



RATING ACTION COMMENTARY

Fitch Affirms FS's IDRs at 'BB-'; Upgrades National Scale Rating to 'AA-(bra)'

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Fitch Ratings - São Paulo - 18 Oct 2021: Fitch Ratings has affirmed FS Agrisolutions Industria de Biocombustíveis Ltda's (FS) Long-Term Local and Foreign Currency Issuer Default Ratings (IDR) at 'BB-'. Fitch has also affirmed at 'BB-' the senior secured notes issued by fully-owned FS Luxembourg S.a.r.l and irrevocably and unconditionally guaranteed by FS. In addition, Fitch has upgraded FS's Long-Term National Scale rating to 'AA-(bra)' from 'A+(bra)'. The Rating Outlook for the corporate ratings is Stable.

The ratings incorporate FS's adequate business model and low cash costs in the volatile Brazilian ethanol industry. The high volatility of Brazil's corn and ethanol prices and the lack of meaningful short-term price correlation between these two commodities are key considerations. The upgrade of the National Scale rating incorporates the strengthening of FS's credit profile within the 'BB-' rating category relative to companies with lower National Scale ratings. The upgrade reflects stronger than anticipated cash flow generation and expectation of low leverage during the investment cycle over the next two years.

KEY RATING DRIVERS

High Price Volatility: FS is exposed to price volatility from both raw material and product price perspectives. Spot corn prices adjust rapidly to supply and demand imbalances and follow parity with Chicago Board of Trade (CBOT) corn prices over the long run. The short-term correlation between corn and ethanol prices in Brazil is weak, as Brazilian ethanol prices depend largely on local gasoline price levels, which move in

tandem with international oil prices and the Brazilian FX rate. Ethanol prices are also indirectly influenced by sugar prices, as near 90% of all Brazilian ethanol produced comes from sugar cane processors, which typically shift a portion of production between ethanol and sugar depending on prevailing price parity with sugar.

Positive Price Backdrop: Brazilian ethanol producers should continue to benefit from elevated domestic prices. The ethanol market in 2021 will remain tight, as sugar cane crushed volumes fall and historically high sugar prices reduce the availability of ethanol in the market. The combination of high oil prices and a depreciated local currency in a tight market will keep ethanol prices at elevated levels in 2021. Fitch raised its 2021 projections for average Brent prices to USD63/bbl from USD58/bbl and to USD55/bbl from USD53/bbl in 2022. Hydrous ethanol prices at the mill in Sao Paulo are currently trading at BRL3.43/liter, which is 68% higher than early 2021 and 70% above the same period of 2020. Corn prices in Brazil are currently at historical highs, but are expected to decline in 2022 following an expected reduction in international levels and a recovery in Brazilian output. Fitch projects international corn prices of USD500 cents/bushell in 2022 and USD470 cents/bushell in 2023, from high USD548 cents/bushell in 2021.

Improved Operating Cash Flows: FS's EBITDA generation should improve over the rating period, as scale gains follow the conclusion of expansionary investments. The company finished the expansion at the Sorriso plant in early 2021 and will add another 500 million liters of ethanol once the investment in a new plant in Primavera do Leste, Mato Grosso State, become operational in fiscal 2024. FS is expected to generate EBITDA and CFFO of BRL2.4 billion and BRL1.5 billion, respectively, in fiscal 2022, comparing favorably with EBITDA of BRL1 billion and breakeven CFFO in fiscal 2021. Higher sales volume will offset most of the expected decline in ethanol prices in fiscal 2023 and contribute with EBITDA and CFFO of BRL1.9 billion and BRL1.3 billion, respectively.

FS is expected to generate negative FCF of BRL145 million in fiscal 2022 and near BRL501 million in fiscal 2023, as investments in the new plant accelerate. Base case projection incorporates total investments of BRL850 million in fiscal 2022 and BRL1.6 billion in fiscal 2023. The company is expected to generate meaningful FCF as from fiscal 2024 as expansionary investments are concluded. FS's flexibility to reduce dividends is more limited than peers. The company should distribute with dividends of BRL780 million in fiscal 2022 due to strong results and BRL235 million in fiscal 2023.

Adequate Business Model: FS's business model benefits from its sizable 1.4 billion liters of corn ethanol production capacity. The company's cash cost structure is in line with some of the most efficient sugar cane producers. FS's efficient operational performance is able to deliver a yield of 430 liters of ethanol per ton of processed corn. FS produces and sells corn co-products used in animal nutrition whose prices tend to correlate with

corn prices, helping to reduce the inherent price volatility. Fitch expects that revenues from animal nutrition products will provide the company with a satisfactory 44% coverage over corn costs in the long term. In fiscal 2021, coverage was at 51% comparing favorably with 38% in fiscal 2020. The company's location in the State of Mato Grosso, Brazil's largest corn producing state with the lowest cash cost in the world, reduces its logistics costs and attenuates corn origination risks.

FS's large storage capacity enables the company to purchase corn up to two years ahead of the beginning of the crop season, thus avoiding short-term volatilities of spot corn prices. The long-term purchase agreements with corn suppliers are fixed on a BRL per bag price basis and referenced to CBOT corn prices in BRL when the agreements are closed. These agreements significantly reduce the company's exposure to short-term price volatility. The company already hedged 100% of all of its expected corn needs for 2021/2022 at average price of BRL50.97/bag and 40% for the corn needed for the 2022/2023 season at BRL46.15/bag, which mitigates the impact of a 90% increase in average spot corn prices in Mato Grosso seen in 2021 compared to 2020.

Satisfactory Leverage During Investments: Fitch expects that FS will keep net leverage at satisfactory levels during its new investment cycle. FS's net debt/EBITDA will peak at 1.9x in fiscal 2023 before decreasing to below 1.0x in fiscal 2024, as higher volumes from investments in Primavera do Leste/MT kick in. FS's net leverage for fiscal 2022 is expected at 1.3x, comparing favorably with 2.6x in fiscal 2021. The company reported total debt of BRL3.3 billion as of June 30 2021, net of FX derivatives and the total return swap (TRS) balance, of which the 2025 notes and working capital lines in BRL accounted for 90% and 10%, respectively.

DERIVATION SUMMARY

FS operates in a volatile industry and is more exposed to commodity price risk compared with sugar cane processors, which rely on a market pricing mechanism that links sugar cane costs to commodity prices. However, this is partly mitigated by FS's large storage capacity and well-established commercial policies with corn grain producers, which enhance corn price stability. The natural hedge provided by animal nutrition products and typically small investments necessary to run the business place FS's cash flow generating capacity in an advantaged position compared to sugar cane processors. While the absence of sugar sales makes the company more exposed to ethanol prices in Brazil, the use of corn as the main raw production material translates into a much less capital-intensive production process in comparison with sugar cane processors.

FS is a low-cost producer with capacity to produce ethanol with cash cost comparable with Jalles Machado (A+[bra]/Positive) and Adecoagro (not rated), a cost benchmark in

the industry. While still concentrated in one region, FS's ratings incorporate an expected high capacity to deleverage once expansionary investments are concluded. Jalles Machado should consume its currently high liquidity as it advances with its investments plan, while FS's access to both domestic and international capital markets and presence of largely liquid corn inventories place its liquidity at higher levels compared to most sugar cane processors.

KEY ASSUMPTIONS

- Ethanol sales volumes of 1.4 billion liters in fiscal 2022 and 2023. Ethanol sales will increase to over 1.8 billion liters in fiscal 2024 following investments in capacity expansion. Hydrous ethanol will make up 56% of total ethanol volumes going forward;
- Sales of animal nutrition products of over 1.2 million tons in fiscal 2022 and 2023 and near 1.7 million tons in fiscal 2024.
- Ethanol prices to vary in tandem with a combination of oil prices and the FX rate. Brent crude prices have been forecast to average USD63/bbl in 2021 and USD55/bbl in 2022.
- Average FX rate at BRL5.20/USD in fiscal 2022 and 2023,
- Corn prices at BRL49/bag in the current crop season and BRL46/bag in 2022/2023;
- Animal nutrition products providing 44% coverage for total corn costs.
- Total investments of BRL848 million in 2021/2022 and BRL1.6 billion in 2022/2023.
- Dividends of BRL780 million in fiscal 2022 and BRL235 million in fiscal 2023.

RATING SENSITIVITIES

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

- Longer track record in different cycles of ethanol and corn prices;
- FCF consistently positive, with the maintenance of conservative capital structure.

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

- Deterioration in liquidity and/or difficulties refinancing short-term debt;
- EBITDA margins below 20% on a sustainable basis;

---Net leverage above 3.0x on a sustainable basis.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Satisfactory Liquidity: FS is expected to end fiscal 2022 with cash and short-term debt positions of BRL1.2 billion and BRL660 million, respectively, including net derivative balances. The company has diversified its funding sources by issuing a BRL300 million four-year CRA due 2025 in August 2021. Readily marketable inventories and offtake contracts with large fuel distributors reduce refinancing risks and improve financial flexibility; inventories can be easily monetized and accounts receivables can be used as collateral under new credit facilities, if required. As of June 30, 2021, cash and marketable securities were BRL1 billion, including restricted cash, which is assumed to be transitory, and compared favorably with short-term debt of BRL735 million including net derivative balances. Fitch estimates corn inventories of BRL634 million at market value as of the 1Q22, bringing the coverage ratio to about 2.30x.

ISSUER PROFILE

FS produces corn-based hydrous and anhydrous ethanol, dried distillers' grains with Solubles (DDGS) for animal nutrition, corn oil and energy from cogeneration. The company runs two plants in the State of Mato Grosso with total capacity to crush 3.2 million tons of corn and produce 1.4 billion liters of ethanol annually.

SUMMARY OF FINANCIAL ADJUSTMENTS

--Fitch included net derivative balances as debt.

--The total return swap and Cedula de Produto Rural Financeira debt balances have been netted out.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
FS Agrisolutions Industria de Biocombustiveis Ltda.	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	Natl LT	AA-(bra) Rating Outlook Stable	Upgrade	A+ (bra) Rating Outlook Stable
FS Luxembourg S.a.r.l.				

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Corporate Rating Criteria -- Effective from 21 December 2020 to 15 October 2021 \(pub. 21 Dec 2020\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

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