

CREDIT OPINION

2 April 2019

New Issue

✓ Rate this Research

RATINGS

Empresa de Transmision Electrica, S.A.

Domicile	Panama
Long Term Rating	Baa1
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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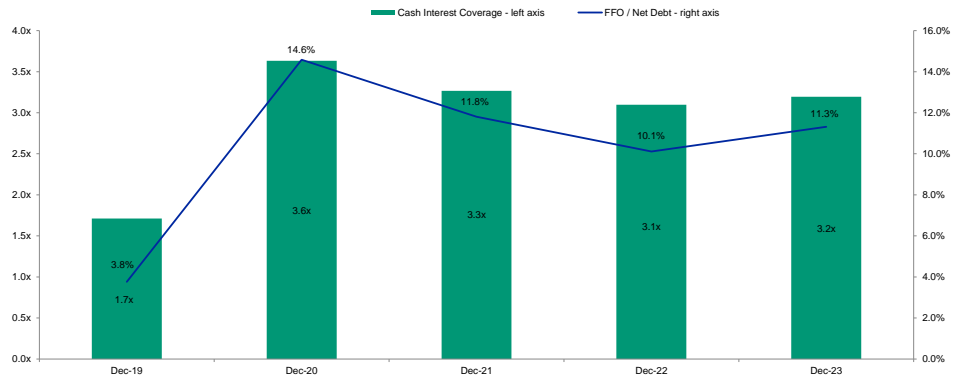
Empresa de Transmision Electrica, S.A.

First-time issuer ratings

Summary

- » Empresa de Transmision Electrica, S.A. ("ETESA" or "the Company") is Panama's electricity transmission company, wholly-owned by the Government of Panama (Baa1, stable). ETESA was created in 1999 with exclusive rights on the transmission, dispatch, control and demand planning for electricity generation in Panama. It owns the national transmission system which mainly consists of three trunk transmission lines.
- » ETESA's creditworthiness is supported by the visible cash flows stemming from its strategic position as the sole electricity transmission provider in the country and the regulated market under which it operates, where tariffs are adjusted in order to provide a determined return on investments. ETESA does not face volume risk since its revenues are a function of the Company's productive assets, key credit strengths.
- » ETESA's projected financial metrics exhibit a relatively high leverage, particularly over the next few years mainly due to the capital investment program. Under Moody's base case, ETESA's cash interest coverage (Funds From Operations (FFO) + interests / interests) and FFO / net debt are projected to average 2.9x and 10% respectively, over the first three years of our projection.
- » The outlook is stable, reflecting the regulated business model that is expected to generate stable and visible cash flows. The stable outlook is also in line with the rating outlook of the Government of Panama, the support provider.

Exhibit 1  
Projected FFO, Net Debt and FFO to Net Debt (\$ million)



Financial metrics based on Moody's Base Case Scenario.  
Source: ETESA and Moody's Investors Service.

## Credit strengths

- » Sole transmission company in Panama with exclusive rights to operate the network
- » Essential and regulated service provides for a highly visible stream of cash flows
- » Wholly owned by the Government of Panama, which under our GRI framework provides rating uplift

## Credit challenges

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

## Rating outlook

The outlook is stable, reflecting the regulated business model that is expected to generate stable and visible cash flows. The stable outlook is also in line with the rating outlook of the Government of Panama, the support provider.

## Factors that could lead to an upgrade

- » Given that the Baa1 rating is in line with the sovereign rating of Panama, an upgrade of the rating is unlikely in the near term.
- » Upward pressure on ETESA's rating would require that the company strengthens on a stand-alone basis and, importantly, that the sovereign rating of Panama is upgraded.

## Factors that could lead to a downgrade

- » The rating would come under downward pressure if there is a downgrade in the sovereign rating or if we change our view on implied government support.
- » The BCA and rating could also be downgraded if ETESA's key financial metrics deteriorate as a result of higher leverage or lower cash flow generation. Specifically, if cash interest coverage and FFO/Debt were expected to fall below 2.8x and 9.0%, respectively, on a sustained basis.

## Key indicators

Exhibit 2

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

	Dec-19	Dec-20	Dec-21	Dec-22
FFO Interest Coverage	1.7x	3.6x	3.3x	3.1x
Net Debt / Fixed Assets	80.1%	66.2%	71.5%	72.4%
FFO / Net Debt	3.8%	14.6%	11.8%	10.1%
RCF / Net Debt	3.8%	14.6%	11.8%	10.1%

Financial metrics based on Moody's Base Case Scenario.

Source: 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

ETESA is Panama's electricity transmission company, wholly-owned by the Government of Panama (Baa1 stable). ETESA was created in 1999 with exclusive rights on 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 km.

## Detailed credit considerations

ETESA's Baa1 rating assigned reflects 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, guarantee its sustainability, and generate a highly visible stream of cash flows.

ETESA has 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 be 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 depreciation of assets. It is calculated as a percentage of its regulated fixed asset base. As such, the Company's revenues do not depend on the energy that is transported through the system, but are a function of the Company's productive assets, a credit positive. Revenues are charged to generation and distribution companies and if any of those companies fails to make a payment to ETESA, the payment is redistributed among the players based on their market share.

As a result of ETESA's capital program for the coming years, that averages a yearly investment equivalent to 14.6% of net fixed assets over the period 2019-2021, Moody's projects that ETESA will record a relatively high leverage. Under Moody's base case, ETESA's cash interest coverage (Funds From Operations (FFO) + interests / interests) and FFO / net debt are projected to average 2.9x and 10% respectively, over the first three years of our projection (2019-2021). A key assumption embedded in our rating is that the planned 4th transmission line, with an estimated EPC cost of \$550 million, will be built under a Build, Operate, Transfer ("BOT") scheme, without recourse to ETESA and without any material capital requirements from the company. The bidding process for this transmission line began in June 2018 and is expected to be completed during the first half of 2019.

ETESA is authorized by the regulator Autoridad de los Servicios Públicos ("ASEP") to provide the public electricity transmission service under an exclusive renewable concession contract expiring in 2024. As such, ETESA operates under a contract with a finite life, although renewal risk is materially mitigated by its linkages with the government and by the fact that under the current law is the only entity permitted to own, operate and develop the country's transmission network. In fact, the concession is expected to be renewed during the first half of 2019 in connection with the 4th transmission line project.

## Close links to the Government of Panama

The Baa1 issuer rating assigned to ETESA reflects the application of Moody's joint default analysis (JDA) framework for government related issuers (GRIs), which takes into account the following four input factors: i) a baseline credit assessment (BCA) of baa2 as a measure of ETESA's stand-alone creditworthiness, ii) the Baa1 rating of the Government of Panama as ETESA's support provider, as well as iii) our estimates of High implied government support in the case of financial distress and iv) a Very High default dependence between ETESA and the Panamanian government. These assumptions are supported by the company's strong linkages with the Government of Panama, which owns 100% of ETESA. These also reflect the strategic and essential nature of the services provided, the government control and direction of the company, and precedents of financial support via tariffs or direct capital contributions, which under our framework ETESA's rating translates into a one-notch rating uplift from the BCA of baa2.

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 Panama government has supported ETESA by providing capital contributions since 2011 for a total amount of \$68.7 million. By policy ETESA does not have to pay any dividends, on the other hand it reinvests all the annual profits in the development and expansion of more efficient transmission lines, which allow the Company to provide more competitive tariffs.

In 2018, the Government of Panama supported ETESA by approving an extraordinary tariff increase that results in additional \$80 million in revenues to compensate for the "Generacion Obligada" expense incurred by ETESA due to the delay of the Third

Transmission Line. Nonetheless, approximately half of the \$80 million will be deducted from tariffs in the coming years to compensate the electricity market.

### Liquidity analysis

Given the visibility on cash flows stemming from the tariff setting mechanism, liquidity is not a credit concern for ETESA. Nonetheless, the Company has credit facilities for up to \$130 million. These facilities are mostly used for short term needs.

### Rating methodology and scorecard factors

The methodologies used in these ratings were Regulated Electric and Gas Networks published

in March 2017, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

Exhibit 3

#### ETESA's Scorecard Factors for Baseline Credit Assessment

Factor	Subfactor	Score	Metric
1. Regulatory Environment and Asset Ownership Model	a) Stability and Predictability of Regulatory Regime	A	
	b) Asset Ownership Model	Baa	
	c) Cost and Investment Recovery (Ability and Timeliness)	A	
	d) Revenue Risk	Aa	
2. Scale and Complecity of Capital Program	a) Scale and Complecity of Capital Program	Ba	
3. Financial Policy	a) Financial Policy	Baa	
4. Leverage and Coverage	a) FFO Interest Coverage (3 Year Avg)	Baa	2.87x
	b) Net Debt / Fixed Assets (3 Year Avg)	Baa	72.63%
	c) FFO / Net Debt (3 Year Avg)	Ba	10.05%
	d) RCF / Net Debt (3 Year Avg)	Baa	10.05%
<b>Notching Considerations</b>		<b>Notch</b>	
	1- Structural Considerations and Sources of Rating Uplift From Creditor Protection	0	
<b>Scorecard Indicated Rating:</b>		<b>Baa2</b>	

Financial metrics calculated using 3 year projected averages for 2019-2021.

Source: Moody's Investors Service.

### Ratings

Exhibit 4

Category	Moody's Rating
<b>EMPRESA DE TRANSMISION ELECTRICA, S.A.</b>	
Outlook	Stable
Issuer Rating	Baa1

Source: Moody's Investors Service

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