MOODY'S INVESTORS SERVICE

Credit Opinion: Interconexion Electrica S.A. E.S.P.

Global Credit Research - 01 Dec 2012

Medellin, Colombia

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa3

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Key Indicators

[1]**Interconexion Electrica S.A. E.S.P.**

	2008	2009	2010	2011
(FFO + Interest) / Interest	**2.9x**	**3.1x**	**3.9x**	**3.0x**
FFO / Debt	**17.6%**	**20.9%**	**18.5%**	**11.0%**
Debt / Fixed Assets	**82.9%**	**69.7%**	**76.5%**	**86.1%**
RCF / Capex	**2.7x**	**1.9x**	**1.9x**	**0.8x**

[1] All ratios calculated in accordance with the Global Regulated Electric and Gas Networks Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Limited impact from the group's foreign subsidiaries, particularly the Brazilian transmission operations

- Relatively transparent regulatory framework and limited volumetric exposure underpin cash flows

- Aggressive growth initiatives, especially within the concession toll-road sector

- Credit metrics expected to weaken but remain commensurate with the rating category

Corporate Profile

Headquartered in Medellin, Colombia (LC and FC Baa3 sovereign ratings; stable), Interconexion Electrica S.A., E.S.P. (ISA; Issuer Rating: Baa3) is the largest electricity transmission company in the country with a market share of over 71.4% in terms of income generated in the Interconnected National Transmission System (STN). These operations are subject to the purview of the Comision de Regulacion de Energia y Gas (CREG).

ISA also holds direct and indirect ownership-stakes in a portfolio of power transmission companies including 99.99% in Colombian Transelca (about 10% market share), 100% in ISA Bolivia (34% market share) and ISA

Capital do Brasil (58.6% including preferred stock) which controls with 89.5% of the common voting stock (37.8% of the capital stocks) the Brazilian Companhia de Transmissao de Energia Electrica Paulista (CTEEP; around 16% market share).

In Peru, it holds directly and indirectly ownership stakes in ISA Peru (83%), Red de Energia del Peru (REP; 60%) and Consorcio TransMantaro (CTM; 60%) whose collective market shares currently aggregate around 80%. ISA is also participating in the development of the Central-America SIEPAC transmission project via its 11.11% interest in Empresa Propietaria de la Red (EPR) as well as Interconnection Colombia-Panama (50% interest in Empresa de Transmision Electrica S.A.). The power transmission business currently accounts for over 80% of ISA's consolidated EBITDA (without adjustments for minority interests). The group will extend its transmission activities to Chile via a new subsidiary after recently wining the bid auctions for three new Greenfield projects.

ISA also fully owns the Colombian coordinator of power operations in the STN, Compañia de Expertos en Mercados XM (99.7%). Moreover, the group provides telecommunication data transport services via optic fiber in Colombia, Peru, Venezuela, Chile, Brazil, Argentina and Ecuador through its subsidiaries Internexa and Transnexa. The group further diversified its operations into the concession road business in 2010 with the acquisition of a 60% interest in Intervial Chile S.A. (formerly Cintra Chile). This ownership increased to 100% in 2011.

The Colombian government is ISA's majority shareholder (51.41% ownership-stake). Other major shareholders include Empresa Publicas de Medellin E.S.P. (Baa3; 10.17%), Ecopetrol (Baa2; 5.32%) and Empresa de Energia de Bogota (Baa3; 1.67%). Similar to other public entities, ISA is subject to fiscal control under the General Nacional Accounting Authority, and requires approval from the Ministry of Finance to incur new debt or provide guarantees.

As of September 30, 2012, ISA reported assets, indebtedness and cash flows of around US$5.1 billion, US$841 million, and US$120 million (excluding around US$15 million intercompany) respectively. This equates to around 35%, 15% and 21% of the consolidated assets, indebtedness, and cash flows.

Rating Rationale

Because the Colombian government is ISA's majority shareholder, ISA falls under the scope of Moody's rating methodology for government-related issuers (GRIs). The Baa3 rating reflects Moody's assessment of (i) a medium probability of extraordinary support from the government, (ii) a high level of dependence, as well as (iii) ISA's baseline, or standalone, credit assessment (BCA). ISA's BCA of baa3 is a representation of the group's intrinsic creditworthiness before taking into account possible extraordinary support from the sovereign, based on a scale of aaa to c in which aaa indicates the highest credit quality.

The Colombian government does not guarantee ISA's debt obligations, and there is no evidence that this could change in the future; however, we believe that there is a "medium" likelihood of government support in the case of distress for several reasons, including the 51.1% ownership stake and the strategic importance of the company's operations for the country's economy. Our estimate of "high" default dependence reflects the significant degree to which Colombia is exposed to the same risks as those that would affect the credit quality of ISA, and our expectation that there is an elevated likelihood that the government and ISA would default simultaneously due to common risk factors.

ISA's BCA captures its leading position within the Colombian transmission sector and the low business risk profile of these operations. It also factors in the company's cash flow visibility given its limited volumetric exposure and the relatively transparent regulatory framework. We acknowledge the importance of the group's foreign subsidiaries, particularly the Brazilian transmission company, CTEEP; however, the rating assumes sufficient financial and operational separateness between ISA and CTEEP such that the uncertainties currently surrounding the renewal of CTEEP's concessions has no immediate impact on ISA. The BCA assumes that ISA will further pursue new growth opportunities in Colombia and other regional countries with transparent regulatory frameworks. Nevertheless, the rating assumes management will fund any growth initiatives in a prudent fashion, such that credit metrics will remain aligned with the current rating category. Further key factors tempering the rating include ISA's material dependence on the capital markets to meet unexpected cash flow shortfalls albeit its current debt maturity profile is manageable.

DETAILED RATING CONSIDERATIONS

LEADING COLOMBIAN TRANSMISSION COMPANY

ISA's rating acknowledges its significant operational cash flows and the modest dependence on the dividends received from its subsidiaries (2012: around US$30 million; 2011:US$24.3 million; 2010:US$44.3million) to service its debt. ISA's transmission assets are long lived, with relatively low operating risk along with high historical availability factors (around 99.9%) and low energy losses (0.01%). Despite efforts to eliminate barriers to entry, the top five transmission companies in Colombia (total of nine) account for over 90% market share with ISA and Transelca accounting for around 80% over the foreseeable future. We note that Transelca granted several intercompany loans to its parent company with the balance currently aggregating around US$110 million. This accounts for about half of the dividends received by ISA.

We understand that ISA plans to invest around US$280 million over the next three years in new transmission projects (2012: US$85million) in Colombia. This includes the capital outlays associated with the project it won in July 2012 to build the substation at Termocol and the associated transmission lines (scheduled completion end August 2013). The rating assumes ISA will further participate in new transmission initiatives in Colombia. These are awarded under a tender process coordinated by the Ministry of Mines and Energy. Colombia's required generation asset base and transmission grid expansion is updated annually by the special administrative body of the Ministry of Mines and Energy, Unidad de Planeacion Minero Energetica (UPME).

LIMITED VOLUMETRIC EXPOSURE AND REGULATORY FRAMEWORK ENHANCES CASH FLOW VISIBILITY

We believe the Colombian regulatory framework compares well to those in other Latin American countries in terms of stability and transparency. This is underpinned by its predictable track-record since the enactment in 1994 of Law 142 (Household Public Utilities Services Law; LSPD), associated Decree 1524, as well as other pieces of legislation, including the Electricity Law (Law 143) and additional regulation that has further developed the framework over the last fifteen years. However, our opinion of the regulatory framework is somewhat tempered by the composition and election of the CREG's board members which does not fully insulate it from possible political interference. That said, there has not been any evidence in this regard to date.

Revenues depend on whether transmission assets became operational before or after the year 2000. The bulk of ISA's transmission assets fall under the pre-2000 category. Their remuneration is based on a formula that includes an 11.5% rate of return to be applied on the assets' replacement value. Transmission charges are subject to the CREG's review every five years with the next review not anticipated before 2015. Projects that became operational after 2000 are part of the STN expansion projects wherein the construction, operation and concession were awarded under a competitive tender process. For the first 25 years of operations, the remuneration of the assets is based on the winning bid that included estimated annual revenues in USD, as well as Administration, Operation and Maintenance expenses, as well as opportunity costs of the capital invested. After 25 years, these assets will be also subject to the CREG's transmission charges. We consider a credit positive the very limited volumetric exposure of the remuneration for both types of assets. We further observe that transmission charges are also linked to inflation but lack adjustments for changes in the exchange rate (USD/local currency) as is the case in other jurisdictions. The visibility of ISA's operational cash flows is a credit positive from a credit perspective, as they enhance the company's ability to service its outstanding indebtedness.

RATING INCORPORATES LIMITED IMPACT FROM THE GROUP'S FOREIGN OPERATIONS

Moody's acknowledges the importance of the group's foreign operations, especially those in Brazil (as of September 30, 2012, debt aggregated US$1.2 billion; 88% at CTEEP) and the Peruvian subsidiaries (debt: US$558 million). These two operations currently account for over 50% and 8%, respectively, of consolidated EBITDA (without adjustments for minority interests).

We consider the Peruvian subsidiaries in our analytical assessment given the ISA guarantees provided to some of the lending banks (around US$47 million), and the pro-rata equity contributions made to fund their investment programs. CTM continues its investment program after completing recently its 500km transmission line project (34 months; investments: US$205 million) such that it is not expected to distribute dividends before 2015, while REP is expected to complete its project before year-end 2013 and begin making dividend distributions next year.

ISA also provides financial guarantees for EPR (US$44.5 million until 2027) and ISA Bolivia (US$16.1 million until 2019). It is our understanding that ISA does not plan to provide any significant additional guarantees on behalf of its existing telecommunication and transmission subsidiaries.

ISA's rating anticipated that CTEEP's dividends would be used to make payments on the redeemable preferred equity issued by ISA Capital do Brasil which was issued in 2010 to refinance US$522 million in bonds due in 2017 (around US$30 million not tendered are still outstanding). We note that ISA received from ISA Capital do Brasil an intercompany loan (about US$25 million). This limited reliance on CTEEP's dividends, our expectation that ISA does not plan to make any equity contributions to aid in the funding of CTEEP's current substantial capital outlay program, along with the fact that the company is not exposed to cross-default clauses to any of the indebtedness incurred by CTEEP support our opinion about the sufficient degree of operational and financial separateness that exists between ISA's and CTEEP's activities. This separateness is a credit positive for ISA given the current uncertainties surrounding the renewal of CTEEP's primary transmission concession (excluding subsidiaries) expiring in July 2015. Earlier this month CTEEP's Board of Directors recommended the company's Shareholders (meeting to be held December 3) not to renew the concession under the current conditions outlined by the Brazilian government in September. Should the shareholders agree, the concession will be operated under the current conditions, albeit some uncertainty remains about the reimbursement amount to be received for CTEEP's non-depreciated assets at the end of the concession. ISA's rating currently assumes CTEEP will be able to fully repay its outstanding 2013-2015 debt obligations; however, we also believe that some reputational risk remains that could incentivize ISA to provide financial support to its Brazilian subsidiaries if their available cash is not enough to repay its maturing debt.

AGGRESSIVE EXPANSION STRATEGY EXPECTED TO CONTINUE DESPITE SOME SET BACKS

ISA currently owns 100% of Intervial Chile S.A. after exercising at the end of last year the purchase option over the remaining 40% stake for US$211 million (US$296 million paid at the end of 2010 for the initial 60%). The 2011 purchase was funded with internally generated funds (US$71 million), proceeds from local bonds and a US$140 million intercompany loan granted by ISA to ISA Inversiones Chile in December last year. ISA's rating recognizes the diversification benefits and the investment-grade ratings of the indebtedness incurred to fund portions of three out of the five existing toll road concessions currently embedded in Intervial Chile S.A., namely Autopista del Maipo (Baa3; Stable), Autopista Talca Chillan (Baa3;Stable) and Autopista del Bosque (Baa3;Stable). The remaining two toll roads are not publicly rated. The concesions' ability to upstream dividend is subject to distribution tests under each of the toll roads' indebtedness indentures or credit agreements (at the end September 2012, ISA's reported indebtedness includes around $2.5 billion associated with this concession indebtedness was around $2.5 billion; about 46% of Intervial's consolidated indebtedness). Moody's understands that ISA's strategy includes seeking for a partner in this segment.

ISA's removal earlier this year from undertaking the Autopistas La Prosperidad project (formerly known as Autopistas La Montaña) in Colombia was a setback in the company's aggressive expansion strategy, particularly within the road concession sector, especially given that the project's proposed terms and conditions included a guaranteed 9% Internal Rate of Return over the project's generated Free Cash Flows in real terms after taxes. However, from a credit perspective this outcome is not viewed as a negative since this ambitions multi-year road project was not without risks. While ISA planned to use the know-how acquired via its acquisition of Intervial Chile, we considered ISA's relatively limited experience in this business sector, and the obvious challenges of completing the project given the overall size and the terrain to be covered. Furthermore, it was our expectation that ISA would have been required to make substantial capital contributions over the medium-to-long term to fund the project (around US$8 billion), and we anticipate that the associated indebtedness would have had a negative impact on ISA's credit metrics. It is expected that ISA will be able to recover the costs it had already made in the project.

We understand that ISA's management is currently assessing new growth investment opportunities for the group in lieu of the Colombian road project, and amid the challenges faced by CTEEP (ISA's previous 2012-2016 projected capex in Brazil exceeded US$1.5 billion), and in the development of the electric interconnection project between Colombia and Panama. The bid to allocate the Panamanian utilities' load, a key milestone, was postponed again in August of this year and has not been rescheduled yet as the project awaits clarification on certain environmental issues. ISA's planned US$100 million equity contributions associated with this project has been also delayed in its near-term investment program.

ISA still intends to generate 80% of its revenues outside of Colombia (as of September 30, 2012 about 69%). Consequently, our rating incorporates as a key assumption that ISA will largely pursue investments in regulated-type operations in stable and predictable regulatory environments and that potential new investments will be prudently funded such that the company continues to report robust credit metrics for the rating category. In this regard, we note that ISA won in October 2012 the auction for three projects to build in aggregate 743 kilometer transmission lines in the Chilean Sistema Interconectado Central (aggregated investments approximates US$800 million) to be completed before year-end 2017. ISA is currently developing the funding strategy for the project with a combination of equity contributions (initially at least US$100 million) and indebtedness to be incurred at the new Chilean subsidiary for the reminder. We understand that the bulk of the funding will be required in the latter years of these estimated five year projects. Given the transparency and stability of the Chilean regulatory framework and ISA's expertise in the transmission sector we believe this investment is credit positive. The project's annual revenues during the first twenty years are expected to approximate US$63 million; thereafter, the project will be subject to the regulated transmission tariffs.

CREDIT METRICS EXPECTED TO REMAIN COMMENSURATE WITH THE RATING CATEGORY

ISA continues to report credit metrics that are well positioned within the rating category. Specifically, its standalone CFO pre-W/C to debt, interest coverage and RCF to debt over the three-year period 2009-2011 averaged 17%, 3.3x, and 8%, respectively.

We note that although ISA's dividend distributions have consistently grown over the last few years (2007: around US$65 million; 2011; US$96 million) its dividend payout ratio has remained below 60% the last three years. However, we also observe a substantial increase in both the distributed amount ($137 million) and the dividend payout ratio (79%) during the first nine months of 2012, a credit negative.

That said, our rating incorporates the expectation that management will continue prudent financial policies based on a combination of internally generated cash flows, additional indebtedness and equity issuance when needed to fund any new growth strategy investment coupled with a less aggressive dividend payout ratio when warranted. As a result, we expect key credit metrics will remain robust within its existing rating category such that FFO to debt remains in the high teens, interest coverage exceeds 2.7x, and its RCF to debt is at least 10%.

To that end, we understand management is considering repaying over the near to medium term some portions of its outstanding debt, which will further aid the company's credit profile. That said, we also anticipate that new indebtedness will be incurred after management's decisions regarding new investments initiatives. However, we also gain additional comfort from the incurrence test included in the company's financing documentation that requires that net debt to EBITDA remain below 4x which places limits on ISA's ability to incur incremental debt in the absence of incremental EBITDA generation.

Liquidity Profile

ISA's rating is tempered by its reliance on the capital markets to fund its capital requirements to fund unexpected cash shortfalls in the absence of committed credit facilities. Historically, this weakness has been somewhat offset by ISA's cash balances and marketable securities (peak in 2008 and 2009 with around US$124 million and US$300 million); however, since 2010 the company has recorded significantly lower balances (2010: US$45 million; 2011: US$80.6 million for the last twelve months ended September 30, 2012; US$24 million), a credit negative.

That said, we expect ISA will be able over the next two years to bridge any funding requirements with internally generated cash flows with only modest additional indebtedness. ISA has attained authority approval to refinance with 10-year new intercompany loans up to ColPs $18.7 billion (around US$96 million) of its outstanding intercompany loan with Transelca. These were scheduled to become due during 2013 and 2014, and their early refinance is a credit positive. We understand that the balance (about US$16 million) will be repaid, and as mentioned earlier ISA may also further reduce its outstanding indebtedness, another credit positive. The rating also consider ISA's remaining debt maturity profile relatively manageable with around US$60 million due in 2013 before declining to approximately US$45 million in 2014.

Rating Outlook

The rating outlook for ISA's BCA rating is stable, based on our expectation for continued, predictable cash flow generation from its core Colombian transmission businesses, along with the prudent management of the group's capital expansion programs for the Peruvian and Brazilian transmission companies. The stable outlook also factors in our expectation that future growth will be pursued only in regulated businesses that will be appropriately funded such that ISA continues to reports metrics that are commensurate with the Baa rating category.

What Could Change the Rating - Up

Since ISA's Baa3 rating is based on Moody's methodology for GRIs, upward rating pressure is unlikely given the stable rating outlook for the Colombian government, with the BCA further capped by the aggressive growth initiatives underway, particularly, in the road concession sector. However, consideration of a rating upgrade could occur if ISA reports FFO to debt and interest coverage of around 30% and 5x, both on a sustainable basis.

What Could Change the Rating - Down

The BCA rating could be downgraded as a result of a deterioration in the supportiveness of the Colombian regulatory framework. A rating action could be also triggered if leverage ends up being higher than currently expected, or if Moody's key assumption regarding ISA's limited involvement in the expansion of its Brazilian subsidiaries in terms of capital contributions or guarantees, is not proven to be correct. A downgrade could also occur with a material deterioration in ISA's liquidity profile and/or credit metrics, such that its interest coverage and FFO to debt ratios fall below 2.7x and 15%, respectively, on a sustainable basis. Moreover, a downgrade in Colombia's foreign currency ceiling could negatively affect ISA's ratings.- Colombia's leading transmission company.

Other Considerations

Management's foreign exchange rate risk policy strives to optimize the natural hedge associated with the group's operations such that the debt currency breakdown reflects the expected revenue streams. In this regard, as of September 30, 2012, over 90% of ISA's outstanding standalone debt is denominated in Colombian pesos with indebtedness in USD accounting for the reminder. In addition, around 75% of ISA's indebtedness denominated in Colombian Pesos is indexed to the Consumer Price Index to hedge against inflation variations.

Moody's evaluates ISA's BCA mainly relative to Moody's Regulated Electric and Gas Networks that was published in

August 2009. As depicted in the grid below, the issuer's indicated BCA rating based on both historical and projected credit metrics is Baa3, the same as its current assigned BCA.

Rating Factors

Interconexion Electrica S.A. E.S.P.

Regulated Electric and Gas Networks [1][2]	**12/31/2011**			**Moody's 12-18 month Forward View* As of November 2012**	
Factor 1: Regulatory Environment and Asset Ownership Model (40%)	**Measure**	**Score**		**Measure**	**Score**
a) Stability and Predictability of Regulatory Regime		Baa			Baa
b) Asset Ownership Model		Aa			Aa
c) Cost and Investment Recovery		Baa			Baa
d) Revenue Risk		Aa			Aa
Factor 2: Efficiency and Execution Risk (10%)					
a) Cost Efficiency		Baa			Baa
b) Scale and Complexity of Capital Programme		Baa			Baa
Factor 3: Stability of Business Model & Financial Structure (10%)					
a) Ability & Willingness to Pursue Opportunistic Corp. Activity		B			B
b) Ability & Willingness to Increase Leverage		Baa			Baa
c) Targeted Proportion of Op. Profit outside Core Reg. Activities		B			B
Factor 4: Key Credit Metrics* (40%)					
a) (FFO+ Int exp) / Int exp (3 Year Avg)	3.3x	Baa		2.5x - 3.5x	Baa
b) Debt / Fixed Assets (3 Year Avg)	77.3%	Ba		60 - 75%	Baa
c) FFO / Debt (3 Year Avg)	16.8%	A		12 - 20%	A
d) RCF / Capex (3 Year Avg)	1.7x	A		1.5x - 2.5x	A
Rating:					
Indicated BCA Rating from Grid		baa3			baa3
Actual BCA Assigned		baa3			baa3

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE

VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT
DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR
DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2011; Source: Moody's Financial Metrics