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Presale:
Emgesa S.A. E.S.P.

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This presale report is based on information as of Jan. 19, 2011. The ratings shown are preliminary. This report does not constitute a recommendation to buy, hold, or sell securities. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings. Final ratings will depend upon receipt and satisfactory review of all final transaction documentation, including legal opinions. Accordingly, the preliminary ratings should not be construed as evidence of final ratings. If Standard & Poor's does not receive final documentation within a reasonable time frame, or if final documentation departs from materials reviewed, Standard & Poor's reserves the right to withdraw or revise its ratings.

Major Rating Factors

Strengths:

- Strong competitive position, as Colombia's largest power generator.
- Diversified asset base, comprising 12 plants and exposure to different hydrology systems.
- Good cash flow generation ability and prudent leverage.

Weaknesses:

- Exposure to hydrological risk adds volatility to profitability and cash flow, and might oblige the company to increase spot purchases to meet commercial commitments.
- Aggressive practice of paying 100% of net profits in dividends.
- Exposure to construction risk in new projects.

Rationale

On Jan. 14, 2011, Standard & Poor's Ratings Services assigned its preliminary 'BBB-' corporate credit rating to Emgesa S.A. E.S.P. At the same time, we assigned our preliminary 'BBB-' senior unsecured rating to the company's proposed 10-year bullet notes for up to $400 million (or its equivalent in Colombian pesos). The outlook is stable.

The ratings are preliminary, pending our receipt and review of final terms and conditions of the proposed notes. The preliminary rating incorporates our assumption that the issuance will either be fixed rate, denominated in Colombian pesos (COP), or if issued at fixed rate in a different currency, the issuer will obtain cross-currency swaps that fully cover interest and principal payments for the term of the obligation, from a counterparty that we rate at least 'BBB-'.

The preliminary rating on Colombia's largest power generator (in terms of installed capacity), Emgesa, reflects our assessments of the company's business risk profile as satisfactory and its financial risk profile as intermediate.

From an analytical perspective, we view the company's credit quality as intertwined with that of its sister company, Codensa S.A. E.S.P. (not rated), because of a high degree of integration between the two companies, shared management and support units, shared ownership, and the existence of intercompany loans to optimize cash allocation and diversify financing sources. Therefore, we follow a consolidated approach to the rating. Empresa Nacional de Electricidad S.A., Chile (Endesa; BBB+/Stable/--) has 48.5% of Emgesa's capital stock, as well as 56.4% of the voting shares and the right to appoint the majority of the board of directors. Endesa Chile is an indirect subsidiary of Endesa S.A. (A-/Watch Neg/A-2), which is in turn controlled by Italian group Enel SpA (A-/Stable/A-2). Empresa de Energia de Bogota S.A. E.S.P. (EEB; BB+/Stable/--) holds 51.5% of the capital stock in

Emgesa. EEB is controlled by the City of Bogota (BBB-/Stable/--), with an 81.5% ownership stake. Codensa has a similar ownership structure and final controlling stakes, but through different holding companies.

Our preliminary rating on Emgesa is one notch above the foreign currency rating on the Republic of Colombia. This reflects our opinion that in a sovereign default scenario on foreign currency obligations (including a significant contraction of the GDP, a strong devaluation of the domestic currency, rising inflation, inability to adjust tariffs, and a lack of new financing), the company would be able to generate sufficient resources to meet all of its financial obligations. Our expectations about the company maintaining its financial obligations in domestic currency (even originally denominated or after hedge agreements with creditworthy counterparties), and its willingness to honor its obligations in a sovereign default scenario, are critical rating components.

The rating reflects our view of the company's strong competitive position, satisfactory free cash flow (FCF) generation ability, and prudent leverage. Those factors are partially offset by Emgesa's inherent volatile profitability and cash flow due to its exposure to hydrological risk and an aggressive practice of paying dividend equivalent to 100% of net profits.

From a consolidated standpoint (combined figures), we expect cash flow generation to remain solid, but volatile, supported by favorable near-term economic growth prospects, although depending on hydrological conditions. Assuming about 3% annual growth in power demand and normal hydrological conditions (taking into account the proposed debt issuance), combined funds from operations (FFO) to total debt should remain in the 30%–40% range, while total debt to EBITDA credit metrics should be less than 2.5x.

Liquidity

In our opinion, the company has an adequate liquidity position, based on significant combined cash balances, along with a smooth, manageable debt maturity profile and good FCF generation ability. These attributes mitigate the strong projected capital expenditures (more than COP700 billion annually in the next three to four years considering Emgesa and Codensa) and aggressive dividend payments.

As of Sept. 30, 2010, Emgesa and Codensa had about COP740 billion in aggregated cash and cash equivalents (about $350 million), exceeding the short-term debt of about COP500 billion. However, we expect both companies to continue refinancing most of their principal maturities. We do not expect dividend payments to jeopardize the company's repayment or refinancing capacity. On the contrary, we expect certain flexibility in dividends and capital expenditures in case of further unexpected financing needs or under challenging refinancing market conditions.

Neither Emgesa nor Codensa has financial covenants in its outstanding debt instruments. The proposed notes would include mandatory redemption clauses under change-of-control events.

Outlook

The stable outlook reflects our expectation that Emgesa and Codensa would be able to maintain financial performance commensurate with the rating expectations, supported by a strong competitive position and good near-term economic growth prospects. Thus, FFO to total debt should exceed 30% and/or total debt to EBITDA of less than 2.5x. We believe the rating upside is limited at this point and would most likely depend on material improvements in Colombia's business environment. We could lower the ratings, however, if the company assumes a more aggressive leverage that could lead to a deterioration in its main credit metrics from the levels mentioned above.

Business Description

With a total installed capacity of about 2,914.2 megawatts (MW) as of Sept. 30, 2010 (12 plants: 85% hydro, 15% thermal), Emgesa is Colombia's largest electricity generator measured by total power generation (8.519 gigawatt-hours [GWh] generated during the first nine months of 2010), and in terms of installed capacity (about 21.2% of the system). The company generates and supplies electricity to distribution companies, large industrial and commercial customers, and sales to the spot market. During the first nine months of 2010, about 73% of the company's sales were through contracts, and 27% via the spot market.

With about 9.814 GWh distributed during the first nine months of 2010, Codensa is Colombia's second-largest power distribution company, with an estimated market share of about 26%, serving approximately 2.4 million customers. The company enjoys a strong residential client base (about 88%) that traditionally provides more stable sources of revenues. The company's area of service includes about 14,087 sq km, comprising Bogota (Colombia's capital city and 102 districts ["municipios"]) in Cundinamarca, Boyacá, and Tolima.

Ownership

The preliminary ratings are neither enhanced nor constrained by ownership factors. Endesa Chile (BBB+/Stable/--) has 48.5% of Emgesa's capital stock, as well as 56.4% of the voting shares and the right to appoint the majority of the board of directors. Endesa Chile is an indirect subsidiary of Endesa S.A. (A-/Watch Neg/A-2), which is in turn controlled by Italian group Enel. EEB holds 51.5% of the capital stock in Emgesa. EEB is controlled by the City of Bogota (BBB-/Stable/--), with an 81.5% ownership stake. Codensa has a similar ownership structure and final controlling stakes, but through different holding companies.

EEB (BB+/Stable/--) holds 51.5% of the capital stock in Emgesa and Codensa. EEB is controlled by the City of Bogota (BBB-/Stable/--), with an 81.5% ownership stake. EEB is an integrated energy company engaged in the power generation, transmission and distribution, and the transportation and distribution of natural gas.

Business Risk Profile

Regulation

Electric utilities in Colombia face relatively low regulatory risk. Regulation defines the role of each market segment participants and intends to ensure supply, regulate quality of service, and create incentives to promote investments in the sector in order to meet demand growth prospects. The regulator is very active in the sector, as evidenced in some recent resolutions during the strong drought that affected the country between 2009 and 2010.

Emgesa is exposed to a certain level of competitive pressures, given the country's regulatory framework, and an oversupply in the system under normal hydro conditions. The Colombian regulatory framework is designed to pass on higher power-generation efficiencies by dispatching power plants based on competitive bids. If power generators reduce operating cost, they could be more aggressive when participating in the competitive bids and the contract market, and that would mean lower power costs for end-users. There is an energy pool to which each generator must submit a daily offer, bidding a single price for the whole day as well as for hourly energy and the availability of ancillary services. The spot price equals the bid price of the last plant dispatched.

Electricity can be sold through spot-market transactions (where power is traded at an hourly price based on supply and demand), or contracts at fixed prices. Both transactions are carried out in Colombian pesos. Contracts can be signed with regulated customers (typically distributors) through public tenders, or with non-regulated customers (typically traders or large users), both at freely negotiated prices.

In September 2009, given the very dry hydrological conditions and natural gas restrictions in the country, and with the goal to ensure reliability of the system, the Energy and Gas Regulation Commission (CREG) passed Resolution 137. This temporary ruling confers the Centro Nacional de Despacho the authority to analyze the energy situation and establish reference levels of power generation by type of generator if needed. Although such resolution did not have a material impact in Emgesa, it evidences, in our opinion, a high level of regulation.

Since 2000, the system has compensated power generators for providing ancillary services (frequency control), which are subject to regulated tariffs. This service is positive for the Colombian electric industry because it improves service quality and represents an additional incentive to build new generation capacity.

To attract new investments in the sector, CREG changed its methodology for calculating the reliability charge (formerly capacity revenues) for power generators in December 2006, which improved capacity revenues for generating companies. Reliability charges result from competitive public actions in which power generators offer firm energy and a certain price (call options). End-users fully pay this charge. The first auction took place in May 2008 for the commitment period beginning in 2013. For the transition period between December 2006 and 2012, the regulators set the prices, currently at $13.998 per MWh.

Codensa has the distribution monopoly in its area of service. The tariff structure for distribution companies allows the pass-through of energy and transmission costs to end-users. Thus, having large energy supply contracts at prices at or below the average of the market is a key profitability factor. Codensa went through a tariff revision during mid-2009 that resulted in a slight average tariff decrease of minus 0.3%. The next tariff review is scheduled for 2013, although it is usual in Colombia to see postponements at the regulator's decision, which we consider a negative credit factor.

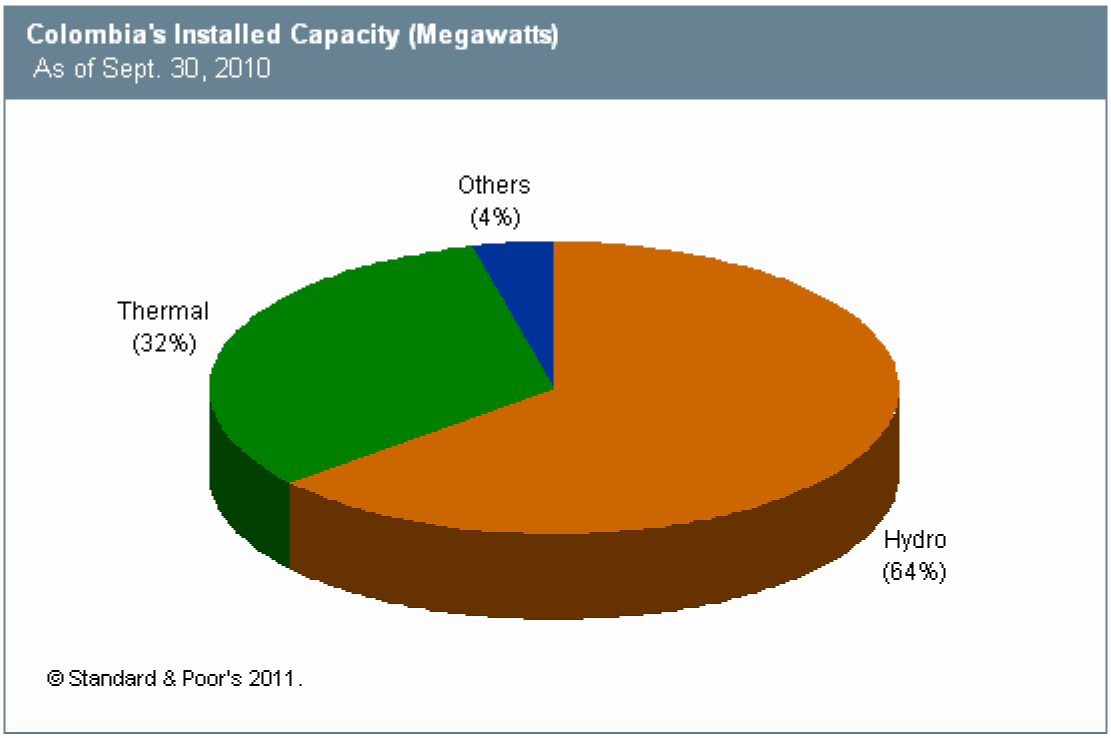
Markets

Market risk for Emgesa and Codensa has improved in recent years, mainly as a result of the growing Colombian economy. The Colombian market exhibited a 1.9% growth in demand for the 12 months to September 2010, and a compounded annual growth rate of 3.3% from 2003 to 2009 (including a 1.5% growth in 2009 despite the global economic crisis). We expect power demand to continue growing as a result of increased investments in the country and GDP growth prospects. However, Colombia's per capita power consumption of about 1,200 kilowatt hours is low, mainly reflecting the country's relatively small industrial sector.

Colombian power exports, which are carried out after meeting domestic demand, are an important factor that boosts demand for power in Colombia, affects local power prices, and benefits local power generators. (It allows Colombia, which has excess capacity, to export power mainly to Ecuador, which has low capacity reserves.) In the 12 months to August 2010, exports to Ecuador and Venezuela amounted to about 730 GWh, negatively affected by the drought caused by "El Niño," down from more than 1,000 GWh in 2008.

The Colombian electricity industry consists of one large system, the National Interconnection System. It connects Colombia's main consumption centers, with a total installed power-generation capacity of 13,496 MW as of December 2009. Of this amount, about 63% is hydro-based and 32% is thermal (about 85% natural gas and 15% coal). In the past five years, the system has exhibited a decline in capacity reserve margins (excess installed capacity over peak demand) due to growing demand and no significant capacity additions. However, we expect capacity reserves to remain at adequate levels of 30% in the medium term, with the start in operations of new projects (especially in 2011 and 2014). These levels of reserves are typical of a largely hydro-based electric system, accounting for the high volatility of Colombia's hydro generation and its high exposure to droughts.

Chart 1



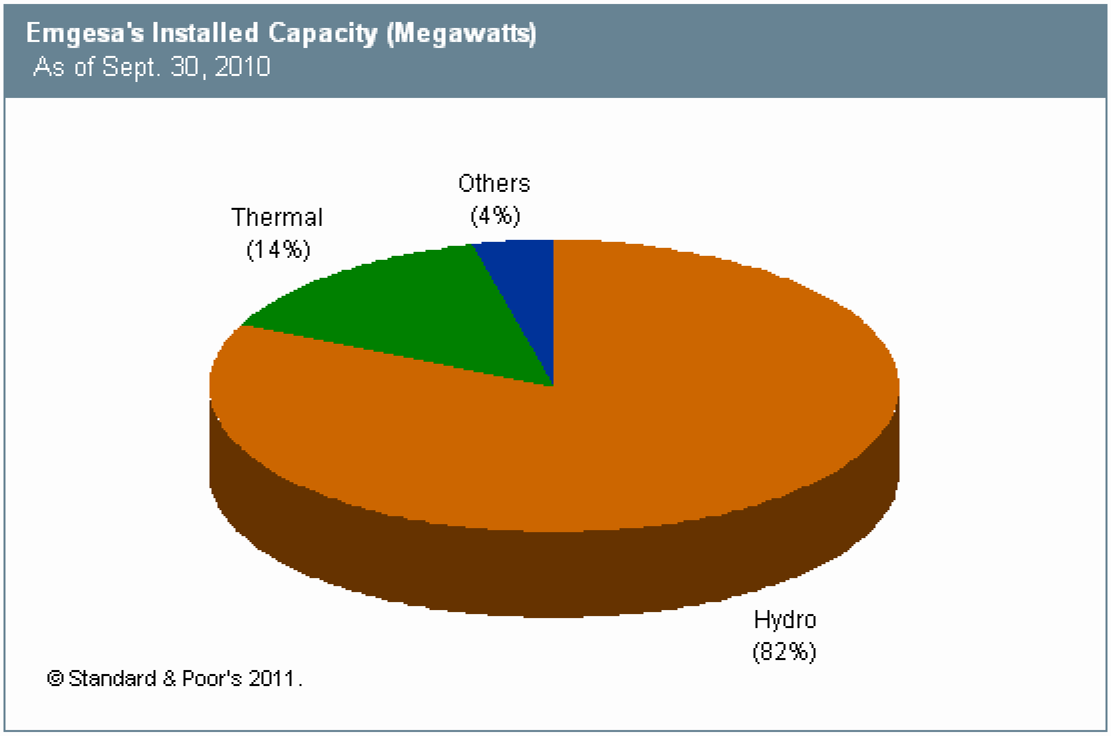
Total demand from regulated customers represents about 70% of national power consumption, and non-regulated demand accounts for the remainder. The relatively high market liberalization demonstrates the relatively small industrial sector in Colombia. National power consumption amounted to about 54,700 GWh in 2009 compared with 53,870 GWh in 2008, 53,021 GWh in 2007, and 50,982 GWh in 2006. We expect capacity expansions beginning in 2011 to cover the increase in power demand (of between 1,000 GWh and 2,000 GWh per year).

Codensa operates as a regulated monopoly in an area of about 14,087 sq km, covering the City of Bogota (Colombia's capital city), 94 municipals in Cundinamarca, eight in Boyacá, and one in Tolima. The bulk of the customer base is located in Bogota, the wealthiest city in the country.

Operations

We believe Emgesa has good and efficient operations, evidenced by the high availability of its plants, and a diversified asset base dependent on more than one hydro system. Emgesa has a total installed capacity of 2,914.2 MW, comprising 10 hydro plants and two thermal plants (see chart 2). Emgesa's annual power generation reached an average of 10,142 GWh between 2000 and 2009. The company showed high availability factors of 88.8% in 2008, 87.97% in 2009, and 84.3% in September 2010. During the first nine months of 2010, the company carried out programmed maintenance in the Paraiso and Guaca plants.

Chart 2



Codensa also has good and efficient operations, in our view, with low energy losses and good quality of service indicators. We consider that both companies have enough financial strength to continue to make all the necessary capital expenditures in maintenance and expansion to support operations.

Competitiveness

Emgesa has a strong competitive position, as Colombia's largest electricity generator. Given that few capacity expansion announcements have been made, we expect Emgesa to continue to maintain or even improve its market position in the medium term (the next five years). The company's large hydro capacity enables it to be one of the country's lowest-cost electricity generators. The flipside of this is that the company is exposed to hydrology risk, which adds profitability and cash flow volatility.

Codensa's competitive position is protected by its natural monopoly within its area of operations.

Profitability/Peer comparison

Emgesa's profitability shows certain inherent volatility due to hydrological risk. However, the company's relatively diversified asset base, good market position (about 21% market share), and commercial policy allowed it to post operating margins (before depreciation and amortization [D&A]) consistently in the 55%–60% range in the past five years. Such margins compare favorably with regional rated peers. Emgesa's higher margins could be explained mainly because of its higher hydro-generation (about 70%) when compared with peers, and thus its lower variable cost.

We consider that Emgesa would be likely able to reach operating margins above 50% under normal hydrological conditions.

Codensa has been able to reach very stable operating margins (typical for the distribution business) in the 35%–40% range, which also compares favorably with its rated peers. We believe a strong residential client base and energy losses under control should help enable Codensa to continue reporting strong profitability.

Table 1

EMGESA S.A. E.S.P--Peer Comparison					
	EMGESA S.A. E.S.P	**AES CHIVOR & CIA S.C.A. E.S.P.**	**Empresa de Energia de Bogota, S. A. E. S. P. (EEB)**	**AES Gener S.A.**	**Colbun S.A.**
Rating as of Nov. 16, 2010	Prelim BBB-/Stable/--	BB+/Stable/--	BB+/Stable/--	BBB-/Negative/--	BBB-/Stable/--
	Average of past three fiscal years (mil. $)				
Revenues	756.8	277.0	559.0	1,578.2	1,167.6
Net income from continuing operations	221.8	69.3	293.5	181.5	61.8
Funds from operations	286.2	93.3	301.8	302.9	166.7
Capital expenditures	669.3	9.0	91.6	537.6	308.9
Debt	843.5	203.0	1,560.2	1,315.9	1,064.6
Equity	2,754.1	487.6	3,086.1	2,178.0	2,846.1
Adjusted ratios					
Operations income (before D&A)/revenues (%)	59.0	48.0	79.5	26.7	16.4
EBIT interest coverage (x)	4.5	5.9	5.0	3.8	2.6
EBITDA interest coverage (x)	5.1	6.4	3.4	4.9	4.2
Return on capital (%)	11.5	16.8	15.3	10.8	3.1
FFO/debt (%)	33.9	45.9	19.3	24.2	15.7
Debt/EBITDA (x)	1.9	1.5	3.5	3.3	5.6

FFO--Funds from operations. D&A--Depreciation and amortization. EBIT--Earnings before interest and taxes. EBITDA--Earnings before interest, taxes, depreciation, and amortization.

Financial Risk Profile

Accounting

Emgesa and Codensa present financial statements audited by Deloitte & Touche Ltd. under Colombian generally accepted accounting principles (GAAP). We did not make material analytical adjustments to reported figures. Pension-related liabilities of about COP72 billion (for Emgesa) and COP225 billion (for Codensa) are on balance sheet, and we added them to financial debt.

Financial Governance

The group's financial policy is characterized by overall low leverage (although with no explicit policy or target ratio), but aggressive dividend payments (100% payout and certain capital reductions).

Although both companies have been consistently paying 100% of the previous year's distributable net income, the shareholders' agreement between Emgesa and EEB states that Emgesa would distribute all the profits it can each fiscal year, as long as it is permitted by credit agreements and if good commercial practices do not recommend the opposite.

In addition, the company's by-laws say that the company will distribute at least 50% of liquid profits, but the shareholders could decide not to distribute dividends. We consider that the company would continue to maintain an aggressive dividend policy, but we also think that dividends are flexible and could likely be suspended or postponed in case of financial distress.

Emgesa's board of directors comprises seven directors, out of which three are appointed by Endesa Chile, two by EEB, and each of the companies appoints one independent director. Most of the corporate decisions require a simple majority (a favorable vote of four directors out of seven), with the exception of certain specific decisions that require five votes (such as mergers or spin-offs).

Cash flow adequacy and capital structure

Both companies show historical healthy cash flow protection and capital structure metrics, with total debt to EBITDA below 2x, FFO to total debt above 30%, and total debt to capitalization below 35%. This financial performance is aligned with our assessment of an "intermediate" financial risk profile. Also, both Emgesa and Codensa show historical adequate free-operating-cash-flow (FOCF) generation, but aggressive dividend distributions.

From a consolidated standpoint (combined figures), we expect cash flow generation to remain solid, but volatile, supported by favorable near-term economic growth prospects, although depending on hydrological conditions. Assuming about 3% annual growth in power demand and normal hydrological conditions (taking into account the proposed debt issuance), we believe combined FFO to total debt should remain in the 30%–40% range, while total debt to EBITDA should be less than 2.5x.

Combined expected financial performance is relatively stronger than considering only Emgesa. This is mainly because of Codensa's more stable cash flow, lower leverage, and lower capital expenditure requirements.

Our preliminary rating on Emgesa is one notch above the foreign currency rating on the Republic of Colombia. This reflects our opinion that in a sovereign default scenario on foreign currency obligations (including a significant contraction of the GDP, a strong devaluation of the domestic currency, rising inflation, inability to adjust tariffs, and a lack of new financing), the company would be able to generate sufficient resources to meet all of its financial obligations. Our expectations about the company maintaining its financial obligations in domestic currency (even originally denominated or after hedge agreements with creditworthy counterparties), and its willingness to honor its obligations in a sovereign default scenario, are critical rating components.

Table 2

EMGESA S.A. E.S.P--Financial Summary

	--Fiscal year ended Dec. 31--				
	2009	**2008**	**2007**	**2006**	**2005**
Rating history	NR	NR	NR	NR	NR
(Bil. COP)					
Revenues	1,929.1	1,510.7	1,326.6	1,049.2	995.4
Net income from continuing operations	538.4	454.3	405.3	283.6	251.1
Funds from operations	689.0	567.4	545.0	457.9	513.6
Capital expenditures	74.9	68.5	3,921.0	79.5	18.5

Table 2

EMGESA S.A. E.S.P--Financial Summary (cont.)					
Cash and short-term investments	648.8	472.1	82.8	195.1	30.4
Debt	1,942.4	1,714.9	1,655.7	760.3	723.9
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	5,943.0	5,769.8	5,645.8	4,902.1	4,702.7
Debt and equity	7,885.3	7,484.7	7,301.5	5,662.4	5,426.6
Adjusted ratios					
EBIT interest coverage (x)	5.0	4.5	3.9	6.4	5.9
FFO interest coverage (x)	3.4	3.1	3.2	6.2	6.6
FFO/debt (%)	35.5	33.1	32.9	60.2	70.9
Discretionary cash flow/debt (%)	9.5	7.8	(240.2)	31.0	12.5
Net cash flow/capital expenditures (%)	374.1	132.7	4.0	425.0	1,759.9
Debt/debt and equity (%)	24.6	22.9	22.7	13.4	13.3
Return on common equity (%)	9.2	8.0	7.7	5.9	5.3

NR--Not rated. COP--Colombian pesos. FFO--Funds from operations. EBIT--Earnings before interest and taxes.