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Research Update:

Poland-Based Soda Ash Producer Ciech Upgraded To 'B+' On Strong Performance And EBITDA Growth; Outlook Stable

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Overview

- We anticipate that Poland-based soda ash producer Ciech S.A. will continue to report strong results in 2015 and beyond, benefiting from, among other things, favorable soda ash prices.
- We also anticipate that Ciech will manage its liquidity prudently during a period of increased capital expenditure.
- We are therefore raising our long-term corporate credit rating on Ciech and our issue rating on Ciech's senior secured notes to 'B+' from 'B'.
- The stable outlook reflects our view that Ciech will maintain adequate liquidity and that its leverage will remain within an adjusted debt to EBITDA ratio range of 3.5x-4.0x.

Rating Action

On Nov. 17, 2014, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Poland-based soda ash producer Ciech to 'B+' from 'B'. The outlook is stable.

At the same time, we raised our issue ratings on Ciech's existing €245 million senior secured notes to 'B+' from 'B'.

Rationale

The rating actions reflect our view that Ciech will continue to report strong results in 2015 and beyond, and that its performance will benefit from favorable soda ash prices, capacity expansions, and the increasing contribution from its crop protection business, Organika Sarzyna.

Our upward assessment of Ciech's business risk profile to "fair" from "weak" reflects Ciech's track record of increasing EBITDA and margins, and our view of its inherently stronger business, following the disposals completed in 2013 and the implementation of cost-saving measures. These actions, combined with favorable conditions in the soda ash industry and Ciech's low cash cost position, led to a significant improvement in the company's performance in 2014, which we anticipate will continue in 2015 and beyond. Under our base-case scenario, we forecast Ciech's EBITDA of about Polish zloty (PLN) 470 million in 2014 and PLN510 million in 2015, with stable margins of about 15%-16%.

That said, the company's strategy remains focused on growing its soda ash business and the Organika Sarzyna crop protection business. Key growth projects currently underway include soda ash capacity expansions in Poland by 200 kilotons per annum (ktpa) and in Romania by 60ktpa, optimizing the product portfolio in the salt business, and investments into further establishing Ciech's market share in the crop protection business in Poland. In addition, Ciech's non-growth investments include environmental projects in relation to Industrial Emissions Directive compliance. According to management, the capital expenditure (capex) related to these projects will amount to approximately PLN450 million over 2015 and 2016.

Further factors supporting our assessment of Ciech's business risk profile include its leading market positions in the soda ash market in Central and Eastern Europe, reflected in its 98% market share in Poland and No. 2 position in Europe, after market-leader Solvay S.A. Ciech's close proximity to well-established group of customers is another positive. We also see Ciech's soda ash activities as less cyclical than the chemical industry as a whole, because about 60% of its end-market demand comes from glass applications.

Factors constraining our assessment of the business risk profile include the company's high exposure to the cyclical packaging and construction industries, which are Ciech's key end-markets; its limited product diversity through its core soda ash production; and its reliance on a small number of suppliers for key raw materials such as brine and limestone. However, we recognize that there is some backward integration, notably of the company's Polish operations into steam production and electricity, and its German operations into limestone and brine, and also into steam and electricity. Our assessment takes into account ongoing competitive threats to Ciech's market position (despite its landlocked location), in particular from new capacity additions such as low-cost natural soda ash in Turkey, potentially by 2018.

Our assessment of Ciech's financial risk profile as "aggressive" factors in the company's focus on growth and the consequent high capital expenditure plans for 2015 and 2016. These plans will lead to significant negative free operating cash flow (FOCF) under our base-case scenario. Consequently, we forecast that Ciech's adjusted debt to EBITDA will increase to about 3.3x-3.5x at year-end 2015 from about 3x at year-end 2014.

The current rating incorporates our view that Ciech will manage its investments prudently, while maintaining adequate liquidity and headroom under financial covenants. For example, we understand from management that about PLN180 million of the planned capex is flexible and could be postponed or cut if needed. In addition, while we do not assume shareholder support from new owner KI Chemistry, we take comfort from the presence of the Supervisory Board, which oversees the company's operating performance and liquidity.

Other Modifiers

We modify Ciech's anchor of 'bb-' downward by one notch because of our negative comparative rating assessment on the company. We base our assessment on Ciech's negative FOCF and increasing leverage under our base case.

Following our discussion with the new owner KI Chemistry, we no longer modify the anchor downward by one notch due to our negative financial policy assessment. This reflects the greater clarity we now have about KI Chemistry's strategy for Ciech and its dividend and financial policies, which we view as rating neutral.

Liquidity

We assess Ciech's liquidity as "adequate" under our criteria. We estimate that liquidity sources should cover liquidity uses by more than 1.2x over the next 12-18 months. We also anticipate that Ciech will comply with covenants incorporated in its revolving credit facility (RCF) documentation despite a reduction in headroom under our base-case scenario, as the covenant steps down substantially in 2015.

We estimate the following liquidity sources:

- About PLN310 million of funds from operations under our base case;
- PLN100 million long-term committed RCF due 2016, which was fully available on Sept. 30, 2014; and
- About PLN63 million of cash on Sept. 30, 2014.

We estimate the following liquidity uses:

- PLN400 million-PLN450 million of capex in 2015, which we understand is partly flexible;
- PLN60 million of dividends; and
- No material short- to medium-term debt maturities: the series 02 PLN160 million domestic notes mature in 2017 and the €245 million notes mature in 2019.

Structural Subordination

The issue rating on the €245 million senior secured notes issued by Ciech Group Financing AB is 'B+', in line with the corporate credit rating. We consider that the structural subordination of the notes is not material, and is effectively mitigated by an extensive security package.

In terms of the insolvency jurisdiction, any insolvency proceedings against Ciech would most likely originate in Poland. Although we have assigned an issue rating to the €245 million notes, we have not assigned a recovery rating because our review of Poland's insolvency regime is not complete.

For detailed structural subordination analysis, please see "

Poland-Headquartered Soda Ash Producer Ciech Assigned 'B' Rating; Outlook Stable," published on Dec. 18, 2012, on RatingsDirect.

Outlook

The stable outlook reflects our view that Ciech will continue to deliver strong operating results over the short to medium term. We anticipate that Ciech will benefit from favorable soda ash prices and capacity expansions, as well as the increasing contribution from its crop protection business Organika Sarzyna. We also assume that the company will manage "adequate" liquidity and headroom under financial covenants during the high capex period. We view an adjusted ratio of debt to EBITDA of 3.5x-4.0x as commensurate with 'B+' rating.

Downside scenario

Downward rating pressure could build if the company's investments lead to negative FOCF that is significantly more than we currently anticipate, putting pressure on liquidity and leading to leverage higher than 4x.

Upside scenario

Rating upside is currently unlikely, reflecting our forecast of ongoing negative FOCF in 2015 and 2016. However, upside potential could arise over the longer term, if, for example, Ciech reports stronger-than-anticipated EBITDA growth, while maintaining "adequate" liquidity and a sustainable adjusted ratio of debt to EBITDA of about 3.0x-3.5x.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Upgraded

	To	From
Ciech SA		
Corporate Credit Rating	B+/Stable/--	B/Stable/--

Ciech Group Financing AB

Senior Secured*

B+

B

*Guaranteed by Ciech SA.

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