# Fitch Affirms Elektra Noreste's IDRs at 'BBB'; Outlook Stable

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Fitch Ratings-New York-02 November 2018: Fitch Ratings has affirmed Elektra Noreste, S.A.'s (ENSA) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB'. The rating action affects approximately USD100 million of outstanding debt due in 2021. The Rating Outlook is Stable.

ENSA's ratings are based on its strong financial position, stable cash flow generation and low business risk profile, which is characteristic of electric distribution companies. Cash flow stability is positively incorporated into the rating as it lowers business risk and adds to certainty. The ratings also incorporate ENSA's exposure to regulatory risk, which is considered moderate.

KEY RATING DRIVERS

Solid Credit Metrics: ENSA's financial profile is solid with investment-grade credit protection measures. The company has historically maintained moderate indebtedness, adequate liquidity and sound cash flow generation capacity. ENSA maintains healthy interest coverage, which as of year-end 2017 was 6.2x with EBITDA of USD91 million. Fitch forecasts an annual EBITDA average of between USD87 million to USD103 million during 2018-2020, and leverage of around 3.5x in the medium term as the company deploys investments in its network coverage in the future years.

FCF Affected by CAPEX and Dividends: ENSA has recorded negative free cash flow (FCF) in recent years mainly because of its dividend policy and capex program, and paid a majority of its net income out in dividends. During 2017, the company paid USD15 million in dividends on 2016 net income of USD32 million. Fitch estimates cumulative capex over the next four years of over USD200 million. This compares with the capex plan of USD193 million for the 2018 - 2022 tariff period.

Low Business-Risk Profile: ENSA's credit profile is supported by its natural monopoly position. ENSA's concession area is exclusive and has well-defined boundaries. The concession is permanent but the concession contract is reviewed every 15 years (the current contract expires in October 2028). ENSA is 51% owned by Panama Distribution Group, S.A. (PDG), a subsidiary of Empresas Publicas de Medellin E.S.P. (EPM; rated BBB/Rating Watch Negative), and 48.25% by the Panamanian government.

As per regulation, the majority of the shares of the three electricity distribution companies are auctioned in a public bidding process one year before the end of the concessions. The last bidding process was conducted in August 2013 and PDG was the only bidder for the 51% stake of ENSA. PDG retained its majority stake with no requirement to make any payment to the Panamanian Government. The bidding process is held at the holding company level; therefore, it did not affect ENSA's operations.

ENSA is an efficient electricity distribution company with energy losses from both technical and non-technical factors that
are reasonable for an electric distributor in Latin America. ENSA reported energy losses of 11.83% in 2017 (the company
expects losses of 11.75% in 2018). Although they may prove to be more challenging as the company becomes more effective, further modest improvements to the company's efficiency over the coming years should benefit margins and earnings.

Moderate Regulatory Risk: ENSA faces moderate regulatory risk associated with tariff adjustments, which can directly affect the company's cash flow generation. ENSA's distribution tariffs are based on a price-cap methodology with the value added of distribution (VAD) reset every four years. Additionally, the company is exposed to sovereign risk through the country's continued electricity subsidy. With the goal of bolstering the long-term sustainability of the electricity sector, the scope of the subsidies is gradually being reduced. Tariffs are adjusted on a monthly basis to pass through fuel price changes and, on a semi-annual basis, to reflect changes in the Panamanian consumer price index (CPI).

The government subsidizes electricity consumption in Panama. Since 2003 the fuel component adjustment has not been
fully passed through to distribution companies' customers in the form of tariff increases; the amount not billed to
customers has been subsidized by the Panamanian Government through the FET (Fondo de Estabilizacion Tarifaria -
Tariff Stabilization Fund).

DERIVATION SUMMARY

ENSA's rating is in line with its peers in the region. Its closest rating peers are its parent company Empresas Públicas de
Medellin (EPM) (BBB / Rating Watch Negative) and Grupo de Energia de Bogota (GEB) (BBB / Stable Outlook). Both GEB and EPM benefit from their much larger scale, with annual EBITDA many times that of ENSA. ENSA has a comparatively more stable cash flow, which is also reflected in a smoother leverage trajectory.

Lower-rated peers include Energuate Trust (BB / Stable Outlook) and AES El Salvador Trust II (AES SLV) (B- / Stable Outlook). Both distribution companies are constrained by weaker capital structures and, in particular, exposure to weaker operating environments. AES SLV has been especially affected by the unreliability of subsidy receipts from the government. Energuate's challenges are largely logistical with most of its concession area covering rural areas, which carry concomitant geographic and social challenges. ENSA faces some similar social challenges within some of its coverage area, specifically within the Colon province. However, Colon only constitutes 15.6% of ENSA's client base. Additionally the company benefits from a largely urban user base.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
-- Demand growth linked to Fitch GDP forecast
-- 15-year concession contract starting November 2013 remains in place
-- No material delays in gov't subsidy payments

-- ~USD100 million dividends over next 5 years, consistent with target leverage of 3.5x

RATING SENSITIVITIES

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

- Although a positive rating action is not expected in the short to medium term, developments such as an improved debt-to-EBITDA ratio to below 2.5x on a sustained basis, a higher sovereign rating and absence of subsidy dependence could bode well for the company's rating.

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

- Future developments that may, individually or collectively, lead to a negative rating action include: increased reliance
on government subsidies; weakening of leverage to a range above 3.5x on a sustained basis; tariff adjustments that significantly reduce cash flow generation; increases in debt and/or dividend distribution; sovereign downgrades reflecting deterioration of macroeconomic conditions.

LIQUIDITY

Long-term debt is composed of USD100 million senior unsecured notes due in 2021, and USD80 million senior unsecured notes due in 2027. The company recently refinanced a USD20 million bond due in 2018 and has similar plans for its bond due in 2021. Credit lines totalled USD330 million from eight different banks, both local and international. The company maintains only a nominal cash balance. As of year-end 2017 ENSA held USD4.6 million in cash.

2021 Senior Notes (USD 100M):

The notes have a fixed interest rate of 7.6%, payable semi-annually, and mature in 2021. Principal payment is due upon

maturity. The notes maintain a senior credit position and are unsecured. The Company may redeem the Senior Notes, in
whole or in part, at any time prior to their maturity. Bondholders are AIG and Allstate.

2027 Senior Notes (USD 80M):

The notes were agreed at a fixed rate of 4.73% payable semi-annually, with a maturity date of December 13, 2027. These notes are not rated.

Both notes are governed by the following covenants:
-- Prohibition on creating, assuming, incurring or suffering any Lien on any of the properties or assets of the
Company or its subsidiaries.
-- Not allowing any Subsidiary, in one or a series of transactions, to consolidate or merge with any company or to
assign or transfers, all or most of its property, assets or revenues to any company (other than a Subsidiary of the
Company) or allow any company (other than a Subsidiary of the Company) to merge with or into it.
-- Not allowing the ratio of Consolidated Total Indebtedness to Consolidated EBITDA for the then most recently
ended four fiscal quarters to exceed 3.50x. The Consolidated Total Indebtedness to Consolidated EBITDA may
exceed 3.50x during a period of eligible acquisition or capital investment, no more than twice during the term of
the Notes, provided that during such the Consolidated Total Indebtedness to Consolidated EBITDA Ratio does
not exceed 4.0x.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings:

Elektra Noreste S.A.
--Long-term Foreign Currency IDR at 'BBB';
--Long-term Local Currency IDR at 'BBB';
--Senior unsecured notes at 'BBB'.

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Summary of Financial Statement Adjustments: Fitch incorporates operating leases into off-balance sheet debt using an 8.0x multiple.

For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

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**Applicable Criteria**

Corporate Rating Criteria (pub. 23 Mar 2018)

Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)

**Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form

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