Fitch Ratings-Chicago-27 September 2011: Fitch Ratings has upgraded Empresas Publicas de Medellin E.S.P.'s (EPM) foreign and local currency Issuer Default Ratings (IDRs) to 'BBB' from 'BBB-'. The rating action affects USD500 million senior unsecured notes due 2019 and COP1,250 billion senior unsecured notes due 2021. Fitch has also affirmed EPM's national scale rating at 'AAA(col)' and its senior unsecured debt issuance program of COP2,000 billion at 'AAA(col)'. The Rating Outlook for all ratings is Stable.

The rating upgrade reflects the company's increased cash flow diversification and growth while maintaining strong investment grade credit protection measures. The rating upgrade also takes into consideration the improved macroeconomic conditions in Colombia and the continued absence of government intervention in the company. On June 22, 2011, Fitch upgraded the foreign and local currency IDRs of Colombia to 'BBB-' and 'BBB', respectively. Over the past few years, EPM has expanded its operations outside the city of Medellin and Colombia by investing mostly in distribution companies in Colombia, Panama, El Salvador and Guatemala. This adds to cash flow diversification and lowers government intervention risk, present through the municipality of Medellin ownership.

EPM's ratings reflect the company's low business risk resulting from its business diversification and characteristics as a utility service provider. EPM provides electricity, water and sewage water, natural gas distribution services as well as electric generation and telecommunication services. The company's ratings also reflect its solid credit protection measures supported by low leverage, healthy interest coverage and strong liquidity position. EPM's ratings also reflect the company's somewhat aggressive growth strategy as well as the company's exposure to regulatory risk, which is considered moderate.

**Low Business Risk:**

EPM's low business risk profile stems from its natural monopoly position as the main supplier of power, water and natural gas services to the Medellin's metropolitan area. The company is one of the largest generators of electricity within Colombia, with nearly 24% of the country's installed capacity, and the third largest telecommunications operator in Colombia. As of June 30, 2011, EPM's electricity distribution assets reach a network of 4.7 million customers in six states in Colombia and four countries; the company provided water services to approximately 1 million users, and its telecommunications business had approximately 2 million clients. This diversification provides EPM with a stable and predictable cash flow stream, primarily derived from regulated utilities, thereby offsetting some of the company's hydrology risk.

**Strong Credit Metrics:**

EPM's financial profile is strong, characterized by healthy cash flow generation, low leverage and healthy interest coverage and liquidity. As of the last 12 months (LTM) ended June 30, 2011, EPM reported a consolidated EBITDA of approximately USD1.8 billion and total consolidated financial debt of approximately USD3.9 billion. This translates into a leverage ratio of 2.2 times (x), which is considered solid for the rating category. Interest coverage, as measured by EBITDA-to-interest expense is strong at approximately 9.2x as of the LTM ended June 30, 2011, mostly due to the company's low cost of funding. The company's adequate liquidity position is characterized by a manageable maturity schedule and satisfactory cash on hand of approximately USD1.5 billion as of June 2011.

The company dividend policy has been moderate and is currently not considered a credit constrain. EPM has transferred as dividends, on average, between 45% and 50% of its net income to the city of Medellin. Although not considered likely in the near term, an increase in the company's dividend...
distribution policy could pressure its free cash flow generation, which is already expected to be negative due to the company's investment plant. During the past year, EPM's EBITDA and cash flow generation have improved due to the acquisition of distribution companies in Colombia, Panama, El Salvador and Guatemala.

Aggressive Growth Strategy:

EPM's growth strategy is considered aggressive, although the company is currently reviewing its goals after achieving its previously set target of reaching USD5 billion ahead of time. EPM's growth strategy is aimed at increasing consolidated revenues by investing in related business both within Colombia and abroad. Over the medium term, free cash flow is expected to be negative as the company funds its capital investment budget of more than USD8 billion. Fitch expects EPM's debt to increase moderately as the company finances a portion of its investments with debt while maintaining consolidated leverage ratios between 2.0x to 2.5x. Over the medium term, the company's interest coverage ratios might weaken to about 6.0x to 9.0x. This credit metrics would still be considered consistent with the company's assigned ratings.

EPM's 10-year capital investment program is largely earmarked towards increasing generation capacity and investing in its telecommunication business. Of the approximately USD8 billion to USD10 billion of estimated investment, approximately half will go towards generation, one quarter towards telecommunication industry and the balance will be divided between distribution, natural gas and water businesses. Among the largest investment projects is the development of the hydroelectric generation plant 'Pescadero Hituango' (Hidroituango), a 2,400 MW of installed capacity project with an estimated cost of USD5 billion. This project will be developed as a 50-year build, operate, manage and transfer (BOMT) project, which the company expects to develop as a joint venture with a strategic third party yet to be determined. Construction time is estimated to be between eight to 10 years.

Exposure to Regulatory Risk:

EPM is exposed to some regulatory risk, but it is considered low. The bulk of EPM's consolidated revenues are generated either by regulated tariffs or medium-term contracts, which exposes the company to unfavorable tariff regimes. Historically, all regulatory entities in Colombia have been independent from the central government and have provided a fair and balanced framework for both companies and consumers. Recent regulatory changes have had a neutral to marginally positive impact for the company's financial profile. Going forward, future regulatory changes are expected to be aimed at adding transparency to the market and the regulatory framework overall and to have a neutral impact on EPM's financial profile. EPM's diversified business profile further mitigates the company's regulatory risk as a simultaneous tariff decrease across all businesses is unlikely.

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Applicable Criteria and Related Research:
--'Corporate Rating Methodology', Aug. 12, 2011;

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Corporate Rating Methodology
National Ratings Criteria

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