CFE Q2-20 financial results: Apparent improvement with shadow signals.

- Last Monday night, CFE (the state-owned electricity facility) released its quarterly financial report as of Q2-2020.
- As we have discussed previously, the spillovers of the pandemic impacted the company through different metrics. The latter, plus policy adjustments in the sector, particularly regarding final consumer prices, led to a marginal improvement in some parameters.
- Revenues in H1-2020 reduced by 4.5% due to a different mix of power generation (higher to households and lower to industry) and relatively higher prices. The firm's costs decreased by 25% in the same period, mainly because of lower input prices. As a consequence, the operating result improved 4.7x to USD 2.7 Bn.
- Besides, lower taxes offset the higher financial costs primarily due to the FX depreciation in Q2. Still, the company registered a cumulative 2020 net loss of USD 4.2 Bn (as of June), compared to a net loss of USD 0.04 Bn in the same period of 2019.
- Once the country has hit bottom in economic activity, the question remains the pace and length of the recovery. Such a trajectory will be crucial in CFE's performance in the remainder of the pandemic and onwards.
- Our daily monitor of the wholesale electricity market data deems an annual growth of demand in the last week of June for the first time since the pandemic started. The challenge in H2 will be to sustain or even increase this trend.
- As we previously acknowledged, although the shift in financial conditions from Q1 to Q2 alleviated financial cost pressures, the company's operating result will be critical down the road.

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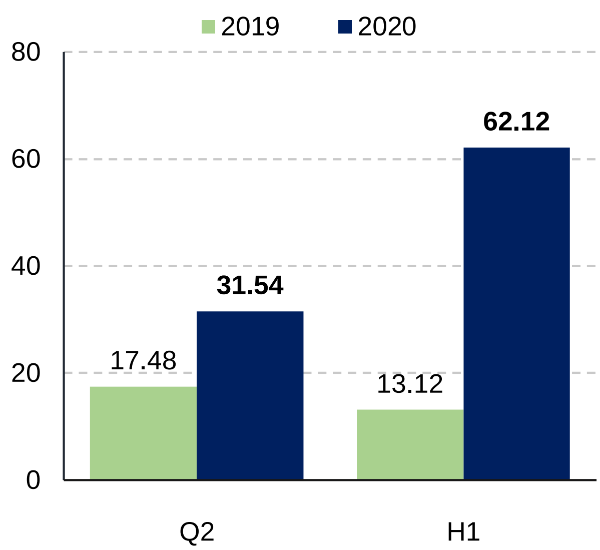
As of Q2-2020, CFE registered an MXN 247.6 Bn gross revenue. This figure is 4.5% lower YoY, and contributes to the deterioration of the operating result and a higher cumulative loss for the firm on a net basis:

- The YoY contraction is the result of higher electricity prices during Q2 and electricity generation reductions.
- When analyzing the CPI's electricity component, YoY average inflation in the three months of the quarter was 1.8%.
- Lower power generation offset the relative increase in prices. The amount in TWh recorded a 5.7% YoY contraction in Q22.

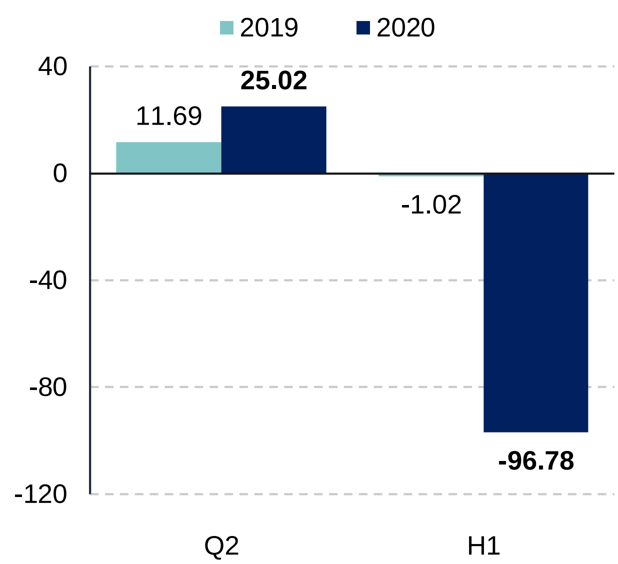
CFE operating result as of Q2 registered MXN 62.1 Bn, MXN 49.0 Bn above the same period in 2019 (see Figure 1a). In contrast, its net result contracted sharply during the same period, registering an MXN 96.8 loss, down from the MXN 1.0 Bn loss recorded in the previous year (see Figure 1b)..

Figure 1a. CFE Operating result (MXN Bn)



Source: Finamex Economic Research with data from CFE.

Figure 1b. CFE Net result (MXN Bn)

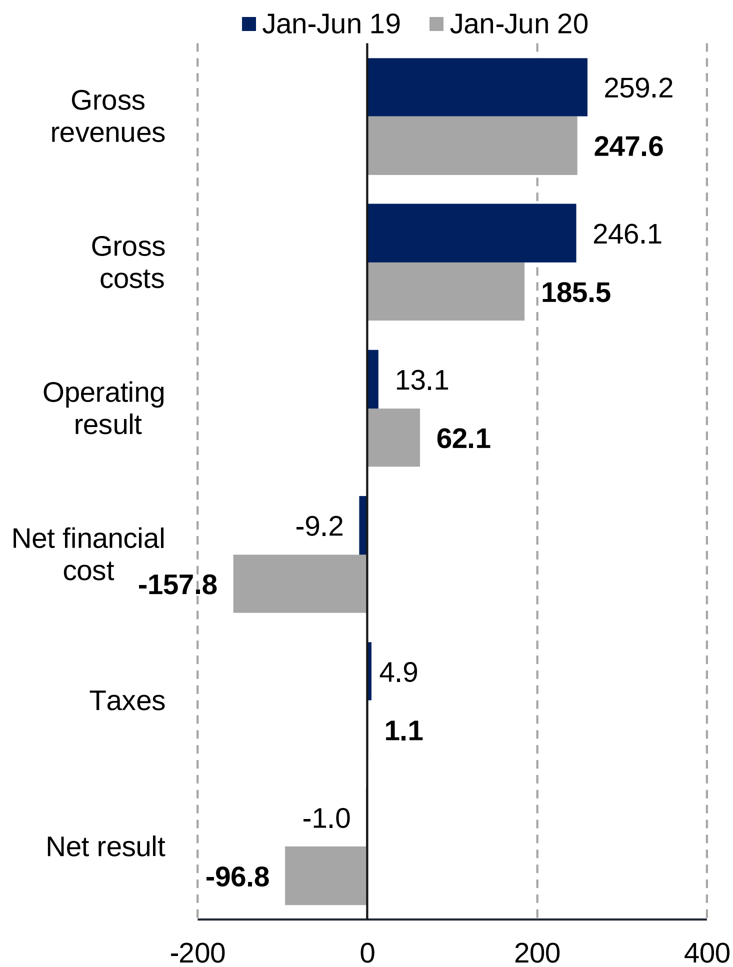


Source: Finamex Economic Research with data from CFE.

Despite the improvement in the operating result and the annual reduction in its tax burden, the net result continues accumulating a sizeable deficit (see Figure 2):

- Gross revenues decreased by around MXN 11.6 Bn, a 4.5% YoY contraction.
- Total costs reduced by MXN 60.0 Bn, -24.6% YoY.
- The net financial cost expanded by MXN 148.6 Bn.
- Taxes reduced by MXN 3.8 Bn; -76.9% in annual terms.

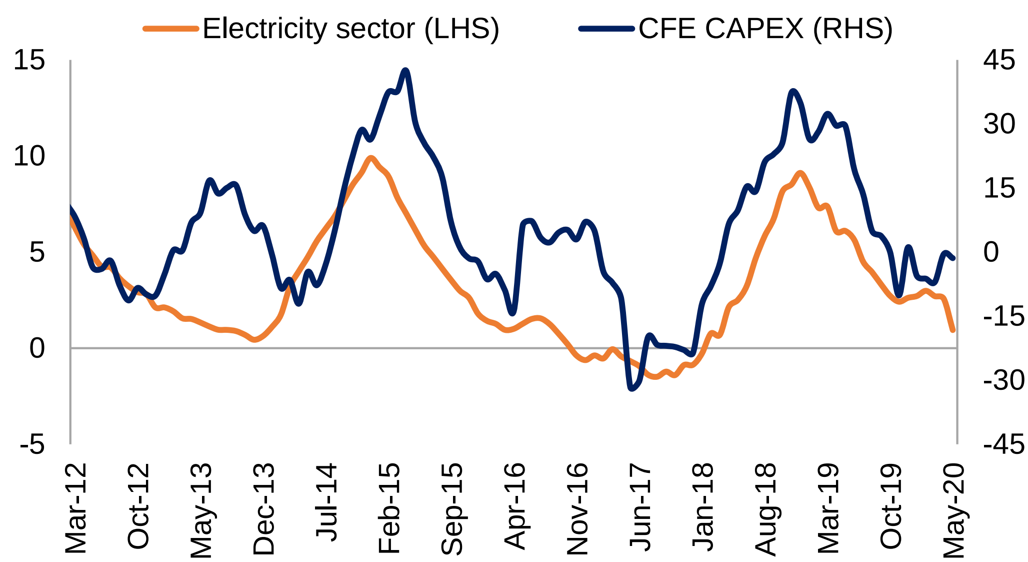
Figure 2. H1-2020 Financial results (MXN Bn)



Source: Finamex Economic Research with data from CFE.

As we have discussed previously, the spillovers of the pandemic impacted the company through different metrics. The latter, plus policy adjustments in the sector, particularly regarding final consumer prices, led a marginal improvement in some indicators. Such deterioration in incoming resources dampens the company's capacity to increase its CAPEX expenditures. The sluggish dynamics of these expenditures have been manifested in electricity's IP's component in the last months (see Figure 3).

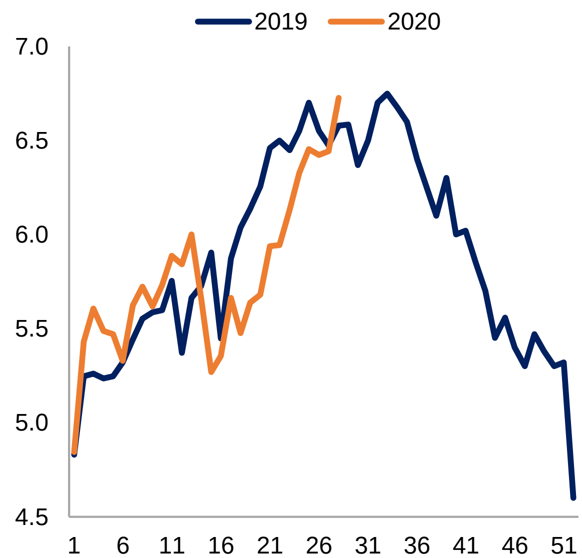
Figure 3. IP-electricity component and CFE CAPEX (YoY%, 12-month MA)



Source: Finamex Economic Research with data from INEGI and Mexican Ministry of Finance.

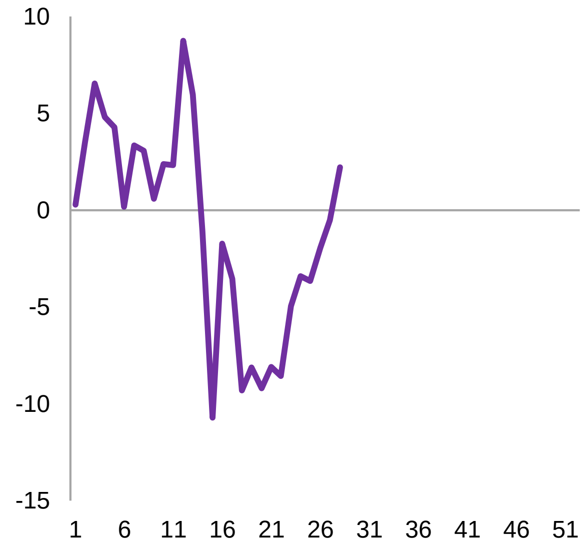
Once the country has hit bottom in terms of economic activity, the question that remains is the pace and length of the recovery. Such a trajectory will be fundamental in CFE's performance in the remainder of the pandemic and onwards. Our daily monitor of the wholesale electricity market data deems an annual growth of demand in the last week of June for the first time since the pandemic started. The challenge in H2 will be to sustain or even increase this trend (see Figure 4a and 4b.)

Figure 4a. Weekly electricity production (TWh)



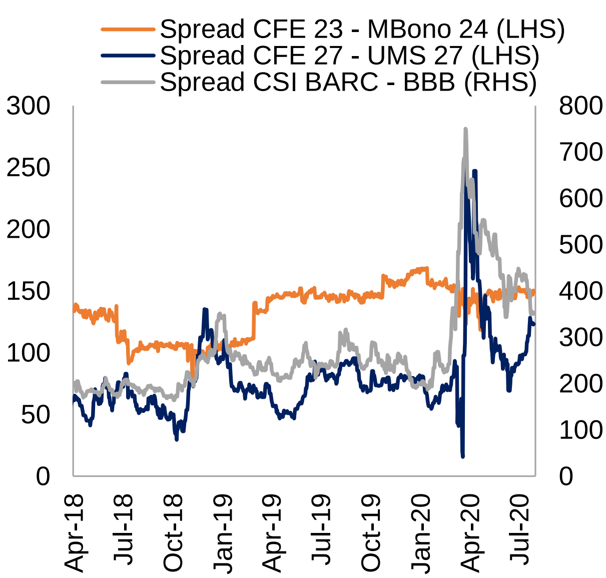
Source: Finamex Economic Research with data from CENACE.

Figure 4b. Weekly change in electricity production (YoY)



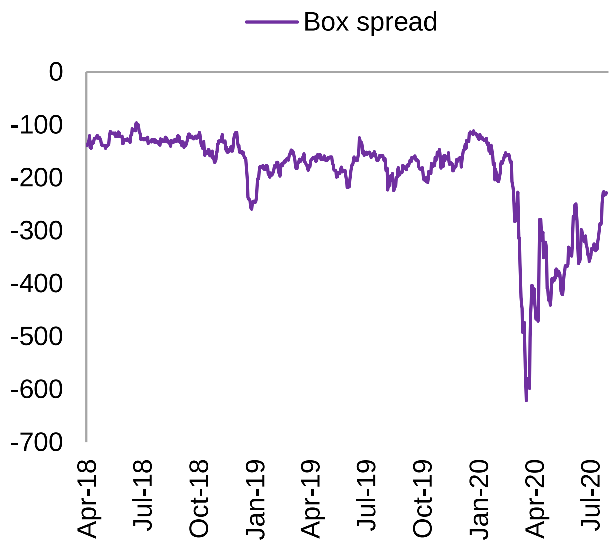
Source: Finamex Economic Research with data from CENACE.

Figure 5a. CFE-Sovereign spreads (Bp)



*CSI BARC refers to YTW of the Barclays Capital US Corporates high yield, and CSI BBB to BBB US Corporates. Source: Finamex Economic Research with data from Bloomberg.

Figure 5b. CFE- High yield box spread (Bp)



Source: Finamex Economic Research with data from Bloomberg.

As we previously acknowledged, although the shift in financial conditions in Q2 alleviated financial cost pressures, the company's operating result will be critical down the road. An essential driver within this balance is that the company's access to financial markets is not as compromised as it is in the case of other quasi-sovereign issuers.

Credit spreads for CFE improved after the risk-off sentiment of Q1, and although they regain an upward trend in Q2, its level in hard currency locates around 115 basis points. The state-owned electricity facility holds the benefit of the doubt as to whether the energy policy under implementation works in its favor. Nonetheless, the strong dependence on the sovereign support and the latter's links to Pemex's contingent liabilities can reduce CFE's tolerance margin if the deterioration of public finances continues its trend (see Figures 5a and 5b.)

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