FitchRatings

Fitch Affirms Votorantim Cimentos' IDR at 'BBB-'; Outlook Remains Negative

Fitch Ratings-Chicago-18 April 2017: Fitch Ratings has affirmed the Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) of Votorantim Cimentos S.A. (VCSA) at 'BBB-' and its National Scale rating at 'AAA(bra)'. The Rating Outlook for the IDRs remains Negative while the Outlook for the national scale rating has been revised to Negative from Stable. A full list of rating actions follows at the end of this release.

The Negative Outlook reflects the challenges VCSA and its parent Votorantim S.A (VSA) face as they attempt to deleverage by 2018. It is likely VSA and VCSA will need to sell non-core assets and take other extraordinary measures to lower debt to prevent negative rating actions.

KEY RATING DRIVERS

Credit Linkage with Parent

VCSA is a key operating subsidiary of VSA Long-Term Foreign Currency IDR 'BBB-'/Negative Outlook), accounting for approximately 55% of VSA's EBITDA and 64% of its net debt as of Dec 31, 2016, per Fitch's calculation. As of Dec. 31, 2016, around 30% of VCSA's total debt had guarantees from its parents (VSA and Hejoassu Participacoes S.A.). VSA has clearly stated that VCSA is an important, wholly owned subsidiary, and that it would provide cash to the company if necessary, through equity support or debt assumption. For 2017, Fitch projects VSA's consolidated net leverage will be 3.5x and that it will decline to 2.9x in 2018.

VCSA's current rating is one notch above Brazil's 'BB+' Country Ceiling. Besides the linkage with a stronger parent, other factors that mitigate sovereign transfer and convertibility risk include having approximately 60% of its EBITDA generation outside of Brazil, a large cash balance in the U.S. and USD700 million of revolving credit availability until 2020.

Sluggish Cement Market in Brazil to Persist

The Brazilian cement market declined approximately 11.7% to
57 million tons in 2016 from 65 million in 2015 and 72 million tons in 2014 due to a slowdown of infrastructure projects and bagged cement sales during the country's economic recession. Fitch expects cement volumes in Brazil to remain subdued at around 53 million tons for 2017. Recovery of cement volumes will likely occur by 2018, but growth in volumes will be sluggish as Fitch projects cement volumes to remain below the level sold in 2014 for at least the next three years.

Brazil to Continue to Pressure CFFO; Lower Capex Not Enough to Turn FCF Positive

Fitch projects VCSA's EBITDA generation to decline to BRL2.1 billion for 2017 from BRL2.2 billion in 2016. These figures compare poorly with around BRL3.3 billion of EBITDA during 2015 and 2014. This deterioration reflects sharp declines in volumes sold, which have lowered the capacity utilization rate, along with limited price increases. Fitch envisions capacity utilization rate in the Brazilian cement industry to remain low around 50%-60%. VCSA's business diversification is also an important rating consideration. EBITDA in the North America and in Europa, Africa & Asia's clusters have increased around 13% during 2016 and now account for 35% and 23% of the company's total EBITDA. Capex will be lower than 2016 as the company has completed its two new plants in Brazil and Bolivia. Nevertheless, FCF is projected to remain negative at around BRL230 million for 2017.

Leverage to Remain High; Expected Gradual Reduction by 2018

Over the last two years, VCSA's leverage rose mainly as a result of the severe economic recession in Brazil and ongoing expansion capex plan (BRL2.4 billion). Per Fitch's calculations, VCSA's net leverage rose to 5.4x for year-end 2016 from 4.8x in 2015 and 3.5x in 2014. Fitch projects net leverage to remain high in the range of 5.0x to 5.3x during 2017, only declining to below 4.0x in 2019. Fitch believes that VCSA has some ability to accelerate its deleveraging through the sale of non-core assets and other contingency plans that the company has in place. The ongoing financial support from VSA, through capital injection as observed during 2016 has also been incorporated into the ratings.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for the issuer include:

--Low single-digit consolidated volume decline in 2017 and low single-digit consolidated volume increases in 2018 and 2019;
--Brazil's volumes decline around 8% in 2017 with limited recovery in 2018;
--Consolidated EBITDA margin falling to 16%-17% during 2017 and moving towards 18%-20% during 2018;
--Capital expenditures around BRL1 billion in the next 3 years;
--Net leverage to remain high around at 5.0x to 5.3x in 2017, considering Fitch's methodology;
--Efforts to complete non-core assets sale or other contingency plans;
--Maintenance of strong liquidity position and proactive liability management strategies in order to avoid refinancing risks in the next two to three years.

RATING SENSITIVITIES

Considerations that could lead to a negative rating action on the rating or Outlook:

VCSA's Long-Term Foreign Currency ratings could be downgraded further if the macroeconomic conditions in Brazil result in cement volumes declining more than Fitch's expectations for 2017, resulting in pressure on credit metrics beyond a tolerable level. A return to through-the-cycle net leverage around 2.5x following the current economic contraction in Brazil and its investment cycle is expected from VCSA.

Considerations that could lead to a positive rating action in the rating or Outlook:

A rating upgrade is unlikely in the near future for VCSA given the deteriorating conditions in the company's key market, investments in growth capex, and weaker credit metrics. A revision of the Outlook to Stable could occur if VCSA is successful in limiting its free cash flow burn and takes additional extraordinary measures to reduce its level of gross debt.

LIQUIDITY

VCSA's liquidity is very strong and is a key ratings consideration. From 2012 to 2016, VCSA's cash and marketable securities were sufficient to cover short-term debt by an average of 2.6x. The company reported cash and marketable securities of BRL4.1billion as of Dec. 31, 2016 comparing favorably to short-term debt of BRL1.7billion, which includes BRL601 million of confirming payables obligation (risco sacado). VCSA's amortization schedule is manageable. Current cash on hand can repay debt maturities through 2021, as the company does not have significant debt concentration in the short- and medium-term. VCSA also has access to a USD700 million revolving credit facility that expires in 2020. Furthermore, VCSA has strong capital market access in both Brazil and abroad. The company has been proactive in managing its financial profile by maintaining a high cash balance in domestic and foreign currencies.

Fitch affirms the following ratings:

Votorantim Cimentos S.A

--Long-Term Foreign Currency IDR at 'BBB-';
--Long-Term Local Currency IDR at 'BBB-';
--National Scale Rating at 'AAA(bra)'.
--2021, 2022, and 2041 senior unsecured long-term notes at 'BBB-'.

St. Marys Cement Inc.
--2027 senior unsecured notes at 'BBB-'.

The Rating Outlook for the IDRs is Negative.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017) (https://www.fitchratings.com/site/re/895493)
National Scale Ratings Criteria (pub. 07 Mar 2017) (https://www.fitchratings.com/site/re/895106)
Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016) (https://www.fitchratings.com/site/re/886557)
Rating Non-Financial Corporates Above the Country Ceiling Rating Criteria (pub. 15 Feb 2017) (https://www.fitchratings.com/site/re/894126)

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Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

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