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

Fitch Ratings-New York-05 August 2016: Fitch Ratings has affirmed Elektra Noreste, S.A.'s (ENSA) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB'. The rating action affects approximately USD100 million of outstanding debt due in 2021. The Rating Outlook is Stable.

KEY RATING DRIVERS

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

SOLID CREDIT METRICS:

ENSA's financial profile is solid with investment-grade credit protection measures. The company has historically maintained moderate indebtedness, adequate liquidity and sound cash flow generation capacity. ENSA maintains healthy interest coverage, measured as EBITDA to interest paid, which as of the latest 12 months (LTM) ended March 31, 2016 was 6.5x. The company's distribution tariffs are based on a price-cap methodology with value-added distribution (VAD) reset every four years, which provides an incentive for efficient operations. The new tariff reset for the period July 2014-June 2018 was approved and became effective in January 2015. Fitch forecasts an annual EBITDA average of USD88 million during 2016-2018, up from USD77 million average 2011-2014.

Fitch expects ENSA's leverage ratio to range between 3.0x-3.5x in the medium term as the company deploys investments in its network coverage in the future years. ENSA reported a total debt-to-EBITDA ratio of 3.0x for the LTM ended March 31, 2016, up from 2.8x in 2015 (2014: 2.4x). The debt increase is earmarked to finance the company's capex program for the 2014-2018 period of USD270 million, which is the capex required as determined in the tariff reset. An increased leverage level on a sustained basis to above 3.5x; could pressure the ratings.

Fitch views ENSA's liquidity risk as manageable given the company's predictable cash flow generation and its debt amortization profile. ENSA's liquidity position is supported by its stable cash flow generation and flexible debt amortization schedule. Additionally, ENSA maintains working capital facilities for up to USD165 million, which can be used to finance purchases of energy.

ENSA's debt as of March 2016 is composed of USD44 million short-term bank debt, and USD200 million senior unsecured notes. The company's amortization schedule is manageable, as 10% of its long-term debt matures in 2018 (USD20 million), and 90% matures between 2021 (USD100 million) and 2027 (USD80 million). The company expects to refinance its short-term debt in 2017 to concentrate 90% as long-term debt.

FCF AFFECTED BY CAPEX AND DIVIDENDS:

ENSA has recorded negative free cash flow (FCF) in the last years mainly because of its dividend policy and capex program. ENSA pays dividends of up to 100% of the net income of the previous year. During 2015, the USD74.1 million dividend payment corresponded to net income of 2013 and 2014. Capex will reach approximately USD270 million, on a cumulative basis in four years, as a result of the new concession contract and the tariffs approved for July 2014-June 2018.

The contracted concession's capex program recognized in the tariff reset is higher than the one included in the last tariff review of 2010-2014 of USD160 million. In 2015, capital expenditures accounted for

USD83.7 million (2014: USD53.7 million). ENSA is committed to expand its distribution network coverage in 5,000 meters from the existing network at the beginning of the term contract and to improve service reliability under the request of the new concession contract, and the tariffs approved for July 2014 to June 2018.

LOW BUSINESS-RISK PROFILE:

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

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, and therefore 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 commercial energy losses of 10.6% in 2015 (2014: 10.1%). Although they may prove to be more challenging as the company becomes more effective, further modest improvements to the company's efficiency over the coming years should benefit margins and earnings.

MODERATE REGULATORY RISK:

ENSA faces moderate regulatory risk associated with tariff adjustments, which can directly affect the company's cash flow generation. ENSA's distribution tariffs are based on a price-cap methodology with the value added of distribution (VAD) reset every four years. The net present value of VAD approved for the period July 2014-June 2018 is USD636.7 million (vs. USD442.2 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 semi-annual basis, to reflect changes in the Panamanian consumer price index (CPI).

The government subsidizes electric consumption in Panama. The amount not billed to customers has been subsidized by the Panamanian Government through the FET (Fondo de Estabilizacion Tarifaria - Tariff Stabilization Fund, which benefit residential customers), and through FACE (Fondo de Compensacion Energetica - Energy Compensation Fund). The latter was eliminated during the second half of 2015. Since 2012, the FET subsidy has been gradually reduced depending on consumption ranges. The government's objective is to maintain FET subsidies for users with monthly consumption up to 350Kwh.

The company's exposure to government subsidies has decreased since 2015 compared to previous annual subsidies payments (2014: USD139.5 million) due to low energy prices and the gradual FET subsidy reduction in place since 2012. Fitch considers that prolonged reduction of the amount of government transfers would contribute to a more sustainable sector as the distribution companies benefit from fewer working capital requirements previously derived from the lag period of subsidy payments.

Subsidies for 2015 amounted to negative USD28.7 million, which was comprised of FET USD33.5 million, and FACE and fuel price variation of negative USD62.4 million. FET subsidy in 2014 was USD39.8 million, and it showed an annual average of USD46.0 million between 2011 and 2013. In the event that ENSA would not be able to transfer the energy cost to the end user through tariff adjustments, or through government subsidies, liquidity could be affected.

KEY ASSUMPTIONS
--Average annual Energy sales growth (GWh) of 5.5% from 2016-2019;
--15 year concession contract starting on November 2013 remains in place;
--Government subsidies continue to be paid in a timely manner;
--Capital expenditures in line with the company's annual business plan;
--Debt-to-EBITDA below 3.5x.

RATING SENSITIVITIES
Positive Rating Sensitivities: With debt-to-EBITDA at or above 3.0x, ENSA has limited headroom in the 'BBB' category. Therefore, Fitch does not anticipate positive rating action in the near term.

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

LIQUIDITY
The company's liquidity position is supported by its stable cash flow generation and flexible debt amortization schedule of its long-term debt (USD20 million matures in 2018), and USD180 million matures beyond five years (USD100 million in 2021, and USD80 million matures in 2027). Additionally, ENSA maintains working capital facilities for up to USD165 million, which can be used to finance purchases of energy. Short-term debt accounted for USD44 million as of March 2016.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings:

Elektra Noreste S.A.
--Foreign Currency Issuer Default Rating (IDR) at 'BBB';
--Local Currency IDR at 'BBB';
--Senior unsecured notes due 2021 at 'BBB'.

The Rating Outlook is Stable.

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Date of Relevant Rating Committee: Aug. 4, 2016.

Additional information is available on www.fitchratings.com.

Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1010053)
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