



RATING ACTION COMMENTARY

Fitch Downgrades EPM's Ratings to 'BBB-'; Maintains Rating Watch Negative

Thu 13 Aug, 2020 - 18:11 ET

Fitch Ratings - New York - 13 Aug 2020: Fitch Ratings has downgraded Empresas Publicas de Medellin E.S.P.'s (EPM) Foreign and Local Currency Issuer Default Ratings (IDRs) to 'BBB-' from 'BBB' and maintained the Rating Watch Negative. The downgrade is due to increased intervention by EPM's owner, the City of Medellin (BBB-/Negative), in the management of the company, which represents a deterioration of corporate governance controls at the company. Fitch believes recent actions taken by the company are contrary to the Governability Agreement, signed on April 23, 2007, between the City of Medellin and EPM's management, in which the municipality agreed to respect the autonomy of EPM as an industrial and commercial enterprise of the state and to act exclusively through the board of directors.

Earlier this week, all eight independent members of EPM's board of directors announced their resignations after the recently-elected mayor of Medellin instructed the company to take certain actions without the board of directors approval. The resignations of eight of the nine board of director members follows an announcement in July 2020 that EPM's social objective may be expanded beyond

providing public services to include tourist services, new technologies, infrastructure and bridges and tunnels, among other items. Furthermore, the company initiated a lawsuit this week for COP9.9 trillion (approximately USD2.7 billion) against the contractors, supervisors and the contractors' insurance companies of its embattled 2.4 GW Ituango project without consulting with the board of directors.

EPM's ratings reflect the company's low business risk resulting from its diversification and characteristics as a utility service provider. EPM is a leading electricity generator in Colombia and exhibits a diversified portfolio of utility businesses that include electric generation, transmission and distribution, water and sewage services, natural gas distribution, and garbage collection and disposal services. The company's ratings also reflect its solid credit protection measures supported by moderate historical and projected leverage, healthy interest coverage and an adequate liquidity position. EPM's ratings also reflect the company's somewhat aggressive growth strategy and exposure to regulatory risk, which is low.

EPM's Rating Watch Negative reflects continued uncertainty regarding the closure of Ituango's blocked Auxiliary Diversion System since April 28, 2018, and final cost over-runs of its Ituango project. In June 2020, the company announced an additional delay due to the coronavirus pandemic. Fitch's expectation is that 300MW of the project will be online by early 2022. Additional technical and infrastructure complications are possible, and could further delay the project's Commercial Operation Date (COD). Additional unforeseen contingencies have been partially mitigated after the insurers announced the damages qualified under the insurance policy, but there is no clarity as to when and what damages will be covered. The resolution of the Rating Watch may extend longer than six months given these uncertainties.

KEY RATING DRIVERS

Deteriorating Corporate Governance: Fitch views recent actions taken by the company apparently without consulting the board of directors as well as the subsequent resignation of all eight independent board members as clear evidence of deteriorating corporate governance. Fitch also believes these actions are a violation of the longstanding Governability Agreement, signed in 2007, between the City of Medellin and EPM, which stipulates that the city would respect the company's autonomy as a commercial and industrial enterprise of the state and manage the

company exclusively through the board of directors. As a result, Fitch has assigned EPM an ESG score of 5, indicating that the score caused a change in rating.

Minor Delay at Ituango: Fitch continues to maintain the Rating Watch Negative until further confirmation that the diversion and auxiliary tunnels are appropriately plugged. In June 2020, the company announced an additional delay as a result of the coronavirus pandemic. Fitch believes that the financial impact of the Ituango project is mitigated after the announcement that its insurer, Mapfre, determined that the causes of damage at the Ituango project is covered by the insurance policy. EPM received USD150 million in insurance proceeds in 2019 and expects to receive between USD100 million and USD200 million in 2020.

Fitch believes the company remains exposed to execution risk even though the company has made progress to remediate the collapse of the project's tunnels. Fitch expects EPM will plug the diversion tunnels and auxiliary diversion tunnels (ADT) within the next six to 12 months. Fitch's base case assumes that 300MW will be in operation in 2022, in line with the company's guidance.

Stable Credit Metrics: Fitch estimates EPM's consolidated gross leverage, defined as total debt to EBITDA, will average 4.1x between 2020-2023. The elevated leverage is mostly explained by the company's Ituango project, which Fitch estimates will cost a total of USD3.4 billion by the final completion, an incremental cost of USD1.5 billion as well as the additional debt incurred from the offering. Net leverage is expected to average 3.5x over the same horizon as the company is expected to increase its cash on hand to combat economic uncertainty.

Fitch's base case assumes a modest increase in cash flows in 2022 when 300MW of the project comes on line, followed by two additional launches of 300MW thereafter. Fitch believes that despite higher leverage in the medium term, EPM has a solid credit profile with FFO interest coverage averaging 3.7x times between 2020-2023 and average net debt to EBITDA of 3.5x over the same time period. Lastly, Fitch believes EPM has strong access to international and local financial markets, and over the rated horizon, will refinance upcoming maturities to preserve liquidity.

Assumption of CaribeMar Assets: EPM's assumed ownership of CaribeMar is positive for the business and credit neutral. Fitch's base case for EPM assumes the company will take over CaribeMar's operations and assets in September 2020, which are just north of its existing concession areas and will commit up to USD1.0

billion of investment capex by 2024 to reduce energy losses, quality improvements and general collections. CaribeMar's capex is expected to be 3.3x greater than its projected EBITDA between 2020 through 2024. Fitch expects material increases of EBITDA by 2025, when losses are expected to decrease and tariffs adjustments. Fitch understands that CaribeMar has no financial debt and the government will assume the pension obligations of the company.

Insurance Payments Support Capex: Fitch's base case assumes that EPM will receive payments up to USD1.1 billion from its insurance policy between 2019 through 2022. The company received the first payment of USD150 million from Mapfre Seguros Generales de Colombia S.A. in December 2019. Fitch believes the insurance payments will be made in instalments as both entities review damages and costs. The payments are a credit positive and relieve pressure of selling EPM assets to further offset the estimated incremental cost of USD1.5 billion of the project.

Stable Cash Flow Profile: EPM has a stable and predictable cash flow profile supported by regulated businesses in investment grade markets. Fitch estimates 80% of EPM's 1Q20 EBITDA was derived from its Energy business, where its generation segment comprised 32%; 43% was distribution; and the gas and transmission segments combined for 5%. EPM's distribution business operates in highly regulated markets, mostly concentrated in Colombia, where it is the largest distributor in the country, with a market share of 25%. Further, EPM is a majority shareholder in the second largest distribution company in Panama, Elektra Noreste (BBB/Stable). EPM also has a presence in water and waste management services in Chile, Colombia and Mexico. Fitch estimates that 20% of the company's EBITDA comes from its water and waste management services.

Moderate Regulatory Risk Exposure: Fitch believes EPM's exposure to regulatory risk is low. The bulk of EPM's consolidated revenues are generated by regulated tariffs or medium-term contracts. The latter exposes the company to potentially sustained low electricity prices. Historically, Colombian regulatory entities have ruled independently from the central government and have provided a fair and balanced framework for both companies and consumers. Fitch expects future regulatory changes will have a neutral impact on the company's cash flow generation and financial profile. Future regulatory changes are expected to be aimed at adding transparency to the market and the regulatory framework overall. EPM's diversified business profile further mitigates the company's regulatory risk, as a simultaneous tariff decrease across all businesses is unlikely.

Moderate Linkage with Parent: EPM consistently contributes significant cash flows in the form of dividends to its parent, the City of Medellin (BBB-/Negative). These distributions comprised 20% of the city's total revenues in 2019, and have exceeded government revenues by 20% four out of the last five years. Under Fitch's criteria, a government-related entity (GRE) that sustainably generates more than 10% of the government's revenues is considered a strong linkage factor that would lead to an equalization of the ratings. Fitch may nevertheless choose to apply notching down from the government if there are concerns regarding the company's financial structure. Considering EPM's capital structure is not as strong as its parent's and uncertainty surrounding the financial impacts of the Ituango project, Fitch maintains a Rating Watch Negative on EPM's ratings until the company can regain control of the project.

DERIVATION SUMMARY

EPM's low business-risk profile is commensurate with its investment-grade rating and is comparable with that of Grupo Energia Bogota S.A. E.S.P.'s (GEB, BBB/Stable), Enel Americas S.A. (A-/Stable), AES Gener (BBB-/Stable) and Promigas (BBB-/Stable). EPM's ratings are three notches below Enel Americas, as the latter has a strong diversified and geographic footprint in South America and a more conservative capital structure. Fitch estimates Enel Americas gross leverage will be 1.6x in 2020 and will remain below that level thereafter, not considering any acquisitions. Fitch projects EPM's total leverage to average 4.2x over the rating horizon but 3.5x on a net basis due to increased cash on the company's balance sheet. In 2024, Fitch expects gross and net leverage to be 3.8x and 3.4x, respectively.

EPM is rated in line with AES Gener and Promigas. GEB's operating environment and exposure to regulated business bodes well for its credit quality compared with AES Gener, which operates in a more competitive environment. Also, Fitch projected leverage for GEB is in the range of 3.5x to 4.0x, slightly lower than AES Gener, for which Fitch expects leverage metrics to average 4.0x. Promigas is also rated one notch below GEB in the international scale, given its lower level of business and geographic diversification and its higher leverage levels over the medium term compared to GEB.

KEY ASSUMPTIONS

- Ituango project gradually launched into operations with 300MW by early 2022, 600MW later in 2022 and 1,200MW in 2026;
- Total Ituango cost of USD3.4 billion, a \$1.5 billion increase from original budget;
- Ituango's medium-term commercial obligations are covered with electricity purchases, existing hydroelectric asset base and thermal generation;
- No Dividends from UNE expected over the rated horizon;
- Dividend pay-out of 50% of previous year's net income;
- No Divestment in 2020 or during the rating horizon;
- Total Insurance payments of USD1.1 billion from 2019 through 2022;
- Refinancing of all Local and International bonds maturing over the rated horizon;
- Capex for ElectriCaribe to be financed predominately through debt up to USD800 million.

RATING SENSITIVITIES

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

- An upgrade is not likely in the short to medium term given the expected delay in Ituango's operation, the company's current credit metrics, large capex program and the potential materialization of project relation contingencies.

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

- The materialization of significant cost overruns and contingencies that weaken the company's liquidity;
- Additional delays in Ituango's COD;
- Sustained leverage above 4.5x;

--An overly aggressive investment and/or acquisition strategy that drives leverage metrics consistently above 4.5x.

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: Fitch expects the company's July 2020 issuance to bolster liquidity and does not anticipate a material near-term effect on EPM's liquidity and operating cash flow resulting from the Ituango landslide. Approximately 66% of the company's EBITDA is from regulated businesses with highly stable cash flow generation. EPM held approximately COP2.4 trillion of cash on hand as of March 2020. Fitch expects the company will have COP4.1 trillion cash on hand at the end of 2020 following the issuance and cash flow from operations of approximately COP2.4 trillion for the year. These amounts provide sufficient liquidity to cover short-term financial obligations of COP1.5 trillion for 2020 and its capex program.

Currently, the company's dividend policy is expected to remain in place despite the cash flow impact derived from Ituango's delay. Historically, EPM has transferred on average between 45% and 55% of its net income to the city of Medellin in the form of dividends. EPM's transfers to Medellin have historically represented approximately 20% to 30% of the city's investment budget. Although not likely in the near term, an increase in the company's dividend distribution policy could pressure its FCF generation, which is already expected to continue to be negative in the medium term as the company continues to execute its investment plan.

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

Empresas Publicas de Medellin E.S.P. (EPM): Management Strategy: 4, Governance Structure: 5

Except for the matters discussed above, the highest level of ESG credit relevance, if present, 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.

RATING ACTIONS

ENTITY/DEBT	RATING			F
Empresas Publicas de Medellin E.S.P. (EPM)	LT	BBB- Rating Watch Negative	Downgrade	E
	IDR			V
				N
	LC	BBB- Rating Watch Negative	Downgrade	E
	LT			V
	IDR			N
● senior unsecured	LT	BBB- Rating Watch Negative	Downgrade	E
				V
				N

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Lincoln Webber, CFA, CAIA

Associate Director

Primary Rating Analyst

+1 646 582 3523

Fitch Ratings, Inc. Hearst Tower 300 W. 57th Street New York 10019

Jose Luis Rivas

Director

Secondary Rating Analyst

+57 1 484 6770

Natalia O'Byrne

Senior Director

Committee Chairperson

+57 1 484 6773

MEDIA CONTACTS**Elizabeth Fogerty**

New York

+1 212 908 0526

elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Parent and Subsidiary Rating Linkage \(pub. 27 Sep 2019\)](#)[Government-Related Entities Rating Criteria \(pub. 12 Nov 2019\)](#)[Corporate Rating Criteria \(pub. 01 May 2020\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)[Solicitation Status](#)[Endorsement Policy](#)**ENDORSEMENT STATUS**

Empresas Publicas de Medellin E.S.P. (EPM)

EU Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, THE FOLLOWING [HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT](https://www.fitchratings.com/rating-definitions-document) DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

[READ LESS](#)**COPYRIGHT**

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch

believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact

purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

[READ LESS](#)

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the [EU Regulatory Disclosures](#) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Corporate Finance Utilities and Power Latin America Colombia

