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Corporates Argentina - Equity

April 4, 2024

TGS & TGN receiving 675% tariff increase

Trade Book

TGS ADRs | Price (USD)

TGS	**Overweight**
Price target	22.00
Price (4-Apr-24)	17.02
Potential Upside	29%

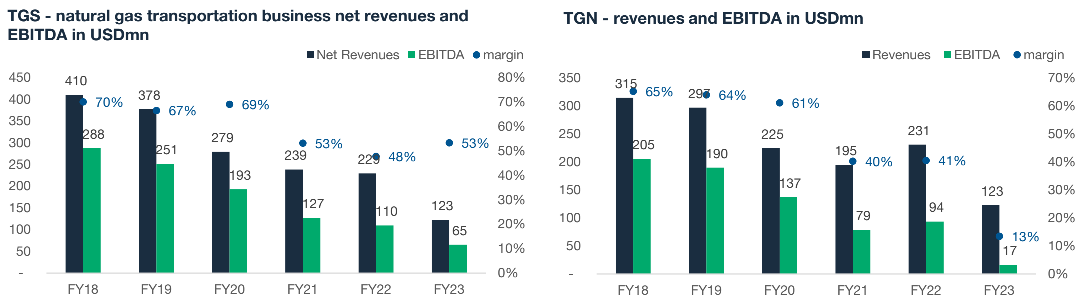
Open Trades

Trade	Trade		Rationale
EXD			
Buy **TGS** or **TGSU2**	Open Price: **USD12.17** 6-mo Target Price: **USD22** 6-mo Target Price: **ARS4,700**	Opening Date: **11/03/24**	We expect the transitional increase in natural gas transportation tariff to boost TGS and TGN 2Q24 results. However, we expect TGS to show stronger results than TGN on the back of higher revenues from the Liquids and Midstream and Other services businesses. For this reason, we recommend a tactic move of increasing exposure to TGS over TGN.
TGN04	Open Price: **ARS843** 6-mo Target Price: **ARS2,800**	Opening Date: **05/09/23**	

On April 3rd, the ENARGAS (The National Natural Gas Regulatory Entity) announced a new transitional increase in natural gas transportation tariff of 675%. It will help to compensate for the accumulated inflation between April-22 and April-24. The last tariff increase was 95% a year ago. Until the completion of the new RTI (Integral Tariff Revision), tariffs will adjust monthly, according to an index that is comprised of the monthly variations of private sector wages index, the wholesale price index and the construction cost index published by the INDEC. In addition, TGS will have to commit a capex plan of ARS27,690mn (USD32.4mn) while TGN of ARS19,150mn (USD22.4mn), adjusted by the same indexes. In our view, they do not look like a significant amount considering FY23 Capex, which was USD302.4mn for TGS and USD79.6mn for TGN.

TGS and TGN revenues will jump in 2Q24, while 1Q24 revenues will be weaker than 4Q23. In FY23, TGS's revenues from natural gas transportation were down by 22% yoy to ARS99,052mn, reaching a record low of USD122.5mn. Due to the lack of tariff adjustment in line with inflation, revenues have been down from USD410mn in FY18. The EBITDA margin decreased to 53% in FY23 from 70% in FY18. Likewise, TGN's revenues dropped by 22% to ARS99,437mn (USD123mn), 70% below FY18 levels. The EBITDA margin shrank to 13% in FY23 from 65% in FY18. TGN's net income was negative in FY21 and FY22. In FY23, it turned positive thanks to the income from commercial compensation, in which YPF must pay USD190.6mn in 4 annual installments from February 1st, 2024, until 2027.

Figure 1: With the new transitional tariff increase and subsequent monthly adjustments, TGN & TGS natural gas transportation profitability levels will revert to pre-pandemic levels



Source: TPCG Research estimates based on TGS and TGN's FFSS, figures converted into USD at the EOP FX.

While TGN is only focused on the natural gas transportation business, TGS is also involved in the liquids business, producing ethane, propane, butane, and natural gasoline, and midstream business, which comprise natural gas transportation and conditioning services at Vaca Muerta, and Nestor Kirchner's pipeline operation, maintenance, and complementary works. These other businesses helped TGS to offset natural gas transportation declining revenues in the past years, mainly due to the high international price environment for liquids.

YTD TGN04 outperformed TGSU2, with a total return of 566% vs. 362%, respectively. Now that the price differential between TGN04 and TGSU2 is at lows, we prefer moving from TGN04 to TGSU2. We believe that at this level TGSU2 price will increase more rapidly than TGN04, as TGS's shares are more liquid than TGN's. The number of shares floating of TGS is higher than TGN and TGS also accounts for ADRs in NYSE. Other factors that should help TGS's share to remain on the rise are:

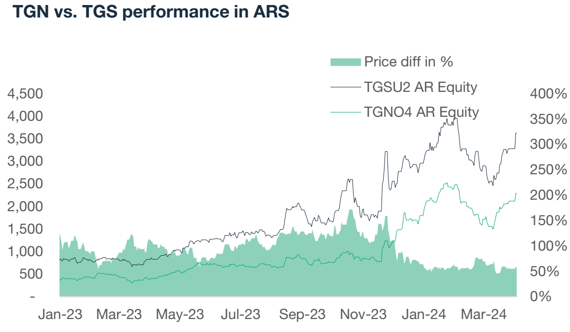
- the announcement of the completion of two modular conditioning plants, each with a treating capacity of 6.6MM3/d of natural gas to increase Tratayen's conditioning capacity. Also, if TGS moves forward with the project to build 5 additional modular conditioning plants, a polyduct and fractionation plant.
- TRAGAS 6.75 2025 successful liability management
- TGS showing stronger results than TGN on the back of a stronger yoy performance in the liquids business, because of higher export volumes sold and a more competitive FX than last year.

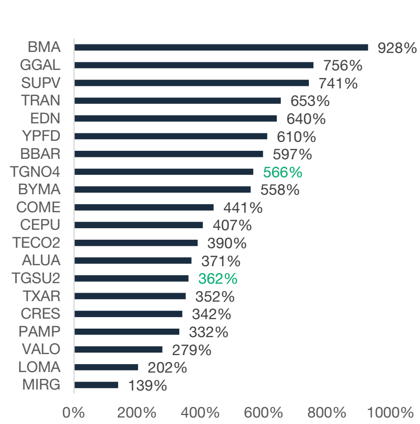
Although we currently recommend TGS over TGN, TGN fundamentals are solid, with low indebtedness levels and strong liquidity, which gives the company an ample margin to incur in new investment projects. In FY23, TGN total debt was USD70.7mn. TGN already canceled local debt with Banco de Galicia y Buenos Aires and Banco Macro. Currently, the debt outstanding is comprised of a 1.5% USD55mn loan maturing in October 2024 and USD343K loan to pay imports maturing in June 2024 both with Itaú Unibanco S.A. Nassau Branch. As of Dec-2023, cash + cash equivalents + ST investments were USD90mn, more than covering short-term debt.

Regarding TGN's growth potential, it set up a new subsidiary, Gasoducto Vicuñas S.A.U., to build a new pipeline that supplies miner companies, mainly focused on lithium production, with natural gas in the north of Argentina. In the long run, Argentina could export natural gas to Chile through the Tres Cruces pipeline, which went out of use, but first, the last stage of the reverse of the North gas pipeline should be completed. With this in mind, TGS growth prospects seem more tangible in this year than TGN.

TGS ADR has already reached our target price of USD17, which we recommended on March 11th, 2024, when it was at USD12.17, just 24 days ago. At that time, we were cautious about when and at what rate ENARGAS would grant TGS and TGN the tariff adjustments. In view of the more favorable scenario for the companies, we update TGS ADR target price to USD22, TGSU2 to ARS4,700 and TGN04 to ARS2,800.

Figure 2: We expect TGSU2 performance to outpace TGN04





Source: TPCG Research based on Bloomberg

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