

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

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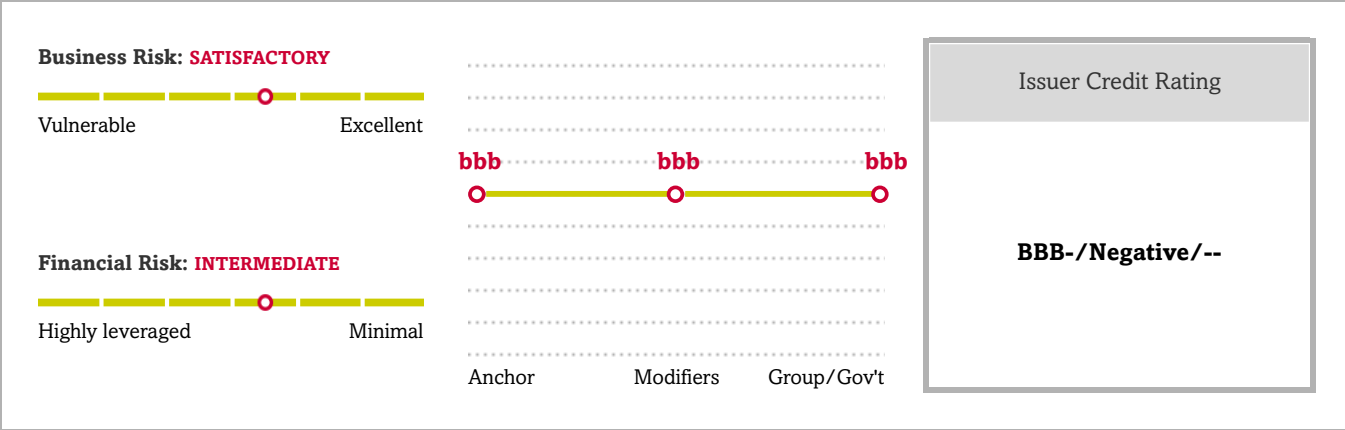
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Interconexion Electrica S.A. E.S.P. (ISA)



Credit Highlights

Overview

Key strengths	Key risks
The availability-based transmission segment offers protection for the group during macroeconomic downturns.	If market conditions worsen, ISA's financial flexibility and ability to refinance its maturities could diminish.
Geographic diversification allows Interconexion Electrica S.A. E. S.P. (ISA) to mitigate regulatory exposure to a single jurisdiction.	Increasing investments will lead to a shortfall in free operating cash flows (FOCF) in the next two years, requiring new debt.

Despite the COVID-19 pandemic, we expect ISA to generate resilient cash flows. We believe that ISA's main operations in the electric power transmission segment are insulated from cash flow volatilities related to economic downturns, such as the one that COVID-19 pandemic has been causing. This is because these assets receive payments for their availability to the national systems in which they are located, and not by the energy flow through them. This mechanism assures that ISA has a resilient and predictable revenue stream, regardless of economic performance.

The key risk, in our view, for the transmission segment is indirect, giving the structure of payment chain in the electric sector. If clients--either residential customers or large users--delay their payments, increasing the sector's delinquency rates, it could trigger payment bottlenecks among the distribution, generation, and transmission companies. In order to cope with such a potential situation, regulators in many Latin American countries have adopted various measures to preserve cash flows throughout the sector.

On the other hand, the company's toll road business is facing a traffic drop of about 35% in the past months, but the impact on ISA is not material because these entities have a cash waterfall structure and reserve accounts that assure the timely debt repayment. For the lower cash flow generation that ISA will absorb in the short term, the regulator in Chile will compensate it mainly in the form of extension of their contracts.

We don't expect ISA to face refinancing risk in the short term, given that the company's cash position of COP2.8 trillion is more than enough to cover its COP2.2 trillion short-term debt maturities as of March 31, 2020. In addition, we believe that the company has solid financial flexibility and relationship with creditors.

Acquisition of new toll road in Colombia diversifies slightly the group's business and geography footprint. On Oct. 24, 2019, ISA announced that it intends to purchase the entire share capital of Concesión Costera Cartagena Barranquilla through its 100%-owned subsidiary, Intervial Chile S.A., for COP500 billion (about \$150 million) through a combination of cash and new debt. The final acquisition price is still subject to change until the closing of the transaction, which is pending some final approvals, such as the creditors, which we expect to occur through the second half of 2020. We expect the acquisition to diversify slightly the group's portfolio, because the toll-road segment could represent about 18% of ISA's EBITDA from 2021 onwards, versus about 15% currently, while the electric power transmission segment would continue to generate the bulk.

Costera Cartagena Barranquilla's Key Highlights

Acquisition price	COP 500 billion
Annual EBITDA	COP 230 billion
Length	147 kilometers
Concession due	2039*

*According with traffic estimates

Outlook: Negative

The negative outlook on ISA reflects a potential downgrade of Colombia in the next 18 months. The ratings on the latter pose a limitation on ISA's credit quality, given its exposure to sovereign risk. Therefore, we expect the ratings on ISA to move in tandem with the sovereign ratings.

Downside scenario

We would likely downgrade ISA in case of a similar rating action on Colombia. We could lower the sovereign ratings if the external shocks undermine GDP growth prospects, contributing to worsening public finances, or pose further risks to Colombia's external liquidity.

Upside scenario

We could revise the outlook to stable on ISA in case we take a similar action on the sovereign rating on Colombia, while all other credit factors remaining unchanged. The outlook revision to stable on Colombia could occur if timely and adequate policy measures stabilize the economy, sustain GDP growth prospects, limit the increase in the general government's net debt burden, and contain risks to external liquidity.

Our Base-Case Scenario

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 		2020E	2021E
	Debt to EBITDA (x)	3.5-4.0	3.5-4.0
	FFO to debt (%)	15-20	15-20

and new toll roads.

- ISA's Brazilian subsidiary to continue receiving 85% of the total indemnities related to the early renewal of its concessions in 2012.
- We expect traffic on the company's Chilean toll roads to decline around 20% in 2020 because of the COVID-19 pandemic and recover in 2021.
- A robust investment plan of around COP10 trillion in 2020 and 2021, which could be lower due to COVID-19, mostly for the assets under construction.
- ISA to distribute about 40% of previous year's net income as dividends to its shareholders, but the company could reduce them to preserve its financial flexibility.

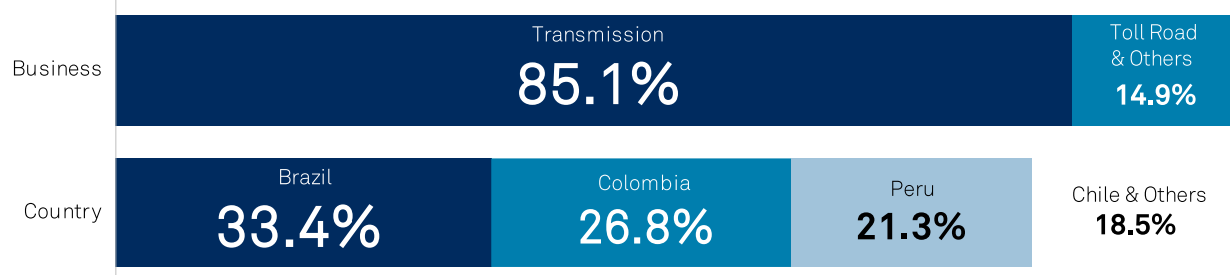
	2020E	2021E
FOCF to debt (%)	(15)-(10)	(10)-(5)

Company Description

Colombia-based company ISA operates in four main business lines: electric power transmission, toll road concessions, communications technology, and real-time system management. ISA operates in several countries in Latin America, including Brazil, Colombia, Chile, and Peru. In the transmission segment, ISA operates mostly in Brazil, Chile, Colombia, and Peru. The company has more than 63,000 kilometers (km) of lines in operations (including the shared control investments) with an average availability of 99.99%, and more than 5,000 km of lines under construction. For its toll road business, ISA has in Chile 907 km of roads in operation with an annual traffic of around 150 million equivalent vehicles. ISA is also building up to 136 km in new roads, also in Chile. In addition, the company has recently made an offer to acquire a 147-km road in Colombia.

EBITDA Breakdown

Does not consider construction and costs



Source: S&P Global Ratings.
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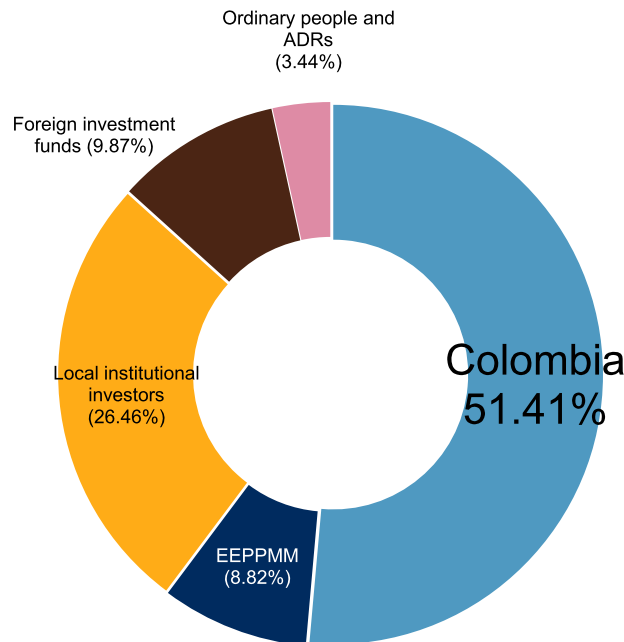
The Republic of Colombia (foreign currency: BBB-/Negative/A-3; local currency: BBB/Negative/A-2) controls ISA

through a 51.41% stake, while Empresas Públicas de Medellín – EEPPMM, which the city of Medellín owns, controls 8.82% of ISA, resulting in a 60.23% control from state-related investors. Private investors own the remaining portion.

Chart 2

ISA's Ownership Structure

As of April 2020



Source: S&P Global Ratings.

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Peer comparison

We have chosen the following peer companies for ISA:

- Grupo Energía Bogotá S.A. E.S.P. (GEB; BBB-/Negative/--), which also operates transmission lines in Colombia and Peru, 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 Aliança de Energia Elétrica S.A. (Taesa; global scale: BB-/Stable/--; national scale: brAAA/Stable/brA-1+), a pure transmission company, and ISA has a stake in the company, jointly controlling it with Companhia Energética de Minas Gerais – CEMIG (B/Stable/--; brA+/Stable/--).
- Transelec S.A. (BBB/Stable/--), the largest transmission company in Chile, controlling more than 85% of the transmission lines in the country.
- Although Enel Americas S.A. (BBB/Negative/--) 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.

Table 1

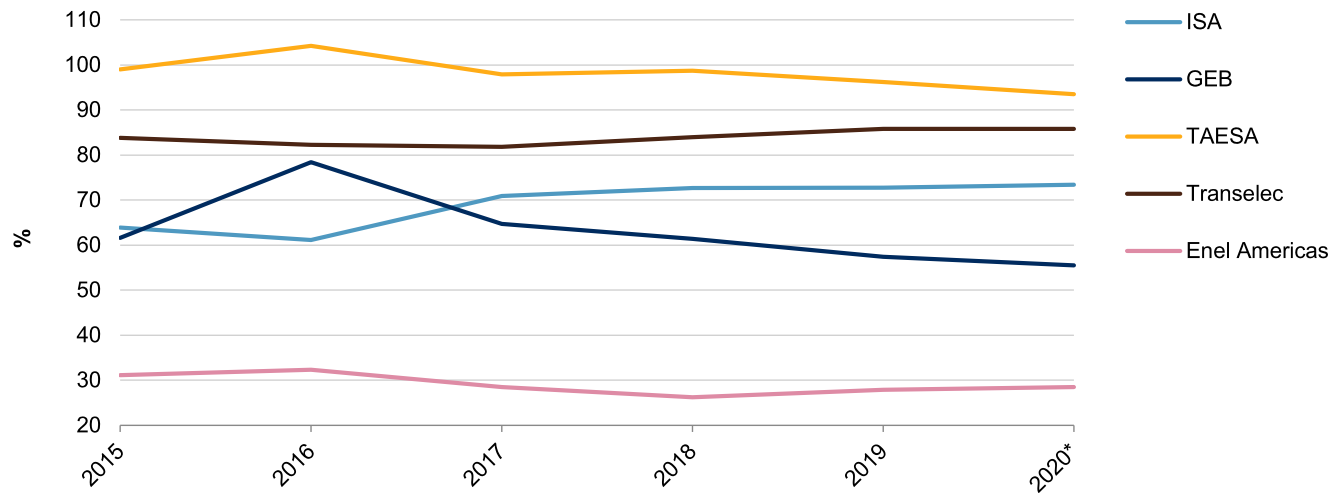
Interconexión Eléctrica S.A. E.S.P. (ISA)--Peer Comparison Table					
	Interconexión Eléctrica S.A. E.S.P. (ISA)	Grupo Energía Bogotá S.A.E.S.P.	Transmissora Aliança de Energia Eletrica S.A.	Transelec S.A.	Enel Americas S.A.
Rating	BBB-/Negative/--	BBB-/Negative/--	BB-/Stable/--	BBB/Stable/--	BBB/Negative/--
(bil. COP)					
--Fiscal year ended on Dec. 31, 2019--					
Revenue	7,039.5	4,887.2	889.6	1,652.4	46,978.0
EBITDA	5,109.5	2,807.0	855.8	1,417.3	13,108.7
Funds from operations (FFO)	3,181.4	2,019.2	651.6	1,097.2	9,196.3
Interest expense	1,224.0	560.8	189.3	330.0	1,453.2
Cash interest paid	946.5	587.2	163.5	320.1	2,068.6
Cash flow from operations	3,475.4	1,958.3	568.2	949.7	6,588.2
Capital expenditure	2,229.6	1,180.8	316.7	461.8	5,392.8
Free operating cash flow (FOCF)	1,245.9	777.5	251.6	487.9	1,195.4
Discretionary cash flow (DCF)	76.1	(493.7)	(280.3)	67.9	(1,180.7)
Cash and short-term investments	2,487.2	790.6	1,975.7	479.5	6,758.8
Gross available cash	2,487.2	790.6	1,975.7	479.5	6,758.8
Debt	15,837.4	10,229.6	2,350.9	6,323.3	14,141.5
Equity	21,103.2	13,556.5	4,022.6	3,696.7	40,191.2
Adjusted ratios					
EBITDA margin (%)	72.6	57.4	96.2	85.8	27.9
Return on capital (%)	13.6	13.0	15.7	11.8	19.4
EBITDA interest coverage (x)	4.2	5.0	4.5	4.3	9.0
FFO cash interest coverage (x)	4.4	4.4	5.0	4.4	5.4
Debt/EBITDA (x)	3.1	3.6	2.7	4.5	1.1
FFO/debt (%)	20.1	19.7	27.7	17.4	65.0
Cash flow from operations/debt (%)	21.9	19.1	24.2	15.0	46.6
FOCF/debt (%)	7.9	7.6	10.7	7.7	8.5
DCF/debt (%)	0.5	(4.8)	(11.9)	1.1	(8.3)

COP--Colombian peso.

In general, these companies are in the investment-grade category, including Taesa, which has a 'bbb-' stand-alone credit profile (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.

Chart 3

ISA's EBITDA Margin Comparison



*Rolling twelve months ended March 31, 2020. Source: S&P Global Ratings.

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ISA doesn't have a close peer, because it mainly operates in the electric power transmission lines and toll road businesses. When we compare it with pure transmission companies, such as TAESA and Transelec, they have better margins. On the other hand, GEB is more focused on natural gas transportation, which has lower margins, although they're resilient. Finally, Enel Americas operates mainly in the electric power distribution segment, which has lower margins by nature.

Business Risk: Satisfactory

ISA's activities are mainly regulated, and its geographic diversification mitigates the company's exposure to multiple regulatory jurisdictions, in our view. Overall, we believe the Latin American electric sector's regulatory framework supports credit quality of the local players. The framework in Colombia is among the strongest ones in the region, followed by Brazil. In both cases, we believe the regulatory bodies have actively acted to assure that the payment chain remains through the electric sector. Overall, we believe various regulations help to reduce cash flow volatility, based on their tariff-setting mechanisms.

In periods of economic downturn, such as the one stemming from COVID-19, companies like ISA are among those least affected, given the resilience and predictability of their cash flows. About 85% of ISA's EBITDA comes from electric power transmission activities, which rely solely on the availability of the lines to the national systems, not on volumes transported, shielding the company's cash flows from economic downturns. On the other hand, we expect lower cash flows in the company's toll roads, following a drop of around 20% in traffic volume. However, we expect this impact to be mitigated with the integration of the new toll road in Colombia starting in the second half of 2020.

The Colombian electricity regulator, Comisión Reguladora de Energía y Gas (CREG), is planning to set a new rate-setting model for the transmission lines in the country that are currently undergoing a rate-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 such a change, which is likely to be implemented in the third quarter of 2021.

We expect the Brazilian subsidiary, CTEEP – Companhia de Transmissão de Energia Elétrica Paulista (not rated), to continue receiving the monthly payments until 2024, stemming from the early renewal of its concessions in 2012. Currently, CTEEP has been receiving only 85% of the total amount, because several large electricity consumers have obtained a favorable court injunction when they questioned the methodology used. Although CTEEP and other transmission companies in the country are challenging this decision, and are in conversations with the regulatory authorities, the timing of a resolution is uncertain.

Financial Risk: Intermediate

ISA generates about 85% of its EBITDA from electric power transmission activities, which are very resilient during weak economic periods, such as the current one. Given that we believe that ISA's cash flow will remain resilient, which supports the rating. However, we expect debt to rise in order to cope with the investment plan, which will cause credit metrics to slip.

As ISA continues pursuing growth mostly in Latin America, we expect the company will raise new debt for its investment plan. Given that the rating is one notch below the SACP, because the Colombia's credit quality limits ISA's rating, the company has some cushion to maintain the current rating level even if credit metrics weaken.

Financial summary

Table 2

Interconexión Eléctrica S.A. E.S.P. (ISA)--Financial Summary						
(bil. COP)						
	2020*	2019	2018	2017	2016	2015
Revenue	7,258.8	7,039.5	6,561.9	5,463.5	5,307.3	4,472.8
EBITDA	5,325.3	5,109.5	4,769.3	3,873.3	3,244.5	2,859.5
Funds from operations (FFO)	3,364.2	3,181.4	2,804.5	2,429.9	2,289.1	1,615.1
Interest expense	1,292.7	1,224.0	1,110.2	1,001.2	1,070.2	897.6
Cash interest paid	959.6	946.5	814.5	519.5	879.9	741.5
Cash flow from operations	3,071.9	3,475.4	2,417.1	2,379.8	1,361.6	2,153.9
Capital expenditure	2,630.1	2,229.6	2,213.3	2,271.4	2,364.6	1,740.0
Free operating cash flow (FOCF)	441.8	1,245.9	203.8	108.4	(1,003.0)	413.9
Discretionary cash flow (DCF)	(764.6)	76.1	(1,659.8)	(749.6)	(1,003.0)	117.0
Cash and short-term investments	2,797.8	2,487.2	1,522.1	1,529.5	1,167.4	1,029.3
Gross available cash	2,797.8	2,487.2	1,522.1	1,529.5	1,167.4	1,029.3
Debt	17,822.7	15,837.4	16,158.0	14,692.4	11,842.5	10,382.1
Equity	20,427.8	21,103.2	18,941.8	18,423.5	16,911.5	11,393.1

Table 2**Interconexión Eléctrica S.A. E.S.P. (ISA)--Financial Summary (cont.)****(bil. COP)**

	2020*	2019	2018	2017	2016	2015
Adjusted ratios						
EBITDA margin (%)	73.4	72.6	72.7	70.9	61.1	63.9
Return on capital (%)	13.6	13.6	13.3	11.3	12.1	12.5
EBITDA interest coverage (x)	4.1	4.2	4.3	3.9	3.0	3.2
FFO cash interest coverage (x)	4.5	4.4	4.4	5.7	3.6	3.2
Debt/EBITDA (x)	3.3	3.1	3.4	3.8	3.7	3.6
FFO/debt (%)	18.9	20.1	17.4	16.5	19.3	15.6
Cash flow from operations/debt (%)	17.2	21.9	15.0	16.2	11.5	20.7
FOCF/debt (%)	2.5	7.9	1.3	0.7	(8.5)	4.0
DCF/debt (%)	(4.3)	0.5	(10.3)	(5.1)	(8.5)	1.1

*Rolling 12 months ended March 31. COP--Colombian peso.

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

--Rolling 12 months ended March 31, 2020--

	Debt	Shareholders' equity	Revenue	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations
Interconexión Eléctrica S.A. E.S.P. (ISA) reported amounts								
Reported	20,050.0	12,744.6	8,392.4	5,578.2	4,825.0	1,292.7	5,325.3	4,031.5
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	--	-1,001.4	--
Cash interest paid	--	--	--	--	--	--	-959.6	--
Accessible cash and liquid investments	-2,797.8	--	--	--	--	--	--	--
Income (expense) of unconsolidated companies	--	--	--	-243.5	--	--	--	--
Nonoperating income (expense)	--	--	--	--	286.1	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	-959.6
Noncontrolling interest/minority interest	--	7,683.2	--	--	--	--	--	--
Debt: Workers compensation/self insurance	570.6	--	--	--	--	--	--	--
Revenue: Other	--	--	-1,133.6	-1,133.6	-1,133.6	--	--	--

Table 3

Interconexión Eléctrica S.A. E.S.P. (ISA)--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (bil. COP) (cont.)								
COGS: Other nonoperating nonrecurring items	--	--	--	1,118.1	1,118.1	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	6.1	6.1	--	--	--
Working capital: Taxes	--	--	--	--	--	--	--	-218.3
Operating cash flow: Taxes	--	--	--	--	--	--	--	218.3
Total adjustments	-2,227.2	7,683.2	-1,133.6	-252.9	276.6	-1,961.1	-959.6	-959.6
	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations
S&P Global Ratings' adjusted amounts								
Adjusted	17,822.7	20,427.8	7,258.8	5,325.3	5,101.6	3,364.2	3,071.9	3,071.9

COP--Colombian peso.

Liquidity: Adequate

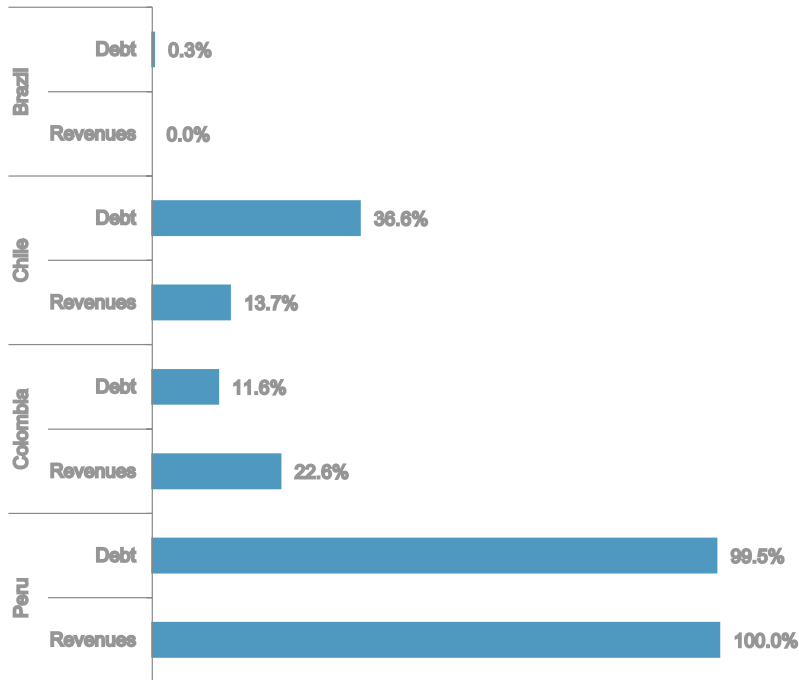
We expect ISA's sources of cash to exceed its uses by around 15% in the next 12 months. In case of a 10% EBITDA decline in the following 12 months, we still expect ISA to continue having higher sources of cash than its uses. This illustrates ISA's ability to cushion itself against high-impact, low-probability events, such as the current pandemic. Additionally, we take into consideration that ISA has high standing in the capital markets, in addition to sound relationship with local and international banks. ISA is one of the largest companies in Colombia and it operates throughout Latin America. Reinforcing our view of the company's financial flexibility, it has the ability to defer investments and dividend payments, as seen in the past.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> Cash and cash equivalents of COP2.8 trillion, as of March 31, 2020; and Expected cash flows of about COP3.5 trillion in the next 12 months. 	<ul style="list-style-type: none"> Debt maturities of COP2.2 trillion as of March 31, 2020; Minimum investments of about COP1.3 trillion in the next 12 months; Payments of about COP500 billion for the toll road acquisition in Colombia; and Minimum dividend payments of around COP1.2 trillion.

Debt maturities

The currency denomination of ISA's debt takes into consideration the revenue stream in each country, and the company uses derivatives to reduce the gap between revenue and debt service in different currencies. As a result, mismatches are not sufficient to weaken ISA's credit quality, because we expect the interest coverage ratio above 1.2x going forward.

Chart 4
Foreign Currency Indexation

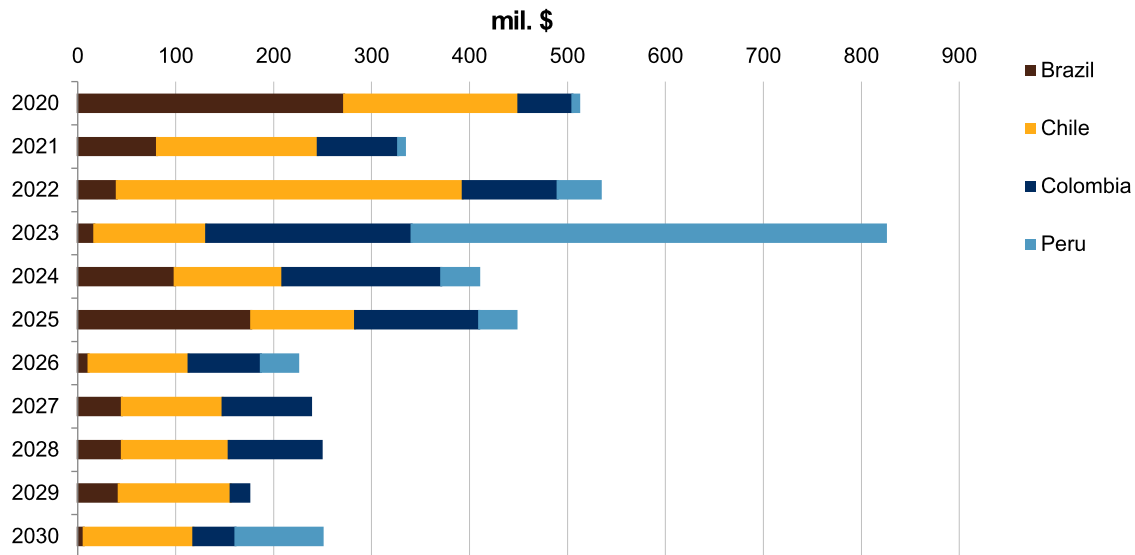


Source: S&P Global Ratings.
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Overall, ISA has manageable debt maturities in the next years, with operations in each country playing a more relevant role in each year. We expect that the subsidiaries in each country will be able to properly amortize or refinance the existing debt maturities, preventing a currency mismatch for the group.

Chart 5

Debt Maturity Profile



Source: S&P Global Ratings.
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Covenant Analysis

ISA doesn't have to comply with financial covenants measured at the consolidated level. However, some of its subsidiaries have to comply with specific financial covenants measured at their individual level, with which they were in compliance as of March 31, 2020, and we expect this situation to remain so in the future.

Government Influence

The government of Colombia currently controls ISA with a total stake of 51.41%. Therefore, we consider ISA as a government-related entity. 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 our view that the regulatory framework and the legal system in Colombia don't prevent the government from interfering in ISA's operations. Under a hypothetical sovereign default scenario, we expect ISA to be subject to government interventions in the form of higher dividend payments, which could diminish ISA's financial flexibility.

Rating Above The Sovereign

ISA has operations in the following countries:

Table 4**Country Exposure Of ISA's Operations**

Country	Foreign Currency Rating
Brazil	BB-/Stable/B
Chile	A+/Negative/A-1
Colombia	BBB-/Negative/A-3
Peru	BBB+/Stable/A-2

The company's 'bbb' SACP is higher than the foreign currency ratings on Brazil and Colombia, which together represent about 60% of the group's consolidated EBITDA. As we said above, given that the government of Colombia controls ISA, we don't expect the company to be rated above the sovereign foreign currency rating.

Environmental, Social, And Governance

We believe governance factors play a more important role for ISA, while environmental and social are less important from a credit perspective. ISA's 2030 growth strategy incorporates expansion 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 the natural habitats. 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 carbon emission contributors--through the implementation of new technologies and potentially new business opportunities to integrate the group's activities.

Ratings Score Snapshot**Issuer 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)
- **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

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

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Companies With Noncontrolling Equity Interests, Jan. 5, 2016
- Criteria | Corporates | Industrials: Methodology: Investment Holding Companies, Dec. 1, 2015
- 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 | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Outlook On Nine Colombian Corporate And Infrastructure Entities Revised To Negative On Same Action On Sovereign, March 27, 2020

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 June 29, 2020)***Interconexión Eléctrica S.A. E.S.P. (ISA)**

Issuer Credit Rating BBB-/Negative/--

Issuer Credit Ratings History

27-Mar-2020 BBB-/Negative/--
 11-Dec-2017 BBB-/Stable/--
 19-Feb-2016 BBB-/Negative/--

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