

# Fitch Affirms ENSA's Ratings at 'BBB'; Outlook Stable

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Fitch Ratings - New York - 14 Dec 2021: Fitch Ratings has affirmed Elektra Noreste S.A.'s (ENSA) Local- and Foreign Currency Issuer Default Ratings (IDRS) and its notes due 2036 at 'BBB'. 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 electricity 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. Fitch rates ENSA on a standalone basis from its ultimate parent, Empresas Publicas de Medellin E.S.P. (EPM; BB+/Rating Watch Negative), due to ENSA's relative financial and operational independence as well as the government's significant minority stake in the company.

## KEY RATING DRIVERS

**Solid Financial Structure:** ENSA's solid financial structure supports its 'BBB' rating and is comparable with similarly-rated regional peers. Fitch expects the company's total debt with equity credit/operating EBITDA to be near 2.9x in 2021, down from 3.2x in 2020, due to a recovery in energy sales volumes. Going forward, Fitch expects that metric to improve over the rating horizon due to energy sales volume growth, lower energy loss levels, moderate capital investment spending and inflation adjustments to regulated energy margins. Fitch expects the company's FFO interest coverage to be 4.8x in 2021 as a result of lower interest costs following the refinancing of the company's 2021 bond with lower-cost debt.

**Moderate Capex Boosts FCF:** Fitch expects capex requirements in the tariff effective 2H22 to be manageable for ENSA with total capex of USD211 million between 2021-2024, and for free cash flow to be neutral during this horizon. This amount is comparable to the 2H18-1H22 tariff, which requires ENSA to make capex of USD191 million over the four-year period. Capex requirements peaked at USD271 million during the 2H14 to 1H18 tariff period, when the country was growing more rapidly with real GDP growth regularly above 5%. This higher requirement caused ENSA to exceed 3.0x in 2017 and 2018.

**Higher Energy Losses Mitigated by Lower Prices:** After a rise last year, due partly due to increased theft during the coronavirus pandemic, Fitch expects ENSA's power losses to decline this year and thereafter. Fitch projects losses to fall from around 12% in 2021 to just over 11% in 2024. For each percentage point in losses, ENSA loses about USD4 million-USD5 million in EBITDA. While energy costs are largely passed through to end customers, Fitch estimates approximately 2%, or USD7 million to USD8 million, of the company's energy purchases are losses absorbed by ENSA.

**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, encompassing roughly half of the Panama City metro area and provinces to the north and east. While the less stable area of Colon is 16% of ENSA's demand, its user base is relatively densely populated with 38 users per kilometer of lines, making its concession area easier and more economical to manage. The concession is permanent but the concession contract is reviewed every 15 years, with the current contract expiring in October 2028.

**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 from distribution (VAD) reset every four years. The current 2018-2022 tariff allows the company to charge users USD41.95/MWh above the cost of energy, and this amount is adjusted semi-annually to reflect changes in the Panamanian consumer price index (CPI). Fitch considers this allowance reasonable for the company to meet its commercial and financial obligations. Tariffs are adjusted monthly to pass through fuel price changes.

## DERIVATION SUMMARY

In 2020, ENSA's total debt with equity credit to operating EBITDA ratio stood at 3.2x, and the firm's rating and credit profile are in line with those of its peers in the region. Its closest rating peers are its parent company Empresas Publicas de Medellin (EPM; BB+/Negative Watch) and Grupo Energia Bogota (GEB; BBB/Stable), which had 2020 leverage of 4.7x and 3.7x, respectively. Both GEB and EPM benefit from their much larger scale, with annual EBITDA many times that of ENSA.

ENSA has a comparatively more stable cash flow, which is also reflected in a smoother leverage trajectory. Lower-rated peers include Energuate Trust (BB-/Stable) and AES El Salvador Trust II (AES SLV; B-/Stable). Both DisCos are constrained by weaker capital structures and, in particular, exposure to weaker operating environments.

## KEY ASSUMPTIONS

--Volumes sold grow at 8.5% in 2021 and 3.5%-4% between 2022-2024;

- Majority of previous year's net income paid in dividends;
- New tariff effective 2H22-1H26 will have a similar value-added from distribution (VAD) as the current tariff;
- Capital expenditures of USD211 million between 2021-2024.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Improvement of gross leverage to less than 2.5x on a sustained basis.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Weakening of gross leverage to above 4.0x on a sustained basis;
- Increased reliance on government subsidies coupled with a downgrade of the sovereign.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## LIQUIDITY AND DEBT STRUCTURE

**Strong Liquidity:** Following the refinancing of ENSA's USD100 million bond due 2021 into a USD100 million bond maturing in 2036, the remainder of the company's financial obligations are staggered with a USD100 million loan from The Bank of Nova Scotia due 2023 and a USD80 million bond due 2027. Fitch expects the company to have negative FCF in 2021 and 2022, with cash flow turning positive for the rest of the rating horizon.

Additionally, the company has uncommitted credit lines totaling USD342 million from eight different financial institutions, all of which were untapped as of Oct. 31, 2021.

While the company's practice of paying the majority of its net income in dividends does affect FCF, Fitch expects capex requirements to be reduced over the rating horizon. As of September 30, 2021, Elektra Noreste had a cash balance of USD19.3 million, down from USD54.0 million as of YE 2020.

## ISSUER PROFILE

Elektra Noreste S.A.'s (ENSA) activities include the purchase of electricity in blocks and its distribution to customers throughout its concession area in Panama. The company is also responsible for installing, operating, and maintaining public lighting in the same area.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Elektra Noreste, S.A.	LT IDR BBB <span>•</span> Affirmed	BBB <span>•</span>
	LC LT IDR BBB <span>•</span> Affirmed	BBB <span>•</span>
senior unsecured	LT BBB Affirmed	BBB

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## **VIEW ADDITIONAL RATING DETAILS**

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

## **PARTICIPATION STATUS**

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## **APPLICABLE CRITERIA**

- [Corporate Rating Criteria \(pub. 15 Oct 2021\) \(including rating assumption sensitivity\)](#)
- [Parent and Subsidiary Linkage Rating Criteria \(pub. 01 Dec 2021\)](#)

## **APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 ([1](#))

## **ADDITIONAL DISCLOSURES**

- [Dodd-Frank Rating Information Disclosure Form](#)
- [Solicitation Status](#)
- [Endorsement Policy](#)

## **ENDORSEMENT STATUS**

[Elektra Noreste, S.A.](#)

[EU Endorsed](#), [UK Endorsed](#)

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