MOODY'S

Rating Action: Moody's affirms Transportadora de Gas Internacional's Baa3 rating; outlook changed to negative from stable

28 Apr 2023

New York, April 28, 2023 -- Moody's Investors Service (Moody's) affirmed the Baa3 foreign currency senior unsecured rating assigned to Transportadora de Gas Internacional ("TGI" or "Issuer"). The outlook on the ratings changed to negative from stable.

Affirmations:

..Issuer: Transportadora de Gas Internacional

....Senior Unsecured Regular Bond/Debenture, Affirmed Baa3

Outlook Actions:

..Issuer: Transportadora de Gas Internacional

....Outlook, Changed To Negative From Stable

RATINGS RATIONALE

TGI's rating outlook change to negative from stable reflects (a) the potential financial deterioration from the regulatory changes being implemented by the energy regulator in Colombia, Comision de Regulacion de Energia y Gas (CREG), (b) the company's lower weighted average gas transport contract life, and (c) the uncertainty stemming from the government attempts to further interfere in the gas sector.

TGI's Baa3 rating is supported by its large scale and entrenched business profile with capacity-based revenue that is regulated and subject to contractual tariff caps. The latest tariff review, which concluded last year, reduced the annual rate of return on investments to a fixed 11.88% from 15%, before taxes. In addition, the regulator changed tariff indexation to Colombian pesos from US dollars and reduced the asset value recognized in the tariff formula after the 20-year regulatory useful life (VUN). Following feedback from market participants, CREG has issued resolutions that aim to provide a transition period to fully implement the changes related to tariff indexation and asset value. The regulator also recognized changes that will have a net positive impact on the company, such as: (i) additional investments made on previous years that were still not included on the regulatory asset base, (ii) changes in demand expectations and (iii) operating cost assumption (AOM). However, the overall impact of the current regulatory cycle will be negative to TGI.

Since TGI's debt is dollar-denominated and the company will no longer not be able to generate dollar-denominated revenue, the regulation created exposure to foreign-exchange (FX) volatility. The company will need to contract additional hedging instruments for protection of these foreign currency mismatches. Management expects CREG to allow the recovery at least part of those incremental costs, but the scale and timing for compensation is yet unknown.

The other key change is the asset value recognition once they reach the end of 'regulatory useful life' of 20 years. For those that have already met VUN, assets will be recognized at 60% of replacement value according to a third-party expert and those that will reach VUN in the future, value will be recognized with a gradually decreasing weight over a 5-year period until reaching no value by the end of the 5th year. The main impact of this change will be reflected after

2027 when relevant assets meet the VUN. Given that TGI's senior unsecured notes have maturity date in November 2028, this change introduces a higher refinance risk in the medium-term because of uncertainty on TGI's ability recover investments on its regulatory asset base. Management also expects CREG to compensate for this impact but the final result remains uncertain.

Moody's anticipates deterioration on key financial metrics due to the projected interest payments and the cost of FX hedges that TGI plans to acquire to mitigate the currency exposure introduced by the recent regulation. For 2023, the rating's base case assumes the cash interest coverage ratio measured by the funds from operations (FFO) plus interest expense-to-interest expense will be between 2.3x and 2.5x, while the leverage ratio measured by the FFO-to-debt ratio will be in the range of 16 to 18%. Those ratios are lower than the interest coverage of 4.5x and leverage of 19.9% recorded in 2022. These projections are subject to the final decision of the regulator and the timing of their application.

Market dynamics have led to a lower average contract life than historical levels. Our latest estimate is that the average remaining contract life is around 4.8 years, lower than previous levels of 5 years or more. While the existing contracts provides adequate revenue visibility during the life of the transaction, the ability to renew or recontract capacity will be increasingly relevant over the next few years, as to sustain cash flow visibility ahead of the company's financing needs in 2028.

TGI's credit challenges are partially mitigated by TGI's high capacity-based revenue profile and entrenched position and large scale (owns more than 50% of the national pipeline network). To mitigate the refinancing risk, the company also executed a leverage reduction strategy with a partial cash tender offer and a market purchase for its notes, in which the company purchased around $171 million in aggregate principal, reducing the notes balance to about $579.1 million from $750 million.

TGI has adequate liquidity over the next 12 to 18 months. As of December 2022, the company held a cash balance of COP 457,981 million (around $100 million). The company's next significant obligation is a $370 million intracompany loan payment to the Grupo Energia de Bogota due in December 2023, which is expected to be funded with an new debt in local currency at TGI level, decreasing its exposure to foreign currency. After that, the only other significant debt maturity is the 5.55% Senior Notes due November 2028.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Social considerations were a key driver of today's rating action, given the perception of a deterioration in the regulatory environment in Colombia amid growing public concern over affordability of energy, with potential negative impact for TGI's credit metrics.

TGI's ESG Credit Impact Score is moderately negative (CIS-3), indicating that its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. Its score reflects moderately negative exposure to environmental and governance risks and highly negative exposure to social risks.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

Given the negative outlook, an upgrade in the ratings of TGI in the near term is unlikely. However, the outlook could be stabilized if the company records cash interest coverage ratios above 4.0x and FFO/debt above 15% on projected and sustained basis, and our assessment that government interference or regulatory changes are immaterial to the company's credit profile. A stable outlook would also consider the track record of balanced dividend distributions, allowing the company to gradually expand its financial flexibility ahead of major debt maturities.

Conversely, a negative regulatory outcome or government intervention that leads to a material impact on TGI's financial performance would trigger a downgrade. For example, if TGI records cash interest coverage ratios remain below 4.0x or FFO/debt below 15% would also exert downward pressure.

Headquartered in Bogota, TGI is a natural gas transportation company that operates 4,033 kilometers (km) of natural gas pipelines in Colombia (Government of Colombia, Baa2 stable). The system operates mainly with natural gas from the Ballena-Chuchupa and Cusiana-Cupiagua basins.

The principal methodology used in this rating was Natural Gas Pipelines published in July 2018 and available at https://ratings.moodys.com/api/rmc-documents/64961. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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