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Corporates – Argentina

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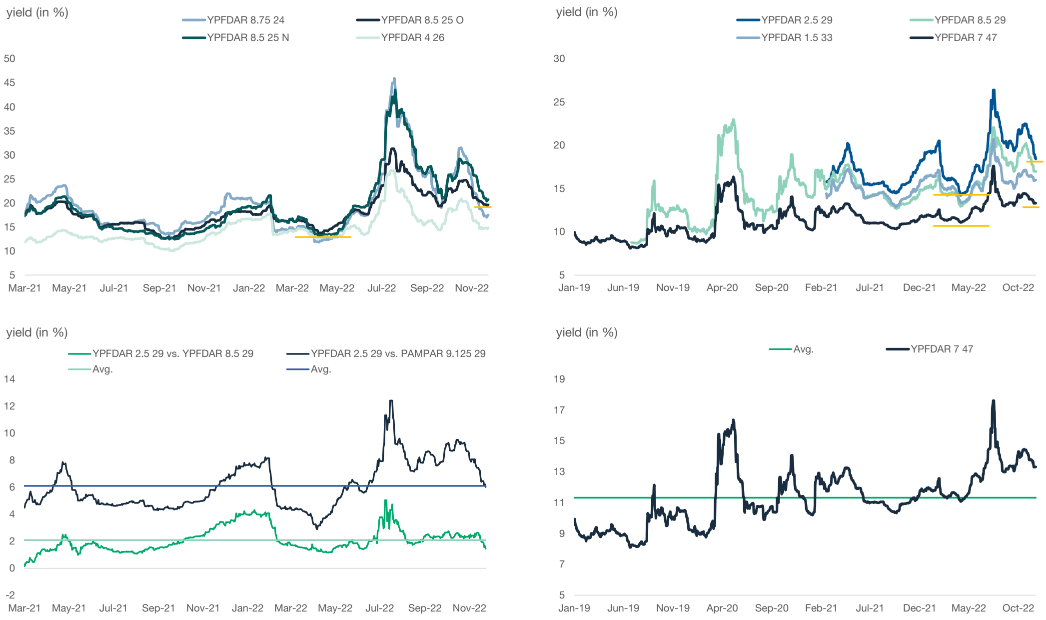
YPF: on the sunny side of the street

YPF reported one of the highest EBITDA for the second consecutive time at USD1.5Bn in the past 5 years and the lowest net leverage at 1.2x in 7 years. In this way, the company has rebuilt its cash flow and driven its net leverage to adequate levels to be in good shape to face 2023-2024, which will be the years of working on capital-intensive projects. We believe it currently is a buying opportunity for the YPFDAR 25s Old to keep it to maturity (Indicative ASK PX: USD79, yield:18.8%) . We do not rule out YPF announcing an exchange offer by that time. However, we are under the opinion that the company will have the cash to pay those who do not participate in it, as it will be the year that YPF will reap the reward of the projects. YPF should have a new cash flow stream by that time, mainly from crude oil exports and domestic natural gas sales.

Moreover, the attractiveness of the bond will increase as the maturity date approaches, as it happened with the 24s and 25s, when they started paying amortizations. Although the bitter memory of the 2021s exchange offer may appear due to the 2025s bond having the highest amount outstanding among YPF and Argentina corporate bonds, we believe we will stand in a different scenario than in January 2021, when YPF was recovering from the pandemic. What is also key to our view is the Fed easing interest rates as of 2H24-2025. By that time YPF may consider tapping the international markets to finance the start in production in new fields with the pronounced drop in conventional fields production.

We believe that it is currently an attractive entry point for the long part of the YPF curve for those considering a more dovish Fed. We currently prefer the 29s New and 47s. In our view, the 29s New price differential with the 29 Old, which is currently at USD4, will increase as the first one will become more attractive for (i) offering +0.5pp higher coupon as of June 30th, 2023, when the coupon step-up to 9% from 2.5% and (ii) paying semi-annual amortizations of 14.3% as of 2026. Due to this, the price differential with PAMPAR 29s should also tighten as Pampa Energia's bond is longer in duration for being bullet. Then, those looking for increasing duration, we prefer the 47s bonds over the 33s as they are USD2.5 cheaper. The 33s will offer the same coupon of the 47s of 7% as of 2023.

Figure 1: We prefer 25s Old, 29s New and 47s



Source: TPCG Research based on the companies' reports

Our recommendations are supported from the fundamental side. In the following paragraphs, we analyze the YPF's 3Q22 results while considering those of its peers to help us determine our view of its performance in the upcoming years.

In 3Q22, YPF's revenues were up by +43% yoy / +6.7% qoq to USD5,179mn, of which 38% were domestic diesel sales (USD1,950mn), 17% domestic gasoline sales (USD878mn) and 12% exports (USD604mn). Except for natural gas sales to third parties, the rest showed yoy increases. Within the domestic market, diesel sales were up by +60% yoy, and gasoline sales by +22% yoy. Then, exports grew by +51% yoy, mainly driven by jet fuel (+270% yoy to USD120mn). Our analysis of qoq performance shows that exports were the only ones that decreased, posting a 12% qoq drop, explained by lower grain and flours sales (-28% qoq) as between July-September, the soybean harvest season was already over. YPF Luz performance was solid, with revenues up by +8.5% yoy / +10% qoq to USD131mn.

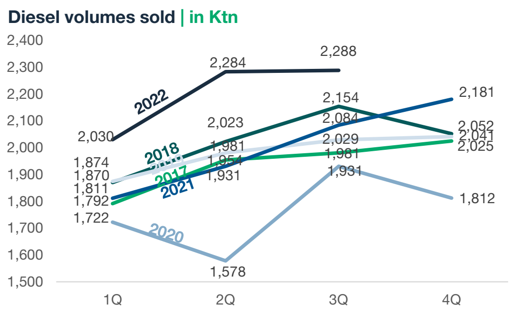
Among the different products, diesel has been the main growth driver so far this year, reaching a record high in volumes sold of 2,288Km3 on the back of higher demand from the power generation and agribusiness sectors. Due to the Russia-Ukraine war, this year was unusual as LNG prices were higher than diesel. Consequently, it led thermal power plants to shift the fuel mix towards more diesel. During this year's winter period, from May to September, power plants' natural gas consumption was 70%, down from 76% in 2021, with diesel oil consumption increasing by +64% yoy.

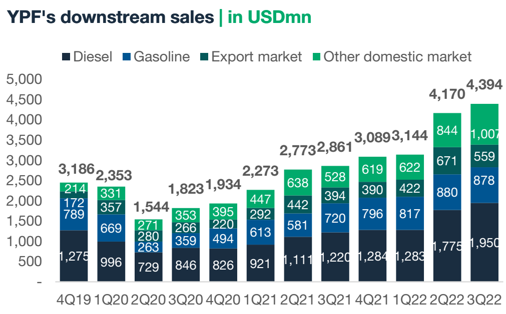
According to TGS, Pampa Energia, and YPF Luz management, 2023's fuels price will remain similar to this year. In terms of volumes sold, the 2Q and 3Q are the strongest in the year. Diesel demand in 4Q and 1Q mainly depends on the performance of corn, wheat, and soybean second harvest, as with the end of the winter, the residential demand for natural gas declines. Thus, there is more supply of natural gas for power generators. For instance, 33% of YPF's natural gas sales to third parties went to distributors in 3Q22 compared to 11% in 1Q22.

Given that Argentina is currently facing one of its more severe droughts and the seasonal decline in diesel consumption by power plants, we expect diesel volumes sold on a downtrend in 4Q22 and 1Q23. However, it should be compensated by gasoline sales and higher exports of jet fuel and petrochemicals. On the cost side, it will help to reduce diesel imports, which have increased by 75% qoq to 448Km3 and tend to be higher in 4Q.

Gasoline volumes sold have risen so far this year, partly explained by prices increasing below inflation. In 3Q22, the average gasoline price was down by 4.2% qoq to USD597/m3, standing 5% below FY18 average and 10% that of FY17. Volumes sold have ranged from 1,410Ktn in 1Q22 and 1,419Ktn in 3Q22, way above the FY21 average at 1,247Ktn, FY18 at 1,338Ktn, and FY19 at 1,319Ktn. Due to holidays, volumes sold should further increase in 4Q22 and 1Q23s and stand near 1,500Ktn. Then, we expect them to come down to 1,450Ktn.

Figure 2: Diesel and gasoline sales together grew by +7% qoq / +46% yoy

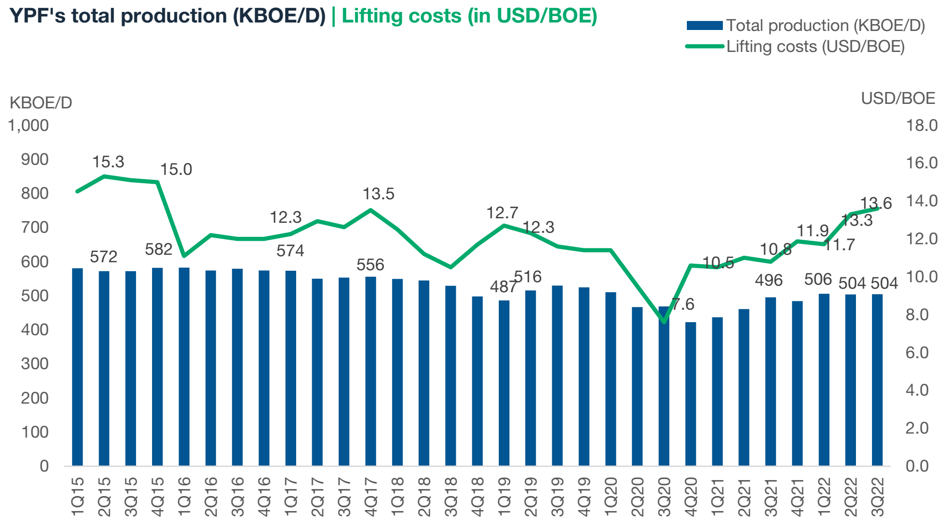




Source: TPCG Research based on the companies' reports

Cost pressures due to inflation are starting to get more visible; personnel and transportation costs doubled yoy while Fuel, gas, energy, and miscellaneous expenses grew by +59% yoy in 9M22, mainly imported raw materials for maintenance and Capex activity. Although lifting costs increased to their highest level in the past 5 years at USD13.6kboe, surpassing 4Q17 levels at USD13.5kboe, upstream revenues and EBITDA were +8.6% and 31% higher than 4Q17 at USD2,008mn and USD953mn, respectively. This is explained by YPF shifting production to shale from conventional which has lower lifting costs. In 3Q22, 50% of total production was unconventional while in 4Q17 it was 24%. Due to the natural decline of conventional mature fields, lifting costs rose to USD21.7/boe from USD17.6/boe in 1Q22. In contrast, lifting cost from unconventional fields were USD3.8/boe in 3Q22, still below 1Q22 of USD3.9/boe despite they increased +6% qoq from USD3.5/boe in 2Q22.

Figure 3: Mature fields lifting costs are dragging down the Upstream margins



Source: TPCG Research based on YPF reports

The sale of mature fields would make a difference to YPF. The company is reporting improvements in tertiary production. Given the results obtained at Manantiales Behr block, YPF would use similar techniques in other 3 fields: Chachahuen in Mendoza, El Trebol in Chubut and Los Perales in Santa Cruz. With this track record, YPF could sell the matured fields at higher prices.

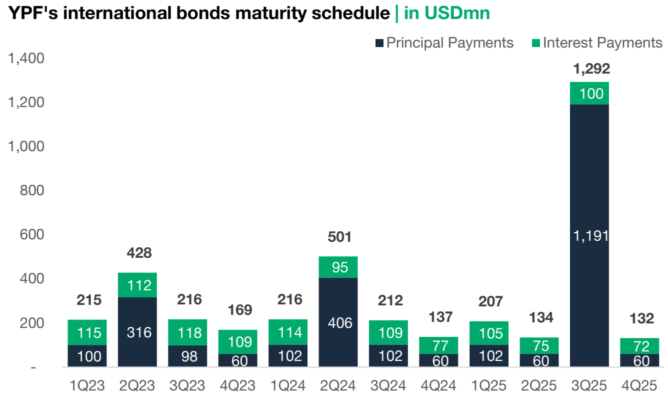
However, given that next year are the elections, the company will not make any move in this direction despite 2023 and 2024 being the years more demanding in Capex. Independently which political party wins in October 2023, YPF's top management has historically changed with the change in government. Therefore, 2024 will be a transitional year more focused on the advance of the Oldeval pipeline expansion and the OTE terminal expansion, which are expected to reach COD in 1Q25. In our view, YPF has incentives to complete them as scheduled to boost exports and, thus, stand in a more comfortable position to cancel the two bonds maturing in 2025. YPF will have to pay USD42.6mn of the last amortization of the 2025s New bond on March 23 and USD1,132mn of the 2025s Old on August 28. We believe that with the increase in exports and, thus, of royalties and taxes, politicians would support, or at least not interfere, with the sale of mature fields. For this reason, we see more probable that these fields' sales to be concrete in 2025.

In 2023 and 2024, we expect YPF cash flow to be tighter than the one seen in 2021 and 2022 due to higher Capex and debt services. Capex has been increasing gradually during the year. In 3Q22, the reported Capex went up +27% qoq to USD1,186mn accumulating USDUSD2.9bn in 9M22. We expect it to increase by +5-10 qoq in 4Q22E, leaving FY22E Capex at USD4.1bn, +55% above last year. We expect Capex to stand at USD4.5-USD4.8bn in FY23. We do not rule out reaching USD5bn in FY24, with major infrastructure projects, which are already ongoing as the Vaca Muerta Norte pipeline (USD250mn) and the Oldeval pipeline expansion (USD750mn), and others that would start in 2023: the Vaca Muerta Sur pipeline and terminal (USD1,500mn).

The OTE terminal expansion of USD300mn should start in 4Q22. The projects will demand USD850mn in 2023 and USD1,200mn in 2024 to end in USD600mn in 2025. Additionally, YPF will have to ramp up Capex in its shale fields to increase crude oil and natural gas production to more than compensate for the decline of the mature fields' production. From the oil side, we expect YPF shale production of 77kboed to double driven by the new exports to Chile through the Trasandino pipeline. In line with this, YPF will continue working on adjusting the processing process of the La Plata and the Lujan de Cuyo refineries. The most important project is to adequate the plants to process a higher share of Vaca Muerta crude oil, which is lighter than the Escalante from the Golfo San Jorge. The other project is the reduction of the sulfur content in gasoline. From the natural gas side, production should grow as a result of the new Plan Gas Ar. rounds, which will mainly supply the Nestor Kirchner pipeline.

Looking at YPF's indebtedness, the total debt amortizations will increase from USD696mn in FY22 to USD941mn in FY23 (+35% yoy) and USD967mn in FY24 (+3% yoy). It is mainly because the 26s start paying quarterly amortizations as of February 2023 and the CAF loan semiannual amortizations as of 3Q23. Interest payments also take off as the 26s, 29s and 33s coupons step-up in 2023. Consequently, YPF's global bond interest payments will increase from USD354mn in FY22 to USD454mn in FY23 and USD396mn in FY24.

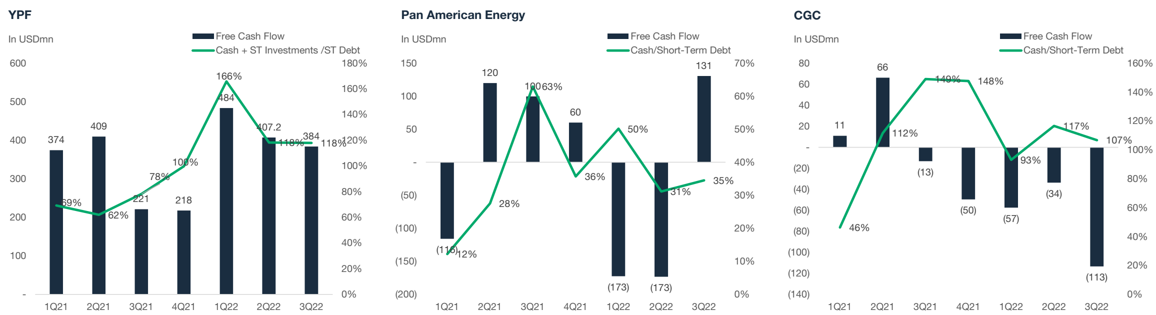
Figure 4: The 2Q shows the highest debt payments in the year. However, they coincide with the increase in cash inflows from exports of grains, flours, and oils and natural gas and diesel sales.



Source: TPCG Research based on the company's reports

With this in mind, YPF's FCF would slip near negative territory as of 2H23 after 16 positive consecutive quarters due to the substantial increase in Capex and debt payments. However, so far, what has been differentiating YPF from Pan American Energy and CGC is that it has been showing positive FCF since 3Q19, while it was mostly negative for PAE and CGC. Ultimately, we expect YPF to tap the local market or get financing from multilateral or bank loans.

Figure 5: YPF shows the strongest cash flow generation vs peers

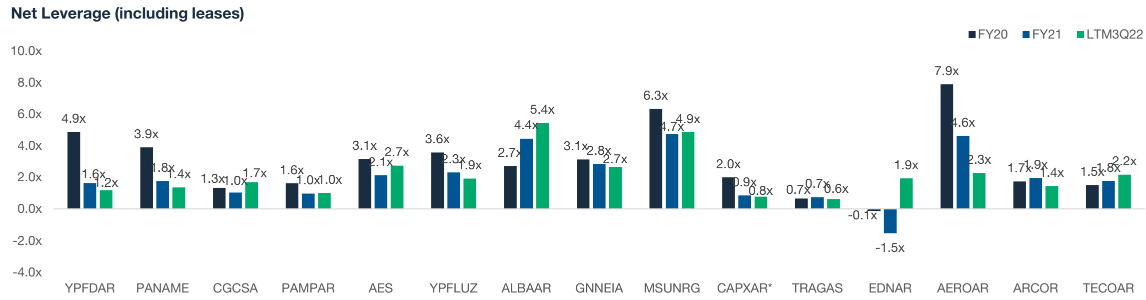


Source: TPCG Research based on the companies' reports

YPF will not be the only company increasing Capex in the following years, Pan American Energy and CGC also have new projects ongoing, as well as we expect them to participate too in the new rounds of the Plan Gas Ar, which will lead them to a deterioration of their FCF. Pan America Energy is working on the Fenix offshore project of USD700mn in the Austral Basin together with Total Energies and Wintershall Dea. The objective is to develop 3 offshore wells to produce a total of 10Mm3/d of natural gas to offset the decline of natural gas production in the Carina and Aries offshore fields. It is expected to reach COD between 4Q24 – 1Q25. The tubes connecting the Vega Pleyade platform with the new one have already been bought. Then, regarding CGC, we expect it to continue focusing on Sinopec's assets revamping to boost crude oil exports tanking advantage of the still high international price environment.

When analyzing Argentine liquidity and indebtedness levels, YPF ranks among the top performers, with cash covering short-term debt by 118% and a net leverage of 1.2x in LTM3Q22. It compares favorably vs. Pan American Energy ratios at 72% and 1.4x and CGC at 108% and 1.7x. Although YPF is the most indebted company with global bonds in Argentina, owing USD5,752mn, followed by Pampa Energia with USD1,314mn and Telecom with USD789mn, its net leverage has shown the most significant improvement among Argentine companies since the pandemic. It is mainly because the O&G sector has been the most dynamic. In contrast, the utilities sector struggled to maintain its margins due to the government granted tariff adjustments below inflation. It is mainly seen in AES Argentina Generacion, which net leverage was up to 2.7x in LTM3Q22 from 2.1x in FY21. Similarly, the decline of real wages negatively affected other sectors such as telecommunication, food and, retail in the past quarters. Telecom Argentina LTM3Q22 net leverage increased to 2.2x in LTM3Q22 from 1.8x in FY21.

Figure 6: YPF accounts for the 4th lowest net lvg among Argentine corporates, standing at 1.2x in LTM3Q22, following Pampa Energia with 1.0x.



Source: TPCG Research based on the company's reports * Capex as of LTM1Q23.

Figure 7: YPF SA's 3Q22 summary financials.

Summary financials (in USDmn)	3Q21	3Q22	*Chg yoy*	2Q22	3Q22	*Chg qoq*
Income Statement Items						
Revenues	**3,620.9**	**5,178.7**	***43.0%***	**4,854.8**	**5,178.7**	***6.7%***
Opex	(3,226.8)	(4,358.2)	*35.1%*	(3,993.3)	(4,358.2)	*9.1%*
Adj. EBITDA	**1,154.5**	**1,498.2**	***29.8%***	**1,500.4**	**1,498.2**	***-0.1%***
Net Income	**236.9**	**678.2**	***186.3%***	**797.9**	**678.2**	***-15.0%***
Gross Margin	**22%**	**27%**		**29%**	**27%**	
Adj. EBITDA Margin	**32%**	**29%**		**31%**	**29%**	
Balance Sheet Items						
Short Term Debt	**1,321.3**	**1,131.4**	***-14.4%***	**1,051.5**	**1,131.4**	***7.6%***
Long Term Debt	**6,657.4**	**6,379.5**	***-4.2%***	**6,578.6**	**6,379.5**	***-3.0%***
Total Debt	**7,978.7**	**7,510.9**	***-5.9%***	**7,630.1**	**7,510.9**	***-1.6%***
Cash & Cash Eq. + ST Investments	**1,033.7**	**1,334.5**	***29.1%***	**1,242.8**	**1,334.5**	***7.4%***
Gross Leverage (LTM)	**2.5x**	**1.6x**		**1.7x**	**1.6x**	
Net Leverage (LTM)	**2.0x**	**1.2x**		**1.3x**	**1.2x**	
Cash / ST Debt	**78%**	**118%**		**118%**	**118%**	
ST Debt / Total Debt	**17%**	**15%**		**14%**	**15%**	
Debt / Capital	**35%**	**30%**		**31%**	**30%**	
Liquidity ratio	**116%**	**104%**		**115%**	**104%**	
Cash Flow Items						
Funds From Operations	**1,358.1**	**1,727.0**	***27%***	**1,698.9**	**1,727.0**	***1.7%***
Change in Working Capital	(270.2)	(140.6)	*-48%*	(360.6)	(140.6)	*-61.0%*
CFO after cash interest & taxes	**908.9**	**1,430.9**	***57%***	**1,225.2**	**1,430.9**	***16.8%***
Capex	(701.8)	(1,049.2)	*49%*	(819.8)	(1,049.2)	*28.0%*
Disposals	-	-	*n.m.*	-	-	*n.m.*
Free Operating Cash Flow	**207.0**	**381.7**	***84%***	**405.4**	**381.7**	***-5.8%***
Acquisition (Disposals)	14.2	2.2	*-85%*	1.8	2.2	*20.4%*
Free Cash Flow	**221.2**	**383.9**	***74%***	**407.2**	**383.9**	***-5.7%***
OCF/Total Debt	**46%**	**76%**		**64%**	**76%**	
FOCF/Total Debt	**10%**	**20%**		**21%**	**20%**	
FCF/Total Debt	**11%**	**20%**		**21%**	**20%**	
Capex/Sales	**19%**	**20%**		**17%**	**20%**	

Source: TPCG Research based on the company's reports

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