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Fitch Rates Engie Energia Chile's Proposed USD400MM 'BBB'

Fitch Ratings-New York-15 January 2020:

Fitch Ratings has assigned a 'BBB' rating to Engie Energia Chile S.A.'s proposed up to UD400 million notes due 2030. Engie plans to use the proceeds from the issuance to refinance its USD400 million senior unsecured notes due January 2021 and for general corporate purposes. Fitch currently rates Engie Energia Chile's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB', long-term National Scale rating at 'AA-(cl)', National Equity ratings at 'Primera Clase Nivel 2'. The Rating Outlook is Positive.

Engie's ratings are supported by its solid business position in the electricity market in Chile and strong portfolio of diversified generation assets. Fitch expects Engie to maintain adequate liquidity levels in the medium term, supported by strong and predictable cash flow. The Positive Outlook reflects Fitch's view that Engie 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, along with the successful conclusion of its USD2.2 billion expansion plan. Fitch believes that Engie will have the capacity to finance its energy transition program shifting toward more renewables energy and estimates a capex of approximately USD290 million between 2019 and 2021 for this plan, combined with positive annual FCF that will average USD70 million during the same period.

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 clause.

Strong Contractual Position: Fitch believes the company will be 100% contracted until 2026, presenting a more balanced portfolio from 2019 onward, where non-regulated clients will represent approximately 52% of total energy sold, and the remaining portion with regulated clients. Fitch estimates Engie will benefit from higher segment and geographic as the 15-year PPA with regulated clients in the southern Sistema Electrico Nacional is in full force until 2032. Additionally, the company has signed long-term LNG supply contract for the use of its existing combined cycle units, further contributing to the predictability of its cash flow generation.

Strong Credit Metrics: Engie's solid credit profile is supported by stable EBITDA and moderate to low leverage during 2019-2021. For LTM September 2019, EBITDA reached USD526 million and total debt/EBITDA was 1.6x, significantly lower compared with the 2.2x registered by the end of 2018. Recent EBITDA increase was due to higher energy sales to regulated customers, associated to the PPA secured during 2014's auction including the step up to a maximum contracted volume of 5,040GWh beginning 2019 from 2,060GWh in 2018. Fitch projects total debt to EBITDA below 2.0x from 2019 through 2021. The projections assume a capacity expansion from Infraestructura Energetica Mejillones (IEM) commercial operation, contributing to reduce costs, and the new contracts with regulated clients increase energy sales.

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. During 2018, Engie anticipated the disconnection of units 12 and 13 from Central Tocopilla (170MW of installed capacity), completed during June 2019. Company announced that units 14 and 15 from the same Tocopilla complex will be disconnected during January 2022, totaling 268MW of additional coal-based installed capacity disconnected from the grid.

In addition, the company has approvals for three renewable projects with aggregate installed capacity of 365MW of installed capacity to start construction during 2019/2020, combined with the recent acquisition of Los Loros and Andacollo, a 55MW solar plant, for USD35 million. Disconnection of units 14 and 15 could be postponed to May 2024, in case Engie does not successfully conclude its expansion phase in renewables. 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 (A/Stable) zero-carbon transition takes place, it may prove to be challenging over the first steps.

Derivation Summary

Engie is an integrated utility company in Chile that benefits from a diversified business profile migrating in 2019 to a more balanced distribution portfolio between non-regulated and regulated clients, similar to Colbun (BBB/Positive) and Enel Chile (AA(cl)/Positive). 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. (BBB+/Positive) and Colbun present an evenly distributed generation mix between hydro and thermal. AES Gener (BBB-/Stable) is mainly concentrated on thermal units and has a small portion of hydroelectricity generation. Similar to the other Chilean electricity genco's mentioned above, Engie's credit profile benefits from a diverse generation portfolio, a component of long-term contracted assets with investment-grade counterparties. Engie's PPAs have an average remaining life of 12 years, providing stable cash flow.

In terms of credits metrics, Engie's credit profile is similar to Colbun and consistent with the 'BBB' rating level with leverage in the range of 2.5x to 3.0x measured as total debt to EBITDA. As Engie concluded an aggressive expansion phase, with total debt to EBITDA peaking at 3.1x at the end of 2017, and new PPAs started during 2018, combined with the commercial operation of its last generation unit IEM, total debt to EBITDA will decline below 2.0x from 2019 onward. While 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. AES Gener capital structure remains pressured and is weaker than Engie's, Colbun and Enel Chile, being consistently above 3.5x, and therefore warrants a lower rating than its peers.

Key Assumptions

--Gross installed capacity reaching 2,204MW during 2020, including 375MW from IEM, 55MW from Los Loros Solar PV and disconnecting Units U12 and U13;

--Fitch assumes total energy sales will average 12,000GWh from 2019 through 2021;

--USD35 million acquisition of solar PV Los Loros & Andacollo;

--Capex program of USD241 million for 2019, and USD280 million during 2020, including maintenance and new investments on renewable projects;

--TEN does not consolidate under Engie, no recurring dividends expected from TEN during 2019-2021.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action

The Outlook could be revised if the company does not implement an asset transition plan shifting from coal-based units to renewable assets, while also maintain on a sustained basis, a total consolidated debt to EBITDA below 2.0x.

Developments that May, Individually or Collectively, Lead to Negative Rating Action

--A change in the company's commercial policy leading to an unbalanced contractual position in the long term undermining the company's cash flow stability;

--A material and sustained deterioration of credit metrics reflected in total consolidated debt to EBITDA above 3.5x.

Liquidity and Debt Structure

Adequate Liquidity: As of September 2019, liquidity is supported by cash on hand of USD160 million, covering short-term debt of nearly USD90 million. Liquidity is further buoyed by the company's proven track record of accessing local and international debt capital markets. Engie has no significant maturities until 2021.

Date of Relevant Committee
17-Jun-2019

ESG Considerations

Engie Energia Chile S.A. has an ESG Relevance Score of 4 for GHG Emissions & Air Quality due to its reliability 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.

Engie Energia Chile S.A.
----senior unsecured; Long Term Rating; New Rating; BBB

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Metodología de Calificaciones en Escala Nacional (pub. 02 Aug 2018)
Metodología de Clasificación de Acciones en Chile (pub. 01 Aug 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage - Effective from 16 July 2018 to 27 September 2019 (pub. 16 Jul 2018)
Vínculo de Calificación entre Matriz y Subsidiaria - Efectiva desde diciembre 06, 2018 hasta diciembre 20, 2019 (pub. 06 Dec 2018)

Additional Disclosures

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