Research Update:

Engie Energia Chile S.A. 'BBB' Ratings Placed On CreditWatch Negative On Persistent Liquidity Pressures

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Rating Action Overview

- Engie Energia Chile S.A.'s (Engie Chile) liquidity position has worsened due to increased working capital requirements in 2022, and we believe this situation will persist until the company is able to refinance or repay part of its short-term debt, which reached $360 million as of December 2022.
- In addition, the higher fuel and energy spot prices in Chile along with the company's short position on its power purchase agreements (PPAs), have eroded its credit metrics. We expect it to recover to historical figures once it increases its renewable generation capacity, but not before 2025.
- As a result of these factors, on March 31, 2023, S&P Global Ratings placed its 'BBB' ratings on Engie Chile on CreditWatch with negative implications, indicating a 50% chance of a downgrade if the company is unable to remediate the current liquidity pressures through a successful refinancing strategy in the next three months. Engie Chile's debt maturity profile could improve from either the monetization of its accounts receivables, a liability management program, or explicit support from its parent, Engie S.A.
- We also revised downward Engie Chile's stand-alone credit profile (SACP) to 'bb' from 'bb+'. However, we continue to view the company as a strategically important subsidiary of Engie S.A. (Engie; BBB+/Stable/A-2), and its group support provides three notches of rating uplift from the SACP.

Rating Action Rationale

We could downgrade Engie Chile if it isn't able to alleviate its liquidity pressures in the next three months. More volatile spot energy and fuel prices in 2022, combined with Engie Chile's short position of 4 terawatt hours (TWh) on its PPAs, resulted in a situation where the company had to fulfill its PPAs by buying energy at spot prices, which hurt its EBITDA and liquidity position.

As of December 2022, the company had $360 million in bank credit lines due in the next 12 months. This, in addition to its still recovering funds from operations (FFO), will continue to squeeze its liquidity profile, absent any refinancing or repayment strategy. There's evidence that the company has access to financing from different banks--its debt with several banks increased by $310 million in 2022--and it has refinanced some of these facilities recently. Regardless, if we don't see a more comprehensive solution to improve Engie Chile's debt maturity schedule in the next three months, we would no longer view the situation as temporary, but instead as a structural weakness.

Engie Chile is working to improve its liquidity by monetizing its accounts receivables (that should represent about $320 million in cash) and has signed a mandate for a new 10-year loan with International Finance Corp. (IFC) for $400 million. If these two transactions materialize, Engie Chile could refinance part of its short-term maturities, giving it more flexibility to face upcoming financing needs. However, if the monetization of its receivables is delayed or the disbursement of the loan with IFC is not closed, all else being equal (including parent support), we could downgrade Engie Chile.

We expect credit metrics to recover more slowly than we previously anticipated, leading to our downward revision of the SACP. We lowered our base-case projections for Engie Chile's EBITDA and EBITDA margins for 2023 and 2024, as a result of the still challenging conditions in which the company operates, which include the still high spot prices and the company's net buyer position to fulfill its existing PPAs. Engie Chile has commitments to sell about 12 TWh per year, of which we expect it can cover 6 TWh-7 TWh with its own generation and between 3.2 TWh and 3.3 TWh per year with the backup PPAs. These backup PPAs aim to reduce electricity price volatility and the company's exposure to spot market, hedging about 25% of Engie Chile's total expected demand between 2023 and 2030.

In addition, the company completed the Coya and Capriconio solar projects, totaling 268 megawatts (MW) in 2022, and acquired a wind farm that combined will add 0.9 TWh of renewable generation starting in 2023. We also consider that as more renewable generation enters the system, spot prices should decline, which could also improve the company's margins. However, Engie Chile is also engaged in a significant investment plan that tightens credit metrics. It has committed to investing $650 million in new renewable capacity through 2024, aiming to eventually replace its coal-based energy production and increase capacity in the next few years, which will subsequently limit Engie Chile's need to buy energy.

Considering these factors, we expect the company's adjusted net debt to EBITDA to recover in the upcoming years, decreasing to 5.5x-5.8x in 2023 from 9.9x in 2022, and to continue to fall to about 4.5x in 2024. However, we believe that the volatility is high and, if the company is unable to execute its investment plan or fuel prices are higher than we expect, leading to leverage consistently above 5x, we could revise the company's financial risk profile downward.

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 continue to view Engie Chile as a strategically important subsidiary of Engie because we consider that it is unlikely to be sold and is important for the group's long-term strategy, which includes expanding its operations in Latin America and developing new renewable capacity through its Chilean subsidiary's platform. As a result, we expect the company to receive support from the group in most foreseeable circumstances.

Although Engie S.A has financial flexibility due to its solid performance (with our adjusted FFO to

debt in 2022 well above our 18% threshold for the current rating), if we continue to see Engie Chile's financial profile deteriorate and lead to a stress scenario, and the group doesn't step in to provide timely and sufficient support, we could revise our assessment of support downward, which would trigger a negative rating action.

CreditWatch

The CreditWatch negative reflects that there's a 50% of a downgrade if Engie Chile is unable to remediate the current liquidity pressures through a successful refinancing strategy in the next three months. We expect that an improvement of the company's debt maturity profile would come from either monetizing its accounts receivables, a liability management program, or explicit support from its parent.

Company Description

Engie Chile is one of the leading electric power generators in Chile, with a 7% market share of capacity. It's the fourth-largest player after Enel Chile S.A. (27%; BBB/Stable/--), Colbun S.A. (16%; BBB/Stable/--), and AES Andes S.A. (11%; BBB-/Stable/--). Engie Chile has 2,364 MW of installed capacity as of Dec. 31, 2022, 45% of which comes from coal-based plants, followed by gas-based plants (27%), renewables (26%), and oil/diesel plants provide 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). The company 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 18.61%, followed by pension funds (13.20%), foreign institutions (7.80%), and individuals (the rest).

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 (see "Economic Outlook Emerging Markets Q2 2023: Global Crosscurrents Make For A Bumpy Deceleration," published March 27, 2023). We forecast Chile's GDP to contract 0.4% in 2023 and expand 2.6% in 2024, and inflation at 7.9% in 2023 and 4.1% in 2024. In addition, in line with our article "Economic Outlook U.S. Q1 2023: Tipping Toward Recession," published Nov. 28, 2022, we expect the U.S. consumer price index (CPI) to be 4.7% in 2023 and 2.8% in 2024. We assume coal prices in line with those mentioned in our article "Metal Price Assumptions: Lower Prices And Higher Costs Start Squeezing Profits," published Nov. 1, 2022.
- Power generation of 6,000 gigawatt hours (GWh) - 7,000 GWh. We expect Engie Chile to continue buying 5,000-5,500 GWh in the open market, of which 3,200 GWh-3,300 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 $160 per

MWh and $140 per MWh for unregulated and regulated clients, respectively.

- Other revenue consists of $5 million from the spot market, gas sales near $50 million, and transmission revenue and ancillary services close to $120 million.
- Capex, financed with a combination of cash flows and debt, of about $570 million in 2023 and $375 million in 2024. These investments include maintenance capex of about $70 million.
- We incorporate that the company will receive about $300 million from the monetization of its accounts receivables in 2023.
- No delays or cost overruns associated with the construction of current projects.
- Dividend distributions aligned with the minimum 30% requirement in 2023 and 2024.

Key metrics

- EBITDA of $310 million to $350 million in 2023 and $420 million - $450 million in 2024
- Net debt to EBITDA of 5.5x-6.0x in 2023 and about 4.5x in 2024

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. We still expect Engie Chile to refinance its existing short-term debt of $360 million in the next three months, considering its generally satisfactory standing in the credit markets.

Principal liquidity sources for the next 12 months:

- Cash and liquid investments of $150 million as of Dec. 31, 2022; and
- Funds from operations approaching $230 million.

Principal liquidity uses for the next 12 months:

- Short-term debt maturities of $360 million as of Dec. 31, 2022;
- Capex of $78 million (only considering maintenance capex);
- Dividend distributions aligned with the minimum requirement of 30%; and
- Working capital outflows of about $100 million.

Environmental, Social, And Governance

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

In our view, Engie Chile is more exposed to environmental risk factors than most of its peers because its carbon footprint represents about 57% of generation. 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 ($MtCO_2$) equivalent in 2030 from 67 $MtCO_2$ equivalent in 2021. The group's phaseout of coal-based generation and the increasing 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.

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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
Engie Energia Chile S.A.	
Senior Unsecured	BBB

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Engie Energia Chile S.A.		
Issuer Credit Rating	BBB/Watch Neg/--	BBB/Stable/--

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