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## Research Update:

# Emgesa S.A. ESP 'BBB-' Rating Placed On CreditWatch Positive On The Sovereign Upgrade

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## Research Update:

# Emgesa S.A. ESP 'BBB-' Rating Placed On CreditWatch Positive On The Sovereign Upgrade

## Overview

- On April 24, 2013, we raised the foreign currency rating on Colombia to 'BBB/A-2' from 'BBB-/A-3'.
- We are placing our 'BBB-' rating on Colombia-based power generator Emgesa on CreditWatch with positive implications.
- We expect to resolve the CreditWatch listing during the next 30 days, after an analysis of Emgesa's projected operating performance for 2013-2015.

## Rating Action

On April 30, 2013, Standard & Poor's Ratings Services placed its 'BBB-' ratings on Emgesa S.A. ESP on CreditWatch with positive implications following the upgrade of the sovereign.

## Rationale

The CreditWatch listing reflects our view that a better business environment in Colombia favors Emgesa's credit quality. We expect continuity in pro-investor economic policies after the 2014 national elections, thanks to a political consensus in favor of market-oriented policies. Continued investment in the energy and mining sectors should support Colombia's future economic growth. Emgesa's solid operating and financial performance and the potential benefits from the further improved cash reserves of its indirect parent, Chile-based Enersis S.A. that has chosen Colombia as one of the potential markets to expand its operations in the next few years, are also rating considerations.

Our ratings on Emgesa, as Colombia's second-largest power generator by installed capacity, reflect our assessment of the company's business risk profile as "satisfactory" and its financial risk profile as "intermediate," as our criteria define those terms.

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 the high integration between the two companies including 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.

The ratings on Emgesa reflect our view of the company's strong competitive position, satisfactory free cash flow generation, and relatively low debt. Those factors are partially offset by Emgesa's inherently volatile profitability and cash flow, given its exposure to hydrological risk and its aggressive practice of paying dividends equivalent to 100% of its net profits.

We expect Emgesa's cash-flow generation to remain solid but volatile with funds from operations (FFO) to total debt likely remaining at 25%-35%, and total debt to EBITDA at less than 2.5x. On a consolidated basis, and because CODENSA has shown stronger and more stable stand-alone financial performance than Emgesa has, we expect FFO to total debt of 35%-45% and debt to EBITDA of less than 2x.

Empresa Nacional de Electricidad S.A. Chile (Endesa Chile; BBB+/Stable/--) and Cono Sur Participaciones S.L. (not rated) jointly hold 48.5% of Emgesa's capital stock. Endesa Chile has the right to appoint a majority of Emgesa's board of directors pursuant to an agreement between them, and together with Cono Sur Participaciones S.L. holds 56.4% of Emgesa's voting shares. CODENSA has a similar ownership structure and final controlling stakes, but through different holding companies. Endesa Chile is 60% owned by Enersis S.A. (BBB+/Stable/--), a Chilean holding company with investments mainly in power generation and electricity distribution in Latin America. Enersis, in turn, is 60.6% owned by Spanish utility Endesa S.A. (BBB+/Negative/A-2).

## **Liquidity**

We believe that Emgesa currently has "adequate" liquidity to meet its needs over the next two years. Relevant aspects of our assessment of the company's liquidity profile include:

- Sources of liquidity (including FFO and cash balances) exceeding uses by at least 1.2x over the next two years;
- Liquidity sources continuing to exceed uses, even if EBITDA were to decline by 20%;
- Good access to the credit markets, especially in Colombia; and
- A current absence of financial covenants.

Also, the company's significant combined cash balances, along with a smooth, manageable debt maturity profile and ability to generate good free cash flow, support our assessment of "adequate" liquidity. These attributes mitigate the expected aggressive dividend payments and heavy capital expenditures in the next three years.

## **CreditWatch**

We expect to resolve the CreditWatch listing during the next 30 days, after an analysis of EMGESA's projected operating performance for 2013-2015.

## Related Criteria And Research

- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

## Ratings List

Ratings Affirmed; CreditWatch Action

	To	From
Emgesa S.A. E.S.P.		
Corporate Credit Rating	BBB-/Watch Pos/--	BBB-/Stable/--
Senior Unsecured	BBB-/Watch Pos	BBB-

Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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