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Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to the IEnova First Quarter 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker, Miguel Osio. Please go ahead.

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

Thank you. Good morning to everyone. Thank you for joining us. Today, we will be discussing IEnova's first quarter 2021 financial results. A live webcast of this teleconference and slide presentation is available on our website in the 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, April 29, 2021, 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 Ortiz, Chief Executive Officer; Carlos Ruiz, Chairman; Carlos Mauer, 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 Carlos.

Carlos Ruiz Sacristan - *Infraestructura Energética Nova, S.A.B. de C.V. - Chairman of the Board & Executive President*

Thank you, Miguel, and good morning to everyone. I hope everyone continues to be well and safe. I would like to start today's call by addressing certain processes that Sempra is conducting. Sempra recently launched a public exchange offer to acquire the outstanding shares of IEnova, not owned by Sempra, that trade in the Mexican stock exchange.

After taking into account the recommendation of the Corporate Practices Committee, IEnova's Board of Directors voted in favor that the final non-binding offer from Sempra is fair to the shareholders from a financial point of view. It's important to mention that Directors, who had a conflict of interest, excluded themselves from voting.

Additionally, Sempra announced an agreement to sell a noncontrolling interest in Sempra Infrastructure Partners to KKR. Sempra Infrastructure Partners is a platform that combines the strength of Sempra's non-utility investments, Sempra LNG and their ownership that is in IEnova. The transaction is subject to customary closing conditions. These are an ongoing process, and as you can well understand, we cannot share more information.

Now I would like to turn the call over to Tania.

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

Thank you, Carlos. Good morning, everyone. I hope you and your families are well and safe. Please turn to Page 4. It has been over a year since we implemented extraordinary actions to protect our employees' health and safety and, at the same time, ensure the continuity of our operations. Because we are still facing difficult conditions related to the pandemic throughout the country, Fundación IEnova will continue supporting our most affected communities.

I would now like to mention some of our accomplishments for the quarter and then Carlos Mauer will talk about our financial results and the progress that we have achieved in our projects under construction. Please turn to page 5.

In March, we announced the closing of the acquisition of the remaining 50% of Energía Sierra Juárez. We now own 100% of the project. As you all know, ESJ is a cross-border wind generation complex located in Baja California. The first phase has been in operation since 2015 and with an installed capacity of 155 megawatts, and the second phase is under construction and will have an installed capacity of 108 megawatts. ESJ also owns a cross-border private transmission line. Both projects have long-term contracts with SDG&E.

Please turn to Page 6. During March, we also executed an agreement for the acquisition of the remaining 17.5% (sic) [17.15%] of the Manzanillo Refined Products Terminal. The transaction is expected to close during the second half of 2021 and is subject to customary approval. M&A has been an important growth pillar for the company. These 2 transactions show our commitment of growing the business, not only through greenfield but also through acquisitions.

With that, I'll pass the call over to Carlos Mauer to talk about our financial performance.

Carlos Mauer Diaz Barriga - *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Thank you, Tania, and good morning to everyone. Please turn to Page 7 to review our financial results. In the first quarter of 2021, adjusted EBITDA was \$261 million, up 4% from \$251 million in 2020. The increase was mainly due to higher margin at gas business, lower operating expenses, higher distribution rates and volumes, the start of operations of Don Diego and Border Solar facilities, and the acquisition of the remaining 50% share in the ESJ wind generation facility, offset by lower results at TDM power plant.

I would like to mention that Don Diego and Border have been selling energy to the spot market since they started operations. We are waiting for the approval by the regulators to be able to supply the energy generated in both projects to their corresponding off-takers.

Please turn to Page 8 so I can provide updates on the projects we have under construction. I am very pleased that during the first quarter, we placed Border Solar and Veracruz storage terminal into service. The Puebla and Mexico City storage terminals are in commissioning stage and ready to receive products. This terminal should start commercial operations shortly. Topolobampo and the ESJ expansion continue to advance construction according to schedule.

Please turn to Page 9, and I would like to turn the call back to Tania.

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

Thank you, Carlos. In summary, I am very pleased with the performance of our business and the progress that we have achieved both in the M&A front and in our projects under construction, which will deliver additional growth to our shareholders. We continue to focus on the health and safety of our employees, on providing solid financial results, executing the projects we have under construction, providing safe and reliable operations, and strengthening our balance sheet. Before opening the call to Q&A, I would like to remind everyone that we cannot talk today about the tender offer process that Sempra is conducting or about Sempra's transaction with KKR.

With that, I will open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of Pablo Monsivais from Barclays.

Pablo Monsivais Mendoza - *Barclays Bank PLC, Research Division - Assistant VP & Lead Research Analyst*

Can you please provide some takeaways from the potential impact of the government-proposed new hydrocarbon law? That will be my first question. And my second question would be on the growth opportunities that you are seeing right now, excluding ECA.

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

Pablo, with regards to the new hydrocarbon law, this law was recently passed by both chambers, and we are waiting for the law to be published to become effective. This law is primarily intended to fight illegal commerce of fuel. So it has certain provisions in that regard, which obviously have no impact whatsoever in our business. And there are other provisions related to potential suspension of permits. And we would -- we believe because those provisions are very general and, of course, we are always in full compliance with all of our permit obligations, I think we need to look at the secondary laws that will regulate those activities in detail to really understand what the impact may be.

With regards to growth opportunity, of course, ECA is our main area of focus, but we do continue to see opportunities in renewables, particularly in cross-border projects and specifically in Baja California. So that's an area where we continue to be very active. And we continue to see opportunity for expansion to feed new off-takers along our natural gas pipelines, and we do have certain requests to look at expansions of refined fuel terminal. So those would be, I would say, our short-term area of focus, but ECA is, again, our priority.

Operator

Our next question will come from the line of Christian Audi from Santander.

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

Tania, Carlos, I have a couple of questions. Tania, on this topic of growth, I was just wondering if you could talk in general terms how you're seeing the environment in Mexico right now, given that, obviously, COVID weighs on everybody, but beyond that, the recent moves by the government in potentially changing some of these laws.

And just kind of appetite -- you deal with very important foreign clients, who in the past had an interest in Mexico. So I was just wondering if you could talk in general terms about kind of the appetite for private sector, particularly foreign private sector companies who want to do business in Mexico.

And then on the financial side, if you guys could provide an update on the deleveraging process as it relates to the -- if there was anything new as it relates to the marine pipeline, which is something I know you've been working on for a while.

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

Well, with regards to growth, I believe, again, and I say this very often, in the energy sectors, you need to keep your sight on the fundamentals and on the long term, and Mexico continues to need energy infrastructure to be able to supply its energy needs, and it will continue to require private investment to meet those needs. We are going through some important changes in the regulatory and legal framework on the sector. So we need to be careful as to how we evaluate those changes and continue to find ways to collaborate with the current administration to continue developing projects.

But we continue to believe that there will be, again, space to develop new projects. I just mentioned a few cross-border renewables, expanding pipelines, and we work hand-in-hand with CFE and CENAGAS, particularly to try to develop new projects together.

With regards to the leverage initiatives, I will ask Carlos Mauer to address that.

Carlos Mauer Diaz Barriga - *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Thanks, Tania. Regarding the marine pipeline financing, unfortunately, so far, we have not been able to find a solution that works also for our partner. We continue discussions with them as well as focusing on other potential initiatives. The other thing I would say is that maintaining a strong balance sheet is still a very important priority for us, and we're very focused on maintaining our credit ratings.

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

Christian, I'm sorry, I forgot to answer your question about our off-takers. I mean we have, obviously, very different off-takers, I mean, from CFE to very large international oil companies to smaller Mexican industrials. But I think the way we structure our business that everybody is aligned on taking long-term views so our projects continue to make sense for our customers or customers, whether they're Mexican industrials that continue to [have] business in Mexico or large international oil companies that continue to want to access the Mexican market. So we continue -- obviously, again, it's a different environment, but we continue to see interest and appetite on Mexico's long-term view.

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

Very clear, Tania. And in your view, investors should pay attention, particularly to what regulatory changes that may be undergoing right now? Is there anything in particular that investors should pay particular attention to in the 2021 year?

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

I would say, I mean, at a very general level, really, all of the changes that have been made, and I'm repeating what we've heard President López Obrador say. He wants to ensure that CFE and PEMEX are stronger. So that's where every -- all of these changes are pointing and that's why I do believe that working together with whether it's -- I mean, mostly PEMEX and CENAGAS, in our case -- I mean, sorry, CFE and CENAGAS, in our case, it may be PEMEX with regards to other companies. Just, I mean, finding a way to work with them, I think, is the correct approach.

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

Great. And I have a follow-up for Carlos. Carlos, assuming that you're unable to find a solution with the partner for the marine pipeline, is there any other option that, if you will, can be implemented as timely as the marine pipeline one that could be implemented during 2021 to more significantly lower your leverage?

Carlos Mauer Diaz Barriga - Infraestructura Energética Nova, S.A.B. de C.V. - CFO

Yes. Well, we're still working on several other initiatives. At this point, we cannot publicly comment on them, but for sure, maintaining a strong balance sheet continues to be a focus for the company.

Operator

Our next question will come from the line of Alejandra Obregon from Morgan Stanley.

Alejandra Obregon Martinez - Morgan Stanley, Research Division - Research Associate

I actually have a couple, if I may. The first one is on free cash flow. So what would be a fair level or a normalized free cash flow for your operations, meaning, after all the CapEx and the pipeline is completed? So that will be number one.

And then the second one would be on the Texas-Tuxpan project. If you could please elaborate on the permitting of the project and if there is any potential risk regarding permitting after the local news flow raised some potential issues on permitting for the project. So that will be from my end.

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

Let me start with the marine pipeline, the Texas-Tuxpan project and then I will ask Carlos to talk about our cash flow. Regarding the marine pipeline, it's operating normally. We have met all of our permitting obligations. As you may recall, we own 40% of the asset and the pipeline is operated by TC, not by us. But the pipeline is not under risk of being interrupted in any way. There appears to be some administrative issues that need to be resolved, but it's just very simple administrative issues. So I would say, there's nothing to be concerned about.

Carlos, do you want to talk about our free cash flow?

Carlos Mauer Diaz Barriga - Infraestructura Energética Nova, S.A.B. de C.V. - CFO

Sure. Regarding our cash flows, I would say, they are in the \$550 million range per year. Obviously, that grows over time as more projects come online and we start to see cash flows from those new projects. So that's a pretty healthy amount that allows us to fund our CapEx program for the foreseeable future.

Alejandra Obregon Martinez - Morgan Stanley, Research Division - Research Associate

That's very clear. And just a follow-up, if I may. On the Manzanillo project, there seems to be some small CapEx increase. Is that accompanied by changes in the capacity? Or is there any other thing that we need to consider for that project specifically?

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

Yes. Alejandra, we had originally provided, let's call it, an indicative CapEx. We did review the configuration in the project. There's a little bit of capacity increase, and that's the new, let's call it, updated CapEx, but there was a little bit of a capacity increase.

Operator

Our next question will come from the line of Diego Serrano from Credit Suisse.

Diego Serrano

Can you hear me?

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

Yes. Perfect.

Diego Serrano

Just a quick question on Termoelectrica at Mexicali. I was wondering if you could give us some color on what to expect for the power division moving forward after another weak performance in this area.

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

Diego, as you know, TDM is our only asset that sells into -- directly into the market. It's a merchant power plant. So again, in the past few years, I know that you've seen a lot of volatility for that asset specifically. So it's really difficult to provide guidance for TDM. Carlos, would you like to provide a little bit of color?

Carlos Mauer Diaz Barriga - *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Sure. I would say, part of the reason why the results for TDM have not been very good so far this year is, it's related to mark-to-market, which related to the hedges that we had. So those effects should be reversed in the coming months. And just the other thing I would add is, for TDM, the important months are in the summer, when you see a spike in demand in California. So we're very focused on performing during the summer months so that we can capture good market opportunities.

Operator

Our next question will come from the line of [Matias Tosto] from Citibank.

Unidentified Analyst

I would like to know what the company's expectations for annualized free cash flow before and after the [current growth CapEx] on project please.

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

Carlos, would you like to answer that?

Carlos Mauer Diaz Barriga - *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Could you repeat the question? I couldn't hear you.

Unidentified Analyst

Of course. The expectation for normalized annual free cash flow once the current growth CapEx is completed.

Carlos Mauer Diaz Barriga - *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Yes. As I mentioned, our CapEx program is consistent with our cash flows. So for the next couple of years, we see an increase of those cash flows that will allow us to fund our CapEx.

Operator

(Operator Instructions) Our next question will come from the line Mariel Abreu from T. Rowe Price.

Mariel Abreu-Santiago - *T. Rowe Price Group, Inc. - VP*

I just want to clarify. I think this question was asked before. If you can tell us, again, the status of the South Texas pipeline. There were news on the local newspapers talking about a potential revocation of license for IEnova. Can you give us a little bit of color on that? And what do you expect? Should we be worried? I'm not sure if that's what you answered before in the question that was asked.

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

Thank you, Mariel. Thank you for your question. The pipeline is operating normally. There is no risk that any of the permits will be revoked. We are in full compliance with all of our permit obligations. And I mean, TC is the operator of the pipeline. They're responsible for -- I mean, all of the -- including all of the regulatory obligations. But, I mean, I can confirm that there is no process underway to revoke any of the marine pipeline permits. It's operating normally.

Operator

And we have a follow-up from the line of Pablo Monsivais from Barclays.

Pablo Monsivais Mendoza - *Barclays Bank PLC, Research Division - Assistant VP & Lead Research Analyst*

Tania, just -- I'm curious in one of the comments you just said about the projects that you are working together with the government and how you are cooperating with this new administration. Can you please just share some examples of the things that you are working together or like those spaces when you can find a common agreement to do something together?

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

Well, I mean, Pablo, I mean, there are certain initiatives in which we are working. And until they, let's call it, become a firm commitment as we would do with any partner or customers, we would not disclose them. But I would say, a good example is the collaboration that we're having with CFE, which is installing some temporary plants in Baja for the summer. We're working very closely with them to be able to supply gas and get them

interconnected to our pipeline system. By the way, we did the same during the February Texas storms, where we supported CFE to ensure that they had appropriate gas supply. So it's, again, very, very close collaboration, same thing with CENAGAS.

Operator

(Operator Instructions) Our next question will come from the line of [Tomas Lemos] from [Barings].

Unidentified Analyst

Can you provide a little bit of color regarding the rating agencies. We saw that you got a downgrade from, I believe, it was Moody's, and you also have a negative rating from S&P. Just wondering, I mean, how frequently are you talking to them? Did you expect it or not? And any additional color would be great.

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

Carlos, do you want to comment, please?

Carlos Mauer Diaz Barriga - *Infraestructura Energética Nova, S.A.B. de C.V. - CFO*

Sure. Sure. I'll take this one. Well, I believe Moody's decision to downgrade us by 1 notch was mostly driven by our leverage level, which, under their methodology, is more consistent with a Baa3 level than Baa2. Obviously, this is still investment grade. One important thing to note is that they changed their outlook to stable, which basically means and they recognize that our leverage level in the future is pretty stable. So that's something important to mention. Even though we got a downgrade, we now have a stable outlook. And regarding S&P and Fitch, I believe, in December and February, respectively, they reconfirmed our rating, which is BBB plus.

Operator

I don't see anybody else in the queue. I'd like to turn the call back over to Tania Ortiz, CEO, for any closing remarks.

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

Thank you, and thanks, everyone, for joining our earnings call today. As always, if you have any questions or need any information, please reach out to our Investor Relations team, and have a good week. Thank you.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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