Venezuela/PDVSA Monthly Report
March 2019

As could be expected under the sanctions that limit trading, during March transactions in the Venezuelan debt market remain scarce and unrepresentative. The average level of prices for PDVSA and the Republic bonds were in the range of 30% - 34 % throughout the month. At the close of this period, the average price of the PDVSA bonds would be around 25% if PDVSA 2020, whose price decreased 4%, is excluded.

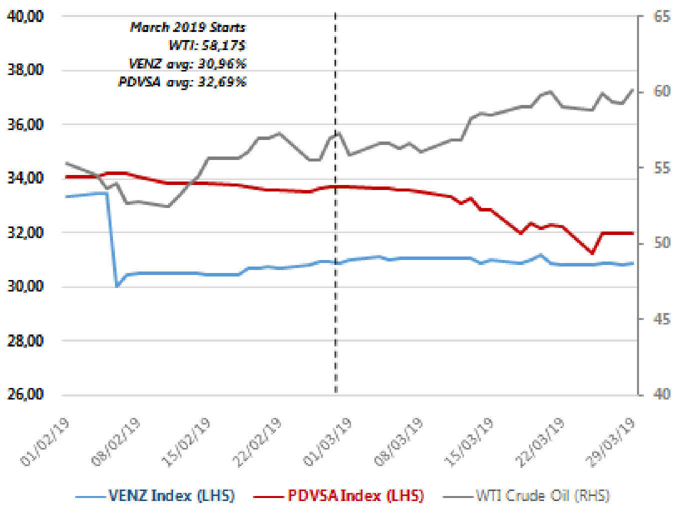

Chart N°1: VENZ/PDVSA bond indexes and oil prices, Feb - Mar 2019.
Source: Bloomberg, Knossos Asset Management.

The variation in the price of PDVSA 2020 is the product of uncertainty regarding the coupon payment that is expected for the end of April. Now that the Maduro government lost effective control of CITGO and the ability to dispose of the cash in accounts within the US financial system, they have no incentive nor can continue paying this debt. On the other hand, in statements of March 23rd, Guaidó said that his government was evaluating all available options to deal with the expiration of the coupon. More than making the payment, we believe that this indicates that his administration will try to opt for a legal solution, taking advantage on the support provided by the United States, to strengthen protection measures on CITGO, which announced the last week of March that had managed to raise 1,200 million dollars to finance commercial operations.

Security	28/02/2019	29/03/2019	Total Return	Total Return (2019 YTD)
VENZ 13 5/8 08/15/18	32,35	31,10	-3,86%	+31,48%
VENZ 7 12/01/18	30,20	28,30	-6,29%	+32,41%
VENZ 7 3/4 10/13/19	31,60	28,25	-10,60%	+19,02%
VENZ 6 12/09/20	30,45	31,45	+3,28%	+36,46%
VENZ 12 3/4 08/23/22	30,50	31,05	+1,80%	+29,99%
VENZ 9 05/07/23	30,60	30,45	-0,49%	+32,13%
VENZ 8 1/4 10/13/24	30,35	31,00	+2,14%	+34,31%
VENZ 7.65 04/21/25	30,40	31,50	+3,62%	+37,73%
VENZ 11 3/4 10/21/26	30,75	31,10	+1,14%	+26,45%
VENZ 9 1/4 09/15/27	30,90	31,40	+1,62%	+35,22%
VENZ 9 1/4 05/07/28	30,65	31,15	+1,63%	+35,52%
VENZ 11.95 08/05/31	30,70	30,95	+0,81%	+31,43%
VENZ 9 3/8 01/13/34	33,00	32,45	-1,67%	+14,15%
VENZ 7 03/31/38	30,80	32,15	+4,38%	+41,44%
PDVSA 8 1/2 10/27/20	94,45	90,60	-4,08%	-3,24%
PDVSA 9 11/17/21	27,60	27,45	-0,54%	+49,11%
PDVSA 12 3/4 02/17/22	30,50	27,65	-9,34%	+44,26%
PDVSA 6 05/16/24	25,35	25,10	-0,99%	+66,75%
PDVSA 6 11/15/26	25,35	22,45	-11,44%	+49,37%
PDVSA 5 3/8 04/12/27	25,60	22,60	-11,72%	+49,93%
PDVSA 9 3/4 05/17/35	29,20	28,60	-2,05%	+49,50%
PDVSA 5 1/2 04/12/37	25,35	25,20	-0,59%	+67,03%

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

In this regard, on April 9th, the number of members of the ad hoc board of PDVSA was extended and new duties were assigned. This new duties include representing the company abroad and negotiating the external debt. We are of the opinion that, in order to protect CITGO, a financial engineering operation should be considered within the American legal framework (to avoid that the pledge on CITGO shares is executed and to guarantee [illegible] In the case a political transition takes place, the way in which this situation is going to be handled will give us indications about how the negotiation process of the rest of the debts of the oil company and the Republic could be.

The ups and downs of expectations on government change

The first quarter of the year for the Venezuelan debt market was certainly very turbulent. Expectations of change, which were significantly low at the close of 2018, rose considerably at the end of January of this year, when Juan Guaidó jumped up in the political scene, generating an unprecedented crisis of governance. With the support of the international community and the measures of diplomatic pressure implemented, Guaidó undertook a campaign centered in promoting a break within the

Venezuelan Armed Forces, with the intention of separating Nicolás Maduro from the executive power.

The political crisis, together with the ongoing humanitarian crisis has now been exacerbated by the crisis in utilities services. Currently, even though the expectations of a change of government are still above the levels prior to the appearance of Guaidó, and pressure is still being exerted to achieve a break within the military institution, these expectations have been readjusted and the spectrum of options to promote Maduro's departure from Miraflores include now two additional options, which are sitting down again in a negotiation table and elections. Furthermore, we believe that the Venezuelan conflict is still far from being solved and we hope that this process of struggle for power will continue to be characterized by being slow, uncertain and fragile.

What will the day after look like for bondholders ? It depends on who is the winner

Once the crisis of governance which the country is going through is resolved, we expect the scenario faced by the bondholders of PDVSA and the Republic will be one of the followings:

- Maduro prevails: non-payment without the possibility of restructuring. If the status quo is maintained, we do not expect the sanctions on PDVSA and the Republic to be lifted, or that the protection of foreign assets will disappear and therefore any access to liquidity in the financial markets will be ruled out. These conditions would make it impossible to restructure the debt in the short term, whereby the recovery value would be in the range of 10-15 cts, with possibilities to continue decreasing as time goes by.
- A government of transition is established: haircuts with restructuring. A transitional government led by Guaidó will have the support of the international community and therefore access to the US financial system and financing from development banks. However –as clearly stated by Ricardo Hausmann and Miguel Angel Santos declarations – the government led by interim president would give priority attention to the humanitarian crisis and rebuilding the country, so that bondholders should expect aggressive haircuts in this scenario and therefore a recovery value that will be below the reference price levels that are reflected in table No. 1. In this case, a value of 20-25 cts could be expected. It is probable that part of the value of the debt in this scenario will be tied to the performance of the oil prices, in the form of warrants (some type of optionality that gives investors greater income when the country begins to grow significantly).

Alternatively, it should not be ruled out that the transition may be led by a person other than Guaidó, with a team of advisors that gives more weight to regaining markets access. In our opinion, even in that situation, it is still too optimistic to expect recovery values equal or greater to current reference prices, since the post - crisis Venezuela will need between 60 billion and 70 billion dollars to recover.

Every day that the crisis persists plays against the interests of the bondholders and makes the work of the transitional government more complex. The challenge they would face is carrying out the restructuring of the financial debt of PDVSA and the Republic, while trying to avoid sending a hostile message to private investment, which will be required by the nation. The same dilemma extends to all cases of claims that are going to be appealed, for example, those related to expropriations such as is the case of Conoco Phillips before the ICSID or Cristallex before the court of Philadelphia, in which the interim government of Guaidó is already exercising a proactive role through legal channels, to protect the assets of the nation from the potential actions of all the creditors. Thus, it is clear that one of the most difficult tasks for the future economic team will be to find the right balance between the needs of the country, the rights of creditors and the signal sent and precedent set for new investors and those who contemplate returning to Venezuela.

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