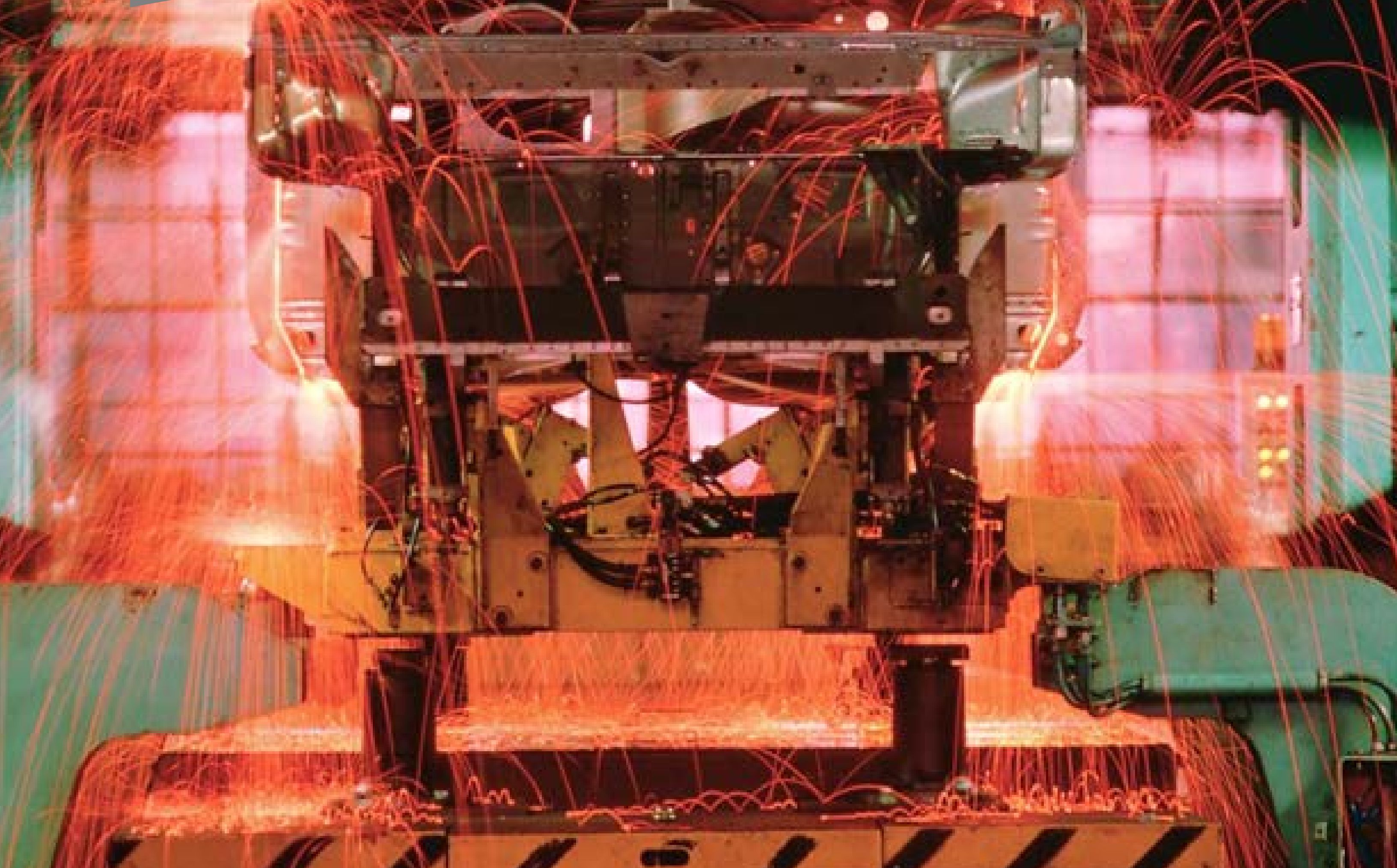
Argentina: understanding the current situation

Potential impacts to the automotive industry

Building a better working world

Table of contents



Argentina sovereign debt

After intense and unsuccessful negotiations with a group of holdout bondholders, Argentina is still in negotiations with holdouts of its restructured debt.

Overview

In January 2005, the Argentine Government, led by President Nestor Kirchner, negotiated the restructuring of nearly 76% of defaulted sovereign debt with an exchange of approximately US$63 billion. Five years later, in April 2010, Argentina reopened the debt restructuring to bondholders who rejected the first exchange. After negotiations, 7% of the original bondholders were left (holdouts). During the debt restructuring process, the rights upon future offers (RUFO) clause was created to protect the bondholders entering the exchange of a potential future better agreement with the holdouts. This clause, which expires on 31 December 2014, specifies that Argentina cannot voluntarily offer holdouts more consideration than it did during its 2005 and 2010 restructurings without extending new offers to all bondholders.

Some of the holdouts, led by NML Capital (NML), decided to pursue payment of full principal plus interest in the New York courts, under whose law the original bonds were written.

Current situation

This legal battle has forced Argentina into default despite having the necessary funds available to cancel owed installments.

In 2012, a ruling by Thomas Griesa, a New York district-court judge, banned Argentina from paying the restructured debt as long as the Government didn't also pay NML what it was owed. Argentina appealed that decision and presented a "stay," which allowed the Government to keep fulfilling its obligation with the 2005 and 2010 exchange bondholders.

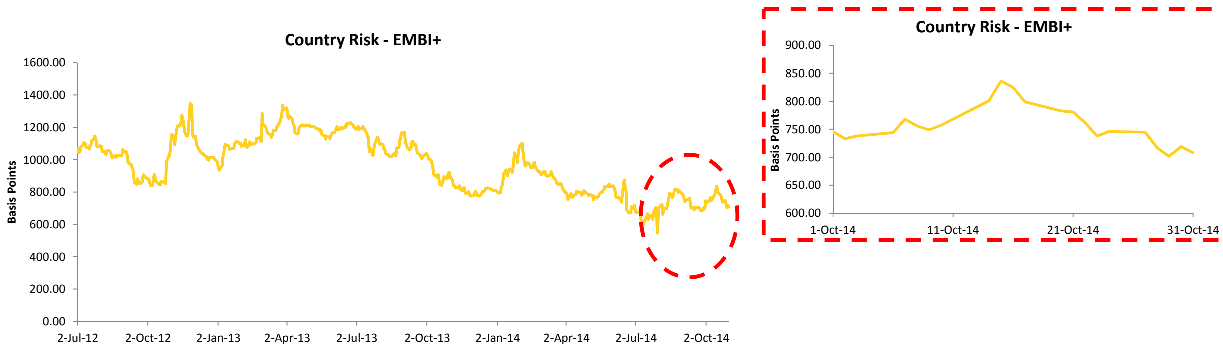
In July 2014, the US Supreme Court refused to hear Argentina's appeal, making Griesa's ruling effective. Without the stay and forced to comply with Griesa's ruling, Argentina was left with two possible choices, both with potential negative impact for the country: pay NML what it was owed and accept the risk of triggering the RUFO clause or disregard the judge's ruling, triggering a default on its debt obligations once again. After several meetings and unfruitful negotiations, the counterparties were unable to reach an agreement, and Argentina defaulted its debt on 30 July 2014.

In October 2014, Griesa ruled that Argentina is in contempt of court for failing to abide by his orders to pay the defaulted debt (the penalties are to be decided later).

Consequences

Argentina's default has several possible implications for the country:

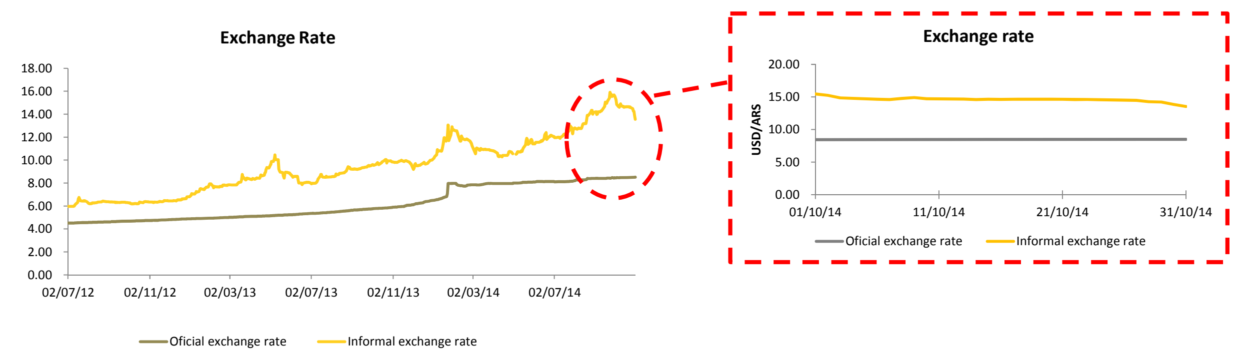
Argentina's sovereign and corporate credit ratings: A downgrade of Argentina's sovereign and corporate credit ratings was expected if Argentina effectively defaulted on its debt. Not surprisingly, S&P lowered the sovereign credit rating to "selective default" on 30 July 2014.



Cost of external financing: Due to Argentina's overall financial situation coupled with the default on the payment of the restructured debt and higher risk ratings, an increase in the cost of external financing is likely.

Foreign investment: The default will decrease foreign capital inflows since the uncertainty will discourage investments in the short term.

Dollar shortage: Due to the decrease of foreign investment, combined with the increase in the cost of external financing, it is highly likely that Argentina will experience a dollar shortage. Most economists agree that the Government, in order to mitigate this situation, will start tightening measures to decrease the outflow of dollars. In this sense, both imports and dividend distributions will be affected by stronger restrictions.

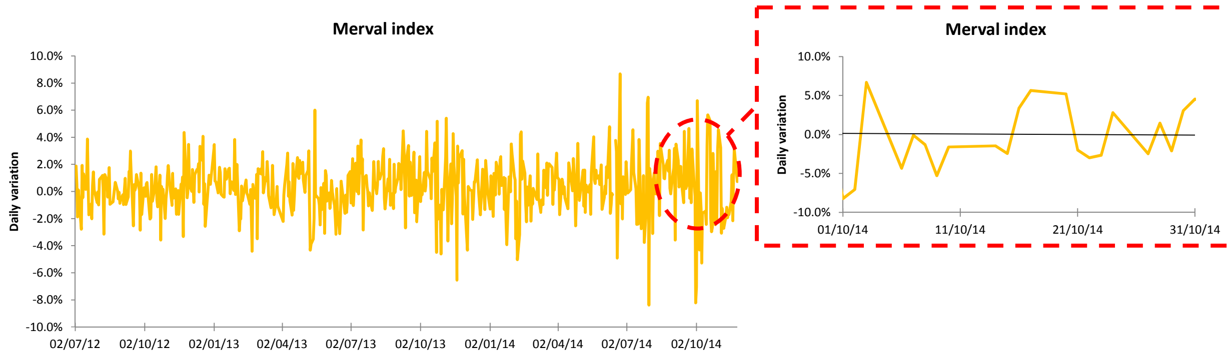


Devaluation/inflation: Due to the dollar shortage, most economists expect the devaluation of the Argentine peso to accelerate. In the last weeks, the gap between the informal exchange rate and the official exchange rate grew up to 54%. The devaluation, coupled with an increase in public expenditures, will fuel the already high projected inflation rate for 2014.

Consumption: Due to uncertainty and fear of a crisis and the loss of purchasing power that real wages have suffered so far this year, a decrease in the level of consumption is expected.

GDP stagnation: Although the Argentine economy had been decelerating before the default, this uncertainty is worsening the stagnation and causing a decline in GDP. Economists agree that the Government is going to increase public expenditure with the intent of offsetting this decline, but at the same time it will worsen the fiscal deficit.

Market volatility: High volatility in bond and stock prices is expected and, as the default continues, the market value of Argentine companies will decrease.



Post-default possible outcomes

Private agreement: A hypothetical agreement between the parties where Argentina would buy the debt subject to litigation could help normalize the situation. This outcome has the potential to be negotiated once the RUFO clause expires and Argentina looks for a comprehensive solution to the holdouts.

Agreement with Griesa: The judge could unlock part of the payment to the bondholders, giving Argentina the option of paying the short-term debt. This would make the default brief, would not trigger RUFO and would provide some time to negotiate after RUFO expires on 31 December 2014.

Extended default without payment acceleration: The debt situation could continue as is and creditors could not demand the acceleration of the payment of debt. In such case, Argentina would remain in default, at least until 2015, when there would be the potential to negotiate a more comprehensive settlement once RUFO expires.

Short-term effects on Argentine companies

The potential negative effects of the default on the Argentinean macroeconomic variables are expected to have a direct impact on local companies.

The uncertainty created by the current debt crisis, coupled with a slowdown in growth and economic output, has created a challenging business climate in Argentina for local and global companies.

Possible consequences for companies based in Argentina		
▸ Corporate credit ratings downgrade and GDP slowdown	▸ Decrease in demand	▸ Decrease in foreign investments
▸ Higher costs of external financing	▸ Stronger restrictions for imports	▸ High volatility in stock prices
▸ Increase in costs	▸ Stronger restrictions for dividend distribution	

How can EY help

EY has a dedicated team of US and Argentine professionals who understand the operational and financial risks associated with exposure to Argentina and South America. Our teams can assist on a variety of initiatives, including:

(i) Assessing and mitigating third-party supplier risk

(ii) Understanding operating divisional results and forecasts

(iii) Selling or winding down operations

(iv) Assessing partner financial wherewithal and capabilities

Current economic situation

Argentina is one of the richest countries in natural and human resources in Latin America and one of the main global producers of food products, particularly meat, grains and soybean, around the world.

The country suffered a significant economic, political and social crisis during 2001 that included (i) the end of the Convertibility Law, (ii) strong devaluation of the local currency (more than 40% in one day), and (iii) default of the sovereign debt.

The recession reached its worst stage in 2002, with an economic recovery beginning in 2003. However, the economic expansion observed in Argentina came to a halt in 2009 when the economy suffered a slowdown as a result of:

(i) The international financial crisis

(ii) The unstable domestic environment caused by the misalignment of interests between domestic farmers and the Argentine Government

In 2010, there was a strong recovery of the entire economy, with GDP peaking at 9.2%. Despite uncertainties in the international macroeconomic environment, there was a recovery in demand for Argentine exportable goods, driven in part by the strong performance of the Brazilian economy (Argentina's major trading partner).

In 2011, the Argentine economy continued to grow, with the Argentine Government promoting and implementing a varied set of policies aimed at reducing the impact of international economic and social issues. As a result, the annual growth rate reached 8.8% in 2011.

Beginning in 2012 and continuing today, there has been a significant slowdown in economic activity as a result of rising inflation driving down consumer demand. As a result, the Argentine Government has introduced severe capital and import controls, which are aimed at preventing capital flight and avoiding a deficit in its current account.

Inflation has become a key concern for the Argentine Government as the rate has steadily increased over the past few years. There are several explanations, but the conventional thinking is that after the 2010 economic recovery and the corresponding increase in domestic demand, there was not an equivalent increase in supply given the lack of incentives for long-term productive investment. Consequently, economic growth, increased international prices, increased public spending and a monetary policy that avoided nominal currency appreciation drove upward pressure on prices, resulting with the Government implementing a strong price control policy.

Additionally, the measurement methods for price indexes, such as the consumer price index (CPI), started to be subject to public debate. For instance, the annual CPI estimate published by the National Statistics Institution (INDEC) stood at 9.8% for 2011, whereas figures published by private consulting firms were in the range of 23% to 27%. For 2012, inflation continued its trend — reaching 25% and approaching 30% in 2013.

Inflation is the result of the current monetary policy and the fiscal deficit, which can be attributed to an expansion in the monetary base. The likelihood of developing an effective inflation targeting policy is becoming more remote due to the strong control of the executive power and political influence over the central bank.

The foreign-exchange controls have created a gap between the official exchange rate and the parallel market exchange rate (between 40% and 90%), forcing the country to operate under an implicit multiple exchange system. The demand for US dollars increased significantly due to uncertainty and speculation fed by doubts of further restrictions and the added hurdles to the foreign-exchange market.

The growth in 2011 and early 2012 (mainly caused by an increase in private consumption and investment) was followed by a more moderate economic development. The Argentine economy's recovery continues to be influenced by high inflation, which erodes real salaries and therefore causes a fall in private consumption.

Additionally, foreign exchange restrictions have created deferrals in capital investment as businesses have delayed decisions until the economic variables become more certain.

With regards to exports, specifically for commodities, there are significant risks driving any correction in commodity prices. The current Government position has been to place significant trade barriers on imports, which impact the manufacturing sector, as it is forced to find domestically produced inputs.

The end result of the fiscal policies implemented over the last six years has been detrimental to the Argentine economy and has:

(i) Impaired the prospects for economic growth

(ii) Driven high inflation and

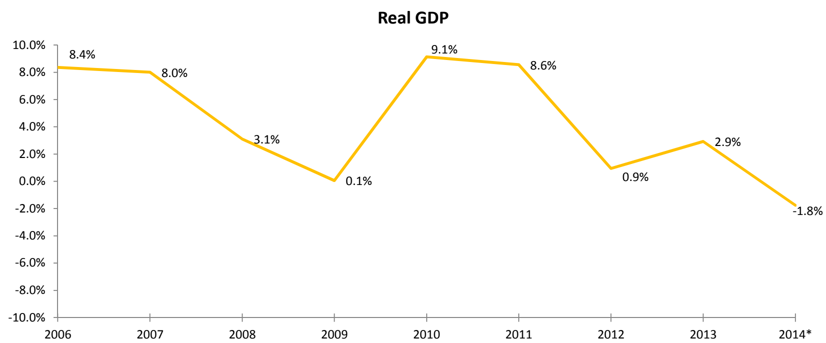
(iii) Decreased the trade balances

Looking toward the future, we believe Argentina's economic recovery will be weak in 2015, as high inflation negatively affects real private consumption and investor pessimism continues. We have revised our 2015 real GDP growth forecast from 3.1% to .2%; however, this is subject to additional downward revisions based on the outcome of the negotiations with the bond holdouts.

Financial distress in the automotive industry's supply chain

Financial distress in the automotive sector's supply chain

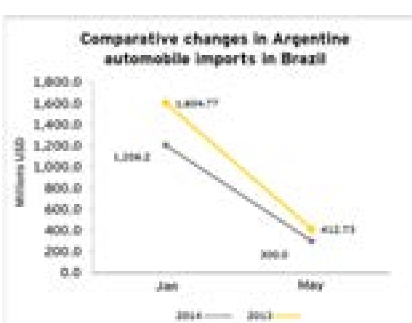
In general, the financial performance of the group of companies that comprise the automotive sector's value chain is strongly related to Argentina's economic growth and the high volatility of its demand.



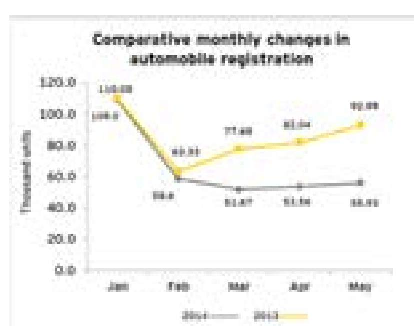
Source: INDEC (Argentine Institute of Statistics and Census)

(*)= Until the 2Q of 2014

From an operating viewpoint, the auto sector has strong supply chain integration with international companies coexisting with local small and medium-sized companies. The latter are mostly weak in terms of solvency and they have restricted access to financing to face periods with an unfavorable economic situation, such as the first half of 2014. A series of adverse factors converged during such period, such as recession, a drop in demand from Brazil (Argentina's main automotive business partner), negative impacts associated to excise tax and an increase in interest rates. This led to a steep accumulated fall in production (22%) and the registration of new vehicles (24%), as well as the suspension of about 13,000 workers in manufacturing facilities and auto parts sellers.



Source: ACARA (Argentine Association of Automobile Dealers)



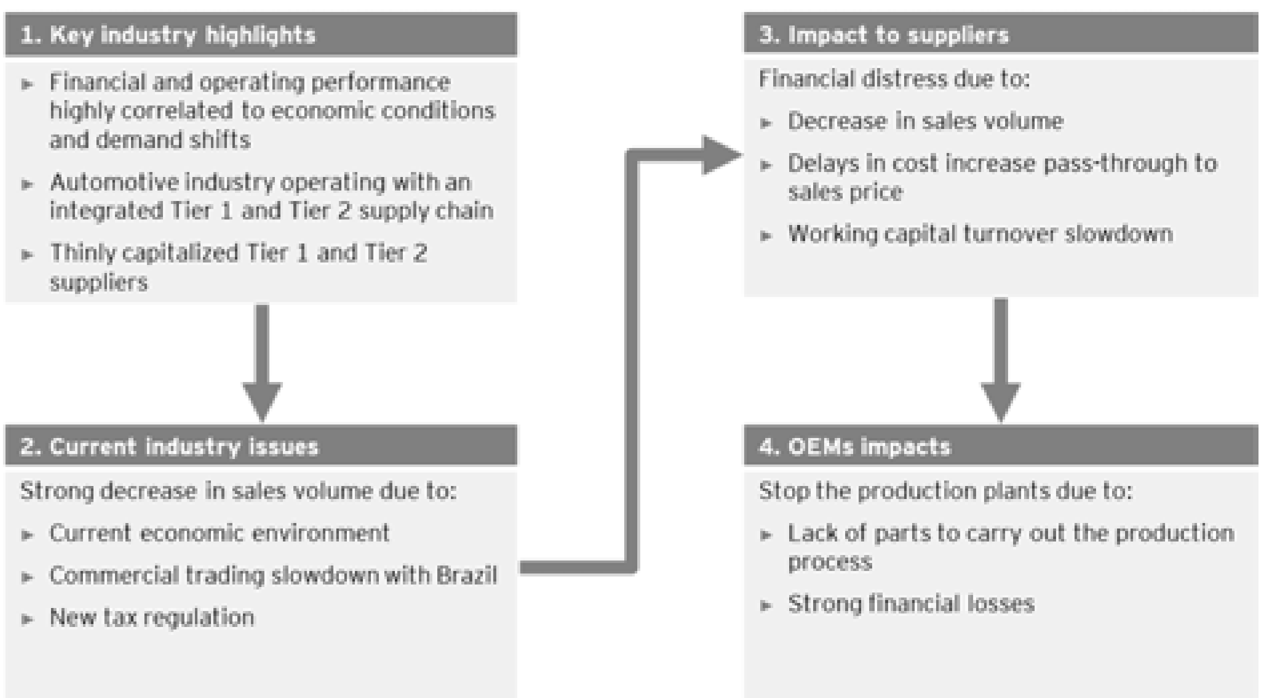
Source: Ministry of Development, Industry and Foreign Trade

In addition, certain financial and operational decisions taken by manufacturing facilities affected the working capital and cash situation of the weakest members in the supply chain. Consequently, these companies suffered from recurring financial stress and, in certain cases, failed to provide the auto parts required by the production process. This resulted in a rebound effect as adverse conditions began to affect the supply chain throughout and caused unscheduled halts in production lines, which generally entail material financial loss for manufacturing facilities. Based on the above, it is important for this issue to be addressed as a whole by the Government and the different components of the chain of value, seeking to promote initiatives to activate market demand and boost the financial and operating situation of the weakest segment in the automotive supply chain.

It is also necessary that both manufacturing facilities and big auto parts sellers take an active role in monitoring and managing the weakest segment in its supply chain to identify in time any financial stress situations and business continuity risks borne by the most vulnerable companies. Moreover, initiatives to strengthen the supply chain's financial position should be implemented. Below are some examples of such initiatives. They were elaborated based on our experience providing advice for companies in the sector:

- Develop key early warning indicators of potential financial stress and supply risks run by the most vulnerable suppliers
- Optimize demand forecasts and production schedules to gain assertiveness and, accordingly, increase the efficiency in production and the inventory levels of the most vulnerable suppliers
- Consider shortening negotiation frequencies temporarily and the terms to resolve price adjustments (retro-pricing) with the weakest suppliers
- Consider temporarily increasing the flexibility in the terms and conditions of payment to the most vulnerable suppliers, among others

In summary, adopting a strategic vision and proper initiatives to approach and address adverse situations, in addition to a coordinated effort by the public and the private sectors, will benefit the entire value chain of the automotive industry, its consumers and the people as a whole.



Appendix A: Team biographies

Mark Short

Partner, Transaction Advisory Services

+ 1 313 628 8760
mark.short@ey.com

Background

- Global Automotive Sector leader for EY's Transaction Advisory Services (TAS) practice and is based in our Global Automotive Center in Detroit, Michigan
- Also serves as our TAS markets leader for the Michigan and Northwest Ohio market
- More than 30 years of experience with EY including 19 years in our Transaction Advisory Services practice
- Industry sector experience includes automotive, both light and commercial vehicle, mining and metals, transportation and logistics, general manufacturing, chemicals, building products and consumer goods
- Works with both public and privately held organizations as well as private equity funds

Experience

- Successfully led over 500 transactions including both buy- and sell-side transactions, joint venture arrangements; assisted with purchase price disputes; and assisted clients in developing and executing integration as well as separation plans
- Significant cross-border transaction experience throughout Latin America, Europe and Asia, including countries such as Brazil, Argentina, Mexico, China, Australia, Malaysia, India, Russia, Czech, Poland, Germany, Italy, Spain, Portugal, France, Netherlands and United Kingdom
- Automotive sector clients include numerous OEMs, tier one and two suppliers, and companies that support the sector in areas such as transportation and logistics, metals, and services

Education and memberships

- Graduate of Wittenberg University, located in Springfield, Ohio
- Certified Public Accountant registered in the states of Michigan and Ohio

Jeffrey Ficks

Partner, Restructuring Advisory Services

Office: + 1 312 879 5761
Mobile: + 1 248 417 5501
jeffrey.ficks@ey.com

Background

- Jeff has over 14 years of combined experience in the aerospace, defense, automotive and diversified manufacturing industries through financial advisory roles served in crisis management, turnaround consulting, transaction support and corporate finance, in addition to corporate accounting and public accounting experience.
- Prior to joining Ernst & Young LLP, Jeff was a director of FP&A with Johnson Controls, Inc. and a member of Grant Thornton LLP's (formerly Stout Risius Ross, Inc.) restructuring group.

Experience

- Jeff has advised numerous distressed companies, secured lenders, unsecured creditors and customers involving US Chapter 11 planning, UK insolvency planning, debt and equity restructuring, and mergers and acquisitions:
- Advised a global tier one auto supplier on the wind-down and sale of its Argentine operations
- Advised a global manufacturing company to reach a standstill and, ultimately, restructuring agreement with a consortium of lenders supporting its India businesses
- Presently advising a global aerospace and defense company on its strategic options regarding several distressed counterparties involving negotiations support with the all parties in interest, including counterparties' lender(s) and key stakeholder(s)
- Advised a global commercial vehicle original equipment manufacturer (OEM) on a global distressed automotive supplier that had filed for insolvency in Italy, Poland and Mexico
- Advised a UK aerospace and defense contractor and its key stakeholder to develop its strategic options, reach a standstill with its multinational lender syndicate and achieve a solvent sale of its US assets via UK administration
- Advised a global light vehicle OEM on a Chinese distressed automotive supplier, including creation of a mechanism to provide secured financing into China
- Advised a global tier one automotive supplier as a customer, subsequent debtor-in-possession lender and acquirer of a $1-billion distressed automotive supplier
- Advised a global tier one automotive supplier on the acquisition of a distressed automotive supplier's bank debt and subsequent placement into Canadian receivership for purposes of acquiring the operating assets of the business
- Led both buy- and sell-side due diligence services for various Fortune 500 companies

Education and memberships

- Jeff has a BA in Accounting from Michigan State University.
- He is a certified insolvency and restructuring advisor (CIRA), certified public accountant (CPA) and member of the Association of Insolvency and Restructuring Advisors (AIRA) and American Institute of Certified Public Accountants (AICPA).

Bill Malczyk

Managing Director, Restructuring Advisory Services

Office: + 1 312 879 2789
Mobile: + 1 312 560 0618
bill.malczyk@ey.com

Background

- Bill is a managing director at Ernst & Young LLP with a primary focus on providing corporate debt restructuring, reorganization and strategic advisory services to companies, creditors, equity holders and other parties in interest.
- He has more than 15 years of experience dealing with a variety of complex capital structure solutions in distressed situations, including out-of-court and Chapter 11 debt restructurings, exchange offers, capital raisings, and mergers and acquisitions. Additionally, he has significant experience in cash flow forecasting, budgeting, acquisition and disposition of assets and strategic advisory services.
- Bill has served clients in a wide variety of industries including manufacturing, aerospace, governmental, business-to-business media, automotive, real estate, home builders, leasing and cruise lines.
- He is a published author on a variety of topics, including deconstructing current market conditions and assessing future trends.
- Mr. Malczyk was previously a director in the investment banking division at Macquarie Capital (USA), a leading merchant bank focused on distressed situations. Prior to that, he was a vice president at Giuliani Capital Advisors LLC.

Experience

- Advised a global tier one auto supplier on the wind-down and sale of their Argentine operations
- Advised a global aerospace and defense company on its strategic options regarding a distressed counterparty, which included negotiations support with the parties in interest, including counterparties' lender and key stakeholder(s)
- Assisted a global manufacturer of construction and mining equipment on the acquisition of a business in German insolvency
- Advised a global heavy truck OEM on the strategic alternatives and cash flow requirements for one of their distressed suppliers
- Advised the City of Detroit in its ongoing restructuring initiative, including, budgeting, cash flow projection and labor negotiations
- Assessed strategic alternatives and oversaw a Chapter 11 process for the first lien lenders of a business media enterprise, which resulted in the lenders acquiring a majority ownership position post-emergence
- Advised the senior secured lenders to a major home builder in developing cash flow and wind-down analyses, negotiated a settlement between the lenders and creditors and supported the ultimate wind-down of the business

Education and memberships

- Bill graduated from Northern Illinois University (dual major of Finance and Accounting).
- He is a certified public accountant.
- Bill is a member of the Turnaround Management Association and the AIRA.

Matías de San Pablo

Partner, Transaction Advisory Services, South America

Office: + 54 11 4318 1531
Mobile: + 54 9 11 52299339
matias.de-san-pablo@ar.ey.com

Background

- Matías is the partner in charge of developing the OTS practice in South America.
- Matías has 16 years of consulting experience in corporate finance matters, mainly focusing on transaction advisory, profitability improvement and working capital and cash optimization.
- He has given lectures in universities and is a frequent speaker in transactions and working capital seminars and training sessions in Argentina and South America.
- Matías is fluent in Spanish and English and has basic understanding of Portuguese.

Experience

- Relevant experience includes corporate finance advisory services throughout the transaction life cycle, mainly focusing on process improvements, oriented to optimize business performance, release cash and improve companies' working capital and profitability.
- Selected clients include:
  - OEMs:
    - Mitsubishi Autos del Perú: Peruvian subsidiary of Mitsubishi Corp.
    - Toyota Tsusho Corporation: subsidiary of Toyota Corp. in Ecuador
    - Volkswagen Argentina: subsidiary of Volkswagen A.G.
  - Dealers:
    - Finning South America: South American division of Finning International Inc, the world's largest Caterpillar equipment dealer
    - Neal & Massy: car dealer of the following brands in Colombia: Mazda, Volkswagen, Seat, Skoda, Fiat and Foton
  - Auto parts manufacturers:
    - Dana Spicer Ejes Pesados: Argentine subsidiary of Dana Holding Corporation that operates in the automobile parts industry (axle differentials, cardan shaft, transmissions for off-highway, etc.)
    - Johnson Controls Inc.: auto parts manufacturing company that produces and commercializes automotive seats, interiors and batteries, among others
    - L'Equipe Monteur: auto parts manufacturing company based in Argentina that produces and commercializes car dashboards
    - PABSA: auto parts manufacturing company based in Argentina that produces and commercializes car seats
    - Prensiplast: auto parts manufacturing company based in Argentina that produces and commercializes car plastic devices

Education and memberships

- A certified public accountant, Matías graduated from University of Buenos Aires in Argentina.
- He also obtained a Master's in Corporate Finance at CEMA University and an MBA from the IAE Business School.

EYGM Legal Disclaimer

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

1409-1326484

ED None