FitchRatings

Fitch Affirms **Grupo Argos** at ‘AA+ (col)’; Outlook Stable

Fitch Ratings - Bogotá - (July 15, 2016): Fitch Ratings has affirmed Grupo Argos S.A.'s (Grupo Argos') Long-term and Short-term domestic Ratings at ‘AA+ (col)’ and ‘F1+ (col)’, respectively. The outlook is Stable.

KEY RATING DRIVERS

Grupo Argos' ratings reflect the credit quality of its investment portfolio and the performance and diversification of the inflows of received dividends. The ratings also consider company ability to maintain proper liquidity ratios, resulting from a manageable financial debt amortization structure, as well as having a robust investment portfolio of listed companies. Grupo Argos' ability to maintain low portfolio LTV (*Loan to Value)* levels has been considered a key rating driver. Structural subordination of company debt to the debt of its subsidiaries has also been considered. This situation is balanced via control of its major subsidiaries.

The rating considers the expectation that Grupo Argos will maintain high financial leverage during 2016, higher than anticipated by Fitch in its latest review, arising from the expected reduction of dividends received during the year as well as a more challenging economic environment in Colombia. However, Fitch considers that the company retains flexibility to reduce its debt levels in the medium-term, through desinvestment of its investment portfolio and access to the securities market.

Adequate Credit Profile of Major Investments:
Grupo Argos' ratings are based on the credit profile of its major investments. The company holds controlling positions in Cementos Argos S.A. and Celsia S.A. Fitch has rated Cementos Argos at 'AA+(col)' with a Positive Outlook. During 2015, dividends received from Cementos Argos represent 47% of total dividends received by the company. Cementos Argos has a solid competitive standing with a share of nearly 47% in the Colombian market and stands out as the fifth cement producer in Latin America. Cementos Argos' ratings incorporate the view of a reduction of the Debt/EBITDA leverage to levels close to 3x. Grupo Argos controls 55% of the share capital of Cementos Argos.

Celsia, jointly with its subsidiary Empresa de Energía del Pacífico EPSA, rated at 'AAA (col)' by Fitch, yielded 27% of the dividends received by Grupo Argos in 2015. Celsia is a power generation company, with a 50.01% interest in EPSA, where Grupo Argos also has an indirect interest of 11.9%. At a consolidated level, Celsia is the fourth power generation company in the country and the fifth power distribution and transmission company through EPSA. Fitch expects Celsia to reduce its current leverage as it will recover the generation of operating cash flows. During 2015, Celsia underwent heavy pressures on its Colombian operation resulting from El Niño, which had a negative impact on thermal-generating companies, for which a scarcity price-based compensation compared unfavorable to operating variable costs under hydrological conditions.

The remaining 30% of dividends received by Grupo Argos during 2015 were provided by its portfolio investment in Bancolombia, Grupo de Inversiones Suramericana and Grupo Nutresa, all rated at 'AAA (col) by Fitch. These companies belong to the same shareholders of Grupo Argos.

Grupo Argos complements its investment portfolio with the recent acquisition of 54.75% of the share capital of Grupo Odinsa S.A., a company rated at 'AA-(col)' with a Negative Outlook. Odinsa rating reflects the increase of the company's prospective financial leverage, arising from its recent entry into very large infrastructure projects that will demand significant financing inflows in the medium term. Fitch's view is that Grupo Argos' ability to receive dividends from this subsidiary in the short-term is limited by the pressure on the free cash flows expected by the company, given capital contributions required during the project construction stage and the time lag between such stage and the inflow of surplus from concessions. However, as Odinsa's project portfolio reaches increasing maturity levels, this should entail a predictable inflow of dividends for Grupo Argos over time.

Growth of Received Dividends Inflow:
The inflow of dividends received by Grupo Argos has proven a positive behavior over the last years, with a 12% year-on-year growth between 2011 and 2015. For 2016, Fitch foresees a reduction in the inflow of dividends received by Grupo Argos due to Celsia's decision of distributing share-based dividends during 2016 as a measure to release the pressure on its free cash flow generation. Ratings reflect the expectation that the company will recover the dividend inflow growth as of 2017.

The company reinforces its operating generation with a presence in the real estate segment, trading its own plots of land, as well as with the recent incorporation of Pactia, jointly with Conconcreto, operation that is likely to generate increasing dividends to the company in the years to come.

Aggressive Growth Strategy:
The ratings reflect the company's high financial leverage levels since 2015, arising from the acquisition of an interest in the share capital of Grupo Odinsa. The transaction in which the company has invested more than COP1.0 trillion has been funded with a mix of financial debt and sales of investments from its asset portfolio.

From a strategic viewpoint, the participation of Grupo Argos in the infrastructure business through the acquisition of Grupo Odinsa stock is viewed as positive by Fitch, given that it supplements its investment portfolio, contributes to diversify its operations and has the potential to become a steady source of dividends in the future.

Low LTV, Reduction of Financial Leverage in the Medium Term.
Fitch believes that Grupo Argos has financial flexibility to reduce its financial leverage to levels that are consistent with the ratings, in the forthcoming years. At the closing of March 2016, the company reported portfolio investments in amount of COP21.4 trillion and a balance of financial debt of COP1.55 trillion. This results in a portfolio LTV ratio of 7%, a level deemed conservative.

At the closing of 2015, Grupo Argos reported a debt to dividends received financial leverage of 6.1x, a level deemed high. Fitch expects that Grupo Argos' trend of debt to dividends received ratio will be towards 4x in the next 2 years, which, along with maintaining low LTV levels, supports the company's credit profile.

Structural Subordination of Financial Debt:
Fitch's view is that Grupo Argos financial debt has a structural subordination relative to the financial debt of its subsidiaries, given that dividends received, representing the recurring source of the company's operating cash flows, are only generated upon subsidiaries' payment of the amortizations foreseen in their balance sheets. However, since 70% of dividends are received from companies where Grupo Argos has a majority interest and are deemed strategic to the group, subordination is compensated by the control exercised by the Group over its main sources of dividends. Likewise, Grupo Argos receives a significant inflow of dividends from non-controlled companies rated at 'AAA (col)'.

KEY ASSUMPTIONS
Fitch key assumptions to rate the issuer include:

- in 2016, dividends received decreased by the payment of share-based payments from Celsia;
- as of 2017, the inflow of dividends will show a growing trend with sustained growth rates of 7%.
- the loan to dividends ratio will tend to around 4x in the next 2 years.

RATING SENSITIVITIES
Future developments that may, individually or collectively, lead to a positive rating action include:

- the positive development of the credit quality of its major dividend-generating related parties;
- medium-term moderate and sustained financial leverage;
- maintenance of a conservative dividend distribution policy.

Future developments that may, individually or collectively, lead to a negative rating action include:

- the weakening of credit quality of any of major dividend generators;
- new significant acquisitions mainly funded with debt;
- impairment of the LTV ratio.

LIQUIDITY RATIOS

Company liquidity is adequate, supported by the performance of its dividend inflows, the manageable financial debt amortization profile, the liquidity of its investment portfolio and proven company access to the domestic equity market. Excluding short-term debt at March amounting to COP 108 billion, for the period 2017 to 2019, debt repayments are expected to be in the range of COP 115 billion to COP 132 billion. This is manageable by Grupo Argos based on its projected dividend inflows.

SIGNIFICANT ADJUSTMENTS TO THE FINANCIAL STATEMENTS

- Revenues under the equity method were recognized as non-operating.
- Dividends received from companies controlled by Grupo Argos were recognized as operating revenue.

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These ratings were requested by the issuer or on behalf of the issuer, and consequently Fitch has received the fees relevant to the provision of its rating services.

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Date of Rating Technical Committee: July 14, 2016.
Minute Number: 4425
Purpose of the Committee: Periodic Review

Defining Rating: 'AA+ (col)' represents a very high credit quality. This rating is assigned to a very solid credit quality relative to other issuers or issues in the country. Credit risk entailed by these financial liabilities slightly differs from domestic issuers or issues with the highest ratings.

Short-term 'F1+ (col)' rating means high credit quality. Represents the soundest ability to timely meet financial commitments relative to other domestic issuers or issues. Under Fitch Colombia's domestic rating scale, this category is assigned to the top credit quality relative to any other risk in the country, and is generally assigned to financial commitments issued or guaranteed by Government. When the features of the issue or issuer are particularly sound, the sign "+" is added to the rating.

As applicable, in assigning this rating Fitch Ratings considered section 4 of Decree 610 of 2002 as set out by section 6 ibidem.

Methodology applied:

- Rating methodology for non-financial companies (December 19, 2014).

The credit rating of Fitch Ratings Colombia S.A. Securities Rating Agency constitutes a professional opinion and never implies a recommendation to buy, sell or maintain a security, nor is assurance of compliance with the obligations of the rated issuer. Members of the Rating Technical Committee who participated in the meeting in which hereinbefore rating(s) was (were) assigned were: Daniel R. Kastholm, Joseph Bormann, Johnny Da Silva, Julio Ugueto and José Rivas. The resumes of the members of the Technical Committee are available on the website of the Rating Company: www.fitchratings.com.co.