RATING ACTION COMMENTARY

Fitch Affirms Compania General de Combustibles' IDR at 'B-'; Outlook Stable

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Fitch Ratings - New York - 31 Aug 2022: Fitch Ratings has affirmed Compania General de Combustibles S.A.'s (CGC) Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDR) at 'B-'. The Rating Outlook is Stable.

CGC's ratings reflect its production profile, reserve base, leverage and the recent improvement in its liquidity profile. CGC's increased production and its strong liquidity profile and exports help mitigate the impact of capital controls.

CGC's 'B-' LT FC IDR is constrained by Argentina's Country Ceiling of 'B-', which limits the foreign currency rating of Argentine corporates. Fitch's Country Ceilings are designed to reflect the risks associated with sovereigns placing restrictions upon private sector corporates, which may prevent them from converting local currency to any foreign currency under a stress scenario and/or may not allow the transfer of foreign currency abroad to service foreign currency debt obligation.

KEY RATING DRIVERS

Weak Operating Environment: CGC's ratings are capped by the country ceiling of Argentina, given its exposure to the federal government through gas purchasing agreements (Plan Gas) over the rating horizon. Argentina's energy sector is influenced by the government, as it is a strategic sector for economic growth and revenues (through taxes, royalties, and exports). It also relies on government subsidies to incentivize gas development. CGC is a major participant in the gas market, especially in the southern part of Argentina (Austral). It stands to benefit from the further development of the energy market but is exposed to unpredictable government intervention, which has historically been challenging for corporates.

In recent years, despite having the world's largest shale gas deposit, Argentina has relied on gas imports from Bolivia and LNG to meet local demand. This increased gas prices domestically, which benefited gas producers, but Fitch expects further government intervention since current prices are not sustainable.

Production Profile: CGC's production increased by 58% in 2021 compared to 2020, reaching 55,500boed, following last year's acquisition of Sinopec Argentina. The acquisition diversified the company's operations and production profiles by adding sites in San Jorge, Neuquina, and Cuyo basins. These are prolific basins, and Cuyo falls within the prolific Vaca Muerta basin, complementing CGC's existing operation in the Austral basin.

As of end of June 2022, CGC is now the seventh largest gas producer, up from eighth, and fifth largest oil producer, up from 16th, in the country. CGC's 1P reserve base increased by 108% to 122mmboe, and its 1P reserve life at 6.4 years expected for 2022, up from 4.5 years at the end of 2020. Production mix was 63% gas and 27% oil.

Stable Cash Flow Profile: Fitch's rating case estimates FCF will be negative in 2022 as the company deploys USD300 million in capex to its assets located in the San Jorge and Austral basins. For 2023-2025, CGC is expected to be FCF positive, absent any extraordinary dividends, capex, or acquisitions. CGC's cash flows are supported by contracted revenues under Plan Gas 4 (PG4) through 2024. Fitch estimates the weighted average realized price for gas in 2022 will be USD4.14Mmbtu and between 2023 through 2025. At least 40% of its total production is contracted under PG4 at a price of USD3.46Mmbtu.

CGC is exposed to potential payment delays by the government, but this is mitigated through its oil production, which will partially be exported, and non-contracted gas sales. Moreover, the company maintains a strong liquidity position, a large portion of which is held in USD abroad, to offset the impact of capital controls and payment delays. The company stands to benefit from the easing of the capital controls (Decree 277/2022) that encourages energy companies to increase exports, by allowing them to maintain dollars abroad.

Adequate Leverage Profile: CGC's gross leverage, defined as total debt to EBITDA, is expected to be 2.1x in 2022 and decrease to an average 1.7x over the rating horizon, which assumes debt will be rolled over each year through 2025. Total debt to 1P is expected to be USD4.43boe in 2022, an improvement from USD6.76boe in 2020. CGC has roughly USD110 million of debt maturing in 2022. The largest portion comprises of USD57.5 million outstanding of its 2021 syndicated loan. The rating case assumes that CGC will tap local markets to replenish its cash position and will maintain debt at or below USD500 million per annum between 2023-2025 on its balance sheet.

DERIVATION SUMMARY

CGC's (B-/Stable) credit profile compares favorably to Argentine corporates Pampa Energia (B-/Stable) and Capex S.A. (CCC+) and to other small independent oil and gas companies in the region. The ratings of GeoPark Limited (B+/Stable), SierraCol Energy (B+/Stable), Gran Tierra Energy International Holdings Ltd. (GTE)(B/Stable), and Frontera Energy (B/Stable) are constrained to the 'B' category, given the inherent operational risks associated with small scale and low diversification of their oil and gas production profiles.

Compared to Argentine peers Pampa Energia and Capex, CGC's has a conservative leverage profile and strong liquidity that help mitigate the impact of capital controls.

CGC is an energy company, and its business profile compares mostly to Capex and Pampa's upstream business, but both Capex and Pampa are diversified energy companies that generate majority of cash flows from power generation, thus they are more exposed to CAMMESA. Both Pampa and CGC are leaders in Argentina in their respective business operations.

CGC produces both oil (33%) and gas (67%) exclusively in Argentina, which limits its ratings, its offtaker and impact of capital controls. Nonetheless, its pro forma production size compares favorably to other 'B' rated oil and gas E&P producers, which will constrain its rating to the 'B' category. These peers include Canacol, Geopark, SierraCol, Gran Tierra Energy, and Frontera Energy.

Over the rating horizon, Fitch expects that CGC's production will average 57,000boed, which is higher than all its peers, as SierraCol is expected to produce on average 36,000boed, Geopark and Frontera both of which are expected to be 45,000 bbld, GTE at 35,000boed, and Canacol at 45,000boed. CGC's 1P reserve life is expected to be 6.9 years, which is comparable to that of its peers, as Sierra Col's 1P reserve life is 7.2 years, Frontera at 6.2 years, Geopark at 6.3 years, GTE at 6.0 years, and Canacol at 6.3 years.

CGC's 2021 half-cycle production is expected to be USD20.0boe and full-cycle cost to be USD27.06boe. In line with GTE at USD20.2boe in 2021 and full-cycle cost to be USD38.4boe, but CGC is higher than SierraCol's half-cycle production cost of $13.70 bbl in 2021 and full-cycle cost was $26.60 bbl, but better than Frontera's at $28.60bbl and $42.20 bbl. CGC's high cost of production is mostly attributed to a higher cost of capital of USD4.8boe, due to its operating environment in Argentina.

CGC has an adequate capital structure with gross leverage, defined as total debt to be EBITDA, expected to be 2.1x in 2022 and total debt to 1P estimated to be USD4.43boe, and average 1.7x and 3.24boe between 2023-2025, respectively. This compares well to GTE's 1.4x gross leverage and total debt to 1P be USD9.97boe, Frontera at 1.5x and USD5.21 bbl, and Canacol at 3.5x and USD7.0boed.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

Operations

--Oil and gas production to average 57,000 boe/d over the next four years;

--Average realized natural gas price of USD3.50mmBTU flat over the rating horizon under PG4;

--Average realized Brent price of USD86bbl in 2022, USD85bbl in 2023, and USD53bbl long term;

--Capex of USD300 million in 2022; annual average of USD150 million between 2023 and 2025;

--Lifting cost (COGS - D&A) of USD18.00boe average between 2023-2025;

--Selling expenses are USD1.70boe flat from 2023-2025;

--SG&A expenses are USD 2.00boe flat from 2023-2025;

--Exploration expense are USD 0.20boe flat from 2023-2025;

--Other income expenses are USD0.50boe flat from 2023-2025;

--Reserve replacement ratio of 105% per annum.

Financial:

--Fitch Average and EOP ARS/USD exchange rates;

--Dividends received of USD7 million per annum 2022-2025;

--Dividends paid of USD10 million per annum 2022-2025;

--Debt outstanding remains close to USD500 million per annum from 2022 through 2024;

--Interest costs are 9% of total debt outstanding.

RATING SENSITIVITIES

--Any further regulatory developments leading to a more independent market that is less reliant on support from the Argentine government could positively affect its collections and cash flow given the company's dependence on PG4 subsidies paid by the government;

--Contracted exports with high quality off-takers with a long-term tenure with adequate legal protections to avoid interference from the federal government;

--Loosening of central bank capital controls rules allowing the company to strengthen its hard-currency cash balance;

--Maintaining a gross leverage, total debt to EBITDA profile of 2.0x or less.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade of Argentina's country ceiling ratings;

--Amendments to capital control rules which weakens the company's ability to access its capital and refinance debt;

--Significant delays in payments that negatively affect working capital, liquidity and leverage;

--Revision of existing contracts (PG4);

--Significant deterioration of credit metrics of total/EBITDA of 4.5x or more.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: CGC reported USD300 million in cash and cash equivalent in 2Q22, sufficient enough to cover debt maturities in the next 12 months. The company's debt was USD719 by the end of June, composed by USD247 million in short-term debt. The rating case assumes that CGC will tap local markets to replenish its cash position and will maintain debt at or below USD500 million per annum between 2023-2025 on its balance sheet.

ISSUER PROFILE

CGC is an energy company with operations in Argentina, engaged in the development, production and exploration of natural gas, crude oil, LPG (upstream business) and with a significant interest in a network of pipelines in northern and central Argentina.

Sources of Information

The principal sources of information used in the analysis are described in the applicable criteria.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Compania General de Combustibles S.A.	LT IDR	B- Rating Outlook Stable	Affirmed	B- Rating Outlook Stable
	LC LT IDR	B- Rating Outlook Stable	Affirmed	B- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Compania General de Combustibles S.A.	EU Endorsed, UK Endorsed

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