

Research Update:

Ambipar Participacoes e Empreendimentos S.A. Assigned 'BB-' Issuer Credit Rating; Outlook Stable; Bond Rated 'BB-'

January 22, 2024

Rating Action Overview

- Ambipar recently announced its intention to issue a seven-year senior unsecured green bond of approximately \$500 million through Ambipar Lux S.a.r.l., with proceeds used to repay outstanding debentures in the Brazilian market. As a result, we expect the company's gross debt to remain unchanged at around Brazilian real (R\$) 7 billion but with a smoother maturity schedule and more flexibility under existing financial covenants.
- We expect Ambipar will benefit from organic growth after several acquisitions in the past two to three years and from strong geographic revenue diversification while maintaining strong financial discipline in the next 12-24 months, as shown by cost controls, no new acquisitions, and significant cash on hand.
- Therefore, on Jan. 22, 2024, S&P Global Ratings assigned its 'BB-' long-term issuer credit rating to Ambipar. We also assigned a 'BB-' issue rating to the proposed green bonds of Ambipar Lux S.a.r.l.
- The stable outlook considers our expectation for operating results to gradually improve while cash flow generation in the upcoming 12-24 months results in a steady reduction in indebtedness to below 3.5x, based on the company's strong liability management strategy, merger and acquisition (M&A) activity, investment management, and our expectation that dividend payouts won't jeopardize liquidity.
- We have assigned a management and governance (M&G) assessment of neutral to Ambipar. This assignment follows the Jan. 7 publication of S&P Global Ratings' revised criteria for evaluating the credit risks presented by an entity's M&G framework.

PRIMARY CREDIT ANALYST

Gaston Falcone
Buenos Aires
+ 54-11-4891-2147
gaston.falcone
@spglobal.com

SECONDARY CONTACT

Candela Macchi
Buenos Aires
+ 54 11 4891 2110
candela.macchi
@spglobal.com

Rating Action Rationale

We expect Ambipar's business model and strong geographic diversification will support growth. With over R\$4.7 billion in revenue and R\$1.3 billion in EBITDA in the 12 months ended September 2023, Ambipar has smaller scale than its global peers such as those in the U.S. but larger scale and greater diversification than domestic players. The company's solid business model encompasses a wide variety of services in its two main subsidiaries:

- Environmental ESG Participacoes S.A. mainly does waste management and recovery. It represents around 50% of revenue and benefits from agreements with an average duration of five years and low contractual exposure to volume risk.
- Ambipar Emergency Response aims to mitigate environmental damage from accidents. It represents about 50% of revenue and is backed by renewable contracts of about three years.

We anticipate Ambipar will keep its international activities in low-risk countries in Latin America, North America, and Europe. We also expect it to benefit from its long record of contract renewals (above 95%) and the absence of players with similar geographic coverage and services. Ambipar's strategy will likely remain mainly oriented toward consolidating its business model in a highly fragmented industry.

Revenue growth, customer loyalty, and the consolidation of the asset base will help Ambipar gradually lower leverage in 2024 and 2025. We expect the company to lower its debt-to-EBITDA ratio through gradually increasing its shares in its key markets and through organic growth with the opening of new asset bases, cross-selling opportunities, and a steady retention rate of about 95%. We anticipate 10%-15% revenue growth in 2024 and 2025, which should translate into higher EBITDA and push down net leverage from its peak of 4.5x in 2022 (including obligations on investment acquisitions) to close to 3.0x in 2025. The high volume of debt raised to fund acquisitions should keep interest coverage below 1.5x in 2023, before it recovers to around 2.0x in 2025.

We have a positive view of Ambipar's strategy and financial policy. Our base case relies heavily on Ambipar successfully integrating its acquisitions and benefiting from synergies across its current operating businesses while it maintains strong financial discipline. Ambipar's services have an EBITDA margin of 27%-30%, with contracts mostly based on a cost-plus scheme. Approximately 70% of the cost and expense structure is variable and mostly staffed, which allows for greater flexibility in adjusting and protecting margins in scenarios of weakened business demand.

We expect steady EBITDA margins in the next 12-24 months as the group consolidates its asset base and manages organic growth. More important, we expect strong financial discipline to continue in the upcoming 12-24 months, with a focus on leverage control and no new acquisitions. Ambipar's management has committed to gradually reducing net leverage and keeping a high cash balance of at least R\$2.7 billion to R\$3 billion. We expect this unencumbered cash position to remain in place for the next 12-24 months.

Outlook

The stable outlook considers our expectation for operating results to gradually improve while cash flow generation results in a steady reduction in indebtedness to close to 3.0x in the next two years, based on the company's strong liability management strategy, merger and acquisition (M&A) activity, investment management, and our expectation that dividend payouts won't jeopardize liquidity.

Downside scenario

We could lower the rating in the next 12 months if credit metrics deteriorate, as shown by leverage sustained above 4x and negative free operating cash flow, which could occur if:

- Ambipar fails to lower leverage,
- It embraces a more aggressive financial policy by using cash to increase dividends payment or for new M&A instead of reducing debt, or
- It experiences softer-than-expected operating performance due to severe macroeconomic or geopolitical stress that hurts its growth.

Upside scenario

Although it's unlikely in the next 12 months, we could raise our rating if Ambipar adopts a more conservative financial policy by reducing capital expenditure (capex). The company would also need to demonstrate its ability to increase its market share while expanding profitability and generating positive free cash flow to reduce debt, with free operating cash flow to debt above 5% and net debt to EBITDA below 3x.

Company Description

Ambipar Participacoes e Empreendimentos S.A. is a leading Brazilian environmental services company with an increasing presence in international markets. Ambipar provides environmental solutions services in Brazil (about 60% of consolidated EBITDA) and the rest of Latin America, the U.S., Canada, and the U.K. The group operates two major businesses: Ambipar Emergency Response and Environmental ESG Participacoes S.A.

Our Base-Case Scenario

Assumptions

- Brazilian inflation of 4.6% in 2024 and 3.6% in 2025 (see "Economic Outlook Emerging Markets Q1 2024: Challenging Global Conditions Will Constrain Growth," Nov. 27, 2023) and U.S. inflation of 2.4% in 2024 and 2.1% in 2025 (see "Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking," Nov. 27, 2023).
- Average Brazilian real-to-U.S. dollar exchange rates of R\$5 in 2023, R\$5.10 in 2024, and R\$5.20 in 2025.
- Brazilian GDP growth of 1.5% in 2024 and 1.9% in 2025 and U.S. GDP growth of 1.5% in 2024 and 1.4% in 2025.
- We expect the company's organic growth plan, with the opening of new asset bases (around five per year in Latin America, mainly from Response), commercial efforts to develop the franchise, and cross-selling, to influence its volume growth.
- We expect operating margins in line with past performance, even after the acquisitions. Actual performance in 2023 supports this assumption. We follow a conservative approach and reduce

by half the synergies expected by the client, resulting in EBITDA at 28%.

- We incorporate R\$709 million of proceeds from a follow-on and the intended new bond for an equivalent of about R\$2.5 billion, to be entirely used to reduce existing debt and repay outstanding debentures. We apply a 20% haircut to cash to accommodate deviations and to align more with Brazilian peers.
- Our capex assumptions follow the company's investment program for the coming two years, which focuses on organic growth, developing the asset base, and cross-selling. We also add a balance still to be paid in 2023 and 2024 from the acquisitions made. We envision no new acquisitions in the next few years.
- We stressed working capital in 2023-2024 by stressing days receivable to support commercial efforts in the consolidation and cross-selling opportunities.

Key metrics

Ambipar S.A.

	2021a	2022a	2023f	2024f	2025f
EBITDA margin (%)	27	27.5	27-28	27-28	27.5-28.5
Debt to EBITDA (x)	4.5	4.5	3.5-4	3.5-4	3.5-4
Funds from operations to debt (%)	16.3	12.8	3-5	5-8	8-12
EBITDA interest coverage (x)	4.1	1.7	1-3	1-3	2-4

All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast.

Liquidity

The company's liquidity is adequate, in our view. We expect sources over uses to be around 1.2x in the next 12 months. This is a result of the significant cash the company holds after a recent follow-on issuance. Ambipar could adjust its capex, given the opening of new bases represents most of the cash outflow expected for the next 12-24 months. The company has solid relationships with banks and proven access to domestic debt and equity markets.

Principal liquidity sources

- Consolidated cash position and liquid investments of R\$2.56 million as of September 2023.
- Expected funds from operations of around R\$680 million in the next 12 months.
- Ad hoc inflows related to the follow-on (R\$709 million).

Principal liquidity uses

- Short-term debt maturities of R\$835 million as of September 2023.
- Ad hoc debt repayments.
- Working capital outflows of R\$200 million to R\$250 million in the next 12 months.

- Capex of around R\$800 million in the next 12 months.
- Minimum dividend payments of R\$40 million in the next 12 months.

Covenants

The group was in compliance with its financial covenants as of September 2023.

Existing debentures, indentures, and potential bonds have financial ratio constraints. The recent follow-on sought to repay those debentures with the stricter covenants, while the new bond seeks to flatten the debt maturity profile while limiting debt incurrence, with a decreasing covenant of net leverage: 3.75x during the first year, 3.5x during the second year, 3.25x during the third, and 3.0x thereafter. This covenant will only be of incurrence, and we expect a cushion of 10%-15%.

Issue Ratings--Subordination Risk Analysis

We don't see subordination risk at Ambipar. The announced bond will be issued by Ambipar Lux S.a.r.l. and will benefit from the guarantee of Ambipar Participacoes e Empreendimentos S.A., Environmental ESG Participacoes S.A., and Ambipar Emergency Response. These guarantors are the bulk of Ambipar's business. Ambipar Emergency Response and Environmental ESG Participacoes are both holding and operational companies from each key business line and are the main operating subsidiaries of the group.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/--

Business risk: Fair

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

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers:

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

Stand-alone credit profile: bb-

Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

New Rating

Ambipar Lux S.a.r.l.

Senior Unsecured	BB-
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New Rating; CreditWatch/Outlook Action

Ambipar Participacoes e Empreendimentos S.A.

Issuer Credit Rating	BB-/Stable/--
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