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Research Update:

Interconexion Electrica S.A. E.S.P. 'BBB-' Issuer Credit Rating Affirmed, Outlook Remains Stable

Primary Credit Analyst:
Vinicius Ferreira, Sao Paulo + 55 11 3039 9763; vinicius.ferreira@spglobal.com

Secondary Contacts:
Marcelo Schwarz, CFA, Sao Paulo (55) 11-3039-9782; marcelo.schwarz@spglobal.com
Daniel A Morales, Mexico City + 52 55 5081 4543; daniel.morales@spglobal.com

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Overview

- We believe that ISA's strong and stable operating cash flows compensate for our view that deleveraging will be slower than we previously expected because of its higher investment plan, with net debt to EBITDA temporarily peaking at about 3.5x in 2018 and 2019.
- We're affirming our 'BBB-' issuer credit rating on the Colombia-based infrastructure group ISA. We're also keeping its 'bbb' stand-alone credit profile (SACP) unchanged.
- The stable outlook on ISA reflects that on Colombia, which caps the ratings on ISA.

Rating Action

On Aug. 24, 2018, S&P Global Ratings affirmed its 'BBB-' issuer credit rating on Interconexion Electrica S.A. E.S.P. (ISA). The outlook remains stable. The company's 'bbb' SACP also remains unchanged.

Rationale

The affirmation of the 'BBB-' credit rating, which is one notch below the company's 'bbb' SACP, reflects our view that ISA's rating is capped at the 'BBB-' sovereign foreign currency rating on the Republic of Colombia. This is because the government controls the company through its 51.4% stake. In addition, we believe that if a sovereign default occurs, there would be a high likelihood that ISA would default as well, based on our view that the government could intervene in the company by redirecting resources to itself, and therefore weakening ISA's credit quality.

The 'bbb' SACP on ISA reflects our view of that although the company might deleverage slower than we previously expected because of its higher investment plan, with net debt to EBITDA peaking at about 3.5x in 2018 and 2019, this is compensated by the resiliency of its business, as seen in its strong and stable operating cash flows. ISA has a leading position in Latin America for electric power transmission lines, with a large footprint in Colombia, Brazil, and Peru. The company also plays an important role in the Chilean toll road segment, because it's the leading operator with around 30% market share in terms of kilometers under management.

We don't expect the current review of rates for ISA's transmission business in Colombia to have a significant impact on consolidated metrics, given the group's scale and geographic diversification. The regulator has proposed to use the depreciated value instead of the replacement value to determine the asset base, which should be fully implemented by the end of 2019.

ISA has a robust investment plan of around COP10 trillion for the next three years to expand its operations throughout the countries in which it already operates. The bulk of these investments will be for building new transmission lines in Brazil. The funding for this will come from COP8.8 trillion in indemnities that its Brazilian subsidiary, CTEEP – Companhia de Transmissao de Energia Eletrica Paulista (not rated) has been entitled to receive on a monthly basis between July 2017 and June 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 an injunction questioning the methodology used and therefore are currently not paying these indemnities. 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 in uncertain.

Our base-case scenario assumes the following factors:

- Although transmission revenues are usually pegged to the domestic inflation of each country in which the group operates (please refer to " Credit Conditions Latin America: Domestic Politics And Increasing U.S. Protectionism Undermine Favorable Conditions," as of June 28, 2018, for macroeconomic assumptions), overall they should grow at a faster pace given the startup of some new assets.
- ISA, through CTEEP, will receive 85% of the total indemnities, so it will require some debt financing to perform the scheduled investment plan.
- Low single-digit revenue growth at ISA's toll roads in Chile, reflecting the mature status of the existing concessions. Rutas del Loa, the recently awarded concession, is still under construction.
- Capex of about COP3.8 trillion in 2018 and around COP2.8 trillion in 2019.

Based on these assumptions, we expect the following credit metrics:

- EBITDA of COP4.3 – COP4.5 trillion in 2018 and 2019;
- Net debt to EBITDA of 3.3x-3.7x in 2018 and 2019; and
- Free operating cash flow (FOCF) to debt of negative 10%-5% in 2018 and in the range of negative 2% and 3% in 2019.

Liquidity

We expect ISA's cash sources to exceed its uses by at least 10%, even if the company's EBITDA declines by 10% in the next 12 months. This, in our view, shows ISA's ability to protect 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 that ISA has the ability to defer investments and dividend payments, if needed.

Principal liquidity sources:

- Cash and cash equivalents of COP 1.6 trillion, as of June 30, 2018;
- Funds from operations (FFO) generation around COP 2.8 trillion in the next 12 months; and
- Committed lines of around COP 1.5 trillion.

Principal liquidity uses:

- Debt maturities of COP1.6 trillion as of June 30, 2018;
- Investments of around COP3 trillion for the following 12 months; and
- Minimum dividend payments of around COP300 billion.

ISA doesn't have to comply with financial covenants on its debts, although some of its subsidiaries have covenants on their debt, measured at their individual level. As of June 30, 2018, they were all in compliance.

Outlook

The stable outlook on ISA reflects that on Colombia, which caps our ratings on ISA.

Downside scenario

We could downgrade ISA in the next 12-24 months if a similar rating action occurs on Colombia. Given a one-notch difference between the company's SACP and the final rating, we don't expect a downgrade stemming from the group's intrinsic conditions in the short term. However, we could revise the SACP downwards in the next 12-24 months, if ISA would consistently present a net debt to EBITDA of 3.5x or above and negative FOCF. This could be a result of a further increase in the group's investment plan along with sizable dividend distributions.

Upside scenario

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

Ratings Score Snapshot

Corporate credit rating	
Global scale	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

- 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
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- 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

Related Research

- Credit Conditions Latin America: Domestic Politics And Increasing U.S. Protectionism Undermine Favorable Conditions, June 28, 2018

Ratings List

Ratings Affirmed

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

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.