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Research Update:

Spanish Engineering And Construction Company Abengoa 'B/B' Ratings Affirmed; Outlook Remains Positive

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Spanish Engineering And Construction Company Abengoa 'B/B' Ratings Affirmed; Outlook Remains Positive

Overview

- Spanish engineering and construction company Abengoa included a guaranteed bond within debt labelled as nonrecourse in its third-quarter financial report.
- Although we view this accounting classification as less prudent, we have always included all Abengoa's consolidated financial debt, whether nonrecourse or corporate, in our calculations.
- We understand management is committed to reducing its stake in Abengoa's yield company to below 50% within the next six months.
- We are affirming our 'B/B' ratings on Abengoa.
- The positive outlook reflects a one-in-three possibility of a one-notch upgrade over the next six months if Abengoa continues to meaningfully reduce its level of consolidated debt.

Rating Action

On Dec. 3, 2014, Standard & Poor's Ratings Services affirmed its 'B/B' long- and short-term corporate credit ratings on Spain-based engineering and construction company Abengoa S.A. The outlook is positive.

Rationale

We understand that Abengoa's management remains very committed to reducing its stake in Abengoa's yield company, which we think will lead to reduced consolidated leverage and improved credit ratios. This is despite recent market turmoil that followed the company's third-quarter results announcement reporting a guaranteed bond as nonrecourse debt. We view the classification as less prudent. This is because it makes it more difficult for investors to understand where in the complex group structure various debt types are located and also what portion of debt is guaranteed or not.

We now perceive that the company will strive to improve disclosure, including releasing quarterly accounts and splitting overall financial debt into three categories:
- Full recourse corporate debt;
- Debt in process, guaranteed by Abengoa but still labelled as "nonrecourse in process" because refinancing at completion of projects should ultimately be in the form of nonrecourse project finance debt; and

- Nonrecourse project finance debt.

In our analytical approach, we use reported consolidated debt, which includes both recourse and nonrecourse debt, and thereby we capture all of Abengoa's financial debt in our analysis.

We also understand that management remains committed to reducing its stake in Abengoa's 64%-owned yield company to below 50% in the near term. This implies that most of the debt associated with the yield company will be deconsolidated from Abengoa's reported balance sheet, and that an improvement of Abengoa's credit ratios is likely to follow. We forecast credit ratios moving to the higher end of our "highly leveraged" category if this transaction is executed, thanks to reduced consolidated debt, a lower interest burden on Abengoa, and the possible use of disposal proceeds to lower corporate debt. We currently do not envisage changing our analytical approach by deconsolidating any nonrecourse debt that is reported on the balance sheet.

On Sept. 30, 2014, Abengoa reported gross debt of €13.5 billion, of which about €6.3 billion is full-recourse corporate debt, €5.6 billion is reported as nonrecourse (albeit fully-consolidated), and €1.6 billion is designated as nonrecourse debt in process.

Although the positive outlook captures the possibility that the yield company is deconsolidated, our base case still assumes no change to Abengoa's scope of consolidation. Following our review, we have updated our forecast and now assume:

- Consolidated revenues in 2014 of about €7.4 billion.
- EBITDA of about €1.3 billion-€1.4 billion for the year.
- Standard & Poor's-adjusted debt of about €11 billion-€12 billion (from the gross debt we deduct surplus cash and add our adjustments for operating leases and factoring to arrive at the adjusted numbers).

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

- An EBITDA margin of about 18%-19%.
- Funds from operations (FFO) to debt at 4%-5%.
- Debt to EBITDA at 8x-8.5x.

Liquidity

We assess Abengoa's liquidity as "adequate," as defined in our criteria. We estimate that Abengoa's ratio of sources to uses of liquidity will remain above 1.2x over the 12 months started Oct. 1, 2014.

Principal liquidity sources:

- Consolidated cash balances of €2.9 billion as of Oct. 1, 2014. We assume part of this is tied to operations, and projects and, therefore, that about €2 billion can be used for general corporate purposes. The company also has €1.2 billion of short-term investments that we do not include in our liquidity assessment.
- Available committed long-term credit lines of about €300 million for corporate purposes.

- We note there are also amounts available on a nonrecourse basis for capital expenditures in concessions, but this liquidity cannot be used for general corporate purposes. However, it matches the company's financing needs for projects.
- Assumed FFO of about €450 million-€600 million during the year.
- In the fourth quarter, Abengoa signed off on the first asset sales to its 64%-owned yield company. The transaction, together with other contracted asset sales, implies Abengoa will receive €316 million in cash that can be used for general corporate purposes.

Principal liquidity uses:

- Corporate debt maturities of about €1.5 billion. A further €600 million of nonrecourse debt is due over the period.
- Corporate capital expenditures and equity to concessions of about €600 million-€800 million.
- Dividends of about €40 million-€50 million.
- Working capital movements, which could at times be sizable. We have assumed €250 million outflow for full-year 2014, which implies strong inflow in the fourth quarter.

Both the incurrence covenant on Abengoa's senior unsecured notes and the maintenance covenant on most of the group's bank debt specify debt-to-EBITDA ratios of less than 3x, where debt and EBITDA exclude nonrecourse subsidiaries. However, debt is netted against total consolidated cash and short-term financial investments, including those held by nonrecourse subsidiaries. Furthermore, the syndicated bank facility renewed in September 2014 includes a more demanding ratio of 2.5x net debt to EBITDA from Dec. 31, 2014. As of Sept. 30, 2014, the ratio was 2.15x. Under our base-case assumption, Abengoa will be able to continue to meet those ratios.

Outlook

The positive outlook on Abengoa reflects a one-in-three possibility that Abengoa's financial risk profile will improve within the next six months, following management's plan to reduce ownership in its yield company. This could lead to reduction in reported consolidated debt, implying credit ratios at the upper end of the "highly leveraged" category. We expect the group to continuously place mature projects in the yield company. If these measures prove successful over the coming six months, we could raise our long-term rating on Abengoa by one notch, assuming the group's liquidity remains at least "adequate."

Downside scenario

We could revise the outlook to stable if Abengoa proves unable to tap capital markets over the coming six months as a consequence of recent investor concerns about its disclosures. We could also revise the outlook to stable if management, for any reason, proves unable to reduce its stake in the yield company below 50% and Abengoa's adjusted FFO to debt ratio remains near the

currently low 4%-6%. We could also consider revising the outlook to stable if Abengoa stops placing concessions business into the yield company.

Upside scenario

We could raise the long-term rating in the next six months if Abengoa continues placing a material part of its concessions business into its yield company, and at the same time reduces its stake in the yield company. This would likely require credit ratios being at the higher end of the "highly leveraged" financial risk profile category. We are unlikely to take any positive rating action until the improvement is fully visible in the company's audited accounts. An upgrade would also hinge on the company maintaining at least "adequate" liquidity.

Ratings Score Snapshot

Corporate Credit Rating: B/Positive/B

Business risk: Fair
- Country risk: Intermediate risk
- Industry risk: Intermediate risk
- 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

Recovery Analysis

Key analytical factors

- The issue rating on the senior unsecured notes issued by both Abengoa and Abengoa Finance, and including the €265 million and $300 million green field bonds is 'B'. The recovery rating on these facilities is '4', reflecting our view of the group's diversified portfolio of businesses, benefiting from strong growth profiles, regulated environments, and a strong reputation in the engineering and construction business.
- This is balanced by our view of the group's exposure to various

relatively unfriendly insolvency regimes, including Spain, the unsecured nature of the debt, and the group's ability to raise additional nonrecourse finance in process.

- The existence of the corporate guarantees effectively, in our view ensures, that all the nonrecourse finance in process will have recourse in a default scenario, and will rank pari passu with the existing corporate debt.
- We understand that this nonrecourse finance in process, which includes the greenfield bonds,the €701 million under the senior unsecured Term Loan B issued in October 2014, and a bridge loan of approximately €1 billion, benefits from corporate guarantees from the parent, as well as from several subsidiaries that also guarantee the existing senior unsecured notes. Previously we considered both the greenfield bonds and the Term Loan B to be pari passu at the point of default with the existing senior unsecured bonds and senior unsecured Term Loan A. Our assumptions now also include the bridge loans, because, although these are issued by an unrestricted subsidiary that cannot be a guarantor for the other unsecured debt, they benefit from corporate guarantees similar to that on Term Loan A and the senior unsecured notes.
- Further material issuances of debt guaranteed by the parent, either as corporate debt for general corporate purposes or nonrecourse finance in process, may put significant pressure on the ratings.
- We value Abengoa as a going concern, although in light of the asset-heavy nature of the business, we use a discrete asset valuation to estimate the group's enterprise value at the point of default.
- In our valuation, we give only limited credit to Abengoa's equity ownership in its nonrecourse projects. However, we recognize that a default by Abengoa would not necessarily affect the performance of the project assets uniformly, and so there could be additional value available to lenders if performing projects can be sold.
- Under our hypothetical default scenario, a default is triggered by Abengoa's underperformance in the bioenergy business, combined with high capital expenditures and a rising cost of capital.

Simulated default assumptions

- Year of default: 2017
- Jurisdiction: Spain

Simplified waterfall

- Net enterprise value (after 9% administration costs): €3 billion
- -----------------------------
- Priority claims: €35 million
- Unsecured debt claims: €6.7 billion*
- Recovery expectation: 30%-50%

*All debt amounts include six months of prepetition interest.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- 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
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009

Ratings List

Ratings Affirmed

Abengoa S.A.	
Corporate Credit Rating	B/Positive/B
Senior Unsecured	B
Recovery Rating	4
Abengoa Finance S.A.U.	
Senior Unsecured*	B
Recovery Rating	4
Abengoa Greenfield, S.A.U	
Senior Unsecured*	B
Recovery Rating	4

Guaranteed by Abengoa S.A.

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