

Words are easier said than done

We are a little skeptical about the decrease in energy subsidies next year. First, the government must designate the new authorities of the ENRE, ENARGAS, and CAMESA to call a public hearing to increase electricity bills tariff transitory. Then, the process can take a month. It means that the results of the public hearing may come out in February. Thus, the increase would be implemented as of March. The integral revision of tariffs (RTI – Revision Tarifaria Integral) is expected to take place in April. If we look in the past, the RTI process took over 6 months. In Sept-2016, Edenor submitted the ENRE the electricity rate proposal. By the end of Oct-2016, the public hearing was held. The RTI process was completed by the end of January 2017 and enforced as of February 1st, 2017. However, the new power and electricity reference prices for the different categories of electricity users were in force as of March 1st, 2017.

In the meantime, Edenor and Edesur revenues will dilute by inflation, as it happened in the past years. Considering that 49.6% of low-income households are fully subsidized and that mid-income households' bills are barely above the aforementioned stratum, the increase would have to be enough to compensate for the increase in power generation costs and the accumulated inflation. On top of that, the Massa administration decreased the seasonal energy price paid by GUDIs (Industrial customers), which are not subsidized, and mid income households, which are partly subsidized, as of November. With this in mind, the price correction for mid-income households would be stratospheric. For this reason, we find it difficult for public hearings to approve that level of tariff correction.

We expect the same dynamics that we saw in Cammesa's payments performance in the past years, as Cammesa's income will deteriorate due to the lack of adjustment in tariffs and the increase in thermal power and renewable energy generation costs and fuel and natural gas costs due to the ARS devaluation. Because of the government transition, companies' collection days could deteriorate between January-March, until the new work teams of the Secretariat of Energy, and the rest of the entities are fully operative.

On the positive side, we expect companies with revenues predominately USD-linked to show an improvement in their margins, driven by the positive effect of the devaluation on costs and SG&A in USD terms. Among these companies are MSU Energy, Genneia, and YPF Luz, with a high % of revenues deriving from PPAs. Pampa Energia will show stronger results, not only from the PPA revenues but also from the E&P and liquids business, as natural gas, crude oil, and its derivatives, prices are denominated in USD. This last applied to O&G companies focused on the Upstream sector, like CGC and Vista. Despite companies in the Downstream sector, like YPF and PAE, increased pump prices twice in the past week, the accumulated increase was below the rate of devaluation. It means that gasoline and diesel prices at gasoline stations remain cheap at a regional level. Companies should continue with the catch-up of prices to avoid shortages, as it happened in October, even more if we consider that December and January are the strongest months in terms of demand.

We believe it is a positive signal that Alejandro Lew, the previous YPF's CFO, is a new director at the Central Bank. It leads us to think that the O&G sector and YPF are key for the government. Horacio Marin is the new CEO and President of the company. Considering his extensive experience on shale production in Tecpetrol, we expect Mr. Marin to continue Mr. Lew's crude oil growth production strategy. To accomplish that, YPF will have to further adjust pump prices, as it relies on downstream cash generation to increase hydrocarbon production. It is worth mentioning that diesel and gasoline account for 75% of total refined volumes sold. Thus, the positive effect of the FX devaluation will impact the prices of 25% of refined volumes, crude oil and natural gas exports, and grain and flour exports.

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