KNOSSOS ASSET MANAGEMENT

AN AFFILIATED COMPANY OF MIURA

Venezuela/PDVSA Monthly Report
May 2020

Trading in the 3.5 – 4.5 cents range, PDVSA bond prices reflect the worldwide risk-off that has shaken financial markets during the last three months. These new lows come together with collapsing oil prices and an increase in the offer of distressed debt, as several other companies and countries entered default with a better risk/reward profile. As if all the global turmoil was not enough, a major overhaul in PDVSA was also announced with new management and a plan that might create a new PDVSA, diminishing the potential recovery value for bond holders.

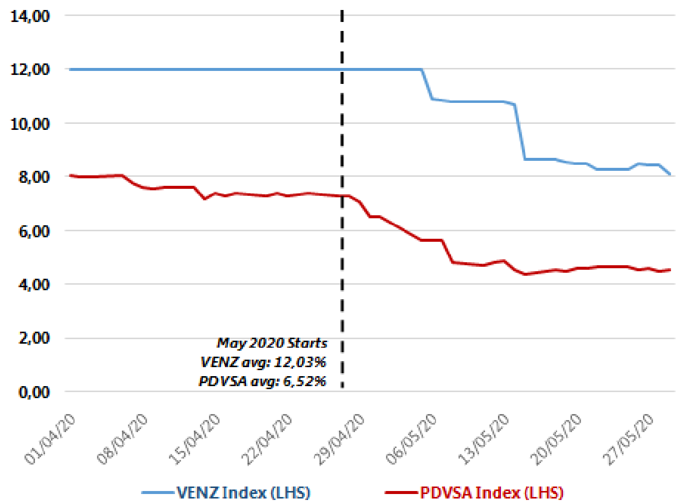

Chart N°1: VENZ/PDVSA bond indexes (Apr – May 2020).
Source: Bloomberg, Knossos Asset Management.

In this new stage that began in April 27th, Tareck El Aissami has been designated as head of the Ministry of Energy and Oil, becoming more relevant after he was pointed as the leader of the Presidential Commission for the Reorganization of the Oil Industry created in February. Former CEO of CITGO Asdrubal Chavez, who is a relative of former President Hugo Chavez, was also included in the commission and has been pointed as CEO of PDVSA. In this role he is expected to turn around the company minimizing its size while eliminating non-profitable, non-core business segments. Chavez might try to achieve this goal by creating a new company, leaving PDVSA as an empty shell, something that has been considered a longstanding risk.

Another relevant challenge that the new leadership is facing in both PDVSA and the Ministry of Energy and Oil is related to the reactivation of the industry. Venezuelan oil industry is now experiencing an unprecedented crisis and Maduro's traditional oil allies seems less willing to support him in this context. Nevertheless, the Iran Government has step in and has been sending fuel supplies and trained personnel to help Venezuela restore operations in PDVSA facilities located in Amuay, the largest refinery of the country.

Security	30/04/2020	29/05/2020	Total Return	Total Return (2020 YTD)
VENZ 6 12/09/20	9,50	6,35	-33,16%	-47,23%
VENZ 12 3/4 08/23/22	9,85	6,20	-37,06%	-47,72%
VENZ 9 05/07/23	9,90	6,50	-34,34%	-47,96%
VENZ 8 1/4 10/13/24	9,25	6,45	-30,27%	-47,71%
VENZ 7.65 04/21/25	10,10	6,05	-40,10%	-46,04%
VENZ 11 3/4 10/21/26	9,80	6,45	-34,18%	-47,17%
VENZ 9 1/4 09/15/27	10,05	6,05	-39,80%	-49,54%
VENZ 9 1/4 05/07/28	9,95	6,35	-36,18%	-48,14%
VENZ 11.95 08/05/31	10,70	6,45	-39,72%	-48,10%
VENZ 9 3/8 01/13/34	10,00	6,40	-36,00%	-46,81%
VENZ 7 03/31/38	10,40	6,40	-38,46%	-47,81%
PDVSA 8 1/2 10/27/20	20,65	11,25	-45,52%	-35,32%
PDVSA 9 11/17/21	5,30	3,80	-28,30%	-52,60%
PDVSA 12 3/4 02/17/22	5,25	3,60	-31,43%	-55,66%
PDVSA 6 05/16/24	4,85	3,90	-19,59%	-51,93%
PDVSA 6 11/15/26	4,80	3,80	-20,83%	-52,27%
PDVSA 5 3/8 04/12/27	4,80	3,70	-22,92%	-51,60%
PDVSA 9 3/4 05/17/35	4,80	3,90	-18,75%	-52,56%
PDVSA 5 1/2 04/12/37	4,75	3,90	-17,89%	-51,39%

Table N° 1: Venezuela/PDVSA bond performance, May 2020.
***Source: Bloomberg CBBT, Knossos Asset Management.* *Note: Returns were adjusted to account for the accrued interest lost, per EMTA resolutions.**

In the middle of the COVID 19 outbreak and given the difficulties in source fuel, the Maduro administration decided to reduce significantly gasoline subsidies. The new price scheme will allow 100% subsidize gasoline for public transportation and cargo during 90 days. People can buy maximum 120 liters / month of gasoline at VEF 5.000 (around USD 0,026 using the Central Bank exchange rate as of May 28th), or they can pay USD 0,5 per liter in premium gas stations in which there will not be any limits amounts to buy. Due to severe constrains to produce gasoline locally, we think differences in prices will traduce in shortages that will be more intense for certain segments of the population.

Further on the oil theme, American corporations appear to be planning their final departure. On April 21th, Treasury's OFAC issued General License 8F prompting Chevron, Halliburton, Schlumberger, Baker Hughes and Weatherford to wind down operations in Venezuela by December 21, 2020. This is not the first time OFAC asks those companies to halt operations in Venezuela, while also grating extensions on. The latest extension of GL 8F is the fifth since its issuance. As a result, some companies will be looking for ways to reduce its exposure, as demonstrated by the recent announcement of the restructuring of Swedish refinery Nynas AB. In this case, the participation of PDVSA was reduced below 50%, removing Nynas AB from the list of sanctioned organizations (SDN list). Other options for US operators might include equity transfers and ventures with non-US companies, in which cases OFAC surveillance and scope of action might ease.

On the creditors' front, OFAC might also keep supporting Venezuela grating extensions in protection against creditors. This has been the case in regards to the protection that prevents the seizure of CITGO shares, first established in October 2019 before the imminent default on the payment of coupons of the PDVSA 2020 bonds, renewed in January and later extended in April 2020 until July 22nd. OFAC declared that the goal of this extension is to provide time for PDVSA to reach an agreement with bondholders and stated its willingness to ease its licensing policy if that happens. The same sort of sympathy from OFAC might eventually hurt Crystallex, now that on May 19th the US Supreme Court denied the interim administration request to reconsider a decision that allows the company to go after CITGO. The odds seem against Crystallex, which will probably have to wait for the completion of a broader restructuring process to collect. Despite all the before mentioned, we see PDVSA 2020 bonds as attractive, trading around 11 cents, which does not reflect the still likely possibility to collect from the collateral at some point in time.

Sense of confusion and lack of action: Has the interim government lost compass?

Guaidó's administration might be going through its worst moment since January 2019. Hopes of a quick regime change appear to have vanished and division among opposition members is resurfacing. As an example in the economic front, recent comments from former PDVSA ad hoc board member Alejandro Grissanti, questioning the decisions made by the Special Attorney about demanding PDVSA 2020 bondholders, are revealing differences in the approach towards the management of the relationship with bondholders and creditors.

With the international community trying to resolve its own domestic problems, Venezuela's opposition looks helpless. The only glimmer of hope seems to come from a recent agreement between Maduro and Guaido to attack the pandemic. If this is a prelude for future agreements on other issues, like electricity, fuel supply, water, etc, we might end up with a "transitional emergency co-government" in disguise. This might be just extreme wishful thinking and bonds prices certainly don´t seem to reflect that in any way.

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