FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Colbun's IDRs at 'BBB+'; Outlook Stable

Tue 02 Aug, 2022 - 15:30 ET

Fitch Ratings - New York - 02 Aug 2022: Fitch Ratings has affirmed Colbun S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) at 'BBB+'. The Rating Outlook is Stable. In addition, Fitch has affirmed the Long-Term National Scale Rating at 'AA(cl)', revised the Outlook to Stable from Positive, and affirmed the company's National Equity Rating at 'Primera Clase Nivel 1(cl)'.

Colbun's ratings reflects Fitch's view that the company continues strengthening its credit profile based on its strong capital structure, with leverage expected between 2.5x and 3.0x during 2022-2025 combined with improved contracted position with an average life of its power purchase agreements (PPAs) of eight years and solid liquidity. The Outlook revision to Stable from Positive on National Scale Ratings is driven by Fitch's expectations that Colbun will be FCF negative through 2022-2025 as it executes the renewable expansion plan without incurring in additional debt.

KEY RATING DRIVERS

Strong Contractual Position: Colbun has long-term PPAs with an average life of eight years, migrating toward unregulated customers since 2022. Fitch expects the company to maintain a significant portion of its capacity contracted in the long term, after securing a PPA with BHP Group (A/Stable) to supply an average of 3.0TWh per year for 10 years, starting January 2022. In addition, Colbun has subscribed approximately 4.0TWh per year with unregulated customers, where this segment of customers will represent approximately 70% of the company's contracted profile during 2022-2023, increasing to

90% during 2023-2024. Fitch estimates annual energy sales in Chile around 13TWh during 2022-2025.

Diversified Asset Base: Fitch believes that Colbun has a balanced portfolio of assets that is expected to further improve as the company expands into renewables. This expansion will help offset the company's existing exposure to hydrology risk, as 45%-50% of the company's total power generations is sourced from its hydro plants. The company mitigates this risk by maintaining a conservative commercial policy, where the company can meet its total contracted positions through its efficient natural gas units or purchase on the spot market, with a negative effect on margins if the company faces a dry hydrological scenario.

Colbun is executing an expansion pipeline of 2.1 GW of new installed capacity from renewables, out of which 812MW is currently under construction, and the remaining portion with environmental approvals. Fitch estimates that these investments will be financed through cash flows resulting in a slightly negative averaging US$50 million per year during 2022-2024. In addition, Colbun mitigates its exposure to fuel price risk by entering into contracts that include adequate price indexation mechanisms. These contracts consider a significant portion of fuel price variations. Additionally, Fitch views positively Colbun's long-term liquefied natural gas (LNG) supply agreement with ENAP (A-/Stable) until 2031, when regasification capacity will be reassessed.

Strong Leverage Profile: Colbun has a strong leverage profile with total debt to EBITDA estimated below 3.0x over the rated horizon. In 2021, Colbun's cash flow generation was negatively affected by weak hydrological conditions, which has decreased to 30% in 2021, from an historical 45%, in conjunction with higher costs of natural gas. As a consequence, to cover its contracted position, Colbun dispatched less efficient generation units coming from thermal sources at a higher cost, affecting the company's gross margins. Going forward, EBITDA generation will reach approximately US$600 million during 2022, returning to US$650 million per year during 2023-2025 and total debt/EBITDA to remain between 2.5x and 3.0x, assuming no additional debt. As of June 2022, the company reported total debt/EBITDA of 3.7x, lower when compared with the 4.3x registered during December 2021.

National Equity Rating: Fitch rates Colbun's National Equity at 'Primera Clase Nivel 1(cl)' based on the company's solid solvency position and its consolidated stock history. As of July 2022, Colbun had a market capitalization of US$1.5 billion with an average volume traded in the last month of US$867 million. The stock is part of the IPSA (Indice de Precio Selectivo de Acciones) and has historically maintained a free float of 40.46% between pension funds and other shareholders.

DERIVATION SUMMARY

Compared with peers, Colbun's business profile and solid contractual position is similar to that of Engie Energia Chile (BBB+/Stable) and AES Andes (BBB-/Stable), with PPAs having an average life of 10 years. Relative to its peers, Colbun also has a generation mix evenly distributed between hydro and thermal, similar to Enel Generacion Chile (A-/Stable). Both companies have adequate indexing mechanisms that closely match their generation mix and contracts, which mitigate the exposure to fuel price volatility and lowers business risk consistent with the rating category. AES Andes and Engie are mainly concentrated on coal-based units and present a lower exposure to hydroelectricity generation in Chile.

Enel Chile (A-/Stable) shows a slightly lower business risk among its peers, due to the integration provided by the generation business under Enel Generacion Chile, the renewable business from Enel Green Power (EGP) and distribution business under Enel Distribution. In terms of credits metrics, Colbun's credit profile is similar to Engie Energia Chile with leverage between 2.5x and 3.0x measured as total debt to EBITDA. While Engie Energia Chile successfully concluded an aggressive expansion phase, Colbun's strong EBITDA generation is solid for the rating category.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

--Energy sales in Chile for approximately 13,000 gigawatt hours (GWh) during 2022-2024;

--Hydro production in Chile at 5,000GWh during 2022, returning to 5,500GWh per year during 2022-2024;

--Coal energy production at 2,500GWh annually and natural gas at 3,500GWh annually during 2022-2024;

--Thermal coal (Australia Newcastle) at US$270 per tonne during 2022, US$120 per tonne in 2023, US$87 per tonne during 2024 and US$80 in 2025;

--Henry Hub at US$6.25 per mcf during 2022, US$4.00 per mcf in 2023, US$3.25 per mcf during 2024 and US$2.75 per mcf in the long term;

--Contracted capacity averaging 474MW until 2024 in Peru, with spot prices at USD27/MWh during 2022-2024;

--Total capex averaging US$390 million per year during 2022-2023, increasing to US$460 million during 2024;

--50% dividend pay-out ratio during 2022-2025.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Although unlikely in the short term, a positive rating action could be considered if the company has the ability to maintain gross debt/EBITDA consistently below 2.0x, maintaining robust liquidity indicators consistent with the past. Colbun's ability to maintain a long-term contracted position will be view positively.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A change in Colbun's commercial policy that results in an imbalanced long-term contracted position;

--Pressure from shareholders that could result in a significant increase in dividend payments beyond the company's plan.

--A material and sustained deterioration of credit metrics reflected in total consolidated debt-to-EBITDA ratios above 3.0x;

--Inability to re-contract a significant portion of expiring contracts;

--Debt-financed acquisitions that would deteriorate the company's credit metrics.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best-and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Colbun has a solid liquidity position, with over US$900 million of cash and cash equivalents as of June 30, 2022, compared with approximately US$120 million of short-term debt. Fitch expects it will maintain a strong liquidity position, driven by its cash generation. Liquidity is further buoyed by uncommitted credit lines of approximately US$150 million and two bond lines registered in the local market for a total of UF7.0 million.

Colbun's debt is composed of almost international notes for approximately US$2.0 billion, including the US$300 million outstanding notes from Fenix Power Peru. The company has no significant maturities until 2024.

ISSUER PROFILE

Colbun is a Chilean electric generation company with an installed capacity of 4,010MW, representing 15% market share in Chile by installed capacity. Colbun owns 51% of Fenix Power Peru S.A., a 567MW combined cycle unit that represents approximately 7% of market share by installed capacity in Peru.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

Colbun S.A.	LT IDR BBB+ Rating Outlook Stable Affirmed	BBB+ Rating Outlook Stable
	LC LT IDR BBB+ Rating Outlook Stable Affirmed	BBB+ Rating Outlook Stable
	Natl LT AA(cl) Rating Outlook Stable Affirmed	AA(cl) Rating Outlook Positive
	Nat Equity Rating Primera Clase Nivel 1(cl) Affirmed	Primera Clase Nivel 1(cl)
senior unsecured	LT BBB+ Affirmed	BBB+
senior unsecured	Natl LT AA(cl) Rating Outlook Stable Affirmed	AA(cl) Rating Outlook Positive

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Metodología de Calificaciones en Escala Nacional (pub. 22 Dec 2020)

Chilean Equity Rating Criteria (pub. 10 Aug 2021)

Metodología de Clasificación de Acciones en Chile (pub. 10 Aug 2021)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Metodología de Calificación de Finanzas Corporativas (pub. 02 Dec 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 15 Jul 2022)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Colbun S.A.	EU Endorsed, UK Endorsed

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