

Argentina Power & Utilities

A brief update and feedback on key themes

Industry Overview

Feedback from the road: tariffs review and next steps

We spent the last week in a marketing trip discussing Argentine Utilities. We see increasing interest since Milei's election (Nov/23), but apparently light positioning. As expected, the main pushback is potential lack of political support to implement required tariff hikes for regulatory de-risking. In addition, investors raised concerns on: 1) market anticipation of the transitory readjusted before the full tariff review (2H24) and 2) impacts to DisCos' operations (e.g. delinquency). We published a report discussing the impacts for EDN and ran a sensitivity analysis which supports our positive view ([Edenor: Equations on tariffs](#)).

Next steps: legacy power generation, gas production

As per our meetings, investors share our view that power distribution tariffs should be the first regulatory issue to be addressed by the government. Next, we expect an update of power generation "legacy" contracts (driver for CEPU and PAM). Legacy contracts remuneration is currently at US\$5-10/MWh vs ~US\$40 /MWh of new PPAs. Gas production growth remains a key LT trend and yields a relatively low-risk CF (USD-linked), but a growth beyond current contracts depends on pipelines not tendered yet.

Omnibus bill approved by lower house: sector impact?

Last week, Argentina Lower House approved the Omnibus bill in general ([Argentina Watch](#)). Among announced reforms, the main impacts for the sector are lower restrictions for gas exports (driver for PAM), while deputies removed the rise in export taxes, proposed by govt. Moreover, deputies removed the authorization of ANSES selling its stakes in public companies (ANSES holds: 22% of PAM, 27% of EDN). We see limited impact for DisCos as the tariff review depends on discussions in the reg. bodies.

DisCos transitory tariffs to be published until Feb 15th

Local news reported that the gvt. wants to publish the DisCos transitory tariffs until Feb-15th. Companies requested a ~250% tariff increase, in-line with our estimates. We see the transitory tariffs a positive progress and a possible monthly inflation readj. is crucial. However, we see the full tariff review (in 2H24) as the main de-risking event.

Enel could re-think Argentine exit: cross read for EDN?

Local news reported that the Italian Utility Enel could re-think its plans to leave Argentina, demonstrating confidence to Milei's regulatory de-risking plans. We see the news as a positive signal for the power distribution sector (e.g. EDN) and increases the optimistic for a positive tariff review in 2H24. Enel is the 2nd largest power distributor in Argentina and has 4% of market share in power generation.

Edenor is our favorite name in Argentine Power & Utilities

We rank EDN our top pick as we see the power distribution, the most leveraged sector to the regulatory de-risking. We maintain our Buy on PAM and Neutral on CEPU.

05 February 2024

Equity
Latin America
Utilities-Other

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Glossary

ANSES = National Social Security
CEPU = Central Puerto (CEPU US)
CF = Cash-flow
DisCos = Power Distribution Companies
DNU = Mega-Deregulation decree
EDN = Edenor (EDN US)
LT = Long-term
PAM = Pampa Energia (PAM US)
PPAs = Power Purchase Agreements
Reg. = Regulatory

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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\$ 9.6	C-2-9
CEPUF	CEPU AR	Central Puerto	ArP 1274.7	C-2-9
EDN	EDN US	Edenor	US\$ 19.51	C-1-9
XEDTF	EDN AR	Edenor	ArP 1291	C-1-9
PAM	PAM US	Pampa Energia	US\$ 48.59	C-1-9
PPENF	PAMP AR	Pampa Energia	ArP 2535.1	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.

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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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