Research Update:

Engie Energia Chile S.A. 'BBB' Ratings Affirmed Despite Weakening Financial Metrics, Outlook Remains Stable

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Rating Action Overview

- Financial performance of the Chilean power generator Engie Energia Chile S.A. (Engie Chile) weakened due to increased energy spot and fuel prices and an extraordinary incident at the Freeport terminal that reduced the company's capacity to receive gas, and therefore, generate through more efficient technologies.
- We revised our forecast and now expect the company's leverage to fall to the 3.0x-3.5x range in 2023 and 2024 due to backup power purchase agreements (PPAs) signed with other generators and due to additional renewable capacity coming online 2022, after peaking at 6.5x-7.0x in 2022.
- We revised downward Engie Chile's stand-alone credit profile (SACP) to 'bb+' from 'bbb-', reflecting a more volatile scenario in the short to medium term than we expected that will dent the company's EBITDA, margin stability, as well as main credit metrics.
- However, on Aug. 17, 2022, S&P Global Ratings affirmed its 'BBB' issuer credit and issue-level ratings on Engie Chile. This is mainly because we view the company as a strategically important subsidiary of Engie S.A. (Engie; BBB+/Stable/--), which will likely provide support in most foreseeable circumstances.
- The stable outlook on Engie Chile incorporates our view of its importance to its parent, along with our expectations that the latter will manage the effects of extreme market volatility linked to the Russia-Ukraine conflict thanks to its strong liquidity position, while benefiting from structurally higher power prices.

Rating Action Rationale

We expect the company's exposure to higher energy spot market prices amid its investments in renewable capacity will weaken its financial metrics and pressure liquidity. We're lowering our base-case projections on Engie Chile's EBITDA and EBITDA margins for 2022 and 2023, given the challenging conditions in which the company is operating. Engie Chile is currently a net buyer in the energy spot market to fulfill its existing contracts. This is because of the currently high spot energy prices owing to the country's dry conditions and spiking fuel prices in the second quarter of 2022 (especially coal and liquefied natural gas [LNG]). In addition, in June 2022, a shipment of 3.44 trillion British thermal units of LNG to Engie Chile from Total Energies Gas & Power Ltd. was cancelled due to an incident in the Freeport LNG export terminal, given an explosion at that facility. This caused the company to increase purchases in the spot market, reducing EBITDA by about $45 million in 2022. Given these factors, we're cutting our EBITDA projections for 2022 to $190 million - $210 million. However, we forecast EBITDA to recover to $430 million - $480 million in 2023, thanks to additional EBITDA stemming from price adjustments of PPAs, higher availability at its thermal plants, imported gas from Argentina, as well as EBITDA from the new renewable facilities of 500 megawatts (MW) that were developed in 2021 and 2022.

Engie Chile has commitments to sell about 12 terawatt hours (TWh) per year, of which we expect it can cover about 6 TWh with its own generation and will cover between 2.3 TWh to 2.7 TWh per year with the backup PPAs. The PPAs are aimed to reduce electricity-price volatility and the company's exposure to spot market, hedging up to 20%-25% of Engie Chile's total expected demand between 2022 and 2030. The company completed the Tamaya solar park (114 MW) in January 2022, and expects to complete the Coya and Capricon solar projects totaling 268 MW in the fourth quarter of 2022. This will eventually replace the company's coal-based energy production, and increase capacity in the next years, which will subsequently limit Engie Chile's need to buy energy. This is in line with trends among most of power generation companies in Chile, which should also push down the system's marginal costs, raising Engie Chile's profitability margins.

In the meantime, the company's investment plan requires significant capex--approximately $270 million in 2022, $450 million in 2023, and $500 million in 2024--while higher fuel prices (especially for coal) have increased its short-term working capital needs. As a result, we expect the company's leverage to peak in 2022 at 6.5x-7.0x and decline to 3.0x-3.5x in 2023 and 2024. We will continue monitoring the company's deleveraging in 2023, and we could revise our assessment of its financial risk profile and its SACP to a weaker category if leverage remains above 3.5x by 2023.

In our view, Engie Chile is a strategically important subsidiary of Engie and will receive financial support from its parent in case of financial distress. Engie owns 59.99% of Engie Chile. The rest is owned by noncontrolling minority shareholders floating on the stock market. We assess Engie Chile as a strategically important subsidiary due to the group's long-term strategy, which includes expanding its operations in Latin America and developing new renewable capacity through its Chilean subsidiary. Engie targets a complete phaseout of its coal facilities by 2027, which are primarily located in Latin America, depending on each asset's specific prospects (closure or conversion). Engie also aims for decarbonization of its power generation activities by 2045. More broadly, the group's strategy is to expand its renewable energy fleet. Engie Chile is adhering to the group's strategy, illustrated by its significant capex plan to convert its coal-fired plants and develop renewable capacity to achieve the 2027 target.

Outlook

The stable outlook incorporates our view that Engie Chile is a strategically important subsidiary of a parent company, which will likely provide support in most foreseeable circumstances. The outlook also reflects our expectations that the leverage metric will fall to 3.0x-3.5x in 2023, assuming the adjustment in PPA prices and that Engie Chile expands its renewable capacity with no significant delays.

Downside scenario

Although unlikely considering the stable outlook, we could downgrade Engie Chile if we were to downgrade Engie to 'BBB' from 'BBB+'. We could revise downward Engie Chile's SACP in the next 12 months if EBITDA margin is lower than we expect, which could result from still high spot prices that squeeze profitability or if the company incurs additional short-term debt that could harm liquidity and raise debt to EBITDA above 3.5x in 2023. The drop in SACP wouldn't trigger a downgrade due to the likelihood of parent support. In addition, we could revise downward the company's SACP if it isn't able to execute the transition energy plan as we expect, which would weaken its business profile below those of its competitors.

Upside scenario

We could raise the ratings on Engie Chile if it maintains net debt to EBITDA below 2x, which we view as unlikely in the next few years due to the sizable investment plan.

Company Description

Engie Chile is one of the leading electric power generators in Chile, with an 8% market share of capacity. It's the fourth-largest player after Enel Chile S.A. (25%; BBB/Stable/--), AES Andes S.A. (11%; BBB-/Stable/--), and Colbun S.A. (11%; BBB/Stable/--). Engie Chile has 2,443 MW of installed capacity as of June 30, 2022, 55% of which comes from coal-based plants, followed by gas-based plants (26%), renewables (17%), and oil/diesel plants the remainder). The company is also the third-largest transmission operator in Chile, operating 2,407 kilometers (km) of high and medium voltage transmission lines with 24 substations. Engie Chile has a 50% stake in Transmisora Eléctrica del Norte (TEN). Engie Chile also operates 1,066 km of gas pipelines, and the Tocopilla and Andino ports. In November 2020, the parent increased its stake in Engie Chile to 59.99% from 52.76%. The remaining 40.01% floats on Santiago's stock exchange: local institutions own 18.50%, followed by pension funds (12.93%), foreign institutions (8.09%), and individuals (the reminder).

Our Base-Case Scenario

Assumptions

- Engie Chile has limited exposure to the correlation between GDP growth and electricity demand in the spot market, because the company sells less than 5% of its total energy on the spot market. We also factor in inflation's effect on cost over time (please see our latest publication on Latin America, " Economic Outlook Latin America Q3 2022: Resilient So Far This Year, With Tougher Conditions Ahead ," published June 27, 2022). We forecast Chile's GDP to expand 2.1% in 2022 and 1.3% in 2023, and inflation at 9.7% in 2022 and 4.0% in 2023. In addition, in line with our article " Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent ," published on June 27, 2022, we expect U.S. consumer price index (CPI) to be 5.6% in 2022 and 3.3% in 2023. We assume coal prices in line with those mentioned in our article "Metal Price Assumptions: Shortages Worsen And Prices Spike As Conflict Roils Metals Trading," published March 17, 2022.

- Power generation of 6,000 gigawatt hours (GWh) - 7,000 GWh, and Engie Chile is likely to continue buying about 5,500 GWh in the open market, of which 2,100 GWh - 2,700 GWh are for PPAs with other generation companies.
- Engie Chile sells most of its output through its contracts with regulated and unregulated customers. We expect realized monomic (energy plus capacity) prices to be about $120 per MWh and $150 per MWh for unregulated and regulated clients, respectively.
- Other revenue consists of $5 million from spot market, gas sales near $50 million, and transmission revenue and ancillary services close to $140 million.
- Capex, financed with a combination of cash flows and debt, of about $280 million in 2022 and $450 million in 2023. These investments include maintenance capex of about $40 million.
- Working capital outflows of $150 million - $200 million in 2022, decreasing in 2023 as the company is able to monetize its accounts receivables.
- No delays or cost overruns associated with the construction of the current projects.
- No dividend distributions in 2022, and 60% of previous-year's income afterwards.

Liquidity

We assess Engie Chile's liquidity as less than adequate because we expect sources over uses to be below 1.2x in the next 12 months. Despite the absence of restrictions in financial covenants, Engie Chile's generally satisfactory standing in the credit markets, and overall prudent risk management indicated by the historically low leverage (compared to its cash flow), the recent short-term financing needs pressured liquidity. We expect Engie Chile to be able to refinance its existing short-term debt of $280 million in the next few months, extending its debt maturity schedule and relieving liquidity pressures.

Principal liquidity sources for the next 12 months:

- Cash and liquid investments of $121.6 million as of June 30, 2022; and
- Funds from operations approaching $260 million.

Principal liquidity uses for the next 12 months:

- Short-term debt maturities of $281 million as of June 30, 2022;
- Capex of $38 million (only considering the portion that corresponds to maintenance);
- No dividend distributions; and
- Working capital outflows of around $100 million.

Covenants

The existing debt doesn't have financial covenants, only reporting requirements (including the presentation of financial statements).

Environmental, Social, And Governance

ESG credit indicators: E-4, S-2, G-2

In our view, Engie Chile is in a weaker position from an environmental perspective than most of its peers, because its carbon footprint represents about 55% of its installed capacity. However, we expect the company to reduce this ratio through renewable energy investments. In addition, we believe Engie Chile's renewable strategy follows that of its parent, which has resulted in a relatively low carbon footprint for the latter. To eliminate emissions by 2045 across all scopes, the group plans to reduce its carbon intensity to 168 grams per kilowatt hour (g/KWh) in 2030 from 240g/KWh in 2021 (excluding Equans) and its greenhouse gas emissions from energy production to 43 million tons of carbon dioxide (MtCO2) equivalent in 2030 from 67 MtCO2 equivalent in 2021. The group's phaseout of coal-based generation and increasing the share of renewables in the mix should help reach these targets, even if they remain ambitious given that Engie's carbon intensity remains higher than best-in-class peers.

Issue Ratings - Subordination Risk Analysis

We don't see any material structural subordination risk on the senior unsecured debt instruments issued by Engie Chile and rate them 'BBB', in line with the issuer credit rating on the company.

Ratings Score Snapshot

Issuer credit rating

- Foreign currency BBB/Stable/--
- Local currency BBB/Stable/--

Business risk Satisfactory

- Country risk Intermediate
- Industry risk Moderately high
- Competitive position Satisfactory

Financial risk Significant

- Cash flow/leverage Significant

Anchor bb+

- Diversification/portfolio effect Neutral (no impact)
- Capital structure Neutral (no impact)
- Financial policy Neutral (no impact)
- Liquidity Less than adequate (-1 notch)
- Management and governance Satisfactory (no impact)
- Comparable rating analysis Positive (+ 1 notch)

Stand-alone credit profile bb+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

Ratings List

Ratings Affirmed	
Engie Energia Chile S.A.	
Issuer Credit Rating	BBB/Stable/--
Engie Energia Chile S.A.	
Senior Unsecured	BBB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.