Venezuela/PDVSA Monthly Report
September 2019

Ending September, Venezuelan debt experienced sharp declines again as investors anticipated OFAC wouldn't extend its wind-down period on bonds transactions beyond September 30th. On October 8th it was notified that the wind-down period deadline is now set for March 30th 2020, as stated under the amendment of the General Licenses 3G and 9F. However, this situation left most sovereign bonds trading between 10 and 11 cents, which imply an average monthly decline of almost 30%.PDVSA bonds were trading around 8 cents, except for PDVSA 2020 bond that is trading just above 36 cents. The price of this bond is also affected by the expectations of a potential default of the USD 913 payment due on October 27th.

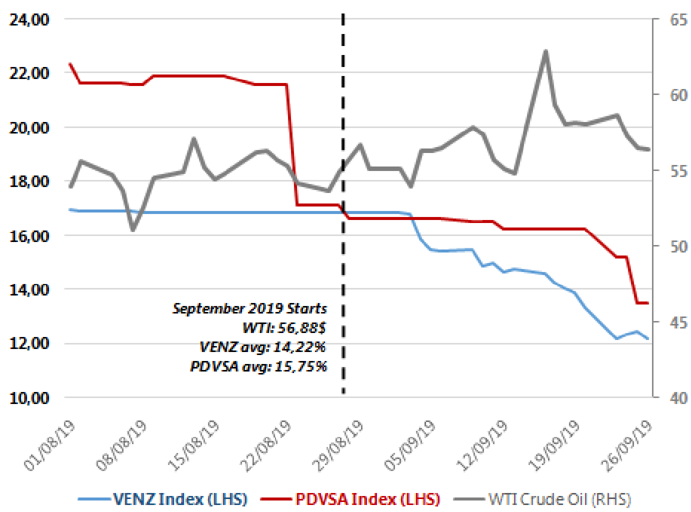

Chart N°1: VENZ/PDVSA bond indexes and oil prices, Aug-Sep 2019.
Source: Bloomberg, Knossos Asset Management.

As crisis in Venezuela deepens and keeps prolonging, last quarter lacked a catalyst that could move the forces in either direction to bring back Venezuela to the debt markets. Instead, to avert the potential loss of CITGO we see two opposite sides trying to send an unclear message.

On one side, Maduro call for debt renegotiation announced on September 30th resulted unfruitful as he delegated responsibilities of this task on Delcy Rodriguez and Tareck El Aissami, both of whom are on the US sanctions list, and have zero chances of been considered legitimate speakers for debt renegotiation purposes. On the other side, Guaidó is apparently still waiting for an US government or court action to help his administration keep CITGO control. With no strategy and adding Crystallex and ConocoPhillips claims, as October 27th approaches keeping CITGO control in Venezuelans hands seems harder than ever.

Security	31/08/2019	30/09/2019	Total Return	Total Return (2019 YTD)
VENZ 7 3/4 10/13/19	15,55	10,50	-32,48%	-55,79%
VENZ 6 12/09/20	13,45	10,85	-19,33%	-52,49%
VENZ 12 3/4 08/23/22	14,75	10,85	-26,44%	-54,60%
VENZ 9 05/07/23	15,60	10,85	-30,45%	-53,01%
VENZ 8 1/4 10/13/24	15,50	10,80	-30,32%	-54,12%
VENZ 7.65 04/21/25	15,40	10,75	-30,19%	-52,93%
VENZ 11 3/4 10/21/26	15,70	10,80	-31,21%	-56,78%
VENZ 9 1/4 09/15/27	15,35	10,90	-28,99%	-53,89%
VENZ 9 1/4 05/07/28	15,70	11,00	-29,94%	-52,44%
VENZ 11.95 08/05/31	15,70	11,05	-29,62%	-53,61%
VENZ 9 3/8 01/13/34	15,30	10,75	-29,74%	-61,81%
VENZ 7 03/31/38	15,70	10,85	-30,89%	-52,89%
PDVSA 8 1/2 10/27/20	43,50	36,50	-16,09%	-61,01%
PDVSA 9 11/17/21	13,75	8,25	-40,00%	-55,19%
PDVSA 12 3/4 02/17/22	13,75	8,45	-38,55%	-55,99%
PDVSA 6 05/16/24	14,05	8,45	-39,86%	-43,90%
PDVSA 6 11/15/26	13,60	8,25	-39,34%	-45,09%
PDVSA 5 3/8 04/12/27	13,90	8,15	-41,37%	-45,91%
PDVSA 9 3/4 05/17/35	13,95	8,45	-39,43%	-55,90%
PDVSA 5 1/2 04/12/37	13,90	8,25	-40,65%	-45,35%

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

With an output below 1.000.000 barrels per day, outlook for the oil industry is also gloomy. Lacking investments and buyers, PDVSA's oil production is forced to decline every time storage capacity hits its maximum. As announced on October 10th, return of Indian company Reliance as client is a fact, but it won't change the situation for PDVSA cash flow as they are expected to pay with fuels, including diesel, in compliance with US sanctions. In this sense, Venezuelan oil industry fate is similar to the fate of Venezuelan debt, and we won't expect to see any major change until Maduro regime ends.

Interim government and National Assembly are working to prepare the oil industry for that moment, as according to Reuters they are considering a proposal that would allow private companies to hold majority stakes in joint ventures with PDVSA. It is difficult to understate private sector important role in recovering Venezuela's oil industry, so this kind of incentive are expected and necessary. However, as we have pointed out before, time plays against these efforts to attract investments and if losing CITGO becomes a reality this situation will only get worse.

PDVSA 2020 amortization and CITGO ownership: kicking the can down the hill won't solve the real problem

Regarding the possible outcomes for the PDVSA 2020 payment due October 27th, we can discard any solution coming from Maduro administration. Furthermore, considering current prices it seems like the market isn't expecting any favorable outcome even from Guaidó administration.

Among the scarce options interim government has to face this event, annulling PDVSA 2020 bond is the one that is concentrating most of the efforts to hold back any attempt from the bondholders to seize CITGO shares. The main reason National Assembly use to justify the annulling of this debt take us back to 2017, when Maduro administration carried out a refinancing of PDVSA 2017 bonds using CITGO shares as collateral, without the approval of the National Assembly, which was required under article 150 of the Venezuelan Constitution.

On October 15th, the National Assembly issued an agreement in which they ratify its position, also referring to a previous agreement from May 26th, 2016 that follows the same tone. The interim government also said the coupon payment made last April was done to protect CITGO as they weren't prepared to defend the company in the courts.

In our opinion, this apparently shift in the approach towards PDVSA 2020 bondholders is just the interim government using a more aggressive way to gain time, and possibly a stick to use in negotiations, as some weeks ago the negotiation with bondholders option seemed to be the preferred by the interim government. Furthermore this course of action has other flaws, as we understand it aims to protect CITGO from PDVSA 2020 bondholders, so Guaidó administration may being missing an opportunity to deploy a broader strategy focused in aligning the interest of all creditor that may come after CITGO shares.

Despite final outcome to this matter make take years to come if it reaches courts, it also depends on many things (e. g. governing law, arguments that lawyers use), in that sense we think trying to annul PDVSA 2020 bond will lead nowhere and it may severely hurt Venezuela's future relationships with the markets, so we expect interim government to keep working in other kind of solutions to alleviate the effect defaulting PDVSA 2020 will have on Venezuelan assets and bondholders.

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