NON-RATING ACTION COMMENTARY

Fitch Rates Promigas' Notes Reopening 'BBB-'

Tue 13 Oct, 2020 - 11:38 ET

Fitch Ratings-New York-13 October 2020: Fitch Ratings rates the proposed reopening of Promigas S.A. E.S.P.'s 3.75% senior notes due 2029, co-issued by Gases del Pacifico S.A.C., 'BBB-'. The company is targeting an amount of up to USD150 million. The notes' proceeds will be used to repay or refinance existing short-term and long-term indebtedness. Fitch currently rates Promigas' Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) 'BBB-' with a Stable Rating Outlook.

Promigas' ratings factor in 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 their area of influence, which results in relatively stable and predictable cash flows, even though Promigas is exposed to some recontracting risk in its natural gas transportation business. The ratings also consider the expectation of neutral to negative FCF generation over the rating horizon. Promigas is also exposed to regulatory risks, which Fitch deems moderate given the constructive regulatory framework and balanced rules found in Colombia.

Although it is premature to assess the final result of the potential lawsuit announced by Promigas against Canacol, due to the decision of the latter to unilaterally backout of the contract of its 100MCFPD expansion capacity project, Fitch does not anticipate an impairment on Promigas' credit profile. Fitch will continue to monitor the development of this controversy and its final effect on Promigas.

KEY RATING DRIVERS

Manageable Coronavirus-Related Impact: Fitch believes that Promigas will sustain its credit profile despite the negative effect of the coronavirus pandemic. A strong contractual position and the regulated nature of the different businesses make Promigas somewhat resilient to the diminished industrial and commercial natural gas and energy consumption. This has been partially offset by a higher natural gas demand from thermoelectric plants during the first half of 2020, due to low hydrology conditions, and the positive effect of the depreciation of the Colombian peso (COP), on the company's revenues. Fitch believes the company's efforts to cut capex by roughly USD70 million and SG&A by an additional USD10 million, as well as the full implementation of expansion projects should contribute to the company's deleveraging process.

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 3,225 km of pipelines, making up around 45% 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 3.7 million clients, which represent 38% of the connected users in the country. Promigas also participates through subsidiaries and associates in the natural gas distribution market in Peru, serving 1.1 million clients, which make up 93% of the total client base in the market.

Predictable Cash Flow Generation: Promigas' cash flow predictability is factored positively into the ratings, supported by its 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, which operate as regulated monopolies within their area of influence, making up 66% and 24%, respectively, of the consolidated EBITDA. In the transportation segment, however, Promigas faces some recontracting risks with around 20% of the current contracted capacity expiring by the end of 2020. The predictability of Promigas' cash flow has also benefitted from the distribution business, which has low exposure to economic cycles and stable demand due to the nature of the load.

EBITDA to Strengthen: The ratings factor in the completion of the Canacol's expansion project during June 2020. This project increased Promigas' transportation capacity by 100 million cubic feet per day (mcfd), and it is expected to make up USD40 million of revenue in 2020 and USD55 million in 2021. This project allowed 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. Additionally, Fitch expects the distribution business to continue strengthening from the implementation of the final tariff scheme in Colombia from 2021 and the increasing contribution of the Peruvian subsidiaries, Gases del Pacifico and Gases del Norte.

FCF Neutral to Negative: Fitch expects Promigas' FCF to continue to be negative over the short to medium term. Promigas' FCF was structurally negative over the last four years due to high capex intensity and dividend distribution. Consolidated capex for 2020-2023 is projected to total COP2.6 trillion, mainly focused on the expansion of Promigas' transportation capacity (41%) as well as on the development of the natural gas market in Peru through Gases del Norte (20%) and Gases del Pacifico (10%). Fitch believes Promigas' dividends received from its non-controlling stakes in Calidda and Gases del Caribe will continue to represent a stable source of cash in the short to medium term.

Leverage to Remain High: Fitch's base case scenario for Promigas forecasts gross leverage remaining close to the negative threshold for a downgrade during 2020, trending to 4.0x in the short to medium term, in line with Promigas' current ratings. Fitch's base case scenarios incorporates the re-set of the regulatory tariff for its natural gas transportation business in Colombia from 2023, which is expected to lower the return on capital for this business segment. Promigas' business diversification, with around 38% 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 is in line with Companhia de Gas de Sao Paulo - COMGAS (Comgas; LC IDR BBB-/FC IDR BB/Negative) 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 net adjusted 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 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 GEB.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

--Remuneration from Canacol's 100mcfd expansion project of USD40 million in 2020 and USD55 million from 2021.

--Final tariffs for natural gas distribution companies in Colombia implemented from 2021.

--Average dividends received from noncontrolled companies of COP180 billion during the rating horizon.

--Capex of COP2.6 trillion between 2020 and 2023.

--Leverage increasing to 4.5x in 2020, trending to 4.0x over the medium term.

--Negative FCF over the next two years.

RATING SENSITIVITIES

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

--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.

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

--Significantly lower tariffs that pressure cash flow generation;

--Gross leverage of 4.5x or greater on a sustained basis;

--Material cost overruns or project delays that pressure Promigas' credit metrics.

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: Promigas' liquidity is supported by cash on hand, the stability of its CFO and its proven access to long-term local and international financing. At the end of June 2020, the company had scheduled debt amortization that reached close to COP200 billion for the second half of 2020 and about COP1 trillion for 2021. Promigas reacted to the pandemic by drawing uncommitted short-term credit facilities of around COP1.3 trillion to underpin its liquidity position and anticipate working capital needs for 2020. The company expects to refinance this debt through a local bond issuance for up to COP600 billion, as well as the current reopening of its 3.75% senior notes due 2029 for up to USD150 million. Fitch considers Promigas refinancing risks as low, given its access to debt markets. The company maintains COP700 billion uncommitted credit lines that could be used by Promigas and its subsidiaries, as an additional liquidity support.

ESG CONSIDERATIONS

Promigas S.A. E.S.P.: Exposure to Social Impacts: 4. 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.

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(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Contact:

Lincoln Webber, CFA, CAIA
Associate Director
Primary Rating Analyst
+1 646 582 3523
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street
New York, NY 10019

Jose Luis Rivas
Director
Secondary Rating Analyst
+57 1 484 6770

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including

forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents

in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail

pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Energy and Natural Resources Corporate Finance Utilities and Power Latin America

Colombia