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AES Panama S.R.L.

Primary Credit Analyst:
Vinicius Ferreira, Sao Paulo + 55 11 3039 9763; vinicius.ferreira@spglobal.com

Secondary Contact:
Juan Barbosa, Buenos Aires (54) 114-891-2108; juan.barbosa@spglobal.com

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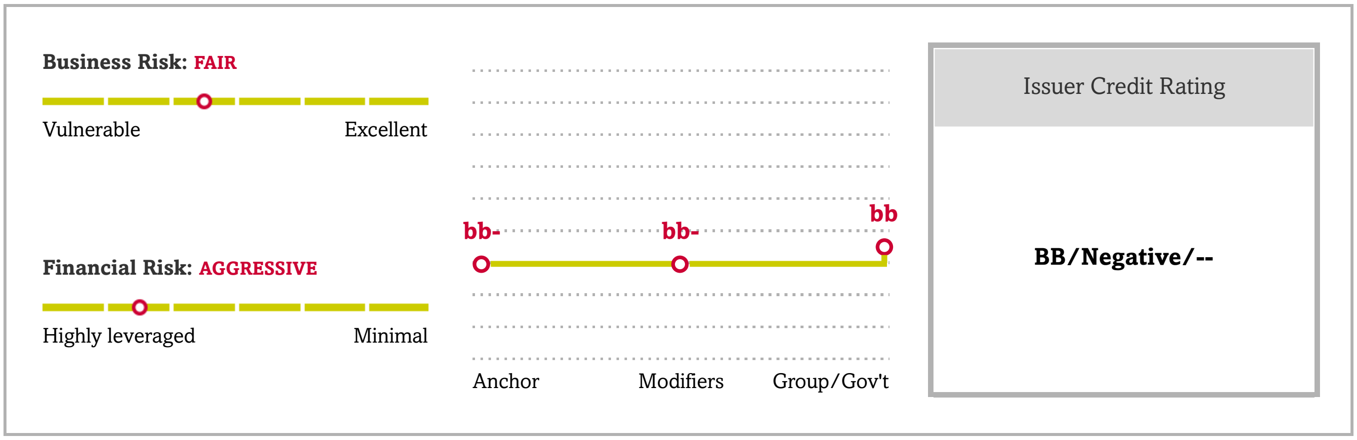
AES Panama S.R.L.



Credit Highlights

Key risks	Key strengths
Uncertainties related to COVID-19's impact.	The company is the largest power generator in Panama.
Dependence on third-party generators to honor the company's contracts.	AES Panama is one of the first companies to be dispatched in the merit order.
Adverse hydrology conditions could require purchases in the spot market.	Solar and wind projects, although small, may diversify energy mix.

Covid-19 is causing the electricity demand in Panama to plummet. Due to the social-distancing measures to contain the coronavirus, economic activity slowed down and electricity demand decreased around 15% in the first weeks of April in Panama (compared with the same period last year). In mid-March, the government prohibited electricity distributors from disconnecting clients from the networks. We believe these two factors could impair the sector's revenue; therefore, power generators such as AES Panama could be affected by higher working capital needs in the next months. We believe that AES Panama has enough liquidity to face these shocks, given that its cash position of about $55 million, a recently drawn credit line of $23 million, and no debt maturities in the next 12 months.

We will be closely monitoring the initiatives that the Panamanian government can take, and the impact they can have on the electricity sector and on the company's credit quality.

Purchases of energy in the spot market weakened credit metrics in 2019. AES Changuinola S.R.L. (not rated) is a 223 megawatt (MW) hydro plant that sells its total output to AES Panama through a bilateral contract that expires in 2030. After almost one year out of operations due to repairs of water leaks on sections of the hydro plant tunnel, it resumed operations on Jan. 2, 2020.

According to the contract, AES Panama has to make the payments in full for AES Changuinola in case it delivers the minimum required of 10%, which was the case in 2019. Therefore, in addition to payments to AES Changuinola, AES Panama had to purchase electricity in the spot market at an average price of $91 per megawatt hour (MWh), which reduced cash flows last year.

As a result, AES Panama ended 2019 with an adjusted EBITDA of $119.5 million, debt to EBITDA of 5.4x, and funds from operations (FFO) to debt of 8.1%, in line with our expectations. Despite the pernicious impact of COVID-19 in

2020, we expect the company's credit metrics to improve gradually.

AES Panama's diversification in unconventional renewable sources.

AES Panama is building a 52 MW solar farm and is acquiring a 55 MW wind farm for $80 million, 90% of it financed through new debt. The wind project already has power purchase agreements (PPAs) until 2023, preventing exposure to spot market prices. We believe the new assets will help diversify AES Panama's asset base, given that its generation comes from four hydro plants that total 482 MW of installed capacity, along with the 72 MW fuel oil barge.

Outlook: Negative

The negative outlook on AES Panama reflects a one-in-three chance of a downgrade in the next 6-12 months. This could occur if the company's credit metrics deteriorate throughout the year or if liquidity weakens because of higher working capital needs due to a prolonged economic downturn in Panama caused by COVID-19.

Downside scenario

We could lower our ratings if the company's cash sources-to-uses ratio is below 20% throughout 2020 either due to greater working capital needs or high dividend payments amid challenging economic conditions. 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 could change the outlook to stable if AES Panama financial flexibility strengthens, with sources of cash exceeding its uses of cash by at least 20% in 2020.

Our Base-Case Scenario

We have revised our 2020 base-case scenario on AES Panama to incorporate our expectations of higher working capital needs during the COVID-19 pandemic.

Assumptions

- Electricity sales: about 2,800 gigawatt hours (GWh) in 2020.
- Average spot prices: given the lower electricity demand in the next few months, we expect spot prices to be around $75/MWh in 2020.
- Maintenance investments: $10 million - $15 million annually.

Key Metrics

	2020E	2021E
Debt to EBITDA (x)	4.5-5.0	4.0-4.5
FFO to debt (%)	10-14	12-16

- Acquisitions: $80 million for the wind farm's acquisition 90% of which funded through new debt.
- New debt: in addition to the one to finance the acquisition, the company already issued $23 million to fund potential working capital needs in 2020. The maturity of both debts is one year.
- Dividends: we are incorporating a 100% payout, although we believe that the company has flexibility to temporarily postpone distribution, as already happened in the past.

Base-case projections

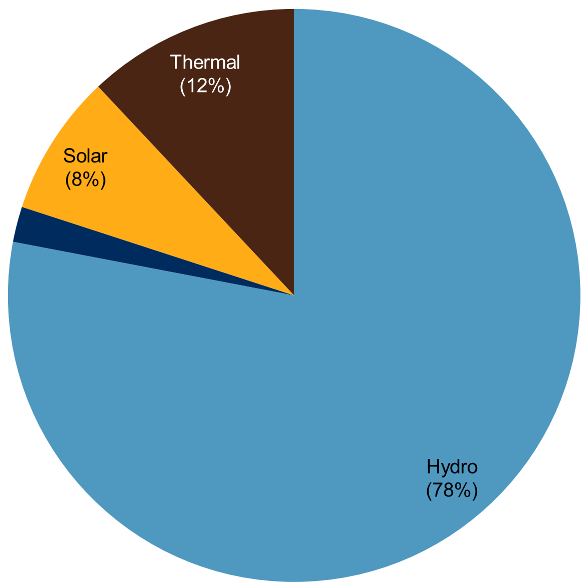
We expect AES Panama to maintain its credit metrics in the next 24 months. Nevertheless, the company may face high working capital needs due to lower collection in the distribution segment, because of lower demand and prohibition to disconnect delinquent customers, which can impact the whole electricity value chain.

Company Description

Panama-based electric power generation company AES Panama owns and operates four hydroelectric plants and a thermal barge as well. It also has a 20% stake in the 223 MW hydroelectric power plant AES Changuinola.

Chart 1

AES Panama's Installed Capacity (MW)
Assets Acquired And Under Construction



Source: S&P Global Ratings.

The government of Panama (BBB+/Stable/A-2) controls a 50.46% stake in the company, while The AES Corp. (AES; BB+/Stable/--) has 49.07%. Minority shareholders own the remaining 0.47%.

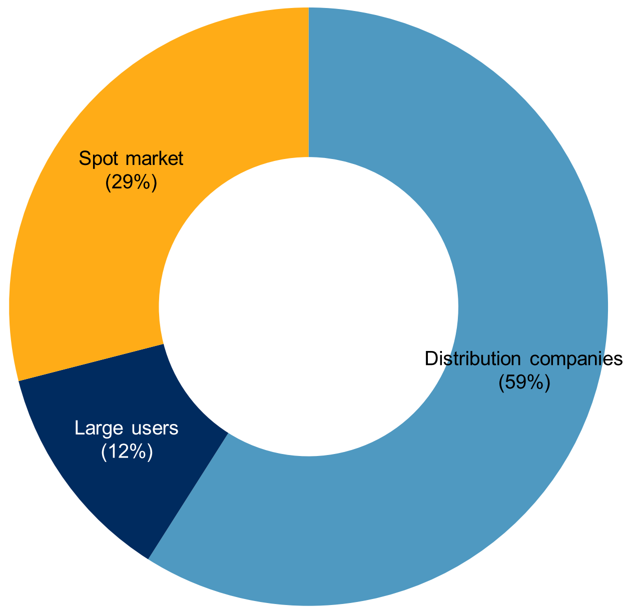
Business Risk: Fair

Our assessment of AES Panama's business risk profile takes into consideration the company's high exposure to hydrology risk, because the vast majority of its assets are hydro plants, along with its long-term contracts with the distribution companies and large consumers. These agreements make the company's cash flows more predictable, and we don't view significant risk of early termination of contracts.

Chart 2

Chart 2

AES Panama's Electricity Sales



Source: S&P Global Ratings.

AES Panama is the largest generation company in Panama and its asset mix is based on renewable sources (482 MW out of its 554 MW of installed capacity consists of hydro plants). The share of the latter will increase following the wind farm's acquisition and the completion of the solar asset's construction. We expect AES Panama to continue seeking opportunities in Panama's unconventional renewable energy segment, and closing new PPAs at attractive margins will be key for the company to maintain high margins.

Peer comparison

Table 1

Peer Comparison

	AES Panama S.R.L.	Nautilus Inkia Holdings LLC	Guacolda Energia S.A.	Empresa Generadora de Electricidad Itabo S. A.	AES Andres B.V.
Rating	BB/Negative/--	BB/Stable/--	BB-/Negative/--	BB-/Negative/--	BB-/Negative/--
Fiscal Year ended on Dec. 31	**2019**	**2018**	**2019**	**2018**	**2018**
Revenue	338.2	1,612.5	497.9	238.2	553.5
EBITDA	119.5	556.9	145.9	84.1	90.4
Funds from operations (FFO)	51.9	366.4	117.4	57.8	56.1
Interest expense	42.3	148.3	28.8	8.8	18.0

Table 1

Peer Comparison (cont.)					
Cash interest paid	42.1	145.3	28.5	8.6	17.7
Cash flow from operations	83.5	379.0	66.3	4.3	60.4
Capital expenditure	13.5	155.1	5.0	12.9	15.5
Free operating cash flow (FOCF)	70.0	223.9	61.3	(8.6)	44.8
Discretionary cash flow (DCF)	31.2	200.5	51.3	(38.6)	6.8
Cash and short-term investments	29.6	201.0	27.9	13.5	40.2
Gross available cash	29.6	201.0	27.9	13.5	40.2
Debt	645.1	2,761.2	578.0	96.6	225.4
Equity	57.2	1,080.0	401.9	235.6	244.0
Adjusted ratios					
EBITDA margin (%)	35.3	34.5	29.3	35.3	16.3
Return on capital (%)	10.5	9.3	8.1	21.5	16.0
EBITDA interest coverage (x)	2.8	3.8	5.1	9.5	5.0
FFO cash interest coverage (x)	2.2	3.5	5.1	7.7	4.2
Debt/EBITDA (x)	5.4	5.0	4.0	1.1	2.5
FFO/debt (%)	8.1	13.3	20.3	59.8	24.9
Cash flow from operations/debt (%)	12.9	13.7	11.5	4.5	26.8
FOCF/debt (%)	10.9	8.1	10.6	(8.9)	19.9
DCF/debt (%)	4.8	7.3	8.9	(39.9)	3.0

We have chosen the following peers to AES Panama, all of which are generation companies in Latin America with ratings in the 'BB' category:

- Nautilus Inkia Holdings LLC (Nautilus; BB/Stable/--);
- Guacolda Energia S.A. (Guacolda; BB-/Negative/--);
- Empresa Generadora de Electricidad Itabo, S.A. (Itabo; BB-/Negative/--); and
- AES Andres B.V. (BB-/Negative/--).

From a business standpoint, AES Panama, Nautilus, and Guacolda share some strengths that include the contracted nature of their businesses under long-term contracts that allow them to generate more resilient cash flows. On the other hand, we view Itabo and AES Andres as having a high dependence on government subsidies, which is a weakness in comparison with the other peers.

Financial Risk: Aggressive

AES Panama's debt has been stable in the past years, but it suffered from lower cash flows in 2019 given the outage of AES Changuinola. Given that AES Panama had to continue paying for AES Changuinola's capacity while purchasing electricity in the spot market to honor its existing contracts with its clients, its costs rose. We now expect AES Panama to maintain its debt to EBITDA at 4.0x-5.0x in 2020 and 2021, while directing investments toward maintaining the existing assets, unless the company engages in an opportunistic acquisition, which isn't part of our base-case scenario.

Financial summary

Table 2

AES Panama S.R.L. -- Financial Summary	--Fiscal year ended Dec. 31--				
	2019	2018	2017	2016	2015
(Mil. $)					
Revenue	338.2	363.4	342.6	316.5	299.1
EBITDA	119.5	168.8	161.8	145.7	122.3
Funds from operations (FFO)	51.9	99.3	92.9	83.7	80.2
Interest expense	42.3	44.1	46.4	45.1	40.6
Cash interest paid	42.1	44.8	46.4	44.9	42.1
Cash flow from operations	83.5	86.9	74.7	50.6	63.5
Capital expenditure	13.5	15.0	20.4	22.4	44.1
Free operating cash flow (FOCF)	70.0	71.9	54.3	28.2	19.4
Discretionary cash flow (DCF)	31.2	(26.6)	(15.5)	(32.9)	(9.1)
Cash and short-term investments	29.6	15.8	16.4	17.2	33.1
Gross available cash	29.6	15.8	16.4	17.2	33.1
Debt	645.1	725.2	719.6	734.5	615.6
Equity	57.2	71.1	103.3	109.7	120.1
Adjusted ratios					
EBITDA margin (%)	35.3	46.5	47.2	46.0	40.9
Return on capital (%)	10.5	16.7	15.2	13.8	13.0
EBITDA interest coverage (x)	2.8	3.8	3.5	3.2	3.0
FFO cash interest coverage (x)	2.2	3.2	3.0	2.9	2.9
Debt/EBITDA (x)	5.4	4.3	4.4	5.0	5.0
FFO/debt (%)	8.1	13.7	12.9	11.4	13.0
Cash flow from operations/debt (%)	12.9	12.0	10.4	6.9	10.3
FOCF/debt (%)	10.9	9.9	7.5	3.8	3.2
DCF/debt (%)	4.8	(3.7)	(2.2)	(4.5)	(1.5)

Liquidity: Adequate

We remain assessing AES Panama's liquidity as adequate. We expect sources of cash to exceed its uses by about 1.2x in the next 12 months and that the company's sources minus uses would remain positive even if our forecasted

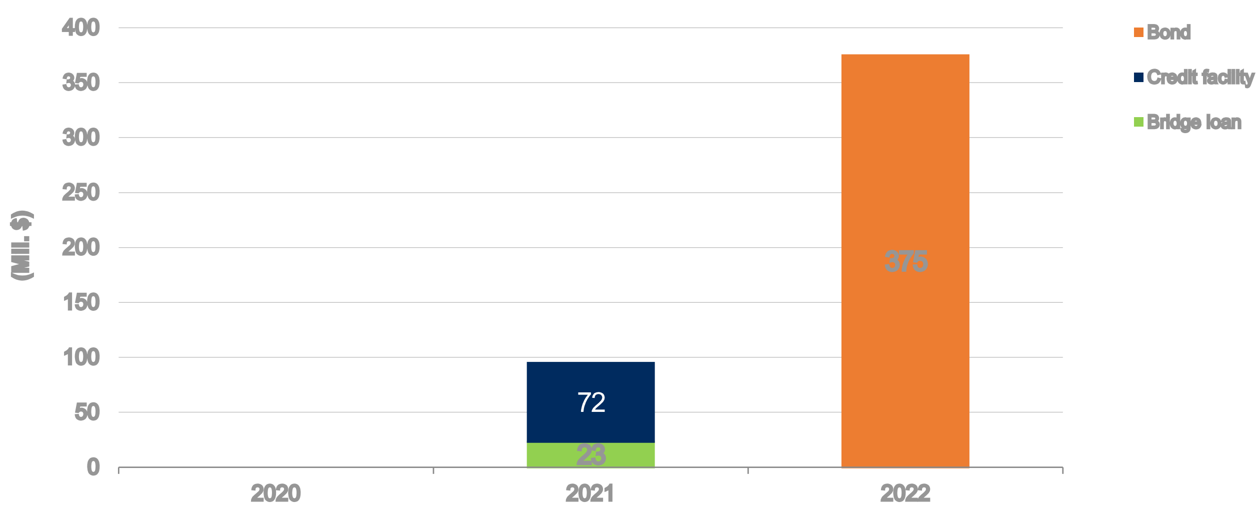
EBITDA declines by further 15%. Moreover, we believe that AES Panama has some financial flexibility to address the short-term pressures, such as dividend payments postponement.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash position of \$55 million as of March 31, 2020; • Disbursement of \$23 million from its 12-month committed credit facility; • Expected cash flows of around \$90 million in the next 12 months; and • A 12-month bridge loan to fund the \$72 million acquisition of a wind park.	• No debt maturities in the next 12 months; • Maintenance investments of around \$15 million; • Payment of the \$80 million acquisition; • Working capital needs of about \$60 million in the next 12 months; and • Dividends of around \$30 million, but which can be postponed, in our view.

Debt maturities

Chart 3

Debt Maturity Profile



Source: S&P Global Ratings.

Covenant Analysis

Compliance expectations

We expect AES Panama to continue complying with its financial covenants in the next 12 months, even if EBITDA falls 15%.

Requirements

AES Panama has to comply with the following financial covenants on a quarterly basis:

- Debt to EBITDA up to 3.5x; and
- EBITDA interest coverage of at least 2.5x.

These covenants are just for the incurrence of additional debt and not for debt acceleration. The company's covenant calculation takes into consideration only the debt related to the bonds and any new debt that the company has taken. For further details on S&P Global Ratings calculation, please refer to the Reconciliation section.

Environmental, Social, And Governance

The electric power generation sector has significant exposure to energy transition, CO2 (carbon dioxide) emission risks, and climate change risks. AES Panama, in our view, is more exposed to climate changes, because its asset portfolio mostly consists of hydro plants. Therefore, rainfall levels are key to determine the company's operations. In order to diminish that risk, the company is entering the unconventional renewable energy segment through wind and solar assets. Generally, we view that renewable generation as more credit supportive than carbon-based one, because of more supportive pricing and the marginal cost is closer to zero. Therefore, we view AES Panama's asset mix, which is mostly based on renewable sources, as better than those of peers that have a greater share of carbon-based generation, such as the ones in Chile or the Dominican Republic.

Group Influence

Although the government owns the majority stake in the company, AES has the control of AES Panama's board of directors. Out of its five members, AES is entitled to nominate three of them. Therefore, AES has the managerial and operational control of AES Panama. Nevertheless, we don't expect AES to give extraordinary financial support to AES Panama in case of a financial distress. In our view, AES manages its subsidiaries as self-sustained units. We have seen that AES Panama has flexibility in terms of dividend distribution, so the parent could postpone the receipt from the subsidiaries to give them some financial flexibility under more stressful conditions.

Government Influence

AES Panama is among the largest low-cost power generators in Panama. Therefore, it plays an important role in the national electricity sector. In addition, the government has a majority stake in the company. As a result, we believe that the government has incentives to provide extraordinary support to AES Panama, as seen in a compensation payment mechanism in 2014.

Issue Ratings - Subordination Risk Analysis

We rate AES Panama's $375 million notes at 'BB', which is at the same level as our issuer credit rating on the company. It has no operating subsidiaries or secured debt in its capital structure. Therefore, there's no structural subordination of the notes to any other debt.

Reconciliation

We adjust our debt figures to include the present value of the future stream of capacity payments under AES Panama's and AES Changuinola's PPAs. We believe long-term PPAs create fixed, debt-like financial obligations that substitute for debt-financed capital investments in generation capacity. We also consider operating leases and guarantees as debt-like obligations. The adjustment adds around $360 million to AES Panama's debt.

Table 3

AES Panama S.R.L.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

--Fiscal year ended Dec. 31, 2019--	Debt	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Capital expenditure
AES Panama S.R.L. reported amounts (mil. $)	373.3	92.9	60.1	22.9	119.5	76.4	10.7
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	(25.5)	--	--
Cash interest paid	--	--	--	--	(22.7)	--	--
Operating leases	96.3	13.2	8.8	8.8	(8.8)	4.3	--
Accessible cash and liquid investments	(29.6)	--	--	--	--	--	--
Capitalized interest	--	--	--	0.3	(0.3)	(0.3)	(0.3)
Share-based compensation expense	--	0.1	--	--	--	--	--
Power purchase agreements	146.9	13.4	10.3	10.3	(10.3)	3.1	3.1
Asset-retirement obligations	1.1	--	--	--	--	--	--
Nonoperating income (expense)	--	--	(0.8)	--	--	--	--
Debt: Guarantees	34.6	--	--	--	--	--	--
Debt: Other	22.5	--	--	--	--	--	--
Working capital: Taxes	--	--	--	--	--	12.8	--
Operating cash flow: Taxes	--	--	--	--	--	(12.8)	--
Total adjustments	271.8	26.6	18.3	19.4	(67.6)	7.2	2.8
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
S&P Global Ratings' adjusted amounts	645.1	119.5	78.4	42.3	51.9	83.5	13.5

Ratings Score Snapshot

Issuer Credit Rating

BB/Negative/--

Business risk: Fair

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

Financial risk: Aggressive

- **Cash flow/leverage:** Aggressive

Anchor: bb-

Modifiers

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

Stand-alone credit profile : bb-

- **Group credit profile:** bb+
- **Entity status within group:** Nonstrategic (no impact)
- **Related government rating:** BBB
- **Likelihood of government support:** Moderate (+1 notch from SACP)

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

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	Significant	**Aggressive**	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	**bb-**	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of May 15, 2020)*

AES Panama S.R.L.	
Issuer Credit Rating	BB/Negative/--
Senior Unsecured	BB
Issuer Credit Ratings History	
17-Jul-2018	BB/Negative/--
28-Dec-2016	BB/Stable/--
28-Sep-2016	BB-/Watch Pos/--
18-Jun-2015	BB-/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.