



RATING ACTION COMMENTARY

Fitch Downgrades PERU LNG to 'B'; Assigns Negative Outlook

Tue 03 Oct, 2023 - 1:07 PM ET

Fitch Ratings - New York - 03 Oct 2023: Fitch Ratings has downgraded PERU LNG S.R.L.'s (PLNG) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B' from 'B+'; and assigned a Negative Rating Outlook. Fitch has also downgraded PLNG's USD940 million senior unsecured notes due 2030 to 'B'/'RR4' from 'B+'/'RR4'.

PLNG's downgrade reflects the weakening of the company's financial profile, as a result of low international prices for natural gas. Fitch estimates PLNG's EBITDA leverage will be close to 10x by end of 2023, and will remain above 4.5x in 2024 and EBITDA to interest expense will average 3.0x.

The Negative Outlook reflects the company's tight debt service coverage ratios in 2025 and 2026, when the company faces USD199 million and USD190 of debt service, respectively.

The Recovery Rating for PLNG's 'B' senior unsecured notes is capped at 'RR4' due to Peru's designation as a Group D country within Fitch's Country-Specific Treatment of Recovery Ratings Criteria.

KEY RATING DRIVERS

Higher Leverage: PLNG's earnings and leverage profile are volatile and tend to fluctuate drastically. The company's sale and purchase agreement (SPA) limits its upside revenue potential and intensifies exposure to commodity price risk, as up to 55% of PLNG's revenues are indexed to Henry-Hub (HH) destination prices and the remaining can be sold more optimistically to high price markers, such as National Balance Point (NPB) and Japan Korea Marker (JKM). The HH indexed volume will be reduced to 41% in 2026, and will not apply afterwards. FY2023 EBITDA is estimated to reach USD93 million on lower than expected production; and leverage will be close to 10x by FY2023, and remain above 4.5x in 2024.

Weakened Financial Flexibility: Fitch expects PLNG's liquidity to tighten within the next 24 months, as the company faces USD128 million in debt service in 2024, and USD199 million in 2025. Fitch estimates that cash and equivalents available plus FCF, in 2025 and in 2026, will cover debt obligations by 1.7x on average. Fitch's base estimates the company's cash balance will be near to USD181 million by YE 2024, and USD152 million by YE 2025.

Gas Prices Trending Downward: LNG spot market prices are expected to tighten in Europe due to ample LNG supplies to the region, curtailed demand and high storage levels; the expansion of LNG infrastructure and improving interconnectivity in the region should help reduce prices to normalized levels in a sustainable manner in the medium to long term. Gas price assumptions for European Title Transfer Facility (TTF) for 2023 was marginally increased to USD13/mcf from USD12/mcf, reflecting higher-than-expected YTD prices; HH was reduced to USD2.8/mcf from USD3.0/mcf, due to increasing gas production, higher storage levels and a likely mild winter in the U.S. and Europe. YTD Sept. 27, 49% of PLNG production was sold under European markers.

Strategic Asset in the Country: PLNG is a strategic asset for the country that supports continued gas development in the country. As of August 2023, the Peruvian government has received close to USD648 million from both natural gas production and associated liquids from Blocks 56, 57 and 88 in the Camisea field. The company has no domestic competitors given the high investment barriers to entry and the gas supply agreement (GSA) that effectively gives it exclusive rights to much of the country's exportable gas supply, allocated from the prolific low-cost operations of Block 56 and 57.

Strong Shareholders: PLNG is rated on a stand-alone basis, but Fitch believes it benefits from having strong shareholders: Shell Plc (AA-/Stable, 20%), Hunt Consolidated, Inc. (50%), SK Innovation (20%), and Marubeni Corporation (10%). All companies have strategic and operational incentive to support the company in the event it falls under financial distress. The shareholder agreement reflects the commitment to maintain the company's viability, mainly through supportive contracts clauses, and on a lesser extent in the form of USD60 million in capital injection and USD50 million in extra support from the Quarterly payment and USD30 million in subordinated loans obtained in 2021, fully repaid in 2022.

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 (TGP; BBB+/Negative) and GNL Quintero S.A. (GNLQ;

A-/Stable) benefit from the related cash flow stability afforded by their revenue structure.

GNL Quintero, in particular, supports a significantly higher, as it operates a tolling terminal unloading, storing and re-gasifying LNG on behalf of gas buyers under 20-year exclusive term use-or-pay agreement.

While TGP has a projected leverage of 2.0x 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 the U.S. corporate universe, Cheniere Energy Inc. (CEI; BBB-/Stable) rating reflects stable cash flows provided by long-term SPA and integrated production marketing (IPM) GSA with investment-grade counterparties. TransCanada PipeLines Limited's (TCPL; BBB+/Stable) 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.

Freeport LNG Investments, LLLP (FLNGI; B-/Negative) rating incorporates the long-term, take-or-pay contracts to supply LNG for export, similar structure than of PLNG's, but with current operational restrictions following the ignition of a natural gas vapor cloud from a ruptured LNG transfer line at the Texas LNG facility.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

--Fitch's Gas price deck for HH at USD2.80/mcf by YE 2023; USD3.25/mcf in 2024, USD3.00/mcf in 2025 and long-term price at USD2.75/mcf;

--Fitch's Gas price deck for TTF at USD13.00/mcf by YE 2023; USD10.00/mcf in 2024 and in 2025, and long-term price at USD5.00/mcf;

--HH-indexed destinations receive 55% of shipments until 2025; 41% in 2026, and does not apply from 2027 onwards. Remainder volumes evenly distributed between European and Asian indexed destinations;

--YE cash balance of at least USD50 million over the rating horizon;

- Exported volumes at 192 Tbtu in 2023, and 202 Tbtu on average between 2024-2026;
- Average plant efficiency of 92% for the rating horizon;
- Transportation costs annually adjusted by the U.S. Producer Price Index;
- Annual capex of USD32 million in 2023. Average of USD20 million between 2024-2026;
- No dividends payments during rating horizon.

RATING SENSITIVITIES

The Negative Outlook may be revised to Stable if the company's financial flexibility materially improves in the next 12 months.

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;
- Consistent track record of built up cash over the rating horizon with EBITDA interest coverage consistently over 3.0x;
- Liquidity ratio consistently above 1.5x over the rating horizon;
- 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:

- Material disruptions in gas supply or other operational outages eroding the company's cash flow generation;
- Cash available below USD50 million;
- Liquidity ratio consistently below 1.25x over the rating horizon;
- EBITDA leverage above 5.0x over the rating horizon;

--EBITDA interest coverage below 1.25x;

--Consecutive years of negative FCF.

LIQUIDITY AND DEBT STRUCTURE

Tightening Liquidity: As of June 2023, PLNG had USD146 million of cash on hand and USD70 million available under a working capital facility due in August 2024; while having USD78 million in short-term debt maturities, as the bond starts amortizing in September 2024. Lower than expected export volumes in 2023 combined with low LNG prices will challenge PLNG's liquidity in the upcoming year. Fitch estimates FCF to be positive and close to USD20 million in 2023, and should average USD110 million between 2024 and 2026, based on our price deck scenarios.

During 1H23, the company repaid USD110 million to its off-taker corresponding to the quarterly payment SPA clause and made a USD45 million distribution in the form of capital reduction to its shareholders. The company has access of up to USD60 million in cash support from its SPA in low prices environments.

ISSUER PROFILE

PERU LNG S.R.L. was created in 2003 with the purpose of developing, building, and operating a LNG plant. The company operates a 4.5 million mtpa gas liquefaction plant and its related facilities, a marine terminal and a 408km pipeline that transports natural gas (NG) from the Camisea fields to the coast.

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 ⚡	RECOVERY ⚡	PRIOR ⚡
PERU LNG S.R.L.	LT IDR		B+ Rating Outlook Stable
	B Rating Outlook Negative		
	Downgrade		
	LC LT IDR		B+ Rating Outlook Stable
	B Rating Outlook Negative		
	Downgrade		
senior unsecured	LT B Downgrade	RR4	B+

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)](#)
(including rating assumption sensitivity)

[Corporate Rating Criteria \(pub. 28 Oct 2022\)](#) (including rating assumption sensitivity)

[Country-Specific Treatment of Recovery Ratings Criteria \(pub. 03 Mar 2023\)](#)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub. 12 May 2023\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 16 Jun 2023\)](#)

[Climate Vulnerability in Corporate Ratings Criteria \(pub. 21 Jul 2023\)](#) (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

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PERU LNG S.R.L.

EU Endorsed, UK Endorsed



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