S&P Global Ratings

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Transaction Update: Emgesa S.A. E.S.P.

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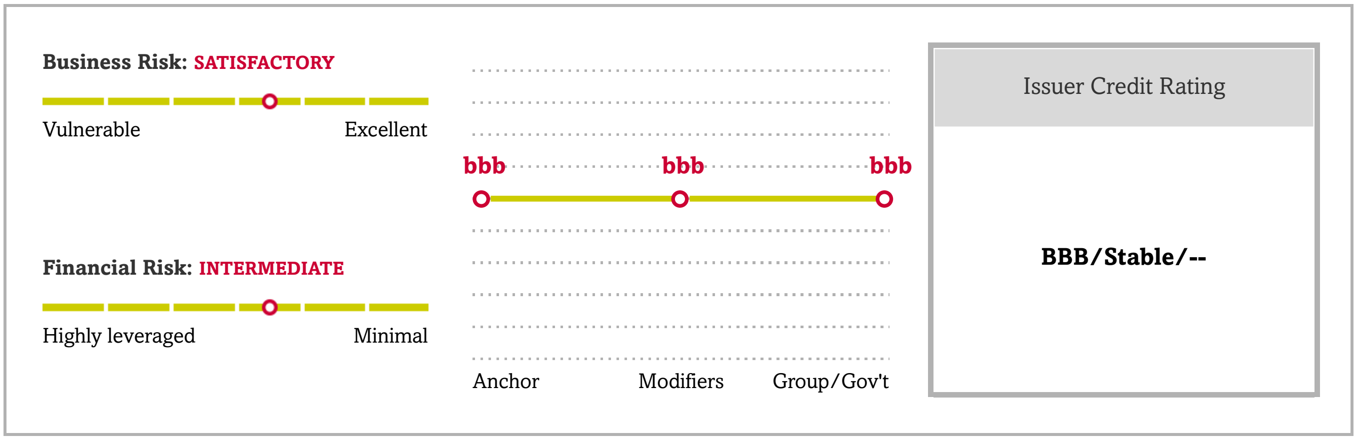


Credit Highlights

Overview

Key strengths	Key risks
Leading market position in Colombia's energy generation sector;	Exposure to hydrological conditions; and
Relatively stable and predictable revenue stream, driven by its highly contracted nature;	Although marginal, some exposure to spot price fluctuations.
Improving credit metrics supported by both EBITDA growth--that we attribute mostly to continued gains in efficiency--and by the decrease in expected capital expenditures (capex) as projects under construction become operational and debt decreases; and	
Strong controlling shareholder.	

Emgesa should maintain its leading position in the generation business in upcoming years. The company is the second largest electricity generator in Colombia, providing power to about 20.5% of the national interconnected system with about 3,500 megawatts (MW), of which 88% are hydro. We expect this trend to continue in the next two to three years. This assessment considers Empresas Publicas de Medellin E.S.P.'s (EEPPMM; not rated) recent announcement that the 2,400 MW capacity Ituango hydropower plant has been delayed for several years, and the company expects it will not start operating before December 2021. Given the relevant size of this project for Colombia's electric system, and more importantly that only limited additional capacity will be beginning to operate from 2019 to mid-2021, we don't anticipate significant changes in the contribution of the major players to the system in the next few years. However, in the longer term, with Ituango fully operational and new renewable capacity dispatching, we expect Emgesa could lose some market share, but still remain a leading operator.

We expect a relatively stable and predictable revenue base due to the power purchasing agreements (PPAs) currently in place. Emgesa's capacity is mainly contracted with creditworthy counterparties (mostly distribution companies and large consumers). More precisely, as of June, its total contracted capacity surpassed 80% and the average life of the contracts was about 3.5 years. The remaining capacity is used as a hedge for hydrology risk, and commercialized in the spot market, which we view as positive from a credit perspective. For example, during El Nino climate events, Emgesa has been able to maintain stable EBITDA generation.

Main credit metrics should strengthen in 2019 and 2020 in light of higher spot prices, lower investments, and scheduled debt repayments. Ituango's delay and the dry season raised the spot price during the first half of this year, and we expect that because of market dynamics, namely demand and supply interaction, prices will only return to lower levels by late 2021 or early 2022. Therefore, we anticipate Emgesa's EBITDA generation to slightly improve because we include in our base case higher revenues from spot sales from 2019 until 2021. In addition, we expect Emgesa's capex to decrease in the next two to three years because there are no significant projects in the pipeline. We don't forecast debt to increase either. In this context, we expect main relevant credit metrics to strengthen, with adjusted debt to EBITDA and FFO to debt of about 1.5x and 45% in 2019, from 1.8x and 34.4%, respectively, last year.

Emgesa should continue to be a key subsidiary for its controlling shareholder, Enel Americas S.A. (Enel Americas: BBB/Stable/--). In our view, the company is integral to the group's identity and strategy, and as a result should receive parent support under any foreseeable circumstances. For this reason, we equalize our ratings on Emgesa with those on Enel Americas, allowing us to rate it above the sovereign rating on Colombia (foreign currency BBB-/Stable/A-3; local currency BBB/Stable/A-2).

Outlook: Stable

The stable outlook on Emgesa reflects our expectation that the company will remain a key subsidiary of Enel Americas and that its parent will support it even in a hypothetical scenario of sovereign stress.

It also reflects our expectation that the company will continue to benefit from growing power demand in Colombia and more importantly that it will post relatively stable revenues in the next two years due to its highly contracted nature. In addition, we expect its leverage will continue decreasing because we don't anticipate heavy capex, resulting in a debt-to-EBITDA ratio of about 1.5x and a FFO-to-debt ratio above 45%.

Downside scenario

We could downgrade Emgesa in the next 12 to 24 months if we downgrade Enel Americas, which we do not anticipate in the current context, or if we come to believe that the latter has lower incentives to support it. This could happen if, for example, Enel dilutes its voting stake or if we perceive Emgesa has become less strategic from a business perspective.

We could revise Emgesa's stand-alone credit profile (SACP) downwards if its financial risk profile worsens due to, for example, a more aggressive commercial strategy in the midst of worsening hydrology conditions or a more aggressive expansion plan, leading to a debt-to-EBITDA ratio of over 3.0x and FFO to debt of less than 30%, consistently.

Upside scenario

A positive rating action on Enel Americas in the next 12 to 24 months could lead us to upgrade Emgesa. Additionally, we could revise Emgesa's SACP upwards if we see its financial ratios consistently improving, which could happen following a combination of lower dividend payouts and lower investments, leading to debt to EBITDA consistently below 1.0x-1.5x and FFO to debt above 50%.

Our Base-Case Scenario

Assumptions

- Macroeconomic variables that we view as relevant for the generation business, particularly GDP growth that's highly correlated to electricity demand and inflation because it affects costs. (Please see "Policy Uncertainty Undermines Growth Prospects," published Sept. 30, 2019). Our forecast for Colombia's GDP growth is 3.2% in 2019 and 3.3% per year thereafter, and we forecast inflation to remain in the 3.0%-3.5% range.
- Overall normal hydrology levels and stable energy capacity, given that there are no significant projects in the pipeline in the short to medium term, and no non-recurrent disruptions in plant operations. This would lead to annual net power generation of about 15,500 GWh between 2019 and 2021.
- No changes in the contractual status of the power plants and relatively stable spot prices until 2021, when we include the start of operations of the Ituango plant.
- Cost increases in line with inflation.
- Capex of about COP450 billion in 2019, decreasing thereafter to COP260 billion. We incorporated as growth capex the finalization of improvements to the Canoas and Quimbo plants, the life extension of the Termozipa plant, and the Bateries project at Termozipa. We don't incorporate additional new projects mainly because Emgesa anticipates challenges due to oversupply starting in 2021.
- The refinancing of the international bond due in January 2021 and no increase in debt.
- Dividend payout ratio of 70%.

Key Metrics

	2018A	2019	2020
Adjusted EBITDA (Bil. COP)	2,133	2,305	2,390
Adjusted debt to EBITDA (x)	1.8	1.4	1.2
Adjusted EBITDA interest coverage	6.1	6.6	7.1
Adjusted FFO to debt (%)	34.4	46.5	54

A--Actual. FFO--Funds from operations.

Company Description

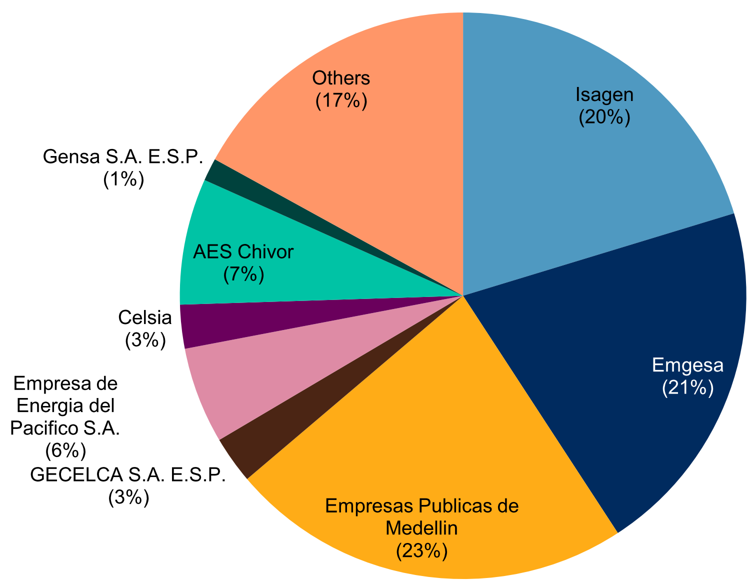
Emgesa is the second largest power generator in Colombia. The company operates in three different markets:

- the wholesale market, which includes large block energy purchases and sale operations between generators and marketers;

- the non-regulated market that comprises end-customers that consume more than 55 megawatt hours (MWh) per month or that have more than 0.1 MW and;
- the energy exchange market that allows generation deficit and surplus daily trades.

Chart 1

Total Generation In The National Interconnection System (%)
As Of 2018

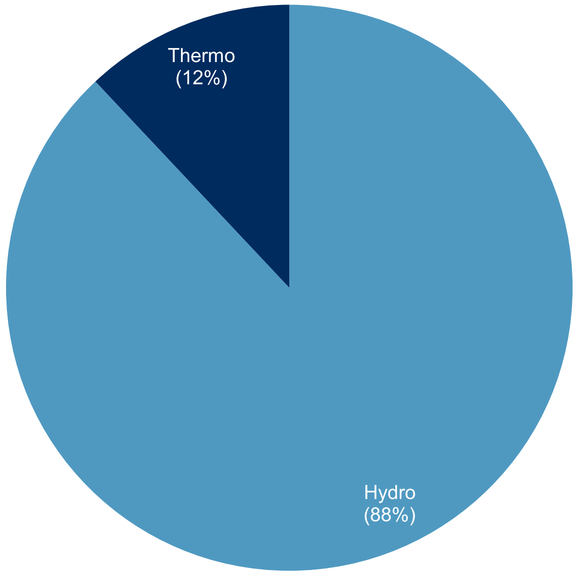


Source: S&P Global Ratings.

The company benefits from a diversified asset base because it owns 12 hydroelectric power plants and two thermal electric power assets with an installed capacity of about 3,500 MW, generating 14.135 gigawatt hours (GWh) last year.

Chart 2

Emgesa's Net Production By Technology
As Of 2018



Source: S&P Global Ratings.

Enel Americas holds 48.5% of Emgesa's capital stock, while Grupo Energia de Bogota S.A. E.S.P. (EEB; BBB-/Stable/--) holds the remaining 51.5% of shares. Enel has the right to appoint a majority of Emgesa's board of directors, since it holds 56.4% of Emgesa's voting shares--thus, we view Enel as Emgesa's controlling shareholder.

Business Risk: Satisfactory

Our view of Emgesa's business risk profile is supported by our view that it will maintain a solid competitive position in the Colombian market; its relatively stable cash flow generation because we expect most of its capacity will remain contracted in the next two to three years; its somewhat diversified assets, with 14 power plans distributed in diverse regions of the country; and the strong operating efficiency and profitability driven by its low variable cost structure. Our assessment also contemplates our favorable view of Colombia's regulatory, legal, and contractual framework. The key weaknesses include exposure to drought, since hydropower represents about 88% of its installed capacity, and some level of exposure to the volatile spot market.

High levels of contracted sales for 2019 and 2020. As stated in the credit highlights section, we expect Emgesa's capacity will remain highly contracted in the upcoming two to three years. In the medium term, we anticipate some exposure to contracting risk, but we don't view this as a credit weakness for Emgesa given that it's not a company specific dynamic but a market condition in Colombia because the average contract life has always been shorter than in the rest of Latin America. More importantly, Emgesa has been historically able to satisfactorily re-contract its capacity, which we attribute to the high efficiency levels and its track record in the industry.

We view Colombia's regulatory, legal and contractual framework as supportive. The regulation in Colombia allows for the timely recovery of operating costs and capital. More importantly, we have a satisfactory record of tariff revisions and expect no significant modifications in the next few years. Therefore, we consider the framework predictable and transparent, which supports the ratings.

Exposure to drought, since hydropower makes up more than 85% of its installed capacity, and some exposure to spot prices. As of June 2019, Emgesa had 3,093 MW of hydropower installed capacity in Colombia, followed by 4,780 MW of thermo generation, and coal-fueled facilities. Although exposure to natural resources is high, its prudent commercial strategy partially mitigates this risk. On the other hand, we expect some level of exposure to the spot market given that it will dispatch a portion of its capacity there.

Peer comparison

We incorporated as peers other electricity players that we rate in the region, including AES Gener S.A., Enel Chile S.A., Enel Americas S.A, Colbun S.A, Nautilus Inkia Holdings LLC, Trinidad Generation Unlimited, ISAGEN S.A. E.S.P., as well as global players, including Emgesa' ultimate controlling sponsor Enel SpA, and Engie S.A.

From a business perspective, there are some differentiating characteristics with AES Gener, Nautilus, Colbun, and Enel Americas because they all operate in more than one country in the region and generally in more than one segment, including electricity transmission or distribution. Emgesa is more comparable to ISAGEN and Trinidad Generation Unlimited because those operate in Colombia and Trinidad and Tobago, respectively, and derive revenues entirely or mostly from the generation business. While all the Latin American peers have satisfactory business risk profiles, the two global peers benefits from strong profiles, mainly because of lower country risk and strong competitive position scores that reflect primarily the track record of the regulations, their solid competitive positions, and their geographic and asset diversity (each operates on several continents and has more than 150 assets).

From a financial perspective, Emgesa compares well with Colbun, Enel Americas, and AES Gener because we expect all of those to post adjusted debt to EBITDA of no higher than 2x in the next two to three years. However, Colbun and AES Gener are focusing investments in the generation business in upcoming years, mainly by developing new renewable capacity, whereas we expect Emgesa will only finish its ongoing capex and then converge in the medium term to maintenance level, unless there is a change in the perception of the market in that timeframe. On the other hand, we expect Enel Americas will mostly concentrate its capex in the distribution business.

Table 1

Emgesa S.A. E.S.P. -- Peer Comparison

Industry Sector: Electric Utility

	Emgesa S.A. E.S.P.	ISAGEN, S.A. E.S.P.	Enel Americas S.A.	AES Gener S.A.	Colbun S.A.	Trinidad Generation Unlimited	Nautilus Inkia Holdings LLC	Enel SpA	E
Ratings as of Oct. 15, 2019	BBB/Stable/--	BBB-/Stable/--	BBB/Stable/--	BBB-/Stable/--	BBB/Stable/--	BBB-/Stable/--	BB/Stable/--	BBB+/Stable/A-2	A-/St

Table 1

Emgesa S.A. E.S.P. -- Peer Comparison (cont.)

	--Fiscal year ended Dec. 31, 2018--							
(Mil. $)								
Revenue	1,145.3	816.3	13,184.1	2,647.4	1,571.3	105.9	1,612.5	86,238.2
EBITDA	657.1	458.9	3,456.6	758.5	684.1	83.9	556.9	17,499.2
Funds from operations (FFO)	400.7	369.2	2,400.1	423.8	501.2	46.9	366.4	12,402.9
Interest expense	107.4	98.1	778.4	77.9	72.9	38.6	148.3	2,959.9
Cash interest paid	111.2	89.7	462.5	245.4	74.6	37.1	145.3	3,125.9
Cash flow from operations	481.0	88.4	1,496.5	116.6	467.8	16.0	379.0	12,966.2
Capital expenditure	77.7	22	1,521.3	143.6	107.9	1.4	155.1	9,455.7
Free operating cash flow (FOCF)	403.4	66.4	(24.8)	(27.0)	359.8	14.7	223.9	3,510.5
Discretionary cash flow (DCF)	218.6	66.4	(616.8)	(249.4)	69.2	4.7	200.5	(584.2)
Cash and short-term investments	192.6	26.3	2,034.0	327.2	788.4	132.3	201.0	7,401.8
Debt	1,164.3	1,342.40	7,881.6	863.7	1,011.9	450.9	2,761.2	58,462.1
Equity	1,305.7	1,820.80	8,831.9	2,969.1	3,856.9	223.7	1,080.0	57,234.0
Adjusted ratios								
EBITDA margin (%)	57.4	56.2	26.2	28.7	43.5	79.3	34.5	20.3
Return on capital (%)	24.3	13.6	20.0	7.1	8.6	12.0	9.3	12.6
EBITDA interest coverage (x)	6.1	4.7	4.4	9.7	9.4	2.2	3.8	5.9
FFO cash interest coverage (x)	4.6	5.1	6.2	2.7	7.7	2.3	3.5	5.0
Debt/EBITDA (x)	1.8	2.9	2.3	1.1	1.5	5.4	5.0	3.3
FFO/debt (%)	34.4	27.5	30.5	49.1	49.5	10.4	13.3	21.2
Cash flow from operations/debt (%)	41.3	6.6	19.0	13.5	46.2	3.6	13.7	22.2
FOCF/debt (%)	34.6	4.9	(0.3)	(3.1)	35.6	3.3	8.1	6.0
DCF/debt (%)	18.8	4.9	(7.8)	(28.9)	6.8	1.0	7.3	(1.0)

Financial Risk: Intermediate

Main credit metrics should continue strengthening.

The company's debt peaked in 2015--adjusted debt to EBITDA was about 2.5x-- because of the construction of the El Quimbo power plant that required a major investment of about $1.2 billion. Since that year up until now, we've observed a gradual deleverage, and therefore improving main credit ratios.

Going forward, we only include growth capex associated with the Canoas and Quimbo projects that consists mainly of improvements and works related to Termozipa. Overall, we expect capex should decrease from near COP440 billion this year to about COP265 billion in 2021, and don't anticipate additional capacity or an increase in debt in the next few years.

Our updated forecast indicates adjusted debt to EBITDA should trend down to near 1.4x by the end of 2019, a similar level prior to the Quimbo development, from 1.8x in 2018. We also expect an improvement in FFO to debt to 45% from the 35% posted late last year.

We don't expect the shareholders' arbitration process to significantly affect Emgesa's repayment capacity.

In late December 2017, EEB, the minority shareholder, notified Enel Americas that it was filing arbitration related to differences in the profit distribution in 2016, as regulated by the Investment Framework Agreement (AMI). The minority shareholder argues Enel Americas acted against its own interest when voting for a profit distribution of 70%, in breach of provisions of a specific clause of the AMI, which establishes that the voting parties should vote for the most profit distribution possible. After setting the initial date, EEB decided to withdraw the claim to revise it to include new topics, for example, the group's position about renewables. The arbitration is still in an early stage and we do not expect a resolution soon.

If the arbitration is favorable for EEB, Emgesa will be requested to distribute the remaining 30% in dividends for 2016, 2017, and 2018 that on aggregate should be, according to our calculations, about $275 million. Even if this is the case, we do not believe it will impair Emgesa's repayment capacity. In that scenario, adjusted debt to EBITDA would increase up to 2x, but would remain aligned with the current rating level.

Financial summary

Table 2

Emgesa S.A. E.S.P. -- Financial Summary					
Industry Sector: Electric Utility					
	--Fiscal year ended Dec. 31--				
(Mil. $)	**2018**	**2017**	**2016**	**2015**	**2014**
Revenue	1,145.3	1,147.4	1,170.2	1,029.5	1,100.7
EBITDA	657.1	695.4	664.1	547.0	722.8
Funds from operations (FFO)	400.7	419.0	349.5	291.0	697.6
Interest expense	107.4	126.6	164.1	109.3	52.4
Cash interest paid	111.2	137.0	159.9	103.8	25.2
Cash flow from operations	481.0	384.5	383.2	257.5	1,214.3
Capital expenditure	77.7	105.8	96.8	222.1	365.6
Free operating cash flow (FOCF)	403.4	278.8	286.5	35.4	848.7
Discretionary cash flow (DCF)	218.6	78.6	21.7	(294.0)	537.3

Table 2

Emgesa S.A. E.S.P. -- Financial Summary (cont.)					
Industry Sector: Electric Utility					
	--Fiscal year ended Dec. 31--				
(Mil. $)	**2018**	**2017**	**2016**	**2015**	**2014**
Cash and short-term investments	192.6	191.0	209.9	98.1	404.7
Gross available cash	192.6	191.0	209.9	98.1	404.7
Debt	1,164.3	1,373.3	1,331.6	1,256.4	1,192.7
Equity	1,305.7	1,289.2	1,164.2	1,120.9	2,198.6
Adjusted ratios					
EBITDA margin (%)	57.4	60.6	56.7	53.1	65.7
Return on capital (%)	24.3	24.5	23.2	20.3	19.3
EBITDA interest coverage (x)	6.1	5.5	4.0	5.0	13.8
FFO cash interest coverage (x)	4.6	4.1	3.2	3.8	28.7
Debt/EBITDA (x)	1.8	2.0	2.0	2.3	1.7
FFO/debt (%)	34.4	30.5	26.2	23.2	58.5
Cash flow from operations/debt (%)	41.3	28.0	28.8	20.5	101.8
FOCF/debt (%)	34.6	20.3	21.5	2.8	71.2
DCF/debt (%)	18.8	5.7	1.6	(23.4)	45.0

Liquidity: Adequate

We continue to view Emgesa's liquidity as adequate. We expect its consolidated liquidity sources to exceed uses by at least 1.4x in the next two years, which provides protection against adverse events. We also expect sources to exceed uses even if EBITDA declines by 15%. The company can retain discretionary cash by reducing its large dividends distribution and we anticipate lower expansionary capex in the next two years once the company finalizes some specific projects currently under construction.

We continue to believe that Emgesa has adequate financial flexibility, with proven access to the capital markets and banks, which in our view is enhanced by its ownership structure. In addition, Emgesa is not subject to financial covenants on its outstanding bonds as long as it is rated in the investment-grade category.

Emgesa's principal liquidity sources are:

- Cash balance and short-term investments of COP644 billion; and
- FFO of about COP1.5 trillion.

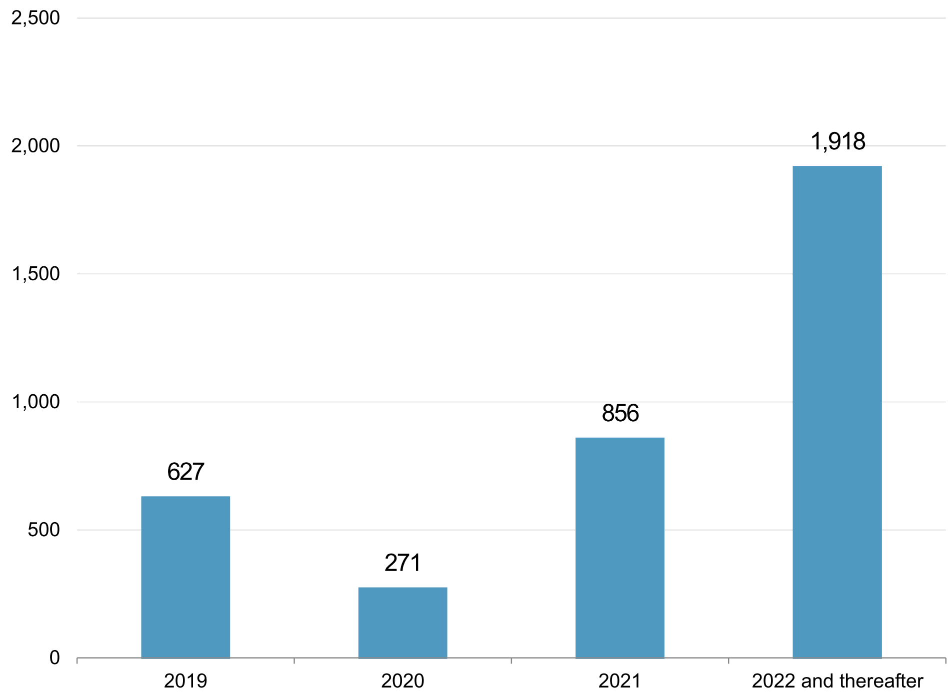
Principal liquidity uses:

- Short-term debt of about COP630 billion;
- Maintenance capex of about COP170 billion; and
- 70% payout ratio.

Debt maturities

Chart 3

Debt Maturities (Bil. COP)



Source: S&P Global Ratings.

Group Influence And Rating Above The Sovereign

We consider Emgesa a core subsidiary of Enel Americas, its controlling shareholder. We expect the parent to have the ability and willingness to provide sufficient support even during a potential sovereign default. This view allows us to rate Emgesa above our ratings on Colombia, and also provides downside protection in case Emgesa's credit quality worsens on a stand-alone basis. Enel Américas holds 56.4% of Emgesa's voting shares, while EEB holds 43.5%.

Issue Ratings - Subordination Risk Analysis

There is no structural subordination, because rated debt is at the operating level.

Reconciliation

Table 3

Reconciliation Of Emgesa S.A. E.S.P. Reported Amounts With S&P Global Ratings' Adjusted Amounts As Of Dec. 31, 2018 (Mil. $)

Emgesa S.A. E.S.P. reported amounts							
	Debt	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
	1,171.6	645.1	577.8	93.3	657.1	574.3	80.1
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	(145.1)	--	--
Cash taxes paid: Other	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	(97.0)	--	--
Operating leases	0.5	0.3	0.0	0.0	(0.0)	0.2	--
Postretirement benefit obligations/deferred compensation	18.1	--	--	--	--	--	--
Accessible cash and liquid investments	(192.6)	--	--	--	--	--	--
Capitalized interest	--	--	--	2.5	(2.5)	(2.5)	(2.5)
Power purchase agreements	166.8	11.7	11.7	11.7	(11.7)	--	--
Nonoperating income (expense)	--	--	7.6	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(91.1)	--
Total adjustments	(7.2)	11.9	19.3	14.2	(256.3)	(93.3)	(2.5)
S&P Global Ratings' adjusted amounts							
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
	1,164	657	597	107	401	481	78

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/--

Business risk: Satisfactory

- **Country risk:** Moderately high
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral
- **Financial policy:** Neutral
- **Liquidity:** Adequate
- **Management and governance:** Satisfactory
- **Comparable rating analysis:** Neutral

Stand-alone credit profile : bbb

- **Group credit profile:** bbb
- **Entity status within group:** Core

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of October 15, 2019)*

Emgesa S.A. E.S.P.	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Issuer Credit Ratings History	
31-Aug-2017	BBB/Stable/--
19-Feb-2016	BBB/Negative/--
30-May-2013	BBB/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.