

Fitch Assigns Pampa Energia S.A.'s Proposed Issuance 'B+(EXP)' Expected Rating

January 6, 2017

Fitch Ratings-New York-06 January 2017: Fitch Ratings has assigned Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) of 'B' and 'BB-', respectively, to Pampa Energia S.A. (Pampa). The Rating Outlook is Stable. Fitch has simultaneously assigned an expected rating of 'B+(EXP)/RR3' to Pampa's proposed senior unsecured notes. The company expects to use the proceeds from the issuance to refinance existing debt at its subsidiaries, funding capital expenditures and for general corporate purposes.

KEY RATING DRIVERS The ratings consider Pampa's status as Argentina's largest integrated energy company, with significant markets shares across all its business lines. In particular, the ratings reflect the company's substantial operations in exploration & production (E&P), as well as the favorable domestic price environment for its natural gas business in Argentina. Additionally, the company's electricity generation segment is expected to provide cashflow stability and gradual growth as new plants qualifying for more profitable regulatory programs are constructed. In addition to broad macroeconomic constraints captured by Argentina's Long-Term IDR of 'B', a potential pressure point for the company is its participation in the historically unprofitable distribution company, Edenor. Pampa's foreign currency rating is constrained by the 'B' country ceiling of the Republic of Argentina, which limits the foreign currency rating of most Argentine corporates. Country ceilings are designed to reflect the risks associated with sovereigns placing restrictions upon private sector corporates that 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 obligations.

FAVORABLE NATURAL GAS PRICES In an attempt to foster energy independence, Argentina has created various incentive programs across the energy sector including subsidies that guarantee a realized price of USD7.5 per million BTU (mmBTU) for qualifying gas production, known as Plan Gas and Plan Gas II. Fitch estimates approximately 60% of the company's natural gas production will qualify for these price incentives in 2017. Plan Gas is set to expire at the end of 2017, and Plan Gas II is set to expire in the middle of 2018, although there is some political support for extending these programs for another year or two. Even if the programs are not renewed, Fitch expects Pampa will be able to achieve a realized price of around USD6/mmBTU considering the substitution costs implied by LNG imports and Fuel Oil #6. Pampa's joint venture with YPF S.A. for the exploitation of the Rincon del Mangrullo and its purchase of Petrobras Argentina have had a transformative effect on the company, growing its production volumes from around 3,000 barrels of oil equivalent per day (boe/d) in 2013 to an expected 75,000 to 80,000 boe/d over the next three years, making it the fourth largest oil and gas producer in the country. Under Fitch's base case assumptions, the consolidated exploration and production (E&P) operations of Pampa and Petrobras Argentina should generate around 80% of consolidated EBITDA in 2017, excluding Pampa's distribution business.

INVESTMENTS IN GENERATION IMPROVE PROFITABILITY The company's 3,433MW of installed capacity represent 10% of the country's total capacity. However, most of Pampa's generation assets operate under a regulatory system applied to older generation units, remunerated at lower prices to reflect their inefficiency. As a result, a significant portion of Pampa's growth capex is expected to go toward the construction of new plants that would qualify for new regulatory schemes that offer higher capacity prices and are paid in USD. In October 2016, the company won bids for four generation plants (three thermal, one windpower) totalling approximately 400MW of capacity, with expected commercial operation dates (CODs) in the second half of 2017. Fitch expects this strategy of seeking higher generation margins through the construction of new plants to continue through the medium term.

POTENTIAL REVERSAL OF FORTUNES IN ELECTRICITY DISTRIBUTION

For the last decade, Argentina's electricity prices have been artificially suppressed, with average monthly electricity bills of around USD 3. As a result, distribution companies, such as Pampa's Edenor, have operated at significant losses, requiring various government subsidies and credit programs to stay afloat. Nevertheless, with the aggressive efforts at liberalizing Argentina's energy sector under the Mauricio Macri administration, there are indications that this sector might return to profitability. In February, a tariff increase reflecting adjustments to the fuel cost component was implemented by the Macri administration, effectively raising the average monthly residential electricity bill to USD16. This increase was provisional; an official tariff review was discussed in December 2016, which resulted in increases of 22%-44%. In addition to the upward revision to the distribution component of the tariff, even the revised fuel cost component (approximately ARS300/MWh) remains significantly below breakeven costs of approximately ARS650/MWh as of year-end 2015. While the Macri Administration has already run into some legal and political obstructions that resulted in a tempering of the liberalization process, this is a clear priority. Less clear is the speed at which the system will be effectively transformed, much less how long such a transformation would last. With low expectations informed by the last decade's electricity regulation, the upside potential could represent yet another transformational change for Pampa.

KEY ASSUMPTIONS -- Natural gas production of between 45,000 and 55,000 boe/d over the next three years; total hydrocarbon production of between 70,000 and 80,000 boe/d during the same period. --Average realized natural gas price of USD 6/mmBTU; crude prices reaching international parity over the next 12 to 18 months. -- Average of USD150 million invested annually in additional generation capacity --Gradual improvement in cashflow for Edenor over the next three years.

RATING SENSITIVITIES Although the Argentine regulatory environment for oil and gas and utilities appears to be undergoing positive changes, detrimental government intervention remains the greatest risk to Pampa's ratings. In that vein, failure to implement effective tariff adjustments through the medium term could potentially lead to a downgrade. While all recent trends point to a supportive view towards the E&P sector (and particularly natural gas), any reversal in that environment would have a material impact on Pampa's cashflow. Finally, failure to balance expansion goals with the maintenance of a solid capital structure would be viewed negatively. Gross leverage of above 3.0x on a sustained basis could lead to a negative rating action. Barring an upgrade to the sovereign, an upgrade for Pampa is unlikely in the near term. However, sustained improvement in the company's distribution segment would be viewed positively, particularly if it resulted in substantial deleveraging.

LIQUIDITY Fitch expects year-end debt of around USD1.6 billion, with approximately USD540 million of maturities expected in 2017, largely associated with loans incurred to execute the purchase of Petrobras Argentina. Proceeds from the company's proposed issuance will be primarily used to refinance these maturities and rebalance its amortization schedule. If the company successfully refinances its short-term debt, it will have more than 70% of its debt maturing beyond five years. Other significant debt obligations other than the acquisition-related debt include a USD500 million Petrobras Argentina bond (to be absorbed by Pampa in 1Q17), a USD176 million Edenor bond (structurally subordinate to Pampa-level issuances).

FULL LIST OF RATING ACTIONS Fitch has assigned the following ratings to Pampa: --Long-Term Foreign Currency Issuer Default Rating 'B'; -- Long-Term Local Currency IDR 'BB-'; --Proposed senior unsecured notes 'B+(EXP)/RR3'. The Rating Outlook is Stable. Contact: Primary Analyst John Wiske Analyst +1-212-908-9195 Fitch Ratings, Inc. 33 Whitehall St New York, NY 10004 Secondary Analyst Cinthya Ortega Director +1-312-606-2373 Committee Chairperson Joseph N. Bormann Managing Director +1-312-368-3349 Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com. Date of Relevant Rating Committee: Dec. 20, 2016 Additional information is available on www.fitchratings.com. Applicable Criteria Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016) Criteria for Rating Non-Financial Corporates (pub. 27 Sep 2016) Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers (pub. 21 Nov 2016) Additional Disclosures Dodd-Frank Rating Information Disclosure Form Solicitation Status Endorsement Policy ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

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