

RATING ACTION COMMENTARY

Fitch Affirms Isagen's Ratings at 'BBB-'; Outlook Stable

Wed 06 Apr, 2022 - 2:28 p. m. ET

Fitch Ratings - New York - 06 Apr 2022: Fitch Ratings has affirmed Isagen S.A. E.S.P.'s (Isagen) Long-Term (LT) Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BBB-' and 'BBB', respectively. The Rating Outlook is Stable. Fitch has also affirmed Isagen's LT national scale rating at 'AAA(col)' with a Stable Outlook and Isagen's Short-Term national scale rating at 'F1+(col)'.

Isagen's ratings reflect its leading business position in the Colombian electricity generation market and portfolio of diversified generation assets. The ratings are supported by the predictability and stability of its EBITDA, which is supported by contracts coupled by its moderate financial metrics. Isagen's LT FC IDR is constrained by Colombia's Country Ceiling of 'BBB-', as the company operates entirely within Colombia, and it does not have substantial offshore cash or EBITDA from other countries rated above the Country Ceiling.

KEY RATING DRIVERS

Solid Business Position: Isagen's ratings reflect its strong competitive position in the Colombian electricity generation sector. The company is the third-largest electricity generation company in Colombia, as of December 2021, with 3,187MW of installed capacity and the second largest in terms of energy generated 16,434 gigawatt hours (GWh). The company owns and operates 16 hydroelectric plants and one combined-cycle power plant.

The scale and low marginal costs of Isagen's asset portfolio give the company operational flexibility to weather the highly competitive Colombian market. The company acquired a 149MW hydro assets from Lareif plus 39MW from Luzma I and II, 138MW solar and a 32MW wind projects under construction. The acquisitions are expected to improve the company's assets base and diversify its energy matrix toward non-conventional renewable sources, offsetting its hydrological risk.

Moderate Leverage: Isagen's gross leveraged, defined as total debt to EBITDA, is expected to average 3.3x over the rating horizon, which is consistent with the BBB rating category. Fitch does not consider Isagen's shareholder loan (SHL) as financial debt, as the SHL is a subordinated obligation, with interest payments optionally paid-in-kind, subject only to Isagen's request.

The lender of the SHL cannot accelerate or enforce any of its rights or exercise any of its remedies to collect the principal of the loan. The structure of the SHL gives the company additional flexibility to carry out its growth strategy if necessary without affecting its capital structure.

Low Business Risk Profile: Isagen continues to deploy a conservative commercial strategy that links its contract sales with the firm energy of its hydroelectric plants. This strategy allows the company to limit its exposure to spot market purchases, since hydroelectric generation should be able to cover contracts sales during low hydrological conditions.

The company decreased its electricity purchases in the spot market in 2021 due to higher hydroelectric generation, as a result of increased water inflows to the system. Water reservoir management aims to meet the company's commercial obligations and guarantee the sustainability of hydroelectric resources.

Adequate EBITDA Performance: The rating case scenario forecasts a moderate increase in EBITDA generation over the rating horizon mainly driven by the positive effect of additional capacity added from 2021. This would partially offset the negative effects of lower electricity prices in the short to medium term from the gradual entry into operation of the hydro power project Ituango during 2H22.

A higher hydro generation and a strong contractual position pushed the company's EBITDA margins up. Adjusted EBITDA exhibited a significant increase to COP2.3 trillion in 2021, 28% higher relative to 2020. Under a conservative scenario, the company will be able to continue to generate positive FCF over the rating horizon, given the moderate capex.

Internal cash flow generation should allow Isagen to fund this capex without eroding its financial profile.

Cash Generation Depends on SHL Payments: Isagen's future cash generation performance would mostly depend on the company's distributions to its shareholders, which could take place as interest payments and prepayments on the SHL or as dividends.

The ratings factor in the expectation that Isagen's positive FCF will be distributed to shareholders. During 2021 Isagen's subordinated SHL increased by COP667 billion to partially fund inorganic growth. The company distributed COP921 billions dividend to its shareholders. The balance of the SHL was roughly COP3.4 trillion at YE 2021.

DERIVATION SUMMARY

Isagen's credit profile is commensurate with investment-grade electric generation companies in the region, such as Enel Generacion Chile S.A. (A-/Stable), Enel Americas S.A. (A-/Stable), Colbun S.A. (BBB+/Stable) and Engie Energia Chile S.A. (BBB+/Stable). All of these companies benefit from predictable cash flow from operations (CFFO), stemming from robust business profiles and conservative capital structures.

Differences in specific rating levels are largely a function of revenue mix, both geographically and by business, along with asset base diversification and the presence of long-term contract sales. Enel Generacion Chile has the largest installed capacity among its peers, with more than 7.5GW distributed among hydroelectric, thermal and wind farms. Additionally, leverage has averaged 1.5x.

Enel Americas' ratings reflect strong and sustained credit metrics coupled with a solid business platform, as well as a strong degree of business and geographical diversification across Latin America. Isagen's leverage is expected to remain below 3.3x, above levels reported by Colbun and Engie at 2.5x.

Isagen also compares well with electricity generation peers that have national ratings, namely Enel Colombia S.A. E.S.P., Empresas Publicas de Medellin E.S.P. (EPM) and Celsia Colombia S.A. E.S.P., all rated 'AAA(col)'. Isagen is the third-largest electricity generation company in Colombia, trailing Enel Colombia and EPM. Its conservative commercial policy mitigates the volatility of its results stemming from the structural characteristics of the Colombian market, which is heavily concentrated in hydroelectric assets.

KEY ASSUMPTIONS

- Isagen's electricity generation reaches around 13,000GWh per year;
- Isagen maintains a contracting policy of around 70% of total electricity sales on average;
- The company's shareholder distribution is contingent on excess cash, with SHL paid at COP800 billion annually;
- Total debt/EBITDA consistently below;
- Electricity monomic prices of COP275/KWh in 2022, COP271/KWh in 2023, COP262/KWh in 2024 and COP256/KWh in 2025.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Fitch considers a positive rating action unlikely in the near term, given business and geographical concentration in electricity generation in Colombia, and leverage expectations.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A downgrade of Colombia's Country Ceiling;
- A steep decline in electricity prices, coupled with low generation and poor electricity demand;
- Sustained leverage of more than 3.5x;
- A change in company strategy that weakens CFFO performance or results in a more aggressive plan in terms of leverage and capex.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best-

and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity Position: Isagen maintains adequate liquidity, supported by prospects for strong and predictable EBITDA generation. The company has the flexibility to capitalize interest payments on its SHL, which reached COP283 billion in 2021, and it can retain CFFO generation if necessary. It is anticipated that Isagen will maintain relatively low cash balance levels and refinance most of its debt obligation. Any cash excess is expected to be distributed to shareholders in the form of dividends or serving its SHL loan.

The company reported COP7.2 trillion of financial debt at Dec. 31, 2021. Isagen's financial debt was comprised of 49% in local bond issuances at about COP3.6 trillion, 49% for credit loans at about COP3.6 trillion and the balance in financial leases. Approximately 98% of its debt is COP-denominated, which matches cash flow generation and limits the volatility of results from foreign exchange movements.

Isagen does not have immediate liquidity concerns as short-term maturities are virtually nonmaterial (COP146 billion). Isagen issued COP600 billion in bonds in 2021, extending maturities and reducing financial costs. The company has uncommitted credit lines with local and international banks for roughly COP1.3 trillion.

ISSUER PROFILE

Isagen is the third-largest electricity generation company in Colombia in terms of installed capacity with 3,187MW and the second one in terms of produced energy with 16,434GWh/year during 2021. Isagen operates 16 generation plants; 15 of them are hydro with 2,915MW capacity and one thermal with 272MW.

SUMMARY OF FINANCIAL ADJUSTMENTS

Shareholder loan treated as equity-like.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			PRIOR ⚡
Isagen S.A. E.S.P.	LT IDR	BBB- Rating Outlook Stable		BBB- Rating Outlook Stable
	Affirmed			
	LC LT IDR	BBB Rating Outlook Stable		BBB Rating Outlook Stable
	Affirmed			
	Natl LT	AAA(col) Rating Outlook Stable		AAA(col) Rating Outlook Stable
	Affirmed			
	Natl ST	F1+(col)	Affirmed	F1+(col)
senior unsecured	Natl LT	AAA(col)	Affirmed	AAA(col)
senior unsecured	Natl ST	F1+(col)	Affirmed	F1+(col)

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Corporate Hybrids Treatment and Notching Criteria \(pub. 12 Nov 2020\)](#)

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.2 ([1](#))

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Isagen S.A. E.S.P.

EU Endorsed, UK Endorsed

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Corporate Finance Utilities and Power Latin America Colombia
