

Interconexion Electrica S.A. E.S.P. (ISA)

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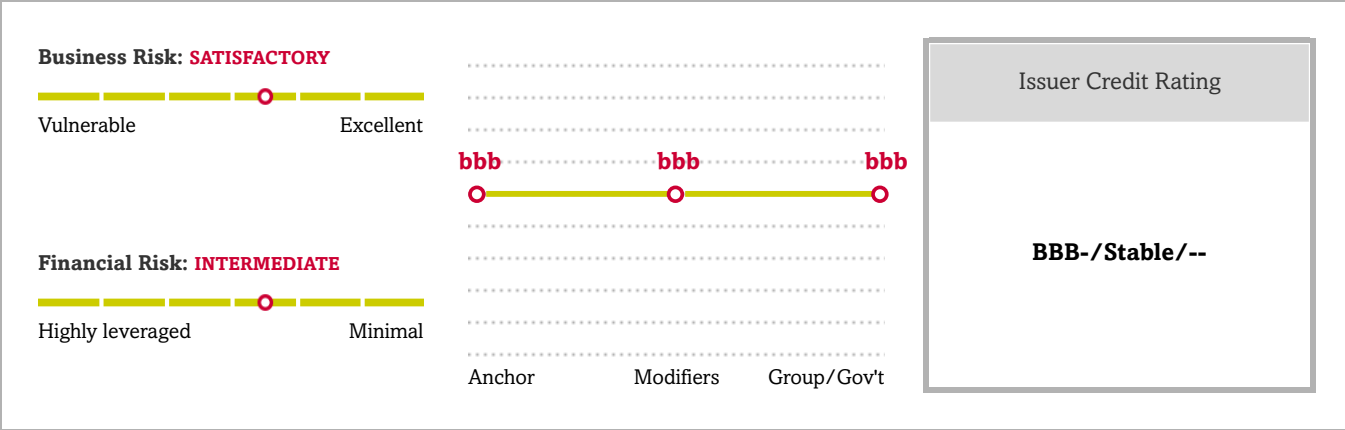
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Interconexión Eléctrica S.A. E.S.P. (ISA)



Credit Highlights

Key strengths	Key risks
Interconexión Eléctrica S.A. E.S.P. (ISA) generates resilient cash flows because its main business units—electricity transmission and toll roads—have limited or zero demand risk.	The Colombian government, ISA's controlling shareholder, could sell its stake in the company, resulting in its privatization.
Geographic diversification allows ISA to mitigate regulatory exposure to a single jurisdiction.	Increasing investments will lead to negative free operating cash flows in the next two years, requiring additional debt.

We expect ISA's cash flow generation to remain resilient going forward ISA generates cash flows from regulated businesses—electric power transmission and toll roads. In addition, the company's geographic asset diversification throughout Latin America helps it to mitigate regulatory risk exposure.

The transmission line operations, in all countries where the company operates, is based on the availability of the lines to the national systems. Therefore, there's no demand or volume risk. We believe ISA has operational experience and technological knowledge to maintain the lines, minimizing the time that they will be unavailable for the system, and consequently, preventing any reduction in the regulated revenues. Although the company's toll road business is exposed to traffic volumes, we believe this risk is mitigated through regulatory mechanisms that compensate the concessions for lower-than-expected traffic volumes.

ISA has recently announced its 2030 growth strategy, which contemplates increasing its EBITDA by 70% until that year, and an investment plan of more than COP35 trillion in the next decade that could include countries that ISA already operates or in new ones. ISA's last investment plan totaled more than COP10 trillion until 2023, with the bulk of that concentrated in 2019 and 2020. In addition, ISA has announced a strategic partnership with the Colombian construction group, Construcciones El Condor S.A. (not rated), to expand the company's toll road business throughout Colombia (through the 4G program) and Peru.

As a result, we expect ISA to post free operating cash flow shortfall throughout these years, resulting in weaker credit metrics, with debt to EBITDA temporarily surpassing 3.5x.

Colombia could be willing to sell ISA, but the timing and conditions are unknown In an effort to cope with Colombia's challenging fiscal conditions, the government is contemplating the divestiture of at least part of its stake in the state-owned companies, including ISA. The government announced a COP8.5 trillion (\$2.5 billion) asset sale program, which is part of its 2020 budget. The Ministry of Finance announced on Sept. 12, 2019, that it plans to hire a financial advisor to analyze, design, and potentially sell its stake in the company. However, currently there's no official announcement that the company is for sale.

Our ratings already incorporate a moderate likelihood of extraordinary support from the government to ISA, because the company generates more than 70% of its operating cash flows outside Colombia and has a significant portion of its debt at its overseas subsidiaries, which in our view, reduces the government's incentive to support ISA.

Outlook: Stable

The stable outlook on ISA reflects that on Colombia, because the company's stand-alone credit profile (SACP) is currently 'bbb', while its final rating is 'BBB-', at the same level as the sovereign rating.

Downside scenario

We could downgrade ISA in the next 12-24 months in case of a similar rating action on Colombia. Given that the company's SACP is one notch higher than the final rating, we don't expect a downgrade of ISA in the short term stemming from its intrinsic conditions. However, we could revise the company's SACP downwards in the next 12-24 months if debt to EBITDA is consistently 3.5x or above and ISA posts free operating cash flow shortfall. This could be a result of a further increase in the company's investment plan, combined with the sizable dividend distributions.

Upside scenario

Given that the rating on ISA is capped at the sovereign level, a positive rating action in the next 12-24 months would depend on a similar rating action on Colombia.

Our Base-Case Scenario

We believe that the strong resilience of ISA's cash flows, given the stability and predictability of the transmission and toll road businesses, allows the company to maintain the rating at the current level, although we expect debt to rise to maintain robust investment plan.

Assumptions	Key Metrics			
<ul style="list-style-type: none"> Revenue to grow at a faster pace than inflation in the countries the company operates as a result of the startup of operations of some new transmission lines. ISA's Brazilian subsidiary to continue receiving 85% of the total indemnities related to the early renewal of its concessions in 2012. The Chilean toll road operations to post low single-digit revenue growth in the next years, reflecting the mature status of the existing concessions. Investments of about COP3.1 trillion in 2019 and COP4.2 trillion in 2020, mostly for the assets under construction. ISA to distribute about 40% of previous year's net income as dividends to its shareholders, but it could reduce them in case of additional investment needs. 		2019E	2020E	2021E
	EBITDA (tril. COP)	5.1-5.5	5.2-5.6	5.3-5.7
	Debt/EBITDA (x)	3.0-3.5	3.2-3.8	3.2-3.8
	FFO/Debt (%)	15-20	13-17	13-17
	FOCF/Debt (%)	(5)-0	(10)-(5)	0-5
	E--Expected			

Base-case projections

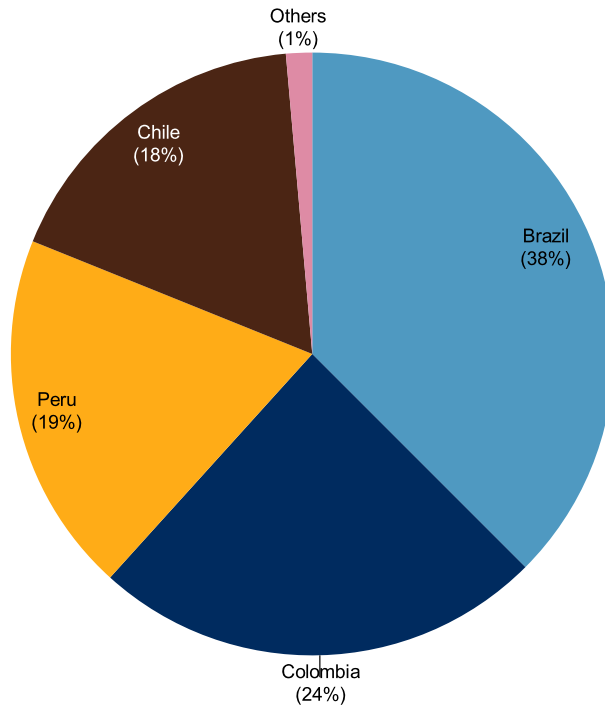
ISA has a robust investment plan for the next few years in order to maintain the leading position in the region.

However, we believe the company will seek new debt to finance the investment needs, so credit metrics will slip in the next few years.

Company Description

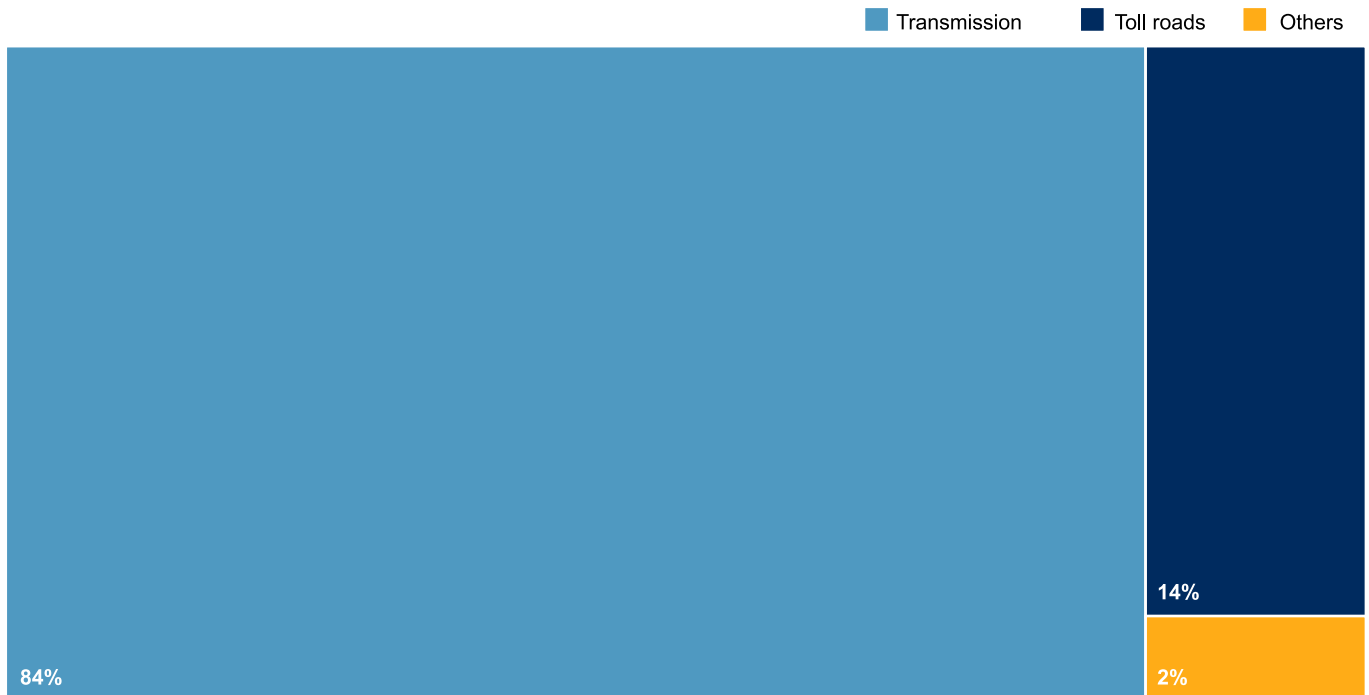
Colombia-based company ISA has operations through its subsidiaries in four business lines: electric power transmission, toll road concessions, communications technology, and real-time system management. ISA operates in Colombia, Brazil, Chile, Peru, Ecuador, Bolivia, Argentina, and Central America. In the transmission line segment, ISA has more than 62,000 kilometers (km) of lines in operations with an availability of 99.87%. The company is adding 7,200 km to its portfolio through the construction of assets. It also has 907 km of roads in operation with annual traffic of almost 150 million vehicles. ISA is also constructing 136 km in new roads. Finally, the company has 49,500 km of optic fiber in operations as part of its telecommunication business.

Chart 1
EBITDA Breakdown By Country



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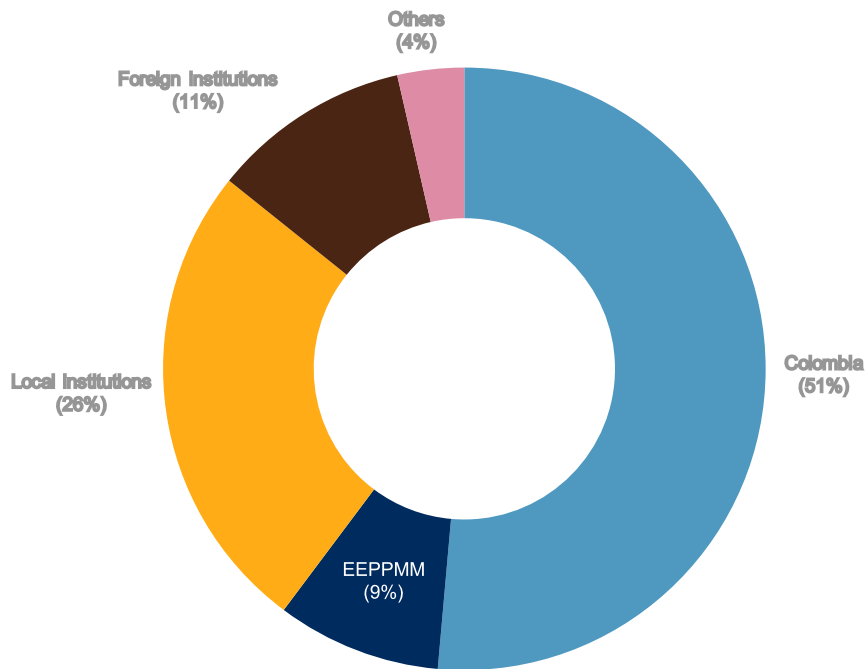
EBITDA Breakdown By Business



Source: S&P Global Ratings.
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The Republic of Colombia (foreign currency: BBB-/Stable/A-3; local currency: BBB/Stable/A-2) controls ISA through a 51.41% stake and the city of Medellin-owned company Empresas Públicas de Medellín – EPPMM has 8.82% of ISA, resulting in 60.23% from public-owned companies. Private investors control the rest.

Chart 3
ISA's Ownership Structure



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Business Risk: Satisfactory

We believe ISA's geographic diversification mitigates the company's exposure to multiple regulatory jurisdictions. Overall, we believe the electric sector's regulatory framework supports credit quality of the companies in Latin America. The framework in Chile and Colombia are the strongest in the region, followed by that in Brazil. Overall, we believe various regulations help to reduce cash flow volatility, based on their tariff-setting mechanisms.

The Colombian electricity regulator--Comision Reguladora de Energia y Gas (CREG)--is planning to set a new rate-setting model for the transmission lines in the country, which are currently undergoing a tariff-review process. The net replacement value should shift to one based on the depreciated value of the assets. In order to maintain the same revenue level, companies will have to have a minimum maintenance level that at least equalizes the depreciation level, and we don't expect an impact on ISA's cash flows due to that change.

We expect the Brazilian subsidiary CTEEP – Companhia de Transmissao de Energia Eletrica Paulista (not rated) to continue receiving the monthly payments until 2025 stemming from the early renewal of its concessions in 2012. Currently, CTEEP has been receiving only 85% of the total amount, because some large electricity consumers in Brazil

have obtained a favorable injunction when they questioned the methodology used. Although CTEEP and other transmission companies in the country are challenging this court decision, and are in conversations with the regulatory authorities, the timing of a resolution is uncertain.

Finally, ISA has a 40% share of the Chilean toll-road market through its concessions. We don't believe they face significant competition from other means of transportation or even other roads, and the existing contractual framework is transparent, predictable, and consistent in a way to mitigate volume risk downturns. This mechanism enables ISA's toll roads to have their costs fully covered, and investments properly remunerated.

Peer comparison

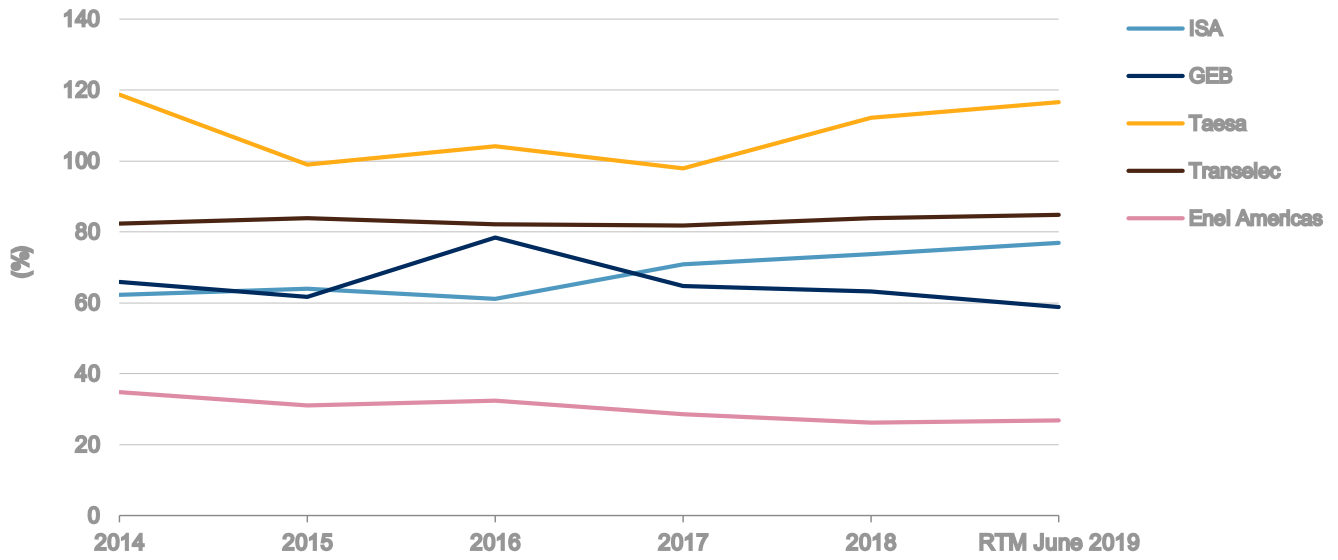
We chose the following companies as peers for ISA:

- Grupo Energia Bogota S.A. E.S.P. (GEB; BBB-/Stable/--) because it also has transmission line activities in Colombia and Peru, where ISA also operates, and a small line in Brazil, where ISA generates the bulk of its cash flows. Most of GEB's cash flows come from its gas transportation business, which has similarities with the electricity transmission business in terms of risk.
- Transmissora Alianca de Energia Eletrica S.A. (Taesa; global scale: BB-/Stable/--; national scale: brAAA/Stable/brA-1+) because it's a pure transmission company, and ISA has a stake in the company, jointly controlling it with Companhia Energetica de Minas Gerais – CEMIG (B/Stable/--; brA+/Stable/--).
- Transelec S.A. (Transelec; BBB/Stable/--) because this is the largest transmission company in Chile, controlling more than 85% of the transmission lines in the country.
- Although Enel Americas S.A. (BBB/Stable/--) is an electric power integrated group focused on electric power distribution, its geographic diversification is similar to the one of ISA because of concentrations in Brazil, Colombia, and Peru, markets that ISA also operates in the transmission segment.

In general, these companies are in the investment-grade category, including Taesa, which has a 'bbb-' SACP but the rating is capped at the sovereign rating on Brazil. The companies have in common strong and resilient cash flows that allow them to post more leveraged credit metrics. They're all engaged in regulated activities with regulatory frameworks that have proven track record of adequate return on the investments made.

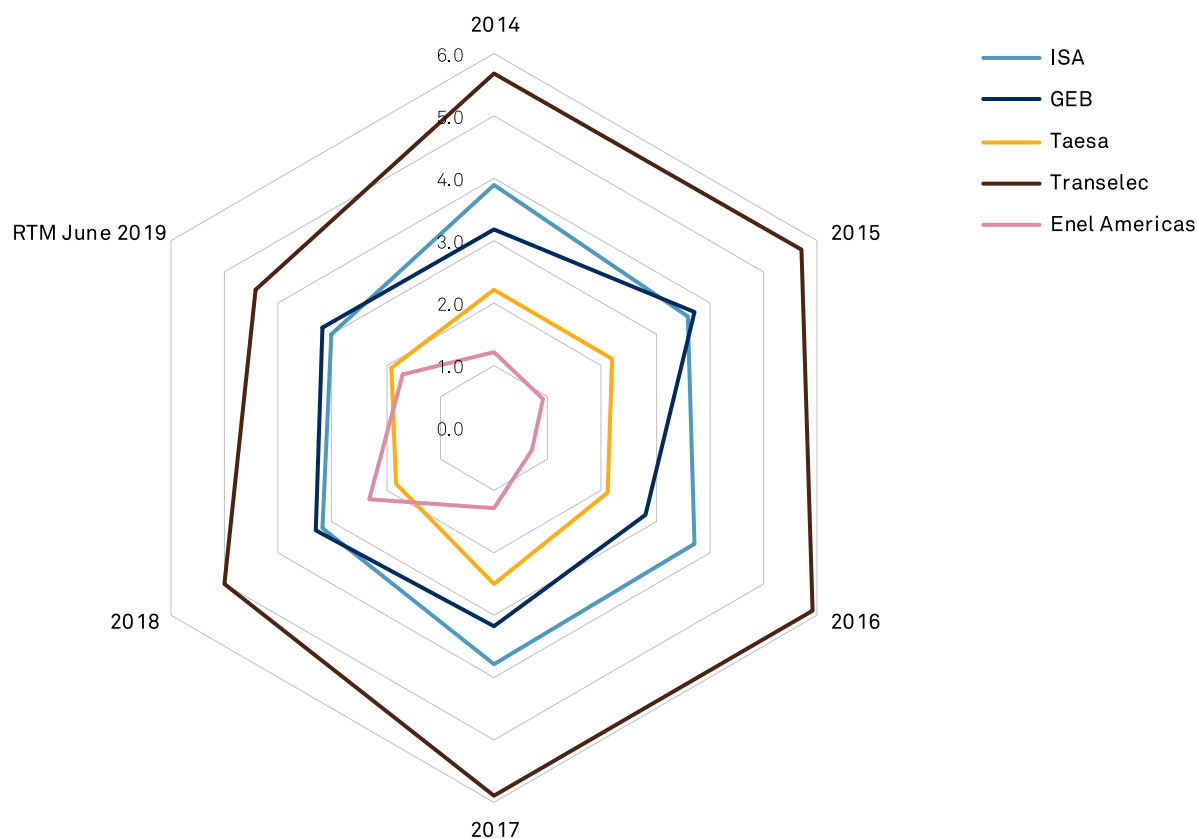
Chart 4

EBITDA Margin Comparison



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Debt To EBITDA (x)



Source: S&P Global Ratings.
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Table 1

Interconexión Eléctrica S.A. E.S.P. (ISA) -- Peer Comparison

Industry Sector: Electric						
	Interconexión Eléctrica S.A. E.S.P. (ISA)	Grupo Energía Bogotá S.A.E.S.P.	Transmissora Aliança de Energia Elétrica S.A.	Transelec S.A.	Enel Americas S.A.	
Ratings as of Oct. 18, 2019	BBB-/Stable/--	BBB-/Stable/--	BB-/Stable/-- brAAA/Stable/brA-1+	BBB/Stable/--	BBB/Stable/--	
--Fiscal year ended Dec. 31, 2018--						
(Bil. COP)						
Revenue	6,853.2	4,001.8	1,023.3	1,540.7	42,815.9	
EBITDA	5,060.6	2,528.4	1,147.0	1,293.2	11,225.4	
Funds from operations (FFO)	3,095.7	1,854.4	941.2	970.3	7,794.4	
Interest expense	1,110.2	523.7	147.5	337.7	2,527.9	
Cash interest paid	814.5	453.0	123.9	322.9	1,502.1	
Cash flow from operations	2,417.1	1,480.5	880.5	944.9	4,859.8	
Capital expenditure	2,213.3	1,125.1	30.6	443.1	4,940.5	

Table 1

Interconexión Eléctrica S.A. E.S.P. (ISA) -- Peer Comparison (cont.)					
Industry Sector: Electric					
	Interconexión Eléctrica S.A. E.S.P. (ISA)	Grupo Energía Bogotá S.A.E.S.P.	Transmissora Aliança de Energia Elétrica S.A.	Transelec S.A.	Enel Americas S.A.
Free operating cash flow (FOCF)	203.8	355.4	850.0	501.8	(80.6)
Discretionary cash flow (DCF)	(1,659.8)	(761.2)	44.5	227.6	(2,003.1)
Cash and short-term investments	1,522.1	1,156.3	687.4	492.7	6,605.6
Debt	16,158.0	8,469.5	2,055.8	6,455.7	25,596.0
Equity	18,941.8	12,993.1	3,835.4	3,748.1	28,682.0
Adjusted ratios					
EBITDA margin (%)	73.8	63.2	112.1	83.9	26.2
Return on capital (%)	14.2	12.0	21.7	9.9	20.0
EBITDA interest coverage (x)	4.6	4.8	7.8	3.8	4.4
FFO cash interest coverage (x)	4.8	5.1	8.6	4.0	6.2
Debt/EBITDA (x)	3.2	3.3	1.8	5.0	2.3
FFO/debt (%)	19.2	21.9	45.8	15.0	30.5
Cash flow from operations/debt (%)	15.0	17.5	42.8	14.6	19.0
FOCF/debt (%)	1.3	4.2	41.3	7.8	(0.3)
DCF/debt (%)	(10.3)	(9.0)	2.2	3.5	(7.8)

Financial Risk: Intermediate

We believe ISA's credit metrics will weaken in the next years, because the company will maintain with its growth strategy in Latin America, raising new debt in order to sustain its investment plan. Given that the rating is one notch below its SACP, the company has some cushion to maintain the current rating level even if credit metrics slip. Some of ISA's toll-road concessions in Chile, such as Rutas de Maule, start to expire starting in 2020, so the company plans to replace the maturing them with new ones. This will require greater investments; therefore, will lead to higher debt. ISA created a joint venture with Colombian construction group El Condor in order to seek new toll-road concessions, mostly in Colombia and Peru in the next years.

Financial summary

Table 2

Interconexión Eléctrica S.A. E.S.P. (ISA) -- Financial Summary					
Industry Sector: Electric					
	June 2019	March 2019	2018	2017	2016
(Bil. COP)					
Revenue	1,837.6	1,623.9	6,853.2	5,463.5	5,307.3
EBITDA	1,545.2	1,239.7	5,060.6	3,873.3	3,244.5
Funds from operations (FFO)	1,046.4	758.4	3,095.7	2,429.9	2,289.1
Interest expense	335.7	267.3	1,110.2	1,001.2	1,070.2
Cash interest paid	263.9	208.4	814.5	519.5	879.9
Cash flow from operations	386.9	898.9	2,417.1	2,379.8	1,361.6
Capital expenditures	471.0	498.3	2,213.3	2,271.4	2,364.6
Free operating cash flow (FOCF)	(84.1)	400.5	203.8	108.4	(1,003.0)
Discretionary cash flow (DCF)	(168.3)	391.0	(1,659.8)	(749.6)	(1,003.0)
Cash and short-term investments	1,757.5	1,831.1	1,522.1	1,529.5	1,167.4
Gross available cash	1,757.5	1,831.1	1,522.1	1,529.5	1,167.4
Debt	16,759.0	15,729.5	16,158.0	14,692.4	11,842.5
Equity	19,325.1	18,383.9	18,941.8	18,423.5	16,911.5
Adjusted ratios					
EBITDA margin (%)	76.9	73.8	73.8	70.9	61.1
Return on capital (%)	14.2	13.5	14.2	11.3	12.1
EBITDA interest coverage (x)	6.6	5.4	4.6	3.9	3.0
FFO cash interest coverage (x)	4.2	4.7	4.8	5.7	3.6
Debt/EBITDA (x)	3.0	3.1	3.2	3.8	3.7
FFO/debt (%)	20.8	20.5	19.2	16.5	19.3
Cash flow from operations/debt (%)	16.1	16.9	15.0	16.2	11.5
FOCF/debt (%)	2.0	3.9	1.3	0.7	(8.5)
DCF/debt (%)	(6.9)	(8.0)	(10.3)	(5.1)	(8.5)

Liquidity: Adequate

We expect ISA's cash sources to exceed its uses by at least 15% in the next 12 months. In case of a 10% EBITDA decline in the following 12 months, we still expect ISA to continue having higher sources of cash than its uses. This underscores ISA's ability to cushion itself against adverse market conditions. Additionally, we incorporate our view of ISA's high standing in domestic capital markets, and sound relationship with banks, given its status as one of Colombia's largest corporations, with a geographic diversification throughout Latin America. We also believe ISA has the ability to defer investments and divided payments, if necessary, reinforcing its financial flexibility.

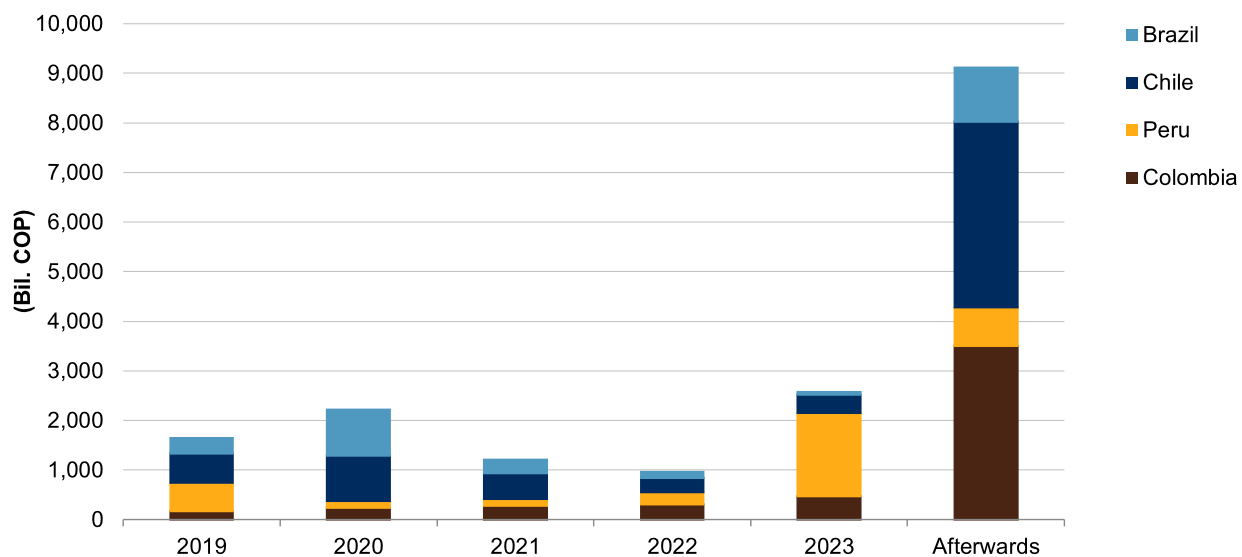
Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • Cash and cash equivalents of COP1.8 trillion, as of June 30, 2019. • Cash flows of about COP3.1 trillion in the next 12 months. 	<ul style="list-style-type: none"> • Debt maturities of COP1.4 trillion, as of June 30, 2019. • Minimum investments of around COP1.3 trillion for the following 12 months. • Minimum dividend payments of around COP1.0 trillion.

Debt maturities

As of June 30, 2019, ISA presented the following debt maturity schedule:

Chart 6

Debt Maturity Profile



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Covenant Analysis

Compliance expectations

Although ISA doesn't have financial covenants measured at the consolidated level, some of its subsidiaries have covenants on their debt, measured at their individual level. We expect subsidiaries to remain in compliance with their covenant requirements, as has been the case as of June 30, 2019.

Environmental, Social, And Governance

We believe governance factors play a more important role for ISA, while environmental and social are also important, but to a lesser extent from a credit perspective. Given that ISA launched its 2030 growth strategy, the company based it on expanding with a sustainable value throughout the years. This means, along with adding value to shareholders, a positive impact on the communities and to the environment in areas where company builds new transmission lines to connect isolated communities to the electric system. Particularly in Colombia and Brazil, the remote areas are surrounded by the Amazon forest, so we expect the company to continue seeking to bring electricity access to people without jeopardizing natural habitat. We believe this strategy seeks to reinforce ISA's contribution to the planet's decarbonization--although we believe that its current business units are not large contributors with carbon emissions--through the implementation of new technologies and potentially new business opportunities to integrate the group's activities.

Government-Related Entity

The government of Colombia currently controls ISA with a total stake of 51.41%. Therefore, we consider ISA as a government-related entity. Although the Colombian government could sell a controlling stake in the company, we already consider the likelihood of receiving support from the government as just moderate. The company generates more than 70% of its operating cash flows outside Colombia and has debt outside the country, which in our view reduces the government's incentives for extending support. In addition, the business lines that ISA in which operates also have private players, so the state-owned company could be replaced if needed.

Rating Above The Sovereign

The 'BBB-' rating on ISA is one notch below the company's 'bbb' SACP and capped by the sovereign foreign currency rating on Colombia, based on:

- As we mentioned above, the government of Colombia is the controlling shareholder of ISA, and we don't believe the regulatory framework and the jurisdictional environment in Colombia prevents the government from interfering in ISA's operations.
- Under a hypothetical sovereign default scenario, there's a high likelihood that ISA would default as well. This is based on our view that the government could intervene in the company by redirecting resources to itself, weakening ISA's credit quality.

Reconciliation

S&P Global Ratings' adjusted revenues exclude the construction revenues and the accounting revenues related with the indemnities received by CTEEP, while we add the cash indemnities that CTEEP receives.

Table 3**Reconciliation Of Interconexión Eléctrica S.A. E.S.P. (ISA) Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. COP)**

	Debt	Shareholders' equity	Revenue	EBITDA	Operating income	S&P Global Ratings' adjusted EBITDA	Cash flow from operations
	--Rolling 12 months ended June 30, 2019--						
Interconexión Eléctrica S.A. E.S.P. (ISA) reported amounts	18,017.5	11,906.4	7,992.9	5,603.6	4,887.5	5,595.6	3,799.3
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	(1,027.0)	--
Cash taxes paid: Other	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(1,079.2)	--
Accessible cash and liquid investments	(1,757.5)	--	--	--	--	--	--
Income (expense) of unconsolidated companies	--	--	--	(257.1)	--	--	--
Nonoperating income (expense)	--	--	--	--	(141.6)	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(1,102.5)
Noncontrolling interest/minority interest	--	7,418.7	--	--	--	--	--
Debt: Workers compensation/self insurance	499.1	--	--	--	--	--	--
Revenue: Other	--	--	(721.0)	(721.0)	(721.0)	--	--
COGS: Other nonoperating nonrecurring items	--	--	--	928.5	928.5	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	41.7	41.7	--	--
Working capital: Taxes	--	--	--	--	--	--	(84.0)
Operating cash flow: Taxes	--	--	--	--	--	--	84.0
Total adjustments	(1,258.4)	7,418.7	(721.0)	(8.0)	107.6	(2,106.2)	(1,102.5)
	Debt	Equity	Revenue	EBITDA	EBIT	Funds from operations	Cash flow from operations
S&P Global Ratings' adjusted amounts	16,759.0	19,325.1	7,271.9	5,595.6	4,995.1	3,489.4	2,696.7

Ratings Score Snapshot**Issuer Credit Rating**

BBB-/Stable/--

Business risk: Satisfactory

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

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb

Modifiers

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

Stand-alone credit profile : bbb

- **Likelihood of government support:** Moderate (no impact)
- **Rating above the sovereign:** (-1 notch from SACP)

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
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- 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: 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						
Business Risk Profile	Financial 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 November 18, 2019)*	
Interconexión Eléctrica S.A. E.S.P. (ISA)	
Issuer Credit Rating	BBB-/Stable/--
Issuer Credit Ratings History	
11-Dec-2017 <i>Foreign Currency</i>	BBB-/Stable/--
19-Feb-2016	BBB/Negative/--
19-Aug-2014	BBB/Stable/--
11-Dec-2017 <i>Local Currency</i>	BBB-/Stable/--
19-Feb-2016	BBB/Negative/--
19-Aug-2014	BBB/Stable/--

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