

Canal de Isabel II, S.A.

The upgrade mirrors a similar rating action on Canal de Isabel II, S.A.'s (Canal) ultimate parent, the Autonomous Community of Madrid, to 'BBB' (with a Stable Outlook) from 'BBB-' on 21 May 2021, reflecting that Canal's Issuer Default Rating (IDR) was constrained at one notch above the parent's. Following the rating action on Madrid, Canal's IDR now stands at the same level of the company's Standalone Credit Profile (SCP), assessed at 'bbb+'.

The ratings of Canal 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 region of Madrid, and by a conservative financial profile.

The Stable Outlook mirrors that on Madrid's IDR and also reflects the company's resilient business model, as proven by the limited impact of the pandemic, approved tariff freeze until 2021 and low leverage.

Key Rating Drivers

Upgrade Reflects Parent Linkage: Fitch Ratings assesses the links between Canal and Madrid as weak-to-moderate under its *Government-Related Entities (GRE) Rating Criteria* and *Parent and Subsidiary Linkage (PSL) Rating Criteria*. This is based on weak-to-moderate legal and operating links, despite Madrid's control of Canal, including the lack of guarantees, declining back-to-back funding, and independent daily operations and treasury.

All the above, along with the presence of internal targets (on maximum indebtedness, net debt/EBITDA and dividend pay-outs) that limit cash extraction from Canal, are key considerations in our approach of a maximum differential of one notch between the IDRs of Canal and Madrid, and constrains rating upside for Canal.

Strong Standalone Credit Profile: Canal's SCP is supported by a healthy financial profile and low business risk. Canal enjoys stable and visible revenue that is generated by its 50-year water concession agreement in Madrid, which expires in 2062. We estimate EBITDA of about EUR390 million in 2021, almost entirely generated from concession-based water activities in Spain (Latin America's EBITDA is expected at about 2%).

The SCP also factors in Canal's historical and ongoing corporate-governance issues, leading to various judicial processes in Spain and Latin America, the loss of control of Triple A S.A., its main operating company in Colombia, and a less conservative liquidity policy than peers'. These risks are partly mitigated by its focus on the core Spanish business.

Low Leverage: Canal has continued to reduce its indebtedness in line with its amortising debt profile. Funds from operations (FFO) dividend-adjusted net leverage declined to 1.1x in 2020 from 2.6x in 2019, further widening the company's ample leverage headroom compared with our negative rating sensitivity of 4.8x for the 'BBB+' rating. We expect leverage to remain low on average at 1.7x for 2021-2025, although above historical levels due to expected higher capex, and our more conservative assumptions for tariff increases and dividend distributions than management's.

Tariff Freeze Assumed Until 2023: Canal's tariffs have not increased since 2016. Madrid initially froze tariffs until 2019, but this was extended first to 2020 due to the expected delays in the company's capex plan and then to 2021 as a result of the pandemic. This shows political interference in tariff-setting, which is a negative factor for the Spanish regulatory water framework compared with other European jurisdictions, which benefit of an independent

Ratings

Rating Type	Rating	Outlook	Last Rating Action
Long-Term IDR	BBB+	Stable	Upgrade 27 May 21
Standalone Credit Profile	bbb+		Affirmed 27 May 21

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Applicable Criteria

- [Corporate Rating Criteria \(December 2020\)](#)
- [Government-Related Entities Rating Criteria \(September 2020\)](#)
- [Parent and Subsidiary Linkage Rating Criteria \(August 2020\)](#)
- [Corporates Recovery Ratings and Instrument Ratings Criteria \(April 2021\)](#)

Related Research

- [Fitch Ratings Assigns ESG Vulnerability Scores to 100 Utilities \(April 2021\)](#)
- [Fitch Upgrades Canal de Isabel II's IDR to 'BBB+' on Madrid's Upgrade \(May 2021\)](#)

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regulator and transparent tariff-setting mechanisms. Management has shared with us a plan that includes inflation-based tariff increases beyond 2021. We conservatively assume that tariffs will remain frozen until 2023.

Limited Impact from Covid-19: The essential nature of Canal's service has supported a limited impact from the pandemic on its earnings. Fitch-calculated operating EBITDA declined by around EUR46 million, or 10%, in 2020. This was due to a mix of effects related to Covid-19, such as a decline in industrial and commercial volumes billed in Madrid, the reduction of the tourism in Lanzarote, the voluntary tariff bonuses (EUR5 million), and to a normalised climate conditions compared to a dry 2019, which had reduced volumes in the comparison.

Canal has incurred in additional costs related to Covid-19 (staff reinforcement, cleaning and disinfection and others), which were largely compensated by lower energy costs and postponement of services. LatAm activity was also affected with contract cancelations and services reduction; however, with no relevant impact at EBITDA as contribution remains limited.

Capex to Ramp Up: Canal's growth plan has remained subdued in the past three years due to delays on the awarding of contracts related to the renewal of supply networks, which involved sizeable capex and complex documentation negotiated with contractors. However, Canal expects capex investment of EUR1.7 billion in 2021-2025, or about EUR310 million annually, which is over double the current level.

Capex Flexibility Retained: Flexibility in capex is retained, as delays would not affect the proper functioning of the network and would not imply any contractual breach or penalty. The plan includes the modernisation of the sewer networks, the standardisation of materials in the distribution network and smart meters installation.

Financial Summary

Canal de Isabel II, S.A.

(EUR 000)	Dec 19	Dec 20	Dec 21F	Dec 22F	Dec 23F
Operating EBITDA (before income from associates)	438,560	392,591	390,765	389,808	388,007
Operating EBITDA margin (%)	44.5	42.8	41.5	40.9	40.4
FFO margin (%)	16.2	29.7	27.3	25.3	23.9
FFO net leverage (x)	2.6	1.1	1.0	1.4	1.9
FFO interest coverage (x)	10.2	16.9	19.2	19.1	18.6

F – Forecast
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 compared with peers.

Canal operates in a decentralised and less developed regulatory environment than some other European countries and its Latin American operations carry higher business and political risks and are 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			
Acea SpA	BBB+/Sta	bbb+	bbb+	bb+	bbb+	bbb+	bbb+	bbb	bbb+	a-	bbb	bbb+	a-
Aquanet S.A.	BBB+/Sta	bbb+	bbb	bbb+	bbb	bbb	bbb+	bbb-	a	bbb	bbb+	bbb	bbb+
Canal de Isabel II, S.A.	BBB+/Sta	bbb+	bbb-	bbb+	bbb	bbb	a-	bbb+	a	bbb	bbb	bbb	bbb
FCC Aqualia, S.A.	BBB-/Sta	bbb+	bbb-	bb+	bbb-	bbb	bbb+	bbb	bbb-	bbb-	bbb	bbb-	bbb-
Wessex Water Services Limited	BBB/Sta	aa-	a-	bbb+	a-	bbb+	a-	bbb	bbb-	bbb+	bbb	bbb	bbb+

Source: Fitch Ratings. Importance: Higher (Red), Moderate (Blue), Lower (Light Blue)

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			
Acea SpA	BBB+/Sta	0.0	0.0	-3.0	0.0	0.0	0.0	-1.0	0.0	1.0	0.0	1.0	0.0
Aquanet S.A.	BBB+/Sta	0.0	-1.0	0.0	-1.0	-1.0	0.0	-2.0	2.0	0.0	0.0	0.0	0.0
Canal de Isabel II, S.A.	BBB+/Sta	0.0	-2.0	0.0	-1.0	-1.0	1.0	0.0	2.0	0.0	-1.0	0.0	0.0
FCC Aqualia, S.A.	BBB-/Sta	2.0	0.0	-1.0	0.0	1.0	2.0	1.0	0.0	0.0	0.0	0.0	0.0
Wessex Water Services Limited	BBB/Sta	5.0	2.0	1.0	2.0	1.0	2.0	0.0	-1.0	1.0	1.0	1.0	0.0

Source: Fitch Ratings. Legend: Red = Worse positioned than IDR, Blue = In line with IDR, Light Blue = Better positioned than IDR

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Positive Rating

Action/Upgrade:

- An upgrade of Madrid (or an assessment or weaker links between the company and the shareholder) together with a positive revision of the SCP, could lead to an upgrade of Canal's IDR.
- The SCP could benefit from a perceived improvement of the corporate-governance issues that have affected the company.

Factors that Could, Individually or Collectively, Lead to Negative Rating

Action/Downgrade:

- Weaker cash flow generation leading to FFO dividend-adjusted net leverage above 4.8x 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.
- 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.

Liquidity and Debt Structure

Healthy Liquidity: At end-2020, Canal's liquidity position comprised EUR430 million of readily available cash (excluding EUR3 million of cash in Latin America) as well as an undrawn committed revolving credit facility (RCF) of EUR132 million maturing in December 2021, which is renewed annually. Canal's total available liquidity of EUR563 million compares with short-term debt of only EUR31 million. We forecast small positive free cash flow (FCF) of about EUR45 million in 2021.

We assume that the RCF will roll over on a yearly basis. Canal is subject to the Madrid Budgetary Law, which requires high-level authorisation to approve long-term committed credit lines. We view Canal's liquidity position as adequate when its smaller short-term credit lines are viewed in conjunction with the company's large cash available and fundamental neutral-to-positive FCF.

ESG Considerations

Canal has ESG Relevance Scores of '4' for "Operational Execution of Management Strategy" and "Governance Structure" due to the investigation of Spanish courts into previous management's acquisitions in Brazil, and the Colombian General Prosecutor's seizure of Triple A's shares. These indicate failures in internal controls related to acquisitions and corporate-governance standards, although Latin American EBITDA was only 10% of the group's total (before deconsolidation of Triple A from September 2018). This has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

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

Available liquidity (EUR 000)	2021F	2022F	2023F
Beginning cash balance	430,386	444,457	363,979
Rating-case FCF after acquisitions and divestitures	44,844	-65,361	-107,149
Total available liquidity (A)	475,230	379,096	256,830
Liquidity uses			
Debt maturities	-30,773	-15,117	-14,885
Total liquidity uses (B)	-30,773	-15,117	-14,885
Liquidity calculation			
Ending cash balance (A+B)	444,457	363,979	241,945
Revolver availability ^a	0	0	0
Ending liquidity	444,457	363,979	241,945
Liquidity score (x)	15.4	25.1	17.3

^a As of December 2020 the company had available committed revolver credit facilities in the amount of EUR132 million; however, these roll over on a yearly basis.

F – Forecast

Source: Fitch Ratings, Fitch Solutions, Canal de Isabel II, S.A.

Scheduled debt maturities (EUR 000)	Original 31 December 2020
2021	30,773
2022	15,117
2023	14,885
2024	14,762
2025	514,762
Thereafter	152,619
Total^b	742,918

^b Total Debt excluding accrued interest.

Source: Fitch Ratings, Fitch Solutions, Canal de Isabel II, S.A.

Key Assumptions

Fitch's Key Assumptions Within its Rating Case for the Issuer

- Madrid's water tariffs frozen until 2023 and annually revised from 2024 at close to CPI.
- 1% annual increase in volumes in 2021 and then flat through to 2024.
- Slight increase in population and customers for the next four years.
- Divestments of real-estate assets in Madrid at appraised value in 2023.
- Declining gross debt to EUR0.5 billion by 2025. EUR500 million bond is partially refinanced at maturity in 2025.
- Annual capex at about EUR310 million on average for 2021-2025.
- About 80% dividend pay-out based on consolidated accounts for Canal.

Financial Data

Canal de Isabel II, S.A.

(EUR 000)	Historical			Forecast		
	Dec 18	Dec 19	Dec 20	Dec 21	Dec 22	Dec 23
Summary income statement						
Gross revenue	1,076,446	984,685	916,733	942,558	953,385	961,158
Revenue growth (%)	-6.0	-8.5	-6.9	2.8	1.1	0.8
Operating EBITDA (before income from associates)	475,136	438,560	392,591	390,765	389,808	388,007
Operating EBITDA margin (%)	44.1	44.5	42.8	41.5	40.9	40.4
Operating EBITDAR	490,367	445,811	399,431	397,605	396,648	394,847
Operating EBITDAR margin (%)	45.6	45.3	43.6	42.2	41.6	41.1
Operating EBIT	271,783	243,269	199,131	206,336	195,072	188,009
Operating EBIT margin (%)	25.2	24.7	21.7	21.9	20.5	19.6
Gross interest expense	-27,838	-20,127	-19,296	-14,180	-13,330	-13,042
Pretax income (including associate income/loss)	213,847	219,895	166,010	187,131	176,058	190,334
Summary balance sheet						
Readily available cash and equivalents	351,947	316,276	430,386	444,823	364,572	242,454
Total debt with equity credit	820,313	783,910	753,088	724,040	709,278	694,517
Total adjusted debt with equity credit	942,161	841,918	807,808	778,760	763,998	749,237
Net debt	468,366	467,634	322,702	279,218	344,707	452,062
Summary cash flow statement						
Operating EBITDA	475,136	438,560	392,591	390,765	389,808	388,007
Cash interest paid	-23,936	-17,304	-17,113	-14,180	-13,330	-13,042
Cash tax	-5,512	1,998	216	-1,082	-1,018	-5,506
Dividends received less dividends paid to minorities (inflow/(out)flow)	-1,048	-196	-219	-219	-219	-219
Other items before FFO	-9,304	-263,554	-103,918	-117,879	-133,767	-139,166
Funds flow from operations	436,587	159,763	271,985	257,474	241,543	230,143
FFO margin (%)	40.6	16.2	29.7	27.3	25.3	23.9
Change in working capital	-24,666	-33,536	-18,059	5,231	-7,270	-5,736
Cash flow from operations (Fitch defined)	411,921	126,227	253,926	262,705	234,273	224,407
Total non-operating/non-recurring cash flow	0	0	0	0	0	0
Capital expenditure	-124,892	-126,965	-111,585			
Capital intensity (capex/revenue) (%)	11.6	12.9	12.2			
Common dividends	0	0	0			
Free cash flow	287,029	-738	142,341			
Net acquisitions and divestitures	0	0	0			
Other investing and financing cash flow items	4,868	117	2,850	-1,360	-127	-207
Net debt proceeds	-89,572	-33,651	-31,081	-29,048	-14,762	-14,762
Net equity proceeds	0	0	0	0	0	0
Total change in cash	202,325	-34,272	114,110	14,436	-80,251	-122,118
Leverage ratios						
Total net debt with equity credit/operating EBITDA (x)	1.0	1.1	0.8	0.7	0.9	1.2
Total adjusted debt/operating EBITDAR (x)	1.9	1.9	2.0	2.0	1.9	1.9
Total adjusted net debt/operating EBITDAR (x)	1.2	1.2	0.9	0.8	1.0	1.3
Total debt with equity credit/operating EBITDA (x)	1.7	1.8	1.9	1.9	1.8	1.8
FFO adjusted leverage (x)	2.0	4.6	2.7	2.8	2.9	3.0
FFO adjusted net leverage (x)	1.2	2.9	1.3	1.2	1.5	2.0
FFO leverage (x)	1.8	4.4	2.6	2.7	2.8	2.9
FFO net leverage (x)	1.0	2.6	1.1	1.0	1.4	1.9
Calculations for forecast publication						
Capex, dividends, acquisitions and other items before FCF	-124,892	-126,965	-111,585	-217,862	-299,634	-331,556
Free cash flow after acquisitions and divestitures	287,029	-738	142,341	44,844	-65,361	-107,149
Free cash flow margin (after net acquisitions) (%)	26.7	-0.1	15.5	4.8	-6.9	-11.1
Coverage ratios						
FFO interest coverage (x)	19.2	10.2	16.9	19.2	19.1	18.6
FFO fixed-charge coverage (x)	12.1	7.5	12.3	13.2	13.0	12.6
Operating EBITDAR/interest paid + rents (x)	12.5	18.1	16.7	18.9	19.7	19.8
Operating EBITDA/interest paid (x)	19.8	25.3	22.9	27.5	29.2	29.7
Additional metrics						
CFO-capex/total debt with equity credit (%)	35.0	-0.1	18.9	6.2	-9.2	-19.2
CFO-capex/total net debt with equity credit (%)	61.3	-0.2	44.1	16.1	-19.0	-29.4

Source: Fitch Ratings, Fitch Solutions

How to Interpret the Forecast Presented

The forecast presented is based on Fitch Ratings' internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch Ratings to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch Ratings' rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch Ratings' forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch Ratings' own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch Ratings' own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch Ratings may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch Ratings' own internal deliberations, where Fitch Ratings, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch Ratings may update the forecast in future reports but assumes no responsibility to do so. Original financial statement data for historical periods is processed by Fitch Solutions on behalf of Fitch Ratings. Key financial adjustments and all financial forecasts credited to Fitch Ratings are generated by rating agency staff.

Ratings Navigator

FitchRatings

Canal de Isabel II, S.A.

ESG Relevance:



Corporates Ratings Navigator
EMEA Regulated Networks

Factor Levels	Sector Risk Profile	Operating Environment	Business Profile				Financial Profile			Issuer Default Rating
			Management and Corporate Governance	Sector Positioning	Regulatory Environment	Asset Base	Operational Profile	Profitability and Cash Flow	Financial Structure	
aaa										AAA
aa+										AA+
aa										AA
aa-										AA-
a+	■								■	A+
a				■				■		A
a-										A-
bbb+	■	■	■	■	■	■	■	■	■	BBB+ Stable
bbb										BBB
bbb-										BBB-
bb+										BB+
bb										BB
bb-										BB-
b+										B+
b										B
b-	■	■								B-
ccc+										CCC+
ccc										CCC
ccc-										CCC-
cc										CC
c										C
d or rd										D or RD

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

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+			

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-			

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+			

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 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.

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.

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			

Regulatory Environment

a-	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	bbb	Tariff setting with challenge mechanisms that may limit efficiently incurred cost and investment recovery, with moderate regulatory lag.
bbb-	Volume and Price Risk	bbb	Moderate insulation from price and volume risk and revenue under-recovery.
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			

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		

Credit-Relevant ESG Derivation

				Overall ESG			
Canal de Isabel II, S.A. has 2 ESG rating drivers and 10 ESG potential rating drivers				key driver	0	issues	5
➡	Strategy development and implementation	driver	2	issues	4		
➡	Board independence and effectiveness; ownership concentration	potential driver	10	issues	3		
➡	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	not a rating driver	1	issues	2		
➡	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)		1	issues	1		

Showing top 6 issues

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

Credit-Relevant ESG Derivation

Canal de Isabel II, S.A. has 2 ESG rating drivers and 10 ESG potential rating drivers

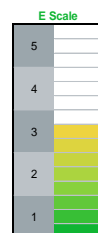
- ➔ Canal de Isabel II, S.A. has exposure to strategic risk which, in combination with other factors, impacts the rating.
- ➔ Canal de Isabel II, S.A. has exposure to board independence risk which, in combination with other factors, impacts the rating.
- ➔ Canal de Isabel II, S.A. has exposure to energy 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.

Showing top 6 issues

			Overall ESG Scale	
key driver	0	issues	5	
driver	2	issues	4	
potential driver	10	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



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.

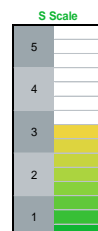
The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned 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).

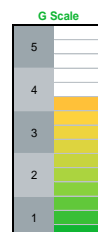
Social (S)

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



Governance (G)

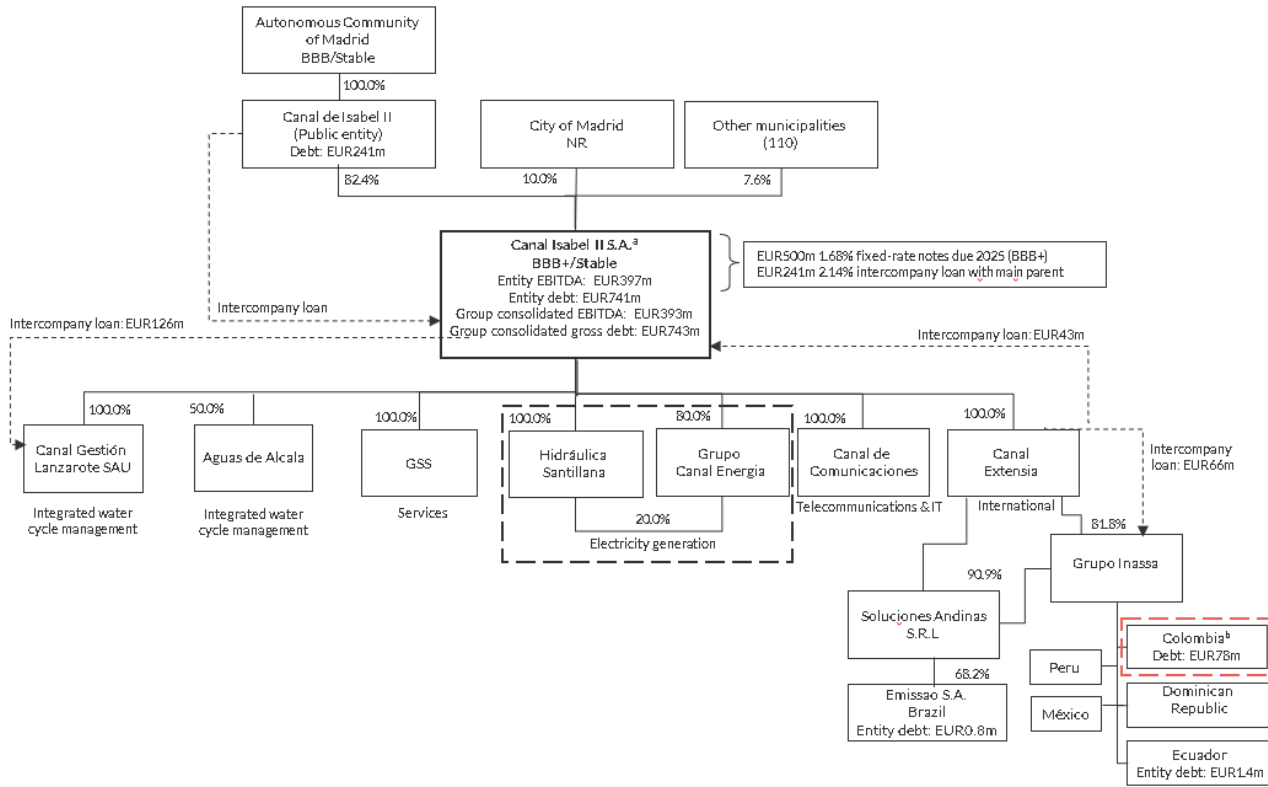
General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	4	Strategy development and implementation	Management and Corporate Governance
Governance Structure	4	Board independence and effectiveness; ownership concentration	Management and Corporate Governance
Group Structure	3	Complexity, transparency and related-party transactions	Management and Corporate Governance
Financial Transparency	3	Quality and timing of financial disclosure	Management and Corporate Governance



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



^a In 2020 Hispanagua was merged and absorbed by Canal Isabel II S.A. to simplify the group structure and due to the legal impossibility of extending the management assignments for the provision of Canal's services.

^b Colombia refers to Triple A, whose control has been seized by the Colombian authorities. Debt in Triple A as of end-August 2018.

Note: The chart does not include equity-method consolidated stakes.

Source: Fitch Ratings, Fitch Solutions, Canal de Isabel II, S.A., debt position and EBITDA as of 31 December 2020, and intercompany/subsidiaries loans as of 31 March 2021.

Peer Financial Summary

Company	IDR	Financial statement date	Operating EBITDA (before income from associates) (EURm)	Operating EBITDA margin (%)	FFO margin (%)	FFO net leverage (x)	FFO interest coverage (x)
Canal de Isabel II, S.A.	BBB+	December 2022F	390	40.9	25.3	1.4 ^a	19.1
		December 2021F	391	41.5	27.3	1.0 ^a	19.2
	BBB	December 2020	393	42.8	29.7	1.1 ^a	16.9
	BBB+	December 2019	439	44.5	16.2	2.6 ^a	10.2
	BBB+	December 2018	475	44.1	40.6	1.0 ^a	19.2
Acea SpA	BBB+	December 2022F	1,223	31.3	21.6	4.9	8.0
		December 2021F	1,161	32.4	22.3	5.0	7.9
	BBB+	December 2020E	1,111	34.7	24.0	4.8	7.8
	BBB+	December 2019	990	31.1	24.2	4.2	7.9
	BBB+	December 2018	890	29.4	21.8	4.2	6.9
Wessex Water Services Limited	BBB	March 2023F	303	51.7	34.2	10.8	3.6
		March 2022F	302	52.5	35.9	10.1	3.7
	March 2021F	287	52.7	35.2	9.9	3.5	
	BBB	March 2020	374	59.2	39.7	7.7	4.1
	BBB+	March 2019	381	61.3	43.6	7.0	4.7
Aquanet S.A.	BBB+	December 2022F	43	30.4	29.4	1.8	20.3
		December 2021F	43	30.4	29.3	1.3	18.7
	December 2020F	42	30.4	29.1	1.4	16.3	
	BBB+	December 2019	41	30.4	30.2	1.6	15.7
	BBB+	December 2018	44	35.8	35.7	1.9	17.4
FCC Aqualia, S.A.	BBB-	December 2022F	231	20.7	19.4	4.6	8.1
		December 2021F	224	19.8	18.0	4.8	7.4
	BB+	December 2020E	197	19.4	17.9	5.5	6.9
	BB+	December 2019	204	19.2	17.4	5.4	7.3
	BB+	December 2018	198	19.6	15.2	6.1	6.0

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

Fitch Adjusted Financials

Fitch Adjustments and Reconciliation Table for Canal de Isabel II, S.A.

(EUR 000)	Notes and Formulas	Reported Values	Sum of Adjustments	CORP - Lease Treatment	Other Adjustments	Adjusted Values
31 December 2020						
Income Statement Summary						
Revenue		916,733				916,733
Operating EBITDAR		399,431				399,431
Operating EBITDAR After Associates and Minorities	(a)	399,431	-219		-219	399,212
Operating Lease Expense	(b)	0	6,840	6,840		6,840
Operating EBITDA	(c)	399,431	-6,840	-6,840		392,591
Operating EBITDA After Associates and Minorities	(d) = (a-b)	399,431	-7,059	-6,840	-219	392,372
Operating EBIT	(e)	199,689	-558	-558		199,131
Debt and Cash Summary						
Total Debt with Equity Credit	(f)	753,088				753,088
Lease-Equivalent Debt	(g)	0	54,720	54,720		54,720
Other Off-Balance-Sheet Debt	(h)	0				0
Total Adjusted Debt with Equity Credit	(i) = (f+g+h)	753,088	54,720	54,720		807,808
Readily Available Cash and Equivalents	(j)	433,347	-2,961		-2,961	430,386
Not Readily Available Cash and Equivalents		0	2,961		2,961	2,961
Cash Flow Summary						
Operating EBITDA After Associates and Minorities	(d) = (a-b)	399,431	-7,059	-6,840	-219	392,372
Preferred Dividends (Paid)	(k)	0				0
Interest Received	(l)	428				428
Interest (Paid)	(m)	-17,113				-17,113
Cash Tax (Paid)		216				216
Other Items Before FFO		-73,633	-30,285		-30,285	-103,918
Funds from Operations (FFO)	(n)	309,329	-37,344	-6,840	-30,504	271,985
Change in Working Capital (Fitch-Defined)		-18,059				-18,059
Cash Flow from Operations (CFO)	(o)	291,270	-37,344	-6,840	-30,504	253,926
Non-Operating/Nonrecurring Cash Flow		0				0
Capital (Expenditures)	(p)	-78,534	-33,051		-33,051	-111,585
Common Dividends (Paid)		-103,931	103,931		103,931	0
Free Cash Flow (FCF)		108,805	33,536	-6,840	40,376	142,341
Gross Leverage (x)						
Total Adjusted Debt/Operating EBITDAR ^a	(i/a)	1.9				2.0
FFO Adjusted Leverage	(i)/(n-m-l-k+b)	2.3				2.7
FFO Leverage	(i-g)/(n-m-l-k)	2.3				2.6
Total Debt with Equity Credit/Operating EBITDA ^a	(i-g)/d	1.9				1.9
(CFO-Capex)/Total Debt with Equity Credit (%)	(o+p)/(i-g)	28.2%				18.9%
Net Leverage (x)						
Total Adjusted Net Debt/Operating EBITDAR ^a	(i-j)/a	0.8				0.9
FFO Adjusted Net Leverage	(i-j)/(n-m-l-k+b)	1.0				1.3
FFO Net Leverage	(i-g-j)/(n-m-l-k)	1.0				1.1
Total Net Debt with Equity Credit/Operating EBITDA ^a	(i-g-j)/d	0.8				0.8
(CFO-Capex)/Total Net Debt with Equity Credit (%)	(o+p)/(i-g-j)	66.5%				44.1%
Coverage (x)						
Operating EBITDA/(Interest Paid + Lease Expense) ^a	a/(-m+b)	23.3				16.7
Operating EBITDA/Interest Paid ^a	d/(-m)	23.3				22.9
FFO Fixed-Charge Coverage	(n-l-m-k+b)/(-m-k+b)	19.1				12.3
FFO Interest Coverage	(n-l-m-k)/(-m-k)	19.1				16.9

^aEBITDA/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.

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