FitchRatings

Fitch Affirms Promigas S.A. E.S.P. at 'BBB-'; Outlook Stable

Fitch Ratings-New York-23 September 2019: Fitch Ratings has affirmed Promigas S.A. E.S.P.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-'. Fitch has also affirmed Promigas' national long-term and short-term ratings, as well as national ratings assigned to local bond issuances and to a local bond and CP program at 'AAA(col)' and 'F1+(col)', respectively. The Rating Outlook is Stable.

Promigas' ratings reflect the company's strong business position in the natural gas transportation and distribution sectors in Colombia. These businesses are regulated and operate as natural monopolies within its influence area, which results in stable and predictable cash flows for the company, even though Promigas is exposed to some recontracting risk in its natural gas transportation business. Promigas is also exposed to regulatory risks, which Fitch deems moderate given the constructive regulatory framework and balanced rules found in Colombia.

The ratings also factor in expectations for continued negative FCF generation over the rating horizon, given the company's ongoing high capex program. Required investment in a recently granted concession to develop the natural gas market in Piura, Peru is expected to contribute to Promigas' consolidated EBITDA from 2021 and will postpone the company's deleveraging trend until that year.

KEY RATING DRIVERS

Solid Business Position: Promigas' ratings are underpinned by its strong market position as Colombia's second largest natural gas transportation company, primarily serving the Caribbean coast region. The company and its subsidiaries operate 3,094 km of pipelines, representing around 44% of the Colombian transportation system. The company is also a key player in the natural gas distribution business. Through its subsidiaries and non-controlling stakes it serves around 3.6 million clients, which represents 38% of the connected users in the country. Promigas also participates through subsidiaries and associates in the natural gas distribution market in Peru.

Stable Cash Flow Generation: Promigas' cash flow predictability is factored positively into the ratings, supported by business diversification that combines natural gas transportation and distribution, as well as electricity distribution. Promigas' consolidated EBITDA generation is mostly explained by its participation in the natural gas transportation and distribution businesses; both operate as regulated monopolies within its service area and represented around 68% and 24%, respectively, of the consolidated EBITDA during 2018. In the transportation segment, however, Promigas faces some recontracting risks with around 20% of the current contracted capacity expiring by the end of 2019. In addition, given the location of Promigas' infrastructure, most of its transportation contracts address thermal electricity generation; these assets are mostly concentrated in the company's service area, which leads to relative volatility in transported natural gas and cash flow generation, depending on the country's current hydrology condition.

The predictability of Promigas' cash flow from operations has also benefitted from the operations of the natural gas distribution business, which has low exposure to economic cycles and stable demand due to the nature of the load. Promigas' subsidiaries that operate in this business decided to adopt the final tariff that replaces the transitory scheme that was implemented in the sector in 2018. This will have a positive impact in the EBITDA performance of this business over the rating horizon.

Projects Completion will Benefit EBITDA: The ratings factor in full incorporation of the Canacol expansion project by the end of 2019, with the first stage of the project having started operations in August 2019. This project will increase by 100 mmcfd Promigas' transportation capacity and represent around USD 40 million in revenues for the company. Moreover, it allows the company to bring additional gas from Canacol's gas fields in the Departments of Sucre and Cordoba to the Caribbean market, thus diversifying the sources of gas in the Caribbean Coast and mitigating the decline in the production of La Guajira fields, owned by Ecopetrol. In addition, Fitch expects Promigas' wholly owned subsidiary, Gases del Pacifico, which has a concession to distribute natural gas in seven cities in the north of Peru, to contribute to Promigas' consolidated EBITDA from 2019. This operation started commercial operation in December 2017 and is expected to reach around COP 60 billion in EBITDA by 2022.

FCF Structurally Negative: Promigas' FCF generation has been negative over the last few years due to high capital expenditures and dividend pay-outs. This trend is expected to continue over the rated horizon as capex for 2019-2023 is projected to total COP2.9 trillion. Fitch's capex assumptions are higher than previously estimated, given the inclusion of around COP 500 billion of additional projects over the next five years. The company is expected to invest in the recently granted concession to Gases del Norte, another wholly owned subsidiary controlled by Promigas that will develop the natural gas market in Piura, Peru. Fitch projects this operation to start contributing to Promigas' consolidated EBITDA from 2021.

Leverage to Remain High: Fitch estimates Promigas' leverage will be elevated due to its five-year capex plan. 65% will be concentrated between 2019 and 2020, maintaining its consolidated leverage at a high level of around 4.5x through 2020. Fitch's base case incorporates the re-set of the regulatory tariff for its natural gas transportation business in Colombia, expected to lower its return on capital for this business segment. Promigas' business diversification, with around 33% of the consolidated projected EBITDA stemming from natural gas and electricity distribution allows the company to withstand some adverse regulatory scenarios in the natural gas transportation business.

DERIVATION SUMMARY

Promigas maintains a credit profile commensurate with its investment-grade rating. The company maintains low business risk that stems from its participation in regulated businesses, with strong business position in the natural gas transportation and distribution in Colombia. Promigas' LC IDR rating is in line with Companhia de Gas de Sao Paulo - COMGAS (Comgas: LC IDR BBB-/FC IDR BB/Stable) since Promigas' business diversification is superior to Comgas' that only distributes gas and can present some demand volatility. This compensates for Promigas' more aggressive capital structure, with a gross leverage level around 4.0x-4.5x, which is higher than Comgas' ratios (around

2.0x-2.5x).

Promigas' ratings are one notch lower than Transportadora de Gas Internacional (TGI, BBB/Stable) and Gas Natural de Lima y Callao (Calidda, BBB/Stable) since these companies benefit from more conservative capital structure and maintain operations in countries with similar operating environments, such as Colombia and Peru.

Promigas' credit profile is also comparable with other operating holding companies in Colombia such as Empresas Publicas de Medellin S.A E.S.P. (EPM, BBB/Rating Watch Negative) and Grupo Energia Bogota (GEB, BBB/Stable). Promigas is nevertheless rated one notch below EPM and GEB in the international scale, given its lower level of business and geographic diversification and its structurally negative FCF generation, which is reflected in higher leverage levels over the medium term than that of these peers.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Expected changes in the regulatory tariff for the transportation segment will have a neutral effect on Promigas' credit profile, although it would reduce the profitability of the business segment;
- Promigas completes its expansion project built for Canacol in the remaining of 2019; this represents around USD 40 million in revenues for Promigas from 2020
- Capex only considers projects underway and estimates of investments in concessions awarded in Peru. It reaches around COP 2.9 trillion between 2019 and 2023.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Fitch considers a positive rating action unlikely in the near term given elevated capex and leverage expectations over the rating horizon;
- Gross leverage levels below 3.5x on a sustained basis.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- A lower than expected return on investment that puts pressures on cash flow generation;
- Additional significant investments that do not involve financing via an equity component and/or are not followed by significant reductions in dividend outflows;
- Material cost overruns or delays in the start of operations of sizable projects that pressures Promigas' credit metrics;
- Gross leverage over 4.5x for two consecutive years.

LIQUIDITY

Adequate Liquidity: Promigas' liquidity is supported by cash on hand, the stability of its CFO generation and its proven access to long-term local and international financing. As of June 2019, the company has a scheduled debt amortization of COP 559 billion during the second half of 2019 and COP 965 billion for 2020. During 2019, the company has repaid local bond issuances at Gases de Occidente and at Promigas' level that together reached COP 250 billion. Fitch expects the company continues refinancing debt amortization during 2019 and 2020, while executing its capex requirements. Fitch considers Promigas' refinancing risk low given its access to debt markets. In August 2019 Promigas received authorization from the local regulator to increase its local bond and CP program in COP 500 billion to COP 1.3 trillion. Also, the company maintains COP 1.3 trillion in uncommitted credit lines that could be used by Promigas and its subsidiaries, as an additional liquidity support.

ESG Considerations
Unless otherwise disclosed in this section, the highest level of ESG credit relevance 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.

Promigas has an ESG Relevance Score of 4 related to exposure to social impacts due to social resistance and holdups in environmental licenses that leads to delays and cost increases, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings:

Promigas S.A. E.S.P.
--Long-Term Foreign and Local Currency IDRs at 'BBB-'; Outlook Stable;
-- Long-term national scale rating at 'AAA(Col)'; Outlook Stable;
--Short-term national scale rating at 'F1+(Col)';
--Local bonds issuances at 'AAA(col)';
--Local bond and CP program at 'AAA(col)' and 'F1+(col)', respectively.

Contact:

Primary Analyst
Saverio Minervini
Director
+1-212-908-0364
Fitch Ratings, Inc.
33 Whitehall St.
New York, NY 10004

Secondary Analyst
Jorge Yanes
Director
+57 1 484 6770

Committee Chairperson
Sergio Rodriguez, CFA

Senior Director
+52-81-8399-9100

Media Relations: Hannah James, New York, Tel: +1 646 582 4947, Email:
hannah.james@thefitchgroup.com

Additional information is available on www.fitchratings.com
Applicable Criteria
Corporate Rating Criteria (pub. 19 Feb 2019)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)
Sector Navigators (pub. 23 Mar 2018)

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