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Research Update:

Emgesa S.A. E.S.P. 'BBB' Ratings Affirmed; Outlook Remains Stable

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Overview

- Colombia-based power generator, Emgesa and its sister company electricity distributor, Codensa, continue to benefit from healthy credit metrics, rising demand for electricity, low generation costs, and favorable electricity prices in Colombia.
- We are affirming our 'BBB' corporate credit and issue-level ratings on Emgesa.
- The stable outlook reflects our expectation that Colombia's power demand will reach at least 3% annually, Emgesa's and Codensa's solid operating performance, the start-up of the Quimbo hydro plant in the second half of 2015, strong cash flow generation, no new power generation projects in 2015 and 2016, and high dividends.

Rating Action

On Aug. 11, 2015, Standard & Poor's Ratings Services affirmed its 'BBB' corporate credit and issue-level ratings on Emgesa S.A. E.S.P. The outlook on the corporate credit rating remains stable.

Rationale

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 existence of intercompany loans to optimize cash allocation and diversity of funding sources. Therefore, we follow a consolidated approach in our credit analysis of Emgesa.

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.

Emgesa's "satisfactory" business risk profile is based on its satisfactory competitive position because it's the third-largest power generator in Colombia by installed capacity and power generation, its diversified asset base through the ownership of 12 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 3,059 megawatts (MW), Emgesa is Colombia's third-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 3 million customers, which represent an about 23% market share in terms of electricity sales.

Emgesa's "modest" financial risk profile mainly reflects the company's strong consolidated cash flow generation and healthy financial metrics (consolidated with those of Codensa). Emgesa generates strong, but somewhat volatile, cash flows, and has aggressive capex and dividends. Codensa generates strong and stable cash flows, and has moderate capex and aggressive dividends. As such, we expect total net debt to EBITDA of less than 2x and funds from operations (FFO) to net debt of about 40% in 2015 and 2016. In addition, we expect free operating cash flow (FOCF) to net debt to reach about 10% in 2015 and shoot up to about 25% in 2016 due to the likely completion of Emgesa's new 400 MW hydroelectric plant, Quimbo, in the second half of 2015. These expectations assume that Quimbo will add about 2,200 GWh annually of low-cost power generation, which should increase Emgesa's total power generation by about 15%. In addition, we expect the implementation of Codensa's tariff revision to be delayed until the second half of 2015 from the original dates of September 2014 (commercialization) and January 2015 (for distribution). This will result in Codensa's lower revenue in 2016 but it 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%. Our assessment also incorporates the company's financial flexibility as seen in its fluid access to credit markets. It can also retain discretionary cash by reducing its large dividends. In addition, Emgesa and Codensa have no financial covenants on their outstanding bonds.

Principal Liquidity Sources (Emgesa and Codensa):

- Cash balance and short-term investment of COP1.5 billion as of Dec. 31, 2014
- FFO of about COP1.9 billion in 2015

Principal Liquidity Uses:

- Short-term debt of about COP350 million as of Dec. 31, 2014
- Capital expenditures of about COP1.5 billion in 2015
- 100% dividend payout policy, although the company can adjust it

Other modifiers

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

Group influence

Empresa Nacional de Electricidad S.A. Chile (Endesa Chile; BBB+/Stable/--) and Enersis S.A. (BBB+/Stable/--) jointly hold 48.5% of Emgesa's capital stock. Endesa Chile has the right to appoint a majority of Emgesa's board of directors, and together with Enersis, holds 56.4% of Emgesa's voting shares. We consider Emgesa a strategically important subsidiary for Endesa Chile. Codensa has a similar ownership structure and final controlling stakes, but through different holding companies.

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

Outlook

The stable outlook reflects our expectation that Colombia's power demand will rise by at least 3% annually, Emgesa's and Codensa's operating performance will remain solid, the Quimbo hydro plant will start operating in the second half of 2015, strong cash flow generation, no new power generation projects to be initiated in 2015 and 2016, and high dividends. We expect a consolidated EBITDA margin at about 50%, FFO to adjusted debt of about 40%, and adjusted total net debt to EBITDA of less than 2x despite high dividend payments.

Upside scenario

The rating on Colombia limits an upgrade potential because we believe a sovereign default scenario could significantly weaken Emgesa's and Codensa's finances.

Downside scenario

We could lower the rating if the company's cash flow generation deteriorates due to 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
- Financial policy: Neutral ("no impact")
- Management and governance: Satisfactory
- Comparable rating analysis: Neutral ("no impact")

Stand#alone credit profile: bbb+
Group credit profile: bbb+
Entity status within group: Strategically Important

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors for The Unregulated Power and Gas Industry, March 28, 2014
- Corporate Methodology, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, 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/--
Senior Unsecured	BBB

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.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.