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Latin American Corporate Midyear Outlook

Improving Access To Financing, But Political Uncertainties Persist

Argentina

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What's changed?

President Macri's poll numbers are improving. During June and July, polls show a recovery trend for Mr. Macri. The scenario still looks pretty tight with the main contender, opposition candidate Mr. Fernandez, and Mr. Macri are virtually tied at roughly 40%. Markets have reacted positively, resulting in a reduction in corporate yields. The first round of the election will take place on October 27th.

Some key macro variables are stabilizing. Inflation is receding at 2.5% pace per month; the Argentine peso is getting a relief from a rough first half, and the trade account is posting a mild surplus, which is aligned with IMF's target of fiscal convergence to primary surplus. Also, consumer confidence has mildly improved in June and July.

Several corporations issued bonds in July and a few more may follow. In the past few weeks, YPF S.A. (for $500 million); Telecom Argentina S.A. ($400 million), and Pampa Energia S.A. ($300 million) tapped the markets with yields between 8% and 9%. These were the first corporate bond issuances in Argentina so far in 2019. The trend may continue in August and September if market perceives rising chances of policies' continuity.

What to look for?

The national primaries in August 11th may introduce volatility. The national primaries won't have much influence in the political offer, in practice they'll serve as a good proxy on how the actual election may play out. According to market opinions, a large gap favoring Mr. Fernandez could exacerbate aversion to Argentine risk because his coalition consists of many politicians from the Kirchner era, including Mrs. Cristina Kirchner, now running as Vice President.

July data confirmed that inflation is receding. Inflation of 2.7% for June was the lowest of the year, pointing to the diminishing trend, although inflation is still too high. This is lifting consumer confidence and investor sentiment, and may strengthen credit growth, which is currently anemic. We believe these variables would continue improving if inflation continues to go down in July.

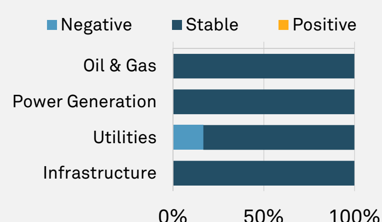
Changes in the operation of the electricity system could pressure cash flows of power generators (gencos). Typically, the fuel gencos use to fire their power plants is supplied by Cammesa (the electricity market clearing house). Since 2018, gencos can also buy fuel from oil and gas companies and receive a refund from Cammesa. But this new procedure seems to have resulted in delays that are weighing on gencos' cash flows. Nevertheless, we expect this to be normalize soon.

What are the key credit drivers?

The oil and gas, and agribusiness sectors are likely to remain relatively strong. Oil and gas companies operating in the Vaca Muerta formation have achieved remarkable results and are likely to continue investing and expanding shale oil production. Also, the agribusiness players are benefitting from a record harvest and favorable export conditions for meat producers, which we expect to continue through 2019.

Infrastructure investments will remain dependent on public resources. Private investment in infrastructure remains very low due to high political risks. We expect the same trend until 2020. Future investment will depend on the new administration's economic plan and fiscal agenda.

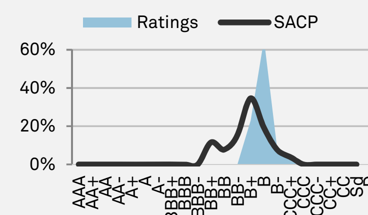
Outlook Distribution (main sectors)



Ratings Statistics (Last 12 months)

	IG	SG	All
Ratings	--	26	26
Downgrades	--	8	8
Upgrades	--	--	--

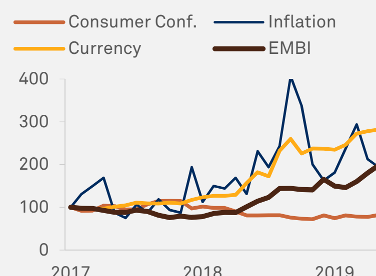
Rating Distribution



Median Ratios (all sectors)

	2017	2018	1Q2019
EBITDA/Interests	5.0x	8.3x	7.1x
Net Debt/EBITDA	1.6x	1.7x	1.8x
Capex/EBITDA	0.4x	0.4x	0.4x
FOCF and Cash/ST Debt	1.8x	2.3x	1.7x

Key Variables



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Brazil

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What's changed?

The pension reform received a high level of support in the first round of the voting session. Although that doesn't guarantee quick approval in the second vote in the Lower House (which the government plans to hold before mid-September), the reform agenda is making progress.

Financing conditions are fairly supportive. Given that the Federal Reserve made it clear that interest rates will remain low, appetite for emerging markets has improved. Brazilian corporate issuers are in good position to take advantage of it. The domestic market is soaring for the third consecutive year. Still, most of the debt issuances so far have been for refinancing purposes. Investments in new capacity remain markedly low relative to regional standards.

Export-oriented sectors such iron ore, protein, pulp, sugar, and ethanol continue to enjoy favorable fundamentals. Iron ore prices are at record levels due to supply constraints (mainly because Brazil-based Vale S.A. temporarily cut output after the deadly dam collapse in January 2019). Pork, poultry, and eventually beef, prices should benefit from the outbreak of the African swine fever in Asia. Ethanol prices are fairly supportive as well. Although sugar and pulp prices are low compared to their peak levels, high productivity more than compensates for that. Domestic-oriented sectors such as cement, homebuilders, and retail face sluggish conditions.

What to look for?

Reform agenda remains a top priority. Brazil's fiscal rigidities remain one of the largest drags on domestic credit quality, so the advance of reforms is key for medium-term sustainability.

Slower revenue growth pace for transportation assets following our revised GDP growth forecast. We correlate GDP expansion to traffic levels on toll roads, airports, and ports, and expect traffic to start recovering but at a slower-than-expected pace.

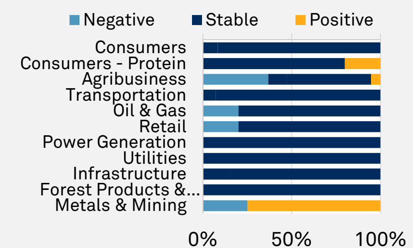
What are the key credit drivers?

The economy is slowly picking up. Credit to household, steel consumption, automobile production, retail sales, and agricultural output are among the main key variables to monitor the pace of the recovery.

Key sectors of the economy need to increase investments. Companies are relatively low leveraged, and domestic investment appetite is robust, as seen in the decline in yields. We believe companies may resume expansionary investments more vigorously if reform agenda moves forward and the economy shows strength.

Infrastructure and power bids for the remainder of the year are negligible. The infrastructure concession agenda for the second half of 2019 only includes three port terminals and a new energy auction for delivery in January 2025 (LEN A-6). Given that infrastructure is such an important engine for the heavy sectors of the economy, bids are definitely a variable to monitor.

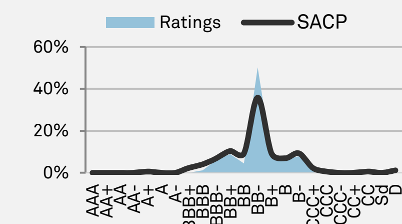
Outlook Distribution (main sectors)



Ratings Statistics (Last 12 months)

	IG	SG	All
Ratings	9	166	175
Downgrades	--	6	6
Upgrades	--	4	4

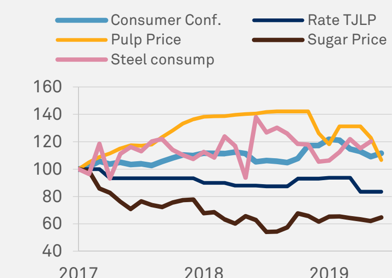
Rating Distribution



Median Ratios (all sectors)

	2017	2018	1Q2019
EBITDA/Interests	4.5x	6.1x	5.6x
Net Debt/EBITDA	2.5x	2.3x	2.8x
Capex/EBITDA	0.2x	0.2x	0.2x
FOCF+Cash/ST Debt	1.3x	1.7x	1.6x

Key Variables



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Chile

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What's changed?

Copper prices dipped below $6,000 per ton. Despite market consensus for $6,500 per ton through 2021, spot prices weakened since May 2019 on fears the trade wars could undermine copper demand. We expect prices to rebound sooner than later due to capacity constraints, the decline in reference rates, and still compelling industrial data from China.

The capitalization program for Corporación Nacional del Cobre de Chile has ended. But the company still faces cash shortfalls due to its heavy tax burden and intense investment program. We believe Chile will support the company to sustain leverage and credit metrics at around current levels.

Economic prospects are cooling down. In June, we lowered our GDP growth forecast for 2019 to 2.6% from our previous 3.3% due to the economy's high exposure to China and a more sluggish internal demand.

Chile issued the first green bond in the Americas. In June 2019, the country raised $1.4 billion through such a scheme, for green initiatives. The issuance demonstrates once more that the country is committed to environmental sustainability, as seen also in its high standards for carbon emission for mining and power companies.

What to look for?

Copper prices. Chilean mining companies that we rate are mostly copper producers, so they're sensitive to prices for this metal. Also, given the large share copper in Chilean exports (roughly 30%), this commodity has a meaningful impact on the economy.

Domestic demand. We're monitoring the strength of the domestic demand in several retail indicators, such as supermarket sales and sales, and import of durable goods, etc.

Political adherence to Mr. Pinera's tax and pension reforms. The government is pushing reforms to simplify the tax system, alleviate tax burden for small- and middle-size enterprises, and increase contributions to the pension system to support larger payments to the low-income slice of population.

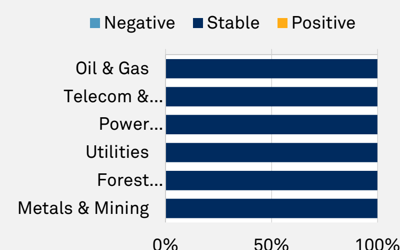
What are the key credit drivers?

How copper companies would deal with potentially lower prices. Although we don't expect a drop, it's a risk we can't rule out. The companies that we rate are dealing with falling ore-grades and will face relatively high maintenance capex with shrinking internal cash flows. We rate the bulk of these companies at investment grade and have dealt with weaker prices in the past by adjusting their cost structures and reducing dividend payouts.

Disruption in retail and consumer finance. We're also concerned about disruption in the retail industry involving e-commerce and consumer finance activities, and how effectively Chilean retailers are adapting to the new trends.

Pulp prices have weakened in June after more than a year at record levels. Pulp projects and companies remain highly profitable at current price levels, but given the last year's industry consolidation, we would have expected stronger levels to last longer. Still, weak demand levels are causing the rise in inventories globally.

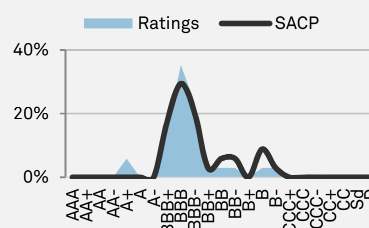
Outlook Distribution (main sectors)



Ratings Statistics (Last 12 months)

	IG	SG	All
Ratings	27	7	34
Downgrades	--	--	--
Upgrades	--	--	--

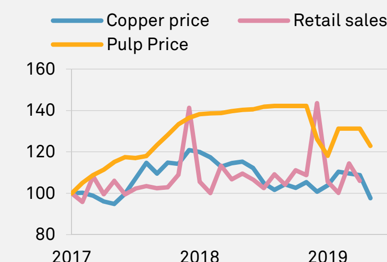
Rating Distribution



Median Ratios (all sectors)

	2017	2018	1Q2019
EBITDA/Interests	7.0x	7.6	7.5x
Net Debt/EBITDA	2.5x	2.3x	2.8x
Capex/EBITDA	0.4x	0.4x	0.4x
FOCF+Cash/ST Debt	2.3x	1.9x	1.5x

Key Variables



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Mexico

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What's changed?

Consumer behavior is becoming cautious. Mexico's macro fundamentals continue to support consumer demand. A record-high, although declining, consumer confidence index, a relatively low unemployment rate, sustained growth in consumer credit, and surging inflows of remittances are driving this trend. However, a recent slowdown in retail and auto sales could signal that consumption may be gradually cooling down.

PEMEX has released its long-term business plan. The plan is fully in line with the energy policy that the administration has been pursuing since December. The plan involves substantial government support in the form of a tax relief and capital contributions, which will help the company accelerate production efforts in shallow water and onshore fields, while PEMEX strengthens downstream activities and builds a new refinery. Given that the plan depends on the timely execution of a capex program, a deviation in production or a decline in oil prices that crimp cash flow prospects would jeopardize PEMEX's financial recovery in the medium term.

What to look for?

Political environment is still a concern. The absence of pragmatic economic policies and other policy decisions have undermined investor confidence. Although the government is trying to build relationships with the private sector to dissipate concerns, we don't expect investment activity to resume until it becomes more evident that the policy framework is supportive of the business environment.

Slow economic growth will act as a drag on corporate performance. We recently lowered our GDP growth forecast for this year to 1.3%, from 1.6% previously. This is already taking a toll on credit quality, because the negative corporate rating bias has increased to more than 30% from about 25% in 2018.

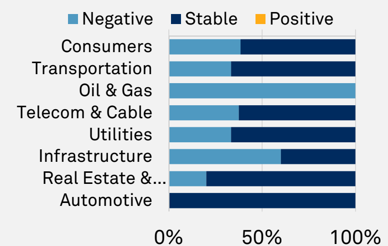
What are the key credit drivers?

Cost of financing and investor sentiment will drive market access. Mexican corporations' access to market remains exposed to the country's slower economic growth trajectory and weak business conditions. In our view, Mexico's country risk could limit companies' market access, particularly for issuers with speculative-grade ratings.

Liquidity risks are largely contained. Refinancing risk is not a large concern across industries. Market debt maturities in 2019 represent about 3% of total market debt, and this figure will increase to a still manageable 9% next year. Such an increase is partly due to PEMEX's high debt maturities in 2020. Until recently, we expected Mexican corporations would try to issue debt this year to address refinancing needs for the 2020-2021 period. However, at this point, bond issuance has been subdued, both global and domestically.

Private investment is unlikely to resume in the next six months. Capital investments have stagnated over the last couple of years, and we expect capex to remain exposed to political risks and sluggish economic growth prospects. Investment decisions remain mostly on hold, which is keeping a lid on infrastructure and related sectors such as building materials, engineering and construction, and capital goods, among others. From a credit risk perspective, a positive angle to such low capex trend is that financing needs will be limited and should alleviate pressures on leverage metrics.

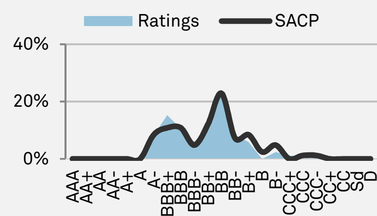
Outlook Distribution (main sectors)



Ratings Statistics (Last 12 months)

	IG	SG	All
Ratings	34	51	85
Downgrades	--	7	7
Upgrades	1	--	1

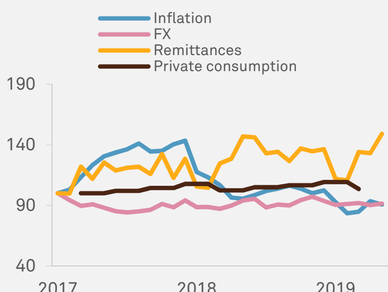
Rating Distribution



Median Ratios (all sectors)

	2017	2018	1Q2019
EBITDA/Interests	5.3x	4.7x	5.1x
Net Debt/EBITDA	2.5x	2.3x	2.8x
Capex/EBITDA	0.4x	0.3x	0.3x
FOCF+Cash/ST Debt	2.7x	2.6x	2.2x

Key Variables



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