

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Empresa de Energía de Bogotá S.A. ESP. (EEB)

Global Credit Research - 22 Aug 2014

Bogota, Colombia

#### Ratings

Category	Moody's Rating
Outlook	Positive
Senior Unsecured	Baa3
<b>Transportadora de Gas Internacional</b>	
Outlook	Stable
Senior Unsecured	Baa3
<b>Gas Natural de Lima y Callao S.A. (Calidda)</b>	
Outlook	Stable
Senior Unsecured	Baa3

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#### Key Indicators

[1]Empresa de Energía de Bogotá S.A. ESP. (EEB)	12/31/2010	12/31/2011	12/31/2012	12/31/2013	6/30/2014(L)
CFO pre-WC + Interest / Interest	9.1x	3.0x	5.5x	9.1x	8.8x
CFO pre-WC / Debt	67.4%	15.8%	32.4%	44.4%	34.9%
CFO pre-WC - Dividends / Debt	0.3%	15.8%	8.3%	19.9%	8.4%
Debt / Capitalization	17.3%	16.2%	12.9%	14.4%	18.5%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

- Ownership structure
- Material structural subordination amid high reliance on cash upstreams from non-controlled subsidiaries
- After the minority interest acquisition Transportadora de Gas Internacional expected to grow in importance with other controlled subsidiaries over medium to long-term
- EEB's credit metrics expected to remain commensurate with the Baa-rating category despite the group's

aggressive expansion plan

## Corporate Profile

Headquartered in Bogota, Colombia (Baa2, stable), Empresa de Energia de Bogota S.A. E.S.P. (EEB) is a Colombian transmission company subject to the purview of the Comision de Regulacion de Energia y Gas (CREG). It is also a holding company with material equity interests in controlled and non-controlled subsidiaries that conduct their electric and natural gas operations in Colombia (Baa2, stable), Peru (A3, stable) and Guatemala (Ba1, stable).

EEB's controlled subsidiaries include the Colombian natural gas transportation company, Transportadora de Gas Internacional S.A. E.S.P. (TGI; Baa3, stable; 99.97% ownership stake); the holding company Decsa S.A. E.S.P. (51% interest) which holds a 82% equity interest in the electric utility Empresa de Energia de Cundinamarca S.A. E.S.P. (EEC); Peruvian natural gas transportation and distribution subsidiaries: Calidda (Baa3, stable; total in- and direct interest 100%) and Contugas S.A.C. (total in- and direct interest 100%; including TGI's 25%); as well as the Guatemalan subsidiaries: EEB Ingenieria y Servicios S.A. (EEBIS; 100%) and Transportadora de Energia de Centroamerica S.A. (Trecsa; 95.3%) both of which are pursuing material investment programs. In 2014, EEB also incorporated EEB Ingenieria y Servicios S.A.C. in Peru (100%) as well as the company Empresa de Movilidad de Bogota S.A.S. E.S.P. to participate via public-private joint-ventures in projects related to the electrical and gas component of mass transport infrastructure in Bogota.

EEB's non-controlled Colombian subsidiaries include the unregulated generation company Emgesa S.A. E.S.P. (43.6% of voting rights), as well as the electric and natural gas utilities Codensa S.A. E.S.P. (42.85% of voting rights) and Gas Natural S.A. E.S.P. (25%) as well as the natural gas transportation company Promigas (15.6%). The latter holds majority stakes in natural gas distribution companies and the remaining 40% equity interest in Calidda. EEB also holds a 40% equity interest in the Peruvian electric transmission companies Red de Energia del Peru (REP) and Consorcio TransMantaro (CTM; Baa3, stable).

The District of Bogota (Baa2, stable) remains EEB's majority shareholder with 76.3% ownership stake. EEB's remaining shareholders consists of Ecopetrol (Baa2, stable; 6.87%; albeit it has announced a potential sale of its stake), Corficolombiana S.A. (3.6%), local pension funds (6%) and retail investors (7.3%). As of June 30, 2014, EEB recorded non-consolidated assets of approximately US\$6.8billion (about 73% of consolidated assets) and funds from operations of around US\$432 million for the last twelve months ended the same period (around 59% of the consolidated FFO).

## Rating Rationale

The Baa3 senior unsecured rating reflects EEB's ownership structure and linkages with the District of Bogota. Given the District's majority ownership stake, EEB falls under the scope of Moody's rating methodology for Government-Related Issuers (GRIs) that as explained later incorporates four components (i) the rating of the District of Bogota (Baa2, stable) along with a (ii) strong probability of extraordinary support from the municipality, and (iii) moderate level of dependence as well as (iv) EEB's Base Credit Assessment (BCA) of ba1.

EEB's BCA is a representation of its intrinsic creditworthiness before taking into account possible extraordinary support from the municipality. EEB's BCA largely reflects the structural subordination that results from its strong dependence on cash up-streams, particularly those from its non-controlled subsidiaries to service its debt despite its own profitable transmission operations. However, the BCA also captures the regulated nature of the operations of most of its subsidiaries and the aggressive dividend policy of key non-controlled subsidiaries that enhances EEB's cash flow visibility. The BCA assumes the successful completion of the material electric transmission and natural gas capital expenditure (capex) projects currently being pursued in Peru and Guatemala. It acknowledges the resulting diversification benefits and the slowly growing relevance of the controlled subsidiaries as a source of cash flows; for example, the recently completed acquisition of TGI's minority interest. It also incorporates the assumption that EEB will further pursue new growth opportunities in Colombia and other regional countries with transparent regulatory frameworks. The BCA assumes that EEB will fund those investments in a prudent fashion, and maintain a reasonable dividend policy that allows it to continue to report robust credit metrics. In the absence of committed bank credit facilities, the BCA also captures EEB's reliance on the capital markets to meet unexpected cash flow shortfalls albeit we consider its current debt maturity profile manageable.

## DETAILED RATING CONSIDERATIONS

### OWNERSHIP STRUCTURE

EEB's Baa3 senior unsecured rating largely reflects its ownership structure and linkages with the District of Bogota (Baa2, stable). It is our understanding that pursuant to Agreement nr 01, 1996, the District of Bogota is required to hold at least a 51% ownership stake in the issuer. Given the District's majority ownership stake, EEB falls under the scope of Moody's rating methodology for Government-Related Issuers (GRIs).

The rating reflects Moody's assessment of a strong probability of extraordinary support from the municipality and a moderate level of dependence. Our assessment factors some potential risk of political interference by the District, particularly in the absence of a governance framework agreement that clearly outlines EEB's relationship with the District of Bogota including dividend distributions; however, our concerns are significantly mitigated by the country's legal and regulatory requirements needed for listed companies like EEB before the implementation of any material corporate reorganizations as evidenced after the last mayoral election at the end of 2011. Our credit assessment reflects the degree to which the District is exposed to the same risks as those that would affect credit quality at EEB. This is considered moderate given the group's businesses outside of Bogota including its international subsidiaries. That said, we may reassess our opinion about the District's ability and willingness to provide extraordinary financial support should EEB encounter significant challenges in its operations abroad due to the expected continued growth of its international activities.

#### GROWING OWN TRANSMISSION OPERATIONS

EEB's transmission operations for the LTM period ended June 2014 reported around US\$37.1 million in EBITDA. Because around 60% of EEB's transmission assets became operational before 2000 the tariffs associated with these assets (pre-2000) are currently premised on a 11.5% rate of return to be applied on the replacement value and are subject to CREG's reviews every five years with the next one not anticipated before 2015. We believe the Colombian regulatory framework's predictability and transparency compares well to those in other Latin American countries. Albeit it is still subject to some further development, it has been in place for over fifteen years, and we believe CREG's decisions are overall credit constructive. The remuneration of the balance of EEB's transmission assets (commissioned after 2000) is based on the winning bid under the public auction for the first 25 operational years. These included estimated annual revenues in USD, along with Administration, Operation and Maintenance expenses, and opportunity costs of the capital invested. After 25 years, these assets will be subject to the CREG's transmission charges (pre-2000 assets) and tariffs reviews.

EEB has currently six projects under different stages of development (total capex of around US\$449 million for the period 2014-2017) including two new projects won under competitive auctions during the 1H2014. Their relatively short construction periods of up to three years is a credit positive. Similar to other countries in Latam, transmission projects in Colombia are increasingly facing challenges to attain rights of way, easements and environmental permits. For example, the latter caused delays in the Armenia (progress at the end of June 2014: 56.23%; projected: 78.59%) and Tesalia (progress at the end of June 2014: 66.74%; projected: 84.77%) projects. However, we understand that the Ministry of Mining and Energy is currently reviewing the extension of its completion deadline in the case of Armenia (previously re-scheduled to August 2014) given that the cause of the delay was considered a Force Majeure outside of EEB's control. If the extension is granted the would be a credit positive. That said, we understand this project continues to face some social opposition. EEB estimates that upon the successful completion of the latest projects its market share in Colombia will grow by 2015 to about 11% (currently 8.2%) in terms of total transmission assets. Despite the inherent construction risk of the new projects the enhancement of EEB's ability to generate its own operating cash flows is credit positive.

#### STRUCTURAL SUBORDINATION WILL REMAIN SUBSTANTIAL

While the BCA acknowledges EEB's own cash flow generation it also factors that those associated cash flows are insufficient to fully cover EEB's aggregate obligations, including interest and expenses incurred in connection with both its own operating activities and its holding company's investment activities. Therefore, the BCA reflects the degree of structural subordination that exists for parent level debt-holders relative to the existing debt outstanding at its various subsidiaries given EEB's material dependence on the dividend and interest payments up-streamed from its controlled and non-controlled subsidiaries to meet its own debt servicing obligations.

Moody's analysis also considers that the parent only indebtedness incurred by EEB of around US\$840 million represents over 30% of the group's consolidated debt. That said, Moody's acknowledges that a significant portion of those proceeds were used to fund intercompany loans to its controlled subsidiaries, namely Transportadora de Gas Internacional S.A. E.S.P. (TGI; US\$370 million) and its two Guatemalan subsidiaries Transportadora de Energia de Centroamerica S.A. (Trecsa; US\$115 million) and EEB Ingenieria y Servicios S.A.(EEBIS; US\$28 million) given EEB's greater access to funding at more competitive market conditions.

#### HIGH DEPENDENCE ON THE PREDICTABLE CASH UPSTREAMS FROM ITS NON-CONTROLLED

## SUBSIDIARIES

The BCA assumes that EEB's non-controlled subsidiaries - particularly the unregulated power generation company Emgesa and the regulated utilities Codensa (electric) and Gas Natural (natural gas distribution) will remain EEB's main source of cash flow over the foreseeable future. The lack of control over these operations is a credit negative; however, this concern is mitigated by the historical track record of aggressive dividend policies (including capital reductions) of both companies, the absence of any distribution tests, and EEB's voting rights under the Shareholders' Agreement with respect to changing Emgesa's and Codensa's dividend distributions to less than 50% of their net distributable profits. We also acknowledge that these companies' ability to generate robust and predictable cash flows is underpinned by their leading position in their respective market segments and the regulated nature of the operations of most of these Colombian companies with tariffs in place until at least 2014. While Emgesa's operations are unregulated, we believe its overall prudent commercial policy helps to offset the cash flow volatility typically associated with power generation activities. We note that its dividend distributions remained material despite the significant investments related with the 400MW El Quimbo hydro-plant (capex: around US\$840 million) and expected to increase after the commissioning of the plant which is now anticipated during the 1H2015 after social opposition caused initial delays to the original completion date at year-end.

During 2013, EEB received from these three subsidiaries dividend distributions that approximated US\$370 million (2012: US\$245 million; 2011: US\$170 million; 2010: around US\$600 million including cash up-streams associated with Emgesa's US\$250 million capital reduction). EEB's BCA assumes that going forward the annual dividends received from these non-controlled subsidiaries will remain significant exceeding US\$250 million albeit we do not anticipate any new capital reductions as the current capital accounts do not meet those legal requirements.

EEB anticipates to receive in 2014 total dividends of around US\$6 million (2013: US\$32 million) from its non-controlled Peruvian subsidiary REP. CTM's Baa3 rating assumes that its dividend policy will be prudent and the size of future dividends will take into consideration its current multi-year capex program. It also assumes that EEB along with ISA will continue providing guarantees for new projects that mitigate CTM's material construction risk.

## SLOW BUT GROWING RELEVANCE OF THE CONTROLLED SUBSIDIARIES

TGI's Baa3 rating assumes that it will start distributing dividends in 2014 (payout ratio of around 50%; EEB's portion of around US\$32 million) while funding in a prudent fashion the tail-end of its capex program amid an enhanced footprint in Colombia as the new projects progressively start operations following the overall credit supportive outcome of the last tariff review (effective since December 2012). This cash upstream will supplement the historical interest payment paid to EEB under the US\$370 million intercompany subordinated loan (currently around US\$23 million p.a.).

On July 1st, 2014, EEB completed its previously announced (April 4, 2014) plan to acquire the remaining 31.92% minority interest in TGI for a total amount of US\$880 million, increasing the direct and indirect participation of EEB in TGI to 99.97%. EEB made an equity contribution of US\$264 million to the Transportadora de Gas Iberoamericana S.L (TGISL), a special purpose vehicle incorporated in Spain for the purpose of completing this transaction. The purchase was largely funded with cash up-streamed from TGI including a dividend distribution that approximated US\$66 million. The balance will be recorded as a payable by EEB. The remaining US\$616 was financed in the form of a short-term intercompany loan to TGISL that was funded with the proceeds of a bridge-loan executed by EEB. We understand that the latter will be refinanced later this year with a long-term amortizing bank-loan increasing TGI's financial leverage, a credit negative as TGI's credit metrics will become weakly positioned within the Baa3-rating category. That said, we acknowledge that EEB will now have full access to TGI's cash flows further enhancing its importance as a source of cash flows; however, we do not anticipate that over the near to medium term that the rest of EEB's controlled subsidiaries will become significant sources of cash flows.

We consider Calidda's tariff review process overall credit supportive manner while it continues making satisfactory progress to expand its gas distribution system under a concession agreement covering the Peruvian departments of Lima and the Province of Callao. Its Baa3 rating assumes that EEB will not be required to make additional equity contributions into Calidda but that EEB also will not receive any material dividend distributions before its significant multi-year capex program achieves further and substantial progress.

Contugas successfully completed earlier this year its project to build a 354km main pipeline and 900km lateral natural gas distribution system in order to supply gas to an additional 30,000 end-users, a credit positive. Contugas executed a US\$345 million capex program that was partially funded with a syndicated bank term-loan. EEB's rating also assumes that Trecca will successfully complete its electric transmission project in Guatemala which at the end of 2Q2014 was deemed 79% completed (capex approximates US\$410 million). The project was funded with equity contributions as well as the proceeds from EEB's intercompany loan mentioned earlier.

TRECSA's annual tariffs under the original agreement with the Guatemalan authorities is US\$35 million (adjusted to reflect changes in the Producer Price Index, IPP) albeit EEB also expects to be compensated for the additional capital outlays required following the extension of the completion date after the challenges incurred attaining rights of ways in the country's indigenous areas. We understand that Treccsa may be interested in participating in the auctions to allocate a second phase of transmission infrastructure expansions albeit this project is unlikely to start before 2016.

#### UNCERTAINTIES ASSOCIATED WITH EEB'S AGGRESSIVE GROWTH STRATEGY

EEB announced mid-August that it no longer has an interest in acquiring the Colombian government's majority stake in the unregulated power generation company ISAGEN (Baa3, negative) given the conditions that the competition authorities imposed on EEB that included divesting its ownership-stake in Emgesa. EEB's current positive outlook reflects our expectation that EEB will pursue in a disciplined manner its previously announced 2013-2017 growth initiatives that still considers an investment budget of around US\$7.5 billion. The positive outlook anticipates that EEB will prudently finance its pipeline of additional projects still under study of around US\$4.4 billion. To that end, we anticipate that EEB will use a balanced capital structure that combines indebtedness at the operating subsidiaries with capital raised by EEB in connection with a new equity issuance, divestitures of non-strategic assets and/or funds received from partnerships. It also considers that EEB's target consolidated debt to EBITDA remains capped at 4.0x.

We expect that EEB will pursue any new green and brownfield investment opportunities in the region by exclusively focusing on operations in stable and predictable regulatory environments where EEB can secure a controlling position.

#### CREDIT METRICS EXPECTED TO REMAIN COMMENSURATE WITH THE RATING CATEGORY

Given EEB's dependence on its subsidiaries' dividend distributions to service its significant parent debt we consider in our assessment mainly EEB's standalone credit metrics albeit we also factor the consolidated credit metrics. Recent fluctuations in the cash up-streams received from its non-controlled subsidiaries cited above have largely driven the development of EEB's credit metrics depicted in the table above.

Importantly, the rating reflects our expectation that despite EEB's potentially aggressive expansion plans its credit metrics will remain well positioned within the Baa-rating category outlined in Moody's Regulated Electric and Gas Utilities ratings methodology. Specifically, that its 3-year average ratio of parent only cash flow (POCF, defined as EEB's own operating cash flows after overhead costs and interest expense but also including received subsidiaries' dividend distributions) to parent only level of debt will at least hover around the high teens with consolidated and parent only interest coverage of at least 3.0x.

The rating further assumes that the group will maintain an overall prudent dividend policy, such that its 3-year RCF to debt remains in the mid to high teens, on a sustainable basis. It further assumes that EEB will pursue new capital reductions (last in 2010) only in conjunction with its subsidiaries' future capital distributions.

These credit metric ranges further assume that going forward EEB's main source of cash flows will continue to be the dividends up-streamed primarily from regulated utilities and that its exposure to cash flows from unregulated companies will be limited to the dividends received from Emgesa S.A. Should EEB's aggressive expansion plans result in a deterioration of the group's overall business risk profile we would, most likely, reassess the minimum key credit metrics required for retaining the current Baa3 rating.

#### Liquidity Profile

Similar to other Latin American issuers EEB has no committed credit bank facility in place. This increases EEB's reliance on the capital markets to meet unexpected cash flow shortfalls, a credit negative. As of June 2014, EEB held around US\$370 million in cash and short term investments (year-end 2013: US\$183 million). The holding company continues to record positive free cash flows (per Moody's definition that considers dividend payments; 2013 about US\$145 million; 2011: US\$72million). Its current debt maturity profile is deemed manageable following the refinancing of its bridge loan with the proceeds to be raised in connection with TGI's long-term bank facility mentioned earlier.

#### Rating Outlook

The positive outlook reflects our expectation that EEB will pursue in a disciplined manner any new growth initiatives, in terms of prudent financing. To that end, the positive outlook anticipates EEB will use a balanced capital structure that combines indebtedness at the operating subsidiaries with capital raised by EEB in connection

with a new equity issuance, divestitures of non-strategic assets and/or funds received from partnerships. It further assumes that EEB will continue to benefit from the strong cash distributions received from its uncontrolled subsidiaries, and the successful completion of its ongoing major capex programs in Guatemala, Peru and Colombia. The positive outlook incorporates our expectation that EEB's credit metrics will remain commensurate with the Baa-rating category albeit, as mentioned earlier, the ranges will depend on the group's overall business risk profile.

### What Could Change the Rating - Up

EEB's rating could be upgraded upon the successful commission by Emgesa S.A. of its El Quimbo hydro-electric facility that has been delayed to 2015, as this subsidiary is one of EEB's main sources of cash flows. An upgrade would also consider the successful completion expected next year of the ongoing major capex program underway in Guatemala. Upgrade considerations would also need to include whether TGI's rating would remain commensurate with the Baa3 after it executes later this year the long-term amortizing bank-loan, mentioned earlier.

### What Could Change the Rating - Down

Given EEB's positive outlook the prospects for a downgrade of its rating are limited.

### Other Considerations

The rating also assumes that EEB will continue to prudently manage the foreign exchange risk exposure.

Currently almost 100% of EEB's indebtedness is denominated in US dollars. It is our understanding that since June 2014 EEB has executed 2014 US\$265.2 million in short-term financial derivatives to mitigate its foreign currency exposure associated with the bridge loan mentioned earlier. EEB still has the 2008 swap in place, with a notional amount of US\$133 million, which along its natural hedges helps offset its foreign exchange risk under its long-term indebtedness. The natural hedges consider the indexation for the first 25 years of operation of a portion of its transmission revenues to US\$ (post-2000 assets). Moreover, similar to TGI's existing 6.125% US\$370 million intercompany loan, around US\$143 million intercompany loans granted to the Guatemalan subsidiaries TRECSA and EEBIS are also in US\$ such that the servicing will also be in US\$. Over 50% of TGI's revenues are indexed to US\$ and it has executed hedges to offset its foreign currency risk exposure while, as mentioned earlier, TRECSA's tariffs consist of a pre-agreed annuity (currently US\$35 million). EEBIS' services are marked in US\$ albeit paid by the local end-users.

Moody's evaluates EEB's BCA mainly relative to Moody's Regulated Electric and Gas Utilities methodology published in December 2013. As depicted in the grid below, the issuer's indicated BCA rating based on both historical and projected credit metrics is baa3.

## Rating Factors

### Empresa de Energía de Bogotá S.A. ESP. (EEB)

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current FYE 12/31/2013		[3]Moody's 12-18 Month Forward ViewAs of 8/22/2014	
	Measure	Score	Measure	Score
<b>Factor 1 : Regulatory Framework (25%)</b>				
a) Legislative and Judicial Underpinnings of the Regulatory Framework	Baa	Baa	Baa	Baa
b) Consistency and Predictability of Regulation	Ba	Ba	Ba	Ba
<b>Factor 2 : Ability to Recover Costs and Earn Returns (25%)</b>				
a) Timeliness of Recovery of Operating and Capital Costs	Ba	Ba	Ba	Ba
b) Sufficiency of Rates and Returns	Baa	Baa	Baa	Baa
<b>Factor 3 : Diversification (10%)</b>				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	N/A	N/A		
<b>Factor 4 : Financial Strength (40%)</b>				

a) CFO pre-WC + Interest / Interest (3 Year Avg)	5.5x	A	4.5x - 6x	A
b) CFO pre-WC / Debt (3 Year Avg)	30.9%	Aa	27% - 38%	Aa
c) CFO pre-WC - Dividends / Debt (3 Year Avg)	15.1%	Baa	7% - 15%	Baa
d) Debt / Capitalization (3 Year Avg)	14.5%	Aaa	29%	Aa
<b>Rating:</b>				
Grid-Indicated BCA Rating Before Notching Adjustment		baa1		baa1
HoldCo Structural Subordination Notching	-2	-2	-2	-2
a) Indicated BCA from Grid		baa3		baa3
b) Actual BCA Assigned		ba1		ba1

Government-Related Issuer	Factor
a) Baseline Credit Assessment	baa3
b) Government Local Currency Rating	Baa3
c) Default Dependence	
d) Support	
e) Final Rating Outcome	baa3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2013(FYE); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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