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LatAm corporate defaults to see at least moderate uptick this year due to coronavirus disruptions

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Corporate default rate expectations for Latin America are already rising, as the region braces for at least a moderate increase this year as liquidity is challenged by the effects of the coronavirus (COVID-19) pandemic, according to four market sources. The expected number is difficult to estimate before knowing the full extent of the disruption, the sources said. Airlines and non-government oil companies, already suffering, are the among the top candidates.

"I would expect there to be a moderate uptick in defaults this year that will just carry into 2021," Dan Kastholm, managing director at Fitch Ratings, told *Debtwire*. Noting that this situation is uncharted territory, he said the outlook for defaults is significantly worse than at the end of 2019. His agency recently identified 17 LatAm issuers immediately vulnerable to ratings actions.

"Emerging markets are more exposed to commodities prices and for many corporates in Latin America that rely mostly on international capital markets for funding, the pressure could be tight, leading to default on their financial obligations" a corporate credit analyst said, agreeing that there would be a moderate increase this year.

"If this situation lasts for six months, expectations for defaults will be going up, although it is still too early to tell," a fixed-income investor said.

Slowing growth, lower commodity prices and volatile financial markets led Moody's to raise its global default rate projection for the end of 2020 to 3.6% from 3.4%, previously. In the agency's most pessimistic scenario, the rate could be as high as 9.7%, Marianna Waltz, managing director at Moody's, told *Debtwire*. Where it finally lands depends on how long the coronavirus outbreak lasts, how widely it spreads and how severely it affects demand, supply and financial sentiment, she said.

Airlines and oil and gas companies are among the issuers that will face a dramatic downturn in operating income and cash flow, already causing severe liquidity pressure that could lead to defaults, according to all four of the sources.

"In addition to the sectors more directly exposed to coronavirus, we are also more concerned about issuers with a weak liquidity profile," Waltz said.

"It's all about liquidity," said Kastholm. "Companies in the highly speculative rating categories, the B category and below, and in sectors most disrupted by social distancing will need to have the liquidity to survive the temporary slowdown or stoppage of their businesses to live through this, hopefully, short but extreme downturn. Those that do not have the ability to meet short term cash needs, will need to restructure or default. It all comes down to survival of the fittest."

PROPRIETARY
Latin America

Transportation
Mexico

Issuer
Avianca Holdings, S.A.

Issuer
Canacol Energy Ltd.

Issuer
Compania General De Combustibles SA

Issuer
Enjoy SA

Issuer
Frontera Energy Corporation

Issuer
GeoPark Limited

Issuer
Gol Linhas Aereas Inteligentes SA

Issuer
Gran Tierra Energy, Inc.

Issuer
Grupo Famsa S.A. De C.V.

Issuer
Grupo Kaltex SA De CV

Issuer
Grupo Posadas S.A De C.V

Issuer
Hunt Oil Company Of Peru

Issuer
LATAM Airlines Group S.A.

Issuer
Pan American Energy LLC

Issuer
Peru LNG SRL

Issuer
Petroquimica Comodoro Rivadavia S.A.

Approximately 62 (27%) of Fitch's internationally rated Latin American corporates operate in an industry that has been designated as "high-risk" as a result of the coronavirus, due to the sector's exposure to falling oil prices, declining tourism and business travel, closed shopping malls, slower industrial activity, disrupted supply chains, and/or weak trade activity, the agency said in a recent report.

Issuer

Tecpetrol SA

Airlines, tourism among the most exposed globally

"Among the rated Latin American non-financial, non-regulated companies, those operating in the airline, lodging sectors, non-food retailers, restaurants and those with weak liquidity are most exposed to a shock in demand and in the capital markets stemming from the coronavirus outbreak," Waltz said.

Issuers with a strong international route presence such as Latam Airlines, Gol, and Avianca will be the most impacted as these routes were among their most profitable. All three have cut capacity, cancelled flights and taken other measures.

Some of the smaller corporates in Mexico, such as Kaltex, Posadas and Grupo Famsa, will also face pressure due to their financial constraints as well as a plummeting Mexican peso. In the case of Posadas, Mexico's lodging sector faces the most risk from declining occupancy rates as people cut travel.

"The sector has little exposure to Asia, but the spread of the coronavirus in the US will have a more direct negative effect, with the US and Canada accounting for around 70% of Mexico's international passengers," Waltz said.

Enjoy, a hotel and casino operator in Chile and Uruguay, would also face enormous financial pressure if quarantine measures result in the temporary closing of casinos, according to the agency.

"In Chile, I think it's going to be a challenging year for gaming companies, such as Enjoy, but there are also challenges appearing for the salmon industry," a bondholder said."

Private Oil and Gas risk high; metals and mining moderate

Issuers with comfortable liquidity and capital structures would be in a better position to withstand the effects of the coronavirus outbreak.

"Commodity producers and exporters in the base metals and pulp and paper sector are also exposed to lower prices," Waltz said. "Here too, a good liquidity profile will make an important difference, in our analysis."

"Latin American pulp producers have fairly strong credit quality and liquidity buffers to withstand continued weak prices, but with China and Europe as the main global markets for market pulp, weaker economic growth will certainly cut overall demand despite the resilient tissue segment," Waltz added.

Latin American oil producers will be affected by price volatility and lower prices, as well as a drop in demand due to reduced air and road travel, and a suspension of manufacturing activities, according to Moody's and Fitch.

“More than 44% of the oil and gas companies in Latin America are government-related issuers that can count on some sovereign support in case of liquidity need,” Waltz said.

Fitch anticipates that state oil companies will be able to withstand the impact. It identified 10 energy companies as having vulnerable liquidity that could potentially lead to default: Canacol Energy, Compania General de Combustibles (CGC), Frontera Energy, GeoPark, Gran Tierra, Hunt Oil Company of Peru, Pan American Energy, Peru LNG, Petroquimica Comodoro Rivadavia and Tecpetrol.

Borrowers in the metals and mining industry have a solid business position and strong capital structure that will allow them to weather the impending storm without impairing their capital structure or running out of liquidity, according to Fitch.

“We believe Latin America's mining sector has moderate risk overall based on the generally strong credit quality of its large players,” Waltz said.

No country is immune, but the threat is obviously worse in jurisdictions with companies already under pressure. In Argentina, “the outbreak will further magnify the economic challenges for the country and for the entire corporate sector,” Waltz said.

“From a rating risk perspective, issuers in Argentina, for the most part, already incorporate higher levels of default risk and the coronavirus will not have a material additional negative impact in terms of ratings,” Kastholm said.

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