

# **Elektra Noreste, S.A.**

**(a 51% owned subsidiary of Panama  
Distribution Group, S.A.)**

## **Financial Statements**

**For the years ended December 31, 2006  
and 2005, and Independent Auditors'  
Report Dated February 12, 2007**

**Elektra Noreste, S.A.  
(a 51% owned subsidiary of Panama Distribution Group, S.A.)**

**Independent Auditors' Report and  
Financial Statements 2006 and 2005**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of  
Elektra Noreste, S.A.

We have audited the accompanying balance sheet of Elektra Noreste, S.A. (the "Company") as of December 31, 2006, and the related statements of income, changes in equity, and cash flows for the year then ended (expressed in United States dollars). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company for the year ended December 31, 2005 were audited by other auditors whose report, dated January 27, 2006, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2006, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been translated into English for the convenience of readers in the United States of America.

Panama City, Republic of Panama  
February 12, 2007

**Balance Sheets**  
**As of December 31, 2006 and 2005**  
(Expressed in United States dollars)

	Notes	2006	2005		Notes	2006	2005
<b>Assets</b>							
<b>Current assets:</b>							
Cash		\$ 18,266,568	\$ 1,576,063				
Accounts receivable				Liabilities and Stockholders' Equity			
Trade, net	3, 13	44,863,611	39,667,739	Current liabilities:			
Fuel component adjustment	2p, 15	1,561,370	16,724,807	Accounts payable:			
Others, net	13		1,736,060	Generation and transmission	7, 13	\$ 37,911,651	\$ 41,228,848
				Suppliers	7	12,304,961	10,226,889
				Construction contracts		6,894,622	6,674,630
				Advance on tariffs subsidy		1,189,965	
				Others	13	490,726	512,700
				Income tax payable	8	6,638,998	
				Deferred income tax	8		4,115,573
				Customer deposits	9	2,924,546	2,665,177
				Fuel component adjustment	2p, 15	3,500,649	
				Withholding taxes		521,065	257,887
				Total accounts payable			
						72,377,183	65,681,704
Accounts receivable, net							
Inventory	4	6,019,634	7,050,919				
Prepaid income tax							
Deferred income tax							
Other current assets							
Total current assets		72,832,572	68,753,701				
Property, plant, and equipment, net of accumulated depreciation	5	233,865,475	227,837,771				
Other assets:							
Debt issuance costs	6	2,578,909	1,597,611	Total current liabilities		77,436,012	78,394,116
Severance fund		1,077,476	911,843				
Security deposits on facilities		99,175	58,138	Long-term debt	10	99,151,798	90,000,000
Trust fund for long-term loan debt	10		2,500,000	Customer deposits and other liabilities:			
Deferred income tax	8		2,069,550	Deferred income tax	8	1,293,466	
Total other assets				Customer deposits	9	7,482,001	8,923,025
				Other accrued liabilities		2,036,727	2,022,050
				Total liabilities			
						187,400,004	179,339,191
<b>Stockholders' equity:</b>							
Common stock authorized, issued and outstanding: 50,000,000 shares without par value; 160,031 held in treasury							
Retained earnings					12	106,098,875	106,098,875
Accumulated other comprehensive loss					11	16,954,728	16,748,041
							(457,493)
Total stockholders' equity							
Total assets		\$ 310,453,607	\$ 303,728,614	Total liabilities and stockholders' equity		123,053,603	124,389,423
See accompanying notes to financial statements.						\$ 310,453,607	\$ 303,728,614

**Elektra Noreste, S.A.**

(a 51% owned subsidiary of Panama Distribution Group, S.A.)

**Statements of Income****For the years ended December 31, 2006 and 2005****(Expressed in United States dollars)**

	Notes	2006	2005
<b>Revenues:</b>			
Net energy sales		\$ 332,058,802	\$ 263,501,949
Other revenues	14	<u>7,154,622</u>	<u>8,184,575</u>
Total revenues		<u>339,213,424</u>	<u>271,686,524</u>
Purchase of energy and transmission charges, net	13, 15	<u>262,345,409</u>	<u>193,905,488</u>
Gross distribution margin		<u>76,868,015</u>	<u>77,781,036</u>
<b>Operating expenses:</b>			
Labor and other personnel		8,755,447	8,218,840
Severance expenses		327,955	195,942
Provision for doubtful account		2,484,940	1,343,191
Repair and maintenance		2,800,678	2,575,193
Professional services		9,275,226	8,499,148
Management fees	13	1,871,726	1,943,000
Depreciation and amortization		12,226,709	11,890,034
Administrative and other		7,074,152	7,517,199
Loss on sale of fixed asset	5	<u>198,789</u>	<u>1,005,214</u>
Total operating expenses		<u>45,015,622</u>	<u>43,187,761</u>
Operating income		<u>31,852,393</u>	<u>34,593,275</u>
<b>Other income (expense):</b>			
Interest income		1,391,671	854,841
Interest expense	11, 16	(6,915,122)	(7,639,719)
Loss on sale of investment	15	<u>(414,368)</u>	
Total other expenses		<u>(5,937,819)</u>	<u>(6,784,878)</u>
Income before income taxes		<u>25,914,574</u>	<u>27,808,397</u>
<b>Income taxes:</b>	8		
Current		10,569,293	2,700,530
Deferred expense (benefit)		<u>(2,685,880)</u>	<u>5,871,022</u>
Total income taxes		<u>7,883,413</u>	<u>8,571,552</u>
Net income		<u>\$ 18,031,161</u>	<u>\$ 19,236,845</u>

See accompanying notes to financial statements.

**Elektra Noreste, S.A.**

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**Statements of Changes in Equity**

For the years ended December 31, 2006 and 2005

(Expressed in United States dollars)

	Notes	Common Stock	Treasury Stock	Retained Earnings	Other Comprehensive Income (loss)	Total Equity
Balance as of January 1, 2005		\$ 106,642,962	\$ (544,087)	\$ 4,011,196	\$	\$ 110,110,071
Net income				19,236,845		19,236,845
Net unrealized loss on hedging instruments, net of taxes of \$196,068	11				(457,493)	(457,493)
Dividends declared		_____	_____	(4,500,000)	_____	(4,500,000)
Balance as of December 31, 2005		106,642,962	(544,087)	18,748,041	(457,493)	124,389,423
Net income				18,031,161		18,031,161
Adjustment of other comprehensive income, net	11				457,493	457,493
Dividends declared		_____	_____	(20,000,000)	_____	(20,000,000)
Complementary dividend tax	12	_____	_____	175,526	_____	175,526
Balance as of December 31, 2006		<u>\$ 106,642,962</u>	<u>\$ (544,087)</u>	<u>\$ 16,954,728</u>	<u>\$</u>	<u>\$ 123,053,603</u>

See accompanying notes to financial statements.

**Elektra Noreste, S.A.**

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**Statements of Cash Flows****For the years ended December 31, 2006 and 2005****(Expressed in United States dollars)**

	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 18,031,161	\$ 19,236,845
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,226,709	11,890,034
Loss on sale of fixed asset	198,789	1,005,214
Loss on sale of investment	414,368	
Provision for doubtful accounts	2,590,869	1,483,867
Discount amortization of senior notes	15,798	
Amortization of debt issuance costs	1,644,820	252,466
Provision for severance payments net of contribution to severance fund	(52,748)	(4,739)
Deferred income tax	(2,685,882)	5,871,022
Fuel component adjustment	7,276,456	(15,559,801)
<b>Change in operating assets and liabilities:</b>		
Accounts receivable	(7,612,051)	(7,249,951)
Prepaid expenses	(93,401)	28,813
Inventory	1,031,285	1,503,286
Advances to suppliers	238,910	115,358
Deposits on facilities	(41,037)	1,981
Trade accounts payable and other liabilities	2,202,643	17,897,423
Income tax, net	8,107,468	(5,019,942)
Seniority premium payments	<u>(70,490)</u>	<u>(163,473)</u>
 Net cash provided by operating activities	 <u>43,423,667</u>	 <u>31,288,403</u>
 <b>Cash flows from investing activities:</b>		
Acquisition of fixed assets	(19,307,280)	(19,473,247)
Proceeds from sales of fixed assets	854,078	193,786
Withdrawal from trust fund	2,500,000	
Proceeds from sale of investment	<u>12,534,632</u>	<u></u>
 Net cash used in investing activities	 <u>(3,418,570)</u>	 <u>(19,279,461)</u>

(Continued)

**Elektra Noreste, S.A.**

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**Statements of Cash Flows****For the years ended December 31, 2006 and 2005****(Expressed in United States dollars)**

	<b>2006</b>	<b>2005</b>
<b>Cash flows from financing activities:</b>		
Repayment of long-term debt	\$ (95,000,000)	\$ (5,000,000)
Proceeds from long-term debt	99,136,000	
Short-term debt, net	(5,000,000)	5,000,000
Dividends paid	(20,000,000)	(16,917,165)
Debt issuance costs	(2,626,118)	(60,228)
Complementary dividend tax	<u>175,526</u>	<u></u>
 Net cash used in financing activities	 <u>(23,314,592)</u>	 <u>(16,977,393)</u>
 <b>Cash and cash equivalents:</b>		
Net increase (decrease) for the year	16,690,505	(4,968,451)
Beginning of year	<u>1,576,063</u>	<u>6,544,514</u>
 End of year	 <u>\$ 18,266,568</u>	 <u>\$ 1,576,063</u>
 <b>Supplemental disclosure of cash flow information:</b>		
<b>Cash paid during the year for:</b>		
Interest	<u>\$ 5,982,546</u>	<u>\$ 7,034,743</u>
Income taxes	<u>\$ 2,461,822</u>	<u>\$ 7,472,155</u>

(Concluded)

See accompanying notes to financial statements.

**Elektra Noreste, S.A.**  
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**Notes to financial statements**  
**For the years ended December 31, 2006 and 2005**  
**(Expressed in United States dollars)**

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**1. Nature of Business and Basis of Presentation**

***Nature of Business***

Elektra Noreste, S.A. (the Company) is a corporation formed as a result of the privatization of the Institute for Hydraulic Resources and Electricity (Instituto de Recursos Hídricos y Electrificación ("IRHE") in Spanish). The Company was incorporated by means of Public Deed No.143, dated January 19, 1998, and began operations in January 1998. The authorized capital stock of the Company consists of fifty million common shares without par value. At present, Panama Distribution Group, S.A. ("PDG") owns 51% of the authorized, issued and outstanding shares of common stock of the Company, while the Panamanian Government and employees own 48.25% and 0.43%, respectively. The remaining amount of shares is held as treasury stock.

The activities of the Company include the purchase of energy in blocks and its transportation through the distribution network to customers. The Company performs voltage transformation, delivers the power to end consumers, and performs meter reading, billing and collections. The Company is also responsible for installing, operating, and maintaining public lighting in the concession zone (as defined in the following paragraph), according to the lighting levels and criteria established by the Public Services Authority (Autoridad Nacional de los Servicios Públicos ("ASEP") in Spanish). Additionally, the Company is authorized to perform power generation activities up to a limit of 15% of the maximum demand and energy in the concession zone.

According to the concession contract described in Note 17, the Company has exclusivity for the distribution and marketing of electric power to customers located in the geographical areas of Panama East, Colon, Panama Bay, and the Comarca of San Blas and Darien (indigenous reserve). In regard to "large customers," defined by Law 6, dated February 3, 1997, as customers with a maximum demand over 100 KW per site that have the option to purchase energy directly from other agents of the electricity market, the Company has exclusivity for only the distribution of electricity.

***Basis of Presentation***

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

The financial statements have been prepared on the historical cost basis.

## **Elektra Noreste, S.A.**

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### **Notes to financial statements**

**For the years ended December 31, 2006 and 2005**

**(Expressed in United States dollars)**

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Records are maintained in balboas, the currency of the country in which the Company is incorporated and operates. The translation of balboas amounts into U.S. dollar amounts are included solely for the convenience of readers in the United States of America, and as of December 31, 2006 and 2005, and for the years then ended were on a par with and freely exchangeable for U.S. dollar. The Republic of Panama does not issue paper currency and uses the U.S. dollar as legal tender.

## **2. Significant Accounting Policies**

A summary of the significant accounting policies used in the preparation of the accompanying financial statements follows:

- a. *Cash and Cash Equivalents*** - All highly liquid investments with original maturities of three months or less are classified as cash equivalents.
- b. *Accounts Receivable*** - Accounts receivable are recorded at the invoiced amount and bear interest on past due amounts. The interest is recognized up until customer account is closed or terminated, which occurred approximately after 90 days after the electric suspension.

It is the Company's policy to review outstanding accounts receivable on a monthly basis and adjust the corresponding allowance for doubtful accounts.

Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by customer type. Account balances are written off after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers.

- c. *Fuel Component Adjustment*** - The regulated system under which the Company operates provides that any excess or deficiency between the estimated energy costs included in the tariff and the actual costs incurred by the Company be included as a compensation adjustment to be recovered from or refunded to customers in the next tariff charges semi annual adjustment. Any excess in energy costs charged to customers is accrued in the accounts payable on the balance sheet and leads to a reduction in the next tariff charges adjustment. Conversely, any deficit in energy cost charged to customers is accrued in the account receivable on the balance sheet and leads to an increase in the next tariff charges adjustment to be recovered from customers.

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**Notes to financial statements**

**For the years ended December 31, 2006 and 2005**

**(Expressed in United States dollars)**

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**d. *Inventory*** - Inventory consists primarily of materials and supplies for the Company's consumption. Inventory is accounted for at the lower of cost or market. Cost is determined using the average cost method.

**e. *Property, Plant, and Equipment*** - Upon the Company's formation, the IRHE transferred a portion of its productive assets stated at historical cost net of the associated accumulated depreciation. New asset acquisitions and construction in progress are recorded at their original cost which includes materials, contractor costs, construction overhead and financing costs. The Company reports property, plant and equipment on the balance sheet net of accumulated depreciation.

Costs associated with improvements made to property, plant and equipment are capitalized as well as major disbursements for renewals. Costs associated with repairs and minor replacements are expensed as incurred. Major maintenance costs procedures that do not extend the useful life by improving the conditions of the asset to the state it held when it was originally purchased are also expensed. The Company also capitalizes interest during construction in accordance with Statement of Financial Accounting Standards ("SFAS") No.34, "Capitalization of Interest Costs".

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable through operations, in accordance with SFAS No.144, "Accounting for the Impairment or Disposal of Long-Lived Assets." If the carrying amount of the asset exceeds the expected undiscounted future cash flows generated by the asset or group of assets, an impairment loss is recognized and the asset is written down to its fair value. Fair value can be determined by the use of quoted market prices, appraisals or other valuation techniques, such as expected discounted future cash flows. Management judgment is involved in both deciding whether testing for recoverability is necessary and estimating undiscounted cash flows. As of December 31, 2006, no impairments of long-lived assets were identified.

Gains or losses on property, plant and equipment are recognized when the assets are retired or otherwise disposed of. The difference between the net book value of the property and any proceeds received for the property is recorded as a gain or loss.

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**Notes to financial statements**  
**For the years ended December 31, 2006 and 2005**  
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Depreciation and amortization are calculated on the straight-line method over the estimated useful lives of the assets. Estimated useful lives used for each fixed asset category are shown below:

	<b><u>Estimated Useful Life (in years)</u></b>
Poles, towers and accessories	30 to 40
Electric transformers	30
Underground conductors and ducts	40
Overhead conductors and accessories	25 to 35
Substation equipment	30
Consumer meters	30
Buildings and improvements	25 to 40
Public lighting equipment	25
Transportation and communications equipment	8 and 15
Office furniture and equipment	5 to 20

**f. Debt Issuance Costs** - The Company defers all costs related to the issuance of long-term debt. These costs include borrowers' commissions and other costs such as legal, registration and stamp costs. Debt issuance costs are amortized over the term of the debt instrument using the effective interest method.

**g. Purchased Energy and Transmission Charges** - The Company records the annual cost of purchased energy obtained under long-term and short-term contracts in the Statements of Income. These contracts are considered executory in nature, since they do not convey to the Company the right to use the related property, plant or equipment. The Company also engages in short-term hourly purchases in the wholesale markets, which is administered by the National Dispatch Center (Centro Nacional de Despacho ("CND") in Spanish).

The Company also pays a regulated tariff to ETESA, a company fully-owned by the Panamanian Government for connecting to and for use of the transmission system. ETESA is responsible for expanding and upgrading the interconnecting transmission system to meet the requirements of demand growth and system stability. The current transmission tariff is due to remain in force until June 30, 2009.

**h. Income Taxes** - Income taxes are accounted for under the asset-liability method as prescribed by SFAS No.109, "Accounting for Income Taxes." Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and

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### **Notes to financial statements**

**For the years ended December 31, 2006 and 2005**

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liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

- i. Investment Tax Credit** - The Company accounts for Investment Tax Credit ("ITC") under the flow-through accounting method (full recognition in the period the asset is placed in service). Thus, a future deductible temporary difference exists, with which a deferred income tax asset is associated.
- j. Customer Deposits** - The Company requires customers to provide cash deposits as a guarantee of payment for energy consumed, according to the legislation set forth by the ASEP. The ASEP has issued resolutions JD-219 (March 31, 1998) and JD-761 (June 8, 1998) which provide that in those cases where the customer has established a good payment record, defined as no more than three late payments in a twelve-month period, the deposit shall be returned.
- k. Derivatives** - The Company records derivatives according to SFAS No. 133 "Accounting for Derivatives Instruments and Hedging Activities". The changes in the value of derivatives that are not designated as cash-flow hedges are recorded in earnings during the period of change. The Company records changes in the value of derivatives designated as cash-flow hedges that are effective in offsetting the variability in cash flows of forecasted transactions in other comprehensive income until the forecasted transactions occur. At the time the forecasted transactions occur, the Company reclassifies the amounts recorded in other comprehensive income into earnings. The Company records the ineffective portion of changes in the fair value of derivatives used as cash-flow hedges immediately in earnings.
- l. Comprehensive Income** - Comprehensive income is represented by the net income for the period plus the effect of the net unrealized gain (loss) on hedging instruments, net of tax.

Comprehensive income for the years ended December 31, 2006 and 2005, is as follows:

	<b>2006</b>	<b>2005</b>
Net income	\$ 18,031,161	\$ 19,236,845
Net unrealized loss on hedging instruments, net of taxes	<hr/>	<hr/>
Comprehensive income	<hr/> <u>\$ 18,031,161</u>	<hr/> <u>\$ 18,779,352</u>

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**Notes to financial statements**  
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***m. Contingencies*** - In the normal course of business, the Company is subject to various regulatory actions, proceedings, and lawsuits related to tax or other legal matters. The Company establishes reserves for these potential contingencies when they are deemed probable and reasonably estimable. For further discussion of contingencies, see Note 17.

***n. Seniority Premium and Severance Fund*** - According to the Panamanian Labor Code, upon the termination of any employee contracted for an indefinite period of time, regardless the cause, the employee is entitled to a seniority premium at the rate of one week's salary for every year of work, since they were first employed. Seniority premiums represent 1.92% of total salaries paid.

Law 44 of 1995 introduced reforms to the Panamanian Labor Code by requiring all employers to make a cash contribution to a severance fund that would cover the payment to employees of a seniority premium and severance for unjustified dismissal. The Company maintains a trust fund through an authorized private entity, Progreso, S. A., who acts as trustee to secure the severance fund liability.

***o. Related Parties*** - As a result of the restructuring of the electricity sector of Panama, three distribution companies, four generating companies and one transmission company were formed. The Panamanian Government retains an approximate fifty-one percent (51%) interest in the hydraulic generating companies, a forty-nine percent (49%) interest in the thermal generating company and distribution companies, and a one hundred percent (100%) interest in the transmission company. The Panamanian Government retained 48.25% of the Company's stock and 0.43% is owned by present and former IRHE employees.

In the normal course of business, the Company purchases electricity from the generating and other distribution companies, sells energy to governmental institutions and makes payments to the transmission company. The Company recognizes these activities as related party transactions.

The Company entered into a Management Consulting Agreement with CPI, Ltd., which owns 100% of the PDG shares. PDG owns 51% of the Company's authorized issued and outstanding shares of common stock. The Company records the related fees derived from the agreement as management fees within the Statements of Income and any outstanding unpaid balance with CPI, Ltd. is shown in the balance sheets as a related company payable.

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**Notes to financial statements**

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**(Expressed in United States dollars)**

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**p. Utility Regulation** - The Company is subject to regulation by the ASEP. This agency regulates and makes the final determination regarding the rates the Company charges to its customers. The Company maintains its accounts in accordance with the Uniform System of Accounts prescribed for electric utilities by the ASEP.

The Company is subject to the provisions of FASB Statement No.71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS No.71"). Regulatory assets represent probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be credited to customers through the ratemaking process.

Regulatory assets and (liabilities) reflected in the Company's balance sheets at December 31 relate to the following:

	<b>2006</b>	<b>2005</b>	<b>Note</b>
Fuel component adjustment - asset (liabilities)	\$ (3,500,649)	\$ 16,724,807	See "Fuel component adjustment", see Note 15
Deferred income tax - asset (liabilities)	<u>1,050,195</u>	<u>(5,017,440)</u>	
	<u><b>\$ (2,450,454)</b></u>	<u><b>\$ 11,707,367</b></u>	

In the event that a portion of the Company's operations is no longer subject to the provisions of SFAS No.71, the Company would be required to write off related regulatory assets and liabilities that are not specifically recoverable through regulated rates. In addition, the Company would be required to determine if any impairment to other assets, including plant, exists and, if impaired, write down the assets to their fair value.

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**Notes to financial statements**  
**For the years ended December 31, 2006 and 2005**  
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***q. Revenue Recognition***

**Energy Sales**

The Company recognizes its revenues for energy sales when service is delivered to and consumed by customers. The Company bills customers based on meter readings that are performed on a systematic basis throughout the month. The applicable rates used to bill the customers include energy cost and distribution components. The energy cost component operates as a pass-through for the energy purchased and transmission charges while the distribution components in the tariff are set by the ASEP to allow distributors to recover the cost of operating, maintenance, administration and commercial expenses, depreciation, standard energy losses and also to obtain a fair return on their investment. The energy cost component is adjusted every six months to reflect fluctuations in energy costs and the distribution components are adjusted based on the consumer price index.

At the end of the year, the Company recognizes revenue for energy sales that have not yet been billed, but where electricity has been consumed by customers. This revenue is recorded as unbilled revenue within the trade receivables on the balance sheet and is calculated based on actual daily average energy consumption and applicable rates to the customers of the Company. The Company believes that it is unlikely that subsequent bills will be materially different from accruals.

**Other Revenues**

The Company recognizes connection and reconnection charges, pole rentals, and wheeling charges as service is rendered. These charges are included in other operating income in the Statements of Income.

***r. Use of Estimates*** - The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates include but are not limited to the useful lives for depreciation and amortization, allowances for doubtful accounts receivable, estimates of future cash flows associated with asset impairments, loss contingencies, collectibility of the fuel component adjustment receivable, derivatives and estimated unbilled revenue. The estimates and assumptions used are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results could differ from those estimates.

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- s. Concentration of Credit Risk** - The Company has exclusivity for the distribution and marketing of electric power to customers located in its concession zone. The Company does not believe that significant risk of loss from a concentration of credit risk exists given the large number of customers that comprise its customer base and their geographical dispersion. The Company also believes that its potential credit risk is adequately covered by the allowance for doubtful account.
- t. Environmental Matters** - The Company is subject to a broad range of environmental, health and safety laws and regulations. In July 1998, the Panamanian Government enacted environmental legislation creating an environmental protection agency (Autoridad Nacional del Ambiente ("ANAM") in Spanish) and imposing new environmental standards affecting the Company's operations. Failure to comply with these applicable environmental standards, stricter laws and regulations may require additional investments or may adversely affect the Company's financial results.

Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated based on current law.

Established accruals are adjusted periodically due to new assessments and remediation efforts or as additional technical and legal information become available.

Environmental costs are capitalized if the costs extend the life of the property, increase its capacity and mitigate or prevent contamination from future operations. Costs related to environmental contamination treatment and clean-up are charged to expense.

- u. Reclassifications** - Certain amounts in the financial statements as of and for the year ended December 31, 2005 have been reclassified in order to conform to the presentation of the financial statements as of and for the year ended December 31, 2006.

**v. Application of Recent Accounting Pronouncements**

In March 2005, the Financial Accounting Standards Board (FASB) issued Interpretation No.47, "Accounting for Conditional Asset Retirement Obligations." The Interpretation clarifies the accounting for a conditional asset retirement obligation as identified in SFAS No.143, "Accounting for Asset Retirement Obligations." Interpretation No.47 refers to a legal obligation to perform an asset

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retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The interpretation requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. This interpretation is effective for the 2006 fiscal year. The Company does not have any legal obligations to perform asset retirement activity.

In May 2005, the FASB issued SFAS No.154, "Accounting Changes and Error Corrections - a replacement of APB Opinion No.20 and FASB Statement No.3", or SFAS No.154. SFAS No.154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No.154 also requires that a change in depreciation, amortization or depletion method for long lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS No.154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 14, 2005. Neither accounting changes nor error corrections has occurred in the year; consequently the adoption has no impacted the financial condition or results.

In June 2006, the FASB released FASB Interpretation ("FIN No.48"), "Accounting for Uncertainly in Income Taxes" an Interpretation of FASB Statement No.109. FIN No.48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. Under the interpretation, the financial statements will reflect expected future tax consequences of such positions presuming the tax authorities' full knowledge of the position and relevant facts. This interpretation is effective for annual periods beginning after December 15, 2006. Accordingly, the Company expects to adopt FIN No.48 on January 1, 2007. The Company is currently reviewing this interpretation to determine the effects on its financial statements, but expect no change to its tax disclosure.

In September 2006, the FASB issued FASB Statement No.157, Fair Value Measurements (SFAS No.157). SFAS No.157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Under SFAS No.157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. The standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability. SFAS No.157 will be effective as of January 1, 2008. The Company is currently assessing the impact that SFAS No.157 may have on its financial statements, but expect no material change in the financial condition or results.

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In June, 2006, the FASB ratified the consensus reached by the FASB's Emerging Issues Task Force ("EITF") on EITF Issue 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation). The scope of this Issue includes taxes that are externally imposed on a revenue producing transaction between a seller and a customer. The EITF concluded that a company should disclose its accounting policy (i.e., gross or net presentation) regarding presentation of such taxes. If taxes included in gross revenues are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. This Issue is effective for the first annual or interim reporting period beginning after December 15, 2006. The Company records such taxes on a net basis; and does not expect this statement to have any impact on its financial statements.

**3. Accounts Receivable – Trade**

At December 31, 2006 and 2005, accounts receivable – trade, are as follows:

	<b>2006</b>	<b>2005</b>
Customers	\$ 32,563,978	\$ 28,993,323
Government and municipal entities	<u>9,370,347</u>	<u>5,668,078</u>
	41,934,325	34,661,401
Unbilled revenue	6,747,192	6,624,154
Government subsidy	<u>2,914,640</u>	<u>2,914,640</u>
	48,681,517	44,200,195
Allowance for doubtful accounts	<u>(3,817,906)</u>	<u>(4,532,456)</u>
Total	<u>\$ 44,863,611</u>	<u>\$ 39,667,739</u>

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**4. Inventory**

At December 31, 2006 and 2005, inventory is composed of the following:

	<b>2006</b>	<b>2005</b>
Materials and supplies	\$ 5,282,480	\$ 6,362,665
Tools and spare parts	<u>737,154</u>	<u>688,254</u>
<b>Total</b>	<b>\$ 6,019,634</b>	<b>\$ 7,050,919</b>

**5. Property, Plant, and Equipment**

At December 31, 2006 and 2005, property, plant and equipment are as follows:

	<b>2006</b>	<b>2005</b>
Poles, towers and accessories	\$ 76,905,717	\$ 77,431,920
Electric transformers	37,270,524	36,336,355
Underground conductors and ducts	52,759,513	48,493,512
Consumer services	26,279,267	25,279,049
Overhead conductors and accessories	24,321,583	21,020,729
Substation equipment	46,416,250	43,373,192
Consumer meters	20,806,792	19,412,171
Buildings and improvements	12,930,061	11,789,783
Public lighting equipment	11,354,095	11,153,615
Transportation and communication equipment	7,138,358	7,386,476
Office furniture and equipment	13,865,610	13,189,788
Construction in progress	14,019,842	13,840,455
Other	<u>2,353,807</u>	<u>2,303,688</u>
	346,421,419	331,010,733
Less: Accumulated depreciation and amortization	<u>(115,702,427)</u>	<u>(105,879,498)</u>
	230,718,992	225,131,235
Land	<u>3,146,483</u>	<u>2,706,536</u>
	<u><b>\$ 233,865,475</b></u>	<u><b>\$ 227,837,771</b></u>

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At December 31, 2006 and 2005, the Company incurred a loss of US\$198,789 and US\$1,005,214 respectively on the disposal of equipment, which is reflected in the Company's Statements of Income.

At December 31, 2005 the Company had pledged property, plant and equipment as collateral for bank debt. The amount pledged includes certain property, plant and equipment at December 31, 2005 up to a total value of US\$65,000,000. At July 2006, all the guarantees and mortgages were released with the repayment of the bank debt.

**6. Debt Issuance Costs**

At December 31, 2006 and 2005, deferred costs are as follows:

	<b>2006</b>	<b>2005</b>
Beginning balance	\$ 1,597,611	\$ 1,789,849
New costs	2,626,118	60,228
Amortization	<u>(1,644,820)</u>	<u>(252,466)</u>
	<u><u>\$ 2,578,909</u></u>	<u><u>\$ 1,597,611</u></u>

At December 31, 2006, the debt issuance cost corresponds to Senior Notes issued pursuant to an Indenture between the Company and the Bank of New York. In 2006, the amortization includes US\$ 1,438,774 associated to the cancellation of the Syndicated Long-Term Loan.

At December 31, 2005, the debt issuance costs, legal fees, and registration costs correspond to a syndicated long-term loan granted by four banks as discussed in Note 10. The balances of the syndicated long-term loan were paid with the net proceeds from the offering of the Senior Notes mentioned above.

The debt issuance costs are being amortized under the effective interest method over the repayment period of the Senior Notes.

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**7. Accounts Payable**

**Generation and Transmission** - At December 31, 2006 and 2005, accounts payable to generation and transmission companies are as follows:

	<b>2006</b>	<b>2005</b>
PanAM Generating Ltd.	\$ 6,182,374	\$ 3,432,429
Pedregal Power Company	4,520,349	930,919
Térmica del Noreste, S. A.	1,606,605	1,832,273
Corporación Panameña de Energía, S. A.	36,097	163,791
Others	<u>29,485</u>	<u>71,022</u>
	12,374,910	6,430,434
<b>Related Parties</b>		
AES Panamá, S. A.	10,934,618	14,176,444
Autoridad del Canal de Panamá	2,101,042	881,435
Empresa de Generación Eléctrica Bahía Las Minas Corp.	9,696,021	13,590,812
Empresa de Generación Eléctrica Fortuna, S. A.	1,187,983	2,496,879
Empresa de Transmisión Eléctrica, S. A.	<u>1,617,077</u>	<u>3,652,844</u>
	25,536,741	34,798,414
	<u>\$ 37,911,651</u>	<u>\$ 41,228,848</u>

**Suppliers** - At December 31, 2006 and 2005, accounts payable to suppliers are as follows:

	<b>2006</b>	<b>2005</b>
Construction contractors	\$ 4,089,487	\$ 3,746,370
Maintenance and repairs	1,140,950	1,491,582
Materials and inventory	3,700,466	1,572,013
Outsourcing and services	1,910,392	1,307,722
Telecommunication	130,852	258,380
Others	<u>1,332,814</u>	<u>1,850,822</u>
	<u>\$ 12,304,961</u>	<u>\$ 10,226,889</u>

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**8. Income Tax**

The provision for income tax is determined based on book income before income taxes, adjusted for any non-taxable income and non-deductible expenses. The statutory income tax rate is 30%. Deferred income tax is recognized for the effects of all temporary differences between the book and tax basis of assets and liabilities. A valuation reserve is recorded to reduce the value of deferred tax assets when it is more likely than not that tax benefits will not be totally realized.

The difference between the provision for income tax for the years ended December 31, 2006 and 2005, and the income tax calculated using the enacted statutory corporate tax rate of 30% for income before income tax reported in the financial statements is attributable to the following:

	<b>2006</b>	<b>2005</b>
<b>Income tax:</b>		
Computed at expected statutory rate	\$ 7,774,372	\$ 8,342,519
Decrease in income tax due to non-taxable income	(161,509)	(198,163)
Increase in income tax due to non-deductible expenses	270,550	38,697
Effect of change on enacted rate	<hr/>	<hr/>
Total income tax	<hr/> <u>\$ 7,883,413</u>	<hr/> <u>\$ 8,571,552</u>

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Deferred income tax assets and liabilities recognized on temporary differences that will be reversed in future periods, are as follows:

	<b>2006</b>	<b>2005</b>
Current deferred income tax assets:		
Provision for doubtful accounts	\$ 405,974	\$ 358,177
Treasury lock derivative		196,068
Fuel component adjustment	1,050,195	
Other	281,086	347,622
Total deferred income tax assets	<u>1,737,255</u>	<u>901,867</u>
Current liabilities-fuel component adjustment		(5,017,440)
Current deferred income tax asset (liabilities), net	<u>\$ 1,737,255</u>	<u>\$ (4,115,573)</u>
	<b>2006</b>	<b>2005</b>
Non-current deferred income tax assets:		
Investment tax credit	\$ 1,576,234	\$ 5,075,988
Provision for contingencies	<u>333,688</u>	<u>333,688</u>
Total deferred income tax asset	<u>1,909,922</u>	<u>5,409,676</u>
Non-current liabilities-depreciation expense	<u>(3,203,388)</u>	<u>(3,340,126)</u>
Non-current deferred income tax (liabilities) assets, net	<u>\$ (1,293,466)</u>	<u>\$ 2,069,550</u>

The Company estimates that it is more likely than not that there will be enough income tax payable in future years to allow for the use of the deductible temporary differences included in the balance sheet as of December 31, 2006.

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In accordance with tax regulations, the income tax returns of companies in Panama are open for examination by the tax authorities for three years. Companies are also subject to examination by the Panamanian tax authorities regarding compliance with stamp tax regulations.

**Investment Tax Credit**

During 2001, the Company received an investment tax credit of US\$13,673,745 which was granted by the Panamanian Government under an incentive law that promoted investments in infrastructure to enhance the energy distribution network. The tax credit can be used as a reduction of up to 25% of the income tax incurred in any given year, until 100% of the amount pending to be realized in future years is consumed.

Due to the benefit received, the Company is not allowed to deduct for tax purposes, the depreciation on the US\$13,673,745 of infrastructure invested. The tax effect of this is US\$4,102,123 (US\$13,673,745 x 30%).

**9. Customer Deposits**

At December 31, 2006 and 2005, the Company estimated that the amount of deposits to be returned to customers during fiscal year 2007 will be US\$2,924,546 (including accrued interest of US\$361,887) and was US\$2,665,177 (including accrued interest of US\$165,177), in fiscal year 2006.

The activity in the customer deposits accounts for the years 2006 and 2005 is as follows:

	<b>2006</b>	<b>2005</b>
Beginning balance	\$ 11,588,202	\$ 12,177,280
Deposits received from customers	1,433,398	1,409,362
Interest accrued	494,408	257,779
Deposits returned to customers	(2,811,763)	(2,033,033)
Interest paid	<u>(297,698)</u>	<u>(223,186)</u>
Ending balance	10,406,547	11,588,202
Current portion	<u>(2,924,546)</u>	<u>(2,665,177)</u>
Long-term portion	<u>\$ 7,482,001</u>	<u>\$ 8,923,025</u>

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**10. Debt**

At December 31, 2006 and 2005, notes and bank debt is as follows:

	<b>2006</b>	<b>2005</b>
<b>Short-Term Facilities:</b>		
The Bank of Nova Scotia	\$ _____	\$ 5,000,000
<b>Long-Term Notes</b>		
Senior Notes, unsecured and unsubordinated due on 2021 with fixed rate of 7.60% per annum and semiannual interest payments	100,000,000	
<b>Long-Term Bank Debt:</b>		
Syndicated long-term loan, with an annual eurodollar rate of 3 months + 3.50%, assigned as follows:		
Banco Continental de Panamá, S. A.	33,250,000	
Primer Banco del Istmo, S. A.	33,250,000	
Citibank, N.A., Panama Branch	19,000,000	
Banco Bilbao Vizcaya Argentaria (Panamá), S. A.	9,500,000	
Total debt	100,000,000	100,000,000
Less:		
Senior notes discount	(848,202)	
Current portion	(10,000,000)	
Long-term debt	<u>\$ 99,151,798</u>	<u>\$ 90,000,000</u>

The Senior Notes were issued pursuant to an indenture between the Company as issuer, and the Bank of New York, as trustee. The terms of the Indenture includes a financial covenant that impose the Company to comply with the ratio of indebtedness to EBITDA (as defined on the Indenture) not to exceed 3.25 to 1.0 for the four consecutive fiscal quarters most recent available. The Company is in compliance with all the provisions and covenants of the indenture.

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Unless previously redeemed, or purchased and cancelled, the Notes shall be redeemed at their principal amount in U.S. dollars on the final maturity date. The redemption price payable at such time shall be the original amount of the Notes plus accrued and unpaid interest thereon at the Note Rate and all other amounts due and payable under the terms of the Notes and the Indenture.

The net proceeds from the offering of these Senior Notes were used to repay the principal and interest on the Company's Syndicated Long-Term Loan; to pay the expenses of the offering of the Notes and to the extent there are amounts remaining; to pay outstanding short-term indebtedness and for general corporate purposes.

With the final settlement of the Syndicated Long-Term Agreement in July 2006, all the guarantees and mortgages set forth under the agreement were released with the repayment of the indebtedness.

The Company maintains revolving credit lines with Bank of Nova Scotia, Banco Bilbao Vizcaya Argentaria (Panamá), S. A., Banco General, S. A., and Citibank, N. A. Total short-term facilities of US\$50,300,000 in 2006 and US\$43,300,000 in 2005 with annual interest rates ranging between 6 months Libor + 1.20% and 1.50%. These unsecured credit facilities are available with a maximum tenor of up to one year. The Company uses these facilities as needed for working capital and other needs. The Company had no outstanding debt under these credit lines, at December 31, 2006, but owed US\$5,000,000 at December 31, 2005.

### **11. Derivative Instrument**

On December 22, 2005, the Company entered into a rate lock agreement exclusively as a tool to fix the yield on a specified treasury security used in connection with an upcoming issuance of a fixed-rate debt to minimize the Company's exposure to an increase in interest rates. This treasury lock was entered with Citibank N.A., New York, for a 120-day period and a notional amount of US\$100,000,000, which was originally designated as a cash flow hedge of the forecasted interest payments on the expected debt offering. This transaction is reflected as of December 31, 2005 within other comprehensive income (loss) as an after-tax loss in the amount of US\$457,493.

As of June 30, 2006 the Company decided to terminate this treasury lock agreement and consequently to discontinue its cash flow hedge accounting since criteria to qualify as a cash flow hedge were not maintained. Accordingly, a pre-tax gain of US\$4,050,000 was reclassified into earnings and included under interest expense on the Statement of Income representing the mark-to-market value at the termination date.

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## **12. Dividend Tax and Treasury Stocks**

### ***Dividend Tax***

Dividends are paid to shareholders net of withholding taxes that the Company pays on behalf of its shareholders. The complementary dividend tax payments are recorded as a reduction to stockholders' equity.

### ***Treasury Stocks***

In 1998, as consequence of the privatization process, the Company's employees had the option to purchase a portion of the common stock of the Company. In the event that employees wish to sell their previously acquired stock, the Company is no longer required to repurchase the stock.

## **13. Related Party Transactions**

### ***Energy Sales and Purchases and Transmission***

In the normal course of business, the Company purchases electricity from the generation and other distribution companies, sells energy to governmental institutions and makes payments to the transmission company. These transactions are made under the terms and conditions of the power purchase agreements and the transmission tariff (See Notes 2 and 17). A summary of the balances and amounts derived from the purchase and sale of energy with related parties is as follows:

<b>Balances</b>	<b>2006</b>	<b>2005</b>
Accounts receivable (trade) - government	\$ 9,370,347	\$ 5,668,078
Accounts receivable (trade) - government subsidy		2,914,640
Accounts receivable (others) – Prisma Energy Int'l. Services, LLC	13,123	
Accounts payable (generation and transmission)	25,536,741	34,798,414

### ***Transaction***

Revenues	\$ 36,178,367	\$ 31,935,581
Purchases of energy	153,981,863	173,187,346
Transmission costs	10,116,511	8,343,175

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***Management Consulting Agreement*** - The Company entered into a Management Consulting Agreement in 1998 with CPI, Ltd. ("the Operator"), the successor to Constellation Power, Inc.

Under this agreement, CPI, Ltd's employees, agents, consultants, contractors or affiliates shall perform the following services:

- Review the business plan of the Company and make the necessary recommendations to the board of directors;
- Provide on-going advice concerning day-to-day operations of the Company, including accounting, billing, quality control, environmental matters, and safety;
- Prepare the annual business plan of the Company in cooperation with senior management;
- Investigate and make recommendations to the board, from time to time, regarding business development opportunities and corporate strategic planning, including potential expansion; and;
- Review all contracts with third parties exceeding an annual value of US\$100,000.

The Company pays the Operator an annual fee as compensation for the performance of its obligations under this agreement in an amount equal to six percent (6%) of earnings before interest, taxes, depreciation and amortization for the first five years of the concession contract and four percent (4%) of earnings before interest, taxes, depreciation and amortization beginning November 1, 2003.

At December 31, 2006 and 2005, the Company had the following balances and transactions with CPI, Ltd.:

	<b>2006</b>	<b>2005</b>
Accounts payable	<u>\$ 490,726</u>	<u>\$ 512,700</u>
Management fees	<u>\$ 1,871,726</u>	<u>\$ 1,943,000</u>

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**14. Other Revenues**

Other revenues is composed of the following:

	<b>2006</b>	<b>2005</b>
Connection/reconnection charges	\$ 800,532	\$ 853,227
Pole rentals	2,588,781	2,484,195
Wheeling charges	2,526,293	3,264,329
Other income	<u>1,239,016</u>	<u>1,582,824</u>
 Total other revenues	 <u>\$ 7,154,622</u>	 <u>\$ 8,184,575</u>

**15. Purchase of Energy and Transmission Charges, Net**

The Company recorded purchase of energy and transmission charges as follows:

	<b>2006</b>	<b>2005</b>
Purchase of energy	\$ 232,003,448	\$ 201,130,024
Transmission charges	10,116,511	8,343,175
Fuel component adjustment	<u>20,225,450</u>	<u>(15,567,711)</u>
 Total net purchase of energy and transmission charges	 <u>\$ 262,345,409</u>	 <u>\$ 193,905,488</u>

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***Fuel Component Adjustment***

Changes in the under/over collection of these energy costs are reflected under net energy purchased and transmission costs in the statements of income. The cumulative amount receivable/payable is presented as a fuel component adjustment receivable/payable on the balance sheets until these amounts are billed or reimbursed to customers. The fuel component adjustment includes six months with actual fuel price information, plus six months of estimated fuel price information.

For the last several years, the fuel component adjustment has not been fully passed through to distribution company customers in the form of a tariff increase; the amount not billed to customers has been subsidized by the Panamanian Government.

On June 28, 2006, the Panamanian Government authorized by Executive Decree No. 22 the issuance of a five year term Treasury Note with a face value of US\$12,949,000. This Treasury Note was issued as a means to partially compensate the Company for the fuel component adjustment receivable balance accumulated between April 1, 2005 and March 31, 2006 amounting to a total of US\$25,132,807, the difference was paid in cash by the Government. This security was accounted for as available-for-sale under SFAS No.115, "Accounting for Certain Investments in Debt and Equity Securities" and recorded at its fair value.

In July 2006, the Company sold the debt security and received proceeds of US\$12,534,632 recording a realized loss on sale of US\$414,368. The cost of this security was determined on a specific identification basis.

At December 31, 2006, a net payable balance of US\$3,500,649 was determined as a consequence of the variance resulting from the energy cost considered in the electric tariff for the year 2006 over the actual cost of energy purchased. The balance of US\$3,500,649 comprise a receivable of US \$1,578,351, accumulated from April to September 2006 to be recovered from customers in the first semester of 2007 with the balance of US\$5,079,000 accumulated from October to December 2006 to be reimbursed to customers in the second semester of 2007.

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**16. Interest Costs**

The Company capitalizes the portion of interest costs associated with construction in progress. The following is a summary of interest costs incurred:

	<b>2006</b>	<b>2005</b>
Interest costs capitalized	\$ 263,477	\$ 249,974
Interest costs charged to expenses, net of treasury lock	<u>6,915,122</u>	<u>7,639,719</u>
Total interest costs incurred	<u><u>\$ 7,178,599</u></u>	<u><u>\$ 7,889,693</u></u>

**17. Commitments and Contingencies**

At December 31, 2006, the Company had contingent liabilities from claims originated in the ordinary course of business. The ultimate outcome of these contingencies is not expected to have a material impact on the Company's financial condition or operating results. At December 31, 2006 and 2005, the Company had accrued the amount of \$1,112,293. Following are the most representative matters:

***Litigations***

During 2005, a labor complaint was filed with a labor court by the Electricity Industry Workers Union of the Republic of Panama against the Company and the other seven electricity companies that originated from the privatization of the IRHE. The plaintiff seeks the payment of US\$7,191,852.59 from the Company, plus additional amounts from the other defendants, claiming that, due to calculation errors, the Panamanian Government did not pay in full the labor rights and severance compensation of the IRHE employees who at that time agreed to terminate their existing employment, as required for the privatization of the new electric companies. This complaint has been opposed by the Company. Legal counsel of the Company is of the opinion that such complaints are groundless, since under Executive Decree No.42 of 1998, the Panamanian Government assumed full liability for the payment of any compensation or calculation adjustment due to IRHE workers terminated as part of the privatization. This case is open and waiting for evidence submission. Management considers that the outcome of this case will not have a material negative impact on the financial statements.

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The Company challenged the ASEP (previously Ente Regulador de los Servicios Públicos) on Resolution JD-2626 which orders the Company to reimburse power generating companies for public lighting charges. The Company based its argument on the fact that the ASEP had previously authorized the distribution company to include public lighting charges within the wheeling charges billed to the generating companies. When the generating companies challenged these charges, the ASEP changed its previous instructions to the Company and through several resolutions, ordered the Company to not only to stop charging for public lighting but to reimburse to the generators all of the previous charges applied and already collected. The Company appealed the decision, and on June 20, 2006 the Supreme Court resolved in favor of the Company invalidating the claims and denying any reimbursement to generators.

The ASEP through Resolution JD-5956 from April 11, 2006 ordered the Company to return US\$4,033,188 to the customers as a monthly credit on their bills starting May 2006 until December 2006 due to an excess of the authorized Maximum Allowed Income, charged by the Company from July 2002 through June 2006. According to the ASEP, this alleged excess was generated from the difference between the breakdown by tariff type of the forecast used to determine the tariff structure and the actual breakdown. The Company appealed this decision due to a lack of legal grounds and also presented a revision of the study developed by the ASEP in which the difference in the "Maximum Allowed Income" caused by tariff type of the forecast used to determine the tariff structure and the actual breakdown is favorable to the Company. The ASEP decided as of June 14, 2006 to suspend any further action on Resolution JD-5956 until the Supreme Court pronounce on a related counterclaim that alleged for illegality against Resolution JD-5845.

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***Commitments***

As of December 31, 2006, the Company had energy and long-term firm capacity purchase contracts with the following generation companies:

<u>Company</u>	<u>MW</u>	<u>Begins</u>	<u>Ends</u>
Térmica del Noreste, S. A.		June 19, 2000	July 19, 2010
Bahía Las Minas	80	January 1, 2005	December 31, 2008
ESTI – AES	48.72	November 20, 2003	November 2013
La Mina Hidro-Power	28	January 1, 2008	December 31, 2015
AES Panamá	20; 40	January 1, 2006	December 31, 2007
AES Panamá	20; 40; 60	January 1, 2006	December 31, 2008
AES Panamá	60	January 1, 2008	December 31, 2008
Bontex	19.8	January 1, 2008	December 31, 2015
Paso Ancho Hidro-Power	4	January 1, 2008	December 31, 2015
Pedregal Power Co.	30	January 1, 2006	December 31, 2008
PanAm	60	January 1, 2006	December 31, 2008
Pedregal Power Co.	12; 5; 15	January 1, 2006	December 31; 2008
Fortuna	80	January 1, 2009	December 31, 2012
Fortuna	120	January 1, 2013	December 31, 2018
Pedregal Power Co.	10; 1; 1	January 1, 2007	December 31, 2009
Semper Group	0.001	January 1, 2007	December 31, 2008
Semper Group	30	January 1, 2009	December 31, 2010
Pan Am	16; 16; 45; 45	January 1, 2007	December 31, 2010
Fortuna	25; 5; 15	January 1, 2007	December 31, 2009
Pedregal Power Co.	42	January 1, 2009	December 31, 2009
Pan Am	32	January 1, 2009	December 31, 2009
Semper Group	0.0075	January 1, 2009	December 31, 2010
Semper Group	23	January 1, 2011	December 31, 2012
Bahía Las Minas	0.001	January 1, 2009	December 31, 2009
Bahía Las Minas	108	January 1, 2010	December 31, 2018
Bahía Las Minas	108	January 1, 2019	December 31, 2023
Pan Am	20	January 1, 2010	December 31, 2019
Pan Am	60	January 1, 2011	December 31, 2020

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In accordance with the 1997 Electricity Law, the Company enters into long-term power purchase agreements with electricity generators that cover most of its regulated customers' contributions to the total peak customer demand of electricity and work towards limiting any associated energy costs. Historically, the Company contracts annually for approximately 79% to 85% of its total energy requirements via purchase agreements on the contract market. For the years ended December 31, 2006 and 2005, the Company purchased approximately 97.7% and 79%, respectively, of its total energy requirements via power purchase agreements on the contract market. These purchase agreements include both a fixed charge based on energy capacity requirements and a variable charge based on energy use.

The Company has several unconditional long-term contracts obligations related to the purchase of energy capacity. The aggregate amount of payments required under such obligations at December 31, 2006, is as follows:

<b>Year</b>	<b>Payment Obligation</b>
2007	\$ 35,877,000
2008	39,860,035
2009	40,805,306
2010	66,006,408
Thereafter	<u>701,458,260</u>
 <b>Total</b>	 <u>\$ 884,007,009</u>

As of December 31, 2006 and 2005, the Company has on-going construction contracts for improvements and developments of the distribution system. Future commitments on these contracts amount to US\$2,522,165 and US\$762,669 respectively.

On October 20, 2003, the Company and the workers' union signed a second Labor Collective Agreement for a four-year term that will expire on October 20, 2007. The Company does not maintain additional material commitments to those established in the labor law.

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***Operating Leases***

The Company have entered into a seven year non-cancelable lease agreement which will provide for the use of office and operating facilities. As of December 31, 2006 the future minimum rental payments required under this operating lease with initial or remaining non-cancelable lease terms in excess of one year are:

Year ending December 31:

2007	\$ 291,981
2008	446,731
2009	460,132
2010	473,936
2011	488,155
Later years	<u>1,195,003</u>
Total minimum payments required	<u>\$ 3,355,938</u>

***Guarantees***

The Company has provided limited guarantees to generating companies in order to provide for credit assurance and performance obligations under the power purchase agreements. These guarantees are not recognized on the balance sheets, because the Company believes that it is able to perform under these contracts and that is not probable that payments will be required. The guaranteed amounts are limited to a month's estimate of energy capacity and associated energy consumption and are established for a twelve-months period with automatic renewals as long as the power purchase agreement is in place. The aggregate guarantee amount for the performance obligation is US\$17,063,260. The Company has also issued a guarantee in favor of the ASEP for US\$8,000,000 in compliance with clause 53 of the Concession Contract.

The Company has several standby letters of credit for US\$5,594,650 in favor of ETESA to guarantee the payment of transmission costs and energy purchases in the spot market.

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***Concession Contract***

The Company has exclusive rights to install, own and operate an energy distribution network, and to supply energy to end customers other than large customers, currently defined as those with peak demand on a site-by-site basis of over 100kW. Large customers can choose to buy energy directly from generators or from the spot market.

The Company's concession contract has a 15-year term and expires in October 2013. One year prior to the expiration of the concession period, the ASEP will hold a competitive tender offer for the sale of the 51% ownership share currently held by Panama Distribution Group, S.A., and who owns the right to set the asking price for the tender (by making its own bid) and will only be required to sell its share of the Company if a higher offer is made, in which case, Panama Distribution Group, S.A. will be entitled to retain the sale proceeds. If no higher offer is made, Panama Distribution Group, S.A. will retain its ownership for another 15-year term, subject to the same renewal procedure thereafter with no requirement to make any payment to the Panamanian Government.

The concession contract establishes provisions related to the Concessionaire's obligation in service supply issues, the non separation of the majority shares package, the delivery of periodic, technical and financial information to the ASEP, compliance with the technical quality standards (quality standards, measurement standards and operation regulations of the CND), and payment of the control, supervision and monitoring tariff of the ASEP, which may not be transferred to the users through the tariff.

**18. Fair Value of Financial Instruments**

The estimated fair values of financial instruments as of December 31, 2006 and 2005 are based on the information available at the date of the balance sheets. The Company has no knowledge of any factors that may significantly affect the estimated fair values of the most common financial assets and liabilities such as cash and trade receivables, severance funds, accounts payable, short and long-term debt and customer deposits.

***Cash, trade receivable, accounts payable and short-term debt***

The carrying amount approximates fair value because of the short maturity of those instruments.

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***Derivatives***

The fair value of the derivatives is estimated based on the mark-to-market value determined as of the balance sheet date.

***Long-term debt***

The fair value of the long-term debt is estimated based on the quoted market prices for the same or similar issues to the Company for debt of the similar remaining maturities. These estimates are subjective in nature and involve uncertainties. Therefore, actual results may differ from these estimates.

The estimated fair values of financial instruments are as follows:

	2006		2005	
	Carrying amount	Fair value	Carrying amount	Fair value
Derivatives	\$	\$	653,561	\$ 653,561
Long-term debt	99,151,798	103,505,448	100,000,000	97,536,218

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