic plan is to increase the share of long-term contracted energy activities, while maintaining a stable consolidated share of regulated networks at about 30%. Engie notably operates the regulated French gas distribution and transmission networks, as well as downstream storage infrastructure.

Overall, the group's RAB, in France and internationally, is forecast to reach €39 billion in 2025, compared with €37 billion in 2023. As of end-2023, Engie has installed generation capacity of over 104.7 GW at 100%, or 67.1 GW in percentage of consolidation, of which 38% was in Europe; 19% in Latin America; 35% in the Middle East, Asia, and Africa; and 7% in North America. The generation portfolio is skewed toward natural gas, the share of which (38% in percentage of consolidation) is gradually diluted by renewable development, hydro (25%), wind (14%), nuclear (8%), and solar (6%).

Engie also benefits from a large and broad customer base, including 5.7 million household and small business gas contracts (60% market share) and 5 million electricity contracts in France (roughly 15% market share) as of year-end 2023. The group is a world leader in energy services. It generated almost €868 million of EBITDA in energy solutions in 2023 and €821 million in supply.

Engie reported revenue of €82.6 billion and EBITDA of €15.0 billion in 2023. 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 market capitalization of more than €36.6 billion as of Nov. 1, 2023.

The French government owns 23.64% of the company and holds 33.56% of the voting rights.

Engie is structured around four global business units that represent the group's four key activities: Renewables (16.1% EBITDA contribution in 2022), Networks (30.7%), Energy Solutions (6.4%), FlexGen and Retail (18.2%), as well as two operating units: Nuclear (11%) and GEMS (20.7%)

Our Base-Case Scenario

Assumptions

- We expect a sustained contribution from Engie's nuclear generation fleet, thanks to availability rates above 80% on average over 2024-2025. For nuclear, we forecast 3.2 GW of capacity remaining operational until 2025. From 2026, we expect nuclear contribution to reduce significantly as we include the extension of the Doel 4 and Tihange 3 reactors (total capacity of 1.8 GW) from 2025 November through 2035, and the closure of the other three reactors in 2025.
- EBITDA growth is led by a step-up in renewables commissioning to 4 GW per year until 2025, and 6 GW from 2026, increasing EBITDA by €1.0 billion-€1.2 billion over 2024-2026. It is also led by growth in network division of about €800 million-€1 billion over 2024-2026 from higher remuneration in France with cost inflation and a new transmission line in Brazil. We anticipate

a high increase in Energy Solutions services with EBITDA almost doubling and a strong contribution from GEMS to a normalized level of about €1.0 billion-€1.5 billion in 2024-2026.

- Some contained cost efficiencies in 2024-2026.
- We assume working capital inflow of €1.4 billion in total over 2024-2026 as power prices materially decreased in with reduced client receivables and derivative initial margins and margin calls.
- We expect average capex of €10 billion-€11 billion per year over 2024-2026 including €6 billion-€8 billion for growth, €2.5 billion for maintenance, and €0.6 billion-€1.5 billion financial investments.
- Total disposals (not including develop, build, sell, and operate proceeds) of €4 billion over 2024-2026. We expect the bulk of these proceeds to be cashed in during 2025.
- A dividend payout of 65%-75% of net recurring income group share (as defined by Engie), with a floor at €0.65 per share translating into cash outflows of €11 billion-€12 billion over 2024-2026 (including dividends to minorities).
- Cash outflow of €11.9 billion over 2024-2026 of which €3.5 billion in 2024 and €4 billion in 2025 related to Belgium's nuclear phaseout and an additional €4.4 billion split equally in 2024 and 2025 from funding of upward revision of nuclear provisions by ONDRAF (Belgium's national agency for radioactive waste and enriched fissile material).
- Funded nuclear waste management obligations transferred to the state for about €12 billion in 2024 and €4 billion in 2025 and a material decrease of unfunded nuclear asset-retirement obligations by the end of 2025 based on our above estimate of a funding of about €4.4 billion. Those elements are neutral on adjusted debt.
- Pension provisions increasing by €500 million over 2024-2026.
- Stable hybrid debt level.

Key metrics

Table 1

Engie S.A.

	--Period ending Dec. 31--				
(Mil. €)	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**
EBITDA	12,967	14,964	15,000-15,500	14,250-14,750	14,750-15,250
Funds from operations (FFO)	10,450	11,911	12,250-12,750	11,000-11,500	11,500-12,000
Capital expenditure (capex)	6,226	7,039	10,500-11,500	10,500-11,500	10,000-11,000
Dividends and share repurchases	2,994	4,084	3,500-4,500	3,000-4,000	3,000-4,000
Discretionary cash flow (DCF)*	-1,577	1,303	(2,500)-(1,500)	(4,500)-(3,500)	(3,000) -(2,000)
Debt	42,090	48,974	52,500-54,500	56,000-58,000	58,000-60,000
Adjusted ratios					
Debt to EBITDA (x)	3.2	3.3	3.4-3.6	3.8-4.0	3.8-4.0
FFO to debt (%)	24.8	24.3	23.0-24.0	19.5-20.5	19.5-20.5

*DCF before nuclear funding, acquisitions, and disposals. All metrics are S&P Global Ratings adjusted. a--Actual. e--Estimate. f--Forecast.

Liquidity

We view Engie's liquidity as strong. The short-term rating is 'A-2'. We think that the group's proactive liquidity management, ample cash, and available committed facilities should provide an adequate buffer against thinkable high commodity prices, market volatility, sizable margin calls, and working capital requirements. As of Sept. 30, 2024, projected sources of funds exceeded projected uses by at least 1.5x over the next 12-month period and by 1.2x over the next 24 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 Sept. 30, 2024, include:

- About €18.3 billion in available cash and marketable securities at the group level;
- Available committed credit lines of €12.6 billion maturing beyond the 24-month period;
- Our forecast of cash FFO of about €11.5 billion over the next 12 months;
- About €350 million of working capital inflow; and
- The Oct. 28, 2024, £500 million bond issuance.

Principal liquidity uses over the same period, include:

- Long- and short-term debt maturities of about €5.7 billion over the next 12 months;
- Our estimate of about €11 billion in annual capex;
- Dividend cash payments of about €3.9 billion, including subsidiaries' minority shareholders; and
- ARO funding of €5.3 billion the next 12-month period and €3.1 billion in the next 24-month period.

Environmental, Social, And Governance

Environmental factors are a moderately negative consideration in our credit rating analysis of Engie, although company has made 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 with a target to reach 230 grams of carbon dioxide equivalent per kilowatt hour (g CO_2 eq./kWh) in 2025, then 158g CO_2 eq./kWh in 2030, from 240g/kWh in 2021 (excluding Equans) and its greenhouse gas emissions from energy production to 43 million tons of carbon dioxide equivalent ($MtCO_2e$) in 2030 from 67 $MtCO_2e$ 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 that Engie's carbon intensity remains higher than best-in-class peers, such as Iberdrola, Orsted A/S, and EDP S.A.

The company's nuclear operations in Belgium represent a lower challenge for the group following the agreement reached with the Belgian state in July 2023. Engie will effectively transfer the liabilities related to waste management of about €15 billion to the Belgian state, eliminating valuation risks, while retaining the more predictable obligations related to plant dismantling of about €8 billion. We now project decreasing liabilities net of dedicated assets to €4.4 billion by the end of 2026 from €12.5 billion as of year-end 2022.

Social risks have diminished in France with lower affordability pressures in 2023 compared to

2022 on very high energy prices.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of year-end 2023, Engie's capital structure comprised about €42.7 billion of senior unsecured debt and about €3.39 billion of hybrid securities issued by Engie and its financing 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 long-term issuer credit rating on Engie.

We rate hybrids that have intermediate equity content at 'BBB-' (two notches below the stand-alone credit profile) to reflect their subordination (if the issuer credit rating is investment-grade) and optional deferability. The fact that the instrument is deeply subordinated does not require different notching.

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 (standard volatility table)
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	Neutral (no impact)
Comparable rating analysis	Positive (+1 notch)
Stand-alone credit profile:	bbb+
Related government rating	AA-/Stable
Likelihood of government support	Low (no impact)

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Utilities Handbook 2024: Western Europe Regulated Gas, Sept. 16, 2024
- Industry Credit Outlook Update Europe: Utilities, July 18, 2024
- Tear Sheet: Engie S.A., June 25, 2024
- France-Based Engie S.A.'s Proposed Green Hybrid Instrument Rated 'BBB-'; Equity Content Intermediate, June 6, 2024
- Tear Sheet: Enel SpA, May 28, 2024
- Tear Sheet: Iberdrola S.A., May 7, 2024

Ratings List

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

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