FITCH AFFIRMS ENSA'S IDRS AT 'BBB'; OUTLOOK STABLE

Fitch Ratings-New York-01 August 2014: Fitch Ratings has affirmed Elektra Noreste, S.A.'s (ENSA) foreign and local currency IDRs at 'BBB'. The rating action affects approximately US$100 million of outstanding debt due in 2021. The Rating Outlook is Stable.

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

KEY RATING DRIVERS

SOLID CREDIT METRICS:

ENSA has historically maintained moderated indebtedness, adequate liquidity and sound cash flow generation capacity. ENSA reported a total debt-to-EBITDA ratio of 2.9x for last 12 months (LTM) ended on March 31, 2014. This level is in line with the rating category and below the covenant of 3.25x established in the rated notes contract. ENSA maintains healthy interest coverage, measured as EBITDA to interest expense, which as of the LTM ended March 2014 was 6.8x. Fitch expects leverage ratio to remain below 3.0x in the long term.

ENSA's liquidity position is supported by its stable cash flow generation and flexible debt amortization schedule as almost 80% of debt matures beyond five years. Additionally, ENSA maintains working capital facilities for up to USD122 million, which can be used to finance purchases of energy.

Between 2010 and 2013, EBITDA grew from US$58.5 million to US$78.7 million supported by a positive tariff review process in 2010, increase in energy demand and gains in operating efficiencies. Fitch does not expect the ongoing tariff reset process to negatively impact company's financial position.

FCF IMPACTED BY CAPEX AND DIVIDENS

ENSA has recorded negative Free Cash Flow (FCF) in the last three years mainly as a consequence of its dividend policy and CAPEX program. ENSA pays dividends for up to 100% of the net income of the previous year subject to cash flow availability. Capital expenditures increased from US$25 million in 2010 to approximately US$54 million in 2013 as a result of the high energy demand growth rate in the country.

Capital Expenditures will reach approximately US$271 million in next four years. ENSA is committed to expand its distribution network in 5,000 meters and to improve service reliability as per request of the new concession contract and the tariffs approved for the period July 2014-June 2018. ENSA is evaluating a financing plan for this Capex requirement. Fitch expects ENSA's FCF will remain negative in the short to medium term.

In first quarter-2014 (1Q'14), ENSA's cash flows were additionally affected by higher working capital requirements, including account receivables related to subsidies for US$35.7 million. Government subsidies increased in 2014 as result of the adverse hydrological conditions. The collection period for these subsidies is approximately 60 days. LTM FCF as of March 2014 was negative US$61.6 million.

LOW BUSINESS-RISK PROFILE:

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

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

ENSA is an efficient electric distribution company with energy losses from both technical and non-technical factors that are reasonable for an electric distributor in Latin America. ENSA reported energy losses for regulated customers of 11.3% in 2013 (11.3% in 2012), showing a consistent reduction trend (2009: 11.5%). Although they may prove to be more challenging as ENSA becomes more effective, further reductions could benefit margins and earnings. The energy loss ratio approved for regulatory purposes is 9.0% for the next four years (8.2% in the previous tariff cycle).

MODERATE REGULATORY RISK:

ENSA faces moderate regulatory risk associated with tariff adjustments, which can directly affect the company's cash flow generation. ENSA's distribution tariffs are based on a price-cap methodology with the value added of distribution (VAD) reset every four years. VAD is set to allow distribution companies to recover operating cost and energy losses and obtain a reasonable return on their invested capital based on the average yield of the 30-year U.S. Treasury bond plus a risk premium of 8%. The net present value of VAD approved for the period July 2014-June 2018 is US$636.7 million (vs. US $442.2 million for the period July 2010-June 2014).

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

The government subsidizes electric consumption in Panama. Since 2003 the fuel component adjustment has not been fully passed through to final users in the form of tariff increases; the amount not billed to customers has been subsidized by the Panamanian Government through the FET (Fondo de Estabilizacion Tarifaria - Tariff Stabilization Fund), and through FACE (Fondo de Compensacion Energetica - Energy Compensation Fund).

In 1Q'14, ENSA received subsidies for US$35.7M. This amount represents approximately 21% of ENSA's revenues in the period. This amount is expected to increase in 2014 as consequence of higher thermo generation given the severe drought in the country and bottle necks in transmission lines. Should the government increase subsidies and/or delay transfers to cover subsidies, ENSA's working capital needs may increase and its credit quality could be affected.

RATING SENSITIVITIES

-- With Debt-to-EBITDA above 2.5x, ENSA has modest headroom in the 'BBB' category. Therefore, Fitch does not anticipate positive rating action in the near term.

-- Future developments that may, individually or collectively, lead to a negative rating action include: increased reliance on government subsidies; weakening of leverage to a range between 3.0x and 3.5x on a sustained basis; tariff adjustments that reduce significantly cash flow generation; increases in debt and/or dividends distribution; sovereign downgrades reflecting deterioration of macroeconomic conditions.

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Applicable Criteria and Related Research:
--'Corporate Rating Methodology' (May 28, 2014).

Applicable Criteria and Related Research:
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393