Equity Research

Latin America
Electric & Other Utilities
Company Note
01 April 2015

IEnova

Growth, yield + FX protection... Initiating with a Buy

Initiating coverage with a Buy rating and a P$98 target price

We initiate coverage on IEnova with a P$98 TP and a Buy. The company, which has an appealing business with exposure to appealing sectors (oil & gas transportation, storage and distribution + power generation), is one of the clear beneficiaries of Mexico's end-2013 Energy Reform, which opened up certain infrastructure segments to the private sector. For IEnova, the benefits are potentially stronger growth in midstream investments and more opportunities in power generation.

The pipeline of pipelines

IEnova seems the right player, in the right sector, at the right time (and with the right management to boot). In the coming years, 14 pipeline projects (US$11bn in investments) are set to be auctioned in Mexico. Armed with a strong balance sheet, an outstanding execution track record and synergies from existing operations, we reckon it is in an excellent position to grab some of this growth…and profitably.

Growth, yield and FX protection

IEnova's business is 100% dollarized, and a natural hedge for investors betting on a structurally stronger USD. Most of its capacity has long-term take-or-pay contracts with solid clients (Pemex and CFE). This profile means IEnova has been a heavy dividend distributor, paying out over 100% of its earnings in the past two years.

Trading at 18% premium to existing NAV, but with many opportunities ahead

Of course, all the positives inevitably come at a price. We reckon the stock is trading at 1.18x P/NAV when we consider only the existing assets. Despite the premium, we see the company's growth as value-accretive, and as such we think the premium could widen. Our TP (for the existing assets) is DDM-derived, discounted at a nominal (in US$) 7.0% kE.

Valuation	12/2013	12/2014	12/2015E	12/2016E	12/2017E
RoIC (EBIT) %	10.7	9.7	9.7	10.1	14.1
EV/EBITDA	19.2	22.5	22.4	20.5	15.0
P/E	32.4	42.2	29.7	24.3	18.1
Net dividend yield %	3.4	2.8	3.4	4.1	5.5

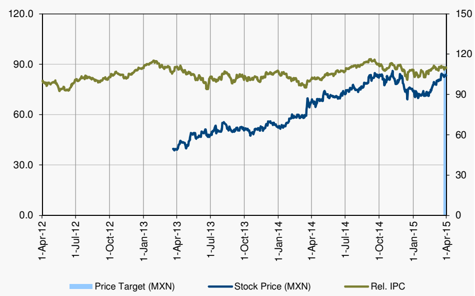
Financials (US$mn)	12/2013	12/2014	12/2015E	12/2016E	12/2017E
Revenues	678	823	798	842	999
EBITDA	249	281	318	357	489
Net Income	142	137	212	259	348
EPS (US$)	0.12	0.12	0.18	0.22	0.30
Net DPS (US$)	0.14	0.14	0.18	0.22	0.30
Net (debt) / cash	(154)	(545)	(833)	(1,027)	(1,031)

Source: Company reports, Bovespa, BTG Pactual S.A. estimates. / Valuations: based on the last share price of the year; (E) based on a share price of MXN83.24, on 31 March 2015.

Rating	Buy
12m Price Target	MXN98.00/US$6.43
Price	MXN83.24/US$5.46
RIC: N.A., BBG: IENOVA* MM Equity	

Trading Data and Return Forecasts	
52-wk range	MXN85.90-64.51/US$6.40-4.69
Market cap.	MXN96,061m/US$6,301m
Shares o/s (m)	1,154.0
Free float	19%
Avg. daily volume('000 Shares)	1,138
Avg. daily value (MXN m)	86.2
Forecast price appreciation	+17.7%
Forecast dividend yield	3.4%
Forecast stock return	+21.1%

Stock Performance (MXN)



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The right player, in the right sector, at the right time

"You and I come by road or rail, but economists travel on infrastructure." – **Margaret Thatcher** (1925-2013)

Of all the major changes passed by reformist president Enrique Peña Nieto at the start of his administration, one was particularly important for the country's long-term economic ambitions: the Energy Reform.

After a long legislative process, which in Mexico also meant debating the matter at state legislative assembly level, the PRI-PAN alliance succeeded in opening up power & energy to the private sector – a move that will clearly fuel Mexico's growth.

IEnova is one of the clear beneficiaries of the Mexican government's decision to prioritize own infrastructure deployment. It benefits twofold: via the private sector's stronger involvement in upstream (which will most likely drive growth in midstream, IEnova's area of expertise); and via the end of CFE's monopoly on power output.

IEnova seems to be the right player, in the right sector, at the right time, and with the right management team as the icing on the cake. Its CEO and VP of Development both have prior experience at Pemex, and its CIO boasts experience in the public sector (at CFE and in the Municipal Water System of Saltillo).

Over the next few years, 14 pipeline projects (totaling US$11bn in investments) are set to be auctioned in Mexico, and IEnova is well-positioned to grab a relevant part of this growth…and profitably so.

We are initiating coverage on this appealing company with a Buy rating. Despite trading at an 18% premium to existing assets' NAV, we see the company's growth as value accretive and believe the premium could widen.

With exposure to Mexico's growth, cash flow predictability and a natural hedge against potential further Peso devaluations, IEnova seems to be one of those investment stories that investors don't come across that often. On the following pages, we provide more details on the company, the sector and the investment case.

How to value an infrastructure growth play?

Paying for growth in Brazil infrastructure is a challenge…

Half of the team writing this report forged their careers analyzing Power Utility names in Latin America (notably in Brazil). In Latin America's biggest economy, the power sector offers growth opportunities, but competition for new concessions is strong and the number of players bidding leads most of the investor community (ourselves included) to avoid incorporating a 'growth factor' into companies' valuations.

In the transmission sector, for example, private players (the likes of CTEEP, Taesa and Alupar) have to contest new concessions with local state-owned players (e.g. Eletrobras and Copel) and foreign players (e.g. Chinese and Spanish companies), who have lower return benchmarks. In recent years, despite the auction of numerous concessions, private players have barely grown.

On the generation side, we can see a similar rationale. Further complicating things, the construction of hydro plants is very complex and requires massive concentration of employees in a small territory, which ultimately increases the chances of capex overruns, strikes, big delays (Belo Monte, Colíder) and even riots (Jirau)!

Growth is always an option for Brazilian power companies, but definitely not one that necessarily adds NAV.

So why incorporate a growth component into IEnova's valuation?

But in Mexico the dynamics are a bit different (for now)

In IEnova's case, we feel more comfortable (at least for now) adding a growth component to our TP.

In the future, industry dynamics might (should?) change, and we wouldn't expect just a handful of players to keep grabbing all the growth out there. In theory, and if the sector really proves to be an open one, new players should appear and we could see something similar to the 'Brazil scenario'.

When this happens, the average expected IRR of future expected growth will probably drop to the same level of players' opportunity cost (in other words, the growth NAV might be worthless ex-ante).

Current industry dynamics in midstream show that only a few players have been grabbing short/mid-term opportunities. In recent years, the three main players have been IEnova, Transcanada and Fermaca. But competition will probably increase.

Our approach when valuing IEnova's 'growth factor' is to assume the company grabs 30% of the growth opportunities arising in 2015-19 in the transportation business, with a post-tax nominal return on capital of 10% (or 15% on equity, if 60% leverage applies to the projects). In this scenario, our model shows that the Equity NPV/capex of the pipeline concessions won by IEnova in the future is 0.45x. In the past four years, IEnova grabbed some 25% of the growth opportunities on the transportation segment.

Next transportation auctions

Pipe	Status	Capex (US$mn)
San Isidro	Progress	100
Tuxpan - Tula	Q1 2015	400
Samalayuxa - Sasabe	Q1 2015	825
Colombia - Escobedo	Q1 2015	370
Baja Sur	Q1 2015	600
Merida - Valladolid - Cancun	to be ann.	460
Texas - Tuxpan (marine pipe)	to be ann.	3,000
Tula - Villa de Reyes	to be ann.	420
Jaltipan - Salina Cruz (Pemex)	to be ann.	640
Ramones - Cempoala (Pemex)	to be ann.	2,000
Villa Reyes - Aguascalientes - Gdl	to be ann.	545
La Laguna - Aguascalientes	to be ann.	885
Lazaro Cardenas - Acapulco	to be ann.	450
Salina Cruz - Tapachula	to be ann.	435

Source: IEnova

In our growth assumption we do not factor in any value for the entrance of the company into new sectors. As discussed below, the Energy Reform opens another angle of optionality which is the opportunity of becoming more involved with the power sector. Though not traditionally in the scope of what IEnova has done, it is certainly within the scope of Sempra. We think it is impossible to put a number on this and the company itself downplays it, but qualitatively it could be used to explain at least partially why the premium to the NAV currently exists.

Target sensitivity for different % of short-term auction success

% of auctions won	Growth NAV	Resulting Target
10%	P$14	P$85
20%	P$20	P$91
30%	P$26	P$98
40%	P$32	P$104
50%	P$39	P$110

Source: BTG Pactual

For the sake of argument, post-2019 we assume that the industry converges to the modus operandi of the Brazilian power sector (perfectly competitive?)

The growth factor valuation will always be a source of opinions divergence

The 'growth factor' of IEnova's valuation should be a key discussion point among investors and analysts for years to come. Ultimately, marginal buyers will always have to reflect on how much they will accept to pay for growth.

Existing assets' valuation

Valuing the existing assets seems much simpler than the above exercise (at least more straightforward and more consensual among market participants). Our TP for

IEnova's existing assets is DDM-derived (how else could we value a stock paying out more than 100% of earnings AND that also deleverages fast once it stops growing?)

Our DDM-derived TP for the existing assets is dollarized (we don't convert the numbers back to pesos), discounted at a nominal 7.0% kE rate. We multiply the dollar-NAV by our year-end FX rate estimate (currently P$15.5).

Adding a premium to the sovereign

In our kE, we add a premium to the spot risk-free rate (similar to the one added in our Cemex discount rate), as we don't feel comfortable (despite being equity analysts) that global rates are at sustainable levels. If we were to remove the "additional premium" line from the exercise below, IEnova's TP would jump by P$14/share (and nominal kE would be an extremely low 5.8%).

Similar to what we did when Brazil's real rates reached record low levels (back in 2012-13), we don't feel comfortable marking-to-market the QE-influenced sovereign rates.

Some might argue that the 7.0% discount rate for the existing assets is low compared to other Mexican names. In our view, though, the existing assets' cash flow risk is highly linked to Pemex's and CFE's financial health, since the bulk of IEnova's business is a liability with them (and with Sempra Energy). When comparing the YTM of 10-year Pemex (4.4%), CFE (3.9%) and Sempra Energy (3.0%) bonds, the spread used in our kE for IEnova's existing assets looks ample.

Existing assets' NAV details (DDM-derived)

kE component	value
UST 10y	1.9%
UMS premium (Mexico 10y sov)	1.3%
Additional premium (our input)	1.2%
Implied dollarized sovereign risk	4.4%
ERP (our input)	4.0%
beta	0.65x
Equity risk component	2.6%
Nominal kE (US$)	7.0%
US$:P$ assumption	P$15.5

Source: BTG Pactual

Length of the assets: we consider some are perpetual

We consider some of the assets to be perpetual. The first (less controversial) is the natural gas distribution, which could operate for decades and has a better investment case, when arguing that it might have demand long enough to be called "perpetual".

The second set of assets to which we add a perpetuity value is transportation (except the Baja East concession, which we terminate in the year its existing contract expires). Our main assumptions for the transportation assets are:

1) Revenues track inflation until the existing contracts expire. We model for 2% annual inflation (US CPI).

2) The top line of each pipeline drops 50% once the existing contracts expire and are adjusted by inflation. We assume the assets operate into perpetuity. If we were to terminate the assets at their 50th year, the price target of IEnova would drop some P$3/share.

We feel comfortable extending the financial life of most of the pipelines that IEnova owns, as (i) the pipelines' actual life tends to be longer than the ~25 years stated in their initial contract (some US pipelines have operated for more than 100 years and the technology they use to build these pipelines has improved over time), (ii) the renewal procedure, since they already operate the pipelines, is a relatively easy process and (iii) Mexico's deficit of natural gas pipelines shouldn't render these pipelines useless 50 years from now.

Valuation summary

SOTP	
Existing assets NAV	P$71
Existing assets kE (nominal, US$)	7.0%
US$:P$	P$15.5
Growth NAV	P$26
Growth kE (nominal, US$)	7.5%
Growth NAV / growth capex	0.45x
Growth / Existing NAV	37%
IEnova's price target	P$98
IEnova's rating	Buy

Source: BTG Pactual

Excluding new assets, IEnova is trading in line with the US MLPs. We don't believe there are good Mexican-listed peers for the company.

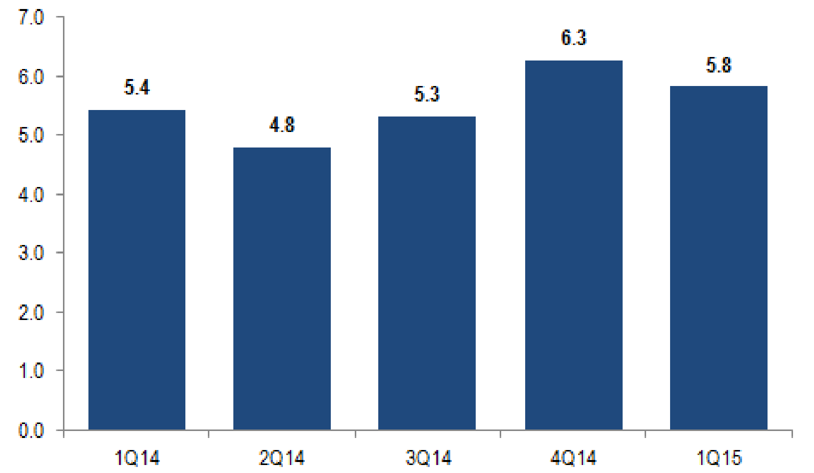
IEnova has consistently traded over US$5m a day over the past 12 months, making it one of the top 25 traded stocks in Mexico. Liquidity could rise considerably if IEnova happens to tap equity capital markets to fund growth in the near future.

Valuation comps

Company	Stock code	Price Local	Mkt Cap US$ mn	P / E 2014E	P / E 2015E	P / E 2016E	Div Yield (%) 2014E	Div Yield (%) 2015E	Div Yield (%) 2016E
Ienova	**IENOVA***	**83.24**	**6,294**	**47.6x**	**29.2x**	**24.3x**	**2.5%**	**3.4%**	**4.1%**
USA									
Kinder Morgan Inc/DE	KMI US	42.06	90,623	35.0x	47.2x	41.2x	4.1%	4.7%	5.2%
Enterprise Products Partners LP	EPD US	32.93	63,805	22.1x	24.0x	21.9x	4.4%	4.7%	4.9%
Enbridge Inc	ENB US	48.50	41,320	31.9x	27.2x	23.1x	2.3%	3.0%	3.4%
Williams Cos Inc/The	WMB US	50.59	37,836	61.7x	45.8x	37.3x	3.9%	4.8%	5.4%
Energy Transfer Equity LP	ETE US	63.36	34,137	38.9x	21.6x	17.9x	2.5%	3.4%	4.1%
TransCanada Corp	TRP US	42.72	30,274	23.2x	22.2x	20.8x	3.5%	3.8%	4.1%
Williams Partners LP	WPZ US	49.22	29,531	42.9x	33.6x	25.8x	4.9%	7.0%	7.5%
Spectra Energy Corp	SE US	36.17	24,282	24.5x	29.7x	26.5x	3.8%	4.2%	4.5%
Energy Transfer Partners LP	ETP US	55.75	22,746	20.9x	20.5x	20.3x	7.0%	7.4%	7.9%
Plains All American Pipeline LP	PAA US	48.77	19,373	21.3x	21.6x	19.5x	5.4%	5.7%	6.1%
Energy Transfer Partners LP	ETP US	55.75	22,746	20.9x	20.5x	20.3x	7.0%	7.4%	7.9%
USA average				**31.2x**	**28.5x**	**24.9x**	**4.4%**	**5.1%**	**5.6%**

Source: Bloomberg

IEnova – ADTV (US$m)



Source: Bloomberg

Investment positives and risks

Investment positives

Strong parent company

Based in San Diego, IEnova's parent company - Sempra Energy (SRE, US$27bn market cap) - holds 81.1% of the Mexican infrastructure player. The rest of the shares were floated in the March 2013 IPO.

In 2014, Sempra Energy reported US$1.16bn in net earnings and over US$11bn in revenues. The company operates in the power generation and midstream/distribution businesses in the US, Mexico and Chile and was created in 1998 by a merger of parent companies of two long-established investor-owned utilities.

Experienced management team

IEnova's management team has vast experience in the Mexican infrastructure sector. The company's CEO (Mr. Carlos Ruiz Sacristán), who is also the board chairman, served as Mexico's Secretary of Communications and Transportation of ex-President Ernesto Zedillo's administration (1994-2000). Previously, he served in several posts at Mexico's Central Bank, the Finance Ministry and Pemex.

Mr. Gerardo Tona, IEnova's vice president of operations and construction, before joining the Sempra group, worked for the Municipal Water System of Saltillo (1997-2000) and for CFE (1992-1997).

Mr. Rene Carbonell, the vice president of engineering and construction, before joining IEnova, was El Paso Mexico's business development director (2008-2010). From 2002-2008, Mr. Carbonell worked at Pemex, at various positions in the transportation and logistical areas.

Mrs. Tani Negrete, IEnova's vice president of external affairs and business development, served at Pemex's foreign trade subsidiary PMI as assistant commercial and refined products manager.

IEnova's CFO, Mr. Arturo Infanzón, has a strong financial background, having worked for Price Waterhouse and First National Bank, before joining Sempra Energy in 1997.

Long-term take-or-pay contracts with solid clients

More than 80% of IEnova's capacity has long-term take-or-pay contracts signed with solid clients. Pemex, CFE, Shell, Gazprom and Sempra (through the LNG Marketing agreement) are easily the main revenue contributors. In the "Existing Assets" section below, we provide more details on the contracts of each of the company's operating or under construction assets.

A dollarized business

Almost 100% of IEnova's assets operate dollarized business units. As such, IEnova is a very good investment vehicle to play a potential longer-term strength of the dollar (and a bad one if Mexico's currency strengthens).

The natural gas distribution concessions (Ecogás) also have dollarized tariffs, but with some lag effect, since tariffs are only changed once a year.

High dividends

Given its high cash flow predictability (and for a long period of time), IEnova has been a heavy dividend payer in the past years. In 2014, payout reached 120% of reported earnings, while in 2013 it was 110%. Given this profile, our target price is DDM-derived. The company's high cash flow generation gives it a greater cushion and ability to leverage if the opportunity arises.

Investment risks

Execution

Naturally, execution is the first notable risk of a company that grows a lot and acts in many different fronts at the same time. Currently the company is building two pipeline projects, one wind power plant and is investing on the transmission capacity of its thermal plant.

The company's track record shows it delivered all its projects in line with the initial operating plan (budget and time-wise).

IEnova won its first natural gas distribution project in Mexico in 1996 and has established a solid track record of building first class greenfield and brownfield energy projects ever since. Having been one of the first private players present in the country, the company has been able to develop certain competitive advantages that have allowed them to build more efficiently than its competitors.

These competitive advantages include, but are not limited to, their local knowledge regarding local and federal government permits, environmental permits, real estate rights-of-way, municipal land-use permits and other authorizations.

Client concentration

We classify IEnova's client base as positive (clients are financially solid and Pemex and CFE, for example, are backed by the country's Treasury) and negative (purely on the grounds of concentration, since tail risks occur once in a while). Looking at what is happening to Petrobras suppliers in Brazil, we can't ignore this risk.

Stronger competition

An important part of IEnova's market cap, in our view, is related to short-term growth expectations. According to our estimates, and as explained in the valuation section above, IEnova's shares currently price in an 18% premium to the existing assets' NAV.

It is reasonable to expect that competition will intensify in the coming years. IEnova should certainly grab as much growth as they can before everyone else figures out how good an opportunity the Mexican infrastructure sector is.

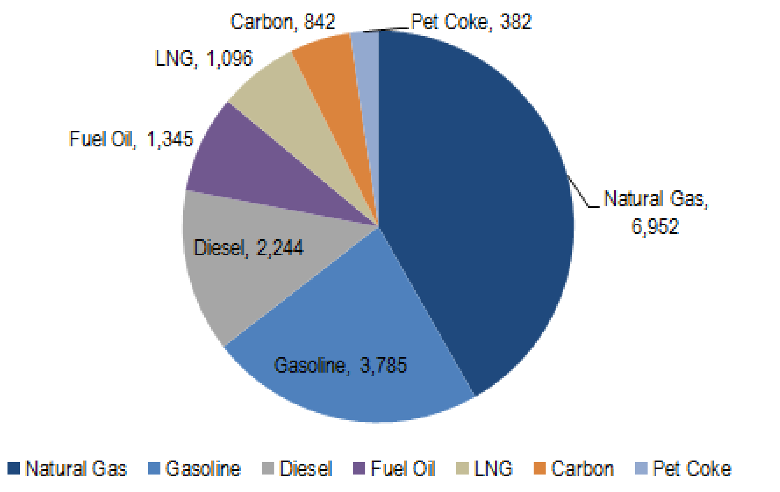
Interest-rate sensitive

IEnova, along with other infrastructure names, is the type of stock one would expect to be highly correlated to the behavior of interest rates. In order to mitigate this in our TP, we add a 1.2% premium to the current Mexican sovereign rate (dollar traded).

A closer look at the natural gas market in Mexico

How does Mexico power itself today?

Power generation by source (2013) – mmcfd equivalent of natural gas

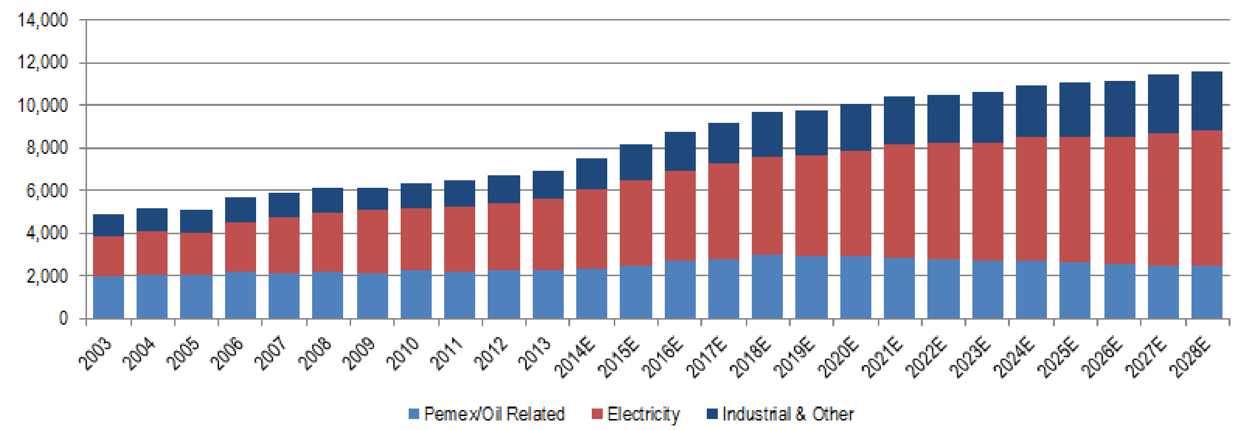


Source: SENER

Natural gas and LNG represented 48% of power supply in Mexico in 2013, from ~15% in 2000. The government expects this figure to reach ~60% by 2030.

What does Mexico use natural gas for?

Breakdown of natural gas demand in Mexico by type of use (2003-2028E) mmcfd

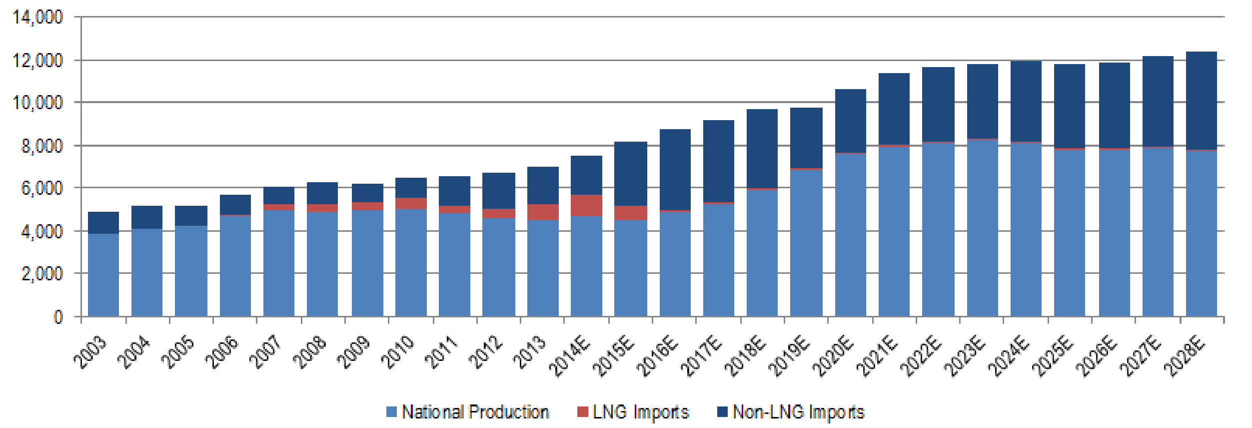


Source: SENER

According to SENER, demand for natural gas in Mexico is set to grow at a CAGR of 3.5% between 2013 and 2028 as it is the cheapest resource available for Mexico to use for growing electricity needs, reaching 11.5bn cfd by 2028. From 2003 to 2013, the amount of natural gas devoted to electricity grew at a CAGR of 6.1% and is set to grow at a CAGR of 4.4% between 2013 and 2028. Electricity is set to represent 55% of total natural gas demand in Mexico, from 48% today and 37% in 2003. The purpose of Mexico's gasification is to lower the cost of electricity.

And where does Mexico get its natural gas from?

Breakdown of natural gas supply in Mexico by domestic production and type of import (2003-2028E) mmcfd

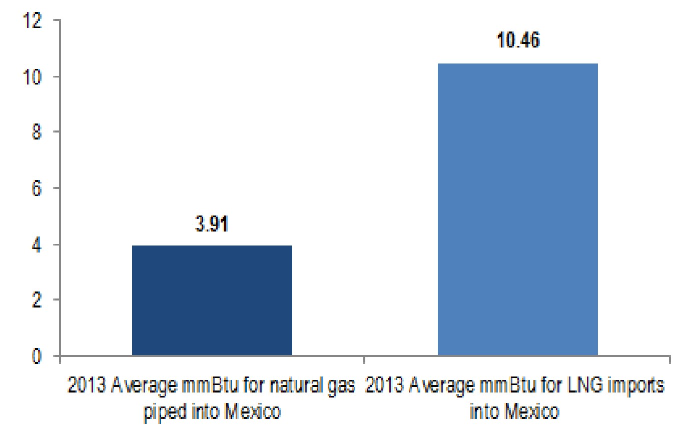


Source: SENER

Between 2003 and 2013, national production of natural gas increased by a mere 1.4% a year while imports increased by an average of 9.7% a year. From 2006 to 2013 Mexico grew imports of LNG at a CAGR of 38.3% as national production decreased by 1% on average during the same time period. National production has decreased by an average annual rate of 3.5% since 2010, exacerbating the gap between demand and local production.

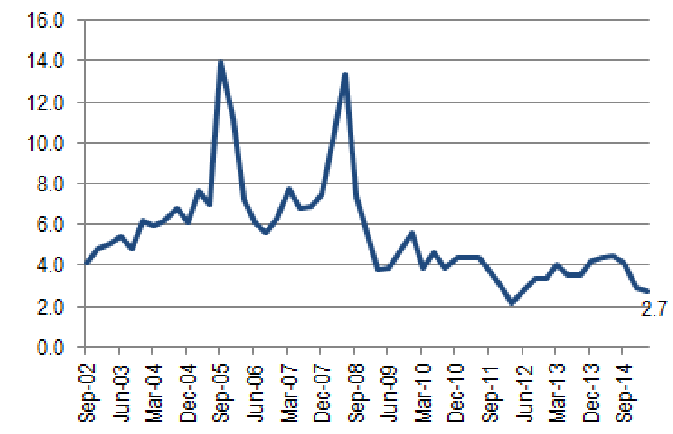
As can be seen in the chart below, LNG imports by sea are almost 3x as expensive as pipeline imports. Pemex paid US$19.45/mmBtu at one point in 2013 for a spot LNG cargo. LNG imports represented ~35% of natural gas imports in 2014. If Mexico were to import all of their natural gas needs by pipes, their energy costs related to natural gas would be ~60% cheaper.

Importing from the US is a lot cheaper than importing LNG (USD/mmBtu)



Source: SENER

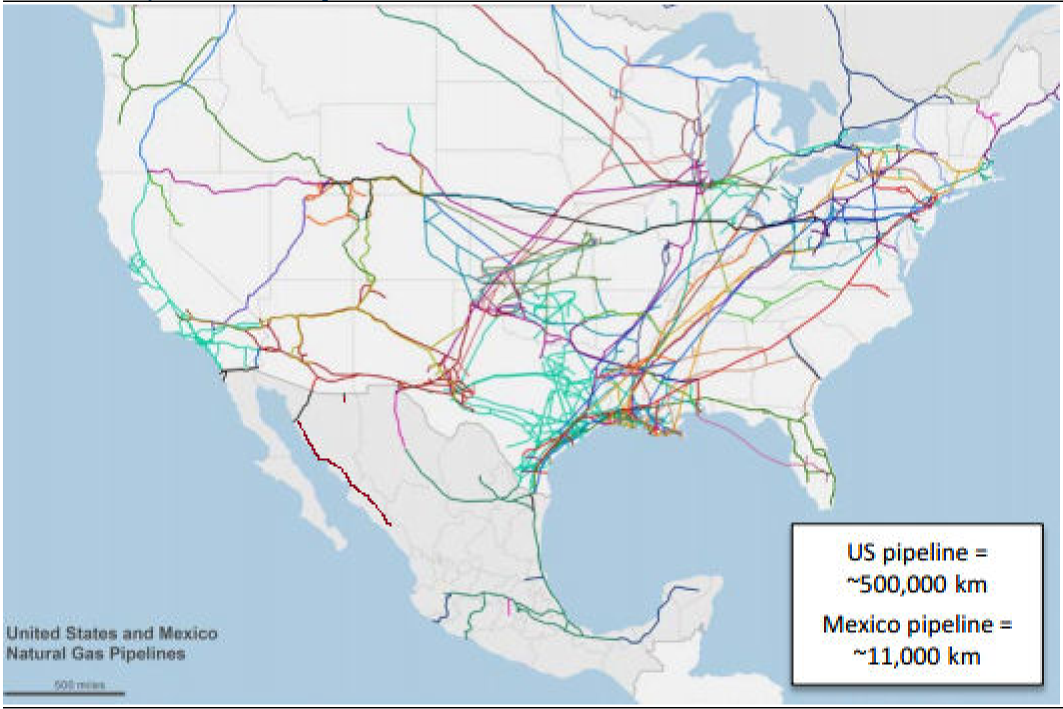
U.S. Natural Gas Spot Prices (USD/mmBtu) – (2002-Today)



Source: Bloomberg

It is also important to keep in mind that US gas at ~$3/mmbBtu is among the cheapest in the world. This is why it is a priority for the government to increase natural gas transportation capacity as fast as possible and IEnova is perfectly positioned to capture these significant growth opportunities in the years to come.

Illustrative comparison of natural gas infrastructure in Mexico and the US



Source: IEA

Energy Reform – a catalyst but not a risk

Energy reform will undoubtedly create new opportunities for IEnova. The reforms modified the Mexican constitution to allow private sector participation in exploration & production activities, petrochemicals, refining, oil and oil products storage, transportation and distribution and electricity generation, marketing, transmission and distribution.

Private players have been able to participate in the transportation, distribution and storage systems of natural gas (regulated by the CRE) since 1995. The reforms will open opportunities in the E&P space as new contract types will increase the production of gas and liquids throughout Mexico. They will also open up opportunities in the downstream segments as the CFE will now grant permits to private players to distribute power (an area where IEnova is already present), not to mention that the reforms fully open the generation and marketing of electricity allowing for direct contracts between generators and large end-users.

The process of building out the pipes and of planning for a replacement of expensive Asian resources with cheaper North American gas had been underway long before Energy Reform was on the table. Thus, regardless of how successful Round 1, Pemex's farm outs, etc. are deemed to be, the segment in which IEnova is involved will continue to offer opportunities for growth.

Even though investors see this as an energy play, there is an argument to be made that it could, amost counter-intuitively, be a cheaper energy play to the degree that: (a) Pemex's cash flows suffer from falling oil prices and output, it will have to focus more on oil production capex and rely on private sector partners for non-essential activities; and (b) as oil prices decline, presumably there will be some correlation with North American gas prices, making it even more compelling and rational to try to bring in US natural gas as much as possible.

Where it can become an opportunity that is admittedly difficult to measure is to the degree that the opening up of CFE presents opportunities for new businesses in which IEnova is not involved but that Sempra knows very well.

Competitive landscape (IEnova's key competitors)

TransCanada has been around since 2006 and is considered to be one of the more rational players in the sector. They bid for all 4 of the Sonora pipeline projects which CFE auctioned off and were awarded 2 of them (El Oro-Mazatlán & El Encino-Topolobampo).

GDF Suez has not been as active in terms of placing bids for some of the recent CFE auctions but won the Ramones II Sur project in a JV with Pemex. They have been active in Mexico since 1989 and operate 2 (soon to be 3) pipelines in Mexico, their other 2 pipelines are in el Bajío and the southeast region of Mexico.

FERMACA is a relatively new player that is managed by Mexicans but owned by a Swiss private equity group called Partners Group. Winning El Encino – La Laguna was key for building their network in the north of Mexico where they have strong relationships with U.S. players such as OneOK that have presence in the U.S. close to the border. They have openly communicated plans for an IPO in Mexico and have publically traded debt in the US.

ENAGAS is a Spanish player which bought its way into the pipeline business by teaming up with Elecnor to build the Morelos pipeline which has yet to take off. They have been the most aggressive in recent CFE bids as can be seen by their losing second place bid for El Encino – La Laguna and a separate bid for a compression station where they were very aggressive. Morelos would be their first pipeline in Mexico but they are obviously looking to get involved in new projects and it seems they would have the balance sheet capacity to be aggressive.

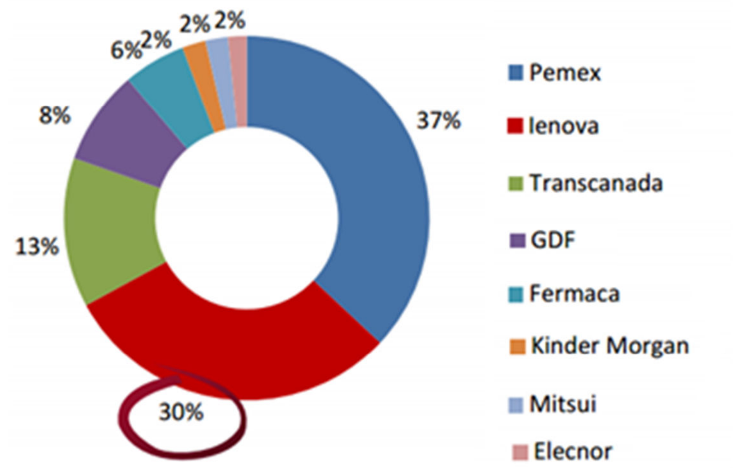
Energy Transfer/ **Grupo Carso** won two key pipelines auctioned in the U.S. by the CFE that are very close to the U.S. border. They will continue to compete for new pipelines in coming years.

Industry snapshot: Latest pipeline CFE auctions + Los Ramones

Project	Location	Operator	Commercial Operations Start Date	Total Project Capex (US$m)	Length (Km)	Average Volume mmcfd
Manzanillo	Manzanillo-Colima; Guadalajara, Jalisco	Transcanada	Jun-11	435	310	500
Tarahumara	Cd. Juárez-Chihuahua	FERMACA	Jul-13	395	389	69
Morelos	Esperanza-Venta de Carpio y CempoalaSanta Ana	Enagas-Elecnor	??	250	160	337
Tamazunchale–El Sauz	Tamazunchale–El Sauz	Transcanada	Feb-14	500	235	630
Zacatecas	Aguascalientes-Calera, Zacatecas	SIMSA	Jul-14	50	175	20
Sonora / Noroeste	Sasabe - Guaymas	IEnova	Oct-14	525	505	770
Sonora / Noroeste	El Encino-Topolobampo	Transcanada	Aug-16	1,000	530	670
Sonora / Noroeste	Guaymas - El Oro	IEnova	Oct-16	400	328	510
Sonora / Noroeste	El Oro-Mazatlán	Transcanada	Oct-16	400	413	200
Ojinaga - El Encino	Chihuahua	IEnova	3Q17	300	205	1,356
El Encino – La Laguna	Durango	FERMACA	1H17	917	423	1,500
Total CFE				**5,172**	**3,673**	**6,562**
And what if we were to add Los Ramones? /1						
Ramones I	Rio Grande (U.S. Border) - Los Ramones, NL	GdC (Pemex/IEnova)	Dec-14	500	117	2,100
Ramones II (Norte)	Los Ramones - San Luis Potosi	TAG + GdC (Pemex/IEnova) JV	Dec-15	1,400	454	1,430
Ramones II (Sur)	San Luis Potosi - Guanajuato	Pemex/GDF JV	Dec-15	1,000	291	1,430
Total Los Ramones				**2,900**	**862**	**4,960**

Source: CFE, Ienova, Transcanada
/1 Pemex did not tender Los Ramones as they had planned to and assigned them directly to GdC and Pemex/GDF JV. IEnova declined to submit a bid for the original tender while GDF Suez, in consortium with Spain's Enagás, submitted a bid that Pemex declared economically and technically invalid.

Natural Gas Pipelines – Market Share (%) /1



Source: Company Data, SENER
/1 Includes 50% interest in a joint venture with Pemex, capacity expansions and CFE's recent bids.

Major Pipeline Systems in Mexico

Source: SENER, Company Data

Existing Assets

IEnova operates assets in two main segments: gas and power. Its presence in the gas segment is bigger and broader, as it operates in the midstream (transportation, storage and regasification) and the downstream and has some trading activity.

As per the power segment, the company owns and operates a 625MW gas-run thermal plant and shares control of a 155MW wind power project, both very close to the US-Mexico border.

Gas segment

As explained above, IEnova is exposed to the gas segment via different activities (*see below*). Most of the assets are fully controlled by the company, but some of them are co-controlled with Pemex, under a JV called Gasoductos de Chihuahua (GdC).

#1 LNG Storage (Energia Costa Azul)

Energia Costa Azul (or ECA) stores and regasifies imported LNG to its customers, sending the gas to the Gasoducto Rosarito pipeline (controlled by the company) for transportation to Baja California and the US.

Operating with take-or-pay contracts, ECA has a storage capacity of 320,000 cubic meters in two equally-sized tanks. 50% of capacity is hired by Shell and Gazprom, while the remaining 50% was contracted by Sempra LNG Marketing. The contracts expire by 2028.

The obligations of LNG Marketing are backed by a financial guaranty from Sempra Energy, the company's indirect controlling shareholder, in the amount of US$282mn.

Big shift in natural gas prices reality since the project's inception

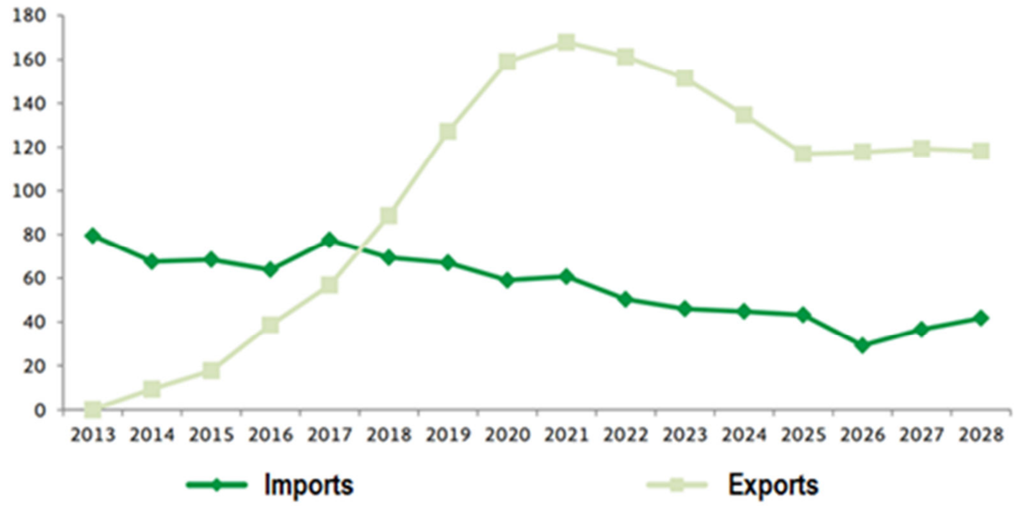
With natural gas prices much cheaper in the Americas (notably the US) than in Asia, importing LNG isn't a wise decision, economically speaking. As such, IEnova's storage business has been operating at idle capacity (~5%) to maintain the plant, as has the pipeline infrastructure connected to the storage facilities. ECA was originally designed for U.S. demand (SoCal) at a time when natural gas was a lot more expensive in the U.S. Two other terminals in Mexico are set to stop importing completely by mid-2016 (Manzanillo and Altamira)

In our valuation calculations, we assume both ECA and the pipeline connected to ECA are shut down at the end of the existing contracts. The company has been studying the feasibility, alongside Pemex and LNG Marketing, of converting the regasification facility into a liquefaction one, in which the cheap natural gas from North American soil could be sold to countries surrounding the Pacific Basin.

The multi-billion dollar project, if deployed, shall be done in partnership with other stakeholders and construction would take place between 2018 and 2021. There might be value creation on this front, but is still too early to tell.

Another discussion that adds some complexity to converting ECA into a liquefaction-export unit is the fact that US companies are not allowed to export energy to other countries (which is why inventories are piling up), with the exception of Canada and Mexico.

Mexico – Expected LNG trade balance (mbd), 2013-2028



Source: IMP (Instituto Mexicano del Petróleo) & SENER

 # 2 Pipeline – the fast growing part of IEnova's business

IEnova owns and operates natural gas and LPG transportation, storage and compression systems. Some of the assets are co-controlled with Pemex via the 50/50 joint venture GdC.

Pipeline concessions

	Beg.	Contract			Other data	
Concession	Operations	%	With	Until	Length	Capex (*)
Baja East pipeline	2002	90%	several	2029	302km	$300
Baja West pipeline	2000	100%	CFE	2028	45km	$60
Aguaprieta pipeline	2002	25%	Kinder Morgan	2027	13km	$20
Sonora I pipeline	2014	100%	CFE	2039	505km	$525
Sonora II pipeline	2016	100%	CFE	2041	330km	$400
Ojinagara - El Encino pipeline	2017	100%	CFE	2042	205km	$300
under GdC JV						
San Fernando pipeline	2003	100%	Pemex	2008	114km	$200
Salamayuca pipeline	1997	51%	Pemex, CFE	n.a.	37km	$20
Gloria a Dios compression st.	2011	100%	CFE	2031		$20
TDF LPG pipeline	2007	100%	Pemex	2027	190km	$130
Guadalajara LPG storage	2013	100%	Pemex	2028		$65
Ethane pipeline	2015	100%	Pemex	2036	226km	$330
Ramones I pipeline	2014	100%	Pemex	2039	114km	$550
Ramones Norte pipeline	2015	100%	Pemex	2040	441km	$675

Source: BTG Pactual and the company. (*) some of the data was estimated by BTG

Baja East: The Baja East system comprises three natural gas pipelines (Rosarito Mainline, NLG Spur and Yuma Lateral) and has a 30,000 horse power compressor station located in Baja California. The combined length of the three pipelines is 302km. Together with the ECA Storage facility, we assume Baja East's operations terminate by 2029, when its last currently existing capacity contract expires. 90% of the system's capacity is contracted.

Baja West: Fully contracted by CFE until 2028, the Baja West pipeline has 45km of length and transportation capacity of 940 MMcfd. It interconnects with a subsidiary in the US and also southwest to CFE's Presidente Juarez 600MW capacity power plant.

Baja California

Source: IEnova

Aguaprieta: The small 13km pipeline has 25% of its capacity contracted with Kinder Morgan until 2027. It transports natural gas from the Mexico-US border to the Naco-Nogals combined-cycle power plant located in Agua Prieta city, which provides electricity to CFE. The pipeline was built with the mindset that CFE would expand the power plants in the region. For now, the growth is only a long-term plan and, as such, we leave the spare capacity usage as upside to our model.

Sonora: The Sonora pipeline is broken down into two parts. With the capacity of both fully contracted by the CFE (for 25 years), Sonora's first leg connects Sásabe to Guaymas, while the second one connects Guaymas to El Oro. The Sonora system has a total of 835km and 1,280 MMcfd transportation capacity. The two projects were awarded by CFE back in October 2012 and the commercial operation start-ups are in 2014 (leg I) and 2016 (leg II). Capex was close to US$1bn.

Sonora and Aguaprieta

Source: IEnova

Ojinaga-El Encino: In December 2014, IEnova was awarded the pipeline project by CFE, which contracted the entire capacity for 25 years. The US$300mn capex pipeline will connect the future Waha-Presidio pipeline at the US border to El Encino. The pipeline has 1,356 MMcfd of transportation capacity and its commercial operations are expected to start in the first half of 2017.

Pipelines held by JV Gasoductos de Chihuahua (GdC)

Back in 2010, El Paso's 50% stake in the Gasoductos de Chihuahua joint venture was acquired by the company, alongside Aguaprieta and Naco's compression station. The joint venture now controls a vast number of assets, listed below.

With oil at US$50/bbl and after Los Ramones' recent transaction (Blackrock and First Reserve acquired Pemex PMI's 45% stake in the project), investors might start discussing the likelihood of IEnova acquiring Pemex's stake in GdC's JV.

In our view, and even though such a transaction could create value, we see the partnership as highly important and with the potential to add value over the next years. But this might arguably be a less risky way of IEnova to deploy some capital without adding operational risk.

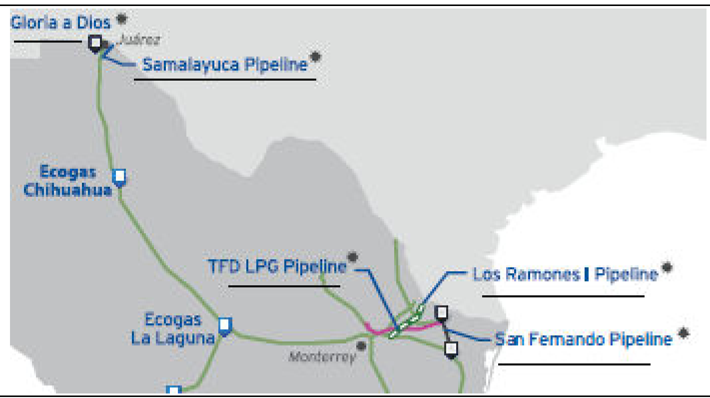
San Fernando: The 114km pipeline, with 1,000 MMcfd transportation capacity and a compression capacity of 1,460MMcfd, has a single customer (Pemex), which has contracted all the pipeline's capacity until 2023.

Samalayuca: This system consists of 37km of pipelines with a capacity of 272MMcfd. It started operations back in 1997 and was the first privately-owned natural gas pipeline in the country. It connects Ejido San Isidro to CFE's Samalayuca power plant. 51% of the system's capacity is contracted.

Gloria a Dios compression station: The 14,340 HP compressor is installed at the interconnection of Samalayuca's pipeline and Pemex Ciudad Juárez's natural gas pipeline. 100% of capacity is contracted with CFE.

TFD LPG: This 190km LPG pipeline has daily transportation capacity of 30,000 Bbld of LPG. It has a pumping station near the pipeline's point of reception and a delivery facility with two storage spheres, with a combined capacity of 40,000 Bbl. It runs from Pemex Gas' Burgos LPG production area to a delivery facility near the city of Monterrey. The capacity is fully contracted to Pemex until 2027 (and it could be extended until 2032, as per the current contract conditions).

Some of GdC assets

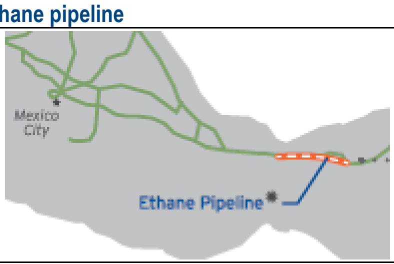


Source: IEnova

Guadalajara LPG terminal: The 80,000 Bbl storage capacity facility is located near Guadalajara and connected to Pemex Gas's separately-owned LPG pipeline system. The capacity is fully contracted by Pemex until 2028.

Los Ramones I: The 114km natural gas pipeline began commercial operations in Q4 2014 and runs from the Mexico-US border into Ramones, with a 2.1bpcd capacity. It cost US$550mn to be built and its capacity is fully contracted by Pemex until 2039.

Ethane pipeline



Source: IEnova

Ethane pipeline: The 224km pipeline had an estimated capex of US$330mn and started operations in Q1 2015. It is fully contracted for 21 years with Pemex. It links Pemex's processing installations in Tabasco to the ethylene and polyethylene polymerization plant Etileno XXI located in Veracruz.

Ramones Norte: The last project currently under construction by GdC's joint venture is 50% controlled by GdC and the remaining 50% by another subsidiary of Pemex

(TAG Norte). The 441km network has an expected construction cost of US$1.3bn (only 25% is the responsibility of IEnova) and its capacity was fully contracted by Pemex until 2040. Operations are expected to start in the last quarter of this year.

#3 Natural gas distribution (Ecogás)

IEnova owns and operates a natural gas distribution utility, called Ecogas, in three distribution zones: Mexicali, Chihuahua and La Laguna-Durango. The last mile pipelines add up to some 3,075km and the business caters to around 100,000 customers.

Rate reviews

Ecogás has no commodity price exposure and the gas price is a pass-through to its final customers. The concessions operate under a ROA-base model, with rate reviews every five years, run by the Mexican Energy Regulatory Commission.

The business is dollarized but charged in pesos. In the yearly tariff adjustment, the foreign exchange move is passed-through. Even though this business is operated under concession terms, the assets are all held by the company and the operations could be perpetual.

Although residential consumers represent 98% of Ecogas' customers, they are responsible for "only" 55% of the concession's profit.

Power segment

IEnova currently owns two different power plants. While Mexicali's power plant is fully controlled by the company, the Energia Sierra Juarez wind power plant is co-controlled by the company via the ESJ joint venture.

Mexicali: The 625MW combined-cycle (and natural gas-run) thermal plant is located near Mexicali and began operations in June 2003. It receives natural gas via IEnova's Baja East pipelines, which allows it to receive regasified LNG from IEnova's LNG terminal as well as gas supplied from the US. Mexicali is directly interconnected to California's Independent System Operator (CAISO) power grid. Even though the plant's entire output is connected to the US grid, the company is starting a transmission investment that will also connect it to the Mexican power grid, allowing it to maximize its returns.

Energia Sierra Juarez: This 155MW wind power plant belongs 50% to IEnova and 50% to Intergen. Having sold a 20y PPA at US$106.5/MWh to the company's US affiliate San Diego Gas & Electric Company, the plant's operations shall start in Q2 2015, after a US$300mn total capex.

Appendices

Revenue per product (excluding the JVs and uncontracted growth)

US$mn	2013	2014	2015	2016	2017	2018	2019
Pow er generation	168	222	163	166	185	186	187
Sale of gas (LNG Marketing)	170	230	200	200	200	200	200
Storage, regas. and others	196	204	205	205	205	205	205
Natural gas distribution (Ecogas)	99	109	100	102	104	106	108
Transportation (pipelines)	44	57	131	168	304	337	344
Total Revenues	**678**	**823**	**798**	**842**	**999**	**1,035**	**1,044**
YoY growth		*21%*	*-3%*	*5%*	*19%*	*4%*	*1%*
EBITDA (ex-JV)	**249**	**281**	**318**	**357**	**489**	**516**	**521**
EBITDA margin	*36.7%*	*34.2%*	*39.8%*	*42.4%*	*48.9%*	*49.9%*	*49.8%*

Source: BTG Pactual and IEnova

Mexicali's main projections

US$mn	2013	2014	2015	2016	2017	2018	2019
Net revenues	168	222	163	166	185	186	187
COGS	(127)	(166)	(110)	(113)	(114)	(114)	(115)
SG&A	(23)	(20)	(30)	(30)	(30)	(30)	(31)
EBITDA	**18**	**36**	**23**	**23**	**42**	**42**	**42**
EBITDA margin	*10.7%*	*16.3%*	*13.8%*	*14.0%*	*22.5%*	*22.4%*	*22.3%*
Termoelectrica de Mexicali							
Installed capacity (MW)	625	625	625	625	625	625	625
Assured capacity (avgMW)	531	531	531	531	531	531	531
Assured capacity (in GWh)	4,654	4,654	4,654	4,654	4,654	4,654	4,654
Availability (%)	*85.0%*	*85.0%*	*85.0%*	*85.0%*	*85.0%*	*85.0%*	*85.0%*
Volume sold (GWh)	3,685	4,225	3,793	3,886	3,886	3,886	3,886
Load factor (as a % of availability)	*79.2%*	*90.8%*	*81.5%*	*83.5%*	*83.5%*	83.5%	83.5%
US$/MWh	45.7	52.6	42.9	42.8	47.7	48.0	48.2
COGS/MWh	34.8	39.5	29.1	29.2	29.3	29.4	29.6
Fuel gas/MWh	26.6	31.0	20.6	20.6	20.6	20.6	20.6
Plant's efficiency (heat rate)	*7.0*	*7.0*	*7.0*	*7.0*	*7.0*	*7.0*	*7.0*
Other costs/MWh	8.2	8.5	8.5	8.6	8.7	8.8	9.0
Gas margin / MWh	10.6	13.0	13.4	13.2	17.9	18.5	18.6
Caiso payment (estimated), US$mn	16.6	19.3	20.0	20.0	21.0	21.4	21.8
Socal Natural Gas (US$/mmbtu)	3.80	4.42	2.94	2.94	2.94	2.94	2.94

Source: BTG Pactual, IEnova, Bloomberg, Bolsa de Mexico

GdC JV income statement

US$mn	2013	2014	2015	2016	2017	2018	2019
Revenue	**147**	**497**	**304**	**426**	**435**	**436**	**445**
Cash costs (estimated)	(22)	(337)	(58)	(77)	(78)	(80)	(81)
EBITDA	**126**	**160**	**246**	**349**	**356**	**356**	**363**
EBITDA margin (estimated)	*85.1%*	*32.2%*	*81.0%*	*82.0%*	*82.0%*	*81.7%*	*81.7%*
Depreciation (estimated)	(29)	(32)	(42)	(52)	(52)	(45)	(45)
Interest expense	(0)	(27)	(43)	(57)	(50)	(52)	(50)
Investment in subsidiries		(9)	0	0	0	0	0
Pre-tax	96	92	161	241	255	259	268
Income tax (expense)	(26)	(42)	(48)	(72)	(76)	(78)	(80)
Tax %	*-27.2%*	*-46.2%*	*-30.0%*	*-30.0%*	*-30.0%*	*-30%*	*-30%*
Net income	**69**	**50**	**113**	**168**	**178**	**182**	**188**
IEnova share of profits	35	25	56	84	89	91	94

Source: BTG Pactual and IEnova

ESJ JV income statement

US$mn	2015	2016	2017	2018	2019
Net Revenues	43.4	59.0	60.2	61.4	62.6
Cash Costs	(11.7)	(9.8)	(10.0)	(10.2)	(10.4)
EBITDA	**31.7**	**49.2**	**50.2**	**51.2**	**52.2**
EBITDA margin	*73.1%*	*83.4%*	*83.4%*	*83.4%*	*83.4%*
Depreciation	(10.8)	(17.3)	(17.3)	(17.3)	(17.3)
Interest expense	(12.5)	(15.5)	(14.2)	(13.4)	(12.0)
Pre-tax	8.4	16.4	18.7	20.5	22.9
Income tax (expense)	(2.5)	(4.9)	(5.6)	(6.1)	(6.9)
Tax %	*-30%*	*-30%*	*-30%*	*30%*	*30%*
Net income	**5.9**	**11.4**	**13.1**	**14.3**	**16.0**
Share of profits	2.9	5.7	6.5	7.2	8.0

Source: BTG Pactual and IEnova

Income Statement (US$mn)	**12/2010**	**12/2011**	**12/2012**	**12/2013**	**12/2014**	**12/2015E**	**12/2016E**	**12/2017E**
Revenue	**-**	**-**	**608**	**678**	**823**	**798**	**842**	**999**
Operating expenses (ex depn)	-	-	(361)	(429)	(542)	(481)	(484)	(510)
EBITDA (BTG Pactual)	**-**	**-**	**246**	**249**	**281**	**318**	**357**	**489**
Depreciation	-	-	(61)	(61)	(62)	(72)	(76)	(83)
Operating income (EBIT, BTG Pactual)	**-**	**-**	**185**	**187**	**219**	**246**	**281**	**406**
Other income & associates	-	-	29	42	25	59	90	96
Net Interest	-	-	(10)	(4)	4	(27)	(40)	(46)
Abnormal items (pre-tax)	-	-	0	0	0	0	0	0
Profit before tax	**-**	**-**	**203**	**226**	**248**	**278**	**332**	**456**
Tax	-	-	(41)	(84)	(111)	(66)	(73)	(108)
Profit after tax	**-**	**-**	**162**	**142**	**137**	**212**	**259**	**348**
Abnormal items (post-tax)	-	-	0	0	0	0	0	0
Minorities / pref dividends	-	-	0	0	0	0	0	0
Net Income (local GAAP)	-	-	162	142	137	212	259	348
Adjusted Net Income	**-**	**-**	**162**	**142**	**137**	**212**	**259**	**348**
Tax rate (%)	-	-	20	37	45	24	22	24
Per Share	**12/2010**	**12/2011**	**12/2012**	**12/2013**	**12/2014**	**12/2015E**	**12/2016E**	**12/2017E**
EPS (local GAAP)	-	-	0.17	0.12	0.12	0.18	0.22	0.30
EPS (BTG Pactual)	-	-	0.17	0.12	0.12	0.18	0.22	0.30
Net DPS	-	-	0.15	0.14	0.14	0.18	0.22	0.30
BVPS	-	-	1.88	2.01	1.95	1.95	1.95	1.95
Cash Flow (US$mn)	**12/2010**	**12/2011**	**12/2012**	**12/2013**	**12/2014**	**12/2015E**	**12/2016E**	**12/2017E**
Net Income	**-**	**-**	**162**	**142**	**137**	**212**	**259**	**348**
Depreciation	-	-	61	61	62	72	76	83
Net change in working capital	-	-	0	(8)	52	0	0	0
Other (operating)	-	-	0	0	0	0	0	0
Net cash from operations	**-**	**-**	**224**	**196**	**251**	**284**	**335**	**431**
Cash from investing activities	-	-	(370)	(325)	(360)	(270)	(87)	(26)
Cash from financing activities	-	-	(141)	86	(212)	(259)	(348)	(427)
Bal sheet chge in cash & equivalents	**-**	**-**	**-**	**232**	**(202)**	**(8)**	**6**	**(4)**
Balance Sheet (US$mn)	**12/2010**	**12/2011**	**12/2012**	**12/2013**	**12/2014**	**12/2015E**	**12/2016E**	**12/2017E**
Cash and equivalents	-	-	88	320	118	110	116	112
Other current assets	-	-	149	178	207	207	207	207
Total current assets	**-**	**-**	**237**	**498**	**326**	**318**	**324**	**320**
Net tangible fixed assets	-	-	1,885	2,214	2,378	2,666	2,860	2,864
Net intangible fixed assets	-	-	26	26	26	26	26	26
Investments / other assets	-	-	353	504	651	651	651	651
Total assets	**-**	**-**	**2,501**	**3,242**	**3,380**	**3,660**	**3,860**	**3,860**
Trade payables & other ST liabilities	-	-	147	170	158	158	158	158
Short term debt	-	-	13	24	209	209	209	209
Total current liabilities	**-**	**-**	**160**	**193**	**368**	**368**	**368**	**368**
Long term debt	-	-	41	451	454	734	934	934
Other long term liabilities	-	-	537	282	309	309	309	309
Total liabilities	**-**	**-**	**738**	**925**	**1,131**	**1,411**	**1,611**	**1,611**
Equity & minority interests	-	-	1,763	2,316	2,249	2,249	2,249	2,249
Total liabilities & equities	**-**	**-**	**2,501**	**3,242**	**3,380**	**3,660**	**3,860**	**3,860**

Company Profile:

IEnova builds and operates energy infrastructure in Mexico. The company's footprint in Mexico spans several lines of business encompassing the entire energy infrastructure value chain open to private investment in Mexico. As of 2014, they have almost 600 employees and invested more than $3.5 billion dollars in operating assets and projects under construction in Mexico, making them one of the largest private energy companies in the country.

Financial ratios	**12/2013**	**12/2014**	**12/2015E**	**12/2016E**	**12/2017E**
EBITDA margin	36.7%	34.2%	39.8%	42.4%	48.9%
Operating margin	27.6%	26.6%	30.8%	33.4%	40.6%
Net margin	21.0%	16.6%	26.6%	30.8%	34.8%
RoE	7.0%	6.0%	9.4%	11.5%	15.5%
RoIC	10.7%	9.7%	9.7%	10.1%	14.1%
EBITDA / net interest	67.9x	-63.3x	11.7x	9.0x	10.6x
Net debt / EBITDA	0.6x	1.9x	2.6x	2.9x	2.1x
Total debt / EBITDA	1.9x	2.4x	3.0x	3.2x	2.3x
Net debt / (net debt + equity)	6.2%	19.5%	27.0%	31.3%	31.4%

Source: Company reports and BTG Pactual estimates. Valuations: based on the last share price of that year(E) based on share price as of 31 March 2015

Required Disclosures

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The figures contained in performance charts refer to the past; past performance is not a reliable indicator of future results.

BTG Pactual Rating	Definition	Coverage *1	IB Services *2
Buy	Expected total return 10% above the company's sector average.	46%	42%
Neutral	Expected total return between +10% and -10% the company's sector average.	48%	47%
Sell	Expected total return 10% below the company's sector average.	6%	15%

1: Percentage of companies under coverage globally within the 12-month rating category.

2: Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

Absolute return requirements

Besides the abovementioned relative return requirements, the listed absolute return requirements must be followed:

a) a Buy rated stock must have an expected total return above 15%

b) a Neutral rated stock can not have an expected total return below -5%

c) a stock with expected total return above 50% must be rated Buy

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Statement of Risk

Ienova receives a relevant part of its revenues from a small number of clients, namely CFE and Pemex. Aside from revenue concentration risk, related-party agreements and the behavior of commodity prices (for its power business and growth of its transportation business) are also relevant risks to track. Like any fast-growth company, executing the capex plan is always a concern as well.

Valuation Methodology

Infraestructura Energetica Nova SAB de CV [MXIENOVA] (Primary) - Our price target (for the existing assets) is DDM-derived, discounted at a nominal kE.

Company Disclosures

Company Name	Reuters	12-mo rating	Price	Price date
IEnova [1, 2, 4, 6, 18, 19, 20]	N.A.	Buy	MXN83.24	31-3-2015

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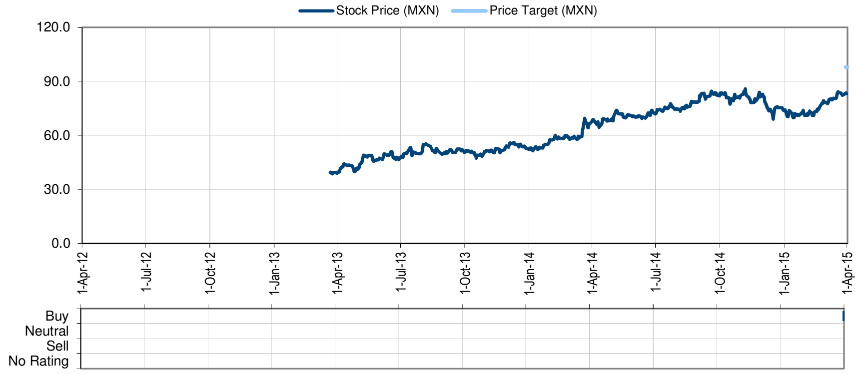
IEnova



Source: BTG Pactual and Economatica. Prices as of 31 March 2015

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