

FITCH AFFIRMS ELEKTRA NORESTE'S IDRS AT 'BBB'; OUTLOOK STABLE

Fitch Ratings-New York-28 August 2017: 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 2016 was 6.6x with EBITDA of USD85 million. Fitch forecasts an annual EBITDA average of around USD90 million during 2017 - 2019, and leverage of around 3.5x in the medium term as the company deploys investments in its network coverage in the future years.

Dividends & Capex Drive Negative FCF: ENSA has recorded negative free cash flow (FCF) in the last years mainly because of its dividend policy and capex program. ENSA pays dividends of up to 100% of the net income of the previous year. During 2016, the company paid USD 20 million of dividends on a 2015 net income of USD31 million. Fitch estimates cumulative capex over the next four years of over USD200 million. A portion of this is related to the existing capex plan of USD271 million for the 2014 - 2018 tariff period. The next tariff cycle (July 2018 to June 2022) will determine the company's investment plan through the medium term.

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+/Negative Outlook), and 48.25% by Panama's 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 electric 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 12.1% in 2015 (the company expects to maintain energy losses at 11.6% level). 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 has gradually been reduced.

Tariffs are adjusted on a monthly basis to pass through fuel price changes and, on a semiannual basis, to reflect changes in the Panamanian consumer price index (CPI).

The government subsidizes electric 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 Publicas de Medellin (EPM) (BBB+ / Stable Outlook) and Empresas de Energia de Bogota (EEB) (BBB / Stable Outlook). Both EEB 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) (CCC). Both DisCos are constrained by weaker capital structure (above 5x gross leverage) 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 the agency's rating case for the issuer include:

- 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 five years, consistent with target leverage of 3.5x.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
-With Debt-to-EBITDA at or above 2.5x, ENSA has modest headroom in the 'BBB' category. Therefore, Fitch does not anticipate positive rating action in the near term.

Future 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 reduce significantly cash flow generation, increases in debt and/or dividends distribution, sovereign downgrades reflecting deterioration of macroeconomic conditions.

LIQUIDITY

Long-term debt is composed USD20 million senior unsecured bonds due in 2018, of USD100 million senior unsecured notes due in 2021, and USD80 million senior unsecured notes due in 2027. The company plans to refinance the debt due in 2018 and 2021. Uncommitted credit lines totalled USD280 million from eight different banks, both local and international. The company maintains only a nominal cash balance. As of year-end 2016 ENSA held USD3.6 million in cash.

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'.

The Rating Outlook is Stable.

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Summary of Financial Statement Adjustments - We incorporate operating leases into off-balance sheet debt using an 8.0x multiple.

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Applicable Criteria

Corporate Rating Criteria (pub. 07 Aug 2017)

<https://www.fitchratings.com/site/re/901296>

Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016)

<https://www.fitchratings.com/site/re/886557>

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