

Research Update:

AES Panama S.R.L. 'BB' Ratings Affirmed Despite Lower Expected Cash Flows, Outlook Still Negative

July 31, 2019

Rating Action Overview

- We expect Panama-based electric generation company AES Panama S.R.L. (AES Panama) to post more aggressive credit metrics in the short term than what we originally expected due to a rise in spot market prices. However, we expect the company's adjusted debt to EBITDA of about 4.5x starting in 2020, in line with the current rating level.
- The company is currently purchasing a significant portion of electricity on the spot market in order to supply its contracts, given that the 175 megawatt (MW) hydro power plant Changuinola will be out of operations due to an unexpected stoppage until mid-October 2019.
- On July 31, 2019, S&P Global Ratings affirmed its 'BB' issuer credit and issue-level ratings on AES Panama.
- The outlook is still negative, reflecting the chance of a downgrade in the upcoming 12 months. This could occur if we perceive either a higher level of spot prices or a delay in the repairs of Changuinola's plant that could further pressure leverage or the company's liquidity.

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Rating Action Rationale

The rating affirmation reflects our view that although AES Panama's debt to EBITDA will deteriorate to almost 6.0x and FFO to debt to about 7% because of the company's exposure to higher-than-expected spot market prices--we expect these ratios to improve starting in 2020 to about 4.5x and 12%, respectively. The improvement will mainly stem from Changuinola's return to operations in mid-October 2019, which should slash AES Panama's exposure to electricity purchases on the spot market, and consequently, its volatility.

Panama's severe drought throughout 2019 and Changuinola's stoppage caused spot market prices to rise. Given the existing contract between AES Panama and Changuinola, even without delivering the power, the company has been obligated to make the payments, while it also has to purchase electricity at the spot market in order to honor its contracts, facing higher costs than in previous years.

Therefore, we're revising our base-case scenario. Main change is related to the average spot market prices in 2019, which we now expect will range in the \$110 per megawatt hour (MWh) from

\$90 per MWh previously. As a result, we expect the following credit metrics for AES Panama:

	2019E	2020E
EBITDA (mil. \$)	110-130	140-160
Debt to EBITDA (x)	5.7-6.8	4.4-5.0
FFO to debt (%)	7-10	11-14

Outlook

The negative outlook on AES Panama reflects a one-in-three chance of a downgrade in the next 12 months. This could occur if either spot prices continue to rise or delay in the repairs of Changuinola's plant occur, which could further pressure leverage or the company's liquidity.

Downside scenario

We could lower the ratings if delays in the repairs further weaken the company's credit metrics. Also, if the company continues posting debt to EBITDA consistently above 5.0x and FFO to debt below 12%, while average spot market prices for the next few years surpass \$125 per MWh, we could downgrade the company. In addition, if the cash sources-to-uses ratio falls below 1.2x in the next 12 months, as a result of high dividend distribution, while the company's cash flows are under pressure, we could take a negative rating action. Finally, if we believe that the Panamanian government has a lesser capacity to provide timely and sufficient extraordinary support to AES Panama's operations, stemming from a weaker economy, we could also lower the ratings.

Upside scenario

We don't expect an upgrade in the following 12 months, but we could revise the rating outlook to stable if, after the Changuinola's repairs, AES Panama demonstrates a conservative hydrology risk management plan, maintaining debt to EBITDA consistently below 5.0x and FFO to debt above 12% in the next two years.

Company Description

AES Panama owns and operates four hydroelectric plants and two thermal plants. The government of Panama (BBB+/Stable/A-2) has 50.46% stake in the company, while The AES Corp. (AES: BB+/Stable/--) has 49.07%. Minority shareholders hold the remaining 0.47%.

Ratings Score Snapshot

Issuer Credit Rating: BB/Negative/--

Business risk: Fair

- Country risk: Moderately high risk
- Industry risk: Moderately high risk
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: bb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb-

Related government rating: BBB

Likelihood of government support: Moderately high (+1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- AES Panama S.R.L. 'BB' Ratings Affirmed, Outlook Remains Negative, April 5, 2019

Ratings List

Ratings Affirmed

AES Panama S.R.L.

Issuer Credit Rating BB/Negative/--

Senior Unsecured BB

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