

# Fitch Ratings

## RATING ACTION COMMENTARY

# Fitch Affirms Elektra Noreste's Ratings at 'BBB'; Outlook Stable

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Fitch Ratings - New York - 28 Oct 2020: Fitch Ratings has affirmed the LC and FC IDRs of Elektra Noreste S.A. (ENSA) at 'BBB/Stable' and affirmed the notes due 2021 at 'BBB'.

Elektra Noreste S.A.'s (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.

## KEY RATING DRIVERS

**Solid Financial Structure:** Elektra Noreste's solid financial structure supports its 'BBB' rating and is comparable with that of similarly-rated regional peers. Fitch expects the company's 2020 total debt with equity credit/operating EBITDA to rise from 3.1x in 2019 to 3.4x in 2020, just below the company's debt covenant of 3.5x, due principally to lower energy sales volumes as a result of the coronavirus pandemic. Going forward, Fitch expects that metric to improve to average 2.9x over the rating horizon due to a recovery in energy sales volumes, lower energy loss levels, moderate capital investment spending and inflation adjustments to its regulated energy margin. Fitch expects the company's FFO interest coverage to be 4.4x in 2020, rising to 5.5x in 2021 as a result of continued strong cash flow and lower interest costs as the company refinances its USD100 million 7.6% fixed coupon 2021 bond with lower-cost debt.

**Coronavirus Impact Limited:** Company operations were hurt significantly by the coronavirus pandemic and Panama's subsequent lockdown, although demand began to pick up in midyear and total energy volumes sold are expected to be down only about 5.5% for all of 2020. While the government granted end-users a moratorium on their power bills for several months, an increase in subsidy payments helped soften the blow; ENSA reported that its subsidy receipts increased from about USD2.8 million in this year's first quarter to around USD11 million in April-June. By the end of June, ENSA said its customer payment rate had increased above 90%, and that figure was expected to reach 100% by year's end.

**Moderate Capex Boosts FCF:** The 2H18-1H22 tariff requires Elektra Noreste to make capital expenditures of USD191 million over the four-year period. This represents a meaningful decrease from the USD271 million required during the previous tariff period from 2H14 to 1H18, when the country was growing more rapidly with real GDP growth regularly above 5%.

**Higher Energy Losses Mitigated by Lower Prices:** This year, power losses are expected to rise from 11.47% in 2019 to 12.07% due partly to increased theft, as restrictions related to the coronavirus on movement hinder the company's ability to police its network. However, losses are expected to decline next year and thereafter. For each percentage point in losses, ENSA loses about USD4-6 million in EBITDA. The loss this year is reduced somewhat due to lower sales prices than last year, when low hydrology pushed end-user customer prices up during the first half of the year. While energy costs are largely passed through to end customers, Fitch estimates approximately 2% of the company's energy purchases are losses absorbed by ENSA. Due to spare capacity entering the generation system, particularly lowcost LNG plants, along with anticipated normalized hydrology conditions, Fitch assumes total energy costs will fall to approximately USD120/MWh by 2021, translating to an additional USD2.5 million in the company's EBITDA.

**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 kilometre 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

With expected gross leverage of 3.4x in 2020, ENSA'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) (BBB-/Rating Watch Negative) and Grupo Energia Bogota (GEB) (BBB/Stable Outlook), which have expected 2019 leverage of 3.4x and 3.9x, 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 Energa Trust (BB-/Stable Outlook) and AES El Salvador Trust II (AES SLV) (B-/ Negative). Both DisCos are constrained by weaker capital structures and, in particular, exposure to weaker operating environments.

## KEY ASSUMPTIONS

- Company refinances USD100 million bond maturing June 2021 and adds additional debt in 2022-23 to fund capex;
- Margins between energy purchase and sales prices will be equivalent to maximum permitted income (IMP);
- Energy losses as a percentage of volumes will decline by 0.5 percentage points after rising during the coronavirus pandemic in 2020
- No dividends paid in 2020; thereafter dividends equal to net income.

## RATING SENSITIVITIES

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

--Future developments that may, individually or collectively, lead to a positive rating action include: improvement of gross leverage to less than 2.5x on a sustained basis.

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

--Future developments that may, individually or collectively, lead to a negative rating action include: 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:** While Elektra Noreste has a USD100 million bond maturing in 2021 and USD30 million in short-term debt, 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 positive FCF in 2020 and 2021, with cash flow turning negative for the rest of the rating horizon. Additionally, the company had credit lines totaling USD325 million from eight different financial institutions as of June 30, 2020, with an average interest rate of 2.53%. 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 June 30, 2020, Elektra Noreste had a cash balance of USD38 million, up from USD6.4 million a year earlier.

## SUMMARY OF FINANCIAL ADJUSTMENTS

Adjustment of USD-42.2 million to EBITDA in 2019 to reflect the net movement in the balance of regulatory accounts.

## 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 Rating Outlook Stable	Af rmed	BBB Rating Outlook Stable
	LC	BBB Rating Outlook Stable	Af rmed	BBB Rating Outlook Stable
	LT			
	IDR			
	LT	BBB	Af rmed	BBB
● senior unsecured				

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Additional information is available on [www.tchratings.com](http://www.tchratings.com)**APPLICABLE CRITERIA**[Corporate Rating Criteria \(pub. 01 May 2020\) \(including rating assumption sensitivity\)](#)[Parent and Subsidiary Linkage Rating Criteria \(pub. 26 Aug 2020\)](#)**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

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Elektra Noreste, S.A. EU Endorsed

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