MOODY'S
INVESTORS SERVICE

CREDIT OPINION
9 April 2021

Update

Rate this Research

RATINGS

**Colbun S.A.**

| | |
|---|---|
| Domicile | Santiago, Chile |
| Long Term Rating | Baa2 |
| Type | LT Issuer Rating - Dom Curr |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*


Contacts

Bernardo Costa +55.11.3043.7353
*VP-Senior Analyst*
bernardo.costa@moodys.com

Daniela Cuan +54.11.5129.2617
*VP-Senior Analyst*
daniela.cuan@moodys.com

Cristiane Spercel +55.11.3043.7333
*VP/SCO Manager*
cristiane.spercel@moodys.com


*» Contacts continued on last page*

# Colbun S.A.

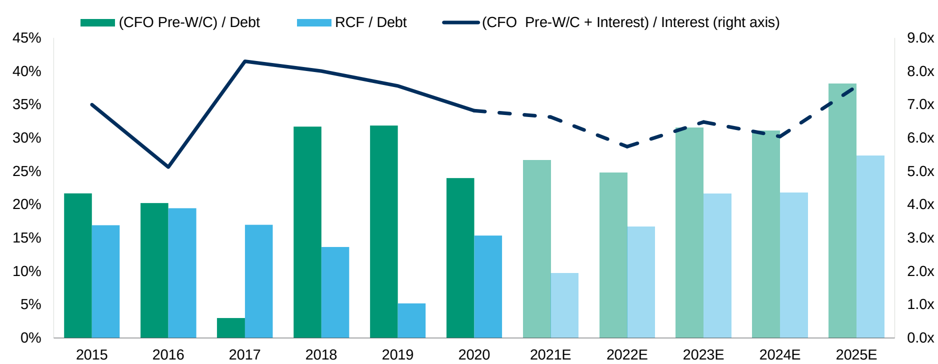
## Update to credit analysis

## Summary


Colbun S.A.'s (Colbun, Baa2 stable) credit profile reflects the company's size and importance within the power generation market in Chile (A1 negative), adequate commercial policy, and strong credit metrics and liquidity. The company is engaged in further diversifying its fuel resource base, which will decrease its operating costs, preserve its margins in light of declining power prices and reduce its exposure to carbon transition risks.

Our credit view incorporates the expectation of stable credit metrics over the next two to three years in spite of the recently announced sale of its transmission business in Chile and as the company moves forward with its investment plan in wind and solar projects amid the transition from legacy regulated power purchase agreements to a largely unregulated contracted base. We expect Colbun's debt/EBITDA to average 3.0 times, and CFO pre WC to Debt of 25%. Our projections exclude the lost cash generation from the transmission business of approximately $50 million per year and it considers that debt amount is maintained at current levels. This view is based on our expectation that the company will continue developing its expansion plans without incurring in more debt, counting on its strong cash position and cash generation as well as a dividend payout ratio of 50%, lower than in recent years.


Exhibit 1
**Credit metrics to dip slightly as a reflection of the investment program focused on renewables**
**Moody's base case[1]**




[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
*Source: Colbun, Moody's Financial Metrics™ and Moody's Investors Service estimates*

## Credit strengths

» Relevant scale and market position in Chile, as the third-largest energy generator

» Prudent commercial policy, with sales largely addressed by own generation

» Strong credit metrics and ample liquidity

## Credit challenges

» Increasing exposure to the unregulated customers in its contracted base

» Tariff stabilization mechanism responding to increase social pressure, created uncertainty on the predictability the regulatory framework.

» High dividend payouts in recent years, above the established policy of 50% of net income

## Rating outlook

The stable rating outlook reflects our expectation that Colbun will continue to successfully execute its financial and commercial policy by focusing on extending its contracted position and managing its investment program prudently, thereby maintaining its strong credit metrics. The outlook also reflects our assumption of good cash flow visibility, with an eight-year remaining weighted average life of contracts and robust terms that support Colbun's stable financial metrics over the next 18 months.

## Factors that could lead to an upgrade

We could upgrade Colbun's rating if the company diversifies its operating profile further through expansion into other markets that have stable, creditor-friendly regulatory frameworks. The rating could also be upgraded if Colbun extends its contracted position further at high price levels, leading to an improvement in its credit metrics on a sustained basis, such that its:

» interest coverage is above 8.0x

» CFO pre-WC/debt is above 35%

» retained cash flow (RCF)/debt is above 15%

## Factors that could lead to a downgrade

A downgrade of Colbun's ratings would be triggered if the company is unable to renew its power purchase agreements (PPAs), leading to a shorter-than-expected weighted average contracted life and limited cash flow visibility; it were to undertake large, fully debt-funded acquisitions; its liquidity significantly deteriorates, with no committed credit facilities; or a perception of a weakening in the regulatory framework develops. In addition, the company's ratings could be downgraded upon a substantial increase in its debt or dividend distribution consistently above the established dividend policy, such that its:

» interest coverage is below 5.0x on a sustained basis

» CFO pre-WC/debt is below 20% on a sustained basis

» RCF/debt is below 10% on a sustained basis

## Key indicators

Exhibit 2
**Colbun S.A.[1]**

| | 12/31/2016 | 12/31/2017 | 12/31/2018 | 12/31/2019 | 12/31/2020 | 2021-2022E |
|---|---|---|---|---|---|---|
| (CFO Pre-W/C + Interest) / Interest | 5.1x | 8.3x | 8.0x | 7.6x | 6.8x | 6.6x - 5.7x |
| (CFO Pre-W/C) / Debt | 20.2% | 33.9% | 31.7% | 31.9% | 24.0% | 26.7% - 24.7% |
| RCF / Debt | 19.5% | 17.0% | 13.6% | 5.2% | 15.4% | 9.7% - 16.7% |

[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
*Source: Colbun S.A. and Moody's Financial Metrics™*

## Profile

Headquartered in Santiago, Chile, Colbun S.A. (Colbun) is an operational holding engaged in the power generation and transmission sectors in Chile and Peru (A3 stable), the latter through its controlling stake in Fenix Power Peru S.A. (Fenix, Ba1 stable). As of December 2020, the company had a total combined installed capacity of 3,811 megawatts (MW), of which 58% was thermal and 42% consisted of renewable power plants. As of the same date, the company had 899 kilometers of transmission lines. In 2020, the company reported net revenue and EBITDA of $1,349 million and $683 million, respectively. The generation business in Chile represented 82% of revenue and 80% of EBITDA, while the transmission business in Chile represented 6% of revenue and 10% of EBITDA. Fenix's generation in Peru represented 12% of revenue and 10% of consolidated EBITDA.

The company is controlled by the Matte Group, which holds 49.96% of Colbun's total capital. Matte Group has investments in the energy, financial, forestry, real estate and telecom sectors.

## Recent Developments

» On March 30th. Colbun announced that it had reach an agreement to sale its transmission business (Colbun Transmision S.A., not rated) to consortium integrated by APG Energy and Infra Investments S.L. (80%), a Dutch pension fund and Celeo Redes S.L.U, subsidiary of Celeo Concesiones e Inversiones S.L. (20%). The sale price has been stablished at $1.295 million.

» The transaction is subject to the approval of the antitrust authorities in Chile, among others and we expect it to close towards the last quarter of 2021.

» While the use of proceeds has not been decided yet, we expect that funds from the sale will be distributed to shareholders.

» In our view, the sale is credit negative because it will diminish annual future cash flows for Colbun in approximately $50 million per year from a very stable business while at the same time it reduces diversification.

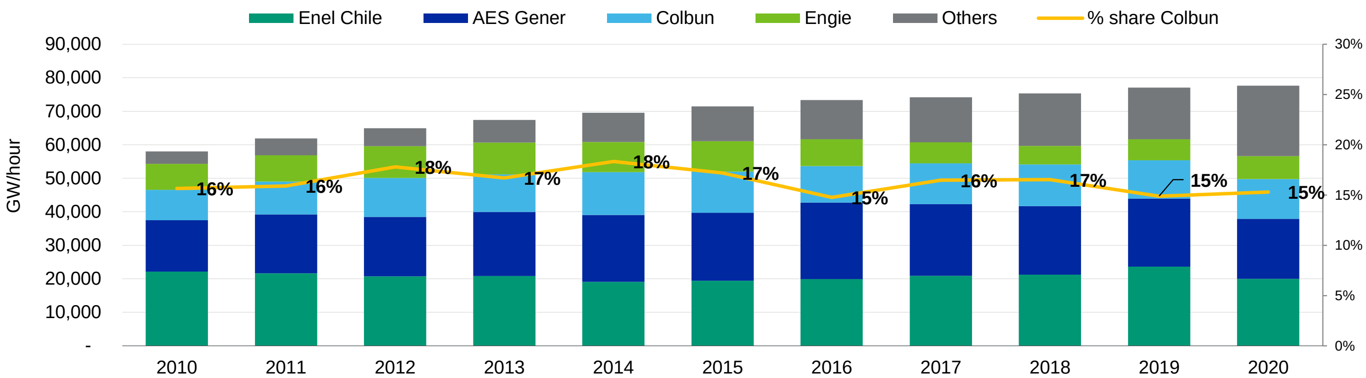
» While we do not expect any debt reduction from the sale, we believe the credit profile continues to reflect leverage metrics that are appropriate for the rating category. Furthermore, the company's strong liquidity and cash generation remain supporting the planned investments for expansion on the renewable space. We also believe that the distribution of proceeds from the sale diminishes the pressure for future distributions.

## Detailed credit considerations

### Relevant market position in Chile

Our credit view of Colbun incorporates its leading position in the Chilean market, where it is the third-largest energy generator and accounts for 15% of the market share as of December 2020. The company has a large scale, with 3,244 MW of installed capacity in Chile and total energy generation of 12.0 terawatt-hours (TWh) in 2020. On a national scale, Colbun is only behind Enel Chile S.A. (Baa2 stable) and AES Gener S.A. (Baa3 stable) in terms of energy generation. All of Colbun's Chilean assets are located in the south-central region of Chile (former Sistema Interconectado Central [SIC]).

Exhibit 3
**Colbun is the third-largest power generation company in Chile**




*Source: Systep*

### The coronavirus pandemic did not cause significant operational or financial issues for Colbun in 2020

The pandemic, the deteriorating global economic outlook and asset price declines are creating severe and extensive credit shocks across many sectors, regions and markets. Among the difficulties are the potential disruption of power plant operations and a potential fall in power prices or demand. We expect the Chilean and the Peruvian real GDPs to decrease by 6.0% and 12.3%, respectively, in 2020, with a rebound of 5.8% (Chile) and 9.0% (Peru) in 2021.

Despite the pandemic, Colbun's consolidated Moody's-adjusted EBITDA declined by less than 3% in 2020. The 9% decline in revenue in 2020 was aided by less costly energy generation, with a 9% increase in hydro generation and a corresponding 9% decline in gas-fired generation. The company maintained normal operations at its power plants while taking measures to safeguard its employees, suppliers and surrounding communities. Furthermore, the company maintained the pace of its investments in 2020, reporting $123 million in capital spending, with no delays because of the pandemic.

### Prudent commercial policy and manageable re-contracting risks

Colbun has secured an adequate contracted position. The company has signed contracts for the delivery of a maximum volume of 12 TWh-14 TWh per year until 2023, which is above its average historical position of around 11 TWh over 2012-18. While these contracts contain fixed and variable volume commitments, they provide for fixed real prices, adjusted for inflation and the cost of fuel. Around 20% of the company's committed PPAs expire by 2024. The company is focused on enhancing its contracted position, particularly through non-regulated customers.

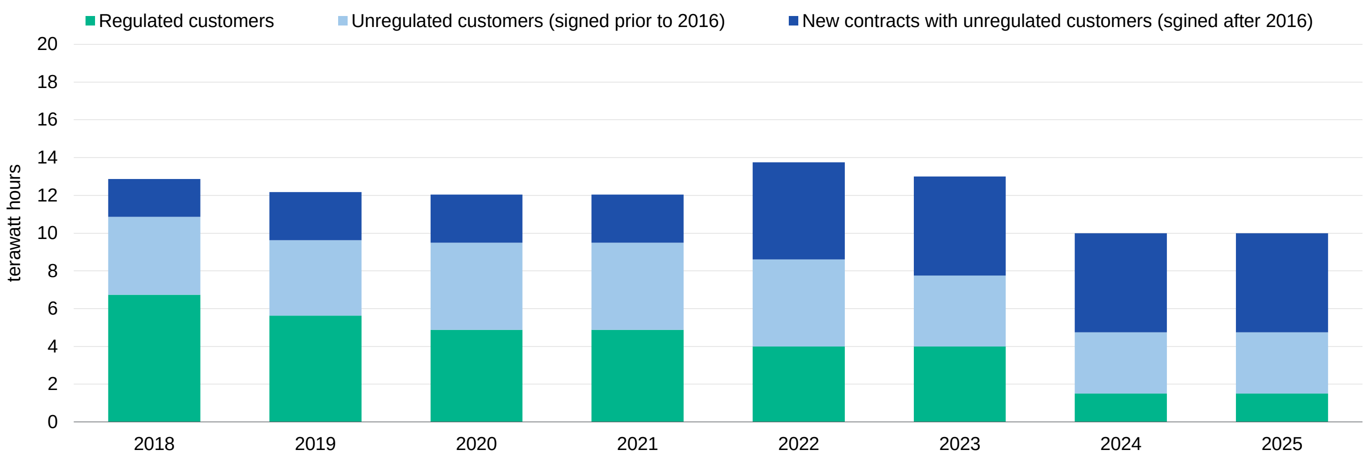
At present, around 75% of Colbun's generation is contracted with unregulated customers, which exposes its cash flow to counterparty risk. However, we acknowledge the diversity of Colbun's customer base, and the company's ability to negotiate collateral packages mitigates this risk. These packages include corporate guarantees and letters of credit from creditworthy shareholders.

In 2020, Colbun continued to participate in various supply bidding processes, favoring the re-contracting of current unregulated clients' contracts that had expired. New contracts signed in 2020 comprise 699 gigawatt hours/year for 52 clients.

In 2020, Colbun's physical sales decreased 1% because of lower sales to regulated clients, mainly driven by the expiration of the contract with Sociedad Austral de Electricidad S.A. (SAESA) in December 2019. The lower sales, despite higher energy generation, are a reflection of lower volumes purchased in the spot market.

Exhibit 4

**Increased contractual position with unregulated customers**




*Source: Colbun*

### Tariff stabilization regime introduces risks beyond immediate short-term financial impact

On 30 October 2019, Chile's Congress approved a bill (Law No 21,185) to retract the previously approved 9.2% hike in electricity tariffs through a mechanism that sets PPA prices for customers in the regulated utilities sector from 1 July 2019 to 31 December 2020 at the same level as those applied during the first half of 2019 (Regulated Customer Stabilized Price, PEC). The previously approved increase in electricity prices reflected the devaluation of the Chilean peso in H1 2019 because power prices in Chile are denominated in US dollars. Higher prices also stemmed from contractual indexation, which is based on a combination of inflation indexes and the cost of certain fuel sources, such as coal and natural gas. This contractual indexation is established in the regulated PPAs that the distribution companies signed with the power generators.

Until December 2020, the distribution companies continued to pay power generators in Chilean pesos the same prices they had paid during H1 2019. The difference between the final prices applied to PPAs and the actual energy costs was accrued as receivables and would be repaid to generators by distribution companies once cheaper PPAs started to kick in as of 2023, smoothening out the effect of lower long-term power prices.

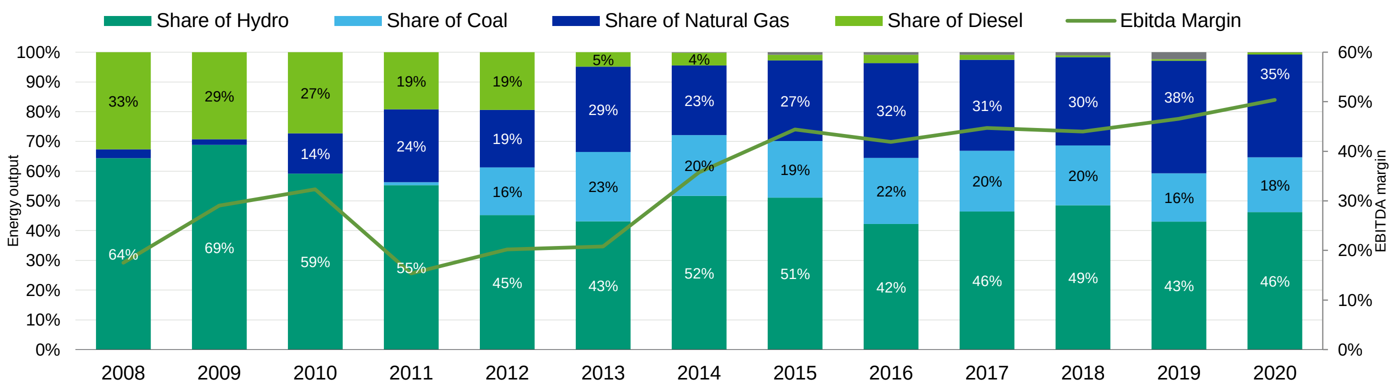
The immediate cash flow effects are mitigated by the securitization of those receivables in January 2021 (see Chile Electricity PEC SpA, Series 2021-1, Baa3(sf)). Colbun will gradually sell receivables, in an amount estimated to be of around $140 million, to mitigate these cash flow effects.

Nonetheless, these one-off regulatory changes raise concerns about the predictability of the regulatory regimes as a direct result of a higher social pressures and potential for government interference in tariff setting mechanisms.

### A diversified and efficient energy generation fleet helps the company preserve its operating margin

The company's prudent commercial policy, in combination with its diversified and efficient energy generation fleet, has helped it cope with continued hydro shortages. In 2020, natural gas dispatch reached 35% of overall generation, which, combined with the 18% derived from coal, took thermal dispatch to 53% of total generation. Hydro generation contributed 46%, with the remaining 1% coming from wind and solar energy. This mix allowed the company to increase its EBITDA margin to around 50%, the highest since 2008. EBITDA declined 2.5% in 2020, while revenue declined 9.3%.

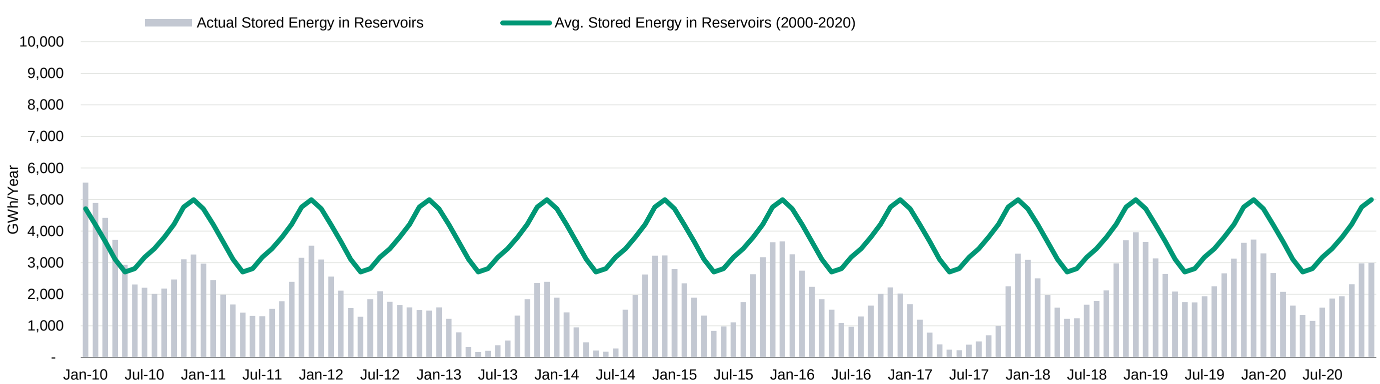
Exhibit 5
**Increased hydro output as a result of improved hydrological conditions**




*Source: Systep*

Colbun's hydro generation improved in 2020 as a result of better hydrology conditions. However, reservoir levels in the national system were at around 60% of the 20-year historical average as of December 2020, a decrease compared with 75% in December 2019. We expect difficult hydro conditions in 2021 as well.

Exhibit 6
**Reservoir level stood at around 60% of the 20-year historical average in 2020**




*Source: Systep*

## Continued appetite for wind and solar project development

In addition to continued interest in expanding within the region to countries with stable regulatory environments, the company has now refocused its growth strategy on Chile, with a pipeline of 2,134 MW of installed capacity in wind and solar projects. The business case is enhanced by the continued decline in development costs and increasing technological efficiencies, which are likely to increase generation output per installed capacity, and a broader generation policy direction on the part of the government tied to carbon regulation. In June 2020, Colbun's board approved the construction of the Diego de Almagro Sur I and II photovoltaic projects, in Atacama (Chile), with a combined capacity of 230 MW. The total investment is $147 million, and the delivery is expected in Q1 2022. In addition, it approved the Machicura photovoltaic project, in Maule (Chile), with a capacity of 9 MW. The investment amount is $7 million, and the delivery is expected in Q2 2021.

We expect the company to continue to pursue new investments over the next three years, increasing its investment budget. In addition to the projects listed above, Colbun has also publicly stated its interest in developing the Horizonte wind project (607 MW) and other potential solar projects with more than 400 MW of installed capacity each. We expect the company to raise modest levels of additional debt to support this investment plan, based on our assumption that dividends distributions will return to lower levels in 2022 onwards (50% of net income), below the payout of 100% or higher from recent years.

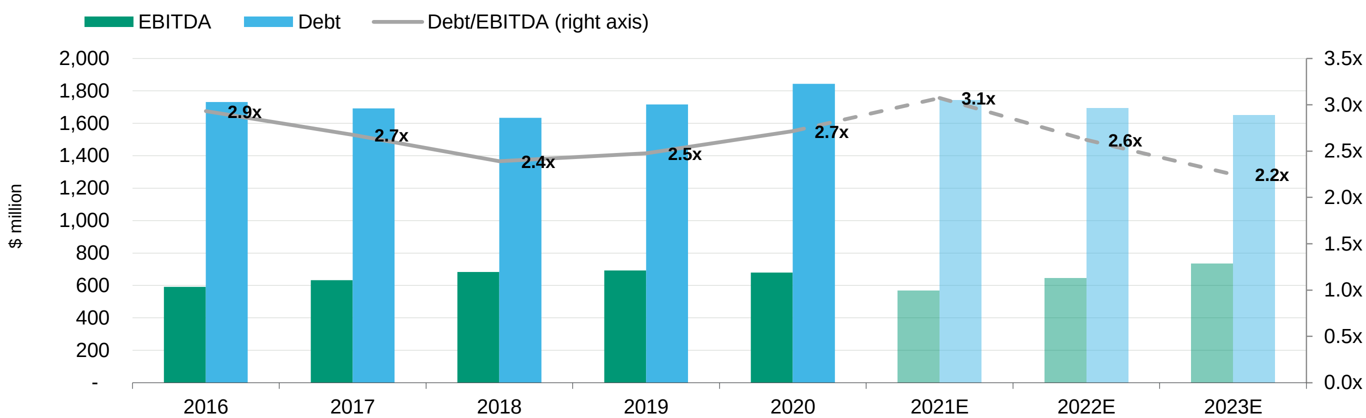
The company also continues its strategy of growing outside Chile and within Latin America, similar to its investment in Fenix Power Peru S.A., in which it acquired a 51% share in 2015. In September 2020, Colbun announced the acquisition of Efizity, a company focused on energy services in the Chilean market, in line with the strategy of improving the competitiveness of its customers by promoting energy efficiency through innovative solutions.

### Strong credit metrics

Colbun's historical credit metrics are strong and we expect they will remain around current levels even as the company implements its capital investment program and continues to distribute dividends to its shareholders in accordance with its stated policy of 50% of net income. While the company's will be FCF negative in the next 2-3 years, it currently has a solid cash balance and its investment plan is focused on a more diversified and cheaper-to-operate fuel resource base, which will position the company well to continue to improve its EBITDA and EBITDA margins, despite declining PPA prices.

Exhibit 7

**Slight increase in leverage, supporting Colbun's capital investment plan[1]**




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

## Environmental, social and governance (ESG) considerations

### Environmental risks

Colbun carries moderate carbon transition risk because it has only a single coal-fired thermal project, the Santa Maria plant, with a total installed capacity of 350 MW. Santa Maria is one of the most modern coal plants operating in Chile, having begun operations in 2012. In October 2019, the company agreed with the Ministry of Energy to retire the plant by 2040, subject to certain contractual commitments. The plant contributed 18% of Colbun's total generation in 2020. While the eventual shutdown may decrease Colbun's fuel resource diversification and reduce the flexibility of its generation fleet, the late schedule allows for ample time to plan and prepare.

In June 2019, the government announced that it reached agreements with the Chilean energy generators to retire eight coal-fired thermal plants with a total installed capacity of 1,024 MW by 2024, equivalent to 5% of the national system's total generation in 2020. The agreements also require the retiring of all coal generation in Chile by 2040. In Q4 2020, coal generation represented 31% of the total energy generated in Chile. The announcement was expected and is in line with the government's agenda on carbon regulations, laid out in its Ruta Energetica 2018-22 energy plan. While credit negative for most energy generators that have been affected, the agreements reduce the uncertainty surrounding the potential costs and the actual timing of the implementation of the government's largely expected carbon regulation agenda.

### Social risks

Colbun's exposure to social risks is higher than that of most Latin American power generators, given the recent passing of the legislation that froze power generation tariffs in response to protests by the population. As explained in previous sections, the immediate impact on cash flow is not significant, and the government has laid out a plan that involves eventual compensation in the long term and minimize the credit impact on power generators. A more pronounced and longer-term negative credit implication may arise if the policy deviates from the established plan or if further changes are introduced. This would raise concerns about the predictability of the regulatory regime as a direct result of a higher exposure to social risks.

### Governance risks

Colbun is a publicly traded company, and its stock is listed on the Santiago Stock Exchange and the Chilean Electronic Stock Exchange. The company is controlled by the Matte Group, which owns 49.96% of the company's shares.

Colbun has maintained a conservative financial policy, very strong liquidity and a prudent approach to acquisitions and capital investment. The company's senior management has extensive sector experience and a long track record with the company. The company's board is composed of nine members, none of whom are executive officers of the company.

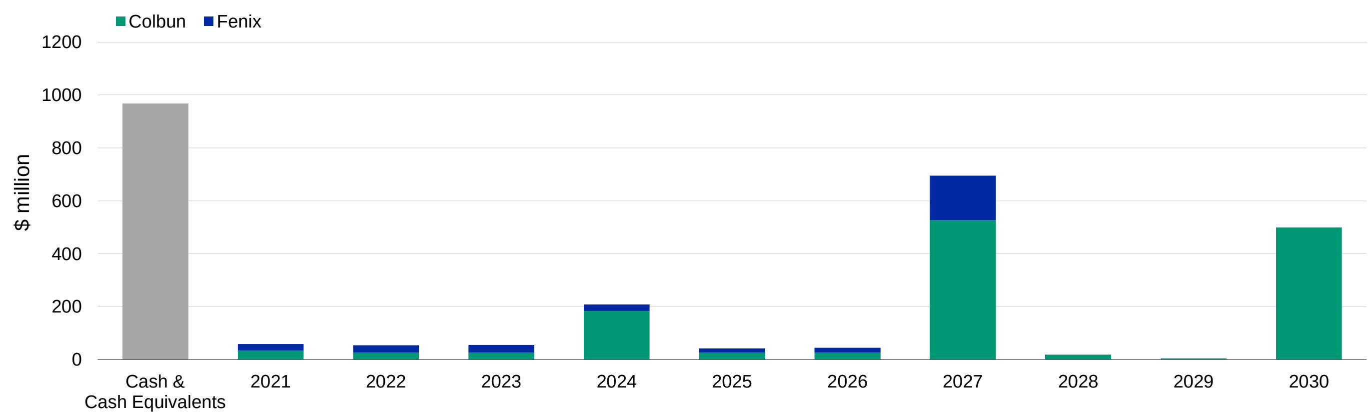
Financial statements are audited on an annual basis and are subject to review by auditors on a quarterly basis. Transparency of information is considered above average for Latin American utility issuers.

## Liquidity analysis

Colbun maintains strong liquidity, with a cash balance of $967 million as of December 2020 and short-term obligations of $86 million. This strong cash balance is already net of extraordinary dividends paid during the year, which total $242 million ($161 million distributed in May 2020 and $81 million distributed in December 2020). This cash balance is present to support potential acquisitions/ investments in accordance with the company's growth strategy. As of December 2020, Colbun's debt had an average life of 6.6 years and average cost of 4.0%, and was 100% fixed rate.

Exhibit 8

**Consolidated debt schedule (as of December 2020)**




*Source: Colbun*

## Methodology and scorecard

The principal methodology used for Colbun's credit analysis was our Unregulated Utilities and Unregulated Power Companies rating methodology, published in May 2017. As depicted in the grid below, Colbun's current and forward-looking scorecard-indicated outcomes are Baa2, consistent with its assigned ratings.

Exhibit 9

**Scorecard Factors**

**Colbun S.A.**

| Unregulated Utilities and Unregulated Power Companies Industry [1][2] | Current FY 12/31/2020 | | Moody's 12-18 Month Forward View As of 4/6/2021 [3] | |
|---|---|---|---|---|
| **Factor 1 : Scale (10%)** | **Measure** | **Score** | **Measure** | **Score** |
| a) Scale (USD Billion) | Baa | Baa | Baa | Baa |
| **Factor 2 : Business Profile (35%)** | | | | |
| a) Market Diversification | Ba | Ba | Ba | Ba |
| b) Hedging and Integration Impact on Cash Flow Predictability | Baa | Baa | Baa | Baa |
| c) Market Framework & Positioning | Baa | Baa | Baa | Baa |
| d) Capital Requirements and Operational Performance | Baa | Baa | Baa | Baa |
| e) Business Mix Impact on Cash Flow Predictability | | NA | | |
| **Factor 3 : Financial Policy (15%)** | | | | |
| a) Financial Policy | Baa | Baa | Baa | Baa |
| **Factor 4 : Leverage and Coverage (40%)** | | | | |
| a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg) | 7.5x | Baa | 5.5x - 6.5x | Baa |
| b) (CFO Pre-W/C) / Debt (3 Year Avg) | 29.0% | Baa | 24% - 27% | Baa |
| c) RCF / Debt (3 Year Avg) | 11.5% | Ba | 10% - 15% | Ba |
| **Rating:** | | | | |
| a) Scorecard-Indicated Outcome | | Baa2 | | Baa2 |
| b) Actual Rating Assigned | | | | Baa2 |

[1] ] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 31/12/2020.
[3] This represents Moody's forward view, not the view of the issuer, and incorporates the sale of the transmission assets.
*Source: Colbun, Moody's Financial Metrics™ and Moody's Investors Service estimates*

## Ratings

Exhibit 10

| Category | Moody's Rating |
|---|---|
| **COLBUN S.A.** | |
| Outlook | Stable |
| Issuer Rating -Dom Curr | Baa2 |
| Senior Unsecured | Baa2 |
| **FENIX POWER PERU S.A.** | |
| Outlook | Stable |
| Senior Unsecured | Ba1 |

*Source: Moody's Investors Service*

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## Contacts

**Philipp Toculescu** +54.11.5129.2644
*Associate Analyst*
philipp.toculescu@moodys.com

**Julia Ponte** +55.11.3043.7339
*Associate Analyst*
julia.ponte@moodys.com

**Bruno Britto** +55.11.3043.7343
*Associate Analyst*
bruno.britto@moodys.com

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