



**THE ELECTRICITY SECTOR
IN THE
DOMINICAN REPUBLIC**

**Washington DC,
June 21st, 2010**



Current Situation



- The electricity sector in the DR has shown little structural improvements, if any, in the last 12 months despite the efforts of the current administration.
- Clearly, the drivers for the historical “vicious cycle” remain unchanged.
- Although the underlying causes for the “vicious cycle” are well known, we have the perception that we continue shooting in the wrong direction. Myths continue to fog the right path.
- After describing briefly these negative drivers our intention is to share with you our view on how to transform them, and create once again a “virtuous cycle” for the sector.

Virtuous Cycle (1999-2001)



Causes

- Privatization process in 1999.
- Regulatory framework
 - ◆ Electricity Law
 - ◆ Specialized Regulatory Bodies (OC, SIE, CNE)
- Long-term contracts
- Market oriented political message

Effects

- Significant direct investment in generation, distribution, and transmission.
 - ◆ Specially over 1,500MW of new efficient generation capacity.
- Additionally diversification of the energy supply matrix (fuel & tech).
 - ◆ LNG, Coal, CC GT

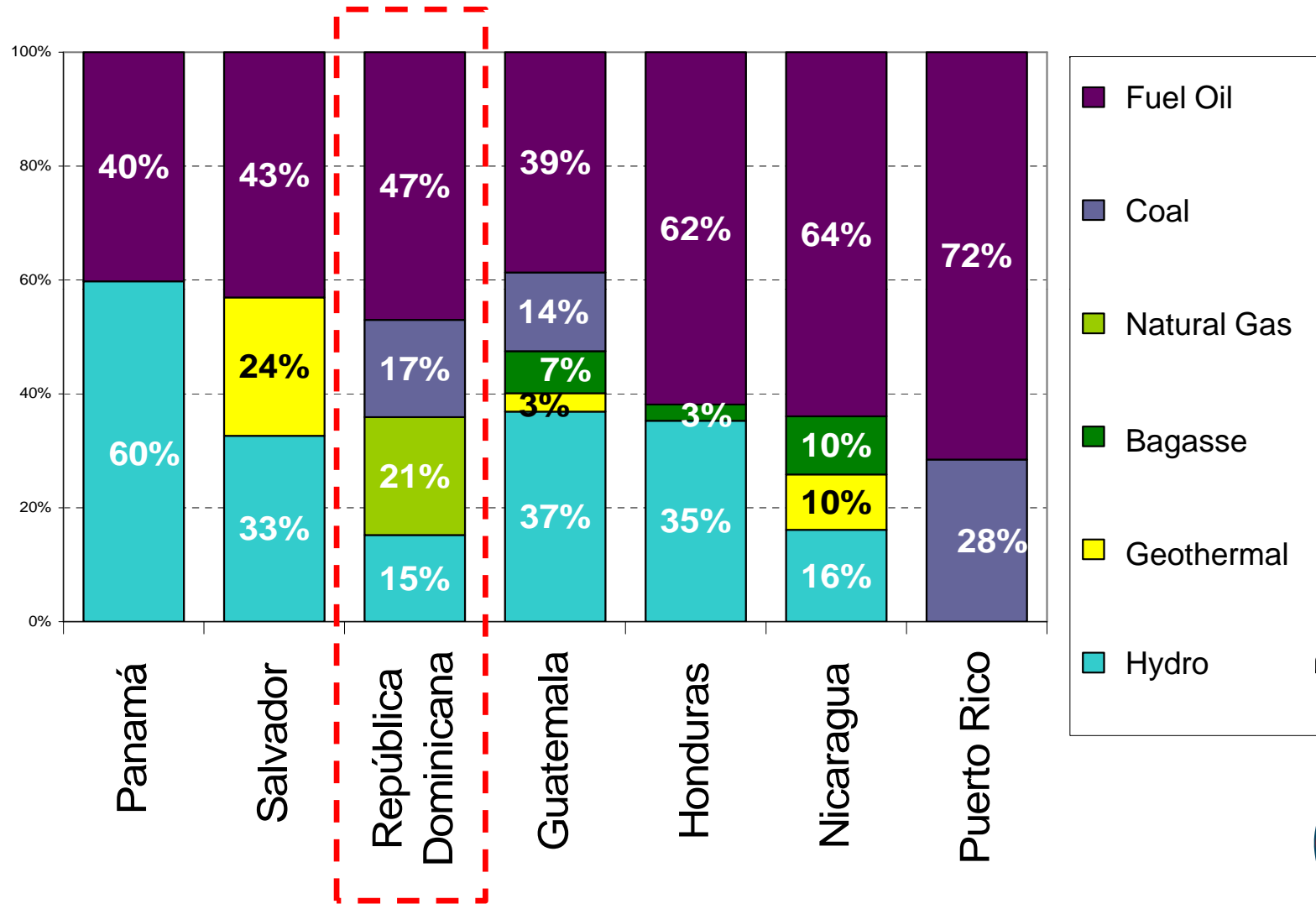
New Investments



Technology	Fuel	MW	Player
CCGT & LNG Terminal	Natural gas	300	AES
OC GT (DPP)	Natural gas	236	AES
Steam Turbine	Coal (Conversion)	235	El Paso, AES
Diesel Engine	HFO	150	Basic Energy, CDC
Steam Turbine	Coal	45	Basic Energy, CDC
Steam Turbine	HFO (Repowering)	200	Basic Energy, CDC
CCGT	LFO	300	CDC, Cogentrix
Diesel	HFO	100	Caterpillar, Local Group
Diesel	HFO	60	Local Goup
	Total	1,626	

Current peak demand ~1,800MW

Energy Matrix



Vicious Cycle (2002-Today)



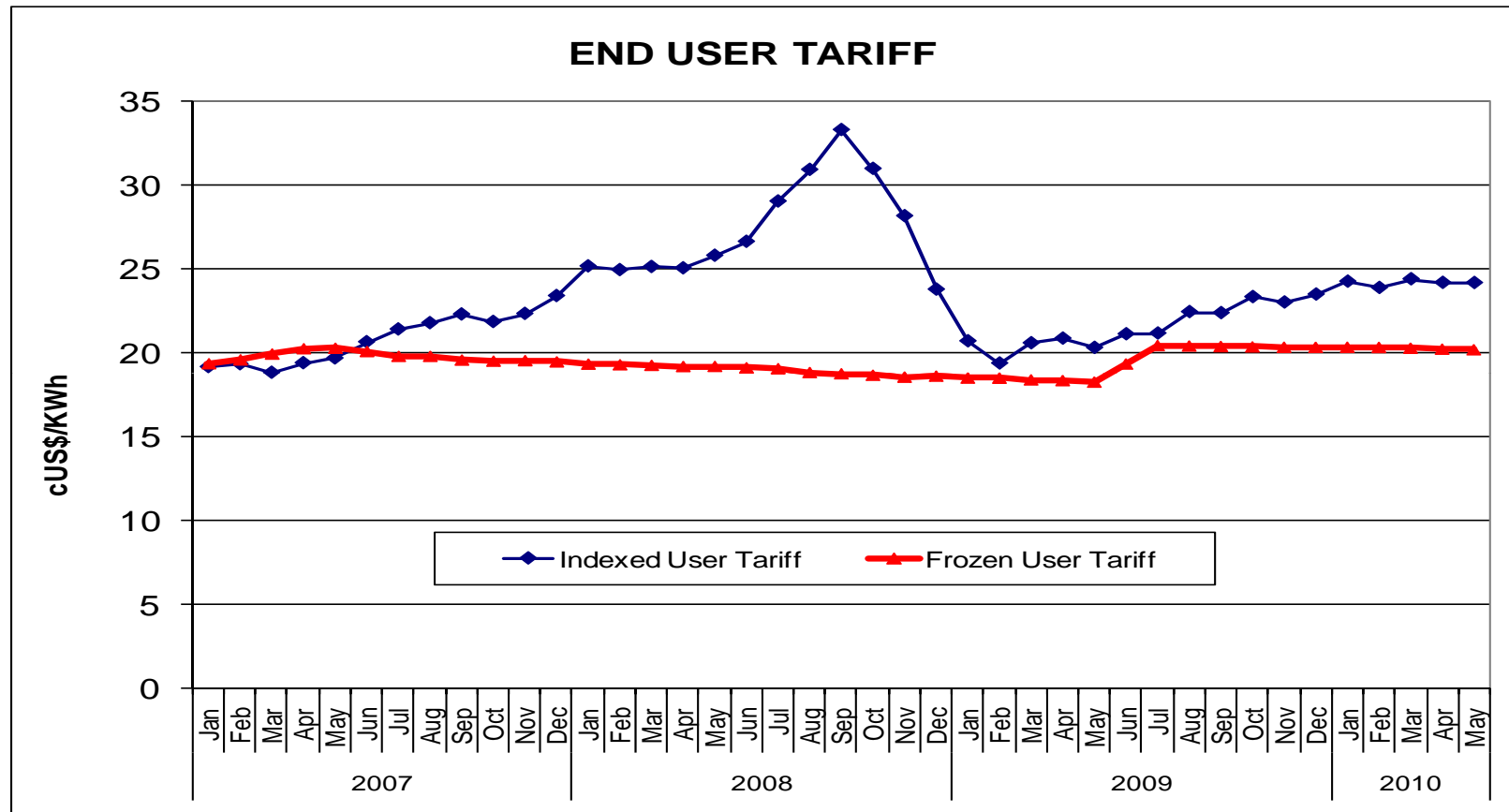
Causes

- No tariff adjustments. Non-technical tariff.
- Non-focalized subsidies
 - ◆ Geographical subsidies (PRA)
 - ◆ All users above 150kWh/mo
- Untimely payments to DisCos before their re-nationalization.
- Renegotiation of LT contracts.
- Change of Political message
 - ◆ State intervention and State utility mindset
 - ◆ Constant threat to renegotiate contracts
 - ◆ Generation used as escape goat
- Lack of consistent LT plan and investments to reduce energy losses
- Financing the “hole” with the generators

Effects

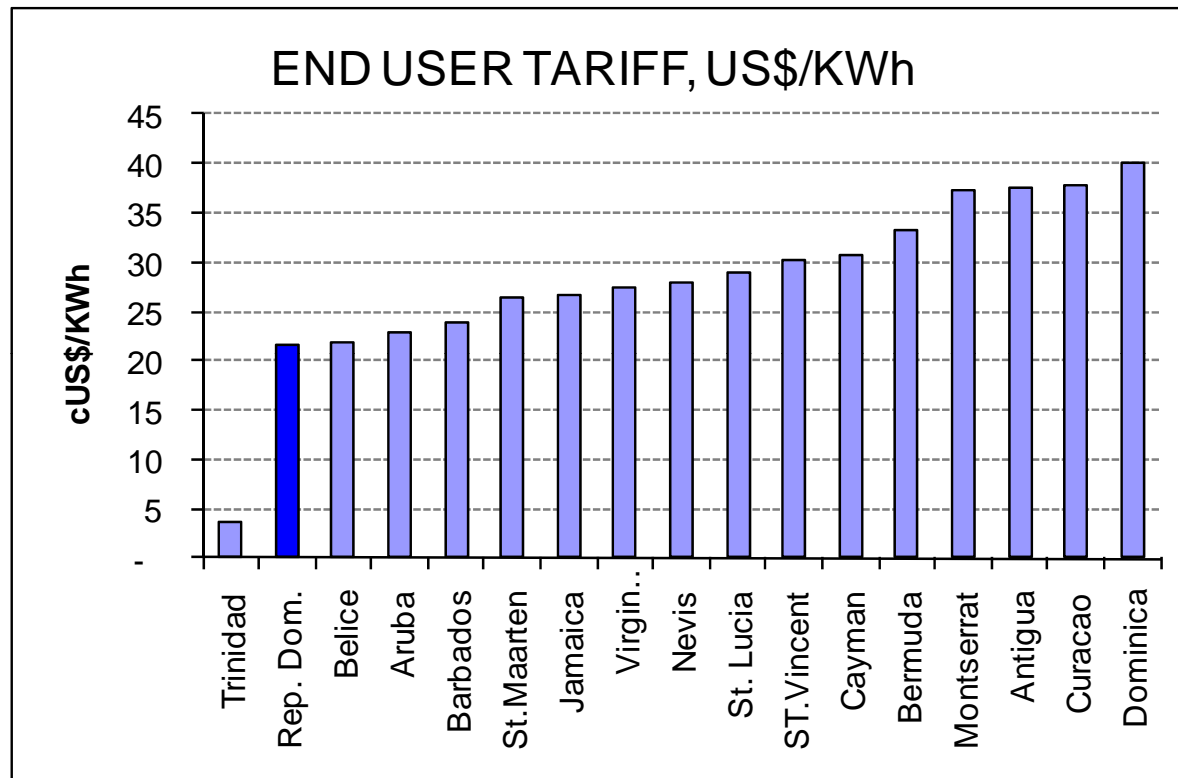
- Significant service interruption affecting population and country growth.
- Exit of private sector from the DisCos and GenCos.
- Stop of new investments in efficient generation within the SENI.
- Withdrawal of existing generation capacity from the SENI.
- Inefficient investment in self-generation by small users.
- Massive injection of state funds to cover part of the “hole”.
- Stalemate in government efforts to reduce fraud and energy losses.
- Higher financing costs for the country and all the players.

No Tariff Adjustments



- The tariff is not used to curve consumption, give a price signal, and reflect market tendencies.
- Tariff is managed politically

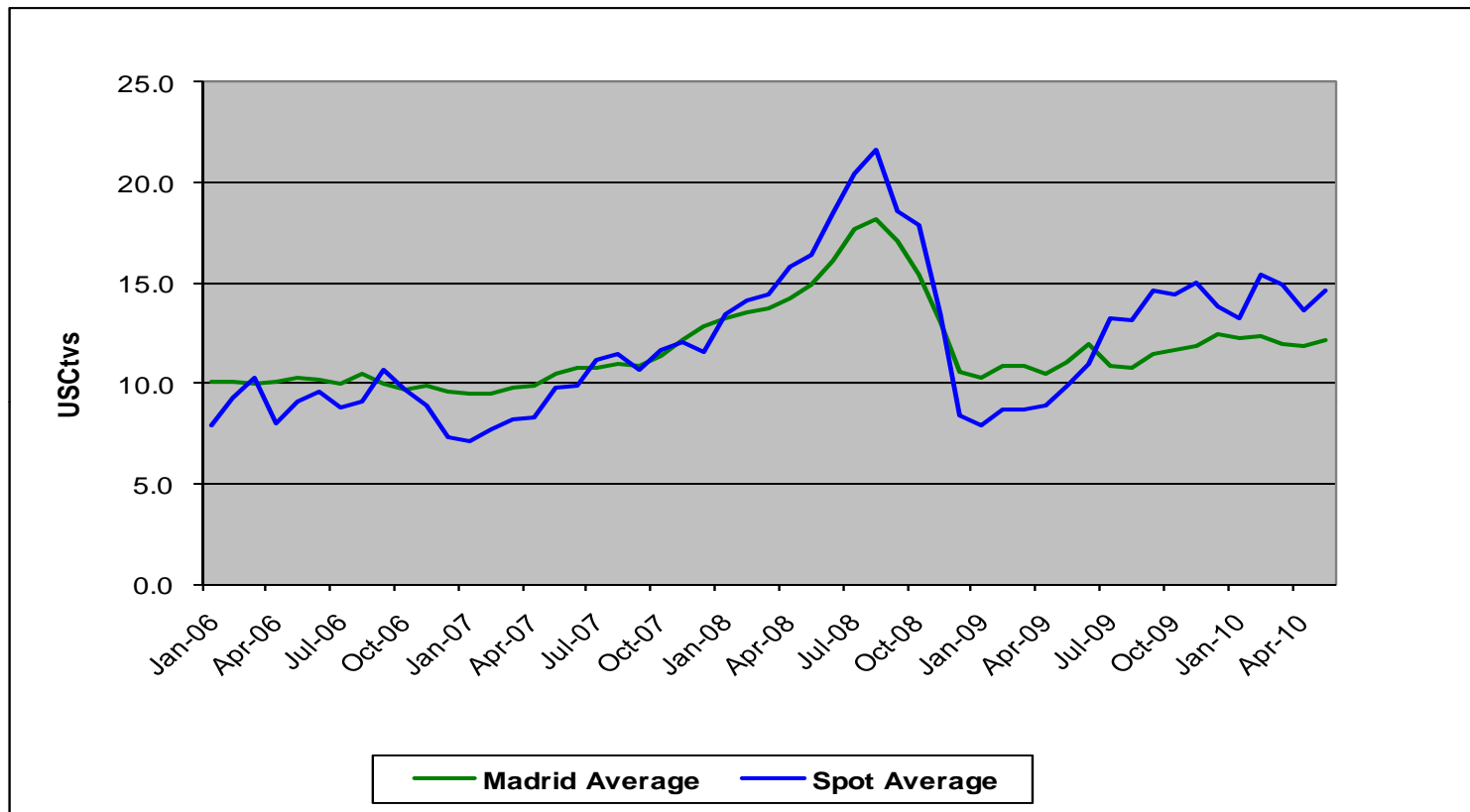
DR Tariff is NOT the highest in the world nor the Region



- Indexed tariff is still competitive when compared to the rest of the region.

Source: Caribbean Electric Utility Service Corporation (CARILEC), 2009

Madrid Contract Prices & Market Spot Price



- Madrid energy prices are in line with the current system generation mix.
- Renegotiation of contracts already occurred once in 2001, however, structural situation remained unchanged.
 - ◆ Energy prices were reduced (up to 40% in some cases).

Myth of Excessive Generation Profit



Company	Country	Corporate Rating	Sovereign Rating	(EBITDA/Sales)
AES Panama	Panamá	BBB-	BBB-	66%
Termocandelaria	Colombia	BB-	BB+	64%
Enel Fortuna	Panamá	BBB-	BBB-	61%
Empresa Nacional de Electricidad	Chile	BBB	A	46%
AES Andres	Dom Rep	B-	B	31%
Itabo	Dom Rep	B-	B	29%
AES Gener	Chile	BBB-	A	23%
Haina	Dom Rep	B-	B	16%
Electroandina	Chile	BB	A	5%

- The profits of the Dominican GenCos listed are amongst the lowest.
- This situation is worsened when returns are risk-adjusted.

Source: Fitch Ratings

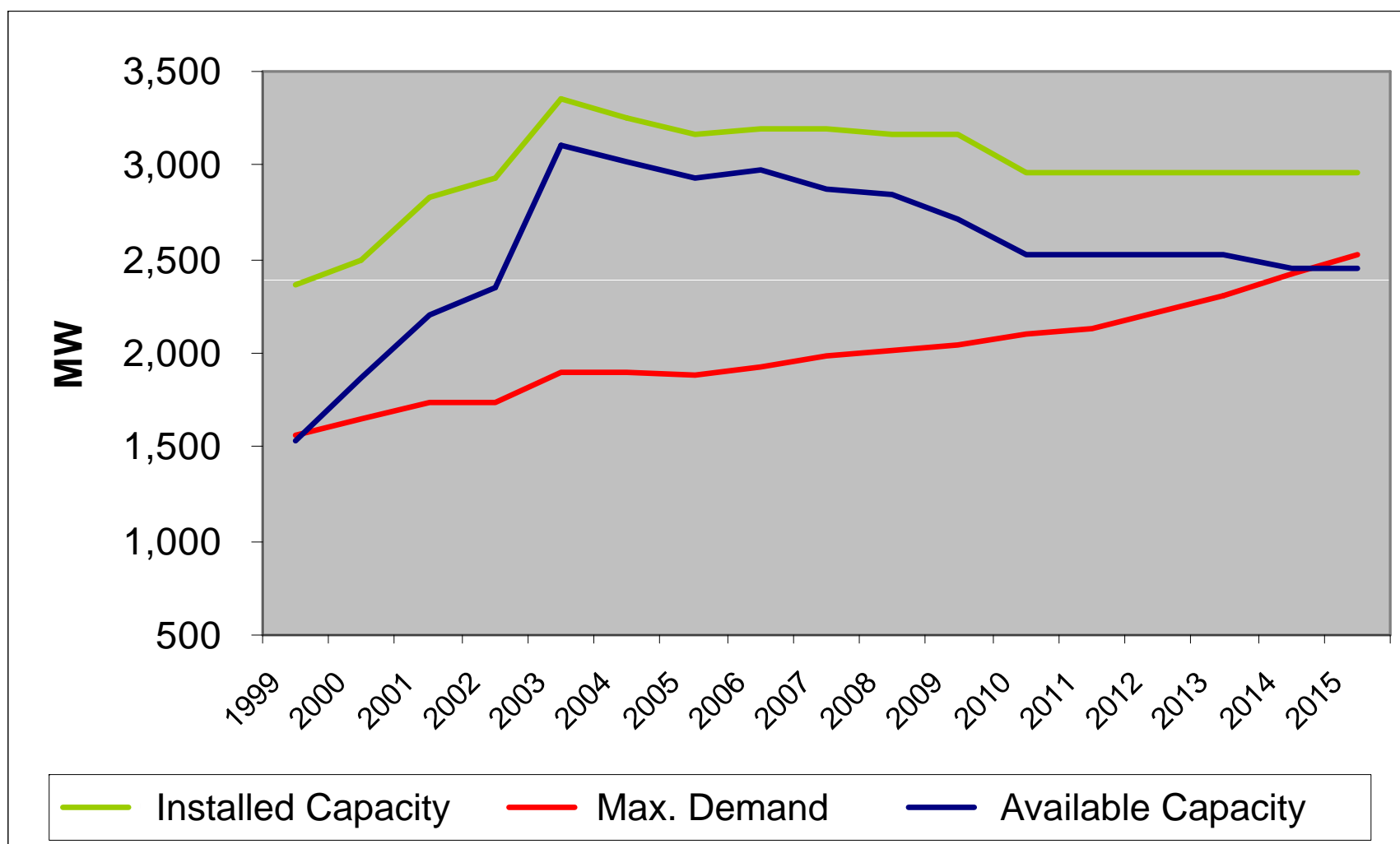
Why the Withdrawals from the SENI?



Power Plant	Technology	Fuel	MW
Sultana del Este	Diesel Engine	HFO	50
Monte Rio	Diesel Engine	HFO	100
Seaboard	Diesel Engine	HFO	97
		Total	247

- Is the business that good?
- Several international strategic players have exited the sector at a significant discount to initial investment.
 - ◆ Union Fenosa and AES as distributors.
 - ◆ El Paso, CDC Globeleq, Cogentrix, Caterpillar.

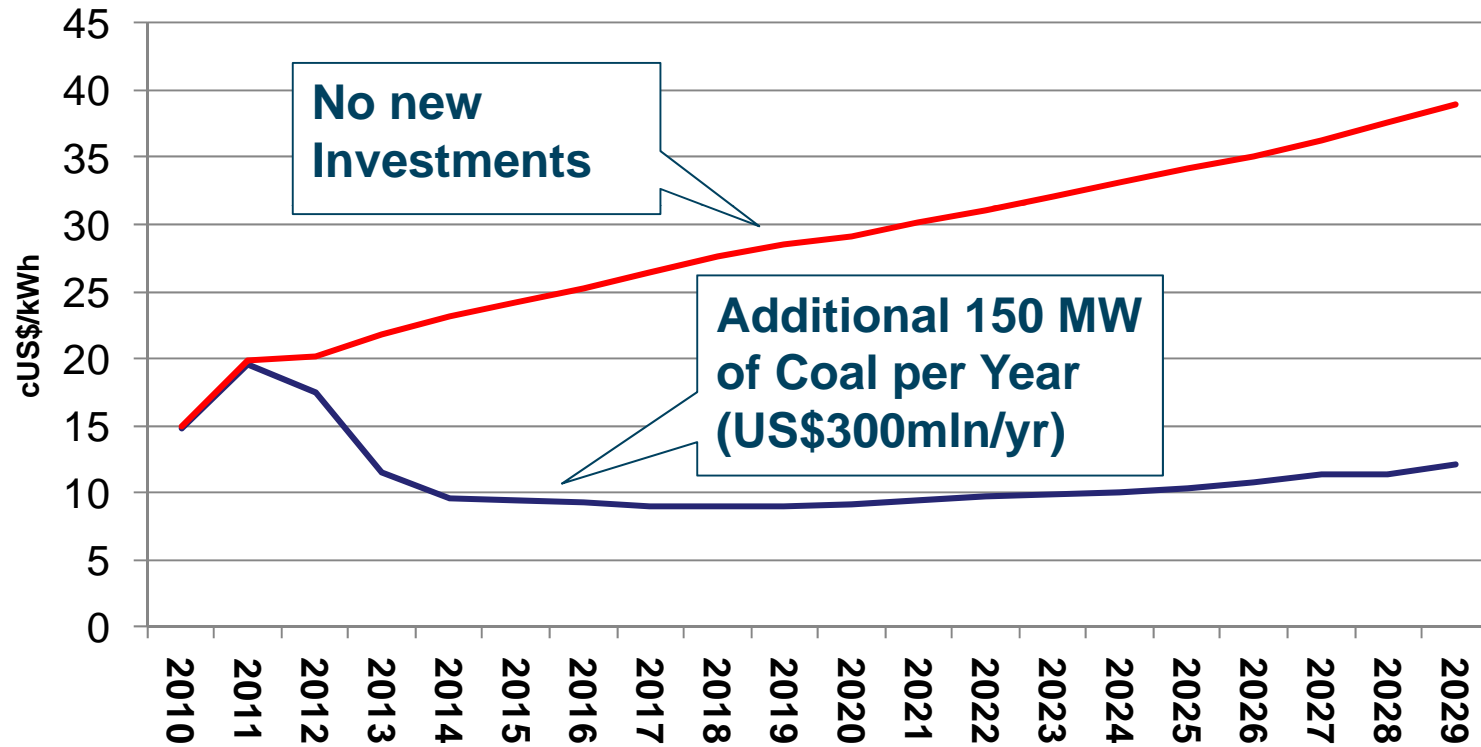
Actual Capacity With & Without Investments



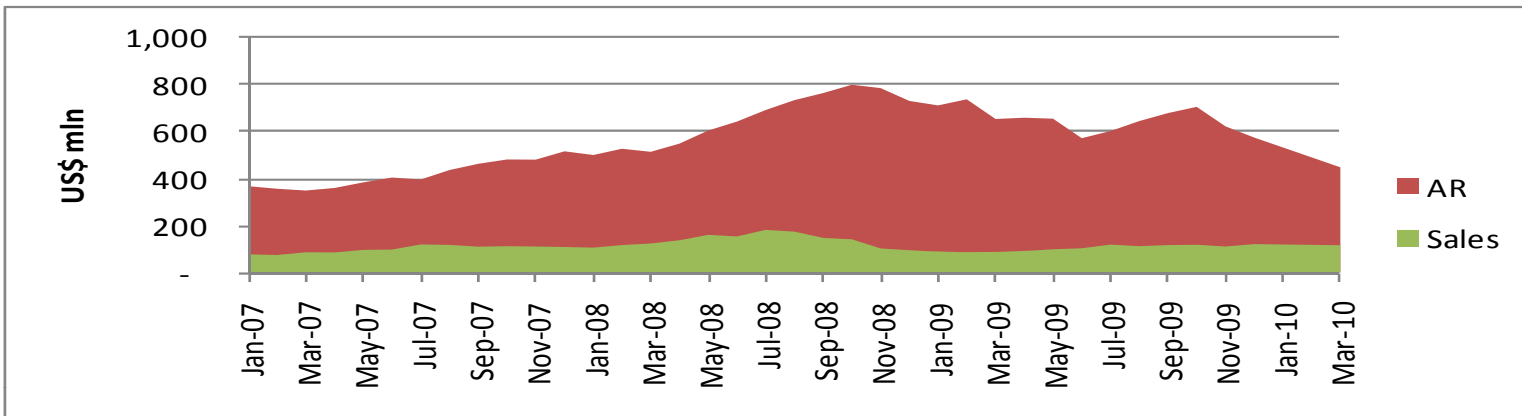
Marginal Costs With & Without Investments



SPOT MARGINAL COST, cUS\$/KWh



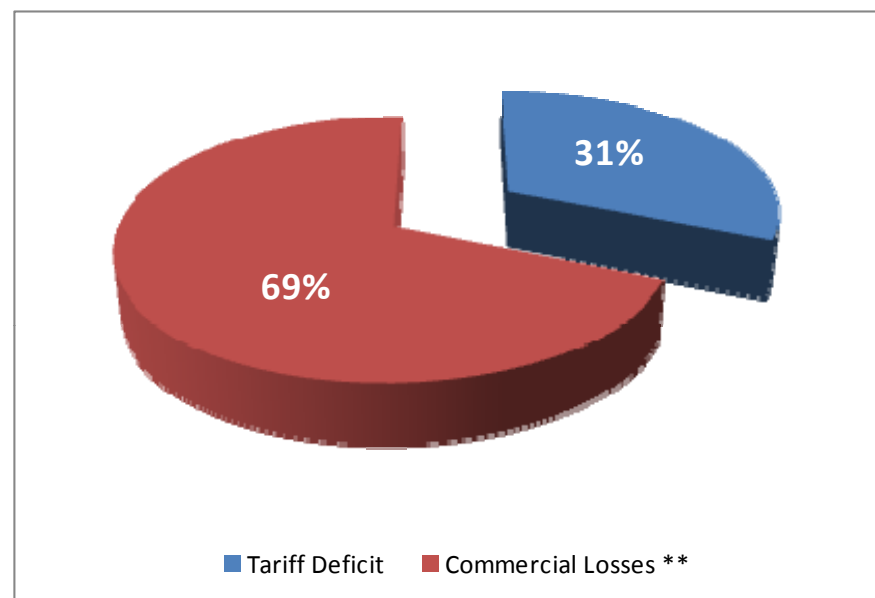
Are AR an attractive financial business?



- Distribution companies' late payments force generators to finance the deficit of the Electrical Sector with a negative carrying.
 - ◆ Generators pay 9.5% to 12% on their indebtedness (144A/Reg S Notes).
 - ◆ Generators charge 7% to 9.5% to the DisCos (Historical USD Local Active Interest Rate under PPAs).
- Additionally, merchant generators (mostly the DR Govt. through CDEEE & EGEHID) charge 11%-18% interest rate in DOP plus an 18% penalty, which combined with exchange rate stability makes a 25%-35% USD effective interest rate on energy purchases of Contracted Generators.
- Conclusion, except for merchant generators financing the DisCos is a very bad business.
- If the GenCos would monetize the AR, USD 400mln could be used to fuel a new wave of investments at higher rates of return.

¿Where is the hole?

	US\$MM
Potential Gross Sales	2,473.1
Tariff Deficit	(404.7)
Commercial Losses **	(889.4)
Real Gross Sales (A)	1,179.0
Real System Costs	
Generation *	1,593.8
Fixed Costs (D&T)	288.0
CAPEX (D&T)	96.0
Sector Debt Interests	32.0
Total System Costs (B)	2,009.8
Annual Deficit (A-B)	(830.7)



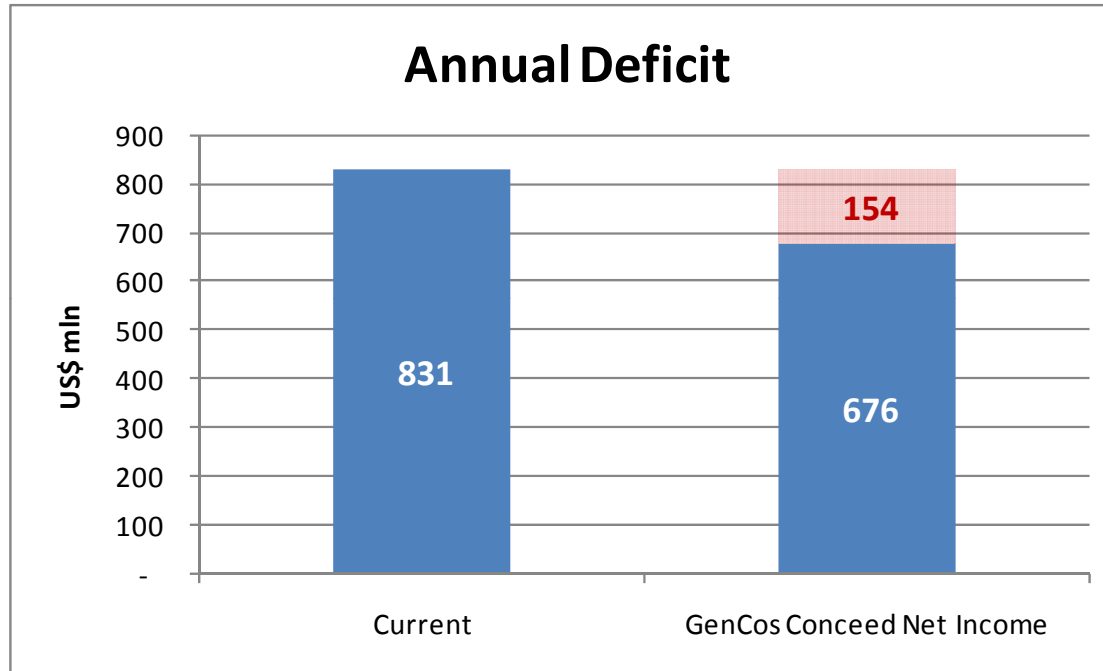
* This includes ~150mln annual profit of the GenCos

** Losses from Theft and lack of collections

What Reducing the Contract Prices Means



- Private GenCos combined Net Income was US\$154mln in 2009.



- If GenCos were to reduce their prices in 0.02 US\$/kWh their profit would disappear and still the hole would be unmanageable. Noted that without appropriate returns there are no investments.
- The problem is not in the GenCos, it is in energy theft, non-focalized subsidies and tariffs.

Conclusions



- We are at a critical point for decision making.
- With the wrong incentives we will continue with the “vicious cycle” and run out of generating capacity in 3 years.
- The electricity sector deficit representing ~1.8% of the GDP is unsustainable.
- Implementing market oriented measures are the way to go:
 - ◆ A technical tariff, which will provide the right price signal
 - ◆ Focalized subsidies, below 150kWh/mo
 - ◆ Fully transfer the DisCos to private ownership
 - ◆ Eliminate arrears with generators
 - ◆ Political will to enforce the law against electricity theft
- Moreover, key elements for positive change are present:
 - ◆ Willingness of existing players to invest in new efficient capacity.
 - ◆ The country remains attractive for the investment community. (telecom, tourism, recent placement of sovereign bond, etc.)
- **The right incentives and fulfillment of contractual obligations, are the only way to reduce long-term energy marginal costs.**