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Corporates: Equity – Argentina

May 30, 2023

PAM: On a more robust position than in 2013-2015

PAM	**Overweight**
Price target	45.30
Price (30-May-23)	36.76
Potential Upside	23%

Pampa Energia ADRs | Price (USD)

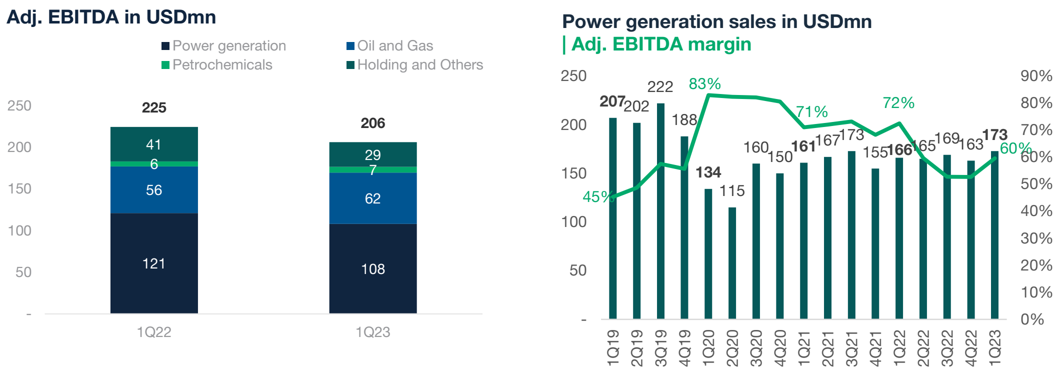
Argentine corporate bonds may look rich vs. other EM corporate bonds. However, we believe there is value in Argentine equity. Among all Argentine sectors, the O&G has the highest growth perspectives. The support of the government will continue regardless of who leads the next administration. Exports of crude oil are key to robust the Central Bank reserves. The completion of the Nestor Kirchner pipeline will decrease LNG imports, leading to a positive impact on the fiscal balance. Our equity top picks are VIST US, YPF US and PAM US. In this report we will focus on Pampa Energia.

In 1Q23, Pampa Energia showed revenues increases in power generation and oil & gas businesses while petrochemical revenue was down by only -1% yoy. We will start analyzing the power generation business, which has been the most important historically, and then we will continue with the O&G, the new revenue growth driver.

Power generation was the largest revenue contributor, with revenues of USD173mn (+4% yoy), accounting for 38% of the total. The company 5,405MW of installed capacity is split between thermal plants (4,107MW), hydro (938MW), and wind farms (360MW). In the past years, the EBITDA margin eroded. It was because the share of revenues under Energia Base increased with the expiration of Res. 220/2007 PPAs. In 1Q23, 68% of the company's capacity is remunerated under Energia Base while the other 32% are PPAs. In 3Q21, Energia Base represented 59% of the installed capacity. The fact that the government has been giving Energia Base tariff increases in March exacerbated revenue seasonality. With tariff increases below inflation, the positive effect reflected in 2Q results is diluted by 4Q.

So far this year, the Energia Base tariff was adjusted by +25%. As of August, it will be increased by +28% yoy. The Secretariat of Energy launched the Res. 59/23. Pampa Energia signed the new PPAs for a total installed capacity of 1,239MW. Management expects the impact on EBITDA to be of USD19mn in FY23. In 1Q23, the Adj. EBITDA was down by 11% yoy to USD108mn. However, if Energia Base continues without any increase beyond August, revenues from Energia Base will diminish in USD terms by 4Q. Thus, the positive effect of the new PPAs may fall short.

Figure 1: Inflation outpacing Energia Base tariff increases has deteriorated the Power Generation profitability.



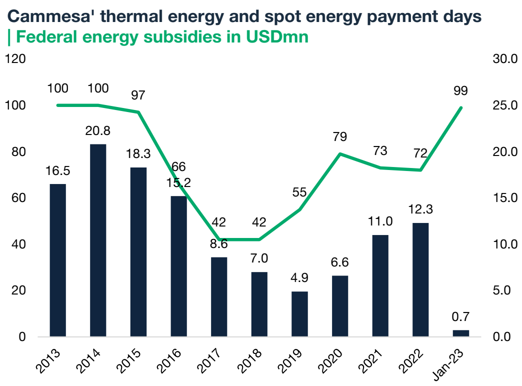
Source: TPCG Research based on Pampa Energia's reports

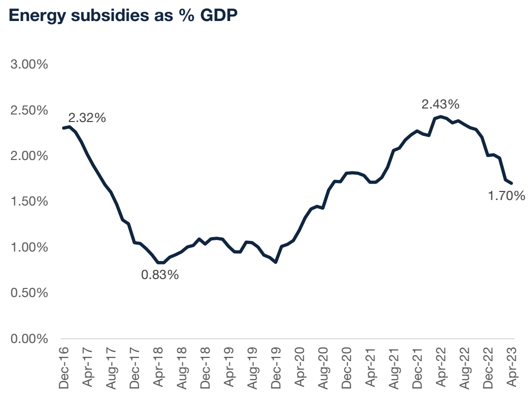
With the upcoming elections and the acceleration of inflation, concerns arise on the increase of Cammesa payment days. Cammesa paid December 2022 bill on 102 days on average. Then, January bill improved to 99 days. However, this is not the first-time power generation companies faces delays of this magnitude. Cammesa collection days averaged 100 days in 2013 and 2014, and 97 days in 2015. In 1Q23 year, the deterioration of payment days was due to the government did not make any transfers to Cammesa in January, according to the budget execution. What differentiates this year from 2013 – 2015 is that first, not all residential segments will receive a subsidy, and second, fuel costs will be lower.

In the first case, there was no electricity tariff adjustment for households living in the Buenos Aires Metropolitan Area (AMBA) for 17 years, since 2002 to 2015. With the ramp-up of inflation in 2013-2015, and thus in transmission and distribution expenses and energy purchases, subsidies to households increased materially. In contrast, currently, there is a stepped tariff. High-income households pay the full tariff as of May, which represents ~30% of the residential users of this area. Middle-income households receive a subsidy for up to 400kwh consumption.

As a result, Edenor paid in full to Cammesa March and April 2023 maturities for energy purchases in the MEM. It is also reflected in energy subsidies as % of GDP, which are in a downturn since May-22, when the government increased tariffs on large users, that do not receive any subsidy since 2021. In this way, energy subsidies came down to 1.7% of GDP in April-23 from 2.4% in Apr-22. We see positive that the government continues on the path of decreasing energy subsidies despite being an election year. In fact, the government established the start of the Comprehensive Tariff Review (RTI) for 2024-2028 on June 1st, 2023.

Figure 2: Cammesa's payment days reached 2013-2015 levels. However, they should decline with the decrease in energy subsidies.





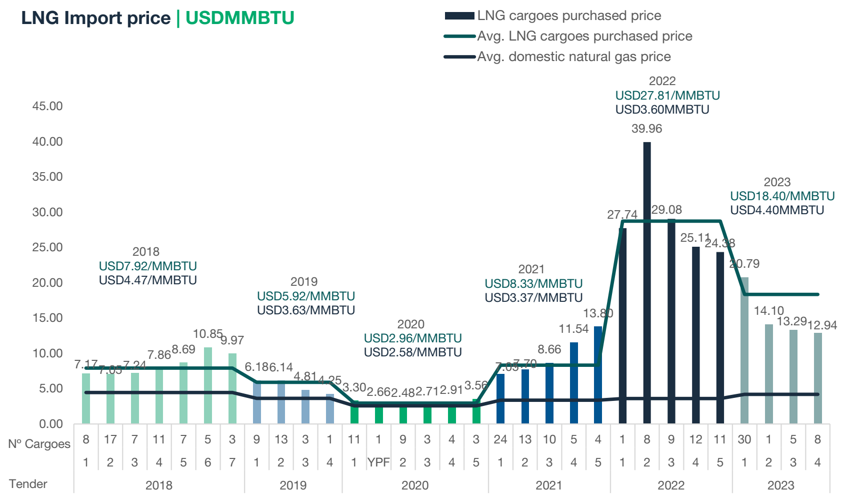
Source: TPCG Research based on Pampa Energia and MSU Energy's presentations, ASAP and CAMMESA reports

Cammesa was under pressure not only because of the lack of tariff adjustments to households, for which Edenor and Edesur didn't pay the full cost of the supplied electricity but also due to the increase in fuel costs. In 2022, LNG prices skyrocketed due to the Russia-Ukraine war. IEASA imported 24% less LNG than in 2021 at a +2.5x higher price. As gasoil prices increased at a lower rate than LNG, +58% yoy, Cammesa supplied thermal energy plants with more liquid fuels than natural gas vs. previous years. In 2022, natural gas accounted for 77% of total fuels vs. 82% in 2021, while liquid fuels were 20% vs. 14% in 2021. So far this year, the cost of fuel has declined. Diesel oil prices decreased by 21% from Dec-22 to Apr-23. The government has already secured 2,796MMm3 of LNG for the winter season, +3% more than in 2022, at an average price of USD18.4/MMBTU (-36% yoy).

On the first tender, which took place on Feb-23, IEASA agreed the purchase of 1,707MMm3 at an average price of USD20.79, accounting for 61% of the total LNG to be imported. The LNG price decreased gradually in the following tenders. In the last one, the government obtained 650MMm3 at an average price of USD12.94, -37% lower than in the first tender. This led us to think that Cammesa will import fewer liquid fuels than last year. For this reason, thermal energy plants' fuel consumption has already tilted towards natural gas. In April-23, the share of natural gas used by thermal plants was 87% vs. 80% last year.

With this in mind, Cammesa should be in a more comfortable position than in 2022 and 2013-2014 when it faced an important increase in its fuel costs. In 2013, the costs of LNG imports increased by +32% yoy while diesel by +35% yoy. In 2014, although the cost of imports improved from the peak reached in 2013 of USD8,153mn it remained high at USD7,458mn. In 2022, the cost of imports was USD7,084mn, 13% and 5% below 2013 and 2014 levels, respectively. Even so, it was +114% higher than in 2021.

Figure 3: LNG import costs dropped significantly, a relief for the government accounts.



Source: TPCG Research based on IEASA and Pampa Energia's reports

One of the reasons why cost of imports did not reach 2013 levels is the strong increase in renewable energy generation. Energy supply increased by 12% to 145,057 from 2013 to 2022, driven by renewable energy that increased by 8.9x to 19,340MW while thermal energy was down by 1% to 81,751MW. In 2016, when the government launched RenovAr rounds, it established the FODER that guarantees the payment of energy bills on time, in 42 days, to promote renewable energy projects. Without this guarantee fund, Argentine renewable projects would not have been that attractive. At that time, renewable energy accounted for only 2% of Argentina's generation capacity vs. 12% in 1Q23.

Time showed that companies that entered RenovAr PPAs, not only increased revenues USD-linked but also presented lower collection days, in addition to reducing their carbon footprint. Pampa Energia entered into Renovar 1.5 with Ingeniero Mario Cebreiro Wind Farm of 100MW. The rest of the 260MW of renewable energy is under MATER contracts with private off takers. MATER payment days depend on each contract. In the case of Genneia, they average 30 days and of YPF Luz 44 days. Given that renewables only account for 7% of Pampa Energia's total installed capacity, while thermal energy accounts for 76% and hydro by 17%, spot energy predominated more on the weighted average of collection days than MATER and FODER contracts.

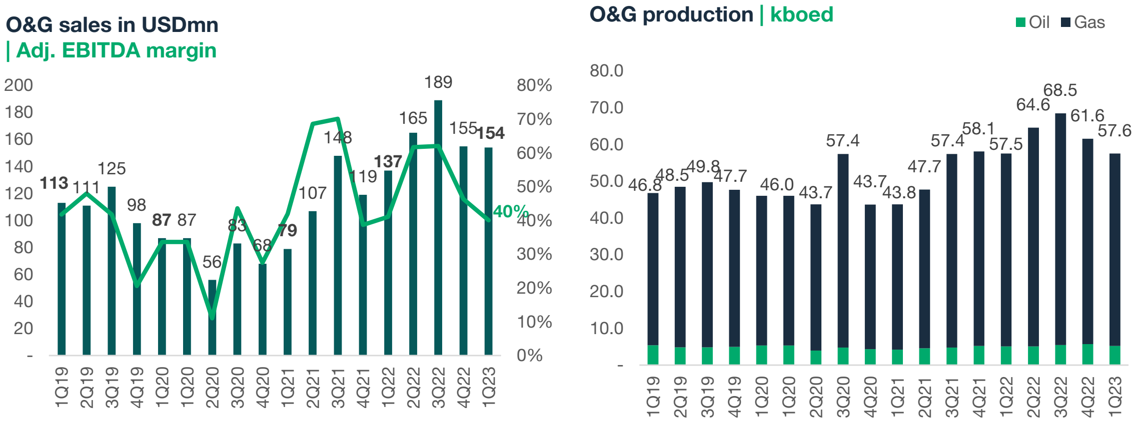
In contrast, Genneia's collection days were 60 days, with 56% of its revenues guaranteed by FODER and 21% from MATER/GENREN. This explains the disparity among power generations in 1Q23. The ones with a higher percentage of renewable energy showed lower deterioration in working capital cash outflows. With the completion of the projects under construction for MATER, companies' collection days should continue improving, reducing the exposure to Cammesa. Pampa Energia will add +167MW, Genneia +222MW, and YPF Luz +255MW.

Our analysis of the sector shows that the tightening in cash generation of 1Q23 due to trade receivables cash outflows deteriorating should be transitory. In fact, according to SCC Power, they received the equivalent of 1.5x a monthly average invoice in May, leading us to think that Cammesa's payment days have already decreased. For the rest of the year, it is important to consider that first, Cammesa accounts should be healthier than in 2013-2015. Second, it is not the first-time companies go through harsh economic conditions. Pampa Energia faced payment delays from Cammesa for 3 consecutive years while it owned Edenor, which was loss-making. So, even if Cammesa's payment days worsen, management already navigated a similar scenario in the past. Third, the projects under construction should not face any setbacks as they already got the financing.

Moving to the **O&G** sector, it represented 34% of Pampa Energia's total revenues. In the past years, it has been the business that grew the most. Revenues increased to USD155mn in 1Q23 from USD113mn in 1Q19. Since Pampa Energia concentrates mainly on natural gas, with 91% of total production, the company's revenues move with seasonality. The 2Q and 3Q are the strongest quarters due to the winter season, with power generation and natural gas demand increasing. During the summer, Pampa Energia exports natural gas to Chile. In 1Q23, it represented 15% of the company's gas deliveries. Given the price differential between the domestic and export price, USD7.35/MMBTU vs. USD3/MMBTU, respectively, exports are material for the O&G business. In 1Q23, exports were USD50mn (-9% yoy), accounting for 32% of the O&G business revenues and 12% of total revenues.

Pampa Energia expects to increase production by +76% to 15.7MMm3/d in the winter from 8.9MMm3/d, as the company committed 4.8MMm3/d to supply the Nestor Kirchner pipeline as of July 2023. On the government agenda is the launch of the reversal of the North gas pipeline, which is expected to cost USD712mn, of which USD540mn the CAF confirmed its financing. The tender for its construction is expected to be launched in the upcoming weeks. On the exports side, Pampa Energia will export natural gas to Enel Generacion Chile and Generadora Metropolitana from May to August at a price of USD7.7/MMBTU. It is possible thanks to the reversal of Argentina's natural gas production decline with the boost of Vaca Muerta's shale production in the past 2 years. Said this, Pampa Energia's revenues have room to continue increasing not only on the domestic market but also in the exports.

Figure 2: Pampa Energia's natural gas production climbs to 15.7MMm3/d (~92kboed) in the winter peak.



Source: TPCG Research based on Pampa Energia's reports

Interestingly, Pampa Energia's stock rallied when the company was at its weakest moment fundamentally, with Edenor tariff frizzed, several power outages, and high Cammesa payment delays. From 2013 to 2015, the PAM climbed from USD3.40 in Jan-13 to USD20.55 in Dec-15. The stock annual total return was +52% in FY13, +91% in FY14 and +105% in FY15. This time, Pampa Energia is in a more solid position. Growth prospects are more visible, with the midstream projects under construction and the company completing its renewable energy projects.

Figure 3: Pampa Energia's 1Q23 summary financials.

Summary financials (in USDmn)	1Q22	1Q23	*Chg yoy*	4Q22	1Q23	*Chg qoq*
Income Statement Items						
Revenues	412.0	431.0	*4.6%*	448.0	431.0	*-3.8%*
Opex	(314.0)	(335.0)	*6.7%*	(348.0)	(335.0)	*-3.7%*
Adj. EBITDA	225.0	206.0	*-8.4%*	183.0	206.0	*12.6%*
Net Income	100.0	141.0	*41.0%*	111.0	141.0	*27.0%*
Adj. EBITDA Margin	55%	48%		41%	48%	
Balance Sheet Items						
Short Term Debt	69.8	325.3	*366.1%*	272.8	325.3	*19.2%*
Long Term Debt	1,382.3	1,355.7	*-1.9%*	1,350.6	1,355.7	*0.4%*
Total Debt	1,452.1	1,681.0	*15.8%*	1,623.4	1,681.0	*3.5%*
Cash & Cash Eq. + ST Investments	607.1	768.2	*26.5%*	699.9	768.2	*9.8%*
Gross Leverage (LTM)	2.1x	2.3x		2.2x	2.3x	
Net Leverage (LTM)	1.2x	1.2x		1.3x	1.2x	
Cash / ST Debt	870%	236%		257%	236%	
ST Debt / Total Debt	5%	19%		17%	19%	
Debt / Capital	36%	34%		34%	34%	
Liquidity ratio	311%	201%		213%	201%	
Cash Flow Items						
Funds From Operations	196.6	175.5	*-10.7%*	182.5	175.5	*-3.8%*
Change in Working Capital	(53.9)	(6.3)	*-88.2%*	5.4	(6.3)	*n.m.*
CFO after cash interest & taxes	140.7	116.9	*-16.9%*	132.4	116.9	*-11.7%*
Capex (Disposals)	(88.6)	(182.0)	*105.4%*	(87.5)	(182.0)	*108.1%*
Free Operating Cash Flow	52.1	(65.1)	*n.m.*	45.0	(65.1)	*n.m.*
Acquisition (Disposals)	4.6	8.7	*88.8%*	(102.8)	8.7	*n.m.*
Free Cash Flow	56.7	(56.3)	*n.m.*	(57.8)	(56.3)	*-2.5%*

Source: TPCG Research based on the company's reports

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