

Conference Call Transcript

ASR - Q3 2010 Grupo Aeroportuario del Sureste (ASUR) Earnings Conference Call

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Speaker: Adolfo Castro, CFO

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the ASUR third quarter 2010 results conference call. (Operator Instructions)

For opening remarks and introductions, I would like to turn the call over to Mr. Adolfo Castro, chief financial officer. Please proceed, sir.

Adolfo Castro - ASUR - CFO

Thank you, Noelia, and good morning, everybody. Thank you for joining us today for the conference call for our third 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 management's current expectations and beliefs and are subject to a number of risks and uncertainties that could cause actual results to differ materially, including risks that may be beyond our company's control. For an explanation of these risks, please refer to ASUR's filings with the Securities and Exchange Commission and the Mexican Stock Exchange.

I will start today with a brief commenting on recent developments, including the bankruptcy of Grupo Mexicana and the consummation of the sale of Copenhagen Airport's interest in ITA to our CEO and chairman. Afterwards, I will discuss passenger traffic performance and the results for the quarter.

As you know, on August 28, Compania Mexicana de Aviacion suspended operations and was granted bankruptcy protection on September 7th. Mexicana Inter and Aerovias Caribe also filed bankruptcy protection. Mexicana group represented 10.88% of ASUR's revenue for the eight-month period ended August 31st, 2010, primarily from domestic passengers. As a result, this quarter we made the corresponding provisions for each of the three companies through which Grupo Mexicana operated.

Grupo Mexicana operated 21 routes to our airports, the majority of which were also operated by other carriers. As a result, we believe that the ultimate impact for the suspension of operations will not be the same proportion as the number of flights cancelled. However, we cannot be sure that competing carriers will seek to increase their flight schedules. We have also estimated that 128 million pesos could be at risk of not being recovered, and this quarter increased the reserve for doubtful accounts in that amount.

In terms of ITA, as we announced on October 13th, ASUR's CEO and Chairman, Mr. Fernando Chico Pardo, consummated his acquisition of the 49% stake in ITA, ASUR's strategic holder, which was previously held by Copenhagen Airports. Mr. Chico Pardo now owns 100% of ITA shares. ITA, in turn, owns 100% of ASUR's class BB shares, representing 7.65% of ASUR's capital stock.

We have initiated discussions with the SCT with the objective of diminishing or delaying the committed investments at Veracruz and Villahermosa airports, following the reduction in infrastructure needs as passenger traffic has decreased since the moment when the master development program was presented. We are not sure what will be the final outcome of this process.

Now, moving to the results. As expected, this was a good quarter, with the passenger traffic up by 10.78% year-on-year. With the quarter, traffic rose 16.2% in July, 8.9% in August and 5% in September. We continue to see a recovery in the international traffic, up to 20.9%, this mainly driven by a strong performance at Cancun Airport. Results reflect easier comps, as 2009 traffic was affected by the H1N1 influenza outbreak and the economic crisis. Domestic passenger traffic posted a small contribution to overall traffic growth by up 1.3%, still reflecting high domestic airlines fares and a slow economic recovery of the Mexican economy. Growth was driven by increases at Cancun, Merida and Tapachula airports. As a result of this, international passenger traffic rose to 53% of the total from the 48% of the third quarter 2009.

Passenger traffic between Mexico, Canada and the United States represented 87.5% of total traffic compared with the 89.7% in the third quarter 2009. Looking ahead, we expect positive traffic figures, still driven principally by easier year-on-year comps on the international origin destination.

However, we remain somewhat cautious in terms of the outlook for the domestic passenger traffic for the remainder of the year as a result of the exit of Mexicana de Aviacion. Remember that September is a month in which airlines in Mexico do not operate at full capacity, and we're able to easily capture passengers left by Mexicana. In December, however, airlines operate at full capacity, which could possibly result in a supply constrain and lower traffic.

Consolidated revenues increased 33.7% this quarter, driven by an increase of 15.6% in aeronautical revenues and 18.5% in non-aeronautical revenues. Commercial revenues per passenger were -- remained strong, up 7.6% year-on-year to 60.11 pesos, but below the 61.17 pesos reported in the second quarter of the year and the record high of 61.34 pesos achieved in the fourth quarter 2009. This quarter we continued to expand commercial space, adding 18 Telmex internet booths and new currency exchange spaces at Cancun Airport.

Operating costs and expenses rose 50.6% year-on-year this quarter. This mainly reflects the 128 million pesos increase in the reserve for doubtful accounts as a result of the bankruptcy announced by our client Grupo Mexicana de Aviacion. Additional energy consumption from the operation of the second runway at Cancun Airport, provisional fees, and maintenance costs also contributed to the increase.

Operating costs and expenses were also impacted by the application of the INIF 17 related to the service concession contracts whereby we are now including in our income statement a new line reflecting the income from improvements to concession assets. The same amount is also included in a new expense line.

Therefore, this quarter revenues included 122 million pesos, which were offset by the same charge to the operating costs and expenses. Excluding the increase in the reserve for doubtful accounts and the impact from applying INIF 17, operating costs and expenses would have declined 6.7 year-on-year.

Operating profit for the quarter rose 7.2% to 298.4 million pesos, while operating margin declined to 31.2% from the 39.0% in year ago quarter. EBITDA margin, in turn, was down by 42.3% from the 60.8% in third quarter 2009. Let me remind you that while the 122.2 million pesos were included in this quarter in construction revenues and expenses as a result of INIF 17, there isn't a corresponding increase in the EBITDA thus negatively impacting EBITDA margin.

This quarter we made capital investments of 121 million pesos as we continue with the terminal expansions in Vera Cruz, Villahermosa and Oaxaca airports begun in the first quarter of this year and the passenger flows operation at Cancun Airport.

In terms of our balance sheet, cash and short term investments at the end of the quarter increased 24.1% to 1,537.7 million pesos. At the same time, Cancun Airport took two three-year bank loans this quarter for a total of

920 million pesos. We also made capital payments of 545 million pesos on bank debt this quarter, thus repaying the three bank loans obtained during 2009. As a result, total bank debt at the close of the quarter rose by 53% to 922.7 million pesos, but at better terms.

Now, let me open the floor for questions. Please, Noelia, go ahead.

QUESTION AND ANSWER

Operator

Thank you. (Operator Instructions)

Your first question comes from the line of Vanessa Quiroga from Credit Suisse.

Vanessa Quiroga - Credit Suisse - Analyst

Hi. Good morning, Adolfo. Thank you for the call. My question is regarding that technical assistance fee. With the change in the ownership of ITA, has there been any modification to the scheme of the technical assistance fee? Does it continue to be 5% of revenues -- sorry, 5% of the profits paid to ITA by the Company?

Adolfo Castro - ASUR - CFO

Hi, Vanessa. Good morning. As we have announced previously, the agreement that we have enter with ITA remains the same. The change in control does not have any impact on this agreement.

Vanessa Quiroga - Credit Suisse - Analyst

Okay. Thank you.

Operator

Your next question comes from the line of Erik Keener from River Road Asset Management.

Erik Keener - River Road Asset Management - Analyst

Good morning, Senor Castro. I appreciate you taking the questions. My first question, sorry, has to do with all of the accounting changes that we saw take hold in this quarter, with the effect to taxes and with the effect to depreciation and amortization. Do you foresee any impact on the dividend policy going forward as a result of these changes?

Adolfo Castro - ASUR - CFO

Okay. Good morning. Very good question. First, these changes are because of new rules, new accounting rules, and we have to adopt them. We have basically, as we have announced previously, we have two different effect. The first one is that anything that we do at the airports in terms of improvements or new constructions are going to be increasing the revenue side and also the cost side by the same amount.

In my personal opinion, this new rule tries -- or was written by someone that was thinking about the construction company holding a concession where they have some kind of margin on the construction in their concession assets,

which is not the case of us. We are not constructing anything or we do not reflect any margin on what we do. So that's why basically what you see is the same amount.

The second change is changing the depreciation or amortization rates in the concession assets. Let me explain myself. In the past when we've bought, let's say, a table or a computer, we were thinking about a ten years depreciation or three years depreciation. This new rule says that everything that we buy or acquire or construct is related to the concession.

So now this ten and three years amortization rate will be the remaining of the concession period, which today should be 38 years and a half. So that's why you are seeing or you will see in the future a lower depreciation in our P&L compared with previous years.

The third comment is you mentioned taxes. In the case of taxes, this is not coming from the INIF 17. This is coming basically because Cancun Airport is changing the -- is changing from paying IETU to generating income tax and now deferred taxes are playing an important role there. And that's why you are seeing a lower tax amount in the P&L for the quarter.

In terms of dividend policy, you know that we do not have written dividend policy. This is something that we analyze every year. Once the year's over, we see the results, we see what we have in front, and then we make our proposal to ITA and then to the operations committee, to the board of directors, and finally to the shareholders assembly. What is important to say here is that as a result of changing the rates of depreciation and amortization, you will see an increase in retained earnings. Why? Because basically we, let's say, deleted the charges that we have made for two years in the past, and this was transformed in retained earnings. So that is giving an additional possibility to pay dividends. But that doesn't mean that we will be paying those dividends or that we will decide to present our proposal in that respect to the board of directors. This will be analyzed at the beginning of next year. But it's true that this change in the accounting standards is a result of an increase on the retained earnings.

Erik Keener - River Road Asset Management - Analyst

Okay. That's very helpful. Also, at the 10-year celebrations, and unfortunately I was not able to attend those, I believe management discussed the Riviera Maya project and the potential for other, perhaps more attractive projects, in Panama, Brazil and the Dominican Republic.

I don't know what you can discuss on those in detail or if there have been any specific projects that the Company has looked at to date, but I guess my question would be: what is the long term strategic aspiration for the Company? Does the Company aspire to be a Latin American regional airport operator? Does it -- do the Company's aspirations go beyond airports? Are there going to be more potential hotel, convention center, that sort of development in the Company's longer term future?

Adolfo Castro - ASUR - CFO

Okay. Too many questions on the same one. Let me start with the beginning, Riviera Maya. We are in the process of the bidding for the Riviera Maya Airport concession that started May this year. And we believe that this will last up to the first quarter next year. So, the effects of this project in our results will be the following.

First, from May up to the end of the first quarter next year, we will be adding some costs related to the preparation of the offer. We have to hire architects. We have to hire lawyers. We have to have -- to hire some of the people to prepare the document that will be presented to the corresponding authorities.

Then, if the concession is granted during the first quarter next year -- you may remember that last year when we concluded our maximum tariff revision we presented a press release, saying that the SCT accepted to adjust our maximum tariff within 90 days after the concession is granted in the case of Cancun Airport. So, if this happens 90 days after, let's say, second quarter next year, our maximum rate in the case of Cancun Airport will be adjusted to reflect the effects of this new airport into the region.

Then we have two options. The first one is if they allow us to participate or if we finally participate, (inaudible) and if we win, then we will have to invest into this project. The investment amount is something between 260 million dollars to 300 million dollars. That should be invested in a period that I believe would be two to three years. If we lose, we will have to wait until this airport starts operation, and then the effects are going to be that we will be losing the commercial revenue for the passenger that chooses to go to the new airport. That's more or less the situation.

What we believe is the following. First is if this airport is constructed or if this airport starts operation, it's very clear that we will lose something. We will lose the value of this commercial revenue for the passengers that will go to the new airport because we do not believe that this new airport will create or generate additional passengers. So we will be talking about the same market.

It's important to say that what we believe in terms of the regulated revenue is that the government will adjust our maximum rate and we will not lose the economic value on this part of the revenue side.

To link this of what you have said in terms of additional projects is the following. First, you know that as from May 2009, we decided to start increasing the leverage of this company. The increasing leverage will be that a portion of the CapEx of the year should be funded by debt. If I can see some positives on this specific project, in the case that we are awarded or that we win the concession of Riviera Maya, we will be able to adjust this in a different way, in a faster way. That will be one of the effects. And the second one is that we are and we will be evaluating this specific project as an independent one.

So divide this thing in two pieces. On the first part is we will have to recognize that we will be losing the commercial revenue. But on the other side, we will have to evaluate this as any other investment. So, that's why we said, okay, what do we have in front and where we can be investing on. And then there were some names. Brazil is coming or should be coming. Anything on Puerto Rico, Guatemala, whatever. So, yes, it's true that what we want is to expand and -- to expand and grow this business.

And finally, my last comment will be that we are thinking about the same core of business. I don't believe that we will be trying to operate or to be became the largest convention center in -- convention center operators in the future. That's not the case. In the case of something different to airport concessions are -- is just that we have made in Huatulco, basically trying to support the operation of the airport. But the main focus will be on airport concessions, I would say, in some Latin American countries.

Erik Keener - River Road Asset Management - Analyst

Okay. Perfect segue. I had hoped to ask about status of the Huatulco development.

Adolfo Castro - ASUR - CFO

The status is we have not made too much progress. We've concluded the MDP for the piece of land. We are approaching people to put some money there, and then to try to find an operator. And also we are trying to make some agreements with FONATUR in order to make a joint effort to develop what we have bought.

Erik Keener - River Road Asset Management - Analyst

Okay, that's very helpful. My last question is another short one. In the wake of all of the drug violence that we've seen mostly in the northern part of the country, have you made any security adjustments at your airports and passed that information along to airlines or tourists to make them feel more comfortable with traveling there?

Adolfo Castro - ASUR - CFO

No, we have not made any adjustment. You know that we are in the southeast region of the country. I don't want to say that the southeast region of the country is better than the north, but it's true in that sense. We are working in a normal condition. Of course, always compliant with all the rules that we have to comply with.

Erik Keener - River Road Asset Management - Analyst

That's very helpful. Thank you for all of your answers, Senor Castro.

Adolfo Castro - ASUR - CFO

You're welcome.

Operator

Your next question comes from the line of Luis Nanes from GBM.

Luis Nanes - GBM - Analyst

Hi, Adolfo. Good morning. I have a question regarding the CapEx. What is your expectation for the last quarter of the year? Thank you.

Adolfo Castro - ASUR - CFO

Well, Luis, you have the numbers on our press release on April the 2nd, April the 4th last year in terms of the committed investments is what we have to comply with. In that sense, my only comment is what I have mentioned during the beginning of this conference in terms of that we are asking for a reduction or a delay in the case of two airports.

If we are successful in this, we will be able to reduce this by around 250 million pesos. So you can deduct from the number that has been published in the document that I have mentioned around 250 million pesos. So with that you would have the total amount that we have to invest this year. And you have to deduct, finally, what we have achieved up to the third quarter this year.

Luis Nanes - GBM - Analyst

Thank you.

Operator

Your next question comes from the line of Steve Trent from Citigroup.

Angela Lieh - Citi

Hi. Good morning. This is Angela Lieh representing Steve Trent.

My first question is looking at the Riviera Maya Airport tender, would you believe that global airline consolidation and now an FAA downgrade of Mexico's aviation safety rating might now make this project even less able to attract incremental commercial traffic?

And my second one would be if you would have any comment on potential overseas projects, for example, Columbia or Brazil, and what might be a source interest in participating? Thank you.

Adolfo Castro - ASUR - CFO

Okay. In the case of Riviera Maya, well, mention two of some of the additional problems that are now in the aviation industry in Mexico. It's clear that this is not the best time for to launch a project like this. But this is something that we do not have a say on. The government decided to initiate the process, and then we will have to complete the process and then to see if we're going to participate or not or if we are going to invest or not, etcetera. So it's true. The only thing that I can say is it's true. It's not the best time to launch a project like this.

In the case of the other, I do not have something in front of me right now. We have seen many, many projects. But for the moment I do not have something tangible, let's say, that can be completed in the short term.

Angela Lih - Citi

Okay. Thank you. And if I may just an additional quick question would be that we understand that Cancun is the busiest airport of the entire country after Mexico City Airport itself. However, could you give us a broad sense as to how many commercial airlines currently service Cancun, 50, 75 airlines or more?

Adolfo Castro - ASUR - CFO

More than that, probably 120. Cancun is the second busiest airport in Mexico and is the first one in terms of international passengers.

Angela Lih - Citi

Oh, okay. Thank you very much.

Adolfo Castro - ASUR - CFO

You're welcome.

Operator

Your next question comes from the line of Augusto Ensiki from Morgan Stanley.

Augusto Ensiki - Morgan Stanley - Analyst

Hi. Good morning. I apologize. I missed part of the call. You were mentioning something regarding a tariff revision, a potential tariff revision. Could you repeat what you said and maybe give some more details on that?

And then actually I have a follow-up question second to that.

Adolfo Castro - ASUR - CFO

Absolutely. Last year when we concluded our maximum tariff revision we negotiated and the SCT agreed to adjust our maximum tariff in the case of Cancun Airport because of the Riviera Maya Airport. You can see a press release

that was published at the beginning of April last year and you will find the text on what we have agreed with the SCT. That's what I can say. I don't know what's your question.

Augusto Ensiki - Morgan Stanley - Analyst

Okay, I'm sorry. I thought it was something more referring to the downturn in traffic this year and if that would impact any potential revision for next year.

Adolfo Castro - ASUR - CFO

No. The revision is basically resulting from the Riviera Maya Airport in the sense that this airport may have an impact on Cancun's passenger traffic. So we will have to include this effect into our future rate.

Augusto Ensiki - Morgan Stanley - Analyst

Understood. But that would only take effect after the concession, ... after construction of the airport?

Adolfo Castro - ASUR - CFO

No, the agreement says within 90 days after the concession is granted.

Augusto Ensiki - Morgan Stanley - Analyst

I see. Okay, so, it could be relatively soon. And then -- okay, thank you for that.

And one question is referring to the release, the section on regulated revenues. You have here regulated revenues for nine months of this year, 2.9 billion pesos. And that seemed uncharacteristically high relative to history. Just wanted to confirm that number is, indeed, correct.

Adolfo Castro - ASUR - CFO

You are saying in the press release --

Augusto Ensiki - Morgan Stanley - Analyst

Yes, regarding tariff regulation -- regulated revenues for nine months of this year.

Adolfo Castro - ASUR - CFO

Hold one second. I'm checking. Apparently you are right. Let me make a double check on this number. I will let you know.

Augusto Ensiki - Morgan Stanley - Analyst

Okay. And one last question regarding traffic for the -- I guess traffic through the rest of the year, and then following up on the safety rating downgrade by the FAA. Does that preclude -- I know that restricts Mexican airlines from initiating new international routes. But does that also prohibit American airlines from establishing new routes to Cancun, say?

Adolfo Castro - ASUR - CFO

It's just for the Mexican airlines.

Augusto Ensiki - Morgan Stanley - Analyst

Just for Mexican airlines, okay. Great. Thank you very much.

Adolfo Castro - ASUR - CFO

You're welcome.

Operator

Your next question comes from the line of Alan Solis from Credit Suisse.

Alan Solis - Credit Suisse - Analyst

Yes, good morning, Adolfo. Thanks for the call. I have just a follow-up question on the strategy to leverage the Company. What would be your target capital structure in terms of debt to total capitalization and net debt to EBITDA ratios?

Adolfo Castro - ASUR - CFO

I do not have a specific number for that, Alan. If you see around the world airports are leveraged, let's say, from 2 to 9 times EBITDA, the only thing that I can say is that I will be very cautious on this in the sense that we have seen September 11, Hurricane Wilma, the swine flu effects, blah, blah, blah. So we cannot be, of course, at 9 times EBITDA, but something between 2 to 4 could be a number. Of course, depending on the results of the Company.

Alan Solis - Credit Suisse - Analyst

Okay. Fair enough. Thank you, Adolfo.

Adolfo Castro - ASUR - CFO

You're welcome.

Operator

And at this moment there are no questions on the line. Mr. Castro, I hand the call back to you for closing remarks.

Adolfo Castro - ASUR - CFO

Okay, thank you, Noelia. And thank you for everybody. Let's discuss our fourth quarter results in January.

Thank you for being here. Have a good day.

Operator

Thank you for your participation in today's conference. This concludes your presentation and you may now disconnect. Have a great day.