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Research Update:

Interconexion Electrica S.A. E.S.P. (ISA) 'BBB' Credit Rating Affirmed, Outlook Remains Stable

Primary Credit Analyst:
Maria del Sol S Gonzalez, CFA, New York (1) 212-438-4443; maria.gonzalezcosio@standardandpoors.com

Secondary Contacts:
Stephanie Alles, Mexico City (52) 55-5081-4416; stephanie.alles@standardandpoors.com
Jose Coballasi, Mexico City (52) 55-5081-4414; jose.coballasi@standardandpoors.com

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Research Update:

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Overview

- We are affirming our 'BBB' corporate credit rating on Colombia-based electricity transmission company ISA.
- The stable outlook reflects our expectation that ISA's investments will continue to boost profitability while its expansion won't compromise the company's key financial ratios.

Rating Action

On Aug. 24, 2015, Standard & Poor's Ratings Services affirmed its 'BBB' corporate credit rating on Interconexion Electrica S.A. E.S.P. (ISA). The outlook remains stable.

Rationale

The rating on ISA reflects its "satisfactory" business risk profile, which benefits from a stable and generally predictable business environment in the countries in which the company operates. In addition, ISA holds a strong market position thanks to its control of a majority of Colombia's and Peru's electricity transmission grids. The stand-alone credit profile also reflects ISA's "intermediate" financial risk profile, which is supported by its key financial ratios.

ISA's "satisfactory" business risk profile reflects the company's competitive position in Colombia, Brazil, Peru, and Chile due to limited competitive pressures, given the nature of the electric transmission business, and natural monopoly in ISA's business units. The company has adequate geographic and business diversification as the largest energy transmission company with a nationwide footprint in Colombia. Given the considerable capital costs involved in building competing networks, we consider electricity transmission as a natural monopoly.

Additionally, the company has adequate operating efficiency based on its experience in building and operating transmission facilities, and the economies of scale that it has developed, which allow it to secure new expansion bids. The rating on ISA also reflects our view of Colombia's favorable institutional and regulatory framework, which contributes to the stability of the energy sector.

ISA's "intermediate" financial risk profile reflects the company's sufficient

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internal cash flow to fund its capital expenditures (capex) in Brazil and Colombia. We expect the company's credit metrics to improve in the next two years as its net debt to EBITDA improves to about 2.5x and funds from operations (FFO) to debt to 22% by the end of 2015. We expect the company's FFO to increase to about Colombian peso (COP) 1.64 billion in 2016. As of June 30, 2015, adjusted net debt to EBITDA was 3.5x and FFO to debt 17%. The company has no significant foreign exchange risk in their debt.

Our base case assumes:

- EBITDA growth of 20% in 2015 and 6% in 2016.Gross margins of about 50% in 2015, 2016, and afterwards; and
- Capex according to ISA's investment plan.

Based on these assumptions, we arrive at the following credit measures for 2015 and 2016, respectively;

- Net debt to EBITDA of 2.5x and 2.3x;
- FFO to debt of 22% and 25%; and
- Interest coverage of about 5.0x.

The rating also incorporates our assessment that there is a "moderate" likelihood that the government of Colombia (foreign currency: BBB/Stable/A-2; local currency: BBB+/Stable/A-2) would provide timely support to ISA, if needed, because the company generates significant cash flow and debt outside of Colombia. As the company's primary shareholder, the Colombian government holds a 51.4% (directly, indirectly the government holds 68.56%) stake in ISA. However, according to our government-related entity criteria, ISA has a "limited" link to the government given the independence of its management and corporate practices.

Liquidity

We assess ISA's liquidity as "adequate." We expect sources to exceed uses by at least 1.2x in the next 12 months, which provides protection against adverse market conditions. Additionally, our view reflects ISA's very good credit standing in the capital markets and with the domestic banks. Our analysis also incorporates the company's ability to adjust capex and dividend payments in our analysis.

Principal Liquidity Sources:

- Cash and equivalents (about COP1.88 trillion as of June 30, 2015)
- FFO generation of COP1.5 trillion in 2015
- ISA's May debt issuance for COP500 billion

Principal Liquidity Uses:

- Short-term debt maturities of COP1.18 billion in 2015) as of June 30, 2015
- Capex for about COP600 billion in 2015
- Dividend payment of about COP250 billion in 2015

Outlook

The stable outlook on ISA reflects our expectation that its key financial metrics will continue to strengthen in 2015 and 2016.

Downside scenario

If ISA were to engage in large debt-financed acquisitions that weaken its financial risk profile, resulting in a consolidated net debt to EBITDA of more than 4.5x and FFO to debt of less than 23%, we could lower the rating.

Upside scenario

An improvement in our view of ISA's business risk profile, which could be triggered by an increase in its operating margin, or a financial performance above our expectations, particularly, a consolidated FFO to total debt above 35% and total net debt to EBITDA of less than 2.5x, could lead to an upgrade following the upgrade of Colombia.

Ratings Score Snapshot

Corporate 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)
- 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

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, 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
- Credit Factors For Corporate Entities And Insurers , Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Rating Affirmed

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

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