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Research Update:

Mexichem S.A.B. de C.V. 'BBB-' Ratings And 'mxAA/mxA-1+' National Scale Ratings Affirmed; Outlook Stable

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Overview

- We expect that Mexico-based chemicals; petrochemicals; and water, gas, and Datacom plastic solutions producer Mexichem will focus on the consolidation of Netafim's recent acquisition while maintaining its target leverage ratios.
- We are affirming our ratings on Mexichem, including our 'BBB-' global scale and 'mxAA/mxA-1+' national scale corporate credit and debt ratings.
- The stable outlook reflects our expectation that the company will continue to consolidate its recent acquisitions, especially Netafim. We expect that Mexichem's leverage ratios will remain broadly in line with the previous forecast—below 2.0x--in the next 12-18 months.

Rating Action

On May 30, 2018, S&P Global Ratings affirmed its 'BBB-' global scale, 'mxAA' national scale long-term, and 'mxA-1+' short-term national scale corporate credit ratings on Mexichem S.A.B. de C.V. We also affirmed our 'BBB-' and 'mxAA' issue-level ratings on the company. The outlook on the corporate credit ratings remains stable.

Rationale

The rating action reflects our view that the company's robust track record of disciplined debt-financed acquisitions and rapid deleveraging thereafter will allow it to maintain leverage ratios below 2.0x net debt to EBITDA 12 to 18 months after Netafim's closing, in line with its financial risk profile assessment. Its leverage will remain healthy despite higher debt from the Netafim acquisition.

Netafim is a global leader in the development, manufacturing, and distribution of advanced drip and micro-irrigation solutions. We believe that with this acquisition, Mexichem will somewhat expand its global footprint, diversify its end-markets, and bring new technology to its current portfolio.

We expect Mexichem will continue to diversify its geographic presence through its recent acquisitions, developing synergies in the markets where it has a competitive advantage. It will utilize its newly acquired technology and transfer its product portfolio through Netafim to the latest Latin America-based plants and markets. The company's very strong market position, extensive vertical integration in its three business units (Vinyl, Fluor, and Fluent), and its proven ability to integrate acquired businesses should allow it to maintain relatively stable margins despite inherent industry and global economic volatility.

Despite Mexichem's acquisition strategy, we do not expect material shifts in the company's financial policies, particularly through its commitment to restore its net debt to EBITDA to below 2.0x in the next 18 to 24 months after Netafim's closing. Additionally, we also view the company's debt maturity profile as comfortable, with no significant maturities until 2022, supported by its strong liquidity.

Our base-case scenario for 2018 and 2019 includes the following assumptions:

- We expect the U.S., Latin America, Mexico, and Europe to post GDP real growth of about 2.9%, 2.7%, 2.4%, and 2.4%, respectively, for 2018 and 2.6%, 2.8%, 2.5%, and 2.1%, respectively, for 2019. Economic growth will contribute to Mexichem's sales growth.
- CPI inflation of the U.S., Latin America, Mexico, and Europe of about 2.5%, 6.2%, 5.1, and 2.3%, respectively, in 2018, and 1.9%, 5.1%, 3.6%, and 2.3%, respectively, in 2019. In light of these inflation rates, we believe that Mexichem's products will remain in relatively healthy demand for the next 12-24 months.
- Exchange rate of MXN18.9 per US$1.00 in 2018 and MXN19.2 per US$1.00 in 2019. While Mexichem's sales in the USA represent about 15% of total sales, only 3.5% of total revenues are exports to the U.S/.; the remaining 11.5% are revenues generated from operations within that country. Therefore, if NAFTA is renegotiated, the impact on Mexichem will be minimal.
- Double-digit revenue growth in 2018, mainly due to the consolidation of Netafim, and sound demand and pricing fundamentals within its segments.
- For 2019, we are forecasting revenue growth of 8%, given the operating synergies across Mexichem.
- EBITDA growth, mainly as a result of operational improvements--especially because the cracker will operate 12 months in 2018 versus nine months in 2017=. Additionally, the increase in its specialty product offerings will result in higher margins.
- For the same reasons, we expect EBITDA margins to maintain thresholds above the industry average (17%).
- No additional debt or refinancing for the next two years.
- However, given its acquisition profile, we have considered small acquisitions of around $50 million for the next few years, since Mexichem will increase its cash flow generation.
- Capex between $350 million-$400 million from 2018, including organic

growth, maintenance, compliance, and small strategic (new plants or expansion of them), according to market conditions.

- Dividend payments of $147 million from 2018. It does not have an established dividend policy.

Our base-case assumptions for 2018 and 2019 for its main business segments are:

- Fluent: Strong demand for pipes and fittings with higher margins from new solutions. Change in its mix from low margin to higher margin products.
- Vinyl: Cracker began production in late February 2017 and the cost of PVC production has decreased since second quarter 2017.
- Fluor: The company has continued to penetrate the cement industry, with a positive resolution in current U.S. ITC (United States International Trade Commission) and better market conditions in the EU, and an increase in sales of medical grade products.

Based on these assumptions, we arrive at the following credit metrics:

- EBITDA margin of about 19% in the next two years;
- Net debt to EBITDA of 2.0x 12-18 months after Netafim's closing and 1.3x in 2019;
- Funds from operations (FFO) to debt above 30% for 2018 and 2019; and
- Free operating cash flow (FOCF) to debt of about 13% in 2018 and 27% in 2019.

Liquidity

We continue to assess Mexichem's liquidity as strong since we forecast that sources over uses of cash will be above 1.5x for the next 12 months, and 1.0x in the subsequent 12 months.

Principal liquidity sources:

- Reported cash reserves of $564.5.1 million as of March 31, 2018;
- Projected FFO of about $998.1 million in the next 12 months; and
- Undrawn committed credit lines for about $1.5 billion.

Principal liquidity uses:

- Short term maturities of about $358.4 million as of March 31, 2018;
- Working capital outflows of $330 million (including peak in intrayear working capital requirements) for the next 12 months;
- Stressed capital spending of about $700 million, which has been the company's average capital spending during the last five years; and
- Dividend payments of about $147 million in the next 12 months.

In our view, Mexichem's debt maturity profile is comfortable, with a weighted average debt life of more than 15 years, which is supported by its sound relationships with banks and satisfactory standing in credit and capital markets. Mexichem is currently in compliance with its financial covenants.

Outlook

The stable outlook reflects our expectation that the company will continue to consolidate its recent acquisitions, especially Netafim. We expect that Mexichem's leverage ratios will remain broadly in line with the previous forecast in the next 12-18 months after Netafim's closing, at below 2.0x. We also expect the company to maintain a financial policy that prevents a significant weakening of its credit metrics and liquidity position.

Downside scenario

We could lower the ratings if Mexichem's financial risk profile deteriorates, particularly if it posts debt to EBITDA of more than 3.0x. This could happen if another debt-financed acquisition takes place before the company achieves its targeted deleveraging level, implying a shift in the company's financial policy.

Upside scenario

An upgrade is less likely at this point. However, if it strengthens its financial performance, posting a debt to EBITDA ratio of about 2.0x and FFO to total debt of 45% on a sustained basis, we could raise the ratings. This could occur if Mexichem continues strengthening its profitability while reducing debt through internal cash flow generation, maintaining a moderate policy regarding acquisitions.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--

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)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Issue Ratings--Subordination Risk Analysis

Capital structure

Mexichem's capital structure mainly consists of global senior unsecured notes and bank loans.

Analytical conclusions

We rate Mexichem's international senior unsecured notes at 'BBB-'. Mexichem's unsecured debt at the subsidiaries represents around 10% of the company's total debt. Additionally, the rated senior unsecured notes are guaranteed by the main subsidiaries of Mexichem on a pari passu basis, accounting for more than 50% of Mexichem's consolidated EBITDA.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Building Materials Industry, Dec. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 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: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Mexichem S.A.B. de C.V.	
Corporate Credit Rating	
Global Scale	BBB-/Stable/--
CaVal (Mexico) National Scale	mxAA/Stable/mxA-1+
Senior Unsecured	
Global Scale	BBB-
CaVal (Mexico) National Scale	mxAA

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.