



**TRANSELEC S.A. AND SUBSIDIARY**

**REASONED ANALYSIS OF THE CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF SEPTEMBER 30, 2012**

**INTRODUCTION**

During the nine months period ended as of September 30, 2012, Transelec S.A. and subsidiary recorded net income of MCh\$51,987, which is 45.99% higher than the prior period (MCh\$35,610). Operating revenues totaled to MCh\$161.323, which represents an increase of 16.5% in comparison to the same period in 2011 (MCh\$139,015). EBITDA for the period was MCh\$127,344, with an EBITDA over revenues of 78.94% (80.39% in the prior period of 2011). The company's non-operating income and taxes for 2012 period represent a charge of MCh\$32,112 (MCh\$37.863 in 2011) and MCh\$7,047 (MCh\$6,608 in 2011), respectively. This decrease in non-operating losses is mainly due to the loss from indexed assets and liabilities for the nine month period ended September 30, 2012 for MCh\$ 10,177, which during the comparison period was a loss of MCh\$ 17,688.

Transelec S.A. and its subsidiary Transelec Norte S.A. have prepared their financial statements as of September 30, 2012 in conformity with International Financial Reporting Standards (IFRS) and correspond to the comprehensive, explicit and non-reserved adoption of the abovementioned international standard. The figures of this ratio analysis are expressed in million of Chilean pesos (MCh\$) as the Chilean peso is the functional currency of Transelec S.A.

**1. INCOME STATEMENT ANALYSIS**

<b>Items</b>	<b>September 2012 MCh\$</b>	<b>September 2011 MCh\$</b>	<b>Variation 2012/2011 %</b>
Operating Revenues	161,323	139,015	16.0%
Toll sales	147,896	131,134	12.8%
Work and services	13,427	7,881	70.4%
Operating costs	-62,220	-53,004	17.4%
Fixed costs	-27,886	-22,506	23.9%
Depreciation	-34,334	-30,498	12.6%
Administraton and sales expenses	-7,957	-5,930	34.2%
<b>Operating Income</b>	<b>91,146</b>	<b>80,081</b>	<b>13.8%</b>
Interest from Leasing	631	196	221.9%
Other Financial Income	3,851	1,892	103.5%
Financial Costs	-27,351	-22,284	22.7%
Foreign exchange differences, net	-299	-952	-68.6%
Gain (loss) for indexed assets and liabilities	-10,177	-17,688	-42.5%
Other income	1,233	973	26.7%
<b>Non-Operating Income</b>	<b>-32,112</b>	<b>-37,863</b>	<b>-15.2%</b>
<b>Income before Income Taxes</b>	<b>59,034</b>	<b>42,218</b>	<b>39.8%</b>
Income tax	-7,047	-6,608	6.6%
<b>Net Income</b>	<b>51,987</b>	<b>35,610</b>	<b>46.0%</b>
<b>EBITDA</b>	<b>127,344</b>	<b>111,748</b>	<b>14.0%</b>

EBITDA= Net income +abs(Income tax)+abs(Depreciation)+abs(Non-operating income)+abs(Other gains)+Lease financial income.

### a) Operating income

During the nine month ended as of September 30, 2012, revenues reached MCh\$161,323 (MCh\$139,015 in 2011), which is an increase of 16%. It is important to note that revenues are mainly obtained from sales of the transmission capacity of the Company's facilities, but also include sales of services related to its principal activity. During the nine month ended as of September 30, 2012, the company provided engineering and other services that accounted for 9.1% of the total revenues; during the prior period in 2011, these services only increased to 6% of the total revenues.

During the period under analysis the operating costs reached MCh\$62,220 (MCh\$53,004 in 2011). These costs are primarily related to the maintenance and operation of the Company's facilities. In percentage terms, 55.2% of the company's costs correspond to depreciation of property, plant and equipment (57.5% in 2011), while the remaining 44.8% (42.5% in 2011) correspond to personnel, supplies and services contracted.

Administrative and selling expenses amounted to MCh\$7,957 (MCh\$5,930 at the same date in 2011) and consist primarily of personnel expenses and expenses for contracted work, supplies and services.

### b) Non-operating income

Net income was negatively impacted by the non-operating loss of MCh\$32,112 (MCh\$37,863 in 2011) registered for the nine month ended as of September 30, 2012, which was generated mainly by the loss from indexed assets and liabilities of MCh\$10,117 in 2012 period, while in the same period of 2011 amounted to MCh\$17,688. The financial cost for the period was MM\$27,351 (MM\$22,284 for the prior year) due to a minor capitalization interest for the period 2012 by MM\$1,938 (MM\$6,084 in 2011)

## 2. BALANCE SHEET ANALYSIS

The decrease in current assets between September 2012 and December 2011 is mainly due to a decrease in accounts receivable from third parties and the decrease in cash and cash equivalents.

Items	September 2012 MCh\$	December 2011 MCh\$	Variation 2012/2011 %
Current assets	120,606	154,709	-22.0%
Non-current assets	1,821,684	1,786,269	2.0%
<b>Total Assets</b>	<b>1,942,290</b>	<b>1,940,978</b>	<b>0.1%</b>
Current liabilities	108,036	108,733	-0.6%
Non current liabilities	921,798	911,203	1.2%
Equity	912,456	921,042	-0.9%
<b>Total liabilities &amp; Equity</b>	<b>1,942,290</b>	<b>1,940,978</b>	<b>0.1%</b>

### VALUE OF THE MAIN PP&E IN OPERATION

Assets	September 2012 MCh\$	December 2011 MCh\$	Variation 2012/2011 %
Land	20,965	20,669	1.4%
Building, Infraestructure, works in progress	976,208	903,866	8.0%
Machinery and equipment	458,607	438,028	4.7%
Other fixed assets	2,539	1,853	37.0%
Depreciation (less)	-243,511	-211,371	15.2%
<b>Total</b>	<b>1,214,808</b>	<b>1,153,045</b>	<b>5.4%</b>

### CURRENT DEBT

Debt	Currency or index	Interest rate	Type of rate	Maturity Date	Amount in original currency (million) Unpaid capital	
					September 2012	December 2011
Series C bond	UF	3.50%	Fixed	Sep 1st, 2016	6.0	6.0
Series D bond	UF	4.25%	Fixed	Dec 15 th, 2027	13.5	13.5
Series E bond	UF	3.90%	Fixed	Aug 1st, 2014	3.3	3.3
Series F bond	CLP	5.70%	Fixed	Aug 1st, 2014	33,600.0	33,600.0
Series H bond	UF	4.80%	Fixed	Aug 1st, 2031	3.0	3.0
Series I bond	UF	3.50%	Fixed	Sep 1st, 2014	1.5	1.5
Series K bond	UF	4.60%	Fixed	Sep 1st, 2031	1.6	1.6
Series L bond	UF	3.65%	Fixed	Dec 15 th, 2015	2.5	2.5
Series M bond	UF	4.05%	Fixed	Jun 15 th, 2032	3.4	3.4
Series N bond	UF	3.95%	Fixed	Dec 15 th, 2038	3.0	3.0

### 3. MAIN CASH FLOWS DURING THE YEAR

Items	September 2012 MCh\$	September 2011 MCh\$	Variation 2012/2011 %
Cash flows provided by (used in) operating activities	77,610	87,702	-11.5%
Cash flows provided by (used in) investing activities	-81,850	-75,279	8.7%
Cash flows provided by (used in) financing activities	-31,444	9,783	-421.4%
<b>Net increase (decrease) of cash and cash equivalent</b>	<b>-35,684</b>	<b>22,206</b>	<b>-260.7%</b>
Cash and cash equivalent at the beginning of the period	64,212	35,496	80.9%
<b>Cash and cash equivalent at the end of the period</b>	<b>28,528</b>	<b>57,702</b>	<b>-50.6%</b>

During the nine month ended as of September 30, 2012, cash flows from operating activities reached only MCh\$ 77,610 (MCh\$ 87,702 in the comparison period).

During the nine month ended as of September 30, 2012, financing activities generated negative net cash flows of MCh\$ 31.444, mainly due to dividends payments amounted to MCh\$33.789, which were offset by intercompany loan payments for MCh\$2.345. During the same period in 2011,



financing activities generated positive cash flows of MCh\$ 9,783, which was mainly due to for bond of Serie M to UF millions UF1,9 issuing in September 23, 2011.

During the nine month ended as of September 30, 2012, investing activities generated cash outflows amounting to MCh\$81,850, because of investments in property, plant & equipment. During the same period in 2011, cash flows from investing activities were negative by MCh\$75,279, as a result of net additions of property, plant & equipment.

The closing balance of cash and cash equivalents as of September 30, 2012 amounted to MCh\$28.528 considering an initial balance of MCh\$64.212. As of September 30, 2011 the final balance of cash and cash equivalents amounted to MCh\$57.702, with an initial balance of MCh\$35.496

In addition, the Company has secured the following committed credit line to ensure funds are available to cover working capital needs:

Bank	Amount (up to)	Maturity	Type of Credit
Scotiabank, Bank of Tokyo-Mitsubishi y DnB NOR	US\$250,000,000	Sep 5th, 2015	Working Capital

#### 4. INDICATORS

Bonds	Covenant	Limit	September	December	Status
			2012	2011	
All local Series	Distribution Test ( ** )	FNO/Financial Expenses > 1,5	4,78	5,70	OK
	Capitalization Ratio (***)	< 0,7	0,50	0,49	OK
	Shareholder's Equity (in UF)	> ThUF15.000	41.429	42,433	OK

(\*) FNO = Cash flow from operating activities plus the absolute value of finance costs, plus the absolute value of the expenditure for Income Taxes.

(\*\*) This is only a test to distribute restricted payments such as dividends.

(\*\*\*) Equity = Total equity attributable to owners of the parent plus accumulated amortization of Goodwill. The accumulated amortization of Goodwill between June 30, 2006 and June 30, 2012 amounted to MCh\$24.970.

INDICATORS	September 2012	December 2011	Variation 2012/2011
<b>Profitability</b>			
Shareholders' Equity profitability *	7.60%	5.09%	49.4%
Assets profitability *	3.57%	2.41%	48.1%
Operating assets profitability *	5.07%	3.60%	40.8%
Earnings per share (\$) *	69,316.00	46,839.62	48.0%
<b>Liquidity &amp; Indebtedness</b>			
Current Ratio	1.12	1.42	-21.1%
Acid-Test Ratio	1.12	1.42	-21.5%
Debt to Equity	1.13	1.11	1.8%
% Short term debt	10.49	10.66	-1.6%
% Log term debt	89.51	89.34	0.2%
Financial expenses coverage	4.66	5.01	-7.2%

\* Yearly basis



## 5. THE MARKET

Transelec S.A. carries out its activities in the electricity market, which has been divided into three sectors: generation, transmission and distribution. The generation sector includes companies that are dedicated to generating electricity that will subsequently be used throughout the country by end users. The purpose of the distribution sector is to carry electricity to the physical location where each end user will use the electricity. Lastly, the primary goal of the transmission sector is to transport the generated electricity from where it is produced (electrical power plants) to the “points of entry” of the distribution company networks or those of large end users.

Transelec’s business mainly centers on commercializing the capacity of its facilities to transport and transform electricity, in accordance with established quality standards. The transmission system of Transelec S.A. and its subsidiary, which stretches between Arica in Chile’s 1st Region to the Island of Chiloé in the 10th Region, encompasses the majority of the trunk transmission lines and substations in the Central Interconnected System (SIC) and the Great North Interconnected System (SING). This transmission system transports the electricity that supplies approximately 99% of Chile’s population. The Company owns all of the 500 kV electricity transport lines, approximately 47% of the 220 kV lines and 86% of the 154 kV lines.

The legal framework that governs the electrical transmission business in Chile is contained in DFL No. 4/2006, which establishes the modified, coordinated and systemized text of Decree with Force of Law No. 1 from the Ministry of Mining, issued in 1982; and the General Electricity Services Law. (DFL(M) No. 1/82) and its subsequent modifications, including Law 19,940 (Short Law I) published on March 13, 2004, Law 20,018 (Short Law II) published on May 19, 2005 and Law 20,257 (Generation with Non-Conventional Renewable Energy Resources) published April 1, 2008. These standards are complemented by the Regulations of the General Electricity Services Law of 1997 (Supreme Decree No. 327/97 from the Ministry of Mining) and its respective modifications; the Regulations to Establish the Structure, Functioning and Financing of Load Dispatch Centers (Supreme Decree No. 291/2007) and also the Technical Standard on Reliability and Service Quality (Exempt Ministerial Resolution No. 40 of May 16, 2005) and its subsequent modifications.

Law 19,940, also called Short Law I, modified the General Electricity Services Law of 1982 in matters relating to electricity transmission activity, subdividing the transmission network into three types of systems: trunk transmission, sub-transmission and additional transmission. It also establishes that electricity transmission – both by trunk transmission as well as subtransmission systems – is considered a public service and is subject to regulated tariffs.

Finally, Law 19,940 established that the new payment regime for the use of trunk facilities would become effective as of March 13, 2004 and determined a transitory period that was in effect until the first trunk transmission decree was issued. Thus, from 2004 to 2007, collection and payment for use of transmission facilities was carried out provisionally using subsequent recalculations in accordance with legal and regulatory standards in effect until Short Law I was published. On January 15, 2008, a decree from the Ministry of Economy, Development and Reconstruction was published that set the new Investment Value (VI), the Annuity of the Investment Value (AVI), the Operation, Maintenance and Administration Costs (COMA) and the Annual Transmission Value per Segment (VATT) for trunk facilities for the period from March 14, 2004 to December 31, 2010, as well as the indexation formulas applicable during that period. New rates for the trunk transmission system began being applied in April 2008 and during 2008 trunk income was recalculated for the period from March 13, 2004 to December 31, 2007. The determination of trunk facilities and their Annual Transmission Value (VATT) is updated every four years using an internationally-tendered study. During 2010, the second Trunk Transmission Study was conducted which will allow setting the tariffs and the corresponding indexation formulas for the period 2011-2014. Decree 61,



published on November 17, 2011 contains the tariffs that will be retroactively applicable from January 1, 2011. During 2012 the new tariffs have been applied and it is expected that the process of recalculation corresponding to the year 2011 will be completed during December of 2012.

Decree No. 320 from the Ministry of Economy, Development and Reconstruction, which sets tariffs for subtransmission facilities, was published in the Official Gazette on January 9, 2009 and the new tariffs begin to be applied on January 14, 2009 and will be in effect until October 31, 2010. The new subtransmission tariffs that will be in effect from November 2010 to October 2014 shall be set by the Ministry of Energy based on valuation studies on subtransmission facilities that began during 2010. As of the date of this management discussion and analysis, the decree setting subtransmission tariffs from November 2011 to October 2014 has not yet been issued. In the meantime, the tariffs set in decree 320/2009 will continue to be provisionally applied. The difference between amounts invoiced using these provisional tariffs and the definitive values ultimately established will be recalculated.

## **6. MARKET RISK FACTORS**

Due to the nature of the electrical market and the legislation and standards that regulate this sector, the Company is not exposed to significant risks in developing its principal business. However, the following risk factors should be mentioned and considered:

### **6.1 Regulatory Framework**

Electricity transmission tariffs are set by law and are indexed in order to guarantee real annual returns for the operator. The nature of the industry enables transmission income to be stable over time. In addition, this income is complemented with income obtained from private contracts with large clients.

However, the fact that these tariffs are revised every four years in Trunk Transmission Studies could place the Company at risk of new tariffs that are detrimental or less attractive given the investments it has made.

The Company cannot guarantee that other regulatory changes will not negatively affect it or its clients or creditors, thus compromising Transelec's income.

### **6.2 Operating Risks**

Although the Company's management believes it has adequate risk coverage, in line with industry practices, it cannot guarantee the sufficiency of its insurance policy coverage for certain operating risks to which it is exposed, including forces of nature, damages to transmission facilities, on-the-job accidents and equipment failure. Any of these events could negatively affect the Company's financial statements.

### **6.3 Application of regulations and / or Environmental Law**

The operations of Transelec are subject to Law No. 19.300, on Chilean environment ("Environmental Law"), enacted in 1994. According to its recent modification, through Law N° 20.417 which was published in the official journal on January 26, 2010, created, among others, new institutions consisting of: (i) the Ministry of Environmental Affairs; (ii) the Minister Council for Sustainability; (iii) the Environmental Evaluation Service; and (iv) the Superintendence of Environmental Affairs; these institutions are in charge of the regulation, evaluation and inspection of the activities involving environmental impacts. These new institutions replaced the National



Commission of Environmental Affairs (“CONAMA”) and the Regional Commissions of Environmental Affairs and are fully operative except for new demands to the evaluation system of environmental impact (SEIA) through the enactment of an updated regulation. That however, recently began its stage of review by the Comptroller General of the Republic. Law No. 20.600 of the official journal was published on June 28, 2012 that creates the environmental courts, last step so the Superintendency of Environmental Affairs(SMA) can begin to implement in full its powers of control and sanction. Within six months from the publication of this law, the environmental court, which will have its headquarters in Santiago, will come into operation at which the powers of control and sanctions of the SMA will be fully in effect.

Notwithstanding that Transelec meets the environmental requirements of the environmental law, it is not possible to assure that these filings (EIA o DIA) before the environmental authority will be approved by government authorities or that the laws and regulations will not change or will be interpreted in a way that may adversely affect the company’s operations and plans, as the new institutional structure is just in progress.

#### 6.4 Delays in the Construction of New Transmission Facilities

The success of the program for extending the trunk transmission network and building new facilities will depend on numerous factors, including financing cost and availability. Although Transelec has experience with large-scale construction projects, construction of new facilities could be negatively affected by factors commonly associated with such projects including delays in obtaining regulatory authorizations, scarcity of equipment, materials or labor, etc. Any of these factors could cause delays in the partial or total completion of the capital investment program, and could increase the costs of the projects.

#### 6.5 Technological Changes

Transelec is compensated for investments it makes in electrical transmission facilities through an annual valuation of the existing facilities (AVI), which is performed every four years using current market prices. Any important technological changes in the equipment at its facilities could lower this valuation, which could in turn prevent recovery of part of the investments made.

#### 6.6 Foreign Exchange Risk

The following factors expose Transelec to foreign exchange risk:

- The functional currency of its subsidiary Transelec Norte is the US dollar.
- Transelec carries out diverse transactions in US dollars (awarding construction contracts, importing, etc.).
- Transelec has a foreign exchange forward to sell dollars in order to cover the risk of future dollar-denominated income. Transelec also has a forward with a related company to finance its subsidiary's dollar-denominated assets.

Exchange rate exposure is managed using a policy that involves fully hedging the Company's net balance sheet exposure using diverse instruments such as: US dollar positions, forward contracts and cross currency swaps.

The following table details assets and liabilities denominated in US dollars and Chilean pesos as of each period end:

In million pesos	September 2012		December 2011	
	Assets	Liabilities	Assets	Liabilities
Dollar (amounts associated with balance sheet items)	38,865	39,611	26,722	3,917
Dollar (amounts associated with income statement items)	0	33,121	0	30,111
Chilean peso	1,866,334	953,632	1,921,662	954,826



(\*) Indexation polynomials for the Company's revenue should be temporarily applied so that, in the short term, they differ from long-term indexation. In order to ensure that short-term indexation is consistent with long-term indexation, the Company periodically (every six months) sells a percentage of its revenue fixed in dollars using income protection forwards. These forwards are considered income hedges and, therefore, changes in their value are recorded in other reserves within shareholders' equity until realized. Once realized, they are classified in operating income.

**EXCHANGE RATES (Observed exchange rates)**

Month	Average 2012 (\$)	Last day 2012 (\$)	Last day 2011 (\$)
January	501.34	488.75	483.32
February	481.49	476.27	475.63
March	485.4	487.44	482.08
April	486	484.87	460.04
May	497.09	519.69	467.31
June	505.63	501.84	471.13
July	491.93	481.94	455.91
August	480.99	480.25	465.66
September	474.97	473.77	515.14
<b>Period Average</b>	<b>489.43</b>	<b>488.31</b>	<b>475.14</b>

The indexation formulas, applied twice yearly, that are incorporated into toll contracts and subtransmission fees, as well as those applied monthly for regulated trunk income, take into account variations in the value of the facilities and of operating, maintenance and administrative costs. In general, those indexation formulas take into consideration variations in the international prices of equipment, materials and local labor.

**6.7 Credit Risk**

Credit risk for receivables from electricity transmission activity is historically very low given the reduced number of customers, their risk ratings and the short collections term (less than 30 days).

However, Transelec's income is highly concentrated in a small number of customers, which are detailed in the following chart:

The company has four main clients which represent more than 10% of the total revenues for the period ended as of September 2012. The total revenues recognized for these four clients for this period was MM\$65,721, MM\$ 19,561, M\$ 17,917 y M\$ 16,428 respectively. For the period ended as of September 30, 2011 the company had one client which more than 10% of the total revenues. The total amount recognized for this client was MM\$70,417 for the same period.

Income from these companies will generate a large part of the Company's future cash flows and, therefore, a substantial change in their assets, financial condition and/or operating income could negatively affect the Company.

In terms of the Company's credit risk associated with financial assets (time deposits, fixed-return mutual funds and sell-back agreements), its treasury policy establishes certain limits on a particular institution's exposure; such limits depend on the risk rating and capital of each institution. Likewise, for investments in mutual funds, only funds with a risk rating qualify.





## 6.8 Liquidity Risk

Liquidity risk is the risk of the Company not satisfying a need for cash or debt payment upon maturity. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price.

### a) Risk from Company's Management Processes

In order to guarantee that Transelec is able to quickly react to investment opportunities and pay its obligations by their maturity dates, in addition to its cash balances and short-term receivables, the Company has committed lines of credit for working capital for US\$ 250 million.

As of September 30, 2012, these lines have not been used and are expected to be renewed upon maturity which is in three years. These credit lines were in effect since September 5, 2012

The Company is exposed to risks associated with indebtedness, including refinancing risk when its debt matures. These risks are lessened by using long-term debt and appropriately structuring their maturities over time.

The following table outlines principal payments for the Company's financial liabilities according to their maturity as of September 30, 2012 and December 31, 2011:

In million pesos	0 to 1 year	to 3 year	5 to 10 years	More than	Total
September 30, 2012	0	142,037	0	553,481	887,542
December 31, 2011	0	196,346	0	546,204	876,314

### b) Risk from Rate Income Recalculations in Trunk Transmission System

By virtue of articles 81, 101, 104, 106 and other complementary provisions of DFL No. 4/20,018 from the Ministry of Economy, Development and Reconstruction, Transelec is entitled to provisionally receive the actual trunk system rate income produced during each period. For Transelec to collect the compensation established in the first paragraph of article 101 of DFL No. 4/20.018, the rate income received provisionally is recalculated each month using payment charts prepared by the respective Economic Load Dispatch Center (CDEC) and then payments are made to or collected from the different generators.

The Company may face the risk of not opportunely collecting the income established in the CDEC payment charts from some generators, which can temporarily affect its liquidity. Thus, in the Company's opinion, Transelec's efforts to collect these amounts do not entail managing collections of debt owed to the Company but rather merely coordinating collections and payments to third parties of loans and debt that are completely removed from the Company and, with the exception of the expected rate income, belong to the generators.

## 6.9 Interest Rate Risks

The Company's assets consist principally of property, plant and equipment and long-lived intangible assets. As a result, financial liabilities used to finance such assets consist mainly of long-term debt at fixed interest rates. This debt is recorded in the balance sheet at amortized cost.

The objective of interest rate risk management is to achieve a balanced debt structure, decrease the impact on financial costs due to interest rate variations and, in that way, reduce volatility in the income statement.



However, increases in inflation in Chile could impact the cost of UF-denominated debt and, therefore, the Company's non-operating income. These impacts are mitigated by the Company's income, which is also partially indexed to local inflation using indexation polynomials.

The Company possesses mercantile current accounts with related companies denominated in Chilean pesos and US dollars that have a fixed interest rate. Therefore, the Company believes that its income is not exposed to risk from changes in market interest rates.