Venezuela/PDVSA Monthly Report
February 2019

The enthusiasm that drove the bond's prices in January is long exhausted. After a month of sanctions issued by OFAC, which now affect both issuers, the market for Venezuelan and PDVSA's bonds closed February practically paralyzed, with very little trading taking place. We consider that prices will now be less relevant, since they constitute an inaccurate reference to the levels at which a transaction could effectively occur, due to the low liquidity and the real bid and offer spread.

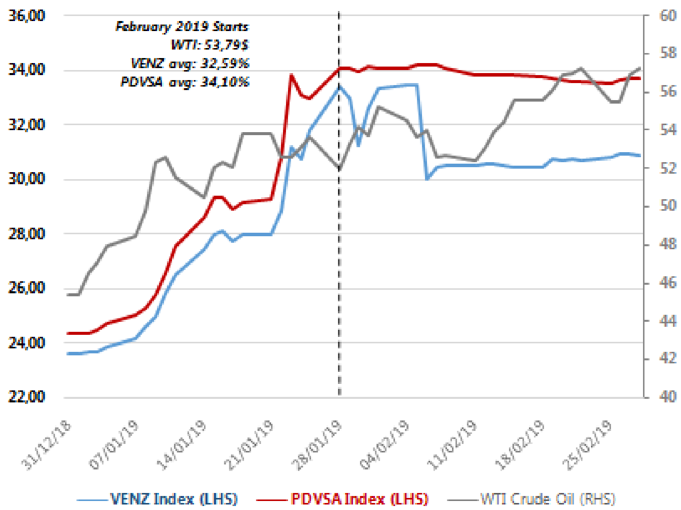

Chart N°1: VENZ/PDVSA bond indexes and oil prices, Jan-Feb 2019.
Source: Bloomberg, Knossos Asset Management.

The sanctions, which were issued on January 28th through executive order 13857 and subsequently amended to make them extensible to the Republic, explicitly prohibit the purchase or investment in PDVSA's or Venezuela's debt. The amendment document issued on February 6th clarifies that American investors will only be allowed to disinvest; transferring titles ownership to **non-US entities**. On the other hand, US securities brokers will be allowed to facilitate the divestment of Venezuelan debt executed by non-US entities and the clearing houses will still be able to act as custodians of Venezuelan securities. However, while the market waits for additional clarifications, many agents have chosen to assume an extremely conservative attitude or *"over compliance"* attitude, which has helped to keep the market practically inoperative.

Regarding the effect of the sanctions on the volume of exports of PDVSA, Reuters estimates indicate that they would have fallen by 40% in February, to settle around 920,000 barrels/day after being in the range of 1.47 – 1.66 million barrels/day, during the three months prior to the sanctions. According to this source, 70% of exports went to the Asian continent, with India being the country that absorbed most of the shipments to the continent and 15% of exports went to Europe. Another estimate elaborated through secondary sources suggests that the average daily production of Venezuela for the month of February would be around 1 million barrels, when for the previous month it would have been 1.15 million barrels/day, which would result in a decrease of 12.35%.

During the month, PDVSA imported 165,000 barrels/day of fuel, mainly from the United States and Europe, as the sanctions banned US exports of diluents used to refine Venezuela's extra-heavy oil. The country has had to pay high premiums for the fuel purchased, mostly supplied by commercial firms, such as Rosneft and Repsol. The Spanish company has continued to exchange Venezuelan crude for gasoline under an agreement signed before the sanctions.

Additionally, on March 8th it was known that the International Center for Settlement of Investment Disputes of the World Bank (ICSID) ruled in favor of ConocoPhillips and determined that Venezuela must pay approximately US $ 8,700 million to the US oil company to compensate it for the expropriation that the Venezuelan State carried out in 2007. This demand is in addition to others that we have previously reported, including one of US $ 2,000 million also in favor of ConocoPhillips and two others in favor of Rusoro Mining (US $ 1,300 million) and Gold Reserve (US $ 1.032 million).

Monthly Performance

Considering the foregoing and given the limited trade activity of bonds that we expect in the future, it is possible that this is the last month in which it makes sense to review the monthly performance, so in following reports this section will be omitted and we will focus more in the facts that can help us estimate the recovery rate of the bonds or an eventual reopening of the market. In this sense, it can be observed that the price variations in PDVSA's securities were not significant, since they experienced an average monthly return of -2%. This return turns out to be -3% when the PDVSA 20 and

PDVSA 27 bonds, which had a positive performance, are excluded. The title with the best monthly return was PDVSA 27 (1.19%), while the title with the worst return was PDVSA 21 (-9.36%), with a performance significantly lower than the rest of the curve. Thus, the title with the best performance in the course of 2019 is the PDVSA 27 (69.77%), while the average yield of the PDVSA bond curve for the same period is 55%.

Security	31/01/2019	28/02/2019	Total Return	Total Return (2019 YTD)
VENZ 13 5/8 08/15/18	31,25	32,35	+3,52%	+36,83%
VENZ 7 12/01/18	30,25	30,20	-0,17%	+41,22%
VENZ 7 3/4 10/13/19	30,95	31,60	+2,10%	+33,15%
VENZ 6 12/09/20	31,45	30,45	-3,18%	+32,22%
VENZ 12 3/4 08/23/22	33,40	30,50	-8,68%	+27,73%
VENZ 9 05/07/23	32,25	30,60	-5,12%	+32,74%
VENZ 8 1/4 10/13/24	32,10	30,35	-5,45%	+31,53%
VENZ 7.65 04/21/25	31,90	30,40	-4,70%	+32,92%
VENZ 11 3/4 10/21/26	33,45	30,75	-8,07%	+25,10%
VENZ 9 1/4 09/15/27	33,50	30,90	-7,76%	+32,88%
VENZ 9 1/4 05/07/28	31,85	30,65	-3,77%	+33,36%
VENZ 11.95 08/05/31	33,50	30,70	-8,36%	+30,41%
VENZ 9 3/8 01/13/34	35,10	33,00	-5,98%	+16,06%
VENZ 7 03/31/38	30,95	30,80	-0,48%	+35,54%
PDVSA 8 1/2 10/27/20	94,20	94,45	+0,27%	+0,85%
PDVSA 9 11/17/21	30,45	27,60	-9,36%	+49,87%
PDVSA 12 3/4 02/17/22	30,60	30,50	-0,33%	+59,08%
PDVSA 6 05/16/24	25,65	25,35	-1,17%	+68,45%
PDVSA 6 11/15/26	25,60	25,35	-0,98%	+68,86%
PDVSA 5 3/8 04/12/27	25,30	25,60	+1,19%	+69,77%
PDVSA 9 3/4 05/17/35	29,50	29,20	-1,02%	+52,55%
PDVSA 5 1/2 04/12/37	26,00	25,35	-2,50%	+68,16%

Table N° 1: Venezuela/PDVSA bond performance, February 2019.
Source: Bloomberg CBBT, Knossos Asset Management. ***Note: Returns were adjusted to account for the accrued interest lost, per EMTA resolutions.**

On the other hand, on average, the monthly return of the bonds of the Republic was -4%. Excluding the VENZ 13 5/8 2018 and 2019, which ended the month in green, the return on sovereign bonds averaged -5.14%. The title with the best monthly performance was VZLA 13 5/8 2018 (3.52%), while the title with the worst return was VENZ 22 (-8.68%), followed by VENZ 31 (-8.36%). With this, the title that exhibits the best performance in the course of 2019 is VENZ 13 5/8 2018 (41.22%); in any case, the general performance taking into account the price level at the beginning of the year is on average 31.55% for the Republic's bond curve.

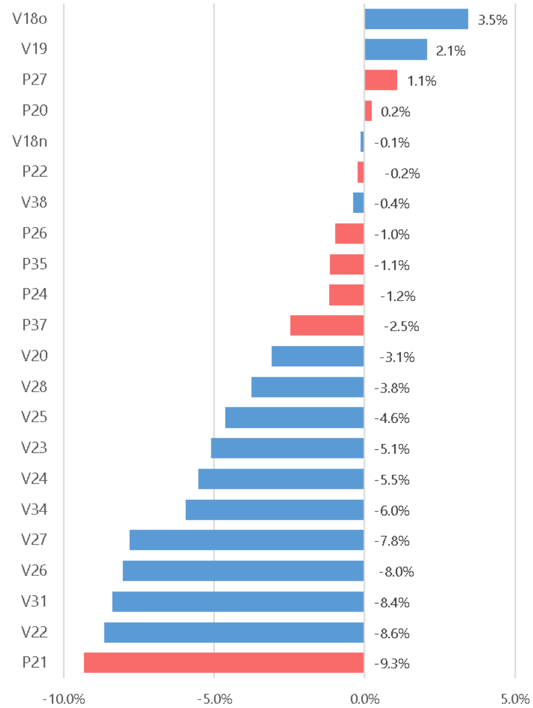

Chart N°2: VENZ/PDVSA bonds by total return, February 2019.
Source: Bloomberg, Knossos Asset Management.

Security	31/01/2019	28/02/2019	Price change
VENZ 13 5/8 08/15/18	31,25	32,35	1,10
VENZ 7 12/01/18	30,25	30,20	-0,05
VENZ 7 3/4 10/13/19	30,95	31,60	0,65
VENZ 6 12/09/20	31,45	30,45	-1,00
VENZ 12 3/4 08/23/22	33,40	30,50	-2,90
VENZ 9 05/07/23	32,25	30,60	-1,65
VENZ 8 1/4 10/13/24	32,10	30,35	-1,75
VENZ 7.65 04/21/25	31,90	30,40	-1,50
VENZ 11 3/4 10/21/26	33,45	30,75	-2,70
VENZ 9 1/4 09/15/27	33,50	30,90	-2,60
VENZ 9 1/4 05/07/28	31,85	30,65	-1,20
VENZ 11.95 08/05/31	33,50	30,70	-2,80
VENZ 9 3/8 01/13/34	35,10	33,00	-2,10
VENZ 7 03/31/38	30,95	30,80	-0,15
PDVSA 8 1/2 10/27/20	94,20	94,45	0,25
PDVSA 9 11/17/21	30,45	27,60	-2,85
PDVSA 12 3/4 02/17/22	30,60	30,50	-0,10
PDVSA 6 05/16/24	25,65	25,35	-0,30
PDVSA 9 3/4 05/17/35	29,50	29,20	-0,30
PDVSA 5 1/2 04/12/37	26,00	25,35	-0,65

Table N°2: VENZ/PDVSA price curves, February 2019.
Source: Bloomberg CBBT, Knossos Asset Management.

Sanctions on PDVSA and Venezuela, what comes next?

The recognition of Guaidó as Interim President by the US, as well as the sanctions against PDVSA and the Republic send a clear signal: The US is willing to cooperate with the transitional government to protect Venezuelan assets in its jurisdiction. These actions are detrimental to all those creditors who expected to be able to attach CITGO or other foreign assets and diminishes their negotiating capacity in a significant way in the scenario of a restructuring, lowering potential recovery value. The appointment of a new CITGO board of directors on February 12th by the National Assembly, under the shelter and with the support of the US, are a clear sign that point in this direction.

Meanwhile the market is still waiting for instructions on how the disinvestment in PDVSA and Venezuela bonds will be implemented. Investment funds and ETFs cannot rebalance while the market is inoperative. This had opened the possibility that the Venezuelan debt would be excluded from JP Morgan's EMBI index. As of February 28th, Reuters reports that the debt continued to be considered for the measurement of that month's index, after JP Morgan circulated a survey among several fund managers to determine if the Venezuelan debt should continue to be included in its EMBI index.

Sanctions make PDVSA an uncomfortable business partner, so its presence in the international payment system will be limited. The threat from the Treasury Department to sanction any non-US entity that collaborates with the Maduro administration has already materialized, as in the case of the Evrofinance Mosnarbank, a financial entity owned by Russian and Venezuelan state-owned companies, which was included in OFAC's list of sanctions on March 11th.

This occurs in parallel with the efforts of Nicolás Maduro to move the accounts and key operations of PDVSA and the Republic to allied countries. On March 1st, the Executive Vice President of the Maduro cabinet, Delcy Rodríguez, announced that the PDVSA office in Lisbon, Portugal, would be transferred to Moscow, Russia. In that country, Russian Financial Corporation Bank (Rusfincorp) -an entity already sanctioned by the US- would be interested in taking over the Russian accounts of Venezuelan companies, including those of PDVSA. On March 14th, Gazprombank -which had already refused to take over those accounts-, confirmed that it would have liquidated its stake in Petrozamora, a joint venture in which it shared ownership with PDVSA.

The ability of PDVSA to monetize its exports that can no longer be placed in the US market is severely limited, due to financial and operational constraints. Although it is true that during the month of February PDVSA was able to export to India, this will not be sustainable or contribute a significant amount of resources in the future. The sanctions imposed by the Treasury Department are an important part of the efforts undertaken by the US to financially fence the Maduro administration, but they also exert pressure on their peers to get support in the same direction. As a result, on March 11th, M.M. Kutty, India's oil secretary, said India's government is pushing for a reduction in Venezuelan oil imports, also indicating that they have emphasized to private companies the risk of sanctions for importing Venezuelan crude. With this action, India seems to assume a position similar to that assumed by England and Portugal, when last month they refused to facilitate the mobilization of resources requested by Maduro. In the case of England, when the Central Bank of that country refused to mobilize gold reserves on behalf of the Republic, and in the case of Portugal when Novo Bank refused to mobilize funds belonging to BANDES.

For this reason, we believe that PDVSA will be less and less lucrative to operate, for logistical and financial reasons. For example, on March 7th the German maritime firm Bernhard Schulte Shipmanagement (BSM) announced its intention to return some of the ships it manages for PDVSA, due to the fact that the oil company has a pending payment of fees ascending to US $ 15 million. Later, on March 14th, BSM said that it was possible that the commercial relationship with PDVSA would cease completely that month or next, because the management of the ships would have become an "almost impossible task". The vessels that BSM operates for PDVSA are mainly used to move oil between the national ports of Venezuela and the Caribbean, although some cover routes to Asia.

The struggle for power continues, what to expect now?

We maintain our appreciation of a negotiating position less favorable to external creditors after recent events. In our previous report we indicated that we only see the possibility of holdouts in the VENZ titles without CACs, or with low CAC thresholds (18o, 18n, 27, 34). However, they would have a severely limited capacity to exert pressure to demand preferential terms of repayment, since it would imply going against a resurgent democratic government, supported by the US, which faces severe difficulties in its attempts to resolve a humanitarian crisis. Besides it faces the task of reactivating the economy of a country whose infrastructure of basic services is practically dismantled, as demonstrated by the electricity and water supply crises that affected the country recently. This crisis left Caracas paralyzed for several days between March 7th and 12th and significantly affected the already diminished productive capacity of the oil industry, stopping for several days the activities at Jose's terminal, one of the most important in the east of the country. For all these reasons, we reiterate that the incentives of the holders of PDVSA to friendly restructure remain strong, since the legal arguments of their liabilities could be challenged in the future.

The designation of Ricardo Hausmann as Representative of the Government of Juan Guaidó before the IDB sheds light on the potential restructuring process. The incorporation of Hausmann to the IDB board was approved by the member countries of the bank on March 15th. Some of the clues that can be drawn from Hausmann's statements regarding how he might influence economic policy for recovery, and particularly debt restructuring, include his position to prioritize investment in infrastructure over the payment of debt. He has said several times that "it will take years" to start paying off the debt. In 2017, Hausmann criticized the purchase of Venezuelan bonds by Goldman Sachs Asset Management (for which he referred to the bonds as "hunger bonds") and asked JPMorgan Chase & Co. to eliminate Venezuela from its emerging market bond indexes.

Prior to this announcement, Hausmann was already acting openly as an informal adviser to Guaidó and together with his team have actively contributed to the design of the plan that aims to trace the path of economic recovery in Venezuela should the transition be consolidated. It should be noted that countries tend to appoint as Representative before the IDB the same person that has the role of Minister of Finance, so there is a possibility that Hausmann's vision might end up being imposed to those of other economists if he finally becomes the Minister of Finance of the transition.

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