Overview Of ESG Credit Indicators For The Latin American Corporate And Infrastructure Sector

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This report does not constitute a rating action

Editor's Note: S&P Global Ratings is no longer publishing or updating ESG credit indicators. See https://www.spglobal.com/_assets/documents/ratings/esg_credit_indicators_mr.pdf for more information.

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Overview Of ESG Credit Indicators For The Latin American Corporate And Infrastructure Sector

We are disclosing in this report our ESG credit indicators for Latin America's corporate and infrastructure sector. Our ESG credit indicators provide additional disclosure and transparency at the entity level and reflect our opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating nor an S&P Global Ratings ESG evaluation.

Sector Snapshot - Latin American Corporations And Infrastructure

Most Influential ESG Factors

- **Climate transition risks**: Many corporate sectors in Latin America heavily rely on fossil fuels to power their industrial operations and to sell or transport their goods or services. In addition, due to the relevance of hydropower in the region, climate volatility is a big component of credit risk.

- **Waste and pollution**: Extractive industries in Latin America are exposed to air, water, and soil contamination, but other industries are as well, such as consumer products, pulp and paper, transportation, and metal processors.

- **Health and safety**: Given the nature of heavy industries, employees of a large portion of our rated portfolio of Latin American corporations are exposed to accidents. In addition, in the past 24 months, mobility restrictions caused various negative rating actions across our Latin American transportation portfolio, particularly airlines and airports and to a lesser degree rail and mass transit assets.

- **Risk management, culture, and oversight**: Governance-related risks are often elevated for Latin American entities, which usually have boards largely influenced by one person, a family, or government ownership. We also consider higher governance risks related to sovereigns in many countries in the region, such as Argentina and the Dominican Republic.

Distribution Of ESG Credit Indicators

<table>
<thead>
<tr>
<th>Environmental</th>
<th>Social</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector (%)</td>
<td>All corporates (%)</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>60</td>
<td>50</td>
<td>100</td>
</tr>
</tbody>
</table>

1 = positive | 2 = neutral | 3 = moderately negative | 4 = negative | 5 = very negative.

Our opinion of the influence of ESG factors on our credit rating analysis is reflected on a 1–5 scale. Source: S&P Global Ratings. Copyright © 2022 by Standard & Poor’s Financial Services LLC. All rights reserved.
Credit Ratings And ESG Credit Factors

Environmental, social, and governance (ESG) factors typically incorporate an entity’s effect on and impact from the natural and social environment and the quality of its governance; however, not all ESG factors materially influence creditworthiness and, thus, credit ratings, which measure the capacity and willingness of the entity to meet its financial commitments as they come due (see “S&P Global Ratings Definitions,” Nov. 9, 2021). Therefore, in our criteria “Environmental, Social, And Governance Principles In Credit Ratings,” published Oct. 10, 2021, we define ESG credit factors as those ESG factors that can materially influence the creditworthiness of a rated entity or issue and for which we have sufficient visibility and certainty to include in our credit rating analysis.

Chart 1

The Intersection Of ESG And Credit

ESG—Environmental, Social, and Governance. Source: S&P Global Ratings.
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When sufficiently material to affect our view of creditworthiness, ESG credit factors can influence credit ratings through, for example:

- A change in the size and relative stability of an obligor’s current or projected revenue base;
- Operating costs and requirements;
- Risk planning;
- Governance controls and standards;
- Profitability or earnings;
- Cash flows or liquidity; or
- The size and maturity of its financial commitments.
Examples of the potential influence of ESG credit factors on our corporate analysis

<table>
<thead>
<tr>
<th>Environmental</th>
<th>Social</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Climate transition risk:</strong> Higher carbon dioxide emissions costs leading to weaker profitability—reflected in the competitive position category of the corporate criteria (see chart 5)—and debt service coverage ratios (cash flow leverage analysis)</td>
<td><strong>Health and safety:</strong> Entities that suffer a drop in demand and revenues because of social distancing rules, including travel restrictions to stop the spread of virus, resulting in lower profitability</td>
<td><strong>Risk management, culture, and oversight:</strong> Material deficiencies in governance and risk management leading to brand and reputation damage and financial losses (considered in the competitive position and management/governance categories)</td>
</tr>
<tr>
<td><strong>Waste and pollution:</strong> Fines imposed due to breach of pollution regulations leading to weaker profitability and liquidity</td>
<td><strong>Social capital:</strong> Aging population trends in advanced economies leading to sustainable positive growth in certain sectors (such as old age homers and health care and pharmaceutical companies), which is reflected in industry risk</td>
<td><strong>Risk management, culture, and oversight:</strong> A history of regulatory, tax, or legal infractions beyond an isolated episode or outside industry norms, creating liability risk that can affect a company's balance sheet (as part of the cash flow leverage analysis) or liquidity</td>
</tr>
<tr>
<td><strong>Other environmental factors:</strong> Increasingly stringent and expensive regulatory requirements that can create prohibitively high barriers to entry in certain industries (reflected in industry risk)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Our ESG Credit Indicators

In November-December 2021, we published ESG Credit Indicators for companies and infrastructure entities through ESG sector report cards, and subsequently we plan to incorporate and update them in our issuer-specific rating publications to complement our existing credit rating analysis and surveillance. Below we explain the definitions and application in determining the ESG Credit Indicators, as detailed in our article, "ESG Credit Indicator Definitions And Application," published Oct. 13, 2021.

Chart 2

ESG In Our Credit Rating Analysis

Our ESG Credit Indicators provide additional disclosure by reflecting our opinion of how material the influence of ESG factors is on the various analytical components in our rating analysis through an alphanumerical 1-5 scale (see Table 1). We apply ESG Credit Indicators after the ratings have been determined.

Given that an ESG Credit Indicator is an alphanumerical representation of the qualitative assessment of ESG factors' impact on creditworthiness produced as part of the ratings process, accordingly the application of — or change of — an ESG Credit Indicator cannot by itself trigger a credit rating or outlook change. However, the impact of ESG factors on creditworthiness could contribute to a
rating action, which in turn could lead to a change in the ESG Credit Indicator. Through the release of ESG Credit Indicators, we aim to further delineate and summarize the relevance of ESG factors to our credit analysis by isolating our opinion of their credit influence and separating it from the non-ESG factors affecting the credit rating.

Table 1

<table>
<thead>
<tr>
<th>Influence on credit rating analysis</th>
<th>Environmental Credit Indicator</th>
<th>Social Credit Indicator</th>
<th>Governance Credit Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive</td>
<td>E-1</td>
<td>S-1</td>
<td>G-1</td>
</tr>
<tr>
<td>Neutral</td>
<td>E-2</td>
<td>S-2</td>
<td>G-2</td>
</tr>
<tr>
<td>Moderately negative</td>
<td>E-3</td>
<td>S-3</td>
<td>G-3</td>
</tr>
<tr>
<td>Negative</td>
<td>E-4</td>
<td>S-4</td>
<td>G-4</td>
</tr>
<tr>
<td>Very negative</td>
<td>E-5</td>
<td>S-5</td>
<td>G-5</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings

The above scale has a negative skew. This is deliberate and reflects our view that ESG considerations that are material to our rating analysis have a negative influence more often than a positive one. A neutral ESG Credit Indicator (E-2, S-2, or G-2) does not necessarily mean that ESG factors are not relevant; it only means that it is currently a neutral consideration in our credit rating analysis. For example, a negative environmental consideration in one area of our analysis (such as industry risk) may be counterbalanced by a positive environmental consideration reflected in another area of our analysis (such as competitive position if the entity is better positioned than its industry peers).

Finally, we list below examples of the key ESG credit factors we currently assess, as stipulated in our ESG Criteria. The ESG Credit Indicators will be accompanied by these factors to flag the actual areas of material influence we considered.
Overview Of ESG Credit Indicators For The Latin American Corporate And Infrastructure Sector

Chart 3

Examples Of ESG Credit Factors

**Environmental factors**
- Climate transition risks
- Physical risks
- Natural capital
- Waste and pollution
- Other environmental factors

**Social factors**
- Health and safety
- Social capital
- Human capital
- Other social factors

**Governance factors**
- Governance structure
- Risk management, culture, and oversight
- Transparency and reporting
- Other governance factors

ESG—Environmental, social, and governance. Source: S&P Global Ratings.
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Many corporate sectors in Latin America heavily rely on fossil fuels to power their industrial operations and to sell or transport their goods or services. The sectors also significantly depend on climate conditions, in particular hydrology given the relatively high exposure the region has to hydropower, especially in Brazil, Chile, Colombia, and Peru. Some of these entities will need to invest heavily to convert to or increase their power supply from renewable energy to comply with stricter regulations. In addition, oil and gas producers, refiners, and transporters face uncertainties about their business conditions in a not-so-distant-future.

Issues of contaminated air, water, and soil occur mostly in extractive industries in Latin America, but also in other industries such as consumer products, pulp and paper, transportation, and metal processors, to name a few. Sectors like these need to devote a meaningful portion of their cash flows and operating expenses to keep waste and pollution contained and increase recyclability. Other forms of pollution, including coal ash and nuclear waste, could also pressure the creditworthiness of some power generators.

We see the power industry’s environmental risk as well above average, considering that the sector accounts for 40% of global carbon dioxide (CO2) emissions. Even though Latin America is at the forefront of the energy transition—renewable generation makes up the majority of the region’s installed capacity—we still see a higher concentration of above-average environmental risk assigned to natural gas plants, although they emit about half the CO2 of coal-fired power plants. In addition, we think coal generation is by far one of the most exposed subsectors in the power industry because it’s at higher risk of being displaced by carbon-free renewables than gas-fired plants. We also note that Chile plans to retire half of its coal power plants by 2025, so displacement risks are very high there.
Physical risks are also elevated among Latin American corporations due to our large rated portfolio of agribusiness and commodity food entities. Periodic weather-induced crop shortages tend to increase profit and cash flow volatility as well as supply-related business risks, which can hurt credit quality. Recent key weather events affecting the sector include droughts in Brazil, which have caused power price increases and supply shocks that have impaired the operating performance of rated issuers.

Chart 6
Environmental Credit Indicators Breakdown By Selected Sectors
Given the nature of heavy industries, employees of a relatively large portion of our rated portfolio of Latin American corporations are exposed to accidents versus our global portfolio. Preventing accidents demands resources and poor performers often face friction with workers and sometimes communities. In the past 24 months, mobility restrictions related to the pandemic caused various negative rating actions in our transportation portfolio in the region, particularly to airlines and airports, and to a lesser degree rail and mass transit assets.

Metals and mining and oil and gas upstream and refining companies face considerable pressure from social factors, given their land use, emissions, and disruptions for neighboring communities, which sometimes includes indigenous groups. However, mining plans often incorporate meaningful investments to advance local living conditions, such as investments in roads, electricity grids, and water systems, although even these can engender dissent. In addition, regulated utilities have higher social risks because if customer bills become volatile, this often leads to a higher percentage of dissatisfied customers and makes it harder for the utility to manage regulatory risk. Currently, increasing capital spending, rising commodity prices, and inflation are simultaneously pressuring customer bills in Latin America.
Chart 9

Social Credit Indicators Breakdown By Selected Sectors
Governance-related risks are often elevated among Latin American entities, which usually have boards largely influenced by one person, a family, or government ownership. Companies with weaker risk management or deficient work cultures often have elevated risk appetites or shortcomings in their ability to identify, monitor, and mitigate risks.

Governance credit indicators in the G-3 or G-4 categories may also reflect some concentration of operations in higher-risk countries, such as Argentina and Dominican Republic, where we see broad governance risks such as institutional effectiveness and rule of law that affect our credit rating analysis.

Latin American midsize entities exhibit governance shortcomings more often than larger companies, by virtue of shorter company histories; weaker financial flexibility, and key person risk. Sectors with greater abundance of such risks are varied and include agribusiness and commodity foods, metals and mining downstream, retail and restaurants, containers and packaging, and telecom and cable.
Chart 12

Governance Credit Indicators Breakdown By Selected Sectors
Overview Of ESG Credit Indicators For The Latin American Corporate And Infrastructure Sector

Related Criteria And Research

Related Criteria
− General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Related Research
− ESG Credit Indicator Report Card: Consumer Products, Dec. 17, 2021
− ESG Credit Indicator Report Card: Investment Holding Companies And General Trading Investment Companies, Dec. 17, 2021
− ESG Credit Indicator Report Card: Business, Environmental, And Consumer Services, Dec. 16, 2021
− ESG Credit Indicator Report Card: Health Care, Dec. 16, 2021
− ESG Credit Indicator Report Card: Retail And Restaurants, Dec. 16, 2021
− ESG Credit Indicator Report Card: Real Estate, Dec. 14, 2021
− ESG Credit Indicator Report Card: Transportation Infrastructure, Dec. 13, 2021
− ESG Credit Indicator Report Card: Aerospace And Defense, Dec. 10, 2021
− ESG Credit Indicator Report Card: Airlines And Aircraft Leasing, Dec. 10, 2021
− ESG Credit Indicator Report Card: Shipping, Road, And Rail, Dec. 10, 2021
− ESG Credit Indicator Report Card: Telecoms, Dec. 9, 2021
− ESG Credit Indicator Report Card: Leisure, Dec. 8, 2021
− ESG Credit Indicator Report Card: Media And Entertainment, Dec. 7, 2021
− ESG Credit Indicator Report Card: Technology, Dec. 7, 2021
− ESG Credit Indicator Report Card: Engineering And Construction, Dec. 3, 2021
− ESG Credit Indicator Report Card: Chemicals, Dec. 2, 2021
− ESG Credit Indicator Report Card: Metals And Mining, Nov. 30, 2021
− ESG Credit Indicator Report Card: Midstream Energy, Nov. 29, 2021
− ESG Credit Indicator Report Card: Oil And Gas Upstream And Refining, Nov. 23, 2021
− ESG Credit Indicator Report Card: Autos, Nov. 19, 2021
− ESG Credit Indicator Report Card: Building Materials, Nov. 19, 2021
− ESG Credit Indicator Report Card: Power Generators, Nov. 18, 2021
− ESG Credit Indicator Report Card: Regulated Utility Networks, Nov. 18, 2021
− ESG Credit Indicator Definitions And Application, Oct. 13, 2021