

## FITCH UPGRADES AES PANAMA TO 'BBB-'; OUTLOOK STABLE

Fitch Ratings-New York-14 June 2017: Fitch Ratings has upgraded AES Panama SRL's (AESP) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'BBB-' from 'BB+'. The Rating Outlook is Stable. The rating action affects USD375 million of notes due 2022. Additionally, Fitch has upgraded AESP's National Scale rating to 'AA+(pan)' from 'AA-(pan)'. The upgrade of the National Scale rating also affects the notes due 2022.

The rating upgrades reflect AES Panama's strategic changes to its generation portfolio and to its re-contracting strategy, underpinned by Panama's evolving electricity matrix designed to mitigate spot price volatility. Under normal hydrological conditions, Fitch expects leverage of 3.0x or lower through the rating horizon, supported by higher average energy prices under Power Purchase Agreements (PPAs).

### KEY RATING DRIVERS

**Improving credit Metrics:** AESP's ratings reflect the material credit metrics' improvement resulting from better hydrology conditions, adequate contractual position and stabilized spot prices. In 2016, AESP reported an EBITDA of USD119 million on revenues of USD316 million, up from USD12 million of EBTIDA on USD261.8 million of revenues in 2014. The increase in cash flow generation was primarily driven by improved hydrological conditions and by lower and more stable spot prices. The currently low global oil and gas prices combined with an increasingly diverse energy matrix in Panama should keep spot price more stable. Consequently, the company's margins have recovered to 38%, up from 5% in 2014, while leverage improved to 3.1x and interest coverage rebounded to 4.9x from a peak leverage of 33.4x in 2014. As Fitch expected, AESP has seen tighter liquidity as the company returns to its stated cash policy whereby excess funds over USD20 million are paid out as dividends.

**Moderate Hydrological Risk:** AESP's highly contracted position of around 90% of installed capacity exposes it somewhat to changes in hydrological conditions and spot market prices such as those observed during 2014 and 2013. To manage hydrology risk, AESP added a 72MW thermal barge, Estrella del Mar, to its asset base. This thermoelectric generation barge serves as an effective hedge against spot price volatility through the life of its PPA ending in 2020. Thereafter, assuming AESP does not sell it, the barge could function as back-up generation capacity for AESP in an event of low hydrology.

**Balanced Contractual Position Expected:** The company's re-contracting strategy will prove equally important as AESP intends to lower its exposure to hydrology volatility by improving its contractual balance between short- and long-term PPA. Panama has nearly 1300 MW of non-hydro based generation under various stages of constructions between now and 2020, including a 380MW natural gas plant that will be operated by AES Corp through a joint venture with Inversiones Bahia. The expansion of alternative generation sources within the Panamanian power matrix should help keep spot prices low, even in stressed hydrological conditions.

**Low Off-taker Risk:** AES Panama's ratings reflect the company's low counterparty risk. Generation companies in Panama are permitted to enter into PPAs for up to their firm capacity allocation. The company sells electricity under separate PPAs with the country's three distribution companies, Empresa de Distribucion Electrica Metro-Oeste S.A. (Edemet), Elektra Noreste (Fitch IDR of 'BBB'), and Empresa de Distribucion Electrica Chiriqui (Edechi), with various maturities.

Panamanian distribution companies appear to have the sufficient credit quality and financial ability to support their respective obligations under the PPAs with AES Panama. According to the local regulator, firm capacity is calculated based on a 30-year historical average. The regulations promote the use of PPAs by requiring distribution companies to secure 100% of their peak regulated demand for the following year. AES Panama maintains PPAs for approximately 90.5%, on average, of available capacity through 2018.

**Strong Market Position:** AES Panama is the largest generation company in the country based on installed capacity accounting for 24% market share (including AES Changuinola's installed capacity of 223MW). AES Panama benefits from a competitive portfolio of low-cost hydroelectric generating assets, including dam-based reservoirs and run of the river units. The diverse location of the company's assets somewhat mitigates its exposure to hydrology risk as the plants are located in different hydrology regions.

**Exposure to Regulatory Risk:** The company's ratings also reflect its exposure to regulatory risk. Historically, generation companies in Panama were competitive unregulated businesses free to implement their own commercial strategies. In the past years, the increase in electricity prices has resulted in increased government intervention in the sector in order to curb the impact of high energy prices for end-users. Efforts to diversify the country's energy matrix will help to lower prices over the medium, reducing the need for regulatory interference.

## DERIVATION SUMMARY

The ratings reflect the company's EBITDA recovery over the past year and expected continued improvement as result of lower spot purchases going forward, supported by the start of commercial operation of the power barge in the second quarter of 2015, and a more flexible contractual strategy after 2018. All these factors should jointly serve to mitigate the impact of potential adverse hydrological conditions in the future. Strategically and fundamentally AESP compares closely with the Colombian hydroelectric generators Emgesa and Isagen, rated 'BBB' and 'BBB-', respectively. Isagen is currently on positive outlook, in spite of recently experiencing temporary contraction in its cash flow as a result of its high contractual position and weak hydrology.

## KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

- New capacity through the next five years keeps spot prices low;
- Increase in average monomial price in 2018, as new DisCo PPA's become active;
- No significant El Nino effects in the near-to-medium term;
- Excess cash above USD20 million paid out as dividends;
- AESP guarantees the transmission line for AES's LNG project (off-balance, beginning in 2018);
- Barge fuel costs track Fitch WTI forecast.

## RATING SENSITIVITIES

**Future Developments That May, Individually or Collectively, Lead to Positive Rating Action**

-A positive rating in the near-term is unlikely. However, possible factors that could trigger a positive rating action include: a sustained decrease in leverage below 2.5x coupled with a contracting strategy that promotes cashflow stability through a diversification of asset types.

**Future Developments That May, Individually or Collectively, Lead to Negative Rating Action**

-A downgrade could result from a combination of the following factors: leverage above 3.5x on a sustained basis, increased government intervention in the sector coupled with weakening

regulatory framework, deterioration in the company's ability to mitigate spot market risk, and/or payment of dividends coupled with high leverage levels

## LIQUIDITY

AESP's policy is to maintain a cash balance of USD20 million, dividends payments are subordinated to this policy. The company maintains short-term credit facilities for up to USD90 million; one with Scotiabank for USD20 million, another with Banco General for USD10 million, Citibank for USD20 million, Banco de Centro America for USD15 million, and BNP Paribas for USD25 million. The company's current debt consists of its USD375 million bond due 2022.

## FULL LIST OF RATING ACTIONS

Fitch upgrades the following ratings:

AES Panama SRL

--Long-Term Foreign Currency IDR to 'BBB-' from 'BB+';

--Long-Term Local Currency IDR to 'BBB-' from 'BB+';

--National Long-Term Rating to 'AA+(pan)' from 'AA-(pan)';

--USD375 million notes due 2022 to 'BBB-' and 'AA+(pan)' from 'BB+' and 'AA-(pan)', respectively.

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com). For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary

Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)

<https://www.fitchratings.com/site/re/895493>

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