Fitch revises Grupo Argos Outlook to positive; Affirms rating at AA+(col)

Thursday, July 17, 2014

Fitch Ratings - Bogota - July 17, 2014. Fitch Ratings has revised Grupo Argos S.A. outlook to positive from stable and has affirmed long- and short-term national ratings at 'AA+(col)' and 'F1+(col)', respectively. Also, Fitch has affirmed at 'AA+(col)' rating on bonds obligatorily convertible into preferred stock (BOCEAS) of Grupo Argos up to COP 750 billion.

KEY RATING FACTORS

The decision to revise the outlook to positive reflects the prospective leverage reduction of the company, as a result of the conversion of BOCEAS in 2015, coupled with a reduction in the financing requirements for the development of its real estate business. Also, the outlook is based on the strong performance shown by its main subsidiaries, which generate most of the dividends received.

The rating reflects the credit quality and diversification of the investment portfolio of Grupo Argos, its wide range of liquidity sources and the increased performance of cash flows from dividends received. In addition, it considers the structural subordination of the company's debt to the debt of the operating subsidiaries, which is offset by the significant role that Grupo Argos plays on the dividend policy of its main investments, together with the volume of marketable investment portfolio.

Prospective Leverage Reduction

Grupo Argos has been implementing a change in the financial strategy that is expected to reduce its prospective debt. The company is undertaking major divestments in companies where it has no controlling stakes for about COP 140,000 million so far this year. This additional cash flow have reduced the Company's future financial needs. Also, greater weighting of its real estate business projects, with shorter term returns, has reduced the need for injection of capital to this business unit by Grupo Argos.

As at the end of March 2014, the non-consolidated financial debt of the Company stood at COP 1,527,887 million, including BOCEAS for COP 584,387 million to be converted in 2015. The leverage, measured by the Debt/EBITDA ratio, adjusted by the equity method and the flow of dividends from controlled entities, stood at 6.2 x, exceeding the expectations of Fitch in 2013 due to lower revenues from the sale of investments. However, the increase in these revenues, which has already been materializing in the 2014, contributed to the reduction of the company's prospective leverage.

The ratings incorporate the expectation that the financial debt be below COP 1 billion at the end of 2015, by the conversion of BOCEAS and greater free cash flows of the company, which translates into an adjusted leverage ratio and debt-to-dividends in a range between 3x and 4x at the end of that year.

Strong Credit profile of Main Investments

The rating of Grupo Argos is based on the credit profile of its main investments, Cementos Argos and Celsia. Cementos Argos maintains an AA+(col) rating with a stable Outlook by Fitch. In 2013, the dividends from Cementos Argos accounted for 43% of the total dividends received by the company. Cementos Argos has a strong competitive position with a participation of about 50% in Colombia and is the fifth largest cement producer in Latin America. Increased efforts to promote greater geographic diversification of its operations have been instrumental in mitigating the effects of the downturn in the industry in some of its international markets. At the end of March 2014, Cementos Argos showed a Debt-to-EBITDA ratio of 3.9x. Fitch considers that the favorable fundamentals of the Colombian economy and the continued recovery shown in the United States, should result in a leverage reduction to levels of about 3x in the mid-term.

Celsia accounted for about 24% of the dividends received by Grupo Argos in 2013. It is a power generation company. It owns 50.01% of Empresa de Energía del Pacífico -EPSA-(AAA (col) rating by Fitch). At the consolidated level, Celsia ranks fourth in power generation in the country and fifth in power distribution and transmission. One of its main strengths is the geographical diversification of its power plants and its power generation sources (56% water and 44% thermal). In the past two years, Celsia, in a consolidated manner, has showed average EBITDA margins of 38.5%, and at the end of 2013 its leverage, measured as Debt / EBITDA ratio, was 2.1x.

The remaining 33% of the total dividends come from portfolio investments of Grupo Argos, composed of noncontrolling stakes in Bancolombia, Grupo de Inversiones Suramericana and Grupo Nutresa (all with AAA(col) rating by Fitch).

Sustained growth of dividend flows

The flow of dividends received by Grupo Argos has shown a positive performance in recent years, recording an interannual increase of 17% over the period between 2009 and 2013. Also, with the spin-off of the assets of Cementos Argos in 2012, Grupo Argos also absorbed important real estate, port and coal assets, which are being developed so that in the medium term they will contribute to strengthen the cash flow of the company. In 2013, Grupo Argos received dividends for COP$ 249.785 million. By 2014, this dividend flow is expected to grow at a moderate pace of about 7%.

Wide range of alternative liquidity sources

At the end of March 2014, Grupo Argos recorded low cash levels in relation to its short-term debt. This is offset by its ability to access alternative liquidity sources. Between cash and liquid securities, it had COP$ 104,694 million, while the cash flow generated by 2013 Operations was COP$ 222,091 million, all of which is lower than its short-term debt of COP$ 498,300 million. Grupo Argos has a wide range of alternative liquidity sources that provide financial flexibility when required. The company's investment portfolio is made up mainly of highly marketable shares, which could be sold without compromising its controlling position in the respective companies and generate resources for nearly COP$ 1.5 billion. It also has uncommitted credit lines with local banks for about COP$ 2.3 billion, as well as access to the local stock market.

To improve its debt term structure and to make it more consistent with its cash flow generation profile, Grupo Argos has started the process of divestment in shares of companies where it has no controlling stakes to pay its short-term liabilities. In addition, it has announced that it is preparing a bond issue program of up to COP$ 1,000,000 million. The proceeds from the bond issuance would be used mainly to reduce its current financial liabilities.

Structural Subordination of the Financial Debt

Fitch considers that the financial debt of Grupo Argos has a structural subordination with respect to the financial debt of its subsidiaries, as dividends received, which explain most of the operating cash flow of the company, are only generated when the subsidiaries pay the amortizations included in their balance sheets. However, given that 67% of the dividends come from companies in which Grupo Argos has controlling interest and that are considered strategic for the Group, the subordination is offset by the control exercised by the company on its main sources of dividends. Also, Grupo Argos receives a significant flow of dividends from uncontrolled companies with AAA(col) rating.

RATING SENSITIVITY

The factors that, individually or collectively, could help upgrade the rating include:

- The improvement of the credit quality of its main dividend generators
- Sustained and moderate leverage after the conversion of BOCEAS
- A conservative dividend payment policy

The outlook could be revised from positive to stable with the occurrence of one or more of the following events:

- The weakening of the credit quality of some of the main dividend generators
- Major acquisitions financed mostly with debt.
- Adjusted credit metrics Debt-to-EBITDA and Debt-to-Dividends sustained above the 5.5x to 6.0x.

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Date - Rating Technical Committee: July 16, 2014.
Minutes No.: 3623
Purpose of the Committee: Periodic review.

Rating definition: Rating definition: AA+(col)' Ratings denote very high credit quality relative to other issuers or issues in the same country. The credit risk inherent to this financial obligations differs only slightly from that of the country's highest rated issuers or issues. F1+(col) rating Indicates the strongest capacity for timely payment of financial commitments relative to other issuers or obligations in the same country. Under the agency's National Rating scale of Fitch Colombia, this rating is assigned to the best credit quality relative to others in the same country. It is normally assigned to financial commitments issued or guaranteed by the Federal Government. Where the liquidity profile is particularly strong, a "+" is added to the assigned rating.

Additional information is available at 'www.fitchratings.com' and 'www.fitchratings.com.co Applicable Rating Criteria and Related reports:
-- ''Non-Financial Corporate Rating Methodology' (August 29, 2013);

The ratings above were requested by the issuer, or on its behalf; therefore, Fitch has received fees for the provision of its rating services.

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