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Fitch Affirms AES Panama Generation Holdings' Ratings at 'BBB-'; Outlook Stable

Fitch Ratings - New York - 27 Jul 2022: Fitch Ratings has affirmed AES Panama Generation Holdings, S.R.L.'s (AES Panama Generation/AESPGH) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-' and the Long-Term National Scale Rating at 'AA+(pan)'. The Rating Outlook on all ratings is Stable. Fitch has also affirmed the company's USD1.38 billion senior secured notes ratings at 'BBB-' and 'AA+(pan)' on the international and national scales, respectively.

Fitch expects AES Panama Generation to deleverage to 3.5x gross leverage by 2024 from 6.4x in 2020 due to scheduled debt amortizations, increased LNG storage fees, and contracted price step-ups on its hydro power purchase agreements (PPAs). A parent and subsidiary relationship exists between AES Panama Generation and AES Corporation (BBB-/Stable) due to the latter's pledge of shares in the operating companies, but Fitch rates AES Panama Generation on a standalone basis, not assuming implicit support from the parent company.

Key Rating Drivers

Strong Market Position: AES Panama is the largest private electricity generator in Panama, commanding a strong market position due to a large and diversified portfolio of assets and a flexible cost structure. Fitch estimates that the companies' combined generation accounted for 39% of the country's generation during 2021, and 40% in 1Q22. The company is expected to maintain its market share and grow its presence in the country by expanding into wind and solar.

Improving Leverage Profile: The company's gross leverage profile, defined as total debt to EBITDA, is estimated to improve to 4.5x in 2022, down from 5.5x in 2021 and 6.4x in 2020. Leverage is anticipated to further decline over the next three years, mostly attributable to debt repayment of USD204 million from its amortizing USD1.4 billion outstanding note, and incremental EBITDA from Colon LNG sales and terminal storage fee growth, with EBITDA estimated to be USD378 million by 2025. Leverage is expected to average 3.5x in the intermediate term and FFO to interest expense is estimated to average 5.0x over the rated horizon, both are consistent with a 'BBB' rating category.

Asset Base: AES Panama Generation's asset base is highly dependent on hydrology, which represents two-thirds of its installed capacity. The company mitigates the risk of the country's periodic drought by dispatching its efficient thermal Colon plant, as well as by expanding into solar and wind assets. The company is highly contracted, representing an average of 70% of its total installed capacity, thus is well positioned to sell excess electricity in the spot market under strong hydrological conditions. During times of low hydrology, the company can dispatch its conventional capacity, currently Colon, and eventually Generadora Gatun (Gatun), to honor its contracted volumes.

Strong Cash Flow Generation: The company's strong contractual position reflects an average contract life of its contracts of seven years with investment grade off-takers, translating into predictable and stable cash flows over the rated horizon. FFO is estimated to average USD240 per annum, comfortably covering its capex and debt maturities. Fitch expects the company will maintain its dividends policy to be 100% of excess cash flow, while aiming maintaining a minimum annual cash balance of USD80 million.

Regulatory Risk: The company's ratings also reflect its exposure to regulatory risk, as the government remains a majority shareholder in most of the companies operated by AES Panama Generation. Historically, generation companies in Panama were competitive, unregulated businesses free to implement their own commercial strategies. However, an escalation in electricity prices due to market inefficiencies and an over-dependence on hydroelectricity catalyzed a push to diversify the country's energy matrix. This transition has helped reduce end-user prices, provide greater system redundancy, and preclude the need for undue regulatory interference.

Derivation Summary

Fitch expects AES Panama Generation's leverage to be between 4.5x and 3.5x between 2022 and 2024 before falling to below 3.4x in 2025 and thereafter. This capital structure is in line with that of Kallpa Generacion S.A. (BBB-/Stable), which is expected to have leverage of around 4.0x over the medium term. Like AES Panama Generation, Kallpa also features a diversified asset base of both natural gas and hydro production. AES Panama Generation Holdings' capital structure is also comparable with that of AES Andes S.A. (BBB-/Stable), which Fitch expects should maintain around gross leverage of around 3.0x over the medium term.

AES Panama Generation's capital structure is more aggressive than those of higher rated Colombian peers, such as Isagen S.A. E.S.P. (BBB-/Stable) and Emgesa S.A. E.S.P. (BBB/Negative), which are expected to have medium-term leverage of 3.0x and 1.0x, respectively. Both companies have significant hydroelectric capacity and mitigate El Nino risk with back-up thermal capacity. Despite comparable market shares, Isagen and Emgesa each have installed capacity in excess of 3,000MW while AES Panama Generation's is 1,232MW. The company compares favorably with Orazul Energy Peru S.A. (BB/Stable) with 2021 leverage of 4.9x.

The company's national scale rating of 'AA+(pan)'/Stable is comparable with that of Empresa de Transmision Electrica S.A. (ETESA; AAA[pan]/Stable). ETESA has higher projected medium-term leverage, with expected 2023 gross leverage of 6.0x, but it operates in the electricity transmission subsector, which is highly regulated and considerably less volatile than electricity generation. AESP's sister company, AES Changuinola (AA-[pan]), had 2021 leverage of 5.5x with deleveraging expected to 2.6x in 2024.

Key Assumptions

--Hydrology conditions and plant load factors will follow long-term historical averages (including yoy variability) in 2022 and beyond;

--Average monomic prices for 2022 through 2025 for each company are: $182.67 for AES Panama; $112.00 for Changuinola; and $185.26 for combined Colon sales;

--Long-term hydro and renewable PPA prices have fixed prices where some of them adjust with inflation, and prices for capacity are fixed with no change over the life of the contract;

--Expiring large user hydro PPAs will be renewed with similar terms;

--Thermal PPA prices adjust based on the cost of fuel and capacity prices are fixed;

--Spot prices will spike to approximately USD116.4/MWh in 2022 due to drought conditions, moderating to USD75/MWh in 2023; and averaging USD55/MWh thereafter as new system capacity is added;

--Generadora Gatun, a 670MW LNG-fired plant, enters operation in 2H24 and contracts LNG storage with Costa Norte;

--No significant asset sales occur during the rating horizon without corresponding debt rebalancing;

--Dividends average USD154 million through 2025, with year-end cash estimated at no less than USD80 million.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained gross leverage below 3.0x over the medium term;

--A conservative contracting strategy that promotes cash flow stability and the ability to withstand hydrological shocks to the system;

--Continued evidence of sustainable spot price stabilization as a result of asset diversification in Panamanian electricity matrix.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Sustained gross leverage above 4.0x and net leverage above 3.5x over the medium term;

--Increased government intervention in the sector, coupled with a weakening regulatory framework;

--Deterioration in the company's ability to mitigate spot-market risk;

--Payment of dividends coupled with high leverage levels;

--Significant asset sales causing an adverse change in financial structure.

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Liquidity and Debt Structure

Adequate Liquidity: Fitch expects the combined company to generate strong cash flow from operations (CFO) of an average of USD81 million in years 2022-2024, after dividend distributions, which will be sufficient to support ongoing annual debt amortizations. The remainder, and majority, of the companies' debt is long term, with nearly USD1.2 billion due in 2030.

The companies' strong operating cash flow and favorable debt maturity profile are partially offset by expected future dividends. Fitch assumes a combined minimum cash balance of USD80 million with any residual amounts expected to be paid as dividends. The combined companies held USD95 million in readily-available cash and equivalents at March 31, 2022.

Issuer Profile

AES Panama Generation is indirectly owned by AES to finance operations in Panama. AES Generation Holdings is the issuer of USD1.38 billion amortizing notes. AES owns and operates a large portfolio of electricity generation and LNG assets in Panama.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
AES Panama Generation Holdings, S.R.L.	LT IDR	BBB-	Affirmed		BBB-
	LC LT IDR	BBB-	Affirmed		BBB-
	Natl LT	AA+(pan)	Affirmed		AA+(pan)
• senior secured	LT	BBB-	Affirmed		BBB-
• senior secured	Natl LT	AA+(pan)	Affirmed		AA+(pan)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		

RATINGS KEY	OUTLOOK	WATCH
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	○	

Applicable Criteria

Corporate Rating Criteria (pub.15 Oct 2021) (including rating assumption sensitivity)

National Scale Rating Criteria (pub.22 Dec 2020)

Parent and Subsidiary Linkage Rating Criteria (pub.01 Dec 2021)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

AES Panama Generation Holdings, S.R.L.	EU Endorsed, UK Endorsed

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Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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