

# No protection

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The Argentine power sector has relied heavily upon foreign financing since the mid-1990s and, in the wake of the economic meltdown, international lenders and bondholders are experiencing a series of defaults from the transmission and distribution utilities, in addition to generators and gas pipeline companies.

The various utilities are currently locked in negotiations with the government about how their tariffs are going to be recalculated, but lenders are clearly going to have to extend their repayment schedules on many bonds and loans, and sizeable writedowns are also inevitable.

Since January, when the government moved to de-dollarise the Argentine economy, all utility contracts have been switched from dollars into pesos at an exchange rate of one to one. At the same time holdings of dollars in bank accounts were also 'pesified', again at a one to one exchange rate. But as of mid-March the free floating peso had touched a new low of 2.60 to the dollar, leaving the servicing of dollar bonds and bank loans an impossible task for many companies.

Like all other companies in the power and energy sector, Transportadora de Gas del Norte (TGN) had its tariffs pesified in January, without any compensating adjustments, and in late February Standard & Poor's downgraded the TGN IFC Trust I and TGN IFC Trust II notes to D from SD (Selective Default).

TGN, which has a 35 year exclusive licence to operate the natural gas pipeline transmission system in the north and centre west of Argentina, has actually been meeting monthly interest payments, but not the monthly principal payments. In early March TGN missed a \$2 million cross border principal payment on its senior unsecured medium term note series, although it did meet interest payments by purchasing \$149,000 in the free foreign exchange market. S&P expects that it will fail to pay a significant portion of its obligations as they come due.

TGN also has an outstanding issue of CRIBS Financial Trust I (CRIBS), which benefits from a transfer and convertibility insurance policy issued by Overseas Private Investment Corp (Opic). The next \$9.5 million payment on the CRIBS is due on 25 July. The ability of TGN to make this payment in July will depend on the existence of transfer restrictions, and TGN's ability and willingness to make the necessary Argentine peso payments to a local account, so that Opic will honour a claim to provide US dollar payments to investors.

The IFC Trusts I and II fall under the preferred creditor status umbrella, but this makes little difference if a company simply does not have the cash to make the amortisation payments.

'Most of the utilities are currently rated double C in the local currency, and in foreign currency are in default since January because of the regulations implemented by the government, by which companies were prevented from transferring funds abroad,' explains Lidia Polakovic, credit analyst at Standard & Poor's in Buenos Aires.

'The Central Bank has to approve all transfers of principal and amortisation, and it has not been giving many authorisations for the transfer of funds to meet principal payments, though it has been authorising interest payments,' she adds. 'The Central Bank has issued a regulation by which payments to multilaterals do not need approval, but the problem is that the financial situation of the companies has deteriorated so much that their payment capacity has weakened.'

This is why both the Inter-American Development Bank (IDB) and World Bank affiliate International Finance Corporation (IFC) B loans are not immune from Default status in the current environment. With regard to normal debts with commercial banks and international bondholders, even if companies do have the cash on hand, their currency transfer requests simply sit in the pending tray at the Central Bank.

Not that many companies have much cash at present. Tariffs have been pesified, but with no adjustment for tariffs, while at the same time the peso has been devalued, and since all these companies have dollar denominated debt there is a huge mismatch between their cash generation in pesos and their debt obligations in dollars, says Polakovic. In addition, all dollar funds held in bank accounts by companies were pesified at one to one, so they don't have dollars any more, but instead have pesos with which they have to go and buy dollars, and that has had a very negative impact on their repayment capacity.

Nor are many observers very optimistic about the ability of utilities to re-negotiate contracts to make up some of the shortfall. We are waiting for the resolution of the problem with the pricing, says Ana Beaumarie at Moody's Investor Services in Buenos Aires. They can't index their prices, and they are waiting for a resolution from the government, Beaumarie continues. The companies don't know what is going to happen with that, or how it is going to be resolved.

Since the decree that established the pesofication, or the de-dollarisation of the tariffs, followed by the floating of the peso, all the utilities have been very badly affected, but the law establishes that the companies have the right to negotiate with the government, and this negotiating process has started in mid-February, with 120 days set aside for these negotiations, adds Cecilia Minguillon, Associate Director at Fitch Ratings in Buenos Aires. Various proposals will be evaluated, and companies want a mix of things to establish the equilibrium of the contracts.

Companies have 120 days to renegotiate the concession contracts, nobody knows on what terms this will be done, adds Polakovic at S&P. But the social situation in Argentina is so critical that tariff increases will be difficult to implement, so it is a very difficult situation for the government and for the companies.

Not surprisingly, a steady flow of missed payments is expected, and in March there was a default involving Inversora Electrica de Buenos Aires (IEBA), with S&P lowering its foreign currency corporate credit rating to D from SD, and the local currency rating from CC to D.

This followed an announcement by the company that it will not be able to make interest payments of \$4.3 million and \$5.8 million respectively due 16 March on its \$100 million senior unsecured notes due 2002, and its \$130 million senior unsecured notes due 2004.

IEBA is a holding company that was created in 1997 to acquire 90% of Empresa Distribuidora Atlantica (EDEA). It serves roughly 410,000 customers in the eastern area of the province of Buenos Aires.

IEBA had already been performing weakly over the past few years, as a result of lower than expected revenue growth, and delays in executing a cost reduction plan. So the current peso crisis, coupled with a depressed economic environment that is negatively affecting collections, and the lack of liquidity in the financial system, have had a dramatic effect upon its finances.

Also in mid-March, the CAPEX utility failed to meet a \$2.5 million interest payment on a \$40 million issue of long-term senior secured notes. CAPEX's primary business is the generation of electricity in the Comahue region in southwest Argentina. It has a thermal plant with six gas-fired units and one steam unit, and installed capacity of 657MW.

Companies have also been making write-offs in their accounts. In early March Pecom Energia (formerly better known as Perez Companc SA) announced that it was writing off \$140 million, having made adjustments for presumed income tax credits of \$47 million and goodwill generated by the acquisition of CIESA for \$92 million.

The domestic utilities are in such bad shape because they now have peso revenues and dollar debt, and the same applies to toll road projects, which will also face severe problems servicing dollar debt. In addition the collapse of the economy is resulting in lower usage from cash strapped car owners and truck operators.

A bridge and road link connecting the Argentine cities of Rosario in Santa Fe province and Victoria in Entre Rios, is scheduled to open in the summer, including 60 kilometres of road plus a cable-stayed bridge over the River Parana. This was built with substantial government support, with a subsidy of \$242 million towards the \$380 million project. German BOT specialist Hochtief Projectentwicklung has a 26% stake in the operating company, which also includes local and international companies.

The new link is designed to help integrate the economies of Argentina, Uruguay, Brazil and Chile, and therefore does have some exposure to trucking of exported goods, so is better positioned than, for example, a commuter toll road aimed at car passengers going to and from work. It has a 25-year concession, and its revenue and debt coverage projections are going to be severely affected by lower traffic and the devalued peso.

### Oil and gas

Best placed in the current crisis are creditors to the oil and gas export sector, since these companies do at least have hard currency earnings. In addition, up to now the government has let oil companies such as Spanish-Argentine YPF continue as normal with their operations, although it has levied a 20% export tax, which is hurting them considerably.

One such venture is the Mega project, a natural gas separation plant, sponsored by YPF, Petrobras of Brazil, and Dow Chemical of the United States. In 1999 Mega offered \$472 million worth of bonds in the first deal to get done on a project basis in the southern cone. The project is underpinned by long term supply contracts to offtakers, including units of the sponsors, though the price paid is determined by market prices.

‘In Mega we had a certain percentage of sales in the domestic market, and a certain percentage of sales into the export market, with the foreign currency received offshore,’ says Steven Greenwald, managing director at Credit Suisse First Boston in New York.

‘Our gas costs are payable in dollars, but under the terms of the Mega transaction, if our domestic sales had to be paid in pesos, which is now the case, then we could pay domestically for the gas in pesos,’ Greenwald explains. ‘So we always had that pretty good match between domestic sales and our biggest cost, which is gas. And our offshore sales are still denominated in dollars. So the project is still going okay.’

Mega is rated B+ by Fitch ratings, and is on negative rating watch, but is certainly performing better than most Argentine projects. ‘This project was affected by the devaluation, but also it has been affected by political interference,’ says Minguillon at Fitch. ‘For example, a decision to refund VAT has been reversed, and postponed, and there is also a tax on certain oil derivative exports.’

There are also a number of future flow-based oil export deals that are still paying creditors. The \$400 million worth of Oil Trading Corp oil export-backed notes, and the \$315 million issue of Oil Enterprise Limited, are both backed by delivery contracts with payments made offshore. Both are performing well, and in any case are wrapped to Triple A. For these notes, should the government somehow hinder payment, creditors have the backup right to take oil from a pipeline delivering oil to Chile from Argentina.

More problematic are the \$234 million worth of Salta Hydrocarbon Royalty Trust notes, backed by royalty payments to the Province of Salta. These have been downgraded to Caa1 by Moody's, though have thus far avoided default.

‘The obligation is to pay interest on a timely basis, and principal by the legal final date in 2015, so as long they make the interest payments they will not be in default,’ explains Maria Muller, credit analyst at Moody's in New York. ‘They have a targeted amortisation schedule, but if they do not meet the principal payments it is not a default, since the promise to investors is to repay principal by the legal final.’

‘The way in which the royalties are being calculated has been changed by the Argentinean government, and have been pesified, so collections have decreased in US dollar terms,’ adds Muller. ‘They have been able to meet the interest payments that have been coming due, and going forward they will be able to meet interest payments for some time by drawing amounts from the reserve account, but if the exchange rate deteriorates further or the government does not

allow an increase in the domestic gas price they may not be able to avoid default.?

More defaults are expected in the coming months from companies in many sectors in Argentina, and bondholders are in for a rough year, as are bank lenders with both term loans and bridge financings that cannot now be taken out. In the present messy environment there will be plenty of writedowns, probably including loans where multinationals were involved as lenders.

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