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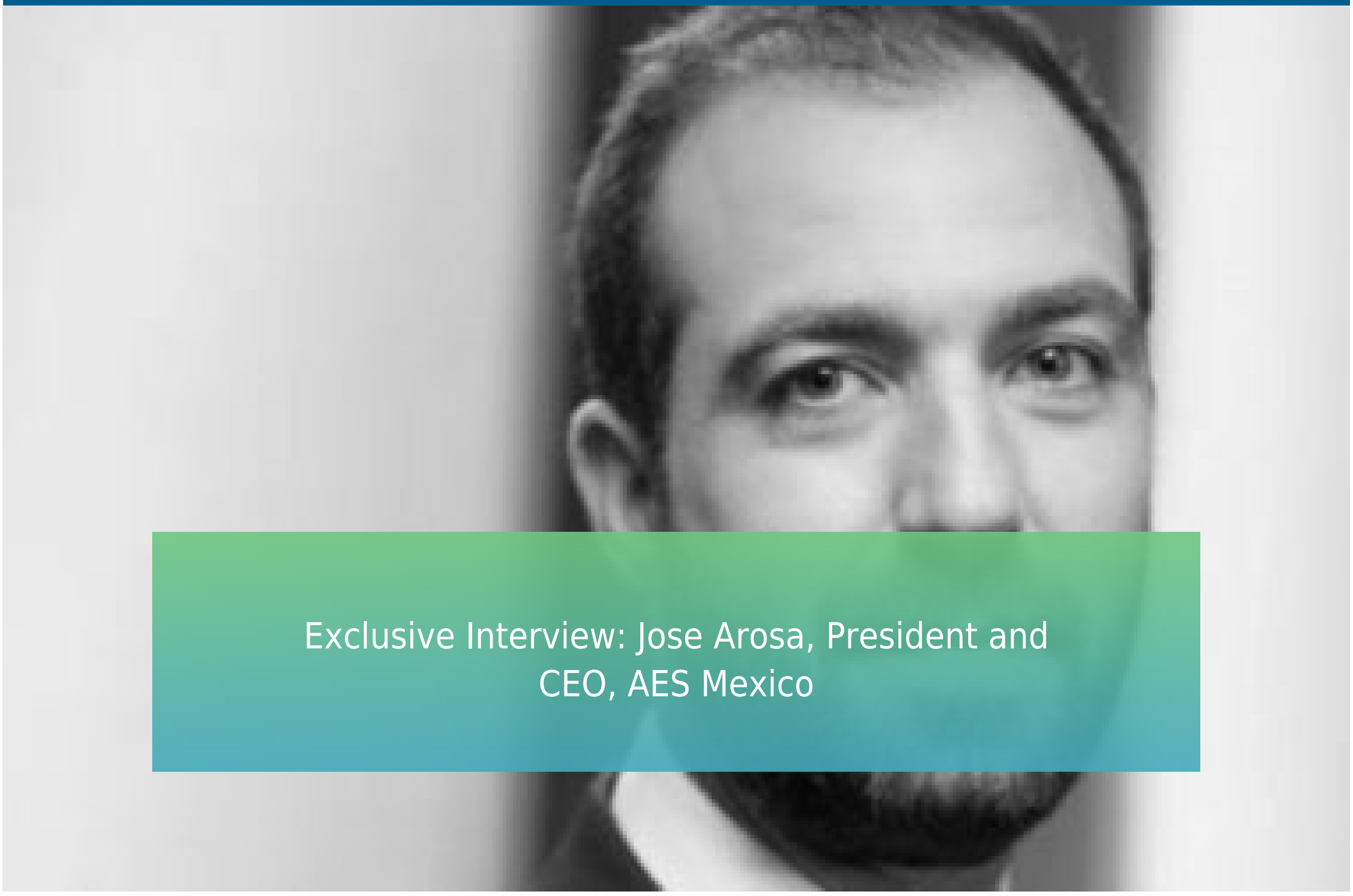

Exclusive Interview: Jose Arosa, President and CEO, AES Mexico

Jose joined AES in 2008 and has worked in a variety of countries and held leadership roles in business development and M&A. He previously led the entry strategy for Inkia Energy as country manager for Mexico and was in charge of the development team for InterGen in the Americas.

Here, Jose talks to Andrew Watson, Head of Latin America at Human Capital, about the power landscape in Mexico and across the region.

AW: What has changed in the power development landscape this year in Mexico?

JA: As in any change of government, this year has been a year of transition. The main development at the beginning of this year was the postponement or cancellation of the renewable auctions that were so successful before. Three auctions were held before the cancellation and they achieved world-record low prices, so we will now wait to see what will happen next. Personally, for AES, we didn't participate in any of the auctions because we want to focus our efforts in bilateral power purchase agreements (PPAs) with industrial and commercial partners.

Another issue that is important for us is the government's commitment to investment in transmission infrastructure in Mexico. The most important challenge for Mexico's development of renewable power is a lack of transmission infrastructure, and at the beginning of this year the government also announced the postponement of two important transmission lines. Mexico needs the auctions and the transmission lines if it is to meet its 35% clean energy target for 2024 that was set in the Energy Reform in 2014.

In October this year, the government also made a regulatory change that reduced the private sector incentives to develop renewable energy. The Energy Reform had created a market for clean energy certificates to encourage new green power generation, obliging companies to obtain a certain amount of electricity from those sources to meet the clean energy goals.

The scheme was tailored to new private sector projects but was amended in October to allow older state-owned hydroelectric energy plants to participate as well. So now the incentive is kind of skewed and that can potentially impact investments that market participants have already made. Market participants are taking legal action to challenge that rule change. If the government wants to change the rules going forward, that’s fine, but it’s hard when a regulatory measure is retrospectively applied and obviously diminishes the value of our assets.

That said, AES is pretty much focused on Mexico, and it is one of our main countries worldwide. We are very keen on expanding, not only our team but also our asset platform. We are looking at investing $2.5bn in the five years up to 2023 – it’s a different environment under the new government but we still believe Mexico has enormous opportunities. We were the first private generator to enter the Mexican market back in 1997, so we have been here a while. We have developed our JV with a local conglomerate, Grupo BAL, and we are pretty aligned on how we see the market, but it is a country we are committed to.

AW: A few years ago, Mexico was heavily targeted by foreign companies for investments in the renewable space. How has this played out?

JA: There are a lot of companies and in the last few months we have seen people announcing some big deals, so there is still very good traction not only in power but also in infrastructure. I still see quite a lot of interest in a number of assets that are going to change hands – there are a lot of pension, private equity and wealth funds from all over the world coming to invest here.

We continue with our development of a few projects and we are sure we are going to start construction sooner rather than later on a number of projects. I believe other companies are in the same position.

AW: What major trends do you expect to see in 2020?

JA: Next year we expect further development in the industrial PPAs. This year it was slow, but hopefully the updated NAFTA agreement will get passed next year and, with that, Mexico will prosper as a manufacturing market with the US as its primary customer. Many companies are waiting to proceed with some caution, but we expect them to start developing industrial PPAs and we are clearly interested in that market.

AW: Outside of Mexico, how attractive are the other countries in Central America for power development?

JA: Central American markets are small markets when you compare to Mexico. Central American countries have limited renewable resources, so even though markets are connected with transmission lines, there is still very limited renewable capacity and their base generation is still dominated with expensive liquid fuels.

AES developed, financed and built the first LNG facility in Central America, in Panama, to supply Central American countries, because we believe that a change to cleaner fuels will not only help the environment but will also lower electricity costs providing greater price stability to support economic growth. The commercial operation of the AES Colón LNG storage facility will allow for the use of LNG throughout the region and establish Panama as the natural gas hub for Central America.

AW: The energy interests of Canada, the USA, and Mexico are highly integrated. What changes, if any, have you noticed in supply agreements across natural gas, oil, and electricity in North America?

JA: Mexico benefits a great deal from being a neighbour to the US, not only when it comes to trade in manufacturing goods, but also in fuel procurement. The US has seen massive gas developments that in a way have to get out to the market. We have seen a lot of LNG developments to sell to other markets in Asia and Europe, but also to Mexico.

In the last decade, Mexico's gas developments and production have decreased significantly, so North America is very important to Mexico and I think Mexico made the right choice. Meanwhile, Mexico has some good resources on the renewables side that can easily be connected to the American system. Today, there are seven electrical interconnections between Mexico and the US and more developments in that area will have a benefit for both countries, because they can be managed to great effect. Right now, Mexico is helping California with a few plants on the border that are connected to the American grid, while Texan facilities are helping the Mexican system. That connection is the right way forward for both countries.

AW: Mexico is known as a difficult market for finding talent in the energy sector. How have you been successful in building and maintaining a strong

team?

JA: People coming to Mexico to share their experience and knowledge in this market is a very good thing and something that we see happening more and more. Here in our office we have a mix of local Mexican talent and people that have come in from other markets over the last few years. There are a lot of companies fighting for the same pool of talent, especially for development and commercial skills.

Our policy is always to hire and develop Mexican talent as much as possible, and so far, that has worked out very well for us.

AW: In five years, what bold and major prediction would you make regarding the Mexican energy sector?

JA: I believe that, in five years' time, hopefully AES will have achieved our goal to invest $2.5bn in Mexico, and we will have cemented our presence here as one of the key players in the Mexican market.

As for the market, it will be more efficient in five years' time.

Change is to be expected – this is a new market that has seen a lot of recent developments and now has a new administration that is working in a different way. The Mexican market fundamentals are still very, very solid and the next five years will be extremely positive for renewable energy here.