

Are The Pillars Of Argentina's Infrastructure Investment Program Sturdy Enough?

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Since President Mauricio Macri took office in December 2015, one of the main priorities of his administration has been putting in place an infrastructure plan to compensate for the insufficient level of investments of the past two decades and the subsequent deterioration in the sector. Moreover, developing infrastructure will help boost economic competitiveness of the country, given that Argentina was ranked 85th among 138 countries in infrastructure development, according to the Global Competitiveness Index 2016-2017 report from the World Economic Forum. This ranking is well behind most of Argentina's neighboring countries, such as Chile (44th), Uruguay (47th), Mexico (57th), and Brazil (72nd).

Energy and transportation are the main pillars of the administration's infrastructure plan, stemming from gas and power shortages, limited or nonexistent railway or road connectivity between the northern and southern regions of the country, and transportation congestion in general. In this sense, the Ministry of Transport announced in 2016 an investment program of \$33 billion to be completed by 2019. The government aims for the private sector to finance about 25% of the plan. The main projects include the doubling of size of the national highway network, the upgrades of existing airports and ports, and the construction and expansion of the rail network, including cargo lines. Furthermore, the Energy Ministry launched a program of \$36 billion in the power sector to be completed by 2025, with the aim of alleviating the energy shortfall by increasing the country's power generation by about 20 gigawatts (GW).

To bolster the framework for investments and attract players, the government approved in February 2017 the new Public-Private Partnership (PPP) law. We believe that the law represents an improvement for credit quality from previous legislation, given that it includes clear adjustment mechanisms over economic equations, allows the conversion of payments into foreign currency, creates a bicameral Congressional control committee that will monitor the projects and establishes clear spread of risk and tasks to be performed by the state and the private investors. However, we consider the biggest challenge for Argentina to boost infrastructure is continuing to rebuild investor confidence in the country and for the new law to gain track record. Moreover, we believe that the need to procure long-term financing is vital, given that under the new PPP law, projects could have an economic life of up to 35 years.

Overview

- In its efforts to bolster economy, Argentina unveiled a massive infrastructure investment plan in 2016, mostly in the transportation and power sectors.
- The country recently approved the new Public-Private Partnership law to help fuel investment, particularly in large projects included in the last year's rollout of transportation and energy investment programs but also in the housing, water, schools, sanitation, and other projects.
- Although we view favorably most of the new law's planks, not enough time has passed to prove its effectiveness in attracting private-sector investment in infrastructure, while most of the financing in the country is still of fairly short tenor.
- Moreover, the country is suffering from the impact of 20 years of negative precedents such as concession contracts still pending renegotiations since 2003, frozen electricity rates, reprofiling of debts, the sovereign's default, and overall unclear investment conditions.

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The Breakdown Of The Transportation And Energy Infrastructure Plans

The main purpose of the government's initiatives is to expand and improve the country's infrastructure sector, which has suffered from considerable underinvestment in the past 15 years. From an economic and political standpoint, the plan will also allow to foster foreign direct investments and improve overall level of the country's competitiveness.

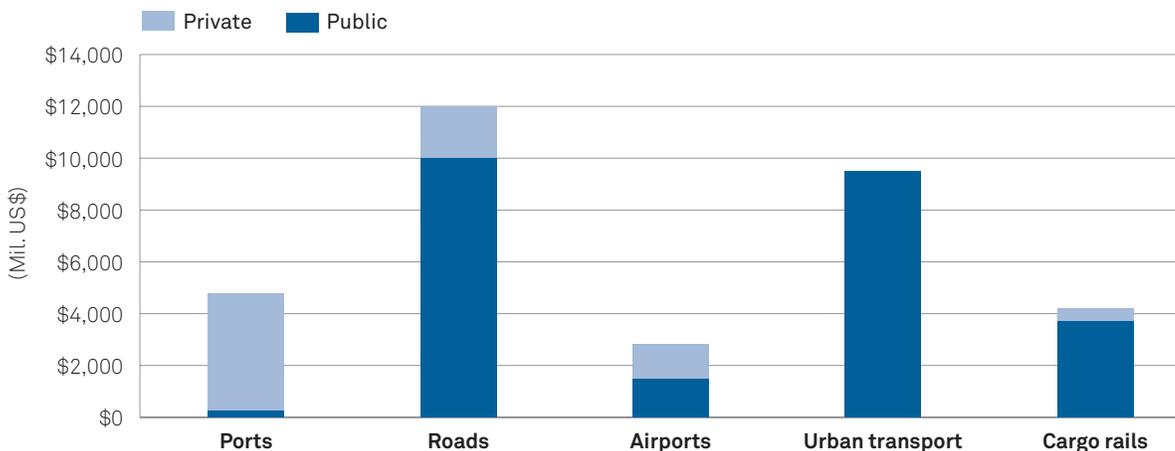
The \$33 billion program for the transportation sector aims to invest in five segments: the cargo rail network, roadways, ports, airports, and urban transportation infrastructure. According to the government, by 2019 there will be 2,800 kilometers (km) of new motorways, 13,000 km of refurbished and paved works, and about 2,500 km of the so called 'safe roads', which are wider to include asphalted benches. This will be complemented by expansion of the core and secondary railway networks and the upgrades of the existing cargo railway lines. Ports and airports are also expected to be expanded and improved, which will also contribute to ameliorating the logistics bottlenecks around the extensive territory of the country. Projects also include the creation

of the Regional Express Rail (RER), burying the Sarmiento rail line, construction of viaducts, and electrification of passenger rail lines in Buenos Aires. Overall, the investment program will constitute the most ambitious and largest transportation infrastructure plan in the country's history for a 4 years period. According to the Ministry of Transport, public sector is expected to provide about 75% of investment for the plan and the remainder, or the equivalent of \$8.5 billion, is expected to come from private sector.

In 2016, the government implemented several initiatives in the energy sector including the increase of the electricity system's capacity through additional conventional and renewal energy, improvement of the transmission and distribution systems, and expansion of the natural gas pipeline network. The target is to add by 2025 10 GW of renewable energy, 8 GW of thermal, 3 GW of hydro, and a minor portion of nuclear energy, and to strengthen the transmission and distribution infrastructure. Overall, the government estimates the electricity sector investments to total around \$36 billion. Unlike the transportation plan, private-sector players are likely to account for the majority share of power-sector investments.

Chart 1 – Argentina's Transportation Plan Until 2019

Breakdown between private and public



Source: Argentine Ministry of Transportation.

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Table 1 – Main Infrastructure Projects In Argentina

Transportation	Detail	Amount (Mil. US\$)	Period
Roads	2,800 km of new roads Refurbishment of roads and paving. Approximately 13,000 km. Works to improve security in 4,000 km	\$12,000	2019
Ports	Works at Buenos Aires port Investments nationwide	\$4,760	2019
Freight rail	Recovered network New locomotives and wagons	\$4,200	2019
Airport	Investments in air traffic Investment in national airports	\$2,810	2019
Urban mobility	Sarmiento's undergrounding Regional Express Rail (RER) Rail plan in the metropolitan area New rolling stock Viaducts Electrification BRT system	\$9,500	2019
Total		\$33,270	
Energy	Detail	Amount (Mil. US\$)	Period
Renewables	Wind, Solar, Biomass - 10 GW	\$15,000	2025
Thermoelectric	8 GW	\$6,000	
Hydro	3 GW	\$10,000	
Transmission lines	>5,000 km	\$5,000	
Total		\$36,000	

Source: Argentine Ministry of Transportation and Ministry of Energy & Mining.

Table 2 - Recent Issuances In The Infrastructure Arena In Argentina

Entity	Sector	Issuance date	Coupon	Maturity	Amount (Mil. US\$)	Amount Offered (Mil. US\$)
AES Argentina Generacion S.A.	Power	January 2017	7.750%	2024	\$300	\$1,600
Aeropuertos Argentina 2000 S.A.	Airport	January 2017	6.875%	2027	\$400	\$2,600
Pampa Energia S.A.	Oil & Gas / Power	January 2017	7.500%	2027	\$750	\$4,000
Genneia	Renewable	January 2017	8.750%	2022	\$350	\$1,050

Source: Bloomberg.

The Government Is Pushing A Raft Of Changes To Lure Investors Back

The Macri administration has accomplished the following initiatives since the end of 2015, which have been sending encouraging signals to investors and reversing, in our view, several restrictions that in the past limited investments in the infrastructure:

- Cuts in subsidies on energy and transportation;
- Liberalization and combination of the exchange rate;
- Elimination of capital controls;
- Reduction, and elimination of some, export duties;
- The start of the restructuring of Argentina's statistical agency; and
- The passage of the "Holdouts Law" in March 2016, which allowed Argentina to cure its July 2014 default and regain access to external financing while restoring relations with the international capital markets.

In light of these business-friendly moves, the private-sector has begun to show interest in Argentina's efforts to boost its infrastructure. For example, in the second half of 2016 and after launching the RenovAR project—a public tender program that includes certain fiscal incentives and financial support mechanisms, along with regulatory enhancements to support investments in renewable energy—the government awarded contracts totaling 2.4 GW to private entities (or the equivalent of about \$3 billion) while the bidders' offers surpassed 6 GW. On the other hand, the number of bidders in the transportation projects increased on average from 4-5 participants to almost 11, according to the Ministry of Transport.

In our view, one of the main challenges at this stage will be developing projects in both transportation and energy sectors by using

a combination of public- and private-sector funding. Financing from multilateral lending agencies and banks is the most popular method to finance Argentine infrastructure projects in general. However, we believe that issuances in the international markets could also become a viable alternative, given that the local capital market is still underdeveloped and that global markets' appetite for Argentine debt has increased in the past year. The latter is seen in the bonds issuances among some domestic infrastructure players, such as AES Argentina Generation S.A. (B/Stable/--), Aeropuertos Argentina 2000 S.A. (B+/Stable/--), Pampa Energía S.A. (B/Stable/--), and Genneia S.A. (not rated). In January 2017, the average rates for Argentine infrastructure entities' bonds were in the 6.875%-8.5% range, compared with 10%-11% in 2015. Moreover, we expect that access to the capital markets could help foster long-term financing, as it has happened in other Latin American countries such as Brazil, Chile, Peru, or Colombia in the past 10 years.

Will The New PPP Law Spur Public-Works Investments?

We believe that the new legislation includes several positive features from a credit standpoint that represent significant advances from previous laws. Particularly, we believe that the framework will allow setting the grounds between obligations and rights for private-sector concessionaires in a clear and established manner, including works that will need to be conducted and compensation mechanisms. Our view is that the law allows sponsors and lenders to design financing structures, which will support repayment of debt. In addition, the law consists of the following credit-friendly planks:

- Transparent and competitive bidding processes.
- Rate adjustments. A concessionaire can maintain the original economic return of the contract, because it allows a rebalance of the

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conditions under stress scenarios. Moreover, PPP participants may agree to have a rate payable in foreign currency, which will alleviate the foreign-exchange risk.

- Security. According to the law, receivables and rights under the PPP contracts can be pledged under various agreements and equity stock from the project developer. This will allow the development of new funding alternatives, such as project finance debt as has been the case in Chile and Mexico in financing the toll roads.
- Lenders will have subrogation rights. Financial contracts may include possibility of taking temporary control of the project during an event of default under the PPP agreement.
- Contemplates the creation of the Congressional PPP Control Committee whose main objective will be to oversee PPPs. We view such a body as a positive development, particularly during the construction period, given that its mission would be to monitor the compliance with the contracts' specifications.
- PPP agreements will set conditions of the compensation in cases of early termination for reasons of public interest, as well as their valuation and payment method. The law also provides clarity on guidelines and consequences for early termination and cure periods.
- Greater visibility in arbitration and dispute resolution processes in which the various parties may appoint expert committees to resolve disputes or select neutral countries to host the arbitration proceedings.

However, the biggest obstacle for this law to be successful is its lack of track record, because the government has yet to grant PPPs under this framework.

Attracting International Construction Giants To Argentina Is Essential

We believe that the participation of major construction and engineering firms will increase the degree of certainty of completing the projects' construction, given the companies' expertise to construct and develop on time, on budget, and according to specifications. In addition, we expect top construction players to increase competitiveness in terms of price.

Chile's success in developing its infrastructure is well known, given that large international players constructed a huge amount of transportation projects in the late 1990s and early 2000s. These assets have demonstrated robust operating performance, even under tough conditions that include severe earthquakes. Moreover, their construction was performed within expectations, and deviations from original budget were minor.

For private-sector participants looking at what Argentina has to offer, the task will be balancing risk and returns.

The Assessment Of Counterparty Risk Will Depend On The Obligor

The main factor to determine our view of counterparty risk in PPPs will be identifying which entity is the ultimate obligor. More specifically, if the payment is an obligation of the sovereign, a subnational government, a ministry, a public-sector agency that oversees the PPPs, or a dependency of a ministry. We will perform an analysis to determine the creditworthiness of the counterparty and assess the risk of performing timely and ongoing payment of the PPP commitments.

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Existence Of An Infrastructure Agency Won't Guarantee Success

In their drive to kick-start infrastructure development, several of Argentina's neighboring countries had created infrastructure agencies: ANTT in Brazil, ANI in Colombia, or ProInversion in Peru. Their main objective is to attract infrastructure investments, oversee and prioritize the bidding process for the projects, and monitor their construction and operations. We view these bodies as helpful tools, particularly because they ensure that all the participants adhere to the regulatory framework and because they gain expertise in the process of granting concessions and PPPs, and supervising projects. However, Chile and Mexico are developing their infrastructure without such an entity.

The main limitation for Argentina is, in our view, the timeframe to develop such an agency because of the ambitious schedules the government has set to complete the investment programs for the transportation and power sectors, 2019 and 2025, respectively. Based on the experience of the Latin American countries, the establishment and ramping up of such an agency takes more than two years. The body would have to have high governance standards, political independence, and a proven track record in order to be credible to the markets and investors.

Argentina Has A Formidable Task In Improving Its Infrastructure Sector

We believe that the PPP law's robust and clear framework will make it easier for the private sector to invest in various new infrastructure projects. Argentina has rolled out a large roster of the latter to jolt its economy from several years of lackluster performance. However, we don't believe the law is sufficient to guarantee the success of the government's infrastructure investment program. This is because we believe that the new law must accumulate a positive track record and reverse the pernicious impact of Argentina's anti-business policies during the past 15-20 years. The second obstacle will be to diversify the funding sources for the projects, given the long-term nature and large scale investments. Finally, the entry of big international players to Argentina's infrastructure sector is much needed because of their expertise in constructing projects within a fairly short horizon.

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