



Fitch Affirms Peru LNG at 'BBB-'; Revises Outlook to Negative

Fitch Ratings-Chicago-06 December 2019: Fitch Ratings has affirmed Peru LNG S.R.L's (PLNG) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-'. The Rating Outlook has been revised to Negative from Stable. The rating also includes PLNG's USD940 million senior unsecured notes due 2030. A full list of rating actions follows at the end of this press release.

PLNG's Negative Outlook reflects the 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 deteriorated scenario for Henry-Hub (HH) and National Balance Point (NBP) indexes, materially higher leverage has been forecast for PLNG, with leverage metrics expected to reach a peak of 9.2x during 2019. Fitch believes declining international gas prices should result in a slower deleverage trajectory for Peru LNG than initially expected, with net leverage potentially staying above 4.5x for the next few years and then decreasing as bond start amortizing. 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 2024.

KEY RATING DRIVERS

Deteriorated EBITDA Due To Lower Commodity Prices: For the LTM as of September 2019, PLNG's EBITDA registered USD139 million, mainly explained by a gross profit decrease reflected on the company's margin contractions due to lower international LNG prices. Fitch assumes 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 Peru LNG given low Henry Hub (HH) and National Balancing Point (NBP) gas prices.

Leverage Remains High: Per Fitch's recent updated Oil & Gas price assumptions, natural gas prices for HH and NBP were revised downward, reflecting reduced marginal production costs in the U.S. and increased LNG supplies globally. Declining international gas prices should result in a slower deleverage trajectory for Peru LNG, with net leverage potentially staying above 4.5x for the next few years, reaching a peak of 9.2x during 2019. FCF is forecast to remain positive through the medium term including additional capex related to the projects of ethane recovery and port availability.

Moderate Business Profile: PLNG's ratings reflect its moderate 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) and HH 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 projects that the government still stands to receive between USD150 million and USD250 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 liquids resources. In addition, PLNG is gradually being integrated into Peru's domestic gas supply strategy in the form of expanded trucking services for the transportation within its borders. Although currently small-scale, this is a service that gains some measure of additional importance to the country in light of the suspension of the 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.

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 business model, whereas PLNG incorporates 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 92% during 2018 for PLNG and 98.3% 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-/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.

KEY ASSUMPTIONS

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

- Fitch's Oil & Gas price deck for HH flat at \$2.5 per MMBtu and NBP at \$5.5 per MMBtu during 2020, \$6.0 per MMBtu during 2021 and \$6.5 per MMBtu in the long-term;
- 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;
- Average annual maintenance capex of USD10 million-USD12 million with additional capex of USD38 million during 2020 and 2021 for the port availability and ethane recovery projects;
- Equal instalments of USD55 million during 2020 and 2021, to repay the drawn credit line with SITME;
- No dividends payments during 2019 to 2022.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Amendments to the 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.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Aggressive cash distribution inconsistent with the company's long-term financing needs;
- Failures to reach total net debt to EBITDA below 4.5x by 2022;
- Failure to accumulated cash to serve the company's debt service;
- Material disruptions in gas supply or other operational outages eroding the company's cash flow generation;
- Long-term fundamentals over depressed international gas prices putting additional pressure the company's cash flow generation.

LIQUIDITY

Adequate Liquidity: As of September 2019, the company reported USD70 million of cash on hand. Going forward, Fitch estimates an average annual capex for maintenance purposes between USD10 million and USD12 million, with additional capex of USD38 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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. 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.

FULL LIST OF RATING ACTIONS

Fitch has affirmed Peru LNG S.R.L's ratings as follows:

--Foreign Currency and Local Currency Long-Term IDR at 'BBB-'; Outlook revised to Negative;
--USD940 million senior unsecured notes ratings at 'BBB-'.

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Sector Navigators (pub. 23 Mar 2018)

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