

Scotland Gas Networks plc, Southern Gas Networks plc

The rating affirmations reflect Fitch Ratings expectations that the financial profiles of Southern Gas Networks plc (Southern) and Scotland Gas Networks plc (Scotland GN) will remain commensurate with the ratings, despite expected materially lower earnings in the new price control from April 2021 to March 2026 (GD2).

The ratings are also supported by the networks' record of robust regulatory and operational performance in GD1 (April 2013 to March 2021). The ratings are underpinned by low business risk stemming from a supportive and transparent UK regulatory framework.

The Outlook revisions reflect our upwardly revised forecast post-maintenance interest coverage ratios (PMICR) for GD2, based on the final regulatory determination and remedial measures taken by the group to reduce interest charges.

Key Rating Drivers

Reduced Cash Flow in GD2: We view GD2 as challenging, despite the Competition and Markets Authority's (CMA) reversal of both a 25bp downward adjustment to allowed equity returns and an 0.2% innovation uplift.

We expect lower EBITDA and cash generation in FY22-FY26 (financial years to end-March), reflecting a reduced allowed weighted average cost of capital (WACC) of 2.9% (real, CPIH) in GD2, from 4.8% (real, CPIH) in GD1, together with limited scope for operational and regulatory outperformance. Fitch's rating case assumes neutral total expenditure performance and no incentive rewards.

Solid Credit Metrics: We forecast average cash PMICRs of around 1.6x over GD2 for both gas distribution networks (GDNs), in the middle of the 1.5-1.7x range for a 'BBB' rating. Nominal PMICRs are also strong with a forecast average of 2.0x, against our rating sensitivities of 1.8x-2.0x.

Fitch has revised upwards its projections for both metrics, largely reflecting more favourable CMA final determinations for GD2 and remedial measures taken by the group to reduce interest charges. Leverage headroom for both Scotland GN and Southern remains limited as we expect both companies to maintain leverage at just below 73%, in line with our guidelines for the ratings.

Reduced Cost of Debt: CPI-linked swaps entered into last year by Scotland GN and Southern for GBP75 million and GBP400 million, respectively, resulted in around 35% and 30% of their debt being inflation-linked, against 33% and 17% at FYE21. These swaps do not have any accretion pay down and will materially reduce their cash cost of debt from FY22.

Nominal cost of debt will also benefit, albeit to a lesser extent, as cash interest inflows under these swaps exceed our long-term inflation assumptions. Fitch's rating case also includes other liability-management measures to reduce interest charges.

Flexible Dividend Policy: We view Scotland GN's and Southern's financial discipline as a key rating driver since such discipline largely determines the companies' financial profiles. We expect them to continue to manage leverage at 70%-73% net debt/regulatory asset value (RAV) in GD2, against our negative rating sensitivity of 73%. We assume their financial policy will

Ratings for Scotland Gas Networks plc

Rating Type	Rating	Outlook	Last Rating Action
Long-Term IDR	BBB	Stable	Affirmed 4 Feb 22
Senior Unsecured	BBB+		Affirmed 4 Feb 22

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Ratings for Southern Gas Networks plc

Rating Type	Rating	Outlook	Last Rating Action
Long-Term IDR	BBB	Stable	Affirmed 4 Feb 22
Senior Unsecured	BBB+		Affirmed 4 Feb 22

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Applicable Criteria

[Corporate Rating Criteria \(October 2021\)](#)

[Sector Navigators - Addendum to the Corporate Rating Criteria \(October 2021\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(April 2021\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(December 2021\)](#)

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remain flexible after changes in the shareholding structure, and expects new shareholders to reduce dividends when leverage or PMICR headroom becomes tight. A more aggressive financial policy would be negative for the ratings.

Strong Regulatory Performance in GD1: Scotland GN and Southern achieved the highest return on regulatory equity (RORE) among peers, at 14.7% and 13.2% respectively in GD1, based on the networks' regulatory financial performance reporting and actual gearing. This was largely driven by totex and incentive outperformance in addition to the cost of equity. Both GDNs have met all regulatory output targets in GD1, apart from the poor fuel connections target for the Southern network, due to Covid-19 restrictions.

These achievements contributed on average GBP17.2 million per year (combined) in incentive rewards. Both GDNs consistently rank among the top with 15.6% of combined totex outperformance during GD1.

Financial Summary

Scotland Gas Networks plc

	Mar 19	Mar 20	Mar 21	Mar 22F	Mar 23F	Mar 24F
Cash PMICR (x)	1.7	1.6	1.7	1.5	1.8	1.5
Nominal PMICR (x)	2.1	2.1	2.3	1.8	2.1	2.0
Net debt/regulated asset value (%)	71.2	71.1	71.0	73.1	72.7	72.5

F - Forecast

Source: Fitch Ratings, Fitch Solutions

Southern Gas Networks plc

	Mar 19	Mar 20	Mar 21	Mar 22F	Mar 23F	Mar 24F
Cash PMICR (x)	1.6	1.5	1.5	1.6	1.7	1.6
Nominal PMICR (x)	2.1	2.1	2.2	2.1	2.2	2.0
Net debt/regulated asset value (%)	77.2	71.5	70.1	72.6	72.4	72.6

F - Forecast

Source: Fitch Ratings, Fitch Solutions

Rating Derivation Relative to Peers

Scotland GN and Southern benefit from a stable and transparent regulatory framework for UK GDNs. Both GDNs have performed reasonably in GD1, with strong operating metrics. The closest peers are Cadent Gas Limited (BBB+/Stable) and Wales and West Utilities Limited (WWU; BBB/Negative). Fitch rates WWU's Class A debt 'A-' and Class B debt 'BBB-', but compared with Scotland GN's debt these benefit from further contractual and structural enhancements, while the Class B debt reflects its subordination to Class A debt.

Cadent's leverage is lower than Scotland GN's and Southern's, and Cadent has lower cost of debt relative to UK GDN peers, given its debt was issued more recently and at much lower rates, resulting in stronger-than average forecast PMICRs.

Rating Sensitivities

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

Action/Upgrade:

- Fitch's sensitivities do not currently anticipate developments, individually or collectively, of leading to a positive rating action, particularly in view of the management's targeted leverage of above 70% net debt/ RAV
- Cash PMICR above 1.7x and nominal PMICR above 2.0x
- Net debt-to-RAV below 68%

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

- Cash PMICR below 1.5x and nominal PMICR below 1.8x
- Net debt-to-RAV above 73%, driven by higher-than-expected dividend payments or lower-than-expected outperformance

Liquidity and Debt Structure

Adequate Liquidity: The holding company Scotia Gas Networks has centralised cash pooling for its regulated companies. However, funds raised at either operating entity are held by the GDNs. As of end-March 2021, Scotland GN and Southern had unrestricted cash and cash equivalent of GBP0 million and GBP99 million, respectively. There is also a GBP360 million revolving credit facility (RCF) maturing in 2025, which was fully undrawn at end-March 2021 and is shared by both networks.

The next maturities are Scotland GN's GBP275 million index-linked bonds in October 2022, while Southern has no maturities until October 2023. Overall, the liquidity positions are sufficient for covering debt maturities and Fitch's negative free cash flow (FCF) forecast in the next 12 months for Scotland GN and 24 months for Southern.

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

Scotland Gas Networks – Liquidity Analysis

(GBPm)	2022F	2023F	2024F
Available liquidity			
Beginning cash balance	0	-67	-391
Rating-case FCF after acquisitions and divestitures	-67	-49	-50
Total available liquidity (A)	-67	-116	-441
Liquidity uses			
Debt maturities	0	-275	0
Total liquidity uses (B)	0	-275	0
Liquidity calculation			
Ending cash balance (A+B)	-67	-391	-441
Revolver availability	120	120	120
Ending liquidity	53	-271	-321
Liquidity score (x)	Not meaningful	0.0	Not meaningful

F – Forecast

Source: Fitch Ratings, Fitch Solutions, Scotland Gas Networks

Scheduled Debt Maturities (GBPm)	Original 31 March 2021
2022	0
2023	255
2024	0
2025	35
2026	0
Thereafter	1,023
Total	1,313

Source: Fitch Ratings, Fitch Solutions, Scotland Gas Networks

Southern Gas Networks – Liquidity Analysis

(GBPm)	2022F	2023F	2024F
Available liquidity			
Beginning cash balance	99	-4	-83
Rating-case FCF after acquisitions and divestitures	-103	-78	-69
Total available liquidity (A)	-4	-83	-152
Liquidity uses			
Debt maturities	0	0	-300
Total liquidity uses (B)	0	0	-300
Liquidity calculation			
Ending cash balance (A+B)	-4	-83	-452
Revolver availability	240	240	240
Ending liquidity	236	157	-212
Liquidity score (x)	Not meaningful	Not meaningful	0.3

F – Forecast

Source: Fitch Ratings, Fitch Solutions, Southern Gas Networks

Scheduled Debt Maturities (GBPm)	Original 31 March 2021
2022	0
2023	0
2024	300
2025	350
2026	566
Thereafter	1796
Total	3,012

Source: Fitch Ratings, Fitch Solutions, Southern Gas Networks

Key Assumptions

- Allowances in line with final determinations for GD2 as reported in the regulatory price control financial model in November 2021 for both GDNs
- Neutral totex performance, no incentive income
- Average combined annual dividend of GBP120 million for FY22-FY26
- Average nominal cost of new debt at around 3%
- Average CPIH of 2.5% for FY22-FY26
- Liability-management measures to reduce interest charges.

Financial Data

Scotland Gas Networks plc

(GBPm)	Historical			Forecast		
	Mar 19	Mar 20	Mar 21	Mar 22 ^a	Mar 23	Mar 24
Summary income statement						
Gross revenue	350	357	384	333	445	369
Revenue growth (%)	4.2	2.0	7.6	-13.3	33.7	-17.1
Operating EBITDA (before income from associates)	215	231	225	170	188	190
Operating EBITDA margin (%)	61.4	64.7	58.6	51.0	42.3	51.5
Operating EBITDAR	217	233	225	170	188	190
Operating EBITDAR margin (%)	62.0	65.3	58.6	51.0	42.3	51.5
Operating EBIT	154	169	164	107	123	123
Operating EBIT margin (%)	44.0	47.3	42.7	32.1	27.6	33.2
Gross Interest expense	-54	-55	-47	-60	-64	-54
Pretax income (including associate income/loss)	98	116	119	47	58	68
Summary balance sheet						
Readily available cash and equivalents	0	0	0	0	0	0
Total debt with equity credit	1,263	1,291	1,313	1,399	1,471	1,536
Total adjusted debt with equity credit	1,279	1,307	1,313	1,399	1,471	1,536
Net debt with equity credit	1,263	1,291	1,313	1,399	1,471	1,536
Summary cash flow statement						
Operating EBITDA	215	231	225	170	188	190
Cash interest paid	-45	-48	-46	-41	-42	-40
Cash tax	-23	-35	-24	-10	-8	-21
Dividends received less dividends paid to minorities (inflow/(out)flow)	0	0	0	0	0	0
Other items before FFO	-7	5	-1	0	0	0
Funds flow from operations	140	153	154	119	138	130
FFO margin (%)	40.1	42.9	40.1	35.8	31.0	35.1
Change in working capital	-56	-40	22	0	0	0
Cash flow from operations (Fitch defined)	84	113	176	119	138	130
Total non-operating/nonrecurring cash flow	0	0	0			
Capex	-134	-128	-93			
Capital intensity (capex/revenue) (%)	38.3	35.9	24.2			
Common dividends	-31	-28	-75			
Free cash flow	-81	-43	8			
Net acquisitions and divestitures	0	0	0			
Other investing and financing cash flow items	4	-7	-7	-2	81	3
Net debt proceeds	75	50	0	59	-32	48
Net equity proceeds	0	0	0	0	0	0
Total change in cash	-2	0	1	0	0	0
Leverage ratios						
Net debt/regulated asset value (%)	71.2	71.1	71.0	73.1	72.7	72.5
Total net debt with equity credit/operating EBITDA (x)	5.9	5.6	5.8	8.2	7.8	8.1
Total debt with equity credit/operating EBITDA (x)	5.9	5.6	5.8	8.2	7.8	8.1
FFO adjusted leverage (x)	6.9	6.5	6.7	8.8	8.2	9.1
FFO adjusted net leverage (x)	6.9	6.5	6.7	8.8	8.2	9.1
FFO leverage (x)	6.9	6.5	6.7	8.8	8.2	9.1
FFO net leverage (x)	6.9	6.5	6.7	8.8	8.2	9.1
Calculations for forecast publication						
Capex, dividends, acquisitions and other items before FCF	-165	-156	-168	-176	-187	-180
Free cash flow after acquisitions and divestitures	-81	-43	8	-57	-49	-50
Free cash flow margin (after net acquisitions) (%)	-23.0	-12.0	2.1	-17.0	-11.0	-13.6
Coverage ratios						
Cash PMICR (x)	1.7	1.6	1.7	1.5	1.8	1.5
Nominal PMICR (x)	2.1	2.1	2.3	1.8	2.1	2.0
FFO interest coverage (x)	4.1	4.1	4.3	3.9	4.3	4.2
FFO fixed-charge coverage (x)	3.9	4.0	4.3	3.9	4.3	4.2
Operating EBITDAR/interest paid + rents (x)	4.6	4.7	4.9	4.2	4.5	4.8
Operating EBITDA/interest paid (x)	4.8	4.8	4.9	4.2	4.5	4.8

^a Estimate for 2021. 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.

Southern Gas Networks plc

(GBPm)	Historical			Forecast		
	Mar 19	Mar 20	Mar 21	Mar 22 ^a	Mar 23	Mar 24
Summary income statement						
Gross revenue	797	817	806	705	897	765
Revenue growth (%)	6.8	2.5	-1.3	-12.5	27.2	-14.7
Operating EBITDA (before income from associates)	489	500	474	379	399	435
Operating EBITDA margin (%)	61.4	61.2	58.8	53.8	44.5	56.8
Operating EBITDAR	490	503	474	379	399	435
Operating EBITDAR margin (%)	61.5	61.6	58.8	53.8	44.5	56.8
Operating EBIT	365	373	345	245	261	293
Operating EBIT margin (%)	45.8	45.7	42.8	34.8	29.1	38.2
Gross interest expense	-126	-116	-105	-113	-124	-119
Pretax income (including associate income/loss)	242	254	243	132	137	174
Summary balance sheet						
Readily available cash and equivalents	10	85	99	99	51	50
Total debt with equity credit	2,868	2,988	3,012	3,146	3,218	3,319
Total adjusted debt with equity credit	2,876	3,012	3,012	3,146	3,218	3,319
Net debt with equity credit	2,858	2,903	2,913	3,047	3,168	3,269
Summary cash flow statement						
Operating EBITDA	489	500	474	379	399	435
Cash interest paid	-117	-111	-109	-82	-82	-87
Cash tax	-49	-81	-45	-32	-31	-55
Dividends received less dividends paid to minorities (inflow/(out)flow)	0	0	0	0	0	0
Other items before FFO	-24	-1	0	0	0	0
Funds flow from operations	305	306	318	265	287	293
FFO margin (%)	38.3	37.5	39.5	37.6	32.0	38.3
Change in working capital	-29	26	-18	-1	0	0
Cash flow from operations (Fitch defined)	276	332	300	264	287	293
Total non-operating/nonrecurring cash flow	0	0	0			
Capex	-261	-294	-240			
Capital intensity (capex/revenue) (%)	32.7	36.0	29.8			
Common dividends	-68	-53	-81			
Free cash flow	-53	-15	-21			
Net acquisitions and divestitures	0	0	0			
Other investing and financing cash flow items	293	-9	-7	-13	7	-7
Net debt proceeds	-240	90	35	114	20	68
Net equity proceeds	0	0	0	0	0	0
Total change in cash	0	66	7	0	-48	-1
Leverage ratios						
Net debt/regulated asset value (%)	77.2	71.5	70.1	72.6	72.4	72.6
Total net debt with equity credit/operating EBITDA (x)	5.8	5.8	6.1	8.0	7.9	7.5
Total adjusted debt/operating EBITDAR (x)	5.9	6.0	6.4	8.3	8.1	7.6
Total adjusted net debt/operating EBITDAR (x)	5.8	5.8	6.1	8.0	7.9	7.5
FFO adjusted leverage (x)	6.9	7.2	7.1	9.1	8.7	8.7
FFO adjusted net leverage (x)	6.9	7.0	6.9	8.8	8.6	8.6
FFO leverage (x)	6.9	7.1	7.1	9.1	8.7	8.7
FFO net leverage (x)	6.9	6.9	6.9	8.8	8.6	8.6
Calculations for forecast publication						
Capex, dividends, acquisitions and other items before FCF	-329	-347	-321	-365	-362	-354
Free cash flow after acquisitions and divestitures	-53	-15	-21	-102	-76	-62
Free cash flow margin (after net acquisitions) (%)	-6.7	-1.8	-2.6	-14.4	-8.4	-8.0
Coverage ratios						
Cash PMICR (x)	1.6	1.5	1.5	1.6	1.7	1.6
Nominal PMICR (x)	2.1	2.1	2.2	2.1	2.2	2.0
FFO interest coverage (x)	3.6	3.8	3.8	4.2	4.5	4.4
FFO fixed-charge coverage (x)	3.5	3.7	3.8	4.2	4.5	4.4
Operating EBITDAR/interest paid + rents (x)	4.2	4.4	4.3	4.6	4.9	5.0
Operating EBITDA/interest paid (x)	4.2	4.5	4.3	4.6	4.9	5.0

^a Estimate for 2021. Source: Fitch Ratings, Fitch Solutions

Ratings Navigator

Southern Gas Networks plc



Corporates Ratings Navigator
EMEA Regulated Networks

Factor Levels	Business Profile										Issuer Default Rating	
	Sector Risk Profile	Operating Environment	Management and Corporate Governance	Sector Positioning	Regulatory Environment	Asset Base	Operational Profile	Profitability and Cash Flow	Financial Structure	Financial Flexibility		
aaa												AAA
aa+												AA+
aa												AA
aa-												AA-
a+												A+
a												A
a-												A-
bbb+												BBB+
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

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

Profitability and Cash Flow

a	Return on Capital	a	Return on capital at, or comfortably above, the regulatory benchmark.
a-	Volatility of Profitability	bbb	Stability and predictability of profit in line with utility peers.
bbb+	Investment Cycle	bbb	Investment cycle position and dividend policy contributing to negative free cash flow. Moderate 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	a	Very comfortable liquidity. No need to use external funding in the next 12 months even under a severe stress scenario. Well spread debt maturity schedule. Diversified sources of funding.
bbb	FFO Interest Coverage	bbb	3.5x
bbb-	FX Exposure	aa	No material FX mismatch.
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

a+	Management Strategy	a	Coherent strategy and good track record in implementation.
a	Governance Structure	a	Experienced board exercising effective checks and balances. Ownership can be concentrated among several shareholders.
a-	Group Structure	a	Group structure has some complexity but mitigated by transparent reporting.
bbb+	Financial Transparency	bbb	Good-quality reporting without significant failings. Consistent with the average of listed companies in major exchanges.
bbb			

Regulatory Environment

aa-	Independence, Transparency, Predictability	a	Transparent frameworks with strong track record and multi-year predictable tariffs set by independent regulators; little political risk.
a+	Licensing, Ring-Fencing, Concessioning	a	Licensing includes effective ring-fencing provisions with creditworthiness requirements; limited concession renewal risk.
a	Cost and Investment Recovery	a	Tariff setting with challenge mechanisms that may marginally limit cost and investment recovery, with little regulatory lag.
a-	Volume and Price Risk	a	High insulation from price and volume risk, little revenue under-recovery.
bbb+			

Operational Profile

aa-	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			
a-			
bbb+			

Financial Structure

bbb+	FFO Leverage	b	8.0x
bbb	FFO Net Leverage	b	7.5x
bbb-	Adjusted Net Debt/Asset Base (or Regulated Asset Base)	bbb	70%
bb+	Cash PMICR	bbb	1.6x
bb	Nominal PMICR	bbb	1.8x

Credit-Relevant ESG Derivation

				Overall ESG	
Southern Gas Networks plc has 9 ESG potential rating drivers					
key driver	0	issues	5		
driver	0	issues	4		
potential driver	9	issues	3		
not a rating driver	3	issues	2		
	2	issues	1		

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

Credit-Relevant ESG Derivation

Southern Gas Networks plc has 9 ESG potential rating drivers

- ➔ Southern Gas Networks plc has exposure to extreme weather events but this has very low impact on the rating.
- ➔ Southern Gas Networks plc has exposure to access/affordability risk but this has very low impact on the rating.
- ➔ Southern Gas Networks plc has exposure to customer accountability risk but this has very low impact on the rating.
- ➔ Southern Gas Networks plc has exposure to labor relations & practices risk but this has very low impact on the rating.
- ➔ Southern Gas Networks plc has exposure to social resistance but this has very low impact on the rating.
- ➔ Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale	
key driver	0	issues	5	
driver	0	issues	4	
potential driver	9	issues	3	
not a rating driver	3	issues	2	
	2	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	2	Energy and fuel use in operations; entities' financial targets for losses/shrinkage	Profitability and Cash Flow
Water & Wastewater Management	1	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	2	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.

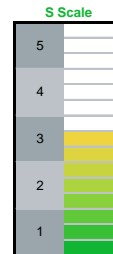
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Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and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

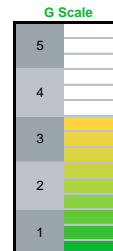
Social (S)

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	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



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.
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2	Irrelevant to the entity rating but relevant to the sector.
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Scotland Gas Networks plc



Corporates Ratings Navigator EMEA Regulated Networks

Factor Levels	Business Profile			Financial Profile			Issuer Default Rating				
	Sector Risk Profile	Operating Environment	Management and Corporate Governance	Sector Positioning	Regulatory Environment	Asset Base		Operational Profile	Profitability and Cash Flow	Financial Structure	Financial Flexibility
aaa											AAA
aa+											AA+
aa											AA
aa-											AA-
a+	↑	↑			↓		↓				A+
a			↑								A
a-	↓			↓	↓			↓			A-
bbb+	↓		↑								BBB+
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

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

Profitability and Cash Flow

a	Return on Capital	a	Return on capital at, or comfortably above, the regulatory benchmark.
a-	Volatility of Profitability	bbb	Stability and predictability of profit in line with utility peers.
bbb+	Investment Cycle	bbb	Investment cycle position and dividend policy contributing to negative free cash flow. Moderate 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	a	Very comfortable liquidity; the need to use external funding at any time is minimal even under a severe stress scenario. Well spread debt maturity schedule. Diversified source of funds.
bbb	FFO Interest Coverage	bbb	3.5x
bbb-	FX Exposure	aa	No material FX mismatch.
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

a+	Management Strategy	a	Coherent strategy and good track record in implementation.
a	Governance Structure	a	Experienced board exercising effective checks and balances. Ownership can be concentrated among several shareholders.
a-	Group Structure	a	Group structure has some complexity but mitigated by transparent reporting.
bbb+	Financial Transparency	bbb	Good-quality reporting without significant failings. Consistent with the average of listed companies in major exchanges.
bbb			

Regulatory Environment

aa-	Independence, Transparency, Predictability	a	Transparent frameworks with strong track record and multi-year predictable tariffs set by independent regulators; little political risk.
a+	Licensing, Ring-Fencing, Concessioning	a	Licensing includes effective ring-fencing provisions with creditworthiness requirements; limited concession renewal risk.
a	Cost and Investment Recovery	a	Tariff setting with challenge mechanisms that may marginally limit cost and investment recovery, with little regulatory lag.
a-	Volume and Price Risk	a	High insulation from price and volume risk, little revenue under-recovery.
bbb+			

Operational Profile

aa-	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			
a-			
bbb+			

Financial Structure

bbb+	FFO Leverage	b	8.0x
bbb	FFO Net Leverage	b	7.5x
bbb-	Adjusted Net Debt/Asset Base (or Regulated Asset Base)	bbb	70%
bb+	Cash PMCR	bbb	1.6x
bb	Nominal PMCR	bbb	1.8x

Credit-Relevant ESG Derivation

				Overall ESG	
Scotland Gas Networks plc has 9 ESG potential rating drivers					
key driver	0	issues	5		
driver	0	issues	4		
potential driver	9	issues	3		
not a rating driver	3	issues	2		
	2	issues	1		

- 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
- Impact of labor negotiations and employee (dis)satisfaction
- Social resistance to major projects that leads to delays and cost increases
- Governance is minimally relevant to the rating and is not currently a driver.

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

Credit-Relevant ESG Derivation

Scotland Gas Networks plc has 9 ESG potential rating drivers

- ➔ Scotland Gas Networks plc has exposure to extreme weather events but this has very low impact on the rating.
- ➔ Scotland Gas Networks plc has exposure to access/affordability risk but this has very low impact on the rating.
- ➔ Scotland Gas Networks plc has exposure to customer accountability risk but this has very low impact on the rating.
- ➔ Scotland Gas Networks plc has exposure to labor relations & practices risk but this has very low impact on the rating.
- ➔ Scotland Gas Networks plc has exposure to social resistance but this has very low impact on the rating.
- ➔ Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale	
key driver	0	issues	5	
driver	0	issues	4	
potential driver	9	issues	3	
not a rating driver	3	issues	2	
	2	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	2	Energy and fuel use in operations; entities' financial targets for losses/shrinkage	Profitability and Cash Flow
Water & Wastewater Management	1	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	2	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



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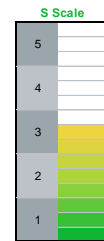
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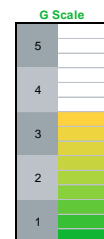
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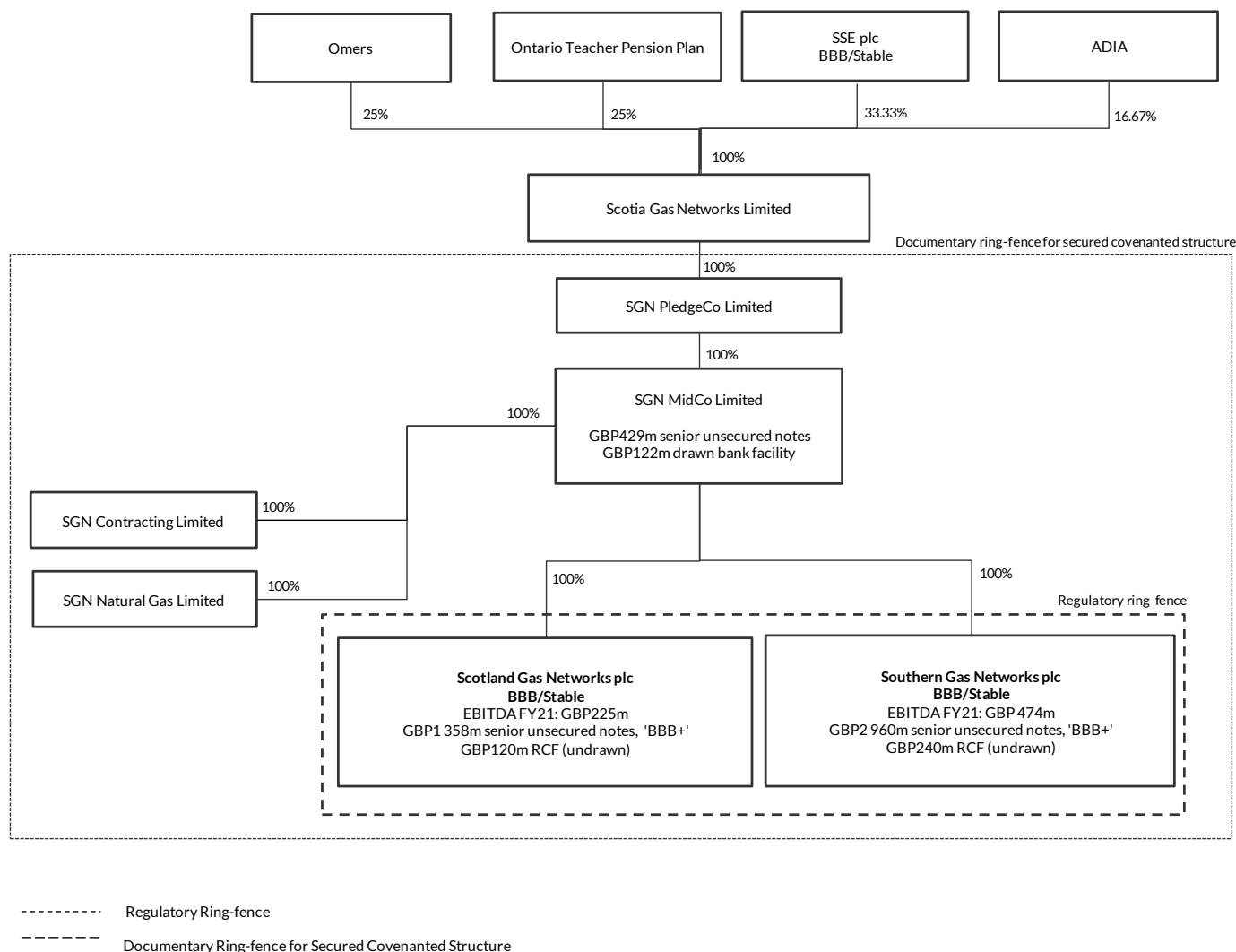


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Simplified Group Structure Diagram

Pre-transaction group structure as of 31 March 2021

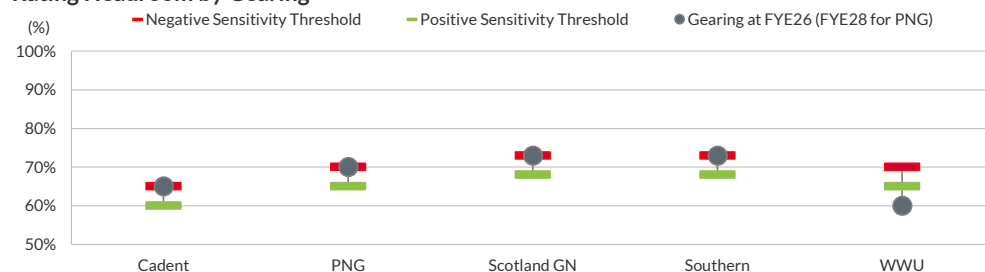


Note: In 2021 shareholders SSE, Omers and ADIA successively announced selling their stakes in the group to Brookfield (37.5%), Global Infrastructure Partners (25%), and existing shareholder OTPPB (37.5%).

Source: Fitch Ratings, Fitch Solutions, Scotland Gas, as of 31 March 2021

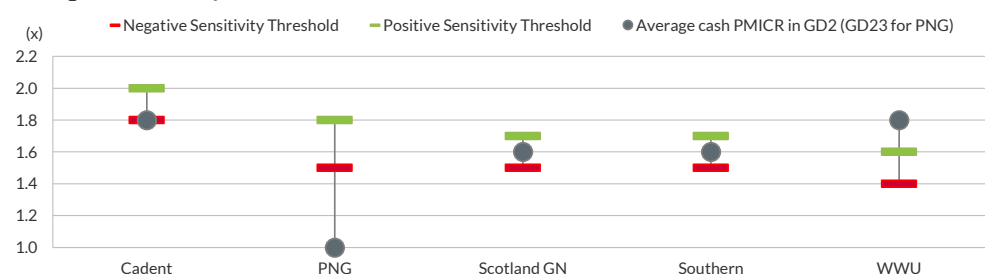
Peer Financial Summary

Rating Headroom by Gearing



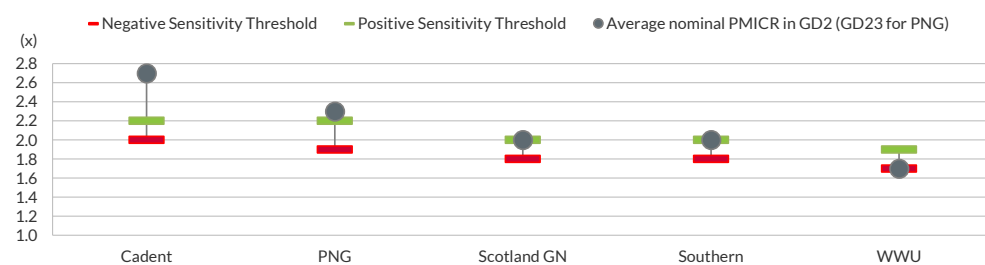
Source: Fitch Ratings, Fitch Solutions, companies

Rating Headroom by Cash PMICR



Source: Fitch Ratings, Fitch Solutions, companies

Rating Headroom by Nominal PMICR



Source: Fitch Ratings, Fitch Solutions, companies

Key

Cadent	Cadent Gas Limited
PNG	Phoenix Natural Gas Limited
Scotland GN	Scotland Gas Networks plc
Southern	Southern Gas Networks plc
WWU	Wales & West Utilities Limited

Source: Fitch Ratings

Fitch Adjusted Financials

Reconciliation of Key Financial Metrics for Scotland GN

(GBPm)	31 March 2021
Gross borrowings (as reported) ^a	1,358
- Intragroup loans owed to company by other group companies ^b	-45
= Total debt with equity credit	1,313
- Cash and equivalents (unrestricted) ^b	0
= Adjusted net debt (a)	1,313
Economic RAV (b)	1,849
Adjusted net debt/RAV (%)	71.0
Operating EBITDA	225
- Regulatory depreciation	-120
- Pension deficit repaid	-5
- Cash tax	-24
Post-maintenance cash flow (c)	76
Cash interest paid	39
+Payment with respect of onerous debt	7
= Adjusted cash interest (d)	46
Cash PMICR (x)	1.7
PMICR = post-maintenance cash flow/cash interest (c/d)	
Indexation on RCV (e)	40
Indexation on debt (f)	4
Post-maintenance cash flow (c) + Indexation on RCV (e)	116
Consolidated cash interest (d) + Indexation on debt (f)	50
Nominal PMICR (x)	2.3
Post-maintenance cash flow (c) + Indexation on RCV (e) / Consolidated cash interest (d) + Indexation on debt (f)	

^aIncluding accretion and index-linked debt, excluding onerous debt related to derivative financial instruments.

^bCash is pooled in the SGN holding company, to which the network companies have instant access. Cash is managed at a group level to ensure all the GDNs' cash requirements are met, and headroom analysis is performed at a group level to ensure there are no liquidity issues for the GDNs.

Source: Fitch Ratings, Fitch Solutions, Scotland GN

Reconciliation of Key Financial Metrics for Southern

(GBPm)	31 March 2021
Gross borrowings (as reported) ^a	2,960
+ Intragroup loans owed by company to other group companies ^b	52
= Total debt with equity credit	3,012
- Cash and equivalents (unrestricted) ^b	-99
= Adjusted net debt (a)	2,913
Economic RAV (b)	4,155
Adjusted net debt/RAV (%)	70.1
Operating EBITDA	474
- Regulatory depreciation	-258
- Pension deficit repaid	-8
- Cash tax	-45
Post-maintenance cash flow (c)	163
Cash interest paid	102
+Payment with respect of onerous debt	7
= Adjusted cash interest (d)	109
PMICR (x)	1.5
PMICR = post-maintenance cash flow/cash interest (c/d)	
Indexation on RCV (e)	89
Indexation on debt (f)	4
Post-maintenance cash flow (c) + Indexation on RCV (e)	252
Consolidated cash interest (d) + Indexation on debt (f)	113
Nominal PMICR (x)	2.2
Post-maintenance cash flow (c) + Indexation on RCV (e) / Consolidated cash interest (d) + Indexation on debt (f)	

^a Including accretion and index-linked debt, excluding onerous debt related to derivative financial instruments.

^b Cash is pooled in the SGN holding company, to which the network companies have instant access. Cash is managed at a group level to ensure all the GDNs' cash requirements are met, and headroom analysis is performed at a group level to ensure there are no liquidity issues for the GDNs.

Source: Fitch Ratings, Fitch Solutions, Southern

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.

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