



## RATING ACTION COMMENTARY

# Fitch Affirms Itabo's Ratings at 'BB-'; Outlook Remains Negative

Wed 16 Dec, 2020 - 4:18 PM ET

Fitch Ratings - New York - 16 Dec 2020: Fitch Ratings has affirmed the rating of Empresa Generadora de Electricidad Itabo, S.A.'s (Itabo) senior unsecured notes due 2026 at 'BB-' and the Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB-'. The Rating Outlook is Negative. Itabo's Negative Outlook reflects impact from the coronavirus pandemic, which has caused a sharp fall in economic activity and pressured the Dominican Republic's balance of payments given its reliance on tourism and remittances.

Itabo's ratings reflect the electricity sector's high dependency on transfers from the central government to service its financial obligations, a condition that links the credit quality of the electric distribution companies and generation companies in the country 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. Itabo's ratings also consider its low-cost generation portfolio, strong balance sheet and well-structured power purchase agreements (PPAs), which contribute to strong cash flow generation and bolster liquidity.

In June 2020, AES Corp. announced an agreement to sell the entirety of its stake in Itabo to Dominican conglomerate Grupo Linda, in a stock-purchase agreement valued at approximately USD101 million. That deal is expected to close at the end of December

2020. The agreement would see AES Grand Dominicana, which is 85%-owned by AES Corp., sell its stake in Coastal Itabo Ltd., the Cayman Islands-based entity that directly owns 50% of Itabo. Grupo Linda currently owns a 10% interest in AES Grand Dominicana. AES would also sell its stake in Dominican-based New Caribbean Investment S.A. Fitch sees the deal as credit neutral for the rating.

Following the deal, Fitch assumes that Itabo's financial structure and corporate strategy will remain largely unchanged. As part of the transaction, AES plans to sign a contract with Linda through which AES Dominicana would continue operating the Itabo plant for at least three years, subject to automatic renewal, in exchange for a management fee. In addition, Itabo's USD99.9 million in 2026 notes, which are currently traded jointly as part of a package alongside USD270.1 million in notes issued by AES Andres B.V. and Dominican Power Partners, would be separated and trade independently.

## 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 a steep economic contraction in 2020 due as a result of the coronavirus pandemic. The regular delays in government transfers pressure working capital needs of generators and add volatility to their cash flows. This situation increases the risk of the sector, especially at a time of rising fiscal vulnerabilities affecting the central government's finances.

**Low-Cost Asset Portfolio:** Itabo's ratings incorporate its strong competitive position as one of the lowest-cost thermoelectric generators in the country, ensuring the company's consistent dispatch of its generation units. The company operates two low-cost coal-fired thermal generating units and a third peaking plant that runs on Fuel Oil #2 and sells electricity to three distribution companies in the country through long-term, U.S. dollar-denominated PPAs. The company will remain a base load generator even after a 752 MW coal generation project, Punta Catalina, is expected to begin full commercial operation in 2021.

**Solid Credit Metrics:** Itabo presents strong credit metrics for the rating category. Total debt/operating EBITDA of 1.1x is expected for 2020, the same level as for 2019. Fitch expects leverage to rise gradually to 1.9x in 2023 as increased power supply from Punta Catalina and other new generation projects push down spot power prices and lower

EBITDA. Fitch expects EBITDA to decline from USD87.4 million in 2020 to USD49.7 million in 2023 following the expiration of Itabo's existing PPAs in 2022.

**Working Capital Pressure:** Instability in the company's collection periods has resulted in operating cash flow volatility. According to the Dominican Electricity Industry Association, the balance owed to all AES companies (AES Andres, Dominican Power Partners and EGE Itabo) by state-owned distribution companies stood at USD216.4 million in April 2020. Since then, AES reports that it received USD197.3 million in government payments in October 2020, bringing its accounts receivable days down to below 90 days. Despite that revenue, Fitch expects that government payment delays will lead to an increase in accounts receivable days going forward.

## **DERIVATION SUMMARY**

Itabo's ratings are linked to and constrained by the ratings of the government of the Dominican Republic, from which it indirectly receives its revenues. As a result, Itabo's capital structure is strong relative to similarly rated, unconstrained peers. Orazul Energy Peru S.A. (BB/Rating Watch Positive), whose ratings 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. By comparison, Itabo is expected to generate approximately USD75 million, with leverage around 1.5x through the medium term.

Fenix Power Peru S.A. (BBB-/Stable) is considered another operational peer to Itabo. It shows 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, its capital structure benefits from a steady deleveraging trajectory in the medium term as its international bond amortizes.

## **KEY ASSUMPTIONS**

- Capacity factor of approximately 72%;
- Coal prices aligned with company forecasts;

- 100% of previous year's net income paid as dividends;
- Operations not impacted by sale to Grupo Linda.

## **RATING SENSITIVITIES**

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

A positive rating action could follow if the Dominican Republic's sovereign rating is 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 would follow if the Dominican Republic's sovereign rating is downgraded, if there is sustained deterioration in the reliability of government transfers, or if financial performance deteriorates to the point of increasing the ratio of debt-to-EBITDA to 4.5x for a sustained amount of time.

## **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:** In May 2016, the company issued attached 10-year notes with its sister companies AES Andres and DPP to repay existing debt and extend its maturity profile. The

tranche assigned to Itabo totaled USD99.9 million. Fitch expects that the expiration of its existing PPAs would limit medium term growth recovery prospects in Itabo's EBITDA. Nevertheless, the company's conservative capital structure confers substantial cushion within its rating category.

As part of AES' planned sale of Itabo to Grupo Linda, expected to close around the end of December 2020, Itabo's USD99.9 million bond would separate from the AES Andres and DPP bonds and trade separately, with the terms remaining unchanged. In August 2020, AES announced that it had received the necessary consent from bondholders holding a majority of the joint issue's outstanding principal to waive the requirement in the securities' indenture that would have otherwise required AES to offer to repurchase the bonds and make a mandatory change of control payment.

## 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](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Empresa Generadora de Electricidad Itabo, S.A.	LT BB- Rating Outlook Negative IDR	Affirmed BB- Rating Outlook Negative

ENTITY/DEBT	RATING		PRIOR
	LC	BB- Rating Outlook Negative	Affirmed
	LT		BB- Rating Outlook Negative
	IDR		
● senior unsecured	LT	BB-	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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## APPLICABLE CRITERIA

[Corporate Rating Criteria \(pub. 01 May 2020\) \(including rating assumption sensitivity\)](#)

[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](#)

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Empresa Generadora de Electricidad Itabo, S.A.

EU Endorsed

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