Fitch Rtgs: Political Mayhem Raises Uncertainty for Peruvian Corporates

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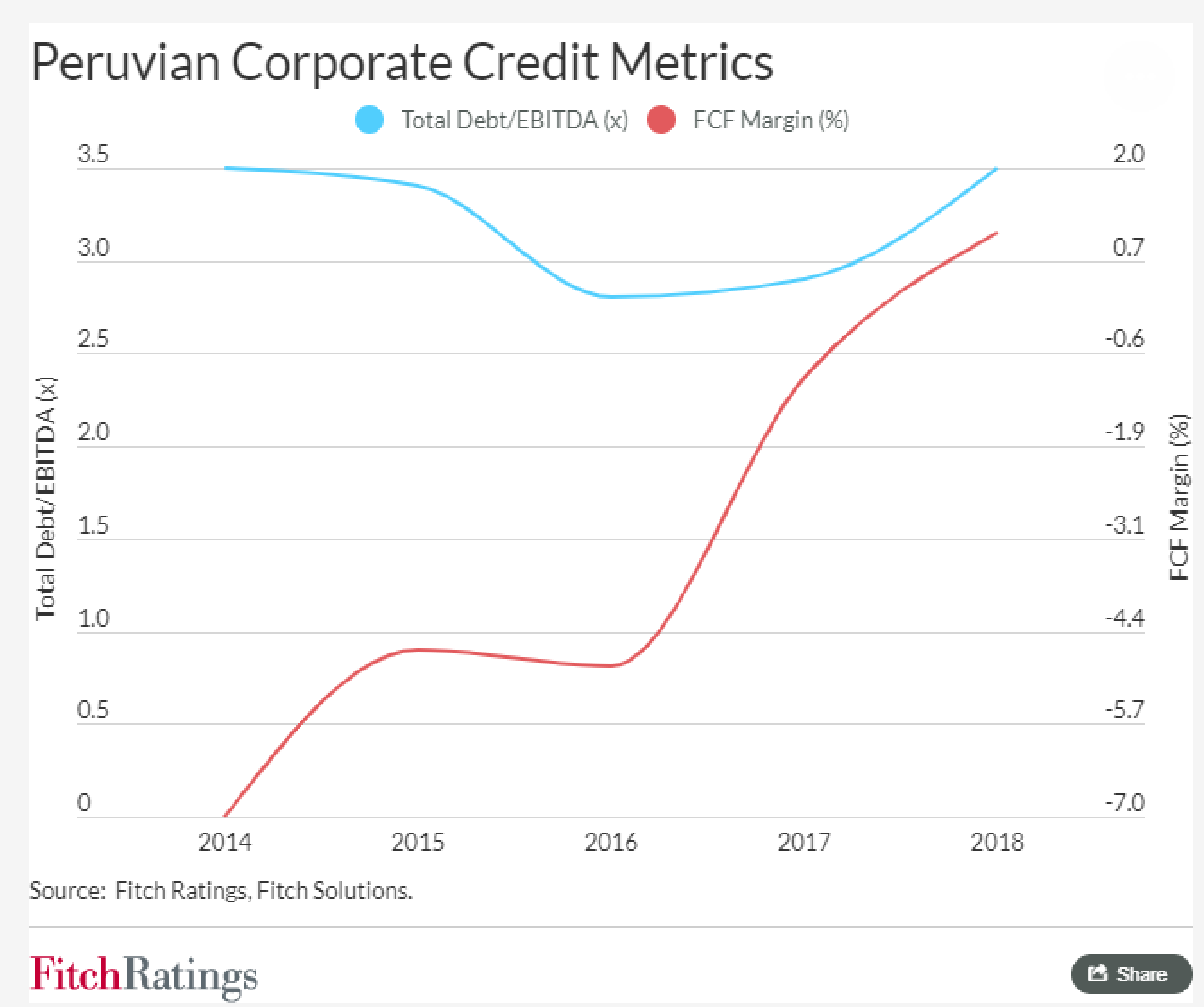
Fitch Ratings-Chicago-02 October 2019: Rising political risk in Peru is increasing uncertainty for Peruvian corporates but near-term credit implications should be broadly limited due to relatively strong balance sheets and improved FCF, says Fitch Ratings. Sector level effects, however, will be mixed. Miners are benefiting from a weaker currency caused by the situation but are expected to continue to face obstacles in obtaining permits and starting new projects. Electricity generators' cash flow generation will be somewhat insulated due to long-term purchase power agreements (PPAs) but weaker growth would perpetuate oversupply of energy and continue pressuring spot prices. Consumer companies would also be hurt by uncertainty that results in a pullback in personal spending.

The dissolution of Peru's legislature, enabled by a vote of confidence provision in the country's constitution, by President Vizcarra earlier this week pushed Peru into a political crisis. Congress responded to Vizcarra's action by suspending him and installing an acting president who subsequently resigned. The crisis is a byproduct of Congress' resistance to Vizcarra's efforts to end corruption through multiple reform measures.

Proposed legislation, including laws related to mining and hydrocarbons, will likely be delayed, presenting a challenge for certain sectors and further slowing overall business investment across the country. Many companies already reduced capex over the past several years due in part to political paralysis, the fallout from the bribery scandal involving the Odebrecht construction company, and difficulty in obtaining environmental permits and operating licenses.

More conservative capital allocation and balance sheet management should improve Peruvian corporates' ability to manage through the uncertainty, as financial flexibility has been enhanced. Leverage for Fitch's universe of 21 Peruvian issuers remained relatively flat over the past several years with median total debt/EBITDA closing 2018 at 3.5x. Moreover, FCF gravitated toward being positive for the majority of these companies due to the sharp reduction in investments. Median FCF margin improved to 1.1% in 2018 from negative 7% in 2014.



Recent downward pressure on the Peruvian Sol should lower the production costs of copper and zinc producers, which have faced a challenging price environment in 2019, due to weak global growth and increasing supply. Southern Copper, Compania de Minas Buenaventura, and Nexa are shielded from the pressure due to their strong balance sheets, diversified assets and low production costs. Minsur and Volcan both have 'BBB-' ratings with a Negative Rating Outlook. Minsur's capital structure is being pressured by its Mina Justa expansion project, while Volcan is seeking to improve its capital structure through asset sales or other extraordinary measures.

Electricity sector revenue should be somewhat insulated by rising political risk due to long-term PPAs, Kallipa Generacion and Orazul Energy have stable and predictable cash flow supported by strong to adequate contractual positions, competitive cost structures and diversified portfolios of complementary generation assets. Fenix Power has an adequate contractual position but has deteriorating cash flow generation and significantly higher leverage. The company's controlling shareholder is providing credit support due to Fenix's already weak operating performance.

Revenue generation for the consumer sector could suffer from the effects of political instability but companies with leading market positions, strong FCF and/or low leverage, including Corporacion Lindley and Alicorp, should outperform peers. Corporacion Lindley has solid market position in beverages and good geographic diversification. The company's credit quality also improved over the past several years due to significant deleveraging. Alicorp is less geographically diversified and higher levered due to a recent acquisition but has a diversified portfolio of leading brands across the food, personal care and home care categories and generates strong FCF.

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