

Research Update:

# ENA Norte Trust Rating Cut To 'BB+' On Expected Higher Costs And Sluggish Traffic Recovery, Still On Watch Negative

May 14, 2020

## Rating Action Overview

- We updated our projections for Panamanian toll road ENA Norte Trust (ENA Norte), which now incorporates our expectation of higher operating expenses due to ongoing maintenance works that are unlikely to be postponed, and a drop in traffic of almost 40% in 2020. We also expect a slower recovery in traffic in the next three months than we previously projected amid the increasing competition from free alternative roads that, due to the current restrictions on movement, are less congested. As a result, we don't expect internally generated cash flows will be enough to cover debt service payments in 2020, and therefore, project a partial use of the existing liquidity reserves.
- Consequently, on May 14, 2020, S&P Global Ratings lowered its issue-level rating on ENA Norte's \$600 million notes to 'BB+' from 'BBB', while keeping it on CreditWatch with negative implications since we placed it on April 6, 2020.
- The CreditWatch negative listing reflects a 50% chance of a further downgrade in the next three months if the Panamanian government tightens or extends the pandemic containment measures, or if traffic on the toll road doesn't recover at the expected pace, resulting in weaker coverage metrics.

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## Rating Action Rationale

**The downgrade reflects our view of ENA Norte's weaker resilience to movement restrictions and higher operating costs.** We updated our forecast for ENA Norte. The new base-case scenario incorporates \$13.5 million in operating expenses for 2020, 15% higher than the 2019 figure, attributable mostly to the acquisition of a crane and additional construction materials for ongoing maintenance works. Although generally projects have some level of flexibility to accommodate maintenance capex during downturns, we don't expect a postponement in ENA Norte's case because of the advanced stage of construction.

In addition, we assume a slower recovery in traffic in the very short term, given that most drivers shifted to free alternative roads parallel to ENA Norte (such as Domingo Diaz Avenue) because they're less congested during the current lockdown, therefore, there's no significant time savings for using the toll road. Given that the Panamanian government plans to lift the quarantine by the end of May, we expect traffic volumes at ENA Norte to remain in line with those in April (80% lower than the 2019 figure) until the end of June and will gradually start to recover afterwards, as the free alternative roads start to congest. As a result, we now expect a traffic drop at ENA Norte close to 40% in 2020, rather than our previous projection of 35%, leading to revenue for 2020 of \$50 million - \$55 million, down from the previous forecast of \$55 million - \$60 million. The combination of these factors will lead to a liquidity shortfall of about \$2.5 million by mid-2020.

In our view, ENA Norte has sufficient liquidity to handle the shortfall due to the existence of a six-month debt service reserve account (DSRA) of about \$8.3 million. ENA Norte benefits from a full cash sweep mechanism for principal payments, providing flexibility to defer payments until the traffic recovers. As such, we only expect interest payments at least in the next few quarters that limits the absolute value of the shortfalls under our current assumptions, which is not the case for other projects, such as ENA Sur Trust. On the other hand, we view negatively the project's weaker resilience to the currently difficult conditions. This will prompt ENA Norte to use the reserve account, while we previously expected minimum debt service coverage metric ratio (DSCR) well above 1.1x under our downside case.

**Environmental, social, and governance (ESG) factors relevant to the rating action:**

- Health and safety

## **CreditWatch**

The CreditWatch negative listing reflects a 50% chance of a further downgrade in the next three months if the Panamanian government tightens or extends its pandemic containment measures or if traffic on ENA Norte doesn't recover at expected pace resulting in weaker coverage metrics. We could further lower the rating if we expect a traffic drop of more than 45% for 2020, which would lower the minimum annual DSCR metric below 1.25x.

We could assign a stable outlook in the following three months if traffic start to recover by the third quarter of the year, reaching above 2.5 million vehicles on a monthly basis (down 50% from the 2019 level in the same period), resulting in annual DSCR ratio above 1.60x.

## **Base Case**

### **Assumptions**

- Traffic decrease of about 40% for 2020 from 2019, with a recovery to 51 million vehicles in 2021 (85% of the 2019 level), 56 million in 2022 (92%), and 59 million in 2023 (97%). Starting in 2024, we expect traffic to increase about 3%, slightly lower than Panama's GDP growth until the end of the notes' term.
- No rate increases, in line with the trend in previous years, given the discretionary rate adjustment mechanism.
- Annual operations and maintenance (O&M) and minor maintenance costs of approximately \$13.5 million in 2020.

- Major maintenance costs of \$7.4 million in 2020.

## **Key metrics**

On the quarterly interest payment dates, we expect the project to use a portion of its \$8.3 million DSRA to cover the projected shortfall in July 2020, when the next interest payment is due.

However, we expect ENA Norte to replenish the reserve accounts until the following interest payment, as long as recovery occurs as expected. This would cause the rolling 12-month DSCR to reach 1.6x in 2020.

## **Downside Case**

### **Assumptions**

- A traffic drop of 45% for 2020, which includes four-month lockdown. The rest of our expectations are in line with the base-case scenario.
- O&M and capex costs up 10% over our base-case assumptions and a 100 basis point decrease in GDP growth rate.

## **Key metrics**

On the quarterly interest payment dates, we expect the project to use a higher portion of its \$8.3 million DSRA to cover the projected shortfall in July 2020. Despite our expectation that ENA Norte would be able to pay the shortfalls, we view negatively the project's weaker resilience to the current conditions, while we didn't previously expect the use of the reserve accounts while for the minimum DSCR to be well above 1.1x under our downside case.

## **Project Description**

ENA Norte has the concession to design, construct, maintain, administer, and operate the Corredor Norte toll road in Panama City. The project currently comprises 33.4 km, named Panama-Madden segment and two branches, Villa Lucre and Zárate (Brisas del Golf) which are 3.3 km and 1.3 km long, respectively. The project started its operations in 1999 and based on the concession agreement, the right to administer the asset will expire on February 2028, or on the date on which the rated notes will be fully paid, which our base-case scenario assumes will also occur in the first quarter of 2028.

Maxipista de Panama S.A. (not rated) provides the O&M activities under a fixed-price contract of about \$9 million during the notes' life. We view Maxipista as an experienced player in the toll road business that also operates ENA Sur Trust.

ENA Norte's \$600 million 4.95% senior secured notes due 2028 (\$337 million outstanding in May 2020) don't have a scheduled amortization. However, ENA Norte's cash waterfall mechanism uses any excess cash flow after the payment of operating costs, interest payments, and replenishment of the reserves to amortize the outstanding principal amount of the notes. As such, we're excluding principal payments in our DSCR calculations. At the same time, we believe that this mechanism overstates the project's metrics, so we adjust the notes' rating by three notches.

## Rating Score Snapshot

### Operations phase SACP (Senior debt)

- Operations phase business assessment (OPBA): 4 (1=best to 12=worst)
- Preliminary SACP: a
- Downside impact on preliminary SACP: bbb+ (-2 notches)
- Liquidity: Neutral (no impact)
- Comparative analysis assessment: Neutral (no impact)
- Debt Structure: Material dependence on cash flow sweeps (-3 notches)
- Adjusted preliminary operations phase SACP: bb+
- Operations counterparty ratings adjustment: Neutral
- Financial counterparty ratings adjustment: Neutral
- Operations phase SACP: bb+

### Modifiers (Senior Debt)

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

## Liquidity

We continue to assess ENA Norte's liquidity as neutral. The project has a six-month DSRA and a minor and major maintenance reserve account of about \$8.3 million, \$1.5 million, and \$1.25 million, respectively, as of May 2020. Additionally, the project benefits from having a restricted capital structure in which no dividend payments are allowed until 100% of the bond is paid.

## Related Criteria

- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Corporates | Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Key Credit Factors For Road, Bridge, And Tunnel Project Financings, 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 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

### Downgraded

	To	From
<b>ENA Norte Trust</b>		
Senior Secured	BB+/Watch Neg	BBB/Watch Neg

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings referenced herein can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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