Industry Top Trends Update

Building Materials

Cost inflation weakens margins and reduces rating cushion

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What's changed?

There are significant indirect effects from the Russia-Ukraine war. The conflict and the related governments' responses have further intensified the inflationary and highly volatile cost environment. So far, most companies have passed through these costs to clients, though with some lag, reflecting resilient-if-slowing demand. Nevertheless, we expect 2022-2023 margins to be well below 2021 levels.

Energy costs have risen further, Already-significant cost inflation in 2021 has been amplified, notably for power, oil, and natural gas. The latter, a key energy source in some subsegments, display a spot price of about 6x higher than in the same period in 2021.

The outlook bias has turned negative. Following negative rating actions since March 2022, 20% of the portfolio has a negative outlook, compared with 7% at Jan. 1, 2022. All negative outlooks relate to speculative-grade companies.

What to look out for?

The energy supply could be interrupted. The risk of a natural gas shortage in Europe has escalated since June, following Gazprom's decision to cut supply to several countries. A lack of gas in the sector would likely force some companies to stop production. This might translate into negative rating actions for less diversified companies, or where available rating headroom is limited.

Carbon dioxide (CO2) reduction is still a priority. Companies' plans to reduce CO2 emissions are irreversible, protecting business models ahead of significant carbon cost increases. The Carbon Border Adjustment Mechanism the EU Parliament voted on in June is even more ambitious than the initial plan from July 2021.

Refinancing risk is limited for now. Most private-equity-owned companies refinanced their capital structure in 2019-2021. Nevertheless, new funding at much higher rates will likely add pressure to free operating cash flow.

What if there's a recession?

Weakened demand will further constrain profitability. We anticipate that average volume growth in 2022 will still be positive, at about 1.5%. A recession in 2023 likely means zero or negative volume growth as households will likely postpone their spending. This will limit companies' abilities to pass through inflation costs to clients, adding significant pressure to margins and cash flow.

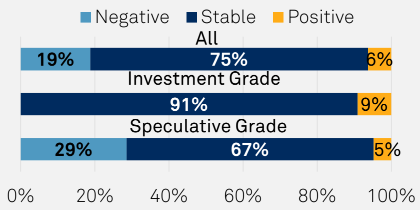
Negative rating actions will largely center in the speculative-grade category. We anticipate that those companies less diversified by geography and with high leverage will suffer the most. Negative rating actions could exceed those during the pandemic due to pressure from both demand decline and high inflation.

Financial policy will be key in preserving investment-grade ratings. If companies do not moderate their shareholder remuneration, rating headroom built in 2021 will quicky disappear, which could further stress the ratings.

Latest Related Research

– [Credit FAQ: How The Russia-Ukraine Conflict Affects European Building Materials Companies,] March 29, 2022

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	21	32
Downgrades	0	1	1
Upgrades	1	0	1

Ratings data as of end-June 2022. * Year-to-date

Ratings Outlook Net Bias