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Research Update:

Emgesa S.A. E.S.P. 'BBB' Ratings Affirmed, Outlook Stable Following Approved Spin-Off Of Parent Company Enersis

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Overview

- Enersis and Endesa Chile's shareholders approved the spin-off of their Chilean operations.
- Emgesa S.A. E.S.P. will be a CORE entity of Enersis Americas.
- We are affirming our 'BBB' corporate credit and issue-level ratings on Emgesa S.A. E.S.P.
- The stable outlook reflects our expectation that Emgesa S.A. E.S.P. and Codensa will post strong cash flow generation with a consolidated EBITDA margin at about 50%, and adjusted total net debt to EBITDA of less than 2x.

Rating Action

On Dec. 23, 2015, Standard & Poor's Ratings Services affirmed its 'BBB' corporate credit and issue-level ratings on Emgesa S.A. E.S.P. (Emgesa). The outlook on the corporate credit rating remains stable.

Rationale

The shareholders of Enersis S.A. (BBB+/Watch Neg/--), Empresa Nacional de Electricidad S.A. Chile (BBB+/Stable/--), and Chilectra S.A. (not rated) approved the spin-off of their Chilean operations from their foreign operations. We estimate the spin-off and the name change to Enersis Americas to be completed in February 2016. Following the restructuring, Enersis Americas, will be a holding company with investments mainly in power generation, transmission, and electricity distribution in Colombia, Brazil, Peru, and Argentina through its subsidiaries.

We view Emgesa's credit quality as integrally linked with that of its sister company, Colombia's largest electric distribution company, Codensa S.A. E.S.P. (not rated), because of their significant integration, including shared management, support units, and ownership, and the possibility of intercompany loans to optimize cash allocation and diversity funding sources. In addition, Codensa has a similar ownership and governance structure. Therefore, we follow a consolidated approach in our credit analysis of Emgesa. Empresa de Energia de Bogota S.A. E.S.P. (EEB; BBB-/Negative/--), holds the majority of Emgesa and Condensa's common stock, but Enersis S.A. (through Endesa Chile) is the controlling shareholder of Emgesa.

Once the spin-off is effective, we will consider Emgesa as a core subsidiary for Enersis Americas given that the Colombian operations will represent its most relevant market. Enersis Americas will hold 56.4% of Emgesa's voting shares and will have the right to appoint a majority of Emgesa's board of directors. The Board of Directors of Emgesa has seven members, three appointed by Endesa Chile (and post-spin-off by Enersis Americas), two by EEB and two independent members. The approval of any decision related to the sale of assets and any decision related to transactions of any sort with related parties exceeding USD5 million, requires five votes. We believe this structure will limit the financial impact on Emgesa that could result from a potential impairment on the financial profile of Enersis America. Therefore, under our group rating methodology, we will consider Emgesa as an insulated subsidiary of Enersis Americas.

Emgesa's 'bbb+' stand-alone credit profile (SACP) reflects our view of the company's "satisfactory" business risk profile, "modest" financial risk profile, and "adequate" liquidity. Additionally, the rating on Colombia limits that on Emgesa because a sovereign default scenario could significantly weaken Emgesa's and Codensa's finances.

Our assessment of Emgesa's business risk profile is "satisfactory" based on its satisfactory competitive position because it's the second-largest power generator in Colombia by installed capacity, its diversified asset base through the ownership of 13 power plants, low generation costs, Codensa's leading market position as the largest electric distribution company in the country, and favorable regulatory framework, which allows it to pass through the cost of power purchases to end users.

Also, Emgesa benefits from an adequate operating efficiency and strong profitability. With a total installed capacity of 3,459 megawatts (MW), Emgesa is Colombia's second-largest power generator and provides power to about 20% of the national interconnected system. In addition, Codensa is the largest electricity distributor in Colombia and sells about 14,700 gigawatt hours (GWh) annually to about three million customers, which represent an about 23% market share in terms of electricity sales.

Our assessment of Emgesa's financial risk profile as "modest" mainly reflects the company's strong consolidated cash flow generation and healthy financial metrics (consolidated with those of Codensa). Codensa generates strong and stable cash flows, and has moderate capex and aggressive dividends. As such, we expect debt to EBITDA of less than 2x and funds from operations (FFO) to debt of about 40% for year end 2015 and 2016. We also expect free operating cash flow (FOCF) to debt to reach about 10% by year-end 2015. The aforementioned forecast reflects our view that Colombia will post low single digit GDP and electricity demand growth.

The 400MW hydroelectric plant Quimbo started operations on Nov.17, 2015, as expected. Nevertheless, Emgesa suspended the provision of services at Quimbo plant on Dec. 16, derived from the precautionary measure ruled by the

Administrative Court of Huila. We believe Emgesa has a strong consolidated cash flow generation and that this delay shouldn't weaken Emgesa's healthy credit metrics.

Liquidity

We assess Emgesa's liquidity as "adequate." We expect consolidated liquidity sources (including those at Codensa) to exceed uses by at least 1.2x in the next two years, which provides protection against adverse events. We also expect sources to exceed uses even if EBITDA were to decline by 20%. Emgesa and Codensa have no financial covenants on their outstanding bonds.

Principal Liquidity Sources (Emgesa and Codensa):

- Cash balance and short-term investment of COP923 million as of Sep. 30, 2015; and
- FFO of about COP2 billion in 2016.

Principal Liquidity Uses:

- Short-term debt of about COP888 million as of Sep. 30, 2015
- Capital expenditures of about COP900 million in 2016; and
- 100% dividend payout policy.

Other Modifiers

On an aggregate basis, the modifiers don't affect the rating.

Outlook

The stable outlook reflects our expectation that Emgesa and Codensa will post FFO to debt of about 40%, and debt to EBITDA of less than 2x.

Downside scenario

The rating on Colombia limits any upgrade potential because we believe a sovereign default scenario could significantly weaken Emgesa's finances. Therefore a positive rating action would require a positive rating action on Colombia and that Emgesa's financial performance meets our expectations.

Upside scenario

We could lower the rating if the company's cash flow generation deteriorates because of an extended and extreme drought and/or if it implements a more aggressive expansion plan, which results in total debt to EBITDA of more than 3.0x and FFO to debt of less than 30%.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/##

Business risk: Satisfactory

- Country risk: Moderate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand#alone credit profile: bbb+

Group credit profile: bbb+

Entity status within group: Core

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013

Ratings List

Ratings Affirmed

Emgesa S.A. E.S.P.

Corporate Credit Rating

BBB/Stable/--

Emgesa S.A. E.S.P.

Senior Unsecured

BBB

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