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Research Update:

Emgesa Ratings Raised To 'BBB' From 'BBB-'; Off Watch Positive

Primary Credit Analyst:
Sergio Fuentes, Buenos Aires (54) 114-891-2131; sergio.fuentes@standardandpoors.com

Secondary Contact:
Alejandro Gomez Abente, Sao Paulo (55) 11-3039-9741;
alejandro.gomez.abente@standardandpoors.com

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Overview

- Colombia-based power generator Emgesa benefits from an improving business environment and enjoys a solid market position, good operating efficiency and expected healthy consolidated financials in spite of relatively high capital expenditures and dividend payments.
- We are raising the rating on Emgesa to 'BBB' from 'BBB-' and removing it from CreditWatch where it was placed on April 30, 2013, with positive implications.
- The stable outlook reflects the growing demand for power in Colombia, expected good operating performance and expected healthy financials.

Rating Action

On May 30, 2013, Standard & Poor's Ratings Services raised its corporate credit ratings on Emgesa S.A. ESP (Emgesa) to 'BBB' from 'BBB-' and removed it from CreditWatch where it was placed on April 30, 2013, with positive implications. The outlook is stable.

Rationale

Our ratings on Colombia's second-largest power generator by installed capacity Emgesa reflect our assessment of the company's business risk profile as "satisfactory" and its financial risk profile as "intermediate," as our criteria define these terms. We view the company's credit quality as integrally linked with that of its sister company, Colombia's largest electric distribution company CODENSA S.A. E.S.P. (CODENSA; not rated), because of their significant integration, including shared management, support units, and ownership, and the existence of intercompany loans to optimize cash allocation and diversify funding sources. Therefore, we follow a consolidated approach to assigning the rating.

The ratings on Emgesa reflect our view of both Emgesa and CODENSA's strong competitive position in their respective markets, strong consolidated cash flow generation and relatively low debt. These factors mitigate Emgesa's relatively volatile profitability and cash flow given its exposure to hydrological risk, aggressive capital expenditures (capex) in the power generation segment and dividend policy (100% of its net profits). We expect consolidated cash-flow generation to remain healthy with funds from operations (FFO) to total debt will likely remain at 35%-45% and debt to EBITDA at less than 2.0x. These expectations include Emgesa's new 400MW hydroelectric plant

QUIMBO, which we expect to be fully operational by 2015, and which will add about 2,200 GWh per year of low cost power generation, which should increase its total power generation by about 15%.

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. Enersis S.A. (BBB+/Stable/--), a Chilean holding company with investments mainly in power generation and electricity distribution in Latin America, holds a 60% in Endesa Chile. Spanish utility Endesa S.A. (BBB+/Negative/A-2) owns 60.6% of Enersis.

Liquidity

We believe liquidity is "adequate" and should meet consolidated needs over the next two years. Our assessment includes:

- Sources (including FFO and cash balances) will likely exceed uses by at least 1.2x over the next two years;
- Sources will likely exceed uses, even if EBITDA were to decline by 20%;
- Very good access to the credit markets, especially in Colombia; and
- No financial covenants.

Also, significant consolidated cash balances of above Colombian peso (COP) 500 billion (about $270 million), along with strong cash flow from operations of at least COP 1,500 billion (about $800 million) would allow Emgesa to face relatively high capex of about COP 1,000 billion (about $500 million) and distribute 100% of its net income while maintaining a total debt to EBITDA below 2.0x and benefitting from a smooth debt maturity profile during 2013.

Outlook

The stable outlook reflects the growing demand for power in Colombia of at least 3% per year, Emgesa's and CODENSA's good operational performance, with a consolidated EBITDA margin at about 50%, and expected healthy financials with total debt to EBITDA below 2.0x in spite of relatively high capex and dividend payments. A positive rating action is limited by the rating on Colombia as we consider that the companies' financial condition could be significantly weakened in a sovereign default scenario. We could lower the ratings if the companies adopt a more aggressive business expansion strategy, increase cash flow upstream to shareholders through dividends or through capital reduction resulting in leverage levels exceeding 3.0x.

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Related Criteria And Research

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

Ratings List

Upgraded; CreditWatch/Outlook Action

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

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