Research Update:

Compania General de Combustibles S.A. 'CCC+' Ratings Affirmed On Exchange Offer, Proposed Notes Due 2025 Rated 'CCC+'

August 6, 2020

Rating Action Overview

- On Aug. 6, 2020, S&P Global Ratings affirmed its 'CCC+' ratings on Argentine oil and gas company Compañía General de Combustibles S.A. (CGC) following its announcement of a debt exchange proposal.
- At the same time, we assigned a 'CCC+' issue-level rating to CGC's proposed senior unsecured notes due 2025. CGC intends to exchange its outstanding 9.5% senior unsecured notes due 2021 for the proposed 2025 notes. We also kept the company's stand-alone credit profile (SACP) at 'b-'.
- The outlook on the issuer credit ratings remains negative, reflecting the potential further deterioration in sovereign's credit quality and the domestic economy, including potential further restrictions on accessing and/or transferring funds abroad, which increases our perception of risk. The outlook also reflects CGC's weaker capital structure with increasing short-term debt and high refinancing risk amid the volatile economic conditions.

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Rating Action Rationale

Proposed debt exchange is an opportunity to improve the capital structure. CGC intends to exchange its outstanding $300 million 9.5% senior unsecured notes due 2021 for the proposed 2025 notes that will amortize starting in 2022. Despite the company's current rating (constrained by our assessment of Argentina's transfer & convertibility [T&C] risk), we view the proposed transaction as liability management and not as distressed exchange, because CGC is intending to complete it several quarters in advance of the maturity. The existing notes bullet maturity is on November 2021, so CGC has some time to implement alternative initiatives to roll this debt over if the exchange isn't successful. The company's early tender comprises $1,050 per each $1,000 exchanged, of which $100 will be paid in cash and remaining $950 in new notes with 9.5% coupon and [annual amortizations]. In our opinion, the proposed exchange would improve CGC's capital structure because it would extend the company's debt maturity profile.

Ratings capped at our T&C assessment of Argentina. Our 'CCC+' issuer credit rating on CGC is below its 'b-' SACP. We cap the rating on CGC at our T&C assessment of Argentina. This reflects our belief that the company wouldn't be able to continue honoring its foreign currency obligations under potential restrictions on access to foreign currency and/or restrictions on the ability to transfer money abroad. The rating on the proposed notes is the same as the issuer credit rating on CGC, because we don't believe there's significant contractual or structural subordination. We estimate priority debt represents around 5% of consolidated financial obligations.

The credit profile captures improved operations but also refinancing risks. The SACP reflects the company's small scale, the reserve base's short life, and its limited geographic and product diversification. The mitigating factors are CGC's improved operating performance, resulting in higher production and margins in recent years. The SACP also reflects stronger credit metrics but high cash flow volatility. We expect CGC's leverage at 2.0x–2.5x in 2020 amid sluggish demand and low prices, but we believe the company will generate positive cash flows. We expect CGC to reduce the pace of its capital investments and to be able to roll over most of its near-term debt commitments. The company has issued around $55 million in bond in the domestic markets during the first half of the year, and we believe it could further tap smaller amounts of funding in the domestic bond market and from banks in the second half of the year.

Outlook

The negative outlook reflects the potential further deterioration in sovereign's credit quality and the consequences of its debt restructuring on the domestic economy, including potential further restrictions on accessing and/or transferring funds abroad, which drastically increases our perception of risk. The outlook also reflects CGC's weaker capital structure with increasing short-term debt and high refinancing risk amid the volatile economic conditions.

Downside scenario

We could downgrade CGC if it's unable to refinance its debts, further reducing the debt's average term and pressuring liquidity. We could also lower the rating if further restrictions on accessing and/or transferring funds abroad trigger a downward revision of Argentina's T&C assessment.

Upside scenario

CGC's high exposure to Argentina and its T&C assessment currently limit the possibility of an upgrade. We could upgrade CGC's SACP to 'b' from 'b-' if the company diminishes refinancing risk by extending the average debt term and avoiding liquidity pressures. We would also require stronger gas market, with demand supporting prices above current levels. We would additionally expect funds from operations (FFO) to debt to above 30% and debt to EBITDA below 2.5x consistently.

Company Description

CGC is an Argentina-based oil and gas E&P company. About 96% of its oil and gas production comes from the Austral basin in the province of Santa Cruz in southern Argentina. Gas represents about 85% of the company's total production and approximately 68% corresponds to unconventional sources. CGC's proven reserves (P1) totaled 62.9 million barrels of oil equivalent (boe), and its proven developed reserves totaled 45.9 million boe with an average reserve life of 4.3 years (P1) as of Dec. 31, 2019. Its oil and gas production reached about 40,000 boe per day in the first quarter of 2020.

The company also operates in the midstream segment through stakes in three gas transportation pipelines (a 28% indirect stake in Transportadora de Gas del Norte [TGN], 40% stake in Gasoducto GasAndes, and 15% in Transportadora de Gas del Mercosur) with 25 billion cubic meters (m3) of gas transported by TGN during 2019.

Corporacion America International S.A.R.L (CAI; not rated) ultimately controls CGC through a 70% stake and holds either directly or indirectly controlling interests in various other businesses, mainly related to airport operations. Despite our belief that CGC is important to the group's growth strategy and that the company benefits from financial flexibility and credit access from being part of the group, we don't incorporate any rating impact for our group rating methodology.

Financial Summary

Compania General de Combustibles S.A. -- Financial Summary

Industry Sector: Oil & Gas Exploration & Production

	--Fiscal year ended Dec. 31--				
	2019	2018	2017	2016	2015
(Mil. $)					
Revenue	515.8	470.3	260.3	219.6	195.1
EBITDA	308.6	243.0	67.2	80.7	52.8
Funds from operations (FFO)	248.6	198.0	33.5	42.3	15.5
Interest expense	43.1	40.8	27.7	34.4	21.9
Cash interest paid	41.3	33.5	30.1	33.5	23.3
Cash flow from operations	266.2	122.6	36.8	3.6	(28.3)
Capital expenditure	183.1	157.4	132.0	65.8	74.7
Free operating cash flow (FOCF)	83.0	(34.8)	(95.2)	(62.3)	(103.0)
Discretionary cash flow (DCF)	83.0	(34.8)	(95.2)	(62.3)	(103.0)
Cash and short-term investments	97.8	36.1	22.6	133.0	15.5
Gross available cash	97.8	36.1	22.6	133.0	15.5
Debt	479.1	472.5	399.4	412.5	232.8
Equity	321.0	261.7	40.7	72.4	104.7
Adjusted ratios					
EBITDA margin (%)	59.8	51.7	25.8	36.7	27.1
Return on capital (%)	33.0	33.1	7.6	8.8	25.5
EBITDA interest coverage (x)	7.2	6.0	2.4	2.3	2.4
FFO cash interest coverage (x)	7.0	6.9	2.1	2.3	1.7
Debt/EBITDA (x)	1.6	1.9	5.9	5.1	4.4
FFO/debt (%)	51.9	41.9	8.4	10.3	6.6
Cash flow from operations/debt (%)	55.6	25.9	9.2	0.9	(12.2)

Compania General de Combustibles S.A. -- Financial Summary (cont.)

Industry Sector: Oil & Gas Exploration & Production

	--Fiscal year ended Dec. 31--				
	2019	2018	2017	2016	2015
FOCF/debt (%)	17.3	(7.4)	(23.8)	(15.1)	(44.3)
DCF/debt (%)	17.3	(7.4)	(23.8)	(15.1)	(44.3)

Peer Comparison

Compania General de Combustibles S.A. -- Peer Comparison

Industry Sector: Oil & Gas Exploration & Production

	Compania General de Combustibles S.A.	GeoPark Ltd.	Petroquimica Comodoro Rivadavia S.A.	Gran Tierra Energy Inc.	Frontera Energy Corporation
Ratings as of Aug. 4, 2020	CCC+/Negative/--	B+/Negative/--	CCC+/Negative/--	B-/Stable/--	B+/Negative/--
	--Fiscal year ended Dec. 31, 2019--				
(Mil. $)					
Revenue	515.8	628.9	386.1	571.0	1,383.6
EBITDA	308.6	394.3	174.8	334.9	657.9
Funds from operations (FFO)	248.6	257.6	124.6	247.5	614.5
Interest expense	43.1	34.9	20.2	47.1	61.2
Cash interest paid	41.3	29.5	28.3	38.2	37.3
Cash flow from operations	266.2	206.0	84.8	178.8	508.5
Capital expenditure	183.1	125.9	211.3	379.3	324.0
Free operating cash flow (FOCF)	83.0	80.0	(126.5)	(200.5)	184.5
Discretionary cash flow (DCF)	83.0	8.7	(135.5)	(238.1)	5.7
Cash and short-term investments	97.8	111.2	85.8	8.3	328.4
Debt	479.1	498.2	460.7	840.7	598.3
Equity	321.0	132.9	259.2	1,032.6	1,270.0
Adjusted ratios					
EBITDA margin (%)	59.8	62.7	45.3	58.6	47.6
Return on capital (%)	33.0	36.8	21.5	6.2	14.8
EBITDA interest coverage (x)	7.2	11.3	8.6	7.1	10.8

Compania General de Combustibles S.A. -- Peer Comparison (cont.)

Industry Sector: Oil & Gas Exploration & Production

	Compania General de Combustibles S.A.	GeoPark Ltd.	Petroquimica Comodoro Rivadavia S.A.	Gran Tierra Energy Inc.	Frontera Energy Corporation
FFO cash interest coverage (x)	7.0	9.7	5.4	7.5	17.5
Debt/EBITDA (x)	1.6	1.3	2.6	2.5	0.9
FFO/debt (%)	51.9	51.7	27.0	29.4	102.7
Cash flow from operations/debt (%)	55.6	41.3	18.4	21.3	85.0
FOCF/debt (%)	17.3	16.1	(27.5)	(23.9)	30.8
DCF/debt (%)	17.3	1.8	(29.4)	(28.3)	1.0

Our Base-Case Scenario

- Argentina's GDP to decline 8.5% in 2020 and grow 2.9% in 2021.
- Argentin's inflation rate of 45% in 2020 and 38% in 2021, mainly impacting labor and other domestic-currency denominated costs.
- Argentina's average foreign exchange (FX) rate of ARP72 per $1 this year and ARP100 per $1 in 2021.
- Average Brent crude oil prices of $36 per barrel in 2020 and $50 per barrel in 2021, in line with our oil and gas price deck (please see "S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure," published March 19, 2020).
- Average realized gas prices around $4.0 per million of British thermal units (mmBTU), including the benefits related to the government's unconventional gas incentive program.
- Total oil production of 5,600 barrels of oil equivalent (boe) per day in 2020 and 6,300 in 2021.
- Total gas production of 5.4 million cubic meters (Mm3/d) per day in 2020 and 2021.
- Dividends from midstream assets of about $5 million in 2020 and 2021.
- Capital expenditures (capex) of about $100 million in 2020 and $160 million in 2021.
- No dividend distribution.
- Our adjusted debt calculation incorporates CGC's asset retirement obligations and lease liabilities, which totaled $44.4 million as of March 31, 2020.

Key Metrics

	2020A	2021E
EBITDA (mil. $)	193.4	226.9
EBITDA margin (%)	50.3	53.3

	2020A	2021E
Debt to EBITDA (x)	2.3	1.9
FFO to debt (%)	34.8	43.2
FOCF to debt (%)	14.4	0

All figures are S&P Global Ratings adjusted. E—Estimate.

Liquidity

Our liquidity analysis excludes the bond exchange. In the current scenario, we assess CGC's liquidity as less than adequate, given that we expect sources of cash to be slightly above uses of cash in the next 12 months. Even though the company successfully issued $55 million in bonds in the domestic market during the first half of 2020, they have short maturity and CGC still faces around $110 million in debt maturities in the next 12 months.

Principal Liquidity Sources

- Cash and liquid investments of $85 million as of March 31, 2020; and
- FFO of about $165 million for the next 12 months.

Principal Liquidity Uses

- Short-term debt of $110 million as of March 31, 2020;
- Working capital outflows of about $5 million for the next 12 months; and
- Capex of about $115 million for the next 12 months.

Even though liquidity could slightly improve after the debt exchange, we believe the company's ability to absorb high-impact, low-probability events is limited.

Covenants

CGC is subject to financial covenants that limit its ability to incur new debt if its EBITDA interest coverage ratio is below 2.5x and net debt to EBITDA ratio is above 3.0x. For the purposes of this covenant, debt is measured on a net debt basis excluding non-recourse debt with collateral from midstream assets, while EBITDA excludes dividends from those assets. We believe the company will be able to comply covenants with ample headroom.

Issue Ratings--Subordination Risk Analysis

Capital Structure

CGC's capital structure as of March 31, 2020, mainly consisted of $300 million senior unsecured notes due 2021, $85 million bank loans, $29 million guaranteed non-recourse bond, $34 million of local bonds. As of March 31, 2020, 23% of debt was short-term maturity and around 99% of debt was denominated in dollars.

Analytical conclusions

We rate CGC's senior unsecured notes at the same level as the issuer credit rating because we don't believe there are material financial obligations that would rank ahead of the company's unsecured debt by way of structural or contractual subordination in a default scenario. CGC doesn't hold any debt at the level of operating subsidiaries.

Reconciliation

Table 3

Compania General de Combustibles S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

	--Fiscal year ended Dec. 31, 2019--				
Compania General de Combustibles S.A. reported amounts (000s Ar$)					
	Debt	EBITDA	Operating income	S&P Global Ratings' adjusted EBITDA	Cash flow from operations
	25956036	15310834	7502193	18478037	17247037
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	--	(184,327)	--
Cash interest paid	--	--	--	(2,472,328)	--
Reported lease liabilities	1085051	--	--	--	--
Dividends received from equity investments	--	1161228	--	--	--
Asset-retirement obligations	1646269.3	--	--	--	--
Exploration costs	--	934145	--	(934,145)	--
Nonoperating income (expense)	--	--	3910572	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	(1,311,100)
EBITDA: Other income/(expense)	--	1071830	1071830	--	--
Total adjustments	2731320.3	3167203	4982402	-3590800	-1311100
S&P Global Ratings' adjusted amounts					
	Debt	EBITDA	EBIT	Funds from operations	Cash flow from operations
	28687356.3	18478037	12484595	14887237	15935937

Ratings Score Snapshot

Issuer credit rating: CCC+/Negative/--

Business risk: Vulnerable

- Country risk: Very high
- Industry risk: Intermediate
- Competitive position: Vulnerable

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: b

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Less than adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: b-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating	
Compania General de Combustibles S.A.	
Senior Unsecured	CCC+
Ratings Affirmed	
Compania General de Combustibles S.A.	
Issuer Credit Rating	CCC+/Negative/--
Compania General de Combustibles S.A.	
Senior Unsecured	CCC+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.