March 3, 2023

Compañía General de Combustibles

Compañía General de Combustibles (CGC) is an Argentine company founded in 1920 dedicated to the exploration, development and exploitation of natural gas, oil, and LPG (upstream) and gas transportation (midstream). Upstream activities are carried out mainly by the company, while gas transportation is carried out through associated companies. CGC is present in the Austral, Northwestern, Golfo San Jorge, Cuyana, and Neuquina oil & gas basins in Argentina. Moreover, CGC has a stake in Termap, a port terminal operator in Patagonia. With respect to gas transportation, CGC indirectly owns 28.23% of Transportadora de Gas del Norte (TGN) through their investment in Gasinvest, which is co-owned with Tecpetrol. Likewise, the group has a 40% stake in Gasandes Argentina, a 40% stake in Gasandes Chile, and a 15.8% stake in Transportadora de Gas del Mercosur (TGM).

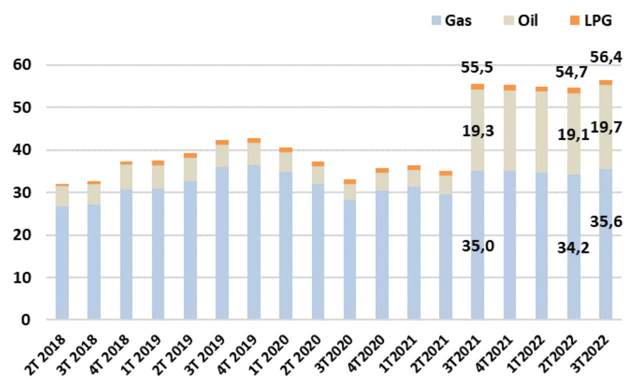
70% of CGC's equity is owned by Corporación América through Latin Exploration SLU, while the remaining 30% is owned by another Argentine conglomerate, Comercial del Plata. CGC closes its fiscal year in December and the latest balance corresponds to the third quarter of 2022.

Production

The company reached a total production of 56.4 thousand barrels of oil equivalent per day (Mboe/d) during the third quarter. This represents a 2% increase y/y and a 3% increase q/q, thus beating a new historical record for the company.

Production has been gradually increasing since the acquisition of Sinopec (now known as CGC Energía) in June 2021. CGC Energía operates concessions in Golfo San Jorge Basin and in Mendoza in the Cuyana basin. The company, fully owned by CGC, covers an area of more than 1 million acres.

Total Production (MBoe/d)

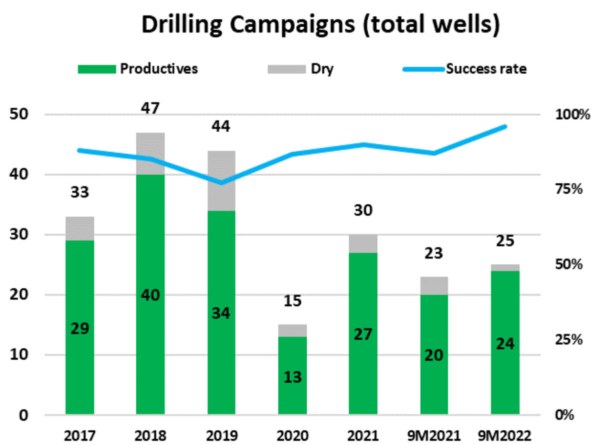


Source: Sekoia Research based on CGC presentations.

During 3Q22, natural gas accounted for 63% of total production, oil 35%, and LPG 2%. Sinopec has balanced the production ratio between oil and gas. Oil production increased more than four times, which generated greater diversification and hedge against the local regulatory risks of the natural gas market.

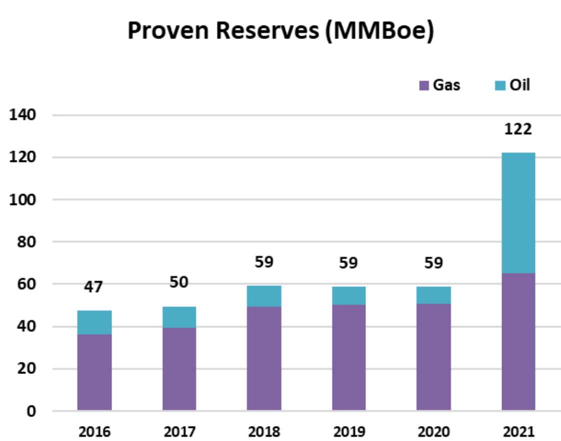
In December 2021, CGC extended the concessions in Golfo San Jorge Basin for another ten years. Differentiating itself from its competitors, instead of focusing on the development of Vaca Muerta (in Neuquén), CGC decided to expand its fields over the Santa Cruz basins. The company considers that the assets obtained alongside the acquisition of CGC Energía have an important potential for conventional oil and aims to achieve an equal amount of oil and gas production in the long run.

In mid-2022, CGC started to operate a second set of drilling equipment in Golfo San Jorge Basin. During the first 9 months of the year, the Company drilled 25 wells (3 were exploratory wells), thus increasing the number of drilled wells compared to the same period of the previous year and bringing the success rate to 96%.



Source: Sekoia Research based on CGC presentations.

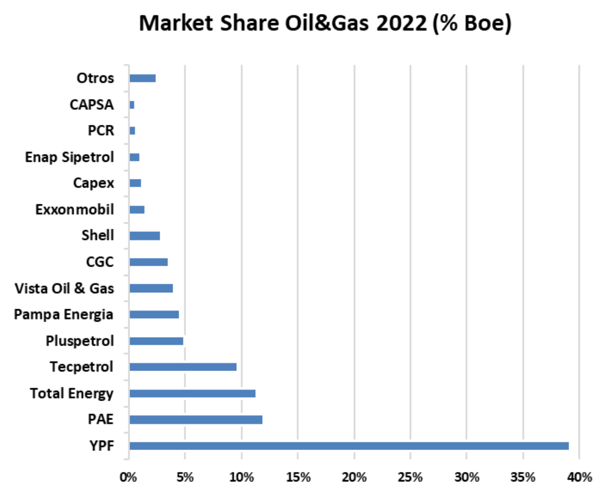
Regarding proven reserves (1P), the company doubled its oil & gas total reserves after the acquisition of Sinopec in 2021. Specifically, oil reserves multiplied sevenfold. The company is expected to report the status of proven reserves for the end of the 2022 fiscal year in the next earnings release.



Source: Sekoia Research based on CGC presentations.

In relation to this, CGC confirmed in February the finding of unconventional oil in Golfo San Jorge basin. The company found shale and tight oil during the drilling campaign. These wells represent a huge bet to boost its activity in the area. According to CGC's directors, there is still more room for exploration. Expectations are high in the area.

As described in our previous report (see here), the acquisition of Sinopec made CGC the sixth biggest company in Argentina in 2021 in terms of total production. The company held its position within the Top 10 in 2022, thus being the eighth Company with a 3.6% market share. CGC is now behind Pampa Energia and Vista Oil & Gas, which are companies with strong growth in recent times.



Source: Sekoia Research based on Secretary of Energy.

Revenues and Results

We will analyze the consolidated results as of the third quarter of 2022. Due to the nature of the oil & gas business, which is tied to the international market, results will be shown in US dollars at the average or closing official exchange rate corresponding to each period.

Sales as of the third quarter totaled USD 769 million, which was 58% higher compared to the same period of the previous year. This huge growth was mainly explained by the consolidation of CGC Energía's results as of 3Q21. Oil & Gas production during the first nine months of the year increased 31% y/y.

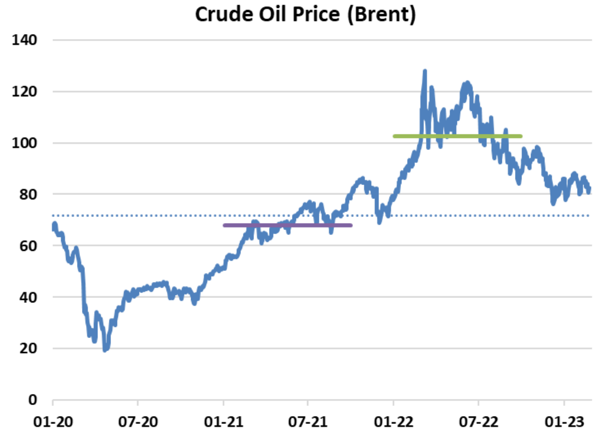
Crude oil revenues increased by 178%, while natural gas revenues increased by 22%. As to natural gas, production incentives declined after the end of Resolution 46 at the end of 2021 (Plan Gas of 2017). Taking into account the increase in gas production, the end of this program meant a loss of USD 115 million to the company.

As shown in the table below, oil participation in revenues increased from 37% to 65%, thereby redefining CGC's revenue equation in a significant manner. The company shifted the focus from gas to oil.

CGC (millions of USD)	9M22	% Share	9M21	% Share	USD q/q	Share q/q
Crude Oil	501	65%	180	37%	178%	2819 bps
Gas	227	30%	186	38%	22%	-857 bps
Services & Others	29	4%	17	4%	68%	24 bps
Production Incentives	12	1,5%	104	21%	-89%	-1986 bps
Total	769	100%	488	100%	58%	-

Source: Sekoia Research based on balance sheets.

The acquisition of CGC Energía is not the only reason for such an increase in revenues, international prices also played their part. Right after the start of the Ukraine-Russia conflict in February 2022, oil & gas prices skyrocketed. The average price of Brent oil during the first nine months of 2021 was USD 72, while during the first nine months of 2022 it was USD 102.



Source: Sekoia Research based on Bloomberg.

During this latter period, 100% of oil revenues from the Austral basin were exports while all of the production from the Golfo San Jorge basin was sold locally. Local oil prices averaged relatively lower than Brent oil as prices gradually adjusted to the evolution of international prices.

As observed in 2021, revenues continue to reflect the expansion of CGC's productive capacity and the good times of the industry. Accumulated revenues for the first nine months of 2022 already exceeded those for the entire of 2021. On a linear estimate of revenues for the fourth quarter, 2022 would have exceeded the USD 1 billion barrier in sales, which would entail a 33% jump with respect to 2021.

Regarding EBITDA, the period accumulated USD 245 million, a 10% contraction with respect to 2021 and 1% with respect to 2019. This reduction was mainly due to the increase of costs which more than doubled. During the first nine months of 2022, both purchases (+286% y/y) and productions costs (+121% y/y) increased. CGC spent more on contractors, payrolls, maintenance, and royalties. The higher costs reduced the gross margin which brought both the EBITDA margin and operating margin down.

CGC (millions of USD)	9M22	9M21	%	9M19	%
Revenues	769	488	58%	396	94%
Cost of Revenues	601	274	119%	246	144%
Gross Results	168	214	-21%	149	13%
Adjusted EBITDA	245	274	-10%	247	-1%
Operative Results	99	171	-42%	105	-6%
Gross Margin	22%	44%	-2196 pb	38%	-1586 pb
EBITDA Margin	32%	56%	-2419 pb	63%	-3062 pb
Operative Margin	13%	35%	-2227 pb	27%	-1370 pb

Source: Sekoia Research based on balance sheets.

On a positive note, the Company increased inventories by 49%, thus doubling its oil and derivatives inventories by 116% in a year. It remains to be seen whether the extraordinary expenses incurred in fiscal 2022 for the start-up of the former Sinopec will pay off in the coming quarters, so that the company can recover its historical margins.

Debt profile and Corporate Bonds

At the close of the last results, CGC reported total financial debt of USD 714 million, fully denominated in dollars. Corporate bonds represent 91%, bank loans 8%, and the remaining 1% corresponds to debts with counterparts.

Debt increased 21% y/y, and CGC issued 5 new bonds for a total of USD 265 million in 2022. The company is a frequent issuer in the local market. Of the USD 650 million of the outstanding capital, 52% corresponds to dollar-linked bonds (class 18, 19, 22, 23, 24, 26, and 28), 25% to the hard dollar 2025 under NY law (class 17), and the remaining 23% to hard dollar bonds under Argentine Law (class 21, 25, and 27). Bank loans are mostly unhedged, they represent USD 57.5 million, and the maturity date is in the first quarter of 2023.

The company will have to pay USD 34.5 million annually in interest, with an annual financing cost of 4.9% due to the dollar linked bonds which some of them have an interest rate of 0%. Moreover, 26% of the financial debt matures in less than a year, while the remaining 74% is distributed until 2031. The average maturity is 2.8 years. Net financial debt is USD 505 million, almost doubling from the previous year.

Cash and equivalents totaled USD 205 million, decreasing 38% with respect to the previous year. It is 72% dollar-denominated in either bank accounts and hard dollar corporate bonds, while the remaining 28% is in Argentine Treasury bills and mutual funds in pesos. Furthermore, financial investments (stocks and bonds) are denominated in US dollars, are valued at fair value, and amounted USD 5 million.

As shown o in the table below, with a linear EBITDA projection for the last quarter of 2022, the company should be able to cover its debt with only one and a half years of operations.

The decline in EBITDA and the rise of its debt, along with the decrease in cash and equivalents considerably raised CGC's debt ratios. Either way, considering that the company is expanding, the financial position remains stable. Likewise, thanks to the fall in financing costs, the EBITDA still represents more than nine times the annual interest payments.

CGC (millions of USD)	3Q22	3Q21	%	3Q19	%
Total Debt	714	592	21%	431	66%
Cash & Equivalent	205	330	-38%	41	405%
Investments	5	8	-44%	42	-89%
Net Debt	505	255	98%	349	45%
EBITDA (annualized)	327	365	-10%	330	-1%
Net Debt/EBITDA	1,5	0,7	121%	1,1	46%
Interests (annualized)	35	40	-13%	41	-16%
EBITDA /Interest	9,5	9,2	3%	8,0	19%

Source: Sekoia Research based on balance sheets.

The NY Law bond has an annual interest rate of 9.5% with semiannual payments. The bond started its sink schedule in September 2022 and has a residual value of 86.7% at the moment.

There are still four more payments of 13.3% and a final one of 33.5% at maturity, so its duration is reduced to only 1.1 years.

Date	Interest	Capital	Sink Factor	Total
3/8/2023	4,12	13,30	86,70	17,42
9/8/2023	3,49	13,30	73,40	16,79
3/8/2024	2,85	13,30	60,10	16,15
9/8/2024	2,22	13,30	46,80	15,52
3/8/2025	1,59	33,50	33,50	35,09
Total				100,97

Source: Sekoia Research based on bond prospect.

The bond was issued after an exchange offer of the 2021 bond during the 2020 pandemic. This exchange was promoted by Argentina's Central Bank in order to control the companies' access to the forex market. Along with the production growth, the bond compressed its risk premium. It now trades close to 101% with a YTM of 8.9%. Participants had a considerable capital gain as the bond traded at 73% in August 2020.

Source: Bloomberg.

View

CGC has been expanding its capacity in the oil business and has enough financial room to sink more capital in order to expand both its conventional and unconventional production. Due to its reserves, CGC Energy has the capacity to keep increasing its oil production with a focus on the international market. The acquisition of Sinopec drastically changed the profile of the company giving it a leap in quality, diversification, exports, and reserves.

CGC 2025 is a bond with good performance, short duration, and an attractive sink schedule that makes it a worthwhile addition to any portfolio. The firm has a healthy financial position, low leverage, and prudent liquidity management. As we have been mentioning, internationally traded Argentine corporate bonds have seen its returns tightened, but there are still some attractive names. CGC is one of them. For this reason, we maintain a strong position of CGC 2025 in our Argentine mutual funds.

For local portfolios that are unable to access the blue chip swap rate due to foreign currency restrictions, dollar corporate bonds under Argentine law are an excellent alternative. Likewise, for those in the import business that need an exchange rate hedge, we recommend the dollar linked variants. We will keep close watch for new issues from this excellent company.

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