THE JMMB GROUP

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INVESTOR UPDATE

AUGUST, 2018

PETROTRIN UPDATE-

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SUMMARY

JMMB has been tracking the financial stability of Petrotrin, the state owned refinery of Trinidad and Tobago (T&T). We believe the Government of Trinidad and Tobago (GOTT), is in a position to back full repayment of the company's external obligation in the event that the international capital market is not receptive to rolling the debt. However, **based on the information expressed below, JMMB is changing its outlook on the Petrotrin 2019 and 2022 bonds and recommend that clients reduce the proportion of the bonds in their portfolio to less than 5%**.

Following years of successive losses and allegations of poor management at Petrotrin, the government instated a new board in March under the chairmanship of Wilfred Espenit. The team is being tasked with, among other things, improving operational efficiency at Petrotrin and placing it on a sounder financial path. Accordingly, the board of directors named a transition team to oversee splitting operations at Petrotrin in four (4) distinct components, namely: upstream land operation; marine operations; refinancing and marketing; and health operations. The management of each unit is being tasked with the responsibility of minimising cost, boosting productivity and improving the overall contribution to the corporate's bottom-line.

Company Financials

Total Asset fell during the period by TT$3.2 billion (7.3%) to TT$40.6 billion. Cash and cash equivalent increased marginally to $852.2 million. Cash from operation remains positive, but fell 7% to TT$1.6 billion. This combined with net changes in investments and financing activities resulted in increase in cash and cash equivalent of TT$24 million. Interest coverage, which looks at how easily a company can repay interest on its loans, is measured by Earnings Before Interest, Taxes, Depreciation and Amortization divided by its interest expense (EBITDA/interest expense) increased to 1.7X, up from 0.9X. Total liability declined by $783.2 million (2.1%) due to reduction in long-term liability by $1.3 billion (4.9%) to $24.5 billion. This was offset in part, by a rise in current liabilities of $472.2 million (4.0%). There was a noticeable reduction in short-term borrowings from $4.8 billion to $4.3 billion, a decline of $517.4 million (10.7%). Consequent on mounting losses, the leverage ratio (liabilities/equity) increased from 2.3 in 2011 to 9.3 in 2017.

It is our opinion, that the strategy of the new board to turn around operation of Petrotrin is possible, but transformation of the corporate will not occur overnight. Given this outlook and our baseline forecast that hydrocarbon prices will increase incrementally over the medium-term, it is highly likely Petrotrin will continue to suffer loses and bleed cash over the next three (3) years at least.

PETROTRIN AND ITS IMPORTANCE TO THE ECONOMY OF TRINIDAD AND TOBAGO

Petroleum Company of Trinidad and Tobago (Petrotrin) was incorporated in January 1993 and is wholly owned by the Government of Trinidad and Tobago (GOTT). The company is involved in the upstream production of oil and the transportation of hydrocarbons. Petrotrin operates Trinidad and Tobago's sole refinery at Pointe-a-Pierre, which has production capacity of 168,000 barrels per day (b/d). The refinery has the capacity to process a wide variety of crude with varying sulphur content which allows the company to source crude oil from a number of suppliers.

Petrotrin plays a vital role in the T&T economy, and more so the petroleum sector, which accounts for well over 30% of GDP, 85% of exports and 35% of government revenues. The corporate is an important strategic asset for the government. The debt of the corporate is implicitly guaranteed by the sovereign and the government provides guidance on its operation, debt authorization and tax payments.

SWOT Analysis

A SWOT analysis of the corporate, as summarized in Table 1 below, reveals that the strength of the entity redounds in its monopoly on domestic oil refining, the entity being a major domestic supplier of fuel oils, ownership of a large fleet of tanks and its unrivaled access to exploration acreage relative to other players in the industry. Despite these strengths, the company capacity to increase revenue and profit is limited as it is not involved in the lucrative gas operation. Petrotrin has no hand in downstream retail fuel market and suffers from an inefficient cost structure.

Table 1: SWOT Assessment of Petrotrin

STRENGTH	WEAKNESSES
• Major domestic oil producer in Trinidad and Tobago • Refining monopoly in Trinidad • Unrivaled access to exploration acreage • Ownership of tanker fleet	• Poor corporate governance structure and the government's continued interference hinder operational efficiency • Cost and efficiency disadvantages • Absence of fuel retail segment • Not involved in the exportation of gas
OPPORTUNITIES	**THREATS**
• Growth in regional demand • Exploration upside potential • Upgrading/expansion of refining system	• Stagnation of domestic oil production • Increased refinery investment required • Changes in national energy policy Deterioration in the corporate's financials makes it difficult to refinance near term maturity at relatively low rate, and/or without government guarantee.

HOW PETROTRIN INTENDS ON MINIMIZING COST, AND BOOTING PRODUCTIVITY

Following years of successive losses and allegations of poor management at Petrotrin, the government instated a new board in March under the chairmanship of Wilfred Espenit. The team is being tasked with, among other things, improving operational efficiency at Petrotrin and placing it on a sounder financial path. Accordingly, the board of directors named a transition team to oversee splitting operations at Petrotrin into four (4) distinct components, namely: 1) upstream land operation; 2) marine operations; 3) refinancing and marketing; and 4) health operations. The management of each unit is being tasked with the responsibility of minimising cost, boosting productivity and improving the overall contribution to the corporate's bottom-line.

The Chairman noted that Petrotrin was in need of further investments, amounting to US $300 million, to complete build out of its ultra-low sulphur diesel plant by 2020. The commencement of the plant's operation, forms part of the strategy to improve operational efficiency and drive profitability.

STANDARD & POOR'S CREDIT RATING

In April 2018, Standards & Poor's (S&P) revised the outlook on Petrotrin to negative but maintained the corporate's BB credit ratings, which indicate that the company faces major future uncertainties. S&P advised that the rationale for its outlook reflects concerns regarding the **likelihood of the corporate refinancing the US$850 million bond due August 2019**. The ratings agency noted that failure by the company to refinancing the bond in the second half of 2018 could lead to deterioration in its ability to meet its short-term debt and trigger a ratings downgrade.

S&P, in its baseline forecast, is projecting real economic growth in Trinidad and Tobago of 1.5% and 1.8% respectively and inflation of 3.2% and 3.7% in 2018 and 2019, respectively. The ratings agency noted that there is a strong correlation between GDP growth and energy demand, and inflation and payroll and administrative expenses. S&P is forecasting oil prices of $55 per barrel. For Petrotrin, the built in assumption is for production level of 140 million – 145 million, capital expenditure (Capex) of US$390 million, and no dividend payment.

Given the foregoing, S&P is projecting Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) for 2018 and 2019 of US$300 million. Additionally it's operating profitability as a percentage of its total revenue. (EBITDA margin) is approximately 10%; debt to EBITA higher than 8X; and it has relatively low funds from operation. The ratings agency noted that Petrotrin's liquidity is less than adequate; however, the company does have access to the credit market given its ownership by the government of Trinidad and Tobago. This is demonstrated through access to credit lines from banks amounting to over US$163 million.

On the positive side, S&P noted that its ratings reflect a very strong possibility that the sole owner of the refinery, the government of Trinidad and Tobago, would provide timely and sufficient extraordinary support to the company in the event of financial distress. S&P is prepared to revise Petrotrin's outlook to positive if the corporate successfully refinance the maturity, which becomes due in August 2019.

CONCLUSION

Petrotrin is facing mounting financial challenges and as a standalone entity the corporate will find it difficult to rollover the 2019 bond at a relatively low coupon without the explicit guarantee from the Government of Trinidad and Tobago (GOTT). Owing to mounting debt levels over the past decade, which among others things, have resulted in the sovereign losing it's A+ credit ratings, the government is reluctant to guarantee additional debt contracted by state operated entities, including Petrotrin. As neither of the Petrotrin bonds are guaranteed by the government, there is no clause in there indenture which commit the government to make good on creditors' claim in the event that the corporate is unable to honour its debt either in part or in full. Notwithstanding, a credit event at Petrotrin would reflect very poorly on the government, which has a 100% stake in the entities. In this regard, any credit event by the corporate could trigger a sovereign ratings downgrade. The government also stands to expend a lot of political capital, at home and abroad, if such events are realized.

Thus, given the strong linkages between the government and the corporate and the strength of the sovereign's external position, we are of the opinion that the government will continue to give its unwavering support to Petrotrin. The sovereign is in a position to back full repayment of corporate's external obligation in the event that the international capital market is not receptive to rolling the debt.

Despite this view, we cannot ignore the precarious financial position of the corporate as a standalone entity and the elevated refinancing risk of the 2019 bonds. It is our opinion that the strategy of the new board to turn around operation of Petrotrin is possible, but transformation of the corporate will not occur overnight. Given this outlook, and our baseline forecast that hydrocarbon prices will increase incrementally over the medium-term, it is highly likely Petrotrin will continue to suffer loses and bleed cash over the next three (3) years at least. **Thus, we are changing our recommendation on the Petrotrin 2019 and 2022 global bonds to underweight.**

Based on JMMB's recommendation guidelines underweight means that the asset should represent less than 5% of your portfolio.

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation DEFINITIONS/ RECOMMENDATIONS.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT - REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL - REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKET WEIGHT -
EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY -
EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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