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Ratings

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Research Update:

Peruvian Cement Producer UNACEM Outlook Revised To Stable From Negative On Deleveraging; 'BB' Rating Affirmed

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Rating Action Overview

- Peru-based cement producer, Union Andina de Cementos S.A.A. y Subsidiarias' (UNACEM) rapid recovery in sales and EBITDA, following a difficult second quarter of 2020, allowed its net debt to EBITDA drop below 4.0x in the 12 months ended March 31, 2021.
- We expect deleveraging to continue in the next 12 months, thanks to strong cement demand in UNACEM's key markets and favorable industry fundamentals. On the other hand, we will monitor the likely shift in Peru's policies, which in our view, can affect the country's growth prospects and curtail construction activity.
- On June 25, 2021, S&P Global Ratings revised its outlook on UNACEM to stable from negative and affirmed its 'BB' global scale issuer credit rating.
- The stable outlook reflects our view that UNACEM will continue to deleverage in the next 12 months due to continued top-line and EBITDA growth, coupled with limited financing needs. This should result in a net debt to EBITDA trending towards 3.0x and discretionary cash flow (DCF) to debt of 5%-10%.

Rating Action Rationale

The rising construction and cement demand in UNACEM's key markets, coupled with prudent financial policies, have allowed the company's credit metrics to quickly recover to pre-pandemic levels. Thanks to stronger-than-expected cement demand in UNACEM's key markets, the company's sales and EBITDA have been rebounding since the second quarter of 2020. This, coupled with an efficient working capital management and relatively low capital expenditures and dividend distributions, have caused UNACEM's key credit metrics to improve. In the 12 months ended March 2021, UNACEM's net debt to EBITDA dropped below 4.0x, and we estimate this metric to drop towards 3.0x and to the 2.5x-3.0x range by the end of 2021 and 2022, respectively.

We expect the healthy momentum to continue in the coming quarters. The company's double-digit revenue growth during the fourth quarter of 2020 and first quarter of 2021 has almost erased the 2020 second-quarter contraction of 51%. We expect cement demand to remain robust thanks to the rising informal housing in Latin America and the upswing in the U.S. construction industry. Cement volume sales have overtaken pre-pandemic levels in 2021 in a majority of UNACEM's markets. For example, in UNACEM's largest market, Peru, cement dispatches during the first five months this year have been about 20% above the 2017-2019 average. On the other hand, we estimate that concrete, aggregates, and other building materials sales will recover at a slower pace and could reach pre-pandemic levels by the end of 2021. In our view, UNACEM is well positioned to continue meeting the rising demand, given that utilization rates at its largest plants has been 55%-60% in the past 12 months. During 2020, UNACEM's sales in Peru represented close to 65% of total, followed by those in the U.S. (17%), Ecuador (12%), Chile (6%), and Colombia (less than 1%).

Despite favorable industry fundamentals, policy risks loom in the Peruvian market in the longer term. Although we expect demand for building materials to remain strong in the upcoming quarters in Peru, the electoral win by Mr. Castillo could represent a major shift from Peru's current economic model. During his campaign, Mr. Castillo proposed several reforms such as a potential expansion of the state's role in the economy and introducing protectionist measures, seeking to increase tax revenue from foreign firms. Even if some of these proposals are not approved by the divided Congress, there's a risk that the country's investment trajectory in key sectors will be undermined, crimping demand for cement and concrete. However, given UNACEM's revenue mix in Peru, where about 75% of sales come from bagged cement--usually consumed for informal construction activity--we would expect some resiliency in UNACEM's cement dispatches.

Solid cash flows and no major acquisition or expansion for the next 12 months should continue reducing net leverage. We estimate the company will generate cash flows in the next 12 months, despite higher working capital needs for greater inventory production. Other cash outflows remain relatively low, such as capital expenditures at 5%-6% of sales and dividend distributions that should return to 30%-40% of free operating cash flows in the next two years, equivalent to $30 million - $40 million. We expect UNACEM to remain committed to lowering leverage in the next 12 months, although M&A opportunities could delay this trend if a feasible prospect arises. Nonetheless, we don't expect any major acquisitions in the near term. UNACEM's latest acquisition occurred in December 2020: the purchase of 100% of Cementos La Union S.A. for $23 million, which had little effect on the company's leverage. The purchase included a Chilean cement grinding facility with an installed capacity of about 300,000 tons per year and ready-mix assets with capacity of 336,000 m3 per year.

We expect UNACEM to continue refinancing its debt. The company refinanced its international bond and bank loan for about PEN1.2 billion in January 2021, extending its weighted average maturity and lowering its borrowing costs. In May 2021, UNACEM announced a local notes program for up to PEN1.2 billion. The company doesn't have yet a specific plan for issuing and the use of proceeds, but we expect that this additional funding source will support UNACEM's debt refinancing strategy without significant effect on its leverage.

Outlook

The stable outlook on UNACEM reflects our view that it will continue to deleverage in the next 12 months thanks to continued top- and bottom-line growth. In 2021, we expect UNACEM's cement and concrete volumes to grow at a high double-digit rate, with relatively stable prices. At the same time, we expect the company's financing needs to remain modest. Our base-case scenario for the next 12 months assumes UNACEM's EBITDA margin of 29%-30%, recovering from the pandemic's impact. The company will continue to gradually reduce debt, reflected in net debt to EBITDA trending towards 3.0x in the next 12 months and DCF to debt of 5%-10%.

Downside scenario

A negative rating action is possible in the next 12 months if UNACEM's leverage metrics deviate from our current expectations. Such a scenario could occur if the company's EBITDA and cash flows weaken because of lower construction activity in its key markets, or if UNACEM engages in more aggressive investment projects, including M&As. We could lower the ratings if:

- UNACEM's net debt to EBITDA surpasses 4.0x consistently;
- Its DCF-to-debt ratio is below 5% on a consistent basis; and
- Its liquidity position worsens beyond our expectations, with cash sources sharply lower than uses over a 12-month period.

Upside scenario

An upgrade could occur in the next 12 months if UNACEM's operating and financial performance surpasses our current expectations, with a sustainable increase in EBITDA or a more rapid deleveraging of its balance sheet. We could raise ratings in the next 12 months if:

- Net debt to EBITDA is near 2.5x on a consistent basis; and
- DCF to debt is consistently above 10%.

Moreover, we would also need to see an improvement in the company's liquidity position, such that its liquidity sources over uses are consistently above 1.2x on a 12-month basis, while it maintains ample covenant cushion.

Company Description

UNACEM mainly operates in Peru, producing and selling cement, clinker, concrete and energy--and to a lesser extent--in Ecuador, the U.S., Chile, and Colombia with concrete operations of ready mixed and precast industrialized concrete structures. In Peru, the company offers bagged cement under several brands such as Cemento Andino, Cemento Sol, Cemento APU, and others. The company also provides bulk cement to construction, energy, and oil and gas companies. Furthermore, through its subsidiaries--UNICON, CONCREMAX, and PREANSA--it sells ready-mix, manufactured cement, aggregates, pumps, concrete prefabs, and other byproducts. UNACEM was founded in 1916 and is based in Lima, Peru. In the 12 months ended March 2021, UNACEM reported revenue of PEN3.8 billion and adjusted EBITDA margin of 26.1%.

Our Base-Case Scenario

- An economic recovery in UNACEM's key markets in Latin America and continued growth in the U.S. for 2021-2022: Peru's GDP to grow 11% and 3.5%, respectively; U.S. (6.5% and 3.1%); Ecuador (3% and 2%); and Chile (6.9% and 2.9%).
- During 2021 and 2022, relatively stable inflation in all of UNACEM's markets: 2%-2.5% in Peru, 2%-3% in the U.S., about 1% in Ecuador, and 3.4%-3.6% in Chile. These relatively higher levels will stem from a recovery in oil prices and commodities, which could pressure fuel and transportation costs for UNACEM.
- We estimate UNACEM's revenue to grow about 16%-20% in 2021, mostly thanks to higher volumes across all segments (cement, concrete, and byproducts) and stable prices. Revenue growth in 2022 to moderate towards 5%-7% due to a continued recovery of volumes of ready-mix concrete and prefabricated products.
- UNACEM's profitability to recover towards historic averages, with EBITDA margins near 30%, as volumes grow that should generate economies of scale.
- Slightly greater working capital requirements from inventory development in 2021-2022, which should result in modest working capital outflows of about PEN140 million, comparable to the 2019 level.
- Capex of about $60 million in 2021 and $100 million in 2022.
- Annual dividends of PEN100 million - PEN130 million in the next two years.
- Net debt decreasing to about PEN3.8 billion in 2021 and PEN3.6 billion in 2022.

As a result, we estimate the following key credit metrics for UNACEM in 2021 and 2022:

- Net debt to EBITDA of 3.0x-3.5x in 2021 and close to 2.7x in 2022; and
- DCF to debt close to 5% in both years.

Liquidity

We continue to assess UNACEM's liquidity as less than adequate, reflecting our view that the company's sources of liquidity will be less than 1.2x for the next 12 months. This is primarily due to the company's relatively low cash balance against short-term debt maturities, as of March 31, 2021. We also consider that the company has limited ability to absorb high-impact, low-probability events without refinancing despite its ability to reduce its capital spending and pause dividends amid pressured liquidity. We nonetheless believe that UNACEM has a generally satisfactory standing in credit markets and maintains sound relationships with banks, as seen in its access to financing from various creditors.

Principal liquidity sources include:

- Cash and cash equivalents of PEN652 million as of March 31, 2021; and
- FFO of about PEN740 million for the next 12 months.

Principal liquidity uses include:

- Short-term debt maturities of PEN779 million as of March 31, 2021;

- Working capital requirement of about PEN195 million for the next 12 months; and
- Minimum capex of about $40 million (or close to PEN140 million-PEN150 million) for the next 12 months.

Covenants

As of the first quarter of 2021, UNACEM complied with all of its financial maintenance covenants at the consolidated and subsidiary levels. On a consolidated basis, UNACEM must maintain:

- Minimum debt service coverage of 1.1x in 2021 and 1.2x afterwards;
- Maximum debt to EBITDA of 4.75x in 2021, 4.0x in 2022, and 3.75x afterwards; and
- Maximum financial leverage below 1.50x.

While at UNACEM Peru level, it must maintain:

- A maximum financial leverage of 1.50x;
- A maximum debt to EBITDA ratio of 5.5x in the second quarter of 2021, 5.0x in the third quarter of 2021, 4.0x in 2022, and 3.75x for subsequent periods; and
- Minimum debt service coverage ratio of 1.2x.

We expect the company to maintain ample covenants headroom in the next 12 months, above 35%, under all these covenants.

Ratings Score Snapshot

Issuer credit rating: BB/Stable/--

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb

Modifiers:

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Less than adequate (-1 notch)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bb

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Union Andina de Cementos S.A.A. y Subsidiarias		
Issuer Credit Rating	BB/Stable/--	BB/Negative/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.