

## RATING ACTION COMMENTARY

# Fitch Affirms Isagen's IDR at 'BBB-'; Outlook Stable

Thu 30 Mar, 2023 - 1:25 p. m. ET

Fitch Ratings - New York/Bogota - 30 Mar 2023: Fitch Ratings has affirmed Isagen S.A. E.S.P.'s (Isagen) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-' and 'BBB', respectively. The Rating Outlook is Stable. Fitch has also affirmed Isagen's Long-Term National Scale Rating at 'AAA(col)'/Stable, and Isagen's Short-Term National Scale Rating at 'F1+(col)'.

Isagen's Long-Term Foreign Currency IDR is constrained by Colombia's Country Ceiling at 'BBB-', as the company operates entirely within Colombia, and does not have substantial offshore cash or EBITDA from other countries rated above the Country Ceiling. Isagen's Long-Term Local Currency IDR reflects 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 with moderate financial metrics.

## 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 2022, with 2,982MW of installed capacity and the second largest in terms of energy generated with 18,320 gigawatt hours (GWh). The company owns and operates 15 hydroelectric plants, as well as two wind and two solar farms.

The scale and low marginal costs of Isagen's asset portfolio give the company operational flexibility to weather the highly competitive Colombian market. During 2022, 38MW solar and 32MW wind farms became operational, while another 100MW solar project is under construction.

**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 2022 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.

**Strong EBITDA Performance:** Fitch's rating case expects EBITDA will end-up close to COP3.3 trillion during 2022, 50% above previous forecast of COP2.2 trillion. Increased hydro generation, strong contractual position and higher prices pushed the company's EBITDA up. Under a conservative scenario, the company will be able to continue to generate positive FCF over the rating horizon, absent sizable capex. EBITDA will benefit from the entrance of 100MW solar project Sabanalarga during the second half of 2023. On a proforma basis, this project could generate between 175GWh and 229GWh per year, assuming a factor plant between 20% and 25%, and an incremental EBITDA between COP32.000 million and COP42.000 million from 2024.

**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.

**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 the first nine month of 2022, the company repaid COP322 billions to its shareholders and

distributed COP1.4 trillion in dividends. Additionally, the company extended a COP2 trillion seven-year loan to BRE Colombia Hydro Finance during 2022, as a result of a temporary excess of liquidity and until investment options materialize. The balance of the SHL was roughly COP3.1 trillion at Sept. 30, 2022.

## **DERIVATION SUMMARY**

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

Differences in specific rating levels are largely a function of the asset base size and diversity, which may influence price competitiveness and provide operational flexibility. Isagen is well positioned relative to Kallpa, with 3.0GW installed capacity distributed among 15 hydro plants, two wind and two solar. Kallpa's current installed capacity is smaller than Isagen's with 1,075MW with two natural gas-fired power plants and one hydro. Enel Generación Chile's and Colbun's installed capacity are larger than Isagen's and evenly distributed between hydro and thermal.

In terms of credit metrics, Latin American peers have strong capital structures, commensurate with 'BBB' rating category. Isagen's leverage, measured as total debt to EBITDA, is expected to remain below 3.3x and above Kallpa's 2.0x, which offsets its smaller asset size and lack of diversification and allows them to be rated at the same level. Enel Generación Chile (1.5x) and Colbun (2.5x) have stronger capital structures which allow them to be rated one notch higher at 'BBB+'.

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 in terms of installed capacity, 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**

--Average electricity generation of 14,400 GWh per year from 2023;

--Contracting policy remains at 70% of total electricity sales on average;

--The company's shareholder distribution is contingent on excess cash;

--Total debt/EBITDA consistently below 3.5x.;

--Average monomic prices of COP242/kWh from 2023.

## **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;

--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 had reached COP322 billion as of September 2022, and 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 excess cash is expected to be distributed to shareholders in the form of dividends or service its SHL loan.

The company reported COP10.1 trillion of financial debt as of Sept. 30, 2022, comprised of 39% local bond issuances and 61% credit loans. Approximately 98% of Isagen's debt was COP-denominated, which matches cash flow generation and limits FX risk. Isagen does not have immediate liquidity concerns as cash on hand plus CFO covered 3.0x short-term maturities as of Sept. 30, 2022. The company has available credit lines with local and international banks for roughly COP1.4 trillion, of which USD47 million is committed with an international bank, providing additional flexibility if needed.

## **ISSUER PROFILE**

Isagen is the third-largest electricity generation company in Colombia with 2,982MW of installed capacity and second largest with 18,320GWh/year of produced energy during 2022.

## **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](http://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. 28 Oct 2022) (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), v8.1.0 (1)

**ADDITIONAL DISCLOSURES**

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Isagen S.A. E.S.P.

EU Endorsed, UK Endorsed

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