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Research Update:

ENA Sur Trust 'BBB' Issue-Only Rating Affirmed; Outlook Remains Stable

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Rating Action Overview

- We believe traffic at ENA Sur Trust (ENA Sur) will decrease around 3% this year given that its main competitor, Domingo Diaz Avenue, will be reopened soon. We anticipate the avenue will absorb part of the traffic the project received in the few past years when the avenue was partially closed due to construction works in an adjacent area. Even considering this context, we expect the project's financial performance to remain strong, 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) class A $170 million notes.
- The stable outlook reflects our expectation that traffic performance should recover in early 2020 given that the toll road will continue to offer a better service and represent significant time savings for its users versus its competitor. We anticipate ENA Sur will post an annual traffic increase of about 5% until the end of the notes' term, resulting in minimum and average debt service coverage ratios (DSCRs) of 2.21x and 2.94x, respectively.

Project Description And Key Credit Factors

ENA Sur Trust has the concession to design, construct, maintain, administer, and operate the Corredor Sur toll road in Panama City. The toll road construction began in May 1997. The toll road partially opened in June 1999 and started fully functioning in February 2000.

Based on the concession agreement, the right to administrate 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 being operative (June 2029), or on the date on which the notes will be fully paid, which our base-case scenario assumes will occur in the first half of 2025.

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 Norte 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 company has issued $170 million class A notes (which is the current rated bond) and $225 million class B notes, which we don't rate but are pari-passu with the class A bond. The latter has scheduled amortization payments, which will be due in May 2025. The class B note is 100% cash-sweep, in which principal payments are paid 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, we believe the project will be able to service 100% of outstanding class B notes (around $55 million) by September 2020, four years and a half before its legal maturity. Consequently, in our view, the project will have sufficient cash flow (after pre-paying the class B notes) to repay the existing rated class A bond while maintaining high DSCR metrics of up to 3x.

Strengths

- Strong traffic performance and fundamentals, indicated by a historical compound average traffic growth rate of 10.15% in the past nine years and a projected traffic increase of 5% 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 ENA Sur pays 100% of class B bond, protecting issuers' 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;
- Certain degree of competition from other free alternative roads that could dent the traffic growth at ENA Sur; and
- The project's tariffs, which the government adjusts 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 Sur will maintain a solid financial performance, posting a minimum and average DSCR of around 2x and 3x, respectively (which we calculate based on class B interest payments and class A interest and principal payments) despite a drop in traffic of around 3% in 2019. This decrease will be driven mainly by part of ENA Sur's users migrating to Domingo Diaz Avenue after its reopening this April or May.

Over the past three years, we've seen the construction of the Panama Metro's Lines I and II affect the toll-road's traffic performance. The construction closed the main alternative road, which is free. Work on Line II of the Metro will be completed by mid-2019 and Domingo Diaz Avenue will reopen. From then until the end of 2019, we project that some traffic that now uses ENA Sur will migrate to Domingo Diaz. Domingo Diaz previously reopened in 2015, and we saw the project's traffic decrease by 7.7%. We expect a similar effect this year, but to a lesser extent--we're now expecting a decrease of around 3%, given that we´ve already seen a lower increase of traffic levels in 2018 (more than 50% below our expectations) due to some works performed on some of ENA Sur's exits that we believe were a one-time event. Even assuming this 3% drop in traffic levels, we don't anticipate that it will have a significant impact on the project's cash flow generation because we still project traffic to stabilize between the two competing roads from 2020 on. In our view, ENA Sur still has better competitive strengths, mainly attributable to the asset's time savings and conditions.

Liquidity

We assess ENA Sur's liquidity as neutral. The project has a six-month debt service reserve account and a 12-month major maintenance reserve account, holding about $15 million and $2.5 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 reserve accounts is higher when compared to other projects that have recently issued new debt, especially considering that ENA Sur has a 100% cash sweep mechanism on its class B notes, which accounts for about 40% of the outstanding total debt.

Currently, 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 by early 2020, given that the highway will continue to offer a better service and represent significant time savings for its users versus its competitor. We anticipate ENA Sur will post an annual traffic increase of about 5.5% next year, converging in the long term to a growth rate of about 5% until the end of the notes' term, resulting in minimum and average debt service coverage ratios(DSCRs) of 2.21x and 2.94x, respectively.

Downside scenario

We could lower the debt rating on ENA Sur in the next twelve months if traffic levels decrease more than 10%, resulting in a minimum DSCR of less than 2x, 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 Sur's stand-alone credit profile (SACP) upwards because of a traffic increase above 20%, 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 Sur's traffic grew 2.7%, which is less than half of the traffic projected last year. This is explained by the fact that some users decided to use alternative roads because of some temporary works that raised congestion levels for two of ENA Sur's exits. The 2.7% increase in traffic and a flat tariff generated a total annual revenue of $73 million, which was slightly below our expectations, but more than 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 $26 million of the cash sweep class B notes (30% of the notes' outstanding amount as of December 2017). As of January 2019, 76% of ENA Sur's class B bond had been repaid, and we expect an early full prepayment by September 2020.

This year, 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 Sur, as we saw in 2015, with a drop of about 7.7% that year following the completion of line I.

Going forward, we project that once Domingo Diaz Avenue is fully available, ENA Sur performance will improve again, maintaining its current market position. We believe most of users will choose the highway even if they will be charged for it, since it offers a better service than its competitors in terms of time saving and road conditions.

In our updated base case, we expect traffic will increase 5.5% in 2020, converging to a long-term average growth rate of 5% until the end of the concession, in line with our GDP growth rate projection. We expect ENA Sur's long-term traffic growth rate to be 100 basis point (bps) higher than ENA Norte (for which we project an average growth rate of 4% from 2020 until the end of the concession), given that ENA Sur has fewer congested road sections than ENA Norte. This traffic increase will allow the project to generate stable cash flow to pay the debt service and post minimum and average DSCRs of 2.21x (in 2019) and 2.94x, respectively.

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 5.5% increase in 2020, converging to a long-term growth rate of about 5% until the end of the notes' term;
- No tariff increases, which is 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 in 2020.

Key metrics

- A minimum DSCR of 2.21x in 2019; and
- An average DSCR of 2.94x 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 lowest DSCR) and 2023. We assumed a 6% traffic reduction from our base-case projections (of negative 3% and 5.5% for 2019 and 2020, respectively) starting in 2019, followed by a 3% 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 1.91x in 2019; and
- An average DSCR of 2.25x during the notes' life.

Rating Score Snapshot

Construction phase SACP: N/A

Operations phase SACP: bbb

- Operations phase business assessment: 5 (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 Sur 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.