



RATING ACTION COMMENTARY

Fitch Affirms Peru LNG at 'BB-'; Assigns Negative Outlook

Thu 10 Sep, 2020 - 11:41 AM ET

Fitch Ratings - Chicago - 10 Sep 2020: Fitch Ratings has affirmed Peru LNG S.R.L's (PLNG) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB-'. The Rating Watch Negative has been removed, and a Negative Outlook has been assigned. The rating also includes PLNG's USD940 million senior unsecured notes due 2030.

PLNG's Ratings and Negative Outlook reflects weaker operational performance given the declining international prices for natural gas, and consequent higher leverage due to decreasing EBITDA generation. Per Fitch's recently updated Oil & Gas Price Deck reflecting a slight upward trend scenario for Henry-Hub (HH) and depressed National Balance Point (NBP) indexes, materially higher leverage has been forecast for PLNG, with net leverage metrics expected to reach a peak of 17.0x during 2020, and remain above 8.0x during 2021, exacerbating the company's cash flow volatility. Fitch expects PLNG's net leverage to reach 5.0x during 2023, in line with international gas prices recovery.

Fitch believes lower international gas prices should result in a slower deleverage trajectory for Peru LNG than initially expected for the next few years and then decreasing as bond start amortizing. Fitch expects PLNG will remain with adequate

liquidity, offsetting the high leverage during 2020-2021. As of June 2020 PLNG, reported USD163 million of cash on hand, with an additional USD75 million on committed undrawn credit line facility, covering annual interest payments of roughly USD50 million of PLNG's outstanding USD940 million notes. Going forward, Fitch expects PLNG to not distribute any dividends over the rating horizon, combined with EBITDA to Debt Service to average approximately 0.9x during the amortization period, and that PLNG is expected to build up its cash position over the next few years to cover the shortfall in debt service, as the notes amortization payments start in September 2024.

KEY RATING DRIVERS

Deteriorated EBITDA Due to Lower Gas Prices: For the LTM as of June 2020, PLNG's EBITDA registered USD52 million, mainly explained by a gross profit decrease reflected on the company's margin contractions due to lower international LNG prices. Fitch expects PLNG's EBITDA during 2020 will reach approximately USD50 million, assuming 67% of shipments sent to HH-indexed destinations, making a substantial portion of PLNG's operational performance linked to this index, and the remaining portion evenly distributed between NBP and JKM indexes. Given the company's structure of its Purchase Agreement with Shell International Trading Middle East Limited (SITME), Fitch estimates the exposure to commodity price risk remains a key issue for PLNG given low HH and NBP gas prices.

Leverage Remains High: Per Fitch's Oil & Gas price assumptions, natural gas prices for HH and NBP will remain pressured during 2020-2021, reflecting European natural gas supply glut, exacerbated by the coronavirus crisis, while Henry Hub price assumptions reflect lower associated gas production in the U.S. Declining international gas prices should result in a slower deleverage trajectory for Peru LNG, with net leverage staying above 4.5x for the next few years, reaching a peak of 17.0x during 2020. FCF is forecast to remain negative during 2020, turning positive through the medium term including additional capex related to the projects of ethane recovery and port availability. Fitch expects PLNG to not distribute any dividends over the rating horizon in order to accumulate cash to make front-to-debt amortization payments starting in September 2024.

Moderate to Low Business Profile: PLNG's ratings reflect its moderate to low

business-risk profile, stemming from its Sales and Purchase Agreement (SPA) with Shell International Trading Middle East Limited (SITME), which has no volume risk, but has commodity price exposure to Liquefied Natural Gas (LNG) prices. As per the company's Contracted Sales Prices (CSP) Structure with SITME, PLNG is committed to deliver a fixed volume to its off taker under a take or pay structure until 2028. SITME delivers natural gas cargos to international markets, which are paid at different pricing indexes depending on actual natural gas supply and demand in those markets. PLNG receives payments from SITME defined on indexes such as HH, NBP and Japan Korea Marker (JKM). Subsequently, PLNG pays Camisea, through the Gas Supply Agreement (GSA) based upon the multiple destinations natural gas cargos were dispatched.

Strong Off-Taker and High-Quality Shareholders: The Company's ratings are supported by the strength of PLNG's gas buyer: Royal Dutch Shell Plc (AA-/Stable). Fitch estimates that PLNG's production represents 3% to 5% of Shell's global integrated gas sales. In addition, Shell is PLNG's second largest shareholder with a 20% stake in the company, after Hunt Oil with a 50% stake, which is also the operator of PLNG. SK Innovation owns a 20% stake and the Japanese industrial conglomerate Marubeni Corporation with the remaining 10% stake of PLNG's shares. Strong shareholder agreement shows the commitment to maintaining the viability of the company both in the supportive contracts to which they are party to, as well as in the form of direct support, including a USD60 million capital injection in 2016 that bolstered PLNG's already robust liquidity position.

Strategic Asset in the Country: PLNG's operations are a key link in the chain of royalties, which has historically contributed up to USD650 million in payments to the government. Although depressed oil and gas prices have diminished these cash flows, Fitch estimates that the government still stands to receive between USD100 million and USD150 million annually over the medium term related to both natural gas production and, more importantly, associated liquids from Block 56 in the Camisea field. PLNG consumes approximately 50% of Camisea's natural gas production, exporting to international markets almost all of its production, contributing to the country's monetization of its liquid's resources.

In addition, PLNG is gradually being integrated into Peru's domestic gas supply strategy in the form of expanded trucking services for transportation within its borders. Although currently small-scale, this is a service that gains some measure of additional importance in light of the suspension of Southern Gas Pipeline project. Fitch estimates

these factors as mitigation to the kind of social and environmental obstacles that can disrupt companies in the sector.

Natural Monopoly: PLNG is insulated from competitive risk within Peru by virtue of high investment barriers and a gas supply agreement (GSA) that effectively gives it exclusive rights to much of the country's exportable gas supply, allocated in Block 56. PLNG's total construction costs reached USD3.8 billion during 2010 and remains South America's sole liquefaction plant. Additionally, the company has secured a forty-year investment agreement with the government, protecting PLNG from any modification or amendments upon the terms agree through a unilateral decision.

Given the NG supply characteristics of the continent, it seems unlikely that additional investments in capacity will be forthcoming. Within Peru, liquefaction capacity is also limited, primarily as function of the allocation of gas resources and PLNG's GSA with Block 56 of the Camisea field. The bulk of the country's reserves are located within the Camisea consortium's Block 88, but this block is exclusively reserved for domestic NG consumption. Nearly 90% of the country's remaining gas reserves are within Blocks 56 and 57, whose production is ultimately committed to PLNG.

Manageable Capex Program: Fitch estimates total capex of USD18 million during 2020, including PLNG's investments to increase port availability (USD8 million), and ethane recovery project (USD2.3 million) and total capex during 2021 will reach approximately USD30 million, including USD17.6 million, to complete the port availability project, USD5.4 million for ethane recovery, and USD7 million for maintenance at the plant. Going forward the agency expects PLNG's regular maintenance capex flat at USD5 million over the rating horizon. Fitch believes PLNG could cover these investments, with the company's internal cash flow generation without incurring in additional debt.

DERIVATION SUMMARY

PLNG has limited regional peers. Even outside Latin America, LNG plants tend to operate on a more purely take-or-pay, capacity-based on a tolling business model, whereas PLNG incorporates commodity price risk. Tolling based peers such as Transportadora de Gas del Peru (BBB+/Stable) and GNL Quintero S.A. (BBB+/Stable) benefit from the related cash flow stability afforded by their revenue structure. GNL

Quintero, in particular, supports a significantly higher leverage (between 6.0x to 7.0x through the medium term), as it operates a tolling terminal unloading, storing and re-gasifying liquefied natural gas on behalf of gas buyers under 20-year exclusive term use-or-pay agreement.

While TGP has a projected leverage of 2.5x in the near term, its revenues derived from long-term ship or pay contracts to transport natural gas and natural gas liquids from the country's main gas production formation, Camisea, to the main consumption area and export terminal. Similar to GNL Quintero, PLNG is considered a strategic asset for the country, while GNL Quintero allows the liquefaction from imported natural gas in Chile, PLNG is the main infrastructure allowing Peru to export natural gas. In terms of operation, both terminals present high efficiency levels with an average of 91.7% during 2019 for PLNG and 99.5% for GNL Quintero.

In the U.S. corporate universe, Cheniere Energy Partners' (BB/Stable) rating is supported by a secured debt structure and subsidiary business models consistent with the aforementioned tolling structure. Its rating is primarily linked to its deep structural subordination, with roughly USD14 billion out of USD16 billion of non-recourse debt structurally senior to Cheniere's bonds. TransCanada PipeLines Limited's (A-/Negative) large scale and diversity across regulatory-based and long-term contracted businesses in natural gas pipelines warrants a higher rating compared with PLNG's single operation.

KEY ASSUMPTIONS

--Fitch's Gas price deck for Henry Hub (HH) at \$2.1 per MMBtu during 2020 and long-term price at \$2.45;

--Fitch's Gas price deck for National Balance Point (NBP) at \$2.5 per MMBtu during 2020, \$3.75 in 2021, \$4.5 during 2022 and long-term price at \$5.0;

--HH-indexed destinations receive 67% of shipments, with the remainder evenly distributed between NBP and JKM-indexed destinations;

--Transportation costs annually adjusted by the U.S. Producer Price Index;

--Annual capex of USD18 million during 2020 and USD30 million in 2021, including the

port availability and ethane recovery projects. Long term maintenance capex of USD5 million;

--No dividends payments during rating horizon.

RATING SENSITIVITIES

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

--Amendments to contracts that would reduce price and volume risk, similar to its tolling-based peers in the region;

--Net leverage consistently below 3.5x;

--Built up cash consistently over the rating horizon with EBITDA interest coverage consistently over 3.5x;

--Hedge strategy to mitigate the company's exposure to commodity price risk;

--Greater visibility on medium- to long-term re-contracting options.

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

--Any cash distribution to shareholders combined with acceleration in repayments of USD110 million drawn credit line with SITME;

--Consecutive years of negative FCF preventing the company to accumulated cash to serve its debt payments;

-- Failure to reach total net debt to EBITDA below 5.0x; and EBITDA interest paid coverage ratio above 2.5x by 2023;

--Material disruptions in gas supply or other operational outages eroding the company's cash flow generation.

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/1011157>

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: As of June 2020, the company reported USD163 million of cash on hand. Going forward, Fitch estimates an average annual capex for maintenance purposes USD7 million, with additional capex of USD33 million during 2020 and 2021 for projects. PLNG faces no significant maturities in the short term, as the bond starts amortizing during 2024. In addition, PLNG has a USD75 million undrawn committed credit line.

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, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR	
Peru LNG S.R.L.	LT IDR	BB- Rating Outlook Negative	Affirmed	BB- Rating Watch Negative
	LC LT IDR	BB- Rating Outlook Negative	Affirmed	BB- Rating Watch Negative
● senior unsecured	LT	BB-	Affirmed	BB- Rating Watch Negative

[VIEW ADDITIONAL RATING DETAILS](#)**FITCH RATINGS ANALYSTS****Paula Bunn**

Associate Director

Primary Rating Analyst

+1 312 368 3218

Fitch Ratings, Inc.

One North Wacker Drive Chicago 60606

Jose Ramon Rio

Associate Director

Secondary Rating Analyst

+56 2 2499 3316

Lucas Aristizabal

Senior Director

Committee Chairperson

+1 312 368 3260

MEDIA CONTACTS**Elizabeth Fogerty**

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

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

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

[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub. 25 Jun 2020\)](#)

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

Peru LNG S.R.L.

EU Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings) . IN ADDITION, THE FOLLOWING [HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT](https://www.fitchratings.com/rating-definitions-document) DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF

INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM /SITE/REGULATORY](https://www.fitchratings.com/site/regulatory) . FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

[READ LESS](#)

COPYRIGHT

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. 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.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the

relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers. 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/regulator>), 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.

[READ LESS](#)

SOLICITATION STATUS

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

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the [EU Regulatory Disclosures](#) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Energy and Natural Resources Corporate Finance Latin America Peru
