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Latin America Corporates – searching for value

Emerging Market Credit Trading

STRICTLY PRIVATE AND CONFIDENTIAL

February 2017

Latam Corps | EM technicals

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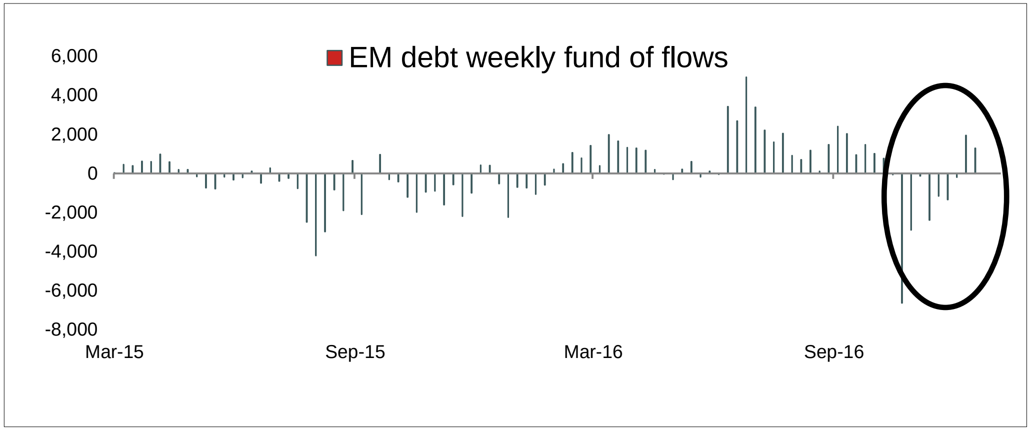
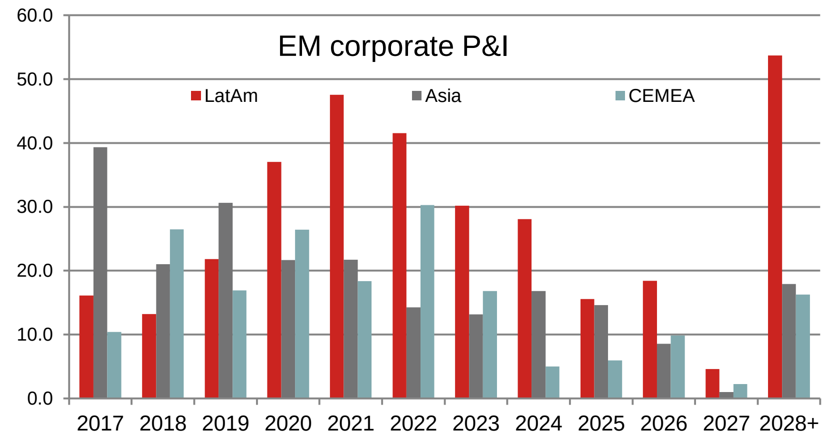




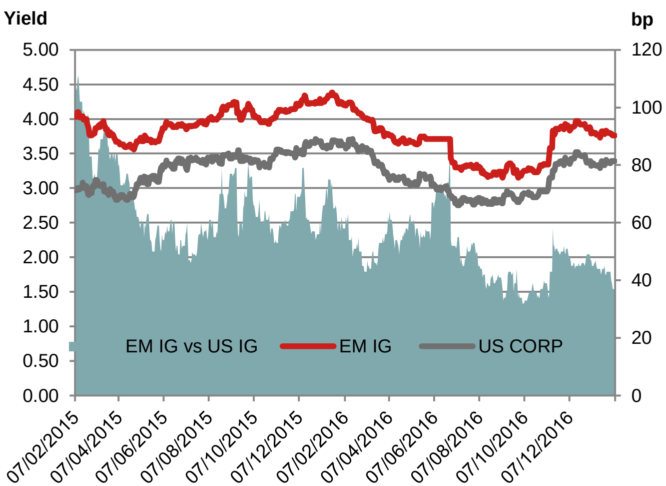
- Technicals for EM corporates were supportive for most of 2016 with positive funds flows for most of the year that turned sharply negative following the US presidential election in early November. 2017 has gotten to a positive start with positive fund flows through January.
- Another supportive technical for EM corporates is the sizeable cash-flows going back to investors from principal and interest payments which we estimate to total approximately $66bn during 2017. The bulk of P&I payments will come from Asian corporates at about $39bn while LatAm corporates should pay about $16bn and CEMEA $10bn.
- Solid inflows supported a solid issuance calendar that say $280bn in gross issuance priced during 2016. Asia represented over 50% of total issuance and Latin America priced about $53bn in new bonds.
- For 2017, we expect a similar level of gross issuance for LatAm ($50bn to $60bn). YTD 2017 LatAm corporates have issued $10.6bn in bonds with Petrobras accounting for about 40% and Argentine corporates with about 20% of the total.

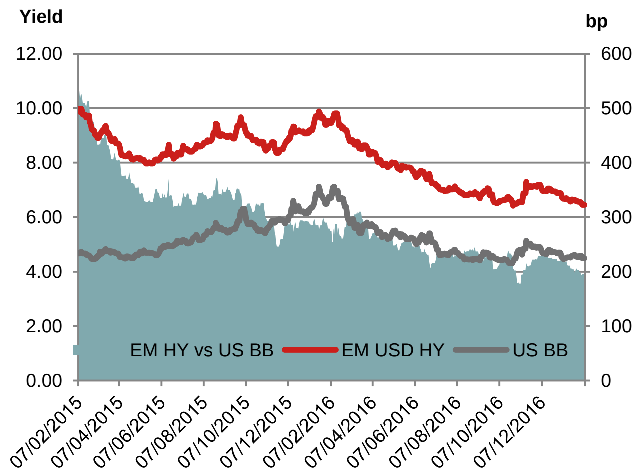
EPFR fund flows for EM

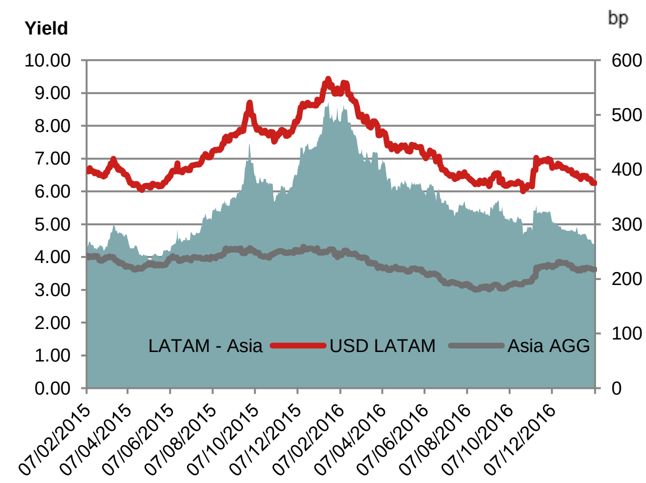
	Weekly flows (USD millions)				Cumulative	
	Last week	Previous week	4-wk avg	3-MO Z-score	2015	2016
Total EM flows	1,660	(374)	747	(3.38)	(24,803)	29,926
Local Currency funds	625	(699)	106	(3.09)	(11,710)	13,574
Hard Currency funds	1,025	289	603	(3.43)	(8,891)	20,553
Blended Funds	10	36	38	(3.02)	(4,202)	2,480

Source: Bloomberg; EPFR

Latam Corps | recent performance

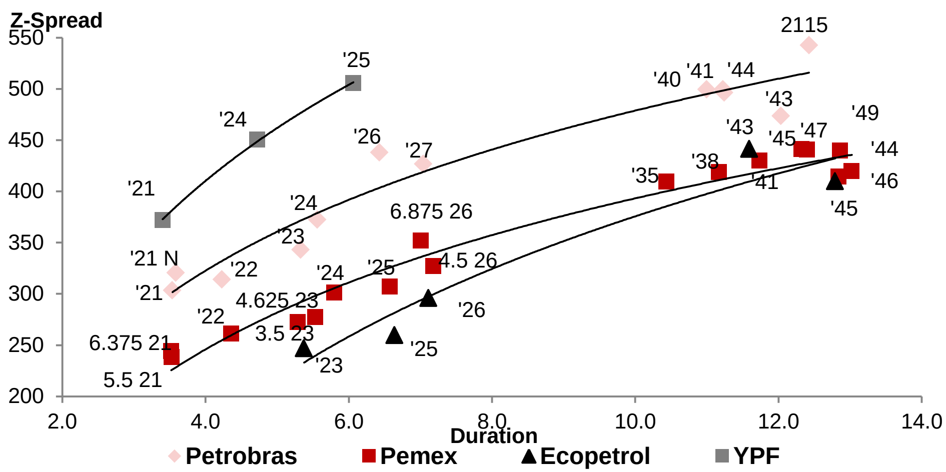


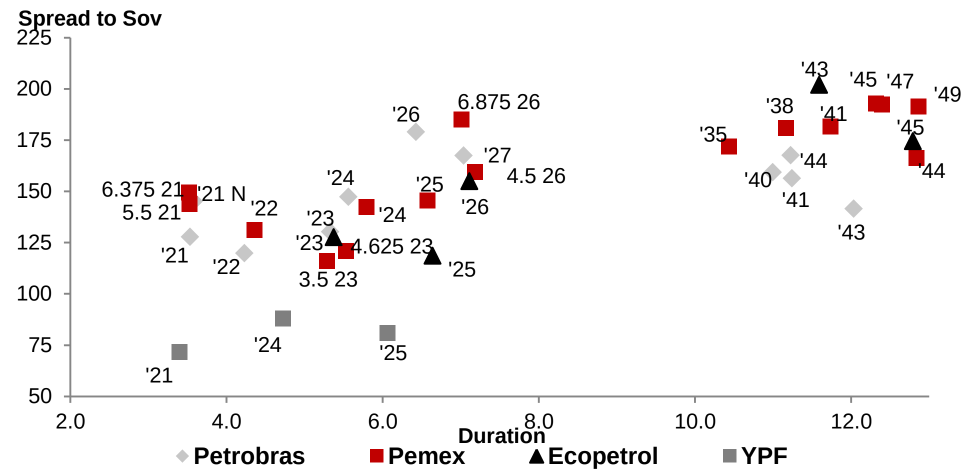




- The recovery in commodity prices during 2016 was supportive EM corporates with the yield for the Barclays EM Agg index tightening nearly 100bp during the year with EM IG yields tighter by about 40bp while EM HY tightened by about 220bp in yield.
- In terms of regions, during 2016 LatAm tightened by nearly 200bp in yield while Asia tightened by about 45bp. Within LatAm, Brazil outperformed, tightening about 360bp in yield while Mexico tightened only 30bp.
- EM corporates in general and LatAm corporates specifically have continued to perform YTD 2017 with EM Agg tighter by about 20bp with LatAm tighter by nearly 40bp, Asia about 14bps tighter and Brazil continuing to outperform and about 75bps tighter.
- Relative to US corporates, EM IG trades at about a +40bp spread to US IG while EM HY trades about +190bps to US BBs.
- Despite the rally in LatAm during 2016 and YTD 2017, LatAm continues to offer compelling value relative to Asia at +270bp pickup in yield.
- In terms of credit fundamentals, we think 2017 will be mixed amid tepid economic growth, uncertainties around US policy that could drive US rates higher and EMFX weaker and lead to deteriorating balance sheets.
- In this context, we prefer credits with improving fundamentals stories and sufficient credit spreads to cushion any rate and FX volatility (Argentine corporates, Quasi sovereign O&G) as well as those that are exposed to US growth (Cemex). We remain cautious IG credits trading at historical tights as well as credits that generate local currency cash flows (Andean utilities, IG telecoms).

Source: Bloomberg





- **PEMEX**: We see more value in the **long-end**, but think overall valuations are fair. We believe that if oil prices hold, there could be room for another ~25bp of tightening relative to the sovereign, as we expect lower levels of issuance (compared to 2016), improved (although still negative) cash flow generation and additional farmouts. The tightening, however, could be limited by Pemex's weak credit metrics, declining production, supply risk and uncertainties regarding Mexico's outlook. Our economists believe that a combination of headwinds to growth (coming from trade policies in the U.S.) and fiscal risks could result in a one-notch downgrade of Mexico, which would have consequences for Pemex ratings.
- **PETBRA**: We still like the PETBRA curve given improving fundamentals and higher absolute yields compared to most quasis and other opportunities in the Latam corporate space. We believe PETBRA will continue to deliver on asset sales, market-oriented fuel price adjustments and gradual deleveraging. In our view, the biggest risk for valuations is potential political volatility in Brazil. While the current spread-to-sovereign seems tight compared to the last couple years, it is in line with the pick-up offered by the other quasis. Our favorite bonds in the curve are the **'26s,** as they offer the highest spread in the belly, highest spread to sovereign and have lower supply risk compared to the '27s. We also like the **'40s and '41s**, given a combination of high spreads and lower dollar price. We think the '**22s** are the most expensive bonds on the curve and would prefer to switch to the '**23s** for a 30bp pick-up in spread and 10pts lower dollar price for 1yr additional duration.
- **YPFDAR**: Although YPF bonds offer the lowest pick-up to the sovereign, we believe this is justified, as the company has the lowest leverage (~2x NL) compared to other quasis and operates in a strategic sector which should benefit from favorable government policies. We prefer the **'25s** given a spread pick-up of 55bp vs the '24s.

Source: Bloomberg, Nomura, company reports.

Latam Corps | Oil Drillers ODEBRE ’21s & ‘22s

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ODEBRE ‘21s

- Bonds are backed by cash flows **of two 6th gen drillships** (Norbe VIII/IX) contracted until 2021, with est. dayrates of ~$390k and ~$415k.
- We estimate **current prices of $47-48 imply**: (i) a discount rate of 15%; (ii) dayrates are cut by 10-15% to $355k and contracts are not extended; (iii) 93% avg uptime; (iv) the rigs distribute ~$20m in dividends to the holdco; (v) the transaction fully covers all opex and capex; (vi) rigs are worth ~$150m each in 2021; (vii) LoCs of $100m used at maturity to pay bonds.
- **There could be upside for the bonds** if negotiations with Petrobras are NPV neutral (on a per rig basis) and/or provide certainty that contracts will remain in place, allowing investors to use lower discount rates. Additionally, bonds could benefit if higher oil prices translate into expectations of higher valuations for the rigs (which cost ~$700m each to build).
- In an **optimistic scenario** in which negotiations are NPV neutral for each rig and the assets are worth $175-200m each at maturity, bonds could be worth close to **70c** if we use a 10% discount rate.

ODEBRE ‘21s Recovery – Sensitivity Analysis

Discount Rate \ Average Dayrate	300	320	340	360	380	*400*
7.5%	0.45	0.50	0.55	0.60	0.65	0.70
10.0%	0.41	0.46	0.51	0.55	0.60	0.65
12.5%	0.38	0.42	**0.47**	**0.51**	**0.56**	**0.60**
15.0%	0.35	0.39	**0.43**	**0.47**	**0.52**	**0.56**
17.5%	0.32	0.36	**0.40**	**0.44**	**0.48**	**0.52**
20.0%	0.30	0.33	0.37	0.41	0.45	0.48
22.5%	0.28	0.31	0.35	0.38	0.42	0.45

ODEBRE ‘22s

- Bonds backed by **two 6th gen drillships** (ODN I/II) contracted until 2022, with est. dayrates of ~$364k, and **one 5th gen semi-sub** (Norbe VI) contracted until 2019 with est. dayrate of $340k. Tay IV was terminated.
- **Current prices ($35-36) imply**: (i) 15% disc. rate; (ii) dayrates kept at current levels and contracts not extended; (iii) Norbe VI isn’t renewed; (iv) 93% avg uptime; (v) rigs send ~$20m in to holdco; (vi) the transaction fully covers all opex and capex on rigs; (vii) 6th gen rigs worth ~$150m each at maturity and Norbe VI $50m; (viii) LoCs of ~$160m used at maturity.
- **There could be upside to current levels** if negotiations with Petrobras are NPV neutral and/or provide certainty that contracts will remain in place, resulting in lower discount rates. Bonds could also benefit if higher oil prices translate into expectations of a renewal of Norbe VI’s contract in 2020 and/or higher valuations for the rigs.
- In an **optimistic scenario** in which negotiations are NPV neutral, Norbe VI is renewed in 2019 and the assets are worth an average of $175m each at maturity, bonds could be worth close to **50c** if we use a 10% discount rate.

ODEBRE ’22s Recovery – Sensitivity Analysis

Discount Rate \ Average Dayrate	280	300	320	340	*360*	380
7.5%	0.29	0.33	0.38	0.42	*0.46*	0.50
10.0%	0.27	0.30	**0.34**	**0.38**	***0.42***	0.46
12.5%	0.24	0.28	**0.31**	**0.35**	***0.38***	0.42
15.0%	0.22	0.26	**0.29**	**0.32**	***0.36***	0.39
17.5%	0.20	0.24	0.27	0.30	*0.33*	0.36
20.0%	0.19	0.22	0.25	0.28	*0.31*	0.34
22.5%	0.17	0.20	0.23	0.26	*0.29*	0.31

Source: Bloomberg, Nomura, company reports.

Latam Corps | Odebrecht Construction (ODBR)

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- **We acknowledge the leniency agreement was a very positive development, but remain cautious on the credit.**
- Since the announcement of the execution of agreement on December 21 (which imposed a R$3.8bn fine on the company), political authorities from several different countries have announced that they plan on taking measures against the company.
- **We believe the main questions for 2017-2018 are whether OEC will be able to preserve liquidity and win new contracts.**
- **We estimate that ~40% of ODBR's 3Q16 backlog ($21bn) could be at risk of cancelation/non-performance**, as the company had $4.6bn in contracts in Venezuela, $2.6bn in Peru, $350m in the Navalena project (Colombia) and $733m in projects with no variation vs 2Q16.
- For ODBR to have a cash position of $1bn+ at YE17, we estimate that the company would need to have a working backlog of $13bn at YE16, win $2.5bn in new projects (guidance is$4bn in 2H17), monetize at least $300m in overdue A/R, and give no additional intercompany loans.
- For ODBR to maintain a runrate EBITDA of ~$450-500m and neutral FCF before WC, we believe the company would need to maintain a backlog of $18-20bn with a 3yr average life and 8% margins.
- **We believe the above scenarios seem challenging considering the company's current situation, and therefore do not recommend the bonds to investors.**

	3Q16	*Adj Avg Life*	Adjustments to backlog	Adj. Backlog At 3Q16
Backlog	**21,311**			**13,003**
Brazil	4,950	*3.74*		4,950
Abroad	16,361	*3.52*	-8,308	8,052
Venezuela	*4,596*		*-4,596*	
Peru	*2,627*		*-2,627*	
Colombia - Navalena	*352*		*-352*	
Contracts with no /\ qoq	*733*		*-733*	

2017 Forecast	Negative	Base	Positive
Working Backlog at YE16	**11,503**	**13,003**	**15,000**
Avg life	3.0	3.0	3.0
Addl backlog 2H17	**500**	**1,500**	**4,000**
Avg life	3.0	3.0	3.0
Revenues	**3,918**	**4,584**	**5,667**
From current backlog	*3,834*	*4,334*	*5,000*
From new backlog 2H17	*83*	*250*	*667*
COGS (~80%)	(3,134)	(3,667)	(4,533)
G&A (~12%)	(470)	(550)	(680)
Implied EBITDA	**313**	**367**	**453**
EBITDA margin	*8.0%*	*8.0%*	*8.0%*
Interest on bonds and bank debt	(205)	(205)	(205)
Insurance fees	(25)	(25)	(25)
Fines – Brazil, US, Switzerland	(60)	(60)	(60)
Other fines	(100)	(75)	(50)
Capex	(59)	(69)	(85)
Taxes	(47)	(55)	(68)
WC	(313)	(163)	150
Advances Used	*(588)*	*(688)*	*(850)*
Advances received (15%)	*75*	*225*	*600*
Overdue A/R received	*200*	*300*	*400*
Intercompany loans (given)/received	(100)	-	350
FCF	**(908)**	**(447)**	**610**
ST debt rolled / (paid)	(210)	(100)	-
Cash at YE16 (est.)	1,300	1,350	1,400
Cash at YE17	**182**	**803**	**2,010**
Debt	3,317	3,317	3,417
Fine	1,152	1,152	1,152
Net Debt including fine	4,286	3,666	2,558
GL incl fine	**14.26**	**12.19**	**10.08**
NL incl fine	**13.68**	**10.00**	**5.64**

Source: Nomura, company reports.

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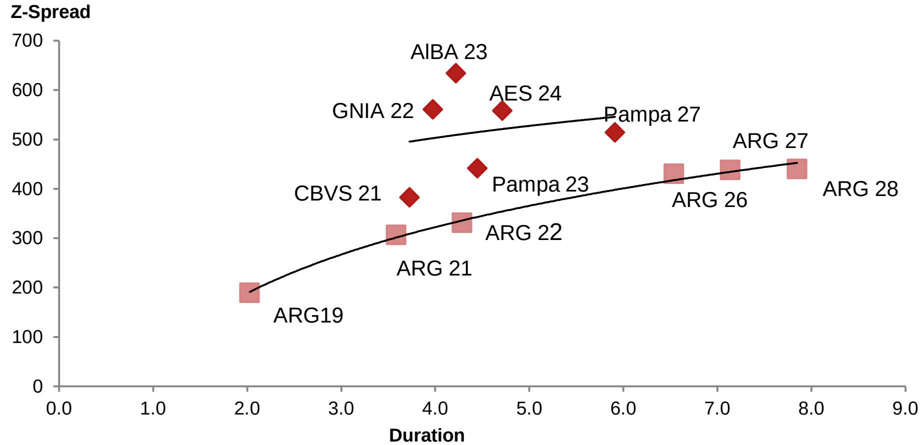
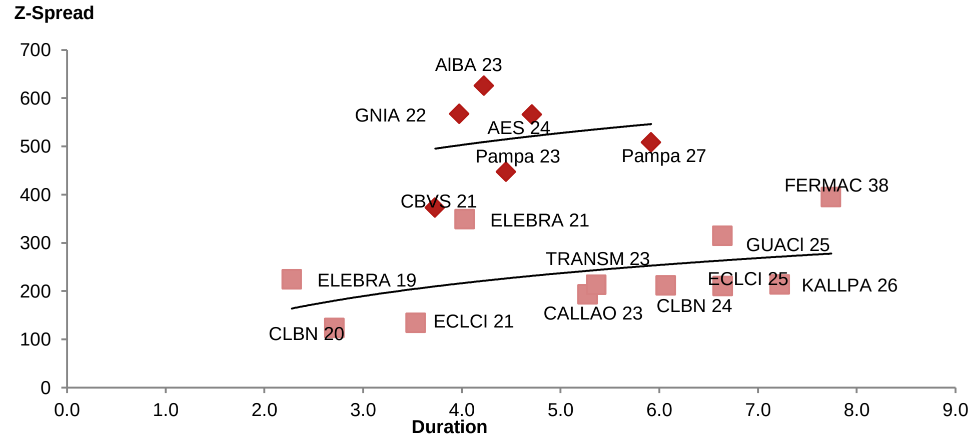
Argentine utilities should benefit from higher tariffs





- 2017 has been a busy month for Argentina with the sovereign issuing $7bn in bonds and Argentine corporates issuing a further $2.1bn. The bulk of the corporate activity was concentrated in the utility space, including Pampa, AES Argentina and Genneia.
- We expect Argentine utilities will benefit from improvement in the regulatory and tariff framework during 1H17, ahead of the midterm elections in October. The government recently announced increases in electricity tariffs that will raise end-user costs by up to 150%. Despite this steep increase, Argentina power tariffs remain amongst the lowest in the region. The tariffs are due to take effect March 2017 (absent legal challenges) and will benefit the large distribution companies serving Greater Buenos Aires, potentially setting them up to come back to the capital markets later in the year.
- On the generation front, the recent new issues have included large players such as AES Argentina and Pampa and smaller generators (Albanesi, Genneia) characterized by high leverage (circa 3.5x - 4x) for the next two years as they expand capacity.
- Our preferred credit in the Argentine utility space is Pampa given its diversified business mix (oil, gas and power generation), its relatively low leverage (1.75x proforma) and the potential for credit upside across its businesses.
  - We like the Pampa 27s which trade to a 2025 call at 510bp in zspread, provide +70bp pickup to Pampa 23s, +80bp pickup to the sovereign and better liquidity than the smaller generators.

Source: Bloomberg

Latam Corps | high yield TMT

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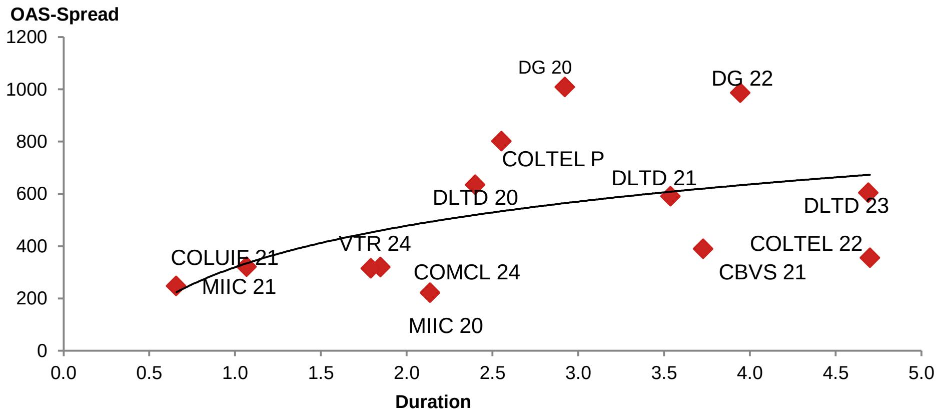
Digicel Limited remains attractive despite rally



Debt Structure as of Sep 30, 2016

Security Description	Amount Outstanding	Leverage	Net leverage	Comm.	L/B
Cash	$152				
Opco-level debt					
Senior Secured debt					
DIFL Facility	$856				
Total senior secured debt	**$856**	**1.0x**	**0.8x**		
Senior unsecured debt					
DLLTD 7 02/15/20	$250				B
DLLTD 6 04/15/21	$1,300				B
DLLTD 6 3/4 03/01/23	$925				B
Total senior unsecured debt	**$2,475**	**3.8x**	**3.7x**		
Total opco-level debt	**$3,331**	**3.8x**	**3.7x**		
Net Debt	**$3,179**				
LTM EBITDA	**$871**				
LTM Interest Expens	**$202**	**4.3x**			

Debt maturity profile		
FY'2017	0.5%	$17
FY'2018	8.4%	$290
FY'2019	18.2%	$628
FY'2020	8.7%	$300
FY'2021	0.0%	$0
FY'2022	37.6%	$1,300
FY'2023	26.7%	$925
		$3,461

- The Digicel Limited ("Opco") curve remains attractive relative to other TMT HY opportunities at a +200bps pickup to longer dated bonds (LBTYA, MIICCF). We prefer the DLLTD 6% 2021 given its shorter duration, comparable dollar price and a slight 10bp give up relative to the DLLTD 2023s.
- Opco bonds have been rallying late November 2016 and are now some 300bp tighter. Compared to the Digicel Group ("Holdco"), Opco bonds have outperformed with Opco 2021s now about -450bp inside the Holdco 2020s and 2022s versus about 400bp at the end of November 2016. The bonds should continue to benefit from a supportive technical backdrop absent any negative operating surprises.
- The Opco's performance is underpinned by:
  - Declining capex should translate into sustained free cash flow generation necessary to refinance debt.
  - Fair / manageable liquidity. The next major debt maturity for Opco is the amortization of 25% of the DIFL bank facility March 2018. We think that the banks will likely refinance given leverage through the secured tranche is only 1x.
  - The Opco has other sources of potential liquidity, including sale and lease back of towers.
- The main risk to our view include:
  - Seasonally higher capex during fiscal 2H could lead to deteriorating credit metrics in the short term.
  - Significant deterioration in Opco FX basket. To date, the Jamaican and T&T currencies have been relatively stable, down only about 2%. A disorderly restructuring at Digicel Group.

Source: Bloomberg, Nomura

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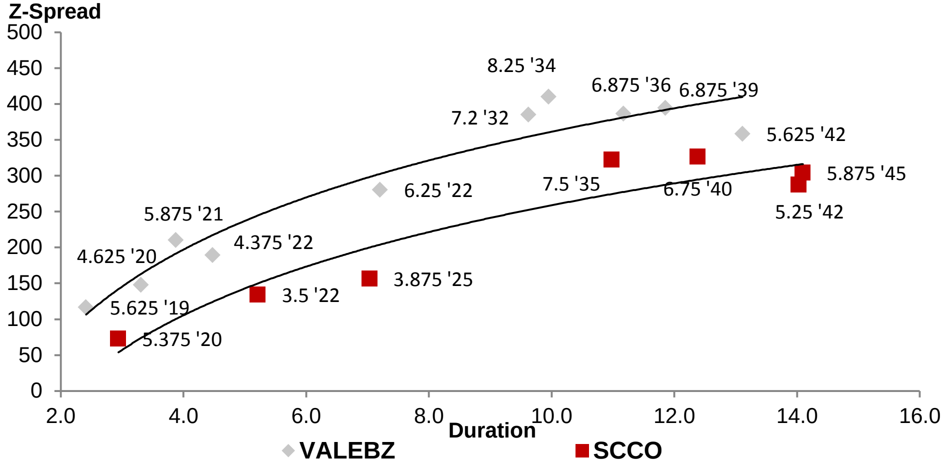
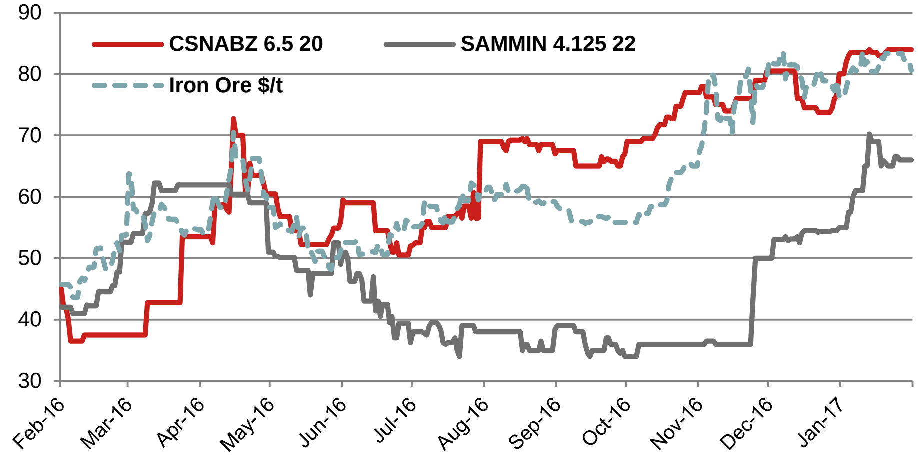
Trade Theme: Iron ore price volatility is not the same for everyone





- Iron ore recovery has been driven by continued Chinese demand and marginal supply reductions from the 3 majors, but price outlook appears skewed to the downside after 76% YoY increase from $46/t to the current $81/t.
- Iron ore inventories at Chinese ports are back to record highs, China's manufacturing PMI data has declined for each of the past 3 months and threat of oversupply could be exasperated if higher cost Chinese iron ore production comes back on line given rise in prices.
- **Long VALEBZ 39s at 107bp wide (Z-spread) to SCCO 42s –** spread differential should continue to converge with expectations for similar NL at FYE17 (low 2.0x) as VALEBZ remains committed to deleveraging. We see FV closer to 25-50bp apart considering that VALEBZ and SCCO traded within a narrow (+/- 25bp) band before the 2015 commodity crisis.
- **Short CSNABZ and SAMMIN** – given liquidity constraints both credits are dependent on spot prices to amend respective financial situations.
  - **CSNABZ -** lower spot market makes asset sales more difficult and could cause debtholders to be less willing to negotiate $9.3bn of obligations.
  - **SAMMIN –** bonds appear to be "priced to perfection" despite numerous regulatory, environmental and operational questions that still remain. Even with parent support, manageable liability settlement and operational re-start, lower spot prices could alter bondholder recovery assumptions.

Source: Bloomberg

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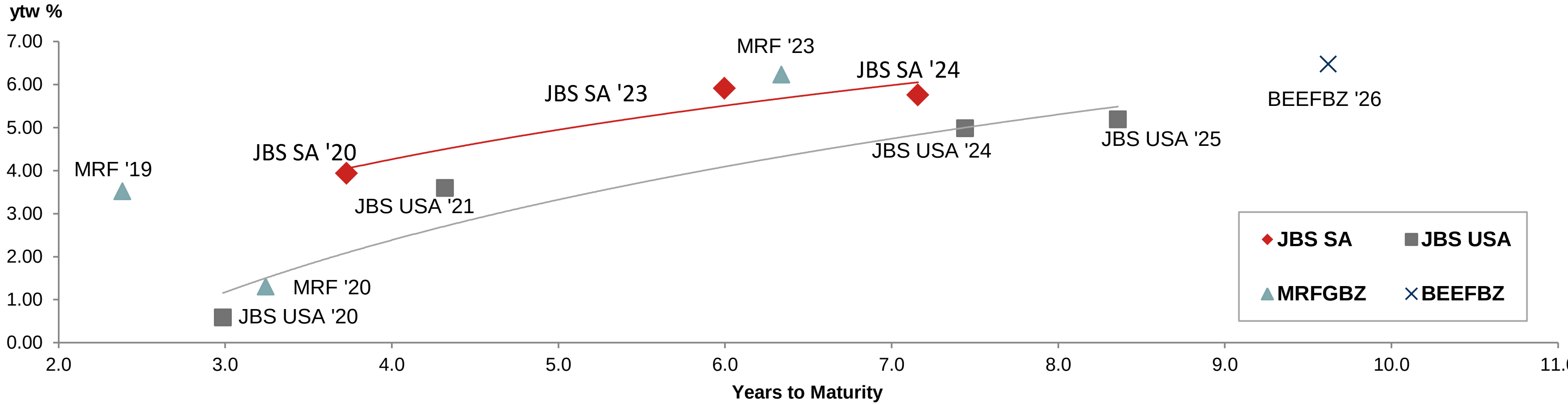
Trade Theme: Can the grind continue?



- We remain positive on the outlook for the Brazilian protein space given expectations for increased cattle availability by mid-2017, continued expansion of the export market and potential for bonds to benefit from scarcity value as JBS pursues its re-organization to become a US listed company.
- **Long JBS SA bonds versus JBS USA bonds** - JBSSBZ 7.25% 24s offer 115-125bp pick-up (Z-spread) to similar maturity JBS USA bonds.
  - JBS aims to complete its plan to consolidate and IPO all businesses, except Brazilian beef, under the newly proposed US listed entity, JBSFI.
  - IPO should generate proceeds for deleveraging, improve transparency and provide cheaper funding as entity moves from EM to US HY.
  - We expect JBS SA and USA bonds to converge back to 25-50bp (Z-spread) apart as the plan materializes in coming months, after initially tightening to a 50bp differential when initiative was first announced in December.
- **Long BEEFBZ 26s and MRFGBZ 23s -** For investors not inclined to take on the "Batista risk" that accompanies the re-domiciling, Minerva and Marfrig also stand to benefit from the improving industry backdrop and ample liquidity while providing relatively attractive yields of 6.5 – 6.75%.
  - If JBS is successful in migrating towards US HY, US$2.5bn of existing JBS SA debt may shift to US HY indices, leaving traditional EM investors with limited options in the Brazilian beef space. Conversely, if the process is unsuccessful, JBS investors may look to swap into the higher yielding comps within the space.

Source: Bloomberg

Nomura Latin America Platform

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