

## REASONED ANALYSIS OF THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013

### 1. PERIOD OVERVIEW

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■ In the fourth quarter of 2013 (4Q13) the Company had a **profit of US\$6.9 million** (vs. a profit of US\$57.1 million in the fourth quarter of 2012 (4Q12) and a loss of US\$10.1 million in the third quarter of 2013 (3Q13)).

Accumulated figures as of December 31, 2013 (Dec13) shows profits of US\$63.0 million, compared to a profit of US\$50.9 million for the same period of the previous year (Dec12).

■ **EBITDA** for 4Q13 reached **US\$106.8 million**, slightly lower than the US\$116.7 in 4Q12, but substantially higher than the US\$25.9 million in 3Q13. It should be noted that the EBITDA for 4T12 includes non-recurrent net income of US\$39.6 million as a consequence of the insurance compensation for the delay in start-up of the Santa María I power plant caused by the earthquake of Feb10. If this effect is eliminated, EBITDA increases as a product of an improvement in the Company's generation mix structure.

Accumulated EBITDA as of Dec13 reached US\$352.4 million, compared with the US\$286.7 million as of Dec12. The increase as compared to the same period of the previous year, is mainly explained by an improvement in the cost structure (the coal-fired Santa María I power plant operated throughout the whole year, more access to gas supplies and less generation with diesel) and by a one-time income of insurance compensation for the loss of profit caused by a fire in our Nehuenco I thermal power plant in Dec07 for an amount of US\$63.9 million. These effects more than offset the extremely low hydro generation due to a fourth consecutive dry year and a catastrophic failure at the Nehuenco II power plant occurred in Mar13, which had the plant out of operation for 132 days (operating income incorporates US\$9.7 million for an advance on this claim associated to business interruption).

■ **Non-operating income** shows a loss of **US\$26.1 million** (vs. a loss of US\$16.5 million in 4Q12 and a loss of US\$3.9 million in 3Q13). This higher loss compared to 3Q13 is mainly due to a US\$9.7 million reclassification of the partial advance paid by the insurance company in 3Q13 from the non-operating "Other Profits (Losses)" line to the "Other Operating Income" line, since a fraction of this advance corresponds to business interruption or loss of profits, which the Company has a policy of reflecting in operating income.

Accumulated non-operating income as of Dec13 shows a loss of US\$70.8 million compared to a loss of US\$35.6 million as of Dec12. The effect of the previous reclassification is not applicable in accumulated terms and therefore the greater loss is mainly explained by less capitalization of finance costs due to the accounting treatment of the Santa María I power plant as an operating asset since Sep12, in conjunction with lower net income due to exchange rate differences and two asset impairment charges (Nehuenco II casualty in 1Q13 and the Los Pinos casualty in 2Q13).

■ **Income Taxes** reached an **expense of US\$31.1 million** (vs. an expense of US\$3.6 million in 4Q12 and an income of US\$8.0 million in 3Q13). The increase is explained mainly by an increase in the taxable income, by a recalculation of PPUA (provisional payment on absorbed net income) tax rates and by the effect of the depreciation in the Ch\$/US\$ exchange rate that negatively affected deferred tax liabilities with the consequent effect on the income tax expense.

Accumulated income tax expense as of Dec13 amounted US\$56.0 million, a decrease compared to the US\$64.2 million as of Dec12, explained by the non-recurring tax rate change abovementioned that had an impact on deferred tax balances. It is worth mentioning that in 3Q12 a tax reform law that increased the statutory tax rate was passed, with the corresponding effect on deferred taxes.

■ ■ **Physical sales to customers under power purchase agreements** during 4Q13 reached **3,177 GWh**, 38% higher than the same period of the previous year, mainly explained by the new long-term supply contract with Codelco which began in Mar13, and to a lesser extent, by an additional supply agreement that started in May13 with this same unregulated customer, which will be in force until Dec14. The latter considers a monthly supply in the order of 80 GWh and presents no risk for the Company since the price is indexed to the spot or marginal price. Sales under contract for the quarter decreased by 5% compared to the previous quarter, mainly due to regulated contracts which reached their supply limit before year-end. Finally, there were **net purchases in the CDEC market amounting 403 GWh** during the quarter compared to net sales of 642 GWh in 4Q12 and net purchases of 789 GWh in 3Q13.

Accumulated physical sales to customers under contract as of Dec13 reached 12,306 GWh, 25% higher than those as of Dec12, mainly explained by the growth in sales to regulated customers and by the contracts with Codelco previously mentioned. Net purchases in the CDEC market totaled 1,225 GWh as of Dec13, compared to net sales of 1,476 GWh as of Dec12.

■ ■ **Hydraulic generation** for 4Q13 reached **1,446 GWh**, an increase of 24% compared to both, 4Q12 and 3Q13. This increase is mainly explained by a melting period that was slightly better than the previous year in the Company's most significant basins, in addition to more available reservoir energy.

In spite of the above, in accumulated terms, the hydrological conditions continue being unfavorable with a fourth year of extremely dry weather. Thus hydraulic generation decreased by 7% as of Dec13 compared to the previous year, reaching 4,857 GWh.

■ ■ **Coal-fired generation** during 4Q13 amounted to 592 GWh, 18% and 8% lower than 4Q12 and 3Q13, respectively. This decrease is mainly because in Oct13 the Santa María I power plant had its scheduled major maintenance, which kept it out of service for 19 days. This stoppage coincided with a low marginal costs period in relation to the year's average, therefore the stoppage cost was low.

Accumulated coal generation as of Dec13 reached 2,616 GWh, a 41% increase compared to Dec12. The power plant had its first full year in service, with an availability factor of 86% which favorably compares with an average of 84% for the coal power plants in the SIC.

■ ■ **Gas generation** during 4Q13 was 779 GWh, 4% and 56% higher than in the 4Q12 and in the 3Q13, respectively. This increase compared to the previous quarter is because the Company negotiated an additional supply contract with ENAP from Oct13 to Dic13, foreseeing a poor melting season. Likewise, this greater production contrasts with lower gas production in the 3Q13 because the Nehuenco II power plant was out until July 24 due to the failure that meant changing the rotor and the subsequent outage of Unit I for scheduled maintenance.

In accumulated terms, there was a significant increase (44%) due to the supply agreements in force at the beginning of the year that Colbún negotiated with Metrogas and ENAP. Gas production could have potentially been higher if it was not for the breakdown in the Nehuenco II power plant, which left the plant out of service for 132 days. Furthermore, the purchasing position of Colbún could have been significantly reduced, considering that a combined-cycle power plant can generate approximately 250 GWh per month.

■ ■ **The Angostura hydroelectric project (316 MW)** is in its final stages and is in compliance with all relevant social commitments. In mid Dec13 the filling of the reservoir was completed and at the end of that month the first unit (135 MW) was synchronized for the first time. This unit is completing the water testing stages. Up to date, this unit has shown a stable generation. At the same time the Company continues progressing with the other two generating units, with dry tests, verification of instrumentation and software. It is expected that the plant will be fully operational at the end of Mar14. The sequential start-up of the units is consistent with the plant's design criteria, which operates only with one unit in the summer months due to the normal pattern of low flows in

the summer season. Once the project is completed, it will be the biggest hydroelectric power plant built in the last decade in Chile.

■ ■ In October 2013, Colbún **subscribed an international bank loan** for a total amount of US\$250 million and a bullet maturity of 5 years. The funds will be used to refinance short term debt, of which a portion has already been used, therefore the operation will not increase the level of debt. At 4Q13 closing Colbún had a cash **liquidity of US\$260.5 million.**

## 2. INCOME STATEMENT ANALYSIS

Table 1 shows a summary of the Income Statement for the 4Q13<sup>2</sup>, 3Q13 and 4Q12 and accumulated income statement for Dec13 and Dec12<sup>3</sup>.

**Table 1:** Income Statement (US\$ million)

Accumulated Figures			Quarterly Figures		
dec-12	dec-13		4Q12	3Q13	4Q13
<b>1,409.5</b>	<b>1,695.9</b>	<b>OPERATING INCOME</b>	<b>401.3</b>	<b>461.1</b>	<b>349.5</b>
742.0	727.8	Regulated Customers Sales	185.7	181.4	170.2
261.0	646.0	Nonregulated Customers Sales	47.8	202.7	130.8
134.7	55.9	Other Generators Sales	92.5	0.1	0.5
149.7	182.3	Transmission Tolls	35.4	68.9	36.5
122.1	83.9	Other Operating Income	39.9	7.9	11.6
<b>(1,047.4)</b>	<b>(1,260.1)</b>	<b>RAW MATERIAL AND CONSUMABLES USED</b>	<b>(262.3)</b>	<b>(413.6)</b>	<b>(222.7)</b>
(144.3)	(163.0)	Transmission Tolls	(38.7)	(46.6)	(39.0)
(61.7)	(420.3)	Energy and Capacity Purchases	(2.8)	(200.4)	(59.0)
(299.2)	(357.6)	Gas	(86.7)	(67.9)	(69.3)
(420.1)	(133.0)	Diesel	(68.3)	(53.7)	(5.0)
(40.1)	(104.5)	Coal	(29.8)	(26.3)	(24.7)
(82.0)	(81.8)	Other Operating Expenses	(36.0)	(18.6)	(25.7)
<b>362.1</b>	<b>435.9</b>	<b>GROSS PROFIT</b>	<b>139.0</b>	<b>47.5</b>	<b>126.9</b>
(53.7)	(60.1)	Personnel Expenses	(16.2)	(15.9)	(13.9)
(21.7)	(23.3)	Other Expenses, by nature	(6.0)	(5.7)	(6.2)
(136.0)	(162.6)	Depreciation and Amortization Expenses	(39.5)	(40.1)	(42.7)
<b>150.7</b>	<b>189.8</b>	<b>OPERATING INCOME<sup>1</sup></b>	<b>77.2</b>	<b>(14.2)</b>	<b>64.1</b>
<b>286.7</b>	<b>352.4</b>	<b>EBITDA</b>	<b>116.7</b>	<b>25.9</b>	<b>106.8</b>
5.0	5.1	Financial Income	1.2	0.8	1.2
(32.5)	(50.1)	Financial Expenses	(15.3)	(10.7)	(12.1)
4.5	5.1	Readjustment Profit (Loss)	2.0	2.2	2.1
10.4	2.3	Exchange rate Differences	(2.0)	(1.9)	0.0
8.3	4.9	Share in the Porfit (Loss) of Associates and Joint Ventures Accounted for Using the Equity Method	3.3	1.1	0.7
(31.4)	(38.0)	Other Profits (Losses)	(5.7)	4.6	(18.0)
<b>(35.6)</b>	<b>(70.8)</b>	<b>NON-OPERATING INCOME</b>	<b>(16.5)</b>	<b>(3.9)</b>	<b>(26.1)</b>
<b>115.1</b>	<b>119.0</b>	<b>PROFIT (LOSS) BEFORE TAXES</b>	<b>60.7</b>	<b>(18.1)</b>	<b>38.0</b>
(64.2)	(56.0)	Income Tax Expense	(3.6)	8.0	(31.1)
<b>50.9</b>	<b>63.0</b>	<b>PROFIT (LOSS) AFTER TAX FROM CONTINUING OPERATIONS</b>	<b>57.1</b>	<b>(10.1)</b>	<b>6.9</b>

<sup>1</sup> The subtotal for "OPERATING INCOME (LOSS)" presented herein, differs from the "profit (loss) from operating activities" line presented in the Financial Statements. This is explained by a change in taxonomy dictated by the SVS in Mar12, where the concept of "other profits (losses)", which in the case of Colbún are only non-operating items, was incorporated as an operating item in the Financial Statements.

<sup>2</sup> The 4Q13 considers reclassification of US\$9.7 million from "Other Profits (Losses)" to "Other Operating Income" for the concept of lost profits indemnity payment.

<sup>3</sup> Dec-12 shows a slight positive adjustment to EBITDA due to 1) the change in the policy for recognition and valuation of actuarial profits (losses) on employee benefits. For further information, please refer to Note 23.g. of the Financial Statements; 2) reclassification of US\$0.7 million from "Other Profits (Losses)" to "Other Operating Income" for sales of Emissions Reduction Certificates (CER).

## 2.1 OPERATIONAL RESULTS

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**EBITDA for 4Q13 amounted to US\$106.8 million**, slightly lower than the US\$116.7 million in 4Q12 but an important increase in comparison with the US\$25.9 million in 3Q13. The slight decrease in EBITDA as compared to the same quarter of the previous year is mainly explained because EBITDA for the 4Q12 included a non-recurring income of US\$39.6 million received from the insurance company due to delay in start-up of the Santa María I power plant caused by the earthquake of Feb10. If this effect is eliminated there is an increase in EBITDA due to an improvement in the Company's generating structure. The increase compared to 3Q13 was due to lower average cost of contracts supply due to a more competitive generation mix, especially greater hydroelectric generation and spot market purchases at marginal costs that was considerably lower than those observed in the previous quarters, due to the seasonality inherent to the melting season. As a reference, the marginal costs measured at Alto Jahuel decreased by 58% averaging US\$75/MWh during the quarter.

Accumulated figures show an EBITDA as of Dec13 of US\$352.4 million, which compares positively with the US\$286.7 million as of Dec12. The increase is explained by an improvement in the cost structure (Santa Maria I operated throughout the year, better access to gas supplies and a decrease in diesel-fired power plants generation). In addition, there are US\$63.9 million of a non-recurrent income from insurance compensation that covers the loss of profit caused by a fire in our Nehuenco I thermal power plant in Dec07. These situations more than compensate another dry year that was even worse than the previous one, making this the fourth consecutive dry year and a failure in the Nehuenco II power plant in Mar13 that caused the plant to be out of service for 132 days (the operating results include US\$9.7 million for an advance received by the insurance company related to the loss of profit).

**Operating revenues from energy and capacity sales to customers under contract** for the 4Q13 amounted to **US\$301.0 million**, an increase of 29% compared to the same quarter of the previous year. This increase is explained by higher physical sales to unregulated customers, mainly due to the new long-term contract signed with Codelco that came into force in Mar13, and to a lesser extent, for an additional supply to the same client that started in May13 and finishes in Dec14. This latter contract considers supply in the order of 80 GWh per month and does not present a risk to the Company since it is 100% indexed to the marginal cost. Income from customers under contract decreased by 22% compared to 3Q13 explained by lower average monomic price of sales, due to the conditions stipulated in the new contracts and to a lesser extent, to lower volume of physical sales.

Accumulated income from energy and capacity sales to customers under contract as of Dec13 amounted to US\$1,374 million, 27% higher than the US\$1,003 million as of Dec12. This increase is mainly explained by the same factors mentioned before (higher physical sales and a higher monomic price).

**Cost of raw materials and supplies used** during 4Q13 amounted to **US\$227.7 million**, 15% lower than those recorded in 4Q12, mainly due to lower fuel purchases, partially offset by higher purchases from the CDEC market. Cost of raw materials and supplies decreased by 46% compared to the 3Q13 as a consequence of lower purchases in the CDEC market and lower diesel consumption. It is worth mentioning that marginal costs (spot prices) in Alto Jahuel decreased by 58% in 4Q13 compared with the previous quarter.

Accumulated cost of raw materials and supplies reached US\$1,260 million as of Dec13, which represents an increase of 20% compared with the same period of the previous year as a consequence of higher purchases in the spot market (CDEC) and an increase in gas consumption, partially compensated by a decrease in diesel consumption. It is worth mentioning that the increase in purchases on the spot market is in part offset by some of the indexation in the price sales in force during the year. In addition, it should be noted that during the period from Jan-Sep12, and in accordance with the accounting treatment associated to the start-up period of Santa

María I power plant, coal consumption costs were netting the plant's operating income and were both registered in the "other operating income" line.

Table 2 presents a comparative table showing sales and purchases of energy, capacity sales and production, in physical units, for 4Q13, 3Q13 and 4Q12 and accumulated as of Dec13 and Dec12.

**Table 2:** Physical Sales and Generation

Accumulated Figures		Sales	Quarterly Figures		
dec-12	dec-13		4Q12	3Q13	4Q13
<b>11,389</b>	<b>12,826</b>	<b>Energy Sales (GWh)</b>	<b>2,945</b>	<b>3,343</b>	<b>3,185</b>
6,912	7,224	Regulated Customers Sales	1,721	1,872	1,708
2,921	5,082	Non-regulated Customers Sales	582	1,471	1,469
1,555	519	Spot market sales	642	0	8
<b>1,502</b>	<b>1,769</b>	<b>Capacity Sales (MW)</b>	<b>1,492</b>	<b>1,898</b>	<b>1,806</b>

  

Accumulated Figures		Production	Quarterly Figures		
dec-12	dec-13		4Q12	3Q13	4Q13
<b>11,568</b>	<b>11,253</b>	<b>Total Production (GWh)</b>	<b>3,009</b>	<b>2,571</b>	<b>2,825</b>
5,233	4,857	Hydroelectric	1,167	1,166	1,446
2,242	3,234	Thermoelectric - Gas	747	499	779
2,240	546	Thermoelectric - Diesel	374	260	8
1,853	2,616	Thermoelectric - Coal	721	646	592
<b>79</b>	<b>1,744</b>	<b>Purchases CDEC</b>	<b>-</b>	<b>789</b>	<b>411</b>

## Generation Mix

The hydrological year Apr13-Apr14 has been marked by poor hydrological conditions that continued to be unfavorable and extremely dry in the northern and central-southern zones of the country, showing lower than normal rainfalls, even worse than the previous year. Despite this, the 4Q13 exhibit an improved hydroelectric generation which is characteristic of the melting period that begins around September of each year, this meant **a 24% increase in the hydroelectric generation during the quarter** both when compared to 4Q12 and to 3Q13. Notwithstanding this increase in hydroelectric generation, the average river inflows for the quarter were between 20% to 40% lower than the flows in an average year in the relevant basins in which Colbún operates.

The hydroelectric generation was complemented **by efficient coal-fired generation, along with natural gas**. These, combined with higher coal-fired thermal power capacity throughout the system (Campiche and Bocamina II power plants), helped to reduce diesel-fired generation compared to the same period of the previous year, reducing marginal costs. As a reference, **electricity generated with diesel by Colbún decreased by 100%** with respect to 4Q12 and 3Q13; and the average marginal cost in Alto Jahuel during 4Q13 was US\$75/MWh, around 60% lower than in 4Q12 and 3Q13.

**Coal-fired power generation decreased** by 18% and 8% compared to 4Q12 and 3Q13, respectively, mainly as a consequence of a schedule maintenance that had the Santa María I power plant out of service for 19 days. Meanwhile, **gas-fired generation increased by 4% in comparison to 4Q12 and 56% compared to 3Q13**. This increase with respect to the previous quarter is due to a new supply contract signed with ENAP for the period Oct13-Dec13, foreseeing a



lower than. This higher production contrasts with lower gas-fired generation in 3Q13, because of the fact that Neuhueno II power plant was out of service for 132 days (until July 24) as a consequence of a failure that implied changing the rotor and after that, the Neuhueno I power plant entered into maintenance. Finally, diesel-fired generation decreased by almost 100% with respect to 4Q12 and 3Q13.

**Accumulated hydroelectric generation as of Dec13 decreased 7%** as compared to Dec12, whereas thermal-efficient generation increased 43%, as a consequence of a 41% increase in coal-fired generation and a 44% increase in gas-fired generation. It is worth mentioning that the gas-fired generation could have been higher if the failure in Neuhueno II power plant that kept the plant out of service for 132 days did not occur. This efficient thermal generation replaced diesel-fired generation, which declined 76%. Of the total thermal generation as of Dec13, approximately half of it corresponded to gas, 40% to coal and the remaining amount to diesel.

## Operating Revenues

**Operating revenues from ordinary activities for 4Q13 amounted to US\$349.5 million**, a decrease of 13% and 24%, compared to 4Q12 and 3Q13, respectively.

Accumulated operating revenues from ordinary activities as of Dec13 amounted US\$1,696 million, 20% higher than in the same period of the previous year. Revenues breakdown is as follows:

**Regulated customer sales:** revenues from sales to regulated customers reached US\$170.2 million in 4Q13, 8% and 6% lower than 4Q12 and 3Q13, respectively. The main driver of the decrease in comparison with 4Q12 is a lower average monomic price and, to a lesser extent, a decrease in physical sales. The decrease compared to the 3Q13 is explained by lower volume of sales (certain contracts reached their maximum delivery limit), partly compensated by a higher selling price.

Accumulated sales as of Dec13 reached US\$727.8 million, in line with the previous year, because the decrease in the monomic price is compensated by an increase in physical sales.

**Non-regulated customer sales:** sales to non-regulated customers reached US\$130.8 million in 4Q13, 2.7 times higher than the 4Q12, and a decrease of 36% with respect to 3Q13. The increase compared with 4Q12 is mainly explained by the higher volume of physical sales due to the new contracts with Codelco that started in Mar13 and May13 and higher average monomic price due to the conditions stipulated in these new contracts. On the other hand, the decrease compared to 3Q13 is a consequence of a **lower average monomic price due to a change on the indexation clauses in some contracts**.

Accumulated sales as of Dec13 reached US\$646.0 million, 2.5 times higher than the same period of the previous year. The increase was driven by an increase in sales and by higher prices set in the new contracts signed.

**Spot Market sales:** During 4Q13 8 GWh were sold to the CDEC market for an amount of US\$0.5 million (vs. 642 GWh equivalent to US\$92.5 million in 4Q12 and no sales in 3Q13).

Accumulated physical sales to the CDEC market as of Dec13 amounted to 519 GWh (US\$55.9 million), compared to 1,555 GWh during the same period the previous year (US\$134.7 million). It should be noted that this item also includes income from power capacity sales to the CDEC.

**Transmission Tolls:** Income from tolls reached US\$36.5 million in 4Q13, 3% higher than 4Q12 but a decrease of 47% compared to 3Q13, respectively. This was the result of toll income reassessments paid one month in arrears after the system decoupled in Jul13 and Ago13, and are invoiced one month later.

Accumulated income from transmission tolls as of Dec13 reached US\$182.3 million, a 22% increase compared to the same period of the last year. The difference is mainly due to higher income from the trunk system lines.

**Other Operating Income:** Other operating income reached US\$11.6 million during 4Q13, compared to US\$39.9 million in 4Q12 and US\$7.9 million in 3Q13. 4Q13 includes a gain of US\$9.7 million due to a reclassification from the non-operating line "Other Profits (Losses)" to "Other Operating Income" for the partial advance paid by the insurance company (Nehuenco II power plant claim) during 3Q13, since a fraction of this advance corresponds to business interruption or loss of profits, which the Company has the policy of reflecting in the operating income. In addition, the decrease compared to the 4Q12 is mainly explained because that quarter recorded US\$39.6 million for the concept of insurance for loss of profits due to the delay in the commissioning of the Santa María I power plant.

In accumulated terms, "Other Income" amounted to US\$83.9 million decreasing by 31% compared to Dec12. It should be noted that US\$73.6 million of the US\$83.9 million correspond to insurance indemnities, mainly for the payment of loss of profit from insurance companies for the casualty occurred in Dec07 at the Neuenco I power plant, whereas as of Dec12, these compensations reached only US\$39.6 million. In addition, it should be noted that the main component of this line as of Dec12 is explained by the accounting treatment (IAS 16 and IAS 18) of the Santa María I power plant in its start-up period, when the margin (sales minus costs) were recorded in this line. Since Sep12, month in which the power plant started to be treated as an operating plant for accounting purposes, the income statement by nature reflects the operation of Santa María I recognizing 100% of its injections in the CDEC balance sales and coal consumption in raw material costs.

#### **Cost of Raw Materials and Consumables used**

**Costs of raw materials and consumables used in 4Q13 amounted to US\$222.7 million**, a decrease of 15% and 46% compared to 4Q12 and 3Q13, respectively.

Accumulated costs of raw materials and consumables used as of Dec13 reached US\$1,260 million, 20% higher than those recorded as of Dec12.

**Transmission toll costs:** in 4Q13 toll costs reached US\$39.0 million, in line with 4Q12 and a decrease of 16% compared to the previous quarter. The decrease is mainly a consequence of lower costs in the sub-trunk system.

Accumulated toll costs as of Dec13 reached US\$163.0 million, compared to US\$144.3 million as of Dec12. The difference at an accumulated level is mainly explained by higher trunk lines costs and, to a lesser extent, to toll from additional lines during the period.

**Spot market purchases:** physical purchases during 4Q13 amounted to 411 GWh (US\$59.0 million), an increase compared to 4Q12 where there were no purchases and a decrease compared to the 789 GWh (US\$200.4 million) in 3Q13.

Accumulated purchases of energy as of Dec13 amounted 1,744 GWh (US\$420.3 million) vs. 79 GWh (US\$61.7 million) as of Dec12. It should be noted that the Neuenco II combined-cycle plant had a catastrophic failure in Mar13, which kept the plant out of operation for 132 days, therefore Colbún's purchasing position could have been significantly reduced considering that this plant generates approximately 250 GWh per month and has a variable cost (with gas and diesel) that is lower than the marginal cost observed during several weeks of the year. In spite of this, higher market purchases during the year were partially offset by trade conditions stipulated in certain energy supply contracts in force during the period. As a reference, the average marginal cost of the system (measured at Alto Jahuel) during the period from January to December 2013 was US\$154/MWh, lower than the US\$194/MWh during the same period in 2012. It should be noted that the amounts in US\$ include power capacity disbursements.



**Fuel costs:** during 4Q13 fuel costs reached US\$99.0 million, 46% and 33% lower than in 4Q12 and 3Q13, respectively.

Accumulated fuel costs as of Dec13 amounted to US\$595.0 million, a 22% decrease compared to Dec12. The difference with the same period of the previous year is due to a favorable evolution in the generation mix, since generation with diesel was largely replaced by more efficient thermoelectric generation with coal and natural gas under more competitive conditions than the previous year.

**Costs for third party work and supplies:** in 4Q13 reached US\$25.7 million, compared to the US\$36.0 million in 4Q12 and the US\$18.6 million in 3Q13. It should be noted that in 4Q12 a non-recurrent effect was recorded for materials and supplies inventory adjustment.

In accumulated terms, as of Dec13 this line amounted to US\$81.8 million, in line with the US\$82.0 million as of Dec12, which included the non-recurrent effect mentioned above.

## **2.2 ANALYSIS OF NON-OPERATING ITEMS**

**Non-operating income for 4Q13 recorded losses of US\$26.1 million**, higher than the loss of US\$16.5 million in 4Q12 and the loss of US\$3.9 million in 3Q13, respectively.

Accumulated non-operating income as of Dec13 recorded losses of US\$70.8 million, which negatively compares to the loss of US\$35.6 million as of Dec12. The main components are:

**Financial income:** income from investments during 4Q13 reached US\$1.2 million, in line with 4Q12 and higher than the US\$0.8 million in 3Q13. This increase compared to 3Q13 is a consequence of a higher liquidity during the quarter due to a new international bank loan (US\$250 million) subscribed in Oct13.

Accumulated income from investments as of Dec13 reached US\$5.1 million, in line with Dec12.

**Financial Expenses:** financial expenses during 4Q13 amounted to US\$12.1 million, lower than the US\$15.3 million recorded in 4Q12, but higher than the US\$10.7 million of 3Q13. The decrease in relation to 4Q12 is explained by the maturity of a local bond in 2Q13. The increase compared to 3Q13, it is because of higher financial debt as a consequence of the new loan mentioned before.

Accumulated financial expenses as of Dec13 reached US\$50.1 million vs. US\$32.5 million as of Dec12. The change is mainly due to lower capitalization of financial costs as a consequence of the accounting treatment of Santa María I power plant as an operating asset since Sep12.

**Exchange Rate Differences:** the exchange rate differences generated during 4Q13 are approximately US\$0 million, compared to losses of US\$2.0 and US\$1.9 million recorded in 4Q12 and 3Q13, respectively.

Accumulated exchange rate differences recorded an income as of Dec13 in the amount of US\$2.3 million, a decrease compared to the income of US\$10.4 million as of Dec12. This result is due to the 9.3% depreciation in the CLP/USD exchange rate during the period, and as a consequence of a negative net balance position in local currency during most part of the year.

**Other profits (losses):** during 4Q13 this line recorded a loss of US\$18.0 million, which includes a non-recurrent charge of US\$9.7 million due to a reclassification from the non-operating "Other Profits (Losses)" line to the "Other Operating Income" line which is part of the income related to the partial advance paid by the insurance company in 3Q13 (Nehuenco II power plant claim), since a fraction of this advance corresponds to business interruption or loss of profits, which the Company has a policy of reflecting in operating income. The loss for the 4Q13 negatively compares with both, the loss for 4Q12 of US\$5.7 million, and net income of US\$4.6 million in 3Q13. The difference compared to 4Q12 is mainly due to the already mentioned reclassification, partly offset

by lower non-operating expenses. The difference compared to 3Q13 is due to the reclassification and to lower non-operating income.

In accumulated terms, as of Dec13 this line recorded a loss of US\$38.0 million, higher than the loss of US\$31.4 million as of Dec12. The effect of the previous reclassification is not applicable in accumulated terms, therefore both periods are explained by non-recurrent effects. Dec12 considered the payment made to GasAndes and other transactional payments, whereas Dec13 considers two asset impairment charges (Nehuenco II in 1Q13 and Los Pinos in 2Q13), charge for carbon credit partly offset by the previously mentioned loss payment advance.

**Income Tax Expense:** as of Dec13 there is an income tax expense of US\$31.1 million, mainly due a higher profit before tax, a recalculation of the tax rates of PPUA (provisional payment on absorbed net income) and to the depreciation of the CLP/USD exchange rate that affects negatively the balances of deferred tax liabilities.

### 3. STATEMENT OF FINANCIAL POSITION ANALYSIS

Table 3 presents an analysis of the most relevant captions of the Statement of Financial Position as of December 31, 2013 and December 31, 2012.

**Table 3:** Statement of Financial Position Key Items (US\$ million)

	dec-12	dec-13
<b>Current Assets</b>	<b>788.6</b>	<b>744.1</b>
Cash and cash equivalents	217.7	260.5
Trade and other accounts receivable	184.8	133.0
<i>Normal sales</i>	121.7	128.9
<i>Others</i>	63.1	4.1
Current tax receivable	15.7	44.0
Other current assets	370.4	306.6
<b>Non-Current Assets</b>	<b>5,214.8</b>	<b>5,321.6</b>
Property, plant and equipment	4,904.2	5,033.0
Other non-current assets	310.6	288.7
<b>Total Assets</b>	<b>6,003.4</b>	<b>6,065.8</b>
Current liabilities	550.8	341.9
Non-current liabilities	1,939.8	2,167.6
Total net equity	3,512.8	3,556.3
<b>Total Liabilities and Net Equity</b>	<b>6,003.4</b>	<b>6,065.8</b>

**Cash and cash equivalents:** 'cash and cash equivalents' reached US\$260.5 million, an increase compared to 2012 due to higher cash flows generated by the operations and the new international bank loan, partially offset by the disbursements on the investment projects that the Company is currently undertaking (mainly the Angostura Project) and debt amortization payments.

**Trade and other accounts receivable:** "trade and other accounts receivable" reached US\$133.0 million, 28% lower than Dec12. This is explained by "other receivables" and is a consequence of a payment in 1Q13 from an insurance settlement recognized as income in Dec12. The payment totaled US\$56 million, which included the concepts of property damages and business interruption due to the delays at the Santa María I power plant after the Feb10 earthquake. The mentioned decrease is partially offset by an increase in "trade receivables" due to higher physical sales. It should be noted that for comparison purposes, a reclassification of US\$17.9 million from "trade and other accounts receivable" to "other current assets" was included in the financial statements as of December 31, 2012 for the concept of advance payments to suppliers.

**Current Tax Assets:** current tax assets recorded a balance of US\$44.0 million as of Dec13, almost three times higher than 2012 due to higher PPUA (provisional payment on absorbed net income), partly offset by lower PPM (monthly prepaid tax installments) in comparison to last year. It should be noted that we have reclassified US\$242.5 million as of Dec12 for comparison purposes, from "Current Tax Assets" to "Other Current Assets" for the concept of other taxes.

**Other Current Assets:** recorded US\$306.6 million, a decrease of 17% which is mainly due to a decrease in stock of inventory, reimbursements requested under Article 27 Bis of DL825 (where part of the VAT credit that had been accumulating due to disbursement of projects that the Company is undertaking are recovered early) and to the recovery of remaining tax credits.

**Property, plant and equipment, net:** property, plant and equipment amounted to US\$5,033 million as of Dec13, a US\$128.8 million increase compared to Dec12, which is explained by the investment projects currently being undertaken (mainly the Angostura Project), effect that is partially offset by the depreciation for the period.

**Current liabilities:** current liabilities reached US\$341.9 million, a decrease of US\$208.9 million as compared to Dec12. This change is mainly explained by payment of the last amortization of two local bond series denominated in UF and by the decrease in the outstanding balance of the revolving facility.

**Non-current liabilities:** non-current liabilities in operation totaled US\$2,168 million as of Dec13, a US\$227.7 million increase compared to Dec12. This change is mainly due to the new international bank loan signed during the last quarter, partially offset by the transfer from the long-term to the short-term of the debt that matures in the next 12 months. The increase is also driven by an increase in the deferred tax liability.

**Shareholders' equity:** the Company reached a net shareholders' equity of US\$3,556 million, a slight increase of 1.2% during the period. The reason behind is the profit for the period.

#### 4. INDICATORS

Below is a table comparing certain financial indicators. The Statement of Financial Position's financial indicators are calculated from the indicated date and the income statement considers the cumulative earnings at the indicated date.

**Table 4:** Financial Indicators

Indicator	dec-12	Sep-13	dec-13
Current Liquidity: Current Assets in operation / Current Liabilities in operation	1.43	1.26	2.18
Acid Ratio: (Current Assets - Inventory - Advanced Payments) / Current Liabilities in operation	1.35	1.17	1.97
Debt Ratio: (Current Liabilities in Operation + Non-current Liabilities) / Total Net Equity	0.71	0.69	0.71
Short-term Debt (%): Current Liabilities in operation / (Current Liabilities in operation + Non-current Liabilities)	22.11%	22.16%	13.62%
Long-term Debt (%): Non-current Liabilities in operation / (Current Liabilities in Operation + Non-current Liabilities)	77.89%	77.84%	86.38%
Financial Expenses Coverage: (Profit (Loss) Before Taxes + Financial Expenses) / Financial Expenses	4.54	3.13	3.37
Equity Profitability (%): Profit (Loss) After Taxes. Continuing Activities / Average Net Equity	1.46%	1.59%	1.78%
Profitability of Assets (%): Profit (Loss) Controller / Total Average Assets	0.87%	0.93%	1.04%
Performance of Operating Assets (%) Operating Income / Property, Plant and Equipment, Net (Average)	3.17%	2.55%	3.82%

- Average Shareholders' Equity: current Shareholders' Equity plus Shareholders' Equity a year ago, divided by two.
- Total Average Assets: total current assets plus total assets a year ago, divided by two.
- Average Operating Assets: current total Property, plant and equipment plus total property, plant and equipment a year ago, divided by two.

## 5. CASH FLOW ANALYSIS

The cash flow behavior can be seen in the following table:

**Table 5:** Summary of Cash Flow Statements (US\$ million)

Accumulated Figures			Quarterly Figures		
dec-12	dec-13		4Q12	3Q13	4Q13
295.8	217.7	<b>Cash Equivalents, Beg. of Period</b>	281.1	223.0	208.0
320.7	423.5	Net cash flows provided by (used in) operating activities	119.6	28.6	87.1
83.5	(47.8)	Net cash flows provided by (used in) financing activities	(57.3)	29.2	32.2
(491.3)	(329.3)	Net cash flows provided by (used in) investing activities	(124.5)	(72.3)	(64.2)
<b>(87.1)</b>	<b>46.4</b>	<b>Net Cash Flows for the Period</b>	<b>(62.2)</b>	<b>(14.5)</b>	<b>55.1</b>
9.0	(3.8)	Effects of exchange rate changes on cash and cash equivalents	(1.1)	(0.5)	(2.7)
217.7	260.4	<b>Cash Equivalents, End of Period</b>	217.7	208.0	260.4

During 4Q13, the Company presented a **positive net cash inflow of US\$55.1 million**. Accumulated figures show that cash flows are positive in the amount of US\$46.1 million, which compares favorably to the same period of the previous year.

**Operating activities:** during 4Q13 operating activities generated net cash inflows of US\$87.1 million, higher than the US\$28.6 million in 3Q13.

Accumulated operating activities generated net cash inflows as of Dec13 of US\$423.5 million, compared to the US\$320.7 million as of Dec12. This higher cash inflow is mainly because of the insurance settlement recognized in Dec12 associated to the Santa María I power plant (portion corresponding to the loss of profit due to the delay in the start-up of the power plant) collected in the 1Q13 and because of the insurance payment received on the claim filed for the Nehuenco I power plant in Dec07.

It is important to note that interest paid has been reclassified from “Net cash flow provided by (used in) operating activities” to “Net cash flows provided by (used in) financing activities”.

**Financing activities:** financing activities generated a positive cash inflow of US\$32.2 million during 4Q13 explained by the new international bank loan signed for an amount of US\$250 million, partially offset by the repayment of a local bond denominated in UF, by the decrease in the short-term revolving debt and by interests paid.

In accumulated terms as of Dec13, it shows a net cash outflows of US\$47.8 million. This is mainly explained by the amortization of a bank loan denominated in Chilean pesos, by the amortization at maturity date of two bonds series denominated in UF, the decrease in the outstanding balance of the revolving facility and by dividends and interests paid during the period. These movements are partially netted by the new loan already mentioned before.

**Investing activities:** investing activities generated net cash outflows of US\$64.2 million during 4Q13, lower than 3Q13 and explained by additions to property, plant and equipment, mostly associated to the Angostura Project, and repair works in the Nehuenco II power plant during the period.

Accumulated investing activities generated negative net cash flows of US\$329.3 million as of Dec13. This is mainly explained by additions to property, plant and equipment of US\$328.8 million and contributions to HidroAysén (US\$9.9 million).



## **6. ENVIRONMENT AND RISK ANALYSIS**

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Colbún S.A. is a power generating company with an installed capacity of 2,962 MW, comprising 1,689 MW in thermal units and 1,273 MW in hydraulic units. It operates in the Central Interconnected System (SIC), where it represents about 20% of the market in terms of installed capacity.

Through its commercial policy, the Company seeks to be a safe and reliable competitive energy provider with a sales volume that allows maximizing long-term profitability of its asset base, reducing the volatility of its results. The Company results show a structural variability due to exogenous conditions such as hydrology and fuel prices (oil, gas and coal). In dry years the hydraulic generation deficit is supplied by increasing production by thermal units with diesel or gas, which complements efficient coal-fired generation. Eventually the Company uses energy purchases in the spot market at marginal cost, which is set by generation with gas or diesel if its own capacity is insufficient.

### **6.1 Medium-Term Perspective**

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The hydrological year Apr13-Apr14 has been marked by poor hydrological conditions that continue to be unfavorable and extremely dry in the northern and central-south zones of the country, showing mild rainfall with respect to an average year and even worse than the previous one. Despite the hydrological situation, 4Q13 shows an increase in hydro generation, which is characteristic of the melting season that starts in September, because of snow accumulation during winter time. Notwithstanding the increase in hydroelectric generation the average level of the rivers during the last quarter were approximately 20% to 40% lower than in an average year in the basins where Colbun operates.

Despite the draught, the Company's operating results in 2013 show an increase compared to 2011 and 2012. Despite the extremely dry hydrological conditions, the increase compared to the previous years is primarily due to the capacity of the Company to cope with adverse scenarios because of a better cost structure (Santa María I coal-fired power plant that operated throughout the year, more access to natural gas under better commercial conditions that replace diesel-fired generation) and a non-recurring income of US\$63.9 million related to the collection from the insurance companies for the loss of profit from Nehuenco I power plant as a consequence of the incident in Dec07. These effects more than compensated the extremely low hydroelectric generation due to the fourth consecutive dry year and a failure in Nehuenco II power plant in Mar13 that had the plant out of service for 132 days. It is worth to mention that Santa María I power plant completed its first year in service with an availability of 86%, compared to the average of 84% from coal-fired power plants in the SIC.

Income for the quarter also reflects a considerable improvement, especially after a particularly weak third quarter (due to the failure of the Nehuenco II power plant and subsequent maintenance of Nehuenco I, which led to a purchasing position in the spot market which could have been reduced considering that this type of power plant generates approximately 250 GWh per month and that it has a variable cost that is lower than the marginal cost paid during several weeks in 2013). Notwithstanding, this 4Q13 once again shows an improvement in the EBITDA due to greater hydroelectric generation (the greatest in the year), which was complemented with efficient coal thermoelectric generation, in conjunction with natural gas. It should be noted that during the quarter there was a natural gas contract in force with ENAP Refinerías S.A. which contemplated the supply for one unit of the combined cycle of the Nehuenco Complex, which was negotiated foreseeing a poor thawing season. All these factors added to the higher coal thermoelectric

capacity present at a system level (Campiche and Bocamina II plants), helped to reduce thermoelectric generation based on diesel in comparison to the same period last year, limiting marginal costs. For reference purposes, the average marginal cost at Alto Jahuel during 4Q13 was US\$75/MWh, approximately 60% lower than the values current in the 4Q12 and 3Q13.

In regards to the Company's commercial policy, it seeks a level of commitments that suits its competitive power generating capacity. This is complemented by supply prices that fit the cost structure of the Company and risk mitigation mechanisms of prices during transition periods (entry of new contracts / construction of new projects). Although this policy does not completely eliminate exposure to extremely dry hydrology, the experience gained shows a significant reduction of those effects. However, our commercial policy do not only intend to reduce exposure to dry hydrology, but also to generate a profile of commercial margins over long periods of time, that allow to make our asset base in operation and under construction profitable.

Compared to previous years, the Company is in a more balanced position between its commercial commitments and its own competitive production capacity, even when we consider the adverse hydrological situation. Since Mar13, the Company has a new long-term supply contract with Codelco. Additionally, during 2Q13 an additional medium-term supply was negotiated with this same unregulated client, which will be in force until Dec14. This last contract presents no risk to the Company, given that the costs associated with this supply are transferred to the client.

The Company's results during the next few months will be mainly determined by a more balanced position between its contracted sales and its efficient generation. This is due to: the end of certain contracts with unregulated clients; the start of commercial operation of Angostura and; finally, because of thermal efficient coal-fired Santa Maria I and gas-fired Nehuenco I and II operating at full capacity. Regarding the latter, the Company has two natural gas supply agreements. The first is medium-term contract with Metrogas S.A., and considers the supply for one unit of the Nehuenco Complex from January to April for the years 2013 (already used), 2014 and 2015. The second agreement, recently negotiated with ENAP Refinerías S.A., considers the supply for the other combined-cycle unit of the Nehuenco Complex from October 2013 to March 2014 (partially used). Regarding the supply of natural gas, the company is continuously signing contracts with both ENAP and Metrogas, depending on the flexibility and hydrological conditions.

On the medium-term, the results will depend on the previously mentioned factors and on the insurance outcome related to the incident occurred in Mar13 in the combined-cycle Nehuenco II (398 MW) where a final settlement could be reached, for both the physical damage and the loss of profit.

It should be noted that after the entry into operation of the Angostura project, the Company has incorporated more than 900 MW of efficient capacity to the system since 2006, investing more than US\$2 billion. Angostura will complete this growth phase leaving Colbún as the Company that has incorporated the most capacity to the system, representing 38% of the total. With this, we expect to continue with the progress both in the financial metrics that have been improving in the last years, as well as in the search for consolidation of this strong investment showing excellency at an operating level.

In a more long-term horizon, the Company's income will be determined mainly by the level of reliable operation of our power plants, which are expected to have a high level of availability and by a normalization of rainfall conditions.

## **6.2 Growth plan and long-term actions**

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Colbún is executing a development plan that consists in increasing its installed capacity keeping a relevant hydroelectric component, with efficient thermoelectric complement that allows it to increase supply security in a competitive manner diversifying its sources of generation. The status of the projects that the Company is developing is detailed as follows:

### Projects Concluded

- **Angostura-Mulchén Transmission Line Project:** the energizing of the Angostura-Mulchén line was completed in Dec13. This project composed of the Angostura-Mulchén, 220kV, 470 MVA double circuit that is 40 kilometers long, and the Mulchén substation with its six sets of lines, one bus tie and a disconnector, completed its placement in operation, which will allow the Angostura power plant to inject energy to the Central Interconnected System (SIC).

### Projects under Construction

- **Angostura Project (316 MW):** this hydroelectric project will take advantage of the water resources of the Biobío and Huequecura Rivers in the Biobío Region. The project is in its final stages and is in compliance with all relevant social commitments. In mid Dec13 the filling of the reservoir was completed and at the end of this month the first unit (135 MW) was synchronized for the first time, and is completing the water testing stages. Up to date, this unit has shown a stable generating level. At the same time, the Company continues progressing with the other two generating units, with dry tests, verification of instrumentation and software. It is expected that the plant will be fully operational at the end of Mar14. The sequential entry in service of the units is consistent with the plant's design criteria, which operates only with one unit in the summer months due to the normal pattern of low river inflows in the summer season. Once the project is completed, it will be the largest hydroelectric plant built in the last decade in Chile.

### Projects under Development

- **San Pedro Hydroelectric Project (150 MW):** The Company concluded the phase of analyzing the results of prospection and land studies conducted from 2011 to 2013. Additionally, there have been other studies and monitoring in order to define the required adjustments in the civil works. Given the information gathered so far, the analysis is expected to continue in the first semester of 2014 in order to present a new design to the authorities. Once this analysis is completed, the Company will be able to define a clear timeline for the construction of the project.

- **La Mina Hydroelectric Project (34 MW):** This project, located in the community of San Clemente, will use the waters of the Maule River. The project qualifies as a NCRE mini hydro power plant, having obtained Environmental Qualification Resolution in November 2011 and its DIA optimization approval in May 2013. As of today, the Company is reviewing the offers received during the tender for construction of civil works and hydro mechanical equipment that began last year.

- **Coal-fired thermal project Santa Maria II (342 MW):** Colbún has an environmental permit to build a second unit, similar to the first unit in operation. Currently the Company is studying the possible modifications required by the new emissions standard enacted in 2011. It also is analyzing the technical, environmental, social and financial progress to define the timely start of development.

- **Floating Terminal of LNG regasification (FSRU - floating storage regasification unit):** The Company is developing the technical environmental and economic feasibility studies for an LNG regasification project. The goal of this project would be to access the international natural gas markets and secure this fuel under flexible and competitive

conditions.

▪ **Hidroaysén:** Colbún, together with Endesa-Chile, participates in the development of hydroelectric projects in the Baker and Pascua Rivers in the Aysén region. These hydroelectric plants will have a total installed capacity of approximately 2,750 MW. Once operational, this capacity would be sold independently by the two companies. Although the Hidroaysén Project received environmental approval to build five hydroelectric plants in May 2011, which was confirmed both by the Court of Appeals of Puerto Montt as well as the Supreme Court, it is not yet resolute because of outstanding claims that have existed for almost two years before the Council of Ministers, of both the owner of the project and opposition to it. While Hidroaysén was in the process of preparing the Environmental Impact Study (EIA) of the engineering and the broadcast of the transmission project, on May 30, 2012 Colbún's Board decided to recommend at the corresponding instances of Hidroaysén S.A. the indefinite suspension of the transmission project EIA. This decision was based on the view that while there is no national policy that has broad consensus and gives guidelines of the energy needed by the country, Colbún estimated that the adequate conditions were not in place to develop energy projects of this magnitude and complexity. To date, the total amount invested in Hidroaysén is US\$159.7 million.

### **6.3 Environmental policy and community development**

In the development of their projects Colbún has emphasized integration with its neighboring communities. In this sense, they work hard with stakeholders, functional organizations and local authorities in order to understand social dynamics and be able to develop projects that are geared to the real needs and create shared value with communities.

In environmental terms, Colbún has sought closer alignment to power generation with high rates of "eco-efficiency", considering their design criteria of being technically and economically sound, as well as environmentally efficient. The development focus of the Company is in renewable energy, with a complete thermal efficiency to achieve a secure supply, remain competitive and provide sustainability for our customers.

### **6.4 Electricity Business Risks**

Colbún faces risks associated with exogenous factors such as the economic cycle, hydrology, the level of competition, demand patterns, the structure of the industry, changes in the regulation and levels of fuel prices. Moreover, it faces risks associated with project development and failures of generating units. The main risks for this year are associated with hydrology, fuel prices, failure risks in operating plants and risks in project development.

#### **6.4.1. Hydrology Risks**

Approximately 55% of the installed capacity of Colbún corresponds to hydroelectric and thermal plants with coal, which enables the Company to deliver its commitments to low operating costs. However, in dry hydrologic conditions Colbún must operate its combined cycle thermal plants mainly with natural gas purchases or with diesel, allowing for lower hydraulic generation supply to complement the efficient coal-fired generation. In extreme conditions it may be necessary to operate open cycle plants operating with diesel.

This situation raises the costs of Colbún, increasing variability of its earning depending on the hydrological conditions. The Company's exposure to hydrological risk is reasonably mitigated by a commercial policy that aims to maintain a balance between competitive base generation (hydraulic in a medium to dry year and thermal coal generation) and commercial

commitments. Additionally our sales to customers are agreed upon on the basis of indexes that reflect the cost structure of the Company. However, given extreme hydrological conditions the variability in the results may increase. This situation is constantly under analysis in order to take timely mitigating actions required.

In this sense, given the hydrological conditions of the past three years, in several instances the Company has perfected purchase agreements of natural gas to operate its combined cycles. These agreements incorporate operational flexibility allowing the use of this fuel in different power plants.

#### **6.4.2. Risk of fuel prices**

As mentioned in the description of hydrological risks, in situations of low water availability in its hydraulic plants, Colbún should use its thermal plants or purchase energy in the spot market at marginal cost.

In these scenarios, Colbún's production costs or the marginal costs are directly affected by fuel prices, with a risk for the variations that international fuel prices present. Part of this risk is mitigated by contracts whose selling prices are also indexed to changes in fuel prices. Additionally, in order to reduce fuel price risks and considering factors such as hydrological conditions, the evolution of commodities markets, the level of correlation of contract prices to commodities prices, coverage programs have been implemented with different derivative instruments including call options, put options, etc.

#### **6.4.3. Fuel supply risk**

For the supply of fuel the Company has agreements with suppliers and its own storage capacity to ensure adequate reliability in respect to the availability of this type of fuel.

New tenders have been undertaken inviting important international suppliers to bid on coal purchases for the Santa María I power plant, awarding the supply contract to well supported competitive companies. This is in line with an early purchasing policy in order to prevent any risk of not having this fuel available.

#### **6.4.4 Risk of equipment failure and maintenance**

The availability and reliability of generating units and transmission assets is essential to ensure the levels of production to adequately cover our commitments. This is why Colbún's policy to conduct regular maintenance on its equipment according to the recommendations of its suppliers and the accumulated experience in its long operational history about failures and accidents. We have seen that the thermal generation equipment that can operate with gas or diesel (originally designed to operate with natural gas) increase their equivalent operating hours when using diesel as compared to when using gas. As a result, if the units operate on diesel they require more frequent maintenance than usual and have lower levels of availability. Given this, we have adopted maintenance policies, processes and procedures as well as the investments needed to increase levels of reliability and availability of thermal units.

As corporate policy, Colbún maintains insurance for its physical assets, including coverage for physical damage and loss of profit due to business interruption.

In spite of the maintenance performed and the daily operating measures taken, on January 12, 2014 there was a failure at the Blanco power plant (60 MW) located in the basin of the Aconcagua

River. The failure in question, whose origin is being investigated, caused damages to the generator-turbine equipment and annex equipment, which has kept it out of operation. Our technicians are on site performing engineering work to estimate the startup date of this power plant.

It should be noted that Blanco, as well as all our generating facilities has property damage and loss profits insurance.

#### **6.4.5 Project Construction Risks**

The development of new generation and transmission projects can be affected by factors such as delays in obtaining environmental approvals, regulatory framework changes, prosecutions, increases in the price of equipment, opposition from local and international stakeholders, and adverse geographical conditions, natural disasters, accidents or other unforeseen events.

Colbún is currently developing several projects simultaneously, so any of these factors may adversely affect them and further increase the final cost estimated. This situation may have an adverse effect on the normal operation of the Company, as it means postponing the implementation of competitive power generation plants for an indefinite period and replacing its production with generation with diesel fuel, or in its absence by increased purchases in the spot market.

The Company's exposure to such risks is managed through a commercial policy that considers the effects of potential project delays. Alternatively, we incorporate clearance levels in the time and cost of construction estimates.

Additionally, the Company's exposure to this risk is partially covered with the "All Risk Construction" insurance policies covering both physical damage and loss of profit as a result of delay in service resulting from a disaster, both with standard deductibles for this type of insurance.

#### **6.4.6 Market Risks**

We are facing a very challenging electricity market, which shows an imbalance between growing demand and an efficient and competitive supply. The lack of progress in the development of new SIC-based power plants due to the obstacles faced by investment processes, generates great uncertainty regarding the manner in which future demand will be supplied once the existing capacity is reached and the few projects currently under construction.

The problem is not lack of interest in investing (there are many projects that have been approved or are in the approval process in the Environmental Assessment System), the central issue is that only a small fraction of these projects are being built.

Some of the causes of this situation are:

1. Neighboring communities and society in general legitimately demanding greater participation and a more protagonist role.
2. Long and uncertain environmental procedures followed by legal processes of the same characteristics.

Colbún has worked intensely on developing a social bond that will allow it to work together with neighboring communities and society in general. The basic challenge is to generate conditions for the communities to be better off with the projects than without them. In order to achieve



the above, we focused our efforts on beginning a process of citizen participation and generating trust at the early stages of our projects and maintaining an open and transparent presence during their entire life cycle (design, construction and operation).

In addition, it is necessary to reach a broad social and political agreement to drive an agenda destined to the reactivation of investments and concreting the generation of efficient base power plant projects in order to enable sustained development of the economy and safeguard the environment.

#### 6.4.7 Regulatory Risks

Regulatory stability is fundamental for a sector such as electricity generation where the development, execution and return on investment has a long-term period. Such regulatory stability has been a valuable characteristic in the Chilean electricity sector.

Notwithstanding the above, there is always room for improvement in respect to regulations. We believe that it is currently important to develop new initiatives to resolve some uncertainties in the balanced and logical operation of the system and in the lack of initiatives for new generation projects with significant capacities.

Here we refer in detail to certain risks or recent regulatory measures:

- **Electricity Highway Bill:** this project proposes the construction of public utility electricity transmission lines throughout the entire country, with the necessary means to allow efficient connection of all electricity generation available to the grid. This planning with a long-term horizon seems key to supply the future growth of the demand and the manner in which it will be implemented is a very relevant issue for the country and Colbún will seek to better contribute in the national discussion.
- **Legal Regulation of Compensation to Neighboring Communities:** encouraging that communities where projects are generated receive direct benefits seems to us to be an initiative that is going in the right direction, i.e. this mechanism would allow for the financing of social projects in benefit of neighboring communities.

### 6.5 Financial Risks

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Financial risks are those associated with the inability to perform transactions or the breach of obligations from the activities for lack of funds, as well as variations in interest rates, exchange rates, counterparty bankruptcy or other financial market variables that may materially affect Colbún.

#### 6.5.1 Foreign Exchange rate risk

The foreign exchange rate risk is mainly due to payments that must be made in currencies other than the dollar for the power generation process; by investments in power generation plants existing or new plants under construction, and contracted debt in currencies other than the functional currency of the Company. The instruments used to manage foreign exchange risk are currency swaps and forwards.

In terms of matching the currencies the Company's current balance sheet shows a surplus of assets over liabilities in Chilean pesos. This "long" position translates into income from exchange rate differences of approximately US\$1.4 million for each Ch\$10 variation in the CLP/USD exchange rate.

#### 6.5.2 Interest Rate Risk

Refers to changes in interest rates that affect the value of future cash flows tied to variable interest rate, and changes in the fair value of assets and liabilities linked to fixed interest rate that are measured at fair value.

The objective of this risk management is to achieve a balanced debt structure, reduce the cost impacts driven by fluctuations in interest rates and in this way to reduce volatility in the income statement of the Company. To meet those objectives and according to Colbún estimates, hedge derivatives are contracted in order to mitigate these risks. The instruments used are fixed interest rate swaps and collars.

The Company's financial debt, including the effect of the contracted interest rate derivatives, has the following profile:

Interest Rate	dec-13	Sep-13	dec-12
Fixed	90%	89%	90%
Floating	10%	11%	10%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

There is exposure to the Libor rate, which means that in case of an increase of 10 basis points in the Libor rate, the Company must annually disburse an additional US\$0.16 million.

### 6.5.3 Credit Risk

The Company is exposed to the risk arising from the possibility that counterparty fails to meet its contractual obligations and produce economic or financial loss. Historically all counterparties with which Colbún has maintained energy delivery commitments have made the corresponding payments correctly. In addition to this, many of the charges invoiced by Colbún are to members of the Chilean Central Interconnected System, highly solvent entities. Notwithstanding the above, during the past year there have been specific problems of insolvency of some members of the CDEC.

With respect to cash and derivatives statements, Colbún carry out the transactions with high credit ratings agencies, recognized nationally and internationally, so as to minimize the credit risk of the Company. Additionally, the Company has established participation limits by counterparty, which are approved by the Board of Directors and reviewed periodically.

As of Dec13, investments of cash surpluses are invested in local and international banks for periods of less than 90 days (known as "money market"); the first with local risk classification rated equal or superior to AA-, and foreign with international investment grade credit rating. These investments are diversified over a wide range of financial institutions, where the one with the highest share reaches 32%. Regarding existing derivatives, the Company's international counterparts have risk rating equivalent to BBB or above and national counterparts have local rating of AA- or higher. It should be noted that no counterpart concentrates more than 12% in notional terms.

### 6.5.4 Liquidity Risk

This risk results from different funding requirements to meet investment commitments and business expenses, debt payments, etc. The funds needed to meet these cash flow outputs are obtained from our own resources generated by the ordinary activity of Colbún and by contracting credit lines to ensure sufficient funds to cover projected needs for a given period.

As of Dec13 Colbún has cash in the amount US\$260.5 million invested in deposits with an average duration of less than 90 days and in short-term mutual funds with maturity of less than 90 days. Furthermore, the Company has additional liquidity sources available to date: (i) a committed line with local funding for UF 4 million, (ii) two lines of bonds registered in the local market for a set amount of UF 7 million, (iii) a line of trade notes in the local market for UF 2.5 million and (iv) uncommitted bank lines of approximately US\$150 million.

In the next 12 months, the Company must disburse approximately US\$107 million in interest and amortization of principal, which mostly correspond to the maturity of the loan with Corpbanca (assigned to Banco Santander) for an amount of US\$24 million in January 2104. The rest of the disbursements will be attended with cash flow from the operations.

As of Dec13 Colbún has national risk classification of A+ from Fitch Ratings and AA- from Humphreys, both with stable perspectives. At an international level the Company's classification is BBB with a stable perspective from Fitch Ratings and BBB- with negative perspective from Standard & Poor's.