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## Research Update:

# Abu Dhabi National Energy Co. 'A' Rating Affirmed; Outlook Stable

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## Research Update:

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## Overview

- Abu Dhabi National Energy Co. (TAQA) remains under pressure from declining oil and gas prices, which have reduced cash flow debt coverage.
- Although we consider that TAQA's stand-alone credit profile has weakened to 'b', we believe the company will continue to benefit from support from Abu Dhabi's government.
- We are therefore affirming our 'A' rating on the company.
- The stable outlook reflects our view that the extremely high likelihood of extraordinary government support for TAQA will remain unchanged, and that TAQA will maintain adequate liquidity and robust cash flow from its power and water businesses.

## Rating Action

On April 28, 2016, Standard & Poor's Ratings Services affirmed its 'A' long-term corporate credit rating on Abu Dhabi based power, oil, and gas producer Abu Dhabi National Energy Co. PJSC (TAQA). The outlook is stable.

## Rationale

The affirmation reflects our continued view of an extremely high likelihood that TAQA will receive extraordinary support from Abu Dhabi's government if needed. TAQA's strategic importance to the government is underpinned, in our view, by the company's very important role as the provider of more than 90% of the emirate's electricity and water. TAQA also has an integral link with the government, in our view, because of the government's significant oversight and involvement in TAQA's business and financial strategies. The emirate and its related entities own 75.2% of the company. In addition, we understand that a government-related entity has a put arrangement with the company, giving TAQA an option to sell most of its oil and gas assets at book value. This put option extends to oil and gas assets in North America, Iraq's Kurdistan region, and certain assets in Europe. This provides a floor to the value of the oil and gas business and, in our view, is further evidence of the financial links between TAQA and the government.

Our assessment of TAQA's fair business risk profile takes into account that 70% of revenues and EBITDA come from the power generation and water businesses and the remaining 30% from the oil and gas segment. Positive factors are the essential strategic nature of TAQA's power and water assets, for which the company has off-take agreements under purchase contracts that are long term

and pose minimal volume or price risk. TAQA's commodity business' exposure to volume and price risk somewhat offsets these strengths. It arises from volatile oil and gas commodity prices, relatively low proven-reserve lives compared with that of larger oil and gas players, some inherent currency risk, and potential fluctuations in profitability.

We assume that TAQA will maintain a dominant market share, particularly in the power and water segment, in the United Arab Emirates (UAE), since expansion into higher-risk countries and untested markets would likely weigh on its business and financial risk profiles.

TAQA's financial risk profile is highly leveraged, in our view, reflecting high debt combined with weakening operating cash flows following declining oil and gas prices. This caused funds from operations (FFO) to debt to decline to 6% in 2015, compared with our forecast of at least 7%. We do not anticipate any improvement over the next few years, due to the depressed hydrocarbon price environment.

In our base case for TAQA, we assume:

- A continued gradual decline in oil and gas production, with prices at about \$40 per barrel for 2016 and \$45 per barrel for 2017 in line with Standard & Poor's oil price deck.
- Power and water business will perform well, with more than 90% availability assumed for the UAE assets, leading to improving revenue forecasts.
- EBITDA margins declining to 46%-48% in 2016-2017, due to the lower oil prices, partly offset by new cash flows from the Atrush field in North Kurdistan and stable performance of the power and water assets.
- Annual capital expenditures of between \$500 million and \$600 million.

Based on these assumptions, we arrive at the following credit measures:

- An FFO-to-debt ratio of 4%-6%; and
- Positive free operating cash flow generation.

## **Liquidity**

We assess TAQA's liquidity position as adequate rather than strong, reflecting significant debt maturities over the next two years. We forecast the company's liquidity sources will exceed uses by more than 1.2x in the next 12 months. We base this on our assessment of the company's positive cash flow generation and availability under its credit facilities. TAQA's refinancing in 2016 consists of the equivalent of \$1.6 billion in debt, including a \$1.0 billion bond maturing in October.

Principal liquidity sources on Dec. 31, 2015, comprise:

- Cash balances of about \$215 million or UAE dirham (AED) 790 million.
- More than \$2.3 billion (AED8.3 billion) of committed but undrawn amounts under various facilities with maturities exceeding one year.
- About \$1 billion-\$1.2 billion (AED3.7 billion-AED4.4 billion) in operating cash flow over the next 12 months, by our estimates.

Principal liquidity uses comprise the following:

- \$1.7 billion (AED5.9 billion) in debt maturing over the next 12 months.
- About \$450 million-\$550 million (AED1.6 billion-AED2 billion) in capital expenditures over the next 12 months.
- About \$200 million (AED722 million) in dividends to minority shareholders.

## Outlook

The stable outlook reflects our view that the extremely high likelihood of the Abu Dhabi government providing timely and sufficient extraordinary support to TAQA will remain unchanged. This incorporates our assessment of TAQA's very important role for and integral link with the Abu Dhabi government. Moreover, we anticipate continued robust cash flow generation from TAQA's power and water businesses in the medium term and that the company will maintain sufficient liquidity after meeting its refinancing and capital spending needs. We expect that TAQA's credit metrics will remain commensurate with our base-case forecast, including positive free cash flow in the medium term. We expect TAQA will address future profitability challenges in the current low commodity price environment and implement its cost-reduction strategies, with all of its operations performing in line with our base case.

### Downside scenario

A dilution of the government's ownership stake or unexpected significant changes to TAQA's business model could lead us to revise downward our assessment of extraordinary support and lower the rating. Examples of such changes are a key divestiture of assets or acquisition of new assets that we would consider high risk or located in untested markets. Additionally, if the company's financial position were to deteriorate, for example, with FFO to debt below our base case projection or free cash flow turning negative, we may consider a negative rating action because this could also imply weakening government support.

### Upside scenario

Upside rating potential could develop if we revise our assessment of government support upward, which could potentially happen if, for example, virtually all of TAQA's operations were to comprise domestic power and water. Improvement of TAQA's stand-alone credit profile to 'bb-' or higher would support an upgrade. This could materialize if the company were to report better-than-expected financial performance, with FFO to debt higher than 12% on a sustainable basis.

## Ratings Score Snapshot

Corporate Credit Rating: A/Stable/--

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b

- Sovereign rating: 'AA'
- Likelihood of government support: Extremely high (+9 notches from SACP)

## Related Criteria And Research

### Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Key Credit Factors For The Oil And Gas Exploration And Production Industry , Dec. 12, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

Ratings Affirmed

Abu Dhabi National Energy Co. PJSC

Corporate Credit Rating

A/Stable/--

Senior Unsecured

A-

**Additional Contact:**

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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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