



RATING ACTION COMMENTARY

Fitch Affirms Province of Chubut's Ratings at 'CC'

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Fitch Ratings - São Paulo - 08 Nov 2022: Fitch Ratings has affirmed the Province of Chubut's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'CC'. Chubut's standalone credit profile (SCP) is assessed at 'cc'. In addition, Fitch has affirmed Chubut's senior secured step-up notes of USD650 million due in 2030 (Bocade) at 'CC'.

Fitch relied on its rating definitions to position Chubut's ratings and standalone credit profile. The rating action reflects Chubut's pressured debt service cover ratio over the next 12-24 months, reflecting high debt service requirements despite adequate operating balances, and exposure to foreign exchange risk.

KEY RATING DRIVERS

Risk Profile: 'Vulnerable'

The 'Vulnerable' assessment reflects Fitch's view that there is a very high risk of the issuer's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon (2022-2024), due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt-service requirements.

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Revenue Robustness: 'Weaker'

The 'Weak' revenue robustness assessment considers the country's complex and imbalanced fiscal framework for LRGs with no equalization funding. Weak and volatile national economic performance is also factored into Fitch's revenue robustness KRF assessment.

Chubut's revenue structure highlights a moderate fiscal autonomy and reliance on cyclical oil & gas royalties and transfers from a 'CCC-' sovereign. Transfer from the national government amounted to 40% of operating revenues in 2021, while royalties amounted to 26.5%. Own-source tax collection represented 22.4% of operating revenues. The more balanced revenue composition relative to Argentine peers is undermined by the dependency towards commodity sales, which is highly cyclical.

Revenue Adjustability: 'Weaker'

For Argentine LRGs, Fitch considers that local revenue adjustability is low, and challenged by the country's large and distortive tax burden. The weak macroeconomic environment also limits LRGs' ability to increase tax rates and expand tax bases to boost their local operating revenues.

The Province of Chubut's ability to generate additional revenue in response to possible economic downturns is limited by its high dependency on royalties. Legislation on royalties is defined at the national level and provinces' influence is limited. Chubut's affordability of revenue increases is also constrained by the moderate income of residents by international standards and social-political sensitivity to tax increases; income metrics in Chubut are distorted by a high economic dependence on non-renewable resources.

Expenditure Sustainability: 'Weaker'

Argentine provinces have high expenditure responsibilities, including healthcare, education, water, transportation and other services. The country's fiscal regime is structurally imbalanced regarding revenue-expenditure decentralization. This is further exacerbated by the nation's recent standby agreement with the IMF in 2022. Hence,

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Chubut's operating balance has been quite volatile across the years, reflecting its dependency towards oil royalties. Despite the recent improvement of operating margins, pressure to adjust payroll to past inflation is likely to lead to real growth of opex in the coming years.

Expenditure Adjustability: 'Weaker'

For argentine subnationals, infrastructure needs and expenditure responsibilities are deemed as high, with leeway or flexibility to cut expenses viewed as low. National capital expenditure (capex) is low and insufficient translating capex burdens to LRGs. Province of Chubut capex to total expenditure ratio average at 12.2% for 2017-2021.

Staff cost in 2020 corresponded to 60.4% of total expenditures, translating into a high expenditure rigidity for the Province of Chubut. This further limits the ability of the province to perform expenditure cuts.

Liabilities & Liquidity Robustness: 'Weaker'

There is a weak national framework for debt and liquidity management and an underdeveloped local financial market, which led Argentine LRGs to issue debt in foreign currency, causing this structural reliance on external markets for financing.

At YE 2021, the Province of Chubut direct debt totaled ARS 101 billion. Approximately 68% of debt is denominated in foreign currency. Exposure to FX risk and capital controls are a significant fragility of Argentine LRGs. The province also currently has approximately ARS 3.5 billion of short-term debt.

There is significant maturity concentration in the 2023-2028 period. The Distressed Debt Exchange (DDE) of Chubut's senior secured bonds created some fiscal space for 2021-2022, but from the next year onwards, capital repayments will be more sizable. These bonds count with pledged royalty revenues as collateral.

Liabilities & Liquidity Flexibility: 'Weaker'

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the imposition of exchange regulations could ultimately affect LRGs' ability to fulfill their financial obligations.

Debt Sustainability: 'a category'

Considering the current 'CCC-' sovereign rating and curtailment of the external market amid a volatile macroeconomic and regulatory context, Fitch is only projecting a rating case for YE 2024. Fitch analyzed debt sustainability metrics to evaluate Chubut specific debt repayment capacity and its liquidity position in this short rating case horizon.

The Province of Chubut's 'a' debt sustainability score considers a 'aa' primary payback ratio of 6x for 2024 under Fitch's rating case. The assessment also considers the 'aaa' fiscal debt burden of 43.8% and an override from the 'b' actual debt service coverage ratio (ADSCR) of 0.5x in 2024. Fitch classifies Chubut as a type B LRG, as it covers debt service from cash flows on an annual basis.

DERIVATION SUMMARY

The Province of Chubut's 'cc' SCP reflects rating definitions that consider the province's very high level of credit risk, given its pressured debt service coverage ratio over the next 12-24 months. Chubut's risk profile is assessed as 'Vulnerable', while its debt sustainability is assessed 'a'. Chubut's SCP also factors in a comparison with national and international peers. The province's IDRs are not affected by any other factors.

Debt ratings

The Province of Chubut's senior secured step-up notes of USD650 million due in 2030 (Bocade) are positioned at 'CC', the same level as the province's IDRs. The bonds benefit from pledged revenues of oil royalties. Nonetheless, given the challenging macroeconomic context and recent history of a DDE, credit enhancements are not reflected in the bond rating.

KEY ASSUMPTIONS

Risk Profile: 'Vulnerable'

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Expenditure Sustainability: 'Weaker'

Expenditure Adjustability: 'Weaker'

Liabilities and Liquidity Robustness: 'Weaker'

Liabilities and Liquidity Flexibility: 'Weaker'

Debt sustainability: 'a'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Sovereign Cap: 'CCC- (aligned to Country Ceiling)'

Sovereign Floor: 'N/A'

Quantitative assumptions - Issuer Specific

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2017-2021 figures and 2022-2024 projected ratios. The key assumptions for the scenario include:

--Operating revenue average growth of 77.6% for 2022-2024;

--Operating expenditure average growth of 86.8% for 2022-2024;

--Average net capital balance of around minus ARS46.6 billion during 2022-2024 dependent on financing from multilateral official creditors, national agencies or foreign commercial banks;

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--Consumer price inflation (annual average % change) of 71.6% for 2022, 95% for 2023, 77% for 2024.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained operating balances that strengthen debt metrics with actual debt service coverage ratio (ADSCR) above 1x for the first two years of the projected horizon under Fitch's rating case.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Signs of deeper liquidity stress that could compromise debt repayment capacity in the coming years, including evidence of increased refinancing risk or transfer and convertibility risk in its local and foreign currency debt.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

ISSUER PROFILE

Chubut is located in the Patagonian region of Argentina, where socioeconomic indicators tend to be better than the national average. Chubut's economy is based on services. The province is in a strategic geographic position and is the country's largest oil-producing province.

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REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

ESG-Social: Fitch has revised the Province of Chubut's ESG Relevance Score for Labor Relations & Practices to '3' from '4' as Chubut has remained current on its payroll bill in the last year and is expected to continue to fund salaries moving forward. This means this ESG issue is credit-neutral or has only a minimal credit impact on the rating, either due to its nature or the way in which it is being managed by the entity.

ESG - Environmental: Chubut has an ESG Relevance Score of '4' for Biodiversity and Natural Resource Management due to the province's significant economic and financial exposure to the volatile hydrocarbon sector, which negatively impacts the credit profile and is relevant to the rating in conjunction with other factors.

ESG - Governance: The province has an ESG Relevance Score of '4' for Rule of Law, Institutional and Regulatory Quality and Control of Corruption reflecting the negative impact of the weak regulatory framework and national policies of the sovereign on the province's governance in conjunction with other factors.

ESG - Governance: The province has an ESG Relevance Score of '4' for Creditor Rights. Chubut concluded its DDE in December 2020 and has complied with the negotiated terms throughout 2021 and 2022. However, the DDE continues to weigh on its credit profile and there is a very high risk in the issuer's ability to cover debt service, therefore, the Creditor Rights issue is relevant to the rating in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Chubut, Province of	LT IDR	CC	Affirmed	CC
	LC LT IDR	CC	Affirmed	CC
senior secured	LT	CC	Affirmed	CC

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[International Local and Regional Governments Rating Criteria \(pub. 03 Sep 2021\)](#)
(including rating assumption sensitivity)

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