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Research Update:

AES Panama S.R.L. Ratings Raised To 'BB' On Improved Liquidity; Removed From CreditWatch; Outlook Stable

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Overview

- Panama's largest power generator, AES Panama, has placed a $75 million add-on to its senior notes due in 2022.
- We have revised its liquidity position to adequate.
- We are raising the corporate credit rating and issue-level ratings to 'BB' from 'BB-'.
- We removed the ratings from CreditWatch, where they were placed with positive implications on Sept. 28, 2016.
- The stable outlook reflects our expectation that the company will continue to perform a conservative commercial strategy, maintaining a 5%-10% cushion for its firm capacity to mitigate hydrology fluctuations, which should result in stable cash flow and funds from operations (FFO) to EBITDA of 15% and debt to EBITDA converging to 4x in the next two years.

Rating Action

On Dec. 28, 2016, S&P Global Ratings raised the corporate credit rating and issue-level ratings on AES Panama S.R.L (AES Panama) to 'BB' from 'BB-'. At the same time, we removed the ratings from our CreditWatch listing, where they were placed with positive implications on Sept. 28, 2016. The outlook is stable.

Rationale

The upgrade follows the reassessment of the company's financial flexibility, after it successfully placed the $75 million add-on of its bonds maturing in 2022. These funds were used to repay the $82.7 million 2016 notes that matured on Dec. 21, 2016. We believe that the company has good financial flexibility to absorb the hydrology risk, with a track record of execution of a conservative and prudent commercial strategy adopted in 2014--with a 5%-10% cushion for its firm capacity to mitigate hydrology fluctuations, on top of its 72 megawatts (MW) diesel-powered plant--and an absence of short-term liabilities (as the only debt outstanding is the balance of notes due in 2022 and no committed capital expenditures for expansion or new investments).

Our 'BB' corporate credit rating on AES Panama is based on our assessment of it as the largest power generator in Panama, which is somewhat counterbalanced by the historical volatility of profitability due to hydrological exposure. We also consider the somewhat leveraged financial risk profile with metrics of 16% FFO to debt and 3.8x debt to EBITDA as of September 2016, which are aligned with our definition of an aggressive financial risk profile. This results in a 'bb-' anchor and stand-alone credit profile, as there is no impact of the modifiers, and after factoring reassessment of the liquidity flexibility. The rating also incorporates our view that there is a moderately high likelihood that the government of Panama (BBB/Stable/A-2) would provide timely and sufficient extraordinary support to the company in the event of financial distress.

AES Panama owns and operates four hydroelectric plants totaling 482 MW of installed capacity and a diesel-powered barge with 72 MW of installed capacity. In addition, AES Panama has a power purchase agreement (PPA) with hydropower generator, AES Changuinola, from which it buys 175 MW or 100% of the generator's firm capacity until 2030 at a fixed price. The AES Corp. holds a majority stake in AES Changuinola, which has 223 MW of installed capacity.

Liquidity

We have revised AES Panama's liquidity to adequate. In our view, the company's liquidity sources will be sufficient to cover its uses for the next 12 months, with a 20% cushion to absorb adverse effects, such as hydrology risk. In addition, we believe that the company has good access to banks and the capital markets, as seen in its $300 million 2022 bonds issuance in 2015, and subsequent add-on performed in September 2016. In addition, we believe that the company has adopted a prudent risk management strategy after 2014 that includes the flexibility to reduce dividend payments in case of liquidity constraints.

Principal liquidity sources:

- Cash and short-term investments of $28 million as of Sept. 30, 2016;
- FFO of about $75 million over the next 12 months;
- $75 million add-on performed in September; and
- Undrawn committed bank lines of $5 million.

Principal liquidity uses:

- $83 million bond maturity in December 2016;
- Working-capital requirements of about $5 million;
- Capital expenditures (capex) of about $11 million, excluding any extraordinary maintenance at the thermal plant; and
- Flexibility to forego dividend payments.

Outlook

The stable outlook reflects our expectation that the company's cash flow generation will continue to improve in 2017 and afterward, though remaining in line with our aggressive financial risk profile, as seen in projected debt to EBITDA in the 4x area and FFO to debt in the 15% area in the next two years.

Downside scenario

We could lower the ratings if there is a revision of the SACP to 'b+', which would occur, for example, if the company is unable to implement its hydrology risk management plan due to worse-than-expected hydrology conditions or it embarks on a more aggressive commercial strategy, resulting in FFO to debt below 12% and/or a liquidity assessment revision to a weaker category.

Because AES Panama is a government-related entity, a downgrade is possible following a reassessment of our expected view of extraordinary support, and/or a lowering of the local currency rating on Panama to 'BB+' or weaker, while all other factors remain unchanged.

Upside scenario

We could raise the ratings if the consolidation of the conservative hydrology risk management plan results in stronger than expected cash flows and deleveraging, which would in turn result in FFO to debt consistently above 20% and debt to EBITDA below 4x, leading to a reassessment of its financial risk profile to significant. In this scenario, all other factors would remain unchanged, in particular our view of liquidity and the government extraordinary support assessment.

Ratings Score Snapshot

Issuer Credit Rating: BB/Stable/--

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: 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- AES Panama S.R.L. 'BB-' Ratings Placed On CreditWatch Positive On The Planned Notes' Add-On On, Sept. 28, 2016
- AES Panama 'BB-' Rating Affirmed As Operating And Financial Performance Is In Line With Expectations; Outlook Stable, July 7, 2016

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
AES Panama S.R.L.		
Corporate Credit Rating	BB/Stable/--	BB-/Watch Pos/--
AES Panama S.R.L.		
Senior Unsecured	BB	BB-/Watch Pos

	To	From
AES Panama S.R.L.		
Analytical Factors		
Local Currency	bb-	b+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.