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Research Update:

Unigel Participacoes Upgraded To 'BB-' From 'B+' And To 'brAA+' From 'brAA' On Stronger Cash Flows, Outlook Stable

June 11, 2021

Rating Action Overview

- Brazil-based chemicals producer, Unigel Participacoes S.A. (Unigel), is benefiting from strong spreads and solid volumes in acrylics and styrenics.
- The ramp-up of the company's two new fertilizer plants should compensate for the expected reduction in spreads over the next few quarters, leading to a significant increase in cash flows than in previous years.
- On June 11, 2021, S&P Global Ratings raised the global scale ratings on Unigel to 'BB-' from 'B+' and the national scale rating to 'brAA+' from 'brAA'.
- The stable outlook indicates that higher cash flows for the next 12 months should reduce gross debt to EBITDA to 2.0x-2.5x and FFO to debt rising to 25%-35% in 2021 and 2022.

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Rating Action Rationale

Favorable spreads, strong demand, and ramp-up of the fertilizers business bolster the operating results in 2021. The company's core business, acrylics and styrenics, has benefited from above-average international spreads in the first half of 2021 given robust demand, likely pushing up margins to 27%-30% from 13% in the first half of 2020. At the same time, Unigel recently started production at one of the two new leased fertilizer plants in April, and the second will likely start this month. While we forecast narrower spreads during the second half of 2021, given the expanding global styrene capacity, this should be outweighed by the company's fertilizer plants' ramp-up. Therefore, we expect EBITDA to almost triple to R$1.3 billion - R$1.5 billion in 2021 from R$547 million in 2020.

The new fertilizer business will likely generate about 30% of revenue in 2022. The two leased plants will have combined annual production capacity of 930,000 tons of ammonia, 1.13 million tons of Urea, and 320,000 tons of ammonium sulfate. This will not only enlarge the company's scale and diversification of end products, but also provide integration, as it allows Unigel to meet all the ammonia supply needs for its acrylics segment. Additionally, we expect the fertilizer business's margins to be higher than those of the company's other segments, given the profitable natural gas contracts signed with EBITDA margins related to that segment at 25%-30% in the first operating year, now rising to 30%-35% as volumes increases.

Sound liquidity supports additional investments at the core business. Unigel raised $110 million through the 2026 notes add-on in January to fund the operations of the two new fertilizer plants. The higher cash flows this year will enable the company to increase investments in its core acrylics and styrenics business, along with the expansion of the latex and acetonitrile capacity. Despite capex rising to about R$570 million in 2021 from R$223 million in 2020, the company's liquidity should be at comfortable levels for the next 12 months.

Outlook

The stable outlook incorporates the very profitable styrenics and acrylics spreads and the ramp-up of the fertilizer operations in 2021 and 2022. We expect the company to more than double its EBITDA in 2021, with gross debt to EBITDA dropping to 2.0x–2.5x and FFO to debt rising to 25%-35% in 2021 and 2022.

Downside scenario

We could downgrade the company in the next 12-18 months if spreads on acrylics and styrenics sharply narrow in the next 12 months, leading to significantly lower margins. In addition, any production setback for ammonia and urea could weigh on the company's metrics. In that scenario, we would likely see cash losses and/or gross debt to EBITDA more than 4.0x and FFO to debt below 20% over the next few years.

Upside scenario

An upgrade in the next 12 months is unlikely. Over the next few years, it would depend on higher scale and diversification of end products, combined with greater profitability and a track record of lower cash-flow volatility. In addition, we would need to see gross debt to EBITDA below 3.0x and FFO to debt above 25% on a consistent basis.

Company Description

Unigel is a Brazil-based resin producer engaged in the second generation of the petrochemical supply chain. The company's business is split into three main divisions: acrylics, styrenics, and agro (fertilizers) with estimated annual production capacity of 4.6 million tons. Although it has a small global market share, Unigel has a significant position in Latin America's styrenics and acrylics market. It's the main producer of styrene, the second of polystyrene, and the sole producer of acrylonitrile and methacrylate in the region. In acrylics, the company also produces cell cast acrylic sheets in Mexico (representing 8% of the company's installed capacity) and has a commercial presence in the U.S. The company also produces sodium cyanide. Additionally, the company is the sole producer of urea, ammonia, and ammonium sulfate in Latin America.

Our Base-Case Scenario

- After the supply shrunk and still strong demand for acrylics and styrenics due to COVID-19, we expect spreads for these products to normalize in the second half of 2021. We expect a peak in styrenics' spreads in the second quarter and a sharp contraction in the third and fourrth quarter as new capacity should come online. We expect acrylics' spreads to return to normal levels more gradually, benefiting the company's margins.
- The new agro unit to contribute revenue of about R$1.25 billion in 2021, R$1.9 billion in 2022, and R$2.05 billion in 2023. We expect the unit's EBITDA of R$350 million - R$450 million in 2021, R$500 million - R$600 million in 2022, and R$650 million – R$750 million starting in 2023.
- Acrylics volumes to increase 37% in 2021 as the company has been operating at full capacity since the third quarter of 2020, recovering from a low volume sold in 2020 given the pandemic. We don't expect significant volume increases starting in 2022.
- Styrenics volumes to increase 20% in 2021 given competition from new global capacity in the second half (if we were to annualize the first-half volumes, growth would be about 40%).
- The fertilizer units at full capacity, given that the Sergipe plant started operating in April and Bahia plant in June. That would represent 60% of capacity for the entire 2021. For 2022, 2023, and 2024, plants are likely to gradually increase output through small investments.
- EBITDA margin to increase in 2021 to 22% from 17% in 2020. Margins of 22%-24% starting in 2022.
- Capex of about R$570 million in 2021, about R$350 million of which will be for capacity expansion, and about R$350 million in the next few years.
- No dividends in 2021 and payment of 25% of previous year's net income starting in 2022.
- Debt amortization of R$450 million in 2021, R$190 million in 2022, and R$230 million in 2023.

Key metrics

Table 1

Unigel Participacoes S.A. -- Financial Summary

Industry Sector: Chemical Cos

	--Fiscal year ended Dec. 31--						
	2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
(Mil. R$)							
Revenue	2,787.6	3,393.8	3,322.7	3,233.2	6,254.4	6,665.4	6,569.0
EBITDA	351.2	467.4	407.5	547.2	1,391.7	1,571.3	1,642.2
Funds from operations (FFO)	229.5	302.4	233.1	290.6	962.4	1,165.7	1,245.2
Interest expense	231.5	229.1	228.9	303.8	308.3	303.8	282.8
Cash flow from operations	60.8	75.4	218.9	270.6	690.6	987.7	1,133.1
Capital expenditure	74.0	103.7	175.0	223.7	570.0	350.0	360.0
Free operating cash flow (FOCF)	(13.3)	(28.3)	43.9	47.0	120.6	637.7	773.1

Table 1

Unigel Participacoes S.A. -- Financial Summary (cont.)

Industry Sector: Chemical Cos

	--Fiscal year ended Dec. 31--						
	2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Discretionary cash flow (DCF)	(13.3)	(28.3)	43.9	47.0	120.6	520.2	627.7
Cash and short-term investments	34.7	239.5	382.3	624.0	810.0	1,105.5	1,468.6
Debt	1,290.4	1,895.1	2,089.5	2,960.8	3,060.8	2,870.8	2,640.8
Equity	374.7	324.2	366.7	57.5	527.6	991.6	1,498.3
Adjusted ratios							
EBITDA margin (%)	12.6	13.8	12.3	16.9	22.3	23.6	25.0
Return on capital (%)	13.1	16.9	10.3	14.9	32.4	33.1	33.0
EBITDA interest coverage (x)	1.5	2.0	1.8	1.8	4.5	5.1	5.8
FFO cash interest coverage (x)	2.9	3.1	2.4	2.2	4.1	4.8	5.4
Debt/EBITDA (x)	3.7	4.1	5.1	5.4	2.2	1.8	1.6
FFO/debt (%)	17.8	16.0	11.2	9.8	31.4	40.6	47.2
Cash flow from operations/debt (%)	4.7	4.0	10.5	9.1	22.6	34.4	42.9
FOCF/debt (%)	(1.0)	(1.5)	2.1	1.6	3.9	22.2	29.3
DCF/debt (%)	(1.0)	(1.5)	2.1	1.6	3.9	18.1	23.8

Liquidity

We assess Unigel's liquidity as adequate. The cash sources-to-uses ratio will be higher than 1.5x for the next 12 months. However, we view the company as having limited ability to absorb unexpected, high-impact events without refinancing, along with a sound--but still not sufficiently established--relationship with banks and only satisfactory standing in credit markets. In the past two years, Unigel's issuance of 2026 unsecured notes replacing the 2024 secured ones and the recent add-on improved the liquidity cushion and financial flexibility.

Principal Liquidity Sources:

- Cash position of R$721 million as of March 31, 2021; and
- Forecasted FFO of roughly R$950 million for the next 12 months after March 2021.

Principal Liquidity Uses:

- Short-term debt maturity of R$302 million in March 2021;
- Annual working capital needs of about R$250 million; and
- Capex of about R$515 million in the next 12 months after March 2021.

Covenants

The company has incurrence covenants on its 2026 senior unsecured notes that require net debt to EBITDA below 3.5x. The covenants also limit dividend payout at 25% of net income (legal minimum) unless cash position pro forma for distribution is higher than $100 million. We expect the company to maintain a significant cushion over its covenants.

Table 2

Unigel Participacoes S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

	--Rolling 12 months ended Dec. 31, 2020--									
Unigel Participacoes S.A. reported amounts (mil. R$)										
	Debt	**Shareholders' equity**	**Revenue**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
	2,600.4	57.5	3,233.2	498.5	349.4	301.7	547.2	270.6	--	223.7
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(24.0)	--	--	--
Cash interest paid	--	--	--	--	--	--	(232.6)	--	--	--
Reported lease liabilities	388.5	--	--	--	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	25.9	--	--	2.1	2.1	2.1	--	--	--	--
Nonoperating income (expense)	--	--	--	--	9.4	--	--	--	--	--
Debt: Derivatives	(135.3)	--	--	--	--	--	--	--	--	--
Debt: Other	81.2	--	--	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	0.9	0.9	--	--	--	--	--
EBITDA: Other	--	--	--	45.6	45.6	--	--	--	--	--
Total adjustments	360.4	0.0	0.0	48.6	58.1	2.1	(256.6)	0.0	0.0	0.0
S&P Global Ratings' adjusted amounts										
	Debt	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
	2,960.8	57.5	3,233.2	547.2	407.5	303.8	290.6	270.6	--	223.7

Issue Ratings - Recovery Analysis

Key analytical factors

The 'BB-' issue-level rating on Unigel's senior unsecured notes due 2026 is the same as the issuer credit rating on the company. It has a recovery rating of '3' with meaningful recovery expectation of 65% (rounded). We analyze Unigel's recovery under a going concern, assuming that the company would likely restructure rather than liquidate in a distress scenario. We evaluate Unigel using EBITDA multiple valuation, assuming a 5x EBITDA multiple over our expected emergence EBITDA of about R$470 million. The 5x EBITDA multiple is the same as we use for most other commodity chemicals companies. Our assumption of emergence EBITDA already incorporates the structural change in next years, with the agro operations increasing the company's value.

Simulated default assumptions

- Simulated year of default: 2025
- Jurisdiction: Brazil
- Estimate emergence EBITDA: R$470 million
- EBITDA multiple: 5.0x

Simplified waterfall

- Gross enterprise value (before 5% admin expenses): R$2.3 billion
- Total value available to unsecured claims: R$2.2 billion
- Senior secured debt: R$100 million
- Senior unsecured debt: R$3 billion
- Expected recovery of senior unsecured debt: 65%

Ratings Score Snapshot

Issuer Credit Rating

- Global scale: BB-/Stable/--
- National scale: brAA+/Stable/--

Business risk: Weak

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb-

Modifiers:

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

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded

	To	From
Unigel Participacoes S.A.		
Issuer Credit Rating	BB-/Stable/--	B+/Stable/--
Brazil National Scale	brAA+/Stable/--	brAA/Stable/--
Unigel Luxembourg S.A.		
Senior Unsecured	BB-	B+
Recovery Rating	3(65%)	