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TGSU2.BA - Q1 2019 Transportadora de Gas del Sur SA Earnings Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Bruno Montanari *Morgan Stanley, Research Division - Equity Analyst*

PRESENTATION

Operator

Good morning. My name is Melissa, and I will be your conference operator today. At this time, I would like to welcome everyone to TGS' First Quarter 2019 Results Earnings Conference Call. TGS issued its earnings report last Friday. If you did not receive a copy via email, please do not hesitate to contact us in New York City at (646) 284-9435.

Before we begin the call today, I would 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 in financial results. These statements are subject 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 constant Argentine pesos as of March 31, 2019, unless otherwise noted. Joining us from TGS in Buenos Aires is Alejandro Basso, Chief Financial Officer; Leandro Perez Castaño, IR and Finance Manager; and Carlos Almagro, Investor Relations Officer.

And now I'll turn the call over to Mr. Basso. Please begin, sir.

Alejandro Mario Basso - *Peking University - 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.

Today, I would like to talk about relevant events that occurred in the last quarter. First, as you know, a new transportation tariff increase of 26% was granted by ENARGAS, which went into effect on April 1. This increase is related to Wholesale Price Index increase for the period from September 2018 to February 2019.

Second, at the beginning of March, the Secretary of Energy issued Resolution #82 through which the national government requested proposals from the private sector to increase the Natural Gas Transportation capacity from the Neuquina basin to the north of the province of Buenos Aires, aiming to replace the LNG and gas oil imports.

Following the request on April 8, TGS presented its proposal, which consists of the construction of a new pipeline of more than 1,000 kilometers in 2 steps: the first one from Tratayén to Salliqueló in the province of Buenos Aires, and the second from Salliqueló to San Nicolás in the north of the Buenos Aires province. It is expected that the national government will launch a bidding process in the coming months.

Third, on March 27, we launched the third buyback program for a maximum amount of ARS 1.5 billion for a 6-month period. Considering the shares acquired under previous and current programs, the total treasury shares represent around 2.5% of the capital stock, which implied an investment of approximately \$55 million. Fourth, on April 23, we paid a dividend amounting to ARS 7.2 billion, which almost equals \$170 million.

Fifth, on April 16, the Board of Directors appointed Oscar Sardi as Chief Executive Officer of TGS following the resignation of Javier Gremes Cordero due to personal reasons, effective April 30, 2019. Mr. Sardi is a mechanical engineer and began working at TGS in 1992. At the time of his appointment as CEO, Oscar was Director of Operations.

Finally, at the end of April, we finalized the works of the first phase of Vaca Muerta midstream project. This will allow to begin transporting natural gas to both the South Tranche and the last part of the North Tranche as well as partially operate the conditioning plant while it is still under construction. The conditioning plant and the home (sic) [oil] gathering pipeline will be fully constructed and in operation by the end of 2019.

As we move on to Slide 4, I will now briefly talk about some highlights of 2019 first quarter results. Figures presented for this quarter and the comparison with 2018 first quarter are expressed in constant pesos as of March 31, 2019, as the result of the adoption of inflation adjustment for reporting purposes.

As you can see, we recorded a net income of almost ARS 2.4 billion compared with ARS 2.3 billion in the same quarter of 2018. The main variations are: one, a higher operating income of ARS 199 million associated with the transportation tariff increases as well as the significant increase of the foreign exchange rate mainly occurred in the period between May and September 2018, which positively impacted nonregulated operating income denominated in U.S. dollars. All effects were higher than the negative impact associated with inflation in the period since the first quarter of 2018 to the current quarter.

Second, a negative variation of ARS 468 million in the financial results mainly due to higher depreciation of the Argentine pesos. And finally, a positive variation in the income tax of ARS 356 million mainly due to a lower provision derived from the inflation adjustment effect, which may be probably considered for the 2019 fiscal year in accordance with the tax rules.

Moving on to Slide 5. As seen, we recorded higher natural gas transportation revenues during the first quarter, increasing by 15% to almost ARS 4 billion compared to ARS 3.4 billion in the same period of 2018. The increase is mostly due to higher tariffs. Increases came into effect in April 2018 at 50% and the last one in October 2018 at almost 20%. These 2 tariff adjustments generated higher revenues of ARS 1.7 billion (sic) [ARS 1.08 billion]. This increase in revenues was partially offset by inflation adjustment effect, which amounted to ARS 1.1 billion.

On Slide 6, you can see that the revenues generated by the production and commercialization of liquids rose by 23% measured in real terms. The main variation is related to a higher average U.S. dollar exchange rate, which almost doubled and generated higher revenues of ARS 2.2 billion.

Secondly, we also exported 25,000 tons of Liquids, more than the first quarter of last year, which increased our revenues by ARS 389 million.

These 2 positive effects were partially offset by the inflation adjustment which amounted to ARS 1.1 billion, along with lower international prices, which negatively impacted revenues by ARS 539 million.

As shown on Slide 7, other services revenues declined by 11% to ARS 394 million. This decrease is mainly explained by the inflation adjustment negative effect of ARS 147 million. In addition, revenues fell by ARS 109 million mainly due to the fact that in the first quarter of 2018, we provided certain onetime midstream services.

A higher foreign exchange rate average generated higher revenues amounting to ARS 202 million and partially compensated the other 2 negative effects I mentioned before.

On Slide 8, we can see the cost of sales variation, which rose 25% to more than ARS 4.4 billion. One of the key factors stems from higher natural gas costs in the Liquids business, which rose ARS 646 million. Of this total, ARS 901 million are related to higher natural gas prices in pesos generated by the huge increase in the average foreign exchange rate even when the average price in dollars fell by 9%. In addition, higher volumes of natural gas purchased during the first quarter of 2019 impacted costs by ARS 200 million. These increases were partially offset by the effect inflation adjustment of ARS 525 million. In addition, maintenance cost of Natural Gas Transportation PP&E grew by ARS 113 million while labor costs rose by ARS 43 million, both measured in real terms.

Moving on to Slide 9. Administrative and selling expenses rose by 55% to ARS 824 million. The increment is mainly attributed to the new tax on exports, which was implemented starting September 2018 and has generated an additional cost of ARS 226 million only in the last quarter. Similarly, we recorded an increase in turnover tax of ARS 68 million, which is mostly related to higher regulated revenues.

On Slide 10, we can see the financial results for the first quarter, which resulted in a negative variation of ARS 468 million. This variation is mainly explained by the higher peso depreciation during the first quarter of 2019, while the foreign exchange rate increased by 15% compared to an 8% increase in the first quarter of 2018. In addition, our net liability position denominated in U.S. dollars increased by more than \$50 million. These 2 effects generated a higher foreign exchange rate loss of ARS 463 million. In addition, higher interest expenses of ARS 205 million were recorded in the quarter and are related to a higher foreign exchange rate and a higher debt level, which grew from almost \$250 million to \$540 million. A higher gain of ARS 252 million related to exposure to inflation partially compensated the negative effects I just mentioned.

Finally, on Slide 11, you can see that income tax decreased by ARS 355 million while the effective tax rate decreased from 36% to 28%. This reduction of effective tax rate, which generated a decrease of ARS 256 million, is due to a lower provision in the 2019 quarter, as inflation adjustment affects were considered in accordance with the tax rules that established the adoption of [interlinked] inflation adjustment in case the inflation of 2019 is over 30%, and it is expected that this condition may be met. In addition, pretax income was lower, thus reducing the income tax charge [to] ARS 99 million. 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 comes from the line of Bruno Montanari with Morgan Stanley.

Bruno Montanari - Morgan Stanley, Research Division - Equity Analyst

A couple of questions on investments. First, on the Vaca Muerta midstream project. Could you remind us what is the ramp-up phase until you reach full capacity? I understand now you are at 800,000 cubic meters a day. So towards the end of the year, how much capacity are you going to be paid for? And at full capacity, if you could remind us what is the total volume, that would be great.

And then thinking about the new big project for the new pipeline. How would management rank the appetite to invest and participate maybe more aggressively in the bids within TGS' capital allocation process?

Alejandro Mario Basso - Peking University - CFO & VP of Administration, Finance & Services

Okay. Well, first, about the Vaca Muerta project, the first stage, the capacity in the Vaca Muerta South plant is -- South pipeline is around 800 million cubic feet per day, and the total capacity will be at around...

Unidentified Company Representative

1.6 million.

Alejandro Mario Basso - Peking University - CFO & VP of Administration, Finance & Services

1.6 million of cubic feet per day. And that's for the pipeline, okay? Then the gas conditioning plant has a pretty much lower capacity because we're going to build it up as we get new contracts.

Regarding the new pipeline, we think that we can finance that project with [access] loans and -- or peak loans. At the same time, the government is currently looking forward to getting those financing sources. And so -- and at the same time, we are going to present our proposals with other



parties in the project, okay? So we think that we can be able to -- we are going to be able to finance the project, okay? I don't know if I answered your questions.

Bruno Montanari - *Morgan Stanley, Research Division - Equity Analyst*

Yes. That's great.

Operator

(Operator Instructions) Mr. Basso, there are no questions at this time. I'll turn the floor back to you for any final comments.

Alejandro Mario Basso - *Peking University - CFO & VP of Administration, Finance & Services*

(inaudible) Okay. Okay. Thank you for participating in this year's first quarter 2019 conference call. We look forward to speaking with you again when we release our second quarter results.

Operator

Thank you. This concludes the teleconference.

Alejandro Mario Basso - *Peking University - CFO & VP of Administration, Finance & Services*

However, in the meantime, please do not hesitate to contact our Investor Relations department with any questions. Have a good day.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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