

Argentina

Less government interference

Since Mauricio Macri took office on December 2015 several sector-based measures were adopted, among which stand out: (i) a price cut of about 10% for crude oil at the wellhead, (ii) the stepped rise of fuel pump prices as part of an agreement with distributors to curb inflation, and (iii) the dissolution of the commission that oversaw production and investments during the last 4 years. As a whole, and pending structural reforms, these measures set a trend of adjustment and less regulation for the local oil and gas market in 2016.

Production mix dependent upon price dynamics

In our view, small E&P companies concentrated in oil production will be heavily impacted by price adjustments; therefore we anticipate likely M&A activity in the near future. Despite the sharp drop in the cost of imported gas, the Government would maintain stimulus packages to increase production of natural gas given the current dependence on imports to meet demand (20-to-25 percent of total consumption). In this regard, we believe that investment destination and productive mix of companies that have access to gas fields could further change towards development of gas operations. A separate remark for upstream firms that generate exportable surpluses, whose earnings from international sales will remain constrained by a global market dynamic characterized by oversupply and a price per barrel below \$45. To mitigate exporters's decline in profitability, the Government agreed in February to a subsidy of \$10 per barrel of heavy oil destined to foreign markets during 2016.

Local currency devaluation narrows refining margins

Integrated oil companies will reduce their costs in dollars due to the lower price of raw material, but on the other hand will also experience greater pressure on business margins as a result of the strong devaluation of the Argentine peso (almost 60% since the new Administration eased capital controls and floated the currency) that fails to be offset by the agreed rise in retail fuel prices. In turn, we expect lower-scale not integrated refineries to have higher exposure to financial stress situations, as they will suffer from the imbalance between the purchase price of feedstocks and the wholesale price of refined products. The opening up to "cheap" crude imports to cover shortfalls would moderate segment costs.

Stable investment flow, but focused on productivity

We consider that signals of transition towards a less regulated market could encourage capital inflows, although in the current context of depressed international prices we do not expect a significant increase of foreign direct investment in the sector. Conversely, recent tightening measures affecting profitability could have a negative impact on local source investments, mainly in those aimed at resource exploration and refining capacity expansion.

Downward price scenario hinders sector development

Current local prices are above international levels. Fix estimates that, in the mid-term, local prices will tend to converge to international prices at a lower level, resulting in declining activity, some deterioration of the sector's balance of trade and increased idle capacity. The extent of the above depends on the gradual recovery from the depressed phase of the cycle affecting the sector globally (possibly starting in the second half of 2016).

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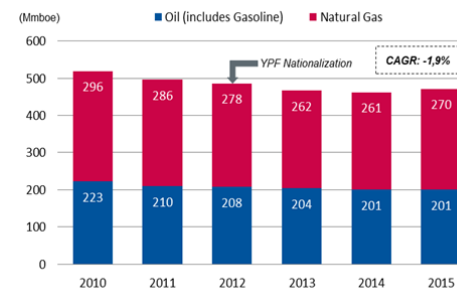
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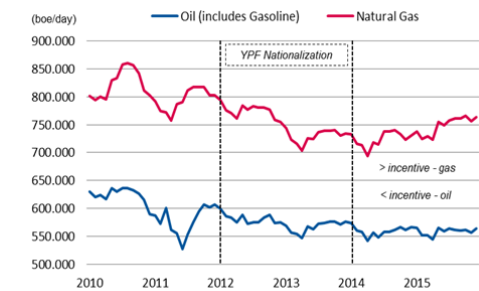
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Oil & Gas Production (annual)



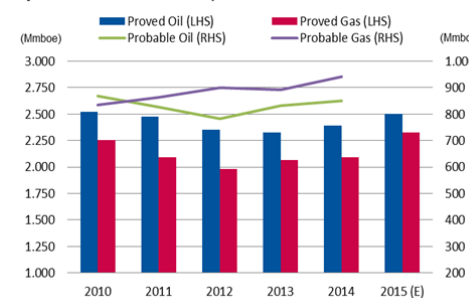
Source: Ministerio de Energía y Minería

Oil & Gas Production (daily)



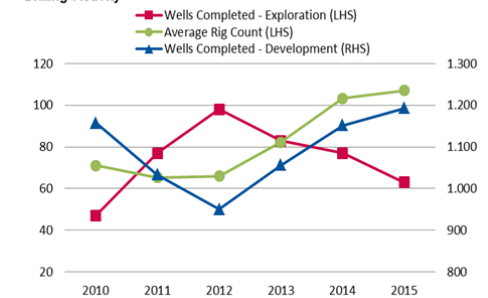
Source: Ministerio de Energía y Minería

Hydrocarbon Reserves Development*



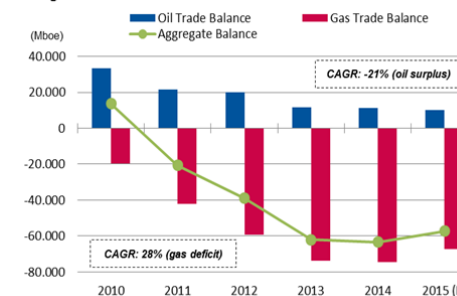
Source: Ministerio de Energía y Minería, EIA, Fix Scr
* does not include new discoveries of unconventional reservoirs in recent years

Drilling Activity



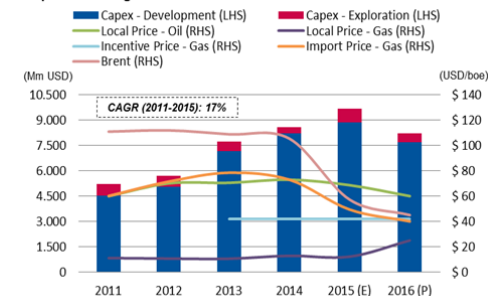
Source: Ministerio de Energía y Minería, Baker Hughes

Foreign Trade



Source: Ministerio de Energía y Minería, IAPG, Fix Scr

Capex* & Average Prices



Source: Ministerio de Energía y Minería, IMF, Fix Scr
* does not include foreign direct investment

Glossary:

boe: Barrel of oil equivalent CAGR: Compound Annual Growth Rate EIA: U.S. Energy Information Administration IMF: International Monetary Fund IAPG: Instituto Argentino del Petróleo y del Gas LHS: Left Hand Side RHS: Right Hand Side

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