28th November 2023

Transportadora de Gas del Sur

Transportadora de Gas del Sur (TGS) is an Argentine company that offers integrated services for the local gas industry. Its main segments are divided into Natural Gas Transportation, Production and Sale of LPG, and Midstream along with other services. Beginning operations in 1992, it is the main natural gas transportation company in Argentina. Its gas pipeline system connects gas fields in the south and west of the country to gas distributors, power plants, and industrial plants. In this highly regulated business, TGS transports 60% of the annual gas consumed in Argentina each year through over 9,200 km of pipelines.

TGS is the second-largest processor of LPG in the country, with a processing capacity of 47 MM m3/d. The company sells locally and exports over 1 million tons annually of ethane, propane, butane, and natural gasoline. Additionally, TGS has a presence in Vaca Muerta as a Midstream company, with 182 km of pipelines and an injection capacity of 60 MM m3/d, as well as gas treatment plants with a compression capacity of 14.8 MM m3/d. In this segment, it also operates and maintains 573 km of the GPNK pipeline.

The controlling entity of TGS is CIESA, which owns 51% of the capital. CIESA's shareholders are Pampa Energía with 50%, Grupo Inversor Petroquímica (Sielecki family) with 27%, and PCT LLC with 23%. Thus, indirectly, Pampa owns 25.5% of TGS. The remaining capital is divided between: ANSES with 24%, free float in the New York and Buenos Aires markets with 20%, and the remaining 5% is in the hands of TGS itself.

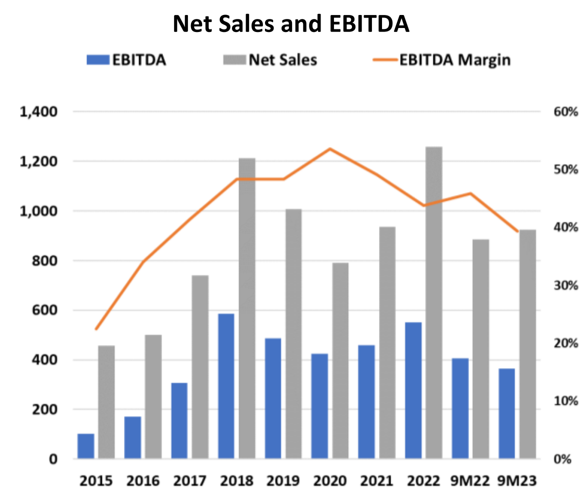
Sales and EBITDA Evolution

TGS released its latest results at the end of the third quarter of 2023. As its debt and assets are mostly dollarized and belong to a business with significant capital investments, we will analyze the company by dollarizing flows and stocks at the average or closing official exchange rate, as appropriate for each period.

The exceptional year of 2022 was the result of high international prices for LPG and the midstream growth in Vaca Muerta, segments that more than compensated for the decline in revenues coming from regulated gas transportation.

In the first 9 months of 2023, sales and EBITDA showed mixed results. Sales reached USD 925 million, while EBITDA reached USD 364 million. This represents a 5% increase in sales and a 10% decrease in EBITDA compared to the same period last year. Operating and EBITDA margins fell by around 700 bps. Alternatively, in constant local currency, the decline deepens due to a greater inflationary pressure on revenues: sales and EBITDA fell by 10% and 23%, respectively.

Despite the setback, thanks to unregulated businesses, TGS continues to maintain revenue levels that are strong in historical terms. Projecting sales and EBITDA for the rest of the year (USD 1,233 million and USD 486 million, respectively), these comfortably exceed the years of the pandemic and the period of strong delay in tariff adjustments of 2015.



Source: Sekoia Research based on financial statements.

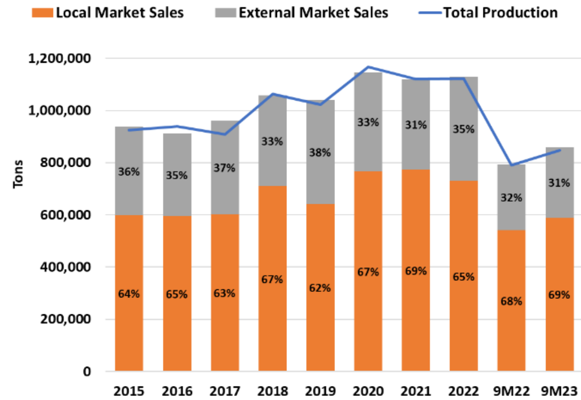
Segment analysis

Natural Gas Transportation. The segment reported USD 208 million in sales during the first three quarters of the year, an 8% decrease compared to the previous year. Keeping on with the trend, since 2019 the contribution of gas transportation to TGS's total revenues has been declining. During 2023 sales accounted for 22% of total sales, whereas last year they accounted for 26%, and in 2019 they reached 47%.

The decline in revenues is explained by a decline in real tariff values. After the 60% adjustment that came into effect in March 2022, ENARGAS, through Resolution No. 186/2023, approved new tariffs with a 95%. Despite this increase effective from May, due to the rampant inflation of the period, revenues measured in constant pesos fell by 21% compared to the previous year.

The deterioration of the segment was more pronounced in EBITDA, with a 30% drop compared to 2022. With an operating loss, EBITDA at 9M23 reached USD 79 million. Annualized, this EBITDA would mean the worst year in gas transportation for the company since 2016. There was no decline in terms of productivity. The contracted firm capacity remained at 83 MMm3/d LTM, while the average daily deliveries decreased slightly to 67.5 MMm3/d LTM, both historically high values in efficiency.

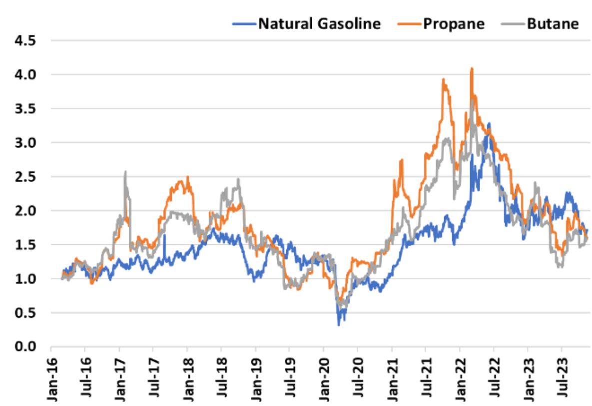
Production and Sale of LPG. The star segment of the company during the recent years continues to deliver very good results in both volumes and sales. Sales for the current year reached USD 555 million, slightly higher than the accumulated amount up to 9M22 of USD 553 million. At this rate, the company would be only 7% below the record sales of almost USD 800 million in 2022, with much less favorable international prices. The segment represented 60% of total sales at 9M23. In terms of volumes, TGS produced around 847 thousand tons of LPG, 7% more than what was produced during 9M22.



Source: Sekoia Research based on financial statements.

As we always emphasize, LPG production allows TGS to access international markets. Until 9M23, exports represented 35% of the segment's sales and 31% of the dispatched tons. Seen in another way, 21% of revenues from all of TGS's businesses were exports.

However, the share of exports with respect to total sales of the segment decreased. Compared to the same period last year, exports reached 57%. This was mainly due to the fact that the average prices of butane, propane, and natural gasoline in 9M23 fell by 16%, 41%, and 37% respectively compared to the previous year. In contrast, the prices of ethane, which is sold 100% locally to the multinational chemical company Dow, became more attractive.



Source: Sekoia Research based on Bloomberg.

Looking at the EBITDA of the LPG segment, inflation in dollars on production costs also impacted margins. For this year, EBITDA reached USD 189 million, a 19% decrease compared to 9M22. EBITDA margins were adversely affected, decreasing from 39% in 2022 to 33%.

Midstream and others. Unlike gas transportation and LPG, Midstream services achieved excellent results so far this year. Until 9M23, sales totaled USD 157 million, an increase of a whopping 57% compared to the accumulated amount until 9M22. Projecting the closure of the 2023 fiscal year, the sales of this segment would more than double those of 2022. This productive leap represents 17% of TGS's total sales.

The productive expansion was mainly due to TGS's investments in Vaca Muerta that follow the boost in higher gas volumes produced by the new Gas.Ar 2023-2028 Plan. The company maintains contracts with the main producers in Neuquén: Chevron, Exxon, GyP, Oilstone, Pampa Energía, PAE, Pluspetrol, Shell, Tecpetrol, Total, Vista, and YPF.

During the first half of 2023, the installation of two modular gas conditioning plants, each with a capacity of 3.5 MM m3/d, and a new gasoline stabilizing tower was completed at the Tratayén plant. The investment of USD 22 million expanded the natural gas treatment capacity to 14.8 MM m3/d. This meant a 36% increase in capacity compared to 2022. As a result of these investments, the contracted firm conditioning capacity expanded from 7.3 MM m3/d in 9M22 to 10.1 in 9M23.

At the end of July TGS completed the extension of its gas pipeline network in Vaca Muerta. With an investment of USD 60 million, it added 32 km in Vaca Muerta Norte from Los Toldos to the El Trapial field. To date, TGS owns 182 km of operational pipelines in the Neuquén basin. Thanks to these investments, the contracted firm capacity average increased from 10.4 MM m3/d in 9M22 to 15.1 in 9M23.

Also, in April of this year the company was awarded the operation and maintenance service of the GPNK gas pipeline in the Tratayén-Salliqueló section for a period of 5 years, extendable for an additional 12 months.

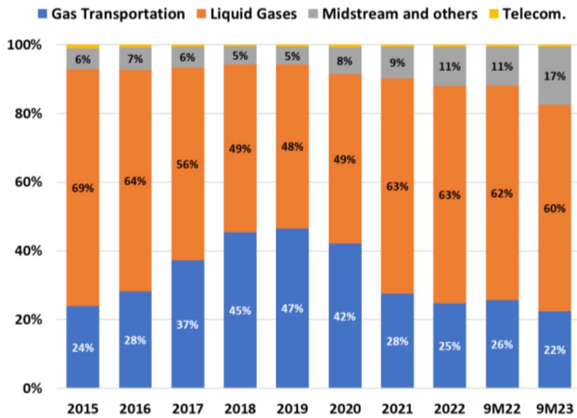
Regarding EBITDA, the Midstream operational flows had an excellent performance growing by 52% against 9M22. The EBITDA of the segment contributed 29% to the total, increasing by 1,200 bps compared to the previous year and surpassing for the first time the EBITDA generated by gas transportation. Continuing its expansion strategy, TGS is gradually advancing with greater investments. With an investment of USD 300 million, it expects to finish installing two new modules with a treatment capacity of 6.6 MMm3 in Tratayén by 2024. The company would totalize a treatment capacity of 28 MM m3/d next year.

At the same time, the company keeps an eye on the progress of the second stage of the GPNK gas pipeline, planned to be inaugurated in 2024. It will extend to 524 km, from Salliqueló in the southern province of Buenos Aires to the town of San Jerónimo in Santa Fe.

In this context of increased gas transportation, TGS informed investors that it has two investment projects in sight. The first consists of installing an LPG processing plant in Tratayén and a pipeline that transports LPG from the Neuquén basin to a new fractionation, storage, and dispatch plant in Bahía Blanca. The second project involves the construction of a liquefaction plant that allows the production of LPG in the Bahía Blanca port.

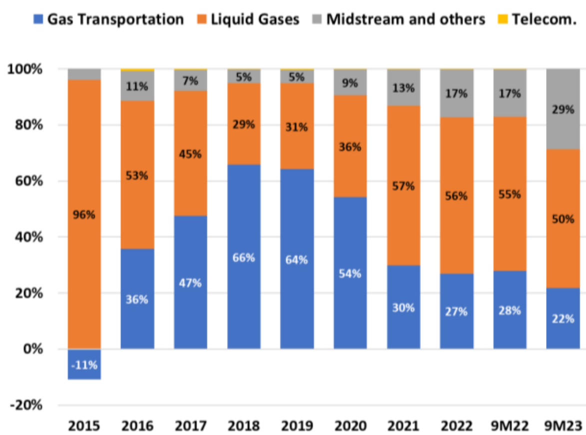
In summary, gas transportation significantly decreased its weight, LPG continues to lead the company's flows, and Midstream has consolidated as its second business.

Segments by % Sales Participation



Source: Sekoia Research based on financial statements.

Segments by % EBITDA Participation



Source: Sekoia Research based on financial statements.

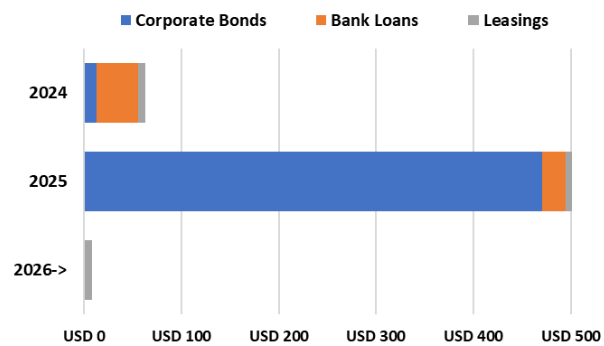
Million USD	9M23	9M22	Var (%)	2023*	2022	Var (%)
Sales	925	884	5%	1,233	1,258	-2%
Operating Result	248	302	-18%	330	401	-18%
EBITDA	364	406	-10%	486	551	-12%
Net Result	124	191	-35%	165	247	-33%
Operating Margin	27%	34%	-735 pb	27%	32%	-511 pb
EBITDA Margin	39%	46%	-652 pb	39%	44%	-439 pb

Source: Sekoia Research based on financial statements.
*The values for FY2023 were projected.

Debt profile

With the release of the results for the third quarter, TGS reported a financial debt of USD 574 million, a 6% increase compared to the reported amount in 3Q22 due to the rise in bank loans and import financings. The debt is completely denominated in dollars and is composed of: 84% in the bond due in 2025; 12% in bank loans; and 4% in leasing. The bond has a coupon rate of 6.75% with semiannual payments and bullet. After a series of repurchases, working capital was reduced from USD 500 million to USD 470 million.

Debt Distribution



Source: Sekoia Research based on financial statements.

Cash and equivalents stand at USD 16 million. This is noteworthy considering that acquisition flows in properties, plants, and equipment for the year amounted to USD 121 million. The company's cash is composed of 24% in dollars and 76% in pesos (placed in mutual funds).

Meanwhile, financial assets increased by almost USD 147 million on a yearly basis, totaling USD 586 million. These instruments are denominated mostly in dollars: 29% are dollar-linked and 57% are hard dollar. In summary, Net Debt closed 3Q23 in the negative, at approximately USD -29 million. The company is now fully deleveraged.

The company's financial situation is excellent. Financial assets alone are enough to pay off the entire debt. Due to the lower EBITDA, interest coverage slightly deteriorated compared to the previous year but remains high. While expanding in Midstream, TGS maintains a highly conservative financing policy and continues to finance its investments with the cash generated by its daily business.

Million USD	3Q23	3Q22	Var (%)
Financial Debt	574	542	6%
Cash & Equivalents	16	46	-65%
Financial Assets	586	439	33%
Net Debt	-29	56	-152%
Annualized EBITDA	486	551	-12%
Net Debt/EBITDA	-0.1	0.1	-0.2
Annual Interest	46	44	4%
EBITDA/Interest	10.6	12.6	-1.9

Source: Sekoia Research based on financial statements.

Alternatively, we could consider a scenario in which there is no access to the official FX market for debt payments, and TGS's EBITDA and assets are dollarized at the blue-chip swap rate. By examining this stress scenario, we can further analyze TGS's financial strength in relation to a more hostile situation.

TGS exports only through the sale of butane, propane, and natural gas. Consequently, its operating cash flow would be significantly affected. Considering the average exchange rate gap between the official exchange rate and the blue-chip swap rate of 100% during the 9M23 period, EBITDA would fall by 41%, reaching USD 285 million annually. On the other hand, debt issued entirely in dollars, along with cash and financial assets denominated 15% in pesos and 28% in dollar-linked (assuming no official FX devaluation in this scenario), would bring net debt to approximately USD 118 million.

With these new numbers, the Net Leverage ratio would deteriorate to 0.4x, and the Interest Coverage would decrease to 6.2x—both reaching very low levels even in an extreme situation. The combination of very low debt and dollarized assets provides TGS with significant flexibility in any future scenario. In summary, TGS is one of the best-positioned local debt issuers to face a context of strong exchange rate stress, making it one of our preferred bonds.

TRAGAS 6 ¾ 05/02/25

Source: Bloomberg.

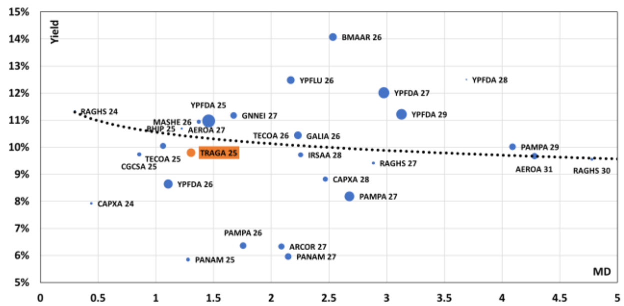
The bond currently trades around 96% clean, with a YTM of 9.8%, a duration of 1.4 and a minimum of 150,000 nominal units. The bond remains very robust, and in the recent context of declining yields on US Treasury Bonds and rising prices in fixed income of all kinds, it experienced a slight upside.

Providing guidance for future financings, the company recently received approval from the CNV to expand its debt issuance program and established a new program maturity date in January 2029.

Outlook

TRAGAS 6 ¾ 05/02/25 trades slightly below the New York Law curve and offers a higher return than its sector peers such as Pampa Energía, Capex, and CGC despite having better debt ratios.

Argentine Corporate Bonds



Source: Sekoia Research based on Bloomberg.

For us, TGS is one of the most robust Argentine debt-issuing companies. We have not observed cases of negative net debt that combine excellent income diversification and CAPEX expansion. In 2024, the company is expected to propose a voluntary exchange of its corporate bonds. We anticipate that this offer will see substantial participation and may result in a higher coupon due to the increase in global interest rates.

Best regards.

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