



Grupo Aeroportuario del Sureste
2Q18 Earnings Call Transcript

Operator: Good day, ladies and gentlemen, and welcome to the ASUR Second Quarter 2018 Results Conference Call. My name is Cathy and I'll be your operator. At this time, all participants are in 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, Cathy 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.

I will start today's call with an overview of key recent events, followed by a brief review of our operations and financial results for the quarter.

As you know, on June 24th, and after an extensive 30-month process, we received approval from the Secretary of Communications and Transportation for our Master Development Programs, including efficiency factor and maximum tariffs for our each of our Mexican airport concessions for 2019 through 2023.

The approved plan contemplates a 28% increase in committed investments in comparison with the previous 5 years. Our main project commitments for the next five years include:

- First, a parallel taxiway for the second runway at Cancún Airport;
- Second, the first expansion of Terminal 4 at Cancún Airport;
- Third, a major terminal expansion at Mérida Airport.

MDP negotiations also included an 0.1% increase in the weighted average maximum rate for regulated revenues, based on work load units for 2017 after the application of the efficiency factor which was

maintained at 0.7%. Note that this will remain the lowest weighted average maximum rate among the three airport groups in Mexico. As part of the MDP negotiations, we also renewed the Technical Assistance Agreement for a five-year period.

In addition, this quarter we also paid out an ordinary cash dividend of Ps.6.78 pesos per share, for a total amount of Ps.1.8 billion.

Finally, last May we acquired an additional 7.58% of Airplan in Colombia, bringing our share ownership in this subsidiary to 100%.

Now, moving on to our performance, we continued to face some external headwinds, including the ongoing fallout from Hurricane Maria in Puerto Rico, and capacity adjustments at a leading carrier in Colombia that affected domestic traffic in the country. While we faced easier year-on-year comparisons in these two countries, these events have had an impact on our overall performance. In contrast, Mexico, continues to post solid results despite more difficult comps from the Easter effect, and the increase in the cost base due to the opening of Terminal 4 at the end of last year.

We saw a total of 13.1 million passengers travel across our airports over the course of the second quarter. Mexico remains a solid performer more than offsetting traffic declines in Colombia and Puerto Rico. Overall passenger traffic rose by 1.0% slightly below the 1.2% increase in the first quarter of the year.

Traffic in Mexico rose by 4.8% year-on-year to 8.3 million passengers, facing more difficult comps as Easter this year fell in March, while last year it fell on April. Domestic traffic was up almost 8% while international traffic rose slightly over 2%. Cancun remains the main growth driver, with increases of over 9% in domestic traffic and 2% in international traffic.

Puerto Rico is still recovering from the effects of Hurricane Maria, which hit last September and continues to impact load factors for both international and domestic traffic. As a result, traffic was down almost 6% year-on-year to 2.3 million passengers for the quarter. While this was a significant improvement from the 19% decline posted in the first quarter of the year, we expect traffic growth to remain in negative territory until this coming August.

Colombia posted mixed results, with a 12% increase in international traffic more than offset by a decline of almost 7% in domestic traffic. Overall, this resulted in a 4% year-on-year decline in total traffic to 2.5 million passengers in the quarter. Looking ahead, we expect to see slightly positive quarterly figures starting in the fourth quarter.

Moving on to the financial results, remember that results for the quarter reflect the consolidation of Aerostar in Puerto Rico starting June 1st of last year, and Airplan in Colombia starting October 19th last year.

Consolidated Revenues, ex-construction, rose almost 57% to 3.7 billion pesos compared to the year before. This was driven by a 12% increase in Mexico, while Puerto Rico contributed with Ps.482 million and Colombia with Ps.416 million in revenues ex-construction.

Aeronautical revenues remained strong – up 50% year-on-year to 2.3 billion pesos, driven by growth of almost 10% in Mexico and the inclusion of Puerto Rico and Colombia, which contributed with Ps.452 million and Ps.318, respectively.

Commercial Revenues increased 45% year-on-year to 1.3 billion pesos. We are pleased with the strong pick-up in commercial revenues in Mexico –up almost 16% year-on year compared with 6% reported in the prior quarter, as we continue to ramp up operations following the opening of Terminal 4 at Cancun Airport in late 2017. Puerto Rico contributed with commercial revenues of 250 million pesos, and Colombia with 98.3 million pesos.

Commercial Revenues per Passenger fell to Ps.99.7 this quarter, from Ps.102.3 in 2Q17, reflecting the consolidation effect.

On a standalone basis, however, commercial revenues per passenger increased across our three countries of operations:

- Mexico posted a 10.4% increase in commercial revenues per passenger to 115.5 pesos, driven by several factors, including:
 - Continued ramp up, along with the completion of VIP lounges in terminal 4 at Cancun airport;
 - The 7.3% quarterly peso depreciation in the period; and
 - Improved performance of our retail operations.
- In Puerto Rico, commercial revenues per passenger rose 22.2% to 109.8 pesos, as we continue to experience increased demand for car rentals and parking lots from the teams undertaking the reconstruction efforts on the island.
- Finally, Colombia posted a 49.9% increase reaching 38.7 pesos per passenger as we continue to upgrade these operations.

Moving down the P&L, consolidated EBITDA rose 32% year-on-year to 2.4 billion pesos. Mexican operations reported a 10.3% YoY increase in EBITDA, while Puerto Rico contributed with Ps.340 million in EBITDA and Colombia with Ps.192 million.

Adjusted EBITDA Margin, excluding IFRIC 12, contracted to 64.1% from 71.3% in the year-ago quarter, mainly reflecting the lower comparative Adjusted EBITDA margin in Puerto Rico and Colombia that were not fully consolidated a year ago.

By region, and on a standalone basis, Adjusted EBITDA margin in Mexico fell 109 basis points to 71.5% reflecting principally additional cost from the new Terminal 4 opened at the end of last year. In addition, the 0.4% decline in net income includes the effect of the 21.6% increase in depreciation resulting from the investment on this Terminal.

In Puerto Rico, Adjusted EBITDA margin declined to 48.2% from 57.8% in 2Q17, mainly reflecting higher concession fees, as starting year-six of the concession the calculation of the fee changed to 5% of revenues for the period from the prior Ps.2.5 million fixed payment. In addition, insurance costs increased 70% year-on-year. Furthermore, depreciation rose 50% year-on-year reflecting the increase in the valuation of the concession asset made at the end of last year.

By contrast, Colombia posted an 18 basis points increase in Adjusted EBITDA margin reaching 46.1%. This was achieved despite a 55% increase in amortization of the concession mainly resulting from the concession terms. Excluding the valuation loss of the intangible asset, EBITDA in Colombia would have increased by 35.5% during the quarter.

Moving on to the balance sheet, we closed the second quarter in a healthy financial position with a Net Debt to Last Twelve Months EBITDA ratio of 1.3 times and **total debt stood** at about 16.6 billion pesos. This includes the 72 million dollars debt paid during the quarter.

In addition, we also made 407.2 million pesos worth of **capital investments** over the course of the quarter. Of this, 130.6 million pesos went towards Cancun's Terminal 4, as well as the modernizing of the airports in Mexico. In addition, Aerostar invested 201 million pesos in Puerto Rico's LMM Airport, while Airplan invested a further 75.6 million pesos in Colombia.

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

Operator:

Thank you. Again, to the audience, it is star, then one for questions, and again, please make sure your mute function is turned off or the handset is picked up before pressing the corresponding digits. We will pause for just a moment to allow everyone an opportunity to signal for questions.

Operator:

As a reminder, it is star, one if you would like to ask a question. We have no additional phone questions at this time, so I would like to turn the call back to Mr. Adolfo Castro for any additional or closing remarks.

Operator:

Again, ladies and gentlemen, if you'd like to ask a question, please press the star, then the one on your telephone keypad. Please make sure your mute function is turned off or your handset is picked up before pressing the corresponding digits. Again, that is star, one for questions.

We'll go first to Ricardo Alves of Morgan Stanley.

Ricardo Alves:

Hi, good morning, Adolfo. Appreciate your time. I have a couple of questions, starting in Colombia. Maybe just a little bit of guidance, if you can provide that, going forward for the second half. Profitability has been a little bit volatile, so any color you can give us to kind of guide us a little bit better on what's to come in terms of profitability in Colombia.

The second part of this question, also in Colombia, you had a pretty strong commercial performance there on a per-passenger basis - I think you highlighted this before - so just wanted you to talk a little bit more about that. You mentioned in the release the 30 new commercial spaces you opened over the past 12 months, if I'm not mistaken, so maybe the question would be if there is further room for more expansion on that front.

I'll have just another follow-up after that. Thank you.

Adolfo Castro Rivas:

Ricardo, good morning and thank you for your questions. In the case of profitability, it's important to say that we are, for indicative purposes, comparing with quarters that we were not in the head of the Company yet, so we are not sure of the way that this was recorded in the previous quarters where we not there. In that sense, I cannot comment too much about the comparisons of the quarters. What I can say to you is that profitability, in the case of Colombia, has increased due to the fact of increasing commercial revenues, which is our main objective in that project.

If I had to see the second half of the year, I would say the most important space that we will have to wait is related to duty-free. I have to say that the duty-free contract expired third quarter last year, and we were in the process of getting a better space, a better location with better passenger flow, and now we are in the process to sign the contract with the new concessionaire. I believe we will be providing this service to the passengers during the fourth quarter of this year, and that, of course, will mean an important improvement for the commercial revenues per passenger during the fourth quarter of this year.

Ricardo Alves:

All right, that's clear, Adolfo. Thank you. The last one, very quickly; in Mexico, you had higher year-over-year traffic, very solid commercial activity in Cancun as well, and your margin was a little bit down year-over-year. I'm sorry, maybe just more of a clarification, because I know you mentioned higher costs in Terminal 4, so the question is, can we expect even higher margins going forward? We saw a year-over-year contraction, but I guess this is just as you ramp up that terminal? Just so we think a little bit on how Mexico operations are going to be, maybe 12 months from now. Thank you, again.

Adolfo Castro Rivas:

Ricardo, in the case of margins, you know in the case of airports, most of the cost is fixed. As you have seen, we have an important increase in our cost resulting from the opening of Terminal 4, so we have to separate the cost from the revenue. Going forward, what I can see is that the cost of operations in Mexico should remain more or less stable, probably a slight increase, first quarter, as from the first quarter next year due to the fact that some of the equipment that was installed in Terminal 4 is still in the guarantee from the original vendor, let's say passenger bridges, electrical stairs, elevators, so as from the first quarter next year, we will have to start paying maintenance for this equipment. But in the case of what you're seeing today in the second quarter, that should remain more or less the same.

Of course, if we look at the line of depreciation that was almost exactly the same amount as the first quarter of this year, that had an impact, an important impact on the net income for the case of Mexico this year. I'm sure that not all of you thought about these situations, so one thing is the cost of additional security, additional cleaning, additional personnel, and the other thing is the depreciation. Also, please remember that the additional capacity that this terminal added to Cancun Airport was around 38%, so this is an important building. From now on, what I believe is that if we have more passengers passing through Cancun Airport, we will see better results.

Ricardo Alves:

That's very helpful. Thank you so much. Good day.

Adolfo Castro Rivas:

You're welcome.

Operator:

We will now go to Alejandro Zamacona from Credit Suisse.

Alejandro Zamacona:

Hi Adolfo, and thank you for the call. I just have one follow-up question on Ricardo's questions. Regarding Colombia, I don't know if you can give us more color on the significant increase of the cost of service. When we compare it to the first quarter of '18, we saw a significant increase, so I don't know if you can give us more color on this.

Adolfo Castro Rivas:

Yes, of course. Colombia was not, in terms of the way to record their operations and [inaudible,] so they were not in compliance with the law. Some of the things that you are seeing today as an expense are, I would say, one-time events because we have to upgrade their administration and their accounts systems. That will be one piece of the puzzle.

The other piece could be additional legal fees that are spent there in order to review all the process of acquisition we have recently made, the final 7.58%. That's the only two things that I see as things that could be considered extraordinary or not equal to previous quarters.

Alejandro Zamacona:

Okay, Adolfo. Regarding the commercial revenues per passenger, I know that Ricardo already asked that, but do you attribute the 50% increase to this new contract in duty-free, also in Colombia?

Adolfo Castro Rivas:

No, no. What I was saying about duty-free, it was that, at the end of the third quarter last year, the contract expired, so today we do not have duty-free operations and we are in the process to have those up to fourth quarter this year. The amounts that you are seeing in commercial revenues for the second quarter does not include duty-free. That was an important element in the equation if you see the report of the third quarter last year. Of course, some of the things that we are doing there are basically to have a better operation and a more efficient commercial operation for the Company.

Alejandro Zamacona:

Okay, thank you.

Adolfo Castro Rivas:

You're welcome.

Operator:

Now we'll take a question from Natalia Zamora of GBM.

Natalia Zamora:

Hi, good morning. Thank you for taking my questions. The first question is regarding the cost of services in Mexico. If I understood correctly, you said we can expect it to remain around the same level during the rest of the year, or even increase beginning in 2019. Could you provide a cost of service level on a per—passenger basis for this year, or even for 2019? That would be my first question, thank you.

Adolfo Castro Rivas:

Well, I cannot give a passenger—a cost per passenger because I really don't know what the amount of passengers we will have in the future. But in order to try to give you a hint of that, I would recommend you to see the presentation we have in our webpage where we basically present the cost that is not related to revenues of the last, around 12 years, on a quarterly basis. You can see the number there. If I don't remember wrong from the top of my head, because I don't have that report in front of me right now, it should be around 47, 48 pesos per passenger, and basically during these 12 years has remained more or less the same on nominal terms. Please refer to that report.

Natalia Zamora:

Okay, perfect. Will do, thank you. My second question would be, I recall, on a previous conference call, you mentioned you were directly taking on the operation regarding advertising in Mexico. Could you please give us an update on this?

Adolfo Castro Rivas:

Yes, you are absolutely right. On September last year, we had to cancel the contract to the concessionaire we had because he was not paying the fees that he had to. If you remember, if you go back in time, we were providing this service directly in the year 2004 up to the year 2013, and 2013, if I don't remember wrong. Today, we are in the process to recuperate or to redo the whole thing, because when we gave the contract to the concessionaire, we gave the contract also including the personnel we had to take care of this business line. As from the month of December, we have been hiring people to take the necessary attention on this particular line of business.

Also, it's important to say that, due to the fact that Terminal 4 opened in November last year and the contract was cancelled in September last year, Terminal 4 basically, as of today, does not have advertising spaces, so we are also in the process to add these to Terminal 4. Basically, we have hired someone in order to provide us the furniture for the commercial—the advertising spaces in Terminal 4. I hope that very soon we will be able to provide this service again in Terminal 4.

The thing is improving. If you see the decreases we had in the fourth quarter and first quarter are [inaudible] than what we presented in the second quarter this year, and I have to say that, month by month, we are doing the things better to try to recuperate what this concessionaire didn't make during last year.

Natalia Zamora:

Okay, perfect. Thank you, that's so helpful. Thank you.

Adolfo Castro Rivas:

You're welcome.

Operator:

Now we'll go to Pablo Monsivais with Barclays.

Pablo Monsivais:

Hi. My questions have been answered. Thank you very much.

Operator:

We'll go next then to Ramon Obeso from Scotiabank.

Ramon Obeso:

Hi Adolfo, good morning and thank you for the call. I have just one question. What levels of cap ex should we expect in Puerto Rico and Colombia for the next couple of years? If you could give us a breakdown between the cap ex related to regulated activities and the cap ex allocated to improve the commercial business, it would be great. Thank you.

Adolfo Castro Rivas:

Okay. In the case of Puerto Rico, let me start with that. Yesterday, it was inaugurated, the last project originally committed in the contract five years ago, and that is the FIS. That was the project that was ongoing for, let's say, expansions for the case of Puerto Rico. In the case of Puerto Rico, expansion projects have been completed and we do not expect to see any more in the coming years.

The other thing that we will see in cap ex for Puerto Rico will be the reconstruction process. Around \$60 million was the total damage from Hurricane Maria last September. We are estimating that, of these \$60 million, \$10 million should be paid by the Company and the other \$50 million should be paid by the insurance company. Of course, as we reconstruct the thing, we will present the necessary documents to the insurance company and then they will be paying us. In this, probably you will see some cap ex, I would say temporary cap ex as the Company pays in advance and then we receive the reimbursement from the insurance company. Apart from that, the thing that we will see there probably is going to be just major maintenance cap ex, so it's not expansion, it's not MDPs as we have here in Mexico.

In the case of Colombia, last year we completed the important expansion in the terminal building of Rionegro that was in the international zone. Today, we are also working on the cargo area that will have to be completed at the end of this year. You can see these figures in the 20-F report, and we do not have too much projects in the future as well in Colombia, so basically it will be, again, major maintenance cap ex.

Commercial projects or commercial cap ex in both cases are basically on a case-by-case basis. The one that I remember, in the case of Puerto Rico, we are in the process to construct a terminal, a cargo terminal for FedEx that will have to be completed during the next 12 months, and this is basically space that we will be renting them. In the case of Colombia, we are making some investments to adjust the passenger flow in the commercial area, but not significant in comparison with the other major maintenance cap ex.

Ramon Obeso:

Okay. Thank you very much for the color.

Adolfo Castro Rivas:

You're welcome.

Operator:

Again, ladies and gentlemen, that is star, one if you'd like to ask a question. As a reminder, please pick up your handset before pressing the corresponding digits.

We will now go back to Ruben Lopez of Santander.

Ruben Lopez:

Hi Adolfo, good morning. Thanks for the call. My first question is on commercial revenues in Mexico. We saw a strong acceleration of growth in second Q, and just wanted to get a sense of how do you see the ramp-up process of Terminal 4 and if this growth rate could continue going forward. Also, if you could give us some color on where do you stand on the adjustments you have to make to Terminal 2, given the change of mix in passengers. Thank you.

Adolfo Castro Rivas:

Good questions, Ruben. Terminal 4 is basically completed. The only space that we have not been able to rent is the space we have for a bank branch, so that's the only one that is still pending for the moment, and basically all the rest of the spaces have been rented. The next process in the case of Terminal 4 is basically what we call the fine tuning, so really, to understand what the passenger is looking for in terms of product presence. That is something that we will have to figure out with the quarterly service we do in the case of Cancun.

You are right in the sense of something that I mentioned during the first quarter this year related to Terminal 2. We are still in the process to adjust that. We are in talks with the concessionaires to see which spaces are not working as they should be working, and to see if we have to change the concept there. Basically, I will be in front of a food and beverage guy next week to review, in detail, what is working there and what is not working and if we have to change the concept in order to improve sales in this terminal building, but that will have to be, I would say, during the remainder of this year.

Ruben Lopez:

Really useful, thank you.

Operator:

Now we'll go back to Natalia Zamora of GBM.

Natalia Zamora:

Hi, sorry. Could you please let us know what you expect for traffic in Colombia going forward? Thank you.

Adolfo Castro Rivas:

Well, that's a tough question because, as I said in my initial remarks, what I expect is to start seeing slight positive figures in the fourth quarter, but what I have seen during the last months is a slight recovery, so I hope that, for the fourth quarter, we see a positive—slight positive figures, and I hope a normalized year for next year.

Natalia Zamora:

Okay, great. Thank you.

Adolfo Castro Rivas:

You're welcome.

Operator:

Our next question will come from Stephen Trent with Citi.

Stephen Trent:

Good morning, Adolfo, and thanks for taking my questions. Just one or two from me. If you could refresh my memory, I didn't remember where you guys are with respect to the other potential Colombian acquisition - there was Airplan and another one - and if you could just remind me what's the status of the other concession.

Adolfo Castro Rivas:

Yes, absolutely. If you remember, basically we closed the original deal in April last year, and we had around six months to receive approval from the federal government. This approval took more than six months, and let's say the original agreement basically expired. This agreement was to buy both companies, Airplan and Aeropuertos de Oriente. After that, we decided to go forward with Airplan and to try to, I would say, renegotiate the terms of the second airport group. We tried several times and we made our last offer, I would say, at the end of third week of April this year, and apparently this offer was not what the company was expecting, so for the moment I would say this acquisition is, in my opinion, on hold; I would not say cancelled, but of course, from our side, all what we had to say has been said, so we are waiting, if they want us to go back to the table to renegotiate or not, the offer we made in April this year.

Stephen Trent:

Okay, thank you, Adolfo. Related to that, as you think about the advantages and drawbacks of these overseas acquisitions that you've done, do you envision going after assets in other markets? I know there's a small one in Jamaica becoming available. Anything else or any other regions you might consider?

Adolfo Castro Rivas:

For the moment, as we speak, we do not have anything, but of course, we continue to see if we—if there is any other attractive investment opportunity.

Stephen Trent:

Got it, thank you, Adolfo. Just one last one from me, I remember in a previous call you'd mentioned in Puerto Rico that some of the commercial revenue growth had been above trend, partially because other retail establishments had been offline as a consequence of the hurricane. I'm just wondering where this stands now, if you think we're kind of back to a more normalized trend in San Juan's commercial.

Adolfo Castro Rivas:

In the case of San Juan commercial, everything—every space is in place there, so nothing—no commercial space has been affected to date by the hurricane or the destruction, so the case of the commercial spaces are basically working. That is basically something that you can see in the numbers we published, with a 22% increase on a per-passenger basis.

Stephen Trent:

Great. Thanks, Adolfo. I guess what I was asking is you'd previously said that—or least implied that Puerto Rico is getting at least somewhat of a temporary boost in commercial because surrounding retail in the area was offline and maybe they were a dearth of places to shop. I'm not sure if this is still the case or if it's more of a normalized situation now.

Adolfo Castro Rivas:

Well, what I said about Puerto Rico in the initial remarks was that car rental and car parking, in my opinion, is extremely strong, and this is basically, I believe, from the people that were sent from the federal U.S. government to support the reconstruction process of the island, and that probably in the future we will not see that.

Stephen Trent:

Okay, apologies. I had missed that earlier comment. I'll stop there. Thanks for the color, Adolfo.

Adolfo Castro Rivas:

You're welcome.

Operator:

We'll go now to Mauricio Arellano of HSBC.

Mauricio Arellano:

Good morning, Adolfo. Thank you for the call. I was wondering if you would consider bidding for the concession for the Mexico City Airport, if it's decided to be auctioned, if you could give us any color into that.

Adolfo Castro Rivas:

Well, we would have to wait until they decide what are they are going to do for this project. What I have heard in the latest news for the last week is that they will take this decision in October this year, so we will have to wait for that.

Mauricio Arellano:

Is it something that you would be interested in, though, assuming that it is decided to be optioned?

Adolfo Castro Rivas:

In the case, of course, first of all, we will have to see what are the terms and the conditions of the proposal, but of course, what I believe is that the entire world will be interested in that project in the case that it's auctioned.

Mauricio Arellano:

Perfect, thank you, Adolfo.

Adolfo Castro Rivas:

You're welcome.

Operator:

Once again, that is star, one if you'd like to ask a question. We'll pause for a moment.

It appears that we have no further questions. Adolfo Castro, I'd like to turn the call back to you for any additional or closing comments.

Adolfo Castro Rivas:

Thank you, Cathy, and thank you, everybody, for joining us today on this conference call for our second quarter results of 2018. Have a great week. Goodbye.

Operator:

Again, ladies and gentlemen, that does conclude today's call. We would like to thank you again for your participation. You may now disconnect.