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Research Update:

Peruvian Cement Group UNACEM Corp Outlook Revised To Positive On Continued Deleveraging; 'BB' Rating Affirmed

June 27, 2022

Rating Action Overview

- Peruvian cement group, UNACEM Corp S.A.A. (UNACEM), has performed better-than-expected, leading to a fast deleveraging and liquidity improvement. UNACEM reported record-high revenues of PEN5.3 billion, EBITDA margin of 30%, and net debt to EBITDA of 2.2x for the 12 months ended March 31, 2022.
- We expect political and economic headwinds to slow down cement demand--the main driver of sales and cash flows--in the company's key markets in the next 12 months. However, the company's resilient performance, maintaining low net leverage metrics, and adequate liquidity position could lead us to raise the rating to 'BB+'.
- On June 27, 2022, S&P Global Ratings revised its outlook on UNACEM to positive from stable and affirmed its long-term issuer credit rating at 'BB'.
- The positive outlook reflects a potential upgrade of UNACEM in the next 6-12 months if the company maintains its prudent financial policy with net debt to EBITDA below 2.5x and discretionary cash flow (DCF) to debt above 10% amid a global economic deceleration and inflationary pressures.

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Rating Action Rationale

The outlook revision reflects improvement in credit metrics and liquidity position, and our expectation of a resilient performance in the next 12-24 months despite a challenging economic and political conditions. After the pandemic broke out in 2020, the strong demand for building materials across UNACEM's key markets led not only to a faster-than-expected recovery in its credit metrics by mid-2021, when we revised our outlook on the company to stable from negative, but UNACEM continued to benefit from the momentum and surpassed our expectations in the past two quarters. The double-digit increase in UNACEM's sales and EBITDA, as well as a drop in gross debt led to a quick reduction in leverage metrics, with net debt to EBITDA of 2.2x at the end of 2021 and March 2022. We expect the momentum to moderate in the next 12 months due to a global economic deceleration and persistent inflationary pressures on key input costs, coupled with a complex political landscape in Latin America. This would result in UNACEM's slightly lower volume sales in Peru and the U.S., and sluggish volume growth in Ecuador. However, higher selling prices, coupled with the consolidation of assets acquired at the end of 2021 in Chile, and mid- to high-revenue growth in other businesses, should result in consolidated revenue growth of 6%-8% in 2022 and 4%-5% in 2023. On the other hand, we estimate UNACEM's EBITDA margin to decline about 200 basis points from 2021 levels to 29% in 2022, due to high input costs, such as raw materials, gas, and fuel, and to a lesser extent, electricity because the company's vertical integration and its hydroelectric plants in Peru with 337 megawatts in installed capacity should protect its profitability. As a result, EBITDA and cash flows should remain steady in the next few years, maintaining net debt to EBITDA near 2.0x.

High cash flows enhance the company's capacity to raise capital expenditures and dividend payments without leveraging its balance sheet. We expect UNACEM to generate between PEN1.0 billion and PEN1.1 billion in operating cash flows in 2022 and 2023, and to allocate them towards capital expenditures (capex), debt repayment, and dividend distributions. The company's main projects for the next five years relate to improving profitability and reducing its carbon footprint. Although we estimate higher capex in the next years, PEN400 million - PEN500 million annually, we consider UNACEM has flexibility to delay or postpone investments, because they're multiannual projects, if cash flows soften. On the other hand, UNACEM revised its dividend distribution policy at the end of 2021, which will raise annual dividends to $35 million - $70 million from $30 million - $40 million previously. We believe that solid cash flows will be sufficient to cover higher investments and dividend distributions, reflected in DCF to debt of 8%-15% in 2022-2023, while the remaining excess cash will be used to continue to repay debt.

UNACEM remains Peru's largest cement producer, while increasing its position in nearby markets and the U.S. The rating continues to reflect UNACEM's leading position in Peru's cement industry, where it holds 45%-50% of market share, and a dominant position in the central region of the country, with an installed cement capacity of 8.3 million tons per year (mtpy). In Ecuador, the company remains the second-largest player and in Arizona, U.S., the third largest. In the past couple of years, UNACEM has acquired cement and concrete assets in Chile, which have been successfully integrated into its operations with high growth rates. We expect UNACEM to continue looking for potential small- to medium-size acquisitions in its current or nearby markets, which could raise financing needs moderately. However, we expect the company to maintain its prudent financial policy and to maintain net debt to EBITDA below 3x at all times. On the other hand, the company's operations of ready-mix, concrete prefabs, and other byproducts through its subsidiaries, UNICON, CONCREMAX and PREANSA in Peru, Ecuador, Chile, and Colombia have posted solid top-line growth since 2017 and will remain an integral part of UNACEM's operations, complementing its cement offering.

Outlook

The positive outlook on rating on UNACEM reflects a potential upgrade in the next 6-12 months if the company maintains a strong operating and financial performance through resilient sales and profitability protection, which would translate into consistent high cash flows, while it maintains its prudent financial policy towards capital allocation. We could raise the rating if:

- UNACEM maintains net debt to EBITDA below 2.5x in the next few quarters;
- Its discretionary cash flow to debt remains at about 10%; and
- Its liquidity position continues to strengthen through higher sources of cash or lower use of short-term financing.

Downside scenario

We could revise the outlook to stable in the next 12 months if UNACEM's leverage metric deteriorates from our base-case assumptions or if its liquidity position worsens. This could occur if the company's EBITDA and cash flows weaken as a result of eroding macroeconomic conditions that undermine construction activity in its core markets, or if we see a sharper deterioration of profitability margins. On the other hand, a more aggressive dividend distribution policy and higher capex deployments could raise financing needs, pressuring credit metrics. As a result, we could revise the outlook to stable if:

- UNACEM's net debt to EBITDA is consistently above 3.0x;
- Its DCF-to-debt ratio is below 10% on a consistent basis; and
- Its liquidity position deteriorates beyond our expectations, with cash sources over uses below 1.2x in a 12-month period.

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 2022, UNACEM reported revenue of PEN5.3 billion and adjusted EBITDA margin of 30.3%.

Our Base-Case Scenario

- UNACEM's key markets in Latin America to post modest growth in 2022 and 2023: Peru's GDP to grow 2.5% and 2.8%, Ecuador 1.8% and 1.4%, Chile 2.1% and 1.3%., and the U.S. GDP to grow 2.4% and 1.6%, respectively.
- High inflation across UNACEM's markets in 2022-2023: 7.0%-3.8% in Peru, 5.6%-3.3% in the U.S., about 3.5%-1.0% in Ecuador, and 10.2%-5.5% in Chile. These higher levels will stem from a sharp recovery in oil prices and commodities from pandemic-related lows, which will continue pressuring UNACEM's fuel and transportation costs.
- UNACEM's revenue to grow 6%-8% in 2022, mostly due to the double-digit increase in selling prices because we expect cement volumes to fall by low-single digits, while concrete volume sales should grow 2%-5%. Revenue growth to moderate to 4%-5% in 2023, slightly above GDP growth of countries in which the company operates, due to a normalization of inflation and steady demand.

- EBITDA margin to remain at 29%-30%, given that the price increments, coupled with efficiencies from its vertical integration, should protect UNACEM from higher raw materials and energy costs.
- Annual capex of $100 million - $130 million (or PEN400 million - PEN500 million) for efficiency projects and sustainability initiatives.
- Annual dividends of $50 million - $60 million in the next two years.
- Net debt decreasing to about PEN3.1 billion in 2022 and PEN2.9 billion in 2023.

As a result, we estimate the following key credit metrics for UNACEM in 2022 and 2023:

- Net debt to EBITDA of about 2.0x in 2022 and 1.7x-2.0x in 2023; and
- DCF to debt close to 16% in 2022 and 8% in 2023.

Liquidity

We've revised our assessment of UNACEM's liquidity to adequate from less than adequate, reflecting our expectations that sources of liquidity will exceed its uses by more than 1.2x in the next 12 months and that liquidity sources will exceed uses even if forecast EBITDA declines by 15% from our base-case scenario. In addition, our liquidity analysis captures qualitative factors that reflect UNACEM's ability to absorb high-impact, low-probability events without refinancing, given its ability to reduce capital spending and postpone dividend payments, if necessary, while the company maintains sound relationships with banks, as seen in its access to financing from various creditors.

Principal liquidity sources include:

- Cash and cash equivalents of PEN407.5 million as of March 31, 2022; and
- FFO of about PEN1.14 billion for the next 12 months.

Principal liquidity uses include:

- Short-term debt maturities of PEN843.2 million as of March 31, 2022;
- Working capital requirement of about PEN30 million for the next 12 months;
- Maintenance capex of about $40 million (or PEN150 million - PEN160 million) for the next 12 months; and
- Minimum dividend payments of $35 million (about PEN140 million) for the next 12 months.

Covenants

As of the first quarter of 2022, UNACEM complied with all of its financial maintenance covenants at the consolidated and subsidiary levels.

On a consolidated basis, UNACEM must maintain:

- Debt to equity of less than or equal to 1.5x.
- Debt service coverage of more than or equal to 1.2x.
- EBITDA interest coverage of more than or equal to 3.0x.

- Net debt to EBITDA of less than or equal to 4.0x.

At subsidiary level, the company has several covenants on similar financial ratios. We expect UNACEM to maintain ample covenants headroom in the next 12 months, above 60%, under all these covenants

Environmental, Social, And Governance

ESG Credit Indicators: E-3, S-2, G-2

Environmental factors are a moderately negative consideration in our credit rating analysis of UNACEM. Although environmental-related regulatory scrutiny is progressing slower in Peru and Latin America than in developed markets, we consider that the company's U.S. operations could be exposed to regulatory tightening, potentially requiring greater investments in the medium term, although its assets are relatively new. The bulk of UNACEM's operations are in Peru, accounting for 65% of sales, while 14% are in the U.S. and 21% in other Latin American countries. Therefore, we expect potential regulatory requirements to be relatively mild for UNACEM and its cash generation to provide sufficient cushion. On average, the company has deployed about PEN30 million annually for environmental investments; about 13% of its total capex. In 2021, it emitted 628 kg of CO_2e per ton of cement produced in Peru, similar to those of regional peers. Moreover, the company has a commitment to reach carbon neutrality by 2050.

Ratings Score Snapshot

Issuer credit rating: BB/Positive/--

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: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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
UNACEM Corp. S.A.A.		
Issuer Credit Rating	BB/Positive/--	BB/Stable/--

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.