

## Special Comment

# Moody's Global Corporate Finance

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## Politics, Regulatory Gridlock Restrain Argentina's Gas Distribution Industry

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### Summary

Argentina's gas distribution companies are caught in a regulatory and political vice grip, and their speculative-grade credit ratings are likely to remain constrained as long as it persists.

A government freeze on tariffs charged to utility customers, in place for nearly seven years, is crimping gas companies' profits and their ability to invest in infrastructure. The government created an agency in 2003 to renegotiate tariffs with utilities individually, but thus far only one gas utility has secured a tariff increase that applies to residential customers. Many of the gas utilities or their shareholders have legal claims pending in international courts against the Argentine government, a further impediment to tariff negotiations. By presidential decree, the industry's regulator has been under the control of the executive branch since May 2007, subjecting it to political interference that compromises its independence.

Ongoing regulatory uncertainty and political intervention are key credit rating constraints for the sector. Argentine gas distribution companies (GDCs) generally have strong credit metrics for their rating categories, but this does not reflect a solid financial position. Rather, their low leverage reflects a lack of needed capital investment caused by the tariff freeze. Meanwhile, with inflation rising in Argentina, the tariff freeze will have an even more pronounced effect on profitability.

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The government froze utility tariffs in 2002 as an inflation-fighting measure amid the country's devastating economic crisis and currency devaluation. This left gas companies without the cash flow to invest in new production, forcing Argentina to increase its reliance on imports. Despite high import prices, residential customers pay artificially low rates for energy because of substantial government subsidies. These subsidies have soared in recent years along with energy prices, pressuring the federal budget. In late July, Argentina finally raised tariffs for a limited number of electrical companies in an effort to alleviate the burden on its fiscal surplus amid rising inflation, but gas tariffs remain unchanged.

There are indications, however, that an increase in gas tariffs could be imminent. Moody's will continue monitoring how the regulatory environment evolves and how any regulatory change would affect individual companies and the regulated industry as a whole.

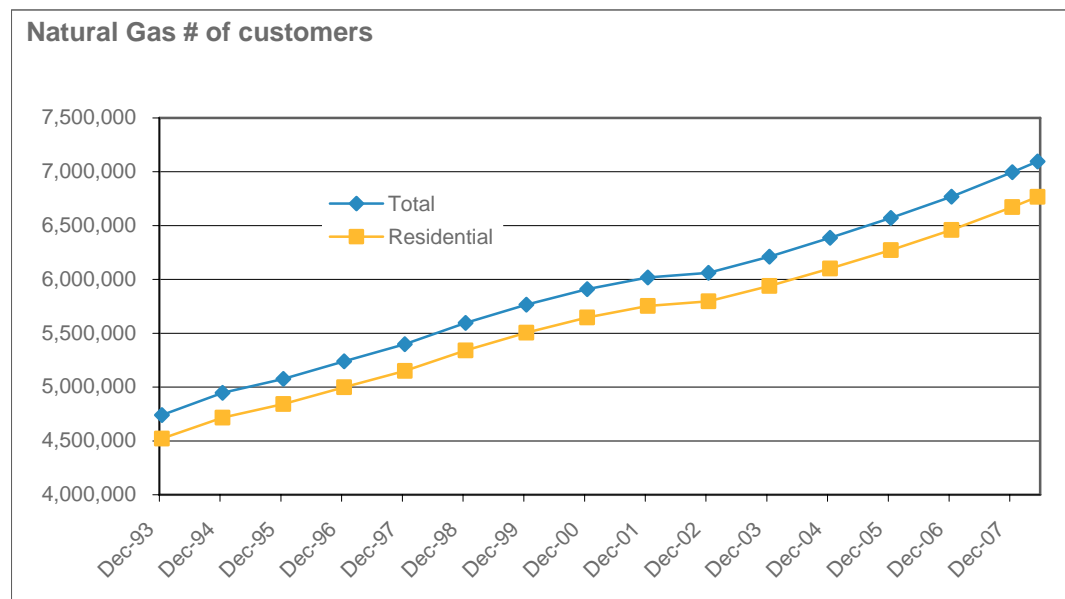
### *Tariff freeze hurts profits, investment*

The gas distribution industry's current pressures have their roots in Argentina's economic crisis of 2001-2002. The devaluation of the Argentine peso led the government to impose severe measures to contain inflation. With passage of the Public Emergency Law by the Argentine Congress in 2002, utility tariffs that were previously dollarized were frozen and converted into pesos at a 1:1 exchange rate, effective January 1, 2002.

The freeze on tariffs has taken a toll on profitability in the sector. The one notable exception is Gasban, the only gas distributor that has managed to negotiate an increase in tariffs for residential customers and seen the higher rates take effect. The company's profitability recovered after the increase last year. For the sector generally, profit recovery will be difficult if inflation and higher costs are not addressed by tariff increases.

In the absence of regulatory relief, operating efficiency is critical. In general, distributors operating in dense metropolitan areas have an advantage. They can generate more revenues per customer, as there is a greater concentration of usage per meter or gas pipeline network. Companies serving rural areas have less opportunity to realize these efficiencies.

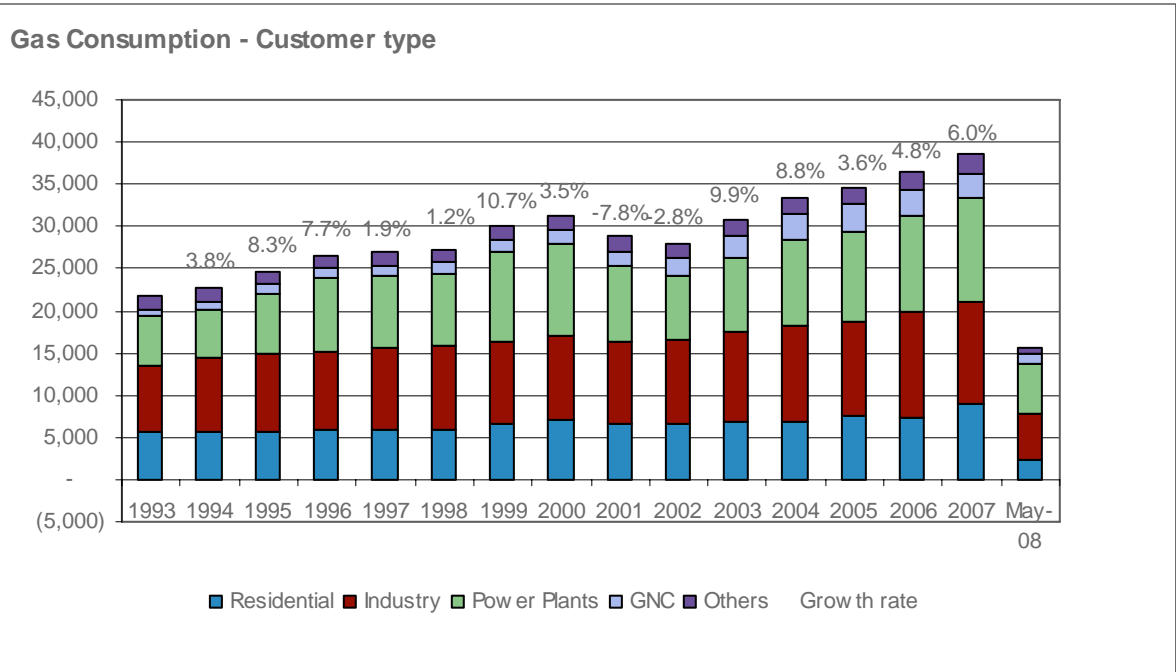
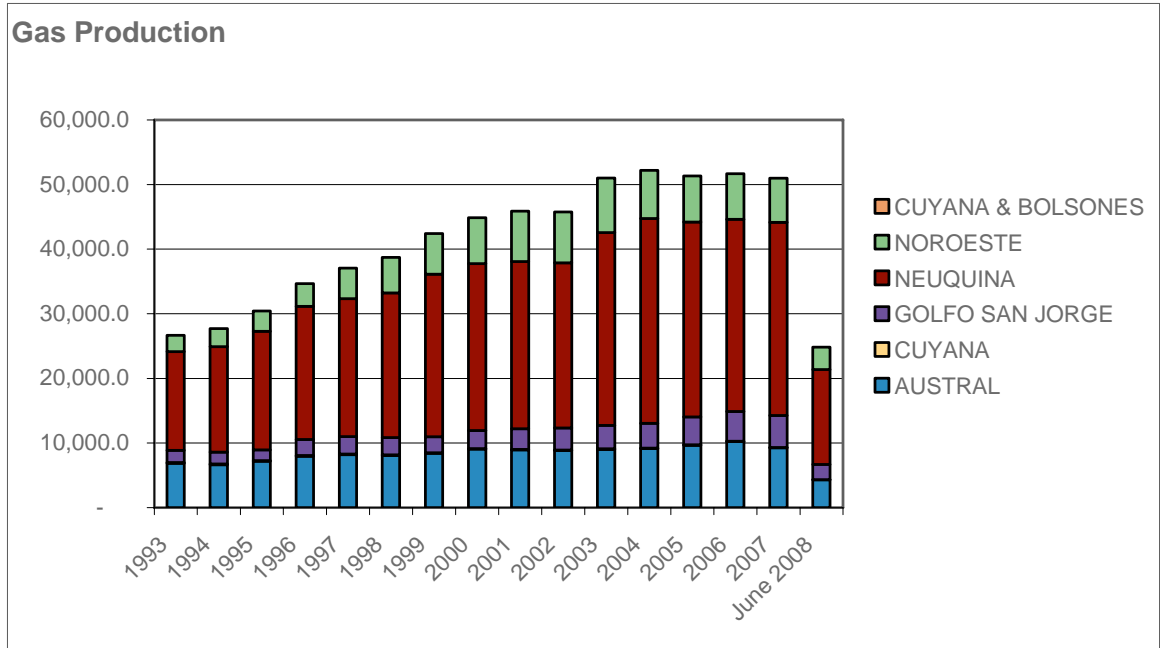
The tariff freeze has greatly limited the ability of gas distributors to invest in critical infrastructure. At the same time, the number of residential gas customers in Argentina has increased by about 1 million since passage of the Emergency Law ushered in the tariff freeze, further burdening existing infrastructure.



The tariff freeze has also resulted in declining gas production and reserves, and it has limited pipeline capacity, all of which have a negative effect on the gas distribution industry. The country has suffered chronic winter gas shortages during which many industries have been subject to cuts in gas supply, which ultimately reduces GDC revenues. A tariff increase would be of limited help under these circumstances, as current

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negotiations are only addressing tariffs for industrial customers. GDCs will not be able to earn a higher tariff if gas shortages limit the amount of product they can distribute to these customers.



One element of distributors' revenues not affected by the current standoff with the government is the gas price cost pass-through mechanism. Even with tariffs frozen, distribution companies are able to pass through to customers the price of gas itself. But increases in distributors' costs other than the price of gas are a risk to future margins for GDCs. This will need to be addressed in the regulatory structure, given the current high level of inflation in Argentina.

Even while both the timing and the magnitude of tariff increases remain uncertain, it is important to note that the fundamental regulatory framework for gas distribution companies is still in place, as outlined in the 1992 Gas Act (for a discussion of the Gas Act and the regulatory framework in Argentina, see Appendix C). We

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expect the gas price cost pass-through mechanism to be maintained for the foreseeable future and we do not expect any direct competition for GDCs, which are likely to remain monopolies with a mandate to provide service in their regions.

### Rating Implications

Moody's currently rates four regulated gas distribution companies and one regulated pipeline in Argentina. The average rating for the industry is B2, well into speculative-grade territory. This reflects the constraints of ongoing regulatory uncertainty and political intervention. Given this climate, the weighting we assign to the regulatory factor is much greater for GDCs in Argentina than for those based in North America or other markets with greater stability and predictability on regulations.

### List of Issuers and Ratings

| Name of Company                             | Business                                 | Global<br>Local<br>Currency<br>Rating | Argentinean<br>National<br>Scale Rating | Outlook | Outstanding<br>debt<br>(million) |
|---|--|---------------------------------------|---|---------|----------------------------------|
| Camuzzi Gas Pampeana S.A.<br>(Pampeana)     | Gas Distribution                         | B2                                    | A1.ar                                   | Stable  | ARS 50.0                         |
| Gas Natural Ban S.A.(GNB)                   | Gas Distribution                         | B2                                    | A2.ar                                   | Stable  | ARS 125.9                        |
| Gasnor S.A.                                 | Gas Distribution                         | B2                                    | A2.ar                                   | Stable  | -                                |
| Metrogas S.A.                               | Gas Distribution                         | Caa1                                  | Ba1.ar                                  | Stable  | USD 260                          |
| Transportadora de Gas del Sur S.A.<br>(TGS) | Gas Transportation<br>and Gas Processing | B1                                    | Aa2.ar                                  | Stable  | USD 450                          |

Moody's view is that the regulatory environment will continue to receive a high weighting in determining ratings in the Argentine gas distribution sector. Given the lack of regulatory independence, gas distribution sector regulatory risk is highly correlated with that of the Argentine government, which is currently rated B3, with a foreign currency ceiling of B2. Thus, most gas distribution ratings are likely to remain in the B rating category on a local currency basis, with more risk differentiation taking place at the national level.

Like other regulated industries in Argentina such as electric utilities and telecommunications, gas utilities generally have strong financial ratios for their rating category when compared with global peers. However, the unpredictable regulatory environment and government interference in the tariff-setting process reduce the relevance of current financial metrics to our ratings, which are forward looking in nature.

The strength of the gas companies' credit metrics relative to their rating category is more a consequence of underinvestment in fixed assets and limitations on dividend payments imposed by accumulated losses, rather than a sign of strong financial position. For these companies, low leverage reflects a challenging business climate and a lack of growth opportunities.

Among the GDCs, there are differences in the currency denomination of their debt that affect the amount of foreign exchange risk they bear. (See the outstanding-debt column in the list above.) As discussed in the Company Profiles section beginning on page 7, two of the GDCs have replaced dollar-denominated debt with local currency debt, eliminating foreign-exchange risk. Another one, Metrogas, has not been able to do so and has no natural dollar income inflows. Finally, TGS has a partial coverage for its dollar-denominated debt coming from its 20% export revenues and also sales into the local market at unregulated prices that, to some extent, follow international prices.

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Looking ahead, Moody's focus in rating GDCs in Argentina will be primarily based on how the regulatory environment evolves. In particular we will monitor:

- Solution of pending renegotiation cases where there is not an agreement yet (Metrogas, TGS, Gas Cuyana, Gas del Centro, Gas Nea)
- Effective implementation of provisional tariff increases already agreed to with the government (Camuzzi Gas Pampeana, Camuzzi Gas del Sur, Gasnor, Litoral Gas)
- New terms for the license after the RTI in process is completed (Gas Ban)

Over the intermediate to long term there are some other fundamental questions that should be addressed, once regulations and the macroeconomic environment for the industry have changed.

In particular, the questions that will be key for the ratings in the future are:

- How inflation affects costs and operating expenses and how companies can manage and control increased costs
- How the companies adjust to an uncertain gas supply scenario and to declining gas reserves
- The decision process for investments and expansions
- How the industry addresses restrictions imposed by limited transportation capacity at the pipelines
- The elasticity of consumer demand to tariff increases and, eventually, to higher gas prices

### *Efforts to address tariffs complicated by legal claims*

The government and the gas companies are involved in negotiations on tariff increases, but pending legal claims against the government are a complication. An interim proposal that would raise tariffs for non-residential customers requires the withdrawal of any claims in international courts against the Argentine government. We believe it is unlikely that the government will allow tariff relief for gas distribution companies that have pending legal claims against it.

Companies or their shareholders filed these claims against the government contesting tariff pesification in international courts such as the ICSID (International Centre for Settlement of Investments Disputes) and the UNCITRAL (United Nations Commission on International Trade Law). Some of the courts have ruled against the country in favor of the companies. In all such cases, the Argentine government has appealed the ruling, asking for the annulment of the proceedings. The resolution of the annulment process could take at least two years.

Resolution of those claims is further complicated by the diverse negotiating strategies among the members of the gas companies' controlling groups. The groups will need to develop a coherent strategy with regard to claims in international courts and existing settlements.

Only Gas Ban, with a strong and unique controlling group, has succeeded in reaching an agreement with the government that has resulted in the implementation of higher residential tariffs. In the remaining cases, where ownership structures are more complex and involve multiple parties, internal conflicts among the shareholders about whether to pursue settlements in international courts have delayed tariff negotiations.

Rising energy costs could force the government's hand at the negotiating table. The decline in gas production resulting from underinvestment has led to increased reliance on imports, which the government subsidizes to keep residential utility rates low. The average cost of gas per million BTU for residential consumers is \$0,40 while the government pays an average of \$6 per million BTU for imports from Bolivia. Considering 2007 average residential consumption of 25 million cubic meters per day at import prices, the implicit subsidy to residential consumers can be estimated at US \$5 million per day, or an annual cost of nearly US \$2 billion for the federal government. The total cost of the subsidy has risen sharply in recent years, pressuring the government's fiscal surplus.

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### *Years of tariff negotiations yield few results*

Efforts to secure tariff increases have been under way ever since the Emergency Law was enacted. There were some attempts in 2002 and 2003 to approve provisional tariff increases, but they were suspended by the courts. In July 2003, the Argentine government created UNIREN (Unidad de Renegociación y Análisis de Contratos de Servicios Públicos or Agency to Renegotiate Public Utilities Contracts) with the objective of providing advice on the renegotiation process of 61 public works and services contracts, and developing a common regulatory framework for all utilities. UNIREN is presided over by the Federal Planning Minister.

After UNIREN's creation, the government began a tariff renegotiation process which has resulted in few practical results to date. Twenty-four utilities have been renegotiating their licenses since UNIREN's creation. Only ten have reached tariff agreements; of those, five have been implemented. Only one company – Gas Ban – has implemented an increase that includes residential consumers.

In the case of gas utilities, UNIREN proposed a provisional agreement (“Acta Acuerdo”) that set an interim tariff increase – provided companies and shareholders drop their legal claims against the government. However, this increase applied only to industrial and commercial users, while tariffs for residential consumers remained frozen. The proposal called for a 25% increase in the distribution margin plus a 2% adjustment to finance new investments. It was submitted to each company individually but not tailored to the technical and operational differences of each company.

These proposals also established that after an interim period, an integral review of the license and tariff regime should be considered. (This integral review process is referred to as the RTI, or Revision Tarifaria Integral.) This process is under way with Gas Ban.

There are still many uncertainties, such as the treatment of residential tariffs, but the Gas Ban case may eventually provide a road map for other GDCs to follow in negotiations with the government. The company and the regulator are working on the development of a new framework that considers most of the key regulatory issues, such as the asset bases used for setting tariffs and the recovery of increased costs. While the new regulatory structure is likely to be technically designed, government approval will still be necessary and Moody's view is that the political component of the process is likely to have more weight than the technical side.

## Conclusion

Despite the regulatory uncertainty and adverse political climate prevailing for the gas industry in Argentina, as a consequence of the low leverage levels, most of the rated companies continue to be in fairly comfortable financial condition and we don't expect any material adverse event affecting the industry. The outlook for the sector continues to be overall stable and rating upgrades will largely depend on an improvement in the regulatory framework and a more stable business environment.

Moody's notes, however, that if inflation continues rising, profits and cash generation will continue deteriorating. Therefore, Moody's will be monitoring not only how the regulatory environment evolves, but the companies' liquidity position and cash available for debt repayment and minimum maintenance capex to sustain the safety of the gas distribution network. Prudent dividend policies and preservation of low leverage levels will also be key to Moody's ratings.

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### Appendix A

#### *Company Profiles*

#### **GASBAN**

##### *Case kicks off tariff adjustments*

Gas Natural Ban (GNB) is the only gas distributor in Argentina to secure and implement a tariff increase applicable to residential customers. Even after the company reached its agreement with the government, it took it more than a year to get the final authorization from Enargas, the industry's regulator, to effectively implement the agreed upon tariff increase. Nonetheless, the negotiations with UNIREN were smooth, facilitated by the conciliatory attitude shown by GNB management. Gas Natural has a widespread presence in Latin America and it has always represented its investments in the region as long-term in nature. Furthermore, neither the company nor its shareholders has pending claims in any international court against the Argentine government.

GNB is already working with Enargas in the studies for the RTI. Although our understanding is that the negotiations are technical in nature and could lead to a more stable regulatory framework for future operations, the outcome of that process is likely to be politically driven.

GNB is controlled directly and indirectly by Gas Natural (Spain) and it had no debt outstanding at the beginning of the negotiations, except for bank loans guaranteed by its parent company. Although bank loans were originally dollar denominated, GNB gradually replaced them with local-currency denominated debt, eliminating foreign exchange risk.

#### **CAMUZZI**

##### *Illustrates complex, time-consuming nature of negotiations*

CAMUZZI GAS PAMPEANA (Pampeana) has an ownership structure split between two main controlling groups: Camuzzi and Sempra. Both of Pampeana's shareholders have presented claims in international courts against the Argentine government. For Pampeana, the implementation of the tariff increases contained in the provisional agreement will likely remain in a state of limbo until those claims are resolved or withdrawn.

Camuzzi has expressed its intention of dropping its international claim, but Sempra is still pursuing legal remedies in international courts. ICSID ruled on September 28, 2007 against the Argentine government, requiring it to pay Sempra a total of US \$128 million – about US \$58 million of which related to Pampeana. This ruling has introduced a new element into an already complex negotiation. Sempra has also publicly announced its intention to sell its assets in Argentina, including its share of Pampeana.

The conflicting strategies of the two shareholders have deadlocked the negotiations with the government for the time being. Further advances in the negotiations and the implementation of the tariff increases in the provisional agreement approved by Congress will largely depend on the evolution of the controlling shareholder group and the alignment of their negotiating strategies.

At the moment of Argentina's currency devaluation Pampeana had no debt outstanding other than a parent loan. Although the loan was dollar denominated, Pampeana paid it out from internal cash and peso-denominated debt obtained from the local capital markets. Pampeana's current debt amounts to pesos 51 million – less than one-time EBITDA.

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### **METROGAS**

#### *Legal dispute holds up tariff increase*

Metrogas is controlled by GASA, a holding company that in turn is controlled by BG (51%) and YPF (49%). In 2002, as a consequence of the devaluation, Metrogas and GASA defaulted on their dollar-denominated debt. After a period of negotiations with bondholders, Metrogas in 2006 entered into a restructuring agreement that extended maturities and reduced interest payments, although it kept its dollar denomination, leaving Metrogas bondholders exposed to devaluation and transfer risk. GASA's debt restructuring is still pending.

UNIREN submitted a proposal to Metrogas for an interim tariff increase, but Metrogas rejected the proposal. The proposal made by the government required that BG withdraw its claim against Argentina in UNCITRAL, which has not yet taken place. In this case, the court has pronounced against Argentina in BG's favor. A tariff increase is unlikely until there is a settlement of the legal dispute.

Metrogas also needs to resolve its ownership structure due to GASA's pending debt restructuring that, once approved, will change Metrogas's ownership. GASA and its creditors agreed on a restructuring in 2005, but the plan still lacks government approval. This year, one of GASA's main creditors announced the termination of the restructuring agreement and a new agreement between parties is expected.

### **GASNOR**

#### *The exception to the rule?*

Gasnor is controlled by GASCART, a holding company controlled 50%-50% by Cartellone, a national group of companies involved in the infrastructure business in Argentina, and Gasco, a Chilean company involved in gas distribution in Chile and also related to Chilean Compañía General de Electricidad. Neither the company nor its shareholders has pending claims against Argentina. Still, Gasnor's provisional agreement has not been implemented. Approvals by the executive branch and Enargas are pending.

As one of the smaller GDCs in the market, Gasnor has adopted a low-profile attitude in the license renegotiation with the government and established itself as a follower. Gasnor has signed the provisional agreement with the government under similar terms to Camuzzi's agreement (a 27% increase in the distribution margin for industrial and commercial clients, with residential excluded). In this case, the tariff increase implementation depends only on a political decision.

### **TRANSPORTADORA DE GAS DEL SUR (TGS)**

#### *Disputing government's provisional tariff increase*

TGS is not a GDC but an operator of a regulated pipeline and an unregulated gas processing business. TGS's regulated business is facing a similar situation as regulated GDCs, with tariffs frozen since 2002. However, more than 50% of TGS's revenues come from its unregulated gas processing segment.

TGS's current ownership structure will change as a result of a debt restructuring at its holding company, Ciesa. Approval of the restructuring is still pending. Once it's completed, Ciesa will continue to be 50% controlled by Petrobras, and 50% controlled by Ashmore Energy.

UNIREN has submitted to the company a proposal for a 10% provisional increase of its regulated tariff, to be followed by an integral tariff review. TGS has responded that the 10% increase is insufficient.

The proposal also required that TGS and its main shareholders withdraw any claim against Argentina, but TGS has responded that TGS, Ciesa and Petrobras have not filed a claim against Argentina in international courts. However, one of Ciesa's current shareholders – Enron – stated it had filed a claim before ICSID and that it would consider waiving it only if it receives fair compensation. In this way, the company's ownership structure is complicating negotiations with the government.

However, TGS's financial profile continues to be solid. Strong prices for its liquid products have resulted in strong cash generation and debt reduction. The recent repurchase of US \$50 million of its own debt is a clear

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indication of TGS's cash generation potential. Increased export taxes and reduced gas processing volumes due to gas cuts have not impacted TGS's cash generation materially. One risk is that the government could interfere in TGS's gas processing segment, even though that business is unregulated. Intervention in the gas industry has been negative to TGN, the northern-west gas pipeline in the country, whose revenues from exports of natural gas to Chile have been reduced substantially. In TGS's case, there is the support of liquid gas product sales at international prices to Petrobras, which is one of TGS's main export clients as well as its controlling shareholder.

The capacity of Argentina's gas transportation system hasn't increased in the past few years because the transportation companies have had no incentives from tariffs to make new investments. The recent expansion of the system was built through the creation of the "Gas Trust Fund," a government initiative, and financed through a special tariff to be paid by industries, power plants, etc.

This government approach to insufficient investments in the transportation capacity has been negative for TGS's regulated business. Instead of granting tariffs sufficient for expanding the pipeline infrastructure, the government decided to introduce a special charge that would require final users to finance the expansion. Therefore, the expansion of the system has been directed by the government instead of being implemented by the transportation companies. The charge caused an 81% increase over the current tariff paid by industries, thus reducing the likelihood of a tariff increase for TGS.

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## Appendix B

## Identification of Key Credit Metrics

Although there are limitations imposed by the lack of transparency of the regulatory framework, we will discuss key credit metrics for the gas distribution industry in Argentina.

The key credit metrics are shown in the table below:

| Co Name                          | GLC  | NSR    | OUT | Date            | Revenue (USD '000s) | ROE (NPATBUI/ Avg. Equity) | EBITA/ Avg Assets | Operating Margin % | EBIT Margin % | EBIT/ Int Exp | RCF/ Debt | Debt / Book Capitalization | Debt/ EBITDA |
|----------------------------------|------|--------|-----|-----------------|---------------------|----------------------------|-------------------|--------------------|---------------|---------------|-----------|----------------------------|--------------|
| Transportadora de Gas del Sur S. |      |        |     | 12/31/2004      | 337,989             | 6.70%                      | 8.66%             | 38.65%             | 43.17%        | 1.59x         | 10.59%    | 55.22%                     | 4.34x        |
|                                  | B1   | Aa2.ar | Sta | 12/31/2005      | 364,354             | 9.28%                      | 8.47%             | 41.60%             | 40.15%        | 2.14x         | 20.69%    | 51.13%                     | 4.06x        |
|                                  |      |        |     | 12/31/2006      | 426,090             | 13.77%                     | 11.39%            | 43.54%             | 44.94%        | 2.83x         | 32.88%    | 42.04%                     | 2.58x        |
|                                  |      |        |     | 12/31/2007      | 403,580             | 5.83%                      | 9.84%             | 38.97%             | 39.60%        | 2.70x         | 35.58%    | 35.19%                     | 2.28x        |
|                                  |      |        |     | 3/31/2008 (LTM) | 441,581             | 6.17%                      | 9.93%             | 37.78%             | 37.16%        | 2.90x         | 38.65%    | 35.15%                     | 2.28x        |
| Camuzzi Gas Pampeana S.A.        |      |        |     | 12/31/2003      | 117,247             | -2.14%                     | 2.13%             | 8.16%              | 7.06%         | 1.12x         | 31.07%    | 19.45%                     | 3.07x        |
|                                  | B2   | A2.ar  | Sta | 12/31/2004      | 131,747             | 0.68%                      | 3.68%             | 9.89%              | 10.87%        | 2.39x         | 48.71%    | 15.05%                     | 1.82x        |
|                                  |      |        |     | 12/31/2005      | 150,319             | 0.87%                      | 3.78%             | 8.67%              | 9.50%         | 3.51x         | 58.34%    | 14.28%                     | 1.69x        |
|                                  |      |        |     | 12/31/2006      | 133,428             | 2.04%                      | 4.63%             | 10.36%             | 12.69%        | 5.95x         | 82.61%    | 10.96%                     | 1.13x        |
|                                  |      |        |     | 12/31/2007      | 144,325             | 2.52%                      | 4.95%             | 9.68%              | 12.43%        | 7.28x         | 125.29%   | 6.35%                      | 0.60x        |
|                                  |      |        |     | 3/31/2008 (LTM) | 144,823             | 3.24%                      | 4.80%             | 8.74%              | 11.72%        | 48.61x        | 165.58%   | 5.14%                      | 0.49x        |
| Gas Natural BAN, S.A.            |      |        |     | 12/31/2003      | 171,902             | -2.91%                     | 4.81%             | 10.90%             | 13.89%        | 2.00x         | 18.74%    | 40.61%                     | 4.00x        |
|                                  | B2   | A1.ar  | Sta | 12/31/2004      | 174,042             | 1.60%                      | 4.65%             | 10.95%             | 12.47%        | 2.34x         | 21.22%    | 36.58%                     | 3.70x        |
|                                  |      |        |     | 12/31/2005      | 188,972             | 0.04%                      | 4.11%             | 7.35%              | 9.98%         | 1.55x         | 19.53%    | 37.36%                     | 3.63x        |
|                                  |      |        |     | 12/31/2006      | 160,307             | -11.54%                    | 3.70%             | 5.67%              | 9.59%         | 0.94x         | 28.14%    | 39.60%                     | 3.69x        |
|                                  |      |        |     | 12/31/2007      | 191,069             | 9.83%                      | 8.62%             | 15.36%             | 18.86%        | 2.06x         | 49.57%    | 33.89%                     | 2.17x        |
|                                  |      |        |     | 3/31/2008 (LTM) | 194,069             | 10.96%                     | 9.42%             | 15.94%             | 19.69%        | 2.20x         | 48.01%    | 33.99%                     | 2.03x        |
| Gasnor S.A.                      |      |        |     | 12/31/2003      | 38,191              | 1.97%                      | 5.47%             | 4.68%              | 13.27%        | 4.69x         | 11.04%    | 22.29%                     | 2.32x        |
|                                  | B2   | A2.ar  | Sta | 12/31/2004      | 45,565              | 1.68%                      | 6.18%             | 9.87%              | 12.13%        | 2.69x         | 24.05%    | 17.61%                     | 1.63x        |
|                                  |      |        |     | 12/31/2005      | 48,557              | 1.70%                      | 5.95%             | 10.58%             | 11.35%        | 2.66x         | 48.49%    | 14.85%                     | 1.39x        |
|                                  |      |        |     | 12/31/2006      | 36,256              | 4.15%                      | 8.33%             | 20.85%             | 22.64%        | 3.80x         | 43.17%    | 12.08%                     | 0.89x        |
|                                  |      |        |     | 6/30/2007 (LTM) | 34,364              | 3.31%                      | 7.15%             | 18.49%             | 20.20%        | 3.61x         | 45.55%    | 10.47%                     | 0.83x        |
| MetroGas S.A.                    |      |        |     | 12/31/2003      | 220,982             | -14.49%                    | 1.68%             | 4.60%              | 5.99%         | 0.37x         | 9.32%     | 64.73%                     | 11.79x       |
|                                  | Caa1 | Ba1.ar | Sta | 12/31/2004      | 276,785             | -5.57%                     | 2.84%             | 7.20%              | 8.29%         | 0.63x         | 9.98%     | 71.00%                     | 10.42x       |
|                                  |      |        |     | 12/31/2005      | 297,437             | -1.17%                     | 3.99%             | 9.21%              | 11.59%        | 0.93x         | 11.69%    | 70.29%                     | 8.75x        |
|                                  |      |        |     | 12/31/2006      | 243,077             | -15.97%                    | 4.35%             | 12.68%             | 13.35%        | 1.21x         | 5.71%     | 42.30%                     | 4.26x        |
|                                  |      |        |     | 12/31/2007      | 253,125             | 7.56%                      | 6.07%             | 11.88%             | 15.14%        | 2.05x         | 19.09%    | 41.95%                     | 3.85x        |
|                                  |      |        |     | 3/31/2008 (LTM) | 256,418             | 8.47%                      | 6.38%             | 12.32%             | 15.64%        | 2.16x         | 19.30%    | 42.93%                     | 3.91x        |

\* Subsidiary's rating

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We conclude that, in general, credit metrics for Argentinean GDCs are strong for their rating category. The most obvious exception is factor 1, where profitability has been highly affected by the frozen tariffs imposed by the emergency law since 2002. The only notable exception is Gasban's recovered profitability after last year's tariff increase. However, incipient profit recovery may erode rapidly if inflation and higher costs are not addressed by tariffs. Underinvestment in fixed assets and limitations on dividend payments imposed by accumulated losses are other factors that make the current ratios appear stronger than they would be under normal operating conditions. Therefore, historical leverage may be artificially low and an indication of the challenging business environment and a lack of growth opportunities rather than of a solid financial position.

Another aspect of the Argentine gas distribution risk spectrum is a gas company's ability to maintain operations in the absence of tariff increases necessary for new investments. In the absence of regulatory relief, a company's ability to stay in business is dependent on its operating efficiency, which could be measured in various ways. Among these are age of plant and equipment, gross margins generated per metered customer or employees, and the ability to control O&M expenses that tend to rise with overall inflation. In addition, it is generally expected that companies operating in a dense urban environment would generate more revenues per customer meter or hectare, as there is a greater concentration of usage per meter or gas pipeline network. Consequently, companies serving the rural areas would generally not be expected to be as efficient or cost effective as those operating in metropolitan areas. This measure is displayed below in the form of various "efficiency" indicators.

To illustrate how efficiency has been affected by the lack of tariff adjustment since the pesification in 2002, we developed the following measures from two of the companies' public information. (Please see next page.) In our view, this illustrates how business efficiency has eroded, despite the industry's relatively low leverage. GasBan's tariff increase last year resulted in higher investments and in better absorption of operating expenses. Camuzzi Gas Pampeana's metrics continue to erode in the absence of a tariff increase.

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| PAMPEANA                                     | 2003        | 2004        | 2005        | 2006         | 2007         |
|--|-------------|-------------|-------------|--------------|--------------|
| <b>Qualitative Data</b>                      |             |             |             |              |              |
| Total # Customers                            | 965,844     | 999,200     | 1,027,577   | 1,060,084    | 1,100,690    |
| Revenues (million pesos)                     | \$340.90    | \$383.00    | \$435.10    | \$405.70     | \$446.00     |
| Employees                                    | 819         | 839         | 882         | 918          | 941          |
| <b>Efficiency</b>                            |             |             |             |              |              |
| Opex (mill. Pesos)                           | \$59        | \$68        | \$80        | \$100        | \$118        |
| Opex per customer (Pesos)                    | \$60.67     | \$67.95     | \$77.56     | \$94.71      | \$107.21     |
| Opex per employee                            | \$71,550.67 | \$80,929.68 | \$90,362.81 | \$109,368.19 | \$125,398.51 |
| Opex % Gross Margin (sales less cost of gas) | 42.16%      | 41.01%      | 42.73%      | 44.91%       | 46.31%       |
| Salaries % Opex                              | 44.54%      | 48.16%      | 49.31%      | 52.09%       | 51.78%       |
| Total Capex per customer                     | \$371.42    | \$734.74    | \$872.51    | \$957.21     | \$884.67     |
| Total Capex per employee                     | \$30,712.03 | \$63,835.40 | \$75,892.86 | \$84,081.04  | \$80,845.07  |
| Exchange Rate (ARS /USD)                     | 2.96        | 2.97        | 3.01        | 3.06         | 3.14         |

| GAS BAN                                      | 2003         | 2004         | 2005         | 2006         | 2007         |
|--|--------------|--------------|--------------|--------------|--------------|
| <b>Qualitative Data</b>                      |              |              |              |              |              |
| Total # Customers                            | 1,230,408    | 1,257,459    | 1,289,033    | 1,320,988    | 1,355,034    |
| Revenues (million pesos)                     | \$492.20     | \$505.50     | \$554.80     | \$488.60     | \$640.50     |
| Employees                                    | 616          | 604          | 601          | 600          | 578          |
| <b>Efficiency</b>                            |              |              |              |              |              |
| Opex (mill. Pesos)                           | \$92         | \$89         | \$107        | \$126        | \$153        |
| Opex per customer (Pesos)                    | \$75.14      | \$70.43      | \$83.26      | \$95.64      | \$112.87     |
| Opex per employee                            | \$150,088.76 | \$146,623.09 | \$178,568.69 | \$210,562.75 | \$264,613.85 |
| Opex % Gross Margin (sales less cost of gas) | 37.44%       | 37.46%       | 43.43%       | 51.50%       | 39.22%       |
| Salaries % Opex                              | 27.69%       | 27.20%       | 27.64%       | 27.20%       | 26.95%       |
| Total Capex per customer                     | \$14.30      | \$20.27      | \$27.03      | \$27.73      | \$47.33      |
| Total Capex per employee                     | \$28,558.10  | \$42,204.18  | \$57,970.40  | \$61,051.44  | \$110,949.25 |
| Exchange Rate (ARS / USD)                    | 2.96         | 2.97         | 3.01         | 3.06         | 3.14         |

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### Appendix C

#### *The regulatory structure created by the 1992 Gas Act*

The GDCs were created in Argentina as a result of the privatization process of public utilities that occurred in the early 1990s. Prior to the privatization of Gas del Estado, which owned and operated virtually all natural gas transportation and distribution facilities in Argentina, the Argentine government effectively controlled the gas industry.

The Gas Act, enacted in June 1992, established a new competitive and partially deregulated industry structure for natural gas transportation, distribution, storage and marketing in Argentina. It created two new transportation companies and nine new distribution companies, each of which was licensed and regulated under the new regulatory framework. At the time of the privatization, the distribution assets of Gas del Estado were divided into nine regions, as specified in the license of each of the nine distribution companies. Gas del Estado's transportation assets were divided on a broad geographical basis into a northern (TGN) and a southern (TGS) trunk pipeline system designed to give both systems access to gas sources and to the main demand centers.

The Gas Act granted each privatized company a license to operate the transferred assets and created a regulatory framework based on open, nondiscriminatory access. Producers and users, as well as distributors, were entitled to equal and open access to the transportation pipelines and distribution system. Distributors were restricted from discriminating among customers or granting any customer an undue preference. A regulatory agency (ENARGAS) was created to regulate the transportation, distribution, marketing and storage of natural gas in Argentina.

#### *Access*

The Gas Act provided that only licensed, private companies may engage in the distribution of gas. A license confers the exclusive right to distribute gas within a specified region. The sale of gas is not exclusive, however; consumers can buy gas from the distribution company or from third-party producers or marketers. Even if a consumer buys gas from a third party, it is still delivered using the distribution system, allowing the distribution company to earn the same distribution margin.

#### *Tariffs*

The regulatory framework established various classes of service and a corresponding tariff for each class of service. The mechanism for setting the tariffs for each class of service was set forth in the Gas Act.

The Gas Act provided that the tariff for natural gas consists of the sum of three components: (1) the price of gas purchased, which is passed through to customers; (2) the transportation tariff for sending gas from the production area to the distribution system, which is a regulated tariff for gas transportation companies and is passed through to final consumers of the distribution companies; and (3) the distribution tariff established by ENARGAS.

The Gas Act contemplated that tariffs would be adjusted semiannually to reflect changes in the cost of gas and transportation services. Prior to passage of the emergency law by the Congress in January 2002, tariff adjustments based on changes in the price of gas took place in May and October.

#### *Five-Year Tariff Review*

Under the Gas Act, ENARGAS was responsible for determining the distribution tariffs that were to be effective during a five-year period. The Gas Act required that ENARGAS provide the companies with (1) an opportunity to collect revenues sufficient to recover all approved operating costs for service, taxes and depreciation and (2) a reasonable rate of return. This process has not been in place since the peso devaluation.

The tariff-setting methodology contemplated by the Gas Act was the "price-cap with periodic review" model. This methodology has been adopted by a number of other countries and is commonly referred to by its mathematical expression "RPI-X+K". The Gas Act's tariff-setting methodology differed from the form of utility

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regulation utilized in the U.S. in two primary ways: the length of the period between regulatory reviews, and the use of a forward-looking rather than historical cost basis.

Under the Argentine model, distribution tariffs were subject to adjustments by the Efficiency Factor (X) and the Investment Factor (K). The inclusion of the Efficiency Factor in the pricing system provided the distribution company with an incentive to cut costs. The inclusion of the Investment Factor in the formula was intended to permit an increase in distribution tariffs to compensate distribution companies for certain investments (those designed to expand the distribution network or to improve the efficiency, safety and reliability of the system).

### ENARGAS

The Gas Act established ENARGAS as the body to administer and enforce the Gas Act and applicable regulations. ENARGAS's jurisdiction extends to the transportation, marketing, storage and distribution of gas. Its mandate includes the protection of users, the fostering of competition in the supply and demand for gas, and the encouragement of long-term investment in the gas industry.

#### *Duties and Structure*

The Gas Act provides that ENARGAS will be managed by a board of five full-time members who are appointed by the Argentine government with the consent of a Congressional committee.

ENARGAS is funded by the annual control and inspection fees paid by distribution and transportation companies, traders and providers of storage facilities.

Since May 2007, ENARGAS has been under an intervention decreed by the President of Argentina and an official appointed by the executive branch is in charge. Therefore, many of ENARGAS's technical duties are subject to political interference and it cannot be considered an independent regulator.

### UNIREN

On July 2003, the Argentine government created UNIREN (Unidad de Renegociación y Análisis de Contratos de Servicios Públicos or Agency to Renegotiate Public Utilities Contracts) with the objective of providing advice on the renegotiation process of 61 public works and services contracts, and developing a common regulatory framework for all utilities. UNIREN is presided over by the Federal Planning Minister. After UNIREN's creation, the government began a tariff renegotiation process, which has produced few practical results to date.

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### Moody's Related Research

#### Rating Methodology:

- North American Regulated Gas Distribution Industry (Local Gas Distribution Companies), October 2006 (99282)

#### Industry Outlook:

- North American Natural Gas Transmission & Distribution: Six-Month Industry Update, March 2008 (108212)

#### Special Comments:

- UK Independent Gas Distribution Companies: Moody's Comments on Rating Approach as Regulatory Framework Evolves, April 2008 (107784 )
- Gas LDCs Report Adequate Gas Supplies and Liquidity, September 2007 (104887)
- Local Gas Distribution Companies: Update on Weather Normalization Adjustments and Their Impact on Credit Ratings, June 2007 (103586)
- Local Gas Distribution Companies: Update on Revenue Decoupling And Implications for Credit Ratings, June 2006 (98022)
- Impact Of Conservation On Gas Margins And Financial Stability In The Gas LDC Sector, June 2005 (92787)
- Comparative ROE Attributes of US Local Gas Distribution Companies, July 2004 (87301)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

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