

13 APR 2021

## Fitch Affirms Isagen's Ratings at 'BBB'; Outlook Negative

Fitch Ratings - New York - 13 Apr 2021: 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'. The Rating Outlooks on the LT FC IDR and LT LC IDR are Negative and Stable, respectively. 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 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.

Isagen's LT FC IDR is constrained by Colombia's Country Ceiling of 'BBB'. The Negative Outlook on the LT FC IDR reflects the Negative Outlook on Colombia. Isagen operates within Colombia and does not have substantial offshore cash or EBITDA from other countries.

### Key Rating Drivers

**Solid Business Position:** Isagen's ratings reflect its strong competitive position in the Colombian electricity generation sector. Isagen remained the third-largest electricity generation company in Colombia as of December 2020 with 2,859MW of installed capacity and 12,433 gigawatt hours (GWh) generated, distributed among six hydroelectric plants and one combined-cycle power plant. The recent acquisition of two small hydro plants (Luzma I and II) added 39.8MW to Isagen's installed capacity.

The scale and low marginal costs of Isagen's asset portfolio give the company operational flexibility to weather the risk posed by a highly competitive market. The acquisition of 139.8MW of solar projects plus the current 20MW wind project under construction will allow the company to diversify its energy matrix toward non-conventional renewable sources and will improve its competitive position.

**Moderate Leverage:** The ratings factor in the expectation that Isagen will have the ability to keep leverage below 3.3x over the rating horizon, the upper threshold commensurate with the company's current ratings. 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. 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 contracted sales during low hydrological conditions.

The company increased its electricity purchases in the spot market in 2020 due to lower hydroelectric generation as a result of reduced water 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 during 1H20.

**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 in 2022.

Adjusted EBITDA stood relatively flat at COP1.82 trillion in 2020, 1% lower relative to 2019. Under a conservative scenario, the company will be able 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. Isagen paid COP1.2 trillion in 2020 of the subordinated SHL and no dividends were distributed to shareholders. The balance of the SHL was roughly COP2.8 trillion at YE 2020.

## **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+/Stable), Colbun S.A. (BBB+/Stable) and AES Gener 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 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.

Isagen's leverage is expected to remain below 3.3x, above estimations for Colbun and Engie at 2.0x.

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 Its Rating Case for the Issuer Include

- Isagen's electricity generation reaches around 13,000 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;
- Total debt/EBITDA consistently below 3.3x.

## **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 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.
- 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 COP430 billion in 2020, 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 excess cash is expected to be distributed to shareholders in the form of dividends or serving its SHL loan.

The company reported COP5.9 trillion of financial debt at YE 2020. Isagen's financial debt is comprised of 51% in local bond issuances at about COP 3.0 trillion, 48% for credit loans at about COP2.8 trillion and the balance in financial leases. Approximately 98% of its debt is Colombian-peso denominated, which matches cash flow generation and limits the volatility of results stemming from FX volatility. Isagen does not have immediate liquidity concerns as short-term maturities are virtually nonmaterial at COP77 billion. Isagen issued COP450 billion in bonds in 2020, extending maturities up to 2045 and reducing financial costs. The company has uncommitted credit lines of roughly COP1.4 trillion.

## **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 Environmental, Social and Corporate Governance (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).

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## Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
Isagen S.A. E.S.P.	LT IDR	BBB 	Affirmed	BBB 
	LC LT IDR	BBB 	Affirmed	BBB 
	Natl LT	AAA(col) 	Affirmed	AAA(col) 
	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)

## RATINGS KEY OUTLOOK WATCH

POSITIVE



## RATINGS KEY OUTLOOK WATCH

NEGATIVE	●	◊
EVOLVING	◊	◆
STABLE	○	

### Applicable Criteria

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

[Corporate Rating Criteria \(pub.21 Dec 2020\) \(including rating assumption sensitivity\)](#)

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

### 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

[Solicitation Status](#)

### Endorsement Status

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

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