Fitch granted 'AA + (col)' and 'F1 + (col)' to the Cementos Argos Bond and Commercial Papers Issuance Program; Stable Outlook

Fitch Ratings granted the long and short-term ratings of 'AA + (col)' and 'F1 + (col)', respectively, to the Cementos Argos Bond and Commercial Papers Issuance Program. (Cementos Argos) for COP 1 billion. The Outlook is Stable.

The ratings of Cementos Argos reflect the company's suitable competitive position, and the geographical diversification of its operations, which has allowed it to mitigate the impact of economic cycles on the generation of operating cash flow (OCF). The ratings include the weakened liquidity and the company's high leverage, which is above what Fitch predicted in its latest revision, with a debt to an EBITDA ratio of 5 times at the closing of 2017. The result is mainly due to the slow dynamics of operations in Colombia and a lower than expected performance in the United States. The agency expects the company to grow in the short term to levels close to 4 times more in 2018 and 3.8 times in 2019, respectively. Backed by the strengthening of the internal generation and the culmination of the divestment strategy, in the times and terms foreseen. Fitch expects that the Bonds and Commercial Papers Issuance Program, subject to the aforementioned ratings of COP 1 billion, will not involve incremental debt.

KEY FACTORS OF THE RATINGS

Solid Competitive Position:
Cementos Argos holds the leading position in cement and concrete production in Colombia with a market share close to 44 percent. The growth strategy enabled Cementos Argos to position itself as one of the largest cement producers in Latin America, with production facilities in 14 countries and an installed capacity of 23 million tons of cement and 18 million cubic meters of concrete. In addition, it is the fourth cement producer in the United States and the second largest producer of concrete in that country. In part, the geographical diversification of the company helps to mitigate uncertainty in the generation of operating flows associated to the exposure of the cement industry to changing factors of demand and economic cycles.

Appropriate Operational Generation:
Fitch expects the generation of operating cash flow to improve mainly due to the favorable performance of the operations of the United States and Central America and the Caribbean (CAC), which represent an important part of the company's consolidated EBITDA and which has contributed to mitigating the lower performance of the operation in Colombia. During 2017, both regions represented approximately 73 percent of revenues and 75 percent of Cementos Argos' consolidated EBITDA (2016: 70 percent and 64 percent, respectively). On the other hand, operations in Colombia represented 27 percent of revenues and 25 percent of consolidated EBITDA during 2017 (2016: 30 percent and 36 percent, respectively). Fitch expects that by advancing on different infrastructure projects in Colombia, along with different operation efficiency initiatives, a gradual recovery of the EBITDA generation will be possible in this region at historical levels.

During 2017, the company recorded an EBITDA of COP1.5 trillion, which is equivalent to a margin of 17.1 percent (2016: COP1.6 trillion and 19.0 percent, respectively). Fitch expects organic EBITDA growth to continue in the coming years due to the consolidation of US assets and demand growth in that country. The rating agency anticipates that the company could generate positive free cash flow (FCF) as of 2018.

High Leverage:
The company's leverage has been pressured, both by the leveraged acquisition of assets in West Virginia at the end of 2016 for USD660 million, and by the low performance of the operations in Colombia. By the end of 2017, the consolidated financial debt reached COP7.3 billion, which with an EBITDA of COP1.5 billion resulted in a leverage measured as the ratio of Financial Debt to EBITDA plus 5 times Dividends, a level higher than that contemplated by Fitch in its latest revision. The agency expects the company to reduce its leverage to levels close to 4 times less by the end of the year, supported mainly by an improvement in the performance of its US and Colombian operations and the completion of the divestment plan in the times and terms planned. If a clear trend to deleveraging is not observed, Fitch could take a negative rating action.

RATINGS' DERIVATION SUMMARY

Cementos Argos is the only construction material company rated by Fitch on a national scale in Colombia. The company's risk is not linked to a particular market since its cash flow is distributed relatively evenly between the regions of Colombia, the United States and Central America and the Caribbean. Its geographical diversification compares favorably with companies in the engineering and construction sector, such as Odinsa S.A. (Odinsa) [AA- (col) Stable Outlook] and Construcciones El Condor S.A. (Condor) [AA- (col) Stable Outlook], whose operating generation or dividend flow is more exposed to the local market.

Although Cementos Argos' business profile allows it to differentiate its rating from those of Odinsa and Condor, its credit profile remains pressured by high leverage. The acquisition of Martinsburg's assets in the United States at the closing of 2016 and the lower performance of operations in Colombia have pushed leverage to 5 times levels at the closing of 2017, well above Fitch's expectations. If a de-leveraging trend is not observed in the short term, the ratings could be affected.

KEY ASSUMPTIONS

The key assumptions of Fitch in the base case of the issuer's ratings are:
- revenue growth and EBITDA supported by a better performance of the Colombian operation as of 2018;
- one and a half-digit growth in the United States and CAC;
- Average EBITDA margin of 18 percent;
- No new acquisitions are contemplated.

SENSITIVITY OF THE RATINGS

Although it is not contemplated in the short or medium term, a positive rating action could take place before a combination of the following factors:
- EBITDA margin above 20 percent in a sustained manner;
- sustained leverage level close to 2.5 times;
- maintenance of liquidity indicators (cash plus OCF among short-term debt) greater than 1.25 times;
- generation of positive FCF throughout the cycle.

A negative rating action could take place before a combination of the following factors:
- leverage levels above 4 times in a sustained manner;
- liquidity levels consistently below 1;
- EBITDA margin consistently below 10 percent;
- capital investments or acquisitions financed mainly with debt.

LIQUIDITY

The company's liquidity looks weak according to its short-term debt. As of December 2017, cash and cash equivalents plus operating cash flow covered 0.65 times short-term financial commitments, which is estimated at approximately COP2 trillion. In Fitch's opinion, the company has demonstrated access to the local banking and capital markets and makes its exposure to a possible refinancing risk low. Fitch considers that the culmination of the divestment plan taken on by the company in the foreseen times and terms will be key to return to liquidity metrics in line with historical levels. In addition, the company maintains unencumbered credit limits close to USD330 million and maintains a portfolio of shares in the corporate groups' related companies that could be divested and worth USD385 million.

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The ratings were requested by the issuer or on its behalf and, therefore, Fitch has received the corresponding fees for supplying its rating services.

Methodology applied on a nationwide level:
- Corporate Finance Rating Methodology (September 14, 2017);
- National Scale Qualification Methodology (March 27, 2017).

REGULATORY INFORMATION

ISSUER NAME or ADMINISTRATOR: Cementos Argos’ Ordinary Bonds and Commercial Papers Issuance Program for COP1 billion
NUMBER OF MINUTES: 5101
DATE OF THE COMMITTEE: April 30, 2018
PURPOSE OF THE MEETING: Initial Qualification
MEMBERS OF COMMITTEE: Natalia O'Byrne Cuellar (Chairman of the Committee) | Rafael Molina Garcia | Julian Ernesto Robayo Ramirez
The Technical Committee Members’ resumes can be found on the website:
https://www.fitchratings.com/site/dam/jcr:1b0dccce-4579-444a-95a4-571e22ec9c13/06-12-2017%20Lista % 20Comite%20Tecnico.pdf.

The credit risk rating of Fitch Ratings Colombia S.A. Securities Qualification Company is a professional opinion and at no time implies a recommendation to buy, sell or maintain a security, nor does it constitute a guarantee of compliance with the obligations of the qualified.

In the cases where applicable, for the assignment of this rating, Fitch Ratings considered the aspects referred to in article 4 of Decree 610 of 2002, in accordance with article 6 of the same Decree, now incorporated in articles 2.2. 2.2.2. and 2.2.2.2.4., respectively, of Decree 1068 of 2015.

DEFINITIONS OF THE NATIONAL SCALE QUALIFICATIONS

NATIONAL LONG-TERM CREDIT RATINGS:
AAA (col). The National Ratings 'AAA' indicate the highest rating assigned by Fitch in the national rating scale of that country. This rating is assigned to issuers or obligations with the lowest expectation of default risk in relation to all other issuers or obligations in that country.

AA (col). The National Ratings 'AA' denote expectations of very low default risk in relation to other issuers or obligations in the same country. The risk of default differs only slightly from that of issuers or obligations with the highest ratings in the country.

A (col). The 'A' National Ratings denote expectations of low default risk in relation to other issuers or obligations in that country. However, changes in circumstances or economic conditions may affect the ability to timely payment to a greater degree than it would in the case of financial commitments within a higher rating category.

BBB (col). The 'BBB' National Ratings indicate a moderate default risk in relation to other issuers or obligations in the same country. However, changes in circumstances or economic conditions are more likely to affect the ability to timely pay than in the case of financial commitments that are in a higher rating category.

BB (col). The National Ratings 'BB' indicate a high default risk in relation to other issuers or obligations in that country. Within the context of the country, the payment is to some extent uncertain and the ability to timely payment is more vulnerable to adverse economic changes over time.

B (col). The 'B' National Ratings indicate a significantly high default risk in relation to other issuers or obligations in that country. Financial commitments are being met but there is still a limited margin of safety and the ability to pay on a continuous basis is conditioned by a favorable and stable economic and business environment. In the case of individual obligations, this rating may indicate obligations in trouble or in default with a potential to obtain extremely high recoveries.

CCC (col). The 'CCC' National Ratings indicate that non-compliance is a real possibility. The ability to meet financial commitments depends exclusively on favorable and stable economic and business conditions.

CC (col). The 'CC' National Ratings indicate that non-compliance of some kind seems likely.

C (col). National 'C' Ratings indicate that the default of an issuer is imminent.

RD (col). The 'RD' National Ratings indicate that in the opinion of Fitch Ratings the issuer has experienced a "restricted breach" or an unpaid breach of payment of a bond, loan or other material financial obligation, even though the entity is not subject to procedures of bankruptcy, administrative, liquidation or other formal dissolution processes, and has not ceased in any other way its business activities.

D (col). National 'D' Qualifications indicate a non-compliant issuer or instrument.

E (col). Description: Suspended rating. Obligations that, before repeated requests of the qualifier, do not present appropriate information.

Note: Modifiers "+" or "-" can be added to a rating to denote the relative position within a specific rating category. These suffixes are not added to the 'AAA' category, or to categories below 'CCC'.

NATIONAL SHORT-TERM CREDIT RATINGS:

F1 (col). The 'F1' National Ratings indicate the strongest capacity for timely payment of financial commitments in relation to other issuers or obligations in that country. In the National Rating Scale of Fitch, this rating is assigned to the lowest default risk in relation to others in that country. When the liquidity profile is particularly strong, a "+" is added to the granted rating.

F2 (col). The National Ratings 'F2' indicate a good capacity for timely payment of financial commitments in relation to other issuers or obligations in that country. However, the margin of safety is not as great as in the case of the highest ratings.

F3 (col). The National Ratings 'F3' indicate an adequate capacity for timely payment of financial commitments in relation to other issuers or obligations in that country. However, this is more susceptible to adverse changes in the short term than that of financial commitments in the higher rating categories.

B (col). National Ratings 'B' indicate an uncertain ability to timely pay financial commitments in relation to other issuers or obligations in that country. This capacity is highly susceptible to adverse changes in short-term financial and economic conditions.

OUTLOOK AND OBSERVATIONS OF THE RATING:

OUTLOOK. It indicates the direction a qualification could possibly move within a period of one and two years. It also reflects trends that have not yet reached the level that would drive the change in rating, but could do so if they continue. These can be: "Positive"; "Stable"; or "Negative."

Most Outlooks are generally Stable. Ratings with Positive or Negative Outlook are not necessarily going to be modified.

OBSERVATIONS. These indicate that there is a greater likelihood that a rating will change and the possible direction of such a change. These are designated as "Positive", indicating a potential improvement, "Negative", for a low potential, or "In Evolution", if the rating can go up, down or be confirmed.

An Observation is typically driven by an event, so it is usually resolved in a short period of time. This event can be anticipated or have occurred, but in both cases the exact implications on the rating are undetermined. The observation period is typically used to gather more information and / or use information for further analysis.