FitchRatings

RATING ACTION COMMENTARY

Fitch Maintains EPM's 'BB+' Long-Term IDRs On Rating Watch Negative

Thu 21 Mar, 2024 - 14:12 ET

Fitch Ratings - Austin/Bogota - 21 Mar 2024: Fitch Ratings has maintained the Rating Watch Negative (RWN) on Empresas Publicas de Medellin E.S.P.'s (EPM) 'BB+' Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) and 'AAA(col)' National Scale Long-Term rating.

Additionally, Fitch has maintained the RWN on EPM's 'BB+' senior unsecured debt ratings and has maintained the company's 'bbb-' Standalone Credit Profile (SCP) on RWN. Fitch has also maintained the RWN on EPM Inversiones S.A.'s 'AAA(col)' National Scale Long-Term rating, and has affirmed the National Short-Term rating at 'F1+(col)'.

EPM's ratings reflect strong ownership and control by its owner, the city of Medellin (BB+/Stable). EPM Inversiones' rating is equalized with that of EPM's, given the existence of legal, operational and strategic incentives for support from EPM.

EPM's RWN reflects continued uncertainty regarding the closure of the right tunnel of Ituango's blocked Auxiliary Diversion System since April 28, 2018. The possibility of major flooding downstream from the project exists until the deviation tunnel is closed. The resolution of the RWN may extend longer than six months given these uncertainties.

KEY RATING DRIVERS

Strong Linkage with Parent: EPM consistently contributes significant cash flows in the form of dividends to its parent, the city of Medellin (BB+/Stable). These distributions comprised 22% of the city's total revenues in 2023 and have made up an average of over 20% of government revenues over the last five years. EPM's financial relevance for Medellin, lack of effective documentation limiting dividend distribution, and the city's influence on the company's administration and operations, leads Fitch to consider a strong linkage factor, resulting in an equalization of the ratings.

Ituango Increases Capacity: Units 3 and 4 of the Ituango project, of 300MW each, came online in October 2023, in line with the company's schedule, and reaching a total installed capacity of 1.200MW. In 2023, Ituango produced a total of 4.461MW for a market share of 5.52%. When complete, the project will consist of eight 300MW units for a total of 2.4GW, or roughly 13% of the country's current installed capacity.

Units 5 through 8 are expected to come online in 2027. The total project cost is estimated to be COP22.5 trillion (~USD5.8 billion) with an annual EBITDA of roughly COP1.2 trillion (~USD307 million). Overall, the project is 92.6% complete.

The RWN will remain in effect until further confirmation that the right deviation tunnel has been appropriately plugged with a 22-meter long concrete wall inside the tunnel to stop any flow of water. The tunnel is expected to be secured in 2024 as the company continues advancing the completion of the remaining units. Additionally, the tunnels should not be part of the critical route to produce electricity. As of February 2024, the company reported 98.6% progress on pre-plug 2 of the right deviation tunnel, 97.1% on pre-plug 1 and 97.3% in overall progress to secure the tunnel.

Moderate Impact from El Niño Phenomenon: In anticipation of El Niño induced dry conditions in the first half of 2023, EPM has adjusted its commercial strategy. It is keeping contract sales at a range of 80% to 90% to reduce reliance on spot market purchases. EPM's risk mitigation strategy is bolstered by its geographically diverse matrix and availability of thermal generation units. Total generation for 2023 reached 19,257Gwh, 5.5% less than in 2022.

The generation segment benefitted from energy sales through contracts and in the spot market at higher prices, with an expected increase in its share of total EBITDA for 2023 to 36% from 29% in 2022. The distribution segment was impacted by higher energy costs, mainly from the recently acquired subsidiary Afinia, which had an increased exposure to the spot market during the year. Fitch expects a fall of over 50% in Afinia's EBITDA in 2023, to around COP215 billion (~USD55 million).

Moderate Leverage Expected: Fitch expects EPM's consolidated gross leverage, defined as total debt to EBITDA, will average 3.0x between 2024-2027, while net leverage will average 2.8x. New debt contracted will be aimed at financing the company's investment plans, as well as working capital needs generated by limitations on increases in tariffs applied by the government during 2023. Demanding capex programs at Afinia (with an estimated USD1.1 billion in capex between 2024 -2027) and for concluding the Ituango project, consistent dividend payments of 55% of net income to the city of Medellin, and elevated interest costs with refinancing needs on debt, prevent steeper deleveraging over the rated horizon.

Stable Cash Flow Profile: EPM has a stable and predictable cash flow profile supported by regulated businesses in investment-grade markets. Nearly 30% of the group's revenue and 20% of its EBITDA are from outside Colombia. Fitch estimates 84% of EPM's 2023 EBITDA was derived from its energy business, where its generation segment comprised 36%; 45% was distribution and transmission, water and waste management was 16% and gas 3%.

As Colombia's largest distributor, with a 37% market share and a smaller 6.5% in transmission, EPM operates primarily in regulated Colombian markets. Government-imposed tariff caps at the end of 2022 have led to higher working capital needs in distribution business and an expected delay in collecting COP2.9 trillion in revenue over two to three years. EPM traditionally allocates 45%-55% of its net income to Medellin as dividends, accounting for 20%-30% of the city's investment budget. While not imminent, any hike in dividend payouts could strain the company's free cash flow (FCF), which Fitch projects to remain negative short-term due to ongoing investments.

Regulatory Risk: Fitch considers EPM's exposure to regulatory risk moderate following president Petro's attempt to control regulations of the country's public services, as well as potential board member turnover at the Electricity and Gas Regulatory Commission (CREG) being increasingly in the president's favor. Given EPM's concentration in regulated businesses within Colombia, Fitch considers the company's risk exposure moderate. Any changes by the administration require that they not cause hardship and must provide all market players with financial stability to operate properly.

DERIVATION SUMMARY

EPM's ratings are linked to those of its owner, the city of Medellin (BB+/Stable), due to the latter's strong ownership and control over the company. The company's low business-risk profile is commensurate with that of Grupo Energia Bogota S.A. E.S.P.'s (BBB/Stable), Enel Americas S.A. (BBB+/Stable), AES Andes (BBB-/Stable), Enel Colombia S.A. E.S.P. (BBB/Stable) and Promigas (BBB-/Stable).

Fitch projects EPM's total leverage to average 3.0x over the rating horizon, considering the financing needed for its investments plan, including demanding capex needs at Afinia, as well as covering working capital needs. This is in line with AES Andes' and Promigas' expected average gross leverage, that will remain between 3.5x and 4.0x. It is higher than Enel Colombia's which will remain below 2.0x.

EPM also compares well with electricity generation peers that have national ratings, namely Enel Colombia S.A. E.S.P., Isagen S.A. E.S.P. and Celsia Colombia S.A. E.S.P., all rated 'AAA(col)'. Similar to peers, EPM has an efficient portfolio of low-cost hydro assets. In 2023, with the entry of units 3 and 4 of Ituango, EPM ranked first in installed capacity behind Enel Colombia and first in generation, ahead of Enel Colombia and Isagen, which were second and third, respectively.

KEY ASSUMPTIONS

--Ituango units 5 through 8 come online in 2027 with no penalties or significant further delays;

--Generation load factor of approximately 50% over the rated horizon;

--Distribution tariffs increase at expected rate of inflation from 2024-2027;

--COP2.9 trillion in uncharged revenue are recovered between 2024-2026;

--Dividend payout of 55% of previous year's net income;

--No divestments in 2024 or the rating horizon;

--Total debt disbursements of COP11.8 trillion between 2024 and 2027;

--Capex of COP7.7 trillion in 2024, COP8.6 trillion in 2025, COP7.6 trillion in 2026 and COP5.6 trillion in 2027;

--Electricity spot prices of COP517/KWh in 2024, COP264/KWh in 2025, and COP255/KWh in 2026 and COP256/KWh in 2027.

RATING SENSITIVITIES

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

--Although unlikely in the near term, Fitch may consider a positive rating action if there is a positive rating action on the city of Medellin;

--Fitch may consider a resolution of the RWN once the company has secured the second deviation tunnel at its Ituango project, which Fitch expects by YE 2024. In this case, the Stable Rating Outlook for the city of Medellin would likely apply.

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

--A negative rating action on the city of Medellin's ratings;

--If penalties are incurred or loss of guarantees related to delays or the materialization of significant cost overruns and contingencies at the Ituango project that weaken the company's liquidity.

--Sustained gross leverage above 3,5x.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: As of 3Q23, EPM had a cash in hand and equivalents of COP3.0 trillion (~USD768 million) at the group level, COP1.0 trillion (~USD256 million) of which was at the parent company. As of 3Q23, the company had consolidated debt of COP27.2 trillion (~USD7.0 billion), the majority of which was due in 2027 and after. The company faces scheduled maturities of COP3.5 trillion and COP1.2 trillion in 2024 and 2025, respectively, resulting in refinancing needs in a high financing cost environment.

Fitch estimates available cash on hand plus forecast CFO will cover more than 2x short-term maturities on average as of YE 2023. In 2023, the company secured a 10-year credit with Agencia Francesa de Desarrollo - AFD for USD190 million to fund its investment plan, and a total of USD220 million in disbursements from the Club Deal committed credit line secured in 2022.

ISSUER PROFILE

EPM, founded in Medellín, Colombia, in 1955 to provide public utility services, participates in the generation, transmission, distribution and commercialization of electricity, the distribution and commercialization of natural gas and the provision of water, sewage and waste management services.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

EPM's ratings are capped by the ratings of its owner, the city of Medellin.

ESG CONSIDERATIONS

Empresas Publicas de Medellin E.S.P. (EPM) has an ESG Relevance Score of '4' for Governance Structure due to its nature as a majority government-owned entity and the inherent governance risk that arises with a dominant state shareholder, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Empresas Publicas de Medellin E.S.P. (EPM)	LT IDR	BB+ Rating Watch Negative Rating Watch Maintained	BB+ Rating Watch Negative
	LC LT IDR	BB+ Rating Watch Negative Rating Watch Maintained	BB+ Rating Watch Negative
	Natl LT	AAA(col) Rating Watch Negative Rating Watch Maintained	AAA(col) Rating Watch Negative

senior unsecured	LT	BB+ Rating Watch Negative Rating Watch Maintained	BB+ Rating Watch Negative
senior unsecured	Natl LT	AAA(col) Rating Watch Negative Rating Watch Maintained	AAA(col) Rating Watch Negative
EPM Inversiones S.A.	Natl LT	AAA(col) Rating Watch Negative Rating Watch Maintained	AAA(col) Rating Watch Negative
	Natl ST	F1+(col) Affirmed	F1+(col)

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Julieta Seebach
Director
Primary Rating Analyst
+1 512 215 3743
julie.seebach@fitchratings.com
Fitch Ratings, Inc.
2600 Via Fortuna, Suite 330 Austin, TX 78746

Juan David Medellin
Senior Analyst
Secondary Rating Analyst
+57 601 241 3227
juandavid.medellin@fitchratings.com

Natalia O'Byrne
Senior Director
Committee Chairperson
+57 601 241 3255
natalia.obyrne@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

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

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Metodología de Vínculo de Calificación entre Matriz y Subsidiaria (pub. 13 Jul 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Metodología de Calificación de Finanzas Corporativas (pub. 22 Dec 2023)

Government-Related Entities Rating Criteria (pub. 12 Jan 2024)

Metodología de Calificación de Entidades Relacionadas con el Gobierno (pub. 07 Mar 2024)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Empresas Publicas de Medellin E.S.P. (EPM)	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (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. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

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. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

Copyright © 2024 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved.

READ LESS

SOLICITATION STATUS

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

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.