

## CREDIT OPINION

31 May 2017

Update

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### RATINGS

#### Mendoza, Province of

Domicile	Argentina
Long Term Rating	B3
Type	LT Issuer Rating - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Mendoza, Province of

### Update Following Release of 2016 Fiscal Results

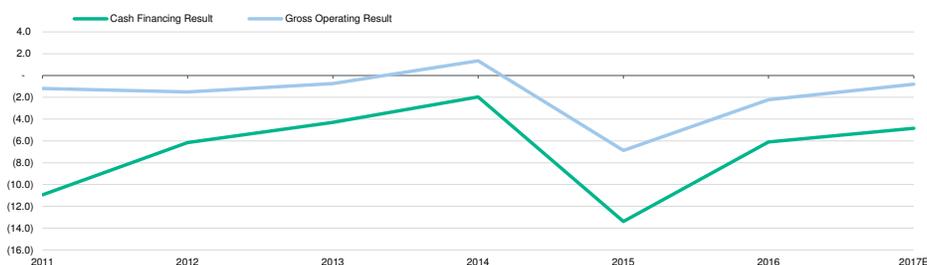
#### Summary Rating Rationale

Moody's assigns debt and issuer rating of B3 (in Global Scale) in foreign and in local and foreign currencies respectively to the Province of Mendoza. The assigned issuer and debt ratings are in line with the Argentina's B3 Government bond rating despite the intrinsic financial characteristics of this Province given that the lack of consistent and predictable policies at the national level affects the institutional framework under which the local governments operate and ultimately anchors their credit quality to that of the Sovereign.

Mendoza's intrinsic creditworthiness is characterized by a diversified economy that supports a stable level of own-source revenue base and low but recently growing debt-to-revenue ratios. The ratings also reflect continuing spending pressures that have normally led to declining operating margins. This negative trend, initiated in 2006, has increased the province's financial reliance on the federal government (B3, positive outlook) and to the bond market, to pay off debt maturities and current operating deficits. Moody's recognizes that Mendoza's still high dependence on federal resources reduces its financial flexibility and draws its credit profile closer to the sovereign in the long term.

Exhibit 1

#### Province of Mendoza: cash financing and operating results, 2011-2017E



Sources: Financial Statements of the Province of Mendoza and Moody's Investors Service

#### National Peer Comparisons:

The Province of Mendoza is rated at the high end of the rating range for Argentina's regional and local governments, whose ratings span from Caa1 to B3. Mendoza's position relative to national peers reflects a GDP per capita higher than some of its peers and an average own-source revenue base, partially offset by an increasing reliance on the national government and bond market.

#### Credit Strengths

Credit strengths for the Province of Mendoza include:

- » Diversified economy that supports an average level of own source revenues,
- » Relatively low debt levels likely to stabilize.

## Credit Challenges

Credit challenges for the Province of Mendoza include:

- » Volatile operating margins including deficits in four out the five last fiscal years,
- » Economic uncertainty with long term pressures in its operating expenses, especially personnel and interests,
- » To achieve and to sustain additional reductions in the amount of transfers from the National Government as a percentage of its total revenues.

## Rating Outlook

The outlook of the Province is positive in line with the positive outlook of the Argentine Government and reflects the very close economic and financial linkages that exist between Argentina's Government and Argentine sub-sovereigns.

## Factors that Could Lead to an Upgrade

An upgrade in the Argentine sovereigns ratings and/or a systemic improvement coupled with lower idiosyncratic risks arising from this Province - for instance with a sustained record of operating and cash financing surpluses coupled with a longer debt maturity profile- could exert an upward pressure in its current ratings.

## Factors that Could Lead to a Downgrade

A downgrade in Argentina's bond ratings and/or further systemic deterioration or idiosyncratic risks arising in this issuer could to exert downward pressure on the ratings assigned and could translate in to a downgrade in the near to medium term.

## RECENT DEVELOPMENTS

On March 7, Moody's affirmed the Province of Mendoza's local and foreign currency ratings at B3, and modified the outlook to positive from stable. The action follows Moody's outlook change to positive, from stable, of Argentina's local-currency and foreign-currency B3 sovereign bond ratings on 6 March 2017. The change of Mendoza's outlook reflects the very close economic and financial linkages that exist between Argentina's government and Argentine sub-sovereigns, as well as the maintenance of their key credit strength and challenges.

## Key Indicators

Exhibit 2

### Province of Mendoza As of 12/31

	2011	2012	2013	2014	2015	2016
Net Direct and Indirect Debt/Operating Revenue (%)	70.0	55.9	38.5	33.5	40.3	53.7
Interest Payments/Operating Revenue (%)	1.7	1.4	1.5	2.6	2.9	6.5
Gross Operating Balance/Operating Revenue (%)	(1.2)	(1.5)	(0.7)	1.3	(6.9)	(2.2)
Cash Financing Surplus (Requirement)/ Total Revenue (%)	(10.9)	(6.2)	(4.3)	(2.0)	(13.4)	(6.1)
Capital Spending / Total Expenditures (%)	11.8	6.7	5.6	5.7	7.5	5.5
Intergovernmental Transfers / Operating Revenue (%)	56.3	52.1	51.1	51.1	53.6	50.7
Self-financing Ratio	0.2	0.1	0.3	0.7	-	-

Sources: Financial Statements of the Province of Mendoza and Moody's Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Detailed Rating Considerations

The rating assigned to the Province of Mendoza combines the baseline credit assessment (BCA) for the province and the likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

## Rating Methodology and Scorecard Factors

The principal methodology used in this rating was Regional and Local Governments published in January 2013. Please see the Rating Methodologies page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

## Ratings

Exhibit 3

Category	Moody's Rating
<b>MENDOZA, PROVINCE OF</b>	
Outlook	Positive
Issuer Rating	B3
Senior Unsecured	B3

Source: Moody's Investors Service

## Baseline Credit Assessment

Mendoza's BCA of b3 reflects the following factors:

### DIVERSIFIED ECONOMY THAT SUPPORTS AN AVERAGE OWN-SOURCE REVENUE BASE

Mendoza benefits from abundant natural resources. It is the nation's major wine-producing center and has important oil production and refining activities, as well as a well-developed tourism sector. These industries support a GDP per capita representing around 90% of the national average. The province's labor force participation rates are lower than the nation's but the gap has narrowed in recent years, while Mendoza's unemployment rate is notably lower than the national average.

Mendoza benefits from a diversified economy that supports a relatively strong own-source revenue base, which in turn enhances the province's financial flexibility. During the period 2012-2016, Mendoza's own-source revenues represented, on average, 49% of its total revenues, an average level compared to peers. However, the province still faces substantial credit risks that stem from concerns about ongoing spending pressures due to salary renegotiations, which Moody's expects will continue to occur given the still high levels of inflation rate.

Regarding its operating performance, Mendoza's operating margins relative to its current revenues have been characterized by a high degree of volatility. The province exhibited gross operating deficits in four out of the last five fiscal years, averaging a negative 2% of current revenues between 2012 and 2016. Once capital revenues and expenditures are taken into account, this figure represents 6.4% of its total revenues. Having said this, Mendoza's current administration has successfully improved its operating performance during 2016 fiscal year as exhibit 1 shows. A much lower growth of its payroll account (by 23% compared to 2015 FY) than its current revenues (almost 36%) caused the observed relevant reduction in its current deficits.

On the other hand, own-source revenues represented 49% of total revenues, which means that Mendoza is showing a slightly lower dependence of federal transfers vis-à-vis other provinces.

Mopre recently, as of April 30, 2017, and thanks to an enhanced fiscal management, Mendoza reported an operating surplus of ARS 2.980 billion, which represents 19% of operating revenues, much better than the 13% reported in the same period of 2016. Once capital revenues and expenditures are included, this surplus falls to 15% of total revenues (compared to 14% reported over the same period of 2016).

### LOW DEBT LEVELS LIKELY TO STABILIZE

Mendoza has shown a declining trend in the important metric of outstanding debt over its total revenues until the end of 2015 fiscal year. Between 2015 and 2016, Mendoza's total debt rose by 81% in nominal terms and to 53% from 40% relative to its total revenues. The issuance of a long term bond in the international market and the effect of the fluctuation of the exchange rate caused this sharp

increase. Moody's expects the stabilization of this key metric for the ongoing fiscal year because of the expected improvement in Mendoza's operating performance -already mentioned- and the expected recovery of the country's economic growth.

A characteristic observed during the last fiscal year is the growth in the weight of dollar-denominated debts, which reached 50% of its total at December 2016 compared to 43% as of December 2015.

Finally, an importantly new trend observed for Argentine sub-sovereigns is the reopening and renewed interest of international investors to their global bonds. Since 2015, the Province of Buenos Aires tapped the international bond market with several bond issuances which contributed to the extension of its debt maturities.

#### CHALLENGING OPERATING ENVIRONMENT

In addition to the Province's own economic and financial fundamentals, Moody's considers Argentina's operating environment in arriving at our final rating indication. Moody's Sovereign Risk group's assessment of the country's economic strength is moderate, its institutional strength is very low - and its susceptibility to event risk is high -. In this sense, it is important to add that it will be extremely necessary to restore economic growth in Argentina after a very weak and erratic GDP change since 2011.

#### Extraordinary Support Considerations

Moody's assigns a low likelihood of extraordinary support from the federal government to the province, reflecting the federal government's general failure to provide such support in the recent past, partly offset by factors that increase the likelihood of support such as federal financial oversight.

#### Output of the Baseline Credit Assessment Scorecard

In the case of the Province of Mendoza, the BCA matrix generates an estimated BCA of b3, in line with the BCA of B3 assigned by the rating committee.

The matrix-generated BCA of b3 reflects (1) an idiosyncratic risk score of 5 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a systemic risk score of B3, as reflected in the sovereign bond rating (B3, POS).

The idiosyncratic risk scorecard and BCA matrix, which generate estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by these tools provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

Exhibit 4

## Province of Mendoza

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
<b>Scorecard 2015</b>						
<b>Factor 1: Economic Fundamentals</b>						
Economic Strength	9	53.73	70%	6.6	20%	1.32
Economic Volatility	1		30%			
<b>Factor 2: Institutional Framework</b>						
Legislative Background	5		50%	5	20%	1.00
Financial Flexibility	5		50%			
<b>Factor 3: Financial Position</b>						
Gross operating balance / Operating revenues (%)	7	-3.65	12.5%	4.5	30%	1.35
Interest payments / Operating revenues (%)	3	2.60	12.5%			
Liquidity	5		25%			
Net direct and indirect debt / Operating revenues (%)	3	40.30	25%			
Short-term direct debt / Total direct debt (%)	5	27.60	25%			
<b>Factor 4: Governance and Management</b>						
Risk Controls and Financial Management	5			5	30%	1.50
Investment and Debt Management	5					
Transparency and Disclosure	5					
<b>Idiosyncratic Risk Assessment</b>						<b>5.17 (5)</b>
<b>Systemic Risk Assessment</b>						<b>B3</b>
<b>Suggested BCA</b>						<b>b3</b>

Source: Moody's Investors Service

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