Venezuela/PDVSA Monthly Report
May 2019

PDVSA 2020 coupon payment was effectively done within the grace period, as the ad hoc board of PDVSA announced on May 16th. Even though this action is in line with the Guaidó's administration strategy to protect the nation's assets abroad, it seems to us more like a move to gain some time, as **lack of cash to make the next amortization payment is obvious, and at this point the only options that appears to be feasible to keep assets safe are to ask the courts for protection or to convince bondholders to collaborate**. As it has become usual since the bonds trading stopped, prices were almost unchanged during the month, and according to our PDVSA and Venezuela indexes, average prices closed the period around 32 cents and 29 cents, respectively.

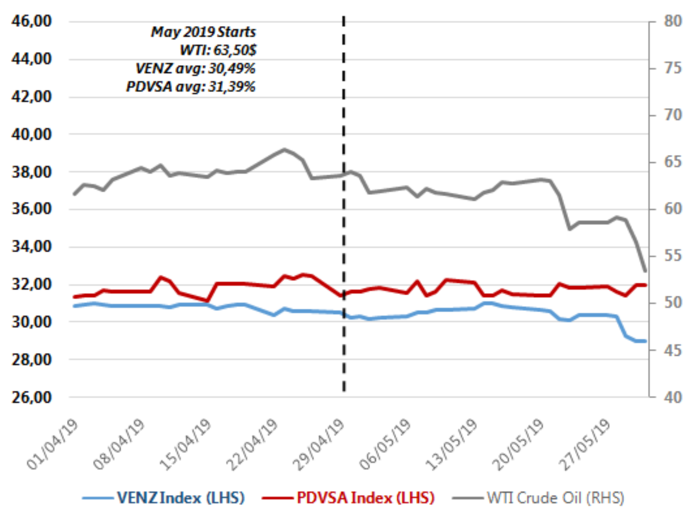

Chart N°1: VENZ/PDVSA bond indexes and oil prices, Apr-May 2019.
Source: Bloomberg, Knossos Asset Management.

Even when it worked out this time, interim government efforts to protect assets by honoring only some debts might become a problem. If holders of other PDVSA issued bonds (non 2020 bonds) consider they are being left behind with nothing worthy to pay them, they may feel encouraged to take their claims to the courts or to be less prone to collaborate in good faith with any attempt of restructuring in the future.

Let's recall that Guaidó team has scored some victories when defending the nation's assets in the courts, but this strategy may have a limited life span. **Beyond the sanctions, the US may be unwilling to fully support actions that harm Venezuela and PDVSA creditors' ability to recover their money.** In this sense, additional protection from foreign courts may depend on how other allied countries collaborate with the interim government and it's probable that achieving such level of coordination between countries may require United Nations participation, as in the case of Iraq (2003).

Security	29/04/2019	31/05/2019	Total Return	Total Return (2019 YTD)
VENZ 13 5/8 08/15/18	31,10	31,10		+31,53%
VENZ 7 12/01/18	28,30	28,30		+32,41%
VENZ 7 3/4 10/13/19	28,30	28,30		+15,77%
VENZ 6 12/09/20	29,60	28,60	-3,38%	+24,21%
VENZ 12 3/4 08/23/22	30,25	28,80	-4,79%	+20,60%
VENZ 9 05/07/23	29,80	29,45	-1,17%	+27,85%
VENZ 8 1/4 10/13/24	30,45	28,50	-6,40%	+23,41%
VENZ 7.65 04/21/25	30,65	28,80	-6,04%	+25,86%
VENZ 11 3/4 10/21/26	31,05	29,00	-6,60%	+17,93%
VENZ 9 1/4 09/15/27	31,65	29,85	-5,69%	+28,51%
VENZ 9 1/4 05/07/28	30,65	28,40	-7,34%	+23,65%
VENZ 11.95 08/05/31	31,35	28,80	-8,13%	+22,37%
VENZ 9 3/8 01/13/34	30,20	29,15	-3,48%	+2,57%
VENZ 7 03/31/38	30,65	28,10	-8,32%	+23,55%
PDVSA 8 1/2 10/27/20	89,75	89,80	+0,06%	-4,07%
PDVSA 9 11/17/21	26,85	27,55	+2,61%	+49,64%
PDVSA 12 3/4 02/17/22	25,50	25,50		+42,47%
PDVSA 6 05/16/24	24,60	24,75	+0,61%	+64,59%
PDVSA 6 11/15/26	22,40	23,30	+4,02%	+55,18%
PDVSA 5 3/8 04/12/27	22,40	24,25	+8,26%	+60,76%
PDVSA 9 3/4 05/17/35	28,25	28,70	+1,59%	+49,98%
PDVSA 5 1/2 04/12/37	21,50	22,70	+5,58%	+50,61%

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

Cases in which Guido's team is unable to negotiate or obtain legal protection are likely to repeat the story of the gold that was used in a swap contract with Deutsche Bank (DB). According to Bloomberg, DB took control of the gold that was used as collateral, after Venezuela missed an interest payment. Guido's administration is now waiting for DB to sell the gold and will ask for the difference in price from when the gold was acquired to current levels (USD 120 million). Furthermore, this cash will require protection from creditors attacks.

Trying to get creditors into a non-seizure agreement while the political situation is resolved is another option. Guaidó has the legitimacy to subscribe these kinds of agreements, which would be inherited by future administrations. Besides, creditors may be persuaded to participate offering, for example, preferential conditions when the time to restructure comes.

We think Lee Buchheit has entered on stage precisely to help Guaidó's team in this direction. His presence also sends a message about how complex negotiations could be. Buchheit articles and interviews reveal the importance he gives to the matter of how to prevent holdouts threats in the case of Venezuelan debt. However, it's still too soon to try to guess what mix of "the carrot and the stick" he would suggest using.

As an attempt to find a solution to the political situation, negotiations in Oslo are expected to be slow and lengthy, as achieving an agreement on electoral conditions seems harder now than in previous similar situations. Despite any positive outcome in this sense, time consumed will traduce in lower recovery value for the bonds, as oil production will continue falling, and living conditions in the country will only get worse.

Once political conditions improve, scarcity of capital will affect the restart of operations in the oil industry, so we expect an uneven recovery of its sectors. In this context, incentive to bondholders may include debt-for-equity arrangements, to make gains in the long term from the recovery of sectors that at the beginning are less profitable or less strategic. Refineries not suited to current oil production might be an example and small and more expensive fields to operate might be another. Bondholders of SIDETUR and ELECAR might find this solution attractive as well.

Next amortization of PDVSA 2020: is it time to give up on CITGO?

The coupon payment of the 2020 bonds was, as stated above, a successful attempt of the interim government to buy time hoping Maduro's administration would step down before the next big payment is due. Yet time is running against this strategy and efforts of new PDVSA board to restructure, renegotiate or find a compromise from all creditors (but especially PDVSA 2020's holders) to safeguard nation's assets abroad should take place.

Currently, CITGO is protected directly or indirectly by three big players from mayor bondholders and creditors. The first being the US through sanctions that limit the ability of current creditors from negotiating and restructuring today's debt. The amount of debt outstanding can only be recovered in a significant way if they are converted into another kind of financial instrument and therefore attacks on the asset are kept at bay until this window opens. The second player is Russia, though Rosneft that holds a lien on 49% of CITGO's shares, reducing and complicating even more the recovery value in liquidation scenarios. And third and most importantly, CITGO is currently protected from other creditors by the pledge that 2020 bondholders have over 51% of its shares. However, the scope of the "protection" is reduced with each amortization payment made on the bonds as it reduces capital outstanding and increases residual value after liquidation.

In our view, this situation opens the window for a strategy that might turn PDVSA 2020 bondholders in valuable allies when defending CITGO from other debtors. Considering that PDVSA 2020 bondholders have already received two amortizations, it seems plausible to agree with them to extend duration, and even decrease the coupon rate, in exchange of an increased value of the future payments, engaging a bigger portion of the current residual value of CITGO.

This move might align bondholders' interest with those of the interim government, and decrease threats from other debtors, at the same time. In this scenario the first group would avoid an unfriendly resolution (with unknown legal complications) while contributing to protect CITGO assets.

Another solution, or the same "hero" in a different disguise, involves using a 2nd lien loan over the same shares that today constitutes the bonds' guarantee. Proceeds would be used to pay interest and amortization, and the new lenders face a risk and return balance that is practically equal to one the described above.

These ideas are by no means intent to be comprehensive and all legal implications must be considered, yet they aim at challenging and changing the perception that all current creditors are enemies and, in some cases, piling up even more debt might be a beneficial. As the ancient proverb goes the enemy of my enemy is my friend.

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