GALP ENERGIA SGPS SA

504499777 CORPORATE

BBB ISSUER RATING
Long term

OUTLOOK
Stable

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Rating Action and Rationale

- EthiFinance Ratings affirms the long-term rating of Galp Energia, SGPS, S.A. (Galp) at BBB, maintaining its Stable outlook.
- This rating is supported by (i) Galp's scale of operations as an integrated oil & gas company with strong market share in downstream activity in Portugal; (ii) Galp's positive operating performance in the past few years leading to sound profitability margins and strong cash flow generation; and (iii) a financial policy in line with the company's solid financial profile. Despite the capital-intensive nature of its activities, Galp has managed to improve its EthiFinance Ratings-adjusted net leverage ratio to 0.7x at end-September 2023 (compared to 0.8x at YE22 and 1.6x at YE21), respecting its long-term reported net leverage ratio target of 1.0x. Galp makes distributions to its shareholders, mainly through share buybacks (€500m completed in FY23 after €150m executed in FY22), as long as its reported net leverage ratio is in line with the target.
- However, the rating is constrained by (i) Galp's exposure to oil price volatility, particularly in the Upstream division (core generator of profitability of the group); (ii) the expected decline in demand for oil & gas products in the years ahead; and (iii) the group's low geographic diversification, as the majority of its upstream assets are located in Brazil, accentuated by the sale of its exploration & production assets in Angola (disposal completion by YE23). Also, in line with our methodology, Galp's final rating is capped at BBB due to an assessment of the Business Risk Profile at BB+
- In line with our methodology, the O&G industry has high ESG risks (heatmap score between 4 and 5) given its impact on the environment, constraining our industry assessment.Our assessment of the company's ESG policy is slightly positive (company ESG score of between 1 and 1.5), as the company has a favorable ESG score (79/100). As the world progressively shifts towards cleaner energy sources, the O&G industry faces the critical challenge of balancing short-term profitability with long-term viability. Considering this, Galp's strategic approach has been to: i) focus on low cost & low carbon intensity upstream assets, with a portfolio carbon intensity of 10.1kgCO2/barrel of oil equivalent (boe), below the industry average of 18.3kgCO2/boe (according to IOGP 2021); ii) expand its renewables portfolio by taking advantage of the supportive oil & gas price environment to accelerate investment; and iii) lower the environmental footprint of the Sines refinery through investments in energy efficiency, expanding biofuel production and green hydrogen. Like most of its peers, Galp has established a decarbonisation roadmap to be carbon-neutral by 2050 and is on track to achieve its 2030 targets (with 2017 as a base year). These include the reduction of its overall scope 1 & 2 emissions and production carbon intensity by 40% (-20% and -14%, respectively, in 2022 vs 2017) as well as all downstream sales carbon intensity (scope 1, 2 and 3) by 20% (-4% in 2022 vs 2017). However, most important for Galp is its scope 3 emissions and consumption of oil products, which will be difficult to reduce. Regarding social criteria, we factor in the year-on-year decreases in employee accident frequency and absenteeism rates, while on the governance side we highlight the low level of board independence.

Issuer Description

Headquartered in Portugal, Galp is an integrated Oil & Gas company, with its activities ranging from exploration & production (upstream) to refining and supplying oil & gas products (downstream). With a distribution network of c.1.3k service stations in Iberia, Galp is the leader in the fuel retail segment in Portugal and a significant player in Spain. The company also operates the Sines refinery, one of the largest in the Iberian Peninsula, with a capacity to process 226k barrels of oil per day (bpd). Through its upstream assets, Galp produced around 121k bpd in the twelve months to end-September 2023 (excl. Angola), 95% from Brazil with the remaining 5% from Mozambique. More recently, Galp has been building a renewable energy portfolio and has developed an important position as a solar player in Iberia, with 2.6TWh of energy generated in the twelve months to end-September 2023, and an installed capacity in operation of 1.4GW at end-September 2023 (0.3GW under construction and 5.5GW under development). Galp is listed on Euronext Lisbon with a market cap of around €10bn (at market close on January 24th, 2024), and around 56% of Galp's stock is free float.

Over 2022 Galp generated revenues of €26.8bn, with adjusted EBITDA of €3.9bn (14.4% margin) and an EthiFinance Ratings-adjusted net leverage of 0.8x. For the twelve months to end-September 2023, the group reported revenues of €21.7bn, and adjusted EBITDA of €3.8bn (17.6% margin).

Main Financial Figures

Main financial figures €m	FY21	FY22	FY23e	FY24e	FY25e	22vs21
Revenue	16 118	26 840	21 558	21 676	22 875	66,5%
EBITDA adjusted (RCA) (1)	2 319	3 859	3 633	3 279	3 113	66,4%
EBITDA Margin	14,4%	14,4%	16,9%	15,1%	13,6%	0,0pp
EBIT adjusted (RCA) (1)	1 373	2 346	2 634	2 088	1 856	70,9%
EBIT Margin	8,5%	8,7%	12,2%	9,6%	8,1%	0,2pp
EBT	1 248	2 200	2 411	1 861	1 620	76,3%
Total Assets	14 912	16 096	15 750	15 664	15 350	7,9%
Equity	3 970	5 117	5 200	5 221	5 096	28,9%
Total Financial Debt	5 737	5 529	4 904	4 672	4 410	-3,6%
Net Financial Debt	3 795	3 097	2 880	2 740	3 016	-18,4%
Equity/TFD	69,2%	92,5%	106,0%	111,8%	115,6%	23,3pp
NFD/EBITDA	1,6x	0,8x	0,8x	0,8x	1,0x	-0,8x
Funds From Operations	1 893	2 457	2 190	1 951	1 888	29,8%
FFO/NFD	49,9%	79,3%	76,0%	71,2%	62,6%	29,5pp
EBITDA/Interest	18,6x	26,4x	16,3x	14,4x	13,2x	7,9x

(1) Replacement Cost Adjusted (RCA) basis, excluding special items and the inventory effect.

Credit Rating

Credit Rating	
Business Risk Profile	**BB+**
Industry risk assessment	*BB-*
Industry's ESG	*Negative*
Competitive Positioning	*BBB-*
Governance	*BBB+*
Financial Risk Profile	**A**
Cash flow and leverage	*A*
Solvency	*BBB*
Company's ESG	Positive
Anchor Rating	**BBB+**
*Modifiers**	*Rating cap*
Rating	**BBB**

*In line with our methodology, our final rating is capped at BBB due to an assessment of the Business Risk Profile at BB+

Rating Sensitivity

- **Long-term rating positive factors (↑)**

Galp's rating already incorporates its solid financial profile and we view an upgrade based on this criterion as unlikely. Consequently, a rating upgrade could be triggered by a combination of better assets diversification in terms of geographic concentration and lower dependence on its Upstream division, currently Galp's core generator of profit, which is significantly exposed to oil price volatility and declining long-term growth drivers. For the same financial risk profile, an improvement of its business risk profile to BBB- would result in the final rating no longer being capped at BBB and therefore entail a long-term rating upgrade to BBB+.

- **Long-term rating negative factors (↓)**

A rating downgrade could be entailed by a sustained deterioration in Galp's financial profile, which could be a consequence of a more aggressive financial policy, particularly in the case of a significant increase in its dividend payout ratio and/or considerably higher share buybacks. For the same business risk profile, an increase in the group's EthiFinance Ratings-adjusted net leverage ratio above 2.5x for a sustained period of time could entail a long-term rating downgrade to BBB-.

Sources of information

The credit rating issued in this report is unsolicited. The credit rating is based exclusively on public information, being the main sources the following:

1. Annual Audit Report.
2. Corporate Governance Report.
3. Corporate Website.
4. Information published in the Official Bulletins.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, EthiFinance Ratings assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Level of the rated entity participation in the rating process

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies. Principal methodology used in this research are :
  - Corporate Rating Methodology - Long Term : https://files.qivalio.net/documents/methodologies/CRA 190 V3 Corporate%20Methodology 2023-10-06.pdf
- The rating scale used in this report is available at https://www.ethifinance.com/en/ratings/ratingScale.
- EthiFinance Ratings publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has provided ancillary services to related third parties of the rated entity, but not to the rated entity. However, according to our Conflict of Interest Policy, it does not involve a conflict of interest, since the aggregate sale does not exceed 5% of net turnover.
- The issued credit rating has been notified to the rated entity, and has not been modified since.