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ARGENTINA

Strong expectation after the Argentine proposal, but still many question marks

After a full week of negotiations and meetings with special master Daniel Pollack in New York, the Argentine economic team announced at the end of the day on Friday that it has presented a proposal to bondholders that did not enter in the 2005 and 2010 debt exchanges. Moreover, it stated that 2 of the 6 big funds with positive court rulings and "most" of the *me toos* have agreed to such proposal. However, the devil is on the detail and not only many questions remain unanswered but also there are several steps that must be fulfilled before the deal can move forward. So far, the news is very positive for Argentina and for investors, as the country is one (significant) step closer to reaching a 15-year awaited solution.

The Offer

The proposal includes two offers:

1.1.1.1. Base Offer: To those holders with no positive ruling from the New York District Court received before February 1st 2016, the offer includes a payment of the full principal amount plus an additional 50% of such principal (a total of 150%).

1.1.1.2. Pari Passu Offer: To those holders with a positive ruling received before February 1st 2016, the offer includes a payment of 100% of the ruling minus 30% of the total amount. For holders who accept the offer before February 19, 2016 the discount on the full amount would be 27.5% (instead of 30%).

Note that the Base Offer is in line with the offer presented and accepted by the Italian bondholders last week.

If 100% of the holders accept the respective offers, the payment would total US$6500 million, according to the statement**.** The payment will be made in cash. Funds will be obtained from the issuance of sovereign bonds. In addition, those holders that accept the offer should waive their right on any amount owed and refrain from any legal action in the future.

Who's in and who's out (so far)?

IN: Dart Management, Montreux Partners, "most" of the *me toos* (no specific numbers have been revealed). It is estimated that Dart and Montreux combined hold roughly 40% of the total debt with positive ruling from Griesa, mostly from the former.

OUT: NML, Aurelius, and 2 other of the big funds, some me toos (no information on whether these me toos are from the US or Europe)

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Some calculations and many question marks

A brief recap

Argentina's defaulted on US$81.3bn in principal back in 2001.

Debt exchange 2005: Holders of as much as US$62.3bn (or over 76%) entered the exchange leaving US$18.6bn of holdouts.

Debt exchange 2010: Argentina reopened the debt exchange for the remaining US$18.6bn, and as much as US$12.4bn entered the new exchange. Combining both exchanges, the acceptance rate was around 93%, leaving 7% or roughly US$6.6bn of bonds (principal only) in default. This amount was composed of almost 150 different bonds, including bonds in AR$, US$, Euros (previously other currency later converted to Euros such as Italian Liras), and JPY. The bonds have different coupons and maturities. Some have already matured while others had maturities after 2016.

A group of holders that did not enter the exchanges decided to litigate against the government claiming not only a 100% of the payment (instead of the haircut version offered in 2005 and 2010) but also to be compensated for the interest. After years of litigation the group of holders that include 6 big funds including NML, Aurelius, Dart Partners, among others and also 13 retail holders grouped under "Grupo Varela" that had a total claim of US428M in principal received a positive ruling for a total of US$1300 million at the end of 2012. That amount has continued to increase (assuming the same interest rate applies) and it is currently estimated at around US$1800M.

Bonds included and excluded from the proposal: uncertainty continues

1. **All bonds or NY bonds?** Out of the total US$6.6bn in bonds in default, we estimated that: (i) In AR$: US$90M, (ii) In US$: 3.9bn, of which (a) US$428M are from holdouts with positive ruling, (b) US$3.5bn from me toos, (iii) Other: (a) US$900M from ICSID (Italians), and (b) US$2.5bn from others, (iv) In EUR: US$2.5bn, and (v) In JPY: US$30M or less.

Taking the offer of US$6.5bn, we calculate that:

- US$1800M from NML, et al x 70% = US$1260
- US$6500M total offered – US$1260M = US$5240M. If US$5240M is 150% of the principal claim offered to those holders, then the original principal would stand at roughly US$3500M (in line with (ii)(b) above).

However, the proposal stated that "The Republic of Argentina proposed a restructuring agreement to ALL holders of sovereign bonds that did not enter the 2005 and 2010 exchanges."

2. **Which bonds prescribed?** There is a lot of uncertainty as to the statute of limitation of some bonds, given that each country has different regulations. As an example, in Argentina principal prescribes after 20 year and interest after 5. In the USA, 6 and 3 years, respectively. Other rules apply in Europe.

In its proposal, the government has not clarified this issue or whether there are discussion with holders regarding this. However, it stated that "the amounts of principal and/or interest of those bonds that have prescribed under the contractual terms and the applicable regulation will not be recognized".

For a complete list of eligible securities, please click in the link below and refer to Annex A-1

http://www.mecon.gob.ar/finanzas/sfinan/documentos/us_prospectus_(version_ingles)_30042010.pdf

As an example Global 2031 (coupon 12%) in US$ (ISIN: USP8055KGV19) had a principal outstanding that did not enter either exchange of US$470M. As of the end of 2015, the total amount owned to holders of these bonds would have reached US$1bn, excluding principal and accrued interest but excluding punitive interest. Given the 150% offer from the government, it would imply roughly a 30% discount on the total claim.

A change in attitude; good reception from Pollack and international community

Special Master Daniel Pollack said that the willingness and attitude of the Macri administration has been very positive and stated "it is my true hope that, with the continuation of the negotiations, the funds will also be willing to resolve their differences and reach and agreement with Argentina".

Also, IMF director Christine Lagarde said "Argentina's decision to try to reach a negotiated solution to the legal battle with the holdouts in New York is very encouraging".

U.S. Treasury Secretary talked to Finance Minister Prat Gay to offer the support of the Obama Administration to the Argentine proposal.

However, it is worth noting that the support of the international financial community has not been enough to resolve the issue in the past.

Next steps and challenges that still lie ahead

Presenting a proposal that had the approval of Special Master Pollack and as importantly was accepted by some bond holders was a first important step. However, there are several steps still ahead:

1. Congressional approval: there are two Argentine laws that need to be modified in order to make the proposal feasible:
    a. Lock Law – the law prohibits the Argentine government from making an offer to those that did not enter the 2005 and 2010 exchanges that differs from or exceeds the offer presented back then. The law was passed to encourage bondholders to enter the exchanges.
    b. Sovereign Payment law – the law removes the Bank of New York as the bonds' trustee to replace it by local institution Nacion Fideicomisos, in order to allow

holders to collect interest and principal payments from the bonds despite Judge Griesa's ruling.

2. "Stay" – This week, Special Master Dan Pollack is expected to meet with Judge Thomas Griesa to present Argentina's proposal and get his approval. In addition, Argentina is expected to request a stay in order to be able to make interest payments on defaulted bonds and as importantly to prevent holdouts from requesting an embargo to any funds coming from new debt issuances.
    a. **Negatives:** Griesa has been very critical of Argentina in the past given the confrontational attitude of the former administration. Also, even if Griesa decided to reinstate the stay, funds that oppose the transaction, such as NML could appeal and extend the process further. The ideal situation would be to have a strong support to prevent the litigation to extend even further. In turn, Griesa could wait to see what the respond to the proposal is before making any decision.
    b. **Positives:** Pollack has stated the good willingness and effort of the Argentine government, and has spoken very favorably of President Macri and of the negotiation team lead by Finance Secretary Luis Caputo, and other members of the Cabinet including Chief of Staff Marcos Pena. It is rumored that he told the Argentine team that he will put in a good word for Argentina with Griesa.
    c. **What is expected from Griesa?** The market –in reaction to Pollack's positive statement- expects the Judge to okey the proposal. The next step would be to open a list with a deadline at the end of February (Feb 29) in which holdouts that support the proposal would write their names. At the end of the established period, the Judge would evaluate the percentage of acceptance. If such percentage appears high enough for the Judge, he could close the litigation. However, the risk is that if such acceptance is below 100% that those that do not accept continue to appeal and litigate. It is rumored that the government would be happy with a 75% acceptance rate – in line with the threshold established in USA's bankruptcy law.

3. **Financing needs – another challenge**

    Argentina offered to pay the full amount in cash. The needed funds would come from a debt issuance.

    Even if the congress approves the needed changes in the law to go ahead with the proposed deal, Argentina will face a significant challenge: attract investors willing to buy as much as US$6.5bn in Argentine sovereign debt
    a. Risks: not enough appetite for Argentine sovereign debt before a deal is reached. Recall that reopening of Bonar 2020 was not successful.
    b. Positives for investor: (i) Argentina would need to offer an attractive yield to attract investors, in line or slightly below the current return on the bonds. As a reference, Bonar 24 with a coupon of 8.75% closed on Friday at 108 to yield roughly 7.5%, still significantly above the return on other LatAm peers. Following the payment to holdouts, bonds should tighten significantly leading a very healthy

return for investos that bought the bonds. (ii) the new bond/s could be included in Emerging Market indices such as the EMBI Global. This should increase even further the buying of Argentine sovereign bonds given mny funds follow those indices. We performed a simple exercise to asses this impact.

Potential new investors: EMBI

Assuming a 75% acceptance rate of the proposal, Argentina would need to issue roughly US$5bn. That would translate in an increase in the weight on the EMBI global from the current 1.6% to roughly 2.48%. This assumes all the other countries do not issue debt and the market cap of the bonds of each country included in the index remain unchanged. Also assumes that the new Argentine debt is issued at par. The percentage would increase if bonds are issued at above par given that the index is weight by market cap. Moreover, if the price of the rest of the Argentine bonds included increase, the % of Argentina as a whole would also increase. Another possibility is that funds increase its position from market weight or underweight to overweight. In that case, the inflow would be even greater. Conversely, if the other countries in the index issue additional debt or the prices of their bonds increase, this would dilute the weight of Argentina.

Cautiously optimistic

We find the significant steps taken by the Macri administration very encouraging, and are very positive of the next steps. However, while this week the market should react positively to the news (the announcement was after the market close on Friday), any unexpected delay or misstep could bring a correction and further volatility. In terms of positive upside for untendered bonds, part was already priced in following the Italian deal, but many were hesitant. This should clear the way to reach those levels of 150 for all untenders, irrespective of the bonds – always accounting for the risk of prescription. In terms of downside risk, in the case of a delay or low acceptance of the proposal, we see January's low as a possible target for the rest of the sovereign bonds (not the untendered). Another key element as Argentina slowly converges to LatAm is the development of the rest of EM. Despite of the risks, we see the proposal as a positive for the market and would also expect a strong upside if/when the proposal is successfully approved.