Operating Performance Overshadowed by Tax Changes in Chile and Colombia

HOLD

The company released 1Q15 results, for the first time under IFRS for Colombia, revealing a significant increase in revenues (+21.6% YoY). However, this contrasted with an equally material expansion in costs and operating expenses (+24.2% YoY). This resulted in progress in terms of operating income (+16.7% YoY), EBITDA (+14% YoY) and net profit (+8.4%) but also in a general deterioration in profit margins (operating, EBITDA and net). Thus, ISA continue to advance gradually but steadily in their different business lines proving their ability to manage, operate and maintain infrastructure of vital importance for the countries where they operate as well as to being awarded with large projects.

1Q15 operating revenues were positively influenced by the performance of all business lines, mainly energy transport and road concessions. Factors such as increased revenues from construction services and the entry into operation of the Trujillo-Chiclayo projects in Peru, revenues related to UPME's projects in Colombia, the adjustment of remuneration in Brazil (since July 2014), and higher revenues from construction of new lanes and their associated financial performance, in Chile, were decisive in the progress seen in these segments.

Regarding the progress in operating costs and expenses, we highlight as main determinants the recognition of the wealth tax in Colombia and higher expenses associated with the construction of new lanes on Chile, as well as some accounting currency effects.

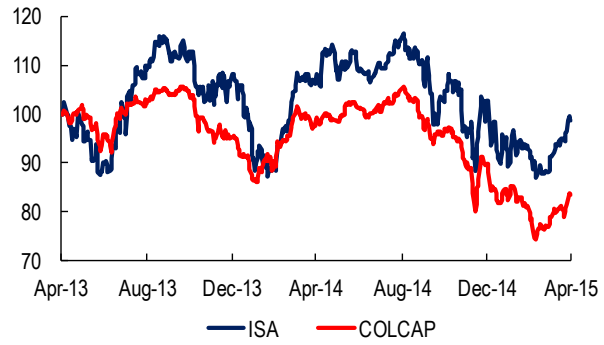
Thus, the EBITDA for the quarter reached COP619,844mn consolidating an EBITDA margin of 53.6%, which excluding the impact of the estate tax would have reached a value similar to the one recorded in the same period last year and which shows that in strictly operational terms the company managed to preserve their efficiency levels.

Finally, it is also important to note how the net profit was affected as a result of the tax reforms carried out in Colombia (5% CREE's surcharge) and Chile (increase in tax rate from 20% to 27%) factors resulting in a net income of COP145,361mn (+8.4% YoY).

We reiterate our HOLD rating and TP on ISA's stock because there are still some outstanding issues that could impact their finances: i) compensation for CTEEP's assets, ii) revision of power transmission tariffs in Colombia, iii) tenders for 4G road concessions, and iv) sale of Ecopetrol's stake in the company.

Summary	
Target Price (COP)	**9.690**
Close Price (COP)	8.290
Upside	**17%**
Range 52 weeks (COP)	7.176 – 9.783
Market Capitalization (COPmn)	9.182.650
Outstanding Shares (mn)	1.107,7
Float mn (without AFPs) (mn)	344,8
Average daily volume 6 m (COPmn)	221,412
Expected Return	16,9%
Dividend Yield	2,5%
Total Return	19,4%
Bloomberg:	ISA CB

ISA vs. COLCAP (Apr. 2013=100)



Source: Bancolombia, Bloomberg

Multiples (COP mn) *	2014	2015E	2016E	2017E	2018E
Revenues	3,921,335	3,934,523	4,122,178	4,419,110	4,586,223
Operating income	1,878,596	1,733,979	1,802,319	1,932,077	1,988,451
EBITDA	2,274,926	2,179,505	2,284,805	2,462,698	2,552,385
Net income	593,065	576,756	599,334	646,007	668,829
EPS	14.8	14.5	14.0	12.9	12.5
EV/EBITDA	9.0	8.3	8.0	7.3	6.7
P/ BV	1.0	1.0	1.0	1.0	0.9
Yield	2.8%	3.0%	3.2%	3.4%	3.6%

Source: Bancolombia. * Data under ColGAAP.

Analysts

Name: Juan Camilo Dauder
Phone: (574) 6049821
E-mail: jdauder@bancolombia.com.co

Name: Diego Alexander Buitrago
Phone: (571) 7463984
E-mail: diebuit@bancolombia.com.co

IFRS

Regarding the IFRS we note that the company had already presented the main aspects behind the application of these standards in a conference call. They started by indicating that this is not the first time they apply the standards as they already had experiences in Brazil, Chile and Peru, since 2010.

It was also highlighted that the recognition of the electric transportation and road concessions as a financial asset, one of the most important implications of the IFRS on the company, is not a new aspect to consider as its application was previously (2013), accepted, regulated, and determined by the CGN (National Accounting Office), and therefore the derived change was allowed to be introduced in the accountability developed under ColGAAP.

Overall, ISA mentioned that in the opening balance sheet its consolidated assets (end of 2014) fell by 5% driven by: i) elimination of valuations and inflation adjustments derived from its fixed assets policy adoption of depreciated reposition cost, ii) elimination of deferred debt costs, iii) elimination of goodwill, and iv) reclassification of debt costs as a lower debt value. In regard to liabilities the company highlighted an increase of 4% explained by: i) the recognition of a deferred liability in Colombia, ii) the recognition of the long-term employment benefits in Colombia, iii) the consolidation of INTERCHILE, and iv) the reclassification of debt costs as a lower value of the debt. All these facts derived in a 26% decrease in equity.

As for the P&L the company mentioned that it was a 5% decline in net profits explained by the net effect of: i) larger depreciations of fixed assets (-), ii) lower deferred tax expense (+), iii) adjustment on actuarial calculation (+) and iv) CTEEP's dividends (-).

Finally, the company presented a comparison between some of its key financial indicators in both GAAPs, indicating an almost neutral effect on ROA, a sensitive increase in ROE, and a mild reduction in EBIT, EBITDA and net margins.

Table 1 - ISA's 1Q15 results

	1Q15	1Q14	Var% (pbs)
Net revenues	1.157.089	951.245	21,6%
COGS	(641.110)	(508.948)	26,0%
Operating profit	515.979	442.297	16,7%
EBITDA	619.844	543.709	14,0%
Net Income	145.361	134.146	8,4%
EPS (COP)	131	121	8,4%
Operating margin	44,6%	46,5%	(190)
EBITDAmargin	53,6%	57,2%	(359)
Net margin	12,6%	14,1%	(154)

Source: Bancolombia

Conference Call Key Points

We highlight the following aspects that support our perspective on ISA:

- **ISA won't stop:** During 1Q15, ISA was awarded with 3 power transmission projects in Colombia: i) Strengthening of Costa Caribe, with estimated revenue of USD14.3mn; ii) Ituango, with expected revenue of USD42.2mn and iii) expansion of Valledupar Substation, with revenue of USD631,000. In this regard, we stress the dynamism of the company to seek new growth opportunities.

- **ANEEL's compensation for existing CTEEP's assets:** On January 8th CTEEP was notified about the ANEEL's decision (Brazilian electricity regulator) regarding the compensation of existing assets before May 2000 established in the early renewal of the concession agreement 059/2001. The decision set an estimated compensation value of BRL3,605mn, well below CTEEP's previous estimate of BRL5,500mn, and because of this CTEEP decided to appeal the ruling. Now, with the appeal underway, not only the final amount to be recognized but the way in which it has to be paid is yet to be confirmed. News expected in mid-2015.

- **Revision of electrical transmission tariffs in Colombia:** Although on February 19th the CREG (Energy and Gas Regulatory Commission in Colombia) published a new resolution with a proposal for the remuneration of the transmission activity, for which ISA and the companies involved have submitted observations and comments, the final regulation is yet to be known while there are sensitive issues to be defined such as the age of the assets subject to the revision and the recognition of investments made in improvements.

  However, it was noted that there is not enough information yet to carry out a proper assessment and therefore there's no conclusion for the time being.

- **4G concessions:** The company was initially shortlisted in 4 projects, for which they haven't bidden for because the conditions have not allowed them to obtain the expected rate of return. However, they are studying the Neiva-Girardot (USD648mn) and Popayan-Santander de Quilichao (USD680mn) projects, which haven't been tendered yet.

Equity Sales

Rupert Stebbings
Equity Markets Vice President
rstebbin@bancolombia.com.co
+574 6045138

Natalia Agudelo Parra
Equity Sales
naaparr@bancolombia.com.co
+574 6045144

Fixed Income

Pablo Caicedo
VP International Business
pcaiced@bancolombia.com.co
+571 488 6000

Economic Research

Juan Pablo Espinosa
Head of Economic Research
juespino@bancolombia.com.co
+571 7463991 ext. 37313

Alexander Riveros
Senior Economist
egrivero@bancolombia.com.co
+571 7463980 ext 37303

Equity Research

Jairo Agudelo
Head of equity research
jjagudel@bancolombia.com.co
+574 6047048

Juan Camilo Dauder Sánchez
Head Energy Analyst
jdauder@bancolombia.com.co
+574 6049821

Maria Paula Cortés Durán
Head Financial & Small Cap
mpcortes@bancolombia.com.co
+571 353 6600 ext 37387

Diego Buitrago Aguilar
Energy Analyst
diebuit@bancolombia.com.co
+571 7463984 ext 37307

German Zúñiga Saavedra
Infrastructure and Industry Analyst
gzuniga@bancolombia.com.co
+574 6047045

Federico Perez Garcia
Oil & Gas Junior Analyst
fedgarci@bancolombia.com.co
+574 6048172

Research Assistant

Claudia Restrepo
Research Editor
claurest@bancolombia.com.co
+574 404 3809

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