



AES PANAMÁ, S.A.

Independent Auditors' Report

Financial statements

Years ended December 31, 2007 and 2006

AES PANAMÁ, S.A.

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INDEPENDENT AUDITORS' REPORT

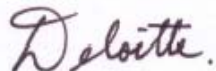
AES Panama, S.A.
to the Shareholders and Board of Directors

We have audited the accompanying balance sheets of AES Panama, S.A. (the "Company") as of December 31, 2007 and 2006, and the related statements of income, stockholders' equity and cash flows for the years then ended (all expressed in United States dollars). These financial statements are the responsibility of the Company. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been translated into English for the convenience of readers in the United States of America.



March 26, 2008

AES PANAMÁ, S. A.

BALANCE SHEETS

DECEMBER 31, 2007 AND 2006

(In thousands of United States dollars)

ASSETS	Note	December 31 2007	December 31 2006	LIABILITIES AND STOCKHOLDERS' EQUITY	Note	December 31 2007	December 31 2006
CURRENT ASSETS				CURRENT LIABILITIES			
Cash		\$ 19,109	\$ 17,435	Loans payable, current portion	6	\$ 136	\$ 4,377
Trust fund	4, 7	9,562	9,525	Capital lease obligations, current portion	8	109	109
Account receivable				Accounts payable			
Trade		3,198	599	Suppliers		3,159	3,499
Related parties, net	5	43,563	34,572	Related parties	5	2,744	4,654
Affiliates	5	1,178	1,337	Affiliates	5	1,257	2,179
Other		740	169	Interest payable		529	616
Inventory, net		1,718	1,781	Income taxes payable		9,478	
Prepaid expenses		1,760	5,040	Accrued expenses and other liabilities		<u>2,073</u>	<u>1,582</u>
Deferred income taxes	13	<u>44</u>	<u>44</u>				
Total current assets		<u>80,872</u>	<u>70,502</u>	Total current liabilities		<u>19,485</u>	<u>17,016</u>
PROPERTY, PLANT AND EQUIPMENT				LONG-TERM LIABILITIES			
Land		5,821	5,830	Seniority premiums payable	10	285	244
Buildings		259,668	256,774	Loans payable	6	1,190	304
Electricity generation facilities		317,599	312,503	Bonds payable	7, 14	297,720	297,531
Office furniture and equipment		6,252	5,758	Capital lease obligations	8	105	211
Transportation equipment		666	623	Deferred income taxes	13	<u>2,037</u>	
Less accumulated depreciation		(175,251)	(156,167)	Total long-term liabilities		<u>301,337</u>	<u>298,290</u>
Construction in progress		<u>78</u>	<u>2,845</u>				
Total property, plant and equipment		<u>414,833</u>	<u>428,166</u>	Commitments and Contingencies	9		
OTHER ASSETS				STOCKHOLDERS' EQUITY			
Deferred financing cost, net		4,643	4,883	Common stock, authorized 215,007,525 shares no par value.			
Deferred income taxes	13	<u> </u>	<u>3,195</u>	Outstanding 214,717,428 shares in 2007 and 2006	11	142,060	141,829
Total other assets		<u>4,643</u>	<u>8,078</u>	Treasury stock, 290,097 in 2007 and 2006		(263)	(263)
				Additional paid-in capital		12,565	12,565
				Retained earnings		25,164	37,600
				Prepaid dividend tax		<u> </u>	<u>(291)</u>
				Total stockholders' equity		<u>179,526</u>	<u>191,440</u>
TOTAL ASSETS		<u>\$ 500,348</u>	<u>\$ 506,746</u>	TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		<u>\$ 500,348</u>	<u>\$ 506,746</u>

See accompanying notes to the financial statements.

AES PANAMÁ, S. A.

STATEMENTS OF INCOME

Years ended December 31 2007 and 2006

(In thousands of United States dollars)

	Note	2007	2006
ELECTRICITY SALES	5	\$ 175,085	\$ 144,694
OPERATING COSTS AND EXPENSES:			
Purchase of electricity	5	31,897	19,694
Transmission costs	5	14,198	12,514
Operating and maintenance expenses		13,844	13,903
Depreciation		19,749	19,302
Administration fees	5	4,601	3,929
Total operating costs and expenses		84,289	69,342
OTHER INCOME			
Rent income		276	-
Gain in disposal of fixed asset		147	-
		423	-
PROFIT FROM OPERATIONS		91,219	75,352
OTHER INCOME (EXPENSES)			
Interest income		2,034	2,114
Amortization of deferred financing cost		(372)	(1,378)
Interest expenses	7	(19,514)	(23,048)
Other income (expenses), net	12	1,302	(28,841)
Profit before income taxes		74,669	24,199
Income taxes	13	22,105	7,299
NET PROFIT		\$ 52,564	\$ 16,900

See accompanying notes to the financial statements.

AES PANAMÁ, S. A.

STATEMENTS OF STOCKHOLDERS' EQUITY

Years ended December 31 2007 and 2006

(In thousands of United States dollars)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Prepaid dividend Tax	Cumulative Other Comprehensive Income	Total Stockholders' Equity
BALANCE AT DECEMBER 31, 2005	\$ 141,649	\$ (287)	\$ 12,565	\$ 71,700	\$ (815)	\$ 2,705	\$ 227,517
Treasury stock purchase	-	24	-	-	-	-	24
Net profit	-	-	-	16,900	-	-	16,900
Dividends paid	-	-	-	(51,000)	-	-	(51,000)
Capital increase	180	-	-	-	-	-	180
Prepaid dividend tax	-	-	-	-	524	-	524
Other comprehensive income of derivative instruments	-	-	-	-	-	(2,705)	(2,705)
BALANCE AT DECEMBER 31, 2006	<u>\$ 141,829</u>	<u>\$ (263)</u>	<u>\$ 12,565</u>	<u>\$ 37,600</u>	<u>\$ (291)</u>	<u>\$ -</u>	<u>\$ 191,440</u>
BALANCE AT DECEMBER 31, 2006	\$ 141,829	\$ (263)	\$ 12,565	\$ 37,600	\$ (291)	\$ -	\$ 191,440
Net profit	-	-	-	52,564	-	-	52,564
Dividends paid	-	-	-	(65,000)	-	-	(65,000)
Capital increase	231	-	-	-	-	-	231
Prepaid dividend tax	-	-	-	-	291	-	291
BALANCE AT DECEMBER 31, 2007	<u>\$ 142,060</u>	<u>\$ (263)</u>	<u>\$ 12,565</u>	<u>\$ 25,164</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 179,526</u>

See accompanying notes to the financial statements.

AES PANAMA, S. A.

STATEMENTS OF CASH FLOWS

Years ended December 31 2007 and 2006

(In thousands of United States dollars)

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net profit	\$ 52,564	\$ 16,900
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	19,749	19,302
Gain (loss) on disposal of fixed assets	(147)	(3)
Loss on extinguishment of liabilities	-	27,965
Reverse of provision	-	(550)
Deferred income taxes	5,276	1,703
Amortization of deferred financing costs	372	1,378
Bond discount	189	-
Changes in operating assets and liabilities:		
Decrease in account receivable	(12,001)	(1,469)
Decrease in inventory	63	125
Decrease (increase) in prepaid expenses	3,280	(3,780)
Increase in account payable	(3,172)	899
Decrease in income taxes payable	9,433	(6,995)
Increase (decrease) in interest payable	(87)	68
Decrease in accrued expenses and other liabilities	491	432
Increase in seniority premiums payable, net	41	40
	<u>76,051</u>	<u>56,015</u>
Net cash provided by operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of fixed assets	(6,464)	(2,570)
Increase in construction in progress	(78)	(2,845)
Proceeds from sales of assets	273	6
Decrease in trust fund	(37)	29,255
	<u>(6,306)</u>	<u>23,846</u>
Net cash provided by (used in) investing activities		

(Continued)

AES PANAMA, S. A.

STATEMENTS OF CASH FLOWS

Years ended December 31 2007 and 2006

(In thousands of United States dollars)

	2007	2006
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from new loans	1,460	-
Loan payments	(4,815)	(3,075)
Proceeds from bonds	-	297,531
Bond payments	-	(286,721)
Payment for financing costs	(132)	(4,897)
Payment of make-whole premium, net	-	(17,062)
Capital lease obligation payments	(106)	(73)
Dividend paid	(65,000)	(48,960)
Prepaid dividend tax	291	(1,516)
Capital increase	231	180
Acquisition of treasury stock	-	24
	<u>(68,071)</u>	<u>(64,569)</u>
Net cash used in financing activities		
	<u>(68,071)</u>	<u>(64,569)</u>
NET INCREASE IN CASH	1,674	15,292
CASH AT BEGINNING OF THE PERIOD	<u>17,435</u>	<u>2,143</u>
CASH AT END OF THE PERIOD	<u>\$ 19,109</u>	<u>\$ 17,435</u>
SUPPLEMENTARY DISCLOSURES		
Cash payments for interest	<u>\$ 19,601</u>	<u>\$ 22,980</u>
Cash payments for income tax	<u>\$ 4,051</u>	<u>\$ 8,851</u>
NON-CASH TRANSACTION		
Acquisition of fixed assets by capital lease obligation	<u>\$ -</u>	<u>\$ 147</u>

(Concluded)

See accompanying notes to the financial statements.

AES PANAMÁ, S.A.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2007

(In thousands of United States dollars)

1. GENERAL INFORMATION

AES Panamá, S.A. (the Company) was incorporated on October 26, 1999 as a result of the merger of Empresa de Generación Eléctrica Chiriquí, S.A. (Chiriquí) and Empresa de Generación Eléctrica Bayano, S.A. (Bayano). Chiriquí and Bayano were incorporated as a company on January 19, 1998 in connection with the privatization and restructuring of the Panamanian energy industry. At the time of its acquisition, the Company operated a hydroelectric power plant with an installed capacity of 150 megawatts in Bayano, a thermal power plant with a capacity of 43 megawatts located in Panama City (which was shut down in 2005 and transferred to Empresa de Generacion, S.A who assumed all the obligations and responsibilities of the plant on October 18, 2006 as established under the transference contract), and the hydroelectric power plants of La Estrella and Los Valles with an installed capacities of 42 and 48 megawatts, respectively, located in the Province of Chiriquí. In February 2004 the Bayano plant completed, the expansion of two existing units increasing their total capacity from 75 to 87 megawatts, and the construction of a third unit of 86 megawatts. On November 20, 2003 the Company completed the construction of the Estí hydroelectric plant with an installed capacity of 120 megawatts, located in the Province of Chiriquí. Additionally, in March 2006 the Company began the repowering project of La Estrella and Los Valles increasing capacity in these plants to 45 and 51 megawatts, respectively, on June 2006 and on June 2007 they were once again increased to 48 and 54 megawatts, respectively with the culmination of the repowering project. As of December 31, 2007 AES Panamá Energy, S.A. owned 105,353,687 (49.0%) shares of the Company, the Republic of Panama owned 108,347,536 (50.5%) shares of the Company, and the employees and ex-employees of the Company owned 0.5% of the shares. The contracts for the additional sale/purchase of shares between the Government of Panama and the employees were signed in July 2003. Of the 2,993,849 (1.5%) shares of the Company to be transferred, only 8,539 were effectively sold in 2003.

The Company generates and sells electricity in the Panamanian electric system, which is regulated by the Authority of Public Services (formerly Entity of Public Services), the supervising government agency that oversees the energy sector in the Republic of Panama. Approximately 88% of the firm capacity of the plants in operation is contracted to date under several power purchase agreements with the distribution companies and larger consumers in the Republic of Panama. These agreements have an average duration of three to four years. Excess capacity is sold in the spot market at the prevailing tariffs.

2. BASIS OF PRESENTATION

Explanation for translation into English - The accompanying financial statements have been translated from Spanish into English for use outside of the Republic of Panama.

These financial statements are presented in conformity with accounting principles generally accepted in the United States of America (“US GAAP”). Certain accounting practices applied by the Company that conform with US GAAP may not conform to accounting principles generally accepted in the country of use.

The accounting records are maintained in Balboas, the official currency of the Republic of Panama, the country where the Company operates. The Balboa is at par and is free to be exchanged with the US dollar. The Republic of Panama does not issue paper currency and in its place used the US dollar as legal tender.

The financial statements and notes are presented in thousands of United States dollars (US\$), unless otherwise indicated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The most significant accounting policies of the Company are summarized as follows:

- a. Inventories* - Inventories, consisting mainly of materials, spare parts and diesel, are valued at the lower of cost or market value. Cost is determined using the first-in, first-out method. Inventories include an allowance for obsolescence of \$146 as of December 31, 2007 and December 31, 2006.
- b. Property, plant and equipment* - Property, plant and equipment are recorded at acquisition cost less accumulated depreciation. Cost includes major expenditures for improvements and replacement, including critical replacement parts for the turbine generator units, which extend useful lives or increase capacity and interest cost associated with significant capital additions. Maintenance and repair costs are charged to expenses as incurred. When assets are sold or retired, the corresponding cost and accumulated depreciation are removed, and the resulting gain or loss is shown in the income statement.

Depreciation is estimated based on the useful life of the corresponding assets using the straight-line method. The rates for depreciation used are based on the estimated useful lives of the assets as shown below:

Buildings	30 to 50 years
Dams	30 to 50 years
Generation equipment	15 to 50 years
Electrical equipment	5 to 50 years
Transmission equipment	35 years
Office furniture and equipment	3 to 20 years
Vehicles	3 to 8 years

- c. **Construction in progress** - Payments for projects under construction, including salaries, engineering, interests, insurance and other costs are capitalized. Balances of construction in progress are transferred to electricity generation facilities when the assets are ready for their intended use.
- d. **Deferred financing costs** - The Company defers all costs related to the issuance of long-term debt. These costs include borrowers' commissions and other costs such as legal, registration and stamp costs. Debt issuance costs are amortized over the term of the debt using the effective interest method.

During the construction period, the deferred financing costs are included as part of the construction in progress.

- e. **Revenue recognition and concentration** - Revenues from the sale of electricity are recognized based on output delivered to clients according to the monthly liquidations prepared by the National Dispatch Center of the Republic of Panama, considering rates and kilowatts specified under contract terms. For the year ended December 31, 2007 and 2006, substantially all revenues were derived from five customers represented by three distribution companies and two generation companies that operate in the Republic of Panama.

The interest income is periodically accumulated taking in consideration the principal balance and the interest rate applicable.

- f. **Income tax** - Deferred income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured based on the application of enacted tax rates to taxable income in the years in which those temporary differences are expected to reverse.

The Company uses the direct method for recognition of investment tax credits for the acquisition of qualifying assets. Under this method, investment tax credits are reflected as a reduction in the income tax of the year in which the corresponding certification is granted according to the enacted tax regulation. The associated deferred tax asset is reduced against the income tax payable based on the utilization of the benefit of 25% of income tax each year.

- g. **Long-lived assets** - In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets", the Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. The carrying amount of an asset is not recoverable when the estimate future undiscounted cash flows expected to result from the use of the asset are less than the carrying value of the asset. The Company measures an impairment loss as the difference between the carrying value of the asset and its fair value.

- h. *Derivative financial instruments*** - The Company enters into derivative transactions to hedge its exposure to certain interest rate risks. The Company does enter into derivative transactions for trading purposes. All derivative transactions are accounted for under SFAS No.133, “Accounting for Derivative Instruments and Hedging Activities”, as amended and interpreted.

The Company has determined that its contracts for purchase or sale of electricity qualify as normal purchase and sale business transactions, are outside the scope of SFAS No. 133. However, contracts that qualify for this exemption must meet certain criteria, which include the requirement for physical delivery of the electricity to be purchased or sold according to the contract during the normal course of business.

According to SFAS No. 133, AES Panamá, S. A. had to recognize the interest rate swap in its balance sheet as an asset or liability at its fair value. The swap qualified as a perfectly effective cash flow hedge, as defined by SFAS No. 133, and AES Panamá, S.A. had completed all the documentation required by SFAS No. 133 in order to apply hedge accounting for this contract. Accordingly, all changes in the fair value of the swap for the interest rates were recognized as other comprehensive income in equity and reclassified into earnings in the same period or periods during which the hedged transaction affected earnings.

As of December 31, 2006 the company canceled this transaction when redeeming the bonds that required the use of a hedge instrument to mitigate interest rate exposure. At this point the company issued new debt that does not require the use of derivative instruments.

- i. *Use of estimates*** - The presentation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the balances and amounts of the assets, liabilities and results, as well as the disclosures of contingent assets and liabilities. Actual results may differ from these estimations.
- j. *New accounting standards*** - In June 2006, the FASB Interpretation (“FIN No.48), “Accounting for Uncertainty in the Income Taxes, an Interpretation of FASB Statement No.109”. FIN No.48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on the tax return. Under the interpretation, the financial statements will reflect expected future tax consequences of such positions presuming the tax authorities’ full knowledge of the position and relevant facts. This interpretation is effective for annual periods beginning after December 15, 2006. FIN No. 48 was already implemented in 2007.

In June 2006, the FASB ratified the consensus reached by the FASB's Emerging Issues Task Force ("EITF") on EITF Issue 06-03, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statements (That Is, Gross Versus Net Presentation)". The scope of this Issue includes taxes that are externally imposed on a revenue producing transaction between a seller and a customer. The EITF concluded that a company should disclose its accounting policy (i.e., gross or net presentation) regarding presentation of such taxes. If taxes included in gross revenues are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. This Issue is effective for the first annual or interim reporting period beginning after December 15, 2006. The adoption does not have any impact in the financial condition or in the results. The adoption does not have any impact in the financial condition or in the results.

In September 2006, the FASB issued FASB Statement No.157, "Fair Value Measurement" (SFAS No.157). SFAS No.157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. The standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability. SFAS No.157 will be effective for annual periods beginning after November 15, 2007. The adoption does not have any impact in the financial condition or in the results.

In February 2007, the FASB issued SFAS No.159, "The Fair Value Option for Financial Assets and Financial Liabilities- including an amendment of FASB Statement No.115". SFAS No.159 provides the options to report at fair value certain financial instruments that are not currently required or permitted to be measured at fair value. This pronouncement is effective for fiscal year beginning after November 15, 2007. The adoption does not have any impact in the financial condition or in the results.

4. FUNDS IN TRUST

In December 2006 the Company issued senior notes (issued under Rule 144A/Reg S) in the international and national market in the amount of US\$300 million in order to repay principal, interest and other costs related to US\$320 million financing completed in 2003. With the cancellation of previous debt, the Company could distribute the funds maintained in the trust accounts.

The new financing arrangement established a trust account defined as the "Debt Services Reserve Account". This Trust Fund has been set up by AES Panama, S.A. as Trustor, and HSBC Bank USA, National Association as Trustee and Collateral Agent, has the general purpose of establishing a cash fund to secure the obligation for payment of interest. The amount held in this account is \$9,562 and \$9,525 for December 31, 2007 and 2006, respectively.

5. BALANCES AND TRANSACTIONS WITH AFFILIATES AND RELATED PARTIES

The Panamanian Government owns a significant investment in the generation, distribution and transmission companies in the electric power industry in Panama. Consequently, all the transactions between the Company and such companies are considered transactions with related parties.

The Company has entered into contracts with distribution companies and wholesale clients, to supply energy and capacity. For 2008, the Company maintains 81% of its firm capacity under contract; 80% for 2009; 79% for 2010; 67% from 2011 through 2013; 63% from 2014 through 2018; and 12% from 2019 through 2020. The electricity sales include approximately \$168,112 and \$141,028 of revenues related to such contracts and on the spot market for year ended December 31, 2007 and 2006 respectively. From time to time, the Company purchases energy in the spot market to meet its contractual requirements. The amounts related to those transactions were \$24,354 and \$10,694 for year ended December 31, 2007 and 2006, respectively.

In addition, the Company incurred in expense for the use of the transmission lines for \$14,198 and \$12,514 in 2007 and 2006, respectively.

During 1999, the Company entered into an administration contract for 20 years with AES Panama Energy, S.A. This contract provides for a fee equivalent to 5% of income before depreciation, interest and taxes for the first five years and of 4% of income before depreciation, interest and taxes from the sixth to the tenth year. Total fees amounted to \$4,601 and \$3,929 for year ended December 31, 2007 and 2006, respectively.

The Company has recognized compensation to AES Panamá Energy, S.A. for the use of its shares as collateral in the AES Panama, S.A. \$320 million financing. The compensation corresponded to an annual 1% of the value of the collateral provided by AES Panamá Energy, S.A. As of December 31, 2006 the total amount of this fee was \$917, which is reflected in other expenses in the accompanying statements of income. This guarantee was canceled on December 2006 after AES Panama refinanced with a \$300 million issuance of senior notes.

As of December 31, 2007 and 2006, the employees, that were also shareholders of the Company received compensation of \$1,427 and \$1,317, respectively.

The Company maintains a Development and Construction Management Advisory Service Agreement with an affiliate company and at December 31, 2007 and 2006 paid the amount of \$403 and \$712. The account receivable is included in the accompanying balance sheet.

6. LOANS PAYABLE

The Loans payable as of December 31, 2007 and 2006, are as follow:

	2007	2006
Banco Continental de Panamá, S. A.:		
Mortgage loan guaranteed with a first mortgage on properties owned by the Company, maturing on September 22, 2017 at annual interest rate of 7%	\$ 1,326	\$ -
Mortgage loan guaranteed with a first mortgage on properties owned by the Company, maturing on June 9, 2014 at annual interest rate of 7%		381
Loan with maturity date on July 1, 2007 at annual interest rate between 7.9810% and 7.9431%	-	4,300
	<u>1,326</u>	<u>4,681</u>
Less current portions	<u>136</u>	<u>4,377</u>
Long-term loans, excluding current portions	<u>\$ 1,190</u>	<u>\$ 304</u>

The Company has lines of credit with several banks, which are presented in the preceding table, as follows:

	2006	Limit	Used
Banco Continental		<u>\$ 4,300</u>	<u>\$ 4,300</u>

7. BONDS PAYABLE

In December 2006 the Company issued senior notes in an aggregate principal amount of \$300 million (issued under rule 144A/Reg S) into the international and national markets. These notes have 10 year bullet maturity, with one principal payment due in December 2016. The notes have a coupon rate of 6.35% and pay interest semi-annually. The Company shows in the balance sheet the debt securities for \$297 million net of unamortized discount that should be amortized under the effective interest rate method, according to APB 21.

The bonds payable were issued under an indenture, among AES Panama, S.A. and HSBC Bank USA, National Association as indenture trustee. The proceeds of the bonds issued were used to repay outstanding principal and interest balances related to the \$320 million financing completed in 2003.

On December 21, 2006 the company refinanced the \$320 million debt with the new credit of facility for \$300 million. This facility was underwritten and distributed by Credit Suisse and UBS Investment Bank. The company paid a cost of \$4,897 for the issuance of this bond, which have been deferred and will be amortized during the term of the debt contract.

The Company had to pay \$20,767 due to the advance payment of institutional bonds. This payment is included in the income statement in other expenses.

Additionally, the Company recognized in the income statement the deferred financing costs of the extinguishment debt of \$10,903.

The most significant covenants of the new debt are as follows:

- The Company must maintain a “Debt Service Reserve Account” with funds deposited and available to secure the semi-annual interest payment.
- Limitation on certain indebtedness:
 - Outstanding bankers’ acceptances, letter of credit and other indebtedness should not exceed \$20 million outstanding at any one time.
 - Enter into outstanding lease contracts that exceed \$10 million at any time.
- Limitation on sales of assets of generation
- Audited financial statements should be delivered to Indenture Trustee, within 120 days after the end of each fiscal year.

As of December 31, 2007 and 2006, bonds payable is as follows:

	2007	2006
Bond	\$ 300,000	\$ 300,000
Discount	<u>(2,280)</u>	<u>(2,469)</u>
 Bond payable, long term	 <u>\$ 297,720</u>	 <u>\$ 297,531</u>

The amortization of the discount is included in interest expenses in the accompanying statements of income.

8. CAPITAL LEASE OBLIGATIONS

The Company has entered into capital lease obligations for transportation equipment that expire in 48 months from December 2006. The present value of the future minimum lease payments are summarized below:

	2007	2006
Up to a year	\$ 118	\$ 124
From one to four years	<u>110</u>	<u>220</u>
Total future minimum payments	228	344
Less interest (from 7.5% to 8.0% per annum)	<u>14</u>	<u>24</u>
Present value of future minimum lease payments	214	320
Less current portion of the obligations under leasing	<u>109</u>	<u>109</u>
Obligations under leasing excluding current portion	<u>\$ 105</u>	<u>\$ 211</u>

The depreciation for the assets under leasing is included under the depreciation expense.

9. COMMITMENTS AND CONTINGENCIES

Commitments

The Company has certain obligations related to its concession and electricity purchase contracts. The Company has guarantees for \$26.8 million to cover the obligations arising from those contracts. The Company also has guarantees for \$28.0 million in favor of the Government of the Republic of Panama for the concession to harness the hydroelectric potential that in turn generates electricity.

In December 2007, the Company entered into new electricity sale agreements for the period of one year. On December 2006, the Company entered into a new electricity sale agreement with two distribution companies for the period from 2007 to 2020.

Mortgage

AES Panama, S.A. signed a sale/purchase contract for the acquisition of a property (23th Floor) at the Torre Plaza Banco General (formerly Banco Continental) (“the Seller”), where the Company has its administrative offices. The agreed selling price was \$1,382 of which the Company has made a first installment of \$122. The Company is analyzing the possibility of obtaining a mortgage on the property, with a local bank, for the remaining US\$1,260.

Contingencies

The Company is involved in several legal actions in the normal course of business. It is the opinion of the Company that none of the pending claims will have a material adverse effect on its results of operations, financial position or cash flows.

In the Caja de Seguro Social Resolution No.964-2007 D.G. dated November 22; was stated that the company will have to pay amounts in concept of social security tax and professional risk. The total amount of this Resolution was paid on September 28, 2007 but actually the lawyers of the company are asking for a reconsideration process. The Company considers that the 78% of this payment can become a credit amount if the court gives a favorable resolution.

10. RETIREMENT PLANS AND SENIORITY PREMIUMS

According to Panamanian labor law, the Company is required to contribute to a severance fund to cover payments and seniority premium of employees upon retirement or termination. Contributions are based on 1.92% for the seniority premium and 0.32% for severance, on remunerations paid to employees. This severance fund must be deposited and administered by an authorized private certified institution.

In addition, the Company sponsors a defined contribution savings plan available to all its employees. The Company makes contributions for up to 5% of the annual salary, in addition to the possibility of discretionary contributions from the employees. Contributions to the plan are restricted for a period of 10 years. The Company contributed \$70 and \$67, to the plan during year ended December 31, 2007 and 2006, respectively.

The Company also offers to its employees a bonus in the form of shares of The AES Corporation. These shares are deposited in a Trust Fund denominated "Non-contributing Private Pension Plant" and it is managed by an authorized third party that maintains individual accounts for each employee. Contributions to this plan are subject to Board of Directors' decisions and are calculated based on a percentage of the salary of every permanent employee. Provision for this contribution was \$215 in 2007 and \$251 in 2006.

11. REACQUISITION OF SHARES

The Company, through its Board of Directors, approved and authorized management to acquire shares previously issued. During 2006, 7,319 shares were acquired and 30,000 treasury shares were sold.

12. OTHER INCOME (EXPENSES), NET

For year ended December 31, 2007 and 2006, miscellaneous income (expenses), net, is detailed as follows:

	2007	2006
Other income	\$ 1,302	\$ 233
Loss on extinguishment of debt	-	(27,965)
Other expenses	<u>-</u>	<u>(1,109)</u>
	<u>\$ 1,302</u>	<u>\$ (28,841)</u>

Other income includes reversions of expire liabilities.

13. INCOME TAX

For the years ended December 31, 2007 and 2006 the provision for income tax consists of the following:

	2007	2006
Current	\$ 16,829	\$ 5,596
Deferred	<u>5,276</u>	<u>1,703</u>
	<u>\$ 22,105</u>	<u>\$ 7,299</u>

The reconciliation between statutory tax rate and the effective tax rate of the Company as and average of the income before tax at December 31, 2007 and 2006 is detailed as follow.

	2007	2006
	%	%
Statutory income tax rate	30.00	30.00
Increase (decrease) as a result of:		
Income no taxes	(0.73)	(2.15)
Non deductible expenses	0.86	3.94
Accumulated depreciation	<u>(0.53)</u>	<u>(1.62)</u>
Income tax effective rate	<u><u>29.60</u></u>	<u><u>30.17</u></u>

As of December 31, 2007 and 2006, the deferred income tax asset and liability was comprised as follows:

	2007	2006
Deferred tax assets:		
Provision for obsolescence	\$ 44	\$ 44
Diference in tax basis of generation assets	<u>2,050</u>	<u>2,127</u>
	2,094	2,171
Investment tax credit	<u>5,253</u>	<u>10,922</u>
Deferred tax assets	<u><u>\$ 7,347</u></u>	<u><u>\$ 13,093</u></u>
Deferred tax liabilities:		
Accumulated depreciation over assets of investment tax credit	\$ 6,465	\$ 6,822
Accumulated depreciation of donation to the government	<u>2,919</u>	<u>3,032</u>
Total deferred tax liabilities	<u><u>9,384</u></u>	<u><u>9,854</u></u>
Net deferred tax assets (liabilities)	<u><u>\$ (2,037)</u></u>	<u><u>\$ 3,239</u></u>

A summary of the activity during the year ended December 31, 2007 and 2006, of the deferred tax asset resulting from deductible temporary differences is as follows:

	2007	2006
Beginning balance	\$ 2,171	\$ 2,478
Decrease during the period/year	<u>(77)</u>	<u>(307)</u>
Ending balance	<u><u>\$ 2,094</u></u>	<u><u>\$ 2,171</u></u>

As of December 31, 2007 and 2006, the deferred tax liability includes the effects of a donation of infrastructure to the Government of Panama, which is deductible for fiscal purposes during the incurred year, while for financial purposes it will be depreciated during the useful life of the asset.

During the year ended on December 31, 2005, management revised the deferred tax payable, because the depreciation of the assets that generated an investment tax credit is not deductible; consequently, a deferred tax liability was generated.

	2007	2006
Balance at the beginning of the year	\$ 9,854	\$ 10,323
Applied during the year	<u>(470)</u>	<u>(469)</u>
Balance at the end of the year	<u>\$ 9,384</u>	<u>\$ 9,854</u>

Law No. 28 dated June 20, 1995 that was in enacted until 2000, enabled companies that invest in technology to be granted investment tax credits. An independent qualified technical institution must certify that the assets qualify for this tax incentive consisting of a fiscal credit of 25% over the income tax in any given fiscal year. The tax credit is applicable until full amount of the investment is utilized.

As of December 31, 2007 and 2006 the Company maintained a deferred tax asset available for investment tax credit as follows:

	2007	2006
Balance at the beginning of the year	\$ 10,922	\$ 12,787
Reduction during the year	<u>(5,669)</u>	<u>(1,865)</u>
Balance at the end of the year	<u>\$ 5,253</u>	<u>\$ 10,922</u>

The Company's income tax returns are subject to review by the fiscal authorities for the last three years, including the year ended December 31, 2007, according to fiscal regulations. Additionally, the Company is subject to review by the fiscal authorities for compliance with the stamps tax law.

14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of certain financial assets, including cash, accounts receivable, accounts receivable to related parties and certain financial liabilities including accounts payable, accounts payable to related parties, as a result of their short-term nature, is considered to be equal to fair value.

The estimated fair values as of December 31, 2007 and 2006 are based on information available as of the date of the balance sheet. The Company has no knowledge of any factor that may affect significantly the fair value estimation at that date.

For fixed rate loans, the fair value is estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rate.

	December 31 2007		December 31 2006	
Financial liabilities:				
Medium and long term obligations and placements	<u>\$ 297,720</u>	<u>\$ 297,720</u>	<u>\$ 297,531</u>	<u>\$ 297,531</u>

15. APPROVAL OF FINANCIAL STATEMENTS

The financial statements at December 31, 2007 were approved by the Management and authorized for their issuance on March 26, 2008.

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