STANDARD & POOR'S

Global Credit Portal
RatingsDirect®

January 25, 2011

Research Update:

Emgesa S.A. E.S.P. And Its Proposed Notes Rated At 'BBB-'

Primary Credit Analyst:
Luciano Gremone, Buenos Aires (54) 11-4891-2143;luciano_gremone@standardandpoors.com

Secondary Contact:
Pablo Lutereau, Buenos Aires (54) 114-891-2125;pablo_lutereau@standardandpoors.com

Table Of Contents

Research Update:

Emgesa S.A. E.S.P. And Its Proposed Notes Rated At 'BBB-'

Overview

- We received final documentation of Emgesa S.A. E.S.P.'s debt issuance.
- We are assigning our 'BBB-' issuer credit rating and senior unsecured rating to the company's proposed 10-year notes.
- The company will issue notes in Colombian pesos at a fixed 8.75% rate due 2021 and payments in dollars at market rate.

Rating Action

On Jan. 25, 2011, Standard & Poor's Ratings Services assigned its 'BBB-' issuer credit rating on Colombia-based power generator Emgesa S.A. E.S.P. and its 'BBB-'senior unsecured rating on the company's Colombian peso (COP) 736.8 billion 8.75% notes with final maturity in 2021, following receipt and review of final documentation. The outlook is stable.

The ratings 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, support units, and 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 and 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. the City of Bogota (BBB-/Stable/--) controls 81.5% of EEB. Codensa has a similar ownership structure and final controlling stakes, but through different holding companies.

Our 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 sharp 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 partly 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 aggressive dividend payments and the expected capital expenditures of more than COP700 billion annually in the next three to four years for Emgesa and Codensa.

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. Under the terms and conditions of the proposed notes, the company would be obliged to offer to purchase the notes under certain change-of-control events. In our view, a change of control is unlikely in the medium term.

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.

Related Criteria And Research

- S&PCORRECT: Emgesa S.A. E.S.P. Assigned Preliminary 'BBB-' Issuer Credit, Senior Unsecured Ratings, Jan. 14, 2011
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010

Ratings List

Emgesa S.A. E.S.P.

Issuer credit rating	BBB-/Stable/--
Senior unsecured rating	BBB-

Complete ratings information is available to RatingsDirect subscribers on the Global Credit Portal at www.globalcreditportal.com and RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.