Rhombus Advisors LLC
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Omotunde A.J. Mahoney
+1-973 509 5300

MOZAMBIQUE FLASH NOTE

The Restructuring bombshell

*Tuesday's announcement that the Republic is seeking to restructure its external commercial obligations[1] came less than seven months after last April's debt exchange. Worse, **the resulting uncertainty has the potential to compromise a series of long-awaited initiatives in the vital natural-gas sector** that are finally under way - more than 24 months after they were initially anticipated.*

1) Reportedly, **Exxon is "very close" to concluding a farm-in, farm-out deal with ENI**, the operator of Area 4 in Mozambique's gas-rich Rovuma basin *(see map on next page).* Under the prospective agreement the supermajor would acquire a 20% interest in this offshore concession.

2) Within the next week, **a consortium of international banks is due to present ENI with proposals on "a multibillion financing package"**[2] for the development of the Coral field (the smaller of the two gas fields lying in this concession). Under the 20-year sale-purchase agreement announced last week, **Shell-BP has committed to taking 100% of the project's annual output** off 3.4 mm MT of LNG.

3) Anadarko is now pushing to secure the final approvals required to embark on the development of the western half of the Mamba field that lies inside Area 1 a concession operated by the US independent.

Exxon has publicly expressed its interest in acquiring a stake of up to 20% in this acreage which is significantly more prolific than Area 4.

4) Even the most modest backward linkages to these two projects during the initial stage of their development would have a **huge impact on the domestic economy** – particularly via the services channel (banking, insurance, housing, logistics) and, to a lesser extent, employment.

5) Most importantly - from a cash-flow perspective - Exxon's prospective farm-in transactions will each generate a **windfall for Mozambique's fiscus** in the form of the 32% capital gains tax to which each deal would be subject[3]. Stated alternatively, each such bonanza could potentially amount to the equivalent of:

- **100%** of projected year-end **external reserves**;
- **11%** of current **GDP**;
- **45%** of **total fiscal outlays** as envisaged under the draft 2017 budget now under consideration.

And yet, although the finance minister's presentation cites the prospective export revenues from the two projects' export revenues, to illustrate Mozambique's medium- and long-term prospects, it remains **curiously silent on the more immediate fiscal impact**[4].

[1] The stated objective is to satisfy the IMF's debt-sustainability criteria, one of the institution's preconditions for reinstating Mozambique's PSI programme, which includes a standby credit line of USD 282 million - of which USD 118 million has already been drawn down.

[2] The RFP issued on Sep. 29 specified that proposals were to be submitted within 4 weeks.

[3] Our calculations suggest that each transfer could carry a valuation in the range of USD 3-3.75 billion, implying a prospective fiscal bonanza of approx. USD 1 billion or more, apiece.

[4] Prior to today's restructuring announcement, the indications were that Exxon's transaction with ENI would materialize before the end of December, with the Anadarko deal following 6-9 months later. The relevant capital gains taxes would therefore become payable in FY 2017 and 2018, respectively.

7) Meanwhile, the Republic hopes to have a **restructuring agreement in place by Jan. 2017**. We consider this **an extremely ambitious target** - for two reasons:

- Given the relatively modest amount of USD 1.725 billion outstanding as commercial obligations, **creditors will feel under considerably less pressure** to reach a deal than had they been more heavily exposed.

- More importantly, the principle of "inter-creditor equity" that the Republic has belatedly affirmed[5], sets the stage for **intense – and potentially protracted - competition among the three creditor classes**[6], based on their divergent history with the obligor.

8) In short, **we see the restructuring decision as fraught with risks that the Republic can ill afford**.

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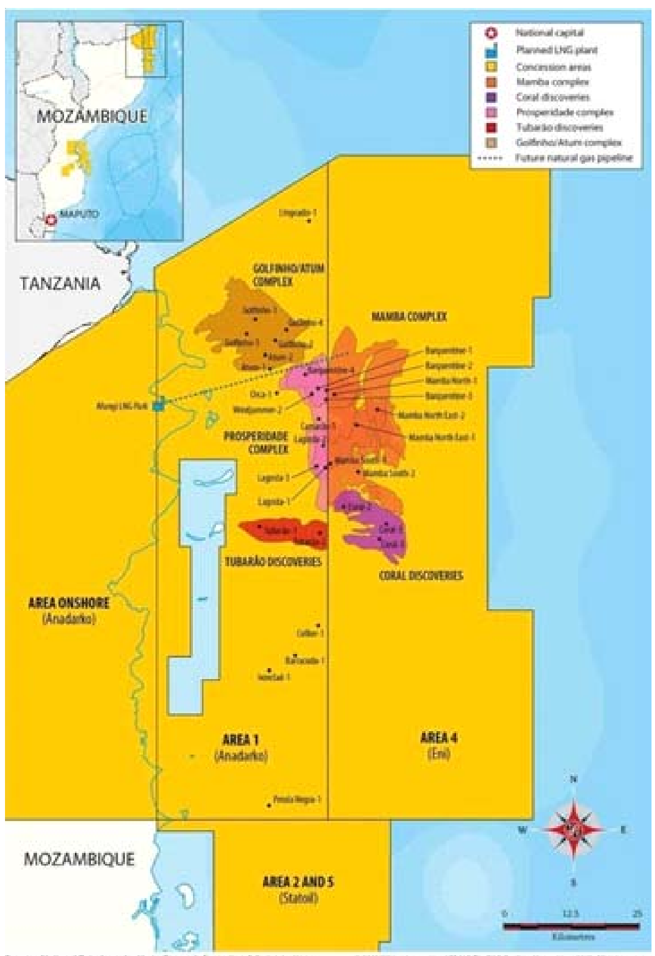
[5] It will be recalled that, the Republic failed to make the USD 178 million payable on May 23rd in respect of interest and principal on the MAM loan within the prescribed cure period.

[6] Respectively: holders of:

- (A) the sovereign Eurobond, who have already endured the restructuring of Apr. 2016, with the first (long) coupon payment of just under USD 60 mm. due in Jan. 2017;
- (B) the ProIndicus loan on which the obligor is current, with the next payment, of USD 118 mm. for interest and principal, due in Mar. 2017; and,
- (C) the MAM loan on which the Republic apparently intends to make the missed May payment before year-end.

Map of Mozambique's Rovuma Basin



Sources: National Petroleum Institute, Energy Information Administration