Argentine Corporates Round-Up: earnings and technicals

VOLATILITY RULED YTD

Argentine assets have experienced strong volatility year-to-date. They moved from its highest YTD spread level at the beginning of February (spread of 1630bps for provincials as measured by the ADCA-P and 1221bps for corporates as measured by the ADCA-C), to its lowest historical spread in early/mid-July (900bps for provincials and 910bps for corporates) to then again widen to current levels (1196bps for provs, 1105bps for corps). In it interesting to note that on the net, year-to-date corporates and provincials have "only" widened by 95bps and 88bps, respectively, again noting the underperformance of corporates over provincials. However, in terms of total return, performance was positive: corporates gained an insignificant +0.6% on average while provincials were up a stronger 7%.

We expect volatility to continue in the short term with downward pressure in both provincials and corporates, as uncertainty regarding the sovereign default remains. At current levels, on a relative basis, corporates look cheap both versus the sovereign (+285bps) and provincials (-91bps) when compared to its YTD and historical spread.

In this report, we examine each industry and provide a brief analysis of 2Q14 earnings as well as a sector outlook, in light of the ongoing uncertainty together with the further macro deceleration expected in 2H2014.

CONSUMER: Solid revenues beat inflation but margins continue to compress

Sector outlook: Top line continues to post strong growth as a result of higher prices, which track inflation in Argentina (note DORADO was affected by other markets) but volume growth has not been as robust. However, operating costs grew at a faster pace causing a margin compression. A deteriorating macro could continue to hurt volumes. Nevertheless, consumers could switch to lower tier brands and put further pressure on margins and bottom line. The sector could underperform other corporates, given its high correlation with consumption behavior. Yet, it is worth noting that consumer companies with global bonds (Arcor, Mastellone) enjoy a very strong market positioning. In terms of debt, there are no significant upcoming debt maturities and leverage remains at very manageable levels (recall that during the quarter, Mastellone successfully pushed debt maturities to 2021).

The companies

ARCOR: Posted solid 2Q14 results. Revenues increased 42% YoY and EBITDA 34% YoY. This expansion was driven by its Cookies and Candy & Chocolates businesses with prices following the annual inflation rate of 30%. Regarding margins, the performance was slightly worse than in 2Q13, gross margin flat (34%), with operating margin (6%) and EBITDA margin (8%) down 100bps. Higher COGS and SG&A related to payroll expenses, utilities services and marketing costs partially offset the strong increase in revenues. The Company increased its debt level in US$ 79M YoY with leverage increasing from 2x in 1Q14 to 2.1x.

DORADO: Arcos Dorados posted very weak 2Q14 results. Revenues declined 7.2% and EBITDA -37.8% YoY. Performance was attributed to weaker regional growth driven by Brazil and the impact of the transition to SICAD II for FX in Venezuela. Guidance was revised downward, with lower GDP growth forecast for the region with traffic in Brazil still impacted by a shift to the informal sector. The FIFA WC had a negative short term impact for the company reducing traffic. Leverage stood at 3X compared to 2.6X in 1Q14.

MASHER: Mastellone Hermanos posted strong sales but an overall weaker than expected quarter due to a combination of: (i) lower production of raw milk that resulted from adverse climatic factors and led to higher costs, and (ii) lower international prices affecting exports. These translated into a significant YoY drop in EBITDA that combined with an FX loss led to a negative net result. Following the exchange and tender offer and the issuance of the new bonds due 2021, total leverage stood at 3.9x (pro forma) compared to 2.8x at FY2013.

Consumers 2Q14 (% change YoY)	Revenues	EBITDA	Leverage
ARCOR	42%	35%	2.1x
DORADO	-7%	-38%	2.6x
MASHER	*36%*	*-40%*	*3.9x*

OIL AND GAS: Positive results and margin expansion led by higher prices and robust production

Sector outlook: In relative terms, the sector is shielded from the local macro, although volume in the downstream business could suffer. Production in the shale O&G segment will be key to increase sales exports, though it will also depend on the ability to find sources of funding. The sovereign conflict could act as hurdle to improve profitability and investments, but this could be partially mitigated in the short term by financing in the local capital market. The sector could still outperform the other Argy corporates given its low leverage, hard currency generation, strategic assets and local blue chip condition.

The companies

YPF: YPF posted solid 2Q14 results with strong revenues growth (+61% on local currency and +5% in US$ YoY), led by a combination of higher volumes and prices. Oil & Gas production was up 15.5% YoY. EBITDA increased at even a faster rate (+67% in AR$ and +42% in US$ YoY) leading to a margin expansion. Total leverage stood at 1.1x while net leverage is 0.9x, flat compared to 1Q14. Strong operating cash flow allowed continued increase in capex without increasing leverage. During the quarter, capex totaled AR$ 10.9 billion, an increase of 67% YoY, with 20% invested in downstream and 80% in upstream (E&P).

PANAME: Pan American Energy (PAE) posted a very strong quarter (72% revenue growth YoY) driven by local currency revenues that are linked to hard currency prices. Although sales volumes decreased in the quarter, operating performance was in line with revenues. EBITDA achieved a 53% margin, recovering from the 41% posted in 2Q13. In US$ terms, Revenues increased 12% while EBITDA 43%. Total leverage decreased from 1.2x in 1Q14 to 1.1x in 2Q14, although CAPEX almost doubled YoY reaching AR$ 5.2 billion.

Oil&Gas 2Q14 (% change YoY)	Revenues	Production	Prices	EBITDA	Leverage
YPF	61%	↑	↑	67%	1.1x
PANAME	72%	↑ ↓	↑	121%	1.1x

UTILITIES: Mixed results led by increase (or lack of thereof) in tariffs.

Sector outlook: For some time now, the performance of the companies in this sector has been solely dependent on government support in the form of tariff increases and subsidies. This has often not been enough to finance significant increases in costs –especially, salaries, given the labor-intensive nature of the business (in addition to high % of unionized workers) and the needed capex. Recession and populist measures to improve GDP in addition to a reduction in subsidies to preserve government funds has diminished the government´s incentive to raise tariffs, especially a year before the presidential elections. We expect this to continue in the short term.

This situation continues to drain the companies´ financials. Short term fixes continue to keep the companies afloat, as the government needs to make sure the full service of its operations continue. In several occasions, financial relief has come as a condition to increase capex (Edenor, Transener) leaving little additional funds for the company. In others, the impact has been more benign (Metrogas). We prefer companies with a more solid business model, namely those that have some (Capex) or a significant (TGS) non-regulated business.

The companies

EDENOR: Reported mild 2Q14 results. Same story, different quarter. This time, the benefit from the CMM starts to erode (and PUREE is still not enough) leading to weaker YoY results. Revenues increased (+3.9% YoY) as a result of the (little) volume increase as tariff are still frozen. Expenses growing fast led by salary increases, fees and ENRE penalties. Total debt was US$190.5M, consisting of US$14.8M in bonds due 2017 and US$176.4M in bonds due 2022. The company has very limited short term debt and no debt maturities until 2017. Cash stood at US$ 40M. During the semester, debt with CAMMESA increase by AR$ 433M.

TRANSENER: Once again, TRANSENER benefitted from the Renewal Agreement authorized by ENRE (which compensates the company for the past costs variations) and posted good 2Q14 results. However, recall that most of these funds will have to be used for the Investment Plan. As a result, total revenues increased 77% YoY, while EBITDA turned positive to AR$ 91.8M vs. a negative EBITDA in 2Q13. Total debt was US$143.1M in 2Q14, largely composed of the company´s bonds due 2016 (US$40M) and 2021 (US$100M). Gross and net leverage stood at 1.8x and 1.4x, respectively.

METROGAS: Metrogas reports a very strong 2Q14 led by tariff increase. Revenues almost doubled (+92% YoY) and EBITDA reached AR$ 115M vs. AR$ 14M a year ago. Operating performance was mainly driven by the very strong increase in natural gas sales, resulting from higher prices. Recall UNIREN approved a 3-stage transitory tariff increase on March 26, 2014 to compensate for the cost increases. Despite the strong improvement in the operating results and the debt reduction post restructuring, leverage continues to be high at 7.1x gross and 6.3x net. Total debt was US$165M, of which only US$12M was short term and compared to cash of US$18M.

TGS: Revenues were very strong (up 102% YoY in local currency) as the non-regulated business sales continued to increase. Therefore, bottom line turned profitable given strong operating results and lower fx devaluation in the quarter. In addition, the company reduced leverage during the quarter (25% of principal amortization in 2017 and 2020 notes) and received a tariff increase in April. Total debt was US$289M as of 2Q14, related to the global bonds (2017 & 2020). Only 13% was short term that is related to interest on both notes.

Utilities 2Q14 (% change YoY)	Revenues	non regulated %	Tariffs increase	Subsidies	EBITDA	Leverage
EDENOR	4%	0%	↑	↑	Negative	n/a
TRANSENER	77%	0%	↑	↑↑	280%	1.8x
METROGAS	92%	0%	↑↑	→	720%	7.1x
TGS	102%	73%	↑↑	→	98%	1.8x

CONCESSION COMPANIES: Strong results led by higher tariffs despite soft traffic

Sector outlook: Concession companies depend on regulated tariffs and traffic. Given the decelerating macro, traffic has been weak. However, the government has granted tariff increases that have helped grow revenues and EBITDA. In the case of DELSOL, the company has a guaranteed traffic flow but a significant increase is capped by its current capacity (this has been a result of the strong increase in car sales over the past few years, which has not been matched by highway expansion). In the case of AEROAR, while still growing, traffic (in particular international) has been softer than in previous periods mainly as a result of a depreciating currency. Nevertheless, the company has a natural hedge given by the dollarization of its regulated tariff (aeronautical revenues account for roughly 50% of total). If volume remains soft, financials could start to deteriorate but it will continue to depend on tariff increases (or lack of thereof). For now, the companies continue to post good results with very healthy financials, in particular, limited leverage.

The companies

DELSOL: Revenue growth (+26% in AR$ YoY) was driven by the tariff increase which was made effective during 1Q14, and partly offset by a small decrease in traffic (-1% YoY). EBITDA grew strongly (+28% in AR$) as a result of higher sales and net income skyrocketed during the quarter driven by stronger operating income and lower financial expenses. Nevertheless, the improvement is almost exclusively led by increases in tariffs that compensate for the increase in operating costs, mainly salaries. As a result, the effect on margin was only fringe. Moreover, leverage decreased further due to the strong EBITDA and debt repayment.

AEROAR: Reported a very solid quarter, led by a strong top line. Revenue growth (+58% in AR$ and 3% in US$ YoY) was mainly driven by the new tariff scheme and a weaker AR$. However, it is worth highlighting that traffic continues to increase but at a decelerating pace. Passenger traffic was up 3.9% YoY in 2Q14, even including the additional traffic from the World Cup. EBITDA grew strongly (+113% in AR$ and +39% in US$) and net income almost tripled during the quarter. Total and net leverage continue to be at very healthy levels, 1.4x and 1.2x, respectively in 2Q14, slightly down QoQ.

Concession 2Q14 (% change YoY)	Revenues	Traffic	Tariffs increase	EBITDA	Leverage
DELSOL	26%	↓	↑	28%	1.2x
AEROAR	58%	↑	↑	113%	1.4x

BANKS: Decelerating macro starts to impact results

Sector outlook: The banking system is starting to be negatively impacted by the country´s economic slowdown, reflected in a weakening demand for credit and marginal increase in NPLs. However, financials continue to be very robust. Yet, it will be important to monitor its performance in the short term and look for signs of weakness, if any, as asset quality and profitability could deteriorate further.

The companies

MACRO: Banco Macro (BMA) achieved weaker 2Q14 results compared to 1Q14, but stronger YoY. QoQ, the bank started to suffer the deceleration of the Argentina economy, higher inflation and stricter bank regulations. Demand for credit is weakening and NPLs are slightly higher. Nevertheless, Capitalization is robust and liquidity is solid although there is a higher concentration in Central Bank Notes.

GALICIA: Banco Galicia (BGAL) posted mixed 2Q14 results compared to 1Q14, but stronger than 2Q13. The bank started to suffer the consequences of an economy experiencing a downward cycle with stricter bank regulations. Demand for credit is still robust in the large corporate segment while NPLs are higher driven by the consumer portfolio. However, Capitalization and liquidity metrics are strong, but slower loan growth led to higher concentration in Central Bank Notes to allocate liquidity and maintain profitability.

Banks 2Q14 (% change YoY)	Net Income	Loan Growth	NPLs ratio	NIM ratio
MACRO	59%	18%	1.9%	14.7%
GALICIA	75%	22%	3.5%	12.6%

DISTRESS: No good news continue to drive bond prices lower. Buying opportunity or stay away?

Sector outlook: Each company experiences a specific situation, each of which has drove a weakening in the financials as well as in the bonds. Under a recessionary scenario, the impact on which differs. CLISA is a big government service provider, which under a recessionary scenario could extend its day receivables and thus deteriorating its liquidity. IMPSA is more dependent on its international activities, but any delay in government backed wind projects and higher inflation could negatively influence profitability in its local business. Note that more severe problems come from other markets, such as Brazil and Venezuela.

The companies

CLISA: The infrastructure manager and developer reported revenue growth of 8.3% YoY in local currency in 2Q14, led by higher revenues from transportation (+42% YoY), water (+29%) and environmental services (+16%), and partly offset by lower revenues from construction (-7%). EBITDA grew by 28% YoY in AR$ to US$39M led by higher revenues while EBITDA margin expanded almost 350bps. Total debt was US$281M, of which more than half (US$155M) was short term. This compares to cash of US$107M. Total and net leverage was slightly up to 1.7x and down to 1.1x QoQ, respectively, while interest coverage was 2.1x. Working capital improved as a result of extending maturities to suppliers by AR$ 238M YoY.

IMPSA: The company fragile financial situation was evidenced by the ongoing problems in the past few months, which included the following: (i) the company was declared in bankruptcy (then revoked) in a Brazilian court for the delay of R$ 10M payment to a local supplier, (ii) the company had to delay the payment of coupon and principal payment of 2 of its local bonds –which resulted from lack of funds due to a delay in a payment that should have been received in Venezuela, (iii) the suspension of workers in its plant located in the Province of Mendoza,. The company has been negotiating with suppliers to extend payments as well as looking to sell some strategic assets in order to improve liquidity and finance new projects. Although backlog is robust (US$ 3B) monetization and further capex depends on assets turnaround in large projects in countries with high sovereign and regulatory risks. Moreover, the company has recently hired a local and an international consultant to explore its options to improve the company´s situation. The bonds have suffered strongly as a result of this events, and are currently trading at distress levels.

Distressed 2Q14 (US$ mln)	WK	ST Debt	LT Debt	EBITDA	Leverage	Cash
CLISA	↓↓	155M	126M	39M	1.7x	107M
IMPSA*	↑↑	163M	168M	5M	2.4x	8M

* consolidated, Argentina subsidiary, financial statements for Venti and WPE 2Q14 are not yet available

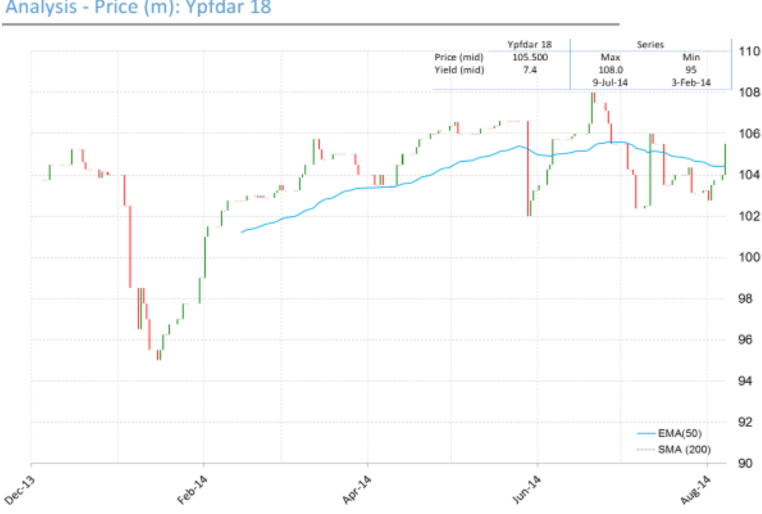
The bonds:

Fundamentals + Techincals: where are the opportunities?

In the current scenario of uncertainty and strong volatility, we believe that corporates with strong fundamentals, that are less exposed to a recessionary scenario and that show a good technical position at current levels, but still offer very health yield are the best alternative to maximize the risk / return equation.

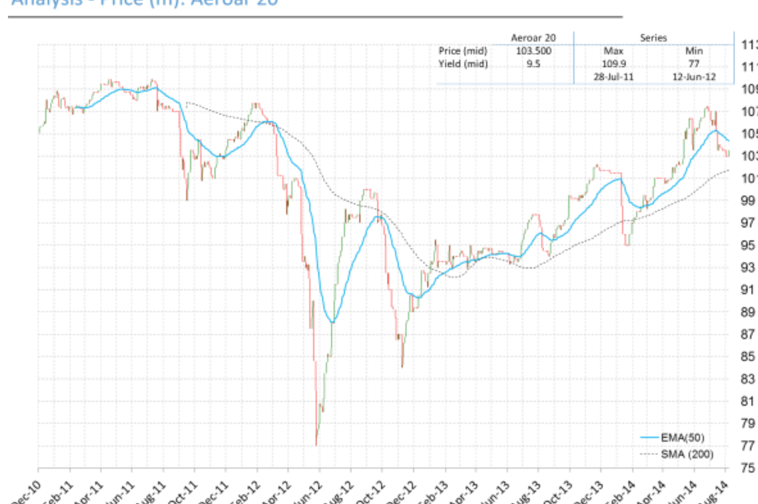
While companies in more distress situations (some utilities, IMPSA; CLISA) offer more attractive returns, we prefer a more defensive play under this scenario. More specifically, corporates with fundamentals that can better absorb the sovereign risk. **Therefore, we like YPF (18 looks more attractive than the 24), AEROAR and IRSA20.**

YPF´s strong growth, increasing output and low leverage makes the bonds attractive from a fundamental stand point. Despite the earlier belief that the bonds should converge to the sovereign (following the nationalization), bonds have outperform and the spread to the sovereign has widened by 200bps (from trading 400bps inside to 600bps inside). Its shale gas potential, ability to grow production and its strategic assets have added value to the name. Moreover, its strong activity in the primary market has given healthy liquidity to the bonds (mainly relative to the rest of the Argentine corporates). Note that the sum of the YPF bonds account for 25.3% of the ADCA-C Index. At current levels, YPF18 and YPF24 are trading roughly at 600bps inside BONAR 17 and BONAR24, respectively. From a technical perspective, the trend has been negative (as with the rest of the Argentine bonds) but in the case of the YPF18 was reversed after yesterday´s price action. In turn, we see a strong entry point of YPF 18 fixed coupon at 102 and the YPF 24 at 100-101, with a preference of the 18s.



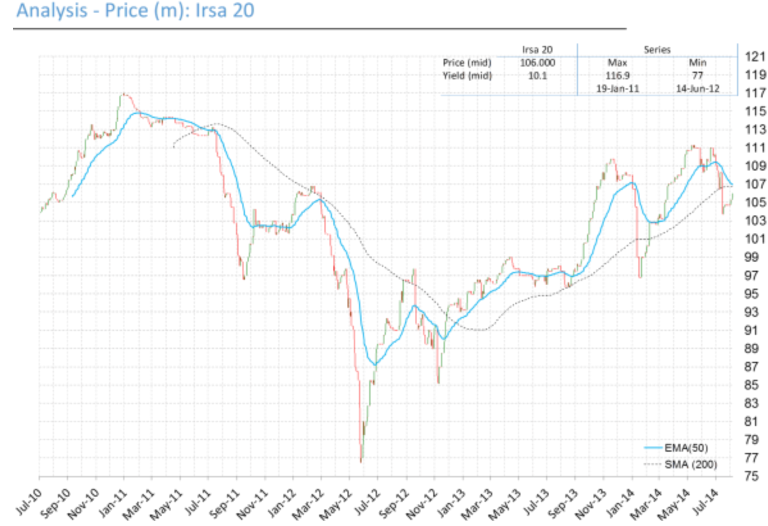
AEROAR enjoys a good combination of regulated and non-regulated business. While the regulated business is subject to tariff increases granted by the government, the company has been consistently receiving them. Moreover, regulated revenues from the international traffic has come down in terms of volume but enjoys a currency hedge given that it is quoted in US$ (paid at the official FX). On the other end, we believe the slowdown in international traffic could continue but should be partly compensated with an increase in local traffic. The non-regulated business will hold as long as traffic continues to be robust. In turn, we believe the company will continue to post good results, which combined with low leverage and strong government backing should act as support for the bonds. AEROAR 20 bonds are trading at 103 down from 108 a month ago. We see an interesting entry point at 102.5 and a stronger support at 96.

Analysis - Price (m): Aeroar 20

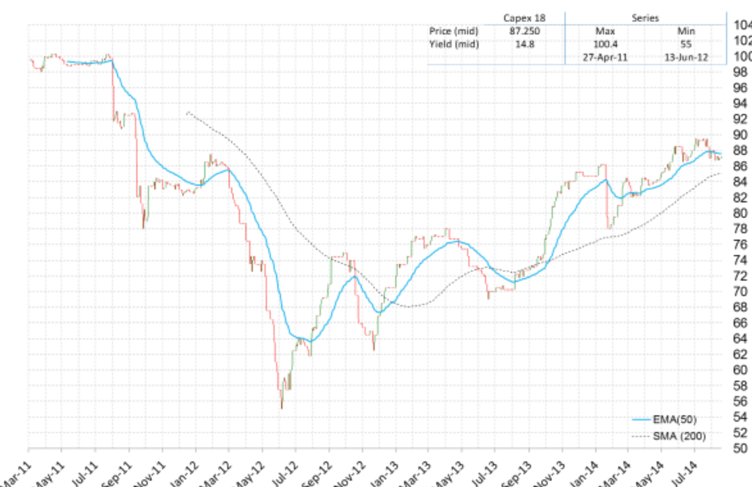


IRSA has benefitted from the consumer boom in the last few years, with a very strong performance of its shopping mall segment. While the macro deceleration could have an impact of its results (the company reports annual earnings of Sept 8), we expect the occupancy levels at its shopping malls to remain robust (recall that revenues from its malls are the max between a fixed amount and a % of sales). We believe the current return of the bonds more than compensate for its risk, given its strong asset quality and financial metrics. In terms of technical, we like IRSA20 at 102.5-103 (compared to its current level of 105.5). The next entry point if the negative trend continues would be at 99.

Analysis - Price (m): Irsa 20



For investors looking for additional yield (and more risk tolerant), we see CAPEXAR 18 as good choice. While the company has suffered from lack of tariff increases, we believe it is better positioned to weather the storm than other utilities in a more fragile financial situation, given its vertical integration, its small non-regulated business and positive operating result. The bonds are trading at 87 yielding 14.9%. We see an attractive entry point at 86 and a stronger support at 83.



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