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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 expect ISA's debt to EBITDA to temporarily remain around 3.5x in 2017 and 2018, given its sizable capital expenditures (capex) program, but then gradually recover to below 3.0x from 2019 on.
- We're affirming our 'BBB' corporate credit rating on Colombia-based electricity transmission company ISA.
- We're also maintaining ISA's 'bbb' stand-alone credit profile (SACP).
- The negative outlook reflects the risk of a slower deleveraging trend in case of unexpected delays in completing new projects, or in case of a debt-financed expansion of its already sizable capex program. The outlook on ISA also mirrors the negative outlook on Colombia.

Rating Action

On Aug. 31, 2017, S&P Global Ratings affirmed its 'BBB' corporate credit ratings on Interconexion Electrica S.A. E.S.P. (ISA). The outlook remains negative.

Rationale

The rating affirmation and negative outlook reflects our expectation that leverage metrics will remain temporarily high over the next few years, considering the company's aggressive growth strategy, but debt to EBITDA should then gradually decrease to below the 3.0x threshold by 2019, and free cash flow should be in positive territory in 2018.

Our assessment of the company's SACP, which represents its credit quality in the absence of extraordinary support or intervention from the Colombian government, remains 'bbb'. We view ISA as a government-related entity (GRE) because Colombia's 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. However, we also believe the government could intervene by redirecting resources to itself, and therefore weaken the GREs' credit quality. As a result, the outlook on ISA also mirrors the negative outlook on Colombia.

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 operates in eight Latin American countries through various business units. It is the largest electricity transmission company in Colombia and Peru and the largest toll-road operator in Chile.

ISA's strategy is to increase its 2012 earnings threefold by 2020, fueled by continued investments in the region. Its investment plan is large, with more than 5,400 kilometers of transmission lines already in construction. The group was also recently awarded new projects that should demand sizable investments, the bulk of which are Brazil, and we expect ISA to finance growth there with the about R$9.1 billion compensation that its domestic subsidiary CTEEP - Companhia de Transmissao de Energia Eletrica Paulista (CTEEP) is entitled to receive from the early renewal of its concessions in 2012. Although there's currently an ongoing litigation, we assume that CTEEP will be able to keep receiving compensation on a monthly basis--it started receiving in August 2017 and is entitled to receive until 2025.

The transmission business in Colombia is undergoing a tariff review process. This process is already delayed, but could result in the reduction of the returns of a majority of ISA's assets in the country. The regulator's proposed changes include using the depreciated value instead of the replacement value to determine the asset base. The involved parties are currently in conversations over this topic, but we don´t expect this process to have a significant impact on ISA's consolidated metrics, especially considering the scale of the group and its geographic diversification.

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

- Double-digit revenue growth in 2017 and 2018 due to the start of new transmission projects and our expectations for inflation for the region.
- Low single-digit revenue growth from ISA's toll roads in Chile, given that we expect GDP growth of 1.6% in 2017 and 2.0% in 2018 and inflation of 2.7% and 2.9%.
- Adjusted EBITDA margins to remain above 60%.

Based on these assumptions, we arrive at the following credit measures for 2017 and 2018, respectively:

- Debt to EBITDA temporarily around 3.5x; and
- Free operating cash flow (FOCF) returning to positive territory by the end of 2018.

Liquidity

We assess ISA's liquidity as adequate. We expect sources to exceed uses by at least 1.1x, even if EBITDA declines by 10% in the next 12 months, which provides protection against adverse market conditions. Additionally, our assessment 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 of COP1.4 trillion as of June 30, 2017;
- Funds from operations (FFO) generation of about COP$2.6 trillion; and

- Committed lines of COP1.5 trillion.

Principal liquidity uses:
- Debt maturities of COP1.6 trillion as of June 30, 2017;
- Capex of about COP3.0 trillion for the next 12 months; and
- Dividend payments of about COP$300 billion.

Outlook

The negative outlook on ISA reflects the risk of a slower deleveraging trend, if, in the case of unexpected delays in completing new projects or a debt-financed expansion of its already sizable capex program, the company's debt leverage rises beyond our expectations, prompting 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 the sovereign's external position could fail to improve in line with our forecasts as a result of a weaker than expected export recovery or unexpected fiscal slippage during the implementation of tax reforms and the peace accord over the next 18 months.

Downside scenario

A downgrade is likely if ISA's debt to EBITDA rises to consistently above 3.5x and if it fails to report positive FOCF by 2019. A negative rating action on Colombia could also lead to the same action on ISA. We could lower the ratings on the sovereign, if, contrary to our expectations, the narrow net external debt burden doesn't stabilize and begins to reverse the recent sharp increase. A sovereign downgrade could also occur if the fiscal deficit fails to sufficiently decline and net general government debt to GDP rises more than we expect. Finally, an unforeseen reversal in the peace process could also weaken growth prospects and exacerbate Colombia's weakened external profile.

Upside scenario

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 fiscal deficit declines and the net general government debt and interest burdens improve more quickly than we expect, with a possible rise in the country's growth trend. Such an improvement, or an external profile strengthening more than we expect, could sustain the rating at its current level.

Ratings Score Snapshot

Corporate credit rating	
Global scale	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

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Ratings Above The Sovereign—Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 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

Ratings List

Ratings Affirmed

Interconexion Electrica S.A. E.S.P. (ISA)	
Corporate Credit Rating	BBB/Negative/--
Analytical Factors	
Local Currency	bbb

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.