FitchRatings

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Fitch Assigns 'B-' to Samarco's IDR; Outlook Stable

Fitch Ratings - New York - 16 Feb 2024: Fitch Ratings has assigned Samarco Mineracao S.A. em Recuperação Judicial's (Samarco) Long-Term Foreign and Local Currency Issuer Default Ratings of 'B-' and a Long-Term National Scale rating of 'BB(bra)'. Fitch has also assigned a 'B-'/'RR4' to Samarco's senior unsecured notes due 2031. The Rating Outlook is Stable.

Samarco's ratings reflect the company's post restructuring credit profile, with still high leverage levels, limited financial flexibility and execution risks related to the ramp up of its operations. The analysis also incorporates that the financial and legal strain coming from the 2015 Mariana dam incident is currently mitigated by the USD1 billion cap to Samarco, as per the restructuring plan these risks were transferred to the shareholders.

The end of the judicial reorganization (JR) process offers a path towards operational and financial recovery, including ability to defer interest payments. FCF generation after capex is expected to be constrained until Samarco completes its ramp-up phases and gross EBITDA leverage metrics are expected to average 5.6x between 2023 and 2025 and trend below 3.0x when full capacity is achieved in 2028. Samarco's business profile is boosted by its low-cost profile and long life in reserves iron ore pellets operations.

Key Rating Drivers

Conclusion of Debt Restructuring: The senior notes exchange resulting from the JR process, Brazil's bankruptcy protection, reflects a 25% debt haircut and aims to support operational resumption, and to sustain environmental remediation priorities. Samarco's total debt has been restructured to USD7.7 billion from USD11.4 billion, including both indebtedness with shareholders and with third parties. The subordinated debt with shareholder (USD3.85billion) has no cash or PIK interest requirements, no event of default and matures after senior debt; hence, it is treated as non-debt for rating purposes. Fitch deems the structure of the new notes, including PIK payments, to be aligned with Samarco's operational ramp-up and cash flow generation.

Renova Repayments Risks: The USD5.3 billion remaining obligations under the Term of Transaction and Adjustment of Conduct (TTAC) that established the Renova Foundation are expected to be concentrated mainly in the next three years. Notably, the JR established a USD1 billion total cap from 2024 to 2030 with yearly limits of Renova related expenses to be paid by Samarco after meeting its business-related cash outlays. There are no minimum obligation requirements for Samarco. The remaining balance would be equally shared between shareholders Vale S.A. (BBB/Stable) and BHP (A/Stable).

Remaining Legal Contingencies: Some judicial and administrative proceedings related to environmental, civil, and labor issues, remain besides the TTAC. Samarco is still negotiating a final integral reparations agreement, similar to the one Vale signed regarding Brumadinho. Additional remediation payments would be subject to the JR defined USD1 billion cap and shareholder funding for the amount not covered. Nonetheless, preemptive measures, such as compulsory court deposits and account freezing could prove disruptive if shareholder support wavers.

Ramp-Up Underway: Samarco plans to resume its full capacity of 30 million tons of iron ore pellets in 2028 (phase 3) from 18 million in 2025 (phase 2) and 9 million in 2023 (phase 1). The construction of a sandy tailings filtering plant and improvements in the concentrators are needed. Dry tailings piling will be used without the operation of upstream dams, while heightening attention to the safety of geotechnical structures and to the de-characterization of the Germano mining pit and dam will continue. Investments required amount to USD2 billion over the next five years, more than half of which will be spent in 2026 and 2027. Staged developments are considered to help de-risk ramp-up.

Track Record of Robust Business Position: Samarco is working to return to be a low cost, long lived, significant pellet producer. When full capacity is achieved by 2028, Samarco would be the second or third world's largest pellet exporter, amid Vale and LKAB, according to metals consultancy CRU. CRU also locates Samarco in the first quartile of iron ore seaborne business costs. This advantage is underpinned by its integrated operations and low-cost slurry pipelines for iron ore transportation. Operations resumed in December 2020 after a five-year suspension, and currently is at 30% capacity prior to the Fundao dam failure.

Strained FCF Generation: Samarco's EBITDA is expected to be about USD725 million (BRL3.61 billion) in 2023 and USD628 million (BRL3.18 billion) in 2024. These figures assume iron ore prices average about USD95 per ton, with pellet premia of USD34 per ton in 2024, minimal working capital needs and capital expenditures increasing to USD456 million (BRL2.30 billion) from USD292 million (BRL1.50 billion) in 2023, to develop its phase 2 expansion increase. FCF margin is forecast to average 4% in 2023 and 2024.

Deleveraging capacity: Average gross debt between 2023 and 2025 is forecast to be USD4.25 billion (BRL21.2 billion). This comprises the JR's resulting senior (USD4.19 billion) and additional PIK accumulation. Despite no dividend distributions, the intense investment period and remediation outflows limit cash build up. Consequently, corresponding gross and net leverage ratios average 5.6x through 2025. When full capacity is resumed after 2028 leverage metrics are expected to trend below 3.0x when excess cash sweep mechanisms may be used.

Derivation Summary

Samarco's (B-/Stable) pellet production business profile is similar to that of Ferrexpo (CCC+/Stable), CAP (BBB-/Negative), and Vale (BBB/Stable).

Ukrainian based Ferrexpo production of 4.9 million tons of iron ore pellets has been affected by heightened operating risk since Ukraine's military invasion by Russia, including severe logistical constraints and reduced utilization levels from its 12 million tons capacity. It is funded at least over one year by cash flow generation from limited but ongoing export sales. Ferrexpo lacks material financial debt.

Chilean based CAP has the capacity produce about 4 million tons of iron ore pellets but also sells high grade iron ore pellet and sinter feed in the amount of 12.5 million tons. Its less favorable third quartile cost position and weaker steel making business is partially offset by its long reserve life and relatively low net leverage at 1.7x.

Vale is the leading low-cost iron ore producer globally, and one of the top three global mining companies. Vale is highly concentrated in iron ore and pellets (about 90% of EBITDA), but also has significant contribution from copper, nickel and other minerals. Similar to Samarco, of which it holds a 50% stake, Vale faces a more challenging operating environment in Brazil (BB/Stable), characterized by increased scrutiny of mining companies linked to governance of operating practices following the Mariana and Brumadinho dam disasters. Vale's expected EBITDA gross leverage is below 1.0x and EBITDA net leverage below 0.6x over the medium term.

Key Assumptions

--Total iron ore pellet, pellet feed and pellet screening sales volumes of around 9.2 million tons in 2023, 10.9 million in 2024 and 16.1 million tons in 2025.

--Iron ore pellet premium average USD38.6 per ton between 2023 and 2025.

--Benchmark 62% iron ore prices average USD118/ton in 2023, USD95/ton in 2024, USD80/ton in 2025;

--Capex of USD292 million in 2023, USD456 million in 2024 and USD469 million in 2025;

--No dividend distributions;

--Foreign exchange BRL/USD Rates of 4.96 in 2023, 5.05 in 2024, and 5.15 in 2025.

Recovery Analysis

The recovery analysis assumes Samarco would be reorganized as a going-concern in bankruptcy rather than liquidated. We assumed a 10% administrative claim. Samarco's going-concern EBITDA assumption is based on iron ore at USD118/ton in 2023, USD95/ton in 2024, and USD80/ton in 2025. The going-concern EBITDA estimate reflects Fitch's view of a sustainable, post-reorganization EBITDA level upon which we base the enterprise valuation in a low iron ore price environment.

An enterprise valuation multiple of 5x EBITDA is applied to the going-concern EBITDA to calculate a post-reorganization enterprise value (EV). The choice of this multiple considered the following factors: the historical bankruptcy case study exit multiples for peer companies were 4.0x-6.0x.

Fitch applies a waterfall analysis to the post-default EV based on the relative claims of the debt in the capital structure. The debt waterfall assumptions consider the company's total debt. These assumptions result in a recovery rate for the unsecured debt within the 'RR2' range, but due to the soft cap of Brazil at 'RR4', Samarco's senior secured are rated at 'B-'/'RR4'.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--An upgrade is unlikely until significant progress, at least 50%, on ramp-up of operations is achieved;

--Significant progress in dam decommissioning;

--Consistent net debt/EBITDA ratio moving below 4.0x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Significant delays in increasing production;

--Indications of weaker shareholder commitment to meet remediation payments when Samarco's cash flow is insufficient;

--Additional legal remediation charges stemming from unfavorable litigation outcomes, after the cap ends in 2030;

--Net debt/EBITDA above 6.0x on a sustained basis.

Liquidity and Debt Structure

Debt Restructuring: Samarco ended Sept. 30, 2023 with BRL 1.1 billion of cash and marketable securities.

As a result of the JR, total debt has been restructured to USD7.7 billion from USD11.4 billion. USD3.6 billion of new notes due in 2031 were exchanged for the past non-performing indebtedness of USD4.9 billion in December, 2023. There also remain about USD27 million of out of court debt, and USD17.7 million of BRL denominated debentures. The unsecured debt has Payment-In-Kind features that decrease significantly in 2026 and end by 2028.

In addition, some USD3.85 billion, which correspond to indebtedness with shareholders, will be converted into a subordinated instrument, with no cash or PIK interest obligation and a 2036 maturity. As part of the JR, Samarco is subject to capped expenses in the remediation obligation payments of up to USD1 billion with stated yearly limits after Samarco's operations needs are fulfilled. Potential debt redemption can ensue after yearly caps requirements are met.

Issuer Profile

Samarco Mineracao is a leading iron ore pellet producer from Minas Gerais and Espirito Santo, Brazil. It resumed operations in 2020 after a tailings dam incident disrupted operations for five years and sent the company into bankruptcy protection.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Samarco Mineracao S.A. has an ESG Relevance Score of '4' for Employee Wellbeing due to the remaining work required to improve dam monitoring and upstream dams' de-characterization. Dry tailings piling will be used without the operation of dams, while heightening attention to the safety of geotechnical structures and to the de-characterization of the Germano mining pit and dam will continue along with the capacity utilization resumption efforts under way. This has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Samarco Mineracao S.A. em Recuperacao Judicial	LT IDR	B-	New Rating		WD
	LC LT IDR	B-	New Rating		WD
	Natl LT	BB(bra)	New Rating		WD(bra)
• senior unsecured	LT	B-	New Rating	RR4	

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.03 Nov 2023) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.13 Oct 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.03 Nov 2023)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

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Solicitation Status

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