



Grupo Aeroportuario del Sureste 3Q17 Earnings Call Transcript

Operator: Good day, ladies and gentlemen, and welcome to the ASUR Third Quarter 2017 Results Conference Call. My name is Shannon and I'll be your operator. At this time, all participants are in a listen-only mode. We will conduct a question and answer session towards the end of today's conference. If you would like to ask a question, please press * followed by 1. You may withdraw your question at any time by pressing * followed by 2. If you are using a speakerphone, please lift the handset before making your selection. As a reminder today's call is being recorded.

For opening remarks and introductions, I'd like to turn this call over to Mr. Adolfo Castro, Chief Executive Officer. Please go ahead.

Adolfo Castro, ASUR Chief Executive Officer: Thank you, Shannon, and good morning, everyone. Thank you for joining us on our conference call to discuss our second quarter results.

Allow me to remind you that certain statements made during the course of our discussion today may constitute forward-looking statements which are based on current management expectations and beliefs and are subject to a number of risks and uncertainties that could cause actual results to differ materially, including factors that may be beyond our Company's control. For an explanation of these risks, please refer to our filings with the Securities and Exchange Commission and the Mexican Stock Exchange.

As announced yesterday, we concluded the acquisition of a controlling stake of approximately 92.42% in Airplan for a purchase price of approximately 3.7 billion pesos. The acquisition was financed through a 4 billion pesos syndicated loan facility contracted with BBVA Bancomer and Grupo Financiero BBVA Bancomer.

In 2016, the six airports operated by Airplan in Colombia, including the International Airport in Medellin, the second busiest in Colombia, served a total of 10.4 million passengers. This represented 37% of the 28.4 million that travelled through our Mexican airports last year.

We expect to consolidate results from these operations into ASUR's financial statements starting October 19.

The acquisition process of Oriente, the other airport group in Colombia we seek to acquire, is delayed as we have not yet received all the necessary regulatory approvals required to close this transaction. Therefore, we have agreed with the sellers to make commercially reasonable efforts to obtain the pending approvals and, if successful, to negotiate in good faith the purchase price. Remember our agreement contemplated a total purchase price for Airplan and Oriente of approximately 4.9 billion pesos, or 262 million dollars, subject to a series of price adjustments.

You can find more information on these transactions in the Information Bulletin filed yesterday

in Mexico and with the SEC.

Now moving on a review of our operations. September was an eventful month in terms of climatic events, with three major hurricanes affecting our passenger traffic. Nevertheless, we delivered a good set of results this quarter given the circumstances and despite the challenges faced in Puerto Rico with Hurricane Maria. The dedication of our team in Puerto Rico allowed us to resume operations just 24 hours after a category 5 hurricane passed over the island.

Note that in Mexico City Airport, which represents around 51% of our domestic traffic had to be closed for almost two days during September due to a major flooding and the earthquake in the city.

Total passenger traffic reached almost 10 million in the quarter, with growth slowing to 4.9% year-on-year, as strong growth in Mexico - up 8% - was affected by a weaker performance in Puerto Rico posting a decline of over 5%.

Operations at San Juan airport were suspended on September 19 and resumed on a limited basis on September 21, starting with 10 flights and increasing progressively to 41 daily flights at the end of the month, compared with a daily average of 70 flights in 2016. Today we are almost back to 70 average daily flights, but with a lower load factor in terms of arrivals.

While we are currently evaluating damages to airport infrastructure to assess reconstruction costs and receive insurance approvals, note that our airport infrastructure is insured against material damages with a maximum deductible of 10 million dollars.

Terminal "B" was affected and is closed. However, this does not represent a reduction in traffic as we are in the low season and we expect to resume operations before higher demand materializes.

Traffic in Mexico was mainly driven by international traffic – up over 9%, while domestic traffic was up almost 7%. Cancun continued to report healthy growth over 9%, with positive contributions from the majority of ASUR's airports. Minatitlan, however, continued to face the challenging oil industry environment and will be affected even more by the reduction in slots to domestic airlines in Mexico City airport.

Traffic between Mexico, Canada and the United States represented 85.8% of the total traffic.

Now moving on to the P&L for the quarter. Consolidated revenues, excluding construction services, were up 46% year-on-year, with Aerostar results representing 22% of this.

Aeronautical revenues remained strong up 50% year-on-year, driven by traffic growth and the inclusion of Aerostar.

We reported robust commercial revenue growth – up 45%, with Aerostar representing 12% of consolidated commercial revenues.

Reflecting our focus on driving commercial revenues– consolidated commercial revenues per passenger rose 5% to 99.5 pesos, reaching 101 pesos in Mexico – up 6% year-on-year. Looking ahead, we expect to achieve further growth following the opening of Terminal 4 at Cancun airport.

Operating costs and expenses, ex-construction costs, rose 68% year-over-year, with Aerostar contributing with 24% this total.

In Mexico, costs ex-construction, rose 14%, mainly due to higher cost of services. As in the previous quarter, this reflects increased energy costs, as the cost per kilowatt hour increased by 21.6% year over year, along with higher maintenance expenses. Higher cost of sales from the 11% increase in commercial revenues from direct operations. And also we also recorded additional costs in connection with acquisitions we are making and other projects. Higher costs also reflect hiring of employees for Terminal 4 as they are trained in preparation for the opening this quarter.

Consolidated EBITDA was up 40% year-on-year increase to 1.9 billion pesos, with Aerostar contributing 18% of EBITDA. Adjusted EBITDA margin, which excludes construction revenue and costs, contracted 335 basis points to 68% reflecting the lower comparative EBITDA margin of Aerostar. Note however, that year-on-year, EBITDA Margin at Aerostar improved by over 550 basis points.

EBITDA of our Mexican operations, remained strong - up 14% year-on year with Adjusted EBITDA margin stable at 71%.

In terms of capex, ASUR invested a total of 313 million pesos in the quarter. Of this, 287 million pesos were allocated to our Mexican operations, mainly in the construction of Terminal 4 that is on track to open by year end, while 26 million pesos were invested at San Juan airport.

Moving on to the balance sheet, we closed the quarter with a healthy balance sheet, with a net debt to last twelve months EBITDA ratio of 1 times, compared with 0.1 times at the close of 3Q16. Total debt increased to almost 15 billion pesos in the quarter, from 4 billion in 2Q16, mainly reflecting debt held at Aerostar along with a 4 billion peso loan at Cancun airport to finance the acquisition of the Colombian airports. Note that 72% of our debt is denominated in US dollars.

Before reviewing Aerostar's stand-alone results, please note that to comply with SEC regulations, I will not be discussing the stand alone financial performance of Aerostar prior to the period in which this subsidiary was consolidated into ASUR's financial results – that is before June 1, 2017. For this reason, we have not included in our third quarter 2017 results any financial information for Aerostar's stand-alone results for the nine-month periods ended September 30, 2016 and 2017. This same criteria will apply to the stand-alone financial information of Airplan, before the date of acquisition. We will start consolidating these results into our financial statements starting October 19th, 2017.

Moving ahead, revenues at LMM Airport for the quarter declined one percent driven by lower non-aeronautical revenues, while aeronautical revenues remained practically flat despite the 5.5% decline in passenger traffic.

Commercial Revenues per Passenger for the quarter rose 3 percent to 95.9 pesos.

Operating costs were down 11% year-on-year mainly reflecting lower cost of services resulting mainly from a decline of 13.6% in energy consumption, along with lower amortization and depreciation.

Finally, Aerostar posted a 10% year-on-year increase in EBITDA reaching 349 million pesos. Reflecting higher operating leverage and the completion of the remodelling plan last year, EBITDA margin expanded 558 basis points to 56.1% in 3Q17.

Note that sequentially, EBITDA margin was seasonally lower, as in the second half of the year margins tends to be lower. This year in particular, results in the second half will be impacted by the aftermath of Hurricane Maria.

Before opening the floor for questions, let me mention that we are working on our master development plan proposal which we will be presenting to the government by year-end.

This completes my prepared remarks. I will now open the call for questions. Operator – Shannon, please go ahead.

Operator:

Thank you, Mr. Castro. Please press star, one if you would like to ask a question. Again, please make sure your mute function is turned off or the handset is picked up before pressing the corresponding digits. We'll pause for just one more moment.

The first question comes from Leandro Fontanesi with Bradesco.

Leandro Fontanesi:

Hi. Thanks, Adolfo, for the call. On my side, if you could provide some clarification on Airplan financials. So the first question that I have is regarding the cost. So there is a big fluctuation if you compare the cost, both in terms of cost of services and SG&A in 2016 compared to the first half of 2017, so if you could provide some color and if there is any nonrecurring cost that we should consider in our analysis?

The second point, if you consider the revenue from construction, the cost from construction you had close to 520 million pesos of profit related to construction. As you consolidate Airplan, starting October and going forward, is it fair to assume that your revenue for construction and costs will be matched as you do it for ASUR and you no longer have this profit on construction? Thank you.

Adolfo Castro Rivas:

Leandro, as I said during the initial remarks I cannot comment on resource previous to our acquisition, however, nevertheless, you're absolutely right, the numbers we presented in the pro forma have an 800 million peso expense in administration during the second half of the year that is making the difference. Also in the case of construction profit, you're absolutely right. There is some construction profit that is not normal in the case of ASUR, where we basically present the same figure for costs as it is for revenue. In terms of construction in the case of Airplan, it should be a nonrecurrent situation because most of the construction has to be done during this year and the year after. That's what I can share with you.

Leandro Fontanesi:

Okay. Thank you. If I may, one more question, so you plan to open the Terminal 4 for Cancun in the fourth quarter. Should we expect any impact in terms of margins as you ramp up this new terminal in the following quarters?

Adolfo Castro Rivas:

That's a good question, Leandro. As I have said before, our cost to operate Terminal 4 is also presented here in our third quarter results because, as I said in the initial remarks, we started

hiring people to be trained and to be ready for the opening of Terminal 4. I would say Terminal 4 opening should occur before this month is over, so we're expecting this to be open the last day of this month of October.

Going forward, of course, our cost will increase as a result of these opening. Just to give you an idea the size of this building, this building is able to operate between 8 million to 9 million passengers, which is what Monterey itself is operating. Another way to see this, this will increase the capacity of Cancun Airport by almost 40%, so this is a major building. It's another 70,000 square meters plus 120 in terms of the apron, plus another 150 in terms of the runway, the connector between the two runways.

So yes, you will see an increase in our cost as from the third quarter because of this new build that should be in operation the last day of October.

Leandro Fontanesi:

Perfect. Thank you very much, Adolfo.

Adolfo Castro Rivas:

Thank you.

Operator:

The next question comes from Stephen Trent with Citi.

Stephen Trent:

Good morning, Adolfo, and thanks very much for taking my questions. Just a few quick ones for me. I think you mentioned San Juan is up to 70 daily flights, if I heard you correctly. Any color as to what is normal peak hour air traffic movements at the airport?

Adolfo Castro Rivas:

Hi. Good morning, Steve. As I said before, more or less today we are operating the same as what we were operating last year. The difference we have today is the load factor in arrivals that is not the same. It's lower than how it was a year ago.

Stephen Trent:

Okay, got it. Very helpful. In terms of the Colombian initiative here, can you refresh my memory as to regulation there? Is it a periodic mandatory regulatory review as it is in Mexico? If so, any color on what the calendar is for that?

Adolfo Castro Rivas:

Yeah, good question. No, we have a complete different regulatory regime there. There is no review of the Master Development Plan every five years as we have in Mexico. The way that it is there is that we have a commitment today of certain works that we have to do. Those numbers are being presented in the document we file with the Securities and Exchange Commission and the Mexican Stock Exchange. There is no review. Nevertheless, this can be reviewed by the parties.

I would say that today this company has around 20 amendments of its original document, so they have reviewed these 20 times, but this has to be done in agreement between the parties. So the document as it is today states a certain works that have to be done by the company.

In terms of rates, the [inaudible] is the one that fixes the rates for the regulated activities, so those aeronautical activities, so we do not have anything to say on that. The other major difference is the terminal agreement. As I said during the first press release published in April, the terminal agreement is moving. It's moving in accordance of the moment when the company recuperates the regulated assets, and that is why the government is the one that is in charge of the regulated rates. So, if I don't remember wrong, the period we mentioned for this specific company was as from the year 2033 up to the year 2048. So it has a minimum and it has a maximum, and between this period of minimum and maximum, the concession will be over once the company recuperates fully their regulated assets.

Stephen Trent:

Very helpful, Adolfo. In that, is there any—I guess, one, is there any chance to renew once it expires? And two, on Airplan, just to follow-up with the gentlemen from Bradesco's question. Any view as to why Airplan's equity capital base is so low? If there something going on with retained earnings. I'll leave it there.

Adolfo Castro Rivas:

Okay. In terms of the possibility of renewing the case of the expiration, the contract doesn't say anything about it. I believe, we don't have the same chance as it is in writing in the case of Mexico. So that is, what I can say for the moment.

In terms of the equity, yes, you're absolutely right. This company presents a completely different level of debt in comparison with what we have in Mexico. A comment in terms of the debt they have there, I can say that what I can see is being negotiated in good terms from a financial perspective.

Stephen Trent:

Okay. I'll let someone else ask a question. Thanks for the color, Adolfo.

Adolfo Castro Rivas:

Thank you.

Operator:

Next question comes from Natalia Zamora with GBM.

Natalia Zamora:

Hi. Thank you for taking my question. My question is could you provide an estimate on how much will maintenance work regarding the damage to the airport in Puerto Rico will amount to? Thank you.

Adolfo Castro Rivas:

Hi. Good morning. Well, we do not have yet an official number of the real damage that we suffered in Puerto Rico because of the Hurricane Maria. The best guess that I have today to share with you is close to US\$60 million. Of course, as I said during the initial remarks, we are insured and the maximum deductible for a catastrophic event is US\$10 million.

Natalia Zamora:

Okay, perfect. Thank you. Very helpful.

Operator:

The next question comes from Marco Montanez with Vector.

Marco Montanez:

Hi, Adolfo, and thank you for the call. Two questions, if I may. The first one, could you share with us the implied transaction multiple of the acquisition of Airplan? The second, have you got any estimate for the committed investments for Airplan in the next years? Thanks a lot.

Adolfo Castro Rivas:

Hi. Good morning. In terms of your second question, you have the numbers in the document we presented. In terms of the first one, it's hard to say an exact number because many people have different views on this, but something between 5 to 6 could be the number.

Marco Montanez:

Okay. Thank you, Adolfo.

Adolfo Castro Rivas:

You're welcome.

Operator:

Next question comes from Pedro Pascoal with JP Morgan.

Pedro Pascoal:

Adolfo, good morning. Thanks for taking my question. I guess, the answer is probably no, but could we see as we're engaging more expansion or M&A activities, we still lack to the bidding documents, but the Brazilian government already announced new airport privatizations maybe on a standalone basis or with a partner. Could you say you guys are showing some interest, or I think that's for the moment? Thanks.

Adolfo Castro Rivas:

Hi. Good morning. We are seeing, we are analyzing those opportunities. This will have to be shared with my Board during our next session. Particularly, the Board have not been very happy with investments there after what we saw during the first round of the privatization process. I don't know what the outcome is going to be but I'm not too optimistic about it.

Pedro Pascoal:

Okay. That's very helpful. Thank you.

Adolfo Castro Rivas:

You're welcome.

Operator:

Next question comes from Gilberto Garcia with Barclays.

Gilberto Garcia:

Hi. Good morning. Thank you for the call. You had a fairly significant decrease in accounts receivable. Are you restricting credit to any of your airline customers? Thank you.

Adolfo Castro Rivas:

Hi. Good morning. The reduction you are seeing is because of the seasonality. We do not have changed anything in relation with our credit policy to customers. So, everything I would say is normal. In terms of that, my final comment will be that all the airlines are paying us on time so we do not have any trouble there.

Gilberto Garcia:

Understood. Thank you very much.

Adolfo Castro Rivas:

You're welcome.

Operator:

I'll take our next question from Luis Prieto with NAU Securities.

Luis Prieto:

Adolfo, hi. Luis Prieto. I have two very short clarification questions. The first one is regarding the damage reconstruction work you mentioned in Puerto Rico. You said between US\$50—US\$60 million, and regarding the US\$10 million, I wanted to clarify whether that's the maximum coverage of your policy, or that is the excess above which the policy covers your expenses?

My second question is you talked about submission of your proposal for new MDP by the end of the year. When would the government come back to you and what sort of steps and when would we have a final decision? Thank you.

Adolfo Castro Rivas:

Hi. Good morning. Yes, to be clear on the 60 and the 10, 60 is the best guess in terms of a number for the reconstruction processes. That is for the moment our best guess of how much

we will have to spend to be construct the damages at the infrastructure of San Juan, Puerto Rico because of Hurricane Maria.

In terms of the \$10 million, that is the maximum deductible in the case of catastrophic event. I believe that we will not reach the \$10 million, but of course I cannot share with you an exact or precise or accurate number of how much this will cost to the Company, but that of course is the maximum amount of the Company will have to pay in terms of a catastrophic event.

In terms of the MDP yes, we should deliver our proposal before the year is over, and the government have one year to come back with us in terms of the approval for cap ex and the maximum rate.

Luis Prieto:

When they come back to you, that's the final decision? There is no back and forth and in between with public documents. It's your submission and they come back within a year and that's it?

Adolfo Castro Rivas:

Well, of course it's not just one meeting to decide all of this...

Luis Prieto:

But on the public side, that we will know...

Adolfo Castro Rivas:

No, well, basically how this works is, it's a very close co-operative process because of first thing they have to review is the passenger traffic projection. Then they will have to go and visit every single one of the airports we have to see the inventory of the airport, inventory in terms of the way the assets—how the assets are today. Then they review every single project we present to them. Normally an MDP for the nine airports should represent around 300 projects.

Finally, they make the calculations in accordance with approval of the cap ex and the passenger traffic and the discount rate to fix the proposal of the maximum rate.

Luis Prieto:

Excellent. Thank you.

Operator:

The next question comes from Ricardo Alvez with Morgan Stanley.

Ricardo Alvez:

Hi, Adolfo. Thanks for the question. Actually, very quick questions, one is actually a clarification. You mentioned the 5 to 6 times multiple. It was not clear to me what kind of multiple you're talking about, if you could clarify that please.

The other one, again related to the Terminal 4, if you could talk a little bit more about this transition period. I mean you're going to open the terminal now by the end of October, so maybe if you could give a little bit of color when you're planning to close the Terminal 1. How can we see the mix of traffic between international and domestic in the new terminal? Any kind of color on how you're going to be operating, how you're going to do the transition, that would be helpful. Thank you.

Adolfo Castro Rivas:

Well, in terms of the multiple, it's EBITDA times. In terms of Terminal 4, yes, we expect to open that the 31st of October this year. Of course, we will not expect to open—well, not to open, to expect to move or transfer all the airlines from Terminal 2 to Terminal 4 the same day. So the outcome is to be able to move 14 airlines. We will be moving them one by one, I would say with a ramp up during three weeks, more or less. Then what we expect is to normalize the operation in Terminal 4 and probably during the first quarter of next year we will move the airlines that are operating in Terminal 1 today to Terminal 2.

Ricardo Alvez:

Okay, that's clear. Thank you.

Adolfo Castro Rivas:

You're welcome.

Operator:

Once again, as a reminder, it is star, one to be placed into the queue. We next move to Josh Milberg with Morgan Stanley.

Josh Milberg:

Hey, Adolfo. Thanks for the question. You touched on this already but I just wanted to get a little more clarity on the duration of Airplan. In the document that you guys released last night, I think it indicates that this will depend on the sum of the revenues generated by the relevant airports. I was just hoping if you could give us an idea of what the revenue thresholds are, or what kind of growth you'd need to come out at the low end of that range, 2032?

Adolfo Castro Rivas:

Okay, Josh, hi. Good morning. What I said is the term is variable in terms of when the Company recuperates the regulated assets. The company recuperates the regulated asset with the regulated returns—sorry, the regulated revenues. Regulated revenues are basically airport activity, okay? So, it's hard to say when these may be recovered because you have a lot of variables into the equation. As you are mentioning, one of them, of course, has to do with the growth in passenger traffic. The other one could be the U.S. dollar against the Colombian peso because of the international traffic. Of course, most of the traffic we have in those airports, it's domestic, but a piece of that has to do with international traffic where it's related to U.S. dollars. Finally, of course, it has to do with inflation there. For the moment, what you can use is the lowest part of the thing which could be 2032.

Josh Milberg:

Okay. Thanks for that. Very helpful.

Adolfo Castro Rivas:

Of course, this will be adjusted in the case, there is a review on the document, okay? As I said before, this company has been able to review 20 times the document and the period has been extended because of this situation in the past.

Josh Milberg:

But you think it makes sense to be conservative, to assume 2032?

Adolfo Castro Rivas:

That's exactly what I'm saying, with the correct conditions.

Josh Milberg:

Got it. Thanks so much.

Adolfo Castro Rivas:

You're welcome.

Operator:

Once again, ladies and gentlemen, as a reminder it is star, one to be placed into the queue. Please make sure that mute function is turned off to allow your signal to reach our equipment. Once again, star, one will place you into the queue at this time.

Sir, it appears there are no further questions. I'd like to turn it back to you for closing remarks.

Adolfo Castro Rivas:

Thank you, Shannon, and thank you everybody for joining us today on this conference call for the third quarter results. Have a great weekend. Good-bye.

Operator:

Thank you. Ladies and gentlemen, that does conclude our conference call for today. Have a great weekend. You may now disconnect.