

## CREDIT OPINION

6 April 2021

### Update

✓ Rate this Research

#### RATINGS

##### Empresa de Transmision Electrica, S.A.

Domicile	Panama
Long Term Rating	Baa2
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Empresa de Transmision Electrica, S.A.

Update following rating downgrade, outlook change to stable

### Summary

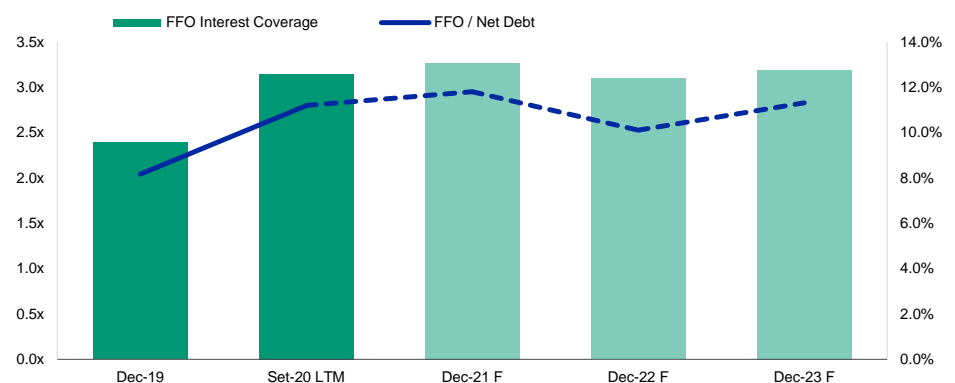
[Empresa de Transmision Electrica, S.A.](#) (ETESA) is an electricity transmission company in Panama wholly owned by the [Government of Panama](#) (Baa2 stable). ETESA has exclusive rights for the transmission, dispatch, control and demand planning for electricity generation in Panama. It owns the national transmission system, mainly three trunk transmission lines.

ETESA's creditworthiness is supported by the visible cash flow stemming from its strategic position as the sole electricity transmission provider in a regulated market, where tariffs are adjusted to provide a fixed return on investments. ETESA does not face volume risk because its revenue is a function of its productive assets, a key credit strength.

ETESA's projected financial metrics reflect relatively high leverage because of its capital investment program. In 2019, ETESA recorded cash interest coverage (funds from operations [FFO] + interests/interests) of 2.4x and FFO/debt of 8.2%. As of September 2020, ETESA recorded cash interest coverage of 3.1x and FFO/debt of 11.2%.

Exhibit 1

#### Actual and projected FFO, net debt and FFO/net debt



Financial metrics are based on our base case scenario.  
Sources: ETESA and Moody's Investors Service

## Credit strengths

- » The sole transmission company in Panama with exclusive rights to operate the network
- » Essential and regulated service, which provides for a highly visible stream of cash flow
- » Wholly owned by the Government of Panama, which, under our government-related issuer (GRI) framework, provides high levels of support

## Credit challenges

- » Leverage is likely to be relatively high, particularly over the next few years, because of the capital investment program.
- » ETESA operates under a concession contract with a finite life, although renewal risk is significantly mitigated by its links with the government and by the fact that under the law, it is the only entity permitted to own, operate and develop the country's transmission network.
- » Transmission capacity shortfalls must be covered by ETESA because the company must compensate for the electricity that it is not able to deliver.

## Rating outlook

The outlook is stable, in line with the rating outlook of the Government of Panama, the support provider. Also, ETESA's regulated business model is likely to generate stable and visible cash flow over the next 12-18 months.

## Factors that could lead to an upgrade

- » Given that ETESA's ratings are in line with the Government of Panama's rating, an upgrade is unlikely in the next 12-18 months.
- » Upward pressure on ETESA's rating would require the company to record a cash interest coverage and FFO/debt above 3.5x and 13.0%, respectively, on a sustained basis and, importantly, an upgrade of Panama's sovereign rating.

## Factors that could lead to a downgrade

- » The rating would come under downward pressure if the sovereign rating is downgraded or if we change our assessment of the implied government support.
- » ETESA's Baseline Credit Assessment (BCA) and rating could also be downgraded if its key financial metrics deteriorate, as a result of higher leverage or lower cash flow generation, such that its cash interest coverage and FFO/debt were to remain below 2.8x and 9.0%, respectively, on a sustained basis.

## Key indicators

Exhibit 2

### Empresa de Transmisión Eléctrica, S.A.

	Dec-19	Set-20 LTM	Dec-21 F	Dec-22 F	Dec-23 F
FFO Interest Coverage	2.4x	3.1x	3.3x	3.1x	3.2x
Net Debt / Fixed Assets	71.2%	65.2%	71.5%	72.4%	77.5%
FFO / Net Debt	8.2%	11.2%	11.8%	10.1%	11.3%
RCF / Net Debt	8.2%	11.2%	11.8%	10.1%	11.3%

Financial metrics are based on our base case scenario.

Sources: ETESA and Moody's Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody.com](http://www.moody.com) for the most updated credit rating action information and rating history.

## Profile

Empresa de Transmision Electrica, S.A. (ETESA) is Panama's electricity transmission company, wholly owned by the Government of Panama. ETESA was created in 1999 with exclusive rights for the transmission, dispatch, control and demand planning for electricity generation in Panama. ETESA is, by law, the only operator and owner of the national transmission system, which mainly consists of three trunk transmission lines, adding up to close to 3,000 kilometers.

## Recent developments

On March 17, 2021, we downgraded the issuer and senior unsecured debt ratings assigned to ETESA to Baa2 from Baa1, and changed the outlook to stable from negative. We also affirmed the BCA of baa2, a measure of ETESA's standalone creditworthiness.

Our rating action on ETESA reflected the rating downgrade and outlook change of the Government of Panama, the support provider under our analytical framework for GRIs.

## Detailed credit considerations

### ETESA's Credit Fundamentals

The Baa2 rating assigned to ETESA reflects its key credit strengths, including its solid market position as the sole transmission company in Panama with exclusive rights to operate the network. In addition, the company provides an essential and regulated service, with tariffs sized to cover operating and investment costs, which guarantees its sustainability and generates a highly visible stream of cash flow.

ETESA receives a maximum permitted income for the transmission services it provides. This amount is determined by the regulator and is defined through a tariff regime that is revised every four years. The next review period will start in 2021 and will become effective in July 2021. This tariff is meant to provide a fixed return after covering transmission and administrative costs, operating expenses and the depreciation of assets. It is calculated as a percentage of its regulated fixed asset base. Therefore, ETESA's revenue does not depend on the energy that is transported through the system, but is a function of the company's productive assets, a credit positive. Generation and distribution companies are charged a tariff, and if any of those companies fail to make a payment to ETESA, the payment is redistributed among the participants based on their market shares.

As a result of ETESA's capital program for the coming years, which averages an annual investment equivalent to 20.2% of net fixed assets over 2020-22, we project that ETESA will record relatively high leverage over the same period. Under our base case, ETESA's cash interest coverage (FFO + interests/interests) and FFO/net debt will average 3.3x and 12.2%, respectively, for the first three years of our projection (2020-22). A key assumption embedded in our rating is that the planned fourth transmission line, with an estimated cost of \$550 million, will be built under a design, build, finance and maintain scheme, following the guidelines of the new public-private partnership law enacted in 2019 (Law 93 of 19 September 2019), without recourse to ETESA and any significant capital requirement from the company. The bidding process for this transmission began in Q4 2020 and the contract will likely be awarded in 2021.

ETESA is authorized by the regulator Autoridad de los Servicios Publicos (ASEP) to provide public electricity transmission services under an exclusive renewable concession contract, which expires in 2025. Therefore, ETESA operates under a contract with a finite life, although renewal risk is significantly mitigated by its links with the government and by the fact that under the current law, it is the only entity permitted to own, operate and develop the country's transmission network.

### Close links with the Government of Panama

The Baa2 issuer rating assigned to ETESA reflects the application of our Joint Default Analysis (JDA) framework for GRIs, which takes into account the following four input factors: a BCA of baa2 as a measure of ETESA's standalone creditworthiness, the Baa2 rating of the Government of Panama as ETESA's support provider, our estimates of high implied government support in case of financial distress, and a very high default dependence between ETESA and the Panamanian government. These input factors are supported by the company's strong links with the Government of Panama, which owns 100% of ETESA. These factors also reflect the strategic and essential nature of the services provided, the government control and oversight of the company, and precedents of financial support through tariffs or direct capital contributions.

According to Law 6 of 1997, the board of directors is responsible for defining the policies for the proper operation, development and modernization of ETESA; it has historically been led by the Minister of Economy and Finance.

The Panamanian government has supported ETESA by providing capital contributions of \$68.7 million since 2011. By policy, ETESA does not have to pay any dividends, and it reinvests all its annual profit in the development and expansion of more efficient transmission lines, which allows the company to set more competitive tariffs.

In 2018, the Government of Panama supported ETESA by approving an extraordinary tariff increase, which resulted in additional \$80 million in revenue to compensate for the "Generacion Obligada" expense incurred by ETESA because of the delay in the construction of the third transmission line. Nonetheless, about half of the \$80 million will be deducted from tariffs in the coming years to compensate the electricity market for the extraordinary tariff increase.

## ESG considerations

### Environmental considerations

Regulated electric networks that operate under a concession contract with a finite life, such as ETESA, carry low environmental risks. New project investments bring execution risks, and environmental licenses can eventually lead to delays in project completion or cost overruns. Nonetheless, ETESA has been able to manage these risks appropriately.

### Social considerations

ETESA typically does not face social protest and objections to particular transmission lines within its portfolio, such as those observed for certain transmission projects globally. Other considerations, such as employee safety and transmission tariff increases, are also of low risk to ETESA, given the low labor-intensive nature of its operations and the low representation of transmission fees in the overall electricity bill.

### Governance considerations

ETESA has a good track record of a conservative financial policy and is not required to make dividend payments. The company's senior management has extensive sector experience, and its overall policies and strategy are well aligned with and complementary to those of the Government of Panama.

### Liquidity analysis

Given the cash flow visibility stemming from the tariff-setting mechanism, liquidity is not a credit concern for ETESA. Nonetheless, the company had almost \$16 million in cash and equivalents compared with \$3 million in short-term debt as of September 2020.

## Methodology and scorecard

The methodologies used in these ratings were our [Regulated Electric and Gas Networks](#), published in March 2017, and [Government-Related Issuers Methodology](#), published in February 2020.

Exhibit 3

### Rating factors

Empresa de Transmisión Eléctrica S.A.

[Empresa de Transmisión Eléctrica, S.A. -Private](#)

Regulated Electric and Gas Networks Industry [1][2]	Current LTM 9/30/2020		Moody's 12-18 Month Forward View As of 3/24/2021 [3]	
	Measure	Score	Measure	Score
<b>Factor 1 : Regulatory Environment and Asset Ownership Model (40%)</b>				
a) Stability and Predictability of Regulatory Regime	A	A	A	A
b) Asset Ownership Model	Baa	Baa	Baa	Baa
c) Cost and Investment Recovery (Ability and Timeliness)	A	A	A	A
d) Revenue Risk	Aa	Aa	Aa	Aa
<b>Factor 2 : Scale and Complexity of Capital Program (10%)</b>				
a) Scale and Complexity of Capital Program	Ba	Ba	Ba	Ba
<b>Factor 3 : Financial Policy (10%)</b>				
a) Financial Policy	Baa	Baa	Baa	Baa
<b>Factor 4 : Leverage and Coverage (40%)</b>				
a) FFO Interest Coverage (3 Year Avg)	3.1x	Baa	3.3x	Baa
b) Net Debt / Fixed Assets (3 Year Avg)	70.5%	Baa	71.5%	Baa
c) FFO / Net Debt (3 Year Avg)	11.2%	Baa	11.8%	Baa
d) RCF / Net Debt (3 Year Avg)	11.2%	Baa	11.8%	Baa
<b>Rating:</b>				
Scorecard-Indicated Outcome Before Notch Lift		Baa1		Baa1
Notch Lift	0	0	0	0
a) Scorecard-Indicated Outcome		Baa1		Baa1
b) Actual Rating Assigned		Baa2		
<b>Government-Related Issuer</b>		<b>Factor</b>		
a) Baseline Credit Assessment		baa2		
b) Government Local Currency Rating		Baa2		
c) Default Dependence		Very High		
d) Support		High		
e) Actual Rating Assigned		Baa2		

[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for nonfinancial corporations.

[2] As of 9/30/2020.

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Financial Metrics™

## Ratings

Exhibit 4

Category	Moody's Rating
<b>EMPRESA DE TRANSMISION ELECTRICA, S.A.</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2

Source: Moody's Investors Service

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