



Fitch Rates AES Panama's Proposed Reopening 'BB+'

Fitch Ratings-New York-28 September 2016: Fitch Ratings rates AES Panama S.R.L.'s (AESP) proposed USD notes reopening 'BB+'. The reopened notes are part of AESP's notes due 2022 and will be used primarily to refinance the remaining outstanding debt for the notes due at the end of 2016.

KEY RATING DRIVERS

Improving Credit Metrics:

AESP's credit metrics have significantly improved since 2014, and Fitch expects this improvement to continue. In 2015, AESP had EBITDA of USD99.7 million on revenues of USD299 million (versus USD12 million and USD261.8 million, respectively in 2014). This was primarily driven by improved hydrological conditions and by lower spot prices, reflecting the global decline in oil prices. Consequently, the company's margins recovered to 33% (versus 5% in 2014) while leverage improved to 3.8x and interest coverage rebounded to 4.2x. Fitch expects to see tightening liquidity as the company returns to its stated cash policy whereby excess funds over USD20 million are paid out as dividends.

The hydrology forecast points to heavier rainfall in the second half of 2016 as a result of the 'La Nina' effect. Base case assumptions indicate normal hydrology for the next few years, while spot prices continue being driven down by the low price of oil and improved energy supply dynamics, as Panama adds new generation projects to the matrix between now and 2020.

Moderate Exposure to Hydrological Risk:

AESP maintains power purchase agreements (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. In the medium term, AESP is considering several alternatives for managing hydrology risk. By adding the 72MW Estrella del Mar thermal barge to its asset base, AESP will be able to offset some of its own spot market costs with the barge's price-adjusted revenues. Alternatively, after Estrella del Mar's contracts expire in 2020, the company could use the barge's capacity to directly supply back-up energy.

As part of the actions being taken by the company to reduce its exposure to hydrology risk, AESP is also considering not renewing the PPAs that expire over the next five years. Thereafter, it would try to enter into short-term contracts to give the company a better degree of climatological visibility. The company's contractual strategy will consist of reducing or increasing its contracted capacity based on hydrology and spot price expectations.

Diversification of the Panamanian Energy Matrix:

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 which 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.

Cash Flow Supported by Contractual Position:

AESP's ratings reflect 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. AESP maintains PPAs for approximately 91%, on average, of available capacity through 2018. Thereafter, the

company has secured contracts for 350 MW (between 70%-80% of capacity) through 2030.

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 (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 AESP.

Strong Market Position:

AESP is the largest generation company in the country based on installed capacity accounting for 18% market share (without considering AES Changuinola installed capacity of 223MW). AESP benefits from a competitive portfolio of low-cost hydroelectric generating assets, including dam-based reservoirs and run of the river units. The company is composed of four hydroelectric plants throughout the country with a total installed capacity of approximately 482 MW and different dispatch priorities. The thermal plant, Estrella del Mar, has an installed capacity of 72MW. The diverse locations of the company's assets somewhat mitigate 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.

KEY ASSUMPTIONS

- New capacity through next five years keeps spot prices low;
- Expiring PPAs are not renewed in 2019 & 2020;
- No significant El Nino effects in the near to medium term;
- Excess cash above USD20 million paid out as dividends;
- Barge fuel costs gradually increasing over the next several years.

RATING SENSITIVITIES

A downgrade could result from a combination of the following factors: leverage above 4.0x on a sustained basis, increased government intervention in the sector coupled with weakening regulatory framework, inability to reduce exposure to the spot market, and/or payment of dividends coupled with high leverage levels.

Factors that could trigger a positive rating action include: a sustained decrease in leverage below 3.0x coupled with an effective diversification of revenues among different fuels, and reduced exposure to spot market risk.

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 USD105 million. The company has no FX exposure, as it operates in Panama.

AESP's current debt consists of USD82 million of outstanding senior unsecured notes due in December 2016, and its recently issued USD300 million bond due 2022. The expected reopening of the latter will be used to refinance the former.

FULL LIST OF RATING ACTIONS

Fitch currently rates AES Panama as follows:

AES Panama SRL

- Foreign Currency Long-Term Issuer Default Rating (IDR) 'BB+';
- Local Currency Long-Term IDR 'BB+';
- National Long-Term Rating 'AA-(pan)';
- USD300 million notes due 2016 (USD82 million outstanding) 'BB+';

--USD300 million notes due 2022 'BB+' and 'AA-(pan)'.

The Rating Outlook is Stable.

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