

### Research Update:

# Empresa Generadora de Electricidad Haina Outlook Revised To Positive From Stable, 'B-' Corporate Credit Rating Affirmed

#### Primary Credit Analyst:

Carolina Duran, Mexico City 52-55-5081-4417; carolina\_duran@standardandpoors.com

#### Secondary Contact:

Marcela Duenas, Mexico City (52) 55-5081-4437; marcela\_duenas@standardandpoors.com

### Table Of Contents

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- Overview
- Rating Action
- Rationale
- Outlook
- Related Criteria And Research
- Ratings List

## Research Update:

# Empresa Generadora de Electricidad Haina Outlook Revised To Positive From Stable, 'B-' Corporate Credit Rating Affirmed

## Overview

- We expect Haina to gradually improve its financial profile as it further diversifies its energy sources and expands its power generating capacity.
- We are revising the outlook on the company to positive from stable and affirming our 'B-' corporate credit rating.
- The rating reflects the Dominican Republic's progress in improving the electric sector's regulatory framework and its ongoing support to the sector through sizable annual subsidies to the distribution companies, which will likely allow Haina to maintain high bill collection rates and improve cash flow generation.

## Rating Action

On Dec. 23, 2011, Standard & Poor's Ratings Services revised its outlook on Dominican Republic-based power generation company Empresa Generadora de Electricidad Haina S.A. to positive from stable. At the same time, we affirmed our 'B-' corporate credit rating on the company and on its senior unsecured notes.

## Rationale

The 'B-' rating incorporates our opinion that there is a low likelihood of timely and sufficient extraordinary support from the Dominican Republic (B+/Stable/B) to Haina in the event of financial distress. In accordance with our criteria for government-related entities, our view is based on our assessment of Haina's limited importance to the government's key economic and political objectives, and its limited link to the government given the latter's low involvement in the company's strategy, day-to-day operations, and no controlling rights. The Haina Investment Co. (HIC; not rated) owns 50% of the company, and the Dominican government owns 50%.

We assess Haina's stand-alone credit profile (SACP) at 'b-', to reflect the challenges of operating in the Dominican Republic's heavily subsidized electric sector with uncertain, although improving, long-term operating and financial sustainability. Also, the SACP incorporates the company's diversified portfolio of dollar-denominated long-term energy sales contracts and its position as the country's largest electricity generator. The SACP also considers the company's improved key financial ratios due to higher average energy sales prices in 2011 as a result of higher energy demand and an

increase in Fuel Oil No. 6 prices, the main driver of price escalations in Haina's power purchase agreement (PPA) pricing formula.

In our view, the Dominican Republic's institutional and regulatory framework has improved during the past two years. We believe that allowance for tariff increments, its improvements in invoicing systems, the distribution companies' ability to suspend the service to debtors, and the strengthening of the management of the state-owned distribution companies have improved the overall business environment in the sector. However, we believe that the sector continues to face several unresolved structural, technical, and institutional deficiencies. These are total electricity theft (including technical losses)--representing approximately 35% of total electricity generated in the Dominican Republic--outdated equipment, dependence on fuel oil, and the distribution companies' failure to improve their overall operating and financial performance--leading to a high dependence on the government's annual subsidy, which totaled about \$800 million in 2011. These unresolved issues continue to hinder the sector's performance and our assessment of industry risk, resulting in high operational and financial costs. Haina's ownership of 11 generation units at seven plants and a diversified portfolio of dollar-denominated, long-term energy sales contracts, which limit its exposure to spot-market volatility and allow pass-through of fuel costs, partially offset these challenges. Haina's generation units consist of a coal-fired steam turbine generating plant, four oil-fired steam generation units, two diesel-fired engine generation plants, one gas turbine generation unit (fired with diesel fuel), and its newly operational 25-megawatt (MW) wind farm--the first in the country.

We assess Haina's financial risk profile as "aggressive" (as our criteria define it) based on its limited, though improving, cash flow generation and moderate, but rising, leverage metrics. As a result of the 2009 standby agreement between the government and the International Monetary Fund (IMF), days of sales outstanding (DSO) with the generators have remained at 60 to 90. Although the DSO with Haina does not currently meet the IMF directive of a maximum 45 DSO, as of September 2011 the average collection rate for the company was 83%, which improved its working capital and increased its cash flow generation. For the 12 months ended September 2011, Haina reported \$65 million in funds from operations (FFO). Our base case expects FFO to increase to \$80 million by year-end 2011, compared with \$60 million in 2010. Furthermore, we expect Haina's top-line growth to exceed 40% in 2011 and its EBITDA margin to be more than 18%. For the nine months ended September 2011, revenues were \$456.3 million, up 48% from the previous year, and for the 12 months ended September 2011, EBITDA was \$106 million, up 47%, due to higher average energy sales prices. This was the result of higher fuel oil prices, the main escalator of Haina's PPA pricing formula, and a 17.2% increase in energy demand mainly due to the reimplementation of the PPA with Empresa Distribuidora de Electricidad del Este S.A. and the increase in the contracted capacity with Consorcio Energético Punta Cana-Macao to 64 MW. Haina also benefited from greater generation, as it had to rely less on energy purchases. Since Haina has a long-term contracted capacity, it can better meet its contracted energy obligations through its own electricity generation, at

higher margins, as it generally produces electricity at lower cost than if it were buying it on the spot market. Also, higher fuel costs led to higher margins as the increase in energy prices more than offset the rise in fuel expenses.

Furthermore, the company plans to increase its long-term debt by 2012 to fund the construction of an additional 52 MW in wind power and a 215-MW dual-fuel plant. Despite the expected increase in debt, we believe that debt to EBITDA will not exceed 3.4x by 2012, FFO to total debt will remain above 20%, and FFO interest coverage will remain above 5.0x. As of September 2011, Haina's total debt was \$232 million, with 89% of this in bonds. These amounts included local bond placements of \$42 million outstanding, and unsecured term loans with Banco Popular Dominicano and Banco BHD.

Haina is the largest generator of electricity in the Dominican Republic based on installed and effective capacity. After the Los Cocos project became operational in mid-2011, Haina increased its total installed capacity to 590 MW. Haina's plants are located throughout the Dominican Republic, mainly on the southern coast of the island.

### **Liquidity**

Haina's liquidity is "less than adequate." In our base case, we expect the company's liquidity to come under pressure in 2012 due to the planned \$386 million capital investment for development of Los Cocos II, the second phase of the wind farm project, and Quisqueya 2, a dual-fuel power plant expected to be operational by March 2013. This project would be funded through a \$200 million bank loan and cash reserves that would significantly reduce the company's liquidity during the next 12 months. However, as of Sept. 30, 2011, the company had about \$67 million of cash on hand, comparing favorably with debt maturities of \$36 million for the next 15 months, including any payments on the new debt to be issued in 2012. Also, under our base-case scenario, we estimate that Haina's cash flow from operations reaching approximately \$65 million in 2012, which compares favorably with the negative trend in previous years, because of improved working capital management. Furthermore, Haina Finance is required to maintain at all times an amount on deposit in this interest reserve account (or letters of credit or certain temporary cash investments having an aggregate face amount) equal to the interest payable on the bond on the immediately following interest payment date, which as of December 2011 was \$8.3 million.

As of September 2011, Haina complied with the covenants on its notes stipulating an interest coverage ratio of no less than 2.5x and net debt to EBITDA of no more than 3.5x. Even with the potential for additional debt in 2012, the company will likely comply with its covenants.

## Outlook

The positive outlook reflects our expectation that Haina will gradually improve its financial profile as it further diversifies its energy sources, expands its capacity through large capital expenditures, and continues to post satisfactory financial indicators and stronger cash flow generation capacity. Our base-case scenario predicts an EBITDA margin of 18% and FFO to total debt of 40% for 2011. We could raise the rating if the company achieves these measures, along with prudent debt management to a total debt to EBITDA of less than 3.4x by 2012. Conversely, we would lower the rating if metrics underperform our expectations, the company assumes a more aggressive financial policy toward the use of debt, or its cash flow metrics deteriorate significantly. If the government fails to support the sector's development, this could also pressure the ratings downward.

## Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry, Nov. 26, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

## Ratings List

Outlook Revised; Ratings Affirmed

	To	From
Empresa Generadora de Electricidad Haina S. A. Corporate Credit Rating	B-/Positive/--	B-/Stable/--

Ratings Affirmed

Haina Finance S.A. Senior Unsecured	B-
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