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Research Update:

Emgesa S.A. E.S.P. Ratings Affirmed At 'BBB-' As Company Performs In Line With Expectations

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Overview

- Emgesa's operating and financial performance has been in line with our expectations.
- We are affirming our ratings on the company at 'BBB-'.
- The stable outlook reflects our expectation that the company will continue to develop strong investment plans without significant financial pressures, given its strong competitive position, adequate liquidity, and good near-term economic growth prospects.

Rating Action

On Feb. 29, 2012, Standard & Poor's Ratings Services affirmed its 'BBB-' ratings on Emgesa S.A. E.S.P. The outlook remained stable. The rating action was part of our regular review.

Rationale

Our ratings on Emgesa, as Colombia's second-largest power generator by installed capacity, reflect our assessment of the company's business risk profile as "satisfactory" and its financial risk profile as "intermediate," as our criteria define those terms.

We view the company's credit quality as intertwined with that of its sister company, CODENSA S.A. E.S.P. (not rated), because of the high integration between the two companies including shared management, support units, and ownership; and the existence of intercompany loans to optimize cash allocation and diversify financing sources. Therefore, we follow a consolidated approach to the rating. Empresa Nacional de Electricidad S.A. Chile (Endesa Chile; BBB+/Stable/--) and Endesa Latinoamérica S.A. (not rated) jointly hold 48.5% of Emgesa's capital stock. Endesa Chile has the right to appoint a majority of Emgesa's board of directors pursuant to an agreement between them, and it holds 56.4% of Emgesa's voting shares. Endesa Chile is an indirect subsidiary of Spanish utility Endesa S.A. (A-/Watch Neg/A-2), which is in turn controlled by Italian group Enel SpA (A-/Watch Neg/A-2). Empresa de Energía de Bogota S.A. E.S.P. (EEB; BB+/Positive/--) holds 51.5% of the capital stock and 43.6% of the voting shares in Emgesa. Bogotá Distrito Capital (BBB-/Stable/--) controls 81.5% of EEB. CODENSA has a similar ownership structure and final controlling stakes, but through different holding companies.

The ratings on Emgesa reflect our view of the company's strong competitive position, satisfactory free cash flow generation, and relatively low leverage. Those factors are partially offset by Emgesa's inherently volatile profitability and cash flow, given its exposure to hydrological risk and its aggressive practice of paying dividends equivalent to 100% of its net profits.

We expect Emgesa's cash flow generation to remain solid but volatile, supported by favorable near-term economic growth prospects, even though it depends on hydrological conditions. Assuming about 3% annual growth in power demand and normal hydrological conditions, funds from operations (FFO) to total debt will likely remain at 25% to 35%, and total debt to EBITDA at less than 2.5x.

On a consolidated basis, and because CODENSA has shown stronger and more stable stand-alone financial performance than Emgesa has, we expect FFO to total debt and debt to EBITDA of 35% to 45% and less than 2x, respectively.

Liquidity

We believe that Emgesa currently has "adequate" liquidity to meet its needs over the next two years. Relevant aspects of our assessment of the company's liquidity profile include:

- Sources of liquidity (including FFO and cash balances) exceeding uses by at least 1.2x over the next two years;
- Liquidity sources continuing to exceed uses, even if EBITDA were to decline by 20%;
- Good access to the credit markets, especially in Colombia; and
- A current absence of financial covenants.

Also, the company's significant combined cash balances, along with a smooth, manageable debt maturity profile and ability to generate good free cash flow, support our assessment of an adequate liquidity position. These attributes mitigate the aggressive dividend payments, and the expected capital expenditures of more than Colombian pesos (COP) 850 billion (about $445 million) annually in the next three years for Emgesa and CODENSA combined--including expected investments in the 400-megawatt El Quimbo hydroelectric project.

As of Dec. 31, 2011, Emgesa and CODENSA had about COP1,002 billion in aggregate cash and cash equivalents (about $500 million), exceeding short-term debt of about COP466 billion (about $233 million). We don't expect dividend payments to jeopardize the company's repayment or refinancing capacity. On the contrary, we expect it will exercise some flexibility in its dividends and capital expenditures to meet any further unexpected financing needs or challenging conditions in the refinancing market.

Neither Emgesa nor CODENSA has financial covenants on its outstanding debt instruments. Under the terms and conditions of the proposed notes, the company would be obliged to offer to purchase the notes under certain change-of-control events. In our view, a change of control is unlikely in the medium term.

Outlook

The stable outlook reflects our expectation that Emgesa and CODENSA will be able to maintain financial performance commensurate with our expectations for the current ratings, supported by a strong competitive position and good near-term economic growth prospects. Consequently, combined FFO to total debt will likely exceed 35% and total debt to EBITDA will likely remain at less than 2x. We believe rating upside is limited at this point and depends on material improvements in Colombia's business environment. We could lower the ratings, however, if the company assumes a more aggressive leverage that could deteriorate its main credit metrics, leading, for example, to a combined debt to EBITDA of more than 2.5x on a permanent basis; or if construction of the El Quimbo project is significantly delayed.

Related Criteria And Research

- Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

Ratings Affirmed

Emgesa S.A. E.S.P.	
Corporate Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

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