

Elektra Noreste, S.A.

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

Financial Statements

**For the years ended December 31, 2007
and 2006, and Independent Auditors'
Report Dated February 15, 2008**

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

**Independent Auditors' Report and
Financial Statements 2007 and 2006**

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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 sheets of Elektra Noreste, S.A. (the "Company") as of December 31, 2007 and 2006, and the related statements of income, changes in equity, and cash flows for the years 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 audits.

We conducted our audits 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 audits provide 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, 2007 and 2006, and the results of its operations and its cash flows for the years 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 15, 2008

Elektra Noreste, S.A.

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

Balance Sheets

As of December 31, 2007 and 2006

(Expressed in United States dollars)

| | Notes | 2007 | 2006 | | Notes | 2007 | 2006 |
|---|--------|-----------------------|-----------------------|--|--------|-----------------------|-----------------------|
| Assets | | | | Liabilities and Stockholders' Equity | | | |
| Current assets: | | | | Current liabilities: | | | |
| Cash | | \$ 6,399,567 | \$ 18,266,568 | Accounts payable: | | | |
| Accounts receivable: | | | | Generation and transmission | 7, 13 | \$ 51,838,006 | \$ 37,911,651 |
| Trade, net | 3, 13 | 48,992,532 | 44,863,611 | Suppliers | 7 | 11,848,241 | 12,304,961 |
| Fuel component adjustment | 20, 15 | 10,830,351 | | Construction contracts | | 6,890,657 | 6,894,622 |
| Others, net | 13 | 1,758,728 | 1,561,370 | Advance on tariffs subsidy | | 2,142,287 | 1,189,965 |
| Accounts receivable, net | | <u>61,581,611</u> | <u>46,424,981</u> | Others | 13 | 473,098 | 490,726 |
| Inventory | 4 | 7,073,144 | 6,019,634 | Income tax payable | | | 6,638,998 |
| Prepaid income tax | | 2,153,309 | | Deferred income tax | 8 | 1,597,256 | |
| Deferred income tax | 8 | | 1,737,255 | Customers deposits | 9 | 2,394,274 | 2,924,546 |
| Other current assets | | <u>699,744</u> | <u>384,134</u> | Fuel component adjustment | 20, 15 | | 3,500,649 |
| Total current assets | | <u>77,907,375</u> | <u>72,832,572</u> | Withholding taxes | | <u>347,030</u> | <u>521,065</u> |
| Property, plant, and equipment, net of accumulated depreciation | 5 | 241,651,345 | 233,865,475 | Total accounts payable | | 77,530,849 | 72,377,183 |
| Other assets: | | | | Interest payable on debt | | 3,546,668 | 3,588,889 |
| Debt issuance costs | 6 | 2,478,822 | 2,578,909 | Accrued expenses | | <u>1,255,000</u> | <u>1,469,940</u> |
| Severance fund | | <u>1,171,694</u> | <u>1,077,476</u> | Total current liabilities | | 82,332,517 | 77,436,012 |
| Security deposits on facilities | | <u>74,421</u> | <u>99,175</u> | Long-term debt | 10, 18 | 99,185,241 | 99,151,798 |
| Total other assets | | <u>3,724,937</u> | <u>3,755,560</u> | Customers deposits and other liabilities: | | | |
| Total assets | | <u>\$ 323,283,657</u> | <u>\$ 310,453,607</u> | Deferred income tax | 8 | 2,849,086 | 1,293,466 |
| | | | | Customers deposits | 9 | 7,125,023 | 7,482,001 |
| | | | | Reserves for contingencies | 17 | 725,218 | 1,112,293 |
| | | | | Other accrued liabilities | | <u>1,418,217</u> | <u>924,434</u> |
| | | | | Total liabilities | | <u>193,635,302</u> | <u>187,400,004</u> |
| | | | | Stockholders' equity: | | | |
| | | | | Common stock authorized, issued and outstanding: 50,000,000 shares without par value; 160,031 held in treasury | 12 | 106,098,875 | 106,098,875 |
| | | | | Retained earnings | | <u>23,549,480</u> | <u>16,954,728</u> |
| | | | | Total stockholders' equity | | <u>129,648,355</u> | <u>123,053,603</u> |
| | | | | Total liabilities and stockholders' equity | | <u>\$ 323,283,657</u> | <u>\$ 310,453,607</u> |

See accompanying notes to financial statements.

Elektra Noreste, S.A.

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

Statements of Income
For the years ended December 31, 2007 and 2006
(Expressed in United States dollars)

| | Notes | 2007 | 2006 |
|--|--------|----------------------|----------------------|
| Revenues: | | | |
| Energy sales | | \$ 348,992,369 | \$ 332,058,802 |
| Other revenues | 14 | 7,534,038 | 7,154,622 |
| Total revenues | | 356,526,407 | 339,213,424 |
| Purchase of energy and transmission charges, net | 13, 15 | <u>280,426,578</u> | <u>262,345,409</u> |
| Gross distribution margin | | <u>76,099,829</u> | <u>76,868,015</u> |
| Operating expenses: | | | |
| Labor and other personnel | | 8,116,471 | 8,755,447 |
| Severance expenses | | 329,965 | 327,955 |
| Provision for doubtful account, net | | 3,077,136 | 2,484,940 |
| Repair and maintenance | | 2,800,749 | 2,800,678 |
| Professional services | | 8,908,255 | 9,275,226 |
| Management fees | 13 | 1,861,866 | 1,871,726 |
| Depreciation and amortization | | 12,510,175 | 12,226,709 |
| Administrative and other | | 7,570,033 | 7,074,152 |
| Loss on sale of fixed asset | 5 | 48,532 | 198,789 |
| Total operating expenses | | <u>45,223,182</u> | <u>45,015,622</u> |
| Operating income | | <u>30,876,647</u> | <u>31,852,393</u> |
| Other income (expense): | | | |
| Interest income | | 1,593,531 | 1,391,671 |
| Interest expense | 11, 16 | (8,412,634) | (6,915,122) |
| Loss on sale of investment | 15 | | (414,368) |
| Total other expenses | | <u>(6,819,103)</u> | <u>(5,937,819)</u> |
| Income before income taxes | | <u>24,057,544</u> | <u>25,914,574</u> |
| Income taxes: | 8 | | |
| Current | | 2,402,673 | 10,569,293 |
| Deferred expense (benefit) | | 4,890,112 | (2,685,880) |
| Total income taxes | | <u>7,292,785</u> | <u>7,883,413</u> |
| Net income | | <u>\$ 16,764,759</u> | <u>\$ 18,031,161</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, 2007 and 2006****(Expressed in United States dollars)**

| | Notes | Common Stock | Treasury Stock | Retained Earnings | Other Comprehensive Income (loss) | Total Equity |
|---|-------|-----------------------|---------------------|----------------------|-----------------------------------|-----------------------|
| Balance as of January 1, 2006 | | \$ 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 | | 106,642,962 | (544,087) | 16,954,728 | | 123,053,603 |
| Net income | | | | 16,764,759 | | 16,764,759 |
| Dividends declared | | | | (10,000,000) | | (10,000,000) |
| Complementary dividend tax | 12 | _____ | _____ | (170,007) | _____ | (170,007) |
| Balance as of December 31, 2007 | | <u>\$ 106,642,962</u> | <u>\$ (544,087)</u> | <u>\$ 23,549,480</u> | <u>\$ _____</u> | <u>\$ 129,648,355</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, 2007 and 2006****(Expressed in United States dollars)**

| | 2007 | 2006 |
|---|-------------------------|------------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 16,764,759 | \$ 18,031,161 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,510,175 | 12,226,709 |
| Loss on sale of fixed asset | 48,532 | 198,789 |
| Loss on sale of investment | | 414,368 |
| Provision for doubtful accounts | 3,077,136 | 2,484,940 |
| Discount amortization of senior notes | 33,443 | 15,798 |
| Amortization of debt issuance costs | 100,087 | 1,644,820 |
| Provision for severance payments net of contribution to severance fund | 53,392 | (52,748) |
| Deferred income tax | 4,890,112 | (2,685,880) |
| Fuel component adjustment | (14,331,000) | 7,276,456 |
| Change in operating assets and liabilities: | | |
| Accounts receivable | (7,403,414) | (7,506,122) |
| Other assets | (290,831) | 104,470 |
| Inventory | (1,053,510) | 1,031,285 |
| Trade accounts payable and other liabilities | 13,127,357 | 2,202,643 |
| Income tax, net | (8,792,307) | 8,107,468 |
| Seniority premium payments | (86,349) | (70,490) |
| Net cash provided by operating activities | <u>18,647,582</u> | <u>43,423,667</u> |
| Cash flows from investing activities: | | |
| Acquisition of fixed assets | (20,510,471) | (19,307,280) |
| Proceeds from sales of fixed assets | 165,895 | 854,078 |
| Withdrawal from trust fund | | 2,500,000 |
| Proceeds from sale of investment | <u></u> | <u>12,534,632</u> |
| Net cash used in investing activities | <u>(20,344,576)</u> | <u>(3,418,570)</u> |

(Continued)

| | | |
|---------------------------------------|---------------------|----------------------|
| Cash flows from financing activities: | | |
| Repayment of long-term debt | \$ | \$ (95,000,000) |
| Proceeds from long-term debt | | 99,136,000 |
| Short-term debt, net | | (5,000,000) |
| Dividends paid | (10,000,000) | (20,000,000) |
| Debt issuance costs | | (2,626,118) |
| Complementary dividend tax, net | <u>(170,007)</u> | <u>175,526</u> |
| Net cash used in financing activities | <u>(10,170,007)</u> | <u>(23,314,592)</u> |
| Cash and cash equivalents: | | |
| Net (decrease) increase for the year | (11,867,001) | 16,690,505 |
| Beginning of year | <u>18,266,568</u> | <u>1,576,063</u> |
| End of year | <u>\$ 6,399,567</u> | <u>\$ 18,266,568</u> |

Supplemental disclosure of cash flow information:

| | | |
|--------------------------------|----------------------|---------------------|
| Cash paid during the year for: | | |
| Interest | <u>\$ 7,972,571</u> | <u>\$ 5,982,546</u> |
| Income taxes | <u>\$ 11,194,962</u> | <u>\$ 2,461,822</u> |

See accompanying notes to financial statements.

(Concluded)

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Notes to financial statements
For the years ended December 31, 2007 and 2006
(Expressed in United States dollars)

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 Hidráulicos 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 commercialization of electric power to customers located in the geographical areas of Panama East, Colon, Panama Bay, the Comarca of San Blas and Darien. 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.

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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, 2007 and 2006, 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 60 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.

The Company establishes a provision for losses if it determines that amounts may not be collectible. The Company estimates the allowance based on the length of time the receivables are past due, conditions affecting its customers, and historical experience.

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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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". As of December 31, 2007 and 2006 the Company had capitalized interest for US\$42,812 and US\$263,477, respectively.

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, 2007 and 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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(Expressed in United States dollars)

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:

| | <u>Estimated Useful Life (in years)</u> |
|---|--|
| 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 market, 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, thereafter the tariff is revised by ETESA and the ASEP for a four-year period.

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- 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 basis. Deferred tax assets and 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 the Statement of 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. In year 2007 the Company did not enter into any derivatives transactions or hedging activities.

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I. 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.

m. 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.

n. 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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o. 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 SFAS No.71, "Accounting for the Effects of Certain Types of Regulation". 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:

| | 2007 | 2006 | Note |
|--|---------------------|-----------------------|---|
| Fuel component | | | |
| adjustment - asset (liabilities) | \$ 10,830,351 | \$ (3,500,649) | See "Fuel component adjustment", see Note 15 |
| Deferred income tax - (liabilities) asset | <u>(3,249,105)</u> | <u>1,050,195</u> | |
| | <u>\$ 7,581,246</u> | <u>\$ (2,450,454)</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.

p. 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

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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.

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. Differences between estimated and actual unbilled revenues are recognized in the following month.

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.

- q. *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, collection or reimbursement of the fuel component adjustment account, 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.
- r. *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.

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s. 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.

t. Reclassifications - Certain amounts in the financial statements as of and for the year ended December 31, 2006 have been reclassified in order to conform to the presentation of the financial statements as of and for the year ended December 31, 2007.

u. Application of Recent Accounting Pronouncements

The Company adopted, or will adopt, the recent accounting standards listed below, if applicable, on their respective effective dates.

In June, 2006, the Financial Accounting Standard Board ("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

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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.

In June 2006, the FASB released FASB Interpretation No.48 ("FIN No.48"), "Accounting for Uncertainty 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 adopted FIN No.48 as from January 1, 2007. The adoption of this interpretation did not have any impact in the Company's financial statements.

In September 2006, the FASB issued SFAS 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.

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities. This statement permits, but does not require, companies to account for financial instruments at fair value that are not otherwise required to be measured at fair value. The statement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the effects of adopting SFAS No. 159 and is not expected to have a material impact on the Company's financial statements.

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3. Accounts Receivable – Trade

At December 31, 2007 and 2006, accounts receivable – trade, are as follows:

| | 2007 | 2006 |
|-----------------------------------|----------------------|----------------------|
| Customers | \$ 44,364,605 | \$ 32,563,978 |
| Government and municipal entities | <u>5,344,040</u> | <u>9,370,347</u> |
| | 49,708,645 | 41,934,325 |
| Unbilled revenue | <u>6,429,577</u> | <u>6,747,192</u> |
| | 56,138,222 | 48,681,517 |
| Allowance for doubtful accounts | <u>(7,145,690)</u> | <u>(3,817,906)</u> |
| Total | <u>\$ 48,992,532</u> | <u>\$ 44,863,611</u> |

4. Inventory

At December 31, 2007 and 2006, inventory is composed of the following:

| | 2007 | 2006 |
|------------------------|---------------------|---------------------|
| Materials and supplies | \$ 6,368,228 | \$ 5,282,480 |
| Tools and spare parts | <u>704,916</u> | <u>737,154</u> |
| Total | <u>\$ 7,073,144</u> | <u>\$ 6,019,634</u> |

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5. Property, Plant, and Equipment

At December 31, 2007 and 2006, property, plant and equipment are as follows:

| | 2007 | 2006 |
|---|-----------------------|-----------------------|
| Poles, towers and accessories | \$ 76,213,279 | \$ 76,905,717 |
| Electric transformers | 39,135,393 | 37,270,524 |
| Underground conductors and ducts | 55,856,479 | 52,759,513 |
| Consumers services | 27,809,075 | 26,279,267 |
| Overhead conductors and accessories | 29,616,124 | 24,321,583 |
| Substation equipment | 49,621,862 | 46,416,250 |
| Consumer meters | 24,401,461 | 20,806,792 |
| Buildings and improvements | 13,512,566 | 12,930,061 |
| Public lighting equipment | 11,750,127 | 11,354,095 |
| Transportation and communication equipment | 6,066,890 | 7,138,358 |
| Office furniture and equipment | 14,312,218 | 13,865,610 |
| Construction in progress | 12,527,494 | 14,019,842 |
| Other | <u>2,368,949</u> | <u>2,353,807</u> |
| | 363,191,917 | 346,421,419 |
| Less: Accumulated depreciation and amortization | <u>(124,687,055)</u> | <u>(115,702,427)</u> |
| | 238,504,862 | 230,718,992 |
| Land | <u>3,146,483</u> | <u>3,146,483</u> |
| | <u>\$ 241,651,345</u> | <u>\$ 233,865,475</u> |

At December 31, 2007 and 2006, the Company incurred a loss of US\$48,532 and US\$198,789 respectively on the disposal of equipment, which is reflected in the Company's Statements of Income in the Loss on sale of fixed asset caption.

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6. Debt Issuance Costs

At December 31, 2007 and 2006, deferred costs are as follows:

| | 2007 | 2006 |
|-------------------|----------------------------|----------------------------|
| Beginning balance | \$ 2,578,909 | \$ 1,597,611 |
| Issuance costs | | 2,626,118 |
| Amortization | <u>(100,087)</u> | <u>(1,644,820)</u> |
| Ending balance | <u><u>\$ 2,478,822</u></u> | <u><u>\$ 2,578,909</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.

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, 2007 and 2006, accounts payable to generation and transmission companies are as follows:

| | 2007 | 2006 |
|----------------------------|----------------|---------------|
| PanAM Generating Ltd. | \$ 11,459,686 | \$ 6,182,374 |
| Pedregal Power Company | 6,997,494 | 4,520,349 |
| Térmica del Noreste, S. A. | 2,180,221 | 1,606,605 |
| Others | <u>218,949</u> | <u>65,582</u> |
| | 20,856,350 | 12,374,910 |

Related Parties

| | | |
|--|-----------------------------|-----------------------------|
| AES Panamá, S. A. | 9,780,186 | 10,934,618 |
| Autoridad del Canal de Panamá | 1,722,685 | 2,101,042 |
| Empresa de Generación Eléctrica Bahía Las Minas Corp. | 13,490,202 | 9,696,021 |
| Empresa de Generación Eléctrica Fortuna, S. A. | 4,273,012 | 1,187,983 |
| Empresa de Transmisión Eléctrica, S. A. | <u>1,715,571</u> | <u>1,617,077</u> |
| | <u>30,981,656</u> | <u>25,536,741</u> |
| | <u><u>\$ 51,838,006</u></u> | <u><u>\$ 37,911,651</u></u> |

Suppliers - At December 31, 2007 and 2006, accounts payable to suppliers are as follows:

| | 2007 | 2006 |
|--------------------------|-----------------------------|-----------------------------|
| Construction contractors | \$ 3,813,034 | \$ 4,089,487 |
| Maintenance and repairs | 1,682,062 | 1,140,950 |
| Materials and inventory | 2,796,356 | 3,700,466 |
| Outsourcing and services | 2,323,835 | 1,910,392 |
| Others | <u>1,232,954</u> | <u>1,463,666</u> |
| | <u><u>\$ 11,848,241</u></u> | <u><u>\$ 12,304,961</u></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, 2007 and 2006, 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:

| | 2007 | 2006 |
|---|-------------------------|-------------------------|
| Income tax: | | |
| Computed at expected statutory rate | \$ 7,217,263 | \$ 7,774,372 |
| Decrease in income tax due to non-taxable income | (61,036) | (161,509) |
| Increase in income tax due to non-deductible expenses | <u>136,558</u> | <u>270,550</u> |
| Total income tax | <u>\$ 7,292,785</u> | <u>\$ 7,883,413</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:

| | 2007 | 2006 |
|--|-----------------------|-----------------------|
| Current deferred income tax assets: | | |
| Provision for doubtful accounts | \$ 704,730 | \$ 405,974 |
| Fuel component adjustment | | 1,050,195 |
| Investment tax credit | 775,343 | |
| Other | 171,776 | 281,086 |
| Total deferred income tax assets | <u>1,651,849</u> | <u>1,737,255</u> |
| Current liability-fuel component adjustment | <u>(3,249,105)</u> | |
| Current deferred income tax (liability) asset, net | <u>\$ (1,597,256)</u> | <u>\$ 1,737,255</u> |
| | 2007 | 2006 |
| Non-current deferred income tax assets: | | |
| Investment tax credit | \$ 1,576,234 | |
| Provision for contingencies | <u>217,566</u> | <u>333,688</u> |
| Total deferred income tax assets | <u>217,566</u> | <u>1,909,922</u> |
| Non-current liability-depreciation expense | <u>(3,066,652)</u> | <u>(3,203,388)</u> |
| Non-current deferred income tax (liability), net | <u>\$ (2,849,086)</u> | <u>\$ (1,293,466)</u> |

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.

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Under FIN No. 48, the Company is required to recognize the financial statement effects of tax positions if they meet a “more-likely-than-not” threshold. In evaluating items relative to this threshold, the Company must assess whether each tax position will be sustained based solely on its technical merits assuming examination by a taxing authority. The interpretation requires the Company to establish liabilities to reflect the portion of those positions that cannot be concluded as “more likely than not” of being realized upon ultimate settlement. These are referred to as liabilities for unrecognized tax benefit under FIN No. 48. Upon adoption of this interpretation, the Company identified and evaluated any potential uncertain tax positions and concluded that there are no uncertain tax positions requiring recognition in the financial statements. Management expects the tax authorities to allow these positions when and if examined and has a high confidence level in the technical merits of these positions. Accordingly, Management expects the full amount of the tax position to be ultimately realized and recognized in the financial statements.

Years starting with 2004 are subject to examination by tax authorities, although no examination is currently scheduled or in process. Years prior to 2004 are closed years.

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%).

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9. Customers Deposits

At December 31, 2007, the Company estimated that the amount of deposits to be returned to customers during fiscal year 2008 will be US\$2,394,274 (plus accrued interest of US\$208,287).

The activity in the customers deposits accounts for the years 2007 and 2006 is as follows:

| | 2007 | 2006 |
|----------------------------------|---------------------|---------------------|
| Beginning balance | \$ 10,406,547 | \$ 11,588,202 |
| Deposits received from customers | 1,579,020 | 1,433,398 |
| Interest accrued | 367,343 | 494,408 |
| Deposits returned to customers | (2,312,670) | (2,811,763) |
| Interest paid | <u>(520,943)</u> | <u>(297,698)</u> |
| Ending balance | 9,519,297 | 10,406,547 |
| Current portion | <u>(2,394,274)</u> | <u>(2,924,546)</u> |
| Long-term portion | <u>\$ 7,125,023</u> | <u>\$ 7,482,001</u> |

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10. Debt

At December 31, 2007 and 2006, the balance of long-term notes is as follows:

| | 2007 | 2006 |
|--|----------------------|----------------------|
| Long-Term Notes | | |
| Senior Notes, unsecured and unsubordinated due on 2021 with fixed rate of 7.60% per annum and semiannual interest payments | \$ 100,000,000 | \$ 100,000,000 |
| Less: | | |
| Senior notes discount | <u>(814,759)</u> | <u>(848,202)</u> |
| Long-term debt | <u>\$ 99,185,241</u> | <u>\$ 99,151,798</u> |

The Senior Notes (the Notes) were issued on June 30, 2006 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.

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 Notes were used to repay the principal and interest on the Company's Syndicated Long-Term Loan for the amount of US\$95,104,388; to pay the expenses of the offering of the Notes and to the extent there were amounts remaining; to pay outstanding short-term indebtedness and for general corporate purposes.

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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\$60,500,000 in 2007 and US\$50,300,000 in 2006 with annual interest rates ranging between 6 months Libor + 1.20% and 1.50%. These unsecured credit facilities are available with a maximum term of up to one year. The Company uses these facilities as needed for working capital and other needs. The Company reported no outstanding debt under these credit facilities as of December 31, 2007 and 2006.

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 January 1, 2006 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.

12. Dividend Tax and Treasury Stocks

Dividend Tax

Dividends are paid to shareholders net of withholding taxes of 10 percent. The complementary dividend tax paid is considered as an advanced income tax on dividends and is recorded as a reduction to stockholders' equity.

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Treasury Stocks

In 1998, as a 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:

| Balances | 2007 | 2006 |
|--|--------------|--------------|
| Accounts receivable (trade) - government | \$ 5,344,040 | \$ 9,370,347 |
| Accounts receivable (others) – AEI Energy Services, LLC | 3,752 | 13,123 |
| Accounts receivable (others) – Prisma Energy Global Services, Ltd. | 48,247 | |
| Accounts payable (others) - Promigas, S.A. | 394 | |
| Accounts payable (others) - AEI Guatemala Ltda. | 17,041 | |
| Accounts payable (generation and transmission) | 30,981,656 | 25,536,741 |

Transactions

| | | |
|---------------------|---------------|---------------|
| Revenues | \$ 40,915,377 | \$ 36,178,367 |
| Purchases of energy | 163,219,738 | 153,981,863 |
| Transmission costs | 10,286,346 | 10,002,716 |

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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, 2007 and 2006, the Company had the following balances and transactions with CPI, Ltd.:

| | 2007 | 2006 |
|------------------|---------------------|---------------------|
| Accounts payable | \$ <u>455,663</u> | \$ <u>490,726</u> |
| Management fees | \$ <u>1,861,866</u> | \$ <u>1,871,726</u> |

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14. Other Revenues

Other revenues are composed of the following:

| | 2007 | 2006 |
|---------------------------------|-------------------------|-------------------------|
| Connection/reconnection charges | \$ 698,972 | \$ 800,532 |
| Pole rentals | 2,779,109 | 2,588,781 |
| Wheeling charges | 2,565,525 | 2,526,293 |
| Other income | <u>1,490,432</u> | <u>1,239,016</u> |
| Total other revenues | <u>\$ 7,534,038</u> | <u>\$ 7,154,622</u> |

15. Purchase of Energy and Transmission Charges, Net

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

| | 2007 | 2006 |
|---|---------------------------|---------------------------|
| Purchase of energy | \$ 284,253,158 | \$ 232,003,448 |
| Transmission charges | 10,504,420 | 10,116,511 |
| Fuel component adjustment | <u>(14,331,000)</u> | <u>20,225,450</u> |
| Total net purchase of energy and transmission charges | <u>\$ 280,426,578</u> | <u>\$ 262,345,409</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, 2007, a net receivable balance of US\$10,830,351 was determined as a consequence of the variance resulting from the energy cost considered in the electric tariff for the year 2007 over the actual cost of energy purchased. The balance is comprised of receivables of US\$1,615,000, accumulated from January to June 2007 to be recovered from customers in the first semester of 2008 and of US\$9,215,351 accumulated from July to December 2007 to be recovered from customers in the second semester of 2008.

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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:

| | 2007 | 2006 |
|---|----------------------------|----------------------------|
| Interest costs capitalized | \$ 42,812 | \$ 263,477 |
| Interest costs charged to expenses, net | <u>8,412,634</u> | <u>6,915,122</u> |
| Total interest costs incurred | <u><u>\$ 8,455,446</u></u> | <u><u>\$ 7,178,599</u></u> |

17. Commitments and Contingencies

As result of issues generated from the ordinary course of business, the Company is or can be involved in legal, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies. The ultimate outcome of these proceedings is not expected to have a material impact on the Company's financial position, result of operations or liquidity. At December 31, 2007 and 2006, the Company had total reserves for loss contingencies in the amount of US\$725,218 and US\$1,112,293 respectively; these reserves are reported in the Balance Sheets in "Reserves for contingencies". 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. On March 28, 2007, the Company was notified by the Fourth Circuit Court of Labor the plaintiffs will no longer continue the process.

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The ASEP through Resolution JD-5683 from February 17, 2006 approved the Title IV of the Distribution and Commercialization Regimen enacted from July 2006 through June 2010, which contains a provision on its article number 22, requiring that excess earnings considered above a reasonable margin of the Company Maximum Allowed Income at the end of each tariff reset period will cause an adjustment by reducing the next approved Maximum Allowed Income provided on the following tariff reset. The ASEP has yet to determine the procedure to calculate and adjust this possible excess. An appeal has been received by the Supreme Court to suspend the effects of this resolution on the grounds of illegality; no further action will be taken by the ASEP until final settlement is concluded. The Company's management does not believe that final outcome of this proceeding will have a material impact on its financial condition, results of operation, or cash flows.

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, 2007, the Company had energy and long-term firm capacity purchase contracts with the following generation companies:

| <u>Company</u> | <u>MW (Monthly)</u> | <u>Begins</u> | <u>Ends</u> |
|---------------------------------|----------------------------|----------------------|--------------------|
| Térmica del Noreste, S.A. | as requested capacity | 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 |
| AES Panamá | 40, 20 | January 1, 2006 | December 31, 2007 |
| AES Panamá | 20; 40; 60 | January 1, 2006 | December 31, 2008 |
| Paso Ancho Hidro-Power | 4 | January 1, 2008 | December 31, 2015 |
| Pedregal Power Co. | 30 | January 1, 2006 | December 31, 2008 |
| Pan Am | 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 |
| Térmica del Caribe | 2.85 | March 1, 2009 | March 31, 2014 |
| Inversiones y Desarrollo Balboa | 16.6 | August 1, 2008 | December 31, 2008 |
| Inversiones y Desarrollo Balboa | 24.6 | January 1, 2009 | December 31, 2011 |
| Energía y Servicios de Panamá | 0.96 | July 1, 2009 | June 30, 2014 |
| Generadora del Atlántico | 30 | July 1, 2009 | June 30, 2014 |

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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 95% of its total energy requirements via purchase agreements on the contract market. For the years ended December 31, 2007 and 2006, the Company purchased approximately 93% and 97.7%, 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 aggregate amount of future payments required under such unconditional long term contracts, is as follows:

| Year | Payment Obligation |
|------------------|-------------------------------|
| 2008 | \$ 38,455,131 |
| 2009 | 49,526,876 |
| 2010 | 76,725,348 |
| 2011 | 77,876,268 |
| 2012 | 68,725,068 |
| Thereafter | <u>572,645,214</u> |
| Total | <u>\$ 883,953,905</u> |

As of December 31, 2007, the Company has expensed the amount of US\$36,087,982 and US\$41,169,749 respectively on such unconditional long-term contracts.

As of December 31, 2007, the Company has on-going construction contracts for improvements and developments of the distribution system. Future commitments on these contracts amount to US\$3,255,567 that will be paid in year 2008.

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On October 20, 2003, the Company and the workers' union signed a second Labor Collective Agreement for a four-year term that expired on October 20, 2007. On January 30, 2008 the negotiations with the worker's union regarding a new Labor Collective Agreement was concluded and does not maintain additional material commitments besides those established in the labor law. The new Labor Collective Agreement is effective as from February 2008 and is valid for the term of four years.

Operating Leases

The Company has entered into a seven year non-cancelable lease agreement which will provide for the use of office and operating facilities. As of December 31, 2007 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:

| | |
|-------------------------------------|------------------------|
| 2008 | \$ 446,731 |
| 2009 | 460,133 |
| 2010 | 473,936 |
| 2011 | 488,155 |
| 2012 | 502,799 |
| Thereafter | <hr/> 692,203 |
| Total minimum payments required | <hr/> \$ 3,063,957 |

As of December 31, 2007 and 2006 the total rental expense for all operating leases is US\$853,081 and US\$679,525 respectively.

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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\$18,245,260. 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\$5,294,640 in favor of ETESA to guarantee the payment of transmission costs and energy purchases in the energy exchange market. The Company also has a standby letter of credit for US\$2,375,509 in favor of Telvent Energía y Medio Ambiente, S.A. to guarantee the payment of a software development.

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 energy exchange 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.

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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, 2007 and 2006 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, long-term debt and customer deposits.

Cash, trade receivable and accounts payable

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

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:

| | 2007 | | 2006 | |
|----------------|---------------------|----------------------|---------------------|----------------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Long-term debt | <u>\$99,185,241</u> | <u>\$109,721,183</u> | <u>\$99,151,798</u> | <u>\$103,539,730</u> |

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