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TGSU2.BA - Q2 2019 Transportadora de Gas del Sur SA Earnings Call

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CORPORATE PARTICIPANTS

Alejandro Basso

CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Greetings, and welcome to the Transportadora de Gas Del Sur Second Quarter 2019 Earnings Call. (Operators Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Alejandro Basso, Chief Financial Officer. Thank you, Mr. Basso. You may begin.

Alejandro Basso

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

To begin, I would like to talk about relevant corporate events that have occurred since the last call. First, the Board of Directors convened a shareholders' meeting to increase the maximum amount of the outstanding global program for the issuance of debt from \$700 million to \$1.2 billion. This will allow us to be ready to issue new debt. As a reminder, under this global program, we issued a bond for \$500 million in May of last year. So this increase will allow us to issue new debt for up to \$700 million. The shareholders' meeting will be held on August 15.

Second, the Secretary of Energy granted the residential consumers a deferral in the payment of 22% of the natural gas invoices to be issued between July and October of this year, which will be paid in 5 installments between December of 2019 and April of 2020. This deferral will be financed by the natural gas producers, the transportation companies and the distribution companies. The Argentine government will repay the companies a monthly interest. Therefore, this measurement will imply a negative impact in our working capital.

Third, PBB Polisor, who is our only client of ethane, suffered some operating problems in late June after the national blackout, which is resulting in a substantial reduction in the sale of ethane during the third quarter. We expect that PBB Polisor will regularize its operation in September.

Finally, on July 30, the Argentine government called for international tender to build and operate a new pipeline from Tratayén to Salliqueló in the province of Buenos Aires with an option to build and operate a pipeline from Salliqueló to the north of the province of Buenos Aires. The license will be for a period of 35 years extendable for an additional 10 years. CAMMESA will contract a (inaudible) capacity of 10 million cubic meters per day. And ANSES, the national pension fund offers financing for up to \$400 million. The bid should be presented no later than September 12. We are working together with other companies to make an offer.

As we move on to Slide 4. I will now briefly talk about some highlights of 2019 second quarter results. Figures presented for this quarter and the comparison with the prior year second quarter are expressed in constant pesos as of June 30, 2019, as a result of the adoption of inflation adjustment for reporting purposes.

As you can see, we recorded a net income of almost ARS 4.1 billion compared with ARS 1.4 billion in the same quarter of 2018. The main variation was contributed by the financial results partially offset by slight impact in the income tax. The ARS 3.7 billion positive variation of the financial



results was mostly the result of the significant devaluation of the Argentine peso in the second quarter of 2018 contrasted by its slight appreciation in the same quarter of 2019.

Moving on to Slide 5. We recorded lower natural gas transportation revenues during the second quarter down 88% to almost ARS 4.9 billion compared to ARS 5.3 billion in the same period of 2018. This decrease was a result of the 2 tariff increases, 20% in October 2018 and 26% in April 2019, which were insufficient to compensate for inflation in the last 12 months, which was around 56%. In addition, we transported lower volumes of natural gas under the international contracts, which generated lower revenues of 200 million -- ARS 275 million.

On Slide 6, you can see that the revenues generated by the production and commercialization of Liquids went down by 6% measured in real terms. Even though a higher-average U.S. dollar exchange rate generated higher revenues by ARS 2.5 billion. This positive variation was more than offset by a combination of factors including: inflation adjustment of ARS 1.8 billion; lower volume of ethane sold, which reduced revenues by ARS 521 million; lower international prices, which lowered revenues by \$501 million; and lower price of ethane, which impacted negatively by ARS 425 million.

As shown on Slide 7, other services revenues declined by 9% to ARS 547 million. This decrease is mainly explained by the negative inflation adjustment effect of ARS 214 million. A higher foreign exchange rate average -- generated higher revenues amounted to ARS 132 million as well as more midstream services of ARS 25 million partially compensated the main negative variation.

On Slide 8, we can see the cost of sales variation, which decreased by 8% to almost ARS 4.5 billion. One of the key factors stems from lower natural gas costs in the Liquids business, which decreased by ARS 195 million. Of this total, ARS 131 million was related to lower volumes of natural gas purchased during the second quarter of 2019, while the increase in the natural gas prices in pesos derived from a higher exchange rate and partially offset by lower prices in dollars was neutralized by the inflation effect. In addition, natural gas transportation operating cost decreased by ARS 115 million.

Moving on to Slide 9. Administrative and selling expenses rose by 36% to ARS 873 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 130 million only in the last quarter. Similarly, we recorded increases in property, plant and equipment depreciation of ARS 38 million and labor cost of ARS 37 million.

On Slide 10, we can see the positive variation of ARS 813 million recorded in other operating results. This is mainly explained by the award of ARS 21 million that TGS paid in June of 2018 to Pan American Energy as a result of the arbitration initiated by that company against TGS in 2016.

On Slide 11, we can see the financial results for the second quarter, which resulted in a positive variation of ARS 3.7 billion. This variation is mainly explained by the significant increase of the U.S. dollar exchange rate of 43% during the second quarter of 2018, which generated a negative result of ARS 2.7 billion versus a slight Argentine pesos appreciation in 2019 quarter, which generated a gain of ARS 464 million. In addition, a higher gain of ARS 955 million was generated by the exposure to inflation.

Finally, on Slide 12, you can see that income tax during the second quarter of 2019 increased by ARS 1.2 billion due to a higher pre-tax income.

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

QUESTIONS AND ANSWERS

Operator

[Operators Instructions] Our first question comes from the line of Bruno Montanari with Morgan Stanley.



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

First one, just to check on the -- if you could tell us what the magnitude of the decline in ethane sales is going to be due to the incident at the Polisur plant. So that we can get an estimate for the third quarter? And in terms of new projects, how would TGS rank the company's capital allocation priorities between investing in smaller pipelines as we have seen the company doing, distributing dividends or embarking on such a major project as a new pipeline?

Alejandro Basso

Okay. First in the ethane volume, it will depend on the extent of the repair -- maintenance of Dow. Nevertheless, our production is 30,000 tons per month. So as you say, we will -- we are expecting to be at full operation in November with some increase in October and very slightly in September. We cannot predict the exact number right now, okay?

As regarding the new projects, well, what I can say is that our main priority right now are these projects, the pipeline, the treatment processing plant and the liquefaction project. First of all, the pipeline [TGS] bid. And so I can say that we -- our dividend -- we don't have any dividend policies, but we will be very cautious in dividend payments, okay?

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

All right. And just to double check and confirm. Right now -- so is there sales to Dow completely halted? Or are you still able to send something to the plant?

Alejandro Basso

No. It's completely halted up to maybe September 10, then it's expected to start slowly and at full capacity in November, if Dow is successful in their maintenance, the maintenance once they are over.

Operator

[Operators Instructions] Our next question comes from the line of Daniel Guardiola with BTG.

Daniel Guardiola - *Banco BTG Pactual S.A., Research Division - Director of Equity Research*

I have a couple of questions. One, I joined the call a little bit late, so I want to know if you can give us more details on these announcement you did on the deferrals of payments related to the invoices issued between July and October. And I wanted to know, how is it going to affect the leverage of the company? And what measures are you planning to take?

So that's my first question. My second question is regarding the cost structure. We saw a very significant expansion in the EBITDA margin during the quarter, and you explained several factors behind that. I wanted to know, how structural is that? Or -- and how dependent was that expansion on basically the macroeconomic environment in the country?

And a third one, if I may. I saw a slight decline in the CFO generation, the cash from operation generation, during the quarter. And I wanted to know if you could give us more details on what was behind the decline? And going forward, what could we expect of the company's cash flow generation from operations for the upcoming quarters?

Alejandro Basso

Okay. Well, regarding the delay on collections in the winter season, you know that the government has put in place a resolution by which the distribution companies have to make a discount of 22%, and they are dues to residential customers. So that is just residential. It's for the 5 -- 4 months of winter from July up to October. And we are going -- and they are going to collect this 22% in 5 months from December to April or May next year. The interest is going to be paid by the national treasury, okay? So what we are expecting is some increase in our working capital of maybe around \$30 million or \$40 million. It will depend on the bills to the residential customers, will depend on the weather conditions in winter. Currently, we are caught in a [wild] weather. And the interest is supposed to be paid by the treasurer maybe in 2 or 3 months, okay? Regarding our capital structure or EBITDA margin, what was the question exactly?

Daniel Guardiola - *Banco BTG Pactual S.A., Research Division - Director of Equity Research*

So I saw that the EBITDA margin expanded during the quarter to almost 54%. And I wanted to know how structural was that -- or how dependent was that on basically macroeconomic factors such as the declining gas prices, the USD appreciation against the Argentine pesos. Wanted to understand going forward, if that's a margin that we could expect for the upcoming quarters?

Alejandro Basso

Well, as regard of -- as transportation revenues, our transportation revenues this quarter increased lower than the inflation, due to the fact that we received adjustment, which was lower than inflation. And despite that, our operating income was higher than -- due to some reduction in costs. As regarding the Liquids business, there we have the favorable effect -- impact of the exchange rate because all our Liquids revenues are in dollars. And at the same time, the favorable effect of lower natural gas prices, which are -- which were compensated by lower liquids price, okay? So we have a favorable effect in that respect. I don't know if -- that I'm answering your questions fully?

Daniel Guardiola - *Banco BTG Pactual S.A., Research Division - Director of Equity Research*

Yes. Yes. And I just wanted to know if you could share more details on your cash from operations -- cash flow generation from operations. And what are you expecting for the upcoming quarters? Because during the second Q of '19, we saw a decline on a quarterly basis.

Alejandro Basso

We don't expect any more decline. So it's maybe some temporary [degree] effect, okay?

Daniel Guardiola - *Banco BTG Pactual S.A., Research Division - Director of Equity Research*

Okay. And just if I may -- sorry, please go ahead.

Alejandro Basso

The decline that you will -- you should be seeing is the effect of this delay on the distribution collection -- distribution company collection due to the 22% discount in the bills, okay? Other than that, I'm not seeing any other impact. Obviously, the sales -- they are on the same revenues, okay?

Daniel Guardiola - *Banco BTG Pactual S.A., Research Division - Director of Equity Research*

Okay. And just if I may squeeze another question, and just a follow-up to the previous analysts that asked some questions on the projects. Could you share with us what is the expected profitability behind the gas pipeline that is connecting Vaca Muerta with Tratayén and the one that is connecting -- well, Tratayén with Salliqueló, what is the expected IRR behind those projects?

Alejandro Basso

I cannot predict any expected profitability right now. What I can say that it's going to be some low or reasonable profitability at the beginning, and then it will depend on the ramp-up of the production in Vaca Muerta, okay, and other projects and the liquefaction projects also.

Operator

There are no other questions in the queue. I'd like to hand the call back to management for closing comments.

Alejandro Basso

Okay. Okay then, thank you for participating in this year's second quarter 2019 conference call. We look forward to speaking with you again when we release our third quarter 2019 results. However, if you have any questions in the meantime, please do not hesitate to contact our Investor Relations department with any questions. Have a good day.

Operator

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day's.

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