FitchRatings

13 Aug 2019 | Rating Changed Outlook to Positive

Fitch Affirms Colbun's IDRs at 'BBB'; Outlook Revised to Positive

Fitch Ratings-New York-13 August 2019: Fitch Ratings has affirmed the Foreign and Local Currency Issuer Default Ratings (IDRs) of Colbun S.A. (Colbun) at 'BBB' and its Long-term National scale rating at 'AA-(cl)'. The Rating Outlook is revised to Positive from Stable. A complete list of rating actions follows at the end of this press release.

Colbun's ratings are supported by its solid business position in the electricity market in Chile and its strong portfolio of diversified generation assets. Fitch expects Colbun to maintain adequate liquidity levels in the medium term, supported by strong and predictable cash flow. The Positive Outlook reflects Fitch's view that Colbun has strengthened its credit profile within its IDR level of 'BBB', based on the company's improved capital structure, strong operating performance and strong EBITDA generation in the medium term, robust liquidity position. Fitch believes that Colbun will have the capacity to maintain an adequate contractual position in the long term, with an expansion toward more renewables energy projects during 2019 to 2022, combined with positive annual FCF that will average approximately USD160 million annually during the same period.

KEY RATING DRIVERS

Balanced Contractual Position: Colbun's ratings incorporate a commercial strategy based on contracts with financially strong power distribution companies and medium to large industrial counterparties with a weighted average life of approximately eight years. These contracts have adequate indexation mechanisms closely matching the company's generation mix and largely mitigate its exposure to fuel price volatility. Based on normal to dry hydrology conditions, contracts requirements are balanced with energy sales in Chile around 12,000 gigawatt hours (GWh) during 2019-2021, concentrated approximately 50% on regulated clients and the remaining portion with unregulated customers.

Stable Credit Metrics: Colbun's cash flow generation is mainly explained by higher hydroelectric generation combined with an increase in energy sales to unregulated clients, lowering its exposure to spot prices. In addition, the company has partially mitigated its contracted position, combined with the operational performance from efficient generation units. As of June 2019, the company reported total debt/EBITDA of 2.4x, in line with the 2.5x average registered during 2016-2018. Fitch believes under normal hydrological conditions, Colbun's consolidated EBITDA would be in the range of USD600-USD650 million during 2019-2021, assuming no additional debt. The company's credit metrics will be around 2.5x over the rating horizon.

Partially Mitigated Re-Contracting Risk: Fitch believes Colbun will maintain an adequate contractual position in the long term. The company's average contract span is eight years. As part of Colbun's commercial strategy, the company has been able to subscribe purchase power agreements (PPAs) with more than 230 unregulated clients for up to 3.7Twh/year. The most significant are with Empresas CMPC S.A. (BBB/Stable) for 630 GWh per year until 2028 and Minera Zaldivar for 550 GWh per year for 10 years starting in July 2020. In line with other generation companies in Chile, Colbun has benefited from the change in the law that allows small to medium industrial clients to choose between regulated and non-regulated market conditions. Fitch expects the company's total contracted position to reach approximately 12 TWh during 2019 through 2021. Fitch believes the company has partially mitigated its re-contracting risk by subscribing PPAs that replace the regulated contracted expiring during 2022.

Exposure to Hydrological Risk: In the event of a severe drought, the company may need to generate power with its thermal assets to fulfil its contracts. Historically, hydro generation represented between 45%-50% of the company's total generation. Fitch estimates approximately 6,000GWh per year during 2019-2021 for hydro generation, representing nearly 50% of the company's total output. The company's conservative commercial policy is based on a long-term balance contracted structure for its hydro units, complemented by its efficient thermal units under different scenarios.

Favorable Natural Gas Contracts: Colbun's contracted position could be met by the company's efficient natural gas units or by purchases on the spot market, with a negative effect on margins if the company faces a dry hydrological scenario. Fitch views positively Colbun's long-term LNG supply agreement with ENAP (A/Stable) until 2031, when regasification capacity will be reassessed. In addition, the company has subscribed medium- and short-term LNG supply agreements with ENAP and Aprovisionadora Global de Energia S.A. (Agesa), a subsidiary of Naturgy Energy Group (BBB/Rating Watch Negative) for up to 2.0TWh of energy based on natural gas units. To a lesser extent, the company has been able to import natural gas from Argentina since October 2018; Colbun has agreements with Argentinean natural gas companies, subject to the condition of interruptible supply upon confirmation.

Renewable Expansion in Chile: Fitch believes that Colbun's investment plan in Chile is manageable and that future investments will be financed through the company's cash flow generation, without requiring additional debt. Colbun's expansion plan in Chile is concentrated in solar and wind projects. The company has a pipeline of 3.200 MW of installed capacity in Chile that it is currently developing approximately 807MW of installed capacity in the north of the country. Diego de Almagro, a 200MW photovoltaic project, is the company's most advanced development with an expected Commercial Operation Date (COD) during June 2021. Horizonte, a wind farm of 607MW of installed capacity, has an expected COD during October 2023.

Transmission Reorganization: During the fourth quarter 2018, Colbun allocated all its National, Zonal and dedicated transmission assets to its fully-owned subsidiary Colbun Transmision S.A. Through this company, Colbun owns more than 940 km of transmission lines with 28 substations generating approximately USD70 million in EBITDA annually, with EBITDA margins above 80%. Fitch estimates a low business-risk profile for the transmission business reflected in highly predictable and stable cash flow generation, as the revenue generation has no exposure to volume or price risks. As of June 2019, Colbun Transmision has no financial debt.

Manageable Growth Agenda: Colbun has an ambitious medium- to long-term regional expansion agenda, mainly concentrated in renewables in Chile and brownfield projects in Peru and Colombia. Fitch believes the company has sufficient liquidity coupled with strong cash flow generation to resume moderate M&A activities in the short to medium term as indicated by the company to buy operating hydro or combined cycle assets, avoiding the construction risk. Fitch expects Colbun will continue to be disciplined in its M&A activities and will remain committed to maintaining a capital structure that is commensurate with an investment-grade rating.

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 August 2019, Colbun had a market capitalization of USD3.209 billion with an average volume traded in the last of USD1.784 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/Positive) and AES Gener (BBB-/Stable), with PPA's having an average life near 10 years. Relative to its peers, Colbun also has a generation mix evenly distributed between hydro and thermal, similar to its other 'BBB' category peers, such as Enel Generacion Chile (BBB+/Positive). 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 Gener is mainly concentrated on coal-based units and has a small portion of hydroelectricity generation in Chile. While Engie has lower exposure to hydrological risks, as its generation assets are concentrated in thermal units, its contracts are well matched presenting fuel costs pass-throughs, making its business risk consistent with other peers. Enel Chile (AA(cl)/Positive) shows a slightly lower business risk of the four companies, 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 and consistent with the 'BBB' rating level with leverage around 2.5x measured as total debt to EBITDA. While Engie successfully concluded an aggressive expansion phase, this is similar to Colbun's more aggressive expansion strategy for growth through potential acquisitions. Colbun's FCF remains positive and is solid for the rating category. Enel Chile has consistently shown strong leverage metrics, measured as total debt to EBITDA less than 2.0x or below. Fitch expects gross leverage to temporarily increase between 2.5x to 3.0x shortly after the reorganization process of Enel Chile, declining to below 2.0x going forward. Enel Generacion Chile's capital structure is the strongest among its peers with gross leverage averaging 1.5x in recent years, Fitch expects Enel Generacion Chile will remain as a key contributor of Enel Chile's consolidated EBITDA. AES Gener's capital structure remains pressured and is weaker than its peers at consistently around 4.0x and therefore warrants a lower rating than its peers.

KEY ASSUMPTIONS

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

--Contracted energy sales in Chile for approximately 12,000 gigawatt hours (GWh) during 2019-2021;
--Hydro production in Chile at 6,000GWh per year;
--Contracted energy sales in Peru expected above 3,000 GWh per year.
--EBITDA in the range of USD650 - USD600 million during 2019-2022;
--USD170 million for Almagro photovoltaic project evenly distributed between 2020-2021;
--Annual capex of USD100 million and USD120 million to maintain current operations;
--50% dividend pay-out ratio during 2019-2022.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
The Outlook could be revised if the company is able to keep its consistent improvement on the contracted position while also maintaining a total consolidated debt/EBITDA below 2.0x on a sustained basis.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
-A change in Colbun's commercial policy that results in an imbalanced long-term contracted position;
-A material and sustained deterioration of credit metrics reflected in total consolidated debt-to-EBITDA ratios above 3.5x; -Inability to re-contract a significant portion of expiring contracts;
-Acquisitions that would deteriorate the company's credit metrics;
-Pressure from shareholders that could result in a significant increase in dividend payments beyond the company's plan.

LIQUIDITY

Strong Liquidity: Colbun has maintained a solid liquidity position with approximately USD670million of cash and cash equivalents as of June 2019, compared with USD80 million of short-term debt. Fitch expects the company will maintain a strong liquidity position, driven by Colbun's cash generation. The company's liquidity is further buoyed by uncommitted credit lines of approximately USD150 million and two bond lines registered in the local market for a total amount of UF7.0 million.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. 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.

FULL LIST OF RATING ACTIONS

Fitch has affirmed Colbun S.A.'s ratings as follows:

--Long-Term Foreign and Local Currency IDR at 'BBB';
--International Senior Unsecured bonds at 'BBB';
--Long-term National Scale Rating at 'AA-(cl)';
--National Senior Unsecured bonds at 'AA-(cl);
--National Equity Rating at 'Primera Clase Nivel 1(cl)'.

The Rating Outlook is revised to Positive from Stable.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)

Metodología de Calificaciones en Escala Nacional (pub. 02 Aug 2018)

Metodología de Calificación de Finanzas Corporativas (pub. 16 Apr 2019)
Metodología de Clasificación de Acciones en Chile (pub. 01 Aug 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Sector Navigators (pub. 23 Mar 2018)

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