

Rating Action: Moody's downgrades Hidrovias do Brasil's ratings to B1; stable outlook

29 Oct 2021

New York, October 29, 2021 -- Moody's Investors Service ("Moody's") has today downgraded to B1 from Ba3 Hidrovias do Brasil S.A.(HBSA)'s corporate family rating and the senior unsecured ratings of the notes issued by Hidrovias International Finance S.a.r.l. due 2025 and 2031 and fully and unconditionally guaranteed by HBSA and its fully-owned subsidiaries, except for the bauxite operations subsidiaries (guarantor group). The outlook for the ratings is stable.

Ratings downgraded:

Hidrovias do Brasil S.A.

- Corporate Family Rating: to B1 from Ba3

Hidrovias International Finance S.a.r.l.

- 5.9500% Gtd senior unsecured notes due 2025: to B1 from Ba3

- 4.9500% Gtd senior unsecured notes due 2031: to B1 from Ba3

The outlook for the ratings is stable.

RATINGS RATIONALE

The downgrade of HBSA's ratings to B1 follows the company's announcement on October 18th that it will raise BRL380 million in new incentivized infrastructure debentures to fund investments at the STS20 terminal at the Santos port, which will further delay HBSA's deleveraging plans. The new debt adds to several setbacks HBSA faced in the past few years that resulted into leverage falling behind Moody's initial expectations, including (i) the renegotiation of short-term take-or-pay volumes with COFCO in 2019-20; (ii) a contract cancellation with Mitsui in 2018; and (iii) a severe drought in 2021 that is impairing river navigability in the company's southern operations and reducing spot volumes due to lower crop output in the northern operations. With the new debt issuance, HBSA's adjusted gross leverage will hover around 4x-5x in 2022-24, compared to previous expectations of 3x-4x prior to the issuance. In 2021, the company's gross leverage will remain atypically high at 6x-6.5x, reflecting lower EBITDA coming from operational issues caused by the drought and the impact of the sharp depreciation of the Brazilian real in the company's unhedged foreign currency debt.

HBSA's credit metrics will improve from the 2021 trough in the next few years as the company benefits from the new contracts (namely the Santos port and salt contracts), ramp-up of the existing take-or-pay contracts, the additional EBITDA from the Imperial acquisition and additional spot volumes from the solid medium-term growth prospects of the northern operation, which will more than compensate for the volume lost with the Mitsui contract cancellation. However, until the company can increase EBITDA and generate positive free cash flow sustainably, leverage will remain high and execution risks on its expansion investments will heighten. HBSA's expansion plans include BRL2.6-3 billion in total investments until 2025, of which BRL900 million-BRL1 billion will be spent in 2021. With the downward revision of the company's EBITDA guidance to BRL630-710 million in 2021 from BRL800-880 million, the cash flow gap that HBSA will need to bridge to fund investments with internal or external liquidity sources increased.

The cancellation of the contract with Mitsui slowed HBSA's deleveraging process, but also brought BRL388 million in proceeds from the legal compensation for the cancellation that were sitting in the HBSA's cash position. In April 2021, HBSA announced the \$85 million (BRL484 million) acquisition of some of Imperial Logistics International B.V. & Co. KG ("Imperial")'s Paraguayan navigation assets, which reduced its cash position to BRL534 million at the end of second quarter of 2021 from BRL1.2 billion at the end of the first quarter. Accordingly, HBSA's liquidity cushion to cover expansion capex diminished and net leverage ratios -- which served as a mitigant to the company's high gross leverage -- deteriorated.

HBSA's B1 ratings continue to be supported by the company's solid business model, with about 70% of its revenue and EBITDA ensured by long-term take-or-pay agreements with strong off-takers. The agreements contain minimum volume guarantees and cost pass-through clauses, which translate into predictable cash flow, high capacity utilization rates and high operating margins for the company. Moody's estimates that the existing agreements will bring around BRL6.5 billion in EBITDA from 2021 until 2030, sufficient to cover the company's total debt by 1.5x (pro forma for the new issuance), and five out of the seven existing contracts — all except HBSA's take-or-pay agreements with COFCO and Sodrugestvo in the south — will remain valid during most of the tenor of the notes, maturing after 2029.

The positive long-term outlook for agricultural production and waterborne transportation in Brazil and Paraguay, and the strategic location of HBSA's operations also support the ratings. The ratings also incorporate HBSA's good liquidity profile and Moody's expectation that HBSA's credit metrics will gradually improve from 2021's trough with the normalization of river navigability and ramp-up of northern operations and new contracts.

The ratings are constrained by the company's current high gross leverage and delays in deleverage over the past few years, short track record of operations and its small size relative to its rated peers. The high degree of product and geographic concentration also constrains the ratings because it exposes the company to adverse weather conditions that could limit agricultural production and river navigability. There is also a high degree of client concentration, although clients' good credit quality and history of contract compliance mitigate any related risk. Finally, given that the totality of HBSA's debt is indexed to the US dollar, the company's gross leverage ratios are exposed to currency volatility risk.

LIQUIDITY

HBSA has a good liquidity profile, with BRL534 million in cash at the end of June 2021, well above its minimum requirements of around BRL300 million, and only around BRL50-60 million in principal debt maturities per year over the next four years. Pro forma to the new issuance, the existing cash will continue to cover debt maturities through 2025, as the new debentures will be amortized from 2028 onwards. In Moody's view, HBSA's cash position and comfortable debt amortization schedule are key to mitigate operational and execution risks on investments, and support the company's credit quality as long as HBSA maintains a certain degree of financial discipline.

RATING OUTLOOK

The stable outlook incorporates Moody's expectations that HBSA's credit metrics will gradually improve with operations performing in line with the terms and conditions established by the existing take-or-pay agreements, and that the company will prudently manage its dividend distribution and future investments to preserve its good liquidity profile.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of HBSA's ratings could occur if the company is able to reduce leverage sustainably, while maintaining its current business model and profitability levels and generating stable cash flows on a sustained basis. Quantitatively, a rating upgrade would require the maintenance of adjusted leverage (measured as debt/EBITDA) sustainably below 4x and interest coverage (measured by adjusted FFO + interest/interest) above 3.5x. The maintenance of a strong liquidity profile would also be necessary for an upgrade.

The ratings could be downgraded if HBSA's operating performance remains weak, such that leverage remains high and liquidity deteriorates without prospects for improvement. A deterioration in the company's business profile because of the loss of any existing take-or-pay agreement without a financial compensation or further debt-financed expansions into the spot market would also put negative pressure on the ratings. Quantitatively, a downgrade could occur if leverage remains sustainably above 5x and interest coverage below 2x. A deterioration in the company's liquidity profile, stemming from large shareholder distribution or more aggressive financial policies, would also result in a downgrade of the ratings.

The principal methodology used in these ratings was Shipping published in June 2021 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1276306. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Sao Paulo, Brazil, HBSA is South America's largest independent provider of integrated

logistics focused on waterway transportation. The company's operations include shipping, transshipment, storage and port services for dry bulk cargo, including grains, iron ore, bauxite, fertilizers and pulp in the Paraná-Paraguay waterway and Amazon river systems. For the 12 months ended June 2021, the company generated BRL1.5 billion (\$282 million) in revenue with an adjusted EBITDA margin of 43.9%, coming mainly from shipping activities (80% of total) and other logistics services (20%). The company's Northern operations, which comprise mainly the transportation of grains represent around 56% of the company's total EBITDA, followed by the Southern operations (35%) and the Coastal Navigation operations (17%), which relate mainly to iron ore and bauxite transportation, respectively. Around 60% of the company's total revenue is generated in Brazil, with the remaining 40% generated through hard currency contracts in Paraguay and Uruguay.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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