

Research Update:

Controladora Mabe, S.A. de C.V. 'BBB-' Ratings Affirmed, Outlook Remains Stable

March 24, 2020

Rating Action Overview

- Mexico-based home appliance company Controladora Mabe S.A.B. de C.V. (Mabe) has been posting better-than-expected results in the past 18 months, which helped improve the company's key credit metrics and liquidity.
- A stronger financial risk profile puts Mabe in a comfortable position to cope with the COVID-19 crisis, and we expect credit metrics to remain resilient even under a hypothetical downside scenario of a pronounced top-line contraction.
- On March 24, 2020, S&P Global Ratings affirmed its long-term 'BBB-' global scale issuer credit rating on Mabe. At the same time, we affirmed our 'BBB-' issue-level rating on Mabe's \$370 million senior unsecured notes due 2028.
- The stable outlook on Mabe reflects our expectations that it will be able to protect its key credit from supply chain interruptions and demand risks metrics in the next 12 months. We expect Mabe to maintain debt to EBITDA at about 2.0x and funds from operations (FFO) to debt close to 45%.

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Rating Action Rationale

Mabe's financial performance has exceeded our expectations. In the past 18 months, Mabe continued to deliver strong financial results thanks to favorable demand in North America and a resilient performance in Mexico. In addition, the company maintained a disciplined financial policy that enabled a sustained leverage reduction to unprecedented levels, while also increasing liquidity. For the 12 months ended Dec. 31, 2019, Mabe lowered its debt-to-EBITDA ratio to 1.8x, an important milestone for the company, given that the ratio remained at about 3.0x for many years.

The improvement in Mabe's key credit metrics led us to revise our assessment of its financial risk profile to intermediate from significant, given that we now expect the company to maintain the leverage metric below 3.0x and FFO to debt above 30% despite risks related to the COVID-19 crisis.

An extended debt maturity profile and low capital investment requirements will protect Mabe's liquidity. We now assess Mabe's liquidity as strong because we expect sources of cash to exceed uses by more than 1.5x during the next 12 months and by more than 1.0x in a 24-month time horizon. This is mainly due to relatively low annual debt maturities in the next couple of years. In addition, in recent years, the company implemented a substantial capital expenditures (capex) plan for capacity expansions and technological enhancements, which will reduce the investment requirements in the short run.

Our expectations for EBITDA margins close to 10%, as well as stringent working capital management will contribute to operating cash flow stability that would further enhance Mabe's cash balance.

A stronger financial risk profile will help cushion Mabe from the pandemic virus effects. For 2020, Mabe's top-line growth may slip due to heightened recession risks across its key markets, stemming from the COVID-19 crisis and its pernicious effect on household income and demand for durable goods. Even under a hypothetical scenario where the company suffers from a double-digit decline in EBITDA, we expect Mabe to comfortably maintain credit metrics consistent with its investment-grade rating.

The company may be exposed to supply chain risks, and to some extent, to exchange-rate volatility. However, Mabe's strategy to maintain a fragmented supplier base, coupled with its inventory policy of ensuring high stocks of parts and replacements for manufacturing purposes, mitigate operating risks. In addition, Mabe recently accelerated production activities and increased inventories of finished goods, in preparation for the potential shutdown of its facilities due to coronavirus.

Mabe's foreign exchange risk is largely contained by the natural hedge given that its North American business generates more than 50% of consolidated EBITDA. In addition, Mabe generally hedges some of its foreign currency exposure to raw materials and financial commitments, to support the predictability of its cash flows.

Outlook

The stable outlook on Mabe reflects our expectations that it will be able to protect its key credit metrics amid the looming disruptions in supply chain and demand risks in the next 12 months. We expect Mabe to maintain debt to EBITDA at about 2.0x and FFO to debt close to 45%, despite the seasonality of cash flows and the risks of the economic slowdown across the company's key markets.

Downside scenario

We could lower the ratings on Mabe in the next 12 months if its leverage and cash flow targets deviate from our assumptions, with FFO to debt consistently below 30% or debt to EBITDA above 3x. Under such a scenario, cash flow wouldn't meet our expectations due to deeper-than-expected deterioration of business conditions in key markets that would crimp revenue and profitability, or if the company adopts a more aggressive growth strategy that requires additional debt.

Upside scenario

Although unlikely in the next year, an upgrade would follow a major business transformation that drastically expands Mabe's scale and further strengthens its competitive position relative to other global players in the home appliance industry, resulting in an improvement of the company's business risk profile. In addition, an upgrade would follow a strengthening of Mabe's financial risk profile, resulting in FFO to net debt consistently above 45% and net debt to EBITDA below 1.5x.

Company Description

Mabe is a Mexican manufacturer and distributor of home appliances, including refrigerators, ranges, dryers, washing machines, built-in ovens and hoods, water coolers, dishwashers, microwave ovens, and related parts and components. The company is 51.6% owned by Mexican shareholders and 48.4% by the Haier Group.

Our Base-Case Scenario

- In 2020 we expect flat GDP growth in the U.S. and a low single-digit contraction in Mexico due to coronavirus. The economic slowdown would be followed by a low single-digit GDP recovery in 2021 and 2022 across both markets.
- The spread of COVID-19 and its negative macroeconomic effects would reduce household income and spending trends for consumer durable goods.
- Mabe should still be able to maintain price increases in line with inflation, underpinned by its brand equity and leadership in the local market. This should support EBITDA margins between 9.5% and 10%.
- Capex in the \$100 million - \$115 million range for 2020, and about \$120 million in 2021, mainly to support the automation of plants, improve cost efficiencies, and for research and development activities.
- Annual dividend payments of \$24 million.
- No incremental net debt in 2020.

Based on these assumptions, we arrive at the following credit measures for 2020 and 2021:

- EBITDA margins between 9% and 10%;
- FFO to debt of 42% and 53%, respectively;
- Debt to EBITDA of 1.8x and 1.4x, respectively; and
- FOCF to debt of about 20%.

Liquidity

We assess Mabe's liquidity as strong, given that we expect its sources of cash will exceed uses by more than 1.5x during the next 12 months and 1.0x over the following 12 months, and that this ratio will remain above 1.0x even if EBITDA falls 30%. Our liquidity analysis also incorporates our view that the company has the capacity to withstand high-impact, low-probability events, its

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sound relationship with banks, good standing in the international debt markets, and an overall prudent financial risk management.

Principal Liquidity Sources:

- Cash of \$247 million as of December 2019; and
- FFO of about \$265 million for the next 12 months.

Principal Liquidity Uses:

- Debt maturities of \$38 million, as of December 2019, for the next 12 months;
- Working capital needs of about \$70 million for the next 12 months, including intra-year requirements;
- Capex of about \$115 million for the next 12 months, given the flexibility curb certain investments if needed; and
- Dividend payments of \$24 million in 2020.

Covenants

Under its credit agreements, Mabe faces financial covenants requiring an EBITDA net interest coverage above 2.5x and net debt to EBITDA below 3.5x. We believe the headroom for covenants is ample and could withstand a drop in EBITDA of more than 30%.

Environmental, Social, And Governance

We believe that environmental and social risks are relatively modest for Mabe from a credit standpoint. Still, given the nature of its products, the company is exposed to environmental risks because it could contribute to hazardous and non-hazardous solid waste generation and energy use. Refrigerators, for instance, can release harmful chemicals when disposed, so there's growing importance around solid waste management and materials recovery. In addition, energy-using durables such as kitchen appliances are one of the fastest-growing sources of residential energy use. As a result, Mabe constantly allocates efforts to add sustainable features to its products in order to reduce environmental impact. Specifically, the company launched a series of initiatives to reduce its carbon footprint and change refrigeration technologies. At this point, we don't see material environmental risks for Mabe that could compromise its operations or its financial position.

We believe social factors also frame Mabe's operations, specifically, in terms of safety management, where defective products could affect its brand reputation and profitability. Mabe faced a significant product recall that weakened its key credit metrics for most of 2018. However, a timely response to this issue allowed Mabe to control reputational risks and contain the negative implications for its financial risk profile. Finally, we assess Mabe's management and governance as fair, reflecting management's expertise in the industry and prudent strategy towards sustained growth.

Issue Ratings - Subordination Risk Analysis

We believe it's unlikely that any lenders would be significantly disadvantaged relative to others, given Mabe's low leverage and intermediate financial risk profile, as well as because most of its debt is at the holding company level.

Capital structure

As of Dec. 31, 2019, Mabe's capital structure mainly consisted of \$370 million rated senior unsecured notes due 2028, a private placement for \$175 million due 2026, and a \$120 million amortizing club deal due 2024.

Analytical conclusions

Based on the existing debt structure, we rate Mabe's 2028 senior unsecured notes 'BBB-', at the same level as the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating:

- Global Scale: BBB-/Stable/--

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Consumer Durables Industry, Dec. 12, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Controladora Mabe, S.A. de C.V.

Issuer Credit Rating BBB-/Stable/--

Controladora Mabe, S.A. de C.V.

Senior Unsecured BBB-

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