

# **Enagás, S.A. (ENGGF) Q1 2024 Earnings Call Transcript**

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**Body**

Enagás, S.A. (ENGGF)

Q1 2024 Earnings Conference Call

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Company Participants

Arturo Gonzalo - Chief Executive Officer

Felisa Martín - Communication, Public Affairs & Investor Relations General Manager

Luis Romero - Chief Financial Officer

Cesar Garcia - Head-Investor Relations.

Conference Call Participants

Javier Suarez - Mediobanca

Ignacio Domenech - JB Capital

Arthur Sitbon - Morgan Stanley

John Campbell - Bank of America

Manuel Palomo - BNP

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to this Earnings Presentation of Enagás for the First Quarter of 2024. The earnings have been filed with the CNMV before market opened and are available on our website, enagas.es.

Arturo Gonzalo, Chief Executive Officer of Enagás will run this presentation which we expect will take about 15 minutes after which we will open a Q&A in which we will try and answer your questions in as much detail as possible.

Thank you for your attention. And I'm now giving the floor to Mr. Arturo Gonzalo.

Arturo Gonzalo

Good morning, ladies and gentlemen. Thank you very much for your attention. I'd like to welcome you to this earnings presentation for the first three months of 2024. I'm here with our CFO, Luis Romero; our Board Secretary and CLO, Diego Trillo; our Chief Officer for Communications Institutional Investor Relations, Felisa Martín; our Head of Investor Relations, Cesar Garcia; and our Head of Management Control and Business Analysis, Natalia Mora-Gil.

As you know we presented our year end results in February and we've also recently held our Annual General Meeting where we went over all the key figures and targets for this year.

And so in this quarterly call I can be brief and I'll focus on four key points; first, the degree of execution of our strategic plan with special emphasis on the milestones met in the first quarter and some data on how the gas system works; secondly, looking into the key financial performance indicators for the first three months; and thirdly discussing some milestones in our ESG positioning. After which I will wrap-up reminding you of the targets for this year 2024 and highlighting our take-home conclusions.

In the first quarter of 2024 we've continued to make brisk progress along the three lines of action of our strategy plan. In the investment line of our plan to contribute to decarbonization and energy security of Spain and Europe, we've increased our presence in Germany upping our stake in the Hanseatic Energy Hub consortium to 15%.

We've also reached the final investment decision and have signed up funding for building the first LNG land terminal in Germany, Stade LNG where Enagás will be the terminal operator. And the second line of action is the control of our operating and capital expenses through our efficiency plan. We maintain our commitment to ensure that core recurrent operating expenses will not rise more than around 1% CAGR in the period 2022-2026. And in our third line of action around decarbonization with renewable hydrogen as a driving force, we've already made significant progress.

In January the Spanish Parliament ratified Royal Decree 8/2023 designated Enagás as provisional manager of the backbone hydrogen network requiring us to drop an infrastructure proposal for Spain and submitted to the Ministry for Environmental Transition and Demographic Challenge before next April 30.

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On April 8, the Official Journal of the European Union published the definitive list of PCIs or common interest projects, which includes those presented by Enagás the first branch lines of the Spanish backbone hydrogen network the two storage projects and H2Med.

The next window for the community finance instrument the Connecting Europe Facility has already been announced. And we'll be opening between April 30 and October 22. Enagás will apply for funds to do the studies needed as the preliminary step leading to the construction of these infrastructures.

Another significant milestone was met, when we and our European partners were awarded the preliminary H2Med engineering studies to the company would and the social and environmental impact studies to Tecnoambiente, with backing from Francom and Natural Power.

With the progress made by H2Med so far, we expect the project to become a reality very soon. Also two weeks ago, the European Parliament adopted the decarbonized hydrogen and gas market directive, which is now going to go through the council, so the member states can transpose it to the domestic legislations.

Regulation in the market are moving forward. There is political will. And with these conditions in place, technology is scaling up ever faster. Enagás wants to contribute to the energy transition with effective solutions, which is why at our Enagás Hydrogen Technical Day, which we held this month and which was attended by a broad range of international experts, we announced the creation of the Hydrogen Technology Observatory, which will be open to all players in the industry.

And this April also, we have announced together with the University of Oviedo, we will be setting up a new renewable gas chair, Oviedo University which will drive forward the Musel E-Hub potential as a multi-molecule plant. Meanwhile, the Spanish gas system has begun the year on a robust footing, with 100% availability and outstanding flexibility. So far in 2024, we have received NLG [ph] and natural gas from nine different points of origin.

Europe ended the winter, with storage at 59% of total capacity with Portugal and Spain first-in-class. Our country closed the winter, with storage at 78%. Spain has over 90% of its LNG tanker storage capacity already under contract. On March 31 2024, 46% of all LNG stored in Europe was in Spanish plants.

Industrial demand has continued to grow. It went up 8.4% in the first three months of the year, confirming a shift in the trend, which began in the second half of last year. In line with the figures for all of Europe, total natural gas demand in the quarter was down 4%. This was mainly due to the larger share of renewable energy in the electricity generation mix and the generally mild temperatures.

Let me now discuss the most relevant highlights of our financial performance. After-tax profit, reached €65.3 million. That's 19.5% more than in the first quarter of 2023. EBITDA stood at €178.3 million. That's up 2.7%, year-on-year. These are excellent results, which show an EBITDA growth that we hadn't seen in our P&L, since the 2021-2026 regulatory framework came into force, and which reflects the successful efforts of the company and the expeditious rollout of our strategy plan. And these first three months of the year, confirm that Enagás is on track to meet the ambitious targets we set in place for 2024.

Of all the factors driving these positive performance, I would like to highlight four. Revenues remain in line with those of Q1 last year, in spite of the impact of the regulatory framework basically due to the contribution from OpEx and the commissioning of the Musel Energy Hub plant.

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Second, the effectiveness of our efficiency plan, which has enabled us not to increase our operating expenses above the 2023 levels. Thirdly, the excellent performance of the Enagas subsidiaries. Tallgrass grew as forecast in this first quarter reaching its annual adjusted EBITDA target of $775 million to $815 million. And the Trailblazer CO2 project has developed on schedule and will start operating in 2025.

And as disclosed in the material event filing with the CNMV, the arbitration court dealing with the GSP dispute in Peru has notified us that they should be ready to hand down their ruling sometime in the first half of this year. And fourthly, we have a sound financial structure and high liquidity.

The company's net debt stood at €3.342 billion, a similar figure to 2023 and more than 80% of that is covered by fixed rate hedge, thus mitigating the impact of any interest rate volatility. Our leverage ratios are compatible with our BBB credit rating, main rating agencies like our financials and our fundamentals. And two weeks ago, Moody's boosted their Enagas outlook to stable confirming their Baa2 rating. This improvement adds further credence to Enagas financial strategy and highlights how our stronger balance sheet will support the new hydrogen asset investment strategy.

As far as our ESG positioning and performance, we are making progress towards our major ESG commitment which is to become carbon-neutral by 2040. And we're making progress on all three levels of ESG environmental, social and governance. And thanks to this and as you can see in the presentation, we have maintained our leadership position in the key sustainability indices worldwide. And to give you just the most recent example, CDP in Paris last month awarded us the award for obtaining the top A-list rating in the world table of leading companies in the fight against climate change.

And AENOR distinguished us a couple of weeks ago with the highest score G++ on their Corporate Governance 2.0 Index, which recognizes our sound business model and our commitment to transparency full disclosure and best practices, something which came through very clearly in our Annual General Meeting, which AENOR specified as a sustainable event for the fifth year running.

With these results in the first three months of the year, we're on track to meet the targets we announced for the full year which are an after-tax profit of between €260 million and €270 million, an EBITDA of between €750 million and €760 million, close the year with our net debt at around €3.4 billion and to cap the annual growth of our core operating expenses at around 1% between 2022 and 2026 CAGR to maintain our funds from operation to net debt ratio above 14% so that it is compatible with our BBB credit ratings.

And finally, to maintain our -- and comply with our payout policy, which in 2024 is specifically to remunerate our shareholders €1 per share. The dividend for 2023 remains it's -- as was expected at €1.74 per share and will as usual be paid out in full in July with €1.044 per share following the interim payment made in December.

Let me wrap up with just six conclusions. First of all, we have presented you with some excellent results this quarter in line with our year-end goals, thanks to the sound execution of our strategy plan with milestones for supply securities such as those we're implementing in Germany. Second, our strategy plan is fully aligned with Europe's decisive commitment to tackle the enormous unavoidable urgent shared challenge of climate change.

Thirdly, hydrogen is a vital vector in decarbonization and Enagas has a lot to contribute there. The right infrastructure will be a crucial catalyst for the development of a genuine hydrogen market in Europe. Fourthly, all the actions that we've been announcing over recent months are now materializing. We've been appointed HTNL [ph] will be submitting the first Spanish hydrogen infrastructure proposal in just a few days and our projects have been designated as projects of common interest by Europe.

Fifthly, to ensure that technology will facilitate such progress rather than becoming an obstacle we have set up the Hydrogen Technology Observatory. And sixthly, we're starting on a new renewable hydrogen-based investment and growth cycle with rock-solid foundations and we will continue to take the initiative and tackle all the remaining challenges.

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And finally, in this context, close to 50% of our company employees are also shareholders. Those who have signed up to the flexible remuneration scheme are now receiving part of their pay in shares as we announced at our annual earnings presentation in February. Scheme has been a huge success, demonstrating the commitment of our professionals and their confidence in the future of the company.

Thank you very much. And now we will be delighted to answer your questions.

Felisa Martín

Thank you very much. We'll now open the Q&A. Whenever you're ready.

Question-and-Answer Session

Operator

Thank you very much. Ladies and gentleman, we are opening the Q&A. [Operator Instructions] First question is from Javier Suarez from Mediobanca. Javier, go ahead.

Javier Suarez

Yes. Hello. Good morning, everyone, and thank you for the presentation. I have several questions. And the first is about regulation. The National Committee of Markets and Competition has published a calendar for 2024, which includes the commitment of revising regulations for the energy networks in Spain. And the question is, could you give us an update on the talks that are ongoing with the government or with the regulator? And what is your proposal for the regulator in terms of what you would need in order to establish a virtuous cycle of proper investment and remuneration to the companies making that investment? That would be my first question.

And the second is about the update on your strategy plan. The latest, I think was from July 2022 and you've benefited from your designation as PCI of the projects to create the European hydrogen network. But when do you think that you will be updating the strategy plan, which runs up to 2030 with more detail in terms CapEx and potential financial effects of that CapEx and long-term commitments of all types including both EBITDA net income debt and payout? When do you think you'll be ready or what would you need in order to present this update of your strategy plan?

And the third question is about the situation in Peru. And this whole arbitration process of GSP which is still experiencing significant delays. Do you think that the deadline you mentioned the end of Q1 is still viable?

And can you explain why there have been these delays? I'd also like to hear something more about GSP, but also about TGP and the possibility of repatriating dividends to Spain? Thank you.

Arturo Gonzalo

Well. Thank you very much, Javier and good morning. Let me answer each of your questions in turn.

First about regulation, you are correct that the CNMC has already announced its calendar for this year, in which they will be revising the methodology to calculate the financial return rate for electricity networks which as you know set the basis for the financial return on gas networks from 2025.

So this year we will already have some very relevant elements to understand the regulators' views on that next phase. We are constantly communicating with the regulator.

And the basic principle for our position is that, as you've quite rightly said we need a remuneration framework that will be attractive so that we can make the CapEx investments, we need to make over the coming years in gas networks, but particularly in Hydrogen Networks.

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And this is very important for us to have clear rules comparable to those of our European peers, because after all the European energy system is going to be increasingly interconnected and integrated.

And so with our European peers, we are often partners or allies launching joint projects but also sometimes we compete for equity in capital markets. And so what we need again is a level-playing field.

So with similar conditions to those that our peers are subject to with a realistic series of assumptions on interest rates in the period with mechanisms that will take into account inflation and impacts on operating costs.

And all of this as we've mentioned before we believe should lead to a significant update of the financial return or remuneration rate which we feel should be around 7% to 8% pre-tax.

But anyway these are the views that we have shared with the regulator in our talks with them although, of course, it will be the regulator's decisions. And they will hopefully start to disclose some of those positions sometime this year.

Secondly, as for the update of the strategy plan as you pointed out, the fact that our projects have now been designated as PCIs gives us a lot of visibility and a lot of credibility for our hydrogen CapEx plan as we announced on February 20th, when we did our 2023 earnings presentations we expect the CapEx of approximately €3.2 billion net for Enagás in the period 2026-2030.

We will be setting down this investment plan in an update of our strategy plan, a very detailed update in which Javier which -- in which we will be sharing with the markets our views on -- or our vision for new businesses which have to do with other relevant molecules for the energy transition where we think Enagás will be able to play a leading role.

And I'm referring specifically to infrastructure associated to hydrogen carriers like ammonia or infrastructure needed for the other very crucial molecule for the energy transition which is CO2. We think Enagás is in a very solid position as an incumbent to efficiently supply and give open access to all market players, infrastructures for all these molecules, but the details of all of that will be included in an update of the strategy plan which we'll be presenting in the second semester of the year. And very soon we will be giving you more information on the estimated dates for that.

And as for the arbitrage in Peru, the arbitrators have told us in writing that they expect their award to be published this first semester. And therefore that is our expectation to us. We announced in that relevant event filing some months ago. So we're not expecting any further delays and we expect to have that award this first semester. I think what has caused some delays in the process is the fact that it's a very complex in-depth analysis. And so clearly they wanted to assess everything in as much depth and as much detail as necessary which we believe is in itself good news because it means that the arbitration court is getting into all the details that are at stake in this proceedings.

As for TGP, we are as we've shared with the market before in a position which we believe that if we obtain a favorable award on GSP this semester which is what we expect to happen it will be a clear driver to accelerate the release of that cash flow in the year. If that doesn't happen then the arbitration for TGP will proceed normally and will be completed by the end of this year or the first semester of next year. So on that topic we maintain the same position. Thank you very much, Javier.

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Operator

Thank you very much and thank you Javier for that question. Now we're going to give the floor to the next. The next question is from Ignacio Domenech from JB Capital. Ignacio go ahead, please.

Ignacio Domenech

Yes. Thank you and good morning for answering my questions. The first one is about the financial return rate again. You said it might reach 7% or 8% in the next regulatory period. So I would like to understand your assumptions for that 7% to 8% regarding the period to set up that interest rate remuneration. And also could you give us an update? In the past you were talking about a 50 basis points premium for hydrogen. So do you maintain the same premium or do you expect remuneration to remain the same both for natural gas and hydrogen? And my second question is about investment. Could you tell us which investments do you expect to make this year since you talked about an extra 5%? And do you expect a further acceleration in investments on hydrogen or CO2 infrastructure? That's all.

Arturo Gonzalo

And thank you Ignacio. I will start from the beginning first part of your question and Mr. Romero will round up the answer. About our vision for the next remuneration period and on the FRR the financial return rate Luis will discuss the observation periods that best reflect the present situation in our opinion. About our vision of the return on hydrogen investment, well our vision has evolved, along with the way the subject has been tackled in Europe, so far. At this point, the fastest country to move which is Germany, established a high -- an extra -- an additional hydrogen premium on remuneration and gas investments that stood around 150 basis points.

Nonetheless, in recent legislation developments not only in Germany but also in other countries, the approach has somewhat shifted and additional risk in hydrogen investments is not remunerated through a premium, but rather through some state mechanism that will take up that risk.

In the case of Germany, risk is taken up by the state via an income guarantee mechanism to hydrogen system operators they call it amortization accounts mechanism. And we believe that this formula is bound to consolidate in other member states. In other words, the public sector taking up most of the hydrogen associated risk, leaving us to consider comparable remuneration mechanisms for natural gas and hydrogen systems, which will remain comparable despite certain differences, which should be.

First of all, since we don't have any history benchmarks to set up unit price, we believe that at least at the beginning OpEx and CapEx should be a pass-through. And second, since we're talking about our greenfield investment plan, we believe that there has to be a mechanism for the remuneration of work in progress, as has been applied in other regulated industries. So under these conditions with these specificities of hydrogen, the approach to the financial return rate can be similar or comparable. But I would ask Luis, to give you the answer to your question on 2024 investments.

Luis Romero

Yes. Thank you very much. And good morning, Ignacio. About the FRR as you know, the regulator is following a WACC methodology, on the equity cost component which is where we believe we have more room for discussion, with the regulator in terms of capturing the true cost of capital we expect to have in the period 2027 2032.

We understand that there are two relevant components in the cost of equity, the 10-year bond and the market premium. About that first component, the risk-free yield well, we believe that we need to discuss the observation period with the regulator. Up until now, the regulator has taken six years of history. We understand that for the next period they would take 2019 to 2024, which is far from the execution period. So they would have to take an observation period closer to 2027, like for instance, 2020 to 2025 or even a shorter observation period 2023 to 2025 for instance.

In the present in volatility and uncertainty environment, which still stands it could make more sense to generate a cost of equity that comes closer to actual reality. And about market premium, well, we could follow the same methodology as a CNMC or applying the same conditions as in the telecom industry, with the market premium coming close to 6%. That's another element, that might be included in our discussions and conversations with the regulator. And we the -- with these two components in the cost of equity, we would reach a pre-tax FRR approaching 7% or 8%.

About investments on hydrogen infrastructure Ignacio, our forecast for the end of the year is approximately €170 million. So far, we're €40 million into it. And between now and the end of the year, our investments in infrastructure will be 80%. Nearly 50% of that is core OpEx, and we expect investment in new business and adjacent business and our investment in bunkering will reach approximately €20 million to €30 million. And then we also have international investment in Stade, which will reach approximately €10 million. So we have a very serious investment process during the first quarter. And at the end of the year, we will grow around €170 million.

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Operator

Thank you very much for your answers. Over to the next question now. There are no further questions in Spanish. We will now take questions in English. Sorry the first question in the English room comes from Arthur Sitbon, Morgan Stanley. Please go ahead.

Arthur Sitbon

Yeah. Thank you for taking my question. I have two. The first one is, you talked in your press release about the strength in financial results in Q1 2024. I was wondering if that's related to the cash that is locked in Peru and if we would see a normalization of that financial results once the cash is not locked there anymore? And you also talked about a positive one-off in the quarter in financial results. I was wondering if you could explain that one-off and quantify it.

The second question is that, I've seen press articles in the past few days saying that a large operator in Spain may close its gas-fired power plants by 2030. I was wondering if that takes place and if that's a broader move that we see that across the industry would that have an impact on the way transport natural gas networks are perceived and on the investment trajectory for Enagas. Thank you very much.

Arturo Aizpiri

Thank you very much for your questions, Arthur. I'll answer about the cash in Peru and which is -- which could be the effect of unblocking that cash for the financial result. Luis will explain the one-off that is influencing this first Q results. And I will give you my view on the possibility of utilities discontinuing the operation of their natural gas-fired plants from 2030 onwards.

Okay. Talking about Peru, it's true that because of our cash being blocked in Peru, we are receiving an extra remuneration for that cash. And once we unblock that cash, we will stop receiving that remuneration, but we will use that cash to reduce our debt and so the effect will be very much compensated. As a matter of fact, the reduction of the financial costs due to our debt will be larger than the remuneration that we get from that cash. So all in all, the net effect will be positive of the unblocking of that cash when it finally takes place.

Concerning the natural gas-fired plants, as you know the Draft Integrated Energy and Climate Plan presented to -- by the Spanish government and which is expected to reach a final version within the next few months. This plan doesn't envisage the decommissioning, the discontinuing of the operation of any natural gas-fired plant in Spain until 2030.

What can happen beyond 2030? This is just a matter of speculation, and we will not enter in such speculation. But it's true that for a horizon beyond 2030, each member state in Europe has to make -- has to choose among different options to provide the backing of the electricity system.

Perhaps one of the countries that have gone in advance of the others has been Germany. And as you probably know Arthur, Germany has, identified hydrogen as a major source of backing -- thermal backing for the electricity system beyond 2030.

So this is an option that, when moving towards the carbonized horizon in Europe, the place that is not going to be occupied by natural gas in the electricity -- in the electricity system can be played by hydrogen.

And so for a company like Enagás, it will mean reducing the weight of the natural gas system in our assets. I repeat, beyond 2030, and the increasing appearance of Hydrogen Infrastructure to cover those uses.

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So I don't have any specific comment on the announcements of other companies' utilities that necessarily have to go beyond 2030, because the government doesn't expect any natural gas plant being discontinued before that date.

And in the long run, we consider that, hydrogen could very well play the backing role that as of today natural gas is playing in the electricity system. Concerning this one-off effect I'm going to ask Luis, to give us the information. Thank you.

Luis Romero

Thank you, Arturo. Of course, I think in relation of this extraordinary effect that we are suffering this first quarter. I think is mainly due to the collection not to delay interest payment of legal settlement. That is something that is not going to be extrapolable to the rest of the year.

I think we maintain as the company a target of financial results that we are going to be close to €100 million at the end of the year. Mainly the main drivers to reach that figure is that we expect to increase the financial expenses in the second semester, due to an additional emission of debt as you know is the expectation of the company.

And also we probably finalized the year now with our financial remuneration of the cash taking into account of course the cash drop that we have in Peru that we are planning a very profitable return during the year that is going to be reached around €40 million of financial revenues now coming from this deposit. With that figures, I think we maintain our targets to be around €100 million of financial results at the rest of the year.

Unidentified Company Representative

Thank you very much, Arthur, for your question. We are ready for taking the next one please.

Operator

The next question comes from John Campbell from Bank of America. Please go ahead.

John Campbell

Yes. Good morning, everyone. Thanks for taking my questions. I have two, if possible. Perhaps could you remind us how much in euro terms Enagás expects to receive pending the favorable outcome of the GSP disputes, and perhaps sort of who came up with those estimates whether it's a legal opinion or the opinion of management?

And then my second question comes back to the topic of allowed returns. So, I think you see -- you sort of expected to go to 7% to 8%. If I plug into my model, the 6% market risk premium, I still think there's probably other elements that you might be looking to change maybe, for example, the unlevered beta. So any guidance on that would be helpful. And perhaps, is the regulator open to a mechanism like in Italy where they review allowed returns on a periodic basis more frequently than the ones in Spain? Thank you.

Arturo Gonzalo

Okay. John, thank you very much for your questions. Regarding GSP, the amount that we are claiming is the 100% of the investment we made in this project in this asset, which is $511 million. And this is what we expect to recover according to the legal opinion of our legal experts. So this is the first answer. And concerning the details of the remuneration scheme for the next period, I think Luis can give us more detail.

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Luis Romero

Okay, Arturo. Yes, I think in terms of the other elements that we haven't commented in relation of the financial remuneration rate, pre-tax. I think our assumptions in terms of the cost of debt and the leverage ratio for that period is that probably nowadays if you analyze our peers in Europe of the TSOs probably the leverage ratio is going to be around 40%. This is another element that we consider that is going to be a new topic for the discussion with the regulator.

The cost of debt in our assumptions and I think we are using also an observation period in a similar way that we have commented for the cost of equity, probably the cost of debt could be between 2.7% 2.8% for the following period. And of course, in terms of the potential interim update for the financial remuneration rate, this is a discussion that we will need to maintain with the regulator. And this is something that nowadays we have time for that discussion but this is a possibility that we are going to be open to discuss with the regulator.

Unidentified Company Representative

Thank you, John for your question. Please we are ready for the next one.

Cesar Garcia

No further questions on the English side. We do have some others on the Spanish room. So I will pass back to that.

Operator

Thank you. Next question from Manuel Palomo from BNP. Manuel, please go ahead.

Manuel Palomo

Hello. Good morning, everyone. It's a very short and simple question, more of a clarification. This tax rate you mentioned for Q1 was I believe 11%. So I wanted to know if there are any one-offs to make it that low and also what made it so low since you expected it to be higher at the end of the year. That's all. Thank you.

Luis Romero

Yes, we're back Manuel. Actually what you see is an effect of a regularization of the Tallgrass corporate tax. And it has a positive effect of nearly 2.8 million. That's why we come to that 11%. Without that effect we would be closer to the guidance we had given.

Manuel Palomo

Thank you, Luis for that answer.

Luis Romero

And thank you Manuel for your question.

Operator

On to the next question if there are any questions out there that is. No further questions so far. So the floor goes back to the main room.

Arturo Gonzalo

Well in that case thank you very much everybody for your kind attention. Remember, we remain available to you and the Investors Relations department to answer any outstanding questions you might have. Thank you very much and have a good day.

**Load-Date:** April 23, 2024

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