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Corporates Argentina – Fixed Income

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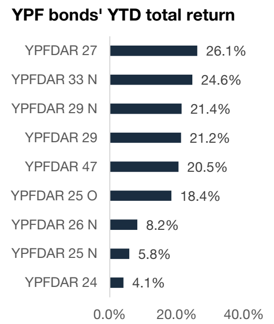
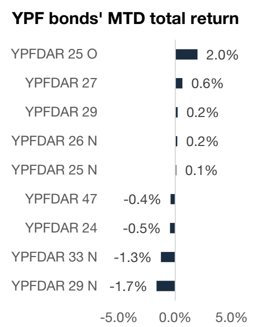
YPF rowing in dulce de leche

In our view, YPF bonds are rich, considering that the company's next quarters' results will weaken. First, the government imposed several measures that narrowed YPF's ability to sustain profitability levels on the domestic market, which is the main revenue generator. Based on the company's past behavior, it will take some months to recover to previous levels. How smoothly YPF will navigate those quarters will highly depend on exports. Second, we expect to see bouts of volatility in YPF bonds value, considering the uncertainties towards who will be the next president. Although all candidates agree on the importance of the O&G sector, it is too early to say how they will address it, even Mr. Massa, as he will need to solve the access to the FX market to avoid sector stagnation.





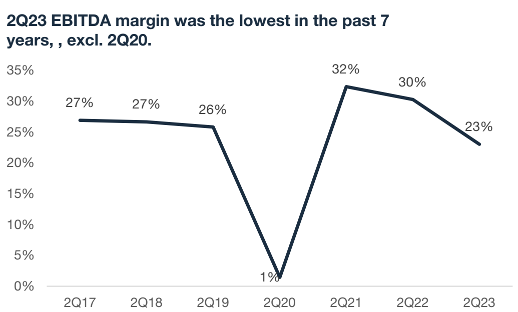
Source: TPCG Research based on Bloomberg

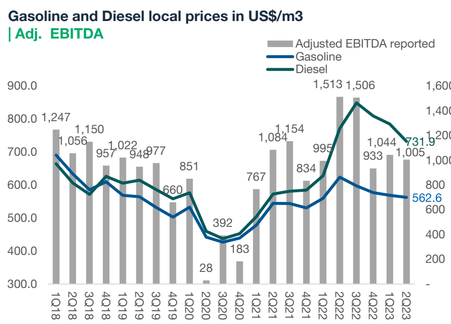
YPF bonds performance has been formidable YTD, with the strongest performance coming from the long-dated bonds. YPFDAR 27s showed a YTD total return of 26%. However, we noticed that prices have been tumbling down in the past month, while others have shown some resistance. The YPFDAR 25 Old was the exception delivering a MTD total return of +2%. From a strategic point of view, we believe that YPF bonds' prices lack the fundamental support to continue rising. Considering the fragile macroeconomic scenario in the upcoming months, we recommend taking profit.

The jump in the official FX to ARS350/USD after the PASO heightened uncertainty on inflation and the sustainability of the FX until the presidential elections. The government announced different measures regarding the O&G sector that will be current until October 31st, 2023. YPF's diesel and gasoline retail prices received an adjustment of 12.5%. Considering fuel taxes that are fixed, the increase was 14%. There will not be any further adjustments during the period. Then, the local crude oil price (Medanito) will stand at USD56/bbl, USD4/bbl below from July's price. To compensate for these, the payment of exports withholding will be deferred to March 2024. Finally, Massa would give the certificates to access the official FX market as of November, for those companies that increased production levels since 2022 and exported crude oil.

In our opinion, the freezing of YPF's pump prices is once again the tool to tame inflation at the expense of squeezing YPF's profitability margins, which translates into lower cash inflows. Even so, we do not see the company's ongoing expansionary projects threatened. If the deterioration of diesel and gasoline prices in USD continues, the Vaca Muerta Sur new pipeline and terminal project, and even more, the LNG project, may end up in a drawer. Then, the promise of the certificates to access the MULC seems flimsy. To date the government has not given any certificate, we do not see them doing it after the elections, even less, if they lose.

Figure 1: YPF's EBITDA margin is downhill.





Source: TPCG Research based on YPF's FFSS

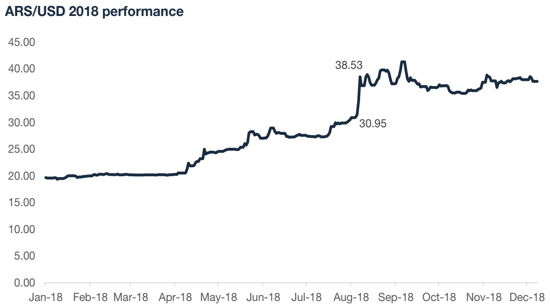
The aforementioned increase in the FX will negatively impact YPF's 3Q23 revenues. It is because 60% of revenues are in ARS, basically Diesel and Gasoline sales. For 75 days, the company will not be able to pass through rising costs to prices. Second, we believe diesel volume sold growth will be muted in 3Q, on the back of the warm weather. Therefore, the decrease in prices will not be offset by higher volumes sold. Due to a seasonality factor gasoline volume sold tend to decrease in 2Q and 3Q. While the 4Q is the strongest quarter. In contrast, the strongest quarters of diesel sales are the 2Q and 3Q due to the harvest and the increase in energy dispatch by thermal power plants. Third, the government remains paying natural gas sales under the Plan Gas with delays. Since sales are paid at the official FX, they will be diluted by inflation as long as the Argentine Peso continues appreciating.

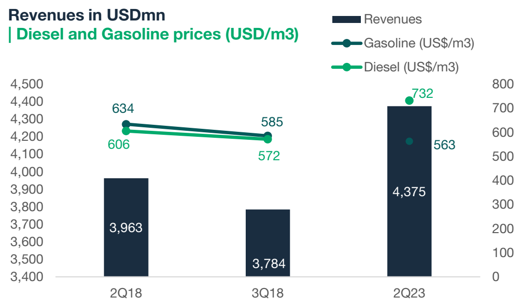
If we look at the past, YPF faced a sharp increase in the FX in 2018 similar to what happened after the PASO this year. During the last week of August 2018, the Argentine Peso depreciated by 20%, going from ARS30.95/USD on Monday 27th to ARS38.53/USD on Thursday 30th. YPF lagged 3 months to pass through the ARS devaluation to prices. In 3Q18, while crude oil international prices were improving, the company slightly decreased local crude oil prices to compensate for the decrease in local gasoline and diesel prices in USD terms. The Brent average price increased +1% qoq to USD75.2/bbl, increasing the gap with Medanito crude oil, which was down by 3% to USD65/bbl. Meanwhile, local gasoline prices were down by 8% qoq, and diesel prices were down by 6% qoq. As a consequence, 3Q18 revenues decreased by 5% qoq to USD3,784mn.

There are several differences between the periods. First, in 3Q18, cost decreased at a higher pace than revenues qoq in USD terms, they were down by 14% qoq. As a result, the EBITDA margin improved to 30% in 3Q18 from 27% in 2Q18. As we will see later, the current inflation inertia has diminished YPF ability to reduce costs. In 3Q23, inflation will more than double the one of 3Q18 which was 10%. Second, shale production represented 11% of total hydrocarbon production in 3Q18 vs. 45% in 2Q23. YPF decreased Capex by 7.8% qoq in 3Q18. Currently, it would be more difficult for YPF to cut Capex since shale production curve decline sharply after the second year.

Although diesel price deteriorated since the record high reached in 3Q22, it remains high on a historical perspective. Thus, the diesel price has room to decline. In contrast, the gasoline price was already at around 2019 and 2021 levels this year. In 2Q23, the price of gasoline was 3.9% lower than in 3Q18. In contrast, the diesel price was 28% higher than in 3Q18.

Figure 2: The jump in FX depreciation in August 2018 derived in a change in demand from premium products to regular ones, although 3Q18 gasoline prices declining by 8%. We expect a similar behaviour in 3Q23.





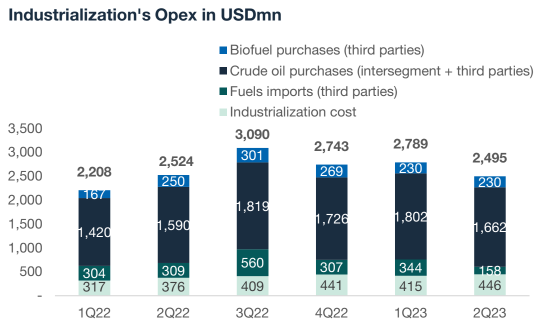
Source: TPCG Research based on Bloomberg

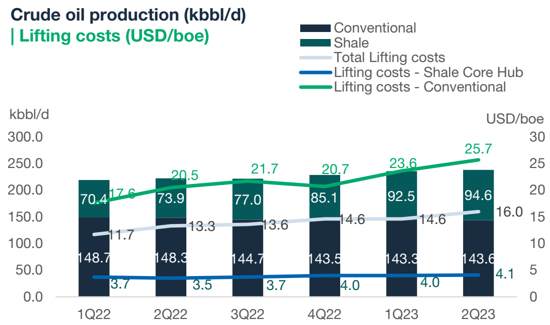
Our analysis of costs by business segment shows that they will rise in the upcoming quarters. The downstream business cost structure is mainly USD-linked, as the company imports gasoline and diesel. Also, it buys around 22% of the crude oil processed by refineries to third parties, which price is established in USD. In 2Q23, Industrialization costs increased by +8% qoq and +19% yoy. What helped industrialization costs not to increase further was that the company imported less diesel due to the drought negatively affecting the agribusiness sector demand. Diesel volumes imports were down by -35% qoq and -26% yoy. In addition, the import price of diesel was down by 20% qoq and 36% yoy. In 2Q23, thanks to YPF increasing its crude oil production by +6.9% yoy / +1% qoq, it imported fewer volumes of gasoline (-67% qoq) and we estimate that it purchased 10% less crude oil to third parties than in 1Q23. That said, diesel import volumes were atypical this year. We should see them rising driven by the recovery in the agribusiness sector demand on the back of the improvement of weather conditions for the next harvest season.

In addition, YPF volumes processed at the Lujan de Cuyo and La Plata refineries will decrease in 3Q23 due to scheduled maintenance works done in July. In 4Q23, crude oil processed will decrease further as a 40-day shutdown is planned at the La Plata refinery, which will mainly cover November. Given that the 4Q is always the strongest quarter of gasoline demand, YPF will have to increase gasoline imports. With this in mind, an FX devaluation will translate into higher costs, which considering the company's past behavior, will not pass through to prices shortly.

In the Upstream sector, wages are one of the main determinants of lifting costs. In 2Q23, lifting costs increased by +10% qoq and +20% yoy to USD16/boe. The reason is that lifting costs from conventional activities were up by +9% qoq to USD25.7/boe from USD23.6/boe. Although shale is what is driving production growth, conventional production remains to account for the highest share of total output, 47% vs. 45% for the first one. Crude oil mainly comes from conventional fields, representing 60% of the total, while unconventional fields represent 39%. In contrast, natural gas from shale fields were 47% of total natural gas production while from conventional fields was 38%. YPF is currently focusing on increasing crude oil shale production. With the rise in the share of shale production, lifting costs will go down. In 2Q23, lifting costs from unconventional activities were up to USD4.1/boe from USD4.0/boe in 1Q23. Conversely to the Downstream segment, lifting costs will dilute if there is considerable depreciation of the Argentine Peso.

Figure 3: Although shale oil grew by +28% yoy, it accounts for 39% of total crude oil production. This partly explains why lifting costs remain high.





Source: TPCG Research based on YPF's FFSS

As it stands, the differentiator to mitigate the decrease in diesel and gasoline sales in USD terms will be refined products, like jet fuel, petrochemical naphtha, LPG, crude oil and grain and flour exports. In three cases, revenues will depend on the performance of international prices. The company started to export crude oil to Chile through the TrasAndino pipeline after 15 years of being out of operation. Currently, crude oil exports are not material, given that they represent only 12% of total exports and just 2% of total sales in 2Q23. YPF exported USD7kbbld in May-23 and 12kbbld in June-23, which translated into USD46mn. In 4Q23, the completion of the Vaca Muerta North pipeline and the TrasAndino pipeline expansions and the advance of the Oldeval's Duplicar Plus project will boost crude oil production. For this reason, the company expects crude oil production to increase 8% yoy to 245kbbld in FY23E, and export 10% of it. To reach that number, the company expects 4Q23 crude oil production of 255kbbld, which will mean an increase of 5.8% from 240.9kbbld in 2Q23. Crude oil exports will double from 2Q by year end, standing at around 24.5kbbld.

Grain and flour exports have been key to YPF in the past years. From 1Q21-3Q22, they were the first and second largest, depending on the quarter due to seasonality, revenue generator from export markets. Due to the drought, they lost weight in the export basket from 4Q22 to 2Q23. In 1H23, revenues from grain and flour exports were down 88% yoy to USD51mn from USD415mn in 1H22. With the arrival of the El niño weather, grain and flour exports should recover their vigor by 4Q23. However, 3Q23 will be another weak quarter. Considering that in the strongest quarter, 2Q revenues from this segment were just USD46mn vs. USD304mn in 3Q22, 3Q23 revenues will be in the range of USD15-20mn, not reaching even a tenth of those reported in 3Q22.

With this in mind, we expect 3Q23 to be the weakest quarter of the year in terms of revenue generation. In 4Q23, the export market should take a leading role that helps to compensate for the shrink in domestic revenues. We believe the presidential elections will not affect the advance of the expansionary projects. The Vaca Muerta North pipeline will connect the hub core (La Amarga Chica block) with Puesto Hernandez facilities. In this way, YPF will increase evacuation capacity to Lujan de Cuyo refinery and to export to Chile. The project is financed with internal cash generation and local bond issuances. The Duplicar Plus project is financed in a 79% through the ship or pay contracts and 21% with USD-linked bonds. The pipeline total evacuation capacity is currently of 70kbbld, but it is expected to increase to 110kbbld.

On our report *O&G sector: Argentina's new engine* we stated that 2023 and 2024 were going to be transition years. So far, companies have been advantaged by the attractive interest rates and the high liquidity of the local market. Companies will need more financing to ramp up production in 2024, in line with the completion of the ongoing midstream projects. The level of indebtedness will depend ultimately on the local pricing policy. While the Vaca Muerta Sur project could be put on hold until the outlook is clearer, the LNG project seem each day more distant. The game changer in Vaca Muerta will be access to the international financial markets.

Figure 3: YPF SA's 2Q23 summary financials.

Operating Data	2Q22	2Q23	*Chg yoy*	1Q23	2Q23	*Chg qoq*
Crude oil production (Kbbld)	225.3	240.9	*6.9%*	238.5	240.9	*1.0%*
NGL production (Kbbld)	41.7	42.7	*2.5%*	42.9	42.7	*-0.3%*
Gas production (Mm3d)	37.6	36.5	*-3.0%*	36.5	36.5	*0.1%*
Total (Kboed)	**503.7**	**513.1**	***1.9%***	**510.6**	**513.1**	***0.5%***
Summary financials (in USDmn)						
Income Statement Items						
Revenues	**4,995.0**	**4,375.0**	***-12.4%***	**4,238.0**	**4,375.0**	***3.2%***
Opex	(4,099.0)	(4,166.0)	*1.6%*	(3,894.0)	(4,166.0)	*7.0%*
Adj.EBITDA	**1,512.6**	**1,005.0**	***-33.6%***	**1,044.0**	**1,005.0**	***-3.7%***
Net Income	**809.7**	**380.0**	***-53.1%***	**341.0**	**380.0**	***11.4%***
Adj.EBITDA Margin	**30%**	**23%**		**25%**	**23%**	
Balance Sheet Items						
Short Term Debt	**1,051.5**	**1,774.0**	***68.7%***	**1,406.0**	**1,774.0**	***26.2%***
ST Borrowings	765.9	1,483.0	*93.6%*	1,108.0	1,483.0	*33.8%*
ST Leases	285.6	291.0	*1.9%*	298.0	291.0	*-2.3%*
Long Term Debt	**6,578.6**	**6,544.0**	***-0.5%***	**6,498.0**	**6,544.0**	***0.7%***
LT Borrowings	6,319.5	6,299.0	*-0.3%*	6,231.0	6,299.0	*1.1%*
LT Leases	259.1	245.0	*-5.4%*	267.0	245.0	*-8.2%*
Total Debt	**7,630.1**	**8,318.0**	***9.0%***	**7,904.0**	**8,318.0**	***5.2%***
Cash & Cash Eq. + ST Investments	**1,242.8**	**1,470.0**	***18.3%***	**1,296.0**	**1,470.0**	***13.4%***
Gross Leverage (LTM)	**1.7x**	**1.9x**		**1.6x**	**1.9x**	
Net Leverage (LTM)	**1.3x**	**1.4x**		**1.2x**	**1.4x**	
Cash / ST Debt	**118%**	**83%**		**92%**	**83%**	
ST Debt / Total Debt	**14%**	**21%**		**18%**	**21%**	
Debt / Capital	**31%**	**31%**		**30%**	**31%**	
Liquidity ratio	**115%**	**99%**		**102%**	**99%**	
Cash Flow Items						
Funds From Operations	**1,764.4**	**1,406.6**	***-20.3%***	**1,300.4**	**1,406.6**	***8.2%***
Change in Working Capital	(410.0)	(91.0)	*-77.8%*	198.0	(91.0)	*n.m.*
CFO after cash interest & taxes	**1,248.5**	**1,186.0**	***-5.0%***	**1,367.0**	**1,186.0**	***-13.2%***
Capex	(828.0)	(1,366.0)	*65.0%*	(1,262.0)	(1,366.0)	*8.2%*
Disposals	-	-	*n.m.*	-	-	*n.m.*
Free Operating Cash Flow	**420.5**	**(180.0)**	***n.m.***	**105.0**	**(180.0)**	***n.m.***
Acquisition (Disposals)	-	8.0	*n.m.*	-	8.0	*n.m.*
Free Cash Flow	**420.5**	**(172.0)**	***n.m.***	**105.0**	**(172.0)**	***n.m.***

Source: TPCG Research based on YPF SA's FFSS

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