Pampa Energía Q1 2020 Conference Call

Buenos Aires, May 13, 2020 (10 am Eastern Time)
Presenting:
Gustavo Mariani, CEO
Gabriel Cohen, CFO
Lida Wang, Investor Relations and Sustainability Officer

Good morning everyone and thank you for joining our conference call.

This is a special call, so for the interest of time, I will make a brief summary of the quarter's key figures, the impact of COVID-19 and the latest events since our last call. We will focus more on the core businesses of Pampa, power and E&P, as TGS and Edenor already held their calls earlier this week. As you can see, 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's Q1 2019 and 2020 figures are all recorded under US Dollar as functional currency. In the case of peso-linked subsidiaries such as our utilities, their figures are adjusted by inflation and shown in dollars at the end of the reporting period FX.

Also, you can see in this slide what businesses are included when we talk about of Pampa consolidated, as well as Pampa restricted group, a definition we commonly use for covenant purposes.

It is publicly known that COVID-19 has spread all over the world and Argentina is no exception. The Federal Government declared mandatory lockdown effective as from March 20, and has been following its evolution by extending it from time to time. However, all Pampa's businesses were deemed essential except for SBR production at the petrochemicals segment. What does this mean? Basically we are carrying out our operations normally but with minimum personnel in place, and only doing essential tasks.

Therefore, for those who unavoidably have to go to work, their health and safety is our paramount, so we put in place new protocols set by an interdisciplinary committee, that is reviewing all the time to keep it updated with the latest information available. From 9,700 teammates working at Pampa and subsidiaries, 2/3 are employed at our operating assets or perform operative jobs, and 70% of them are going to work. The other 1/3 of our personnel are support areas for our businesses and corporate, only 10% of them are going to work. The rest, that is almost 50% of our workforce, is staying at home working remotely.

Q1 20 was not much affected by COVID-19, but it is expected to negatively impact somehow in the next quarters. On the one hand, some direct government measures have been enacted that impact Edenor, such as the halt to service disconnections for certain users that fail to pay or delay payments, unable to perform massive consumption readings, whereas the freeze in the domestic LPG prices affecting TGS, and others. On the other hand, we are witnessing lower demand of oil and gas, lesser power dispatch, collapse in the demand of petrochemical products, and higher delinquency mainly from end-users at Edenor, gas distcos at TGS and from CAMMESA, our largest client at power and gas. Therefore, to reduce the impact of the difficult conditions ahead, we have revisited our budget by reducing operating and capital expenses especially at upstream, without impacting the safety and reliability of our assets.

So, let's start commenting the quarter's key takeaways. As shown on slide 5, revenues in Q1 20 fell 12% year on year to 721 million dollars, mainly because CAMMESA took over fuel procurement at the beginning of the year, in addition to the halts to tariff increases since last year impacting our regulated utilities, lower prices of oil and gas and new pricing scheme in Peso as from February 1 for spot power capacity. These were partially offset by higher sales from new power units, as well as improved electricity demand at Edenor. Therefore, in Q1 20 around 40% of our sales were dollar-linked, but more than 50% in EBITDA terms, mainly coming from our core businesses, new power capacity and E&P.

Adjusted EBITDA increased year on year by 5% to 221 million dollars for the quarter, mainly explained by more power capacity, lower E&P royalties and Edenor's fines due to better quality of service, and dilution of peso-nominated costs because of FX, partially offset by tariff freeze at utilities and lower prices at legacy power and E&P. Quarter on quarter, EBITDA increased by 30%, mainly because Q1 comprises most of the summer peak season for electricity, therefore higher electricity sales, higher spot prices for power, lower fines at Edenor but also lower prices at E&P. As we show on right below, power generation takes more than 50% of the consolidated adjusted EBITDA, while E&P takes 13%, mostly led by gas production and only 3% by oil upstream, and the rest composed of our utilities, Edenor and TGS and Transener at our equity stake.

Moreover, as shown in the chart left below, in the first quarter of this year our capex decreased significantly compared to last year and last quarter, mainly because we are at final stages in Genelba Plus's expansion project and Ensenada just kicked-off. E&P is heavily lowering the drilling and completion pace due to uncertain pricing environment, in addition to lower capex at Edenor mainly because of deval and tariff freeze.

In this slide 6, we want to show you the impact of the lockdown in the Argentine power grid. The crisis began in the second half of 2018, so first half is unaffected. 2019 was mostly hit by the crisis, recovering towards the last quarter. 2020 began with that push, but as the lockdown took place in March 20, April is north 20% on average lower than March, being reduced around 3,000 MW of net demand. If we compare with April 2019, the net demand was around 12% down on average, but if we compare it to April 2018, net demand is around 20% down. It is important to highlight that April was chiller than previous years, as well as May so far, because we are heading to winter season, which starts on June, increasing power demand again. This is why May's demand is revamping, as well as many industries that were approved to reopen in the last weeks.

As the power demand is lower, the marginal unit to be dispatched is cheaper, but also renewables are disrupting the dispatch ranking, therefore, the cheapest combined cycles are the last units to fulfill the demand. However, the power generation business model is highly dependent on capacity payment, so lower dispatch does not much impact on the revenue making as long as records outstanding availability, especially for PPA-based energy. Our two combined cycles at Loma and Genelba fully dispatched, but the remaining thermal units were mostly not required.

If we take the average of gross power demand pre-quarantine of 19 days versus post lockdown of 48 days as of May 6, the Argentine demand overall fell by 26% or 4,500 MW, mostly driven by industries closed that have not been deemed essential such as carmakers, steel industry, construction, textile, and so on. Distcos also got affected but mainly because most of the SMEs and large users were closed by the lockdown. Comparing the lockdown period with the same time in 2019, the decrease is 8%, still mostly due to industries.

Moving to power generation segment as seen on slide 8, during the first quarter of 2020 we posted an adjusted EBITDA of 114 million dollars, 18% higher than Q1 2019, mainly given by the recently acquired Ensenada Barragán power plant that we co-own with YPF, our newly commissioned wind farms with private PPAs and Genelba Plus's new gas turbines, as well as the devaluation impact on our Peso-nominated costs. These effects were partially offset mainly by the reduction and pesification in the remuneration scheme for spot energy as from February 2020, worsen by the FX depreciation. Quarter on quarter, summer pricing for spot energy and higher power dispatch in Q1 20 contributed to the 6% increase in EBITDA. Keep in mind that spot energy comprises 36% of our power generation EBITDA, diminishing its share when ongoing expansions with PPAs become operational.

In Q1 20, generation was 18% higher year on year, mainly due to the commissioning of Genelba Plus thermal power plant's gas turbines, higher dispatch at Piedra Buena and Loma, the operatorship at Ensenada Barragán as well as the higher generation coming from wind farms, which ranks senior in the dispatch priority because its cost is close to zero. Plus, the mandatory dispatch for safety of the transmission grid at Piquirenda and Güemes and higher water input at Pichi Picún Leufú also contributed to Q1 2020 EBITDA. These effects were partially offset by low water flows at Mendoza's hydros, lower dispatch at Ingeniero White and Pilar for variable cost ranking reasons, plus lower generation at EcoEnergía due to scheduled maintenance at TGS's Cerri. Quarter on quarter, power generation increased 21% mainly because of the scheduled maintenances in Q4.

The availability rate in the first quarter of 2020 was 96.6% with an installed capacity of 4.8 GW that includes Ensenada Barragán thermal power plant, 130 basis points higher than same quarter last year but 100 basis lower compared to Q4 2019, mainly because of outages at Güemes. Moreover, regarding installed capacity, in Q1 20 we achieved 4.8 GW, 880 MW more than Q1 19, thanks to the acquisition of Barragán, capacity increase at Genelba Plus and the windfarms, PEPE II and III.

On the news section, since February this year the currency for spot energy remuneration was converted to Peso with monthly inflation adjustment and the capacity payment was decreased. However, after the lockdown began, on April 8 the Secretariat of Energy instructed CAMMESA to postpone said inflation adjustment on legacy energy that should have been applied as from March, until further decision. However, as of the date, we did not receive any administrative notice. Had it been updated, weighing 60% CPI and 40% PPI, March transaction would have adjusted by 2.4%.

Regarding our fully-owned windfarms PEPE II and III, after their commissioning in May last year, we found out certain defects in the blades of the wind generators, resulting in their outage. Vestas, our supplier, have started the repair and replacement tasks. One of the windfarms is almost resumed and full recovery is estimated by August of this year. We highlight that despite the lower generation due to business interruption, the impact is minor as it was covered by the guarantee of Vestas and the insurance policy.

Regarding the expansions in the pipeline, we are in the final stages of the closing to CCGT of 383 MW at Genelba Plus. You can see on slide 9 the picture of the existing CCGT and the new one under works. Because of the lockdown, expansion works were interrupted for almost 3 weeks, resuming in mid-April as all private energy infrastructure works, including Genelba Plus and Barragán expansions, were deemed essential. Consequently, we expect COD to be postponed for about 45 days, estimating by the beginning of August.

Also as you can see on slide 10, due to the aforementioned lockdown impact, we are resuming expansion works at Ensenada Barragán thermal power plant, a 280 MW CCGT project at the southern outskirts of Buenos Aires city. Currently we are focused on regaining the time lost to achieve COD by Q1 2022, therefore billing a PPA for 10 years with CAMMESA.

Like in power, the lockdown negatively impacted the domestic gas demand, but to a lesser extent than crude oil, dropping month to month 0.5 bcf per day or 11% in April, driven by lesser power demand, therefore reducing thermal generation dispatch and lesser gas needed to fire by CAMMESA, and to a lesser extent, lower industrial consumption because of the shutdown to non-essentials. This was partially offset by retail consumption, because weather is cooling.

If we take the average gas demand pre-quarantine versus post lockdown as of April 30, demand overall fell by 17% or 850 mcf per day, mostly driven by thermal power generation, non-essential industries closed and gas for cars, offset by gas distcos but just because weather is becoming colder. Comparing the lockdown period with the same time in 2019, the decrease is 9%, still mostly due to power generation and industries.

This lockdown coincided with the gas off-peak season, which bottoms at fall and spring in Argentina. However, as we are approaching winter, we expect this consumption trend to reverse at a faster pace, like today as CAMMESA is requesting more and more gas again and industries are gradually resuming operations.

So moving on to the results on E&P, as you can see on slide 13, during Q1 2020 this segment posted an adjusted EBITDA of 29 million dollars, 38% lower than in Q1 2019, mainly because it is still reflecting the downward trend in gas sales price driven by CAMMESA and to a lesser extent, lower crude oil prices, partially offset by lower royalties and peso-linked expenses. EBITDA quarter on quarter increased 44%, mainly explained by lower costs due to lower activity and deval dilution, no exploration expenses recorded in Q1 and higher oil production, partially offset by lower gas price and production.

Despite all, our overall production in Q1 2020 remained stable year on year and quarter on quarter, reaching to 46 thousand barrels of oil equivalent per day, of which 88% is composed by natural gas.

On the oil side, which only represented 3% of the total EBITDA for Pampa in the quarter, production level was similar year on year, reaching 5.3 thousand barrels per day, but quarter on quarter oil production grew 7%, mainly due to higher production at Rincón de Aranda, our first shale oil endeavor. During Q1 2020 the crude oil sales price decreased year on year by 9%, but remained similar quarter on quarter, reaching almost 50 dollars per barrel, mainly explained by the falling Brent prices since January and worsen since the lockdown in March. Government is analyzing the return of domestic reference price known as *barril criollo* to ensure domestic production continuity, but as of the date no regulation was issued. 54% of our oil production is Escalante heavy oil, which is sweet and given the current clean fuels trend is pricing premium to Medanito.

Regarding the gas production, on slide 14 we can see the quarter reached an average of 244 million cubic feet per day, stable year-on-year and quarter on quarter despite prices, which have been going down since 2018, affected by the fact this is a highly regulated market though technically should be competitive, the lack of long-term contractualization, incentive programs poorly designed, and the inability to pass through actual prices on to consumers. Lower pricing impacts on the breakeven equation, therefore producers respond with a lesser drilling rate and natural decline takes place. And because of that, production was lower in Río Neuquén and Rincón del Mangrullo in the first quarter of 2020, plus a minor decrease at Sierra Chata and Aguaragüe blocks, that were partially offset by increases 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 Q1 2020, El Mangrullo reached 154 million cubic feet per day of gas production, 11% higher than in Q1 2019 and contributing more than 60% of our overall gas, ranked the fourth highest gas producing block at Neuquina basin. It is also remarkable that 8% of Q1 2020 production corresponded to shale gas from the completion of two horizontal wells at El Mangrullo block last year.

During first quarter 2020, our accrued weighted average sales price for gas was 2.3 dollars per million BTU, 26% lower year on year and 22% quarter on quarter, mainly due to the continuous reductions on the price for gas-fired at power plants, which also impacted negatively the commercialization in industrial segment and spot prices. Prices are now in the lowest point in years and hardly covering the country's marginal breakeven cost.

Also as you can see right below, our production is skewed towards CAMMESA and our own Energía plus units, leaving 15% to other segments. The lower prices obtained in domestic markets were partially offset by exports to Chile, which comprised 7% of our production.

From January this year, CAMMESA is centralizing all the fuel fired at thermal units, concentrating more gas in the market, and taking advantage of the off-peak season until April to keep lowering the purchased prices, so power grid costs are cheaper. Of course, this has trade offs over the long-term domestic production.

Since January, tenders are in a monthly basis but this one in particular, was fully non-binding. Therefore, offers were in excess of actual production and demand, accumulating almost 5 bcf per day of volume, because no commitment was encouraged and because we were in the top of off-peak season, and producers rather keep selling instead of curtailing production. As a result, average sale price was 1.70 dollars per million BTU average at Neuquina Basin. However, aiming to discourage speculative bids and provide an investment signal, since February CAMMESA added a 30% deliver or pay binding condition, encouraging commitment and reflecting more realistic offer curve. Therefore, offered volumes diminished by more than half and realized prices at wellhead rose to roughly 2 dollars per million BTU in Q1 2020.

However, since the lockdown began, the CAMMESA tenders for April and May resulted in even lower average bid prices, as we can see on the chart on slide 15, driven by the sudden drop in gas demand combined with the off-peak season. We think May should be the bottom in prices, because winter season is approaching, retail is demanding more gas and some industries are allowed to resume operations. Additionally, the country still imports gas from Bolivia, and soon from LNG, with prices that even though are reduced because of the collapse in global demand, still outnumbers the prices for domestic production.

Moving on the bottom line of the P&L, in terms of net income attributable to the owners of the Company, Pampa reported a consolidated gain of 14 million dollars in the first quarter of 2020, whereas in the same period of 2019 167 million dollars was reported, mainly due to the recording of a loss from impairment of assets, lesser results from net monetary position or RECPAM recorded due to the lower passive net monetary position allocated to the electricity distribution segment and higher income taxes charges.

Finally, moving on to slide 17, we have always been very proactive towards the cash and liability management, and this time paid-off. In this slide we show all the layers of the company, from restricted group to consolidated figures, but for covenant purposes let's focus on the restricted group, that is primarily Pampa standalone.

We continued redeeming lending facilities, highlighting that during Q1 2020 Pampa paid at maturity and pre-cancelled a total of 65 million of dollar-nominated debt, in addition to bond repurchases of 61 million dollars face value. Therefore, the restricted group gross debt in Q1 20 recorded 1.6 billion dollars, roughly 170 million dollars lower than December 2019, due to said transactions plus lower accrued interests and Peso-nominated debt dilution. The gross debt is 92% denominated in US dollar, like December 2019, bearing an average interest rate of 7.7%. Average life remained around 5.6 years. The cash amounted to 373 million dollars, which is lower than the 537 million dollars in December 2019 due to securities repurchases, debt redemption and higher collection days, offset by lower capex and collection of Plan Gas credits. So the restricted group net debt remained similar to last quarter at 1.2 billion dollars. Moreover, net debt to LTM EBITDA remained low at 2.4 times.

After Q1, despite the challenging situation in Argentina, we continued receiving support from the capital markets which recognize Pampa's credit, thus we issued two short-term Peso bonds for a total of 27 million dollars, in addition to net borrowing of 63 million dollars equivalent of peso-denominated debt. Moreover, Pampa further repurchased bonds for 32 million dollars face value at average of 64 cents. Therefore, we are shifting to AR$-denominated debt, and it is worth highlighting that the cumulative maturities until 2022 amount to 172 million dollars, and 75% of that is nominated in Pesos.

In terms of consolidated including affiliates at ownership, Pampa Group recorded net debt of 1.6 billion dollars, similar to December 19. Moreover, net debt to EBITDA remained low at 1.8 times.

Finally, regarding our share buyback program, in April Pampa's Board approved the seventh share buyback program for 20 million dollars, with price cap of 10 dollars per ADR, effective once the sixth program concludes. Moreover, last month shareholders meeting approved the third cancelation of shares in treasury, for 6.1 million ADRs, and last Friday the Public Registry of Organizations cleared the second cancellation of 6.1 million ADRs in treasury, previously approved by shareholders in October last year. As of the date, Pampa's outstanding capital stock amounts to 62.9 million ADRs, and holds in treasury 0.9 million ADRs.

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