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Research Update:

ENA Norte Trust 'BBB' Debt Rating Affirmed, Outlook Remains Stable

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Table Of Contents

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Rating Action Overview

- We believe traffic at ENA Norte Trust will decrease around 3% this year given that its main competitor, Domingo Diaz Avenue, will be re-opened soon. We anticipate the avenue will absorb part of the traffic the project has received in the past few years when the avenue was partially closed. Even considering this, we expect the project's financial performance to remain strong in upcoming years, fueled by favorable economic conditions in Panama and sound motorization levels.
- On March 27, 2019, S&P Global Ratings affirmed its 'BBB' issue-level rating on the Panamanian toll road operator's (or the project's) $600 million notes.
- The stable outlook reflects our expectation that traffic performance should return during early 2020 to a positive trend, given that the toll road will continue to offer better service and represent significant time savings for its users versus its competitor. We anticipate that ENA Norte Trust will post an annual traffic increase of about 5% next year, converging in the long term to a growth rate of about 4% until the end of the notes' term, resulting in minimum and average debt service coverage ratios (DSCRs) of 2.85x and 10.21x, respectively.

Project Description And Key Credit Factors

ENA Norte Trust (ENA Norte) has the concession to design, construct, maintain, administer, and operate the Corredor Norte toll road in Panama City. The project currently comprises Phase I and Phase IIA with a combined length of 19.4 kilometers (km), the Panama-Madden segment with a length of 14 km, and two branches, Villa Lucre and Zárate (Brisas del Golf) which are 3.3 km and 1.3 km long, respectively. Excluding the aforementioned branches, the toll road's current total length is 33.4 km. Toll operations of phase I started in March 1998, while phase IIA opened in May 2009.

Based on the concession agreement, the right to administer the asset will expire on the earlier of the 30th anniversary of the date that the Ministry of Public Works certified each segment of the toll road as operating (February 2028), or on the date on which the rated notes will be fully paid, which our base-case scenario assumes will occur in the first quarter of 2026.

Maxipista de Panama S.A. (not rated) provides the operating and maintenance (O&M) activities. It's an experienced player in the toll road business that also operates ENA Sur Trust. The sponsor of the project (ENA) has signed a fixed-price contract of about $9 million with Maxipista that will remain in place during the notes' life.

In regards to its debt structure, the bond is 100% cash-sweep, in which principal payments are performed with the excess cash flow after covering the project expenses, interest payments, and replenishing reserve accounts, according to the cash flow waterfall. Because of that, as of today, we believe the project will be able to service 100% of the outstanding debt (of around $400 million) by March 2026, two years before its legal maturity.

Strengths

- Strong traffic performance and fundamentals, indicated by a historical compound average traffic growth rate of 7.15% over the past nine years and a projected traffic increase of 4% on average until the end of the concession, because we believe operating performance will continue to be linked to economic growth and motorization levels;
- An experienced operator with a long track record in the industry working under a fixed-price contract; and
- A restricted capital structure, because no dividend payments are allowed until 100% of the bond is paid, protecting the issuer's interests.

Risks

- All revenues depend on traffic performance. Therefore, a sharp fluctuation in operating performance could affect the project's capacity to comply with its financial obligations;
- Some degree of competition from free alternative roads that could dent the project's traffic growth; and
- The project's tariffs, which are adjusted by the government on a discretionary basis, remained flat during the last five years and we expect no changes going forward.

Rating Action Rationale

The rating affirmation reflects our expectation that ENA Norte will maintain a solid financial performance, posting minimum and average DSCRs of around 3x and 10.2x,respectively (which we calculate based on interest payments) despite the 3% decrease in traffic this year. This drop will be driven mainly by some of ENA Norte's users migrating to use Domingo Diaz Avenue after it reopens this April or May.

Over the past three years, we've seen that the effects of the construction of the Panama Metro (Lines I and II) have been one of the main drivers for the toll roads traffic performance. The construction affected the main free alternative road to the toll road, resulting in its temporary closure.

Work on the Metro's Line II will be completed by mid-2019 and Domingo Diaz

Avenue will reopen. From then until the end of the year, we project that some of the traffic that uses now ENA Norte will migrate to Domingo Diaz. When the avenue previously reopened in 2014-2015, traffic at the toll road decreased 1.8% and 3.4%, respectively, and we expect a similar effect this year. Despite these decreases in traffic levels, we don't anticipate that they'll have a significant impact on the project's cash flow generation. We still project that traffic will stabilize between the two competing roads from 2020 and on. In our view, ENA Norte still has better competitive strengths, primarily the asset's time savings and conditions.

Liquidity

We assess ENA Norte's liquidity as neutral. The project has a six-month debt service reserve account and a 12-month major maintenance reserve account, holding about $14 million and $1.25 million, respectively, as of December 2018. Additionally, the project has a capital expenditure (capex) reserve account, which holds funds equivalent to 20% of the expected outflows for the following year. Moreover, given the project's strong DSCRs, we don't expect the use of the debt service reserve account in our base-case scenario. We believe the amount held as part of the reserves accounts is higher when compared to other projects that have recently issued new debt, especially considering that ENA Norte has a 100% cash sweep mechanism.

Moreover, as of this report's date, there is no breach in the project's covenants, which relate to incurring additional debt, guaranteeing other debt, engaging in other businesses, providing the trustee and rating agencies the required servicing reports, and others. Additionally, the project benefits from having a restricted capital structure in which no dividend payments are allowed until 100% of the bond is paid.

Outlook

The stable outlook reflects our expectation that traffic performance should recover in early 2020 because the highway will continue to offer a better service and represent significant time savings for its users versus its competitor. We anticipate that ENA Norte will post an annual traffic increase of about 5% next year, converging in the long term to a growth rate of about 4% until the end of the notes' term, resulting in minimum and average DSCRs of 2.85x and 10.21x, respectively.

Downside scenario

We could lower the debt rating on ENA Norte in the next twelve months if traffic levels decrease more than 12%, resulting in a minimum DSCR of less than 1.5x, or if we were to downgrade Panama, given that we believe we can't rate the project above the sovereign.

Upside scenario

An upgrade is possible in the next 12 months if we were to revise ENA Norte's stand-alone credit profile (SACP) upwards because of a traffic increase above 15%, resulting in a faster repayment of the existing notes and at the same time we were to upgrade Panama--given that the project's SACP is currently at the same level as the sovereign rating. We could also raise the rating following the same action on the sovereign if we perceive potential extraordinary support from the government under a stress scenario.

Performance Update

In 2018, ENA Norte's operating and financial performance remained strong, in line with our expectations. Particularly, traffic grew 5%, slightly below our 6% expectations, mainly due to lower-than-expected GDP growth that we believe affected last year's motorization growth rate. The 5% traffic increase and a flat tariff generated a total annual revenue of $86 million. This amount was sufficient to cover annual operating costs, interest payments, maintain a six-month debt reserve account and 12-month major maintenance reserve account, and prepay around $45 million of the cash sweep notes (10% of the notes' outstanding amount as of December 2018).

In 2019, we project a 3% drop in traffic due to the reopening of Domingo Diaz Avenue, which was partly closed starting in 2016 due to the construction of Panama Metro's line II that runs close to the avenue. We anticipate that the reopening of the avenue will draw some traffic away from ENA Norte, as we saw in 2014 and 2015 with drops of about 1.8% and 3.4%, respectively, following the completion of line I.

Going forward, we project that once Domingo Diaz Avenue is fully open, ENA Norte's performance will recover, maintaining its current market position. We believe most of users will choose the highway even if they will be charged for it because it offers a better service than its competitors(in terms of time saving and road conditions).

In our base case, we expect traffic will increase 5% in 2020, converging to an average long-term growth rate of 4% until the end of the concession. The 4% increase is slightly lower than our GDP growth rate projection of 5% (the other variable that could affect traffic levels) because the asset will start reaching high congestion levels in some areas of the road by the end of the concession. This traffic increase will allow the project to generate stable cash flow to pay the debt service and post minimum and average DSCRs of 2.85x (in 2019)and 10.21x, respectively, which only incorporates interest payments. As of January 2019, ENA Norte had repaid 35% of its debt, and we expect an early full prepayment by March 2026.

Base Case

We consider GDP growth and competition from alternative routes to be the main drivers for the toll road's traffic growth. In line with our expectations in our latest Latin American credit conditions article, "Tough Fixtures Home And Away," published on Nov. 29, 2018, we forecast Panama's real GDP to expand by 5% starting in 2019.

Assumptions

- Annual traffic decrease of about 3% in 2019, followed by a 5% increase in 2020, converging to a long-term growth rate of about 4% until the end of the notes' term;
- No tariff increases, in line with the trend in previous years, given the discretionary rate adjustment mechanism;
- Annual O&M costs of about $9 million; and
- Annual maintenance capex of about $10 million for 2019 and $8 million starting in 2020.

Key metrics

- A minimum DSCR of 2.85x in 2019; and
- An average DSCR of 10.21x during the notes' life.

Downside Case

Assumptions

We modeled a five-year down cycle scenario between 2019 (when we expect the project to generate the lower DSCR) and 2023. We assumed a 3% traffic reduction from our base-case projections (of negative 3% and 5% for 2019 and 2020, respectively) starting in 2019, followed by a 1.5% reduction between 2021 and 2023. We also modeled the O&M and capex costs up by 10% over our base case and a 100 basis point decrease in GDP growth rate.

Key metrics

- A minimum DSCR of 2.79x in 2019; and
- An average DSCR of 8.98x over the life of the notes.

Rating Score Snapshot

Construction phase SACP: N/A

Operations phase SACP: bbb

- Operations phase business assessment: 3 (1=best to 12=worst)
- Preliminary SACP: a

- Downside impact on preliminary SACP: None (no impact)
- Liquidity: Neutral (no impact)
- Comparative analysis assessment: Neutral (no impact)
- Adjusted preliminary operations phase SACP: bbb
- Operations counterparty ratings adjustment: Neutral
- Financial counterparty ratings adjustments: Neutral
- Operations phase SACP: bbb

Modifiers (senior debt)

- Parent linkage: De-linked
- Structural protection: Neutral
- Extraordinary government support: None
- Sovereign rating limits: BBB
- Full credit guarantees: None
- Senior debt issue rating: BBB

Related Criteria

- Criteria - Corporates - Project Finance: Key Credit Factors For Road, Bridge, And Tunnel Project Financings, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Operations Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Criteria - Corporates - Project Finance: Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

ENA Norte Trust	
Senior Secured	BBB/Stable

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.