Santiago Resico
Strategist
sresico@tpcgco.com
+54 11 4898 6615

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Provinces Strategy Flash

TdF is preparing a restructuring offer for the FUEGO27

On Friday, it was revealed the province of Tierra del Fuego is expected to announce a swap for its 2027 global bond in the coming week.

On Friday, it was revealed the province of Tierra del Fuego is expected to announce a swap for its 2027 global bond in the coming week. The decision comes on the back of the BCRA regulation issued in 1H23, which granted the provinces the right to purchase USD from the CenBank to convert only 40% of their maturities, forcing them to either purchase the remaining USD in the financial markets, at nearly double the FX rate, or to restructure. It seems TdF has chosen to walk the second path, even if officials suggest the administration has enough liquidity to pay its maturities, being the access to the USD the issue. In this context, the province wants to swap its current 2027 bond for a longer maturity, particularly, it wants to extend the average life by two years, with the goal of not paying next year's amortizations. In this context, the offer for the swap would extend for 20 days, with the province rumored to offer a consent fee, if the swap is accepted in the first 10 days. In addition, the province needs 75% acceptance from its bondholders to be able to go ahead with the restructuring.

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The TdF bond was one of the only provincial securities that was not restructured during the 2020-2021 period, as the province failed to get approval from the bondholders, which means the FUEGO27 is breaching BCRA regulation. The structure of the bond includes a trust in Argentina, where royalties are directly deposited by producers in ARS. Then, the Trust tries to purchase USD and send them to the international trust, which is then used to store the monies to comply with the quarterly payments. So, the BCRA could prevent the Argentine leg of the trust from purchasing USD at the official rate. However, in that scenario, the local trust must use the ARS royalties to purchase USD at the BCS, which are then sent to the international leg of the trust. Furthermore, quarterly payments from the bond total roughly USD8mn, which is not an amount significant enough for the CenBank to cause major issues to the province. In addition, since the issuance of the regulation, the province has been able to fund the international trust with USD without problem, being able to make one coupon and principal payment on July 23. Even if the BCRA didn't allow the province to purchase USD, and royalties were not enough to completely fund the international trust at the BCS, the current trust is funded with 2.4x the next quarterly payments, meaning that bondholders have guaranteed payments until April 24. This in turn means that bondholders could wait for the next BCRA administration to give authorization back to the province to purchase USD at the official rate.

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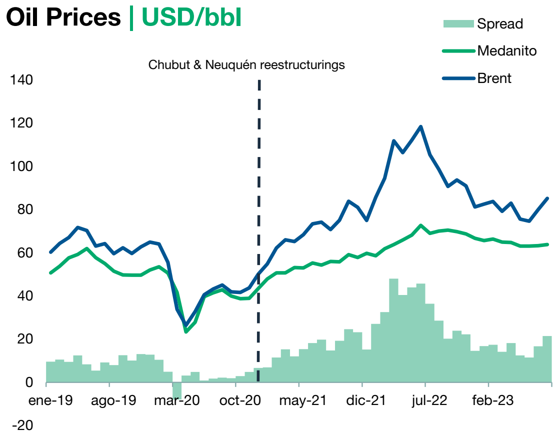
Therefore, we find the structure of the bond gives little incentive to the bondholders to restructure, especially given current Oil prices. In the COVID period, both Chubut and Neuquén managed to restructure their secured issuances, which have similar structures to the FUEGO27. However, during that period, oil prices caused a sub-collateralization of the trusts, which in turn threatened a breach of covenant which could in turn cause a default event. In that context, bondholders had more incentives to restructure said securities, as oil prices caused royalties to be insufficient to fill up the trust and secure payments. However, current oil prices do not showcase a similar dynamic, and the trust accounts should be fully funded, even with the current spread of the Brent crude to the Medanito, which stands at 21USD/bbl. In terms of an extended maturity date, the bond has an issue with the collateral, as the original oil wells used to secure the fund are already mature and will continue to age. This means production in said wells is poised to drop, which in turn means the value of the collateral will continue to drop in value as years pass. The dilution of the collateral value in turn also erodes the bond's secured structure, as the payments are guaranteed by less valuable and productive wells, which ensure less royalties to fund the trusts.

Figure 1: Oil prices do not justify a restructuring



Source: TPCG Research based on Economy Ministry

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All in all, we find the structure of the bond puts most of the bargaining power on the creditors' side, which means that the province should not be able to force a restructuring, but could offer a sweet enough deal that gets bondholders on board. We find that, with the current structure of the bond, even if the BCRA does stop selling USD to the province, the local trust should start transferring USD to the international leg via BCS purchasing, which means bondholders will continue to receive their payments, even if this means a significant amount of fiscal pain for the province, giving it significant incentives to regain access to the MULC as soon as possible. In addition, Oil prices currently are such that a sub-collateralization of the trust does not seem likely in the short run. Furthermore, the international trust has enough funding to stay current until April 23, which means the bondholders could also wait until the next administration is in office to see how the situation with the BCRA develops. Finally, any extension in maturity dates will only result in a depreciation of the collateral, as the used oil wells will continue to age, yielding fewer royalties to fund the trust. With this in mind, it is difficult to envisage a restructuring without very favorable conditions for the bondholders, as the province does not seem to have as valid a reason as Chubut and Neuquén did back during COVID to restructure, as the possibility of a breach of covenant or a non-payment event are not in sight. In this context, we do not envisage the province having many instruments to power a renegotiation through on its own. Most of the bargaining power is on the creditors' side. This means the province must get the creditors on board. This in turn should be consistent with mostly favorable conditions for the latter, if the deal is poised to come to a favorable conclusion.

TPCG Analysts & Staff

Research

Juan Manuel Pazos	**Chief Economist**	**jmpazos@tpcgco.com**	**+54 11 4898-6606**
Paula La Greca	Corporate Research Analyst	plagreca@tpcgco.com	+54 11 4898-6638
Federico Martin	Strategist	famartin@tpcgco.com	+54 11 4898-6633
Santiago Resico	Strategist	sresico@tpcgco.com	+54 11 4898-6615

Sales & Trading

Juan Manuel Truppia	**Head of Sales & Trading**	**jmtruppia@tpcgco.com**	**+54 11 4898-6659**

Institutional Sales

Lucia Rodriguez Pardina	S&T Director	lrodriguezpardina@tpcgco.com	+54 11 4898-6614
Agustina Guadalupe	Sales	aguadalupe@tpcgco.com	+54 11 4898-6682
Maria Pilar Hurtado	Sales	mhurtado@tpcgco.com	+54 11 4898-6616
Juan Ignacio Vergara	Sales	jivergara@tpcgco.com	+54 11 4898-1936
Santiago Baibiene	Sales	sbaibiene@tpcgco.com	+54 11 4898-6648
Pedro Nollmann	Sales	pnollmann@tpcgco.com	+54 11 4898-6617
María Ruiz de Castroviejo Salas	Sales	mruizdecastroviejo@tpcgco.com	+54 11 4898-6643
Victoria Faynbloch	Desk Analyst	vfaynbloch@tpcgco.com	+54 11 4898-6635

Trading

Felipe Freire	Trader	ffreire@tpcgco.com	+54 11 4898-1921
Homero Fernandez Bianco	Trader	hfbianco@tpcgco.com	+54 11 4898-6667
Andres Robertson	Trader	arobertson@tpcgco.com	+54 11 4898-6693

Corporate Finance

José Ramos	**Head of Corporate Finance**	**jramos@tpcgco.com**	**+54 11 4898-6645**

Corporate Sales

Camila Martinez	Corporate Sales Director	cmartinez@tpcgco.com	+54 11 4898-6621
Fernando Depierre	Corporate Sales	fdepierre@tpcgco.com	+54 11 4898-6636
Sol Silvestrini	Corporate Sales	ssilvestrini@tpcgco.com	+54 11 4898-6641
Nicolas Iglesias	Corporate Sales	niglesias@tpcgco.com	+54 11 4898-6612

Capital markets

Nicolás Alperín	DCM	nalperin@tpcgco.com	+54 11 4898-6604

Wealth Management

Josefina Guerrero	Private Wealth Management Specialist	jguerrero@tpcgco.com	+54 9 11 6556 2401

Asset Management

Ileana Aiello	**Portfolio Manager**	**iaiello@tpcgco.com**	**+54 11 4898-6611**
Claudio Achaerandio	**Portfolio Manager**	**cachaerandio@tpcgco.com**	**+54 11 4898-6618**

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