Research Update:

UNACEM Outlook Revised To Stable From Positive On Impaired Liquidity And Higher Leverage; 'BB' Rating Affirmed

November 3, 2023

Rating Action Overview

- We now expect Peru-based building materials company UNACEM Corp. S.A.A. to have tight liquidity for longer than previously expected, while leverage will be higher in the next 12 months after the acquisition of a cement plant in Tehachapi, Calif.
- We estimate the company's short-term debt maturities will remain high compared with its cash reserves and funds from operations until mid-2024.
- On Nov. 3, 2023, S&P Global Ratings therefore revised its rating outlook on UNACEM to stable from positive and affirmed the 'BB' issuer credit rating.
- The stable outlook reflects our view that UNACEM will quickly integrate the Tehachapi assets while maintaining steady performance in other operations in the next 12 months, reaching net debt to EBITDA just below 3x by year-end 2024.

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Rating Action Rationale

The likelihood of an upgrade in the next 12 months has decreased. We now expect UNACEM to maintain a tighter liquidity position and refinance short-term debt maturities beyond what we previously expected. However, we think the company maintains good access to capital markets and sound relationships with several banks, as reflected in the syndicated bank loan secured for the Tehachapi acquisition. Still, short-term financing surpasses our estimated liquidity sources, mainly cash reserves and funds from operations (FFO), for the next 12 months, increasing the company's reliance on rolling over debt maturities

We raised our leverage expectations for 2023-2024 due to the debt-funded acquisition and softer performance in Peru. UNACEM secured the transaction with a $345 million syndicated bank loan with a three-year bullet tenor. Our revised base-case scenario now estimates reported net debt to EBITDA for 2023 will be 3.7x-3.8x, but on a pro forma basis, considering 12 months of

Tehachapi operations, it would likely be 3.1x-3.2x. This is a deviation from our prior expectation of net debt to EBITDA of 2.1x in 2023. The price of the acquisition was $315 million, and we expect UNACEM will use the remainder of the proceeds for ramp-up investments in the plant.

We estimate leverage will fall below 3x by year-end 2024, due to a quick integration of the recently acquired assets, including the Termochilca plant earlier this year, along with a modest improvement in the Peruvian operations' sales and profitability after weaker performance--though better than the total Peruvian market--in 2023. Year to date, cement demand in Peru has decreased by 10%-12% because of softer economic growth and weaker investment sentiment, given political turmoil. In addition, UNACEM's profitability has decreased due to lower administrative expense dilution, given lower cement dispatches and energy purchases amid lower output from its hydroelectric plants, partly compensated by thermal operations recently acquired.

A swift integration of the Tehachapi plant will aid UNACEM's geographic diversification. UNACEM is entering the California market with the Tehachapi acquisition, which provides an important opportunity for the company to expand its operations in the U.S. and continue diversifying its geographic footprint. The Tehachapi plant represents close to 10% of installed capacity in Southern California, which we consider a highly competitive market with big cement industry players, along with seaborne imports. In 2022, the plant had sales close to $114 million with a utilization rate near 90%, but this rate has fallen to about 70% this year.

UNACEM management expects some synergies between its California and Arizona operations, given the greater cement and clinker installed capacity at the Tehachapi plant. We estimate U.S. operations, between California and Arizona, will likely represent 18%-20% of UNACEM's consolidated sales in 2024-2025.

Outlook

The stable outlook reflects our view that UNACEM will quickly integrate acquired assets and maintain steady financial performance in the next 12 months. We estimate the company's consolidated revenue will grow pro forma 10%-12% (reported 7%-8%) in 2023 and 5% in 2024, given its recent acquisition, and that profitability will gradually improve due to easing input costs.

Additionally, we expect UNACEM to maintain access to banks and capital markets and roll over short-term debt maturities. We estimate UNACEM's net debt to EBITDA will be 3.1x-3.2x pro forma in 2023 (reported 3.7x-3.8x) and decline toward 2.5x by year-end 2024, while discretionary cash flow (DCF) to debt will remain just above 10% on average.

Downside scenario

We could downgrade UNACEM in the next 12 months if the company's financial performance deteriorates due to worsening operating performance or if the company engages in capital expenditure (capex) projects or investments that increase its financing needs. We would lower the rating if:

- UNACEM's liquidity position deteriorates because of higher use of short-term debt or shortfalls in FFO, in which case liquidity sources over uses would show a material deficit, even considering minimum capex; or
- The company's leverage increases on a consistent basis, with net debt to EBITDA sustained above 3x or DCF to debt consistently below 10%.

Upside scenario

Although it is unlikely in the next 12 months, we could upgrade UNACEM if the company sustainably improves its liquidity position, as shown in sources over uses of liquidity consistently above 1.2x, while its leverage remains below 3x at all times. This could occur if UNACEM refinances and pushes out a significant portion of its short-term debt maturities, reducing its reliance on rolling over short-term debt. Moreover, we'd expect a quick integration of the Tehachapi and Termochilca plants into its operations, reflected in 10%-12% top-line growth. We could raise the rating if:

- UNACEM's liquidity position consistently improves, with refinancing and extending of short-term debt maturities or significant increases in cash and equivalents and FFO, reducing reliance on rolling over short-term debt;
- The company's net debt to EBITDA quickly decreases and stays below 2.5x; and
- Its DCF to debt remains above 10%.

Company Description

UNACEM mainly operates in Peru, producing and selling cement, clinker, concrete, and energy, and operates to a lesser extent in Ecuador, the U.S., Chile, and Colombia with ready-mix concrete and precast industrialized concrete structure operations. 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 concrete, manufactured cement, aggregates, pumps, concrete prefabs, and other byproducts. Through Celepsa, UNACEM has an energy division of two hydroelectric plants and one thermal plant.

UNACEM was founded in 1916 and is based in Lima, Peru. In the 12 months ended June 30, 2023, UNACEM reported revenue of Peruvian nuevo sol (PEN) 6.1 billion and an adjusted EBITDA margin of 25.3%.

Our Base-Case Scenario

Assumptions

- Modest GDP growth in UNACEM's key markets in Latin America in 2023 and 2024: 0.9% and 2.4%, respectively, in Peru; 1.5% in both years in Ecuador; and no growth in 2023 and 2.0% in 2024 in Ecuador.
- U.S. GDP growth of 2.3% in 2023 and 1.3% in 2024.
- Inflation to ease from 2022 but remain high in UNACEM's key markets, keeping financing conditions tight in 2023.
- Consumer price index in 2023-2024 at 6.6%-3.2% in Peru, 4.1%-2.4% in the U.S., and 7.6%-3.5% in Chile.
- UNACEM's revenue to grow 10%-11% in 2023 on a pro forma basis (7%-8% reported) and

moderate toward 5% growth in 2024, based on the Tehachapi acquisition, higher prices across all segments, and higher concrete volume in Peru and the U.S., which would offset cement volume contraction in Peru.

- Income from the energy division to grow 20%-30% due to the acquisition of Termochilca.
- UNACEM's EBITDA margin to remain about 24% in 2023 and gradually improve toward 25%-26% in the next two years.
- Capex of about PEN668 million in the next 12 months, aimed toward revamping and reducing bottlenecks for projects at UNACEM's Ecuador facilities, the Puzzolana and Florence projects at Skanon, Solimana at Celepsa, and other strategic initiatives.
- Annual dividends of PEN144 million in 2023 and PEN146 million in 2024.
- Net debt remaining near PEN5.0 billion in 2023 and PEN4.3 billion the next two years.

UNACEM Corp. S.A.A.--Key metrics*

	--Fiscal year ended Dec. 31--				
(Mil. PEN)	2021a	2022a	2023e	2024f	2025f
Revenue	5,066.20	5,978.80	6,689.90	7,027.90	7,391.30
EBITDA margin (%)	31.2	26.4	23.5	25.6	26.3
Funds from operations	1,218.20	1,164.10	1,104.00	1,276.50	1,406.10
Capital expenditure	346.9	436.4	652.8	589	873
Dividends	123.1	293.3	135.4	139	140.8
Debt to EBITDA (x)	2.3	2.2	3.1	2.5	2.1
DCF to debt (%)	15.2	4.5	7.3	12.1	10.3
EBITDA interest coverage (x)	8.3	8.1	6.6	6.7	7.8

*All figures adjusted by S&P Global Ratings. 2023-2025 figures are adjusted pro forma, including the acquisition of Tehachapi plant. a--Actual. e--Estimate. f--Forecast. DCF--Discretionary cash flow.

Liquidity

We revised our view of UNACEM's liquidity to less than adequate, reflecting lower cushion in its liquidity sources over uses in the next 12 months. Moreover, the higher use of short-term debt, in our view, limits the company's ability to absorb high-impact, low-probability events without refinancing, despite its ability to reduce its capital spending and postpone dividend payments if necessary.

On the other hand, UNACEM maintains good credit standing in capital markets and sound relationships with banks, as seen in its access to financing from various creditors.

Principal liquidity sources

- Cash and cash equivalents of PEN323.6 million as of June 30, 2023.
- FFO of about PEN1.3 billion for the next 12 months.
- Proceeds from three-year loan of $345 million.

Principal liquidity uses

- Debt maturities of PEN1.7 billion for the next 12 months.
- Working capital requirement of about PEN95.8 million for the next 12 months.
- Maintenance capex of about US$40 million (PEN150 million to PEN160 million) for the next 12 months.
- Acquisition of Tehachapi plant for about $315 million.

Covenants

UNACEM complied with all of its financial maintenance covenants at the consolidated and subsidiary levels as of June 30, 2023.

On a consolidated basis, considering the new syndicated bank loan, UNACEM must maintain:

- A maximum debt-to-equity ratio of 1.5x,
- A minimum debt service coverage ratio of 1.20x, and
- A maximum net-debt-to-EBITDA ratio of 3.75x.

Skanon Investments Inc. and subsidiaries must maintain:

- A maximum debt-to-equity ratio of 1.0x,
- Maximum debt to EBITDA of 3.75x, and
- Minimum EBITDA interest coverage of 3.0x.

We expect the company's EBITDA headroom on its covenants to decrease in the next 12 months, given the acquisition of Tehachapi.

Environmental, Social, And Governance

Environmental factors are a moderately negative consideration in our credit rating analysis of UNACEM. Although environmental regulatory scrutiny is progressing more slowly in Peru and Latin America overall than in developed markets, we think the company's U.S. operations, especially the newly acquired assets in California, could be exposed to tighter regulations, potentially requiring greater investments in the medium term.

The bulk of UNACEM's operations are in Peru--accounting for 64% of sales--while 16% are in the U.S. and 19% in other Latin American countries. Therefore, we expect potential regulatory requirements to be relatively mild for UNACEM, and we expect its cash generation to provide sufficient cushion. On average, the company has deployed about PEN30 million annually for environmental investments--about 6% of its total capex. In 2022, it emitted 650 kilograms (kg) of carbon dioxide equivalent per ton of cement produced, similar to regional peers. Moreover, the company has a commitment to decrease its carbon dioxide equivalent emissions per ton of cement produced to 500 kg by 2030 and to reach carbon neutrality by 2050.

Ratings Score Snapshot

Issuer Credit Rating	BB/Stable/--
Business risk:	Fair
Country risk	Moderately high
Industry risk	Intermediate
Competitive position	Fair
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
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	Neutral (no impact)
Stand-alone credit profile:	bb

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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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/Stable/--	BB/Positive/--