FitchRatings

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# Fitch Upgrades Unigel's IDRs to 'BB-'; Outlook Stable

Fitch Ratings - Rio de Janeiro - 11 Jan 2022: Fitch Ratings has upgraded Unigel Participacoes S.A.'s (Unigel) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'BB-' from 'B+' and its National Scale Long-Term rating to 'AA-(bra)' from 'A-(bra)'. Fitch has also upgraded Unigel Luxembourg S.A.'s unsecured notes to 'BB-' from 'B+'/'RR4.'The Rating Outlook has been revised to Stable from Positive.

The upgrade reflects Unigel's improved credit profile from increased scale and business diversification following the ramp-up of its fertilizer operations (agro segment), while maintaining an adequate credit metric profile through the chemical cycle. The ratings also reflect Unigel's improved financial flexibility and ongoing proactive liability management strategy.

Strong chemical product spreads in 2021 brought record operating cash flow generation, which supported the high capex levels for the agro segment and others' debottlenecking processes. Fitch forecasts Unigel's net debt/EBITDA ratio to move toward 2.0-2.5x by YE 2023/2024 since deterioration and normalization of chemical spreads is likely.

## Key Rating Drivers

Business Diversification: Unigel has increased its nitrogen fertilizer segment by leasing two plants from Petroleo Brasileiro S.A. (Petrobras, BB-/Negative) in the states of Bahia and Sergipe. This should more than double Unigel's EBITDA generation in the medium term on a sustained basis. Fitch forecasts this segment will contribute around USD100-USD120 million in EBITDA in the next three years, considering current natural gas price contracts. It will also bring significant business diversification compared to Unigel's acrylics and styrenics business exposures.

Unigel's total production capacity is 1.125 kilotons (kt)/year of urea, 925kt/year for ammonia, 320kt/year of ammonium sulfate and 220kt/year of automotive liquid reducing agent. The contract is for 10 years for an estimated total lease cost of BRL177 million, and renewable for an equal period.

Intermediate Player in Cyclical Industry: The cyclical nature of the commodity chemicals sector means Unigel is subject to feedstock and end-product price volatility, driven by prevailing market conditions and demand/supply drivers. It is a chemical producer with a medium business scale operating in the midstream of the petrochemical industry value chain, placing the company in a weak position against much larger single-product suppliers and large manufacturing groups. Unigel's long-term contract sales with a price formula based upon raw material prices are mitigating factors that help offset major deterioration in its product spreads. Excluding the record 2021 operating margins, its EBITDA margin averaged 13.6%, which is comparable with small- to medium-size chemical peers.

With the additional contribution of the agro segment, EBITDA margin is expected to be around 16%-18% through the cycle. For full year 2021, Fitch expects Unigel's EBITDA split to be 43%, 27%, and 32%, respectively, for styrenics, acrylics, and agro, and a total EBITDA margin around 21%.

Operational Flexibility: Unigel's credit profile benefits from a diversified product range under the acrylics and styrenics segments and end markets. Varying degrees of integration are present along the production value chain for its key products, providing greater flexibility in sales and fewer constraints from raw material supply, and bolstering its operating margins. The company's small business scale also provides some ability to switch product lines relatively swiftly to take advantage of favorable price movements.

Record CFFO to Support High Capex: Overall record styrenics and acrylics spreads during the past five quarters have boosted Unigel's operating cash flow generation. Fitch expects Unigel's CFFO to be around BRL700 million in 2021/22, which compares to around BRL200 million in 2020. For 2021, Unigel's capex should reach around BRL770 million, per Fitch's estimates, most related to expansion (75%), and should move around BRL680/700 million in 2022/2023. The ongoing capex program should continue to lead negative FCF around BRL130/180 million in the next two years. Fitch expects dividends to be in line with covenants, at around 25% of net income from 2022 onward.

Leverage to Remain Adequate: Fitch's base case incorporates an expectation that spreads will deteriorate in the medium term in line with past cycles. Fitch forecasts Unigel's net debt/EBITDA ratio to move toward 2.1x by YE 2023/24, considering around BRL700 million of capex. This already represents an improvement from the average of 3.3x during 2017 -2019. For 2021 and 2022, leverage is around 1.3x and 1.4x. This strong deleverage reflects the strong product spreads and volumes during 2021 and start of the agro operations. Unigel has flexibility to reduce capex levels for 2023 if EBITDA is weaker than expected, in order to avoid leverage above 2.5x.

## Derivation Summary

Despite Unigel's good market share in Latin America, the company is a price-taker and is medium-sized relative to the global chemical industry, with EBITDA generation moving around USD200 million, including the agro segment. Product diversification and some business integration help to reduce profit margin volatility, although cash generation is still affected by commodity price movements and any change in the supply/demand dynamics of its end products.

Compared with other Latin America petrochemical peers, Unigel is smaller than Braskem S.A. (BBB-/Stable), Alpek S.A (BBB-/Stable) and Orbia Advance Corporation, S.A.B. de C.V. (BBB/Stable). Unigel is well positioned in terms of leverage ratios compared with other Latin American peers in the 'BB-' category and with Cydsa S.A.B. de C.V. (BB+/Stable).

## Key Assumptions

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

--Stable volumes during 2021-2023;

--Average EBITDA margins around 17%-18%, from 2021-2023;

--Capex of around BRL770 million in 2021 and BRL670/700 million in 2022 and 2023;

--Dividend payouts at 25% of net profits.

## RATING SENSITIVITIES

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

--An upgrade is unlikely in the medium term given the company's business risks;

--Fitch would view positively expected net debt/EBITDA below 2.0x through growth cycles combined with sustainable performance of the Agro Segment and total EBITDA Margin above 20%.

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

--Operating EBITDA margin consistently below 10% on a sustained basis;

--Deterioration in liquidity, leading to recurring refinancing risks;

--Net debt/EBITDA moving above 3.5x on sustainable basis;

--Change in imports tariffs in Brazil that could allow increased competition.

## 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

Sound Liquidity: Unigel has maintained an adequate liquidity position relative to its debt amortization profile. As of Sept. 30, 2021, Unigel reported total debt of BRL3.0 billion (net of derivatives), BRL455 million of which was short-term debt, and had a readily available cash position of about BRL760 million. Beside the short-term debt, the majority of the company's debt is due in 2026 (USD530 million bonds).

Fitch expects Unigel to remain proactive on its liability management strategy to avoid exposure to refinancing risks. Total debt at Sept. 30, 2021 consisted of the senior notes (78%) and working capital lines (14%). The majority of the company's debt is denominated in U.S. dollars, but 100% of the 2026 bonds swapped to BRL.

## Issuer Profile

Unigel is a medium-size chemical producer operating in the midstream of the petrochemical industry value chain (acrylics and styrenics), with facilities in Brazil and Mexico. It produces ammonia, urea, ammonium sulfate and DEF, which are primarily used as agricultural fertilizers.

## 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

Unigel Participacoes S.A. has an ESG Relevance Score of '4' for Governance Structure due to ownership concentration and key person risk, which 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

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## Rating Actions

| ENTITY/DEBT | RATING | | | RECOVERY | PRIOR |
|---|---|---|---|---|---|
| Unigel Luxembourg S.A. | | | | | |
| • senior unsecured | LT | BB- | Upgrade | | B+ |
| Unigel Participacoes S.A. | LT IDR | BB- | Upgrade | | B+ |

| ENTITY/DEBT | RATING | | | RECOVERY | PRIOR |
|---|---|---|---|---|---|
| | LC LT IDR | BB- | Upgrade | | B+ |
| | Natl LT | AA-(bra) | Upgrade | | A-(bra) |

| RATINGS KEY | OUTLOOK | WATCH |
|---|---|---|
| POSITIVE | | |
| NEGATIVE | | |
| EVOLVING | | |
| STABLE | | |

## Applicable Criteria

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

National Scale Rating Criteria (pub.22 Dec 2020)

## Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

## Additional Disclosures

Solicitation Status

## Endorsement Status

| | |
|---|---|
| Unigel Luxembourg S.A. | EU Endorsed, UK Endorsed |
| Unigel Participacoes S.A. | EU Endorsed, UK Endorsed |

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