FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades ICE to 'B' After Sovereign Downgrade; Outlook Remains Negative

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Fitch Ratings - New York - 14 May 2020: Fitch Ratings has downgraded Instituto Costarricense de Electricidad y Subsidiarias' (ICE) ratings as a result of Fitch's recent downgrade of Costa Rica's Sovereign Rating to 'B' from 'B+'. The Rating Outlook remains Negative. A full list of rating actions follows at the end of this release.

KEY RATING DRIVERS

Costa Rica

On May 8, 2020, Fitch Ratings downgraded Costa Rica's Long-Term Foreign-Currency and Local Currency Issuer Default Ratings (IDR) to 'B' from 'B+'. The Rating Outlook remains Negative. The downgrade of Costa Rica's IDRs reflects increased risks of near-term financing stress due to widening fiscal deficits, a steep amortization schedule and borrowing constraints, against a background of economic contraction caused by the effects of the coronavirus pandemic. The ongoing health crisis comes at a time when Costa Rica's fiscal space is limited and rapidly narrowing, raising risks to post-crisis debt sustainability. The interest bill is climbing rapidly and the debt burden is on a relatively steep upward trajectory.

The Sovereign's Negative Outlook reflects further downside risks to debt sustainability amid uncertain prospects for post-crisis fiscal consolidation, economic growth and borrowing costs. The government will rely on multilateral loan disbursement this year to secure budget financing. However, uncertain external market access coupled with a domestic capital market that has become costly in past periods of sovereign liquidity stress pose financing risks. Risks from the ongoing health crisis remain tilted to the downside, as Fitch's forecasts are predicated on a three-month period of economic disruption due to the coronavirus. In the event of a second wave of infections and the re-imposition of lockdown measures, economic and fiscal outturns would be weaker for 2020 and 2021.

Instituto Costarricense de Electricidad y Subsidiarias (ICE)

ICE's ratings downgrade reflects its strong linkage to Costa Rica's Sovereign Ratings. As per Fitch's government-related entities (GRE) methodology, ICE's IDRs are capped by those of the sovereign, given its strategic importance to Costa Rica and the potentially significant negative socio-political and financial implications of any financial distress at the level of the company on the sovereign. ICE's Standalone Credit Profile (SCP) of 'b+' incorporates the company's diversified asset portfolio, high leverage, modest capex program, and its monopoly position in the electricity industry and strong market position in the telecommunications business. As of September 2019, 10.6% of the debt was guaranteed by the Costa Rican Government.

DERIVATION SUMMARY

ICE's linkage to the sovereign is similar to peers such as Comision Federal de Electricidad (CFE) (BBB/Stable) and Centrais Eletricas Brasileiras S.A. (Eletrobras) (BB-/Stable). These companies all have strong linkages to their respective sovereigns given their strategic importance to each country and the potentially significant negative socio-political and financial implications of any financial distress at these companies.

ICE's ratings are supported by its linkage to Costa Rica's Sovereign Rating, which stems from the company's government ownership and the implicit and explicit expectation of government support. The ratings reflect the company's diversified asset portfolio, moderate capex program, and its monopoly position in the electricity industry and strong market share position in the telecommunications business. ICE has a relatively lower scale of operations compared with its peers. Adjusted leverage as of LTM September 2019 of 5.9x was higher than CFE's 2.6x but lower than Eletrobras' 6.3x. Regarding the adjusted coverage ratio, ICE's 2.2x compares negatively with peers.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Its Rating Case for the Issuer Include:

- ICE remains important to the government as a strategic asset for the country;

- Electricity demand falls 2% in 2020; organic growth around 1% for 2021-2023;

- Adjusted leverage at or below 6.0x over the rating cycle;

- ICE's Telco market share remains strong;

- Tariffs adjustments for 2020 reflect appropriate operating expenses;

- The recovery analysis assumes that under a hypothetical bankruptcy or debt restructuring process ICE would be a going concern and Fitch has assumed a 10% administrative claim with a going-concern EBITDA close to CRC401,000 million and an EV multiple of 5.0x;

- The Recovery Rating is limited, however, to 'B'/'RR4' as Costa Rica is categorized as Group D, per Fitch's Country-Specific Treatment of Recovery Ratings Criteria, which caps the Recovery Ratings at 'RR4'.

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Upgrade on the sovereign's ratings.

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- A sovereign downgrade;

- Sustained and consistently adjusted leverage over 6.0x;

- Regulatory intervention that negatively affects the company.

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: ICE has historically financed capex with owned resources and new debt, where debt related to electricity projects represents approximately 90% and the rest to the Telco segment. ICE's cash balance, as of May 2020, was CRC305,403 million, enough to cover 2020 debt maturities. Moreover, Fitch expects ICE to generate positive FCF across the rating cycle with annual average of CRC124,000 million, given the modest capex needs.

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

ICE has an ESG Relevance Score of '4' for Governance Structure, Group Structure and Financial Transparency, due to uncertain management strategy coupled with weaker financial transparency reporting compared to regional peers.

Except for the matters discussed above, 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			RECOVERY
Instituto Costarricense de Electricidad y Subsidiarias	LT IDR	B	Downgrade	
	LC LT IDR	B	Downgrade	
• senior unsecured	LT	B	Downgrade	RR4

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Ratings Criteria (pub. 17 Jul 2018)

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

Country-Specific Treatment of Recovery Ratings Rating Criteria (pub. 27 Feb 2020)

Corporate Rating Criteria (pub. 01 May 2020) (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), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Instituto Costarricense de Electricidad y Subsidiarias	EU Endorsed

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