FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms AES Espana at 'BB-'; Revises Outlook to Positive

Thu 07 Dec, 2023 - 6:02 PM ET

Fitch Ratings - New York/Santo Domingo - 07 Dec 2023: Fitch Ratings has affirmed AES Espana B.V.'s Long-Term Foreign Currency Issuer Default Rating (IDR) at 'BB-' and revised the Rating Outlook to Positive from Stable. Fitch has also affirmed AES Espana's USD300 million notes due 2028 at 'BB-'. The ratings consider the combined operating assets of AES Espana and Dominican Power Partners (DPP; jointly referred to as AES Dominicana), which are joint obligors of the USD300 million notes due 2028.

AES Espana's ratings reflect a strong linkage to the Dominican Republic's (BB-/Positive) credit quality, due to its dependence on government transfers, as well as historically strong balance sheet and diversified asset portfolio.

A parent and subsidiary relationship exists between AES Espana and AES Corporation (BBB-/Stable) due to the latter's pledge of shares in the operating companies, but Fitch rates AES Espana on a standalone basis, not assuming implicit parental support.

## KEY RATING DRIVERS

**Outlook Revised to Positive Based on Sovereign:** Fitch revised the Dominican Republic's sovereign Rating Outlook to Positive from Stable on Nov. 29, 2023, reflecting a track record of robust economic growth, a diversified export structure, high per-capita GDP and social indicators, and governance scores that compare favorably to peers. Post-election, there could be scope for the next administration to pass pending legislation related to a new Fiscal Responsibility Law that could contribute towards improving the macro institutional framework. Growth has decelerated in 2023, but Fitch expects it to recover to high levels during 2024-2025. External liquidity metrics have improved in recent years, and foreign currency share of government debt is on a downward path.

**Increased Leverage Manageable, Temporary:** Fitch views AES Espana's multi-year increase in gross leverage from 2.8x at YE 2023 to about 5.0x yoy through 2025 as a manageable, cyclical event, despite being above prior expectations and exceeding Fitch's downward rating sensitivity. The increase will be temporary, and attributable to an increased capex program to expand renewable energy capacity, partially funded by new debt.

In addition, higher leverage is due to continued weaker EBITDA generation, as the company remains only partially contracted with the state-owned distribution companies (discos) until its TTF-linked natural gas supply contract converts to a more economical index beginning in 2026. However, in 2023, the company generated some additional margin as demand increased with hot weather and supply prices steadily declined. In 2026 and beyond, Fitch expects the company to deleverage to the 3x range, as capex rates subside and EBITDA grows with the higher contracted renewable assets, as well as a re-contracting with the discos as a baseload provider under a more economical gas supply contract.

**Expansion Plan Impacts Cash Flow:** Fitch expects that AES Espana will produce a negative annual average FCF of USD85 million during its higher capex program in 2023-2025 and an extraordinary dividend. Cash flow from operations (CFO) should also normalize to historical levels following the temporary lower contracted position, and the rate of dividend payments should moderate in 2024. The renewable expansion program is managed by unrestricted subsidiary ADRE (99.9% owned by AES Espana) and will amount to around USD452 million through 2025, funded by around USD350 million in new debt.

In 2026 and beyond, Fitch expects capex to focus primarily on maintenance work and be funded through FCF and for CFO to rebound to historic levels as the company reverts to baseload status.

**Stable LNG Business; Opportunistic Transactions:** AES Espana's natural gas supply, storage and transportation business accounts for an average 42% of annual revenues and approximately 25% of annual variable margin (subject to volumes sold and prices). The company provides the country's sole LNG import terminal, offering regasification, storage, and transportation infrastructure. EBITDA declined in 2023 yoy as the company executed fewer extraordinary LNG transactions compared to 2022. In 2024, Fitch expects gas transactions to increase for several clients, and going forward to remain a dynamic and opportunistic component of the company's business profile.

**Dependence on Government Transfers:** High energy distribution losses have averaged a chronic 33% due to low collection rates and important subsidies for end-users. This has created a strong dependence on government transfers for the country's generation companies, and has been exacerbated by the country's exposure to fluctuations in fossil-fuel prices and strong energy demand growth from discos. The regular delays in government transfers can pressure generators' working capital needs and add volatility to cash flows.

**High-Quality Asset Base:** Historically, AES Espana has ranked among the lowest-cost electricity generators in the country. AES Espana's combined-cycle plant with dual natural gas, as well as fuel oil No. 2 (diesel), is generally expected to be fully dispatched as a base-load unit as long as the LNG price is not more than 15% higher than the price of imported diesel (as is the situation in 2022-2026). The company continues to invest in renewable assets as well, adding new solar and wind assets to the portfolio at zero variable cost.

## DERIVATION SUMMARY

AES Espana's ratings are linked to and constrained by the Dominican Republic's ratings, from which it indirectly receives its revenues. Empresa Generadora de Electricidad Haina, S.A. (EGE Haina; BB-/Stable) is Espana's closest peer competitor, as both companies ratings are linked to and constrained by the Dominican Republic's ratings, from which they indirectly receive material parts of their revenues. Each company is exposed to working capital volatility due to operating difficulties tied to state-owned discos, which are characterized by high dependency on government transfers due to their and high energy loss and lower collection rates.

EGE Haina benefits from a diversified energy matrix, which includes thermal and nonconventional renewable energy assets, with more installed capacity than AES Espana and DPP combined. However, AES Espana operates the country's sole natural gas port, regasification, storage and gas pipeline facilities. Both companies are in a period of asset expansion, in which they can each expect leverage to increase to around 5x through 2025.

AES Espana's capital structure is strong relative to similarly rated, unconstrained peers. Orazul Energy Peru S.A.'s (BB/Stable) ratings reflect the company's predictable cash flows supported by an adequate contractual position, historically efficient and reliable hydroelectric generation assets, and cost structure flexibility. Contrary to AES Espana, Orazul's historically elevated leverage levels have tempered in recent years due to asset sales and debt reduction, and could improve compared to the rating category over the medium term.

## KEY ASSUMPTIONS

--Both AES Espana and DPP increase generation volumes through partial disco purchased power agreements (PPAs, last updated in February 2023), albeit at lower levels than historical base load volumes;

--By 2026, both generators resume fully-contracted financial PPAs with discos and margins revert to generation;

--Approximately USD350 million in new debt (issued by unrestricted renewable development subsidiary ADRE) to support ongoing capex and dividend payments equivalent to 100% of prior year's net income;

--Dividends of USD124 million in 2023, declining to an average USD46 million through 2026, with year-end cash estimated at around than USD70 million;

--Solar assets Mirasol I and II (each 50 MW capacity) operationalize in 2023 and 2024, respectively, and solar assets Peravia I and II (total 140 MW) to operationalize in early 2025;

--Fuel prices (TTF and NYMEX Natural Gas/Henry Hub) track Fitch price deck.

## RATING SENSITIVITIES

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

--An upgrade in the Dominican Republic's sovereign ratings, inclusive of the electricity sector achieving financial sustainability through proper policy implementation.

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

--A downgrade in the Dominican Republic's sovereign ratings;

--Sustained deterioration in the reliability of government transfers;

--Continued exposure to spot sales and gas sales that collectively represent more than 60% of EBITDA, coupled with a financial performance deterioration resulting in the combined Espana/DPP ratio of debt-to-EBITDA to above 4.5x for a sustained period.

## LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: AES Espana and DPP have historically reported very strong combined credit metrics for the rating category. Both companies have financial profiles characterized by low to moderate leverage and strong liquidity, on a sustained basis. Cash on hand at YE 2022 was USD77 million, and the company maintains around USD70 million by policy each year. The companies' strong liquidity position is further supported by the future refinancing of their 2026 international bond to a bond due in 2028. Andres also has local, amortizing bonds due in 2027.

## ISSUER PROFILE

AES Espana is a 319 MW combined cycle power station and has a 160,000 m3 LNG storage facility, regasification terminal and a 34km pipeline to DPP. The company also operates 100 MW of solar and 50 MW of wind assets, with more in the pipeline.

## 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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | PRIOR |
|---|---|---|---|
| AES Espana B.V. | LT IDR<br>Affirmed | BB- Rating Outlook Positive | BB- Rating Outlook Stable |

| | | | | |
|---|---|---|---|---|
| senior unsecured | LT | BB- | Affirmed | BB- |

VIEW ADDITIONAL RATING DETAILS

## FITCH RATINGS ANALYSTS

**Eva Rippeteau**
Director
Primary Rating Analyst
+1 212 908 9105
eva.rippeteau@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

**Rafael Molina Garcia**
Associate Director
Secondary Rating Analyst
+57 601 241 3228
rafael.molina@fitchratings.com

**Natalia O'Byrne**
Senior Director
Committee Chairperson
+57 601 241 3255
natalia.obyrne@fitchratings.com

## MEDIA CONTACTS

**Elizabeth Fogerty**
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

## PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

## APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| AES Espana B.V. | EU Endorsed, UK Endorsed |

## DISCLAIMER & DISCLOSURES

ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.



**READ LESS**

## SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

## ENDORSEMENT POLICY

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s Regulatory Affairs page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.