

RATING ACTION COMMENTARY

Fitch Affirms FS's IDR at 'BB-'; Outlook Stable

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Fitch Ratings - São Paulo - 27 Sep 2024: Fitch Ratings has affirmed FS Industria de Biocombustíveis Ltda's (FS) Long-Term Local and Foreign Currency Issuer Default Ratings (IDR) at 'BB-', and Long-Term National Scale rating at 'AA-(bra)'. The Rating Outlook for the corporate ratings is Stable. Fitch has also affirmed at 'BB-' the 2025 senior secured notes and 2031 senior unsecured notes issued by fully-owned FS Luxembourg S.a r.l guaranteed by FS.

The ratings incorporate FS' large scale production 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 them are key considerations. FS is exposed to Petrobras' commercial strategy for fuels in Brazil, which may curb ethanol prices.

The ratings incorporate an expected operating margin recovery in fiscal year 2025, following a sharp drop in fiscal year 2024 due to high fixed corn prices and weak ethanol prices. The analysis also considers FS's ability to maintain satisfactory financial flexibility and the expectation that net leverage will decrease to around 3.0x in fiscal year 2025, down from a peak of around 9.5x in fiscal 2024 due to weak EBITDA generation and investments in the third industrial plant. This improvement is crucial to prevent negative rating actions, as there is no headroom for its leverage sensitivity.

KEY RATING DRIVERS

High Price Volatility: FS faces price volatility for both corn, its main raw material, and ethanol, its main output. Corn prices adjust rapidly to global supply and demand imbalances and generally align with Chicago Board of Trade (CBOT) corn prices over time. Brazilian ethanol prices largely depend on local gasoline prices set by Petrobras, which fluctuate with Brent crude prices, the Brazilian FX rate, and other factors. Additionally, ethanol prices are indirectly influenced by sugar prices, as approximately 80% of local ethanol production comes from sugar. Sugar cane processors typically shift portion between sugar and ethanol based on current price parity.

Weaker Corn and Ethanol Prices Correlation: Corn prices in Brazil declined in 2023, following trends and a record-high Brazilian winter crop. However, corn ethanol players will benefit from this cheaper corn in fiscal 2025, as they are still processing high-cost corn inventory in fiscal 2024 due to previously fixed prices. Fitch projects international corn prices at USD4.50 per bushel in 2024 and USD4.25 per bushel in 2025.

Hydrous ethanol is currently trading around BRL2.44/liter (CEPEA/ESALQ as of September 2024), which is 11% higher than one year ago. Fitch's base case estimates average hydrous ethanol prices at BRL2.40/liter for

FYE 2025. Additionally, Fitch projects average Brent prices at USD80/bbl in 2024 and USD70/bbl in 2025.

Large Ethanol Producer: FS benefits from a sizable production capacity of approximately 2.3 billion liters of ethanol and a robust corn supply from neighboring areas, allowing for price discounts relative to CBOT. Additionally, animal nutrition products provide a partial hedge, as their prices strongly correlate with regional corn and soybeans prices. Fitch expects revenues from these products to cover 44% of feedstock costs in the long term, compared to 34% in fiscal 2024.

The company's industrial plants are in Mato Grosso, Brazil's largest corn producing state, which mitigates corn origination risks. Fitch projects that FS will procure corn at an average of BRL40/bag in the current and next crop seasons, supporting healthier margins.

Operating Cash Flow to Recover: Fitch expects EBITDA of BRL2.7 billion and cash flow from operations (CFFO) of BRL960 million in FYE 2025. This marks a significant recovery from the weak EBITDA of BRL846 million and negative CFFO of BRL128 million in FYE 2024. Higher ethanol prices and lower corn prices should quickly restore the EBITDA margin to 29%, after it dropped to 10% in FYE 2024, aligning more closely with previous years. Fitch projects projected positive FCF from FYE 2025 onward, as expansionary investments conclude. The base case assumes no dividends in FYE 2025 and dividends of BRL141 million in FYE 2026.

Net Leverage Around 3.0x in FYE 2025: Fitch projects that net leverage will significantly decrease to about 3.0x in fiscal 2025, driven by higher volumes from the new plant in Primavera do Leste and increased EBITDA margins due to lower corn costs. This improvement is crucial to prevent negative rating actions, as there is no headroom for leverage sensitivity after the peak 9.5x in fiscal 2024. During fiscal 2024, net debt increased by BRL1.8 billion, reaching BRL8.0 billion in March 2024. The expectation is to reduce this to about BRL7.3 billion by March 2026.

DERIVATION SUMMARY

FS's IDR's are four notches lower than Raizen S.A. and Raizen Energia S.A. (collectively referred to as Raizen; BBB/Stable). This gap reflects FS's smaller scale, higher exposure to commodity price risk compared with sugar cane processors, and weaker liquidity and more leveraged capital structure. Unlike FS, sugar cane processors benefit from a market pricing mechanism that links sugar cane costs to commodity prices.

FS's BB-/Stable IDR matches that of Ingenio Magdalena (IMSA, BB-/Stable). While IMSA enjoys a more stable cash flow profile, FS faces greater exposure to commodity price fluctuations in both raw materials and product prices. However, IMSA has tight liquidity, smaller scale in terms of revenues and EBITDA, and less financial flexibility.

FS's National Scale Rating AA-(bra)/Stable Outlook is one notch below LD Celulose S.A. (LDC; AA(bra)/Stable). LDC benefits from strong operating performance, stable EBITDA margins, and a competitive cost structure, which supports its capacity to generate positive FCF within the rating horizon. However, LDC's ratings also consider its limited scale and diversification, with only one dissolving wood pulp mill in Brazil and exposure to a single counterparty risk, as Lenzing AG is the sole off-taker.

KEY ASSUMPTIONS

--Ethanol production capacity of 2.3 billion liters in fiscal 2025 and 2026;

- Sales of animal nutrition products of over 2.0 million tons in fiscal 2025 and 2026;
- Ethanol prices to vary in tandem with a combination of oil prices and the FX rate. Brent crude prices have been forecast to average USD80/bbl in fiscal 2025 and USD70/bbl in fiscal 2026;
- Average FX rate at BRL5.40/USD in fiscal 2024 and BRL5.30/USD in 2025;
- Corn prices at BRL40/bag in fiscal 2025 and 2026;
- Animal nutrition products providing around 44% coverage for total corn costs;
- Total investments of BRL512 million in fiscal 2025 and BRL342 million in fiscal 2026;
- No dividends in fiscal 2025 and BRL141 million in fiscal 2026.

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 net debt/EBITDA below 1.5x through the cycle.

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 sustained basis;
- Net debt/EBITDA above 3.0x on a sustained basis.

LIQUIDITY AND DEBT STRUCTURE

Satisfactory Liquidity: FS has satisfactory liquidity and financial flexibility. As of June 30, 2024, the company reported cash and marketable securities of BRL3.8 billion and total debt of BRL11.5 billion, including reverse factoring transactions and net FX and IRS derivatives. Excluding reverse factoring and derivatives, the company has BRL1.3 billion of debt maturing until June 2025 and BRL1.5 billion from July 2025 to June 2026.

FS has satisfactory financial flexibility to address upcoming maturities and diversified access to funding, banks and capital markets. Readily marketable inventories (around BRL 1.1 billion in corn) and offtake contracts with large fuel distributors improve financial flexibility; inventories can be easily monetized and accounts receivables can be used as collateral under new credit facilities, if required.

ISSUER PROFILE

FS produces corn-based hydrous and anhydrous ethanol, dried distillers' grains with Solubles for animal nutrition, corn oil and energy from cogeneration. The company runs three plants in the State of Mato Grosso with total capacity to crush 5.1 million tons of corn and produce 2.3 billion liters of ethanol annually.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

[Click here](#) to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

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>.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR	
FS 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	Affirmed	AA-(bra) Rating Outlook Stable
FS Luxembourg S.a r.l.					
senior unsecured	LT	BB-	Affirmed		BB-
senior secured	LT	BB-	Affirmed		BB-

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

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

[Metodologia de Ratings em Escala Nacional \(pub. 22 Dec 2020\)](#)

[Corporate Rating Criteria \(pub. 03 Nov 2023\) \(including rating assumption sensitivity\)](#)

[Metodologia de Ratings Corporativos \(pub. 10 Nov 2023\)](#)

[Sector Navigators – Addendum to the Corporate Rating Criteria \(pub. 21 Jun 2024\)](#)

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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