Global Journals LaTeX JournalKaleidoscope™
Artificial Intelligence formulated this projection for compatibility purposes from the original article published at Global Journals. However, this technology is currently in beta. *Therefore, kindly ignore odd layouts, missed formulae, text, tables, or figures.*

Credit Analysis of Emerging Economics Energy Distribution Company of Peru

Edmundo R. Lizarzaburu[1] and Dr. Alfredo Mendiola[2]

[1] UNIVERSIDAD ESAN

Received: 7 December 2012 Accepted: 3 January 2013 Published: 15 January 2013

Abstract

The case focuses in evaluation of a Peruvian company called "The Energy Distribution Company of Peru -DEPSA". This company has several lines of financing (credit lines or credit facilities) in order to cover their operations in the short and long term. In the last board meeting, they (the board members) agreed that DEPSA should continue with the current financing politic for their operations, focusing on the next 12 months in the short term. In order to confirm the possibility of continuing with that politic, the finance manager had to coordinate with the main bank, the evaluation through a credit analysis and ask for a renewal of its credit lines first in front of the respective financial institution.In addition, the board asked that the regulatory area explains, on the next session, how the Electricity Sector works in Peru does and who are the main actors and stakeholders of the business.

Index terms— electricity sector, financial strategies, financial statements analysis, ratios, dupont, profitability and risks.

After checking some documents, Mr. Fausto Menlizqui required a meeting with Mr. Ernesto Valdez, Chief Financial Officer of the Energy Distribution Company of Peru, with the purpose of talking about the information that was going to be processed and analyzed. The meeting was made before the credit report. The meeting will be on summer 2011.

At the meeting, Mr. Valdez comments a little about the sector and the company's history, mentions some things about the growth in the Peruvian market (there's a construction boom 3 in Peru, where before there was one house -one meter, now there are in average buildings of 15 apartments -15 meters and also a meter of the building itself).

As in all investments, the access to the sector's information is a key variable to consider, especially everything about the legal and regulatory aspects. The industry of electric energy in Peru is divided into: (a) Generation, that consists on the creation of energy through several sources, among which water, natural gas, coal and oil are the most important, (b) Transmission, the electricity is transported through transmission lines to the substation, those substations convert high voltage electricity into less voltage electricity, and (c) Distribution, in which the electricity is taken from the substation to houses, offices and factories.

As shown below on Table 1. The electric energy consumption per capita and on Graphic 1 Evolution of electric energy per capital the growth have been constant on the last 15 years and, apparently, it will continue with this increasing trend on the next years. This information can be used to compare the growth trend of consumption against sales growth and the company's margin. In order to have more details of the sector, Mr. Fausto Menlizque coordinated with the regulatory area of Emerging Market, where Dr. Macarena Lizquerri attended him. This information is shown of Annex 1 of this case.

1 III.

2 Background of the Company and Operations

Fausto, has shown interest on the explanation of the sector, but considered relevant to understand the operation of the company and know as much as possible about the financial situation of the company on the last years.

In order to do that, he checked the web page of the Stock Market of Lima (www.bvl.com.pe) and CONASEV (today known as SMV www.smv.gob.pe) and the information given by the company. The detail of its stock prices (stock's information and details of the bonds in circulation) is shown on Annex 2 of this document. On those pages he found important information about financial statements, cash flow and prices of several instruments that the company has, now, DEPSA.

Is important to mention some relevant aspects about the history of the company in study, which is a member of Endesa group. The Electric Distribution Company of Peru started its operation in March 1934. Its principal objective is to make activities of distribution and commercialization of electric energy, on a competitive background and free market according to the standards that are valid on the Peruvian market. Nowadays, the company works on 52 districts in Lima and Callao (Peru) with a total of 2,440 km 2 in which 1,838 km 2 are on the north of the capital city. In addition, it works at the provinces of Huaura, Barranca and Oyon.

In accordance with the provisions of the law and in addition to its social object, in 2006 the company started, on its concession area, the sales of electric artifacts and insurances (multiple insurances, burial insurances and family protection insurances). All of those services are targeted to clients with medium and low sizes of income; they are added an additional charge on their receipts.

Since 1998, DEPSA has a contract of energy purchase and the contracted power with the company Edegel SAA has a maximum capacity of 145MW and a length of 13 years. Since 2007 the company has made several tenders on the base of the Law 28832 with the purpose of ensure the supply of electric energy to its free clients and regulated on the short term (2008-2013) as well as on the long term (2014-2025). As a result of the tenders the company has sign several contracts (more than 100) electric energy supply; in which, between 20 and 25, were signed with Edegel SAA and the minimum power contracted was 0.3MW and a maximum of 275MW.

DEPSA is a member of Endesa group, which a leader company of the Spanish electric market, one of the five biggest in Europe and on the main private electric companies in Latin America. Its main business is to produce, transport, distribute and commercialize electric energy. In addition, it has an increasing presence on the Iberian market of natural gas and develops other services that add value to their main business. Under the acquisition of Endesa by the Italian group Enel, the biggest electric company in Italy and the second Italian operator of natural gas, the Energy Distribution Company of Peru is now part of the second electric company with major installed capacity of the world, with a presence on 23 countries of the 4 continents and has 96,000 MW of installed capacity and 60.8 million clients in generation and electric and gas distribution. In addition, they have an increasing presence on the Iberian market of natural gas and develops other services that add value to its main business and has a characteristic support of its operation and several offices around the world.

3 Financial Situation

regarding the fulfillment of legal dispositions applicable and attached to its electric activities; being the organization in charge of penalize and solve in last administration instance the matters attached to those legal dispositions. In addition, OSINERGMIN controls the fulfillment of environmental obligations in charge of the emitter, in this case the Energy Distribution Company of Peru.

4 7

The financial information selected was obtained on the financial statements of DEPSA, which are shown on its memories of the years 2006 to 2010, on the dates and for every period indicated on this section. Fausto started the analysis the information of the Financial Statements, through some methods and obtaining the behavior of the main accounts.

5 Credit Lines

The company works with 4 local financial entities 8

8 Source: Risk centers with its principal bank Banco de Credito del Peru with more than 50% of their direct and indirect obligations with banks.

In addition, BBVA and Banco Interbank are relevant. The company also finances its obligations on the capital market (between 70% and 80%) since there they have good rates conditions that they obtain from investors. The principal products DEPSA uses on the financial market are: letters of guarantee, treasury operations, medium-term note and leasing transactions.

6 C

Fausto has access to the total amount of exposition with the bank and it is of US$ 180 MM, where 50% are letters of guarantee (tenders, complaints to SUNAT ?? VI.

7 Questions

, others), and the other 50%is distributed on a similar way between the other three products, which mean what is important for DEPSA is to renew and extend the lines of the letters of guarantee and treasury operations. The other operations are being cancelled with no delay.

The amount of the letters of guarantee generate, for the bank, are commission incomes between 0.15% and 1% of the amount of the letter of guarantee. The treasury operations are mainly of exchange rate, since the company has to pay its obligation with a foreign currency and its incomes are mainly with the local currency.

Fausto already has the whole information and has to present the report to the board, and you have to collaborate with the analysis doing the math, being the most important:

? Vertical and horizontal analysis ? Ratio analysis: solvency, liquidity and management.

? Dupont analysis 1. With this information, which are the strengths and weaknesses of Energy Distribution Company of Peru? 2. From the analysis, what does the numbers of the company show? 3. About the sources of financing of the company, where do they obtain most part of their resources? 4. Should the financial entities renew and extend the credit lines of the company? Additionally, and since there is information, the student is require to make a referential review of the EVA. -Private management of the interconnected electric system operations under efficiency principles, minimizing costs and quality guarantee and reliable supply of electricity.

8 Structure of the Electricity Sector

The electricity sector in Peru is divided in three sub-sectors: generation, transmission and electricity distribution. The generation activities can be developed by companies that generate electricity using hydraulic resources or geothermal or fuel. The transmission activities are generally developed by companies that transmit the energy produced by generation companies for the sale of this to third parties. The distribution activities of electricity are developed by distribution companies that acquire electricity from the generation companies for the sales of this to the final clients that can be free or regulated.

The Law of Electric Concessions establishes as the main principle the division of the activities that are from the electricity sector in a way that more than one activity (generation, distribution and transmission). This allows the existing companies that are related in different activities but the same company cannot do both two activities at the same time.

Under the terms of the Antimonopoly and Antioligopoly Law of the Electricity Sector, the vertical and horizontal integration of the activities mentioned before need to have a previous authorization in charge of the Free Competence Committee of the National Institute of Defense of Competition and the Protection of Intellectual Property (INDECOPI), when some of the target parameters established on the norm are overcome. Furthermore, the Law of Electric Concessions allows vertical integration on the cases of isolated systems where the same company is in charge of more than one activity.

When the electric power is transmitted from the generator to the distributor, is divided into two types of clients:

? Regulated clients: around 4.6 millions of users 11 (supplies) with a maximum demand less or equal to 250Kw per supply Electric Companies: the electric companies are the ones that are in charge of generation, transmission or distribution of electric energy to the economic agents that demand that resource. According to the Ministry of Energy and Mines, there are 22 generator companies, 7 transmission companies and 23 distribution companies.

9 Regulators and Supervisor Agencies

The generation, transmission and distribution activities of electricity in Peru are regulated by the Law of Electric Concessions and its regulation. On the legal framework of the sector, there are two entities (The Ministry of Energy and Mines -MINEM -and the Supervisor Agency of Investment on Energy and Mining -OSINERGMIN -) in charge of look after the implementation and fulfillment of the applicable norms to the electric sector activities.

-MINEM establishes the general politic of the sector, regulates the matters related to environmental protection and the grant, supervision and termination or caducity of authorizations and concessions for the development of the generation, transmission and distribution of electricity activities. -OSINERGMIN looks after the fulfillment of the dispositions contained on the applicable laws for the activities of the sector and sanction the ones that not meet what is regulated on the Regulation of Supervision of Energetic Activities.

10 Energy Demand

During 2010 the total production of energy of the system was of 35,764 GWh, which represents a growth of the electric demand at a national level of 9.4% with respect of 2009, according to the preliminary number published by the Ministry of Energy and Mines 14 According to the Law of Electric Concessions, for the supply of Public Electricity Service (Regulated . The demand of electric energy in Peru has grown in 8.1%, with respect of 2009, while the Distribution Company of Peru did in 7.4%.

A growth of the demand have been registered (energy purchase), without including toll of 7.0%. About the maximum potencies (without toll) had grown 5.04% with respect of the maximum demand registered in 2009.

Tariffs 14 MINEM numbers.

Users) and Free Users, different princes have been established b OSINERGMIN 15 .

156 The sales of electricity that are made by generation companies to the distribution companies fluctuates at the
157 tariff applicable that was established by OSINERGIN for the respective point (Bar) of deliver (Bar Tariff). The
158 Bar Tariffs are composed by the Price of Power Point in Bar, the Price of Energy in Bar, the charges of the
159 principal system's transmission and the loss determine by each bar of the interconnected system. The tariffs in
160 Bar are the maximum princes of electricity acquire by distribution companies that they can move to its Regulated
Users. 15 Peruvian regulator of the electric sector. [1] [2] [3] [4]

Figure 1:

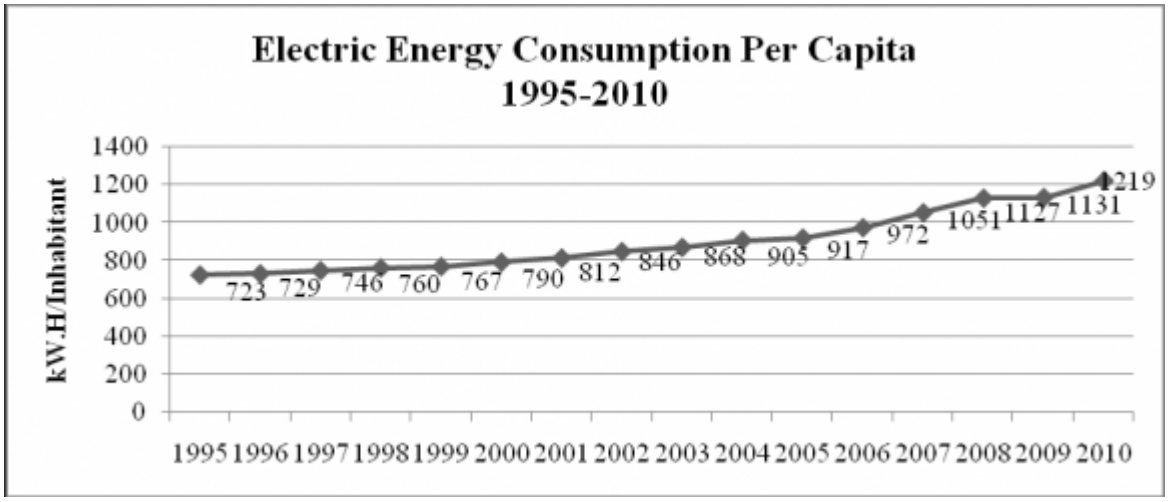

Figure 2:

161

[1]Source: Newspaper Perú 21, Chamber of Commerce of Lima, October 2011. 4 Class & Asociados S.A. Pacific Credit Rating. T © 2013 Global Journals Inc. (US)

[2]© 2013 Global Journals Inc. (US)

[3]Supervosiry agency of investment in energy and mining.7 The information shown had been obtained on the memories of the company and the web pages of the Stock Market of Lima-BVL and the Superintendence of Securities Market -SMV.

[4]At the moment of the study, at the beginning of 2011.

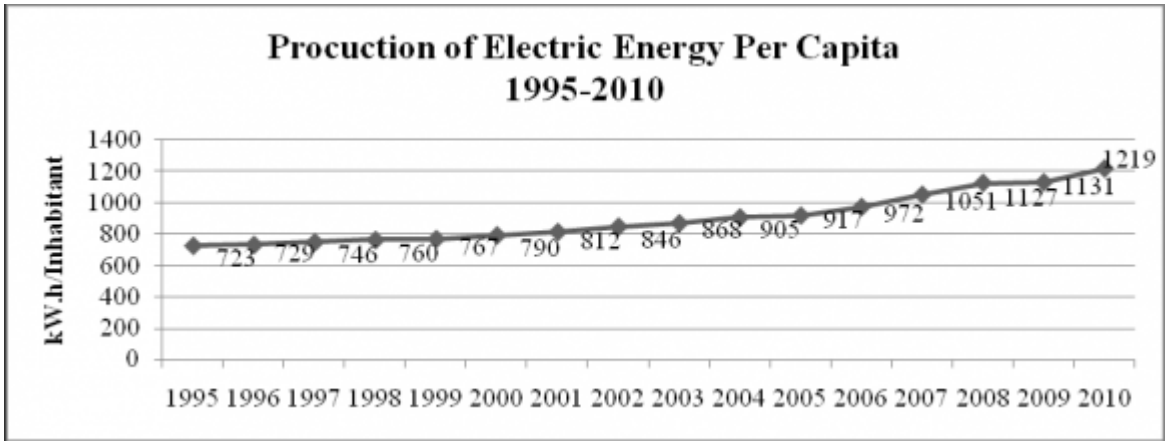

Figure 3: C

1

2013
ear
Y
Volume XIII Issue III Version I
( ) C

Year 1995	kW.h/inhabitant	Global Journal of Management and Business Research
	584	
1996	603	
1997	625	

[Note: 8% Average Variation 10/05 6% Growth 10/00 59% Average Variation 10/00 5% Graphic 1 : Evolution of Electric Energy Consumption Per Capita Also, the production of electric energy during the last 15 years has had the same trend as consumption. The Table 2 Production of Electric Energy Per Capita and Graphic 2 Evolution of the Production of Electric Energy Per Capita show what was mentioned.]

Figure 4: Table 1 :

2

		2001	812
		2002	846
		2003	868
		2004	905
		2005	917
		2006	972
		2007	
		2008	
Year 1995	kW.h/inhabitant 723	2009 2010	
1996	729		
1997	746		
1998	760		
1999	767		
2000	790		

Figure 5: Table 2 :

Charter No 3 : Composition of Liabilities 2010	Charter No. 4 : Income Statement (thousands of dollars)	Ch
	2006 2006	2007 2007 20
		200
Net sales ASSET	1,293,308.00	LIABILITIES 1,29
Other operational incomes CURRENT ASSET	24,356.00	CURREN
Total gross revenue Cash and cash equivalent	Bank overdraft 1,317,664.00	1,349
Financial obligations Commercial Payables Other payables of related parties (net)	Income tax and current p	
Sales expenses TOTAL CURRENT ASSET	-68,428.00 243,639.00	Provisions

Charter No. 2 : Composition of Assets 2010 ASSET CURRENT ASSET Cash and Cash equivalent 158,548.

Figure 6: NON CURRENT LIABILITIES 872,118.00 946,795.00 1,125,088.00 1,245,631.00 1,255,685.00 TOTAL LIABILITIES 1,326,340.00 1,420,372.00 1,544,694.00 1,595,917.00 1,726,216.00 NET EQUITY

Figure 7:

. If the demand is between
250Kw and 2500Kw they freely choose if it is a
regulated or a free client.
? Free clients: 258 big electricity consumer (important
mining complexes, commercial and industrials) with
a potential demand equal or superior to 2,500Kw 13
.

Participants of the Electricity Sector
Ministry of Energy and Mines (MINEM): is a
governing body of Energetic and Mining Sector that
meets regulatory work. Has a mission to promote the
sustainable and competitive development of energetic
and mining activities ensuring the supply of energy in an
effective and efficient way. Furthermore, they are in
charge of enforcing the valid legal framework (Law of
Electric Concessions) and its function is to conduct the
medium and long term energetic politics oriented to the
optimum use of the resources without prejudicing the
environmental background. It is important to mention
that MINEM is the only agency the power of ceding so
they give concessions and authorization to participate
on the electric business in the Country.
Supervision System Energy Investment: this
system is composed by these institutions: Supervisory
Agency of Investment in Energy and Mining
(OSINERGMIN), which monitors, supervises and
regulates the activities made by the energy sector, they
regulate the tariffs and sets the different prices regulated
by the electronic service; INDECOPI, is in charge of
regulating free competence; and finally, the Deputy
Manager Rate Regulation (GART), which is in charge of
setting tariffs.
Committee on Economic Operation of the
System (COES-SINAC): technical agency which

[Note: 11]

Figure 8:

[Crouhy et al. ()] 'A comparative analysis of current credit risk models'. M Crouhy , D Galai , R Mark . *Journal of Banking & Finance* 2000. 24 p. .

[Damodaran and Management (2010)] 'A Corporate Governance Manual'. Aswath Damodaran , Risk Management . http://ssrn.com/abstract=1681017 *Available at SSRN*, September 23. 2010.

[Berger and Udell ()] 'A More Complete Conceptual Framework About SME Finance'. A N Berger , G F Udell . *World Bank Conference on SME: Overcoming Growth Constraints*, 2004.

[Bharath et al. ()] 'Accounting quality and debt contracting'. S T Bharath , J Sunder , S V Sunder . *The Accounting Review* 2008. 83 (1) p. .

[Fernandez (2001)] 'Cash Value Added Do Not Measure Shareholder Value Creation'. Pablo Fernandez . http://ssrn.com/abstract=270799 *Available at SSRN*, May 22. 2001.

[Fernandez (2007)] 'Company Valuation Methods: The Most Common Errors in Valuations'. Pablo Fernandez . http://ssrn.com/abstr-act=274973 *Available at SSRN*, February 28. 2007.

[Chen et al. ()] 'Corporate yield spreads and bond liquidity'. L Chen , D A Lesmond , J Wei . *Journal of Finance* 2007. 62 (1) p. .

[Suisse ()] *Creditrisk+: A credit risk management framework. Credit Suisse Financial Products*, Credit Suisse . 1997.

[Damodaran (2007)] Aswath Damodaran . http://ssrn.com/abstract=1105499 *Return on Invested Capital (ROIC) and Return on Equity (ROE): Measurement and Implications*, July 2007. (Available at SSRN)

[Altman and Sabato ()] 'Effects of the New Basel Capital Accord on Bank Capital Requirements for SMEs'. E I Altman , G Sabato . *Journal of Financial Services Research* 2005. 28 (1) p. 3.

[Lopez and Saidenberg ()] 'Evaluating credit risk models'. J A Lopez , M R Saidenberg . *Journal of Banking and Finance* 2000. 24 p. .

[Altman ()] 'Financial ratios, discriminant analysis and the prediction of corporate bankruptcy'. E I Altman . *The Journal of Finance* 1968. 23 (4) p. .

[Beaver et al. ()] 'Financial statement analysis and the prediction of financial distress'. W H Beaver , M Correia , M F Mcnichols . *Foundations and Trends in Accounting* 2010. 5 (2) p. .

[Peruvian taxes regulator] *Peruvian taxes regulator*,

[Berger and Frame ()] 'Small Business Credit Scoring and Credit Availability'. A N Berger , S W Frame . *Working Paper Series* 2005. (10) .

[Fasb ()] *Statement of Financial Accounting Concepts No. 8. Conceptual framework for financial reporting*, Fasb . 2010.

[Fernandez (2011)] 'WACC: Definition, Misconceptions and Errors'. Pablo Fernandez . http://ssrn.com/abstract=1620871 *Available at SSRN*, September 22. 2011.

[Armstrong et al. ()] *When does information*, C S Armstrong , J E Core , D J Taylor , R E Verrecchia . 2011.