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**Corporates Argentina - Equity**

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# TGS 4Q23 & FY23: in the wait for a tariff increase

## Trade Book

**TGS ADRs | Price (USD)**


| TGS | Overweight |
|---|---|
| Price target | 17.00 |
| Price (8-Mar-24) | 12.17 |
| Potential Upside | 40% |

### Open Trades

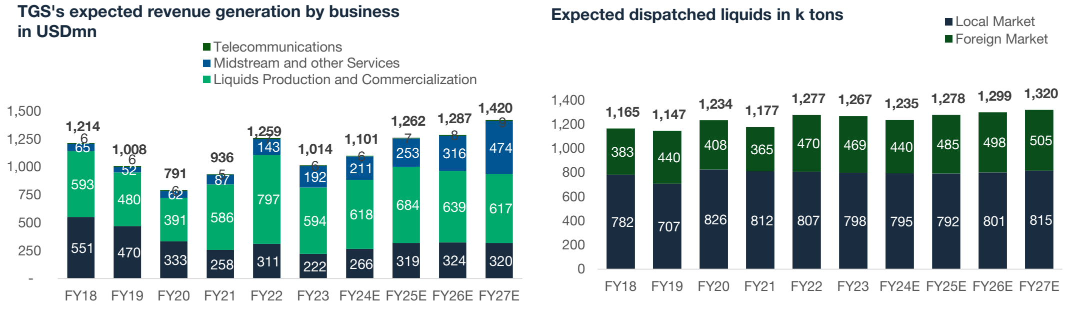
| Trade | Trade | | Rationale |
|---|---|---|---|
| **EXD** | | | |
| Buy **TGS** | Open Price: **USD12.17** Target Price: **USD17** | Opening Date: **11/03/24** | We expect the transitional increase in natural gas transportation tariff to boost TGS 2Q24 results. Growth will be led by Midstream and Other services businesses on the back of higher activity in Vaca Muerta. Currently, TGS is working on the construction of two modular conditioning plants. The construction of a major project is under analysis. |

TGS's natural gas transportation business revenues has been on the downward trend since FY19, reaching a record low of USD223mn in FY23, due to the lack of tariff adjustment. The strong performance of the Liquids business in the past 3 years, explained by a high price environment, was key to offset the poor performance of the natural gas transportation business. The midstream and other services revenues have increased by leaps and bounds driven by Vaca Muerta's strong growth.

We expect TGS to deliver poor results in 1Q24, due to PBB Polisur S.R.L. ethane purchases being on a halt from December 15th to mid-February. It was due to a rough storm that affected the petrochemical plant. Moreover, the government did not announce yet natural gas transportation transitional tariff increase. Management expects this to occur in the upcoming week. Thus, the positive impact should be noticed as of April-2024.

With this in mind, TGS revenues will take off in 2Q24, on higher natural gas transportation tariffs, liquids volumes sold and revenues from the midstream and other services business. We expect this last one to grow on the back of YPF's ramping up natural gas production in Vaca Muerta, as a result of the divestment of mature conventional blocks. 2Q24 performance will be stronger if there is another jump in the FX, as it will positively impact liquids exports and propane local sales, which price is at the export parity. In addition, it will dilute COGS and S&GA measured in USD terms. Another revenue growth driver would be the elimination of the Plan Hogar, which regulates the local butane price.

### Figure 1: TGS performance improving as of 2Q24




Source: TPCG Research estimates based on TGS's FFSS

Currently, TGS is working in the construction of two modular conditioning plants, each with a treating capacity of 6.6MM3/d of natural gas to increase Tratayen's conditioning capacity. There is a more ambitious project which consist of the addition of 5 modular conditioning plants, a polyduct and fractionation plant. The initiative will not only involve TGS but also natural gas producers. TGS would be the owner of the 5 modular conditioning plants while it would have a participation of 30% in the polyduct and fractional plant.

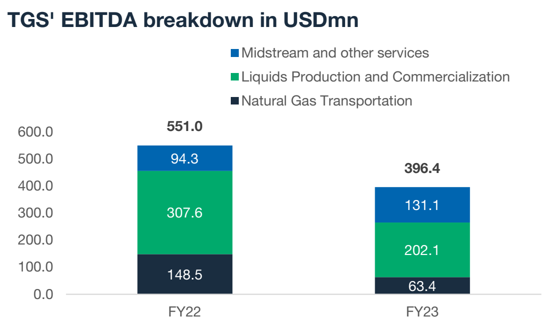
Depending on the economic perspectives, the company will decide to move forward with the project, whose estimated length is of 3 years. The construction of the first module is expected to start in August while the second one in October of this year.

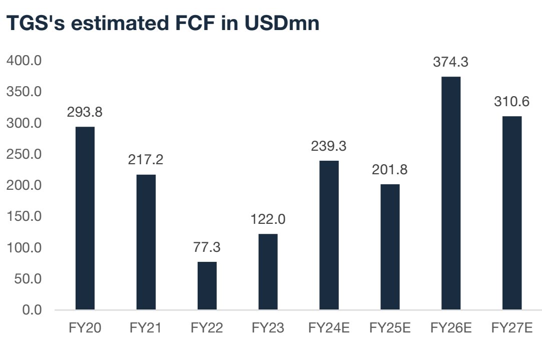
Moving to the company's FY23 performance, according to our estimates, TGS revenues were down by 19% yoy to USD1,014mn. Natural gas transportation revenues decreased by 29% yoy to USD222mn, as the previous government granted a transitional tariff increase of 95% in April-2023 while 2023 annual inflation was 211.4%. Liquid sales were down by 25% yoy to USD594mn, driven by lower exports of propane and lower butane and propane local sales, coupled with lower international prices. Midstream and other services revenues were up by 34% yoy to USD192mn, on the back of the increasing activity in Vaca Muerta.

Despite COGS declined by 13% yoy due to lower costs of gas consumed, it was not enough to compensate for the revenue contraction, resulting in EBITDA decreasing by 28% yoy to USD396mn. By segment, Natural Gas Transportation EBITDA was down by 57% yoy to USD63mn, Liquids EBITDA decreased by 34% yoy to USD202mn. In contrast, Midstream and other services EBITDA increased by 39% yoy to USD131mn.

Even so, TGS's FCF remained on positive ground. In fact, it improved +58% to USD122mn, explained by lower income tax paid (-USD25mn vs. -USD197mn in FY22), higher trade payable cash inflows (+USD66mn vs. +34mn in FY22) and contract liabilities cash inflows (+44mn vs. +USD6mn in FY22). Capex increased by 56% yoy to USD302mn. As a result, TGS liquidity position got more robust, with cash and cash equivalents + ST investments increasing +71% yoy to USD408mn.

## Figure 2: We do not rule out TGS paying dividends, as it did in 2018 and 2019.




Source: TPCG Research estimates based on TGS's FFSS

We estimate TGS FCF will increase by 96% yoy to USD239mn in FY24, on the back of higher profitability levels, with revenues increasing by 9% yoy to USD1,101mn and EBITDA reaching USD473mn (+19% yoy). We expect that the company follows YPF's steps to address TRAGAS 6.75 2025 maturity, announcing a tender and the issuance of a new 2031 bond. What hampers the advance in the major project with natural producers, like Pampa, is Cammesa payment delays which are negatively impacting the companies' working capital and increasing uncertainty within the sector. Considering that energy is key, we are confident that the situation will regularize by April-May. For this reason, we included the major project in our estimates. As a result, TGS capex would increase materially to USD500mn in 2025 and 2026. These increases will also be driven by the new RTI (Integral Tariff Revision), if it is successful, as TGS will have to comply with a Capex plan.

If the FX unifies, we do not rule out TGS paying dividends, as it did in 2018 and 2019. Back then, TGS paid dividends for a total of USD154mn in FY18 and USD203mn in FY19. It is worth mentioning that the payment of dividends must be contemplated in the new RTI. We believe that as it has been 4 years in which TGS's liquidity position has strengthen and has not been able to pay dividends, the new government will be ok with the dividend distribution. However, the company's decision will also depend on its projects' financial needs. For this reason, we estimated dividend payments in FY26, when the major project should reach COD, and in FY27, which would mean a cash outflow of USD263mn and USD200mn, respectively.

## Figure 3: TGS's 4Q23 and FY23 summary financials.

| Summary financials (in USDmn) | FY22 | FY23 | *Chg yoy* | 4Q22 | 4Q23 | *Chg yoy* |
|---|---|---|---|---|---|---|
| ***Income Statement Items*** | | | | | | |
| **Revenues** | **1,258.7** | **1,013.7** | *-19.5%* | **244.2** | **229.4** | *-6.1%* |
| Opex | (856.9) | (751.3) | *-12.3%* | (194.5) | (213.2) | *9.6%* |
| **EBITDA** | **551.0** | **396.4** | *-28.1%* | **90.5** | **87.5** | *-3.3%* |
| **Net Income** | **247.2** | **52.6** | *-78.7%* | **33.0** | **(52.5)** | *n.m.* |
| Gross Margin | 42% | 37% | | 35% | 36% | |
| EBITDA Margin | 44% | 39% | | 37% | 38% | |
| ***Balance Sheet Items*** | | | | | | |
| Short Term Debt | **22.1** | **74.9** | *238.5%* | **22.1** | **74.9** | *238.5%* |
| Long Term Debt | **512.0** | **508.5** | *-0.7%* | **512.0** | **508.5** | *-0.7%* |
| **Total Debt** | **534.1** | **583.4** | *9.2%* | **534.1** | **583.4** | *9.2%* |
| **Cash & Cash Eq. + ST Investments** | **238.7** | **407.5** | *70.7%* | **238.7** | **407.5** | *70.7%* |
| Gross Leverage (LTM) | 1.0x | 1.5x | | 1.0x | 1.5x | |
| Net Leverage (LTM) | 0.5x | 0.4x | | 0.5x | 0.4x | |
| Cash / ST Debt | 1079% | 544% | | 1079% | 544% | |
| ST Debt / Total Debt | 4% | 13% | | 4% | 13% | |
| Debt / Capital | 26% | 36% | | 26% | 36% | |
| Liquidity ratio | 365% | 356% | | 365% | 356% | |
| ***Cash Flow Items*** | | | | | | |
| **Funds From Operations** | **345.6** | **494.1** | *43.0%* | **62.5** | **129.5** | *107.3%* |
| Change in Working Capital | (30.9) | (34.4) | *11.3%* | (3.5) | 4.5 | *n.m.* |
| **CFO after cash interest & taxes** | **270.9** | **424.4** | *56.6%* | **40.6** | **117.2** | *188.6%* |
| Capex | (193.6) | (302.4) | *56.2%* | (62.1) | (98.0) | *57.9%* |
| Disposals | - | - | *n.m.* | - | - | *n.m.* |
| **Free Operating Cash Flow** | **77.3** | **122.0** | *57.8%* | **(21.5)** | **19.1** | *n.m.* |
| Acquisition (Disposals) | - | - | *n.m.* | - | - | *n.m.* |
| **Free Cash Flow** | **77.3** | **122.0** | *57.8%* | **(21.5)** | **19.1** | *n.m.* |
| OCF/Total Debt | 51% | 73% | | 30% | 80% | |
| FOCF/Total Debt | 14% | 21% | | -16% | 13% | |
| FCF/Total Debt | 14% | 21% | | -16% | 13% | |
| Capex/Sales | 15% | 30% | | 25% | 43% | |

Source: TPCG Research estimates based on TGS's FFSS. Income Statement and Cash Flow figures were calculated using AVG FX while the Balance Sheet figures were calculated using EOP FX.

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