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Research Update:

Empresa de Energia de Bogota And Subsidiaries Outlook Revised To Stable From Negative; 'BBB-' Ratings Affirmed

Primary Credit Analyst:
Jose Coballasi, Mexico City (52) 55-5081-4414; jose.coballasi@spglobal.com

Secondary Contacts:
Stephanie Alles, Mexico City (52) 55-5081-4416; stephanie.alles@spglobal.com
Diego Weisvein, Buenos Aires (5411)48912154; diego.weisvein@spglobal.com

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Empresa de Energia de Bogota And Subsidiaries Outlook Revised To Stable From Negative; 'BBB-' Ratings Affirmed

Overview

- EEB's financial performance for the past 12 months has been stronger than our expectations due to a normalized dividend flow, debt reduction, and a stronger Colombian peso.
- We're revising the rating outlook on Colombia-based energy company to stable from negative. At the same time, we're affirming our 'BBB-' ratings on EEB and its rated subsidiaries (TGI and Calidda).
- The stable outlook on EEB reflects our view that it will focus on internal expansion of its electric transmission and natural gas segments in 2016 and 2017. This should allow the company to post debt to EBITDA around 3.5x and funds from operations (FFO) to debt of 20% in 2016 and 2017.

Rating Action

On Sept. 29, 2016, S&P Global Ratings revised its outlook on Empresa de Energia de Bogota S.A. E.S.P. (EEB) and its subsidiaries, Transportadora de Gas Internacional S.A. E.S.P. (TGI) and Gas Natural de Lima y Callao S.A. (Calidda). At the same time, we affirmed our 'BBB-'corporate credit and senior unsecured debt ratings on the companies.

Rationale

The company's financial performance for the past 12 months has been stronger than our expectations thanks to a normalized dividend flow, debt reduction, and a stronger Colombian peso. According to our updated forecast, EEB's core financial ratios will remain in line with its significant financial risk profile. The share of EEB's activities in the gas transportation and power generation business as a percentage of total EBITDA is 55%. Therefore, we have revised our industry risk assessment from low risk to intermediate risk, which prompted us to tighten the ratio thresholds that we use to determine EEB's financial risk profile. This mainly reflects our view that the company's income from activities that are not isolated from competition is inherently more risky.

EEB is one of the largest integrated energy groups in Latin America with interests in the natural gas and electricity sectors and operations in Colombia, Peru, Brazil, and Guatemala. Through its subsidiaries and minority investments, the company holds leading positions in most of the markets that it serves, particularly in the cities of Bogota and Lima, which are two of the largest metropolitan areas in Latin America. EEB is the second-largest operator of transmission lines and the largest operator in the gas transportation business in Colombia. It's the only natural gas distributor in Lima. This, along with our view that EEB operates under stable and predictable regulatory regimes with an operating efficiency that we view as adequate, supports our assessment of EEB's business risk profile as satisfactory. We believe that in 2016 and 2017, EEB's new management will focus on expanding its existing business portfolio; therefore, we don't expect acquisitions during this period.

For the 12 months ended June 30, 2016, EEB posted debt to EBITDA of 3.1x, FFO to debt of 23%, and free operating cash flow (FOCF) to debt of -16.2%, versus 5.5x, 12.1%, and 14.7% in 2015. This mainly reflects the company's higher EBITDA stemming from higher dividends from its unconsolidated investments, lower debt as a result of the peso's strengthening, and some debt reduction. FOCF remains slightly negative as a result of EEB's investments in transmission and gas transportation in Colombia.

Our base-case projections consider the following factors:
- A year-end and average exchange rate of COP3,250 per $1 in 2016 and COP3,200 per $1 in 2017.
- U.S. inflation of 2.3% in 2016 and 2.0% in 2017, which fuels revenue growth in EEB's business in natural gas transportation, electricity transmission, and its activities outside Colombia, which are mainly dollar denominated contracts.
- GDP growth in Colombia of 2.3% in 2016 and 3.0% in 2017 and its inflation of 7.7% and 6.0%, respectively. We base our expectations for revenue growth in electric distribution in Colombia on these two metrics. EEB will cease to consolidate its distribution segment as a result of Empresa de Energia de Cudinamarca's merger with Codensa, which isn't reflected in our projections. However, this should be offset by higher dividends from the investment in Codensa.
- A 15.9% growth in revenue in 2016 and 5.5% in 2017.
- Consolidated EBITDA margin (before dividends from unconsolidated investments) of around 40%.
- Capital expenditures of COP1.2 trillion and COL1.9 trillion in 2016 and 2017, respectively, mainly for the development of projects in electric transmission and gas transportation in Colombia.
- Dividend distribution for about COP560 billion (about 70% of 2015 net income).

Based on these assumption, we arrive at the following credit metrics for 2016 and 2017:
- Debt to EBITDA of 3.3x and 3.5x;
- FFO to debt of 21.9% and 20.7%; and
- FOCF to debt of -1.9% and -6.8%

Liquidity

We assess EEB's liquidity as adequate based on our view that sources will exceed uses by 1.2x in the next 12 months, and that this ratio will be positive even if EBITDA declines by 30%.

Principal Liquidity Sources:

- Cash and equivalents of COP1.271 trillion as of June 30, 2016
- FFO of COP946 billion for the next 12 months; and
- Working capital inflows of COP188 billion for the next 12 months.

Principal Liquidity Uses:

- Debt maturities of COP703 billion as of June 30, 2016;
- Maintenance capital expenditures (capex) of about COP597.5 billion for the next 12 months; and
- Dividend distribution for about COP560 billion for the next 12 months.

EEB isn't subject to the restricted covenants stipulated in its 144A notes, given that the they're rated investment grade by at least two of the three major rating agencies. Our view on the uses of liquidity considers the flexibility in the company's capex. Therefore, EEB's capex figure is lower than our base-case assumption.

We believe that the company has the ability to absorb high-impact, low probability events with limited need for refinancing. EEB's next major debt maturity is 2019. We believe that the company has satisfactory standing in credit markets and relationship with banks.

Group Rating Methodology

We consider TGI to be a core subsidiary. This reflects our view that it's highly unlikely that EEB would sell TGI, the latter is integral to the group's strategy, and it has a strong long-term commitment from EEB's senior management. Due to the lack of meaningful regulatory mechanisms or other structural barriers that restrict EEB's access to TGI's assets and cash flow, we align the corporate credit rating on TGI with that on the parent. Our stand-alone credit profile (SACP) on TGI is 'bbb-'. We consider Calidda to be a strategically important subsidiary because it's unlikely that EEB would sell Calidda in the near term, the company is important for the group's long-term strategy, senior group management has made a long-term commitment to Calidda, and the company is successful in its business line. In our opinion, EEB will continue to support Calidda mainly through its business expertise and commitment to prudent financial management. Our SACP on Calidda is 'bbb-'.

Government-Related Entity

Our rating on EEB considers our view of a high likelihood that the city of Bogota, (Bogota Distrito Capital; BBB-/Stable/--) would provide timely and sufficient extraordinary support to EEB in the event of financial distress, given the link between the two entities. In accordance with our criteria for government-related entities (GREs), the government's support is based on our assessment of EEB's important role as Bogota's integrated energy provider, very strong link with the government due to its majority shareholder position (76.28%), and the city's influence on the company's strategic and business plans. The mayor announced plans to reduce its ownership in EEB to 56.28%. This won't immediately impact our assessment of likelihood of support, given that Bogota will continue to be the controlling shareholder of EEB.

Issue-Level Ratings

The 'BBB-' rating on EEB's senior unsecured debt reflects the diversity of the company's assets both geographically and in the industries in which its subsidiaries participate. We believe this provides EEB with greater opportunities for asset dispositions, transfers, or recapitalization of subsidiaries in case of financial distress. EEB also has operating assets at the holding company, which mitigates structural subordination.

Outlook

The stable outlook on EEB reflects our view that it will focus on expanding its existing transmission and natural gas segments in 2016 and 2017. This should allow the company to post debt to EBITDA of around 3.5x and FFO to debt of 20% in 2016 and 2017. The stable outlook on the company also mirrors the stable outlook on the city of Bogota.

Downside scenario

Weakness in key financial ratios, resulting in debt to EBITDA of more than 4.0x and FFO to debt of less than 20%, could lead to a downgrade. Given that the ratings on EEB are limited by the city of Bogota, a negative rating action on the latter would result in the same rating action on the company.

Upside scenario

The ratings on EEB are limited by the ratings of the city of Bogota. Therefore, an upgrade of Bogota would be prerequisite for an upgrade of EEB. The aforementioned, coupled with a financial performance strong relative to our expectations, particularly a debt to EBITDA ratio below 3.0x and FFO to debt above 30% and positive free operating cash flow could lead to an upgrade of EEB.

Ratings Score Snapshot

Corporate credit rating	BBB-/Stable/--

Business risk: Satisfactory
- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers:
- Diversification/Portfolio effect: Neutral (No impact)
- Capital structure: Neutral (No impact)
- Liquidity: Adequate (No impact)
- Financial policy: Neutral (No impact)
- Management and governance: Fair (No impact)
- Comparable rating analysis: Neutral (No impact)

Stand-alone credit profile: bbb-
Group Credit profile: bbb-

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Revised To Stable

	To	From
Empresa de Energia de Bogota S. A. E. S. P.		

Transportadora de Gas Internacional S.A. E.S.P.		
Gas Natural de Lima y Callao S.A. (Calidda)		
Corporate Credit Rating	BBB-/Stable/--	BBB-/Negative/--

Ratings Affirmed

Empresa de Energia de Bogota S. A. E. S. P.	
Gas Natural de Lima y Callao S.A. (Calidda)	
Transportadora de Gas Internacional S.A. E.S.P.	
Senior Unsecured	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.