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Corporate Liquidity - Argentina

Liquidity Risk Remains High But New Government Improves Credit Prospects

» **Liquidity risk increased for Argentine non-financial companies in 2015, but will remain adequate for most issuers through mid-2017**. Of the 19 non-financial Argentine companies we rate, 32% had low or medium funding risk in 2015, down from 37% in 2014, while 68% had high funding risk, up from 63%. Cash coverage of short term debt has also deteriorated, falling to 74% in 2015, from 76% in 2014, driven by increased debt as a result of working capital needs –fueled by high inflation levels- and currency depreciation. Argentine companies should be able to roll over their short-term debt over the next 12-18 months, supported by their strong banking relationships.

» **Argentina's operating environment is being transformed as a result of policy changes**. Since Argentina's President Mauricio Macri took office in December 2015, Argentina's operating environment has been experiencing significant changes as a result of new government policies, including exchange rate policy, fiscal policy and monetary policy. **We changed Argentina's sovereign rating to B3, up one notch from Caa1** , in April 2016.

» **Argentine companies maintain poor liquidity practices overall.** The limited availability of long-term financing has forced companies to pursue risky financing strategies, increasing their reliance on short-term debt, which raises their exposure to interest-rate swings and funding risks, and weakens their liquidity positions. As a result, Argentine companies depend heavily on their ability to roll over short-term debt.

» **In light of the new administration policy direction to restore the country's international market access, Argentine companies stand to benefit from renewal of long-term funding and investment growth**. Any improvement in refinancing terms will benefit non-financial companies, because 41% of debt maturities are concentrated over the next 24 months. The $3.4 billion in bonds and notes and $2.4 billion in bank loans due 2016-17 strain the companies' liquidity.

» **Foreign-exchange risk will remain high through mid-2017 for companies in Argentina, where the peso fell by 52% against the US dollar in 2015**. Since Argentina lifted capital controls in December 2015, the peso has depreciated by 44% through April 2016. Although Argentina's 19 rated non-financial companies tend to have little exposure to foreign-denominated debt, 14 have more foreign-denominated debt than foreign-denominated cash flow. The oil and gas sector remains the most exposed to foreign-exchange risk.

About this report

This report summarizes the liquidity risk of the 19 Argentine non-financial and non-utility companies that we rated as of 30 April 2016. We define the degree of liquidity risk by looking at a company's cash needs over a 24-month period, from 1 January 2016 until 31 December 2017, against its available cash sources.

Cash needs include estimates of operating uses and short-term debt maturities. Maturities of interest-bearing debt are those reported as of 31 December 2015. We estimate available funds based on assumptions of each company's revenue growth, margins and cash flow generation after planned capital spending and dividend, in addition to committed bank facilities.

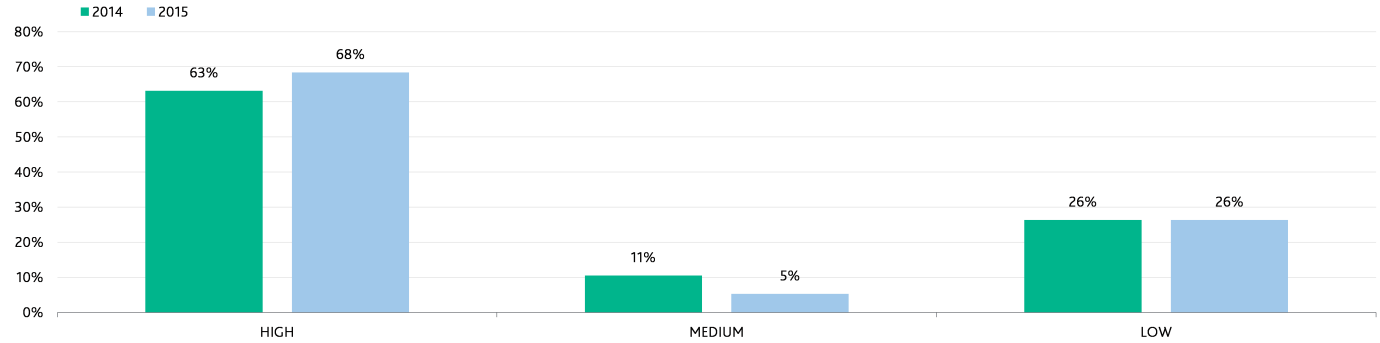
In our liquidity analysis we also take into consideration financial covenants and exposure to foreign-currency risk. The 2014 statistics reflect the historical data for the same pool of companies along with methodological refinements, so could differ from those cited in previous liquidity studies. Other reports in this series discuss corporate liquidity in Brazil, Chile, Mexico and Peru.

High Liquidity Risk for Most Argentine Companies Through Mid-2017

Liquidity risk increased for Argentine non-financial companies in 2015, but will remain adequate for most issuers through mid-2017 (see Exhibit 1). In Argentina, 13 of the 19 companies we reviewed for this report have high funding risk, reflecting their significant debt coming due through 2017, limited cash to address upcoming debt maturities, sizable negative free cash flow, or a lack of access to committed bank credit facilities. The situation has slightly changed since our most recent Argentine liquidity study in May 2015; five companies still have a low funding risk today.

Exhibit 1

Argentine Companies' Exposure to Funding Risk



Source: Moody's Investors Service

We typically define exposure to funding risk as low for Latin American companies with sufficient cash, free cash flow and committed credit facilities to cover more than 150% of debt maturities over the next 24 months; medium if liquidity sources are sufficient to cover more than 150% of maturing debt over the next 12 months, but not the next 24 months; and high if liquidity sources will cover less than 150% of debt maturities over the next 12 months. A few companies in this analysis have significant amounts of debt due in the short term, negative free cash flow generation, or limited cash to address upcoming maturities.

Although no rated Argentine companies defaulted in 2015, their credit quality remains constrained by the weak credit profile of the government of Argentina (B3 stable). Companies with ratings higher than Argentina's B3 rating have strong speculative-grade credit

quality, thanks to factors such as: large size and leading market positions, likely support from an investment-grade parent, broad geographic footprint, export-oriented business and relatively low leverage.

In April 2016 we changed Argentina's sovereign rating to B3 (stable outlook), up from Caa1 (positive outlook), which triggered several changes in the ratings and outlooks of local companies. (See Moody´s upgrades Argentine corporate issuers and places NSRs under review and Moody´s upgrades Argentine corporate issuers.)

Companies with high funding risk include companies in the **oil and gas industry** YPF (B3 stable), Pan American Energy LLC, Argentine Branch (PAE Argentina, B2 review for downgrade) and Petrobras Argentina (B3 negative). Though all three of these companies have adequate levels of cash to cover their short-term debt today, we expect that they will have significant cash outflows as a result of capital spending, much of it denominated in foreign currency. In addition, investment in production and reserve growth will likely entail lower returns during today's persistent global oil industry downturn, resulting in likely increases in financial leverage and lower interest coverage.

Telecom and media companies also present high funding risk. Despite CableVisión's (B3 stable) large capital spending plan in recent years, the company has generated positive free cash flow through strong cash-generation from operations. But CableVisión's debt maturities are highly concentrated in the next 12-18 months through late 2017, which increases its liquidity risk.

Telecom Argentina's (B3 stable) low leverage and strong cash generation before capital spending support its otherwise strong financial metrics. But the depreciation of the Argentine peso will effectively raise capital spending costs, and together with dividend payouts and high working capital requirements, will continue to weaken Telecom Argentina's free cash flow generation.

Food and beverage companies also generally exhibit high funding risk today. Arcor (B1 stable), the candy maker, and Arcos Dorados (B1 negative), the world's largest franchisee of McDonald's, both have tight liquidity profiles, with most of their debt maturities concentrated in the next 12-18 months through late 2017. Arcor's most significant debt maturity corresponds to its $200 million global notes due in 2017, which the company expects to roll over, and Arcos also expects to improve its cash flow generation because of its lower capital investment and higher operating cash generation. Additionally, Arcor has an ample amount of revolving credit available through facilities in various countries, including Argentina, Brazil and Chile.

As of December 2015, Arcos Dorados' liquidity profile was pressured by BRL675 million ($175 million) in notes maturing in July 2016, although capital spending needs will fall as a result of weaker economic activity in Brazil. But in April 2016 its Brazilian subsidiary received a BRL613.9 million four-year term secured loan agreement to refinance this debt maturity, which significantly reliefs liquidity pressure. At the same time, Arcos Dorados had roughly $115 million in cash holdings as of December 2015.

In the **retail and consumer goods industries**, both Longvie (B3 stable) and Mirgor (B3 stable) present low funding risk, with breakeven or positive free cash flow generation through 2017, high cash balances in terms of short-term debt, and low capital spending requirements. Newsan (B3 positive), one of Argentina's largest consumer durables companies, has most maturities concentrated in the short term, but a large portion of them are short-term pre-export credit lines used to finance inventories, and therefore will likely be rolled over.

Despite a weak economic environment for consumer durables companies in 2016, financing for working capital requirements will increase as companies increase financing to encourage sales. But improved ability to access foreign-currency financing for imports of goods will help ease these higher working capital needs, following Argentina's relaxation of capital and international trade controls since December 2015. Capital spending will be mainly limited to maintenance needs, with some extraordinary capital investments, particularly for Newsan and Mirgor.

Operating environment is being transformed as a result of policy changes

Since Argentina's President Mauricio Macri took office in December 2015, Argentina's operating environment has been experiencing changes as a result of new government policies, including exchange rate policy, fiscal policy and monetary policy.

Most notably, the government lifted capital controls, allowing the Argentine peso to float more freely and depreciate to an average of ARS14.4/USD in April 2016—up from about ARS9.7/USD in mid-December 2015. The peso's depreciation has significantly increased the debt burden of dollar-denominated liabilities for Argentine companies that we rate, though some companies have eased this strain

with hedging strategies, and the capital spending costs denominated in foreign currency, which is necessary mainly in the oil and gas industry.

The new administration has also eliminated export taxes on agricultural goods, including beef, corn and wheat, and reduced export taxes on soybeans. This tax reform marked a significant step for the country's protein and agricultural exporters' return to international competitiveness. The new government also eliminated the export and import quota systems for all goods.

Both capital and international trade controls had been limiting companies' ability to access foreign-currency financing for imports of goods, sometimes creating shortages for companies that depend on imported products and raw materials. With those controls lifted, demand for foreign currency financing has reportedly risen sharply. However, regulations still restrict dollar-denominated loans by banks to dollar-earning corporate borrowers.

Although the Argentine economy remains weak, given low global commodity prices and a deep recession in neighboring Brazil, a backlog of capital spending needs has built up in various industries over the last few years. Argentine capital investment in 2013-15 has averaged just 19% of GDP, below the 23% Latin American average. We expect a drop in Argentina's real GDP in 2016, as the government pushes measures to reduce both inflation and the country's fiscal deficit. Economic growth is likely to return in 2017 amid increased investment.

However, a weaker peso and increased public tariffs of utilities will probably accelerate inflation, particularly during the first half of 2016, taking 2016's inflation rate well above the 30% rate of 2015. Argentina's consumer price index rose by 11.6% during the first quarter of 2016 from December 2015.

Overall Liquidity Practices Remain Poor Among Argentine Companies

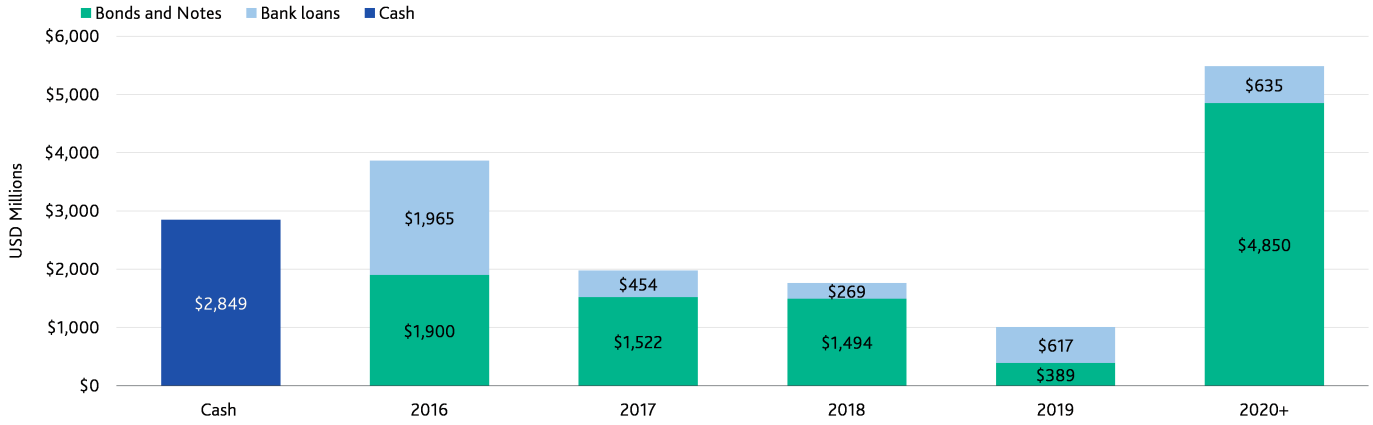
Argentine companies will continue with poor liquidity practices overall through at least mid-2017. The limited availability of long-term financing in recent years has forced companies to pursue risky financing strategies by increasing their reliance on short term debt, which raises their exposure to interest-rate swings and funding risks, and weakens their liquidity. As a result, Argentine companies depend heavily on their ability to roll over short-term debt.

Reliance on local bank debt has skewed Argentine companies' maturity schedules toward the current year (see Exhibit 2). The short tenor of debt maturities is even more pronounced without the three rated oil and gas companies, which hold 77% of rated Argentine companies' total debt (see Exhibit 3).

Exhibit 2

Debt Maturities for Rated Non-Financial Companies in Argentina, 2016-20+

in USD million; exchange rate as of 31 December 2015 (13.04 ARS/USD)

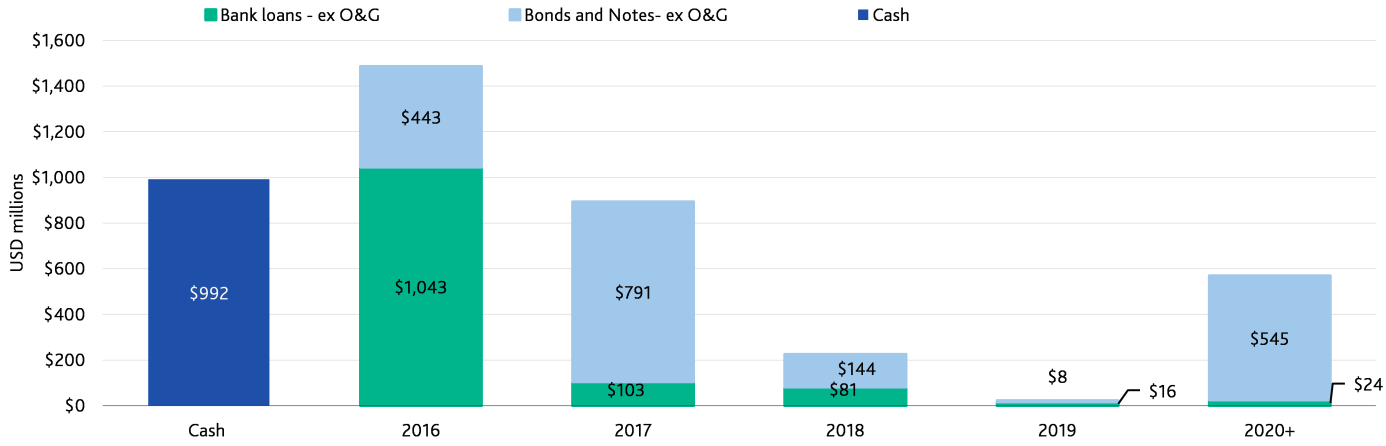


Source: Moody's estimates based on companies' audited financial reports

Exhibit 3

Debt Maturities for Rated Non-Financial Companies in Argentina, 2016-20+, Excluding Oil and Gas

in USD million; exchange rate as of 31 December 2015 (13.04 ARS/USD)



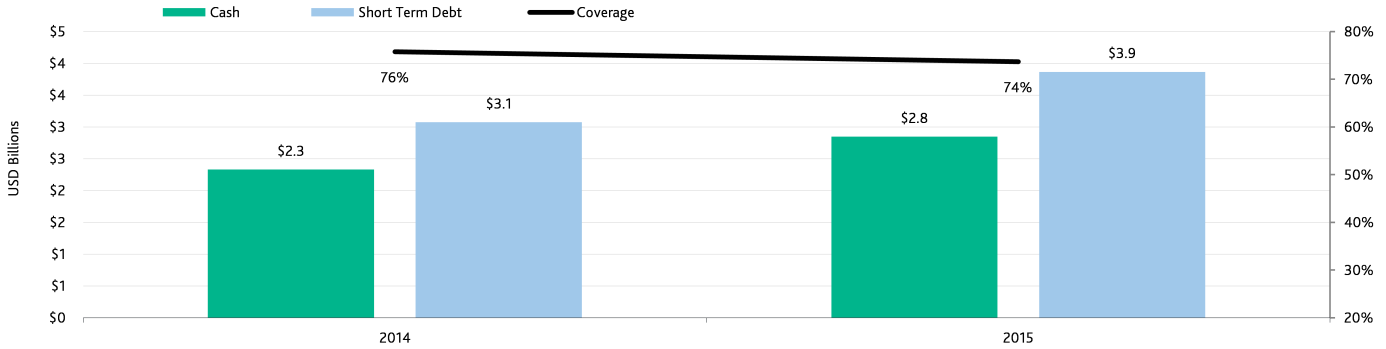
Source: Moody's estimates based on companies' audited financial reports

Argentine companies should be able to roll over their short-term debt through mid-to-late 2017, but like most Latin American companies, they tend to lack committed credit facilities. In fact, Argentine corporate cash coverage of short-term debt fell to 74% in 2015, down from 76% in 2014 (see Exhibit 4). Debt increased as high inflation increased working capital needs and the peso weakened by 52% during 2015, since 71% of total Argentine corporate debt is foreign-denominated. We expect that Argentine companies will maintain conservative dividend policies through at least mid-2017, until economic activity shows signs of recovery.

Exhibit 4

Cash Coverage of Short Term Debt Falls in 2015

in USD million; exchange rates as of year-end



Source: Moody's estimates based on companies' audited financial reports

Corporate capital spending has dropped significantly in recent years amid uncertainty over future economic performance, weak institutions that have led to the misreporting of macroeconomic data since 2007, and most importantly, limited access to long-term funding. Access to long-term funding has been most available for high-profile oil and gas companies, particularly YPF, with few others managing to tap the international capital markets.

Argentine companies continue to maintain more conservative leverage and interest-coverage ratios than those of similarly rated companies elsewhere, with relatively low average adjusted debt to EBITDA ratios of 2.4x in 2015, slightly weaker than 2014's of 2.0x. Local companies' assets are mostly unencumbered, providing additional financial flexibility.

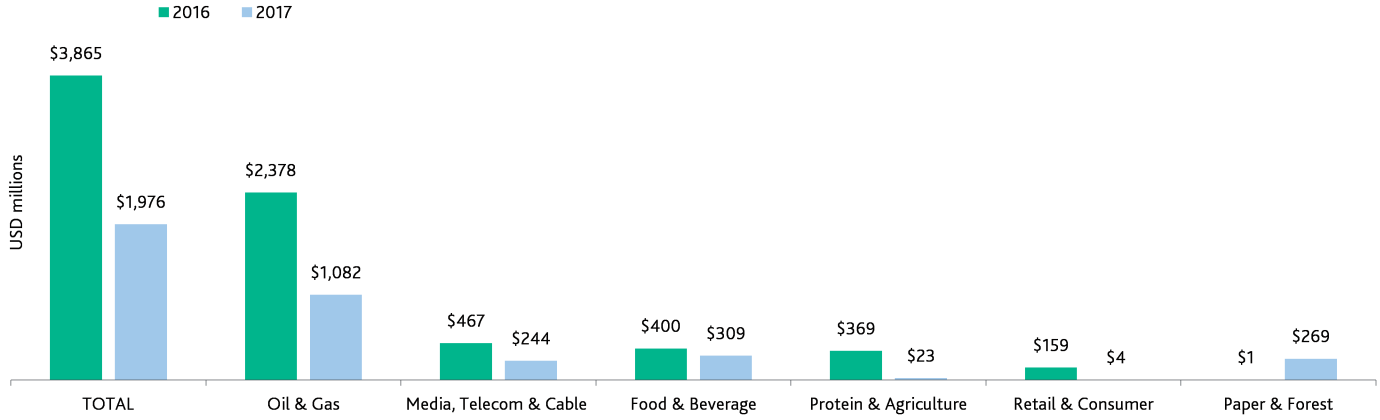
The new government is striving to restore Argentina's international market access by restoring economic imbalances. A significant step was taken last April 22nd when Argentina paid off holdout' bondholders, marking the end of a 14-year default. This effort may give Argentine companies a good opportunity to increase their long-term debt holdings, which would not only help improve their liquidity,

but also help fund investment growth. In fact, companies stand to benefit from any improvement in refinancing terms, since 41% of their current debt is set to mature during the next two years (see Exhibit 5), including $3.4 billion in bonds and notes and another $2.4 billion in bank loans due 2016-17.

Exhibit 5

Corporate Debt Maturities Through 2017, by Industry

in USD million; exchange rate as of 31 December 2015 (13.04 ARS/USD)



Source: Moody's estimates based on companies' audited financial reports

Like most Latin American companies, most Argentine companies also lack committed credit facilities; only Arcos Dorados has a committed facility, which is rolled over every two years. The general lack of committed lines reflects a belief among Argentine companies that historically strong banking relationships ensure that bank loans and uncommitted credit lines will always be available. Indeed, companies will likely continue to have access to bank loans and to renew uncommitted bank facilities, as well as continued access to the local debt capital markets to refinance short-term notes.

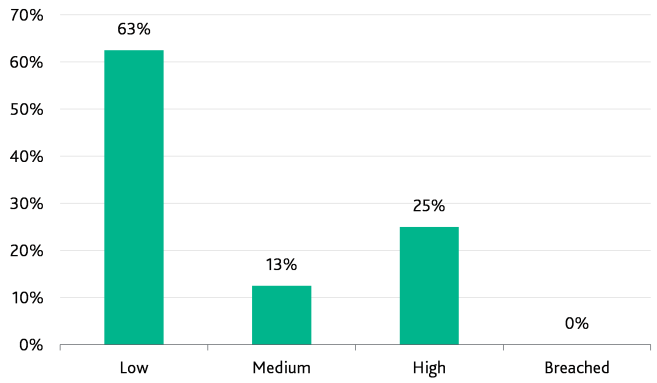
However, we expect Argentine companies to see borrowing costs increased by the overall increase in interest rate levels resulting from the Central Bank's tightening of monetary policy to contain inflation pressures. Meanwhile, Argentine companies often lack explicit liquidity policies that would give creditors a better framework for analyzing their decision-making processes and liquidity risk.

Most Argentine Companies Lack Financial Covenants

Few Argentine debt agreements contain meaningful financial covenants, and issuers today routinely offer at most limited protective provisions to investors in their bonds. Many debt instruments also lack upstream guarantees from operating subsidiaries on debt at holding companies, or in some cases on cross-default or negative-pledge clauses. We expect these weak-covenant practices to continue.

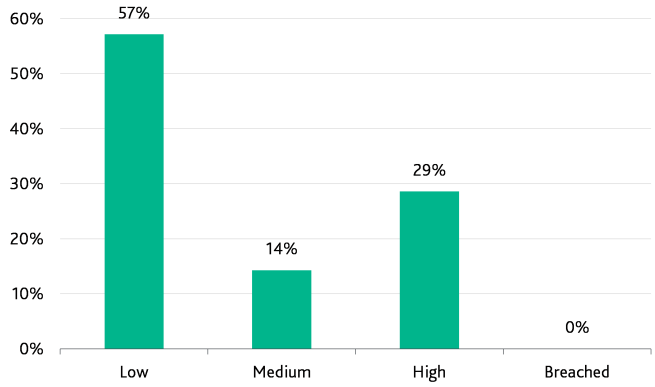
All in all, most of the eight Argentine companies that have covenants run low to medium risk of a covenant breach (see Exhibits 6-7). Companies whose most recent leverage/coverage metrics give them more than 100% cushion on their covenant tests have low risk of a covenant breach; companies at medium risk have cushions of 50%-100%; and companies at high risk have cushions below 50%.

Exhibit 6
Interest Coverage Breach Risk



Source: Moody's estimates based on companies' audited financial reports

Exhibit 7
Leverage Breach Risk



Source: Moody's estimates based on companies' audited financial reports

Argentine Companies Depend Heavily on Bank Financing

The companies we reviewed derive 28% of their funding through banking credit, but the proportion rises to 70% excluding oil and gas companies, which rely more on bonds and notes (representing 81% of total bonds and notes outstanding). Smaller companies of weaker credit quality, rated B2 and below, tend to rely more on banks because Argentina's sovereign risks reduce their access to the global capital markets, while the local corporate bond market is relatively small. Such companies tap the local capital markets for specific purposes, such as discretionary increases in funding for capital investments or working capital requirements.

But some larger companies such as Asociacion de Cooperativas Argentinas (ACA, B2 stable) and Telecom Argentina also rely almost entirely on bank lending. ACA relies on a highly diversified portfolio of bank credit lines to finance inventory (pre-export credit lines), while Telecom Argentina relies mainly on its own cash generation to meet working capital needs and capital investment requirements.

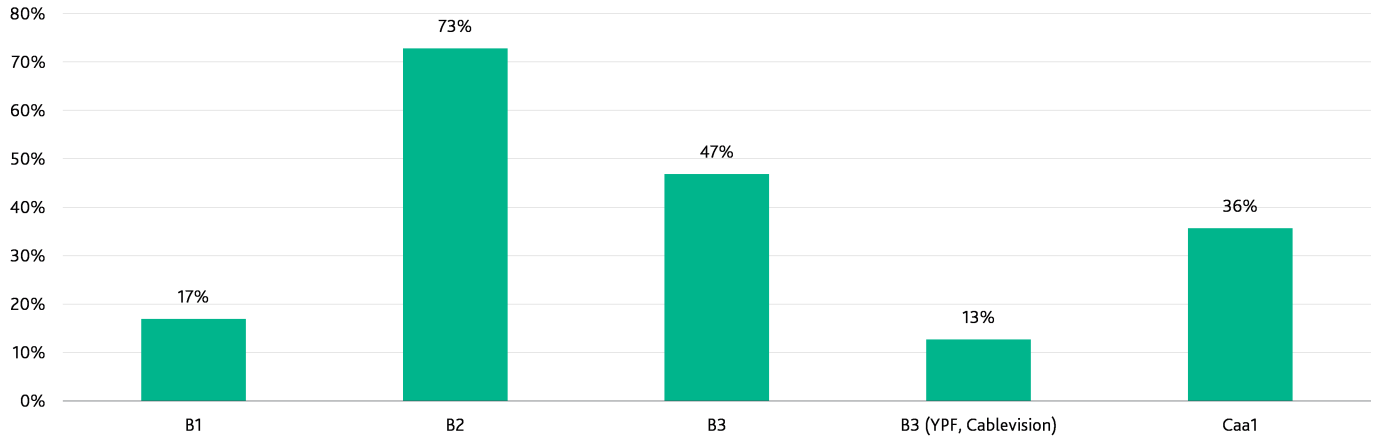
Large B3 rated companies such as Cablevision and YPF rely heavily on bonds and notes, basically to finance capital spending and working capital requirements. YPF, with 88% of debt in bonds and notes, represents 58% of total debt of Argentina's rated non-financial companies, regularly taps the local and international capital markets in order to meet its large capital spending program and other financing needs. Cablevision has, as of December 2015, 75% of its outstanding debt in bonds and notes.

The three companies in our study rated B1 derive in average 83% of their total borrowings from the capital markets (see Exhibit 8).

Exhibit 8

Argentine companies rely heavily on bank financing

Percentage of total debt in bank loans by issuer rating category



Source: Moody's estimates based on companies' audited financial reports

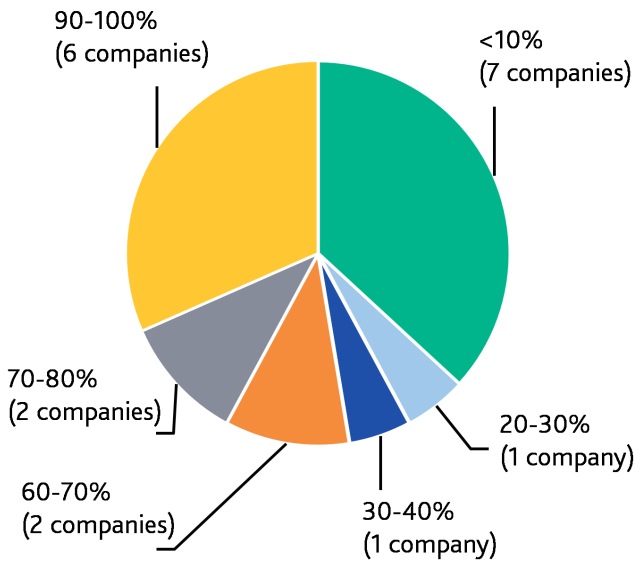
Foreign-Exchange Risk Weighs on Argentine Companies

Foreign-exchange risk will remain high through mid-2017 for companies in Argentina, where the peso fell by 52% against the US dollar in 2015, falling a further 9% from December 2015 through April 2016. The oil and gas sector is most exposed to foreign-exchange risk, particularly because government energy regulation historically has influenced local prices and given increased devaluation risk.

Although Argentina's 19 rated non-financial companies tend to have little exposure to foreign-denominated debt, 14 of them have more foreign-denominated debt than foreign-denominated cash flow. Ten of the 19 companies—mainly commodity exporters and oil and gas companies—have 50% or more of their total debt denominated in foreign currencies (see Exhibits 9-10).

Exhibit 9

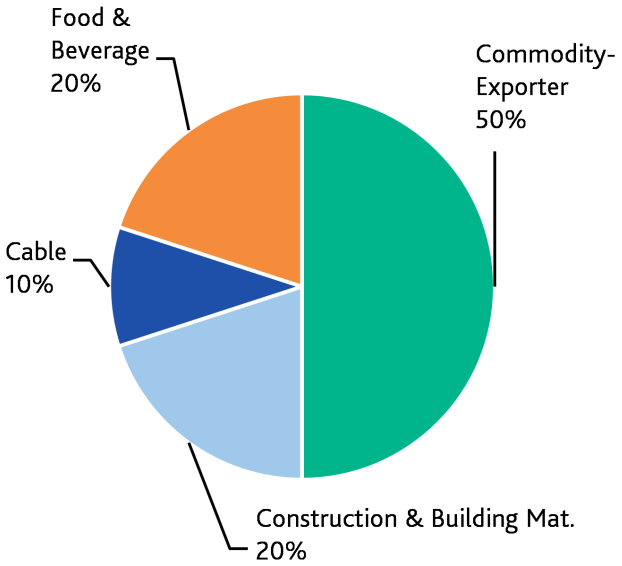
Argentine Corporate Ratio of Foreign Currency Debt to Total Debt



Source: Moody's estimates based on companies' audited financial reports

Exhibit 10

Issuers with Majority of Debt in Foreign Currency, by sector



Source: Moody's estimates based on companies' audited financial reports

Currency devaluations can immediately increase a companies' debt leverage—especially for companies that have significant foreign-denominated debts but draw most revenues in pesos, and that do not hedge for currency fluctuations. Currency devaluation also worsens Argentina's already high inflation, cutting profit margins for companies that cannot raise prices quickly enough to keep pace with rising costs.

Over the years, as local foreign currency market controls tightened, most Argentine companies have shifted their debt into local currency. But a number of Argentine companies still have large foreign-exchange risk because of debt or other supplier financing. Today, exporters and Argentina's largest companies tend to have market access for international bonds and notes, as well as credit lines with foreign banks.

Seven of the 14 companies in this study generate less annual foreign-denominated cash flow than their foreign currency debt balances, even with currency hedges. Carboclor (Caa1 stable) Raghsa (B3 stable), PAE Argentina, Petrobras Argentina, YPF, Cablevision, and Arauco Argentina (B1 stable) all generate most of their revenues and EBITDA in pesos, and have significant unhedged foreign currency debt.

Still, many of these companies have features that generally help offset this risk. Arauco Argentina draws a broad base of revenues from exports, while Raghsa's revenues are indexed to devaluations, with lease fees set in US dollars but payable in pesos. Raghsa, Arcos Dorados, Cablevision and Petrobras Argentina all keep much of their cash, cash equivalents and assets in foreign currencies, which gives them natural hedges. Other companies have most of their foreign-denominated debt guaranteed by companies of stronger credit quality. Chile's Celulosa Arauco y Constitucion (Baa3 stable) guarantees all of foreign-denominated debt for Arauco Argentina, while ANCAP (B1 stable) of Uruguay guarantees notes outstanding by Carboclor.

Appendix: Rating Universe of Argentine Companies, as of April 2016

Exhibit 11

Rating Universe of Argentine Companies as of April 2016

Company Name	Industry / Peer Group	Lead Analyst	Long-term rating	Outlook
Arauco Argentina S.A.	Paper & Forest Products	Veronica Amendola	B1	stable
Arcor S.A.I.C.	Food & Beverage	Veronica Amendola	B1	stable
Arcos Dorados Holdings Inc.	Food & Beverage	Veronica Amendola	B1	negative
Asociacion de Cooperativas Argentinas Coop.	Protein & Agriculture	Martina Gallardo Barreyro	B2	stable
CableVision S.A.	Media, Telecom, Cable & Comm Infrast.	Veronica Amendola	B3	stable
Car Security S.A.	Business & Consumer Services	Martina Gallardo Barreyro	B3	stable
Carboclor S.A.	Chemical	Nymia Almeida	Caa1	stable
Electroingenieria S.A.	Homebuilding & Construction	Martina Gallardo Barreyro	Caa1	stable
Holcim (Argentina) S.A.	Homebuilding & Construction	Martina Gallardo Barreyro	B2	stable
Longvie S.A.	Retail & Consumer Goods	Martina Gallardo Barreyro	B3	stable
MIRGOR S.A.	Retail & Consumer Goods	Martina Gallardo Barreyro	B3	stable
Newsan S.A.	Retail & Consumer Goods	Martina Gallardo Barreyro	B3	positive
Pan American Energy LLC, Argentine Branch	Energy, Oil & Gas	Nymia Almeida	B2	review for downgrade
Petrobras Argentina S.A.	Energy, Oil & Gas	Nymia Almeida	B3	negative
Quickfood S.A.	Protein & Agriculture	Martina Gallardo Barreyro	Caa1	stable
Raghsa S.A.	Lodging & Comm Property	Martina Gallardo Barreyro	B3	stable
Sullair Argentina S.A.	Equipment & Auto Rental	Martina Gallardo Barreyro	B3	stable
Telecom Argentina S.A.	Media, Telecom, Cable & Comm Infrast.	Marcos Schmidt	B3	stable
YPF S.A.	Energy, Oil & Gas	Nymia Almeida	B3	stable

Source: Moody's Investors Service

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Rating Actions:

- Moody's upgrades Argentina's issuer rating to B3 with a stable outlook, 15 April 2016
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