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Research Update:

Russia-Based Uralkali Downgraded To 'BB-' On Continued Share Buybacks And Financial Policy; Outlook Stable

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Research Update:

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Overview

- Uralkali OJSC has announced a new share buyback of up to 6.5% of its share capital that will increase its debt.
- This follows previous share buybacks earlier this year costing a total of $3.4 billion, and will increase the company's leverage beyond our previous expectations.
- We also see a heightened risk of further debt increases related to shareholder distributions or potential shareholder changes.
- We are consequently lowering our global scale rating on Uralkali to 'BB-' from 'BB' and the Russia national scale rating to 'ruAA-' from 'ruAA'.
- The stable outlook reflects our expectation that Uralkali will continue to generate strong free operating cash flow that should partly offset high shareholder distributions and maintain funds from operations to debt above 20%.

Rating Action

On Dec. 9, 2015, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Russian potash fertilizer producer Uralkali OJSC to 'BB-' from 'BB'. The outlook is stable.

We also lowered the Russia national scale rating on Uralkali to 'ruAA-' from 'ruAA'.

Rationale

The downgrade reflects our view that Uralkali's continued significant share buybacks will lead to leverage above our previous expectations. It also takes into account our assessment of the company's aggressive and difficult-to-predict financial policy. A secondary factor is our expectation that potash prices will decline in 2016 on the back of increasing supply in the global market.

Uralkali announced on Nov. 23, 2015, that it will buy back shares of up to 6.5% of the company's share capital. The price of shares has not been determined in advance but, assuming the same pricing as the company's recent tender offer, the total amount could be about $0.6 billion. We think it likely that the company will ultimately buy out all of the 13.9% remaining free float, which is worth $1.3 billion assuming the same price as during the last tender offer. This buyback comes on top of the buybacks it executed in May and in September this year of a total $3.4 billion.

In addition, we cannot exclude further shareholder changes that could lead to a further increase in leverage after the company becomes private. However, neither the company nor its largest shareholders have announced such intentions. Our "negative" financial policy assessment therefore captures these event risks.

We now expect Uralkali's leverage will continue to increase. We factor in that the ratio of adjusted funds from operations (FFO) to debt will be about 25% in 2015. For 2016 we expect it will be between 20% and 25% depending on the amount Uralkali spends buying back shares. We are therefore lowering our assessment of the company's financial risk profile to significant.

We continue to view Uralkali's operating risk as above-average for the industry, even if the decommissioning of the Solikamsk-2 mine appears to be on track. We do not believe that last year's flooding at Solikamsk-2 will affect operations at the neighboring Solikamsk-1 mine. We also note healthy operating performance in 2015, with volumes declining by just 5% in the first nine months of 2015, which is less than we previously anticipated. Furthermore, we believe that Uralkali's business risk profile remains supported by the company's position among the four largest potash producers. These top four players together control more than 60% of global capacity. We also think that Uralkali's business risk profile is underpinned by its unique cost position, which facilitates very high EBITDA margins, even in the current midcycle environment.

Our base-case scenario for 2015-2016 incorporates:
- A potash cost and freight price of about $310 per metric ton (/mt) in 2015 and $280-$290/mt in 2016, against $307/mt in 2014 and $350/mt in 2013.
- Production volumes of about 11 million tons in 2015 and slightly higher in 2016, as the company ramps up production and begins debottlenecking at other mines.
- An exchange rate of about Russian ruble (RUB) 61 to the U.S. dollar in 2015 and RUB65 to the dollar in 2016.
- We don't include in our base-case scenario further share buybacks apart from the $3.4 billion already completed in 2015 because the timing and amount are uncertain. However, we reflect our view of this risk in our financial policy assessment.

Based on these assumptions, and without factoring in further shareholder distributions, we anticipate:
- EBITDA of $1.7 billion-$1.9 billion in 2015 and $1.5 billion-$1.8 billion to 2016.
- A Standard & Poor's-adjusted ratio of FFO to debt of about 25% in 2015 and 2016. This could decline to 20% in 2016 depending on the amount of share buyback.

- A reported ratio of net debt to EBITDA slightly below 3x in 2015 and 2016.

Liquidity

We view Uralkali's liquidity as adequate, based on the company's material cash balances, committed lines, and positive free operating cash flow (FOCF). The ratio of sources to uses of liquidity remains comfortably above 1.2x. We also expect strong support from Russian banks given Uralkali's status within the country, which softens the effect of the currently constrained access to international markets for Russian issuers.

Uralkali is subject to semiannual maintenance covenants under several of its bank loan agreements. We consider that headroom will be adequate. In particular we forecast net debt to EBITDA of below 3x under our base-case scenario, well below the 4.0x and 4.5x limits under various credit agreements.

We estimate the following liquidity sources:

- Cash and short-term investments of $1.3 billion as of Sept. 30, 2015, largely kept in hard currencies in Russia's largest banks. This excludes about $0.1 billion, which we believe is not immediately available for debt repayment.
- Committed bank lines of $1.7 billion, notably the $1.5 billion Sberbank facility due in 2020.
- FFO of about $1.1 billion-$1.4 billion.

We estimate the following liquidity uses:

- Short-term debt of about $1 billion as of Sept. 30, 2015 ($1.6 billion in the following year).
- Capital expenditures of about $0.4 billion.

Additional liquidity uses could result from a share buyback. However, this amount is uncertain and the company doesn't have an obligation to buy back shares.

Outlook

The stable outlook reflects our expectation that Uralkali will continue to generate strong FOCF that should partly offset high shareholder distributions and enable the company to maintain an FFO-to-debt ratio above 20% and refinance its meaningful debt maturities over 2016-2018. We believe that share buybacks of about $1 billion (including the announced buyback of 6.5% of shares) can be accommodated within the current rating level.

We may lower the rating if a material weakening of the potash market or management's financial policy decisions cause FFO to debt to drop below 20% without near-term expectations of recovery. This could happen, for example, in the case of a leveraged buyout or a material acquisition. Leverage may also increase if the potash price declined well below $280-$290 CFR China and this is not countered by further material ruble devaluation.

We may ultimately raise the rating if Uralkali's financial policy becomes more predictable and the company's ratio of FFO to debt is consistently above 25%. However, we consider this scenario remote over the next 12 months.

Ratings Score Snapshot

Corporate Credit Rating: BB-/Stable/--

Business risk: Fair
- Country risk: High
- Industry risk: Moderately high
- Competitive position: Strong

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bb

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Negative (-1 notch)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014

Ratings List

Downgraded

	To	From
Uralkali OJSC		
Corporate Credit Rating	BB-/Stable/--	BB/Stable/--
Russia National Scale	ruAA-/--/--	ruAA/--/--

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