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ISAGEN, S.A. E.S.P.

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

Secondary Contact:
Julyana Yokota, Sao Paulo + 55 11 3039 9731; julyana.yokota@spglobal.com

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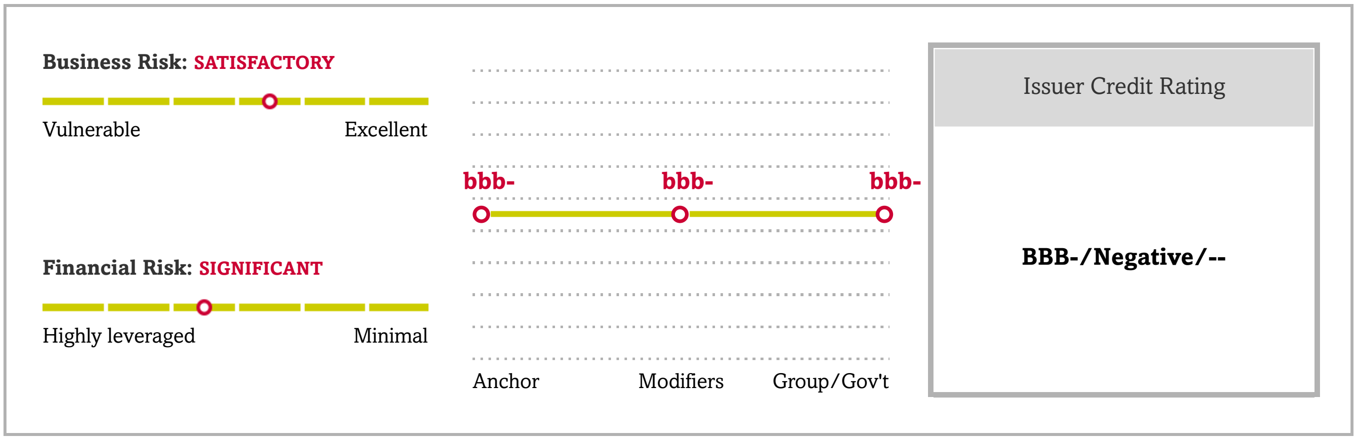
ISAGEN, S.A. E.S.P.



Credit Highlights

Key strengths	Key risks
Well-defined shareholder strategy, allowing the company to receive support if needed.	COVID-19 pandemic could hurt its financial flexibility, but ISAGEN has cushion to absorb negative impacts.
Low investments required to maintain the assets.	Ituango's further delays could affect market dynamics.
Resilient cash flow generation thanks to conservative commercial strategy.	Exposure to hydrological conditions and spot market prices.

COVID-19 could moderately affect ISAGEN. The Colombian government has considered the electricity generation activity as critical, so ISAGEN's hydro and thermal plants have stayed operational since the quarantine period started. The social distancing measures, which caused some industries to temporarily stop their activities, combined with a significant number of people working from home, caused demand to drop 10.7% and 6.7% in April and May 2020, respectively, when compared to the same months in 2019.

We expect the pandemic to pose the following main challenges to ISAGEN in the upcoming months:

- Lower electricity demand in Colombia because of an economic slowdown during the quarantine period; and
- Consumers may try to renegotiate their electricity bills' payments with the generators.

We believe that ISAGEN partially mitigates the demand risk in Colombia because it sells a significant portion of its electricity output through longer term take-or-pay contracts, guaranteeing a predictable and resilient cash flow stream. The remaining portion is either exposed to demand risk or available for sale. Because of lower demand and favorable hydrological prospects, spot prices are currently dropping. They've been about COP200 per kilowatt hour (kWh), which could result in lower revenues from sales in the spot market. Although this represents a minor portion of the company's output, it would negatively affect ISAGEN's cash flows.

In addition, we believe that the company is exposed to potential delays in payments from some of its clients, given the challenging economic scenario during the pandemic, but we dont expect a material increase in delinquency. This could translate into higher working capital needs than in previous years in case of negotiations with some of its clients.

Although it might hamper ISAGEN's financial flexibility, at this point we expect this to be minimal, thanks to the company's initiatives to preserve cash, such as:

- The new COP200 billion loan to give ISAGEN a greater liquidity cushion during the pandemic;
- The debt extension of COP24 billion debt maturities to 2021; and
- The renewal of its COP100 billion revolving credit facility, fully available.

Commercial strategy and hydrology risk. ISAGEN has adhered to a more conservative commercial strategy since the drought that affected Colombia in 2016. On one hand, because the company has been selling less electricity through contracts in order to protect itself against poorer hydrological conditions, this also leaves ISAGEN more exposed to spot market price fluctuations. However, we still believe that the majority of its cash flows will come from sales through longer-term contracts, so fluctuations in spot market prices shouldn't generate substantial volatility to its credit metrics, while it maintains resilient cash flow generation.

Delays in the expansion of hydro capacity in Colombia. Empresas Publicas de Medellin E.S.P.'s (EEPPMM) construction of the 2,400 megawatt (MW) capacity Ituango hydro plant has been delayed for several years, and the most recent expectation is that it won't start operating before December 2021. Given its relevant size for Colombia's electric system, further construction delays could lift spot market prices in the following years. This could pose a risk for ISAGEN, depending on the future hydrological and economic conditions in Colombia.

Shareholder strategy. We believe Brookfield Renewables has the willingness and capacity to provide timely and sufficient extraordinary support to ISAGEN if the latter needs it. At the same time, we continue expecting ISAGEN to distribute its excess cash to the shareholder while maintaining its financial flexibility--through dividends or intercompany loan repayment--as long as there are no new projects in its pipeline.

Outlook: Negative

The negative outlook on ISAGEN reflects a potential downgrade in the next 18 months on Colombia. The ratings on the latter limit ISAGEN's credit quality, given its exposure to sovereign risk. Therefore, we expect the ratings on ISAGEN to move in tandem with the sovereign ratings.

Downside scenario

We would likely downgrade ISAGEN following a similar rating action on Colombia. We could lower the sovereign ratings if the negative external shocks undermine GDP growth prospects, contributing to worsening public finances, or pose further risks to Colombia's external liquidity.

A downward revision of ISAGEN's stand-alone credit profile (SACP) is unlikely, unless the company adopts a more aggressive commercial strategy or repays its intercompany loan from its parent, which we consider as non-common equity financing, at a faster pace, reducing its financial flexibility. This could result in debt to EBITDA consistently above 4.0x or its funds from operations (FFO) to debt below 20%.

Upside scenario

We could revise the outlook to stable on ISAGEN if we take a similar action on the sovereign rating on Colombia, all else remaining equal. The outlook revision to stable on Colombia could occur if timely and adequate policy measures successfully stabilize the economy, sustain GDP growth prospects, limit the increase in the general government's net debt burden, and contain risks to external liquidity.

We could revise the SACP upwards if ISAGEN posts debt to EBITDA below 2.5x and FFO to debt above 30% consistently, which could occur if the company is able to close attractive power contracts, leading to a much higher average sales price.

Our Base-Case Scenario

Assumptions

- Colombian GDP to decline 2.6% in 2020 and grow 4.1% in 2021, which is an important driver for the country's electricity demand.
- Inflation to be about 3.4% in 2020 and 3.7% in 2021, which drives the readjustment of the power purchase agreements (PPAs).
- ISAGEN to sell 14,000 gigawatt hours (GWh) per year of electricity, and the majority will be through contracts at an average price of about COP190/kWh.
- Cost management and selling, general, and administrative expenses (SG&A) to grow below inflation in 2020 and 2021.
- No expansionary investments in the next two years. We assume ISAGEN will perform only maintenance investments of about COP90 billion in 2020 and COP50 billion in 2021.
- ISAGEN's shareholder distributions to Brookfield Renewables, through either dividends or repayment of intercompany loans, will be about COP900 billion in 2020 and COP1.5 trillion annually afterwards.

Key Metrics

	2020E	2021E
Debt to EBITDA (x)	3.0-3.5	2.5-3.0
FFO to debt (%)	18-23	23-28

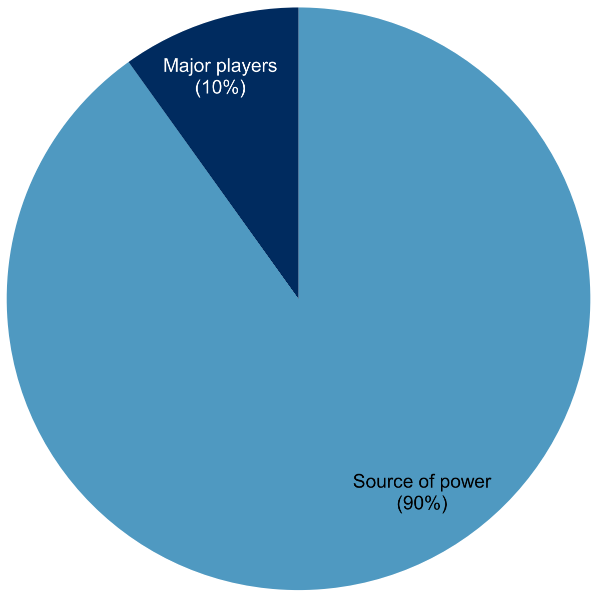
We expect 2020 to be an exceptional year due to the COVID-19 pandemic, which will result in higher working capital needs for the company if some of its clients delay their payments, although we don't expect a significant increase in commercial losses. Despite effects of the pandemic, we expect a resilient cash flow generation because of ISAGEN's long-term contracts.

Company Description

Colombia-based electric power generation company ISAGEN has seven power plants with a total 3,032 MW of installed capacity. As of Dec. 31, 2019, ISAGEN generated net revenues of COP3.2 trillion and EBITDA of COP1.9 trillion.

Chart 1

Installed Capacity



Brookfield Renewable Partners L.P. (Brookfield Renewables: BBB+/Stable/A-2) is ISAGEN's indirect controlling shareholder with a 99.63% stake. Brookfield Renewables owns and operates a diversified portfolio of assets that produce electricity from renewable resources, primarily from hydropower (about 75%). The portfolio comprises total generating capacity of approximately 17.4 GW and long-term average annual generation of approximately 53.4 terawatt hours (TWh). The portfolio encompasses about 220 hydroelectric generating stations in 82 river systems across 25 power markets in 15 countries, mainly in North America, Latin America, and Europe.

Peer Comparison

For regional peers, we compare ISAGEN to the domestic competitor, Emgesa S.A. E.S.P., two companies in Chile (Engie Energia Chile S.A. and Colbun S.A.), and one company in Brazil, CESP – Companhia Energetica de Sao Paulo. We believe these companies are very similar to ISAGEN in terms of business activities and competitive position in their markets, given their size and price competitiveness. In terms of credit metrics, ISAGEN is comparable to Colbun, because they're in the same financial risk profile category. Emgesa has slightly better credit metrics than ISAGEN, but the Chilean companies have the lowest debt. Although CESP compares well in terms of credit metrics, its lower rating reflects that it's limited by the sovereign ratings.

Table 1

ISAGEN, S.A. E.S.P.--Peer Comparison

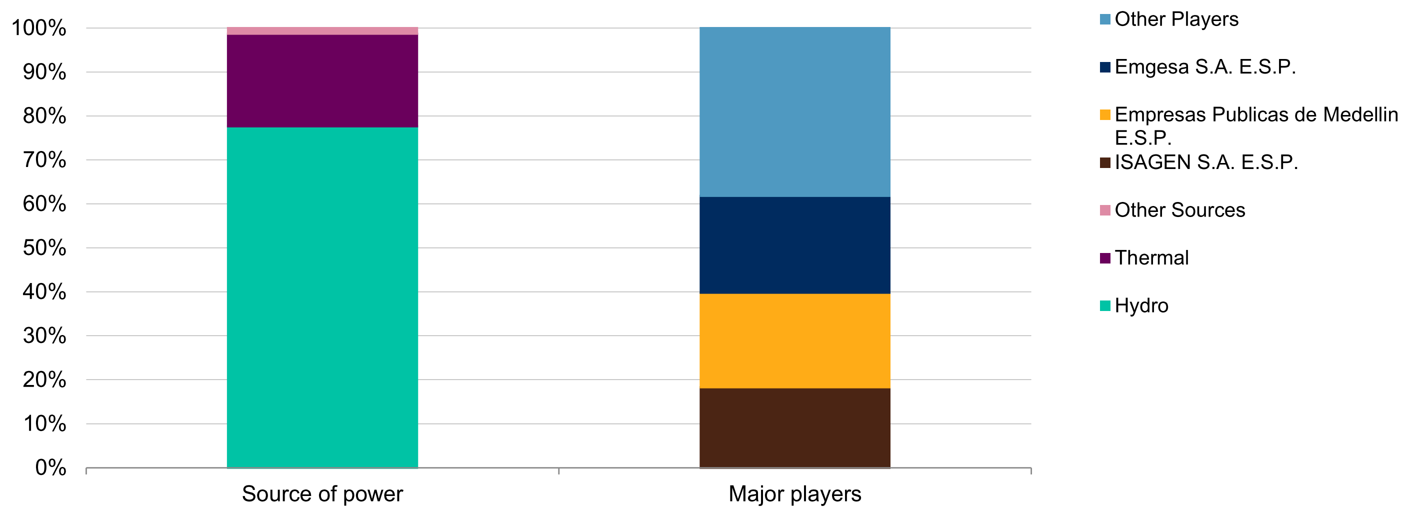
	ISAGEN, S.A. E.S.P.	Emgesa S.A. E.S.P.	Engie Energia Chile S. A.	Colbun S.A.	CESP-Companhia Energetica de Sao Paulo
Rating	BBB-/Negative/--	BBB/Negative/--	BBB/Stable/--	BBB/Stable/--	BB-/Stable/--
	--Fiscal year ended Dec. 31, 2019--				
Revenue	3,183.4	4,091.6	4,773.4	4,881.5	1,282.9
EBITDA	1,879.5	2,335.3	1,725.3	2,287.8	502.4
Funds from operations (FFO)	1,409.9	1,570.1	1,654.8	1,907.1	389.6
Interest expense	353.7	312.9	124.2	261.4	120.5
Cash interest paid	367.9	280.4	70.5	265.0	112.8
Cash flow from operations	784.7	1,375.5	1,506.6	1,705.0	386.2
Capital expenditure	49.0	337.7	507.8	288.1	7.4
Free operating cash flow (FOCF)	735.6	1,037.9	998.8	1,416.9	378.8
Discretionary cash flow (DCF)	(175.4)	341.3	609.3	280.5	136.2
Cash and short-term investments	135.8	289.2	784.7	2,624.5	563.6
Gross available cash	135.8	289.2	784.7	2,624.5	563.6
Debt	5,384.7	2,728.7	2,051.6	3,546.9	899.0
Equity	5,490.4	4,743.3	6,969.5	12,260.1	5,833.7
Adjusted ratios					
EBITDA margin (%)	59.0	57.1	36.1	46.9	39.2
Return on capital (%)	15.9	27.3	13.7	7.6	5.5
EBITDA interest coverage (x)	5.3	7.5	13.9	8.8	4.2
FFO cash interest coverage (x)	4.8	6.6	24.5	8.2	4.5
Debt/EBITDA (x)	2.9	1.2	1.2	1.6	1.8
FFO/debt (%)	26.2	57.5	80.7	53.8	43.3
Cash flow from operations/debt (%)	14.6	50.4	73.4	48.1	43.0
FOCF/debt (%)	13.7	38.0	48.7	39.9	42.1
DCF/debt (%)	(3.3)	12.5	29.7	7.9	15.1

Business Risk: Satisfactory

ISAGEN has about 20% of the Colombian market share in terms of electricity generation, mostly hydro-based. We think that hydropower generation plays an important role in Colombia, and its importance has been increasing, although the country has incentivized installing non-conventional renewable capacity recently. In normal hydrology years, hydroelectric power generation accounts for about 80% of the country's total generation.

Chart 2

Electricity Generation in Colombia



Source: S&P Global Ratings.

In 2019, the availability factor of ISAGEN's plants reached 92% thanks to its efficient operational management. In addition, given that its portfolio is based on hydroelectric plants, cost structure is light and we expect the fixed costs to decrease starting in 2020 because the new centralized operational center will be fully operational, allowing ISAGEN to manage its seven power plants. ISAGEN has a diversified customer base, selling electricity to distribution companies in Colombia and large clients, mostly in the metals and mining, manufacturing, and agribusiness sectors. Therefore, we don't expect ISAGEN to have any considerable counterparty exposure on its contracts.

Financial Risk: Significant

Although we expect ISAGEN to have resilient cash flow generation in the next few years due to its conservative commercial strategy, we expect it might face higher working capital needs because of delays in payments from its clients due to the COVID-19 pandemic. Therefore, we expect ISAGEN to post debt to EBITDA of 3.0x-3.5x in 2020 and 2.5x-3.0x in 2021. Our base-case scenario excludes new expansionary investments in the short to medium term, so the company's cash flow generation will be enough to cover maintenance capital expenditures (capex).

Financial summary

Table 2

ISAGEN, S.A. E.S.P.--Financial Summary

(Bil. COP)	2020*	2019	2018	2017	2016	2015
Revenue	3,251.1	3,183.4	2,650.5	2,350.9	2,747.4	2,844.0
EBITDA	1,857.8	1,879.5	1,490.1	1,111.3	862.9	1,178.4
Funds from operations (FFO)	1,379.7	1,409.9	1,108.3	682.4	308.6	775.4

Table 2

ISAGEN, S.A. E.S.P.--Financial Summary (cont.)						
(Bil. COP)	**2020***	**2019**	**2018**	**2017**	**2016**	**2015**
Interest expense	376.7	353.7	318.4	352.1	411.9	390.8
Cash interest paid	374.0	367.9	291.3	349.6	440.5	320.7
Cash flow from operations	717.4	784.7	286.9	815.8	205.5	610.9
Capital expenditure	50.3	49.0	71.4	79.8	126.2	298.2
Free operating cash flow (FOCF)	667.1	735.6	215.4	736.0	79.2	312.7
Discretionary cash flow (DCF)	(243.9)	(175.4)	215.4	216.0	79.2	(168.6)
Cash and short-term investments	374.8	135.8	85.5	158.3	396.3	362.5
Gross available cash	374.8	135.8	85.5	158.3	396.3	362.5
Debt	5,355.1	5,384.7	4,358.3	3,424.4	3,468.4	3,432.6
Equity	5,600.1	5,490.4	5,911.6	5,485.3	3,593.0	3,460.3
Adjusted ratios						
EBITDA margin (%)	57.1	59.0	56.2	47.3	31.4	41.4
Return on capital (%)	15.1	15.9	13.6	12.1	9.1	14.8
EBITDA interest coverage (x)	4.9	5.3	4.7	3.2	2.1	3.0
FFO cash interest coverage (x)	4.7	4.8	4.8	3.0	1.7	3.4
Debt/EBITDA (x)	2.9	2.9	2.9	3.1	4.0	2.9
FFO/debt (%)	25.8	26.2	25.4	19.9	8.9	22.6
Cash flow from operations/debt (%)	13.4	14.6	6.6	23.8	5.9	17.8
FOCF/debt (%)	12.5	13.7	4.9	21.5	2.3	9.1
DCF/debt (%)	(4.6)	(3.3)	4.9	6.3	2.3	(4.9)

*Rolling 12 months ended March 31. COP--Colombian peso.

Reconciliation

Table 3

Reconciliation Of ISAGEN Reported Amounts With S&P Global Ratings' Adjusted Amounts (Bil. COP)					
	--Fiscal year ended Dec. 31, 2019--				
	Debt	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
ISAGEN, S.A. E.S.P. reported amounts	5,729.9	1,650.0	945.4	1,857.8	717.4
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	--	(104.1)	--
Cash interest paid	--	--	--	(374.0)	--
Accessible cash and liquid investments	(374.8)	--	--	--	--
Nonoperating income (expense)	--	(1.5)	--	--	--
Interest expense: Shareholder loan	--	--	(568.7)	--	--
Working capital: Taxes	--	--	--	--	104.1
Working capital: Other	--	--	--	--	981.1
Operating cash flow: Taxes	--	--	--	--	(104.1)

Table 3

Reconciliation Of ISAGEN Reported Amounts With S&P Global Ratings' Adjusted Amounts (Bil. COP) (cont.)					
Operating cash flow: Other	--	--	--	--	(981.1)
Total adjustments	(374.8)	(1.5)	(568.7)	(478.1)	0.0
	Debt	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
S&P Global Ratings' adjusted amounts	5,355.1	1,648.5	376.7	1,379.7	717.4

COP--Colombian peso.

As shown in the table above, we don't consider ISAGEN's intercompany loan with Brookfield Renewables as debt because:

- The financing that Brookfield Renewables provides to ISAGEN is contractually subordinated to all other debt in ISAGEN's capital structure, its maturity is beyond 10 years, and we expect that, if needed, Brookfield Renewables could extend the tenor to improve ISAGEN's financial flexibility;
- We do not expect Brookfield Renewables to trigger any event of default on ISAGEN, because in case of insolvency from the subsidiary, the parent would convert the loan and related interest into shares; and
- In our view, the company is a strategic investment to Brookfield Renewables, which has resources and incentives to support ISAGEN when needed.

Liquidity: Adequate

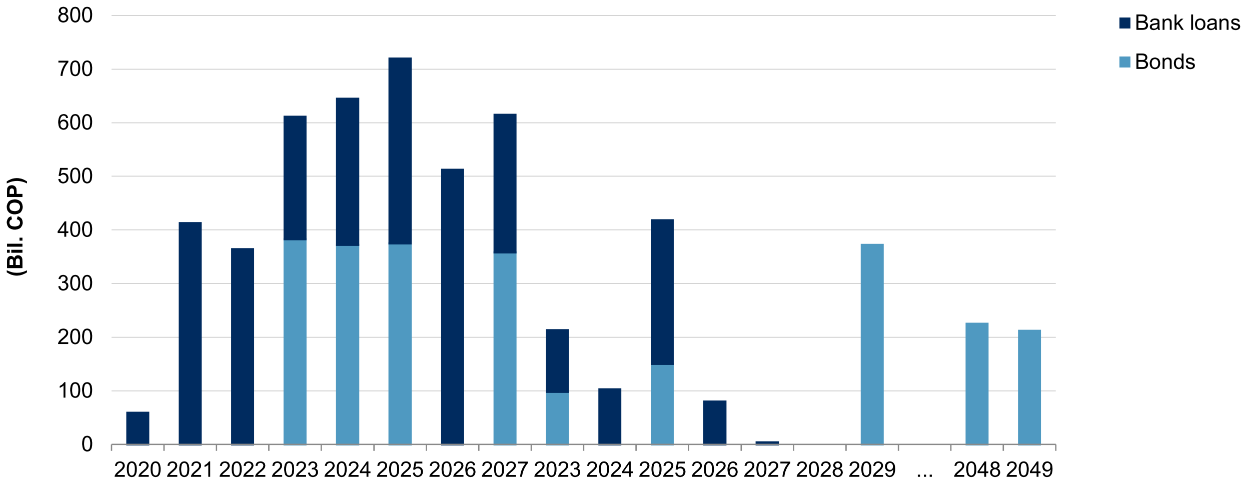
We assess ISAGEN's liquidity as adequate. We expect sources over uses to be above 1.5x in the next 12 months, which provides protection against adverse events. We also expect sources to continue exceeding its uses even if EBITDA were to decline by 15% this year because of adverse conditions coming from the COVID-19 pandemic.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and cash equivalents of COP374.8 billion, as of March 31, 2020; and • Expected cash flow generation of about COP1.2 trillion in the following 12 months.	• Debt maturities of about COP210 billion in the next 12 months; • Maintenance investments of about COP80 billion; and • If there's surplus cash, we expect the company to distribute it to Brookfield Renewables either through dividends or by repaying existing intercompany loans.

Debt maturities

Chart 3

Debt Maturity Profile*



*Considering the refinancing made throughout 2020. Source: S&P Global Ratings.

Covenant Analysis

As of Dec. 31, 2019, ISAGEN was complying with its financial covenants.

Compliance expectations

We expect that ISAGEN will remain in compliance with its financial covenants throughout 2020, even if the company generates EBITDA 15% lower than in our base-case scenario.

Requirements

ISAGEN has to comply with the following incurrence financial covenant on its senior debt obligations:

- Net debt to EBITDA up to 3.75x.

Recently, the company negotiated a new threshold with its creditors, increasing it to 3.75x from 3.50x. We note that not complying with this ratio doesn't trigger an event of default or payment acceleration of the existing debt--it only limits the company's capacity to increase its debt level, but not the ability to refinance existing debt.

Environmental, Social, And Governance

Given that ISAGEN is an electric power generation company, environmental factors are key in our credit assessment of the company. The vast majority of the company's installed capacity consists of hydropower plants--2,732 MW out of a total of 3,032 MW--ISAGEN has been constantly working to protect local reservoirs and biodiversity. In addition, the company has been conducting studies to participate in non-conventional renewable projects in Colombia. ISAGEN's governance practices are in line with those of Brookfield Renewables, which has a clear strategy for developing renewable assets and process execution, in our view.

From a social standpoint, the COVID-19 pandemic has been affecting all economies worldwide. In Colombia, the electricity generation is considered critical, and so won't be suspended during the pandemic. Because of that, the generation facilities are operating normally, but with the minimum personnel required in order to maintain social distancing--since ISAGEN implemented its integrated control center last year, the plants can be remotely operated.

Group Influence

Brookfield Renewables controls ISAGEN, which represents about 30% of the parent's installed capacity and a significant portion of its EBITDA generation. Brookfield Renewables has demonstrated its willingness to support ISAGEN's operations through the intercompany loans provided since acquiring the company in 2016. In our view, ISAGEN would likely receive support from Brookfield Renewables if the subsidiary were to face financial difficulty, but we don't assume that this support would come in a scenario of a sovereign default in Colombia.

Rating Above The Sovereign

ISAGEN's 'bbb-' SACP is at the same level as the 'BBB-' foreign currency rating on Colombia. The company sells about a significant portion of its energy to distributors, which have their rates set by the regulator. Therefore, we believe ISAGEN's ability to receive payments--in case of regulatory interference in distributors' rates--could worsen. In addition, ISAGEN sells part of its output on the spot market, and we believe spot prices could plummet in a recession. Therefore, we limit our rating on ISAGEN by that on the sovereign.

Ratings Score Snapshot

Issuer Credit Rating

BBB-/Negative/--

Business risk: Satisfactory

- **Country risk:** Moderately high
- **Industry risk:** Moderately high

- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bbb-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb-

- **Group credit profile:** bbb+
- **Entity status within group:** Moderately strategic (+1 notch from SACP)
- **Related government rating:** BBB-
- **Rating above the sovereign:** (-1 notch from SACP)

Related Criteria

- Group Rating Methodology, July 1, 2019
- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Research Update: Outlook On Nine Colombian Corporate And Infrastructure Entities Revised To Negative On Same Action On Sovereign, March 27, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 5, 2020)*

ISAGEN, S.A. E.S.P.	
Issuer Credit Rating	BBB-/Negative/--
Issuer Credit Ratings History	
27-Mar-2020	BBB-/Negative/--
11-Dec-2017	BBB-/Stable/--
16-Aug-2017	BBB/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.