FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Isagen S.A. ESP's Ratings at 'BBB'

Mon 20 Apr, 2020 - 2:17 p. m. ET

Fitch Ratings - New York - 20 Apr 2020: Fitch Ratings has affirmed Isagen S.A. ESP's (Isagen) Long-Term Foreign Currency and Local Currency Issuer Default Ratings (IDRs) at 'BBB'. The Rating Outlooks on the Foreign Currency IDR and Local Currency IDR are Negative and Stable, respectively. Fitch has also affirmed Isagen's Long-Term National Scale Rating at 'AAA(col)' with a Stable Outlook, and Isagen's Short-Term National Scale Rating at 'F1+(col)'. A full list of rating actions follows at the end of the press release.

Isagen's ratings reflect its solid business position in the Colombian electricity generation market and strong portfolio of diversified generation assets. The ratings are also supported by the company's predictable EBITDA pattern and moderate financial metrics. The company's commercial strategy limits the exposure of its results to volatile spot electricity prices. Fitch expects Isagen to sustain moderate financial metrics and adequate liquidity levels in the medium term, supported by strong and predictable EBITDA generation, although the company's cash flow generation performance will be driven by discretionary dividends and other shareholder distributions.

Isagen's ratings are constrained by Colombia's Country Ceiling of 'BBB'. The Negative Outlook on the foreign currency ratings reflects the Negative Outlook on Colombia. Isagen operates within Colombia and does not have substantial offshore cash or EBITDA from other countries.

Fitch considers Isagen well-prepared to face the current lockdown scenario resulting from the coronavirus pandemic given its conservative capital structures and strong liquidity position supported by cash flow visibility. The company's commercial policy limits its exposure to volumetric risk. Noncore capex will likely be delayed, focusing only on maintenance requirements.

KEY RATING DRIVERS

Solid Business Position

Isagen's ratings reflect its strong competitive position in the Colombian electricity generation sector. As of December 2019, Isagen remained the third-largest electricity generation company in Colombia with 3,032MW of installed capacity and 12,842 gigawatt hours (GWh) generated and subsequently distributed among six hydroelectric plants and one combined-cycle power plant. The scale and low marginal costs of Isagen's assets portfolio give the company operational flexibility to weather the risk posed by a highly competitive market, historically exposed to energy and fuel price volatility.

Adequate Leverage Metrics

Isagen's ratings factor in the expectation that the company's leverage metrics would be in the 3.0x range over the medium term. As of December 2019, Isagen's leverage remained at 2.9x, fostered by strengthening EBITDA for the year. Fitch does not consider Isagen's shareholder loan (SHL) as financial debt for its leverage calculation, as the SHL is a subordinated obligation, with interest payments optionally paid in kind (PIK), subject only to Isagen's request. Moreover, the lender cannot take any action to accelerate or enforce any of its rights or exercise any of its remedies to collect this loan.

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 the spot market as a buyer since hydroelectric generation should be able to cover contract sales amid hydrologically stressed conditions. In 2019, the company increased its electricity purchases in the spot market due to lower hydroelectric generation as a result of lower inflows to the system. Water reservoir management aimed to meet the company's commercial obligations and guarantee the sustainability of hydroelectric resources, which allowed them to capture higher spot prices recorded in late 2019 and the beginning of 2020.

Positive EBITDA Performance

Fitch expects Isagen to continue reporting moderate growth in EBITDA over the rating horizon, driven by its proven commercial policy and its recent cost-efficiency initiatives. In 2019, adjusted EBITDA reached COP1.85 trillion, 23% higher relative to 2018. Moreover, a moderate capex requirement should contribute positively to free cash flow (FCF) generation. The company has a portfolio of 497MW of expansion plants, of which only 122.3MW already have all the prerequisite environmental licenses granted. Fitch believes 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. Fitch expects that Isagen's positive FCF will be distributed to shareholders. In 2019, Isagen paid a sum of COP867 billion of the subordinated SHL and distributed COP904 billion in dividends. The balance of the SHL was roughly COP4.0 trillion at the end of 2019. Leverage continued to hover around 3.0x, the target established by the company.

DERIVATION SUMMARY

Isagen's credit profile is commensurate with investment-grade electric generation companies in the region, such as Emgesa S.A. E.S.P. (BBB/Negative), Enel Generacion Chile S.A. (A-/Stable), Enel Americas S.A. (A-/Stable), Engie Energia Chile S.A. (BBB/Positive), Colbun S.A. (BBB/Positive) and AES Gener S.A. (BBB-/Stable). All of these companies benefit from predictable cash flow from operations, stemmed 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 within these peers, with more than 6,000MW 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.

Fitch expects Isagen's leverage to remain around 3.0x, above estimations for Colbun (2.5x-3.0x) and Engie (2.0x). The Chilean peers benefit from a longer-term contractual position, which mitigates re-contracting risk. Colombian generators are more exposed to this risk because electricity demand is mostly driven by the regulated market, which tends to purchase electricity with tenures of around three years.

Isagen also compares well with electricity generation peers that have national ratings, namely Emgesa, 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 Emgesa 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

Fitch's Key Assumptions Within our Rating Case for the Issuer

--Isagen's electricity generation reaches around 14,000 GWh 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.

--Average total debt/EBITDA of 3.0x.

RATING SENSITIVITIES

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

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

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

--A steep decrease 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 cash flow from operations (CFFO) performance or results in a more aggressive plan in terms of leverage and capex.

--A downgrade of Colombia's Country Ceiling.

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 COP570 billion in 2019, and it can retain CFFO generation if necessary. Fitch anticipates Isagen will maintain relatively low cash balance levels and refinance most of its debt obligation since the company plans to maintain leverage around 3.0x, while any cash excess will be distributed to shareholders in the form of dividends or serving its SHL loan.

At the end of 2019, the company reported COP5.4 trillion of financial debt. Isagen's financial debt is comprised of 47% in local bond issuances (about COP 2.5 trillion), 51% for credit loans (about COP2.8 trillion) and the balance in financial leases. More than 97% of its debt is COP-denominated, which matches cash flow generation and limits the volatility of results stemming from foreign exchange (FX) volatility. Isagen does not have immediate liquidity concerns as short-term maturities are virtually nonmaterial (COP74 billion). In 2019, Isagen issued COP1.1 trillion in bonds, extending maturities up to 2049 and reducing financial costs. The company has uncommitted credit lines of roughly COP981 billion.

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

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). 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 Negative	Affirmed	BBB Rating Outlook Negative
	LC LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stab
	Natl LT	AAA(col) Rating Outlook Stable	Affirmed	AAA(col) Rati Outlook Stab
	Natl ST	F1+(col)	Affirmed	F1+(col)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Ratings Criteria - Effective from 18 July 2018 to 8 June 2020 (pub. 17 Jul 2018)

Corporate Hybrids Treatment and Notching Criteria (pub. 11 Nov 2019)

Corporate Rating Criteria - Effective from 27 March 2020 to 1 May 2020 (pub. 27 Mar 2020) (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), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Isagen S.A. E.S.P.	EU Endorsed

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