Pampa Energía Q4 2019 Conference Call

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Presenting:
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Gabriel Cohen, CFO
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Good morning everyone and thank you for joining our conference call.

I will make a brief summary of Pampa's consolidated figures, reviewing the year we've just gone by and the quarter highlights. This time, given that Edenor and TGS already held their calls on Monday, we will focus more on the core businesses of Pampa, power and E&P. Our CEO Mr. Gustavo Mariani and CFO Mr. Gabriel Cohen are both here and joining us for Q&A.

Before we begin, let me remind you that Pampa holds US Dollar as functional currency since January 2019. For the 2018 comparative, according to IFRS figures are reported in Pesos adjusted by inflation as of 2018-year-end and shown in dollars at closing FX. This comparison might be difficult to comprehend. Therefore, for a like-for-like basis, 2019 compares with reported nominal figures in Q4 2018 and converted to dollars at average FX. In the case of peso-linked subsidiaries such as our utilities, their figures are adjusted by inflation and shown in dollars at 2019-year-end FX. So, having made this clarifications, we can start.

2019 was once again a year full of political uncertainty as a result of the presidential elections, the worsening of the recession that continued striking the country, and the general deterioration of all macroeconomic variables. Pampa navigated this tough waters with confidence, owing to the outstanding job done by the whole Company over the last years, included the divestment of non-strategic assets, focus on our core businesses, carrying out significant level of investments though at the same time, maintaining high levels of liquidity and extending the average life of our financial liabilities, among other actions. Therefore, in 2019 once again we can say we had a positive year in several aspects, an achievement that makes us proud.

As shown in slide 4, revenues in 2019 were maintained in similar levels, decreasing by 6% despite the peso collapse witnessed again last year. While 50% of our sales were dollar-linked, in EBITDA terms almost 71% came from dollar-denominated core businesses, power and gas. However, E&P is still affected by the downward pricing environment in gas, in addition to the FX volatility and halts to tariff increases affecting our regulated businesses; offset by higher gas production and power capacity, which contributed to deliver a 915 million dollars EBITDA in 2019, 15% lower year-on year, but keeping competitive margins. Power generation keeps leading the share, thanks to new commissionings, PPAs outperformance and newly acquired Ensenada Barragán.

Companies controlled and co-controlled by Pampa continued pursuing their investment commitment with the country, having disbursed over 1 billion dollars last year, a figure slightly lower than 2018, but if you see the chart below, at Pampa we take pride in having remained committed to the country's energy needs throughout our history. Out of the total investment, half was disbursed for the maintenance of our assets, specifically the rendering of a quality service by our regulated subsidiaries, and the other half was allocated to expansion projects, mainly distributed between the construction of new wind farms, the closing to CCGT at Genelba Plus, TGS's Vaca Muerta gas gathering pipeline and the exploration campaign targeting Vaca Muerta formation.

On slide 5, let's make a quick stop by reviewing the quarter's financial highlights.

EBITDA fell year on year by 9%, mainly explained by lower hydrocarbon prices, reduced spot remuneration and devaluation effect on our tariff frozen utilities, partially offset by the commissioning of new power units, more gas production destined to self-procurement, more electricity demand at Edenor, the acquisition of

Ensenada Barragán and inflation outpacing devaluation during Q4 19. Quarter on quarter, EBITDA decreased by 39% mainly because of lower legacy and gas prices, due to off-peak season. As we show on right below, oil and gas share shrank further at Pampa's consolidated EBITDA, given the current pricing environment at E&P, while electricity takes the other 72%, mostly led by power generation.

Moreover, as shown in the chart left below, in the fourth quarter of this year our capex decreased 33% compared to 2018, mainly explained by lower pace in power generation as projects commissioned and Ensenada's expansion works just began, in addition to a lower Edenor's capex mainly because of deval, offset by increased E&P activity in El Mangrullo block. However, capex increased by 31% quarter on quarter, mainly explained by stronger peso driving up Edenor's investments measured in dollars and the execution of the final milestones at Genelba Plus closing to CCGT.

So, as you can see on slide 6, in the fourth quarter of 2019 we reached a consolidated adjusted EBITDA of 170 million dollars, 9% less compared to 187 million dollars EBITDA recorded in Q4 2018, mainly explained by decreases in oil and gas as we detailed before, lower international spreads at petrochemicals and minor EBITDA from holding and others, partially offset by increases at power and electricity distribution, as we detailed before.

Moving to power generation segment as seen on slide 7, during the fourth quarter of 2019 we posted an adjusted EBITDA of 107 million dollars, 13% higher than Q4 2018, mainly given by our newly commissioned wind farms with PPAs and Genelba Plus's new gas turbines, as well as the recently acquired Ensenada Barragán power plant, that we co-own with YPF and we add at our 50% equity stake, and the devaluation impact on our peso-nominated costs. These effects were partially offset mainly by the reduction in legacy thermal remuneration as per Resolution 1 of 2019, in which lowered capacity payment during spring season of October and November by around 40% for Güemes and Piedra Buena's steam turbines, as they are the lowest utilization units in our portfolio. The impact on our highest load factor units under legacy thermal – Genelba and Loma CCGTs – is smoother throughout the year but during off-peak season it gets 20% lower. Moreover, in Q4 2019 Energía Plus volumes and prices were lower year on year. Quarter on quarter, winter season pricing for legacy in Q3 19 contributed to the 18% decrease in EBITDA.

For the second consecutive year, we have positioned ourselves as the largest independent power producer in Argentina, representing 12% of the country's total generation. In Q4 19, generation was 14% higher than last year, mainly due to higher dispatch at Loma and CPB because we managed to get gas and therefore, competitive Variable Production Cost (aka CVP) to get dispatched; plus, it also contributed the commissioning of Genelba Plus thermal power plant's gas turbines as well as higher generation coming from wind farms, which ranks senior in the dispatch priority because its cost is close to zero, and the operatorship at Ensenada Barragán. These effects were partially offset by scheduled maintenances at Genelba's old CCGT, lower load factor at Güemes caused by a higher CVP from the partial recognition of imported gas, therefore placing them behind in the grid's dispatch priority, plus low water flows at Mendoza's hydros. Quarter on quarter, power generation decreased mainly because of Genelba's old CCGT overhaul.

The availability rate in the fourth quarter of 2019 was almost 98% with an installed capacity of 4.8 GW that includes the recently acquired Ensenada Barragán thermal power plant, similar to the availability achieved in the same quarter last year and also similar rate compared to Q3 2019. Thermal availability in Q4 19 also reached 98%, similar year on year but lower quarter on quarter because of Genelba's overhaul.

On the news section, as from February of this year legacy power generation pricing scheme was changed to a new one in pesos, and sets up an automatic update factor that follows CPI and PPI, being the latter more correlated to dollar. Also, this new spot pricing changes capacity payments, reducing them and making it more variable compared to the previous scheme of Resolution 1, a way to make it more flexible, in line with the Government's intention to lighten up power disbursements but, also seeks to protect the highest load factor units in the grid. Hence, introduces an additional remuneration in the hours of high thermal dispatch.

To understand the changes, please turn your attention to the chart on slide 8. Assuming an FX of 60 pesos per US Dollar, the thermal units with the highest load factor, especially during these so-called high demand hours in peak or off-peak season, will end up billing an average capacity payment of the year a little higher than previous scheme. On the other hand, should the unit's dispatch be lower than 70%, power remuneration is reduced by 1,000 dollars per MW-month and it gets wider if load factor is below 30%. Pay attention that low utilization units now would get on average 3,150 dollars per MW-month, which is coincidentally the average back in 2015.

Regarding the expansions in the pipeline, we are currently at 99% completion of the closing to CCGT of 383 MW at Genelba Plus, which began in October 2017. The before and after is remarkable; on slide 9 you may appreciate how it looked like 30 months ago in October 2017, right before the expansion works began, and the great difference compared to now as seen on slide 10. We are preparing for the first steam, key to run the CCGT commissioning tests before reaching Cammesa's final approval, scheduled on June 2020. Hence, Pampa will become the largest operator of combined cycles in Argentina's grid, with 4 out of the 25 combined cycles installed in the country, thus contributing to generating the least possible impact to the environment.

Also as you can see on slide 11, a few days ago we kicked-off the expansion works to CCGT at Ensenada Barragán thermal power plant, a 280 MW project at the southern outskirts of Buenos Aires city, hence once finished will become one of the most efficient and largest thermal plant's in the country. We estimate COD by the end of 2022, which enacts a PPA for 10 years with CAMMESA. The capital required is fully pre-financed, not representing an issue for the expansion project.

As you can see on slide 12, during Q4 2019 in the oil and gas segment we posted an adjusted EBITDA of 20 million dollars, 60% lower than in Q4 2018, mainly because it is still reflecting the downward trend in gas sale prices driven by CAMMESA, lower oil prices resulting from the FX freeze discretionally set by the Government and drop in the international oil reference prices, the increasing activity at El Mangrullo demanding higher gas exploration and transportation costs, and lower oil production, partially offset by 15% higher production of gas, motivated by the vertical integration with power generation, lower royalties and peso-linked expenses. EBITDA quarter on quarter decrease was similar, mainly explained by lower gas price and production as Q4 is mostly off-peak months, partially offset by lesser deval impact on peso-linked expenses as well as slightly higher oil production.

Our overall production in Q4 2019 increased 12% year on year, but quarter on quarter decreased 4%, reaching to nearly 48 thousand barrels of oil equivalent per day, of which 90% is composed by natural gas.

On the oil side, production level year on year decreased 8% reaching 5 thousand barrels per day, but quarter on quarter grew 4%, mainly because of the lower well completion rate at El Tordillo and lesser drilling activity at Río Neuquén, offset by production resume at Chirete since last November, as well as shale oil contribution from Rincón de Aranda since last August. During Q4 2019 the crude oil sales price decreased year on year by 17%, but slightly increased quarter on quarter, reaching 50 dollars per barrel, mainly explained by the Government-imposed price freeze in pesos for domestic oil prices until mid-November 2019, selling at average 20% discount, in addition to Brent prices falling in Q4 2019. 55% of our oil production is Escalante heavy oil, which is sweet and given the current clean fuels trend narrows Medanito prices.

Please turn to slide 13, where we want to explain in deeper detail the situation in gas. Regarding the gas production, the quarter reached an average of 256 million cubic feet per day, 15% year on year increase but decreased 5% quarter on quarter, mainly explained by the increase at El Mangrullo, a block in which evacuation infrastructure was expanded given the outstanding productivity and upside potential, and also keep in mind that it is fully owned by us, holding operatorship as well. In Q4 2019, El Mangrullo reached 151 million cubic feet per day of gas production, 53% higher than in Q4 2018 and contributing almost 60% of our overall gas, ranked fifth highest producing block at Neuquina basin. It is also remarkable that 10% of Q4 2019 production corresponded to shale gas from the completion of two horizontal wells at El Mangrullo block in last

August. These positive effects were partially offset by lower production in other gas-bearing blocks because of lack of visibility on sale prices, which impacts on the breakeven equation. Prices have been going down due to the excess of supply driven by the disruption of shale developments, specifically backed up by the flaw-designed Unconventional Gas Plan, as well as the local demand drop due to seasonal and inability to pass through actual prices on to consumers. These effects negatively impacted on Rincón del Mangrullo block with a lesser drilling rate and natural decline, and a minor decrease at Río Neuquén and Aguaragüe blocks. In the case of Sierra Chata, it kept similar production due to the completion of two horizontal tight wells in last September.

During fourth quarter 2019, our accrued weighted average sale price for gas was 2.6 dollars per million BTU, roughly 25% lower year on year and quarter on quarter, mainly due to the reduction on the reference price for gas-fired power plants and the tenders on an interruptible basis conducted by CAMMESA, as well as demand seasonality if compared to Q3. Since September the drop in CAMMESA reference price reflected the off-peak season, whereas last winter said price was 37% higher in dollars. This effect also impacted negatively the commercialization in industrial segment and spot prices.

The fuel self-procurement for our power generation helped to recover gas production levels, destining most of our production there. Though it did not improve pricing, we covered our breakeven cost and it helped to have a certain offtake, especially during weak demand periods and to monetize some synergies between power and gas businesses. Although our largest power plant Genelba was under programmed maintenance during a month in Q4 2019, export binding volumes to Chile increased and we also made use of our bids awarded at CAMMESA tender. Moreover, since December 30, 2019, the gas supply management for power plants, except for Energía Plus, was restored to CAMMESA, therefore today we are selling roughly 70% of our production directly to CAMMESA.

As you can see on slide 13, the average gas prices that we recorded to demand have been plunging since second half of 2018, falling to the lowest point in years and hardly covering the country's marginal breakeven cost. Winter season picked up prices but as evidenced in the past, the domestic production was not enough to cover the domestic gas demand, needing to cover 15% (and during the worst times, 30%) of the gas consumed with gas imports from LNG and Bolivia at much higher prices than those paid to domestic producers.

We find that a significant reduction in the uncertainty overhanging the gas sector, which is so critical for the country, is paramount. We are concerned about the lack of predictability faced by this business, which has caused the activity to be at historically low levels. This, added to the fact that at present more than half of the national gas production comes from unconventional fields, which decline rate is much higher than that of conventional fields, makes us fear that, if the negative trend in reserves development is not reversed, the country may fall again in the growing need for gas imports, with the resulting negative macroeconomic impact.

We believe CAMMESA understands this and since February tender, CAMMESA changed approach by adding a 30% deliver or pay binding condition, rising price at wellhead to an average of 2.5 dollar per million BTU at Neuquina basin, as we can see on chart on slide 14. This is a huge step compared to previous situation, when non-binding tenders were getting bids at average prices as low as 1.73 dollars per MBTU, which were detrimental to the development of domestic gas.

Before I move on from oil and gas, I wanted to give you a quick update of our E&P operations. We closed the year 2019 with 57 wells drilled and 51 completed. In the case of gas wells, more than 90% were targeting unconventional gas. 8 tight gas wells targeting simultaneously two tight sands formations were drilled at El Mangrullo, as well as workovers to formerly Mulichinco wells retargeting to Agrio formation, which is very important for the maintenance of the record production in the block. We also drilled and completed 2 tight horizontal gas wells at Sierra Chata, helping to sustain the production.

During 2019, we began derisking our resources in Vaca Muerta formation. In the gas window we drilled and completed 2 wells at El Mangrullo, each with horizontal extension of 8 thousand feet, completed with 35 fracking stages, which resulted in an outstanding joint initial gas production of more than 30 million cubic feet per day (today at around 20 mcf per day). Moreover, a vertical pilot well was drilled at Sierra Chata with similar horizontal branch, pending of completion but with promising results. In the oil window, we drilled and completed the first pilot vertical well and its horizontal branch with an extension of 7 thousand feet at Rincón de Aranda, completed with 27 fracturing stages, resulting in an initial flow of 1.1 thousand barrels per day, in line with the expected rate.

As a result of this exploration campaign, 8% of our production in 2019 came from shale gas and oil, a major milestone for our business, which we expect to increase in 2020 by completing the remaining two wells drilled last year and if the context improves, with new drillings. The remarkable results allowed us to certify shale reserves from Vaca Muerta formation for the first time in Pampa's history and, even with a year on year growth in the hydrocarbons production, we also recorded once again a 1.3 positive replacement ratio and average life of roughly 8 years, with proven reserves reaching 135 million boe, being 90% gas.

In terms of net income attributable to the owners of the Company, Pampa reported a consolidated gain of 9 million dollars in the fourth quarter of 2019, whereas in the same period of 2018 289 million dollars was reported, mainly explained by lower accrual of losses from FX difference and inflation exposure as a result of change in the functional currency, as I explained at the beginning of this call, lower gains from affiliates, and a higher loss from impairment of fixed assets.

Finally, moving to slide 17, we must highlight the resilient balance sheet of the Company compared to other peers in the industry and in Argentina. We have always been very proactive towards the cash and liability management, especially after witnessing narrow window in the international financing market. We continued redeeming lending facilities, highlighting that in 2019 Pampa paid at maturity and pre-cancelled roughly a total of 366 million dollars. After Q4 we paid down 25 million more, therefore the outstanding maturity for 2020 is 76 million dollars. Despite the challenging situation in Argentina, we continue receiving support from the capital markets which recognize Pampa's credit, extending the maturities by the issuance of a 10-year international bond for 300 million dollars back in July, in addition to new banking debt in pesos for 74 million dollars.

Therefore, the consolidated gross debt including affiliates at ownership remained at 2.4 billion dollars, 25 million dollars lower than September 2019, mainly because of Edenor's repurchase of own bonds and loan amortization. Consolidated gross debt is 93% denominated in US dollar, same as in September 2019, bearing an average interest rate of 7.7% and 75% is placed at the parent. Average life remained around 5.4 years.

Consolidated cash amounted to 719 million dollars, which is higher than the 699 million dollars in September 2019 due to lower capex and collection of credits.

Consolidated and restricted group net debt remained unchanged at 1.7 and 1.2 billion dollars, respectively. Moreover, net debt to EBITDA remained low at 1.8 times at consolidated level and 2.2 times at restricted group.

During 2019 we also continued with the Company's share buyback program started almost 2 years ago, buying back about further 10% of the outstanding capital stock at a considerable discount of its intrinsic value and 5% of the notional value of the Company's bonds. Based on our conviction on Pampa's financial strength, which includes a sustainable generation of funds, strong cash position and comfortable debt maturities profile, this allowed us to undergo the volatility and uncertainty with the least possible impact, and leverage our position to analyze acquisition opportunities if they arise. Meanwhile we have also analyzed the available alternatives for cash allocation, and have concluded that the risk-return equation favors the investment in our own assets. Since the first buyback program, we have acquired a total of 18 million ADRs, 22% of the initial capital stock of 83 million ADRs. Currently, excluding capital reductions and shares held in treasury, the outstanding capital amounts to 65 million ADRs. Also, Pampa's Board approved the sixth share buyback program for 27 million dollars, with price cap of 13 dollars per ADR.

So this concludes our presentation. Now, I will turn the word to the operator, who will open the floor for questions. Thank you.