

FITCH AFFIRMS AES PANAMA AT 'BBB-'; OUTLOOK REVISED TO POSITIVE

Fitch Ratings-New York-14 June 2018: Fitch Ratings has affirmed AES Panama SRL's (AESP) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-'. The Rating Outlook has been revised to Positive from Stable. Fitch has also affirmed AESP's National Scale rating at 'AA+(pan)'. The Rating Outlook remains Stable. In addition, AESP's senior unsecured noted ratings have been affirmed at 'BBB-' and 'AA+(pan)'.

The ratings reflect AES Panama's strategic changes to its generation portfolio and 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

Mitigating Hydrological Risk: AESP maintains PPAs that represent approximately 90% of its installed capacity. This elevated level exposes AESP to changes in hydrological conditions and spot market prices, such as those observed during 2014 and 2013. To manage climatological risk, AESP added a 72MW thermal barge, Estrella del Mar, to its asset base. With contracts tied to fuel prices, the thermal barge serves as an effective hedge against spot price volatility through life of its PPA ending in 2020. Thereafter, assuming AESP does not sell it, the barge could function as back-up in the event of low hydrology.

The company's re-contracting strategy for the hydro generators will prove equally important. Currently, AESP intends to let its contracts expire over the next five years, whereupon it will try to enter into short-term contracts (giving the company a better degree of climatological visibility), reducing or increasing its contracted capacity as hydrology and spot price forecasts permit. With respect to the latter, 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.

Improving credit Metrics: AES Panama's (AESP) credit metrics have seen sharp improvement since it experienced exceptionally weak hydrology in 2014. In 2017, AESP showed EBITDA of USD130 million on revenues of USD342 million (versus USD12 million and USD261.8 million, respectively in 2014). This was primarily driven by improved hydrological conditions and by cheaper spot prices. Moderate global oil and gas prices combined with an increasingly diverse energy matrix in Panama should keep spot price trends low. Consequently, the company's margins have recovered to 38% (vs. 5% in 2014), while leverage improved to 2.9x and interest coverage rebounded to 5.8x. As expected, Fitch has seen tighter liquidity as the company returns to its stated cash policy whereby excess funds over USD20 million are paid out as dividends.

Fitch expects leverage to remain at around 3.0x through the rating horizon, although a temporary spike in EBITDA in 2019 could drive leverage to 2.0x or lower. This is a result of major repairs to AES Changuinola's generation tunnel, which will take the unit off line for approximately 10 months in 2019. As a result, during the maintenance period, AESP will replace those generation purchases with energy from the spot market at prices significantly below those established under the Changuinola PPA.

Strong Market Position and High-Quality Offtakers: AES Panama's ratings reflect the company's contractual position with low counterparty risk. Generation companies in Panama are permitted to enter into PPAs for up to their firm capacity allocation. 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. 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 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.

AES Panama is the largest generation company in the country based on installed capacity accounting for 24% market share (without considering AES Changuinola 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 lower prices over the medium, reducing the need for regulatory interference.

DERIVATION SUMMARY

AESP's most appropriate peers are Isagen S.A. ESP (BBB/Stable) and Emgesa, both Colombian generators with significant hydroelectric capacity. Consistent with their investment grade ratings, all three companies mitigate El Nino risk with back-up thermal capacity. They also benefit from regulatory environment that have evolved in the last several years to reduce potential price volatility from stressed hydrological conditions. With 547MW of installed capacity and a long term physical contract for 223MW with its sister company, AES Changuinola (A+(pan)/Watch Negative), AESP functionally represents 23% of the Panama's installed capacity. This is in line with peers, which have between 20% to 25% of their respective markets; however, in terms of gross capacity, Isagen and Emgesa each have installed capacity in excess of 3,000MW.

AESP's capital structure is broadly in line with Isagen, posting gross leverage of around 3.0x under normal hydrology conditions. Emgesa's gross leverage has remained below 3.0x historically and is expected to fall below 2.0x through the medium term. AESP's interest coverage is similar to Emgesa's at around 5.0x historically, while Isagen's interest hovers around 3.0x.

KEY ASSUMPTIONS

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

- New, low cost capacity through next 5 years keeps spot prices low;
- Sharp 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;
- Barge fuel costs track Fitch WTI forecast.

RATING SENSITIVITIES

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

--A sustained decrease in leverage below 3.0x;

--A conservative contracting strategy that continues promotes cashflow stability and withstand hydrological shock to the system;

--Continued evidence in the Panamanian market of sustainable spot price stabilization as a result of asset diversification in electricity matrix.

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 USD 45 million (Scotiabank USD20 million, Banco General USD10 million, Banco Panama USD5 million, Banistmo USD5million, Bac International Bank USD5 million).

AESP benefits from a favorable debt maturity profile, with a USD300 million bond due 2022 as its sole debt obligation and approximately USD22 million of interest expense annually.

FULL LIST OF RATING ACTIONS

AES Panama SRL

--Long-term Foreign Currency IDR at 'BBB-'; Outlook to Positive from Stable;

--Long-term Local Currency IDR at 'BBB-', Outlook to Positive from Stable;

--Senior unsecured notes international rating at 'BBB-';

--Long-term National Scale rating affirmed at 'AA+(pan)'; Outlook Stable;

--Senior unsecured notes national scale rating at 'AA+(pan)'.

Contact:

Primary Analyst

John Wiske

Analyst

+1-212-908-9195

Fitch Ratings, Inc.

33 Whitehall St.

New York, NY 10004

Secondary Analyst

Erick Pastrana

Associate Director

+506 2296 9182

Committee Chairperson

Daniel R. Kastholm, CFA

Managing Director

+1-312-368-2070

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at www.fitchratings.com.

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10023785>

National Scale Ratings Criteria (pub. 07 Mar 2017)

<https://www.fitchratings.com/site/re/895106>

Parent and Subsidiary Rating Linkage (pub. 15 Feb 2018)

<https://www.fitchratings.com/site/re/10019836>

Sector Navigators (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10023790>

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.