S&P Global Ratings

Latin American Corporate And Infrastructure Credit Outlook 2023

Dwindling Fundamentals, Elusive Funding

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This report does not constitute a rating action

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Overview

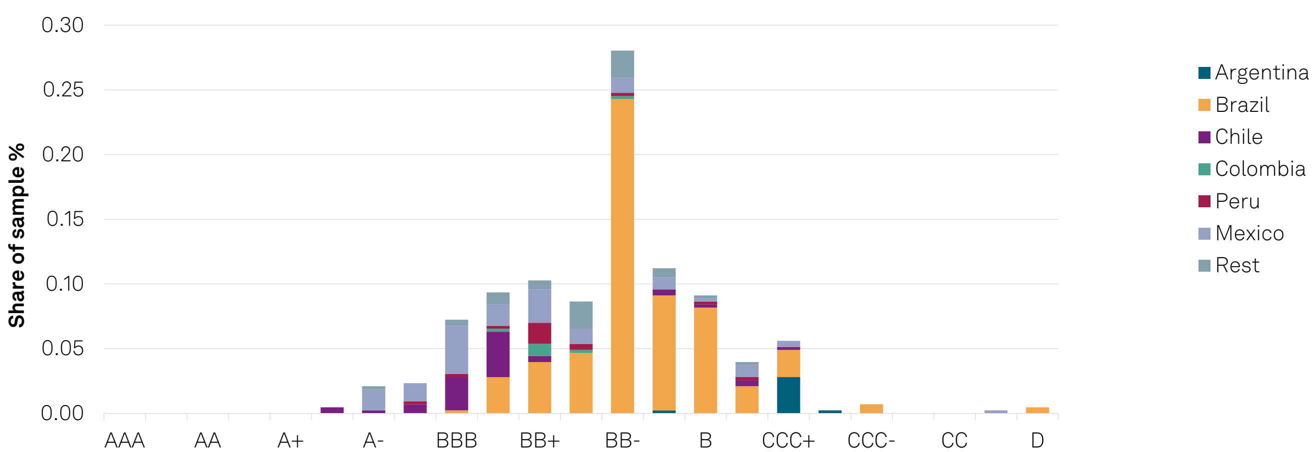
- While growth trajectories across Latin America's (LatAm's) largest economies are likely to worsen in 2023, S&P Global Ratings expects inflation and policy rates to scale back to more normal levels, which would allow consumer spending and economic activity in general to recover more rapidly in the future.
- Our outlook bias is close to zero, reflecting a general stability across sectors and geographies, and the fact that refinancing risks for 2023 are largely manageable. Also, yields of international bonds issued by LatAm corporate and infrastructure entities have dropped between 100 and 200 basis points (bps) across the main rating categories, indicating a potential return to more normal levels. We view the persistence of high interest rates as a major threat to credit quality.
- After a record level of issuances in 2022 across several markets of the region, recent defaults may slow down refinancing activity and exacerbate short-term risks for issuers with weaker credit quality. We expect to see a recalibration of borrowing costs and a gradual normalization in Brazil.
- Sectors, which are more sensitive to interest rates such as consumer products; real estate and homebuilders, and retail, as well as those sectors with more leveraged capital structures, such as transportation and telecom and cable companies, will face stronger headwinds in 2023. Commodity-driven businesses--agribusiness, forest products and packaging, metals and mining, and oil and gas--should post a robust performance, although prices will slip from 2021-2022 highs.

Rating performance in LatAm remains resilient to difficult business conditions stemming from high inflation and interest rates, as well as from slowing economic growth. The rating bias on our rated portfolio is nearly zero, indicating an even number of issuers with positive and negative outlooks. This is very much in line with the rating bias last year, and certainly much stronger than the negative bias of 33% from a couple of years ago. Absent the constraints stemming from sovereign rating caps, we see a comfortable headroom for companies to cope with short-term risks in 2023, although almost 80% of the rated entities are at a speculative-grade level and could face restrictive conditions in an already tight financing environment.

Chart 1

Ratings' Distribution

LaAm corporations

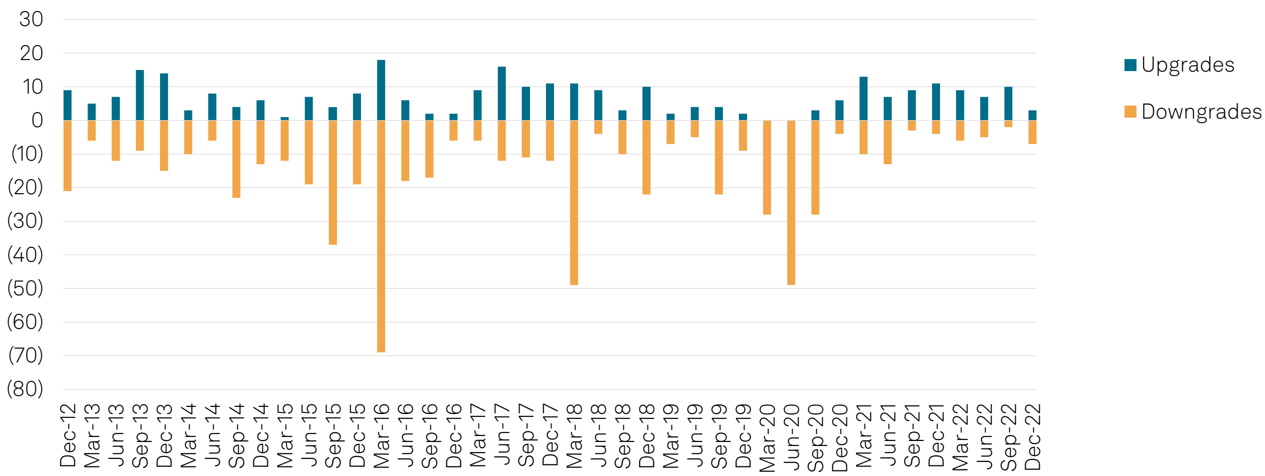


Source: S&P Global Ratings.

Chart 2

Corporate Rating Actions Across Selected LatAm Countries

Downgrade activity has sped up in 4Q 2022



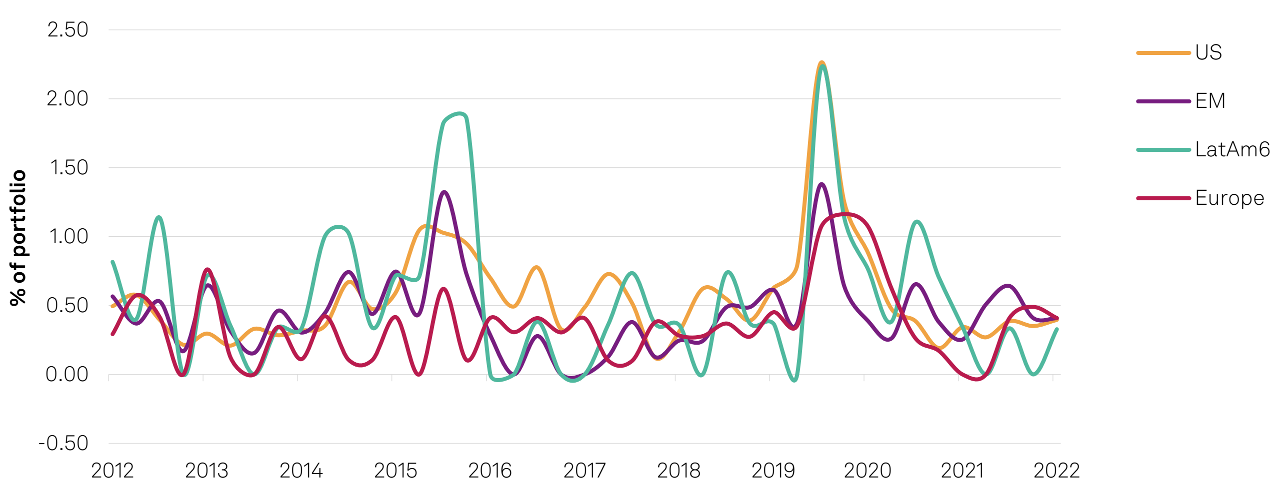
Source: S&P Global Ratings.

After the pandemic-induced global defaults peaked in 2020, the LatAm corporate sector underwent another round of defaults in the first half of 2021, although it only affected-slightly above 1% of the total rated portfolio. In 2022, there were almost no LatAm defaults, as opposed to Emerging Markets (including Russia) and Europe which were hit by the Russia-Ukraine conflict. We expect corporate defaults to rise mildly in 2023. As of mid-February, two entities defaulted (Americanas S.A. and Oi S.A.) and a few more may follow them. As such, we expect the default rate to slightly increase, but to remain below 1%.

Chart 3

Corporate Default Rates By Main Regions For The Past Decade

Defaults in LatAm reached a peak in the first half of 2021



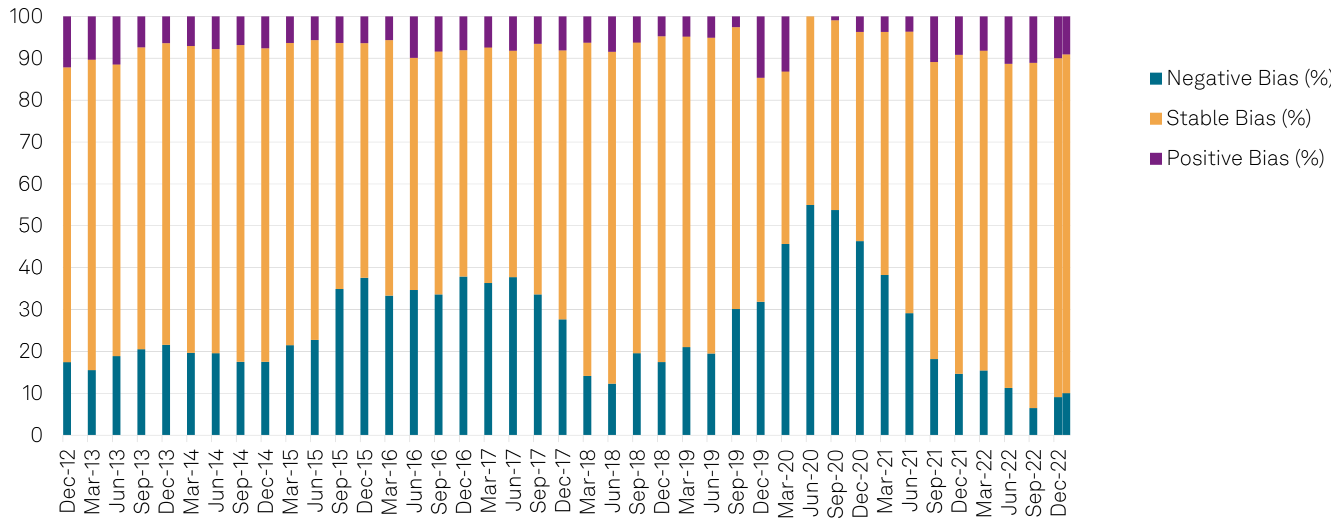
Source: S&P Global Ratings.

Negative bias slightly increased in January 2023, suggesting the start of a new wave of negative outlooks, which is consistent with the slight worsening in financial performances and business conditions that we comment further down in this report. Still, our take is for a mild increase in credit risk, limited to a few sectors that are more capital intensive and balance sheets of which are more leveraged and/or demand for their products and services is more sensitive to interest rates.

Chart 4

Outlook Bias Of LatAm Corporate Sector

Outlooks remain largely stable



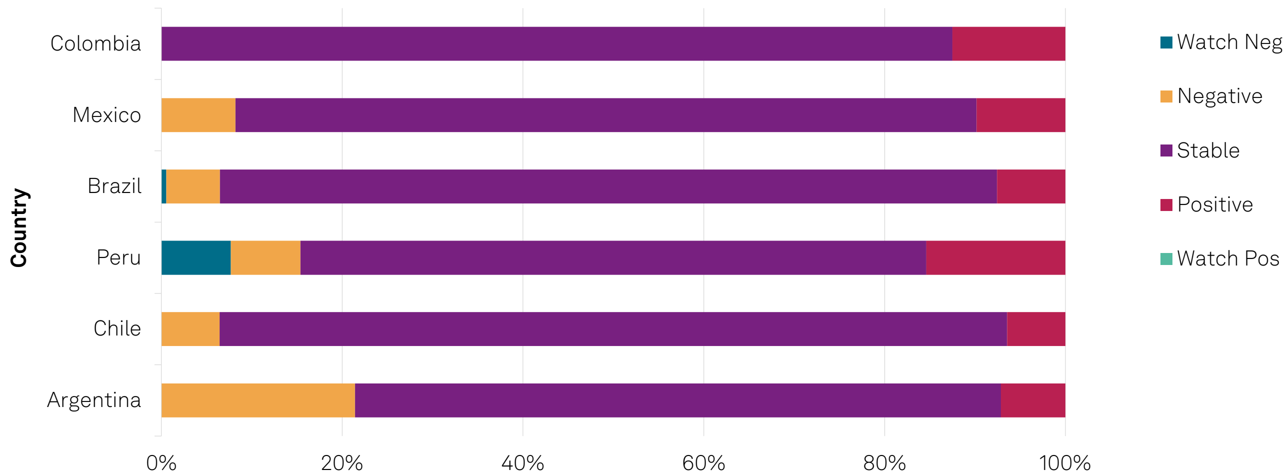
Source: S&P Global Ratings.

The outlook distribution across the region's countries is mostly stable with some concentration of negative outlooks in Argentina, given that credit quality of domestic issuers is dragged down by high inflation and lack of financing, which in turn has been exacerbated by central bank restrictions on accessing foreign exchange in 2023. As of the end of 2022, the vast majority of Argentine issuers had rolled over their debts to comply with these restrictions. As chart 5 shows, most of the largest economies in the region have equally weighted positive and negative outlooks.

Chart 5

Outlook Distribution By Country

LaAm corporations



Source: S&P Global Ratings.

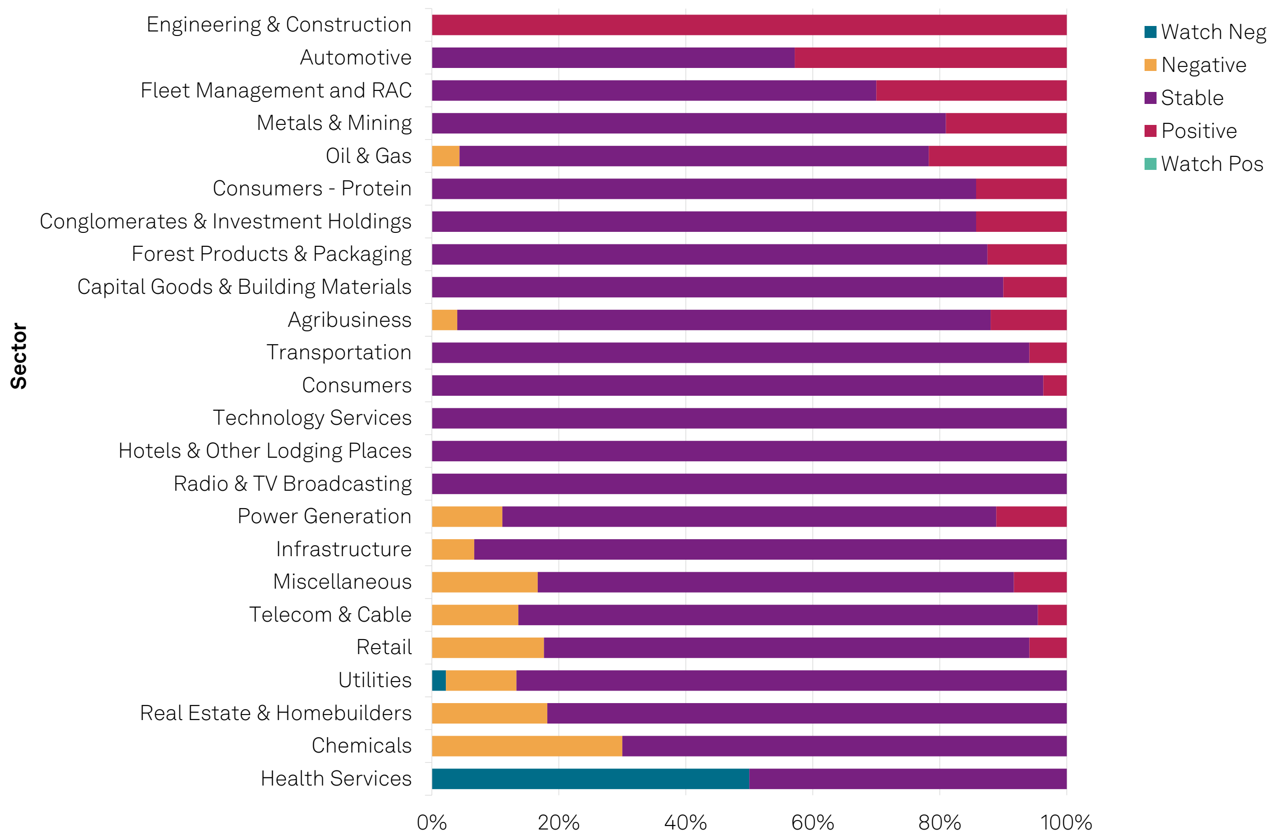
The sectors that face greater downside risks, adjusted by sample size, are real estate and homebuilders, and retail, telecom and cable and infrastructure. Downside risks for the real estate and homebuilding and retail sectors are more pronounced among Brazilian issuers who are suffering from the spike in interest rates and inflation, which is curbing consumer and durable goods demand. Also, telecom and cable companies in Brazil, Mexico, and Chile are hit by high interest rates, especially the smaller and more leveraged players that need to keep investing to maintain their competitive positions.

On the other hand, the auto supplier, fleet management and rent-a-car (RaC), metals and mining, and oil and gas sectors have brighter ratings prospects for 2023. Auto suppliers are benefitting from the normalization of their supply chains, and we expect their production to grow by 4% in 2023 as deliveries pick up. China's strong resumption of imports is pushing prices up once again, bolstering performance of metals and mining companies. Also, oil and gas companies continue to thrive thanks to persistently strong prices owing to geopolitical conflicts. More details on sectorial trends can be found in the last section of this report.

Chart 6

Outlook Distribution By Sector

LatAm corporations



Source: S&P Global Ratings.

Good Fundamentals For Commodities, But Slow Growth And Social Tensions Loom In 2023

Most of the commodities the region exports enjoy solid fundamentals with prices higher than averages in the past. That's the case for iron ore, copper, agricultural products, protein (raw or processed), pulp, sugar, oil and gas -and more recently- lithium. We continue to expect very favorable price dynamics as the world's demand for these products keeps growing and prices of some --such as oil & gas and certain agricultural products- remain abnormally high due to supply shortages owed to the Russia-Ukraine conflict.

The major development of the past two months has been China's surprising volte face in its zero-COVID policy. We were expecting a gradual unwind of the policy this year. The rapid rollback of almost all restrictions was not in our baseline, as seen in table 1. We believe there could be a positive net impact on global for commodity producers such as Latin America (oil and gas, metals, and agricultural products). The current account balance and GDP growth of Chile and, to a lesser degree, of Peru stand to benefit the most, given high share of copper in their exports. For more details on our latest global macro view please read "*Economic Research: Global Macro Update: Post-Davos, We Reaffirm Our View*", published Jan. 26, 2023.

The economic forecasts below can be found in our publication "*Economic Outlook Latin America Q1 2023: A Shift To Lower Growth*", published Nov. 28, 2022.

Table 1

Main Economic Assumptions For Main LatAm Economies

Low growth, and still high inflation and policy rates are our main economic assumptions for 2023

	GDP growth % 2023	Policy rates %	Average inflation %
Argentina	0.5	70.0	95
Brazil	0.5	10.8	4.3
Chile	(0.4)	8.5	7.9
Colombia	1.1	9.0	6.7
Mexico	0.8	8.5	5.8
Peru	2.5	6.0	5.0

2023 GDP growth assumptions are in real terms. Policy rates are on a year-end basis while inflation rates are averages. All of them were published on November 28, 2022. Source: S&P Global Ratings.

Argentina. Our 2023 GDP growth forecast of 0.5% points to a significant slowdown from 2022. Inflation at the end of 2022 was about 100% year-over-year and will stay close to that level throughout most of 2023, due to wage adjustments and the effect of a weaker exchange rate on import costs. The exchange rate will continue to face strong depreciatory pressures next year, with net foreign reserves close to zero. The government will struggle to achieve the Extended Fund Facility (EEF) targets, which were agreed upon with the IMF, after reaching an agreement to renegotiate its $45 billion deal with the multilateral organization earlier this year. The EEF requires Argentina to commit to politically challenging fiscal, monetary, and reserve targets amid high inflation and slowing economic growth. Signs that EEF targets aren't met would likely intensify pressure on the exchange rate, increase inflation, and lower investment. This factor puts the risks to our 2023 GDP growth forecast for Argentina firmly to the downside.

Brazil . We expect the Brazilian economy to stagnate in 2023, given that the initial boost from improved terms of trade gains thanks to higher commodity prices is fading. In addition, the impact of tight monetary policy will likely intensify as growth prospects dim, dampening domestic demand. Furthermore, the change in government could slow investment implementation due to administrative delays. Some uncertainty about President Lula administration's policies, especially on the fiscal front, could also pare back investment until there's more visibility.

Chile . We expect Chile's 2023 GDP to contract by 0.4%. We expect demand to shrink in 2023, as the fading effect of the removal of stimulus measures continues, especially those that boosted consumption such as pension withdrawal allowances. Uncertainty about the rewriting of Chile's constitution will also likely temper investment until visibility on policy increases.

Colombia. In our opinion, there are clear signs that the very strong growth in domestic demand of the last two years is starting to weaken, as the impact of stimulus measures in response to the pandemic abates. So, we expect demand to remain weak in 2023 as the more sluggish global growth weakens confidence. Inflation in Colombia is among the highest in the region (12.2% year-over-year in October), due in large part to rising food import costs. We expect inflation to remain elevated throughout most of 2023. This will keep domestic interest rates relatively high (above 10% for most of the year), given that inflation expectations remain well above the central bank's 3% target--at about 7.5% for the end of 2023. We expect investor uncertainty over the recently elected President Gustavo Petro's policies for the energy sector and on the fiscal side

Mexico . We expect a slow-down in Mexico's GDP primarily due to lower U.S. demand for Mexico's manufactured exports. Services, which have done relatively well in recent quarters, will also soften as employment weakens. Continued strong remittances from the U.S., if they continue in 2023 even as the U.S. economy stalls, would help boost consumption in Mexico. Beyond 2023, we continue to expect Mexico's economy to grow close to its traditional structurally low growth rate of 2% due to low and inefficient investment levels.

Peru . Our 2023 growth projection takes into consideration the political stalemate, which will limit investment in the coming quarters and keep growth well below trend. Consumption also started to decline in the third quarter, hindered by record-high inflation (8.3% year-over-year in October), which has pushed the central bank to raise the reference interest rate to 7.25%, the highest level in more than 20 years.

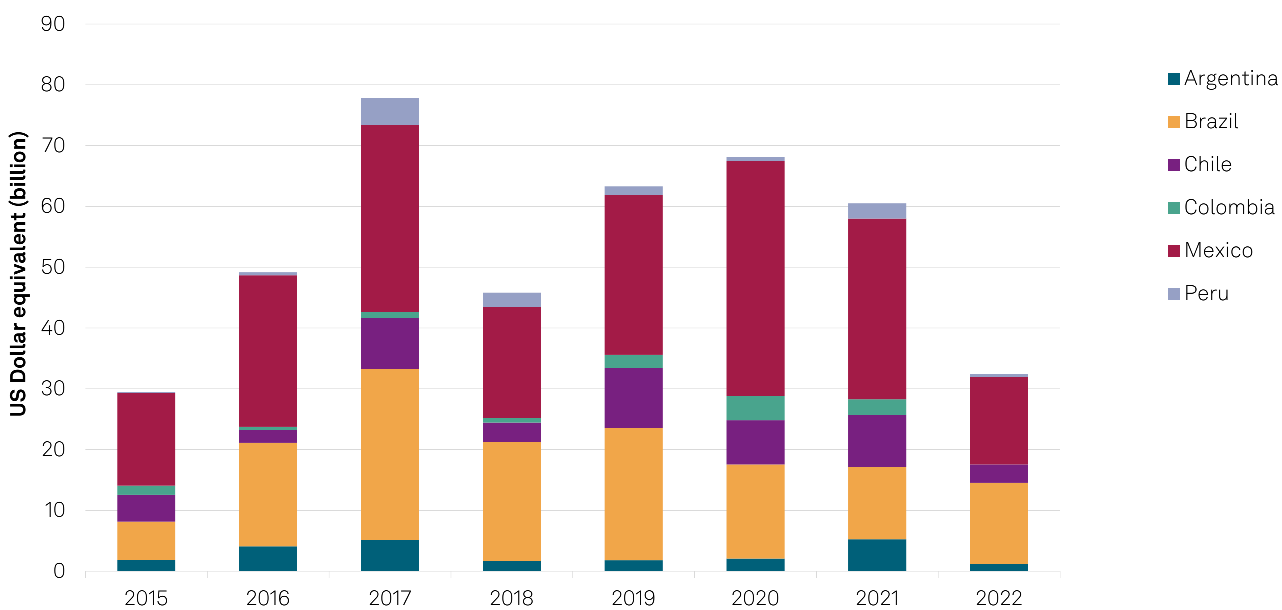
Access To Capital Markets At A Tipping Point?

LatAm companies located in the region's largest economies issued an aggregate of $32.5 billion in 2022 according to Thompson Reuters (chart 7). That's the lowest level in the past seven years. And with median yields for the BB category ranging from 7% to 9% (chart 8) companies are willing to go to great length to avoid tapping international capital markets. The current borrowing costs are seemingly higher than most sectors' asset returns, prompting deleveraging across sectors. The good news is that bond prices have recovered slightly in the past three months, cutting yields by 100 to 200 bps (chart 8), and market activity since January 2023 has ramped up compared with the same period in 2022 and 2021.

Chart 7

International Bond Issuances

LatAm corporations

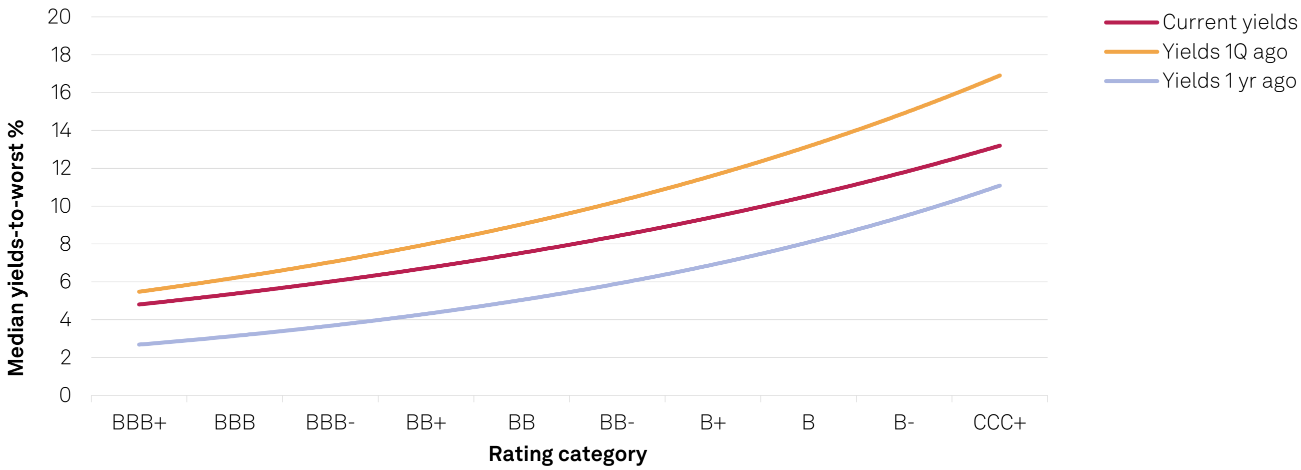


Source: S&P Global Ratings based on Thompson Reuters.

Chart 8

Median Yields Of International Bonds By Rating Category

LatAm corporations



Source: S&P Global Ratings based on Thompson Reuters.

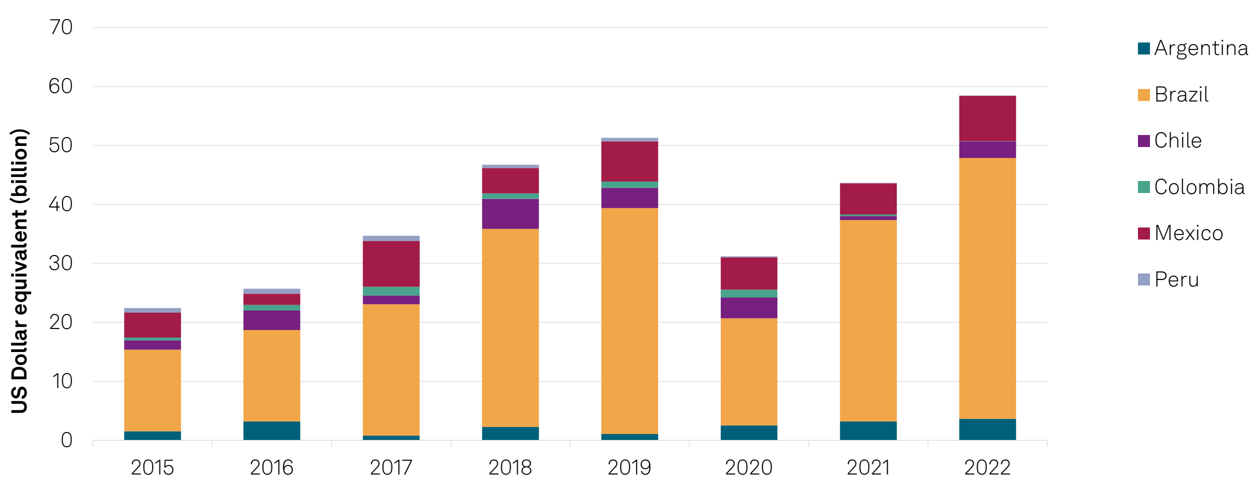
Regional debt markets have picked up in 2022, amid the lack of activity in cross-border markets, although those in Argentina, Colombia and Peru are still dismally insufficient to serve the largest domestic companies' needs. We expect activity in domestic markets to remain vibrant in 2023 as policy rates dwindle and as cross-border issuances rise at a sluggish pace.

In Brazil, debt market activity in 2023 may soften after recent defaults of Americanas S.A. and Oi S.A., and more recently, Light S.A.'s hiring of a financial advisor to explore ways to improve its capital structure and Gol Linhas Aereas Inteligentes S.A.'s debt exchange announcement. We expect domestic issuances there to slow down for a few months, which could exacerbate short-term risks for entities with weaker credit quality, but we expect a recalibration of borrowing costs followed by a gradual normalization.

Chart 9

Domestic Bond Issuances

LatAm corporations



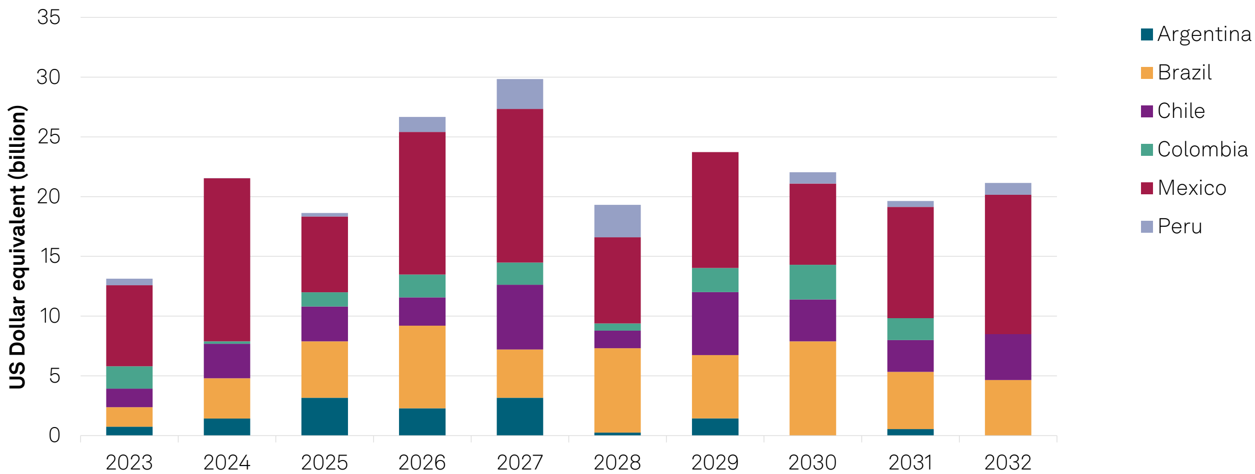
Source: S&P Global Ratings based on Thompson Reuters.

Investors' lack of appetite for LatAm corporate bonds wasn't too troublesome for corporations in 2022 as refinancing needs were low during the year. For 2023, we forecast a fairly similar scenario and less so in 2024, given that international debt maturities will total $13 billion and $21 billion, respectively. Much of debt coming due in those years will be mostly among a few issuers (Petroleos Mexicanos [Pemex], Ecopetrol S.A., and America Movil S.A.).

Chart 10

International Bond Maturities Of LatAm Corporations

Refinancing needs look manageable in 2023



Source: S&P Global Ratings based on Thompson Reuters.

Sectorial Trends: Borrowing Costs Are A Growing Concern

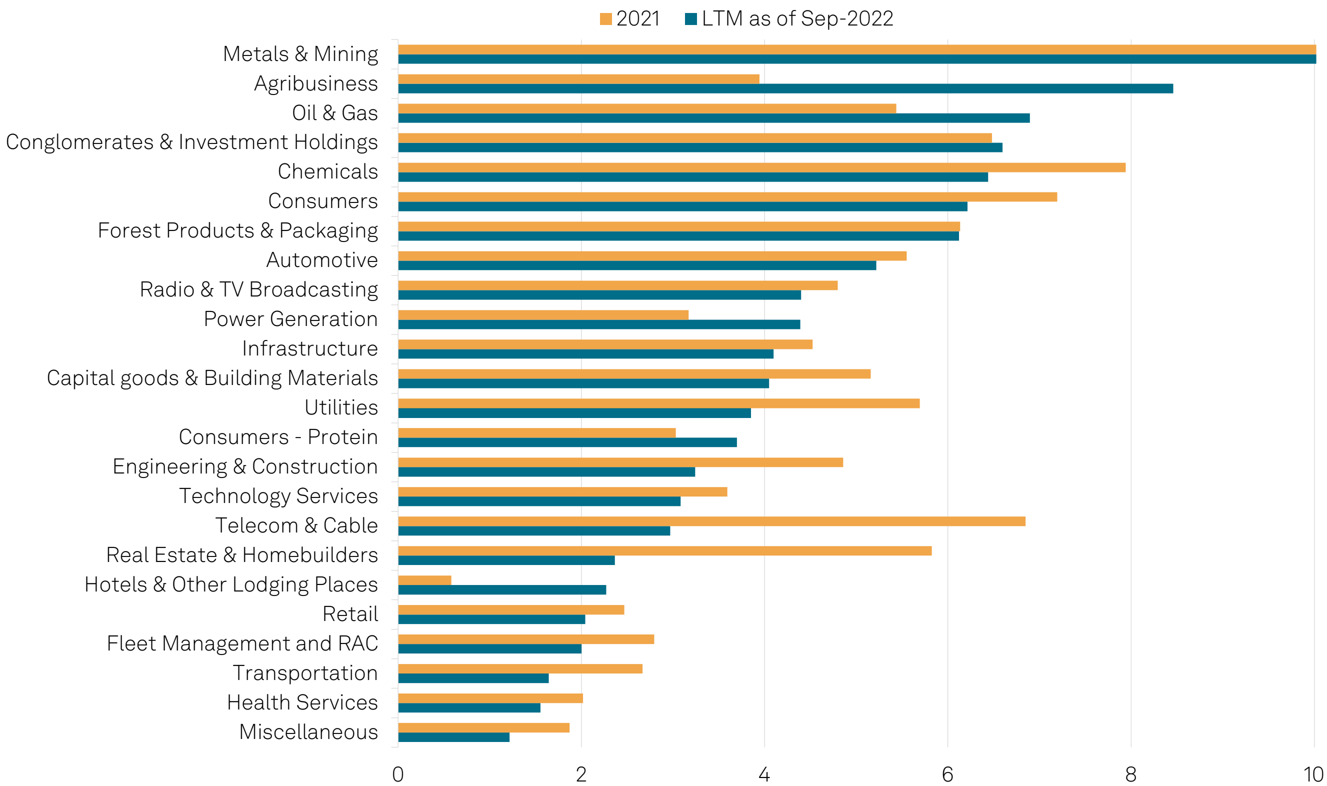
While liquidity isn't a major threat for LatAm corporations in 2023, interest rate levels pose a risk from a credit perspective. As seen in chart 11, borrowing costs for the vast majority of sectors are increasing, inhibiting the companies' ability to generate free cash flows. While companies remain reasonably leveraged (60% of sectors with net debt-to-EBITDA ratios below 4x), interest coverages are shrinking, and the trend is likely to get worse in 2023, as a greater number of debts is reset at higher rates.

As a result, and given that policy rates are likely to decline slightly throughout 2023, we believe companies will remain cautious with their capital allocation and that they will favor debt reduction over growth or shareholder remuneration. This is especially the case for sectors, demand dynamics of which are more sensitive to interest rates (real estate, homebuilding, automakers, capital goods, etc.) and for more leveraged sectors (hotels and other lodging, transportation, retail, and telecom and cable). Below we comment on main trends in key selected sectors.

Chart 11

EBITDA Interest Coverage By Sector

Median coverages were hit by the rise in interest rates

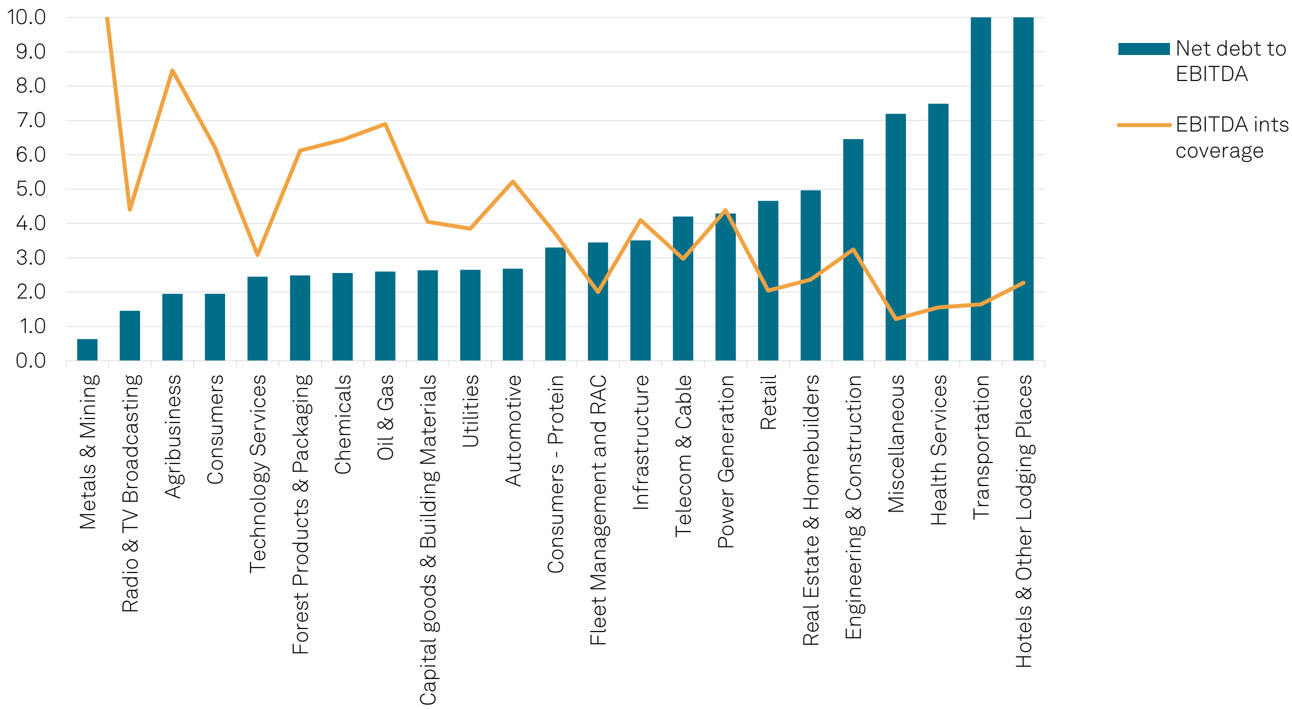


Median coverages were calculated using unadjusted data from Market Intelligence. Source: S&P Global Ratings.

Chart 12

Leverage Patterns For Main LatAm Corporate Sectors

40% of sectors showing net debt-to-EBITDA ratios above 4x



Median coverages were calculated using unadjusted data from Market Intelligence. Source: S&P Global Ratings.

▲ Positive ▬ Stable ▼ Negative

*medians, last twelve months as of Sept. 2022 vs 2021
**medians, last twelve months as of Sept. 2022

Agribusiness

Outlook bias	+8.0
Ratings trend	▲
Gross margin change %*	+10.5
Net debt-to-EBITDA**	1.9x
EBITDA ints coverage**	8.5x

Brazil's sugar and ethanol producers are enjoying strong prices for sugar. Ethanol's competitiveness diminished following the change in fuel taxation in 2022, while sugarcane crushing output rose thanks to a sizable pick up in harvest yields. The latter owed to favorable weather conditions and the increased use of farming technologies such as pest control, a more effective use of irrigation systems and continued investments in the fields. Concerns for 2023 are mainly over the ethanol and gasoline taxation, international oil prices influencing domestic ethanol prices, and whether Petrobras will maintain the global fuel price parity under the country's new administration, although no changes were announced. We expect corn and other crops to also perform well as prices remain attractive, while the rise in fertilizers costs has moderated. Profitability of producers of these crops would remain strong amid growing volumes and stable costs in 2023.

Mexican sugar producers enter 2023 with robust balance sheets, taking advantage of high prices over the last couple years. We expect this favorable pricing trend to continue in 2023 considering a relative sugar scarcity in the combined Mexico-U.S. market. Mexico’s sugar production will reach about 6.025 million tons for the 2022-2023 harvest, according to the Mexican National Committee for the Sustainable Development of Sugarcane (CONADESUCA). We also expect sugar demand to remain broadly stable and insulated from the country's economic slowdown, since most of it is for direct consumption -food, and beverages- which have high inelasticity. We expect sugar producers to allocate more than 90% of their output to the combined Mexico-U.S. market, which has some of the highest prices in the world, with a little need to export to the international market that offers lower prices and leads to lower profitability. At the same time, we expect companies to continue in investing on automatization process, which should lead to savings in labor costs. These factors will be key in protecting profitability and mitigating increasing sugarcane costs, including high fertilizer costs.

Forest Products And Packaging

Record prices in 2022 across all grades and destinations buoyed forest products companies. This was mostly thanks to a very tight supply (logistics bottlenecks, unexpected maintenance shutdowns of mills, and delays in the start-up of new facilities), while demand remained strong.

For 2023 we expect prices to drop 10%-15% as supply normalizes. We expect a greater pressure on prices of bleached eucalyptus kraft (BEK) in China (which is the prevailing pulp type produced in LatAm). This is because new mills (Celulosa Arauco y Constitucion's MAPA and UPM Kymmene Corp.'s facility in Uruguay) will add 3.7 million tons to the global capacity (although their ramp-up will be gradual throughout the year).

Nevertheless, average prices in 2023 should still be significantly higher (about 35%) than the lows of 2020, supporting healthy operating cash-flow and leverage levels. Chilean players are likely to show stronger metrics as they don't plan big expansions in 2023, while Suzano S.A. is building the 2.3 million ton Cerrado mill and Klabin S.A. is completing its PUMA II project.

Outlook bias	+12.5
Ratings trend	—
Gross margin change %*	+8.4
Net debt-to-EBITDA**	2.5x
EBITDA ints coverage**	6.1x

Protein Producers

We expect Brazilian and Paraguayan beef producers to post stronger margins thanks to ample cattle availability that have reduced cattle costs by 15% since record-high levels until mid-2022, amid strong prices and exporting volumes mainly to Asia, despite weak data in the fourth quarter due to seasonality. Large companies with sizable exposure to the U.S. will suffer amid high inventories of cold storage products, weak seasonal demand and high input costs --fairly stable ones for grains but growing for live cattle amid lower availability. Margins of Brazilian pork and poultry operations dropped, given that China's waning demand along with difficulty adjusting prices in the domestic market. Ratings on players in this commoditized sector incorporate margin volatility, and we believe the majority of LatAm rated protein producers can maintain a stable outlook in a weaker cycle.

Outlook bias	+14.3
Ratings trend	—
Gross margin change %*	-6.4
Net debt-to-EBITDA**	3.3x
EBITDA ints coverage**	3.7x

Building Materials

Downside risks seem largely contained. Credit quality of the building materials companies remains largely stable, despite pressure on profit margins stemming from inflation fueled input costs, particularly energy, electricity, and transportation. For 2023, we consider that macroeconomic headwinds and political risks could dent top-line growth. Sluggish economic activity and elevated inflation will further undermine consumer purchasing power. Also, the lack of visibility on some government policies and tight financing conditions will hold back sizeable capital investments. Therefore, we expect prudent capital allocation strategies, balanced between growth and deleveraging, with enough rating headroom to absorb downside risks.

Outlook bias	+10.0
Ratings trend	—
Gross margin change %*	+4.0
Net debt-to-EBITDA**	2.6x
EBITDA ints coverage**	4.0x

Oil And Gas

Oil and gas companies are kicking off 2023 with strong balance sheets and generally ample liquidity due to favorable prices during 2022, with Brent averaging $100/bbl and WTI about $95/bbl. Geopolitical turmoil remains the main price driver. Assuming a moderation of such risks, we expect Brent to slip towards $90/bbl in 2023. And that will sustain margins at high levels, considering that the average breakeven price in the region is between $20-$25/bbl.

Outlook bias	+17.4
Ratings trend	▲
Gross margin change %*	-5.2
Net debt-to-EBITDA**	2.6x
EBITDA ints coverage**	6.9x

Given the sector's relatively high cash flows, we expect the companies to continue investing heavily to raise output and replenish reserves.

Government ownership of national oil companies (NOCs) across the region remains a key credit factor, given the sovereigns' strong influence on ratings. In this sense, new administrations in Brazil and Colombia may alter business strategies of Petrobras and Ecopetrol. And Mexico will have federal elections in 2024.

In our opinion, Brazilian smaller exploration and production players will likely reduce M&As as Petrobras is likely to pause its asset divestments (a new board will be elected in the next few months, probably prompting strategy changes).

On the other hand, Argentine oil and gas companies are likely to keep increasing production (and exports) at a rapid clip as the country expands midstream capacity and the government continues to incentive the gas production growth.

Metals And Mining

Margins of LatAm metals producers and miners plummeted more than 25% in the 12 months ended in September 2022 from the 2021 levels. This was mainly due to the price decline of about 15% for copper and iron ore, volume shortages among Chilean producers, and costs inflation. Nevertheless balance sheets remain strong.

Outlook bias	+19.0
Ratings trend	▲
Gross margin change %*	-25.2
Net debt-to-EBITDA**	0.6x
EBITDA ints coverage**	14.9x

For 2023 we expect performance to improve as prices are surging due to expectations of a drastic resumption of China's imports and the weaker U.S. dollar. In fact, since the start of 2023, base metals prices jumped by more than 10%. Still, volumes aren't likely to grow, as most of the producers are struggling to maintain existing production levels. And Chile's largest copper producer Corporacion Nacional del Cobre de Chile, is facing an output drop of 12.5% versus 2021 levels (about 200,000 tons per year).

Retail

Outlook bias	-11.8
Ratings trend	▼
Gross margin change %*	+0.02
Net debt-to-EBITDA**	4.7x
EBITDA ints coverage**	2.0x

Last year hasn't been easy for retailers. Softer revenue growth, margin compression, and higher cost of debt are squeezing retailers' profits and cash flows. We expect a rocky year ahead as most of the sector's players have high inventories that would prompt promotional prices, and therefore, continued margin pressure amid still high inflation levels and subdued consumer spending. In addition, most of these companies are expanding their online platforms that would require ongoing investments.

the Brazilian sector's, refinancing risks soared after Americanas reported inconsistencies in its financial statements for nearly R$20 billion in early January 2023, arising from supplier financing operations that apparently weren't properly disclosed. The announcement prompted debt payment-acceleration claims from banks, forcing the entity to file for a judicial reorganization. This has raised scrutiny over suppliers' financing across the sector and may curtail access to capital markets.

Real Estate And Homebuilders

Outlook bias	-18.2
Ratings trend	▼
Gross margin change %*	-5.3
Net debt-to-EBITDA**	5.0x
EBITDA ints coverage**	2.4x

Homebuilders are starting 2023 with a slimmer cushion in credit protection measures than a year ago. This is because most of them face margin pressures from the inflation-fueled rise in land sales, building materials and labor costs, as well as higher interest rates. While inflation may have reached its peak and could gradually normalize in the months to come, the business environment is unlikely to improve rapidly due to sluggish economic growth, weak consumer purchasing power, and still tight financing conditions at least during the first half of the year. As a result, we believe that downside risks to our forecast prevail in 2023, with mixed results depending on each entity and country.

Brazilian homebuilders have slowed launches to secure cash and to cope with weak demand, while shortening construction periods to keep inflation contained. As such, credit metrics weakened as revenues decelerated, margins took a hit, and debts have become more expensive. Moreover, homebuilders of housing for low-income buyers have become even more exposed to inflation as they aren't able to adjust units' prices once mortgages are approved, so from those moments until completion, they get fixed payments. For 2023, we expect Brazilian homebuilders' operating and financial performance to gradually improve due to better visibility on the housing program under Mr. da Silva's administration.

In Mexico, housing starts continue to fall, but we expect sales growth and the EBITDA margins trajectory to remain steady as homebuilders continue to shift their product mix towards the middle and high-income housing, coupled with favorable pricing strategies due to a tighter supply than demand. We also expect prudent financial policies and broadly stable credit metrics that would be supportive of current rating levels.

The key risks for the Mexican real estate sector are a prolonged economic slump and political uncertainty that would further erode business conditions beyond our current expectations. Secular trends will continue to test retail and office assets. Also, absence of a medium-term strategy to boost nearshoring, the lack of energy transition regulations, and ongoing security risks in certain jurisdictions remain relevant factors for the sector.

We expect the retail real estate companies to continue to benefit from lifting of pandemic-related restrictions,-which coupled with some divestments and debt refinancing in the past year, should provide buffers to weather a potential slowdown in consumption, particularly for discretionary products.

The performance of office properties will remain weak, given the partial adoption of work-from-home models. Although vacancy rates have stabilized in key markets, we expect continued pressure through 2023, due to a worsening business environment that may crimp further leasing space.

Industrial properties should continue to perform well thanks to the rising momentum in nearshoring and e-commerce activity, despite the expected mild recession in the U.S. that could dent Mexico's manufacturing output in 2023. Nonetheless, tight supply continues to push occupancy and leasing rates to record-high levels.

Telecom And Cable

Outlook bias	-9.1
Ratings trend	▼
Gross margin change %*	-0.04
Net debt-to-EBITDA**	4.2x
EBITDA ints coverage**	3.0x

Mobile subscriber penetration remains relatively low in LatAm, slightly above 70%. We expect the increase in wireless coverage across most markets will lift data usage and revenue in the next few years. Penetration growth, however, could be constrained by weak economic growth in the near term.

For 2023, we expect Latin American telcos to keep lightening their balance sheets by selling assets and leasing them back. The trend has been going on for a while among companies such as America Movil, Telefonica S.A.'s subsidiaries in the region, Empresa Nacional de Telecomunicaciones S.A., and Wom S.A. involving mainly passive infrastructure such as towers, data centers, and fiber networks. The freed-up capital is either distributed to shareholders or used to pay down debt or for investments. Also, the growth of neutral fiber networks sets the stage for fierce broadband competition. Larger players will likely expand their fiber optic businesses, as well as the mobile networks to increase capacity to handle higher data demand, customer growth, and for the deployment of the 5G network. For smaller players, we also expect increasing investments in the fixed network, home broadband, IT solutions, and the gradual development of digital services for SMBEs and corporations.

The sector exhibits wide disparities in terms of financial strength. On the one, hand the largest players like America Movil, Telefonica Brasil, and Telefonos de Mexico have low leverage and generate ample operating cash flows, while other companies such as Oi S.A. and VTR Finance N.V. are experiencing business difficulties. In 2022, the rise in interest rates eroded the sector's financial performance, reducing median EBITDA interest coverages to 3x from almost 7x at the end of 2021. Given such financial pressures and fiercer competition negative rating actions are likely in 2023.

Transportation

Outlook bias	+5.9
Ratings trend	—
Gross margin change %*	+19.8
Net debt-to-EBITDA**	10x
EBITDA ints coverage**	1.6x

Transportation groups are mainly airlines, railroad and trucking companies, and shipping. Airline operations continue to recover after the pandemic's severe blow to the industry. Airlines such as Grupo Aeromexico S.A.B. de C.V., Avianca Holdings S.A., and Latam Airlines Group S.A. have mostly revamped their capital structures as they emerged from bankruptcies and are expanding their operations as demand recovers. They still have a tight grip on capacity and prices which enabled a robust recovery in margins despite rising costs. On the other hand, their Brazilian peers--Azul S.A. and Gol Linhas Aereas Inteligentes S.A.--are also improving operations, but their capital structures remain heavier as they absorbed most of the pandemic-induced losses through additional debt in order to honor their financial obligations and other liabilities. Therefore, ratings' remain very low reflecting their high leverage and expected cash-flow deficits for 2023 which under current market conditions is a major drag. For instance, Gol has recently announced a debt exchange in order to overhaul its financial obligations, which if completed we will view as a de facto restructuring and tantamount to default.

Revenues of the railroad and trucking companies are likely to climb as volumes of main cargoes are on the rise (agricultural, metals and mining, and other commodities). These companies increased their rates to cope with higher key inputs such as oil and labor. For 2023, we expect margins to continue improving as cost inflation slows down, and due to higher capex linked to concession renewal requirements and/or expansion and modernization of existing assets. Leverage should remain fairly stable.

Fleet Management And RaC

Outlook bias	+14.3
Ratings trend	—
Gross margin change %*	-6.4
Net debt-to-EBITDA**	3.3x
EBITDA ints coverage**	3.7x

We expect this sector in Brazil to perform well in 2023 as production and sale of light vehicles Is likely to grow by 4%, according to the National Association of Automotive Vehicle Manufacturers, thanks to the normalization of supply chains. We forecast carmakers to expand the production of cheaper models, which was stagnant in the last two years as they tended to prioritize more profitable categories (luxury vehicles). That would allow car rental companies to spend less on average per unit compared with 2022 and 2021, and accelerate the fleet renewal and expansion. That would also compensate for a reduction in margins in used-car sales.

As a result, we expect car rental companies to continue expanding their fleets, to focus more on longer-term fleet management contracts than on RaC operations, generating more predictable cash flows. Demand for fleet management will remain strong during 2023 considering the elevated prices for new vehicles and high interest rates.

Utilities

Outlook bias	-13.3
Ratings trend	—
Gross margin change %*	+4.7
Net debt-to-EBITDA**	2.6x
EBITDA ints coverage**	3.8x

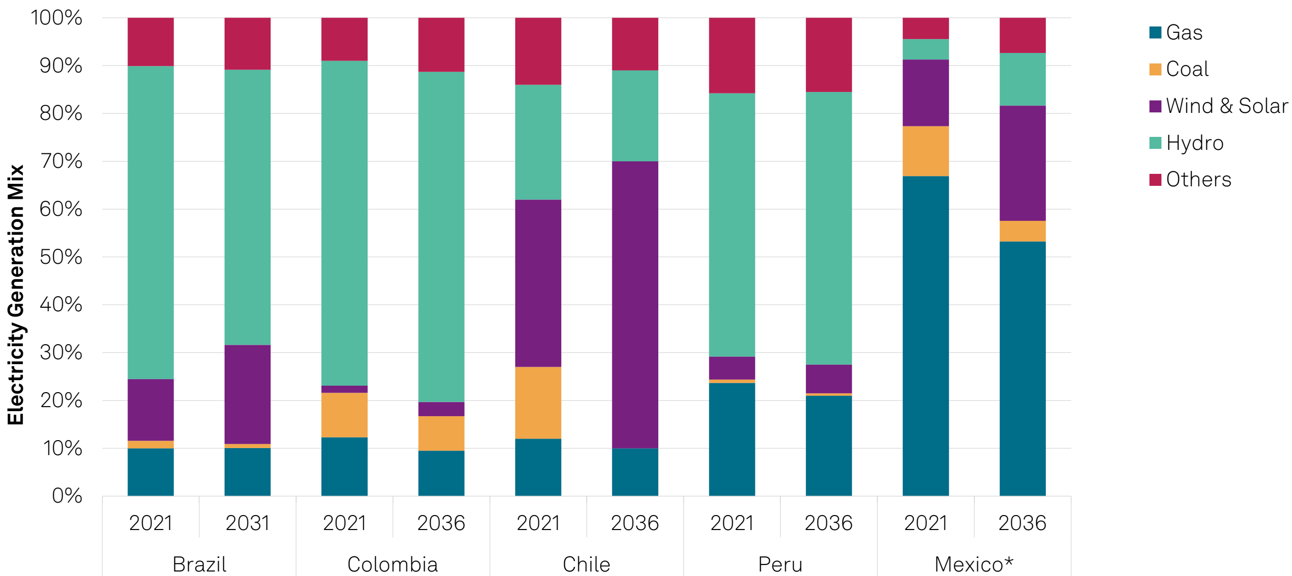
Currently, about 85% of LatAm utilities have a stable outlook, as sovereign ratings continue to determine ratings on the region's largest regulated utilities. The region's slow economic growth should crimp demand in 2023, while high inflation should pressure debt service as central banks are likely to maintain tight monetary policies. In addition, rising electricity bills could impede the utilities' ability to consistently pass on higher costs to ratepayers, denting the industry’s ability to manage regulatory risk.

We expect new capacity to come to come on line at a fast pace, with focus in with non-conventional renewables, except in Mexico given its plans to prioritize fossil-fuel sources. At the same time, we expect investments in renewables to continue to be mainly funded by fixed-rate debt, which represents over 70% of LatAm utilities' debt, except in Brazil, where fixed rate debt is about 25%. As a result, we don't expect utilities' credit metrics to deteriorate if interest rates remain high this year.

Chart 13

Electricity Generation Mix

Power matrix by country



Source: S&P Global Ratings.

Transportation Infrastructure

Outlook bias	-6.7
Ratings trend	
Gross margin change %*	+7.1
Net debt-to-EBITDA**	3.5x
EBITDA ints coverage**	4.1x

Most of the rated LatAm airports, ports, roads and mass transit assets have a stable outlook. Volumes have either fully recovered or at above pre-pandemic levels, except for light-vehicle traffic and mass transit. We believe that remote working and fewer business trips have created a new baseline for commuters with a 5%-10% permanent drop in light-vehicle traffic and 15%-20% for mass transit, which will grow organically going forward, but starting from levels lower than 2019.

In Peru, key infrastructure assets are under increased police and army protection, given the current state of emergency. This, along with the termination of Rutas de Lima S.A.C.'s road concession are factors that we will continue to monitor, as political unrest and violent protests continue in the country.

Volumes at Mexican airports have fully recovered, while we expect volumes for the region's airports to recover to of 90%-95% of 2019 levels for 2023, given high inflation and lower disposable income, offsetting customers' willingness to travel.

Brazilian container ports' revenues might be softened by lower volumes of imports, in line with our forecast of GDP growth of only 0.5% in 2023, while exports of agricultural commodities, proteins, and pulp and paper should continue to sustain volumes handled.

Our outlook for LatAm toll roads is stable with traffic volumes across most of the rated entities having recovered to pre-pandemic levels or above. We expect real traffic growth elasticity of 1x-2x of GDP growth--lower than the historical 3x-4x ratio --considering lower economic activity and the impact of higher toll rates in 2023 across the region. We don't forecast large refinancing needs for roads operators, given that most of them refinanced their debts to lower funding costs and extend tenors in 2021, during which financial conditions were favorable. In addition, over 70% of debt among toll road operators in Brazil, Chile, and Mexico are either fixed-rate or indexed to inflation, so we don't expect higher interest rates to pressure debt service.