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Rating Action: Moody's assigns a Baa3 Issuer Rating to ISA

Global Credit Research - 26 Oct 2010

First-Time Issuer Rating Assigned

New York, October 26, 2010 -- Moody's Investors Service assigned today a Baa3 Local Currency Issuer Rating and a Baa3 Foreign Currency Issuer Rating to Colombia's Interconexion Electrica S.A. E.S.P. (ISA). The rating outlook is stable.

RATINGS RATIONALE

The rating considers ISA's low business risk profile derived from its principal operations as the Colombian leading transmission company. The rating acknowledges ISA's stable cash flows that are underpinned by very limited volumetric exposure and the relatively transparent Colombian regulatory framework, albeit certain technical aspects continue to evolve. The rating further captures ISA's credit supportive relationship with the Comision de Regulacion de Electricidad y Gas (CREG) that has historically allowed for an overall smooth review of its transmission tariffs. However, balancing this history is our view that CREG's independence from political interference is not guaranteed in light of the composition and election process of its board members which tempers our opinion of the regulatory framework. The rating considers ISA's low business risk profile derived from its principal operations as the Colombian leading transmission company.

Because the Colombian government (FC government bond rating: Ba1; FC country ceiling rating: Baa3; positive outlook) is ISA's majority shareholder (51.41% ownership stake), the Baa3 Issuer Rating factors in the application of Moody's joint default rating methodology for government-related issuers (GRIs). Joint default analysis factors in a baseline, or standalone, credit assessment (BCA) of 10 (maps to a Baa3), and, in the case of ISA, an assumption of medium level of support by the government in the event of financial stress, and a high level of correlation of default risk between ISA and the government of Colombia.

Moody's acknowledges the importance of the group's foreign operations, particularly its Brazilian transmission subsidiary Companhia de Transmissao de Energia Electrica Paulista (CTEEP) owned via ISA Capital do Brasil. However, ISA's rating incorporates limited uplift from these subsidiaries given the fact that the company cannot fully rely upon their cash flows due to the restrictions placed on upstream dividends incorporated in their indebtedness documentation and the fact that such cash flow is expected to be reinvested for expansion into the existing operations. To that end, while ISA's Brazilian and Peruvian transmission subsidiaries are expected to grow materially, ISA is not expected to provide equity to fund such expansion as both operations will rely upon excess cash flow generated by existing operations to be reinvested to fund such growth. Moreover, ISA provides a modest amount of financial guarantees in support of its subsidiaries (around US$50 million) with ISA Bolivia accounting for half of the total. Moody's further understands that ISA does not plan to provide any significant additional guarantees on behalf of their telecommunication and transmission subsidiaries.

That being said, ISA's rating is somewhat tempered by an aggressive growth strategy into the concession road business, a new line of business initiated with the September 2010 acquisition of a 60% interest in Cintra Chile for about US$290 million. The transaction was funded with cash and around US$124 million of debt, and terms of the transaction include an option to acquire the remaining 40% within the next two years. Moody's believes that the company's expansion into this business is not without risks given the fact that ISA lacks previous relevant experience in this sector, and ISA will be required to make substantial capital contributions over the medium to long-term (until 2025) for the development of the Colombian Autopistas Las Montañas project which will result in a modest increase in leverage. Nevertheless, the rating acknowledges the geographical and operational diversification benefits associated with ISA's expansion into this business, the favorable commercial conditions of the Colombian road project, and the investment-grade ratings of three of the five projects acquired via Cintra Chile (the remaining two are not publicly rated). Residual cash flow from this investment is subject to distribution tests at each of the project subsidiaries, and ISA also provides a completion guarantee to the monolines that expires in December 2011 relating to the completion of the Maipo South access which is scheduled to occur in early 2011. The Colombian Ministry of Finance approved guarantee amounts of US$856.4 million, although Moody's understands that ISA's actual guaranteed amount is maximum US$442 million.

ISA's 2007-2009 Funds from Operations (FFO) to debt and interest coverage ratio averaged around 18% and 2.9x, respectively, both of which are well positioned within the issuer's current rating category. Moody's expects these specific metrics to weaken in the near-term due to increased leverage associated with its growth initiatives. However, such weakening in credit metrics are expected to be mitigated by the company's relatively prudent funding plans as evidenced by the issuance of US$176 million equity at the end of 2009. Moody's also observes the existence of an incurrence test in the company's financing documents requiring that net debt not exceed 4 times EBITDA which somewhat limits ISA's ability to incur incremental debt in the absence of incremental EBITDA generation. As such, Moody's anticipates that ISA's metrics to remain reasonably well-positioned within its current rating category; as FFO to debt is expected to remain in the high teens and interest coverage is expected to be greater than 3x.

The ratings are also constrained by a lack of committed credit facilities to provide liquidity support which is a similar characteristic observed among the bulk of Moody's other Latin American rated issuers. This weakness is somewhat offset by ISA's cash balance and marketable securities, and its manageable debt maturity profile over the medium term. We also take note of management's foreign currency risk policy that strives to optimize the natural hedge associated with the group companies' operations, such that their debt currency breakdown reflects their revenue stream. In this regard, as of June 2010, about 91% of ISA's outstanding standalone debt is denominated in Colombian pesos with indebtedness in USD accounting for the reminder, with about 75% of the debt denominated in Colombian pesos indexed to Consumer Price Index (CPI) to hedge against inflation variations. On a less credit supportive note, ISA is legally required to make dividend distributions of at least 70% of its adjusted net profits if its accumulated reserves exceed 100% of the subscribed capital.

The rating outlook for ISA's BCA rating is stable, based on an our expectation for continued, predictable cash flow from its core Colombian transmission businesses, along with the prudent management of the group's capital expansion programs for the Peruvian and Brazilian transmission companies with their existing operations providing sufficient internal cash to fund such growth without capital contributions or guarantees from ISA. The rating also factors in our belief that the recently acquired concession road business should provide fairly predictable cash flow for ISA which should help fund capital requirements associated with this operation.

The prospects of an upgrade of ISA's BCA rating are somewhat restricted given the aggressive growth initiatives underway in the road concession business and across the Brazilian and Peruvian subsidiaries. However, consideration of a rating upgrade could occur if ISA reports FFO to debt and interest coverage of around 30% and 5x, both on a sustainable basis.

The BCA rating could be downgraded as a result of a deterioration in the supportiveness of the Colombian regulatory framework. A rating action could be also triggered if leverage ends up being higher than currently expected, or if Moody's key assumption regarding ISA's limited involvement in the expansion of its Brazilian and Peruvian subsidiaries in terms of capital contributions or guarantees, is not proven correct. A downgrade could also occur by a material deterioration in ISA's credit metrics, such that its interest coverage and FFO to debt ratio falls below 3x and 15%, respectively on a sustainable basis. Moreover, a downgrade in Colombia's foreign currency ceiling could negatively affect ISA's ratings.

The principal methodology used in rating ISA is the Regulated Electric and Gas Networks rating methodology published in August 2009. In addition, given ISA's 51.41% ownership by the Colombian State (Ba1 Global Scale; local and foreign currency rating; positive outlook) it falls under the scope of Moody's rating methodology entitled "The Application of Joint Default Analysis to Government-Related Issuers (GRIs)". Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

Headquartered in Medellin, ISA is the largest electricity transmission company in the country with a market share of over 71.4% in terms of income generated in the Interconnected National Transmission System (STN). ISA also holds direct or indirect ownership stakes in a portfolio of power transmission subsidiaries in Colombia, Peru, Brazil, Bolivia as well as in the companies developing the Central-America SIEPAC transmission and Interconexion Colombia-Panama projects. ISA wholly- owns the Colombian coordinator of power operations in the STN, Compañia de Expertos en Mercados XM. The group further renders telecommunication data transport services via optic fiber through its subsidiaries Internexa and Transnexa that operate in Colombia, Peru, Venezuela, Chile, Brazil and Ecuador. Following the September 2010 completion of a 60% interest in Cintra Chile, ISA has also recently started its road concession business.

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