

Argentina Power & Utilities

Omnibus bill failed attempt – Indirect impacts for the sector

Industry Overview

Views on recent underperformance

Argentina Power & Utilities stocks have had volatile trading sessions in the past 5 days (-4% on average vs flat MSCI LatAm). In our view the underperformance has been mostly driven by macro drivers: 1) lack of political support for Milei's macro adjustment plan in Congress (the Omnibus Bill) and 2) stronger USD impacting frontier and emerging markets. In our view, these drivers do not affect the Power & Utilities sector specifics as its main micro drivers (e.g. power distribution tariff reviews and gas production growth) do not need Congress approval to be implemented. However, it could impact the cost of capital for Argentine equities and raise concerns on political friction to approve utilities tariffs hikes. We stick with our positive view on the sector and despite short-term volatility we see the regulatory de-risking and the gas production growth as key themes for the ARS stabilization. We keep our Buy ratings on EDN and PAM.

Omnibus bill failed attempt increases political risks...

Yesterday (Feb 6th), Argentina government sent the Omnibus Bill (macro reforms package) back to the Lower House committees due to the lack of political support for some proposals. Now, the bill will have to be discussed in Congress from scratch. We see this as Milei's first big loss in terms of political support in Congress. As the main impact, the delays in implementing the reforms could increase the cost of capital for all Argentine equities. Coverage companies' betas: EDN 1.4, PAM 1.1 and CEPU 0.9.

... but we do not see direct impacts for micro drivers

However, we do not see the Omnibus bill directly impacting the micro drivers for Power & Utilities cases. Argentina government does not need to approve any bill in Congress to implement the much-awaited power distribution tariff review (driver for EDN). Despite short-term volatility and concerns on political friction, we see the regulatory bodies committed to implement the new tariffs by 2H24. In addition, we do not see direct impacts for the gas production growth long-term trend (driver for PAM), which we see as key for ARS stabilization plan and for power generation operations (driver for CEPU).

We maintain our Buy on EDN & PAM and Neutral on CEPU

We keep our positive view on the sector due to: 1) potential regulatory de-risking at 2024 tariff reviews, 2) de-regulation pushing gas and oil prices higher, lowering export barriers and spurring new capital allocation opportunities. We maintain our Buy ratings on Edenor (EDN) and Pampa (PAM) given positive valuation asymmetry (see report [Keep bullish view despite recent rally – Buy EDN and PAM](#)) and Neutral on Central Puerto (CEPU) as we think the company is least likely to benefit from expected regulatory changes. On valuation, we see EDN and PAM trading at a 35% discount to historical average (EV/EBITDA) and CEPU at a 22% discount.

07 February 2024

Equity
Latin America
Utilities-Other

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Glossary

EDN = Edenor (EDN US)
PAM = Pampa Energia (PAM US)
CEPU = Central Puerto (CEPU US)

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Refer to important disclosures on page 4 to 7. Analyst Certification on page 3. Price Objective Basis/Risk on page 2.

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Exhibit 1: Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
CEPU	CEPU US	Central Puerto	US\$ 9.09	C-2-9
CEPUF	CEPU AR	Central Puerto	ArP 1134.3	C-2-9
EDN	EDN US	Edenor	US\$ 18.91	C-1-9
XEDTF	EDN AR	Edenor	ArP 1152.5	C-1-9
PAM	PAM US	Pampa Energia	US\$ 46.85	C-1-9
PPENF	PAMP AR	Pampa Energia	ArP 2336.45	C-1-9

Source: BofA Global Research

BofA GLOBAL RESEARCH

Price objective basis & risk**Central Puerto (CEPU / CEPUF)**

Our PO of US\$11 / AR\$2470 for Central Puerto is based on a DCF model, discounting the estimated free cash flow to equity at a 15.8% USD nominal cost of equity. Our key assumptions are: 1) no hydro concession renewal, 2) Power Generation "Legacy" contracts in-line with Argentina inflation, 3) steam sales revenues linked to US Dollars, 4) Forestry business revenues flat vs 1Q23 and linked to US Dollars, 5) SG&A and COGS increase linked to ARS Pesos and Argentina Inflation. We assume a 2,280 ARS/USD in FY24.

Upside risks: 1) new power generation growth opportunities with attractive returns, 2) better funding conditions, 3) higher remuneration for legacy generation projects, 4) higher sales prices in forestry business, 5) renewal of hydro plant Piedra del Águila concession.

Downside risks: 1) below Argentina inflation readjustments for legacy power generation contracts, 2) receivables delays in power generation contracts with CAMMESA, 3) Interest in FONIVEMEM plants could be diluted.

Edenor (EDN / XEDTF)

Our PO of US\$30 / AR\$3380 for Edenor is based on a DCF model, discounting estimated free cash flow to equity at a 18% nominal cost of equity in USD. Our key assumptions are: 1) Full Tariff Review in mid-2024 considering: 10% regulatory WACC, 30% capex to RAB haircut, no regulatory opex haircut vs current levels, 2) 2% Volumes growth in 2023-24 and 1.5% from 2025 onwards, 3) -100bps energy loss until 2025, reaching 15% vs 10% regulatory levels, 4) new debt as 50% of capex, 5) Edenor investing 1x of regulatory depreciation. We assume a 2,280 ARS/USD in FY24.

Upside risks: 1) higher-than-expected regulatory returns (reg. WACC), 2) lower capex-to-RAB haircut vs 15% base-case, 3) lower regulatory opex haircut vs 10% base-case, 4) higher energy demand growth, 5) energy losses improvement above 15% BofA base-case (vs 10% regulatory levels), 6) Compensation for improper tariffs readjustments in 2019-22 period.

Downside risks: 1) worse than expected full tariff review results, 2) lower energy demand growth, 3) peso devaluation (100% revenues linked to ARS Pesos), 4) tariffs readjustment deferral with no compensation.

Pampa Energia (PAM / PPENF)

Our US\$62 / AR\$5580 PO for Pampa is based on a DCF, discounting estimated free cash flow to equity at a 14.8% US nominal cost of equity. We apply a reasonable lower cost of equity versus other utilities companies given Pampa's cash-flow profile 85% linked to

USD and protected against ARS devaluation. Our key assumptions are: 1) Natural gas production reaching 13.8mcmpd in 2025 according to company guidance, 2) Oil Brent in US\$80/bbl in 2023, US\$90/bbl in 2024 and US\$70/bbl in 2025 onwards and Pampa selling its production with an 10% average discount, 3) Petrochemicals EBITDA growth in-line with Gas Upstream business, 4) Power Generation "Legacy" contracts in-line with Argentina inflation. We assume a 2,280 ARS/USD in FY24.

Upside risks: 1) gas production increase above base-case with NK Pipeline 2nd stage operational start and new sales contracts with CAMMESA or industrials, 2) new power generation growth opportunities with attractive returns, 3) better funding conditions, 4) tariff adjustments for regulated businesses in subsidiaries (TGS and Transener), 5) higher remuneration for legacy generation projects.

Downside risks: 1) delays in start-up of new generation plants and expansion of the electricity transmission system, 2) dependence on gas supply to thermal power plants, 3) below inflation readjustments for legacy power generation contracts, 4) receivables delays in power generation contracts with CAMMESA.

Analyst Certification

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Latin America - Utilities Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	COPEL	ELP	ELP US	Arthur Pereira, CFA
	COPEL PN	XLPUF	CPL6 BZ	Arthur Pereira, CFA
	Edenor	XEDTF	EDN AR	Gustavo Faria
	Edenor	EDN	EDN US	Gustavo Faria
	Eletrobras	CAIFF	ELET3 BZ	Arthur Pereira, CFA
	Eletrobras	EBR	EBR US	Arthur Pereira, CFA
	Eletrobras-Pref	EBRB	EBR/B US	Arthur Pereira, CFA
	Eletrobras-Pref	CAIGF	ELET6 BZ	Arthur Pereira, CFA
	Energisa S/A	XLXGF	ENGI11 BZ	Arthur Pereira, CFA
	Eneva	XZUMF	ENEV3 BZ	Arthur Pereira, CFA
	Equatorial	XKERF	EQTL3 BZ	Arthur Pereira, CFA
	Neoenergia	XGXGF	NEOE3 BZ	Arthur Pereira, CFA
	Pampa Energia	PPENF	PAMP AR	Gustavo Faria
	Pampa Energia	PAM	PAM US	Gustavo Faria
	SABESP	CSBJF	SBSP3 BZ	Arthur Pereira, CFA
	SABESP	SBS	SBS US	Arthur Pereira, CFA
	Serena Energia	XZQAF	SRNA3 BZ	Arthur Pereira, CFA
NEUTRAL				
	Auren Energia	XZMXF	AURE3 BZ	Arthur Pereira, CFA
	Cemig	CIG	CIG US	Arthur Pereira, CFA
	Cemig	CEMCF	CMIG4 BZ	Arthur Pereira, CFA
	Central Puerto	CEPU	CEPU US	Gustavo Faria
	Central Puerto	CEPUF	CEPU AR	Gustavo Faria
	COPASA	CSAOF	CSMG3 BZ	Arthur Pereira, CFA
	TAESA	XTAEF	TAE11 BZ	Arthur Pereira, CFA
UNDERPERFORM				
	AES Brasil	XDFDF	AESB3 BZ	Arthur Pereira, CFA
	CPFL Energia	XPFGF	CPFE3 BZ	Arthur Pereira, CFA
	CTEEP	XOOTF	TRPL4 BZ	Arthur Pereira, CFA
	Engie Brasil	XZDDF	EGIE3 BZ	Arthur Pereira, CFA
	Sanepar	XJALF	SAPR11 BZ	Arthur Pereira, CFA
RVW				
	Ambipar	XAPEF	AMBP3 BZ	Arthur Pereira, CFA

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Buy	72	46.45%	Buy	52	72.22%
Hold	45	29.03%	Hold	32	71.11%
Sell	38	24.52%	Sell	21	55.26%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2}Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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