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Research Update:

Norwegian Fertilizer Producer Yara International 'BBB' Rating Affirmed; Outlook Stable

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Overview

- Norway-based fertilizer producer Yara's adjusted EBITDA declined by more than 30% to Norwegian krone (NOK) 8.8 billion in the first nine months of 2017 in comparison with the equivalent period in 2016, pressured by the low cycle conditions in the fertilizer industry, higher cost of natural gas in Europe, and weaker U.S. dollar.
- We forecast that the combination of weaker profits at Yara and ongoing high investments in strategic capacity expansions will lead to adjusted funds from operations (FFO) to debt of about 40% in 2017, down from about 63% in 2016.
- At the same time, we anticipate that Yara's adjusted FFO to debt will remain at a stable level of 39%-43% in 2018 as the company benefits from its improvement program, additional volumes from capacity expansions and the Babrala acquisition, and lower capital expenditure, and notwithstanding our assumption of ongoing low cycle fertilizer prices.
- The stable outlook on Yara reflects our view that it will maintain adjusted FFO to debt of about 35%-45%, which we view as commensurate with the rating.

Rating Action

On Nov. 21, 2017, S&P Global Ratings affirmed its long-term and short-term ratings on Norway-based fertilizer producer Yara International ASA at 'BBB/A-2'. The outlook is stable.

We also affirmed our 'BBB' issue ratings on Yara's unsecured bonds of $500 million due June 2019 and $500 million due June 2026.

Rationale

The affirmation factors in our forecast of a recovery in Yara's adjusted EBITDA in 2018 to about Norwegian krone (NOK) 16.5 billion-NOK17.5 billion, supported by the benefits from its improvement program, additional volumes from capacity expansions and the Babrala acquisition, and notwithstanding the subdued fertilizer prices and higher natural gas prices in Europe.

In the first nine months of 2017, Yara's adjusted EBITDA declined by more than 30% to NOK8.8 billion, down from NOK12.7 billion in the first nine months of 2016. This decline was primarily due to low fertilizer prices and margins, and despite broadly stable production volumes of ammonia and finished fertilizer and industrial products, even with the Porsgrunn ammonia plant out of production due to a fire in April. At the same time, against the backdrop of challenging industry conditions, Yara is pursuing an ambitious growth strategy. It has invested highly in strategic capacity expansions of premium and commodity products, which will see an outlay in NOK13 billion and NOK10.9 billion of capital expenditure (capex) in 2017 and 2018, respectively. Yara is also in the process of acquiring Tata Chemicals Ltd.'s Babrala urea plant and distribution business in India for NOK3.5 billion.

Our affirmation also factors in Yara's commitment to maintain at least a 'BBB' rating, and our understanding that Yara's capex is flexible. We also view positively Yara's progress in delivering its improvement program, with US$210 million of realized benefits to Sept. 30, 2017, ahead of estimated US$150 million planned for the year.

In our base-case scenario, we assume:

- Relatively low cycle industry conditions, as observed in the first nine months on 2017, with ongoing low cycle prices for nitrogen fertilizers and phosphates. This reflects our view that supply will exceed demand over the next two years at the very least.
- For nitrogen fertilizers, we expect global capacity growth over the next three years of at least 2% each year (as a percentage of total capacity) to exceed the modest 1.2% demand growth (as a percentage of total demand) each year--as forecast by The International Fertilizer Association (IFA)--of existing capacity in each year for the next three years.
- For phosphate-based fertilizers, we anticipate global capacity additions (as a percentage of total capacity) in 2017 and 2018 are likely to be in the 5% area, declining in 2019 to about 1%. The IFA projects demand growth in contrast at around 1.6% (as a percentage of total demand) each year over the next three years.
- Net benefits to EBITDA from Yara's improvement program of about NOK0.5 billion in 2017 and about NOK1.0 billion in 2018.
- Broadly neutral working capital for the full-year 2017, with possible outflows in 2018 as a result of a production growth and increase in sales.
- Capex of about NOK13 billion in 2017 and NOK10.9 billion in 2018.
- Acquisition of Tata Chemicals Ltd.'s Babrala urea plant and distribution business in India of NOK3.5 billion (US$470 million) in late 2017 or early 2018, and possible mid-sized acquisitions in 2018.
- Shareholder distributions at about 45% of previous years' net income, in line with the upper value of Yara's financial policy.

Based on these assumptions, we arrive at the following:

- Reported EBITDA (excluding special items and interest income) of NOK11.5 billion-NOK12.0 billion in 2017, and about NOK15.5 billion-NOK16.5 billion in 2018.
- Adjusted FFO-to-debt ratio of about 40% in 2017 and 39%-43% in 2018.
- Adjusted debt to EBITDA of about 2.0x in both years.

The above ratios, notably the adjusted FFO-to-debt ratio, are weaker than the

45%-48% for 2017 that we forecast in January 2017. As a result, we have now revised the financial risk profile downward to intermediate from modest. Our assessment of Yara's financial policy no longer constrains the rating, because we believe that the company will balance its growth strategy (including acquisitions) with the publicly stated commitment to maintain at least a 'BBB' rating.

Our assessment of Yara's business risk profile as satisfactory continues to be supported by the company's position as the world's largest distributor of fertilizers with a strong and geographically extended marketing network. It also derives a large share of profits from premium, higher-margin fertilizers as opposed to commodity products such as ammonia and urea--the profits of which depend not on selling prices but on the spread between selling and feedstock prices. This generally translates into more resilient profits. In addition, Yara's production is geographically diverse. It directly operates large scale, efficient plants in Europe and Canada, while its joint ventures also have efficient assets. Nitrogen fertilizers--Yara's primary focus--are by far the largest of the three fertilizer markets (the two others being phosphate and potash), and volume declines in this segment are limited. Farmers tend to consider nitrogen fertilizers as indispensable given their short-term effect on crop yields.

The main business risks include the highly cyclical profits in the nitrogen fertilizer industry, reflecting the industry's changing supply-demand balance, which is difficult to predict as it depends on fertilizer price expectations, harvests, the crop mix, farmers' earnings (which themselves depend on crop prices), the weather, and inventory levels. New supply depends on whether announced expansion projects have actually started and the speed at which they come on-stream. Political decisions influence both demand and supply, through export allowances or taxes and subsidies in various core markets, especially in India and China. Yara is also exposed to relatively high and volatile gas prices in Western Europe, which accounts for a large share of production. In terms of constraints in the industry, Yara, like other players, faces long lead times and capital intensity to expand capacity, especially for green-field projects.

Liquidity

We now assess Yara's liquidity as adequate, based on our view that liquidity sources will cover uses by 1.2x over the 12 months starting Sept. 30, 2017. Our assessment also factors in comfortable headroom under the financial covenant incorporated in Yara's $1.25 billion revolving credit facility (RCF), which stipulates that net debt to equity in the consolidated accounts is at most 1.4x at the end of each quarter. We anticipate that Yara will refinance its debt maturities well ahead of time, notably its $500 million bond due June 2019 and NOK2.2 billion bond due December 2019.

We estimate that Yara's principal liquidity sources in the next 12 months will comprise:

- Available cash and cash equivalents of around NOK1.4 billion as of Sept.

30, 2017. This is NOK0.6 billion lower than the cash reported on balance sheet because we view this amount as restricted and therefore not immediately available for debt repayment;
- FFO of about NOK12 billion-NOK12.5 billion; and
- Full availability under the committed RCF and other long-term committed facilities of about NOK14 billion. The RCF of $1.25 billion matures in July 2020.

We estimate that Yara's principal liquidity uses over the same period will comprise:
- Short-term debt of NOK4.5 billion, of which the majority relates various local lines with 12-month durations;
- Capex of NOK11.4 billion, of which NOK5.8 billion is maintenance;
- Dividend payment of NOK2 billion; and
- Acquisition outlay with regard to Babrala of NOK3.5 billion.

Outlook

The stable outlook on Yara reflects our view that it will maintain adjusted FFO to debt of about 35%-45%, which we view as commensurate with the rating. This is based on our assumption that, in 2018, Yara's profits will be supported by the benefits from its improvement program, additional volumes from capacity expansions and the Babrala acquisition, and notwithstanding higher energy costs in Europe and low cycle prices for fertilizers.

Downside scenario

We could lower the rating if Yara's adjusted FFO to debt ratio declined below 35% with no prospects of recovery. This could occur, in our view, if Yara did not mitigate the challenging conditions in the fertilizer industry with internal measures such as the improvement program, and at the same time if the company increased capex, acquisitions, or shareholder distributions.

Upside scenario

Over time, upside potential could emerge and would depend on our confidence that Yara would be able to sustain adjusted FFO to debt of more than 45%, and that the company's financial policy and growth strategy would support a higher rating.

Ratings Score Snapshot

Corporate Credit Rating BBB/Stable/A-2

Business risk: Satisfactory
- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb

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

Issue Ratings

Subordination risk analysis

Capital structure
Yara's capital structure consists primarily of a $500 million bond due 2019, $500 million bond due 2026, NOK2.2 billion bond due 2019, NOK700 million bond due 2021, NOK600 million due 2024, and various local lines. All notes are unsecured and unsubordinated obligations of the issuer, ranking at least equally with each other. Liquidity is supported by $1.25 billion RCF due July 2020, which has the same seniority as Yara's current and present obligations.

Analytical conclusions
With no material priority obligations ranking ahead of the company senior unsecured obligations, we rate its senior unsecured bonds at 'BBB', in line with the corporate credit rating on Yara.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- 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
- General Criteria: Group Rating Methodology, Nov. 19, 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: Methodology For Linking Short-Term And Long-Term

Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 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

Related Research

- The Credit Quality Of Global Fertilizer Companies Will Remain Under Pressure, Sept. 29, 2017

Ratings List

Ratings Affirmed

Yara International ASA	
Corporate Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB

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