

CREDIT OPINION

11 October 2022

Update



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RATINGS

Chubut, Province of

| | |
|------------------|-----------------------------|
| Domicile | Argentina |
| Long Term Rating | Ca |
| Type | LT Issuer Rating - Fgn Curr |
| Outlook | Stable |

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Chubut, Province of

Update following affirmation of Ca ratings and stable outlook

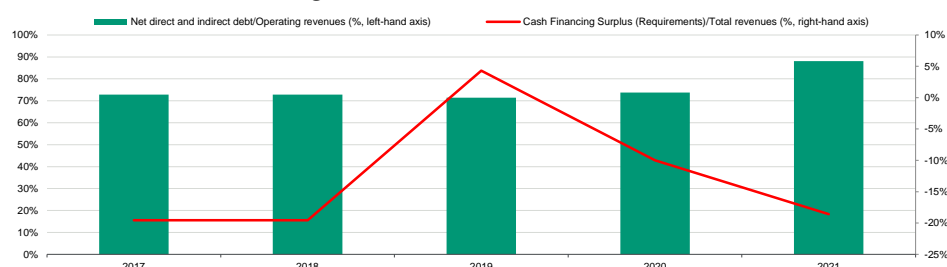
Summary

The credit profile of the [Province of Chubut](#) (Ca stable) reflects its history of weak operating and financial results, tight liquidity, inflexible expenditure and high leverage. Following the debt exchange completed in late 2020, which extended upcoming maturities and reduced interest payments, Chubut benefited from a more comfortable debt service profile until 2023. Nevertheless, the risk of future debt restructuring remains high because of Chubut's persistent idiosyncratic risks, the restricted market access and a difficult operating environment.

Like all Argentine regional and local governments (RLGs), the province has significant macroeconomic and financial links with the [Government of Argentina](#) (Ca stable). The credit profiles of the RLGs incorporate our expectation of a difficult economic environment, marked by a recent severe recession, constrained market access, foreign-currency mismatch, higher financing costs and persistently high inflation.

Exhibit 1

Chubut has increased its leverage amid strained financial results



Sources: Moody's Investors Service and Province of Chubut's financial statements

Credit strengths

- » US dollar-linked revenue stream from hydrocarbon royalties, driven by the fact that Chubut is the largest oil-producing province in Argentina

Credit challenges

- » Track record of weak operating and financial results
- » High and growing debt
- » Difficult operating environment

Rating outlook

The stable rating outlook captures our expectation that the economic and financial strain faced by the province will not differ significantly over the next 12-18 months and therefore lead to fiscal strain consistent with recent results. At the same time, the stable outlook incorporates our expectation that bondholders will not face losses exceeding that captured in the Ca rating (35%-65%).

Factors that could lead to an upgrade

Given the strong macroeconomic and financial linkages between Argentine Sub-sovereigns and the Argentine government, which currently has a stable outlook, we do not expect upward pressure for the Province of Chubut. Nevertheless, we would consider an upgrade if the sovereign rating is upgraded, financing conditions are stabilize and the expected losses to private creditors in future debt restructurings are less than currently forecast.

Factors that could lead to a downgrade

A downgrade in Argentina's bond ratings or further systemic deterioration, or both, could exert downward pressure on the ratings. Increased idiosyncratic risks could also translate into a downgrade. We would also downgrade the ratings if a debt restructuring results in losses greater than those reflected in the current ratings.

Key indicators

Exhibit 2

Chubut, Province of Year ending December 31

| | 2017 | 2018 | 2019 | 2020 | 2021 |
|--|-------|-------|------|-------|-------|
| Net Direct and Indirect Debt / Operating Revenue (%) | 72.8 | 72.8 | 71.4 | 73.8 | 88.1 |
| Cash Financing Surplus (Deficit) / Total Revenue (%) | -19.6 | -19.6 | 4.3 | -10.0 | -18.6 |
| Interest Expense / Operating Revenue (%) | 5.7 | 5.7 | 6.7 | 6.1 | 4.3 |
| Gross Operating Balance / Operating Revenue (%) | -6.9 | -6.9 | 12.9 | -2.7 | -11.7 |
| Capital Spending / Total Expenditures (%) | 13.8 | 13.8 | 11.7 | 7.8 | 6.8 |
| Intergovernmental Transfers / Operating Revenue (%) | 36.8 | 36.8 | 31.4 | 29.9 | 35.7 |

Sources: Moody's Investors Service and Province of Chubut's financial statements

Detailed credit considerations

The credit profile of the Province of Chubut, as expressed in its Ca stable ratings, reflects a Baseline Credit Assessment (BCA) of Ca and a low likelihood of extraordinary support from the Argentine government in the event of acute liquidity stress.

Baseline Credit Assessment

US dollar-linked revenue stream from hydrocarbon royalties because of Chubut's status as the largest oil-producing province in Argentina, counterbalanced by low oil prices

As Exhibit 3 shows, Chubut is the largest crude oil-producing province in Argentina and it derives a large portion of its revenue from hydrocarbon royalties. The hydrocarbons law stipulates that oil and gas concessionaires must pay royalties to the provinces where they operate. The percentage of the hydrocarbon production payable by each concessionaire to each province as hydrocarbon royalties is set forth in each applicable concession. The amount of hydrocarbon royalties payable under Chubut's concessions was fixed at 12% of commercialized oil and gas production, valued at the wellhead price, whose percentage may be reduced to 5% taking into account the productivity, conditions and location of the wells. The wellhead price is defined as the final sale price realized by the concessionaire less certain expenses relating to transportation, treatment, shrinkage and compression (gas only). Royalties are paid in Argentine pesos at the selling exchange rate on the business day immediately before the date on which the payment is due.

The royalties revenue stream, which was equivalent to 22% of Chubut's total revenue as of the second quarter of 2022, provides a natural hedge to the province's US dollar-denominated debt, which is a substantial credit consideration in the current environment of

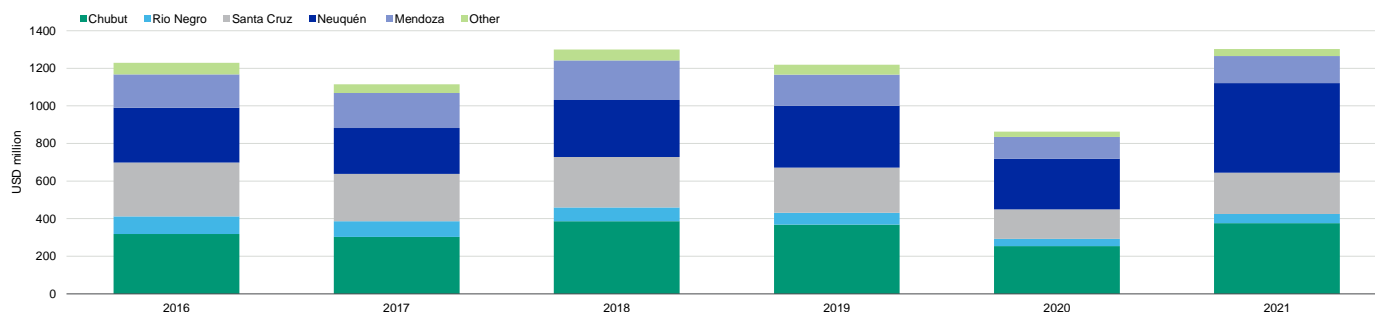
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significant currency depreciation. Additionally, it leads to a higher level of own-source revenue than that of other provinces, which was equivalent to 29% of operating revenue (excluding social security contributions) as of 2021.

Exhibit 3

Chubut is the largest crude oil-producing province in Argentina

Annual crude oil royalties (\$ millions)



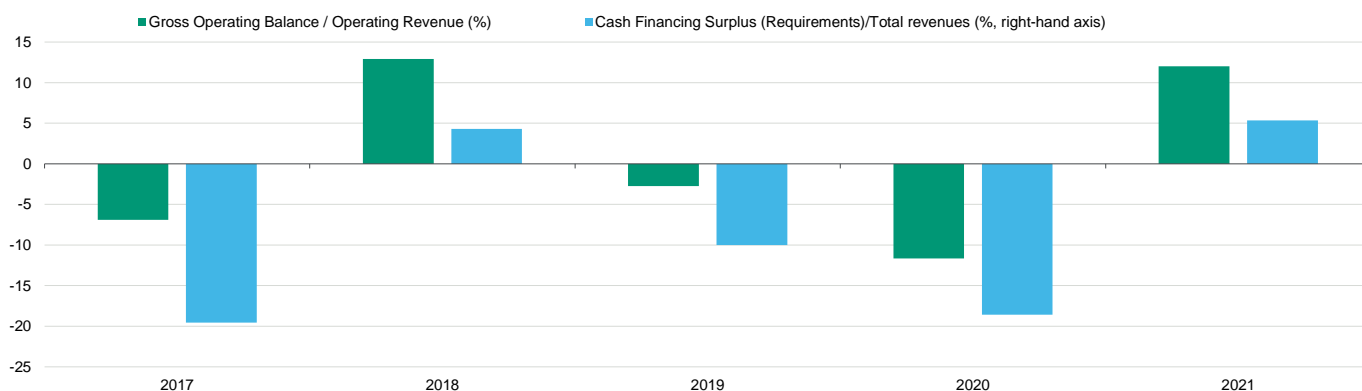
Source: Argentina's Energy Secretariat

Track record of weak operating and financial results

As Exhibit 4 shows, the Province of Chubut's financial performance has been weak mainly because of a very sharp rise in current expenses and a decline in royalties. In 2020, the province posted a gross operating deficit of 11.7% and a cash financing deficit of 18.6%. The deterioration in the operating balance was driven by the increase in current expenses and by the lower dynamism of current revenue, which, compared with a year earlier, grew by 34% and 23%, respectively. The increase in current expenses was mainly driven by the increase in personnel expenses, which represented 61% of operating revenue in 2020. In 2021, the province's operating and financial performance improved relative to historical levels, mainly because of revenue growth above inflation levels and constrained operating and capital spending. In 2021, Chubut reported a gross operating surplus of 12% and a cash financing surplus of 5%. Despite the improvement in 2021, we expect the province to report metrics more in line with historical levels in 2022 driven by pent up spending needs that were delayed in 2020 because of the pandemic.

Exhibit 4

Chubut has historically reported weak operating and financial metrics



Sources: Moody's Investors Service and Province of Chubut's financial statements

High and growing leverage

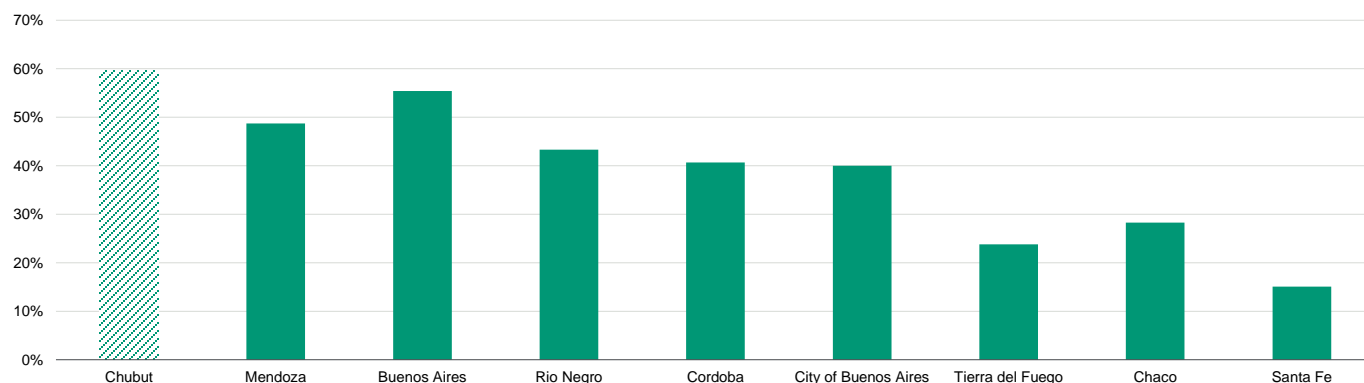
Chubut increased its exposure to foreign-currency debt through issuances of international notes in 2016. As a result of the deterioration in the province's fiscal results, coupled with the severe local-currency depreciation in 2018-19, Chubut increased its debt levels significantly around 60% of operating revenue in 2021 from 18% in 2014. While the devaluation risk is partially mitigated by the

US dollar-linked revenue stream (royalties), the province's debt level is one of the highest among its peers that we rate, as Exhibit 5 shows. The province's high debt levels limit its credit profile.

Exhibit 5

Chubut presents higher leverage than rated peers

Debt to operating revenue (%) as of December 2021



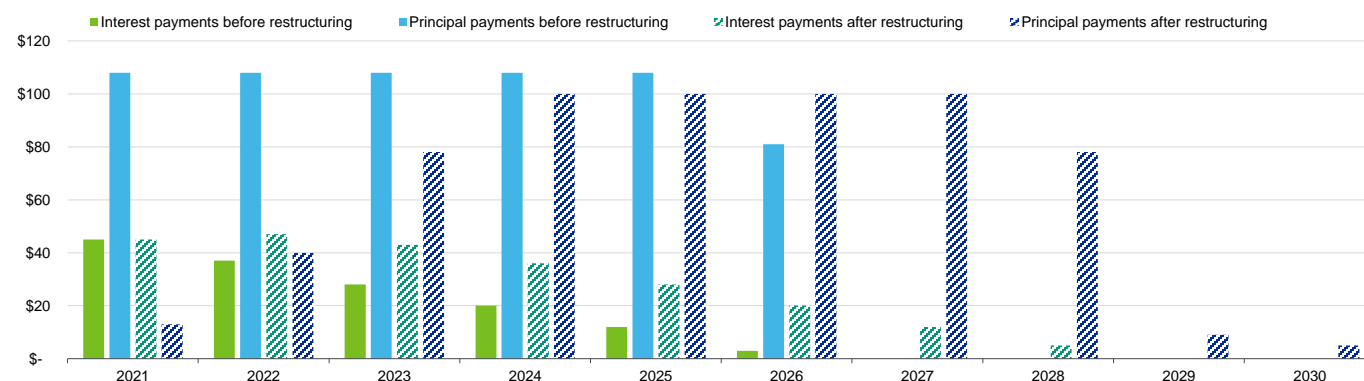
Source: Argentina's economy ministry

In December 2020, Chubut announced that it had reached the necessary consent to modify the terms of its notes due 2026. The agreement reached with bondholders entailed a maturity extension to 2030 and a change in the coupon rate from a fixed 7.75% to a step-up schedule of 7.24% until October 2021 and then to 7.75% thereafter. Despite the restructuring of the \$650 million notes, the risk of future debt restructuring remains high because of Chubut's persistent idiosyncratic risks, the restricted market access and a difficult operating environment. While the restructuring significantly eased the scheduled debt repayment for 2021 and 2022, Chubut will face debt repayments nearly equal to those faced before the restructuring by 2023, with repayments now exceeding pre-restructuring payments in 2024.

Exhibit 6

Following the restructuring, Chubut still faces significant principal payments starting 2023

Debt service before and after restructuring (\$ million)



Source: Argentina's economy ministry

Difficult operating environment

We expect Argentine RLGs to continue enduring elevated systemic risk. Argentina presents high economic volatility, virtual lockout from international market-based sources of financing and significant reliance on the central bank to fund the government's large fiscal deficit, the latter of which risks increasing short term macroeconomic imbalances. Despite the gradual tightening of capital controls, pressure will likely persist on the country's currency and foreign exchange reserves.

Earlier this year Argentina signed a new Extended Fund Facility (EFF) with the IMF. On 19 September the IMF announced it had reached a staff level agreement on the second review of the EFF. However, full compliance with the EFF targets will require continuing with fiscal consolidation in 2023, a presidential election year. Lack of willingness and ability to fully comply with the targets set in the IMF program will prevent Argentina from restoring its access to capital markets.

We expect that RLGs exposure to macroeconomic imbalances, such as growth and exchange rate volatility, will undermine their financial results. Pressures on the exchange rate will erode RLGs operating margins as interest payments on market-based debt are mostly denominated in foreign currency. Moreover, loss of purchasing power, heightened poverty and unemployment will raise social stress and RLGs will have competing policy priorities.

At the same time, we expect the tight conditions in local and international markets to increase provinces' reliance on financing from the sovereign and increase bondholders' exposure to refinancing risk. In addition to high interest rates in local-currency borrowing and the lack of local market liquidity, the increase in the perceived riskiness of Argentine assets will limit the option of accessing funds via international markets. We view that access to the capital markets will not return in time to meet RLGs' principal payments on foreign currency bonds, which will rise in 2023 as a result of the latest debt restructurings.

Extraordinary support assumptions

We assess that there is a low probability of the Province of Chubut receiving extraordinary support from the national government, reflecting the lack of a history of timely intervention by the national government.

ESG considerations

Chubut, Province of's ESG Credit Impact Score is Highly Negative CIS-4

Exhibit 7

ESG Credit Impact Score

CIS-4

Highly Negative



For an issuer scored CIS-4 (Highly Negative), its ESG attributes are overall considered as having a discernible negative impact on the current rating. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-3.

Source: Moody's Investors Service

The Province of Chubut ESG Credit Impact Score is highly negative (**CIS-4**) reflecting its highly negative exposure to social and environmental risks and weak governance profile.

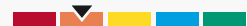
Exhibit 8

ESG Issuer Profile Scores

ENVIRONMENTAL

E-4

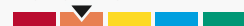
Highly Negative



SOCIAL

S-4

Highly Negative



GOVERNANCE

G-4

Highly Negative



Source: Moody's Investors Service

Environmental

We assess Chubut's exposure to environmental risks as highly negative (**E-4** issuer profile score), reflecting the risk that the loss of natural capital, physical climate risks and water stress pose to this province. Environmental risks would deeply impact relevant industries for Chubut's economic output such as oil and gas and mining. We also acknowledge that carbon transition risks are low because there is no significant pressure for decarbonization in the near term.

Social

Our overall assessment of social risk exposure is highly negative (**S-4** issuer profile score), reflecting high levels of exposure to labor and income and access to basic services related risks with moderate demographic, housing and health and safety pressures. Argentina has history of low job creation and macroeconomic instability that has increased domestic poverty but the country benefits from comparatively strong educational outcomes.

Governance

Chubut's highly negative governance IPS (**G-4** issuer profile) reflects the province's aggressive approach regarding debt and investment management because there has been acceptance of debt structures that pose significant risks. The province has exhibited exposure to foreign currency debt and a debt maturity profile concentrated in the short term. Chubut also presents weak transparency and disclosure practices as information is delivered with delays and with less level of detail. Balancing those risks is the province's overall stable institutional framework, with a relatively defined revenue profile supported by a federal tax sharing regime established by law.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

In the case of the Province of Chubut, the BCA matrix generates an estimated BCA of ca, which is in line with the BCA of ca assigned by the Rating Committee. The matrix-generated BCA of ca reflects (1) an Idiosyncratic Risk score of 6 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a Systemic Risk score of Ca, as reflected in the sovereign bond rating.

For details about our rating approach, please refer to the [Regional and Local Governments](#) rating methodology, published on January 16, 2018.

Exhibit 9

Chubut, Province of

[Regional and Local Governments](#)

| Baseline Credit Assessment (as of 2021) | Score | Value | Sub-factor Weighting | Sub-factor Total | Factor Weighting | Total |
|---|-------|--------|----------------------|------------------|------------------|----------------|
| Scorecard | | | | | | |
| Factor 1: Economic Fundamentals | | | | | | |
| Economic strength | 1 | 142.90 | 70% | 3.40 | 20% | 0.68 |
| Economic volatility | 9 | | 30% | | | |
| Factor 2: Institutional Framework | | | | | | |
| Legislative background | 5 | | 50% | 5 | 20% | 1.00 |
| Financial flexibility | 5 | | 50% | | | |
| Factor 3: Financial Performance and Debt Profile | | | | | | |
| Gross operating balance / operating revenues (%) | 9 | -5.60 | 12.50% | 5.75 | 30% | 1.73 |
| Interest payments / operating revenues (%) | 7 | 5.17 | 12.50% | | | |
| Liquidity | 9 | | 25% | | | |
| Net direct and indirect debt / operating revenues (%) | 5 | 88.10 | 25% | | | |
| Short-term direct debt / total direct debt (%) | 1 | 6.47 | 25% | | | |
| Factor 4: Governance and Management | | | | | | |
| Risk controls and financial management | 5 | | | 9 | 30% | 2.70 |
| Investment and debt management | 9 | | | | | |
| Transparency and disclosure | 9 | | | | | |
| Idiosyncratic Risk Assessment | | | | | | 6.11(6) |
| Systemic Risk Assessment | | | | | | Ca |
| Suggested BCA | | | | | | ca |

[1] Local GDP per capita as a % of national GDP per capita

[2] Gross operating balance / operating revenue

[3] Interest payments / operating revenue

[4] Net direct and indirect debt / operating revenue

[5] Short-term direct debt / total direct debt

Source: Moody's Investors Service; Fiscal 2021

Ratings

Exhibit 10

| Category | Moody's Rating |
|----------------------------|----------------|
| CHUBUT, PROVINCE OF | |
| Outlook | Stable |
| Baseline Credit Assessment | ca |
| Issuer Rating | Ca |
| Senior Secured | Ca |

Source: Moody's Investors Service

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