FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms AES Andres's IDRs at 'BB-'; Outlook Remains Negative

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Fitch Ratings - New York - 16 Dec 2020: Fitch Ratings has affirmed AES Andres B.V.'s (Andres) Long-Term Foreign Currency Issuer Default Rating (IDR) at 'BB-'. The Rating Outlook is Negative. In addition, Fitch has affirmed Andres' USD270 million notes due 2026 at 'BB-' and National Long-Term rating at 'AA(dom)'/Stable.

The Negative Outlook reflects Fitch's revision of the Dominican Republic's sovereign Rating Outlook to Negative, due to the coronavirus pandemic. The pandemic has caused a sharp fall in economic activity and pressured the country's balance of payments, given its reliance on tourism and remittances.

Andres's ratings reflect the Dominican Republic electricity sector's high dependency on transfers from the central government to service their financial obligations, a condition that links the credit quality of the distribution companies and generation companies to that of the sovereign.

Low collections from end-users, high electricity losses and subsidies have undermined distribution companies' cash generation capacity, exacerbating generation companies' dependence on public funds to cover the gap produced by insufficient payments received from distribution companies. The ratings also consider the companies' solid asset portfolio, strong balance sheet, and well-structured purchase power agreements (PPAs).

The rating for the notes considers the combined operating assets of Andres and Dominican Power Partners (DPP) (jointly referred to as AES Dominicana), which are joint obligors of Andres's USD270 million notes due 2026. These notes are attached to Empresa Generadora de Electricidad Itabo's USD100 million notes, also rated 'BB-'. AES Corp. is expected to complete the sale of Itabo to Dominican conglomerate Grupo Linda at YE 2020, and the transaction is credit neutral for Andres.

In late March 2020, Andres discovered damage to its recently-repaired steam turbine. The subsequent repair outage, prolonged due to the country's quarantine, lasted until October 2020. Insurance will cover the business interruption with a total decline in 2020 EBITDA of approximately USD8 million-USD13 million, reflecting the applicable deductible. The company expects the manufacturer's warranty to cover equipment damage.

KEY RATING DRIVERS

Dependence on Government Transfers: High energy distribution losses of 27% in 2019, low level of collections and important subsidies for end-users, have created a strong dependence on government transfers. This dependence has been exacerbated by the country's exposure to fluctuations in fossil-fuel prices and strong energy demand growth from distribution companies of 5.9% in 2019.

The regular delays in government transfers have pressured the generator's working capital needs, and has added volatility to its cash flows. This situation increases sector risk, especially at a time of rising fiscal vulnerabilities affecting the Central Government's finances.

Strong Credit Metrics: The combined credit metrics for Andres and DPP are strong for the rating category, with expected 2020 EBITDA of USD227.5 million for the combined companies. Fitch expects 2020 debt to EBITDA to rise to 2.7x from 2.2x in 2019, due to a fall in demand and the company's need to purchase spot energy in 2020, as well as a USD10 million insurance deductible, due to the outage at Andres.

Leverage is expected to fall through 2022 before increasing to 3.5x in 2023 as renegotiation of Andres's gas supply contract lowers EBITDA. While the 750MW Punta Catalina project will likely lower prices in the near term for the system as a whole, Andres and DPP are substantially contracted through 2022, and their lower leverage provides a cushion against eventual PPA revaluations.

High-Quality Asset Base: Andres ranks among the lowest-cost electricity generators in the country. Andres's combined-cycle plant burns natural gas, and is expected to be fully dispatched as a base-load unit as long as the liquefied natural gas (LNG) price is not more than 15% higher than the price of imported fuel oil No. 6.

In early 2021 Andres expects to bring Bayasol, a 50MW solar plant, online, adding just over 100 GWh of power production at very low cost going forward. Fitch expects higher medium-term margins, although generation may contract initially when the Punta Catalina coal plant enters the dispatch curve.

Cash Flow Volatility Is Moderate: Cash flow to Andres and DPP has historically been affected by delays in payment from the state-owned distribution companies, particularly during periods of high fuel oil prices, which have pressured the system financially. According to the Dominican Electricity Industry Association, the balance owed to AES-owned generators by state-owned distribution companies stood at USD216.4 million in April 2020, relatively unchanged from the level of USD219.7 million in December 2019.

Andres reported little impact on collections from the pandemic. In October, Andres, DPP and Itabo together received USD197.3 million dollars from distribution companies and state power holding company CDEEE, bringing Andres and DPP's combined accounts receivable days to just over 70 days, down from 110 days in 2019. Fitch expects future payment delays to moderate with the entrance of the 752MW Punta Catalina plant, which will lower spot prices and relieve financial pressure on the system.

Expanding Natural Gas Business: Andres operates the country's sole LNG port, offering regasification, storage, and transportation infrastructure. In the medium term, the company plans to expand its transportation network and processing capacity for its LNG operations, as illustrated by the recent 10-year gas supply agreement with Barrick.

In addition, a 50-kilometer gas pipeline is being constructed from Andres's terminal to San Pedro de Macoris to facilitate the conversion from heavy fuel oil to natural gas in that region. Andres' gas supply contract with BP plc prices gas imports at the NYMEX Henry Hub benchmark plus USD1.20; gas costs are expected to rise significantly upon the contract's expiration in April 2023.

DERIVATION SUMMARY

Andres's ratings are linked to and constrained by the Dominican Republic's ratings, from which it indirectly receives its revenues. As a result, Andres's capital structure is strong relative to similarly rated, unconstrained peers. Orazul Energy Peru S.A. (BB/Rating Watch Positive), whose rating reflects combined results that include its subsidiary, Aguaytia Energy del Peru S.R.L., has similar installed capacity and is expected to generate around USD100 million in EBITDA annually, with estimated leverage of approximately 5.0x.

Orazul Energy Peru benefits from the stability conferred by its asset diversification and the flexibility allowed by its vertical integration. Comparatively, the combined Andres/DPP operations are expected to generate approximately USD250 million, with leverage of 2.2x in the medium term.

Fenix Power Peru S.A. (BBB-/Stable) is considered another operational peer to Andres. Fenix has high leverage, similar to Orazul, but benefits from its strategic linkage to its parent company, Colbun S.A. (BBB+/Stable), resulting in a three-notch uplift from its standalone credit quality. Additionally, Fenix's capital structure benefits from a steady deleveraging trajectory in the medium term as its international bond amortizes.

KEY ASSUMPTIONS

--Full recovery of lost EBITDA for operational problems at Andres;

--Fuel prices track Fitch price deck;

--50% of previous year's net income distributed as dividends in 2020, 100% in 2021-22, 70% in 2023;

--Accounts receivable days return to 110 following government payment in 2020.

RATING SENSITIVITIES

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

A positive rating action for Andres could occur if the Dominican Republic's sovereign ratings are upgraded or if the electricity sector achieves financial sustainability through proper policy implementation.

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

A negative rating action for Andres would occur if the Dominican Republic's sovereign ratings are downgraded; if there is sustained deterioration in the reliability of government transfers; or financial performance deteriorates to the point of increasing the combined Andres/DPP ratio of debt-to-EBITDA to 4.5x for a sustained period.

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

Well-spread Maturities: Andres 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. Combined EBITDA as of June 30, 2020 totaled USD308 million (versus USD222 million at June 30, 2019), with total debt/EBITDA of 2.2x and FFO interest coverage of 6.8x. The companies' strong liquidity position is further supported by the 2026 international bond and a series of local bonds due 2027, replacing all short- to medium-term debt.

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.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
AES Andres B.V.	LT IDR	BB- Rating Outlook Negative	Affirmed	BB- Rating Outlook Negative
	Natl LT	AA(dom) Rating Outlook Stable	Affirmed	AA(dom) Rating Outlook Stable
• senior unsecured	LT	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 08 Jun 2020)

Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

AES Andres B.V.	EU Endorsed

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