# GRANT'S

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## So long, then, Cristina Fernandez de Kirchner

Wastrel governments the world over are borrowing at negligible rates of interest (some at less than zero). Argentina, for all intents and purposes, can't borrow, at least not on the international capital markets. The country's a mess and it pays mess-appropriate yields. The Argentine value opportunity is the subject at hand.

Like Russia, Argentina is so bad that it almost can't get worse. Notice: *almost*. In human affairs, there's always room for deterioration. The speculator in Argentine debt and equities may possibly suffer a permanent loss of capital. However, we judge that—again, as with Russia—valuations favor the optimist. *Grant's* is bullish on the Country that Ruined Itself.

In a sense, Cristina Fernandez de Kirchner, the disastrous two-term Argentine president, stands to do the value-seeking investor not one good turn, but two. In misgoverning, she's wrecked the economy. By stepping down, she'll improve it. Her policies have destroyed asset values. Her leaving will crystallize the opportunity to participate in the recovery of those values.

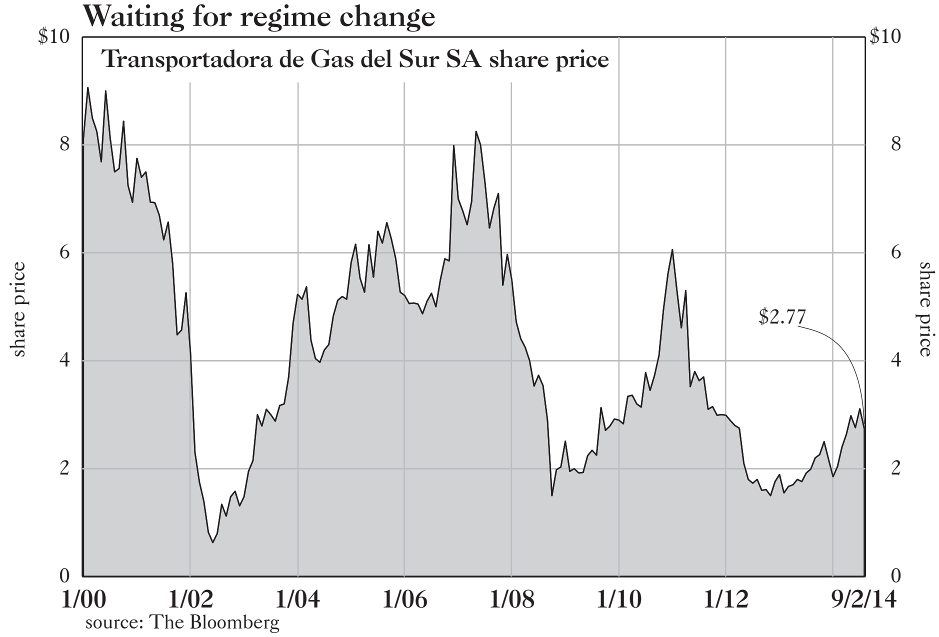
When Vladimir Putin may choose to become the ex-czar of Russia is anybody's guess. When Fernandez leaves office is already on the calendar. Her constitutionally mandated departure corresponds to the next presidential election in October 2015. Bloomberg recently quoted an Argentine asset manager, Claudio Porcel, to the effect that her successor, whoever he or she might turn out to be, will be a person to be envied: "The next president will regain market access and be able to raise as much as $60 billion in sovereign, provincial and corporate debt. I can't imagine a better job."

A general strike in Argentina last week, the second in five months, is testament to how very much room there is for improvement. The unofficial—therefore, reliable—inflation rate is running near 40%. Business activity is stagnant or shrinking. The free-market peso is setting new lows against the dollar. Power outages are recurrent. In the province of Buenos Aires, home to one-third of Argentina's 41 million people, residential real estate sales showed a 20% year-over-year decline in July; they've been falling for 30 consecutive months. Domestic financing activity is moribund.

If CFK, as La Presidenta is unaffectionately known, had merely debauched the currency, the Argentine opportunity would probably not be so ripe as it is today. But her government compounded the inflationary damage by instituting price controls, import bans and capital controls. (In an especially maladroit attempt to pretty up the inflation data, the government leaned on McDonald's to suppress the price of the Big Mac, that eponym of the *Economist* magazine's Big Mac Index.) It nationalized the railroads and the pension system and expropriated the 51% ownership in YPF, the top Argentine oil company that was held by the Spanish energy company Repsol. It famously defaulted on its external debt and has spitefully refused to pay the $1.5 billion it owes to paid-up subscriber Paul Singer.

As it would be unfair to keep all the

**Waiting for regime change**




source: The Bloomberg

money it filches, the regime returns some of it to the people as gifts, or subsidies. "Consider," relates colleague Charley Grant, "an ordinary electric bill from the Buenos Aires utility, Edenor S.A. The bill I've reviewed shows that 373 pesos worth of power was consumed in the 58 days to Jan. 24 ($44.35 at the official exchange rate, $26.27 at the so-called 'blue,' or free-market exchange rate, each as currently quoted). The consumer, however, bears nothing like the full freight. Post-subsidy, he or she pays just 162 pesos. To deepen feelings of customer gratitude, Edenor gives over a portion of the invoice to detailing just how much more those 58 days of power would have cost in Montevideo, Uruguay (1,347 pesos) or Santiago, Chile (823 pesos)."

It can't be said that the prospects for post-Fernandez relief are entirely undiscounted. Since the run-up to the 2013 election in which the incumbent Peronist party suffered its mid-term shellacking, the 13-company Argentine Merval Index has returned 75% in dollar terms, according to Bloomberg. Nor is there much suspense about who the next president might be. Daniel Scioli, governor of Buenos Aires province; Sergio Massa, the former head of Fernandez's cabinet; and Mauricio Macri, mayor of the city of Buenos Aires are the three acknowledged front-runners. Whatever else their differences, the contenders seem to agree that capital controls must be lifted, real rates of interest restored and a Paul Singer settlement effected.

And—*and*—Argentina watchers concur, it would be nice if the government stepped aside long enough to permit development of the country's immense Vaca Muerta shale oil and gas formation, one of the world's richest energy deposits. Discovered by YPF in 2011,Vaca Muerta will cost between $140 billion to $200 billion to develop, according to figures cited by the *Economist*; just $3.7 billion has been ticketed to date (for comparison, the country is expected to spend up to $13 billion this year on foreign oil). "Argentina's biggest problem is the lack of dollars," an Argentine corporate executive—he asks to go nameless, as "it's not good to be quoted in Argentina"—tells Grant. Foreign exchange reserves of the Argentine central bank stood at $52.6 billion as recently as 2011; they have subsequently dwindled to $28.8 billion.

It was Cullen Thompson, president and chief investment officer of Bienville Capital Management, who called the Argentina story to our attention. Constant readers may associate Thompson and Bienville with a very different kind of opportunity. In 2012, they spotted what has proven to be the commanding value inherent in Gulf Coast real estate, then doubly ravaged by the Great Recession and the BP oil spill (*Grant's*, June 29, 2012).

Alabama beachfront property and Argentine real estate and public securities have one thing in common, at least, Thompson said in an interview on Tuesday. Inherent in each is the promise of an "asymmetrical" return, with prospective gains far in excess of prospective loss. Since last fall, Thompson said, he has become a regular commuter to Buenos Aires, which he is wont to refer as "BA." In April, his firm unveiled its Bienville Argentina Opportunities Fund, and Thompson said he means to have the money invested (he wants to raise $300 million) by the first quarter of next year.

"We're playing the normalization," Thompson went on, "being first a rerating of the equity markets, and really all asset prices as the country risk comes down, and we believe the country risk will come down, certainly after Cristina leaves office. And then the second part of the trade, so to speak, will be certain sectors and companies that will benefit from an actual adjustment in the real economy. Financial services come most immediately to mind, banks that are able to offer real rates to attract deposits to actually allow for credit intermediation. Anything capital market-related should do pretty well, but that's going to require a couple of years of effort under a new administration to bring inflation down."

Argentine public equity values look cheaper in the aggregate than they do on a stock-by-stock inspection. Thus, a July report issued by Raymond James Latin America found that, as of May 31, Argentina's domestic market cap totaled $55 billion, representing just 17% of GDP, against the regional average of 49% of GDP (which, if Argentina achieved it, would lift the aggregate value of Argentine equities to $160 billion). As for the stunted local banking situation, the ratio of bank credit to GDP in Argentina stands at 14%; the regional average is 50%.

"Not surprisingly," Grant observes, "liquidity is not the Argentine market's strong suit. According to Bloomberg data, 12 companies have a market cap of more than $1 billion. Just two have market caps of over $5 billion (YPF, the giant, weighs in at $13 billion). From March through May of this year, the daily average of domestic Argentina equity trading amounted to all of $14 million. Reviewing these data, one is not surprised to recall that MSCI Barra demoted Argentina from 'emerging' to 'frontier' status back in 2009. So it was that the long-ago 10th richest nation in the world (that was in 1914) joined the stock market company of Bosnia Herzegovina, Zimbabwe, Ukraine, Oman and Pakistan. ARGT, the NYSE Arca-listed Argentine exchange-traded fund, is valued at the grand total of $34 million."

For a case study in what ails Fernandez's Argentina—and for a hopeful glimpse at what might improve upon the incumbent's long-awaited departure—we present the country's No. 1 natural-gas delivery company, Transportadora de Gas del Sur SA (TGS is the ticker of the New York-listed American Depository Receipt); $440million is the market cap.

There are three business segments: distribution and production of natural gas liquid; natural gas transport; and midstream services. Relatively thriving is the first-named, natural gas liquids unit. Demand is strong and volumes are growing; in the first half of 2014, they jumped by 10.6%. The business is unregulated and revenues are denominated in dollars.

A very different story is the transportation division. Tariffs are regulated—until recently, there had not been an increase since 1999. What with inflation and devaluation, the transportation unit takes in 75% less in dollar terms than it did in 2001. In that year, the parent earned $108.5 million in net income. In the 12 months ended June 30, it netted just $7.8 million.

As to valuation, TGS is quoted at a ratio of enterprise value to EBITDA of just under five times (enterprise value being defined as equity market cap plus debt minus cash). Observes Thompson, "The valuation may seem somewhat cheap when compared to other natural gas transportation/distribution companies in the region—they're trading at six times enterprise value to EBITDA. However, when factoring in the potential profitability recovery that TGS could have, the valuation is extremely attractive and the investment proposition is very asymmetric."

Class B Argentine office buildings, when they come on the market at all, can be had at cap rates of between 12% and 15% (in dollars), compared to the 5% to 8% cap rates prevailing in most of the region (in local currency), according to Thompson and his local contacts. To hedge against the depredations of the state, Argentine savers have tended to buy residential property and farmland, or so we understand; commercial real estate is an asset class under built, underfinanced and (no doubt) undermaintained. There's very little mortgage finance, and next to no liquidity.

"Anecdotally," says Thompson, "prices of land for commercial development are back to levels not seen since the mid-1990s, and the land incidence (that is, the price paid for land in development) on many buildings is a third to a quarter of the levels of comparable projects in Latin America. Land prices for logistics facilities in Buenos Aires are $100/per square meter vs. roughly $500/square meter in Sao Paulo. Thus, even if the end prices for commercial leases or residential apartments don't move higher in Argentina, there is substantial room for prime land prices to re-rate three or four times higher."

With the normalization of governance—say, to borrow from our friend Arjun Divecha, chairman of GMO, with the quality of Argentine politics improving from awful to bad—may come the normalization of finance. For a country notorious as a sovereign-debt defaulter, Argentina is only lightly leveraged. "Most major properties have minimal or zero leverage," Thompson relates. "Mortgage debt is 2% of GDP, virtually nonexistent. Increasing leverage on properties would allow property owners to increase their IRRs and have lower cap rates. Additionally, the broader availability of credit would act as a support to valuations in real estate as an asset class."

Listening to Thompson and to his on-the-ground confreres, we see that Argentina is fundamentally an interest-rate story. Now the country groans under its punitive, self-inflicted sovereign borrowing costs, as evidenced in the 17.3% yield attached to the dollar-denominated Republic of Argentina 8.75s of 2017. Come the liberation, Argentine credit may come in for a bullish reappraisal. And so, sympathetically, may Argentine private credit.

"The investment thesis on Argentina is based on multiple expansion, driven by discount rate compression," Andrew Cummins, portfolio manager at Explorador Capital Management in Buenos Aires, tells Grant. With the resolution of the so-called holdout issue, says Cummins, bonds will go up in value; equities, too, will rally. "But equities," Cummins goes on, "have the added benefit that earnings will also rise post-recession in the 2016-18 window. That earnings growth plus real appreciation of the 'free-market' foreign exchange rate (the parallel or 'blue' rate) will add further positive tail winds for equity investors."

Not for every equity investor, to be sure. Widows and orphans, kindly forget everything you've just read.

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