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Research Update:

## **UPL Corp. Ltd. Outlook Revised To Stable From Positive On Proposed Large Arysta Acquisition, 'BBB-' Ratings Affirmed**

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## Overview

- UPL Corp.'s planned acquisition of Arysta LifeScience could improve UPL Corp.'s global business position but at the cost of increased leverage.
- We are revising our outlook on UPL Corp. to stable from positive to reflect our view that the company's leverage would rise if the deal is completed.
- We are affirming our 'BBB-' rating on the India headquartered agrochemical company and its senior unsecured notes, because we believe the post-acquisition larger franchise could absorb a higher leverage at the current rating levels.
- The stable outlook reflects our opinion that UPL's enlarged business, faster growth, and healthy margins would generate cash flows sufficient to push its FFO-to-debt ratio above 25% within 18-24 months of the acquisition.

## Rating Action

On July 20, 2018, S&P Global Ratings revised its outlook on the India-headquartered global agrochemical company UPL Corp. Ltd. (UPL Corp.) to stable from positive. At the same, we affirmed our 'BBB-' long-term issuer credit rating on UPL Corp. We also affirmed our 'BBB-' long-term issue rating on the company's senior unsecured notes.

## Rationale

We revised the outlook to stable from positive because we expect the company's leverage to rise if the company completes a planned major acquisition. UPL Corp. has announced plans to spend US\$4.2 billion to purchase Arysta LifeScience (Arysta), the agrochemical business of U.S.-headquartered Platform Specialty Products Corp. By our estimates, UPL Corp.'s leverage would double just after the deal, but then markedly improve over the next two years.

We expect UPL Corp. to rely mostly on debt to fund the acquisition. However, it will also raise US\$1.2 billion in equity by selling about 20% stake to a wholly owned subsidiary of Abu Dhabi Investment Authority, a sovereign wealth fund, and TPG Capital, a private equity firm. The company expects the

acquisition to be completed before March 31, 2019.

Our rating affirmation reflects our view on UPL Corp.'s India-listed parent UPL Ltd. (UPL). We consider UPL Corp. as an inseparable part of UPL and therefore equate the rating on UPL Corp. with our group credit profile assessment of its parent.

In our view, the acquisition would be a strategic fit for UPL's fast-growing agrochemical business, and would bolster its business position as the world's largest post-patent agrochemical producer. We expect UPL Corp.'s annual revenues to exceed US\$4.7 billion when combined with Arysta's, ahead of U.S.-based chemical major FMC Corp.

At the same time, we believe the acquisition will significantly increase UPL's leverage for the current reporting period. UPL's pro-forma ratio of funds from operations (FFO) to debt will decline to below 20% in fiscal 2019 (year ended March 31, 2019). This compares to our estimate of more than 45% without the acquisition. We believe the higher leverage significantly diminishes the chances of an upgrade over the next 12-24 months, despite a stronger business position.

We expect UPL to use its free cash flows to significantly lower its leverage within 24 months of acquisition. This should enable the FFO-to-debt ratio to recover comfortably above 25% by fiscal 2021. In our opinion, management is committed to reducing leverage post the acquisition.

The acquisition will likely increase the diversity of UPL's business with a higher share of European business coming from Arysta. We estimate the pro-forma share of the European business will increase to 24%, from 13%. We believe Arysta will also provide strong research and development capabilities, which UPL can leverage on to maintain its faster-than-industry growth.

In terms of product mix, we expect the revenue breakdown of herbicides, fungicides, and insecticides to largely remain the same post the acquisition. However, we do not see a significant overlap between Arysta and UPL's product portfolio, which could provide significant cross-selling opportunities in future. Agro-chemical customers are somewhat sticky and UPL could leverage on the strengths of Arysta's customer profile.

As a specialty crop agro chemical producer, Arysta generates higher margins than UPL. We think the post-acquisition synergies can lift UPL's EBITDA margins to about 22% from about 19.7% in fiscal 2018, after accounting for integration and acquisition related expenses.

UPL's performance in fiscal 2018 was largely in line with our expectation and our pro forma base case for the next three fiscal years assumes the following:

- Real GDP to rise 7%-8% in India, 2%-3% in the U.S. and Brazil, and 1%-2% in the Eurozone over next two years.

- Agrochemical industry to stabilize or possibly return to growth from 2019 onwards, after three years of consolidation and negative growth.
- UPL's post-acquisition revenues to rise 5%-7%, mainly driven by demand recovery and new product launches, with slightly slower growth for the newly acquired business.
- EBITDA margins to be 19%-21% for the next two years, before improving to about 22% in fiscal 2021, when we expect the synergies to start contributing meaningfully.
- Capital expenditure (capex) to be Indian rupee (INR) 15 billion-INR20 billion annually.
- Annual free operating cash flows (FOCF) of INR33 billion to INR37 billion over the next three years.
- Annual dividends to increase gradually to be about INR6.0 billion by fiscal 2021, from about INR4.0 billion currently.
- The company to make no material debt-funded acquisitions post the Arysta deal.

Based on these assumptions, we arrive at the following pro forma credit measures over the next 12 to 24 months:

- FFO-to-debt ratio of 15%-20% in fiscal 2019 improving to about 30% by fiscal 2021.
- Ratio of debt to EBITDA of 4.0x-4.2x in fiscal 2019 and 3.0x-3.2x in fiscal 2020, before improving to about 2.5x or below by fiscal 2021.
- Average EBITDA interest coverage of more than 5.0x.

UPL's significant export revenues in U.S. dollars and euros, positive free operating cash flows, and low debt levels is likely to enable it to maintain positive liquidity in a scenario of hypothetical sovereign stress in its key markets. The company clears our stress-test scenario of a hypothetical sovereign default in India, as well as our transfer-and-convertibility stress test for the Latin American region, specifically Brazil, for a rating above the sovereign.

## **Liquidity**

We assess UPL's liquidity as adequate. We estimate UPL's sources of funds will remain about 2.1x of uses over the next 12-24 months, and that net sources would remain positive even if EBITDA were to decline by 30%. While this ratio can equate with a strong liquidity assessment, we consider it prudent to maintain the liquidity as adequate until we see the impact of the potential acquisition, including whether the company achieves longer-tenor financing for the acquisition.

We believe UPL's liquidity has strengthened after it raised US\$300 million

through a ten-year bond in February 2018 to refinance some of its existing facilities. In our view, UPL's dependence on short-term debt will stay low over the next 12 months.

We expect the immediate financing requirement for the proposed \$4.2 billion acquisition to be supplied by a group of banks and financial investors. UPL Corp. has obtained a bridge loan from a group of banks and financial investors. We anticipate the company will replace this facility with a longer-term loan or bond within 18 months of completion of the acquisition.

UPL Corp. maintains solid relationships with banks and has a high standing in local credit markets. We also anticipate that the company will maintain well-spread long-term debt maturities without the imposition of financial covenants. We consider UPL's financial management to be prudent because the company has also issued equity to address its financing needs on a timely basis.

Our liquidity estimates for fiscal 2019 are:

Key sources of liquidity:

- Cash balance of INR29.1 billion as of March 31, 2018.
- Operating cash flow of INR28.0 billion-INR30.0 billion.

Key uses of liquidity:

- Debt maturities of about INR7.6 billion.
- Working capital requirements of INR2.0 billion-INR3.0 billion.
- Capex of INR12.0 billion-INR15.0 billion annually.
- Dividends of up to INR4.0 billion-INR5.0 billion annually.

## **Outlook**

The stable outlook on UPL Corp. reflects our expectation that the parent UPL Ltd.'s pro forma leverage (adjusted for the proposed acquisition) will recover to above 25% within 12-24 months of the acquisition. We expect this to be driven by steady growth and stable margins of 19%-21% over the period as well as deleveraging with the help of positive free cash flow.

We view UPL Corp. as a core subsidiary of UPL because UPL Corp. accounts for a significant part of the parent's assets and cash flows. We also expect UPL to continue to prudently manage its regulatory affairs, working capital, growth investments, and shareholder returns.

### **Upside scenario**

We could upgrade UPL Corp. if faster-than-expected revenue growth and profitability post-acquisition results in sustainably lower leverage at the parent level. UPL's pro forma FFO-to-debt ratio, adjusted for the acquisition

approaching 40% and the company committing to lower leverage would indicate such improvement. Any ratings upgrade is also contingent upon UPL maintaining sufficient liquidity even in a hypothetical sovereign stress scenario.

### **Downside scenario**

We may downgrade UPL Corp. if weak operating conditions, higher competitive intensity, or integration risks result in deteriorating profitability and higher leverage. This could be indicated by the parent's EBITDA margin falling below 15%, or the pro forma FFO-to-debt ratio, adjusted for acquisition, not recovering above 25%, sustainably. Leverage could also rise if the company or its parent uses free cash flow to engage in another debt-fueled acquisition or outsized shareholder distribution. We could also downgrade UPL Corp. if UPL does not appropriately manage its liquidity especially the refinancing of its bridge finance for the acquisition.

### **Ratings Score Snapshot**

Issuer Credit Rating: BBB-/Stable/--

Business risk: Fair

Country risk: Intermediate

Industry risk: Moderately High

Competitive position: Fair

Financial risk: Modest

Cash flow/Leverage: Modest

Anchor: bbb-

#### **Modifiers**

Diversification/Portfolio effect: Neutral/Undiversified (no impact)

Capital structure: Neutral (no impact)

Liquidity: Adequate (no impact)

Financial policy: Neutral (no impact)

Management and governance: Satisfactory (no impact)

Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

Group credit profile: bbb-

Entity status within group: Core (No impact)

## Issue Ratings--Subordination Risk Analysis

### Capital structure

UPL's capital structure consists of INR66.4 billion of debt, comprised primarily of unsecured debt. The debt includes INR51.7 billion of U.S-dollar-denominated bonds issued by UPL Corp. and INR14.7 billion of non-convertible debentures and bank loans.

### Analytical conclusions

The rated notes are senior unsecured. The majority of the company's assets are located in India, a jurisdiction that we consider lacking in creditor-friendly features, and recovery prospects in the event of bankruptcy are uncertain.

We equalize the rating on the U.S. dollar notes to the 'BBB-' issuer credit rating on the company, because it is not subordinate to other debt.

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## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- 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
- 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Ratings Affirmed; Outlook Action

To	From
UPL Corp. Ltd.	
Issuer Credit Rating	BBB-/Stable/--
	BBB-/Positive/--

Ratings Affirmed

UPL Corp. Ltd.	
Senior Unsecured	BBB-

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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