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Research Update:

Hungary-Based Fertilizer Producer Nitrogenmuvek Zrt. Outlook Revised To Negative; 'B+' Ratings Affirmed

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Overview

- Nitrogenmuvek Zrt. reported a weak ratio of adjusted funds from operations (FFO) to debt of 7% for 2016, due to peak spending, a series of unplanned production outages, and continued depressed fertilizer prices.
- We expect the company's ratio of adjusted FFO to debt will recover gradually to about 12%-15% in 2017 and 2018, helped by materially higher production volumes and much lower expenditures, though we expect prices to remain low.
- We are revising our outlook on Nitrogenmuvek to negative and affirming the 'B+' long-term corporate credit and senior unsecured debt ratings.
- The negative outlook reflects our view that there is at least a one-in-three likelihood that the company could delay anticipated deleveraging due to adverse market conditions (namely lower-than anticipated fertilizer prices, a fall in production, or a material depreciation of the forint), leading to adjusted FFO to debt of less than 12% over the next 12 months.

Rating Action

On July 17, 2017, S&P Global Ratings revised its outlook on Hungary-based fertilizer producer Nitrogenmuvek Zrt. to negative from stable. At the same time, we affirmed the 'B+' long-term corporate credit rating on the company and the 'B+' issue rating on its $200 million bond. In addition, we assigned our 'B+' rating to the company's proposed €200 million, seven-year bond.

Rationale

The outlook revision follows Nitrogenmuvek's weaker-than-expected performance in 2016. Its ratio of adjusted funds from operations (FFO) to debt deteriorated to 7% by year-end 2016 due to peak spending under its large and ambitious capital-expansion program, a series of unplanned production outages related to the engineering and construction work on its single site in Hungary, and continued depressed fertilizer prices. Our forecast is for this ratio to recover to about 12% in 2017, mainly supported by anticipated higher sales volumes and materially lower capital expenditures (capex). Nevertheless, we've factored in a one-in-three likelihood that the deleveraging could be delayed and that adjusted FFO to debt could remain below the 12%-15% range we consider commensurate for the rating.

With the commissioning of several new and expanded facilities in 2017, Nitrogenmuvek is about to complete an ambitious, multi-year investment program, with total capex of Hungarian forint (HUF) 98 billion forint since 2013. Key components of this initiative are an expansion of its ammonia facility's capacity by 200 tons per day (tpd), the construction of a new nitric acid plant with an 1,100-tpd capacity, and the completion of a new CAN (calcium ammonium nitrate) granulation plant. As a result of these efforts, Nitrogenmuvek is expecting significantly improved production stability, complemented by steep decreases in maintenance costs and energy consumption. Another benefit is that a larger share of its products--about 80%--is now produced in granulated form, which offers higher margins.

With Nitrogenmuvek's investment program now substantially complete, our revised base-case scenario anticipates that the company will continue to operate its plant at near-full capacity for the next couple of years. We estimate that its adjusted EBITDA margin will recover to about 17%-19% in 2017 (compared with 15% in 2016 and 23% in 2015) despite our expectation of continued fertilizer pricing pressure. We also assume that there will be no significant capacity additions in Nitrogenmuvek's main markets and that, as in the past few years, increasing demand from farmers will absorb most of its production.

Nitrogenmuvek's business risk profile continues to reflect the company's relatively small scale compared to that of peers, concentrated asset base (it is reliant on one site in Hungary), limited product and geographic diversification, and exposure to the cyclical fertilizer industry. Partly offsetting these constraints are Nitrogenmuvek's strong domestic market position and good cost position as a result of its efficient plant, low transportation costs, and domestic distribution network. Historically, this has resulted in above-average, though very volatile, profitability.

The company's proposed refinancing addresses some of the issues we had raised regarding its capital structure. On top of the extended maturity profile, the proposed €200 million bond, which the company intends to use to refinance the existing $200 million bond due 2020, significantly reduces the mismatch between the company's debt (currently mostly denominated in U.S. dollars) and its revenues (more than 40% of sales were denominated in euros in 2016, and the remainder was in forint).

In our base case, we assume:

- Materially higher (+30%) production volumes in 2017 compared with the last two years, which were hurt by scheduled (2015) and unscheduled (2016) production outages of up to two months each.
- A gradual ramping up of the new and expanded facilities that were constructed under the company's substantial HUF98 billion capex program.
- Continued weak fertilizer prizes in 2017 and 2018, though prices have modestly improved in first-quarter 2017 compared to 2016.
- Moderate outflows for acquisitions.

- As the company's investment program winds down, capex will decline to HUF12 billion in 2017 and HUF3 billion in 2018 from HUF35 billion in 2016.
- No dividends or acquisitions in 2017 or 2018.

Based on these assumptions, we arrive at the following credit measures:
- Adjusted EBITDA of HUF18 billion-HUF 20 billion in 2017 and 2018.
- Adjusted FFO to debt of about 12%-15% in 2017 and 2018.
- Still marginally negative free operating cash flow of HUF 1 billion in 2017 but reaching positive HUF8 billion-10 billion in 2018.

Liquidity

We classify Nitrogenmuvek's liquidity as adequate. We forecast that the company's liquidity sources will exceed its uses by more than 1.2x in the 12 months from April 1, 2017.

We estimate that liquidity sources for that period include:
- About HUF20.7 billion of cash at the end of first-quarter 2017;
- FFO of about HUF13.1 billion for the next 12 months; and
- Undrawn bank lines of HUF3.3 billion at the end of first-quarter 2017.

We estimate that liquidity uses during the same period include:
- Debt maturities of up to HUF5.4 billion over the 12 months beginning April 1, 2017, and HUF6.0 billion for the 12 months thereafter.
- Capex of HUF10 billion.
- A working-capital outflow of HUF630 million.
- A seasonal working capital outflow of HUF12 billion for next 12 months and for future periods.
- No dividends or acquisitions.

Outlook

The negative outlook reflects a one-in-three likelihood that we could lower the rating in the next 12 months if anticipated deleveraging were to be delayed, leading to adjusted FFO to debt remaining below 12%. This could happen due to, for example, lower-than anticipated fertilizer prices, a fall in production, or a material depreciation of the forint against the euro, the U.S. dollar, or both. We could also consider lowering the rating if Nitrogenmuvek were to adopt financial policies that we consider less prudent, which we don't anticipate.

Upside scenario

We would revise the outlook to stable within the next 12 months if the company realizes the anticipated higher production and sales volumes during 2017 and fertilizer prices don't fall further.

Ratings Score Snapshot

Corporate credit rating: B+/Negative/--

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

Financial risk: Aggressive
- Cash flow/leverage: Aggressive

Anchor: b+

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

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Nitrogenmuvek Zrt.		

Corporate Credit Rating	B+/Negative/--	B+/Stable/--
Senior Unsecured	B+	B+

New Rating

Nitrogenmuvek Zrt.	
Senior Unsecured	B+

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.