FitchRatings

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Fitch Affirms Dexco's IDRs at 'BB'; Outlook Stable

Fitch Ratings - Rio de Janeiro - 19 Feb 2025: Fitch Ratings has affirmed Dexco S.A.'s Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BB'. Fitch has also affirmed Dexco's National Scale long-term rating at 'AAA(bra)'. The Rating Outlook is Stable.

Dexco's ratings reflects its prominent business position as the leading Brazilian wood panel producer, with competitive advantages that are difficult to be replicated. Also factored into the rating is Dexco's position as one of the largest Brazilian company in the finishing division. The company's commitment to preserve robust liquidity and comfortable debt amortization schedule are also key credit considerations. The National Scale long-term rating considers Dexco's strong financial flexibility.

The Stable Outlook incorporates the expectation that Dexco will prudently manage its investment and dividend strategy in case operating cash flow is lower than anticipated, to preserve net leverage below 3.5x. Dexco's main challenges will be continuing a sustainable improvement in its metals and sanitary wares products' profitability and demonstrating ability to recover its ceramic tiles segment.

Key Rating Drivers

Strong Business Position in Wood Panel: Dexco's ratings are underpinned by its prominent position in the wood panel division that continues to sustain cash flow generation. The company's large operating scale and wood self-sufficiency are key competitive advantages. Dexco is the largest Brazilian wood panel producer, with estimated capacity share of 34%. This segment generated EBITDA of BRL1.6 billion in the LTM September 2024, supported by the sale of raw wood that benefited from the shortage in local market, and Fitch projects EBITDA of approximately BRL1.5 billion in the medium-term, sustained by the mature stage of the business. Wood division represented about 60% to 65% of total revenue and virtually 100% of EBITDA generation in the last two years.

Gradual Recovery in Finishing Division: Fitch projects a BRL300 million EBITDA in 2025 for the finishing division and BRL350 million in 2026, after BRL125 million expected for 2024 and negative EBITDA of BRL8 million in 2023. Dexco is experiencing a gradual recovery in the profitability of its metals and sanitary wares products, after several quarters of results pressured by the confluence of challenging market conditions and internal issues. Initiatives to recover operating margins, which included divesting from non-profitable units and G&A efficiencies, started to gain momentum. Metals and sanitary wares represent about 25% of total revenue.

The ceramic tiles segment, that represent about 10% of total revenue, on the other hand, continues to struggle. Dexco is challenged to recover profitability and capture cash flow generation from the new facility in Botucatu amid challenging business conditions with climbing interest rates.

Positive FCF Only in 2026: Fitch's rating case considers positive FCF from 2026, after five years of cash burn, supported by Dexco's ability to recover profitability in the finishing division and diminish investments. Fitch forecasts EBITDA of BRL1.7 billion and CFFO of BRL1 billion in 2025, and BRL1.8 billion and BRL1.1 billion in 2026, after BRL1.6 billion and BRL770 million expected for 2024, respectively.

About half of EBITDA generation should be consumed by interest expenses until 2026, as debt increased and interest rates should remain high for a longer period. EBITDA margins are projected between 19% to 21%. Base case considered capex of BRL1.2 billion in 2025, after BRL1.6 billion expected for 2024, reducing to BRL800 million to BRL900 million annually; and dividends at 30% of net income, in accordance with its bylaws. This should result in a negative FCF of BRL245 million in 2025, after negative at BRL1 billion in 2024.

Limited Leverage Headroom: Fitch forecasts Dexco's net debt to EBITDA ratio at 3.2x at YE 2025, in line with the level expected for 2024 and the reported in 2023. Dexco had a track record of net leverage below 2.5x until 2022. Indebtedness increased as a result of high investments and weaker operating cash flow. Net debt increased to BRL5.2 billion in September 2024, from BRL2.4 billion at YE 2022, and Fitch expects it to further increase to BRL5.4 billion this year before gradually decrease. The company needs to carefully manage its investment plan and shareholder's remuneration policy, with limited headroom for M&As, to preserve net leverage below the 3.5x downgrade trigger.

Joint Venture (JV) New Financing Structure: Dexco's 49% stake in dissolving wood pulp producer LD Celulose S.A.'s (LDC; BB-/Stable) diversifies its business model and will contribute to a dividends flow in hard currency in the long term. LDC's liability management was concluded in October 2024 and removed Dexco's debt guarantees, reducing its adjusted leverage metrics. In the past, LDC's debt were guaranteed by shareholders in proportion to their stakes. Fitch's rating case for Dexco does not incorporate significant dividends from LDC from 2025 to 2027 due to their focus on deleveraging.

Derivation Summary

Dexco's closest competitor in the wood segment is Celulosa Arauco y Constitucion S.A. (BBB/Outlook Negative). Dexco has a weaker business risk profile than Arauco as the latter has greater operating scale, strong revenue flow from the pulp division and a more export-oriented business profile. Dexco, on the other hand, is more exposed to demand from the local market. In the ceramic tile segment, the closest competitor is PBG S/A (A-(bra)/Rating Watch Negative). Dexco has a stronger business profile than PBG, with a robust cash flow from the wood division, and also stronger capital structure and financial flexibility.

Key Assumptions

--Wood sales volume of about three million cubic meters in 2025 and in 2026, annually;

--Deca division sales volume of about 20 million items in 2025 and 2026;

--Ceramic tiles sales volume of 20.5 million sqm to 21.5 million sqm in 2025 and 2026;

--Investments of BRL2.9 billion during 2025-2027, after BRL1.6 billion expected in 2024;

--Dividends limited to 30% of net income.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Net debt/EBITDA ratio recurrently above 3.5x;

--Inability to recover profitability in the finishing division and/or adverse environment in the wood division, resulting in EBITDA margin below 18% and/or cash flow generation below our estimates;

--Material capital injections or additional debt guarantees at the JV LDC.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Consistent turnaround of the finishing division on a sustainable basis, with maintenance of solid performance in the wood division;

--Net debt/EBITDA ratio recurrently below 2.5x;

--Ability to reduce net debt.

Liquidity and Debt Structure

Dexco has historically maintained strong cash reserves and an extended debt amortization profile. In September 2024, Dexco had BRL2.2 billion of cash and marketable securities and BRL7.4 billion of total debt. The company's current cash position plus its BRL750 million of unused RCF cover debt maturities up to the end 2026, of BRL2.8 billion. Dexco enjoys strong access to both the debt and equity markets. Financial flexibility is further enhanced by the potential sale of forestry assets and/or less strategic assets, if necessary. The accounting value of Dexco's biological assets was BRL3 billion as of Sept. 30, 2024. Debt is denominated in local currency with a competitive cost.

Issuer Profile

Dexco is the leading wood panel producer in Brazil, with 3.2 million cubic meters of annual domestic production and 0.2 million cubic meters in Colombia. Dexco is also one of the largest producers of sanitary ware and metals in Brazil and one of the main ceramic tile producers.

Summary of Financial Adjustments

--Fitch excludes from EBITDA: asset impairment, results from asset sale, biological asset's fair value variation and impact from business restructuring.

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.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Dexco S.A.	LT IDR	BB	Affirmed		BB
	LC LT IDR	BB	Affirmed		BB
	Natl LT	AAA(bra)	Affirmed		AAA(bra)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.06 Dec 2024) (including rating assumption sensitivity)

National Scale Rating Criteria (pub.22 Dec 2020)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.06 Dec 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)

Additional Disclosures

Solicitation Status

Endorsement Status

Dexco S.A. EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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