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Research Update:

Interconexion Electrica S.A. E.S.P. 'BBB' Rating Affirmed; Outlook Remains Negative

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Overview

- We're affirming our 'BBB' corporate credit rating on Colombia-based electricity transmission company ISA.
- Over the next two years, the company plans to invest heavily in Chile and Peru. We expect its debt to EBITDA to remain at, or below, 3.5x in 2016 and 2017.
- The negative outlook on ISA our view that in case of unexpected delays in completing new projects, which would weaken revenue and EBITDA growth, the company's debt leverage can rise beyond our expectations. The outlook on ISA also mirrors the negative outlook on Colombia.

Rating Action

On Aug. 30, 2016, S&P Global Ratings affirmed its 'BBB' corporate credit rating on Interconexion Electrica S.A. E.S.P. (ISA). The outlook remains negative.

Rationale

The rating on ISA reflects its leading positon in the design, construction, operation, and management of linear infrastructure systems in electricity transmission, telecommunications, transportation, and road concessions. ISA has operations in eight Latin American countries through various business units. ISA is the largest electricity transmission company in Colombia and Peru and the largest toll-road operator in Chile. The ratings also reflect our expectation that ISA's total debt to EBITDA will remain at, or below 3.5x, for the next two years. Our assessment of the company's stand-alone credit quality, which represents its credit quality in the absence of extraordinary support or intervention from the Colombian government, is 'bbb'. Please note that we define debt as: gross financial debt (including items such as bank loans, debt capital market instruments, and finance leases) minus surplus cash (plus or minus all applicable adjustments).

Colombia's (foreign currency: BBB/Negative/A-2; local currency: BBB+/Negative/A-2) government holds a 51.4% stake in ISA. Therefore, the ratings also incorporate our assessment that there's a moderate likelihood that the government would provide timely support to ISA in periods of stress. We base this assessment on our view that:

- ISA has a limited role for the government. This reflects our view that the company's large operations outside Colombia may reduce the

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government's incentives to support ISA.

- ISA has a strong link with the government, given that the former has an independent management that makes autonomous business decisions.

We view ISA's business risk profile as satisfactory. The company holds a leading market position thanks to its control of a majority of Colombia's and Peru's electricity transmission grids. ISA's strategy is to increase its 2012 earnings threefold by 2020 fueled by continued investments in the region. The company current investments are heavy, consisting of construction projects in Chile and Peru at a cost of $2.6 billion and totaling 4,500 kilometers of new transmission lines. Therefore, its capital expenditures, mainly in transmission, for the next three years will continue to be significant, which should lead to a double-digit, top-line growth.

We consider ISA's financial risk profile to be intermediate. This reflects our expectation that the company's total debt to EBITDA will remain at, or below, 3.5x and that its payback ratios will return to the intermediate category by the end of 2018, mainly free operating cash flow (FOCF) to debt of more than 4.0%.

Our base-case forecast for ISA incorporates the following assumptions:

- A double-digit revenue growth in 2016 and 2017 due to the start of new transmission projects in Chile and Peru.
- Stable revenue from ISA's toll roads in Chile given that we expect GDP growth of 1.8% in 2016 and 2.4% in 2017 and inflation of 4.0% and 2.8%.
- High single-digit revenue growth in the company's telecommunications and other services in Colombia, which is in line with our expectations for GDP growth of 2.3% in 2016 and 3.0% in 2017 and inflation of 3.5% and 3.0%.

Based on these assumptions, we arrive at the following credit measures for 2016 and 2017, respectively:

- Debt to EBITDA of 3.4x and 3.5x;
- FFO to debt of 17.3% and 17.9%; and
- FOCF to debt of -17.8% and -10.6%.

Liquidity

We assess ISA's liquidity as adequate. We expect sources to exceed uses by at least 1.1x in the next 12 months, which provides protection against adverse market conditions. Additionally, our view reflects ISA's high credit standing in domestic capital markets and sound relationship with banks, given its status as one of Colombia's largest corporations. We also consider its ability to defer capex and dividend payments in our analysis.

Principal Liquidity Sources:

- Cash and equivalents (COP1.44 trillion as of June 30,2016);
- FFO generation of about COP$2.4 trillion; and
- Committed lines of COP2.75 trillion for the construction of projects in Chile and Peru.

Principal Liquidity Uses:

- Debt maturities of COP1.405 trillion as of June 30,2016;
- Working capital outflows of COP100 billion;
- Capex of about COP4.1 trillion; and
- Dividend payments of about COP$319 billion.

ISA's debt doesn't have financial covenants. Furthermore, ISA doesn't have pledged assets, existing liens of any sort, or cross-default clauses with subsidiaries' debt. In addition, the subsidiaries' debt is non-recourse to ISA.

Outlook

The negative outlook on ISA reflect that view that in case of unexpected delays in completing new projects, which would weaken revenue and EBITDA growth, the company's debt leverage can rise beyond our expectations and prompt a downgrade. The negative outlook on ISA also mirrors the negative outlook on Colombia, given our view that the ratings on the latter limit the ratings on the company. The negative outlook on Colombia reflects the risk that its fiscal and external positions could deteriorate beyond our base-case expectations if the government is unable to advance this year with fiscal measures that would help stabilize its recently rising debt burden and reduce economic imbalances.

Downside scenario

A downgrade is likely if ISA's debt to EBITDA rises above 3.5x and its funds from operations to debt remains below 23%. In addition, a downgrade would occur if ISA's payback ratios don't improve as expected under our base case by the end 2018, mainly FOCF to debt above 4.0%. A negative rating action on Colombia could also lead to a the same action on ISA. We could lower the ratings on the sovereign if the peace negotiations between the government and the main guerilla group flounder or political developments weaken the government's ability to tighten its fiscal policy via a combination of spending and revenue measures. If, contrary to our expectations, the peace process suffers marked setbacks, the government may find it more challenging to take timely and adequate fiscal steps, particularly amid a decelerating economy. Under such a scenario, the government's debt burden would rise and would likely further erode Colombia's weakened external profile, resulting in a downgrade.

Upside scenario

With operating and financial performance in line with our expectations, coupled with a positive rating action on Colombia, could lead us to revise the outlook on ISA to stable before the end of 2018. We could revise the outlook on Colombia to stable if the peace process advances, facilitating the government's ability to bolster fiscal prospects with a combination of spending cuts and increased revenue. In addition, successful implementation of projects associated with the government's "4G" infrastructure program would help sustain GDP growth, partly compensating for the negative impact of low commodity prices, contributing to economic stability and fiscal revenue.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Negative/--

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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

Related government rating: BBB

Likelihood of government support: Moderate (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component of a Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April, 15, 2008

Ratings List

Ratings Affirmed

Interconexion Electrica S.A. E.S.P. (ISA)	
Corporate Credit Rating	BBB/Negative/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. 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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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