

Corporacion America Airports

Third Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Gimena Albanesi – *Investor Relations*

Martin Eurnekian - *President and Chief Executive Officer*

Raul Francos – *Chief Financial Officer*

Jorge Arruda – *Finance and M&A Manager*

PRESENTATION

Operator

Good morning and welcome to the Corporación América Airports' Third Quarter 2018 Earnings Call. A slide presentation accompanies today's webcast and is available in the Investors section of Corporación América Airports' Investor Relations website at <http://investors.corporacionamericaairports.com>. As a reminder, all participants will be in a listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. And, as a reminder, today's call is being recorded.

At this time, I would now like to turn the conference over to Gimena Albanesi of Investor Relations. Please go ahead.

Gimena Albanesi

Thank you. Good morning everyone and thank you for joining us today. Speaking during today's call will be Martin Eurnekian, our Chief Executive Officer and Raul Francos, our Chief Financial Officer. Also with us today is Jorge Arruda, Finance and M&A Manager. All will be available for the Q&A session.

Before we proceed, I would like to make the following Safe Harbor statement. Today's call will contain forward-looking statements, and I refer you to the forward-looking statement section of our earnings release and recent filings with the SEC. We assume no obligation to update or revise any forward-looking statements to reflect new or changed events or circumstances.

I would also like to remind you that following the recent categorization of Argentina as a highly inflationary economy in accordance with IFRS standards, commencing July 2018 we began applying IFRS rule IAS 29. This rule applies retroactively starting January 1st this year. For comparison purposes, in addition to presenting 'As Reported' results, we are also disclosing the isolated impact of the adoption of hyperinflation accounting in Argentina and our results excluding rule IAS 29. Additional information in connection with the application of rule IAS 29 can be found in our earnings report. Note that for comparison purposes and a better understanding of our underlying performance, in our presentation today we will be discussing results excluding hyperinflation accounting in Argentina.

With that being said, I would now turn the call over to our CEO, Martin Eurnekian.

Martin Eurnekian

Thank you, Gimena. Hello everyone and thank you for joining us today. It is a pleasure to welcome you to Corporación America Airports third quarter 2018 earnings conference call. I will begin my presentation with a discussion of the highlights of the quarter, and then Raul will take you through our financial results. Afterwards, I will provide an update on our key business segments and our view for the remainder of year. We will then open the call to your questions.

Starting with slide 3. We faced an increasingly challenging macro environment in some of our key markets this quarter, particularly in Argentina, where we are experiencing significantly weaker travel dynamics and, to a lesser extent, in Brazil. This resulted in the sequential deceleration in total passenger traffic growth of 1% to almost 6% year-on-year this quarter. Against this factor, revenues posted a high single-digit year-on-year decline. In Argentina, we are seeing a drop in international travel along with a mix-shift to domestic destinations. Revenues were also affected by the FX translation impact on local currency in Argentina as well as in overall revenues in Brazil, resulting from the strong currency devaluations experienced in both countries.

Looking at profitability, we turned in another quarter of margin expansion with EBITDA margin ex-IFRIC up more than 430 basis points to over 40%, driven by strong margin expansion in our core markets, Argentina, Brazil, and Italy. In addition, as our cost structure is based in local currency, we benefit from the strong currency depreciation in Argentina. Excluding inflation accounting in Argentina, adjusted EBITDA margin ex-IFRIC expanded over 460 basis points year on year to almost 41% and adjusted EBITDA increased by high single digits. With the goal of expanding our airport platform for the long-term growth and to enhance the service we provide to our passengers, we made capital expenditures of \$51 million in the quarter. Investments were largely centered in our airport infrastructure in Argentina and Italy.

As you can see on slide 4, passenger traffic increased across the majority of our countries of operation. In Argentina, however, traffic growth continued to decelerate to almost 6%. We saw continued slower travel demand along with an ongoing mix-shift from international to domestic traffic, as passengers look for more affordable travel alternatives. In Brazil, traffic was up mid-single digits mainly driven by growth in domestic traffic at Brasilia Airport. Italy continued to report traffic growth of over 3%, mainly driven by higher international traffic supported by the addition of new routes and airlines which more than offset softer domestic traffic. In Uruguay, traffic contracted almost 5% year-on-year, impacted by a continued lower passenger demand from key markets Argentina and Brazil. Our other markets, however, posted solid traffic growth in the quarter. Passenger traffic in Ecuador was up 10% year-on-year, benefitting from easier comps as traffic in the year ago quarter had been impacted by the cancelation of international flights as Hurricane Irma hit Florida. Peru also posted a robust performance, with traffic up 10.3% year-on-year, as new frequencies and promotions by local airlines are driving higher demand, further supported by an improving macro backdrop. Finally, in Armenia we saw a temporary spike in traffic of almost 14% but expect traffic growth to normalize to recent levels.

I will now hand off the call to Raul Francos, who will review our operations and financial results. Please Raul, go ahead.

Raul Francos

Thank you, Martin. Good day everyone. As Gimena mentioned at the beginning of our presentation, for a better understanding of our performance we will discuss our results excluding the impact of hyperinflation in Argentina. Now turning to slide 5, total revenue declined close to 8% year-on-year to nearly \$390 million and almost 4% when also excluding construction revenues. We continued to experience a sharp currency depreciation in Argentina and Brazil this quarter – with a yearly average devaluation of 85% in Argentina and 26% in Brazil.

Aeronautical revenue fell mid-single digits, as the good performance in Uruguay, Ecuador, and Armenia was more than offset by the lower revenues obtained in Argentina and Brazil. Lastly, despite the increase in traffic, Italy continued to face tough comps this quarter as marketing support expenses are deducted from revenues reflecting a change in marketing agreements, while in the year-ago quarter they were included in SG&A. Following a similar trend, commercial revenues declined 3% year-on-year, reflecting a weaker performance in Argentina and the FX translation impact in Brazil. By contrast, commercial revenues in Armenia rose by over 40% driven by higher fuel demand and prices while Italy is benefitting from our investments to enhance service offering to passengers, coupled with higher traffic growth.

As you can see on Slide 6, our cost structure continued to benefit from the strong depreciation in Argentina and Brazil. This brought about a 12% year-on-year decline in total operating costs and expenses. Cost of services ex-IFRIC fell 5% driven by a decline in salaries and lower concession

fees in both Argentina and Brazil, partially offset by higher costs in Armenia. Concession fees declined in Argentina as a result of the devaluation impact on revenues. Lower concession fees in Brazil reflect a change in the passenger curve used to calculate the amortization of the intangible asset. SG&A also benefitted from currency depreciation declining 18% in the period, mainly as a result of lower salaries and sales taxes in Argentina. Italy also contributed to the reduction in SG&A given as this quarter marketing support expenses were deducted from Aeronautical Revenues.

Turning to profitability on slide 7, we delivered a 9% year-on-year increase in adjusted EBITDA ex-IFRIC, reaching \$137 million in the quarter. Brazil and Armenia were the main contributors to this increase, further supported by Uruguay and Italy. This was achieved despite softer adjusted EBITDA growth in Argentina reflecting difficult market dynamics. Importantly, adjusted EBITDA margin ex-IFRIC expanded almost 470 basis points to almost 41% from 36% in the same quarter of last year. This was mainly driven by significant margin expansion across our three key markets, Argentina, Brazil and Italy, that more than offset a margin contraction in our other operations. Note, however, that margin expansion in Argentina is anticipated to moderate as inflation continues to catch up with the currency devaluations. Also, while we turned in strong operating results, our bottom line was negatively impacted by a higher financial loss that resulted from increased non-cash FX losses related to our U.S. dollar denominated debt in Argentina. This was slightly offset by lower income tax expenses recorded in the quarter.

As you can see on slide 8, our healthy balance sheet provides a solid platform to continue carrying out our strategic initiatives. Total debt at the close of the quarter was relatively stable at \$1.2 billion dollars. Our net debt to last twelve months adjusted EBITDA ratio increased slightly to 2.1 times from 2 times in the prior quarter, mainly due to the impact of inflation accounting on adjusted EBITDA. Excluding this effect, the debt ratio was 1.9 times reflecting higher cash generation in the period. We keep a conservative maturity profile with less than 10% of our debt maturing within the year, and an adequate currency mix, with about 59% of our debt denominated in U.S. dollars, 25% in Reais and 16% in Euros.

Let me now turn the call back to Martín, who will go over performance at our key business segments and will comment on our outlook.

Martín Eurnekian

Thanks, Raul. Let me now review the performance of our key business segments, starting with Argentina on slide 9. We saw an 8% year-on-year decline in revenues ex-IFRIC despite the 6% increase in passenger traffic, as business dynamics remain impacted by several factors. First, we are experiencing a stronger mix-shift from international to lower price domestic destinations. As a result, domestic traffic increased over 14% while international traffic contracted almost 7%. Second, aeronautical revenues from domestic passengers and a portion of our commercial revenues that are peso denominated remain affected by the FX translation impact from the sharp peso devaluation. And finally, in this context we are seeing a mix-shift in cargo volume with higher export activity and a lower number of higher-margin imports.

Despite these changed market dynamics, adjusted segment EBITDA ex-IFRIC was relatively flat at \$79 million dollars in the quarter, reflecting higher cost dilution from our cost structure in Argentina, which continues to benefit from the peso devaluation. Adjusted segment EBITDA margin for Argentina expanded close to 400 basis points to almost 45% in the quarter. Note, however, that we expect margin to normalize going forward as inflation catches up with the peso devaluation.

Maintaining our goal of further enhancing our airport infrastructure, we made capital expenditures of almost \$47 million this quarter in Argentina. Investments were mainly targeted to the construction of the new departure terminal building at Ezeiza Airport, which we expect will be finalized by mid-next year and will allow for a more efficient traffic flow, while offering a better travel experience to our passengers. This quarter we also continued with the remodeling of the terminal buildings at Iguazú and Mar del Plata airports, and are making headway in the construction of the new terminal building and expansion of parking space at Comodoro Rivadavia Airport. We continue advancing with capex execution to absorb future passenger traffic growth. Until the overall Capex program is approved, we are supporting the Government's Airplane Revolution Plan investing above the minimum contractual requirements and in line with the Capex plan we are developing closely with the government. Investments are mainly focused on Buenos Aires and specific airports in other regions in the country and are funded with cash flow from operations. We are also pleased to report that El Palomar Airport, which is mainly focused on low-cost airlines, has been recently qualified for international routes and expect to start operating flights to neighboring countries Uruguay, Chile and Paraguay by the end of the year.

Now, please turn to slide 10. Passenger traffic growth in Brazil slowed to 5% reflecting greater uncertainty in a pre-election environment. Revenues in turn were down 11% year-on-year impacted by the FX translation effect from the depreciation of the Brazilian real. However, on a local currency basis, revenue was up over 10%, reflecting the increase in passenger traffic and the positive contribution from recent commercial initiatives, particularly in advertising, VIP lounges, and space rentals. Adjusted segment EBITDA in Brazil was up by 75% year-on-year, reaching \$6.3 million in the quarter. Higher operating leverage, mainly from a reduction in the concession fee as Raul just explained, together with lower SG&A, allowed us to deliver a strong expansion in adjusted segment EBITDA margin, which doubled to 21% from 11% in the year-ago quarter. Keeping up with our Capex program, this quarter we invested close to \$3 million for the construction of runway safety areas and engineering projects at Brasilia Airport. In terms of the expansion of the terminal at Brasilia Airport to accommodate an additional shopping area accessible from the outside, following the recent presidential elections we are currently reassessing the scope of this project and expect to define how to best approach it over the next few months.

Now, moving on to Italy on slide 11, passenger traffic continued to grow at a healthy pace, up 3.2% year-on-year. We also achieved a good top line performance. The redesigned VIP lounge, recently opened retail stores, and new space for duty free shops continue to generate revenue growth. Comparable revenues ex-IFRIC and excluding marketing support expenses were up 6% in the quarter. We are also pleased to report higher profitability this quarter supported by solid traffic growth, a pick-up in commercial revenues, and higher operating leverage. Adjusted segment EBITDA was up 5% and adjusted segment EBITDA margin ex-IFRIC expanded by over 460 basis points to 37% in the quarter. Moving ahead with our Capex program, we invested close to \$5 million in the quarter for expansion of the terminal at Pisa Airport and master plan development at Florence Airport. We expect to obtain the final project approval for the new runway at Florence Airport before the end of the year and to start construction in the first quarter of 2019.

Please turn to slide 12. While we do not provide specific guidance, given the challenging environment in Argentina and to a lesser extent in Brazil, we are providing some additional color this quarter. In Argentina, we expect to see a stronger mix-shift to more affordable domestic destinations in the fourth quarter. Gradually, we should begin to see a slow pick-up in inbound international traffic as travelling to Argentina becomes more affordable on the back of the weak

peso. We expect these trends to continue in the remainder of 2018 and to deepen in 2019. Based on a slowly improving macro environment, we should expect to start to see a recovery in Argentina in the second half of next year, resulting in a low-single digit decline in traffic growth for next year. By contrast, with elections over in Brazil and the economy slowly recovering, we expect to see traffic growth to begin accelerating towards the end of the year, particularly in terms of international passenger traffic, with the addition of four new international routes. At the same time, we expect to continue seeing solid traffic trends in our other markets. We remain focused on further strengthening our global airport platform, developing new routes and frequencies while providing our passengers with a great travel experience. This is further underscored by our strong balance sheet.

We are now ready to take questions. Operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. To ask a question, you may press star (*) one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) two (2). In order to allow all listeners to participate, please limit yourself to one question and one follow-up question. You may re-queue for additional questions. At this time, we will pause momentarily to assemble our roster. And the first question comes from Ian Zaffino with Oppenheimer. Please go ahead with your question.

Mark Zhang

Hi. Good morning guys. This is Mark Zhang on for Ian. Thanks for taking our questions. So, a very good quarter again, very solid. I would just like to, I guess, touch upon the profitability you guys mentioned on the call and the press release. How it's expected to be impacted by inflation as it catches up and maybe lower some operating leverage, you know, down from sequentially this quarter. So, I'd just like to understand what are some of the expectations going forward and are there any other levers you could pull to maintain that level of profitability? Thank you.

Martin Eurnekian

Well, thank you for the question. It's really a tough question you're asking. Forecasting inflation seems very difficult with the current environment in Argentina. We have seen high inflation numbers so far, but we are also seeing recession numbers in the economy that should curb the growth of inflation but it is very difficult to see. The dynamics we've seen in the last couple of years were that after devaluation, in a period of time inflation would catch up in dollar terms, but it is very difficult to forecast for next year what will happen.

Mark

Okay, that's fair. And then just a little bit on the top line, you guys are doing a great job in adding new flights and frequencies. I just wanted to see what the sort of expectations going to maybe the end of the year, fourth quarter '18, what the sort of activity has been going forward and the expectations relative to performance this quarter? Thank you.

Martin Eurnekian

Well, our expectations are that the dynamics we're seeing throughout the year will continue. We are seeing a slowdown in international traffic, mainly due to the devaluation of the peso but we keep seeing domestic growth. We keep seeing airlines continuing with their plans to establish themselves in Argentina to fly domestic. Norwegian, for example, and a couple of other airlines

that are working their way through starting to fly in Argentina, so we are still optimistic in the domestic side of traffic, as we have seen this year. So, we do not expect those same dynamics to change in the fourth quarter.

Mark

Okay, great. Thank you, guys, and I'll jump into the queue again.

Operator

And the next question comes from Charles Cartledge with Sloane Robinson. Please go ahead with your question.

Charles Cartledge

Thank you and thank you very much for the presentation today. So, you point to increased cost pressure in Argentina, which I understand. So, if you are free to price as you wished, presumably you would compensate for these cost pressures with increased revenues, probably through increased passenger ticket revenues. I just want to clarify, to do that, if you wanted to do that, particularly on domestic fees or passenger fees, would you need alternate approval and if so, what are you doing to get alternate approval, because obviously you're operating under a fixed IRR regime. I believe that you're overdue a bit of a catch-up with regard to recessing that regime in the current year with all the dislocations that you're having to manage with the devalued currency. So, if you could just walk me through the procedure for, for example, raising passenger fees on domestic routes. That would be helpful. Thank you.

Martin Eurnekian

Well, it's the regulatory body that has to do the annual analysis and come up with an answer. We are waiting for that. But it also, the fact that most of our revenues are in dollars play a role in, particularly automatically increasing our status in pesos, and also play a role in the fact that our costs dilute in pesos; that's why we are also seeing an increase in margins in this quarter, for example. So, that dynamic is not that clear, although we have to wait for the regulator to do its analysis and come up with an answer.

Charles Cartledge

As a follow-up question, I'd just like to ask, I mean, I believe AA2000 has not had a regulatory reset for a couple of years now, but it's meant to happen every year, so is there any scheduled meeting with your regulator to make sure that you're on track on your IRRs and if not, then to reset passenger fees or landing fees appropriately? Thank you.

Martin Eurnekian

Well, we'll definitely work towards having them do their job, but since it is not within our power to force them, and also there can be temporary disadjustments of the IRR. We are definitely talking to them and hoping that they do their work and come up with a revision on the economic equilibrium of the concession. We hope that they basically finish up their job and establish a revision as soon as they are ready.

Charles Cartledge

Thank you.

Operator

And once again, if you would like to ask a question please press star (*) then one (1). And our next question comes from Andrew Levin with Finisterre Capital. Please go ahead with your question.

Andrew Levin

Hi, how are you, and thank you again for the call. My first question is kind of related to the last one, which was, is just if there has been any discussion about timeline on concession renewal and then, because that will probably be a quick one. Second question is on inbound versus outbound international traffic, if you could provide any color on how that's changed. I would expect an increase in inbound, although the international is down significantly overall to Argentina, in particular.

Gimena Albanesi

Okay, first of all, the second question would be outbound versus inbound traffic. As of the last quarter that we have reported, so third quarter of 2018, we had outbound traffic of around 60% of our international passengers, and 40% inbound. This was down from the previous quarter when the breakdown was 66% Argentinians out and 34% inbound traffic. We expect this trend to continue, and we expect that moving forward we will have a reduced percentage of Argentinians in our overall international passengers.

Martin Eurnekian

And regarding your first question, we are also waiting for the government to be ready to start negotiations, there was this consultancy, which is still delayed, and also we have seen a little bit of priority shift within the government in the last four to six months with all of what happened with the macro of the country, so we hope that those discussions can start as soon as possible.

Andrew Levin

Thank you.

Operator

And our next question comes from Pierre Safa with Silver River Capital. Please go ahead with your question.

Pierre Safa

Hi. Thank you very much for taking our question. So, I had a few. The first one would be you have not really published any estimates of what is overdue in terms of catch-up based on your contractual IRR for the AA2000 concession in Argentina. So, I don't know, could you give us a little more color as to when you do get the opportunity to catch up based on the original contract, what you expect you should receive? Because it appears the concession continues to deliver below what was originally signed, so that's the first question. Then, the second one would be on Brazil. So, you're currently building very significant commercial real estate in downtown in prime Brasilia. Could you give us a little more color as to how large you believe that opportunity could be eventually, especially in light of the recent elections, eventually, this could be a very high EBITDA asset? How should we think about it and when do you believe it could start to meaningfully make a difference in Brazil? And then the last question is, just on the current stock price. How do you internally think about the current level, and is there any opportunity for you to maybe engage in buybacks or, do you have an opinion about the current stock price, and if you do not believe it reflects the prospects of the Company, is there anything you believe you should be doing? Thank you very much.

Martin Eurnekian

Well, starting with your first question. It's similar to the one before. We need the government to do the yearly revision to understand their view for the future of the concession and understand if we would be on track or not regarding the regulatory framework. We hope that that happens

soon, and as soon as it happens, we will be able to have an opinion whether we agree with the government forecasts or not, and you have to keep in mind that we need to meet the IRR by the end of the period, so again, there can be slight adjustments over or under during the period. So, once we have that we will be able to have a clear opinion if we agree or not with the revision. To your second question regarding Brasilia, I would ask Jorge Arruda, who is on the line, to comment on the prospects for real estate development there.

Jorge Arruda

Hello, this is Jorge Arruda. In addition to being the head of Corporate Finance and M&A, I'm also the head of Brazil and the CEO of our Brasilia Airport. The Brasilia Airport is almost a unique situation where we have a large airport that is actually located inside the city, so you know, 10 to 15 minutes from the so-called ministry area, and also the fact that we have a large area within the concession agreement to develop. We plan to develop about 1 million square meters. We've had this plan for a while, the crisis didn't help. We have now, we have since the beginning of the year been growing, actually late last year, we have been growing in terms of passenger and the economy is picking up. As I'm sure you are aware, there is a new government and there is, generally speaking, a very positive mood around; therefore, we are quite optimistic. We have a few agreements lined up. As we mentioned before, we don't provide guidance, but our plan is that third party develops the projects and we basically lease the land; therefore, it is pure income for us. We expect to have projects such as convention centers, entertainment centers, office space, and hotels among a few others and we hope, and we are working towards being able to provide more specific details in our next quarterly meeting. Obviously, that will depend on how the macro environment shapes up in the country.

Martin Eurnekian

Thank you, Jorge. And regarding your third question, of course we believe that the price does not reflect the increasing value of the Company. We have clearly been affected by many factors, being Argentina's performance number one, in terms of our analysis. We are considering every possibility to defend the share price, being number one the sound and good management of the Company for long-term growth, but also other alternatives as share buybacks and so on, but we need to make sure that anything we do will positively affect the dynamics of our share and we see that while Argentina keeps creating concern among investors, we still need to wait and understand what will be the real need or long-term trend of the investments in Argentina.

Operator

And at this time there are no further questions, so please sir, go ahead with concluding remarks.

CONCLUSION

Martin Eurnekian

So, I would like to thank everybody for joining us today. We appreciate very much your interest in the Company, and we look forward to meeting you more and more over the coming months and providing financial and business updates next quarter. Our team remains available for any questions you may have. So, thanks again and have a good day.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.