FITCH REVISES NITROGENMUVEK'S OUTLOOK TO NEGATIVE; AFFIRMS AT 'B+'

Fitch Ratings-London/Moscow-21 June 2017: Fitch Ratings has revised Hungary-based fertiliser company Nitrogenmuvek Zrt's Outlook to Negative from Stable, and simultaneously affirmed the Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'B+'. Fitch has also affirmed its senior unsecured rating at 'B+' with a Recovery Rating of 'RR4'.

The Outlook revision reflects the issuer's large increase in leverage and longer than previously anticipated deleveraging from a funds from operations (FFO) adjusted net leverage (leverage) peak of 6.6x at end-2016. We do not expect nitrogen fertiliser prices to recover to pre-2016 levels in the medium term as the market is oversupplied. This, despite lower capex and positive free cash flow (FCF), would result in around 4x net leverage during 2017-2018 before going below 2.5x from 2019 as fertiliser prices recover. The IDR affirmation reflects reduced capex-related risks, higher output as investments complete, and a strong liquidity profile up to 2020.

KEY RATING DRIVERS

Capex, Pricing and Shutdowns: End-2016 leverage reached 6.6x as the company had a 58-day long ammonia plant shutdown mainly due to construction works, combined with nitrogen fertiliser prices hitting a five-year low and translating into weak FFO generation. We do not expect further unplanned shutdowns as most construction works are complete. However, nitrogen oversupply will put pressure on medium-term fertiliser prices, implying a rebased issuer financial profile with leverage at around 4x over 2017-2018. This is despite low maintenance capex and nil dividends, which translate into positive but moderate FCF and deleveraging over several years.

Absolute Debt Under Control: Gross debt peak at around HUF95 billion in 2016, in line with our previous expectations as capex outflows were largely pre-funded with a seven-year 7.875% USD200 million senior unsecured bond raised in 2013 and the eleven-year EUR93 million bank loan raised in 2016. Weak 2016 FFO and significant working-capital outflows pulled down the cash cushion to HUF27 billion, but the 2017 output-driven FFO recovery, planned destocking, lower capex and assumed nil dividends mean that the company will shift to neutral-to-positive FCF generation and reduce its gross debt.

The extent of the recovery in fertiliser prices will however determine the pace of deleveraging.

New Businesses Supress Margins: Nitrogenmuvek continues to expand its lower-margin grain, pesticide and seed trading operations, boosting direct sales to farmers and enhancing its presence in central Europe through bolt-on acquisitions. Fitch believes that the expansion into new business segments will boost sales but will have a dilutive impact on the EBITDA margin. The expansion will, however, help improve Nitrogenmuvek's brand names and market coverage, which will lead to higher volumes and realised sales prices in the longer term.

Large Domestic Market Share: Nitrogenmuvek is the only producer of nitrogen fertilisers in Hungary with a significant market share. Barriers to entry include the extent of the return on investment given the small regional market, the lead time of four to five years for new plant construction, high transportation costs for importers (Hungary is a landlocked country) and import tariffs for non-EU producers.

Long-Term Demand Fundamentals: The global fertiliser sector's long-term demand outlook remains strong despite medium-term supply-driven pressure, being supported by declining arable land, a growing population and meat consumption, and biofuel production. Nitrogenmuvek is also expected to benefit from the higher growth potential of central European countries where nitrogen fertiliser use per hectare remains below that of mature agricultural markets, especially calcium ammonium nitrate as it suits Europe's environmental regulations for fertilisers and is easy to store.

High Exposure to Price Volatility: Nitrogenmuvek lacks the product and geographical diversification of its international peers, and is located on the upper part of the ammonia cost curve, which leaves it substantially exposed to nitrogen price volatility. The company is also exposed to volatile natural gas prices, its main raw material, although this is partly mitigated by its access to spot and short-term purchases on European gas hubs and contracts based on spot prices.

FX Risk: Nitrogenmuvek has no US dollar-denominated revenues, which exposes it to convertibility and translation risk on its USD200 million notes. Therefore, a strong appreciation of the US dollar and a strong depreciation of the forint or euro could result in deterioration in the group's credit metrics due to the mismatch between operating cash flows and the US dollar-denominated debt.

DERIVATION SUMMARY

Nitrogenmuvek has smaller scale, higher product concentration and a weaker cost position than Fitch-rated EMEA nitrogen fertiliser players Acron (BB-/Positive) and EuroChem (BB/Negative). This is partly mitigated by Nitrogenmuvek's dominant share within its landlocked domestic market of Hungary, its strong and increasing share of direct sales to farmers as well as its strong liquidity. It also benefits from having a near-complete investment cycle with positive free cash-flow generation expected to start from 2H17. No country ceiling, parent/subsidiary, operating environment aspects or other factors impact the rating.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- fertiliser prices to grow in the low single digits from 2016 lows until a stronger recovery from 2019;
- fertiliser sales volumes to rebase at 1,300-1,400kt with calcium ammonium nitrate (CAN)-focused production from 2017 as new capacity is launched;
- non-fertiliser segment to increase sales in the double digits but to have flat margins over the next three years;
- 2017-2020 capex totalling at around HUF15 billion.

Fitch's key assumptions for bespoke recovery analysis include:
- post-restructuring EBITDA is HUF11.2 billion, or equal to 2016 EBITDA, reflecting a hypothetical downturn that would provoke a default as well as Fitch's expectation of the company's corrective actions;
- 4.0x distressed multiple reflects the typical multiple applied to small-scale chemical producers;
- Fitch has applied standard discounts to end-2016 property, plant and equipment (50%), receivables (25%) and inventories (50%);
- 10% administrative claims are deducted from the liquidation enterprise value;
- USD200 million bonds rank pari passu with all the remaining senior unsecured debt in the waterfall.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

-(Outlook Stabilisation) Positive FCF translating into FFO net adjusted leverage sustained below 2.5x, or gross leverage below 3.0x

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

-Dividends, aggressive capex or unexpected maintenance leading to FFO adjusted net leverage maintained above 2.5x, or gross leverage above 3x, by 2019

-Sustained drop in the EBITDA margin of core fertiliser operations to below 20%

LIQUIDITY

Liquidity Comfortable: With HUF27 billion cash and cash equivalents covering HUF4 billion short-term loans and borrowings at end-2016, the liquidity position looks comfortable throughout 2017 and Fitch expects it to remain so until the next significant repayment represented by HUF59 billion (USD200 million) Eurobonds due in May 2020. Positive free cash flow generation from 2017 onwards is driven by capex moderation and adds comfort to the company's liquidity position.

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Summary of Financial Statement Adjustments

- Short-term operating lease commitments of HUF20 million capitalised with 8x multiple (applicable for Hungary)
- HUF3 billion reclassified as Fitch-defined restricted cash
- HUF31.5 billion net loss from sales of tangible and intangible assets was excluded from EBITDA
- HUF2.2 billion capitalised interest reclassified to operational cash flows and cash interest expense from capex
- HUF19.1 billion net increase in advances for investments treated as capex

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary

Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)

https://www.fitchratings.com/site/re/895493

Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 16 Jun 2017)

https://www.fitchratings.com/site/re/899659