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Research Update:

Molibdenos y Metales S.A. Outlook Revised To Negative On Expected Weaker Cash Flow And Leverage; 'BBB-' Rating Affirmed

May 8, 2023

Rating Action Overview

- Higher molybdenum prices have boosted Chile-based Molibdenos y Metales S.A.'s (Molymet's) working capital requirements and cash flow volatility and consequently its debt level. We expect the company's leverage to remain above 2x for the next two years.
- At the same time, we expect high demand for molybdenum products and high prices will translate into sound business performance and EBITDA for Molymet.
- As a result, S&P Global Ratings revised the outlook on Molymet to negative from stable and affirmed its 'BBB-' global scale and 'mxAA' national scale issuer credit ratings. Subsequently we withdrew the 'mxAA' national scale issuer credit rating at issuer's request.
- The negative outlook reflects our expectation that Molymet will face elevated working capital requirements amid molybdenum price volatility during 2023, leading to leverage of 2.5x-3.0x in 2023 that trends toward 2.0x in 2024.

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Rating Action Rationale

We expect record-high molybdenum prices in the first months of 2023 will result in high working capital outflows for Molymet and a peak in leverage. Molybdenum prices increased to their highest levels in 17 years, hitting an average of US$37 per pound in February. This was up from already high prices of US$18.6 per pound at the end of 2022, due to growing demand mainly in China--the world's biggest molybdenum market--and a supply shortage. We expect global molybdenum demand to remain high in the next two years, driven by construction and alloy steels, with prices remaining strong at US$25-US$30 per pound for fiscal years 2023 and 2024.

Increasing molybdenum prices usually means good business fundamentals for Molymet. The company reported record-high EBITDA generation of around US$188 million in 2022 and US$193 million in 2021, and we expect it to continue to have sound EBITDA generation of around US$190 million in the next two years. However, working capital requirements also increased significantly.

To deal with this, the company got about US$450 million in short-term export credit lines during the first couple months of 2023 that will mature this May, June, and September. On April 26, 2023, the company issued two bonds in the Mexican market for about US$190 million and US$120 million, maturing in two and six years, respectively, to refinance the short-term export credit lines. This will result in structurally higher gross debt of about US$200 million in the next couple years. We expect leverage to peak at 2.8x in 2023, even assuming a decline in molybdenum prices in the second quarter, which would relieve working capital needs. We believe as molybdenum prices and hence working capital volatility moderate, net leverage levels should drop in 2024, trending toward 2x but remaining above the historical average of 1x.

We anticipate Molymet will have negative operating cash flow in 2023 that improves in 2024 while maintaining somewhat tighter liquidity The company's cash flow has shown strong exposure to molybdenum price volatility through economic cycles. We expect the company to have negative operating cash flow in 2023 due to higher working capital requirements. We anticipate that for the second quarter of fiscal year 2023, prices will somewhat decrease to around US$20–US$24 per pound, improving cash flow generation, but we still forecast full-year operating cash flow to be negative US$80 million-US$100 million. However, for fiscal year 2024, we expect Molymet to reverse this trend and the company's operating cash flow to remain close to positive US$200 million. Still, the company's leverage could come under more pressure if molybdenum prices continue to rise.

In addition, we believe Molymet's liquidity is highly sensitive to price volatility, and we expect the company to maintain tighter liquidity for the next 12 months. However, we believe that with about US$174 million of cash on its balance sheet as of December 2022 and the recent issuances in the Mexican market, the company has sufficient liquidity sources to cover liquidity needs over the next 12 to 24 months.

We expect business performance will remain strong over the next 12 months because of good industry momentum. Molymet is one of the largest global molybdenum and rhenium processors, with an estimated market share of 35% and 70%, respectively. In turn, it has cost-efficient technology--allowing it to recover high molybdenum content out of the processed concentrate--and a certain degree of bargaining power, resulting in relatively high profit margins despite volatile market conditions. Molymet benefits from its long-term tolling contracts with large copper producers, where it charges a fee to companies for processing the concentrate. These contracts account for approximately 14% of Molymet's EBITDA and provide stable and predictable EBITDA regardless of molybdenum price volatility. Likewise, Molymet's own sales business unit (70% of EBITDA) does not incur price risks because its delivery prices are pegged to the purchase cost from copper producers. However, it does expose the company to working capital swings. Additionally, Molymet recovers a high percentage of rhenium and other byproducts from the roasting and oxidation process in the other two business units and sells them to clients (16% of EBITDA). This business line, although still small, has been growing at about 22% on average for the past two years and we anticipate average growth of about 25% through 2024. As a result, the company benefits from resilient EBITDA generation despite current molybdenum price volatility.

Outlook

The negative outlook reflects our expectation that elevated working capital requirements amid molybdenum price volatility will lead Molymet's liquidity to remain tighter for the remainder of 2023 and leverage to be above 2.0x for the next two years.

Downside scenario

We could lower the ratings in the next two years if:

- The company faces higher than expected working capital needs and we expect it to keep a low liquidity cushion with sources of liquidity to uses persistently below 1.2x; or
- Credit measures remain weaker than expected, and we become increasingly confident that adjusted leverage will remain consistently above 2.5x and covenant headroom is tight.

Upside scenario

We could revise the outlook to stable if Molymet is able to reduce its debt and its cash flow recovers faster than expected due to a decrease in molybdenum prices. In such a scenario, we would expect:

- Adjusted leverage close to or below 2x in a three- to five-year moving average, and
- Positive free operating cash flow generation.

Company Description

Molymet is the world's largest player in the molybdenum processing industry, with 35% of total global roasting capacity, and has a 70% global market share in rhenium. The company gets most of its revenue from processing molybdenite and delivering molybdenum oxide, ferromolybdenum, and other byproducts such as rhenium. Molymet generated US$1.9 billion in revenue and US$188 million of EBITDA in 2022. The company operates through three divisions:

- Own sales: Molymet buys molybdenite from miners and uses its own technology to treat and process the concentrate in order to produce and sell a variety of molybdenum products.
- Tolling: This unit charges a fee to companies in the mining industry to process their molybdenite.
- Byproducts: This unit recovers rhenium and other byproducts from the roasting and oxidation process at the other two business units.

Molymet's EBITDA isn't exposed to molybdenum price volatility because its tolling unit receives a defined fee while its own sales unit finalizes the payment to suppliers after it sells the final product to the market.

Our Base-Case Scenario

- Exchange rates of Chilean peso (CLP) 895 per US$1 in 2023, and CLP900 per US$1 in 2024 and 2025
- GDP contraction in Chile of 0.4% in 2023 and increase of 2.6% in 2024 and 2.8% in 2025
- Molybdenum oxide average price of US$25-US$31 per pound in 2023 and 2024 and US$20-US$23 per pound thereafter
- Tolling fees around US$1.4-US$1.5 per pound of molybdenite concentrate processed for the

next three years

- Slight increase in rhenium prices to around US$615-US$625 per pound for the next three years
- Processed molybdenum volumes of 87 million-90 million pounds in 2023, falling to 84 million-86 million pounds in 2024 and 2025, in line with historical levels
- Rhenium volumes increasing in the next two years to around 80,000 pounds in 2023 and almost 120,000 pounds in 2024 due to penetration of new markets
- Debt to increase to around US$535 million in 2023--from US$359 million in 2022--including the issuance of the two Mexican bonds for around US$310 million, partially offset by the repayment of short-term export credit lines taken in January and April this year, and dropping to US$420 million in 2024 and US$236 million in 2025
- Capital expenditures (capex) of about US$56.7 million in 2023 and US$32 million in 2024, 40% of which is maintenance capex
- Dividend distribution around US$23 million in 2023 and 40% payout ratio going forward

Molibdenos y Metales S.A. key metrics

	--Fiscal year ended Dec. 31--				
(Mil. $)	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**
Revenues	1,453.4	1,883.1	2,500-2,900	2,200-2,500	2,000-2,200
EBITDA	192.7	187.9	180-200	180-200	180-200
EBITDA margin (%)	13.3	10.0	6-7	8-9	8-9
Funds from operations (FFO)	172.6	108.6	90-110	90-110	1000-120
Interest expense	12.6	21.6	40-50	50-56	37-42
EBITDA Interest coverage	15.4	8.7	3.9-4.2	3.3-3.7	4.8-5
Operating cash flow	(301.6)	198.0	(70)-(110)	140-180	180-200
Capital expenditures	32.2	41.8	~57	~30	~30
Debt	459.1	359.5	500-540	400-450	200-250
Debt to EBITDA (x)	2.4	1.9	2.5-3	2-2.5	1-1.5
FFO to debt (%)	37.6	30.2	20-21	26-27	53-54
FOCF to debt (%)	(72.7)	41.4	(25)-(30)	30-35	100-110

All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FOCF--Free operating cash flow.

Liquidity

We assess Molymet's liquidity as adequate, because the company has generally prudent risk management, well-established and solid relationships with banks, and a good refinancing track record. The company has already refinanced the short-term export credit lines with longer-term bonds issued in the Mexican market. This would result in sources exceeding uses of debt by at least 1.2x over the next 12 months and sources would exceed uses even if EBITDA declines by 15%.

Principal liquidity sources:

- Cash position of US$174 million as of Dec. 31, 2022,
- Funds from operations of US$114 million over the next 12 months, and
- Proceeds from the issuance of two Mexican bonds for US$310 million and short-term export credit lines that the company took in January and April this year for US$450 million.

Principal liquidity uses:

- Scheduled debt amortization of US$559 million in the next 12 months (80% of which is short-term export credit lines),
- Working capital outflows of US$210 million in the next 12 months,
- Maintenance capex of about US$24 million in the next 12 months, and
- Dividend distribution of US$23 million in the next 12 months.

Covenants

Under some of its debts, Molymet is subject to certain financial acceleration covenants that are measured annually. These include interest coverage of at least 5.0x and liabilities to equity below 1.75x.

Compliance expectations

We expect the company to remain compliant with these covenants but with somewhat tighter headroom of about 20% in 2023, improving to about 30% in 2024, in its interest coverage covenant.

Ratings Score Snapshot

Issuer credit rating	**BBB-/Negative/--**
Business risk:	Fair
Country risk	Intermediate
Industry risk	Moderately high
Competitive position	Fair
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
Anchor	bb+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)

Issuer credit rating	**BBB-/Negative/--**
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Positive (+1 notch)
Stand-alone credit profile:	bbb-

ESG credit indicators: E-3, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	**From**
Molibdenos y Metales S.A.		
Issuer Credit Rating	BBB-/Negative/--	BBB-/Stable/--
CaVal (Mexico) National Scale	mxAA/Negative/--/NR	mxAA/Stable/--