



Capital
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Argentina

Oil & Gas

**TGS: Buy, despite political turmoil
2Q19**

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TGS 2Q19

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September 19

TGS (BCBA: TGSU2)

AR\$ 106,85

Target Price: 122

Expected Return (USD):
12%

Rating: Market Performer

Price Range (ARS)

52 wk. Min.	52 wk. Max.
83,7	144



	Net Sales (AR\$ mill)	EBITDA (AR\$ mill)	Net Income (AR\$ mill)	EV/ EBITDA (x)	P/BV (X)	P/E (x)	EPS (AR\$)
2018	34.063	16.480	11.416	5,50	2,82	7,51	14,62
2019E	41.216	20.194	13.721	5,23	2,56	6,35	17,27
2020E	52.756	26.147	25.478	4,32	2,96	4,56	24,05

Share Outstanding (\$ m)	794	12M Range	83.7 / 144
ADR Outstanding (\$ m)	158.8	EPS Trailing	14,62
Float (%)	25,10%	P/E Trailing	7,51
Market Cap (\$ m)	87.196	EPS Forward	17,27
Net Debt (\$ m)	13.473	P/E Forward	6,35
EV (\$ m)	100.668		

TGS: Buy, despite political turmoil. Huge long term value.

The unexpected defeat of the ruling party (*Juntos por el Cambio*) in the primaries hit deeply in investor's confidence due to a dramatic change on Argentina's 2020 economic outlook.

The peso fell 25% against the dollar and risk spreads widened to more than 2,000bps. In order to control economic damage, the government set capital controls, "reprofiled" short term debt payments and moved forward to expansionary fiscal policies that compromised the deal signed with the IMF.

Despite the domestic assets' selloff has been across the board, utilities and bank stocks have been harder hit.

The opposition candidate with the greatest chance of winning the elections next October 27, Alberto Fernandez, expressed his intention to boost Vaca Muerta oil & gas production, respecting the contracts' legal terms. However, doubts remain over his energy policy in case he's being elected.

Meanwhile, Macri's government had to take some economic measures in order to contain inflation pressure, affecting oil and gas industry. Two of them were the freezing of fuel prices and capital controls. Both created several business distortions that must be attended by the next president.

Mid-term, either Macri or Fernandez, know that Vaca Muerta field is the best key the country has to attract new investment and create high quality payroll. To achieve it stable and predictable rules are needed, situation that TGS should take advantage.

Considering the described distress, we consider various events for our valuation.

Valuation

Considering a country risk premium of 1,800bps and a WACC rate of 17.6%, our TP is AR\$122 (12% of potential upside in pesos).

Rating: Market Performer

Risks of the thesis investment:

1. Unexpected changes in Vaca Muerta's game rules.
2. Higher export taxes on the products exported by the company.
3. Freeze of domestic gas price that could affect TGS' operating cash flow.

Highlights 2Q19

- Latest domestic rate adjustments allowed a recovery in sequential revenue, although the yoy comparison slowed down as we estimate.
- Quarterly operating income stood at AR\$4,732 million (vs. AR\$4,950 million expected), 3.5% higher than 2Q18. Operating margin was 46.7% vs. 47% estimated.
- 2Q19 EBITDA reached AR\$5,492.5 million compared to AR\$6,090.4 million in 2Q18. Thus, the EBITDA margin fell by 150 bps, to 54.2%.

Stock Buyback Program

The Board modified its own stock buyback program on August 26, considering the current distortion between the current company's value and stock price.

The firm will invest up to AR\$3,200 million (US\$ 57 million) and the maximum price that it will pay is AR\$ 116 in Buenos Aires and US\$10.50 per ADR in Wall Street.

We believe this is a very interesting signal from the company to shareholders.

DCF Valuation

DCF (AR\$ m)	2019E	2020E	Terminal Value
Y/Y Sales growth	21,0%	28,0%	10,0%
Net Sales	41.216	52.756	N/A
EBIT Margin	42,4%	43,3%	43,0%
EBITDA Margin	49,0%	49,6%	49,5%
EBT	19.602	25.478	N/A
Effective tax rate	38%	32%	30%
NOPAT	13.721	19.109	5.021
Depreciations	2.712	1.085	1.085
Interest Paid	1.105	650	650
Capex	(8.529)	(9.382)	(3.495)
Working Capital	(435)	975	(550)
FCF	8.574	15.343	92.102
WACC	17,64%	17,64%	17,64%
VP FCF			110.478
Net Debt			13.473
FCFE			97.005
Shares Outstanding			794,5
Target Price			122,10

Inputs	
Country Risk	18,00%
Risk Free Rate	2,50%
Excess Return	5,00%
Beta	0,94
Cost of Equity	25,20%
Cost of Debt	8,50%
WACC	17,64%

Sensibility Analyses			
Country Risk /	1.100 bps	1.800 bps	2.200 bps
WACC	13,33%	17,64%	20,10%
Target Price (AR\$)	163,7	122,10	80,83

Relative Valuation

Company	Country	Ticker	Market Cap (Million USD)	Price / Earnings	Price / Earnings Fwd.	Price / Sales	Price / Book Value
Transportadora Gas del Sur	ARG	TGSU2	1.291,8	7,51	6,35	2,56	2,40
Copec	CHI	COPEC	12190,00	11,40	16,89	0,53	1,18
Cosan S.A.	BRA	CSAN	5.170,0	12,87	13,40	2,05	2,12
Ultrapar Participacoes	BRA	UGPA	5,0	17,44	17,87	0,23	2,16

Source: Reuters

Financial Statement

Million AR\$	2016	2017	2018	2019E	2020E
Net Sales	7.402	19.953	34.063	41.216	52.756
YoY Growth Rate		169,6%	70,7%	21,0%	28,0%
COGS	(4.436)	(11.935)	(16.188)	(19.907)	(24.795)
YoY Growth Rate		169,1%	35,6%	23,0%	24,6%
Gross Income	2.966	8.018	17.874	21.309	27.961
Gross Margin	40,1%	40,2%	52,5%	51,7%	53,0%
Com. And Adm Costs	(669)	(1.541)	(2.727)	(3.572)	(4.358)
YoY Growth Rate		130,4%	76,9%	31,0%	22,0%
Other operating costs	(66)	(272)	(891)	(255)	(765)
Operating Income	2.232	6.206	14.257	17.482	22.838
Operating Margin	30,2%	31,1%	41,9%	42,4%	43,3%
EBITDA	2.519	8.226	16.480	20.194	26.147
EBITDA Margin	34,0%	41,2%	48,4%	49,0%	49,6%
Financial Income	405	1.137	10.989	8.455	10.250
Financial Expenses	(1.219)	(2.131)	(15.040)	(7.650)	(8.500)
Investments in companies	2	22	18	(35)	35
RECPAM	0	466	1.205	1.350	855
Income before Tax	1.420	5.699	11.429	19.602	25.478
Income Tax	(489)	53	(13)	(5.881)	(6.370)
Minority Interest	3	0	0	6	8
Net Income	931	5.752	11.416	13.721	19.109
Net Margin	12,57%	28,83%	33,51%	33,29%	36,22%
Depreciations	287	2.020	2.223	2.712	3.309
Interest paid	280	304	1.032	1.105	1.333
Capex	(596)	(1.309)	(8.123)	(8.529)	(9.382)
Working Capital	250	106	(2.250)	(435)	975
FCFF	1.151	6.873	4.298	8.574	15.343

Balance Sheet

Thousand AR\$	2018	2019e	2020e
Current Assets			
Other Financial Assets	3.044	3.348	3.683
Intories	360	412	528
Trade Receivables	3.114	6.595	8.177
Cash & Equivalents	16.645	18.547	25.323
Total Current Assets	23.163	28.902	37.710
Non Current Assets			
Property, plant & Equipment	38.685	48.356	50.774
Other assets at amortized cost	9	9	9
Investment in associates	73	102	142
Deferred Income Tax	5	2	1
Other receivables	8	18	18
Total non Current Assets	38.779	48.486	50.944
Total Assets	61.942	77.388	88.655
Current Liabilities			
Provisions	371	697	868
Financial Debt	443	2.190	2.727
Income tax payable	2.444	2.548	3.440
Payroll and social security	384	929	1.111
Trade payables	3.092	2.887	3.595
Taxes payable	202	152	156
Other	210	221	238
Total current Liabilities	7.146	9.623	12.136
Non current Liabilities			
Loans	20.154	27.208	34.282
Contact liabilities	1.469	305	305
Deferred tax liabilities	2.228	2.350	2.650
Total non current Liabilities	23.851	29.863	37.237
Total Liabilities	30.997	39.486	49.373
Total Equity	30.945	37.902	39.282
Ratios			
Current ratio	2,57	2,38	2,29
Acid ratio	2,26	2,05	2,00
LT Debt / Assets	0,183	0,211	0,224
ROE	26,4%	31,4%	41,7%
ROA	15,4%	17,4%	21,5%
Change in Working Capital	-247	-186	2.129

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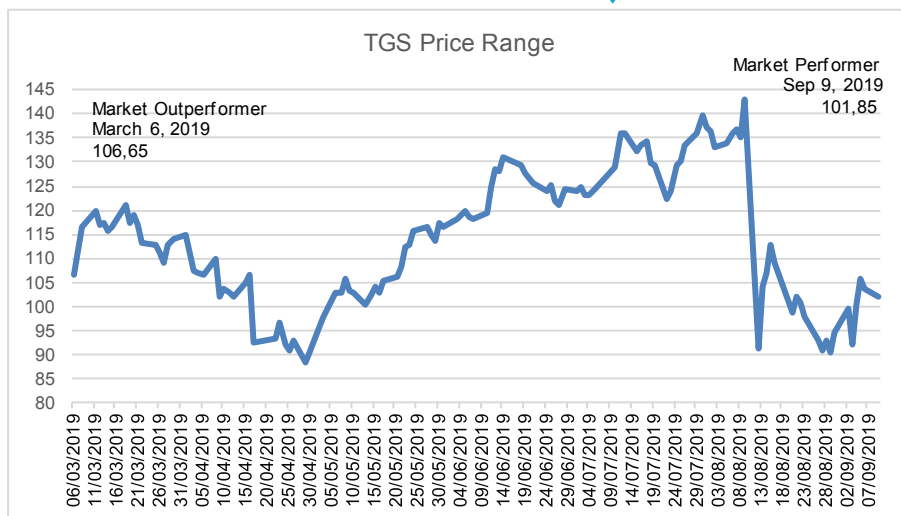
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