Credit Opinion: Interconexion Electrica S.A. E.S.P.

Global Credit Research - 30 Nov 2011

Medellin, Colombia

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa3

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Key Indicators

[1]**Interconexion Electrica S.A. E.S.P.**

	2010	2009	2008	2007
(FFO + Interest) / Interest	**3.9x**	**3.1x**	**2.9x**	**2.4x**
FFO / Debt	**18.5%**	**20.9%**	**17.6%**	**14.3%**
Net Debt / Fixed Assets	**76.5%**	**69.6%**	**82.8%**	**83.5%**
RCF / Capex	**1.9x**	**1.9x**	**2.7x**	**1.4x**

[1] All ratios calculated in accordance with the Regulated Electric and Gas Networks Methodology and and using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Relatively transparent regulatory framework and limited volumetric exposure underpin cash flows

- Limited uplift from the group's foreign operations

- Aggressive growth initiatives, especially within the concession road business

- Credit metrics expected to weaken but remain commensurate with the rating category

Corporate Profile

Headquartered in Medellin, Colombia (LC and FC Baa3 sovereign ratings; stable), Interconexion Electrica S.A., E.S.P. (ISA; Issuer Rating: Baa3) 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). These operations are subject to the purview of the Comision de Regulacion de Energia y Gas (CREG).

ISA also holds direct and indirect ownership-stakes in a portfolio of power transmission companies including 99.99% in Colombian Transelca (about 10% market share), 100% in ISA Bolivia (34% market share) and ISA Capital do Brasil (58.6% including preferred stock) which controls with 89.40% of the common voting stock (37.8% of the capital stocks) the Brazilian Companhia de Transmissao de Energia Electrica Paulista (CTEEP; around 16% market share). In Peru, it holds ownership stakes in ISA Peru (83%), Red de Energia del Peru (REP; 60%) and Consorcio TransMantaro (CTM; 60%) whose collective market share aggregates around 77%. ISA is also participating in the development of the Central-America SIEPAC transmission project via its 11.11% interest in Empresa Propietaria de la Red (EPR) as well as Interconnection Colombia-Panama (50% interest in Empresa de Transmision Electrica S.A.). The power transmission business accounts for over 80% of ISA's consolidated EBITDA.

ISA also fully owns the Colombian coordinator of power operations in the STN, Compañia de Expertos en Mercados XM (99.7%). Moreover, the group provides telecommunication data transport services via optic fiber in Colombia, Peru, Venezuela, Chile, Brazil and Ecuador through its subsidiaries Internexa and Transnexa. With the acquisition of Cintra Chile (via Intervial Chile S.A.) last year, the group has further diversified its operations into the concession road business, and is currently developing the Autopistas de la Montaña road project in Colombia.

ISA targets to grow its consolidated revenues to US$3.5 billion by 2016 (FYE 2010: US$1.8 billion) with the energy related activities accounting for 77% of it (FYE 2010: 92%) given the significant expansion into the road concession business (2016: 18%; 2010: 5%). It also intends to generate 80% of it outside of Colombia (currently around 70%).

The Colombian government is ISA's majority shareholder (51.41% ownership-stake). Other major shareholders include Empresa Publicas de Medellin E.S.P. (Baa3; 10.17%), Ecopetrol (Baa2; 5.32%) and Empresa de Energia de Bogota (Baa3; 1.67%). Similar to other public entities, ISA is subject to fiscal control under the General Nacional Accounting Authority, and requires approval from the Ministry of Finance to incur new debt or provide guarantees.

As of June 30, 2011, ISA reported assets and indebtedness of around $4.8 billion and US$800 million, respectively, that equal around 35% and 19.4% of the consolidated assets and indebtedness. It also recorded funds from operations of $112 million for the twelve months ended September 30, 2011 compared to around $900 million on a fully consolidated basis.

Rating Rationale

Because the Colombian government is ISA's majority shareholder, ISA falls under the scope of Moody's rating methodology for government-related issuers (GRIs). The Baa3 rating reflects Moody's assessment of (i) a medium probability of extraordinary support from the government, (ii) a high level of dependence, as well as (iii) ISA's baseline, or standalone, credit assessment (BCA). ISA's BCA of 10 (maps to Baa3) is a representation of the group's intrinsic creditworthiness before taking into account possible extraordinary support from the sovereign, based on a scale of 1-21 in which 1 indicates the highest credit quality (Aaa). The government does not guarantee ISA's financial obligations, and there is no evidence that this could change in the future.

While the Colombian government does not guarantee ISA's debt obligations, we believe that there is a "medium" likelihood of government support in the case of distress for several reasons, including the 51.1% ownership stake and the strategic importance of the company for the country's economy. Moody's estimate of "high" default dependence reflects the significant degree to which Colombia is exposed to the same risks as those that would affect the credit quality of ISA, and our expectation that there is an elevated likelihood that the government and ISA would default simultaneously due to common risk factors.

ISA's BCA captures its leading position within the Colombian transmission sector and the low business risk profile of these operations. It also factors in the company's cash flow visibility given its limited volumetric exposure and the relatively transparent regulatory framework. While Moody's acknowledges the importance of the group's foreign subsidiaries, particularly the Peruvian and Brazilian transmission companies, ISA's rating incorporates modest uplift in light of the limited potential for upstream dividends; however, we also expect limited ISA equity contributions to fund the material capital expenditure (capex) plans in Brazil. The rating is tempered by ISA's aggressive expansion, particularly into the concession road sector plus possible new investments in other regulated businesses. Nevertheless, the rating assumes management will fund these growth initiatives in a prudent fashion, such that credit metrics will remain aligned with the current rating category. Further key factors tempering the rating include ISA's material dependence on the capital markets to fund its own major capex program in the absence of committed credit facilities and the declining balance of cash and equivalents on its balance sheet.

DETAILED RATING CONSIDERATIONS

LIMITED UPLIFT FROM GROUP'S FOREIGN OPERATIONS

Moody's acknowledges the importance of the group's foreign operations, especially those of CTEEP in Brazil (debt: US$925 million) and the Peruvian subsidiaries (debt: US$409 million). These currently account for over 50% and 6%, respectively, of the consolidated EBITDA; however, ISA's rating incorporates only modest uplift from these subsidiaries given the limited potential for upstream dividends over the medium term. Moody's expects that the dividends received from CTEEP will be used to pay dividends on the redeemable preferred equity issued by ISA Capital do Brasil to refinance the US$522 million bonds due in 2017 and the remaining portion (US$32 million) that was not tendered last year. The Peruvian subsidiaries REP and CTM are not expected to pay-out any dividends before the completion of their material capex program (over $800 million) scheduled for 2013. We expect ISA to make pro-rata equity contributions for the development of the projects at REP and CTM, but we do not expect ISA to provide any equity to fund the Brazilian expansion (2011-2016 capex of over US$1.5 billion). ISA provides a limited amount of financial guarantees in support of its subsidiaries (currently around US$50 million) with ISA Bolivia accounting for half of the total. It is our understanding that ISA does not plan to provide any significant additional guarantees on behalf of their telecommunication and transmission subsidiaries.

LEADING COLOMBIAN TRANSMISSION COMPANY

ISA's transmission assets are long lived, with relatively low operating risk along with high historical availability factors (around 99.9%) and low energy losses (0.01%). Despite efforts to eliminate barriers to entry, the top five transmission companies in Colombia (total of nine) account for over 90% market share with ISA and Transelca accounting for around 81%. In our opinion, this drivers ISA's unique competitive position to win new transmission projects in the country which are awarded under a tender process coordinated by the Ministry of Mines and Energy. The required generation asset base and transmission grid expansion in the country are updated annually by the special administrative body of the Ministry of Mines and Energy, Unidad de Planeacion Minero Energetica (UPME).

LIMITED VOLUMETRIC EXPOSURE AND REGULATORY FRAMEWORK ENHANCES CASH FLOW VISIBILITY

We believe the Colombian regulatory framework compares well to those in other Latin American countries in terms of stability and transparency. This is underpinned by its predictable track-record since the enactment in 1994 of Law 142 (Household Public Utilities Services Law; LSPD), associated Decree 1524, as well as other pieces of legislation, including the Electricity Law (Law 143) and additional regulation that has further developed the framework over the last fifteen years. However, our opinion of the regulatory framework is somewhat tempered by the composition and election of the CREG's board members which does not fully insulate it from possible political interference albeit there has not been any evidence in this regard.

Revenues depend on whether transmission assets became operational before or after the year 2000. The bulk of ISA's transmission assets fall under the pre-2000 category. Their remuneration is based on a formula that includes an 11.5% rate of return to be applied on the assets' replacement value. Transmission charges are subject to the CREG's review every five years with the next review not anticipated before 2015. Projects that became operational after 2000 are part of the STN expansion projects wherein the construction, operation and concession were awarded under a competitive tender process. For the first 25 years of concession, the remuneration of the assets is based on the winning bid that included estimated annual revenues in USD, as well as Administration, Operation and Maintenance expenses, as well as opportunity costs of the capital invested. After 25 years, these assets will be also subject to the CREG's transmission charges. Moody's considers a credit positive the very limited volumetric exposure of the remuneration for both types of assets. We further observe that transmission charges are also linked to inflation but lack adjustments for changes in the exchange rate (USD/local currency) as is the case in other jurisdictions. Tariffs are adjusted when there is a 3% cumulated variation in the local consumer price index (94% of the indexation formulae) and/or local producers price index (6%).

AGGRESSIVE EXPANSION STRATEGY PARTICULARLY WITHIN THE ROAD CONCESSION SECTOR

Earlier this month ISA announced that it had exercised the call option to acquire the outstanding 40% stake in Intervial S.A. for around $200 million after paying $296 million for the initial 60% stake at the end of 2010. The transaction is expected to close within the next three months. This will be funded with debt incurred in Colombia, including the proceeds raised under ISA's 2010-2013 local bond program and with resources from the road concessions.

ISA's rating recognizes the associated diversification benefits and the investment-grade ratings of the indebtedness incurred to fund three out of the five portions of the toll road concession currently embedded in Intervial Chile S.A., namely Autopista del Maipo (Baa3;Stable), Autopista Talca Chillan (Baa3;Stable) and Autopista del Bosque (Baa3;Stable). The remaining two toll roads are not publicly rated. The ability of these concessions to make dividend up-streams is subject to distribution tests under each of the toll roads' indebtedness indentures or credit agreements (at the end September 2011 aggregate indebtedness was around $2.1 billion; about 47% of consolidated indebtedness).

The rating is tempered by ISA's participation in the ambitious Autopista de la Montañas project in Colombia.

This consists of the upgrade and construction over 15 years of four road corridors (760 km) that will link Medellin to the country's main thoroughfares.

After recently completing the preliminary studies, ISA revised the total budget to approximately US$8 billion (previously US$6 billion) with tunnels and bridges accounting for about 49%. While ISA has publicly insisted in the need for significant involvement of both the Colombian (Baa3; stable) and Antioquia governments as well as the Municipality of Medellin (Baa3; stable), the rating incorporates our expectation that ISA will be required to make substantial capital contributions over the medium to long-term to fund this project (around 65%). We also believe that this project is not without risks given that ISA has limited experience in this sector coupled with the obvious challenges of the project given the terrain to be covered. To offset this risk, ISA plans to use the know-how acquired via Intervial Chile. We also note that the project's terms and conditions include a guaranteed 9% Internal Rate of Return over the project's generated Free Cash Flow.

ISA's planned 2011-2016 investments in Colombia aggregate to around US$3.5 billion including ISA's expected capital contributions of around US$100 million associated with the Interconnection Colombia-Panama. We also note that the company has publicly announced its intention to participate in the $800 million auction-program to expand the Chilean transmission system. Moody's rating incorporates the key assumptions that ISA will pursue exclusively investments in regulated operations in stable and predictable regulatory environments and that potential new investments will be prudently funded.

CREDIT METRICS EXPECTED TO REMAIN COMMENSURATE WITH THE RATING CATEGORY

As cited previously, ISA will use proceeds raised under new indebtedness to finance a portion of the acquisition of the additional 40% interest in Intervial Chile, and resources from the road concessions accounting for the remainder. ISA used indebtedness (US$125 million) but also the proceeds from its 2009 US$180 million equity offering to fund the initial 60%-stake. ISA's rating assumes that management will continue prudent financial policies based on a combination of internally generated cash flows, additional indebtedness and equity issuance when needed to fund its material capex program. Furthermore, we gain some comfort that the incurrence test included in the company's financing documentation requires that net debt not exceed 4 times EBITDA which places limits in ISA's ability to incur incremental debt in the absence of incremental EBITDA generation.

As a result, It is also our expectation that despite the anticipated deterioration in key credit metrics amid the increased leverage to fund its growth strategy, these metrics will remain commensurate with the Baa rating category such that FFO to debt remains in the high teens and interest coverage exceeds 2.7x.

RISK MANAGEMENT

Management's foreign exchange rate risk policy strives to optimize the natural hedge associated with the group's operations such that the debt currency breakdown reflects the expected revenue stream. In this regard, as of September 30, 2011, over 90% of ISA's outstanding standalone debt is denominated in Colombian pesos with indebtedness in USD accounting for the reminder. In addition, around 75% of ISA's indebtedness denominated in Colombian Pesos is indexed to the Consumer Price Index to hedge against inflation variations.

Liquidity Profile

ISA's rating is tempered by its reliance on accessing the capital markets to fund its capital requirements in the absence of committed credit facilities. Historically, this weakness has been somewhat offset by ISA's cash balance and marketable securities (2009: US$300 million; 2008: US$135 million) but we note that it reported a substantial drop to around $60 million September 30, 2011 (FYE 2010: US$45 million).

Nevertheless, we note ISA's relatively manageable debt maturity profile with around US$110 million and US$130 million maturing during 2012 and 2013, respectively (2011: around US$130 million) before declining to approximately US$45 million in 2014.

Rating Outlook

The rating outlook for ISA's BCA rating is stable, based on our expectation for continued, predictable cash flow generation 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. The stable outlook also factors in our expectation that future growth will be pursued only in regulated businesses that will be prudently funded such that ISA reports metrics that are commensurate with the Baa rating category.

What Could Change the Rating - Up

Since ISA's Baa3 rating is based on Moody's methodology for GRIs, upward rating pressure is unlikely given the stable rating outlook for the Colombian government, with the BCA further capped by the aggressive growth initiatives underway, particularly, in the road concession sector. 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.

What Could Change the Rating - Down

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 subsidiaries in terms of capital contributions or guarantees, is not proven correct. A downgrade could also occur by a material deterioration in ISA's liquidity profile and/or credit metrics, such that its interest coverage and FFO to debt ratios fall below 2.7x and 15%, respectively, on a sustainable basis. Moreover, a downgrade in Colombia's foreign currency ceiling could negatively affect ISA's ratings.- Colombia's leading transmission company.

OTHER CONSIDERATIONS

Moody's evaluates ISA's BCA mainly relative to Moody's Regulated Electric and Gas Networks that was published in August 2009. As depicted in the grid below, the issuer's indicated BCA rating based on both historical and projected credit metrics is Baa3, the same as its current assigned BCA.

Rating Factors

Interconexion Electrica S.A. E.S.P.

Regulated Electric and Gas Networks [1][2]	**Dec-31-2010**		**Moody's 12-18 month Forward View as of November 2011**	
Factor 1: Regulatory Environment and Asset Ownership Model (40%)	**Measure**	**Score**	**Measure**	**Score**
a) Stability and Predictability of Regulatory Regime		Baa		Baa
b) Asset Ownership Model		Aa		Aa
c) Cost and Investment Recovery		Baa		Baa
d) Revenue Risk		Aa		Aa
Factor 2: Efficiency and Execution Risk (10%)				
a) Cost Efficiency		Baa		Baa
b) Scale and Complexity of Capital Programme		Baa		Baa
Factor 3: Stability of Business Model & Financial Structure (10%)				
a) Ability & Willingness to Pursue Opportunistic Corp. Activity		B		B
b) Ability & Willingness to Increase Leverage		Baa		Baa
c) Targeted Proportion of Op. Profit outside Core Reg. Activities		B		B
Factor 4: Key Credit Metrics* (40%)				
a) (FFO+ Int exp) / Int exp (3 Year Avg)	3.2x	Baa	2.7 x- 3.2x	Baa
b) Net Debt / Fixed Assets (3 Year Avg)	76.4%	Baa	75% - 90%	Baa
c) FFO / Debt (3 Year Avg)	19.4%	A	15% - 20%	A
d) RCF / Capex (3 Year Avg)	2.1x	A	1.5x - 2.5x	A
Rating:				
Indicated BCA Rating from Grid		Baa3		Baa3
Actual BCA Assigned		Baa3		Baa3

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010; Source: Moody's Financial Metrics

adviser.