RATING ACTION COMMENTARY

Fitch Affirms Instituto Costarricense de Electricidad at 'BB-'; Outlook Stable

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Fitch Ratings - New York - 24 Apr 2023: Fitch Ratings has affirmed Instituto Costarricense de Electricidad y Subsidiarias' (ICE) Long-Term Foreign Currency and Local Currency Issuer Default Ratings (IDRs) at 'BB-' and the senior unsecured bonds at 'BB-'. In addition, Fitch assessed ICE's consolidated Standalone Credit Profile (SCP) at 'b+'. The Rating Outlook is Stable.

ICE's ratings incorporate its strategic importance to the country and the potentially significant negative socio-political and financial implications to the sovereign if there is any financial distress at the company level. Additionally, the ratings reflect the company's diversified asset portfolio, moderate capex program and its strong market share position in both the electricity and the telecommunications business.

KEY RATING DRIVERS

Rating Equalization: ICE's ratings reflect its strong linkage with the sovereign of Costa Rica, as the company is an autonomous entity owned by the Costa Rican State. As per Fitch's Government Related Entity Criteria (GRE Criteria), ICE has an Overall Support Score of 45 IDRs that results in an equalization to Costa Rica's sovereign rating at 'BB-'.

ICE is a strategic asset to the country due to its essential role in the domestic electricity market, and it is the incumbent participant in the telecommunications sector, which is an incentive for the government to support the company if necessary. Fitch believes that an event of default at ICE would have a very strong negative impact for the sovereign on the availability and cost of funding.

Operating Results Trend Positive: For 2023, Fitch estimates revenue will increase 4%, mostly reflecting higher electricity demand and recovery in the telecommunications business revenues. Estimated ICE's FY 2022 consolidated revenue grew by 7.0% on higher electricity exports to the region and increased consumption in tourism-related areas. Electricity revenues grew 13.5% and accounted for 60% of ICE's total revenue in 2022, while Telco revenues increased by 3.6%. At the same time, operating expenses were flat compared to 2021. In terms of profitability, ICE's estimated EBITDA was CRC595 billion with a margin of 43% (FY 2021: CRC432 billion and margin of 33.4%).

Leverage Profile: ICE's estimated EBITDA leverage as of December 2022 was 4.1x, down from 6.8x in 2021, on better operating results. Fitch's base case projects ICE's leverage will be close to 4.3x in 2023, assuming EBITDA close to CRC576 billion and no major tariff adjustments, and remaining close to 4.7x in 2024 while annual debt amortizations around CRC200 billion. Fitch estimates that capex levels for 2023 to 2026 will be around CRC340 billion annually on average, which is equivalent to about 23% of revenues, and will be funded with a combination of internally generated cash and debt.

High Exposure to Regulatory and Political Interference: ICE is exposed to the risk of regulatory interference due to the lack of transparency and clarity in the processes for determining tariffs adjustment schemes in previous years. The company proposes electricity tariffs for end-users to the regulator annually.

Electricity tariffs are set through the quarterly adjustment of variable costs of electric generation (energy imports and fuel) and through an ordinary tariff review that considers the company's operating costs.

Diversified Asset Portfolio: ICE is a vertically integrated monopoly in the electricity industry and an incumbent player in the telecommunications industry in Costa Rica. As of December 2022, the company accounted for 72% of the National Electric System's installed capacity and produced 84% of the total electricity consumed in Costa Rica. ICE's mobile market share in terms of subscribers was approximately 41% according to most recent data from Superintendencia de Telecomunicaciones (SUTEL).

The ratings reflect the company's low business risk resulting from its business diversification and positive characteristics as a utility service provider.

DERIVATION SUMMARY

ICE's linkage to the sovereign is similar to Comision Federal de Electricidad (CFE; BBB-/Stable). Similar to ICE, CFE is highly important to Mexico as its largest integrated electric utility, and it is the only domestic entity allowed to both transmit and distribute electricity.

ICE's ratings reflect its strong 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 lower scale of operations compared with its peers. ICE's EBITDA leverage as of FY 2022 of 4.1x was materially lower than CFE's 10.7x.

KEY ASSUMPTIONS

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

--In 2023, revenues grow by 4% on improved electricity demand;

--Leverage close to 4.3x in 2022; and 4.7x in 2024;

--ICE's Telco market share remains strong.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Upgrade of the sovereign's ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A sovereign downgrade;

--Weakening of the linkage between ICE and the sovereign and a material deterioration of ICE's operating and financial profile;

--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's liquidity position is adequate, with a cash and equivalents balance of approximately of CRC343 billion as of YE 2022 and total debt of CRC2.465 billion, of which CRC225 billion was short-term debt.

Historically, ICE has financed capex with its own resources and new debt, where the debt related to electrical projects represents approximately 90% and the rest to the Telco segment.

ISSUER PROFILE

ICE is a government-owned, vertically integrated monopoly in the electricity industry, in charge of developing, constructing and operating an electric power generation, transmission and distribution system and the incumbent player in the telecommunications industry.

Sources of Information

The principal sources of information used in the analysis are described in the Applicable Criteria.

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 and Group Structure due to ownership concentration, as a majority government-owned entity and due to the inherent governance risks that arise with a dominant state shareholder. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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			PRIOR
Instituto Costarricense de Electricidad y Subsidiarias	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
senior unsecured	LT	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria - Effective from 9 April 2021 to 13 October 2023 (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria - Effective from 28 October 2022 to 3 November 2023 (pub. 28 Oct 2022) (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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Instituto Costarricense de Electricidad y Subsidiarias	EU Endorsed, UK Endorsed

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