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Q3 2019 Infraestructura Energetica Nova SAB de CV Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q3 2019 IEnova Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to your speaker, Mr. Miguel Osio. Please go ahead, sir.

Miguel Osio *Infraestructura Energética Nova, S.A.B. de C.V. - Director of M&A and IR*

Good morning. Thank you for joining us. Today, we will be discussing IEnova's Third Quarter 2019 Financial Results. A live webcast of this teleconference and slide presentation is available on our website in Investor Relations section. In the presentation, you will find our disclosure statement.

The forward-looking statements contained in this presentation speak only as of today, October 24, 2019, and the company does not assume any obligations to update or revise any of these forward-looking statements in the future.

With us today on the call are several members of our management team: Tania Ortíz, Chief Executive Officer; Nelly Molina, Chief Financial Officer; and Roberto Rubio, Vice President and Controller.

Please turn to Page 3 of the presentation provided on our website, and I will turn the call over to Tania.

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Good morning, everyone. Thank you for joining our call. Today, I would like to give an update on the successful agreement that we reached with CFE regarding the Marine Pipeline and the second segment of the Sonora pipeline, Guaymas-El Oro. The agreement was announced on August 27 by President Lopez Obrador. The President's direct and personal intervention as well as that of the presidents of the 2 leading national business chambers, the Consejo Coordinador Empresarial and the Consejo Mexicano de Negocios, played key roles in reaching a constructive and win-win agreement for all of the parties involved.

The agreement establishes a new leveled tariff for the original 25-year tenor and an extension of 10 years while maintaining the original contract terms. This resolution is IRR-neutral. Additionally, all arbitration processes have been withdrawn.

As part of the agreement, the government is committed to support the resolution of the dispute on the second segment of the Sonora pipeline.

As you may recall, last August, we signed a suspension agreement with CFE while this gets resolved.

Finally, we announced the start of operations of the Marine Pipeline. This pipeline will significantly increase the current import capacity of natural gas to Mexico, which is urgently needed to meet growing demand. While this quarter, our priority was centered on solving the



pipelines issue, the IEnova team has continued to be focused, as always, on delivering results and pursuing growth opportunities.

Please turn to Page 4, so I can talk about the progress we have achieved. During September and October, we executed 3 long-term energy supply contracts in U.S. dollars with Liverpool, Circle K and Envasas Universales for a new project called Border Solar. This is our fifth solar power plant, and it will have an installed capacity of 150 megawatts with an investment of approximately \$160 million dollars. With this project, we will have a renewable energy portfolio that exceeds 1,000 megawatts of installed capacity, contributing to Mexico's clean energy goals.

We continue to see more short-term opportunities in the renewable space as well as the refined product storage business. Additionally, we continue to focus on our development efforts and are targeting to reach a final investment decision at our ECA liquefaction project around the first quarter of 2020.

Please turn to Page 5. As you may remember, we postponed the decision of the dividend payment while the discussion with CFE regarding the pipeline contracts was ongoing. This week, IEnova's Board of Directors declared a dividend payment of \$220 million dollars that will be distributed in November.

With that, I would like to turn the call over to Nelly to discuss the quarter's financial results and construction progress.

Manuela Molina Peralta *Infraestructura Energética Nova, S.A.B. de C.V.* - CFO

Thank you, Tania, and good morning to everyone. Please turn to Page 6 where you can see our financial results. In the third quarter of 2019, adjusted EBITDA decreased 3% to \$231 million dollars compared with \$238 million dollars in the same period of 2018. This decrease was mainly due to the revenue deferment at our Guaymas-El Oro pipeline and a one-time distribution rate true-up in 2018 at EcoGas Mexicali, partially offset by the start of operations of the South Texas-Tuxpan pipeline and our first solar power facilities, Pima and Rumorosa.

For the 9 months, the adjusted EBITDA increased 2% to \$682 million dollars compared to last year. This increase was mainly due to better TDM performance and the start of operations of the South Texas-Tuxpan pipeline, Pima and Rumorosa solar generation facilities, partially offset by the revenue delay at Guaymas-El Oro pipeline.

In the third quarter of 2019, profit was \$110 million dollars compared with \$112 million dollars in the same period of 2018. The decrease was mainly due to the same EBITDA drivers I just mentioned, partially offset by noncash exchange rate effects.

As we indicated in our last call, we were going to review our adjusted EBITDA guidance once an agreement with CFE was reached. And now, I am pleased to inform you that despite of the revenue delays of our 2 pipelines, we anticipate to be close to the lower range of our guidance for the year at \$935 million dollars.

Now regarding dividends. This is a ninth consecutive year that IEnova will pay dividends, and we have been growing the distributions at 5% per year. It is our intention to continue paying a strong dividend with a similar annual growth, a 4% to 5%, provided, of course, that we have balance sheet capacity and our shareholders' approval.

Please go to Page 7 to see our 9 projects that we currently have under construction. Regarding our Veracruz, Puebla and Mexico City refined products storage terminals, we are advancing very well with construction and are really excited that they will go into commercial operations early next year.

We have been in recent discussions with our customers and would like to update you on a few items. We are revising upward our investment for these 3 facilities by \$150 million to \$200 million dollars. The increased investment is driven by 2 factors: one is increased construction cost related to final design changes, civil works and construction cost associated to unforeseen site conditions, among others. The other factor driving the increase is an expansion of the storage capacity that we are considering in the Mexico City terminal site. While the investment will be increased in those 3 assets, overall in our portfolio of \$1.2 billion dollars of storage terminals, the total economics remain healthy and are within our expected 9% to 11% target returns.

In relation to our renewables portfolio, Tepezalá Solar just started operation this month, and we are very recently announced a new one, which is Border Solar.

And to end the year, we are focusing efforts on some financing processes to improve our debt maturities and financing, finally, the Marine Pipeline.

With that, I'll turn the call back to Tania, and please go to Page 8.

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Thank you, Nelly. I am very pleased to say that IEnova has been able to positively engage with President Lopez Obrador's administration, and we've built a constructive and positive relationship with this new administration. For the next month, we will be focused on project execution, strengthening the balance sheet and continue to progress at our ECA liquefaction project to be able to reach a final investment decision.

With that, I would like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Nikolaj Lippmann with Morgan Stanley.

Nikolaj Lippmann *Morgan Stanley, Research Division - Equity Analyst*

Congratulations on the deal with the CFE. Two questions, if I may. First, could you provide any additional color on the status of the force majeure payment on the 2 pipelines, what's next there? One, and number two, what is missing in order for you to make the final investment decision on Costa Azul?

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Nikolaj, good morning this is Tania. Thank you for joining the call. With regards to the force majeure payment, the Marine Pipeline is operating. So we're receiving regular revenues from that project. With regards to the Sonora pipeline in Guaymas-El Oro, as you may recall, the contract originally provided for 2 years of force majeure payment. Those 2 years expired in August. So we have not been receiving revenues from the Guaymas-El Oro pipeline since then. We will resume receiving revenues once the pipeline goes back in operations. Regarding the final investment decision at our LNG facilities, we have a large group of people working on that project first. And maybe, more importantly, we are running the EPC bid process in order to select a contractor and, of course, determine the definitive CapEx for the facility, and that will be ongoing through the end of the year. Secondly, we're also in the process of negotiating the definitive agreement with our customers, Total, Mitsui and Tokyo Gas as well as the associated equity participation. And finally, we are in the process of obtaining the last -- major permit that we need in Mexico, which is the gas export permit. But we continue to advance on all 3 fronts.

Nikolaj Lippmann *Morgan Stanley, Research Division - Equity Analyst*

That's very clear. Do you -- can you say, well, that you think that you could do the final investment decision? Is that for '19? Or is it a 2020 kind of thing? I don't know if you can give any color on that?

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

It will very likely be 2020, Nikolaj.

Operator

Our next question will come from Jeremy Tonet with JP Morgan.



Charles W Barber JP Morgan Chase & Co, Research Division - Analyst

Good morning, this is Charlie in for Jeremy. Congrats on the quarter. Just following up on ECA there. Just curious about the process for the greenfield pipe that you would need to feed that project. Does the timeline on that project -- I know you haven't given too much color on that, but how does that, I guess, evolve with the process of giving an FID for the ECA liquefaction project?

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

Well, the project will require a pipeline expansion to be built in Mexico. That's not on a critical path. It's parallel to some of the pipelines that we already have in place. So we have more than enough time to execute on that project.

Charles W Barber JP Morgan Chase & Co, Research Division - Analyst

And can you remind us the estimated kind of CapEx expense that would be associated with that?

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

We have not yet disclosed the CapEx associated with the project.

Charles W Barber JP Morgan Chase & Co, Research Division - Analyst

Okay, fair enough. And then just lastly, I know you've talked about it before, but can you give us a sense of your current backlog? Largely getting through 2021, most of those projects will be online. What does the private party exposure versus governments or CFE exposure look like today versus in 2021? And then can you give us any sense of a ballpark number of what it would look like should the ECA liquefaction come into play?

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

I mean, right now, we're roughly at 50-50, 50% government, 50% private. Because the Marine Pipeline just began operations then the government portion increased a little bit. But when all of the projects that we have under construction go online, because they're all contracted with private off-takers, and I'm referring to the refined products terminals and the renewable projects, we're going to be back roughly at a 50-50, which we think is a reasonable and healthy balance.

Manuela Molina Peralta Infraestructura Energética Nova, S.A.B. de C.V. - CFO

And after ECA, of course, it will be modified because we're considering only private customers. But it will be post-2024.

Charles W Barber JP Morgan Chase & Co, Research Division - Analyst

So CFE would be below 50% exposure, correct?

Manuela Molina Peralta Infraestructura Energética Nova, S.A.B. de C.V. - CFO

Not CFE, the government and government ...

Charles W Barber JP Morgan Chase & Co, Research Division - Analyst

The government.

Manuela Molina Peralta Infraestructura Energética Nova, S.A.B. de C.V. - CFO

is composed of CENAGAS, Pemex and CFE.

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

Yes. On the top of our head, making our calculations right now. With ECA, we would be at roughly 60% private, 40% government.

Operator

Our next question will come from Vanessa Quiroga with Crédit Suisse.



Vanessa Quiroga *Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil*

My first question is regarding CapEx. You are running relatively slow on CapEx for the first 9 months of the year compared to your guidance. So should we expect an important ramp-up in CapEx during the fourth quarter? And -- that's my first question. And the second one is if your view on the attractiveness and -- or profitability of the ECA conversion project changes at all with the movement in LNG prices? Those are my 2 questions.

Manuela Molina Peralta *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Good morning, Vanessa, yes, you're right. As of September, yes, our capital expenditure is below expected compared to our full year CapEx guidance of \$825 million. This is primarily due to timing of construction related to payments at our storage terminals, and we do expect to catch up during the fourth quarter.

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Good Morning Vanessa, Buenos días. With regards to the ECA liquefaction project, although LNG prices have been decreased, we're selling at or -- at a fixed price. Our customers or prospective customers are very committed. They're very interested. So no, we're not seeing any impact whatsoever for -- from the decline in LNG prices in North America.

Vanessa Quiroga *Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil*

Okay, okay. That's great. Can I take advantage of the time and also ask you about the changes in your expected delivery dates for the renewable projects? Does that -- do you think there could be more delays? It was just 1 quarter, but still, do you think there's some risk of further delays given where you are in terms of permits or any other reason for the change in the dates?

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Vanessa, the change in dates are mainly related to delays in obtaining permits with the change of administration, the past administration as well as this new administration, things do tend to slow down a little bit. We had provisions in the contracts that allowed us to move those dates. But we hope as the new administration gets up to speed, and they build up their new staff that we'll slowly begin catching up.

Vanessa Quiroga *Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil*

Okay, excellent. And just a quick final one. What's the amount of CapEx increase related to the Veracruz and Central Mexico system that was related to expansion? And what's the amount related to higher costs?

Manuela Molina Peralta *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Vanessa, the majority of the investment increase that we are foreseeing, it comes from the changes in the scope of the design, and that's associated with the 3 terminals. The expansion, we are not yet ready to disclose because we are still in negotiations. So we need to define the magnitude of the capacity increase to determine the CapEx. But we feel comfortable that this range of \$150 million to \$200 million will cover both.

Operator

Our next question will come from Andres Cardona with Citigroup.

Andres Felipe Cardona Gómez *Citigroup Inc, Research Division - Research Analyst*

Good morning everyone. I have a couple of questions. The first one is for Nelly. If you can give us an update about the process to write cash from the Marine Pipeline? When are you expecting it to happen? And the second one has to do with CFE, and if you think they have a commitment to build more thermal capacity backed with gas in the next years? And the last one, I'm not sure if you are ready yet to share some preliminary figures around 2020 guidance?

Manuela Molina Peralta *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Good morning Andres. Regarding the Marine Pipeline financing, we have explored all the different alternatives because it could be a very, very large financing. So we're taking care of that, and we're in touch with our partner, but I don't see a transaction in 2019. It's going to be a financing closing hopefully in the first half of 2020. Now regarding the guidance for 2020, we're -- we disclosed it as usual in our call in February.

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Andres, this is Tania. Regarding CFE bidding for new pipelines, we're not really seeing any signals that they intend to issue anything soon. We've been, of course, very busy with our other projects, but we're not seeing any signals of new pipelines being bid in the short term. And we've....

Andres Felipe Cardona Gómez *Citigroup Inc, Research Division - Research Analyst*

Tania, what I mean is thermal plants backed with gas.

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Thermal plants, I'm sorry. No, CFE has made preliminary announcements on 4 or 5 thermal plants. They disclosed the location, they disclosed the capacity. They have not yet disclosed under what structure they intend to bid those plants. So obviously, we will evaluate that then, but it would very much depend on the structure if we are interested or not in participating in those processes.

Operator

Our next question will come from Frank McGann with Bank of America.

Frank J. McGann *BofA Merrill Lynch, Research Division - MD*

One -- just one question for me. In terms of the Guaymas-El Oro pipeline, any news on getting the repair completed so that you can move forward with operating the pipeline again?

Tania Ortíz Mena López Negrete *Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director*

Good morning, Frank, since we reached the agreement with CFE, the government has been very, very engaged in trying to find a solution. We've -- they visited, in fact, the Yaqui community on several occasions, and we're having meetings at least once per week to work together on the strategy. So what I can tell you is that the new administration is very engaged. And directly involved all the way up to the Secretary of the Interior to find a solution.

Operator

(Operator Instructions) Our next question comes from Gabriel Himelfarb with Scotiabank.

Gabriel Himelfarb Mustri *Scotiabank Global Banking and Markets, Research Division - Associate*

Hi good morning. Just a quick question. You mentioned in the press release that the revenue decreased around \$3 million due to lower price on volume of natural gas. Can you give us a bit of detail how does price impact revenue on certain -- to a fixed tariff? Or does it go through EcoGas?

Roberto Rubio *Infraestructura Energética Nova, S.A.B. de C.V - Vice President and Controller*

Good morning, Gabriel, and thank you for your question. Regarding the decrease in revenues from the 2 quarter 2018 compared with the same period this year, we had 2 main components. One is the decrease in energy prices -- power prices related to the Mexicali by 41% compared with this period. Also, we have a decrease in -- by 28% related to the natural gas prices. Remember, we are a pass-through company. We have no financial impact or impact in our EBITDA margins related to the changes in prices in natural gas. And finally, we have some \$9 million decrease related to Guaymas-El Oro revenue deferment. So that's the 100% information on the decrease.

Operator

Our next question will come from Christian Audi with Santander.



Christian Audi Santander Investment Securities Inc., Research Division - Head of Latin America Equity Research, Agribusiness & Oil, Gas and Petrochemicals

Thank you very much. I was wondering maybe Nelly could provide us with an update on the deleveraging front, more specifically, how the process of potentially moving some debt out of your balance sheet related to the Marine Pipeline off balance sheet? How is that evolving? If there's any updates on as to when that could happen, please?

Manuela Molina Peralta Infraestructura Energética Nova, S.A.B. de C.V. - CFO

Yes, Christian Good morning. Yes, I was explaining earlier that we are advancing well on determining the type of structure we want to raise debt from the Marine Pipeline. But I don't see a transaction closing before -- during this year. It will be a transaction in the first half of 2020.

Christian Audi Santander Investment Securities Inc., Research Division - Head of Latin America Equity Research, Agribusiness & Oil, Gas and Petrochemicals

Okay thanks Nelly. And I apologize if Tania already mentioned this, but the decision on the ECA project, Tania, you are still shooting to announce it by the end of this year? And are there any updates in terms of the permitting that you needed to secure from Mexico, please?

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

Good morning Christian, we, in fact, expect to be reaching a final investment decision early next year because we continue to work on all 3 work streams. First, we are running a bid to select the EPC contractor. But more importantly, that will give us detailed information on the definitive EPC cost for the facility. Second, we continue to advance with all 3 customers on finalizing our gas sale contracts as well as the associated equity agreement, and we continue to make progress on the permitting front. But all 3 work streams are ongoing. So final investment decision will be early next year.

Christian Audi Santander Investment Securities Inc., Research Division - Head of Latin America Equity Research, Agribusiness & Oil, Gas and Petrochemicals

Got it. And Tania, has the -- on the permit front, has that -- I remember you were going to submit that, has that been submitted already or not yet?

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

We have submitted the permit, Christian.

Christian Audi Santander Investment Securities Inc., Research Division - Head of Latin America Equity Research, Agribusiness & Oil, Gas and Petrochemicals

Okay. And do we have a timeline of how many weeks or months it may take to get a final word on it if it was approved?

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

Well, this is the first time that this is done. So that's, let's say, yet to be seen.

Operator

I am showing no further questions at this time. I will now turn the call back over to IEnova's CEO, Tania Ortíz.

Tania Ortíz Mena López Negrete Infraestructura Energética Nova, S.A.B. de C.V. - CEO & Director

Well, thanks, everyone for joining our earnings call. If you have any questions or need additional information, as always, please feel free to reach out to our team. Have a good day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.

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