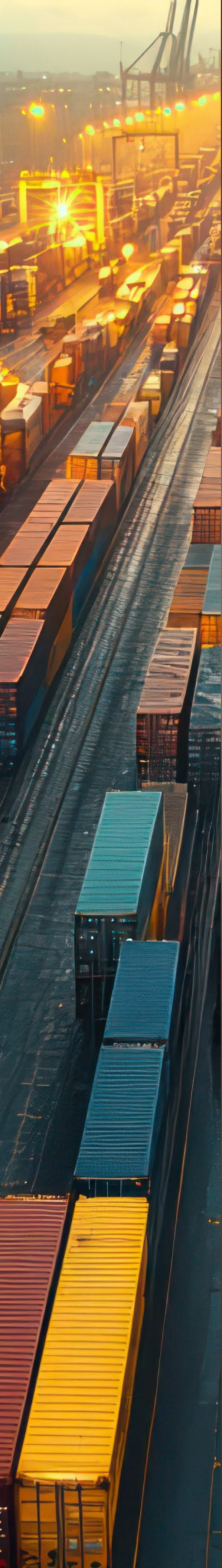
Nearshoring growth opportunities: LATAM Working Capital Index

November 2024



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Executive summary

Working Capital Index paces towards pre-pandemic levels

LATAM companies reported a rise in working capital in 2023, moving the overall index closer towards pre-pandemic levels, largely driven by longer receivable days and declining revenue growth across most sectors.

Reversal in Cash Index

Following a sharp decline in 2021 and 2022, cash levels rose in 2023 as companies increased their leverage and curtailed shareholder distributions in response to sluggish economic activity.

Increase in cash conversion cycle by 1.1 days

The cash conversion cycle (CCC) increased by 1.1 days in 2023, with 59% of companies reporting longer days sales outstanding (DSO), partially offset by 52% of companies reporting an increase in days payable outstanding (DPO).

Regional economic conditions continue to drive working capital movements across countries and sectors

Brazil, Chile and Colombia improved their CCC with favorable supplier terms amid subdued demand. Conversely, Argentina, Mexico and Peru, along with Materials and Oil & Gas sectors, saw deteriorating CCC due to inventory build-up and longer collection cycles. Consumer Staples and Industrials improved CCC through higher adoption of supply chain programs and better inventory management.

Reconfiguration of global supply chains set to accelerate LATAM's economic growth opportunities

Amid global trade shifts, nearshoring in LATAM is expected to boost investments in countries like Mexico, which is one of the US's largest trading partners. It has significant potential to spur manufacturing growth, energy transition and infrastructure spending. LATAM governments are also focusing on fiscal initiatives to attract investment.

Macroeconomic factors at the top of corporate priorities in 2024

- Economic Headwinds
- Deleveraging
- Supply Chain Transformation
- Nearshoring

5.8 Points
Rise in Working Capital Index

↑ 1.1 Days
Lengthened cash conversion cycle

↓ 24%
Major decline in revenue growth

9.2 Points
Rise in Cash Index

↑ 14%
Increase in cash build[1]

↑ 10%
Increase in debt levels

[1] Cash build = ending cash - beginning cash.

Index Coverage and Calculation Methodology

There are three sets of data points analyzed in this report:

i The Working Capital Index tracks the average net working capital/sales values across the LATAM companies and is calculated as follows:

$$\text{Average NWC} = \frac{\sum_{K=1}^{n} \text{Net Working Capital}_k / \text{Sales}_k}{n}$$

ii The Cash Index tracks the average cash/sales values across the LATAM companies and is calculated as follows:

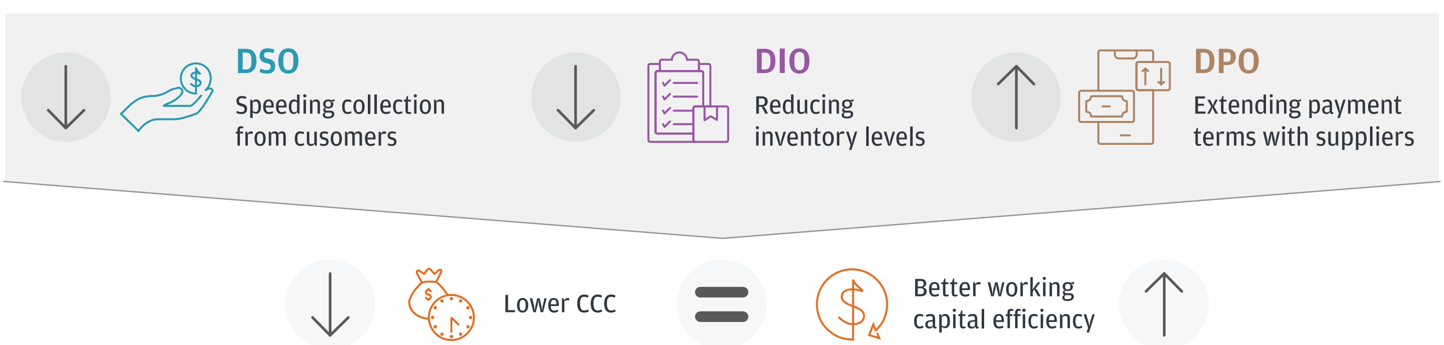
$$\text{Average Cash} = \frac{\sum_{K=1}^{n} \text{Cash}_k / \text{Sales}_k}{n}$$

where:

Net Working Capital = Trade Receivables + Inventory – Trade Payables;
n = total number of companies

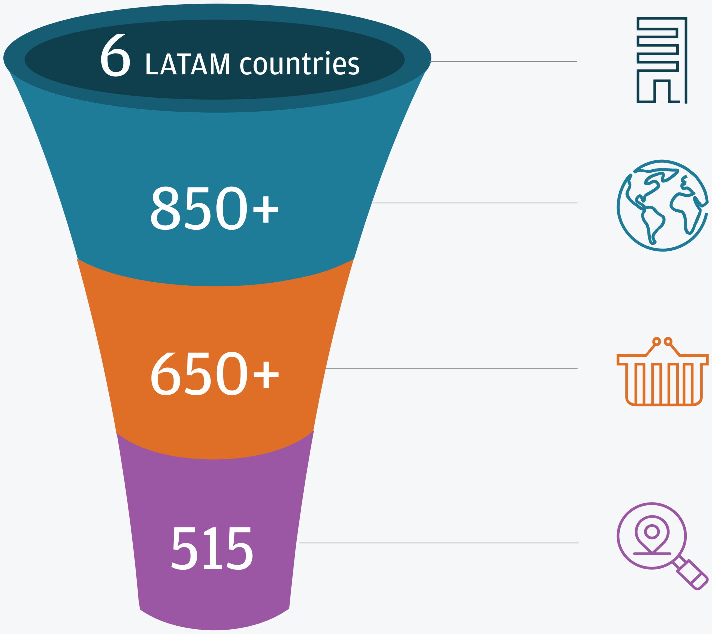
iii The cash conversion cycle (CCC) is the number of days it takes to convert inventory purchases into cash flows from sales. The CCC helps quantify the working capital efficiency of a company and is derived from three components:

- Days sales outstanding (DSO), or the number of days taken to collect cash from customers
- Days inventory outstanding (DIO), or the number of days the company holds its inventory before selling it
- Days payable outstanding (DPO), or the number of days from the time a company procures raw materials to payment of suppliers



Companies can improve their working capital by effectively managing the individual components of their CCC. They can do so by reducing inventory levels (decreasing DIO), extending payment terms with suppliers (increasing DPO) or speeding up collections from customers (shortening DSO). As a general rule, the lower the CCC, the better the working capital efficiency.

Index coverage



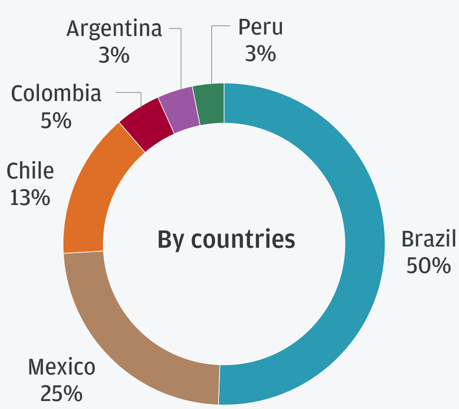
Account for 95% of overall count of listed companies in LATAM

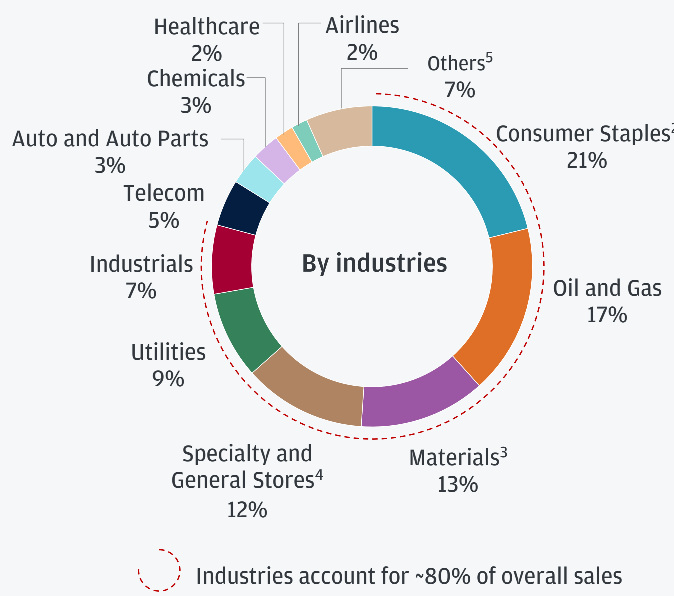
Number of listed companies in key markets

After excluding Real Estate & Financial Service companies

Total companies analyzed in LATAM

Breakdown of the constituents in the index (by revenue)





Note:

To avoid the distortion of data, financial services and real estate firms in LATAM were excluded from the calculations due to their distinct business models and unique working capital metrics in comparison to other industries. Companies with high volatility in working capital and those with incomplete data were also removed, bringing the total number of companies used for this analysis to 515. All numbered data has been gathered from Capital IQ for the purpose of calculations.

[2] Includes foods, beverage, agricultural services and products; [3] Includes mainly metals & mining and paper & packaging companies; [4] Includes a host of broadline, home improvement other specialty retail stores; [5] Others include apparels, quick service restaurants, entertainment, media, logistics, etc.

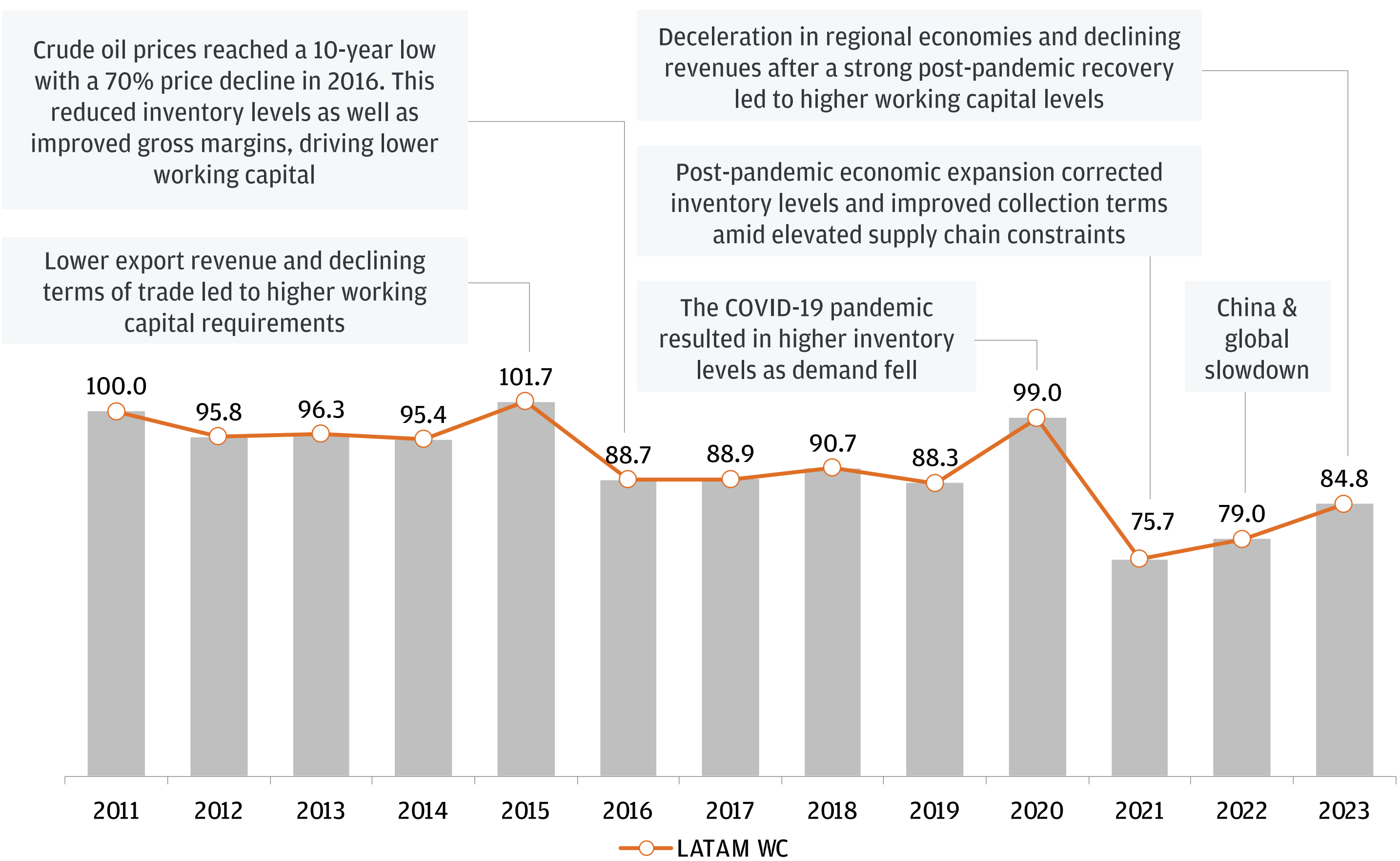
02
Working Capital Index

Working Capital Index nears pre-pandemic levels amid regional slowdown

The LATAM Working Capital Index continued to edge higher from its 2021 drop, with working capital moving up by 5.8 points in 2023. This is closer to pre-pandemic levels, primarily driven by longer receivable days and declining revenue growth after a strong post-pandemic recovery, driving working capital upwards.

After a period of robust growth, the region is now experiencing sluggish economic activity due to persistent inflation and tighter monetary policy. This has dampened demand and pushed corporates to offer more favorable payment terms to sustain their revenues. These conditions, along with slower demand growth and restricted credit conditions, have put additional pressure on working capital.

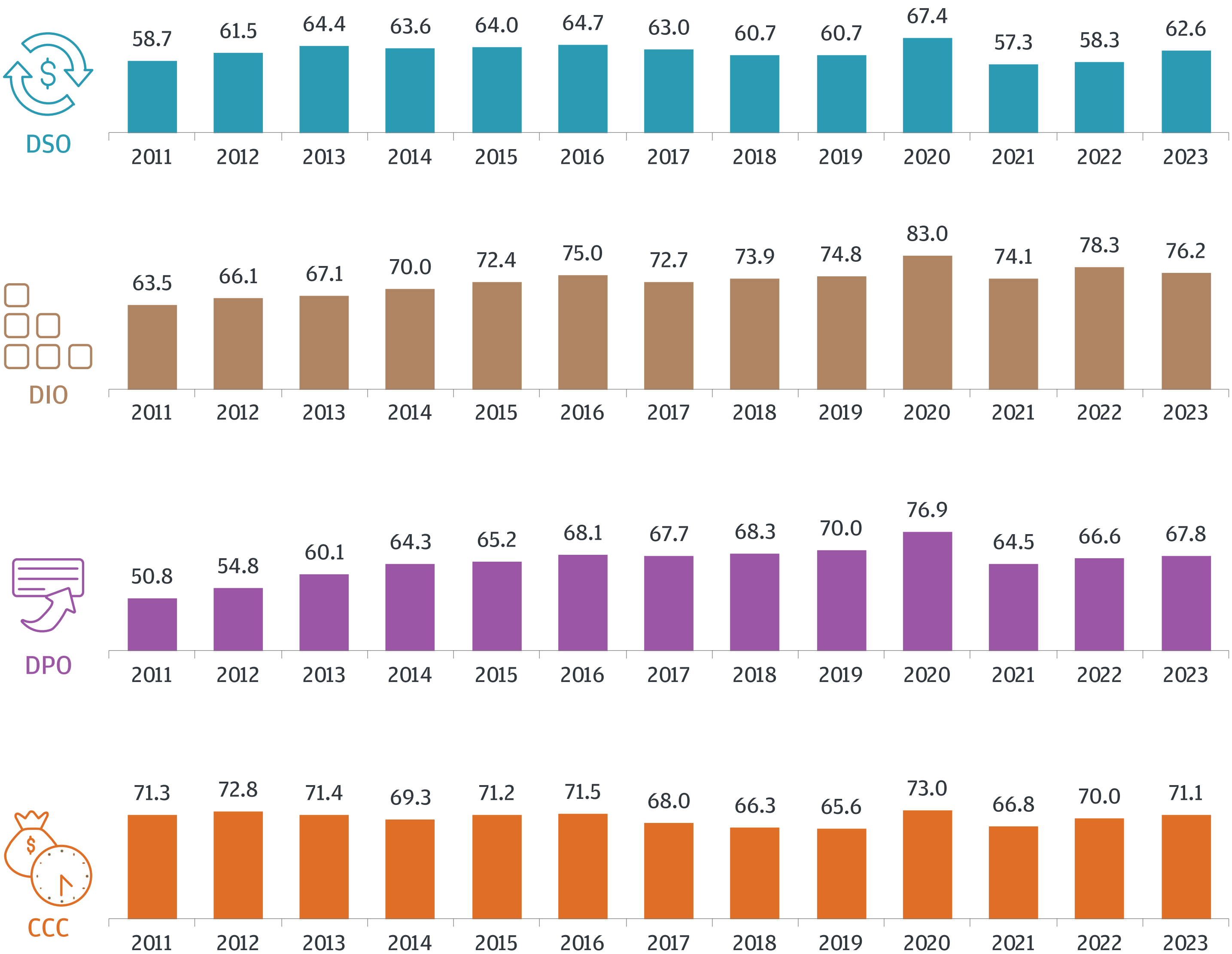
Given the higher interest rate environment, the increased cost of carrying funds tied up in working capital underscores the urgency for treasurers and CFOs to adopt a proactive posture. Collaboration with internal and external stakeholders, including procurement, business units, operations and financial institutions, will be essential in optimizing working capital management.



Source: Capital IQ
Note: 2011 rebased to 100 and change in ratio of Working Capital/Sales has been indexed to 2011 thereafter.

CCC metrics

Weaker demand and challenging financial conditions push CCC higher



Source: Capital IQ

In 2023, the CCC for LATAM companies increased by 1.1 days, consistent with the Working Capital Index. This increase was driven by a rise in DSO, partially offset by a fall in DIO and lengthening of DPO.

Softening demand in 2023, after a notable expansion in 2021 and 2022, increased DSO by 4.4 days. DPO lengthened by 1.2 days largely due to challenging credit restrictions for corporates. During the post-pandemic expansion, DSO and DPO were abnormally low as companies—notably in the Materials, Industrials and Oil & Gas sectors—prioritized securing critical supplies. Given the economic backdrop in 2023, DSO and DPO are now moving back towards pre-pandemic levels.

DIO reduced by 2.1 days in 2023 as inventory optimization remained a key priority following pandemic-induced shortages in 2021 and stockpiling in 2022. Input cost pressures and competitive pricing in sectors such as Consumer Staples and Industrials have also led corporates to focus on inventory management.

03
Cash Index

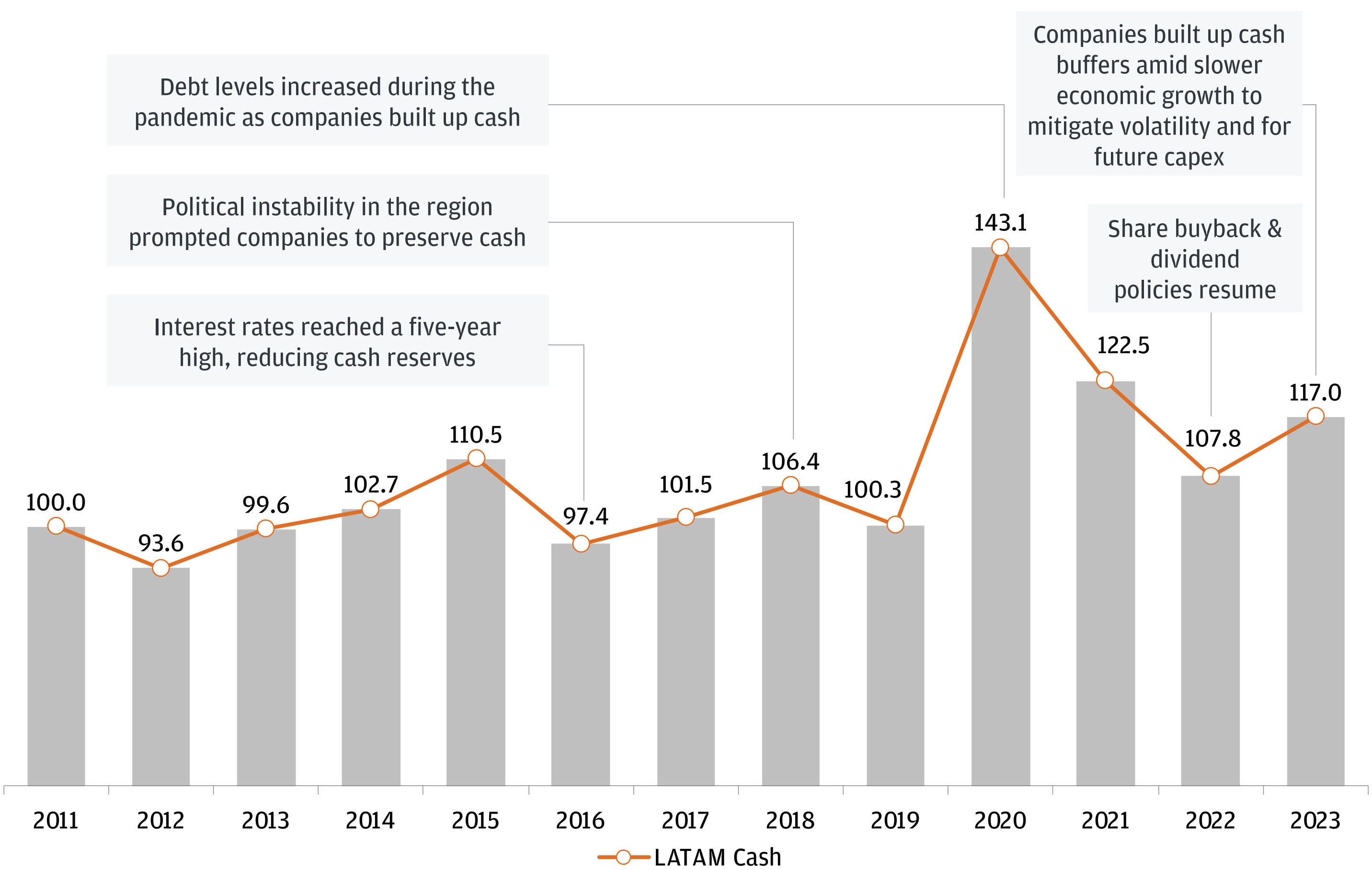
Cash Index rises amid greater cash preservation focus

LATAM companies have historically maintained higher liquidity buffers to guard against escalating costs, rising interest rates and high inflation. In 2023, these challenges were further intensified by geopolitical uncertainties, the ongoing US-China trade tensions and the volatile commodity prices critical to many countries in the region. As a result, companies held more cash on their balance sheets and reduced distribution to shareholders, as compared to heavy capital repatriation in 2021 and 2022.

Sectors like Oil & Gas, Materials, Utilities and Consumer Staples increased capital spending, with higher investment in capacity expansions and growth-oriented initiatives. Companies also substantially increased debt issuance to refinance short-term maturities and fund capex investments. As part of their capital allocation priorities, many companies suspended buybacks and opted for lower dividend payouts.

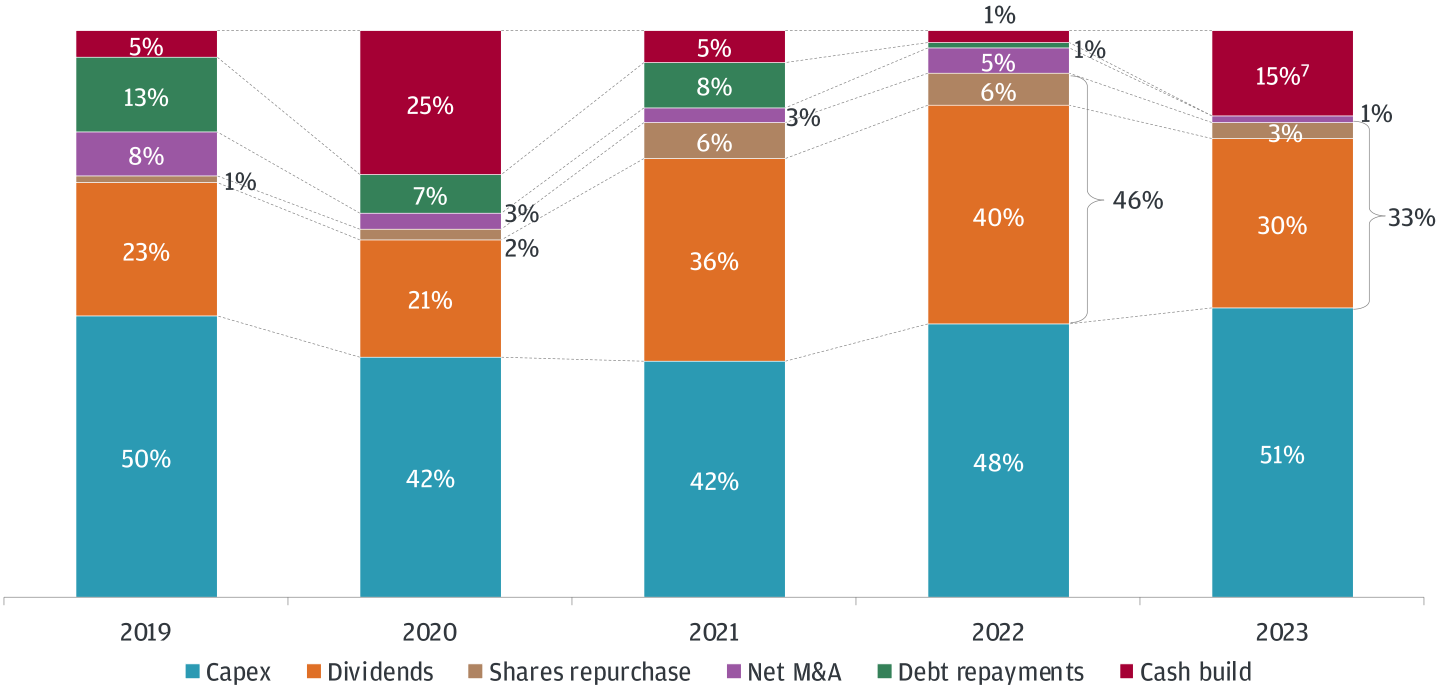
With capital allocation continuing to be a key priority for treasurers and CFOs, it is essential to adopt strategic capital allocation plans that enhance centralized visibility and control over enterprise liquidity to ensure optimal use.

Cash Index

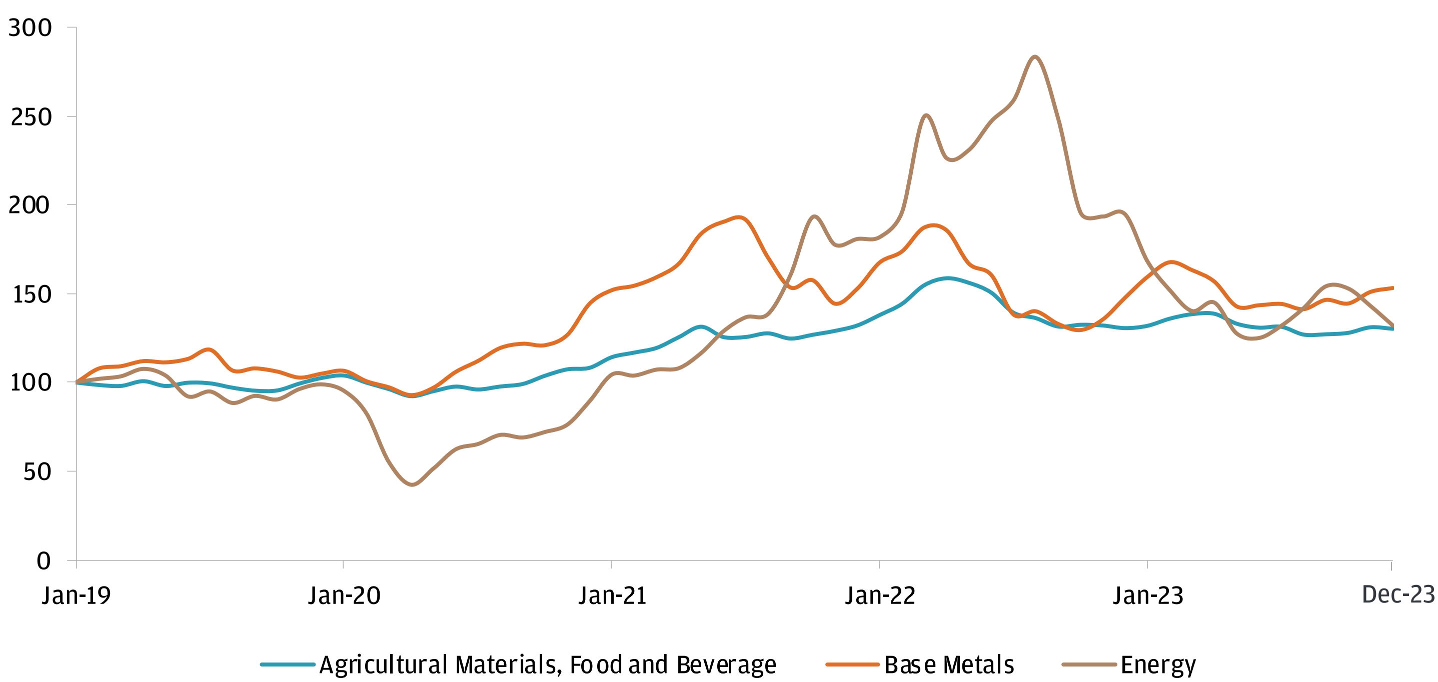


Source: Capital IQ, IMF, company literature
Note: 2011 rebased to 100 and change in ratio of Cash/Sales has been indexed to 2011 thereafter

Capital allocation (LATAM Index constituents)[6]



Global commodity price index over time[8]



Source: Capital IQ, IMF, company literature

Notes:

[6] Chart represents the proportion of capital allocated to each item as a percentage of the total (cash build (ending cash - beginning cash) + net debt repayment + gross share repo + dividends + net M&A + capex) in calendar year mentioned; Net debt repayment = debt repaid - debt issued; Net M&A = acquisitions - divestitures

[7] Includes approx. 2% of net debt issued in 2023 (Net debt issued = debt issued - debt repaid)

[8] Agricultural Materials, Food and Beverage includes food and beverages and agriculture raw materials price indices; Base Metals includes aluminum, cobalt, copper, iron ore, lead, molybdenum, nickel, tin, uranium and zinc price indices; Energy includes crude oil (petroleum), natural gas, coal price and propane indices

04
Sector insights

Changes in CCC by sector (days) 2023 over 2022

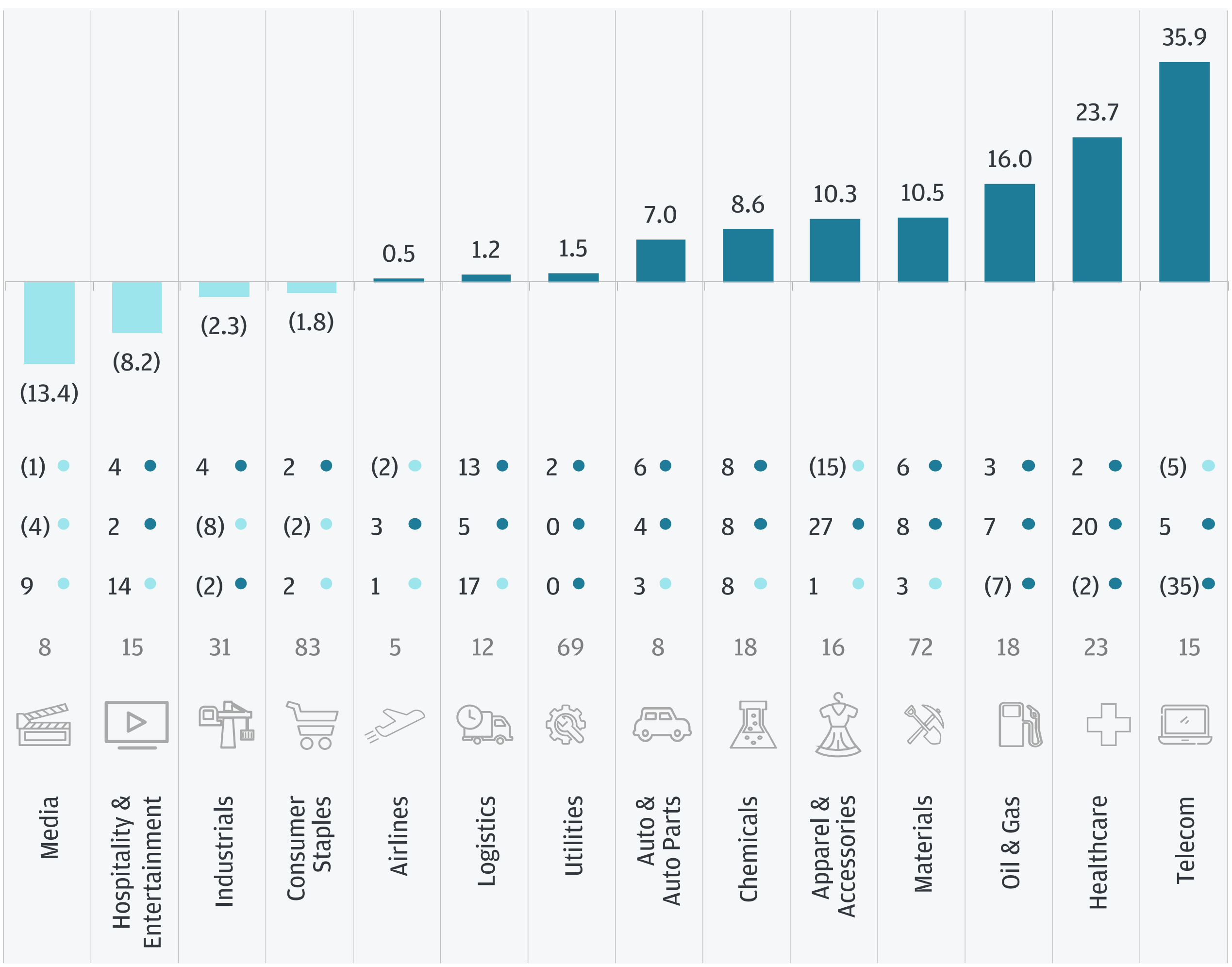
Across 14 analyzed industries, most experienced an increase in CCC in 2023. Media, Hospitality & Entertainment as well as Industrials showed a marked improvement in CCC while Oil & Gas, Healthcare and Telecom experienced significant deterioration.

Telecom: The CCC for this sector increased due to a decrease in DPO.

Healthcare: This sector saw a rise in inventory levels due to increased demand, spurred by statewide flooding in southern Brazil.

Apparel & Accessories: This sector experienced a drop in DSO and rise in DIO due to increased revenue growth in core markets.

Media and Hospitality & Entertainment: CCC increased due to improved supplier terms in these sectors.



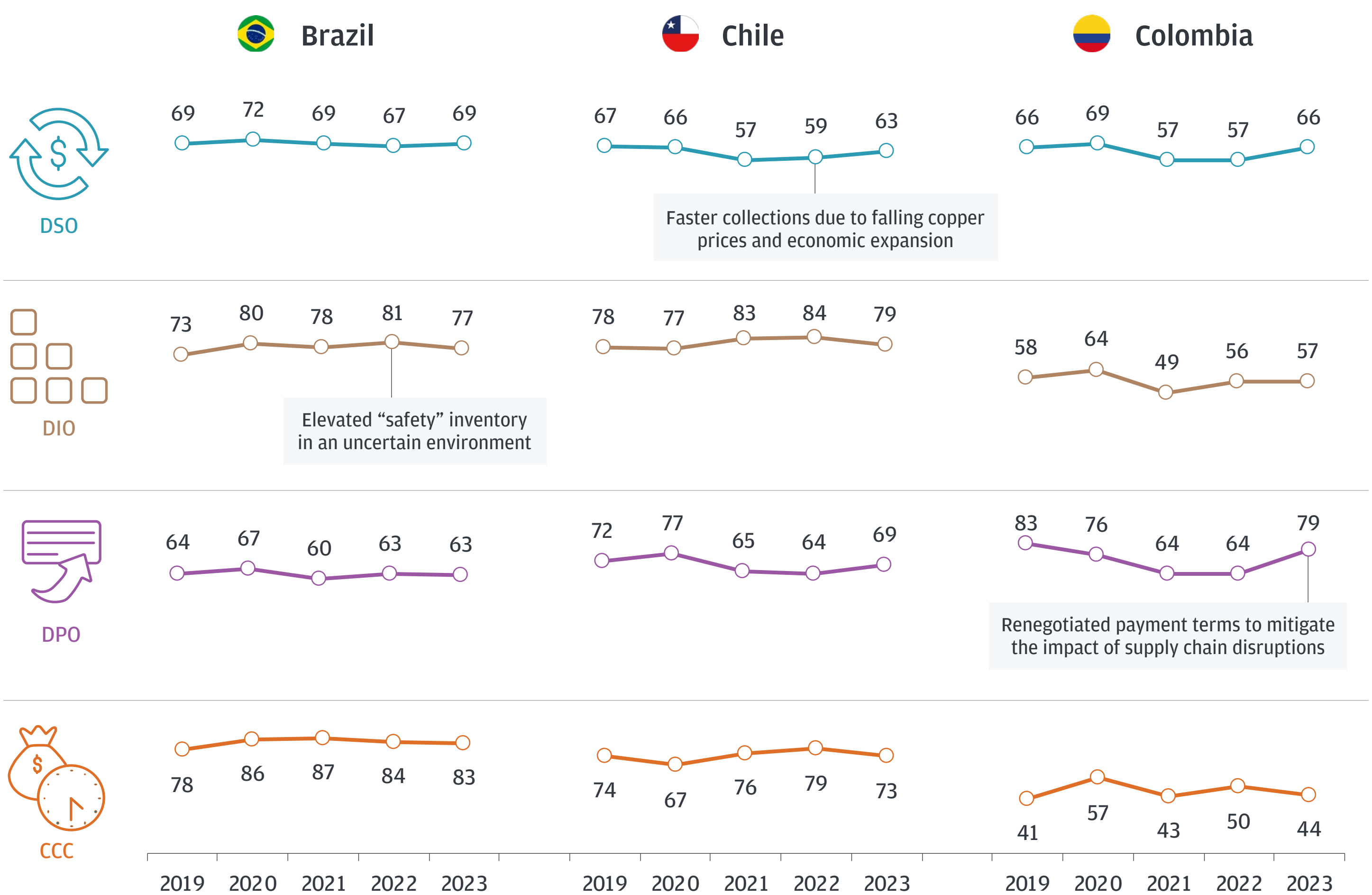
	Media	Hospitality & Entertainment	Industrials	Consumer Staples	Airlines	Logistics	Utilities	Auto & Auto Parts	Chemicals	Apparel & Accessories	Materials	Oil & Gas	Healthcare	Telecom
	(13.4)	(8.2)	(2.3)	(1.8)	0.5	1.2	1.5	7.0	8.6	10.3	10.5	16.0	23.7	35.9
Change in DSO	(1)	4	4	2	(2)	13	2	6	8	(15)	6	3	2	(5)
Change in DIO	(4)	2	(8)	(2)	3	5	0	4	8	27	8	7	20	5
Change in DPO	9	14	(2)	2	1	17	0	3	8	1	3	(7)	(2)	(35)
# of companies	8	15	31	83	5	12	69	8	18	16	72	18	23	15

Improvement   Deterioration

Source: Capital IQ
Note: Total might not add up to CCC due to rounding errors

05
Country insights

CCC for Brazil, Chile and Colombia decreased in 2023



	Brazil	Chile	Colombia
# No. of companies analyzed	**211**	**103**	**33**

Country Insights

Brazil

- Limited access to credit for corporates has impacted payment terms while DIO has normalized due to an increased focus on inventory management.

Chile

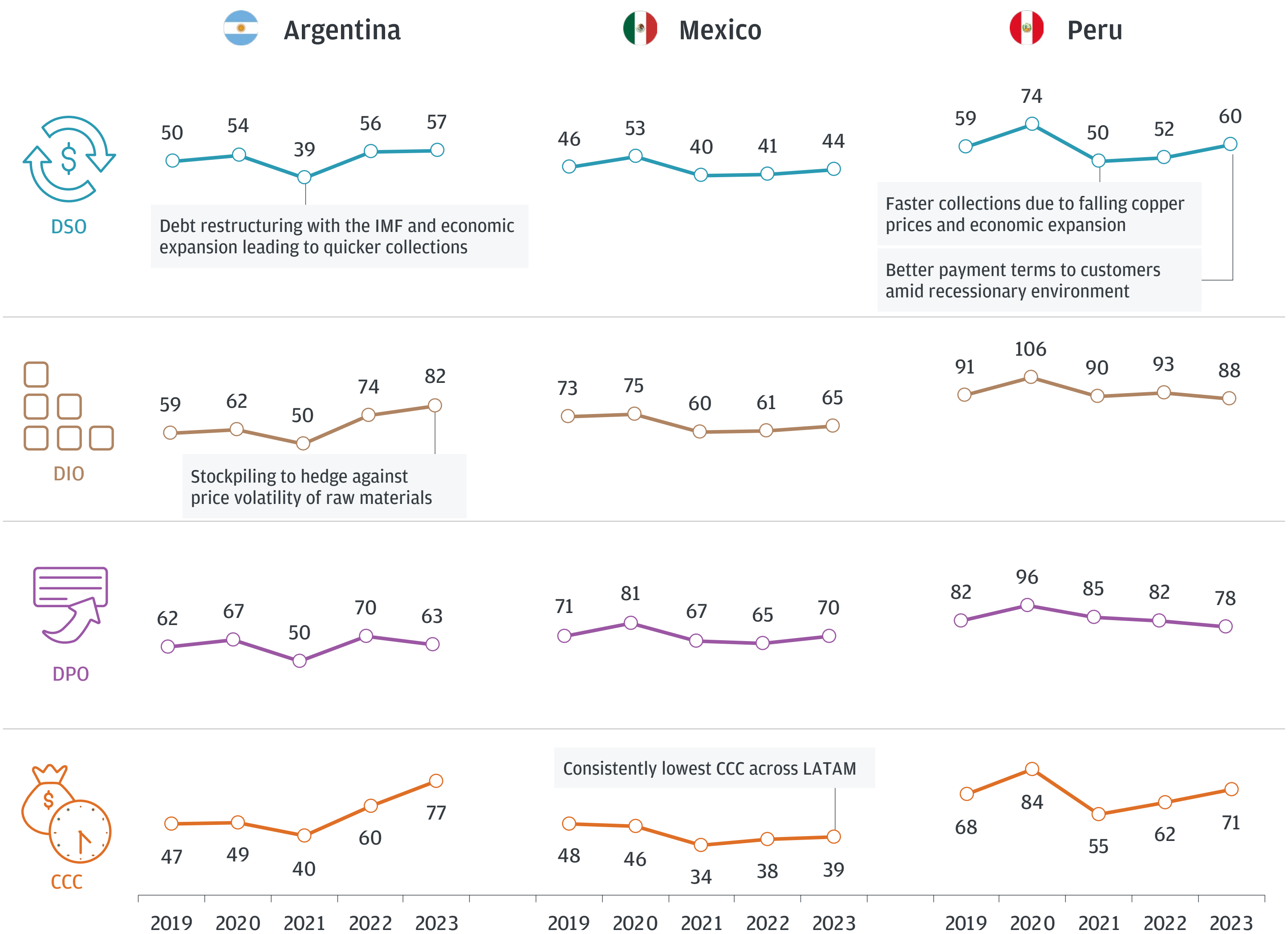
- Collections were delayed due to weaker economic demand.
- Some corporates are ramping up use of credit insurance to offset default risk on their receivables.
- Inventory destocking is also on the rise, as macroeconomic conditions slowly recover through enhanced policy support to stimulate that weaker demand.

Colombia

- A demand slowdown led corporates to offer better payment terms to their customers, adversely impacting DSO.
- Supply chain disruptions extended lead times and increased materials and freight costs.
- To mitigate this impact, corporates renegotiated prices and payment terms with suppliers to optimize payables while managing purchases to control inventory levels.

Source: Capital IQ

CCC for Argentina, Mexico and Peru increased in 2023



# No. of companies analyzed	Argentina	Mexico	Peru
	44	64	60

Country Insights

Argentina

- Argentina has faced significant economic volatility, marked by recurrent boom-bust cycles. The country has been in recession for a third of the time since 1950 due to its weak business environment.
- Import restrictions on raw materials coupled with limited access to corporate credit have adversely impacted DPO in the last two years compared to 2021.
- Corporates are maintaining higher inventory levels as a hedge against raw material price volatility.

Mexico

- Mexico continues to have the lowest CCC in LATAM, as corporates focus on working capital optimization through management initiatives, exploring sales finance and inventory finance programs and revisiting their supply chain programs.
- However, reliance on imports from APAC and EMEA, coupled with global supply chain tensions and price volatility, continued to put pressure on inventory levels and adversely impacted DIO.

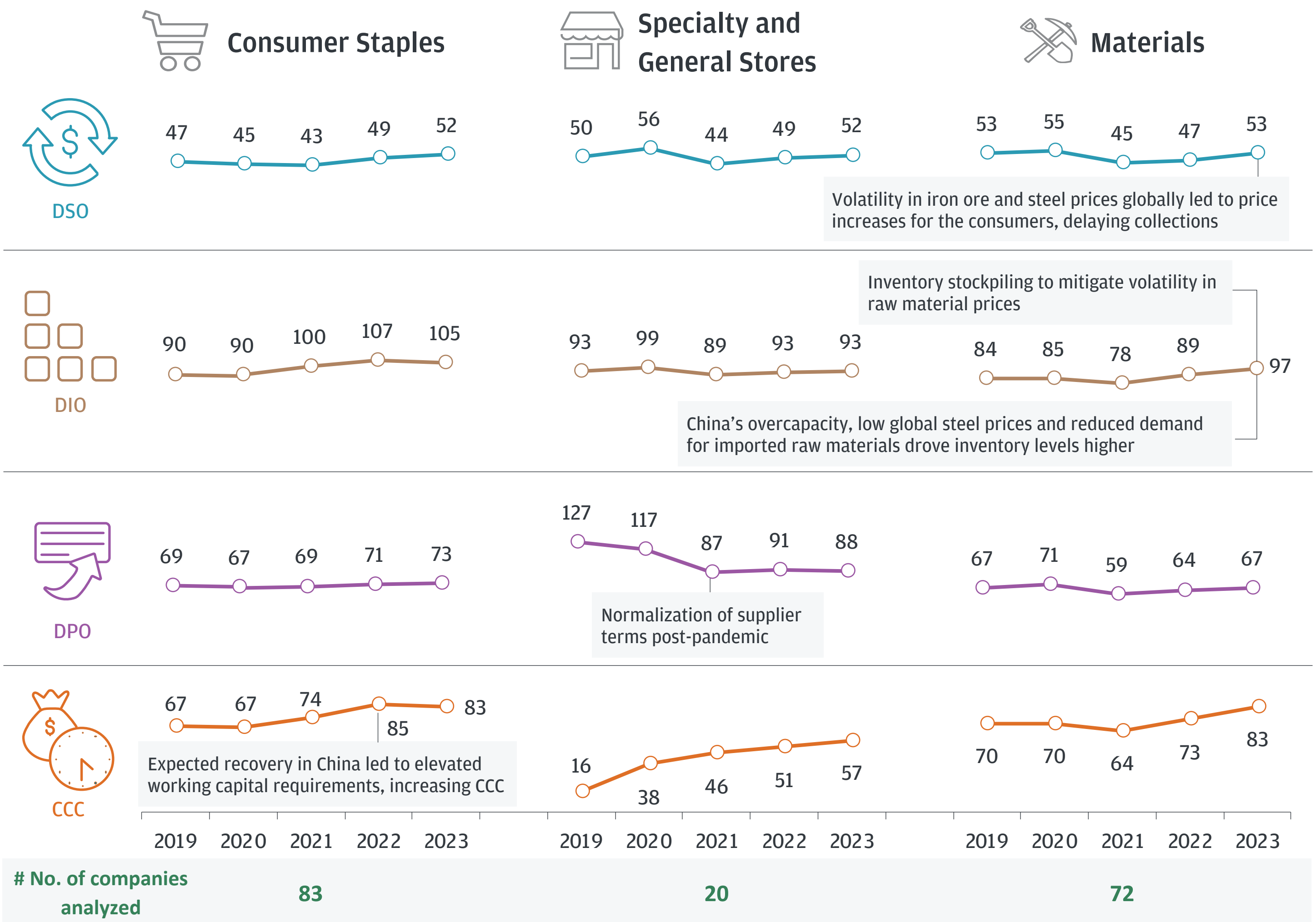
Peru

- Peru’s economy experienced a contraction of 0.6% in 2023 compared to 3.9% growth in 2022.
- Amid this recessionary environment, companies extended their collection cycles to support customers as well as stimulate economic growth and demand.

Source: Capital IQ

06
Industry insights

CCC for all key industries except Consumer Staples and Industrials increased in 2023



Country Insights

Consumer Staples

- Marginal improvement in CCC due to continued focus on credit management of receivables.
- Input cost pressures and supply chain disruptions have led corporates to focus on inventory management.
- Companies are increasingly focused on working capital management by negotiating better terms with suppliers and engaging in supply chain finance and supply chain transformation programs.

Specialty and General Stores

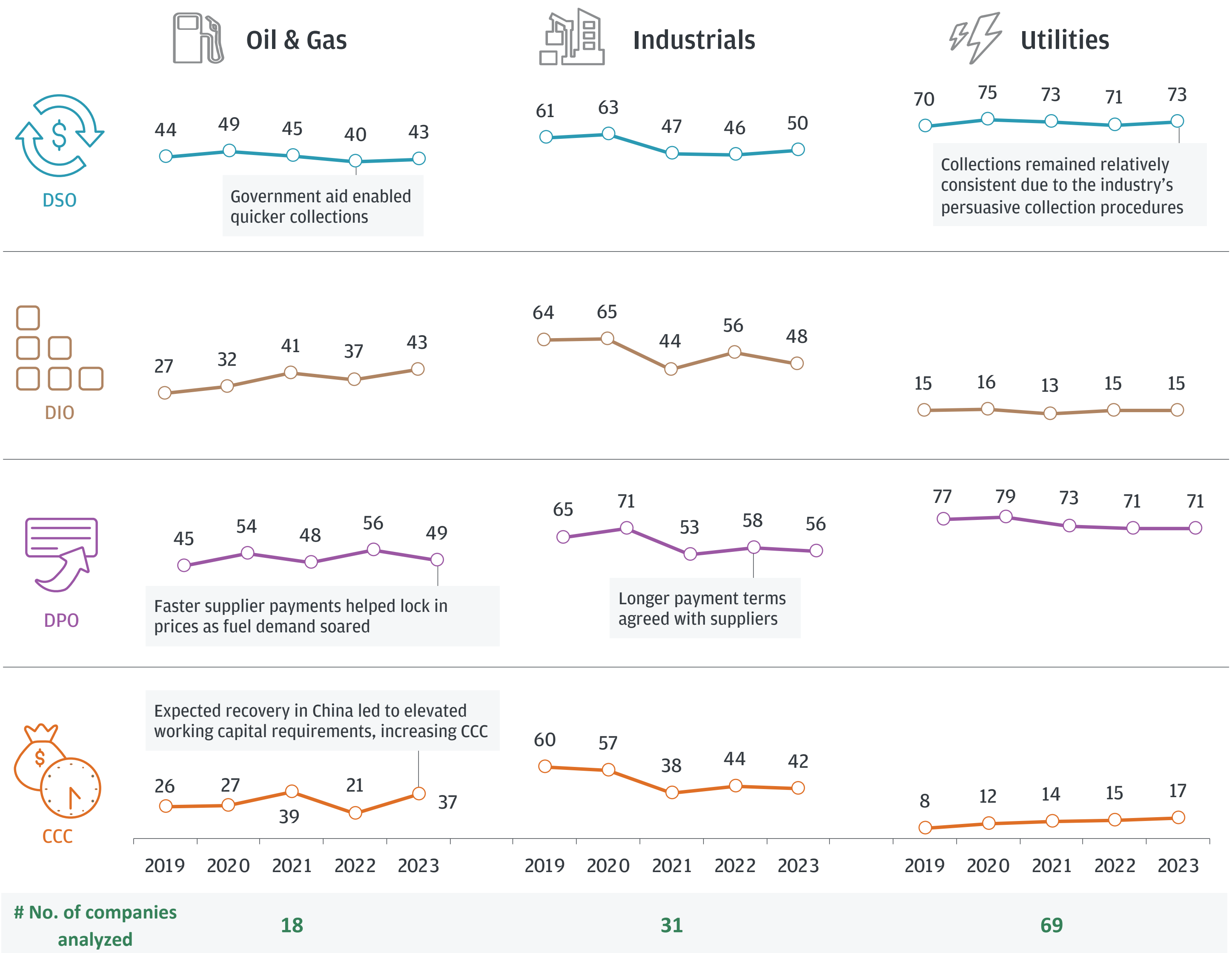
- A challenging macro environment led by a consumption slowdown has delayed collections.
- Inventory management is a key focus area for corporates in this sector following pandemic-era stockpiling.

Materials

- LATAM holds more than a third of the world's lithium, copper and silver reserves, with copper and lithium exports, in particular, driving significant growth in the new energy economy.
- Intense volatility in iron ore and steel prices globally led to higher inventory levels as companies continue to deal with rising raw material costs.
- Supply chain disruptions, high inflation and an economic slowdown in China resulted in the CCC uptick.

Source: Capital IQ

Weaker economic conditions in LATAM increased working capital pressures for most sectors, pushing CCC higher



Country Insights

Oil & Gas

- LATAM companies experienced higher CCC due to increased inventory and normalization of payment cycles amid volatility in the global Oil & Gas markets.
- With LATAM a net importer of oil and gas, corporates in the region increased imports to meet higher fuel demand and lock in prices as oil prices soared.
- Companies in the region continue to diversify supply, export advanced products and boost critical mineral production for clean energy technologies.

Industrials

- In response to softening demand and a regional slowdown, companies suspended further purchases, resulting in a dip in DIO.
- Increased competition and declining raw material costs prompted companies to offer better payment terms to boost sales.
- To reduce their dependence on China and mitigate global supply chain challenges, companies are digitizing processes and reorganizing supply chains through vertical integration or increased reliance on regional suppliers.

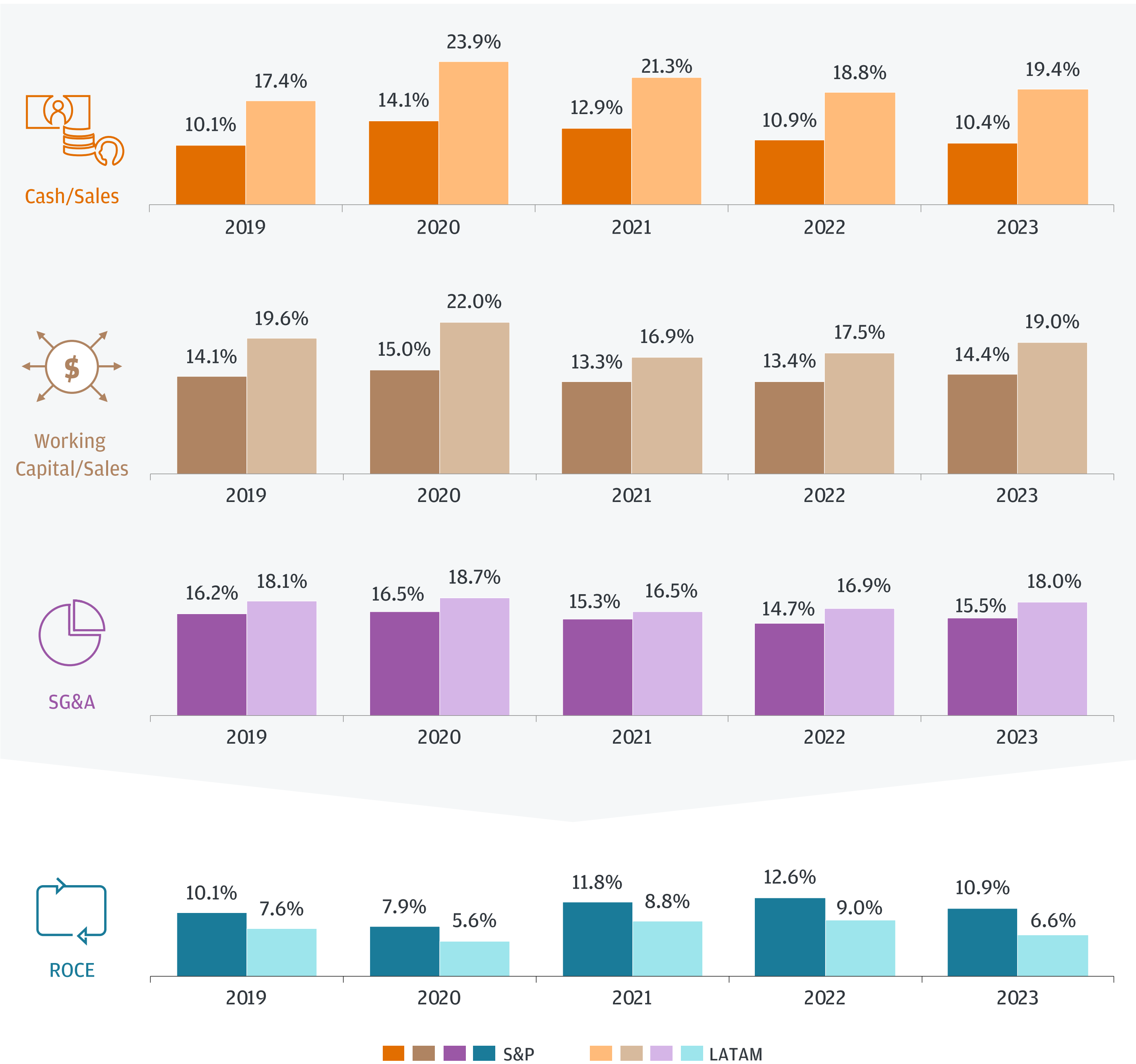
Utilities

- DSO increased compared to 2022 due to electricity sector regulations extending payment terms for customers, affecting collections for corporates.

Source: Capital IQ

07
Challenges and opportunities

Lower working capital efficiency adversely impacts returns



Source: Capital IQ

Note: ROCE – Return on Capital Employed; calculated as EBIT*(1-tax)/(Average of last two years debt + Average of last two years book value of equity); S&P refers to S&P 1500 data but with weights applied to industries to make it comparable to LATAM index.

LATAM corporates have higher working capital needs than S&P counterparts

S&P companies' lean cash levels can be attributed to cash allocation in capex investments to enhance supply chain resilience and domestic manufacturing. Working capital levels have increased for both S&P and LATAM corporates in 2023, with LATAM corporates having relatively higher working capital requirements due to economic deceleration within the region and limited credit access, driving up DSO and DPO. S&P companies frequently seek to streamline business operations and entity structures to unlock operational savings, leading to reduced selling, general and administrative expenses (SG&A).

Challenges for LATAM corporates

Corporates in the region face persistent challenges such as restrictive FX and capital controls, currency volatility and tougher credit conditions. High withholding taxes in LATAM countries are an obstacle to cash repatriation, leading to high liquidity buffers. Corporates continue to address incremental working capital challenges as they navigate a tougher macroeconomic environment in the region.

Key opportunity areas to unlock efficiencies

Corporates should further explore liquidity optimization, bank account rationalization and digitization opportunities. They must also revisit working capital processes and evaluate new technologies to deploy solutions such as supply chain finance, sales finance and inventory finance.

Unlocking working capital benefits amid global supply chain shifts

As corporates rush to capitalize on nearshoring opportunities and intra-regional synergies, treasurers turn their focus to working capital management.

US $78bn

Boost in global exports from Latin America and Caribbean annually due to nearshoring[4]

High impact   Medium impact

Manufacturing

Trends

- Half of US corporates that do not currently **manufacture** in LATAM are planning to move into the region **within the next five years.**[5]
- Mexican manufacturing attracted almost **US$12.9bn** of proposed investment in 2022-2023, with f**ocused government policies** across the region further driving this trend.[6]
- This manufacturing shift is expected to **boost commodities demand** from countries like **Argentina, Brazil and Chile** due to their proximity to LATAM end markets.

Implications for corporate treasuries

Working capital management is emerging as a key priority for corporates seeking to **reduce lead times and enhance inventory responsiveness** to be more competitive in the global manufacturing and outsourcing market.

Key industries

- Consumer Staples
- Materials
- Semiconductors
- Automotive
- Pharmaceuticals

> "The second wave of nearshoring investments is coming from new companies in new industries."
> **– Leading Materials company with over US$17bn in revenues**

New energy economy

Trends

- LATAM **holds a third of global lithium, copper and silver reserves,** generating immense potential for LATAM to diversify global supply chains.[7]
- Revenue from critical minerals production in LATAM totaled over **US$100bn** in 2022, with exports of **copper and lithium** expected to be significant.[8]
- LATAM's **electric vehicle transition is generating substantial inbound Chinese investment** in the region.

Implications for corporate treasuries

With the surge in EV supply chain investments, corporates must ensure **robust cash flow forecasting** for effective **expense management,** while adopting inventory management solutions to ensure timely delivery of critical components.

Key industries

- Materials
- Chemicals
- Utilities
- Oil & Gas

> "We will focus on countries where the strategy towards energy transition can be implemented best and has made a greater degree of progress, such as Brazil and Colombia."
> **– Top Utilities company in LATAM**

Infrastructure

Trends

- The expected surge in manufacturing activities is set to expedite **infrastructure upgrades** across LATAM.
- There is an **estimated US$150bn infrastructure gap** in LATAM that will require enormous investment in country-wide infrastructure.[9]
- This infrastructure demand has prompted the **recovery of construction activity,** driven largely by the development of industrial parks and manufacturing plants, which in turn has huge implications for logistics strategies in these markets.

Implications for corporate treasuries

Corporates must **enhance resiliency** to meet rising working capital requirements driven by the capital-intensive nature of the construction sector and increased infrastructure demand, as global firms establish operations in the region.

Key industries

- Materials
- Construction and Machinery
- Building and Furnishing
- Utilities
- Logistics

> "Construction activity has continued support due to housing starts, which have remained relatively stable in the last 12 months."
> **– Top Materials company in LATAM with over US$2bn in revenue**

Source: [4] Inter-American Development Bank, [5] U.S. Chamber of Commerce – October 2023, [6] EMIS, [7] Allianz, [8] International Energy Agency (IEA), [9] Americas Society/Council of the Americas, company literature, free web

08
Conclusion

Working capital strategies and funding solutions can free up cash for growth and dividends

With a fast-evolving macroeconomic environment, higher interest rates and supply chain uncertainties, businesses should focus on strong balance sheet management while always maintaining access to liquidity. Companies should also continue to focus on working capital optimization opportunities. There isn't a one-size-fits-all solution, and treasury and finance teams should look to improve overall working capital efficiency by analyzing and adopting multiple strategies, including but not limited to:

- Financial and commercial efficiency peer benchmarking
- Supplier economic health and customer relationships
- Payment and credit terms relative to sub-sector norms
- Spend vs. supplier leverage and optimal pay methods
- Pro-forma capital efficiency impact vs. process changes
- Environmental, social and governance (ESG) tiering and diversity, equity and inclusion (DEI) financial impact

J.P. Morgan prides itself on giving clients constructive and unbiased advice so they can make informed decisions on what's best for their organization. Our client connectivity and data resources span industries at scale, globally. This enables the firm to advise companies on working capital strategies and execution through a range of solutions, unlocking trapped capital from their payables, receivables and inventory management cycle.

Payables

- Supply Chain Finance
- Dynamic Discounting
- Pre-Payments
- Bill of Exchange
- Pre-Shipment Finance
- Digital Solutions (e.g., Tax Payment)

Receivables

- Receivables Purchase
- Receivables Financing
- Securitization
- Contract Monetization
- Digital Solutions (e.g., VAM, VRN)

Inventory & others

- Inventory Finance
- Trade Loan
- Borrowing Base Facility

End notes

[1] Capital IQ

[2] IMF

[3] Company literature

[4] Inter-American Development Bank

[5] U.S. Chamber of Commerce – October 2023

[6] EMIS

[7] Allianz

[8] International Energy Agency (IEA)

[9] Americas Society/Council of the Americas, free web

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Special thanks to Aarya Singh and Tanisha McCray for their contribution and efforts.

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