Research Update:

UNACEM Corp. S.A.A. Downgraded To 'BB-' On Weaker Credit Metrics And Tighter Liquidity; Outlook Negative

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Rating Action Overview

- Peru-based building materials company UNACEM Corp. S.A.A. posted weaker-than-expected operating and financial performance. Despite our expectations that the company will improve its financial position in the next 12 months, its credit metrics will still deviate materially from our previous expectations.
- In addition, UNACEM has increased its reliance on the use of short-term debt, which in our view is pressuring its liquidity position. However, we believe the company maintains good access to capital markets and sound relationships with several banks.
- As a result, on Oct. 31, 2024, S&P Global Ratings lowered its global scale long-term issuer credit rating on UNACEM to 'BB-' from 'BB'.
- The negative outlook indicates a potential downgrade in the next 12 months if the company's liquidity position remains under pressure or if its credit metrics deviate from our expectations.

Rating Action Rationale

The downgrade reflects our view that UNACEM will take longer than expected to deleverage following last year's acquisitions. UNACEM's operating and financial performance has been weaker than expected stemming from lower sale volumes across Peru, Ecuador, and Chile in the first half of the year. In addition, the acquisitions of Termochilca (May 2023) and Tehachapi (November 2023) have resulted in higher-than-expected administrative expenses. The greater use of debt, as a result of acquisitions and weaker cash flow, caused the company's key credit metrics to erode. We now expect UNACEM to post adjusted net debt to EBITDA of about 3.2x, free operating cash flow (FOCF) to debt of about 5%, and discretionary cash flow (DCF) to debt of about 1% by the end of 2024, sharply deviating from our previous expectations of 2.4x, 15%, and 12%, respectively.

In Peru, one of the company's core markets (about 65% of revenue), we continue to expect the economy to grow about 2.7% in 2024 and in 2025, primarily fueled by the upturn in the fishing, agriculture, and construction sectors. This should help UNACEM's sale volumes to start recovering in the next 12 months and improve its profitability and cash flow. Therefore, for 2025, we forecast the company's net debt to EBITDA to slip just below 3.0x and FOCF to debt to rise close to 8%, compared with our previous expectations of close to 2.0x and 15%, respectively. Given deviations in credit metrics for 2024 and 2025, we revised our view of the financial risk profile to significant from intermediate, triggering the downgrade.

The negative outlook reflects that we could downgrade UNACEM if it doesn't alleviate liquidity pressures. The company's increasing reliance on short-term debt, mainly for working capital needs, over the last few quarters has tightened its liquidity position, in our view. We expect this to be temporary as UNACEM refinances its debt in the local market. We believe the company maintains good access to capital markets and has sound relationships with several banks, as reflected in several refinancings even during periods of economic stress.

Moreover, we expect Peru's central bank to keep cutting the policy interest rate in the next 12 months, which could improve financing conditions in the country. We will continue to monitor the company's actions to ease liquidity pressures in the next few months. This will become more important, as the bank loan of about $345 million, which was taken out to acquire Tehachapi's assets, approaches its October 2026 maturity. If the loan is not refinanced on a timely basis, it could further weaken the company's credit quality.

We expect UNACEM to improve its profitability in the next 12 months. For the next 12 months, we expect UNACEM to continue benefiting from easing input costs and from operating efficiencies, particularly fuel consumption in Peru. Moreover, we expect the company's U.S. operations (about 20% of revenue) to increase profitability in line with our expectation of higher utilization rates and a gradual normalization of administrative expenses. These factors, together with average price increases in UNACEM's building materials business (about 90% of revenue), should help raise adjusted EBITDA margin above 25% in the next 12 months.

Outlook

The negative outlook reflects a potential downgrade in the next 12 months if the company's liquidity position remains under pressure or if its credit metrics deviate from our expectations. Such a scenario could occur if UNACEM does not take actions to diminish liquidity pressures or if its revenue, EBITDA, and cash generation weaken as a result of a drop in construction activity across its markets.

Downside scenario

We could downgrade UNACEM if one of the following scenarios materialize:

- UNACEM's liquidity position remains under pressure either because of high reliance of short-term debt or if its bank loan that funded Tehachapi's acquisition becomes part of short-term debt.
- Adjusted net debt to EBITDA is consistently above 4.0x, with no foreseeable deleveraging in the near term.

Upside scenario

We could revise the outlook to stable in the next 12 months if the company improves its liquidity position, while its operating and financial performance is in line with our expectations. We could revise the outlook if all the following conditions are met:

- The company's liquidity position strengthens, with expected sources of liquidity over uses close to 1.0x on a consistent basis; and
- Its adjusted net debt to EBITDA is below 3.0x, or if this ratio is above 3.0x and FOCF to debt is above 10%.

Company Description

UNACEM mainly operates in Peru, producing and selling cement, clinker, concrete, and energy, and operates to a lesser extent in the U.S., Ecuador, and Chile 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. Celepsa, UNACEM's energy division, operates 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, 2024, UNACEM reported revenue of PEN6.7 billion and adjusted EBITDA margin of 23.3%.

Our Base-Case Scenario

Assumptions

- Modest GDP growth in UNACEM's key markets in Latin America in 2024 and 2025: 2.7% for both years in Peru; 1.0% and 2.0% in Ecuador; and 2.4% and 2.2% in Chile.
- U.S. GDP growth of 2.7% in 2024 and 1.8% in 2025.
- Average exchange rate of PEN3.75 per $1 in 2024 and PEN3.79 per $1 in 2025;
- Inflation to ease in UNACEM's key markets, improving financing conditions in 2025;
- Consumer price index in 2024 and 2025 at 2.4%-2.1% in Peru, 2.9%-2.0% in the U.S., and 4.2%-3.9% in Chile.
- UNACEM's consolidated revenue to grow about 8% in 2024, based on the full consolidation of Tehachapi and Termochilca, price increases approaching inflation, and higher concrete volumes in Peru and the U.S., which would offset cement volume contraction of 3%-5% in Peru. Revenue growth of 5.2% in 2025, considering the 1%-3% volume growth in the building materials segment and average price increases close to inflation.
- Income from the energy division to stabilize in 2024 and 2025, following excellent performance in 2023.
- EBITDA margin of about 24.6% in 2024 and to improve above 25% in 2025.

- Capex of PEN560 million - PEN570 million per year, considering maintenance and optimization projects in ready-mix production in the U.S., new packaging machines, the roofing of the clinker area and improvements in the kiln cooler at UNACEM Peru, and other initiatives.
- Annual dividends of PEN150 million in 2024 and PEN160 million in 2025.

Key metrics

UNACEM Corp. S.A.A.--forecast summary

Industry sector: building materials & products

	--Fiscal year ended Dec. 31--			
(Mil. PEN)	**2022a**	**2023a**	**2024e**	**2025f**
Revenue	5,979	6,376	6,888	7,243
EBITDA	1,578	1,511	1,694	1,832
Funds from operations (FFO)	1,164	858	1,044	1,177
Capital expenditure (capex)	436	529	565	571
Free operating cash flow (FOCF)	480	110	287	411
Adjusted ratios				
Debt/EBITDA (x)	2.2	3.6	3.2	2.8
FFO/debt (%)	33.6	15.8	19.4	22.6
EBITDA interest coverage (x)	8.1	5.7	4.4	5.3
FOCF/debt (%)	13.9	2.0	5.3	7.9
DCF/debt (%)	4.5	(2.4)	1.3	4.8
Annual revenue growth (%)	18.0	6.6	8.0	5.2
EBITDA margin (%)	26.4	23.7	24.6	25.3

*All figures include S&P Global Ratings adjustments' unless stated as reported. a--Actual. e--Estimate. f--Forecast. UNACEM's 2023 adjusted debt is PEN5.4 billion and mainly consists of PEN5.5 billion of reported gross debt, plus PEN145 million of lease liabilities, less PEN401 million in accesible cash, plus PEN45 million of asset retirement obligations, plus PEN15 million of postretirement obligations, plus PEN143 million in deferred compensation from the acquisition of Termochilca. The 2023 figures do not consider full year consolidation results of Tehachapi and Termochilca assets.

Liquidity

We continue to view UNACEM's liquidity as less than adequate. In our view, the higher use of short-term debt, mainly for working capital needs, 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 and even during periods of economic stress.

Principal liquidity sources

- Cash and cash equivalents of PEN337.6 million as of June 30, 2024; and
- FFO of about PEN1.1 billion for the next 12 months.

Principal liquidity uses

- Short-term debt maturities of PEN2.0 billion, considering a refinancing of about $100 million after second-quarter 2024;
- Working capital requirement of about PEN200 million for the next 12 months; and
- Maintenance capex of about PEN225 million for the next 12 months.

Covenants

As of August 2024, UNACEM was in compliance with all of its financial maintenance covenants at the consolidated and subsidiary levels.

On a consolidated basis, UNACEM must maintain:

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

Skanon Investments Inc. and subsidiaries must maintain:

- A maximum debt-to-equity ratio of 2.25x.

We expect the company to comply with its covenants in the next 12 months. However, we estimate it would maintain a headroom below 15% on forecasted EBITDA on its debt service coverage ratio.

Ratings Score Snapshot

Issuer credit rating	BB-/Negative/--
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	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bb-

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- UNACEM Outlook Revised To Stable From Positive On Impaired Liquidity And Higher Leverage; 'BB' Rating Affirmed, Nov. 3, 2023
- Economic Outlook Emerging Markets Q4 2024: Lower Interest Rates Help As Pockets Of Risk Rise, Sept. 24, 2024
- Economic Outlook U.S. Q4 2024: Growth And Rates Start Shifting To Neutral, Sept. 24, 2024

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
UNACEM Corp. S.A.A.		
Issuer Credit Rating	BB-/Negative/--	BB/Stable/--