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TGSU2.BA - Q1 2018 Transportadora de Gas del Sur SA Earnings Call

EVENT DATE/TIME: MAY 14, 2018 / 2:00PM GMT



CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Rodrigo Mugaburu

PRESENTATION

Operator

Good morning. My name is Robert, and I will be your conference operator today. At this time, I'd like to welcome everyone to TGS First Quarter 2018 Results Earnings Conference Call.

TGS issued its earnings report Friday. If you did not receive a copy via e-mail, please do not hesitate to contact us in New York City at (646) 284-9435.

Before we begin the call today, I'd like to remind you that forward-looking statements made during today's conference call do not account for future economic circumstances, industry conditions and company performance and financial results. These statements are subjects to a number of risks and uncertainties. All figures included herein were prepared in accordance with the International Financial Reporting Standards and are stated in nominal Argentine pesos, unless otherwise noted.

Joining us today from TGS in Buenos Aires is Javier Gremes Cordero, Chief Executive Officer; Alejandro Basso, Chief Financial Officer; Leandro Perez Castaño, IR and Financial Manager; and Carlos Almagro, Investor Relations Officer.

At this time, I'd like to turn it over to Mr. Basso. Sir, you may begin.

Alejandro M. Basso - *Transportadora de Gas del Sur S.A. - CFO & VP of Administration, Finance & Services*

Thank you. Good morning, everyone, and thank you for joining us today on this conference call to discuss the first quarter earnings and highlights for Transportadora de Gas del Sur.

Please go to Slide 3.

First, I would like to underline our success in placing a 7-year new bond amounting to \$500 million. The bond was oversubscribed, having received offers of more than \$3 billion. That is more than 6x the issued amount. The bond was issued at the price of 99.725% with an annual fixed coupon rate of 6.75% and a yield of 6.8%. The funds raised from this issuance will be used to cancel 2020 notes amounted to \$207 million through a tender offer that was made in tandem with the bond issuance; the scheduled amortization, which is today; and the redemption of the remainder notes to be executed on June 1. In addition, \$250 million will be used to finance the midstream project in Vaca Muerta recently announced.

Now we will move to Slide 4. As you may know, we have been granted a concession from the province of Neuquén to build a gathering pipeline of 57 miles long which will be able to support 1.3 billion cubic feet per day. The pipeline will cross along several jade glass (sic) [shale gas] fields which are operated by very well-known producers such as Total, Pampa Energía, Pluspetrol, [GEL], [Exxon], YPF and Pan American Energy. In addition, we will also build a natural gas conditioning plant at the end of the gathering pipeline and the 4 injection points of Tcf and Tcm pipeline systems. This project will imply a \$250 million CapEx and will take 17 months to be built.

Certain agreements have been signed with gas producers, and other new agreements are currently under negotiations with other gas producers. It is important to stress that tariffs are nonregulated and are denominated in U.S. dollars.

Moving on to the following slide, I go on to state that finally, the integral agreement which was signed by TGS 1 year ago was subscribed by the national government on March 27, after the approval of several ministries and the national government. Starting April 1, 2018, we have been granted the third and last tariff increase of 50%, which completes the tariff increase defined by the ENARGAS on March of 2017. This last increase includes the second inflation adjustment for the period between November 2017 and February 2018.

In addition, the ENARGAS has finalized the assessment of the mandatory capital expenditures associated with the 200% transitional tariff increase of 2016, which we completed in December 2017. Therefore, the dividend restriction imposed initially by the ENARGAS has just been lifted.

As we move on to the following slide, I will now give you a brief explanation of 2018 first quarter results. The figures are in pesos and presented compared with the same period of 2017.

As you can see on Slide 6 of the presentation, we recorded a 161% increase in terms of net income. This increase is mostly explained by higher operating income generated by the Natural Gas Transportation business segment of ARS 1.2 billion. In addition, the operating income generated by the Liquids business increased by ARS 259 million.

Moving on to Slide 7. Natural Gas Transportation revenues during the first quarter increased by 200% to almost ARS 2.2 billion compared to ARS 727 million in the same period of 2017. Most of the variation is due to the tariff increases that came into effect in April 2017 at an average of 58% and in December 2017 at 78%, which generated higher revenues of ARS 422 million and ARS 891 million, respectively.

On Slide 8, you can see that the revenues generated by production and commercialization of liquids increased by 50%. This variation is explained mostly by a higher U.S. dollar exchange rate, which generated higher revenues of ARS 383 million, while the higher volumes of ethane sold in the first quarter of 2018 also had a positive effect of ARS 379 million. Other additional explanation that impacted our revenues positively were the increases of international prices for propane and natural gasoline; as well as the local price for butane, which was increased by the energy ministry under the plan HOGAR. During this quarter, we exported lower volumes of propane, negatively impacting sales in ARS 264 million, thus partially offsetting the total increase in revenues for this business segment.

As you can see on Slide 9, other service revenues rose by 62% to ARS 282 million. This increase is mainly explained by more services of operation and maintenance of facilities provided to the natural gas producers, which increased our sales by ARS 47 million. Secondly, a higher foreign exchange rate generated higher revenues of ARS 305 million (sic) [ARS 35 million]. We also obtained higher sales by ARS 16 million from construction services.

In Slide 10, we can see changes in the cost of sales, which rose 44% to ARS 2,029,000,000. This is primarily explained by higher cost of natural gas used in the Liquids business, which rose ARS 314 million; and is mostly attributable to a higher average exchange rate, which increased around 28%. In addition, operating cost for the transportation business grew by ARS 90 million, and labor cost by ARS 60 million.

Moving on to Slide 11. Administrative and selling expenses rose by 113% to ARS 313 million. The increment is mostly attributable to an increase in turnover tax at ARS 88 million due to the higher regulated revenues, along with the reversion of a bad debt provision amounted to ARS 20 million in 2017 and higher labor costs of ARS 19 million.

By moving to Slide 12, we can see the negative variation of ARS 75 million in other operating results, which is mainly explained by the insurance compensation of the ARS 122 million registered in 2017 which was partially compensated by a lower contingency provision of ARS 38 million.

On Slide 13, we can see that the financial results reflected a negative variation of ARS 140 million. This variation is mainly explained by the peso devaluation during the first quarter of 2018 versus a peso appreciation during the same period of 2017. This effect generated a negative variation of ARS 231 million; and was partially compensated by the higher interest income earned during the first quarter of 2018 as our total cash increased and therefore our Argentine peso-denominated temporary investments rose, recording yields above those in 2017 period.

Moving to Slide 14, you can see that income tax increased for ARS 409 million to ARS 729 million. Despite the reduction of the income tax rate from 35% to 30% resulting from the tax reform approved at the end of 2017, income tax charge increased due to a higher pretax income.

This concludes our presentation. I will now turn the call back to the operator, who will open the floor for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Luis Adaime with Newfoundland Capital.

Rodrigo Mugaburu

This is Rodrigo Mugaburu actually. 2 questions. One, if you can give more details from the Vaca Muerta project, if this \$250 million is just the first part of a bigger investment. And also, any kind of color on target IRR for returns? And then second question is on the share buyback program. So now the program is effective as of today, so today you could start buying back shares.

Jorge Javier Gremes Cordero - Transportadora de Gas del Sur S.A. - CEO & General Director

This is Javier Gremes. Regarding the Vaca Muerta project, yes, this is first stage. And as Alejandro mentioned, this is a 57-mile pipeline that will go through the most important areas there in the Vaca Muerta zone in the Neuquén province. As we say, this is TGS becoming a [first streamer] here in Argentina following the U.S. model. And then we have a conditioning plant that will be built in the Tratayén zone before entering into the regulated transportation systems to the North system and to the South, (inaudible) and the [Yeguas II] pipelines. As I said, first stage. This conditioning plant is going to be built in an efficient way so the producers will not need to build -- they don't [plant] in their own areas, yes. So this first stage is a conditioning plant, treatment plant for 5 million cubic meters per day. And then it will be scaled in time as soon as it's -- as the production is coming from the producers. That's why it's the first stage. In addition, of course, this pipeline can be expanded as soon as it is needed. By this time, we shall -- by the time the pipeline is built, we will have something like 40 million cubic meters per day, so we have enough room for the next -- for the short term. And then we will fit a South project that -- like an expansion of the North that will collect the gas from the South. That is going on with negotiations, but we already mentioned this is -- it will be something like \$30 million in addition to this CapEx plan. So this is what we have really in place. That's -- this is going to be built in 2018 and 2019. We will finish third quarter mid-next year, pipeline, and by the third quarter the plant. And this is what we foresee for this -- 2018 and 2019. What I mentioned regarding the expansion of the plant is something that we'll probably see in the future, as I said, as soon as the producers continue with their development plans. You mentioned also regarding the IRRs: What we expect is an IRR of 15%. And we will start to generate cash flow for -- from this project since we finish the construction. That is the third quarter next year but reaching a point of \$80 million in EBITDA at year 5, yes. This is like been transporting 50% of the capacity of the pipeline. That's regarding the first question. And I don't know (inaudible) any additional clarification afterwards, yes.

Unidentified Company Representative

No. Okay...

Rodrigo Mugaburu

Yes. And on the share buyback?

Jorge Javier Gremes Cordero - Transportadora de Gas del Sur S.A. - CEO & General Director

Share buyback...



Unidentified Company Representative

What's the question?

Rodrigo Mugaburu

Effectively you can start buying back as of today, right?

Jorge Javier Gremes Cordero - *Transportadora de Gas del Sur S.A. - CEO & General Director*

Yes. We started last Friday. And we have plans to keep on doing that if the market conditions are okay for us.

Operator

(Operator Instructions) Our next question comes from [Mateo Samali] with [Argo Capital Management].

Unidentified Analyst

Given the recent developments in Argentina with regards to tariffs and tariff negotiations, could you remind us a little bit what you estimate would be the impact if indeed the most recent raise in April is not taken into or not put into effect and likewise if for whatever reason the December hike of 81% is also kind of backtracked? And secondly, recently, I know you guys were talking about how this is very unlikely but what could be more likely is a plan whereby winter gas builds are made more accessible to clients by being paid in installment. So do you have an estimate of how much working capital that might require from you, presuming part of that is going to be financed by the company and part of that could be financed by the government?

Jorge Javier Gremes Cordero - *Transportadora de Gas del Sur S.A. - CEO & General Director*

Okay, well, the project that has passed through the representative chamber. And we think that the executive power is going to veto that project, okay? The impact is very significant, but we expect the project is going to be vetoed by the President if the senate approves it. They are working with the governors. They have a meeting last week. And well, we expect that to be vetoed by the President. The impact is very important. It's around ARS 5 billion per year, okay? And regarding the winter gas builds financing, we think that the ENARGAS has not approved it yet. The impact in working capital may be around ARS 1 billion for 4 months in the winter and which should be recovered in the next -- in the following 6 months after the winter with a reasonable rate, interest rate, which was not established yet, okay?

Unidentified Analyst

Okay, perfect.

Operator

(Operator Instructions) There are no further questions. At this time, I would like to turn the call back to Mr. Basso for closing comments.

Alejandro M. Basso - *Transportadora de Gas del Sur S.A. - CFO & VP of Administration, Finance & Services*

Okay, well, thank you for participating in TGS' First Quarter 2018 Conference Call. We look forward to speaking with you again when we release our second quarter 2018 results. However, if you have any questions in the meantime, please do not hesitate to contact our investor relations department with any questions.

And have a good day.

Operator

This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.

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