FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Hidrovias' IDRs to 'BB-'; Outlook Stable

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Fitch Ratings - Rio de Janeiro - 18 May 2022: Fitch Ratings has downgraded Hidrovias do Brasil S.A.'s (Hidrovias) Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDR) to 'BB-' from 'BB' and National Scale long-term rating to 'AA-(bra)' from 'AA(bra)'. The Outlook for the FC and LC IDRs and National Scale is Stable.

The downgrade reflects Hidrovias' higher than expected leverage in the medium term. Even incorporating recent operating cash flow improvements, Fitch forecasts net leverage of 4.7x and 4.2x during 2022 and 2023, respectively. Ongoing hydrological risks, lower financial flexibility, and the fact that the company could have to renegotiate an important (in terms of EBITDA contribution) take-or-pay contract that historically had a strong credit quality off-taker (Vale S.A.; BBB/Stable) are also incorporated into the analysis and weaken Hidrovias' credit profile within the 'BB' rating category. Fitch does not incorporate any major changes in the contract terms.

KEY RATING DRIVERS

Cash Flow Volatilities Despite Take or Pay Contracts: Hidrovias' business resilience was tested during 2021 when the company experienced a combination of drastic non-manageable events. The hydrological risk, which is now relatively higher than years ago, even considering positive developments during 2022 that indicate water levels in South Corridor to be better than the previous year. The crop failure in 2021 has also affected exports volumes in the North Corridor, reducing Hidrovias opportunities to leverage its assets and improve operating cash flow. For 2022, the scenario is more favorable with expectation of soy crop recovery in Mato Grosso. Fitch estimates around BRL805 million of EBITDAR in 2022 and BRL920 million in 2023.

High Leverage to Remain: The acquisition of Imperial during 2Q21 (USD85 million), relatively lower EBITDA generation, higher capex and impact of FX volatility drove Hidrovias's net leverage to peak at 7,0x in 2021, per Fitch's calculations. Fitch expects net leverage to show significant improvement from 2021, as it stays around 4.7x in 2022 and 4.2x in 2023. This compares with 4.9x in 2019 and 4.7x in 2020, per Fitch's calculations. Those leverage ratios were already high for a 'BB' rating as the ongoing investments had been postponing a more significant deleveraging trend.

Managing Capex is Key: Management's strategy on business diversification, growth (discretionary capex), and returns to shareholders is a key to determining leverage trends. Fitch incorporates that in the medium-term, Hidrovias will continue to invest to leverage its business scale, taking advantage of growth opportunities in the market it operates. Fitch estimates around BRL399million in capex during 2022 and it to grow to BRL456 million in 2023, those levels are still significantly lower than previous planned capex (BRL550-650 million). The ongoing business expansion is likely to lead to negative FCF in 2023 of around BRL94 million. The company has project expansions in the North Corridor.

Challenge to Increase Client Diversification: Hidrovias has portfolio concentration risk, as its main clients are Vale S.A. (BBB/Stable; to be replaced by a new entity), COFCO Group and Alumina do Norte do Brasil S.A. (Alunorte), which Fitch estimates together account for 48%-62% of total EBITDA on historical basis. Over the past years, Hidrovias added new clients and sectors to its portfolio, including projects for salt operations in Brazil's Rio Grande do Norte state and new service activities in Santos Port. Fitch's base case scenario considers that Hidrovias could have to renegotiate its iron ore contract in the South Corridor, but it is projected to be at a reasonable rate.

Grains and fertilizer, iron ore, and bauxite represent around 45%, 38%, and 16%, respectively, of Hidrovias' 2021 EBITDA. Approximately 58% and 42% of EBITDA is generated in Brazil and Uruguay/Paraguay, respectively. Manageable FX Risk Exposure: Hidrovias faces exposure to FX risk, as most of its debt is U.S. dollar-denominated. This is mitigated by strong EBITDA generation (around 60%) in hard currency, as well as 90% of its cash balance denominated in U.S. dollars. This has been key to mitigate currency mismatch risks in short-term cash outflows as it relates to semiannual bond coupon payments.

DERIVATION SUMMARY

Hidrovias's business profile is well-positioned in the 'BB' rating category relative to transportation and logistics peers across the region, which are generally rated in the 'BB' to 'BBB' categories. Hidrovias' rating constraint derives from its medium-size business scale and weakest capital structure among Brazilian peers, including MRS Logistica S.A. (BB/Negative), Rumo S.A. (BB/Negative), and VLI S.A. (AAA[bra]/Stable). Offsetting those factors are Hidrovias' solid business profile with majority of operations being based on take-or-pay contracts.

Hidrovias' expected 2022 net leverage is higher than that expected for other rated Brazilian peers in the transportation and logistics sector with more mature operations and with higher credit ratings. Rumo, VLI and MRS Logistica are forecast to report 2022 net leverage of 3.3x, 3.2x and 2.1x, respectively. Hidrovias' ratings incorporate expectations of net adjusted leverage ratio trending to 4.7x-4.2x by 2022/2023.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within the Rating Case for the Issuer:

--Strong Revenue growth in 2022, reflecting recovery in both South and North Corridor, reaching around BRL1.75 billion and around 10% in 2023;

--EBITDA margin around 46%-48% in the next three years;

--Total capex of around BRL400 million in 2022 and BRL450 million in 2023;

--No dividend distributions until net leverage moves down to 3.5x.

RATING SENSITIVITIES

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

--Broader client diversification;

--Net debt/EBITDA consistently below 3.5x and total debt/EBITDA below 4.0x;

--Interest coverage consistently above 4.5x;

--Maintenance of strong liquidity to avoid refinancing risks.

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

--Large debt-funded M&A transactions or entering into a new business in the logistics sector that adversely affect its capital structure on a sustained basis or increase business risk exposure;

--Net leverage consistently above 4.5x on a sustained basis;

--Deterioration of liquidity position, with increasing short- to medium-term refinancing risks.

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

Adequate Liquidity Position: The challenging scenario during 2021 and the acquisition of Imperial has affected Hidrovias' historical robust cash position and its strong financial flexibility. As of March 31 2022, the company's cash and marketable securities were BRL537 million, which represents a deterioration from the average of BRL1 billion from the 2018-2020 period (BRL659 million in 2021). Fitch expects Hidrovias to maintain adequate cash position while manage its FCF and growth strategy in the medium term, and remain proactive to avoid short-term refinancing risks within 18-24 months.

Hidrovias's cash position as of 1Q22 was adequate at BRL537 milion, while short-term debt was BRL115 million, excluding lease obligations. The company has a comfortable debt amortization schedule in the medium term, with an average of BRL52 million due annually in 2022-2024, but faces some large maturities in 2025, 2028 and 2031. The most relevant maturities are: senior notes of BRL723 million in 2025, BRL393 million of local debentures in 2028 and BRL2.3 billion of senior notes in 2031. Hidrovias does not have a committed standby credit facility. Hidrovias' total adjusted debt, per Fitch's calculations, was BRL4.3 billion at 1Q22, mainly composed of BRL2.3 billion of cross-border bonds due 2031, BRL723 million of cross-border bonds due 2025, BRL393 million of local debentures with final maturity in 2031 and BRL542 million of Banco

Nacional de Desenvolvimento Economico e Social (BNDES) financing. Fitch includes in the debt calculation BRL107 million (USD21 million) of guarantees related to one of its 50% joint ventures, Obrinel S.A., domiciled in Uruguay.

ISSUER PROFILE

Hidrovias is an integrated logistics provider focused on waterways logistics services. It has an end-to-end infrastructure, including transhipment, port terminals and a fleet of barges, pusher tugs and cabotage vessels. The company operates in logistics corridors in the northern region of Brazil and in the Paraguay-Paraná river system.

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

Fitch has revised the ESG Relevance score for Exposure to Environmental Impacts to '4' from '3', considering the effective impact on the company operations in 2021 due the hydrologtical risks. Due to lower draft in rivers, the company stopped navigating for around 2 months in South Corridor (iron ore take or pay contract). This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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 ⬍
Hidrovias International Finance S.a.r.l.				
senior unsecured	LT	BB-	Downgrade	BB

Hidrovias do Brasil S.A.	LT IDR	BB- Rating Outlook Stable	Downgrade	BB Rating Outlook Negative
senior unsecured	Natl LT	AA-(bra)	Downgrade	AA(bra)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Hidrovias International Finance S.a.r.l.	EU Endorsed, UK Endorsed

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