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Research Update:

AES Panama S.R.L. 'BB' Ratings Affirmed On Performance In Line With Expectations; Outlook Is Stable

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Overview

- Panama's largest power generator, AES Panama, should maintain its operating and financial performance over the next two years, including its conservative commercial strategy which should maintain a 5%-10% cushion for its firm capacity to mitigate hydrology fluctuations.
- We're affirming our 'BB' corporate credit rating and issue-level ratings on AES Panama.
- The stable outlook reflects our view that AES Panama will continue to play an important role in the country's energy policy and maintain its strong link to the government in the next two years. It also incorporates our expectations on aggressive leverage, evidenced by ratios of funds from operations (FFO) to EBITDA around 15% and debt to EBITDA in the 4x area in 2017 and 2018.

Rating Action

On July 5, 2017, S&P Global Ratings affirmed its 'BB' corporate credit rating and issue-level ratings on AES Panama S.R.L (AES Panama). The outlook is stable.

Rationale

The affirmation reflects our expectation that the company's cash flow generation will slightly improve in the short term, although its financial metrics will be still in line with our aggressive financial risk profile, as seen in projected debt to EBITDA around 4.0x and FFO to debt above 12% in the next two years, compared to 4.6x and 12.4%, respectively, in the 12 months ended March 31, 2017. In the past two years, we've seen the company's metrics improve mainly due to favorable hydrology conditions and lower exposure to high spot prices. After the drought in 2013 and 2014, AES Panama adopted a more conservative commercial strategy that included:
- A lower level of contracted energy;
- Working with a 5%-10% cushion for its firm capacity to mitigate hydrology fluctuations; and
- Adding 72 megawatts (MW) to its total capacity through a diesel-powered barge to diversify its energy resources.

Our base-case scenario assumes the following factors:

- Economic variables that we view as relevant for the power generation business, particularly an increase in electricity demand in line with our forecasted GDP growth of about 5.5% in 2017 and 5.0% in 2018 in Panama, in line with our credit conditions report (see "Political Uncertainty Hinders Improving Credit Conditions In Latin America", published June 30, 2017).
- Average spot prices of around $76 per megawatt hours (MWh) in 2017 and $55 per MWh afterwards, based on our expectations of normal hydrology conditions and average oil prices of $50 per barrel (bbl) in 2017 and 2018, according to our oil price deck (see "S&P Global Ratings Raises Its Oil And Natural Gas Prices Assumptions For 2017" published December 14, 2016). In our view, AES Panama's exposure to the spot prices will be marginal in the next two years, considering that its revenue is 93% contracted and its energy purchases in the spot market should approach 100 gigawatt hours (GWh) per year in the next two years.
- Average contracted prices of around $100 per MWh in 2017 and 2018.
- Total generation of around 2,900 GWh.
- Low maintenance capital expenditures (capex) for the next two years of around $8 million on average per year.
- The company will distribute its excess cash flows as dividends, leaving a minimum of $20 million for its operations.
- No additional debt.

Based on these assumptions, we arrive at the following credit metrics for 2017 and 2018:

- Adjusted EBITDA of around $150 million and a margin of 50%, compared with $146 million (45%) reported in the 12 months ended in March 2017;
- Adjusted FFO to debt approaching 15%; and
- Adjusted debt to EBITDA of approximately 4x.

We adjust our debt figures to include the present value of the future stream of capacity payments under AES Panama's and hydropower generator AES Changuinola's power purchase agreements (PPAs). We think long-term PPAs create fixed, debt-like financial obligations that substitute for debt-financed capital investments in generation capacity. We also consider operating leases as debt-like obligations. The adjustment adds around $310 million to AES Panama's debt.

AES Panama's ratings also reflect the company's competitive position as the largest power generator in Panama, which is somewhat counterbalanced by the historical volatility of profitability due to hydrological exposure. 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 PPA with AES Changuinola, from which it buys 175 MW or 100% of the generator's firm capacity until 2030 at a fixed price.

Our ratings also incorporate our view that there's 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. In accordance with our criteria for government-related entities, we base our view on our assessment of AES Panama's role as the largest energy producer in Panama, its role as a low-cost power generator, and its strong link to the government, which has a majority stake (50.5%) in the company. The AES Corp. (BB/Stable/--) holds 49% and AES Panama's employees hold the remaining 0.5%.

Liquidity

We assess AES Panama's liquidity as adequate. We believe the company's liquidity sources will be sufficient to cover its uses for the next 12 months by 1.20x, and its sources minus uses are positive even if forecasted EBITDA were to decline by 15%. 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 in September 2016. We also believe that the company adopted a prudent risk management strategy after 2014 that includes the flexibility to reduce dividend payments in case of liquidity constraints. AES Panama's debt does include financial covenants that limit additional debt.

Principal liquidity sources:
- Cash and short-term investments of $33 million as of March 31, 2017;
- FFO of about $88 million over the next 12 months;

Principal liquidity uses:
- No short-term financial maturities;
- Working-capital requirements of about $2 million;
- Capex and working capital outflows totaling about $10 million; and
- Dividends of approximately $80 million.

Outlook

The stable outlook reflects our view that AES Panama will continue to play an important role in the country's energy policy and maintain its strong link to the government in the next two years. It incorporates our expectations on aggressive leverage, evidenced by ratios of FFO to EBITDA around 15% and debt to EBITDA in the 4x area in 2017 and 2018.

Downside scenario

We could lower the ratings if the company's hydrology risk management plan fails due to worse-than-expected hydrology conditions or a more aggressive commercial strategy, resulting in metrics of FFO to debt below 12% or debt to EBITDA above 5.0x in the next two years, or if we revise our liquidity assessment to a weaker category if the company's sources over uses of cash falls below 1.2x. A downgrade is also possible if we reassess our expected view of extraordinary support from the government.

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 result in FFO to debt consistently above 20% and debt to EBITDA below 4x in the next two years.

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 For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 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

Ratings List

Ratings Affirmed

AES Panama S.R.L.	
Corporate Credit Rating	
Global Scale	BB/Stable/--
Stand-Alone Credit Profile	bb-
AES Panama S.R.L.	
Senior Unsecured	BB

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.