Canal de Isabel II, S.A.

Ratings

Rating Type	Rating	Outlook	Last Rating Action
Long-Term IDR	BBB+	Stable	Affirmed 27 May 2022
Standalone Credit Profile	bbb+		Affirmed 27 May 2022

Click here for full list of ratings

Canal de Isabel II, S.A.'s ratings are supported by its low-risk business profile, with the majority of earnings generated by its regulated activities as a regional monopoly-asset operator and provider of water and sewerage services under long-term concession agreements in the Autonomous Community of Madrid (BBB/Stable). Fitch Ratings assesses Canal's Standalone Credit Profile (SCP) at 'bbb+'.

The ratings also reflect our view of increased regulatory risk for Canal due to a protracted tariff freeze, despite increasing cost pressure from stagflation. We have tightened Canal's debt capacity by 0.5x to reflect the worsened business risk profile, albeit with no impact on the ratings given ample headroom under current leverage sensitivities.

The Stable Outlook mirrors that on Madrid's IDR and also reflects the company's resilient business model, the perceived improvement of its corporate governance and a conservative financial policy.

Key Rating Drivers

Protracted Tariff Freeze: Canal's tariffs have not increased since 2016. Madrid initially froze tariffs until 2019, but has since extended the measure three times, first due to delays in the company's capex and latterly as a result of an uncertain economic environment. We assume that tariffs will remain frozen until end-2024. This is driven by Madrid's record of tariff-setting interventionism, especially when the region's economy is under pressure, which is the case due to stagflation and the energy crisis.

Political Risk in Tariff-Setting: Canal is prone to political intervention from Madrid, which is its major shareholder but which also sets and approves its tariffs. This has limited Canal's ability to pass its costs onto customers. In contrast, other Fitch-rated private water operators in Spain have managed to partially pass on increasing costs to tariffs during the same period, while other European regulatory frameworks allow water operators to fully cover the costs incurred, with the added benefit of an independent regulator and transparent tariff-setting mechanisms.

We therefore consider the 'regulatory environment' risk factor to have worsened for Canal, which we reflect in a tighter debt capacity by 0.5x but with no impact on Canal's SCP and IDR given ample headroom under current leverage sensitivities.

Falling Operating Margins: Canal's EBITDA margins (as calculated by Fitch) decreased about 6bp between 2018 and 2021 to 38%, as tariffs remained unchanged while operating costs rose continuously. The cost increases, in some cases above inflation, were largely linked to the implementation of the company's strategic plan (ie supplies, services by third parties, technical assistance and R&D), a gradual increase in wages and higher electricity costs.

We project margins to weaken further to around 34% in the next three years on high inflation and energy costs. Notwithstanding the EBITDA-margin drop, they still compare well with peers'.

Capex to Ramp Up: Canal's growth plan has remained subdued versus initial expectations, due to longer awarding periods linked to sizable and complex contracts and pandemic-related delays in the bidding process and works execution in 2020-2021.

However, Canal expects capex to catch up in the next five years with a total investment of EUR1.6 billion (EUR320 million annually) in 2022-2026, which is more than double its current expense. In 2021, Canal awarded a contract for EUR350 million for the renovation of the supply water network in Madrid, its largest tender ever.

Applicable Criteria

Corporate Rating Criteria (October 2021)
Corporates Recovery Ratings and Instrument Ratings Criteria (April 2021)
Parent and Subsidiary Linkage Rating Criteria (December 2021)
Government-Related Entities Rating Criteria (September 2020)

Analysts

Maria Linares
+34 93 492 9512
maria.linares@fitchratings.com

Jaime Sierra
+49 69 768076 275
jaime.sierrapuerta@fitchratings.com

Capex Flexibility Retained: Flexibility in capex is retained, as delays would not affect the proper functioning of the network nor imply any contractual breach or penalty. Its capex plan includes the modernisation of its sewage networks, the standardisation of materials in distribution, smart meter installation and the installation of photovoltaic plants to boost generation and self-consumption of clean energy.

Unchanged Parent and Subsidiary Linkage: Fitch continues to assess the linkage between parent Madrid and Canal as 'Consolidated +1' under our updated *Parent and Subsidiary Linkage Rating Criteria*. As a result, Canal's IDR is one notch above Madrid's, in line with our previous approach.

However, sustained decision-making on tariff freezing, with negative financial impact on Canal, shows growing effective control and influence from the parent and reduces the relevance we grant to the company's stated financial policy, which has otherwise been consistently applied in the past.

Revised ESG Governance Scores: Risks related to historical corporate-governance issues and ongoing judicial processes in Spain and Latin America have decreased and potential contingencies do not pose a material threat to Canal's credit profile, in our view. Moreover, Canal has made progress on the implementation of good governance practices and scaled back its operations in Latin America.

Its Latin American operations are now not meaningful, with Fitch's EUR316 million EBITDA forecast for Canal in 2022 almost entirely generated from concession-based water activities in Spain (1% in Latin America; largely linked to a concession in Ecuador). As a result, we have changed the ESG relevance score for 'operational execution of management strategy' and 'governance structure' to '3' from '4'.

Leverage to Rise: Canal has continued to reduce its debt, in line with the amortising portion of its financial debt. This is due to strong cash flow generation despite margin pressure. In 2021 funds from operations (FFO) dividend-adjusted net leverage remained low at around 1.0x, compared with a tighter negative rating sensitivity of 4.3x (4.8x previously) for the 'BBB+' rating.

We expect leverage to increase on average to around 2.8x over 2022-2026, still low for the rating but above historical levels. The rise is driven by higher capex and our more conservative assumptions on tariffs, operating costs and dividend distributions versus management's guidance.

Financial Summary

Canal de Isabel II, S.A.

(EUR 000)	Dec 20	Dec 21	Dec 22F	Dec 23F	Dec 24F	Dec 25F
Operating EBITDA (before income from associates)	392,591	348,181	315,957	324,080	335,359	363,018
Operating EBITDA margin (%)	42.8	38.1	33.4	34.1	35.0	36.8
FFO margin (%)	29.7	21.5	19.1	19.5	22.3	22.2
FFO net leverage (x)[a]	1.1	1.0	1.4	2.3	3.1	3.6
FFO interest coverage (x)	16.9	13.9	14.3	14.7	14.4	11.4

F – Forecast.
[a] FFO dividend-adjusted net leverage (FFO after dividend payments)
Source: Fitch Ratings, Fitch Solutions

Rating Derivation Relative to Peers

Canal is a water and sewage network operator, but unlike most European peers does not own its asset base. However, its investments are supported by its concession value. Canal's leverage, adjusted for dividends, is well below that of other peers, such as Acea SpA (BBB+/Stable), Wessex Water Services Limited (BBB/Stable) and FCC Aqualia, S.A. (BBB-/Stable), although we give leverage a lower weight in the overall assessment than for peers.

Canal operates in a decentralised and less developed regulatory environment than some other European countries. Its Latin American operations carry higher business and political risks and were the driver of negative corporate-governance considerations.

In addition, as Canal does not own its assets, it does not benefit from the one-notch uplift to the senior unsecured rating typically afforded to regulated network utilities, which reflects above-average expected recoveries in case of default. No Country Ceiling constraints affect Canal's ratings.

Navigator Peer Comparison

Issuer		Business profile						Financial profile		
	IDR/Outlook	Operating Environment	Management and Corporate Governance	Sector Positioning	Regulatory Environment	Asset Base	Operations	Profitability and Cash Flow	Financial Structure	Financial Flexibility
Canal de Isabel II, S.A.	BBB+/Sta	bbb+	bbb-	bbb+	bbb	bbb	a-	bbb+	a	bbb
FCC Aqualia, S.A.	BBB/	bbb+	bbb-	bb+	bbb-	bbb	bbb+	bbb	bbb-	bbb-
Aquanet S.A.	BBB+/RWN	bbb+	bbb	bbb+	bbb	bbb	bbb+	bbb-	a	bbb+
Wessex Water Services Limited	BBB/Sta	aa-	a-	bbb+	a-	bbb+	a-	bbb	bbb-	bbb+

Source: Fitch Ratings. Importance: Higher / Moderate / Lower

Issuer		Business profile						Financial profile		
Name	IDR/Outlook	Operating Environment	Management and Corporate Governance	Sector Positioning	Regulatory Environment	Asset Base	Operations	Profitability and Cash Flow	Financial Structure	Financial Flexibility
Canal de Isabel II, S.A.	BBB+/Sta	0.0	-2.0	0.0	-1.0	-1.0	1.0	0.0	2.0	-1.0
FCC Aqualia, S.A.	BBB/	1.0	-1.0	-2.0	-1.0	0.0	1.0	0.0	-1.0	-1.0
Aquanet S.A.	BBB+/RWN	0.0	-1.0	0.0	-1.0	-1.0	0.0	-2.0	2.0	0.0
Wessex Water Services Limited	BBB/Sta	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Fitch Ratings. Worse positioned than IDR / In line with IDR / Better positioned than IDR

Rating Sensitivities

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

- An upgrade of Madrid, provided that the links with Canal are intact, together with an upward revision of Canal's Standalone Credit Profile (SCP), could lead to an upgrade of Canal's IDR.
- The SCP may be revised higher on reduced regulatory risk (ie tariff increase).

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

- Negative rating action on Madrid could trigger a similar action for Canal, provided that the strength of the links between the two continues to allow for a maximum one-notch differential.
- Closer linkage with Madrid, leading to an 'open' assessment of all the PSL linkage factors would lead to the alignment of Canal's IDR with that of Madrid (consolidated approach).

- Weaker cash flow generation leading to FFO dividend-adjusted net leverage above 4.3x on a sustained basis would be negative for the rating. This may be due to a worse-than-expected operating environment, including regulatory changes, or higher dividends.

Liquidity and Debt Structure

Healthy Liquidity: At end-2021 Canal's liquidity position comprised EUR523 million of readily available cash (excluding EUR2.3 million of cash in Latin America) as well as an undrawn committed revolving credit facility of EUR104 million maturing in December 2022, which is renewed annually.

Canal's total available liquidity of EUR627 million more than covers short-term debt of only EU16 million and projected negative free cash flow of about EUR270 million for the next two years.

We assume the revolving credit facility will roll over annually. Canal is subject to the Madrid Budgetary Law, which requires high-level authorisation to approve long-term committed credit lines.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Liquidity and Debt Maturities

Canal de Isabel II, S.A. – Liquidity Analysis

(EUR 000)	2022F	2023F	2024F	2025F
Available liquidity				
Beginning cash balance	523,370	431,467	224,416	-45,843
Rating case FCF after acquisitions and divestitures	-76,120	-191,403	-255,416	-139,784
Total available liquidity (A)	**447,250**	**240,065**	**-31,000**	**-185,627**
Liquidity uses				
Debt maturities	-15,783	-15,649	-14,842	-514,762
Total liquidity uses (B)	**-15,783**	**-15,649**	**-14,842**	**-514,762**
Liquidity calculation				
Ending cash balance (A+B)	431,467	224,416	-45,843	-700,389
Revolver availability	0	0	0	0
Ending liquidity	**431,467**	**224,416**	**-45,843**	**-700,389**
Liquidity score (x)	28.3	15.3	-2.1	-0.4

F – Forecast
Source: Fitch Ratings, Fitch Solutions

Scheduled debt maturities (EUR 000)	Original 31 December 2021
2022	15,783
2023	15,649
2024	14,842
2025	514,762
Thereafter	152,619
Total[a]	**713,655**

[a]Debt excluding accrued interest, amortised cost and other intercompany debt items (ie.debt related to group fiscal consolidation)
As of December 2021 the company had available committed revolver credit facilities in the amount of EUR104 million; however, these roll over annually
Source: Fitch Ratings, Fitch Solutions

Key Assumptions

- Madrid's water tariffs frozen until 2024 and annually revised from 2025 to closely track CPI
- Average annual 0.3% increase in billed volumes to 2026
- Slight increase in population and customers for the next four years
- Divestments of real-estate assets in Madrid at appraised value in 2023
- Annual capex on average at about EUR320 million for 2022-2026
- About 70% dividend pay-out based on consolidated accounts for Canal

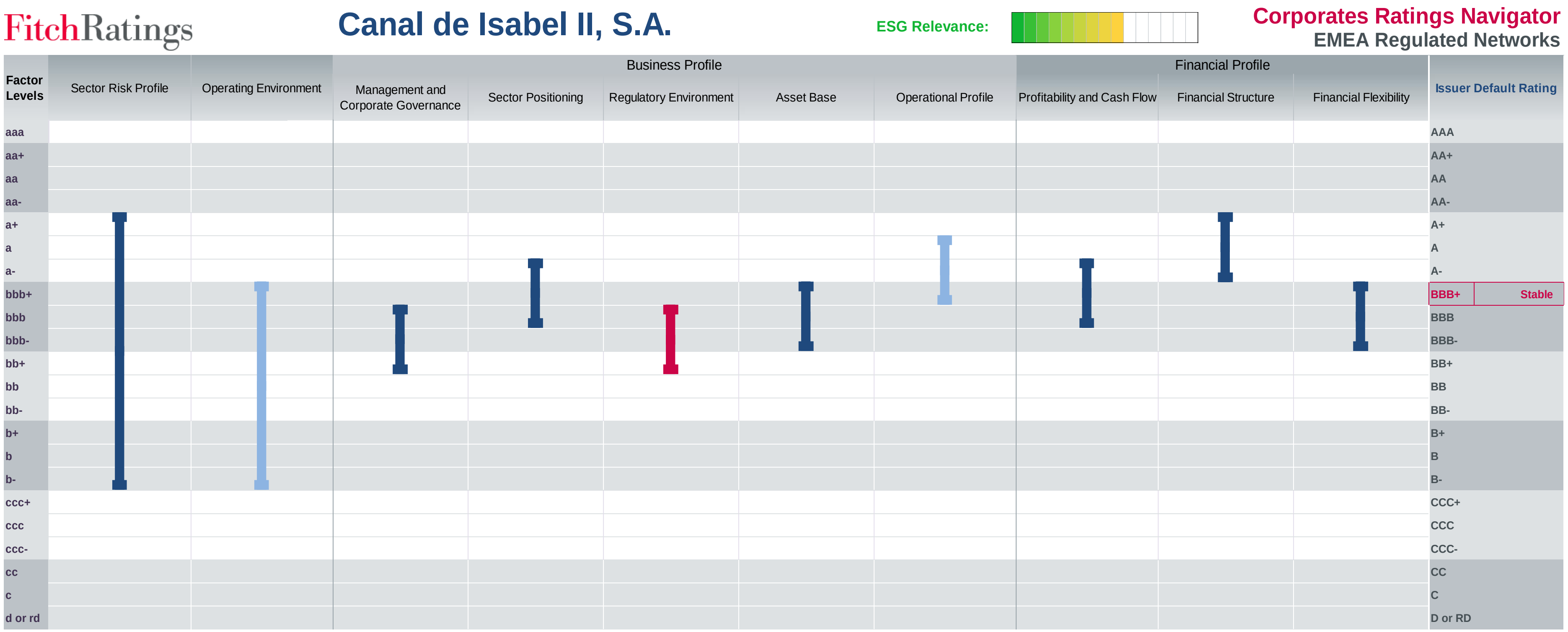
Financial Data

Canal de Isabel II, S.A.

	Historical		Forecast			
(EUR 000)	Dec 20	Dec 21	Dec 22F	Dec 23F	Dec 24F	Dec 25F
Summary income statement						
Gross revenue	916,733	915,024	944,758	949,839	957,431	985,782
Revenue growth (%)	-6.9	-0.2	3.3	0.5	0.8	3.0
Operating EBITDA (before income from associates)	392,591	348,181	315,957	324,080	335,359	363,018
Operating EBITDA margin (%)	42.8	38.1	33.4	34.1	35.0	36.8
Operating EBITDAR	399,431	348,181	315,957	324,080	335,359	363,018
Operating EBITDAR margin (%)	43.6	38.1	33.4	34.1	35.0	36.8
Operating EBIT	199,131	165,190	138,280	141,348	145,884	165,954
Operating EBIT margin (%)	21.7	18.1	14.6	14.9	15.2	16.8
Gross interest expense	-19,296	-19,048	-13,550	-13,448	-15,848	-21,015
Pretax income (including associate income/loss)	166,010	166,207	118,800	145,305	124,828	141,641
Summary balance sheet						
Readily available cash and equivalents	430,386	523,370	443,260	236,895	166,509	111,693
Total debt with equity credit	753,088	726,585	711,823	697,061	882,299	967,537
Total adjusted debt with equity credit	807,808	726,585	711,823	697,061	882,299	967,537
Net debt with equity credit	322,702	203,215	268,563	460,166	715,790	855,844
Summary cash flow statement						
Operating EBITDA	392,591	348,181	315,957	324,080	335,359	363,018
Cash interest paid	-17,113	-15,243	-13,550	-13,448	-15,848	-21,015
Cash tax	216	-1,993	-1,452	-6,656	-1,320	-1,637
Dividends received less dividends paid to minorities (inflow/(out)flow)	-219	-155	-155	-155	-155	-155
Other items before FFO	-103,918	-134,373	-120,719	-118,915	-104,966	-121,385
Funds flow from operations	271,985	197,009	180,165	184,989	213,152	218,909
FFO margin (%)	29.7	21.5	19.1	19.5	22.3	22.2
Change in working capital	-18,059	31,513	-1,254	-16,605	-5,601	-26,924
Cash flow from operations (Fitch defined)	253,926	228,522	178,911	168,384	207,551	191,985
Total non-operating/nonrecurring cash flow	0	0				
Capex	-111,585	-121,739				
Capital intensity (capex/revenue) (%)	12.2	13.3				
Common dividends	0	0				
Free cash flow	142,341	106,783				
Net acquisitions and divestitures	0	288				
Other investing and financing cash flow items	2,635	98	10,771	-200	-208	-269
Net debt proceeds	-31,081	-27,961	-14,762	-14,762	185,238	85,238
Net equity proceeds	0	0	0	0	0	0
Total change in cash	114,110	92,984	-80,111	-206,365	-70,386	-54,816
Leverage ratios						
Total net debt with equity credit/operating EBITDA (x)	0.8	0.6	0.9	1.4	2.1	2.4
Total adjusted debt/operating EBITDAR (x)	2.0	2.1	2.3	2.2	2.6	2.7
Total adjusted net debt/operating EBITDAR (x)	0.9	0.6	0.9	1.4	2.1	2.4
Total debt with equity credit/operating EBITDA (x)	1.9	2.1	2.3	2.2	2.6	2.7
FFO adjusted leverage (x)	2.7	3.4	3.7	3.5	3.9	4.0
FFO adjusted net leverage (x)	1.3	1.0	1.4	2.3	3.1	3.6
FFO leverage (x)	2.6	3.4	3.7	3.5	3.9	4.0
FFO net leverage (x) [1]	1.1	1.0	1.4	2.3	3.1	3.6
Calculations for forecast publication						
Capex, dividends, acquisitions and other items before FCF	-111,585	-121,451	-255,031	-359,787	-462,967	-331,769
Free cash flow after acquisitions and divestitures	142,341	107,071	-76,120	-191,403	-255,416	-139,784
Free cash flow margin (after net acquisitions) (%)	15.5	11.7	-8.1	-20.2	-26.7	-14.2
Coverage ratios						
FFO interest coverage (x)	16.9	13.9	14.3	14.7	14.4	11.4
FFO fixed charge coverage (x)	12.3	13.9	14.3	14.7	14.4	11.4
Operating EBITDAR/interest paid + rents (x)	16.7	22.8	23.3	24.1	21.2	17.3
Operating EBITDA/interest paid (x)	22.9	22.8	23.3	24.1	21.2	17.3
Additional metrics						
CFO-capex/total debt with equity credit (%)	18.9	14.7	-10.7	-27.5	-22.1	-14.4
CFO-capex/total net debt with equity credit (%)	44.1	52.5	-28.3	-41.6	-27.3	-16.3

Source: Fitch Ratings, Fitch Solutions. [1]FFO dividend-adjusted net leverage (FFO after dividend payments)

Ratings Navigator



Bar Chart Legend:			
Vertical Bars = Range of Rating Factor		Bar Arrows = Rating Factor Outlook	
Bar Colours = Relative Importance		⇧	Positive
■	Higher Importance	⇩	Negative
■	Average Importance	⇳	Evolving
■	Lower Importance	☐	Stable

FitchRatings

Canal de Isabel II, S.A.

Corporates Ratings Navigator
EMEA Regulated Networks

Operating Environment

a-	Economic Environment	bbb	Average combination of countries where economic value is created and where assets are located.
bbb+	Financial Access	bbb	Average combination of issuer-specific funding characteristics and the strength of the relevant local financial market.
	Systemic Governance	a	Systemic governance (eg rule of law, corruption, government effectiveness) of the issuer's country of incorporation consistent with 'a'.
b-			
ccc+			

Management and Corporate Governance

bbb+	Management Strategy	bb	Strategy generally coherent but some evidence of weak implementation.
bbb	Governance Structure	bb	Board effectiveness questionable, with few independent directors. "Key person" risk from dominant CEO or shareholder.
bbb-	Group Structure	bbb	Some group complexity leading to somewhat less transparent accounting statements. No significant related-party transactions.
bb+	Financial Transparency	bb	Financial reporting is appropriate but with some failings (eg lack of interim or segment analysis).
bb			

Sector Positioning

a	Operation Type	bbb	Local or regional monopoly asset owners, regional monopoly asset operators.
a-	Non-Regulated Earnings (% of Total Earnings)	a	up to 10%
bbb+			
bbb			
bbb-			

Regulatory Environment

bbb+	Independence, Transparency, Predictability	bbb	Less transparent frameworks, with emerging track record and multi-year tariffs; exposed to political risk. Medium-term predictability.
bbb	Licensing, Ring-Fencing, Concessioning	bbb	Less demanding licensing and ring-fencing provisions; moderate concession renewal risk.
bbb-	Cost and Investment Recovery	bb	Inadequate tariff-setting mechanism for recovery of costs and investments, significant regulatory lag.
bb+	Volume and Price Risk	bbb	Moderate insulation from price and volume risk and revenue under-recovery.
bb			

Asset Base

a-	Diversification	bbb	Limited diversification by geography without regulatory diversification; regional utility.
bbb+	Critical Mass	a	Critical mass in one regulated asset; does not affect efficiency of operations (cost base, customer base, key personnel).
bbb	Asset Quality and Residual Life	bbb	Mid-range asset quality not affecting opex and capex requirements compared with peers. The residual life of regulatory assets is average.
bbb-			
bb+			

Operational Profile

a+	Performance Measures	a	Key performance measures in line with or above sector average and/or regulatory target.
a	Counterparty Risk	a	Low counterparty risk; high collection rates for water suppliers. Economy of area served provides structurally stable background.
a-			
bbb+			
bbb			

Profitability and Cash Flow

a	Return on Capital	bbb	Return on capital comparable with the regulatory benchmark.
a-	Volatility of Profitability	bbb	Stability and predictability of profit in line with utility peers.
bbb+	Investment Cycle	a	Investment cycle position and dividend policy leading to broadly neutral free cash flow. High flexibility in smoothing capex plans.
bbb			
bbb-			

Financial Structure

aa-	FFO Leverage	a	4.5x
a+	FFO Net Leverage	a	4.0x
a	Adjusted Net Debt/Asset Base (or Regulated Asset Base)	a	60%
a-	Cash PMICR		
bbb+	Nominal PMICR		

Financial Flexibility

a-	Financial Discipline	bbb	Financial policies less conservative than peers but generally applied consistently.
bbb+	Liquidity	bbb	One-year liquidity ratio above 1.25x. Well spread debt maturity schedule but funding may be less diversified.
bbb	FFO Interest Coverage	a	4.5x
bbb-	FX Exposure	bbb	Some FX exposure on profitability and/or debt/cash flow match. Effective hedging.
bb+	Dividend Cover		n.a.

Credit-Relevant ESG Derivation

Canal de Isabel II, S.A. has 12 ESG potential rating drivers

- Energy and fuel use in operations; entities' financial targets for losses/shrinkage
- Water usage in operations; water utilities' financial targets for water quality, leakage and usage
- Impact of waste including pollution incidents; discharge compliance; sludge disposal
- Exposure to extreme weather events - negative (e.g. risk of drought and flooding) or positive (e.g. additional return on capex for network weather-resilience)
- Product affordability and access
- Quality and safety of products and services; data security

Showing top 6 issues

			Overall ESG
key driver	0	issues	5
driver	0	issues	4
potential driver	12	issues	3
not a rating driver	1	issues	2
	1	issues	1

For further details on Credit-Relevant ESG scoring, see page 3.

How to Read This Page: The left column shows the three-notch band assessment for the overall Factor, illustrated by a bar. The right column breaks down the Factor into Sub-Factors, with a description appropriate for each Sub-Factor and its corresponding category.

FitchRatings

Canal de Isabel II, S.A.

Corporates Ratings Navigator
EMEA Regulated Networks

Credit-Relevant ESG Derivation

Canal de Isabel II, S.A. has 12 ESG potential rating drivers

- Canal de Isabel II, S.A. has exposure to energy regulatory risk but this has very low impact on the rating.
- Canal de Isabel II, S.A. has exposure to water management risk but this has very low impact on the rating.
- Canal de Isabel II, S.A. has exposure to waste & impact management risk but this has very low impact on the rating.
- Canal de Isabel II, S.A. has exposure to extreme weather events but this has very low impact on the rating.
- Canal de Isabel II, S.A. has exposure to access/affordability risk but this has very low impact on the rating.
- Canal de Isabel II, S.A. has exposure to customer accountability risk but this has very low impact on the rating.

Showing top 6 issues

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	12	issues	3
not a rating driver	1	issues	2
	1	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	Emissions from operations	Profitability and Cash Flow
Energy Management	3	Energy and fuel use in operations; entities' financial targets for losses/shrinkage	Profitability and Cash Flow
Water & Wastewater Management	3	Water usage in operations; water utilities' financial targets for water quality, leakage and usage	Operations; Profitability and Cash Flow; Financial Structure; Financial Flexibility
Waste & Hazardous Materials Management; Ecological Impacts	3	Impact of waste including pollution incidents; discharge compliance; sludge disposal	Operations; Profitability and Cash Flow; Financial Flexibility
Exposure to Environmental Impacts	3	Exposure to extreme weather events - negative (e.g. risk of drought and flooding) or positive (e.g. additional return on capex for network weather-resilience)	Operations; Profitability and Cash Flow; Financial Flexibility

E Scale: 5, 4, 3, 2, 1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	3	Product affordability and access	Profitability and Cash Flow; Regulatory Environment
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Quality and safety of products and services; data security	Profitability and Cash Flow
Labor Relations & Practices	3	Impact of labor negotiations and employee (dis)satisfaction	Profitability and Cash Flow; Financial Structure; Financial Flexibility
Employee Wellbeing	2	Worker safety and accident prevention	Financial Structure; Financial Flexibility
Exposure to Social Impacts	3	Social resistance to major projects that leads to delays and cost increases	Operations; Profitability and Cash Flow

S Scale: 5, 4, 3, 2, 1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Strategy development and implementation	Management and Corporate Governance
Governance Structure	3	Board independence and effectiveness; ownership concentration	Management and Corporate Governance
Group Structure	3	Complexity, transparency and related-party transactions	Management and Corporate Governance
Financial Transparency	3	Quality and timing of financial disclosure	Management and Corporate Governance

G Scale: 5, 4, 3, 2, 1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies the some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

CREDIT-RELEVANT ESG SCALE

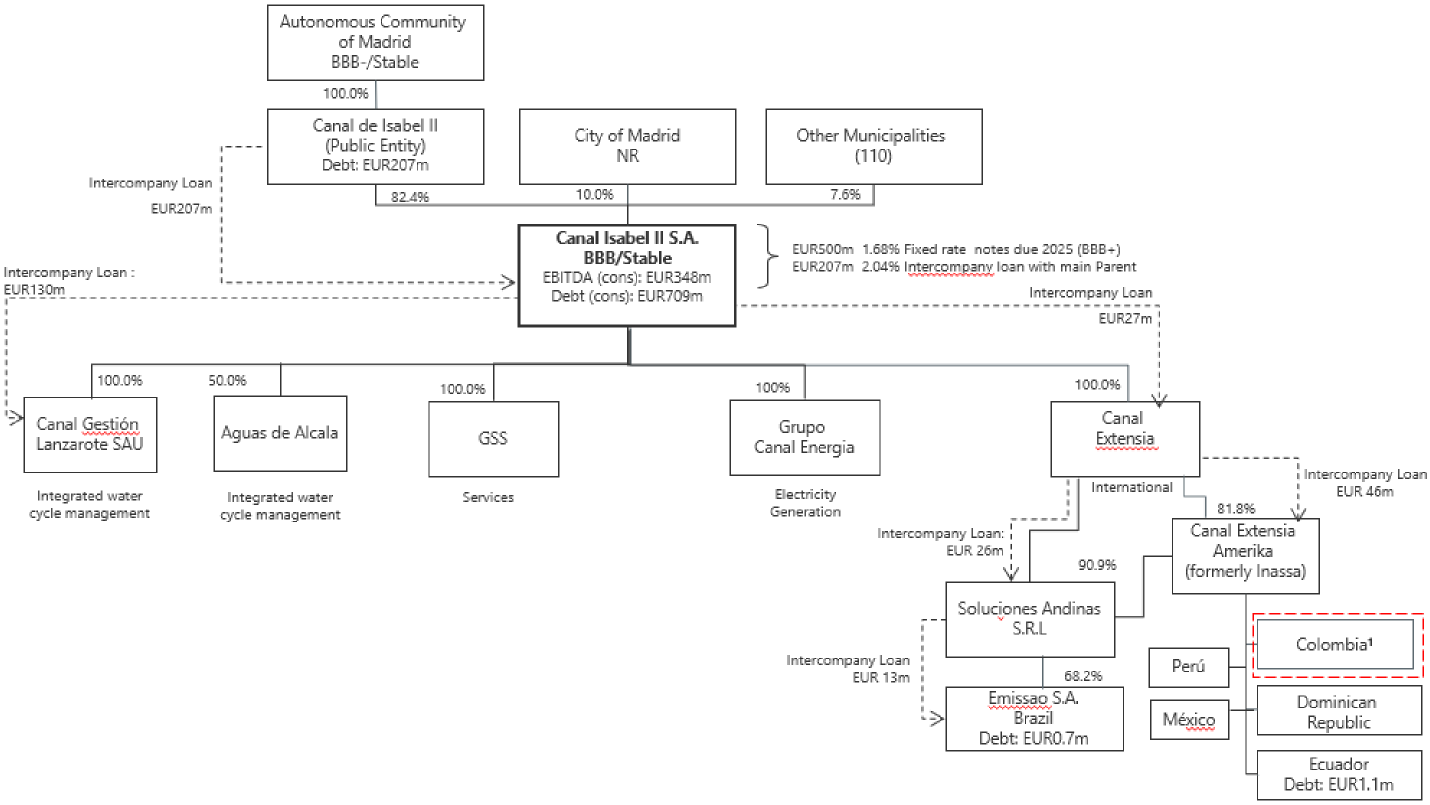
How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Simplified Group Structure Diagram

Simplified Group Structure Diagram

As of March 2022



[1]Colombia refers to Triple A, whose control has been seized by the Colombian authorities.
Source: Fitch Ratings, Fitch Solutions, Canal de Isabel II, S.A. The chart does not include equity method consolidated stakes. EBITDA as at 31 December 2021. Debt position and intercompany with subsidiaries loans as at 31 March 2022.

Peer Financial Summary

Company	Issuer default Rating	Financial statement date	Operating EBITDA (before income from associates) (EURm)	Operating EBITDA margin (%)	FFO margin (%)	FFO net leverage[a] (x)	FFO interest coverage (x)
Canal de Isabel II, S.A.	BBB+						
	BBB+	2021	348	38.1	21.5	1.0	13.9
	BBB	2020	393	42.8	29.7	1.1	16.9
	BBB+	2019	439	44.5	16.2	2.6	10.2
FCC Aqualia, S.A.	BBB-						
	BBB-	2021	218	20.6	17.9	4.8	6.9
	BB+	2020	192	18.2	17.6	5.2	7.4
	BB+	2019	204	19.2	17.4	5.4	7.3
Aquanet S.A.	BBB+						
	BBB+	2020	35	25.3	25.4	2.0	22.1
	BBB+	2019	41	30.4	30.2	1.6	15.7
	BBB+	2018	44	35.8	35.7	1.9	17.4
Wessex Water Services Limited	BBB						
	BBB	2021	308	53.4	37.8	9.0	4.1
	BBB	2020	362	57.4	39.7	8.0	4.8
	BBB+	2019	371	59.8	43.6	7.2	5.3

[a] FFO dividend-adjusted net leverage (FFO after dividend payments) for Canal only
Source: Fitch Ratings, Fitch Solutions.

Fitch Adjusted Financials

Fitch Financial Adjustments

(EUR000)	Notes and Formulas	Reported Values	Sum of Adjustments	CORP- Lease Treatment	Other Adjustments	Adjusted Values
31 December 2021						
Income Statement Summary						
Revenue		915,024				915,024
Operating EBITDAR		355,042	-6,861	-6,861		348,181
Operating EBITDAR After Associates and Minorities	(a)	355,042	-7,016	-6,861	-155	348,026
Operating Lease Expense	(b)	0				0
Operating EBITDA	(c)	355,042	-6,861	-6,861		348,181
Operating EBITDA After Associates and Minorities	(d) = (a-b)	355,042	-7,016	-6,861	-155	348,026
Operating EBIT	(e)	165,684	-494	-494		165,190
Debt and Cash Summary						
Total Debt with Equity Credit	(f)	726,585				726,585
Lease-Equivalent Debt	(g)	0				0
Other Off-Balance-Sheet Debt	(h)	0				0
Total Adjusted Debt with Equity Credit	(i) = (f+g+h)	726,585				726,585
Readily Available Cash and Equivalents	(j)	525,651	-2,281		-2,281	523,370
Not Readily Available Cash and Equivalents		0	2,281		2,281	2,281
Cash Flow Summary						
Operating EBITDA After Associates and Minorities	(d) = (a-b)	355,042	-7,016	-6,861	-155	348,026
Preferred Dividends (Paid)	(k)	0				0
Interest Received	(l)	592				592
Interest (Paid)	(m)	-15,243				-15,243
Cash Tax (Paid)		-1,993				-1,993
Other Items Before FFO		-68,718	-65,655		-65,655	-134,373
Funds from Operations (FFO)	(n)	269,680	-72,671	-6,861	-65,810	197,009
Change in Working Capital (Fitch-Defined)		31,513				31,513
Cash Flow from Operations (CFO)	(o)	301,193	-72,671	-6,861	-65,810	228,522
Non-Operating/Nonrecurring Cash Flow		0				0
Capital (Expenditures)	(p)	-72,731	-49,008		-49,008	-121,739
Common Dividends (Paid)		-137,195	137,195		137,195	0
Free Cash Flow (FCF)		91,267	15,516	-6,861	22,377	106,783
Gross Leverage (x)						
Total Adjusted Debt/Operating EBITDAR[a]	(i/a)	2.0				2.1
FFO Adjusted Leverage	(i/(n-m-l-k+b))	2.6				3.4
FFO Leverage	(i-g)/(n-m-l-k)	2.6				3.4
Total Debt with Equity Credit/Operating EBITDA[a]	(i-g)/d	2.0				2.1
(CFO-Capex)/Total Debt with Equity Credit (%)	(o+p)/(i-g)	31.4%				14.7%
Net Leverage (x)						
Total Adjusted Net Debt/Operating EBITDAR[a]	(i-j)/a	0.6				0.6
FFO Adjusted Net Leverage	(i-j)/(n-m-l-k+b)	0.7				1.0
FFO Net Leverage	(i-g-j)/(n-m-l-k)	0.7				1.0
Total Net Debt with Equity Credit/Operating EBITDA[a]	(i-g-j)/d	0.6				0.6
(CFO-Capex)/Total Net Debt with Equity Credit (%)	(o+p)/(i-g-j)	113.7%				52.5%
Coverage (x)						
Operating EBITDA/(Interest Paid + Lease Expense)[a]	a/(-m+b)	23.3				22.8
Operating EBITDA/Interest Paid[a]	d/(-m)	23.3				22.8
FFO Fixed-Charge Coverage	(n-l-m-k+b)/(-m-k+b)	18.7				13.9
FFO Interest Coverage	(n-l-m-k)/(-m-k)	18.7				13.9

[a]EBITDA/R after dividends to associates and minorities
Source: Fitch Ratings, Fitch Solutions, Canal de Isabel II, S.A.

We treat dividend payments as a fixed non-discretionary operating charge similar to a concession fee. We adjust Canal's FFO calculations accordingly by deducting dividends as shown in the table above.
Source: Fitch Ratings, Fitch Solutions, Canal de Isabel II, S.A.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.