



RATING ACTION COMMENTARY

Fitch Downgrades Peru LNG to 'B+'; Outlook Remains Negative

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Fitch Ratings - Chicago - 11 Aug 2021: Fitch Ratings has downgraded PERU LNG S.R.L.'s (PLNG) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B+' from 'BB-'. The Rating Outlook remains Negative. In addition, Fitch has downgraded PLNG's USD940 million senior unsecured notes due 2030 to 'B+'/'RR4' from 'BB-'

PLNG's downgrade and Outlook reflect the weaker operational performance given international prices for natural gas, operational disruptions at the plant and consequent higher leverage due to decreasing EBITDA generation. Per Fitch's updated Oil & Gas Price Deck for Henry-Hub (HH) and National Balance Point (NBP) indexes, PLNG's net total debt to EBITDA will reach 16.0x during 2021, and remain above 7.0x during 2022, exacerbating the company's cash flow volatility.

KEY RATING DRIVERS

Deteriorated EBITDA Due to Lower Gas Prices: For the LTM as of March 2021, PLNG's EBITDA registered USD51 million, mainly due to a gross profit decrease reflected on the company's margin contractions, which were a result of lower international LNG prices during 2020. Fitch expects PLNG's EBITDA will reach approximately USD54 million during 2021, assuming 67% of shipments to HH-indexed destinations, making a substantial portion of PLNG's operational performance linked to this index. The remaining portion should be evenly distributed between NBP and JKM indexes.

Given the structure of the company's Sales and 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.

In addition, plant interruptions due to several operational events, will reduce the expected volume for exports to approximately 156 Tbtu during 2021, significantly lower than 205 Tbtu of natural gas exported during 2020. These unexpected events will reach approximately USD21 million in additional costs and capex, and will increase total capex to nearly USD46 million during 2021. Fitch estimates these material disruptions in gas supply due to operational outages will extend PLNG's plant interruption until the end of August 2021.

Leverage Remains High: Per Fitch's Oil & Gas price assumptions, natural gas prices for HH and NBP will improve during 2021, reaching 2.90 USD/mcf and 6.00 USD/mcf, respectively, mainly driven by low gas inventories in storage, strong demand in Asia, and recovering demand in Europe. In the long term, prices will remain at 2.45 USD/mcf for HH, depressed international gas prices result in a slower deleverage trajectory for Peru LNG, with net leverage staying above 4.5x for the next few years.

FCF is forecast to remain positive through the medium term, including capex related to the projects of ethane recovery, port availability and unexpected events. Fitch expects PLNG will not distribute 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) 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 Sales and Purchase 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 reflects the commitment to maintain the company's viability, both in supportive contracts, as well as 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 approximately USD600 million in payments to the Peruvian 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 service has gained additional importance in light of the suspension of the Southern Gas Pipeline project. Fitch estimates these factors could mitigate 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 the 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 between 2007 and 2010. Additionally, the company has secured a 40-year investment agreement with the government, protecting PLNG from any modification or amendments upon the terms agree through a unilateral decision.

Given the continent's NG supply characteristics, additional investments in capacity is unlikely or 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. However, this block is exclusively reserved for domestic NG consumption. Nearly 90% of the country's remaining gas reserves are within Blocks 56 and 57, for which production is ultimately committed to PLNG.

Manageable Capex Program: Fitch estimates total capex of USD46 million during 2021, including PLNG's investments to increase port availability, ethane recovery project and operational event that caused the plant interruption. Going forward, the agency expects PLNG's regular maintenance capex will be flat at USD5 million during normal years, increasing to a range of USD12 million and USD15 million in those years with major maintenance. 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 the U.S. corporate universe, Cheniere Energy Partners' (BB/Positive) 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 Key Assumptions Within The Rating Case for the Issuer

- Fitch's Gas price deck for Henry Hub (HH) at \$2.9 per MMBtu during 2021 and long-term price at \$2.45;
- Fitch's Gas price deck for National Balance Point (NBP) at \$6.0 per MMBtu during 2021 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;
- Exported volumes at 156 Tbtu during 2021 due to operational interruption in the plant, returning to 210 Tbtu during 2022, as major maintenance is scheduled, and increasing to 225 Tbtu per year 2023-2024;
- Transportation costs annually adjusted by the U.S. Producer Price Index;
- Annual capex of USD46 million in 2021, including the port availability and ethane recovery projects;
- Long term maintenance capex of USD5 million during normal years, increasing to a range of USD12 million and USD15 million in those years with major maintenance;
- 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;
- Equity contribution from shareholders to enhance the liquidity position to face upcoming debt maturities could help stabilize the Rating Outlook.

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/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Deteriorated Liquidity: As of March 2021, PLNG reported USD125 million of cash on hand. PLNG faces no significant maturities in the short term, as the bond starts amortizing during 2024. In addition, PLNG's original USD75 million undrawn committed credit line was reduced to USD40 million during the first half of 2021, out of which USD20 million is currently available. Fitch anticipates PLNG's liquidity will be eroded during 2021 due to operational events that halted the plant production increasing PLNG's total costs and capex for approximately USD21 million.

ISSUER PROFILE

PERU LNG S.R.L. was created on 2003 with the purpose of developing, building, and operating a liquefied natural gas (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. Additionally, PERU LNG

built a LNG Truck Loading Facility to promote the mass use of natural gas via the transport of this fuel to interior regions of the country. Total investment reached USD3.8 billion.

PLNG's primary shareholder is Hunt Consolidated, Inc. (50% stake), which also has a 25% share in Block 56 in the Camisea field. Likewise, Royal Dutch Shell plc (AA-/Stable), a 20% stake, through its subsidiary Shell International Trading Middle East (SITME) is PLNG's sole off taker. Remaining shareholders include Sk Innovation Co, Ltd (20%) and Marubeni Corporation (10%).

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

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA[Corporate Rating Criteria \(pub. 21 Dec 2020\) \(including rating assumption sensitivity\)](#)[Country-Specific Treatment of Recovery Ratings Criteria \(pub. 05 Jan 2021\)](#)

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

[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub. 30 Apr 2021\)](#)

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](#))

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