

UPL Corporation Limited (/gws/en/esp/issr/96364396)

Fitch Revises UPL Corp's Outlook to Negative; Affirms at 'BBB-'

Fitch Ratings-Singapore/Mumbai-23 July 2018: Fitch Ratings has revised the rating Outlook on Mauritius-based UPL Corporation Limited (UPL Corp) to Negative from Stable, following the announcement that it plans to acquire Arysta LifeScience Inc. At the same time, Fitch has affirmed UPL Corp's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB-'. A full list of rating actions is at the end of this commentary.

The rating on UPL Corp is based on the consolidated profile of India-based parent UPL Limited (UPL). The Negative Outlook on UPL Corp reflects the increase in UPL's leverage after it said UPL Corp would acquire Arysta for USD4.2 billion from Platform Specialty Products Corp, and uncertainty whether UPL will be able to deleverage so as to not exceed Fitch's thresholds for considering negative rating action. The acquisition will be financed with around USD3 billion of debt and USD1.2 billion of equity inflow from the sale of around 22% stake in UPL Corp. The transaction is subject to certain anti-trust approvals, but UPL expects it to be completed by the end of the financial year ending March 2019 (FY19).

Arysta and UPL operate in the same niche of making crop protection chemicals whose patents have expired (post patent products). With the acquisition of Arysta, we expect UPL to become the world's largest post-patent player globally, to almost double its FY18 EBITDA, and to add Arysta's research-based differentiation to its cost advantage. We estimate UPL's adjusted debt to EBITDAR leverage to rise temporarily before declining to around 3.0x by FY21, a level that is reasonable for its rating in light of a significantly better business profile. However, the rate of deleveraging will depend on the company unlocking significant cost and revenue synergies through successful integration, and broader industry fundamentals.

KEY RATING DRIVERS

Acquisition to Drive Market Leadership: The proposed acquisition of Arysta will make UPL the largest company in the post-patent crop protection market, with the combined entity having sales of around USD5 billion and EBITDA of around USD1 billion in

FY18. Arysta's strength in research and development (R&D) of formulations and focus on specialty crops and uses should complement UPL's strength as a low-cost producer for grain crops and large-scale applications. Fitch expects the combined entity to be well-diversified geographically, with around 40% of sales from developed markets of Europe and North America, and the remaining from Latin America, India and others.

Enhanced Product Portfolio: Arysta should more than double UPL's product registrations from around 5,900 at FYE18, we estimate. In addition to supplementing UPL's product portfolio for seeds and conventional crop protection, Arysta's strength in biological solutions and long-standing relationships with several R&D companies will enhance UPL's competitive advantages. Arysta is a partner for several research-focused companies, including some in Japan, and offers them access to emerging regions and niche segments. As a result, it has been able to license or acquire several patented products at a rate faster than many post-patent competitors.

Synergies to Determine Deleveraging Pace: We estimate UPL's net adjusted debt to EBITDAR ratio will decline to around 2.5x by FY21, the second full-year of consolidating Arysta, from over 6x in FY19. Brisk deleveraging is likely to be driven by positive FCF from FY20 and supported by higher revenue and cost savings from a wider product portfolio, expanded sales reach, removal of redundant roles and reduced outsourcing. Inability to achieve substantial synergies is a key risk to our estimates, apart from weak market conditions. UPL has reiterated its focus on retaining its investment-grade rating and metrics, but any further acquisitions may raise leverage and affect the rating.

Industry Recovery, Robust Prospects: The global crop protection market shrank in 2015 and 2016 due to adverse weather, weak crop prices and high inventory. The market remained flat in 2017 and industry participants expect growth in 2018 as pricing power has improved with lower inventory levels. The market expanded around 3% a year over 2011-2017 despite the weakness in 2015-2017, and Fitch expects the market to continue growing, led by fungicides.

The industry also enjoys high barriers to entry as significant investments are needed for registrations, sales and distribution channels and manufacturing facilities. The market is highly regulated and registrations have a long gestation period of several years. These factors also hinder potentially disruptive technologies.

Revenue Growth; Market Share Gain: UPL's revenue growth has been one of the industry's fastest over 2011-2017 and the company's revenue increased by 9% in FY18 (in US dollar terms) despite a flat overall conventional crop protection market in 2017. UPL improved its global market share to 5% in 2017 from 2% in 2010. UPL generates

over 85% of its sales from branded products. It has invested in product registration in key markets and increased its registration portfolio at a CAGR of around 9% over the last seven years, indicating revenue growth is likely to be sustained.

Cost-Efficient Manufacturing: UPL's manufacturing operations are centred in Gujarat, India where it derives benefits from a low-cost base and process improvements, having operated the facilities for more than 20 years. The company's efficient production process drives its robust EBITDA margins, which compare favourably with post-patent crop protection peers. Reliance on in-house manufacturing results in better process control and more stable margins compared with competitors that face increasing costs of contract manufacturing in China. We also see potential cost benefits from insourcing of several ingredients from UPL by Arysta, which currently outsources all of its manufacturing.

Rating Based on Consolidated Profile: We will continue to rate UPL Corp based on the consolidated credit profile of UPL even after the sale of around 22% stake in total in UPL Corp to a wholly owned subsidiary of Abu Dhabi Investment Authority (ADIA), and TPG, under Fitch's Parent and Subsidiary Rating Linkage methodology. Fitch deems the subsidiary UPL Corp to be stronger than UPL and assesses legal and operational linkages between the two as strong. UPL exerts significant management control over UPL Corp and the bonds at UPL Corp have cross-default provisions spanning the consolidated group. We will, however, adjust UPL's EBITDAR-based coverage and leverage metrics for minority interest in UPL Corp.

DERIVATION SUMMARY

UPL Corp is rated lower than innovators such as BASF SE (A+/Negative) mainly due to a smaller scale and patented-product portfolio. While UPL's scale and access to higher-value patented products should improve with the Arysta acquisition, we estimate its revenue to still be about one-tenth that of BASF. Scale and product depth result in a stronger business profile for BASF with a higher degree of protection from competitive threats and generally more stable revenue.

Syngenta AG (BBB/Stable), an innovator, is rated 'BBB-' on a standalone basis and its IDR includes a one-notch uplift to reflect support from China National Chemical Corporation Limited (A-/Stable). It is amongst the largest crop-protection chemical producers in the world. However, Syngenta is more leveraged than its peers and other investment-grade specialist chemical peers. The forecasted leverage over 2018-2021 is more in line with a 'BB' financial profile, whereas the business profile is forecast to remain in the 'A' category range. We also estimate the combined UPL-Arysta will have higher EBITDA margin than Syngenta and similar FCF generation of over USD400

million by 2020. These factors, and our expectation that Syngenta will be more highly leveraged than UPL by 2020, results in UPL being rated at the same level of Syngenta on a standalone basis,

Dow Chemical Company (BBB/Rating Watch Positive), whose rating factors in its position as the largest North American chemical company, strong patent portfolio, leading position in specialty chemicals as well as relatively high historical leverage. However, Fitch expects the company to deleverage through earnings growth and the intended merger and spin off with E.I. du Pont de Nemours and Company (DuPont, A/Rating Watch Negative) and hence the ratings are on Watch Positive.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Consolidation of Arysta from FY20, while acquisition-related cash outflow of USD4.2 billion and inflow from sale of stake in UPL Corp of USD1.2 billion to occur in FY19
- Consolidated revenue of USD5.4 billion in FY20; around 10% annual growth thereafter
- EBITDA margin of around 24%-25% in FY20-21
- Annual capex of around USD330 million in FY20-21
- No further acquisition-related spending beyond Arysta, nor any inflows from divestments

RATING SENSITIVITIES

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

- Adjusted net debt/EBITDAR, excluding minority interest in net income, not on track to be around 2.5x or lower by FY21, possibly due to inability to achieve material synergies from the acquisition
- Adjusted debt/EBITDAR, excluding minority interest in net income, not on track to be around 3.0x or lower by FY21
- EBITDA margin dropping below 15%, reflecting weaker competitiveness

We have changed the leverage metrics for our sensitivities from FFO-based ratios to account for around 22% minority interest at UPL Corp after the sale of stakes to a wholly owned subsidiary of ADIA, and TPG

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

Fitch may revise the Outlook to Stable if performance is better than the sensitivities for negative rating action or if the proposed transaction does not proceed to completion.

LIQUIDITY

Comfortable Liquidity: UPL's INR66 billion of reported debt as at end-March 2018 was almost entirely unsecured. Of the total, over 75% comprised of senior unsecured notes due in FY22 and FY28. UPL had INR7.2 billion of debt (excluding accrued interest of INR0.5 billion) due in FY19 compared with cash and cash equivalents of INR29 billion. In addition, UPL's likely neutral to positive FCF over FY19-FY21 and diverse sources of funding imply a comfortable liquidity position for the company.

FULL LIST OF RATING ACTIONS

UPL Corporation Limited

- Long-Term IDR affirmed at 'BBB-'; Outlook revised to Negative from Stable
- Senior unsecured rating affirmed at 'BBB-'
- USD500 million 3.25% senior unsecured notes due 2021 affirmed at 'BBB-'
- USD300 million 4.5% senior unsecured notes due 2028 affirmed at 'BBB-'

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Summary of Financial Statement Adjustments - Receivables sold under various programmes (FY18: INR20.5 billion) have been added back, along with a corresponding addition to secured debt.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (<https://www.fitchratings.com/site/re/10023785>)

Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (<https://www.fitchratings.com/site/re/10024585>)

Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018) (<https://www.fitchratings.com/site/re/10036366>)

Sector Navigators (pub. 23 Mar 2018) (<https://www.fitchratings.com/site/re/10023790>)

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