Solvay Indupa issues $M 80 in Notes

Preliminary conclusions

During the next Stockholders Meeting the Board of Directors should get the approval for the issue of Notes for 80 million. This would not be a problem, since Solvay Group controls the votes. But it will be hard to convince to minority stockholders who are complaining in the impact of future loss of ownership and the relationship with price of a stock that is quoting at its lower level compared to MerVal Index.

Solvay Indupa have recently announced the decision of the Board to issue Notes for 80 million dollars. The Notes will due 2006 in pesos with an interest not discarded but according to the Company with a very low rate compared with other debt instruments in pesos. The Bonds will list at the Buenos Aires Stock Exchange and will be issued with no other warranty, and will be convertible into Ordinary Shares at the price of one peso each. The stockholders will have a preference right to subscribe the Bond, with no right to accrue and The Credit Suisse First Boston will underwrite the issue.

According to the management, the new Notes will allow to restructure current short-term debt into long-term debt in pesos, with no substantial changes in the interest rate the company is currently paying for its debts in US dollars swapped into pesos.

Assumptions:

- While this have been not yet discarded, we assume that Notes only would be converted into Ordinary Shares at the end. This is important, because the price of the share may have an upside resistance above $1 if Notes may be to be converted before the end of the Notes. A price above to $1 will encourage the holders to convert Notes into shares and sold them at the market immediately. The resistance price may lower with the time due to the fact that cashed interest, converted into dollars, will lower the breakeven point. While this practice may lower final Note IRR results, it will decrease risks. The higher the risk of the devaluation, the higher the incentive to take gains in the middle.
- While the management says that Solvay will not subscribe the issue, we assume that Solvay will do for around 10 million dollars of the new Notes. We also assume that Solvay Group will convert its holdings of near 65 million Preferred Shares into Ordinary, since conversion of Preferred Shares will due before the right to convert Notes into Ordinary Shares. While other methods may be used in the future by Solvay to keep the control of its subsidiary in the MercoSur, both actions will be a right chance to do it. Actually, 3.5 million Notes may be enough, but 10 million Notes, in conjunction with the conversion of Preferred Shares, will maintain the current rate of ownership.

Preliminary conclusions:

- The Notes will have no other warranty than the conversion to Ordinary Shares at $1. Then, we may agree that for The Credit Suisse First Boston, or its customers, the conversion of the Notes into Ordinary <u>Shares are good protection for both: as warranty for the payment and against a devaluation of the Argentine peso</u>.
- Devaluation do not necessarily would vary stock quotation in dollars. <u>Since major components of Solvay Indupa business actually rate in dollars</u> (Sale prices -PVC, Caustic Soda- and cost prices -Ethylene, electricity power), <u>the major changes in the business in case of a devaluation would come from a change in the demand with a better position against imported products</u>. <u>A one-time profit/loss may come or not from monetary items</u> (receivables, payables and debt), <u>since convertibility law allows to sell in dollars</u>. <u>Since some costs are actually in pesos, a devaluation may put the company in a better position to compete in the foreign markets.</u> Some studies in the Argentine market show that shares actually quote in dollars. This is quite similar to the practice that Solvay Indupa is using to account for its non-monetary assets in Brazil. They keep the value in dollars with independence of the devaluation of the real. In our market, when a devaluation have arisen, quotes were adjusted to reflect the previous value in dollars in about one month, plus a difference, above or bellow, to reflect expectations of changes in the results of the company caused by the devaluation.
- Solvay Indupa says the Notes will have a very low rate in pesos. You should take into consideration in your evaluation that the Notes may be paying a rate far bellow the current market rates of Argentina's Bonds. This may be true also when comparing the rate in pesos to rates of Bonds due in dollars. While the Notes of some Argentine Companies have a better qualification than the country Bonds, this is not the case of Solvay Indupa. <u>Shareholders</u>, otherwise The Credit Suisse First Boston or its investors, <u>will consider the difference of the interest rate of the Notes and the market rates, as the price of an Option to buy Ordinary Shares of Solvay Indupa at the exercise price of $1 in 5 years</u>. <u>The greater the difference between the interest rate of the Notes and the market interest rate, the higher the price that investors would be paying for the option to get a 19.3% of the company.</u>
- While the Note's interest may sound quite low today, this may not be necessarily true during a five years time frame, since <u>Note's interest rate is fixed</u> and Country economy may finally recover after a recession of 3 years.
- The higher the chance of a devaluation in Argentina, the higher the chance of the conversion of the Notes.

No devaluation does not necessarily means no conversion.

- The Debts of most Companies that list in the BA Stock Exchange are due in dollars with no swaps into pesos. While the Solvay Group has a Policy to swap the debts into local currencies, this have been bypassed sometimes in the Solvay Indupa's case in the recent past. The settlement of the Notes in pesos is a clear sign that the Solvay Group is foreseen a devaluation of the Argentinean peso. While other Companies assure their Assets exposed to devaluation, Solvay is assuring the Liabilities. As such Liabilities are higher than exposed assets, it seems that the management is looking forward for a gain in case of devaluation, as it was the case in Brazil, something that is not part of the business.
- As a result of this practice that is not common in subsidiaries of major companies in Argentina, we estimate that Solvay Indupa may have lost between 3 to 4 million dollars in Argentina during 2000. The settlement of the Notes will consolidate the situation for the next 5 years. While management explain their experience in Brazil as a background, it seems they do not understand the difference between two countries.
- As in the Murphy's Law, the worst decision is taken in the worst moment. We say:
  - The worst decision, because despite the loss of an important amount in the past years in the intent to protect against devaluation, they are now fixing this practice for a 5 years timeframe. They are also wrong because they protect Liabilities instead of Assets. They also look wrong because they are setting a different strategy than many other important companies in the country.
  - The worst moment: because they are fixing an interest rate for the following 5 years just when the interest rates in Argentina are the highest in many years. Because international interest rates, which are a base for local rates, tend to lower with the time. The nomination of Domingo Cavallo -who imposed the Convertibility of pesos to US dollars- as Economy Minister may give the management an impasse to evaluate better alternatives.
- Solvay Indupa have a big tax credits due to past looses. The tax credits expire with the time if the company does not get profits. In addition, due to the fact that companies pays a minimum tax according to their assets, Solvay Indupa is paying taxes that are generating further credits for the future. The practice to set debt in pesos, or to swap into pesos the debt in dollars, which lead to higher rates, may eventually cause an extra cost due to tax credits expirations. Since interest rates will be fixed for 5 years, the impact in the results will continue despite a change in the country conditions.
- Current shareholders will have no right to accrue the rights for other shareholders non-subscribing the Notes, and the reason is not clear. This was not the position when the company issued the Preferred Shares, underwritten by Solvay Group.
- Current shareholders will loose a 19.3% of their current ownership in case of conversion of Notes. while Notes will due an interest rate, the Preferred Shares will be converted at no extra cost.
- Current shareholders will continue to share the losses the Company is currently experiencing due to low volumes and low PVC prices. But future compensations will be lower due to a Profit per Share decrease of 19.3%. While the funds are necessary today, the Capital will arrive once it may not be necessary, since there are no plan for major investments in many years.

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