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Corporates Argentina – Equity

September 5, 2023

TGN flowing like nat. gas to the north

New Trades

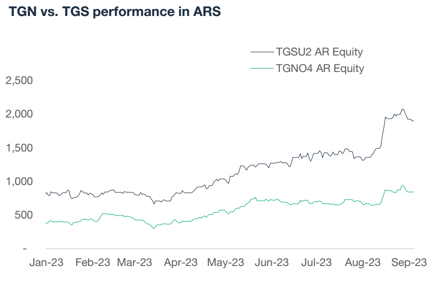
Trade			Rationale
Buy **TGN04**	Open Price: **ARS843** 6-mo Price Target: **ARS1,870**	Opening Date: **05/09/23**	We recommend buying TGN04, as it has lagged behind TGSU2. We expect the price differential, which is currently at ARS1,056, to correct to ARS600, as it has already been announced the tender of the reversion of the North gas pipeline.

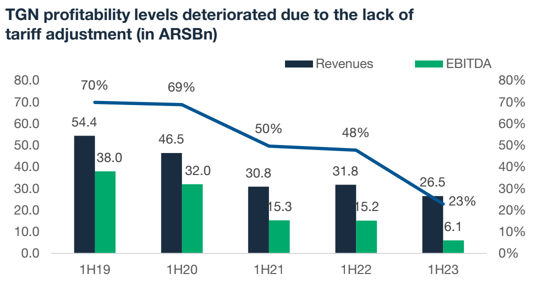
We initiate coverage of Transportadora de Gas del Norte (ticker in BYMA: TGNO4). We believe the stock has lagged behind Transportadora de Gas del Sur (TGSU2) in the past months. In our view, the reasons behind that are (i) the launch of the Nestor Kirchner pipeline, in which TGS awarded a service and maintenance contract, (ii) TGS is not only in the natural gas transportation business but also in the liquid business, with a higher share of USD-linked revenues, (iii) the number of shares floating of TGS is higher than TGN and (iv) TGS also accounts for ADRs in NYSE. Now that the government launched the tender of the North gas pipeline, we expect the price differential, which is currently at ARS1,056, to correct to ARS600. Considering end of Feb-24 MEP FX at ARS1,100/USD, we expect TGN04 to stand at ARS1,870 (or USD1.70), which is line with our DCF model (Df: 16.3%).

Our most probable scenario is that TGN profitability will continue to decline until the integral revision of tariffs (RTI – Revision Tarifaria Integral), which the sector expects for 2025. However, the company will stand still thanks to holding a strong liquidity position and low indebtedness level that will help to navigate these transitional years, in our view. We believe that the scenario for next year could improve if inflation slows down after the government gives another transitional tariff increase. According to the local media, ENARGAS would be pushing the RTI to take place this year, but we believe it will be unlikely considering the presidential elections. An additional positive driver could be the increase in interruptible volumes dispatched on the back of higher exports to Chile.

Compared to TGS's natural gas transportation business, TGN revenues were more resilient, coming down by 16% yoy vs. -21% yoy for TGS. It was due to TGS average daily deliveries decreased 8% yoy to 69MMm3/d while TGN's decreased by 4.9% yoy to 57.9MMm3/d. Given that natural gas producers find it attractive to export natural gas to Chile due to the price differential with the local one, we believe TGN has more growth potential in the transportation business than TGS, as it operates the pipeline that connects with the ones that export natural gas to Chile. With the completion of the last stage of the reverse of the North gas pipeline, Argentina could export natural gas through the Tres Cruces pipeline, which went out of use, to the north of Chile. TGN also operates the pipelines that connect with ones that export to Brazil and Uruguay. However, we do not see any material increase in natural gas transportation in them in the short/mid-term. In terms of liquidity levels, both companies show solid levels, with cash more than covering ST debt. On the debt side, TGS net leverage was low at 0.2x, while TGN showed a negative net debt. Another difference is that TGS main debt is a USD500mn international bond, maturing in 2025, while TGN's is a USD55mn loan with Itau Unibanco.

Figure 1: TGN04 should catch up with TGSU2, as both are facing the similar challenges





Source: TPCG Research based on Bloomberg, TGN's reports

An overview of the company

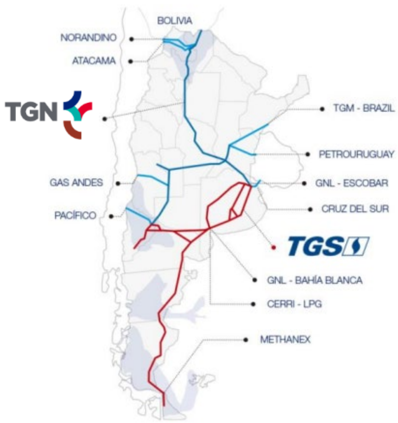
Founded in 1992, TGN is the second largest gas transportation company in Argentina, with the exclusive right to operate and maintain a 6,788km natural gas pipeline in the north and central region of the country until 2027. The license is extendable for an additional 10-year period. Moreover, TGN operates third parties gas pipeline networks, for a total of 4,165km. TGN transportation capacity is of 59.7MMm3/d, of which 48.5MMm3/d are under long-term firm contracts. The company transports 40% of the injected total natural gas, which comes from the Salta and the Neuquina basins in Argentina and the Altiplano basin in Bolivia.

In FY22, the company received and transported 51.3MMm3/d on average, 61% or 31.2MMm3/d were distributed by the Central West pipeline, 26% or 13.4MMm3/d by the Northern pipeline, and 6.65MMm3/d in the Province of Buenos Aires. The Central West pipeline of 1,121km and a 32MMm3/d capacity starts at Loma La Lata gas field to end in San Jeronimo compressor station. The Northern pipeline of 1,454km and 28MMm3/d capacity starts at Campo Duran in Salta province to end in San Jeronimo in Santa Fe province.

In the past years, TGN natural gas dispatch mix changed in favor of the Central West pipeline. With the substantial decrease in Bolivia's natural gas dispatches to Argentina and the decline in the Northwest basin production, the volume dispatched from the Northern pipeline decreased from 9,766MMm3 in FY17 to 6,870MMm3 in FY22.

In 2022, Bolivian imports were 3,842MMm3, down by 40% from 2017 of 6,618MMm3. Bolivia has not been able to comply with the agreement. In fact, in July, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) informed ENARSA that as of 2024 natural gas dispatch under the firm contract will not be guaranteed and the contract will change to be interruptible. The government of Bolivia stated that the volumes sent would diminish by 30% next year. Due to the importing of LNG and liquids being more expensive in the past 3 years, the government did not have any other options than reluctantly accepting whatever Bolivia sent. This is important because only 47% of the 28.5MMm3/d of the North gas pipeline capacity was used in FY22.

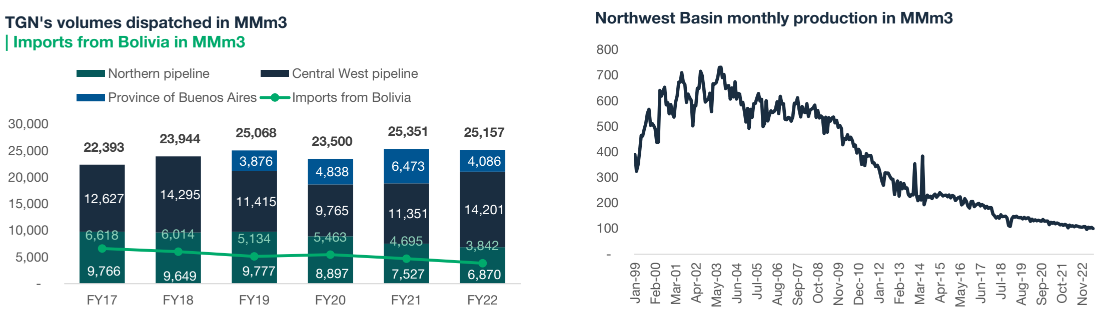
Figure 2: Map of Argentina's natural gas transportation system



Source: TPCG Research based on the companies' reports

The province of Tucuman is the most affected by the acceleration in Bolivia's imports fall, as thermal power plants mainly depend on natural gas. For instance, YPF Luz reported a decrease of 54% in the volumes dispatched by the Tucuman Complex, partly due to this in 2Q22. The reversion of the North gas pipeline is key to offset the lower imports from Bolivia with natural gas production from Vaca Muerta. The decline in the Northwest Basin natural gas production put further pressure on the advancement of this project, as after reaching a peak in 2003, it went on free fall, now standing at its lowest levels.

Figure 3: The reverse of the North gas pipeline is critical. Bolivia's natural gas dispatch is uncertain for 2024, and Northwest Basin production is bottoming out.



Source: TPCG Research based on TGN's reports, Secretariat of Energy.

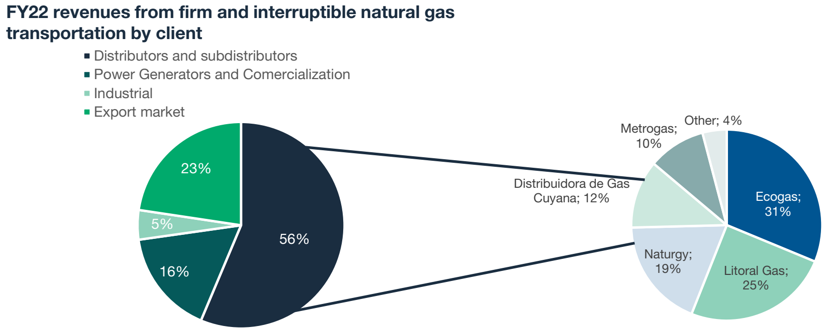
The reversion of the North gas pipeline is split in 3 stages. The first stage, completed last July, increased transportation capacity from South to North from 7MMm3/d to 10MMm3/d. To do that, TGN worked in the reversal of 2 of its compression plants: Tio Pujio and Leones. The company spent ARS3,000mn (~USD12mn). The second stage expects to increase transportation capacity to 19MMm3/d. The project costs USD710mn, of which USD540mn will be financed with a loan from CAF and the rest with cash inflows from CAMMESA. On August 25th, the government launched the tender for the construction of a 122.5km new pipeline from La

Carlota to Tio Pujio towns and the addition of 2 loops. Then, TGN will have to revert 5 compression plants (Tio Pujio, Ferreyra, Dean Funes, Lavalle and Lumbreras). This project is critical for the supply of gas of the northern region next year. The third stage plans to increase transportation capacity to 29MMm3/d. With the completion of this last stage, Argentina will be able to increase natural gas exports.

Given that 81% of total transportation capacity is under firm contracts, the delay in the launch of the second stage of the North gas pipeline does not put the company's cash generation in a tight spot in the short term. Under firm transportation capacity contracts, customers pay for the contracted pipeline capacity, regardless of its use. TGN client base is not concentrated. Natural gas distributors accounts for 56% of firm and interruptible natural gas sales. Ecogas is the largest client, accounting for 18% of total revenues from firm and interruptible natural gas transportation. It is followed by Litoral Gas with 14% and Naturgy with the 10%.

Another important revenue generator is gas transportation for export to Chile which has increased significantly in the past years. TGN transports the natural gas from the Neuquina Basin to GasAndes pipeline. Around 90% of natural gas exports goes through GasAndes pipeline. We believe it is the segment that it will increase the most in the next years. In FY22, natural gas dispatch for export increased by 1.6x yoy to 1.9MMm3/d. Revenues also grew in line thanks to tariffs being charged in USD-linked. In FY22, it represented around 50% of interruptible natural gas transportation sales. Including firm sales, it accounted for 23%.

Figure 4: Revenues from the export market have increased materially



Source: TPCG Research based on TGN's reports

What has eroded the company's revenues despite volumes dispatched remaining sound was the freezing of tariffs. After 2 years without receiving any adjustment (2020 and 2021), the ENARGAS gave a 60% increase in tariffs as of March bills in 2022 and a 95% increase as of April bills in 2023. The government decided not to increase tariffs according to the integral revision of tariffs (RTI – Revision Tarifaria Integral) of 2017 in 2020 and 2021. The government has been postponing doing the RTI since last year. Instead, it gave the aforementioned increases. Because of the presidential elections this year, and that, consequently, next year may be a transitional year, we expect the RTI to take place in 2025.

It is worth mentioning that TGN will report a higher net income in the next 1Qs, thanks to the legal action taken against YPF SA in which the last one agreed to pay TGN USD190.6mn in four annual installments at the official FX each February, from 2024 until 2027. In addition, TGN has a similar legal claim against Metrogas Chile for USD135mn plus 4% in interests accrued.

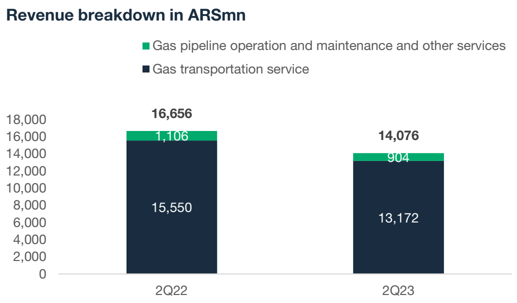
2Q23: TGN stands still thanks to its strong cash position.

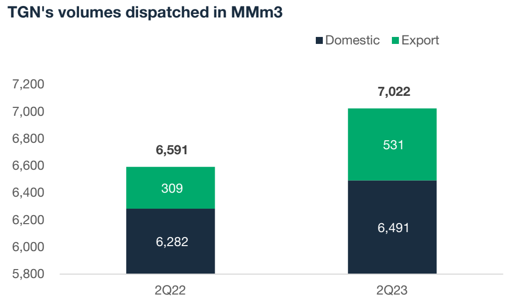
Revenues decreased 15.5% to ARS14,076mn (-7.3% yoy to USD61mn), due to the increase in tariffs was lower than the accumulated inflation. TGN operates third parties nat gas pipelines. In our view, the most significant is the one that transports the natural gas from the floating storage regasification unit (FSRU) in Escobar port. In 2023, 32 LNG vessels arrived at Escobar vs. 27 in 2022. As a result, nat gas transportation volumes in Province of Buenos Aires grew by 63% yoy to 1,808MMm3. Including the operation of third-party natural gas pipelines, volumes dispatched were up by +6.5% yoy to 7,022MMm3. Interruptible & exchange and displacement volumes dispatched increased by +18.4% yoy to 3,747MMm3, mainly driven by the Central West pipeline, on the back of higher natural gas transportation for export (+72% yoy). Even so, gas transportation service revenues were down 15.3% yoy to ARS13,172mn (USD57mn) and Gas pipeline operation and maintenance, and other services declined by 18.3% to ARS904mn (USD3.9mn).

Despite TGN reducing the costs of service by 28% yoy and selling expenses by 6% yoy, administrative expenses were up by +56% yoy, due to the payment of legal advisory for the claim against YPF, driving

EBITDA down 49% yoy to ARS4,703mn (USD20mn). Consequently, the EBITDA margin dropped from 55% in 2Q22 to 33% in 2Q23.

Figure 5: TGN's volumes dispatched grew by +6.5% yoy in 2Q23.





Source: TPCG Research based on TGN's reports

Looking at the FCF, the company burnt ARS1,121mn in 2Q23. It was due to the increase in the exchange rate differences, losses from investments in affiliated companies and higher account payables cash outflows. Capex increased +9% yoy to ARS3,041mn, although it was down by 22% to USD13mn in USD terms. TGN gross debt, including leases, was flat qoq at USD60mn. As of June 30th, 2023, the company's debt was comprised of a USD55mn loan with Itaú Unibanco S.A. Nassau Branch and leases for USD5mn, of which USD4.8mn are long term. Despite the company showing weaker results in terms of profitability and cash generation, the liquidity level remains solid, with cash + ST investments equivalents to USD109mn, including the cash collateral of the loan, it was USD165mn. As a result, the net debt of the company is negative at -USD105mn.

Figure 6: TGN's 2Q23 summary financials.

Summary financials (in ARSmn)	2Q22	2Q23	Chg yoy	1Q23	2Q23	Chg qoq
Income Statement Items						
Revenues	**16,656**	**14,076**	*-15.5%*	**11,480**	**14,076**	*22.6%*
Opex	(18,300)	(15,234)	*-16.8%*	(13,186)	(15,234)	*15.5%*
EBITDA	**8,473**	**4,244**	*-49.9%*	**1,965**	**4,244**	*115.9%*
Net Income	**(2,676)**	**2,455**	*n.m.*	**12,501**	**2,455**	*-80.4%*
Gross Margin	8%	22%		24%	22%	
EBITDA Margin	51%	30%		17%	30%	
Balance Sheet Items						
Short Term Debt	**14,917**	**101**	*-99.3%*	**258**	**101**	*-60.9%*
Long Term Debt	**43**	**15,344**	*n.m.*	**14,230**	**15,344**	*7.8%*
Total Debt	**14,960**	**15,444**	*3.2%*	**14,488**	**15,444**	*6.6%*
Cash & Cash Eq. + ST Investments	**23,549**	**42,379**	*80.0%*	**36,735**	**42,379**	*15.4%*
Gross Leverage (LTM)	0.5x	1.0x		0.8x	1.0x	
Net Leverage (LTM)	-0.3x	-1.7x		-1.2x	-1.7x	
Cash / ST Debt	158%	42073%		14264%	42073%	
ST Debt / Total Debt	34588%	1%		2%	1%	
Debt / Capital	7%	7%		7%	7%	
Liquidity ratio	2.4x	2.1x		7.9x	2.1x	
Cash Flow Items						
Funds From Operations	**7,415.4**	**(625.7)**	*n.m.*	**(2,874.5)**	**(625.7)**	*-78.2%*
Change in Working Capital	4,147.6	1,517.6	*-63.4%*	11,090.5	1,517.6	*-86.3%*
CFO after cash interest & taxes	**11,563.0**	**891.9**	*-92.3%*	**8,215.9**	**891.9**	*-89.1%*
Capex	(2,657.2)	(2,890.7)	*8.8%*	(1,200.6)	(2,890.7)	*140.8%*
Free Operating Cash Flow	**8,905.8**	**(1,998.8)**	*n.m.*	**7,015.3**	**(1,998.8)**	*n.m.*
Acquisition (Disposals)	-	-	*n.m.*	-	-	*n.m.*
Free Cash Flow	**8,905.8**	**(1,998.8)**	*n.m.*	**7,015.3**	**(1,998.8)**	*n.m.*
OCF/Total Debt	309%	23%		227%	23%	
FOCF/Total Debt	238%	-52%		194%	-52%	
FCF/Total Debt	238%	-52%		194%	-52%	
Capex/Sales	16%	21%		10%	21%	

Source: TPCG Research based 2Q22 and 1Q23 figures adjusted by inflation.

Figure 7: TGN's forecast.

Operating Data	FY21	FY22	FY23E	FY24E	FY25E	FY26E
Northern pipeline	7,527	6,870	6,046	5,139	5,242	5,504
Central West pipeline	11,351	14,201	14,911	16,402	17,058	18,082
Province of Buenos Aires	6,473	4,086	5,400	5,832	6,124	6,491
Volumes dispatched (MMm3)	**25,351**	**25,157**	**26,357**	**27,373**	**28,423**	**30,076**
Summary financials (in ARSmn)	**FY21**	**FY22**	**FY23E**	**FY24E**	**FY25E**	**FY26E**
Income Statement Items						
Revenues	**20,041**	**40,942**	**106,605**	**297,825**	**368,024**	**471,024**
Opex	(24,302)	(47,424)	(128,992)	(300,803)	(309,140)	(273,194)
EBITDA	**8,075**	**16,591**	**30,402**	**102,758**	**150,737**	**301,311**
Net Income	**(9,274)**	**(7,174)**	**11,225**	**46,318**	**87,175**	**157,443**
Gross Margin	-3%	2%	15%	23%	35%	55%
EBITDA Margin	40%	41%	29%	35%	41%	64%
Balance Sheet Items						
Total Debt	**6,346**	**10,557**	**24,900**	**65,985**	**15,085**	**17,800**
Cash & Cash Eq. + ST Investments	**13,072**	**18,368**	**20,941**	**76,067**	**78,451**	**182,696**
Gross Leverage (LTM)	0.8x	0.6x	0.8x	0.6x	0.1x	0.1x
Net Leverage (LTM)	-0.8x	-0.5x	0.1x	-0.1x	-0.4x	-0.5x
Liquidity ratio	187%	449%	214%	81%	140%	241%
Cash Flow Items						
Funds From Operations	**5,925**	**6,271**	**14,919**	**58,727**	**143,757**	**200,017**
Change in Working Capital	5,364	9,958	(13,686)	537	(7,084)	(23,035)
CFO after cash interest & taxes	**11,288**	**16,228**	**1,233**	**59,265**	**136,672**	**176,982**
Capex	(3,246)	(7,746)	(8,605)	(17,852)	(75,692)	(87,737)
Free Operating Cash Flow	**8,042**	**8,483**	**(7,372)**	**41,413**	**60,980**	**89,244**
Acquisition (Disposals)	-	-	-	-	-	-
Free Cash Flow	**8,042**	**8,483**	**(7,372)**	**41,413**	**60,980**	**89,244**

Source: TPCG Research estimates based on the company's reports.

EOP Official FX estimates: ARS455/USD in 2023, ARS1,207/USD in 2024, ARS1,509/USD in 2025 y ARS1,780/USD in 2026.
Annual Inflation estimates: 164% in 2023, 165% in 2024, 25% in 2025 y 18% in 2026.

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