12 Jun 2020 | Upgrade

Fitch Upgrades Engie Energia Chile's IDRs to 'BBB+'; Outlook Revised to Stable

Fitch Ratings-New York-12 June 2020:

Fitch Ratings has upgraded Engie Energia Chile S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'BBB+' from 'BBB' and Long-Term National Scale rating to 'AA(cl)' from 'AA-(cl)'. Fitch has also upgraded the company's USD850 million outstanding unsecured notes to 'BBB+' from 'BBB' and affirmed its national Equity Rating at 'Primera Clase Nivel 2(cl)'. The Rating Outlook has been revised to Stable from Positive.

The upgrade of Engie Energia Chile's ratings reflects Fitch's view that the company has strengthened its credit profile based on the company's improved capital structure, with expected leverage expected to average 2.0x during 2020-2022; strong contracted position of 100% until 2028 with a contracted average life of its PPA of 12 years; the successful conclusion of its USD2.2 billion expansion plan. The Stable Outlook is driven by Fitch's expectations that Engie will maintain adequate liquidity levels in the medium term, supported by strong and predictable cash flow.

Fitch believes the company's ability to reduce its exposure to coal and migrate to cleaner energy sources will be key to supporting Engie Energia Chile's ratings in the long term, as the company follows its parent company Engie S.A.'s (A/Stable) zero-carbon transition program. Fitch estimates that Engie will have the capacity to finance its energy transition program shifting toward more renewables energy and estimates a capex of approximately USD540 million during 2020-2021.

Key Rating Drivers

Predictable Operating Cash Flow: Engie's contractual structure substantially mitigates cash flow exposure to fuel price volatility and supports stable and predictable cash flow. Long-term private purchase agreements (PPAs) with strong counterparties, primarily in the mining sector, support the company's robust, stable and predictable cash flow generation from operations. Engie recently renegotiated some PPAs with non-regulated clients, extending its average remaining life to 12 years. These contracts include a price discount for the first three years, after which the fuel indexation clause is eliminated, keeping only the consumer price index indexation as Engie replaces its coal based units with renewable sources.

Strong Contractual Position: Fitch estimates the company will be 100% contracted until 2028, presenting a more balanced portfolio from 2019 onward, where non-regulated clients will represent approximately 50% of total energy sold, and the remaining portion with regulated clients with a contracted average life of its PPA of 12 years. Fitch believes Engie will benefit from segment and geographic expansion as the 15-year PPA with regulated clients in the southern Sistema Electrico Nacional is in full force until 2032. In addition, Engie's entrenched business position in the mining industry is bolstered by more than 2,300 km of transmission lines. Additionally, the company has signed two long-term LNG supply contracts for the use of its existing combined cycle units, further contributing to the predictability of its cash flow generation.

Moderate Impact from Covid-19: Engie's ratings incorporate a balanced commercial strategy based on contracts with financially strong counterparties in the mining sector and power distribution companies in the country. Fitch expects energy demand from non-regulated customers will remain stable, as the mining sector continue its operations and has not been affected by lockdowns. Fitch anticipates a lower energy demand for regulated customers, mainly concentrated in the first half of the year, reflecting an overall contraction of 5% on energy sold to the regulated segment, compared with previous year. Moreover, Fitch does not anticipate potential delays on the company's current construction on renewable projects, as the additional 362MW of installed capacity will start operations during 2021.

Strong Credit Metrics: Engie's solid credit profile is supported by stable EBITDA and moderate to low leverage during 2020-2023. For LTM March 2020, EBITDA reached USD524 million and total debt/EBITDA was 1.6x, significantly lower compared with the 3.1x registered by the end of 2017 during the peak of the company's investment program. The recent EBITDA increase was caused by higher energy sales to regulated customers, associated to the PPA secured during 2014's auction for up to a maximum contracted volume of 5,040GWh starting in 2019. Fitch projects Engie's leverage to average 2.0x during 2020-2022. The projections assume a capacity expansion from Infraestructura Energetica Mejillones (IEM), combined with increase participation in energy from renewable sources and gradual decommission of coal-based units.

Decarbonization Strategy: Engie successfully concluded an intensive investment program with the commercial operation of IEM and the port. Fitch believes that Engie will have the capacity to finance its energy transition program, shifting towards more renewable energy sources. The disconnection of units 12 and 13 from Central Tocopilla (170MW of installed capacity) was completed during June 2019. Fitch assumes units 14 & 15 from Tocopilla complex will be disconnected in December 2021, and CTM units 1 & 2 during 2024, totaling 268MW and 334MW, respectively.

Engie has 362MW renewable capacity currently under construction, with operations expected to begin in 2021. Fitch believes the company's ability to reduce its exposure to coal and migrate to cleaner energy sources will be key to supporting Engie Energia Chile's ratings in the long term. As its parent company Engie S.A.'s zero-carbon transition takes place, it may prove to be challenging over the first steps.

Weak Linkage with Parent Company: Although Engie Energia Chile's ratings are based on its individual credit risk profile, the analysis considers a weak legal and operational link to its parent company Engie S.A., which controls 52.76% of Engie Energia Chile. Fitch views the financial linkage between parent and subsidiary as weak because of a lack of guarantees and of cross-defaults and investment restrictions. Fitch also views operational integration as weak. Linkage related to strategic importance is considered moderate because of reputation risks related to the use of a common name. Considering all three factors, Fitch views the overall credit linkage between Engie and Engie Energia Chile as weak.

Equity Rating: Fitch rates Engie's shares at 'Primera Clase Nivel 2(cl)' based on its solid solvency and free float of 47.24%, according to its ownership structure. In terms of liquidity, it has 100% market presence and average daily traded volumes exceeding USD2.0 million in the last month.

ESG Considerations: Engie has an ESG Relevance Score of 4 for GHG Emissions & Air Quality.

Derivation Summary

Engie is an integrated utility company in Chile that benefits from a diversified business profile with a balanced distribution portfolio between non-regulated and regulated clients, similar to Colbun (BBB/Positive) and Enel Chile (AA+(cl)/Stable). Relative to its peers, Engie has lower exposure to hydrological risks, as its generation assets are concentrated 89% in thermal units, where 57% are coal-based facilities, while Enel Generacion Chile S.A. (A-/Stable) and Colbun present a more balanced generation mix between hydro and thermal. AES Gener (BBB-/Stable) is mainly concentrated on thermal units and has a small portion of hydroelectricity generation in Chile. Engie's credit profile benefits from a diverse generation portfolio, with long-term contracted energy sales with investment-grade counterparties. Engie's PPAs have an average remaining life of 12 years, providing stable cash flow.

In terms of credits metrics, Fitch anticipates Engie's leverage approximately 2.0x during 2020-2022, while Enel Generacion Chile's capital structure is the strongest among its peers in Chile, with gross leverage averaging 1.5x in recent years. Colbun is approximately 2.5x, while AES Gener has been consistently in the 4.5x-5.0x range and is expected to remain at that level.

Key Assumptions

--Energy sales will average 11,500GWh from 2020 through 2022;

--Units 14 and 15 from Tocopilla complex will be disconnected in December 2021, and CTM units 1 and 2 during 2024, totaling 268MW and 334MW, respectively;

--Additional 362MW of renewable capacity under construction with operations starting in 2021;

--Capex program of USD290 million for 2020, and USD250 million during 2021, including maintenance and new investments on renewable projects;

--Additional USD125 million of debt to finance renewable expansion during 2020-2021;

--TEN does not consolidate under Engie, no recurring dividends expected from TEN during 2020-2022;

--Dividend pay-out ratio of 50% of the net income during 2020-2022.

RATING SENSITIVITIES

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

--A positive rating action is unlikely in the short to medium term due to Engie's transition plan shifting from coal-based units to renewable assets.

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

--A change in Engie'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 3.0x;

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

--Potential acquisitions that would deteriorate the company's credit metrics;

--If Engie does not satisfactorily implement an asset transition plan shifting from coal-based units to renewable assets;

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

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

Adequate Liquidity: As of March 2020, liquidity is supported by cash on hand of USD185 million, covering short-term debt of nearly USD19 million. Liquidity is further buoyed by the company's proven track record of accessing local and international debt capital markets.

Engie's debt is composed of two international notes totalling USD850 million, the company recently issued USD500 million to refinance its USD400 million unsecured notes due in 2021 combines with short term debt. Engie has no significant maturities until 2025.

ESG CONSIDERATIONS

Engie has an ESG Relevance Score of 4 for GHG Emissions & Air Quality due to its reliance on coal as much of its energy generation is based on this fuel. Fitch estimates it has a negative impact on the company's credit profile, in conjunction with others factors, following the agreement between the Chilean government and Generation Companies to completely phase-out coal generation by 2040.

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

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.

Engie Energia Chile S.A.; Long Term Issuer Default Rating; Upgrade; BBB+; RO:Sta
; Local Currency Long Term Issuer Default Rating; Upgrade; BBB+; RO:Sta
; National Long Term Rating; Upgrade; AA(cl); RO:Sta
; National Equity Rating; Affirmed; Primera Clase Nivel 2(cl)
----senior unsecured; Long Term Rating; Upgrade; BBB+

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)
Equity Rating Criteria in Chile (pub. 01 Aug 2018)
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 Rating Criteria (pub. 08 Jun 2020)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 01 May 2020)
Vínculo de Calificación entre Matriz y Subsidiaria (pub. 20 Dec 2019)

Applicable Model

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
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