Fitch Assigns Ittihad International Investment LLC Final 'B+' IDR; Outlook Stable

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Fitch Ratings - Dubai - [publication date will be automatically inserted]
Fitch Ratings has assigned Ittihad International Investment LLC (Ittihad) a final Long-Term Issuer Default Rating (IDR) of 'B+' and senior unsecured debt rating of 'B+' with a Recovery Rating of RR4. The Outlook on the IDR is Stable.

Fitch has also assigned Ittihad's USD350 million sukuk trust certificates, issued through Ittihad International Ltd (Ittihad International), a final rating of 'B+' with a Recovery Rating of 'RR4'. The instruments were priced at 9.750% maturing in November 2028. The proceeds of the issuance were used to repay USD310 million of existing secured debt at the group level and USD30m short term facilities at the subsidiaries level.

The ratings reflect Ittihad's high but improving leverage, and moderately negative free cash flow (FCF) as working capital (WC) normalises. Rating strengths are a strong regional presence in paper, cement, building materials and copper production, with a competitive position in the local market. Fitch rates Ittihad on a consolidated basis using the generic approach due to its diversified portfolio of companies spread across the industrials, healthcare and business services sectors.

Ittihad International is the issuer of the certificates and trustee. The trustee is an exempted company with limited liability incorporated in the Cayman Islands and has been incorporated solely for the purpose of participating in the transactions contemplated by the transaction documents to which it is a party and its shares are held by MaplesFS Limited as share trustee.

KEY RATING DRIVERS

Competitive Regional Position: Ittihad’s paper businesses benefit from geographic connectivity and competitive advantage, while allowing it to build long standing relationship with global industry players across 25 markets. The company has a diversified pool of suppliers in LATAM, North America and Europe, adding further visibility in its value chain while reducing dependency risk on single supplier.

Diversified Portfolio Mix: Ittihad operates in four key sectors with the subsectors of paper and building materials contributing 58% and 21% of consolidated gross profit in 2022 respectively. The group’s paper and tissue manufacturer operates to global standards, being the largest producer of uncoated wood-free paper and the largest importer of pulp in the region. The infrastructure and building materials operations comprise the largest standalone producer of copper rods in the region through Union Copper Rod (UCR) and an established distributor of straight steel bars.

For pulp and steel commodities, the group maintains around 35 to 60 days worth of inventory backed by customer orders. Inventory prices reflect raw material costs plus conversion premium in line with industry averages. The company has long order backlog visibility and faces minimal cancellations on client orders. The company production facilities allowed it to be one of the largest importer of pulp in the region. The impact of raw material cost is mitigated. Through its subsidiary IPM, Ittihad stands as the second largest producer of uncoated wood-free paper in MENA and the Indian subcontinent.

Capital Structure Evolving: While funding is relatively centralised, substantial debt obligations have been raised at the Opco level on a secured and guaranteed basis. After the recent sukuk issuance, the company materially reduced prior-ranking debt at the Opco level by USD310 million. The unencumbered asset cover is at 1x with no impact on leverage. As of end-2022, Fitch adjusted readily marketable inventory (RMI)MI gross leverage stood at 5.7x with gradual improvement to 4.6x in 2025.

Working Capital and Capex Pressure FCF: Fitch expects a negative FCF margin in 2024-2025 following capital expenditure and working capital outflows. The spike in capex for 2024 and 2025 is to fund the group's expansionary plans such as Crown Paper Mill's factory in Saudi Arabia and the acquisition of new machinery for UCR. From 2025, we forecast low, single-digit maintenance capex. Capex is committed and prefunded by external debt.

We expect working capital outflows in 2024, driven by high inventory levels at UCR, supported by back-to-back contracts, and an increase in receivables from the paper and pulp businesses. The group has stable yet thin margins with consolidated EBITDA margins at 4.4% in 2022. We expect this to improve over our forecasts, averaging 4.8% supported by high revenue visibilities from its consumer goods, copper and business services segments.

Enhanced Operating Environment: The company benefits from strong market fundamentals in the UAE and in the region. The underlying demand in its businesses remains robust. The demand for copper rods is expected to increase to support growth in electrical cables and utilities in the region. UCR produces on average 220k MT per year, representing nearly half of the UAE's copper rods production capacity. Similarly, steel rebar market in the GCC is expected to benefit from increased momentum in infrastructure projects primarily in the UAE and Saudi Arabia.

Low Commodity Price Exposure: Ittihad operates a physical arbitrage-based model for its copper operations, enabling it to hedge against swings in commodity prices. The company has back-to-back contracts with suppliers and customers, ensuring full pass-through of price risk. Exposure to copper volatility is limited by the LME copper price being a fairly modest component of its products. In addition, about 80% of copper is procured through annual contracts with global companies such as Glencore and Trafigura. The balance is sourced from recycled copper.

Ittihad International - Trustee and Sukuk Issuer

The Sukuk issuance rating is aligned with Ittihad's IDR. This reflects Fitch's view that a default of these senior unsecured obligations would reflect a default of Ittihad, in accordance with the agency's rating definitions.

Fitch has given no consideration to any underlying assets or collateral provided, as the agency believes that the trustee's ability to satisfy payments due on the certificates will ultimately depend on Ittihad satisfying its unsecured payment obligations to the trustee under the transaction documents described in the prospectus and other supplementary documents. The sukuk structure includes a guarantee from wholly-owned subsidiaries of Ittihad such as Ittihad Paper Mill (IPM) and other guarantors in favour of the trustee.

In addition to Ittihad's propensity to ensure repayment of Ittihad International's obligations, Fitch believes it would also be required to ensure full and timely repayment of Ittihad International's sukuk obligations, due to its role and obligations under the sukuk structure and documentation, which include especially but are not limited to the features below:

- The rental payment by and the instalment payment of any profit amount is intended to be sufficient to fund the periodic distribution amount payable by the trustee under the trust certificates.

- On any dissolution or default event, the aggregate amounts of deferred sale price then outstanding will become immediately due and payable; and the trustee will have the right under the purchase undertaking to require Ittihad to purchase all of its rights, title, interests, benefits and entitlements in, to and under the lease assets at an exercise price.

- The exercise price payable by Ittihad under the purchase undertaking to the trustee, together with the aggregate amounts of the deferred sale price then outstanding, if any, are intended to fund the dissolution distribution amount payable by the trustee under the trust certificates. The dissolution distribution amount should equal the sum of (i) the outstanding face amount of the certificates; and (ii) any accrued but unpaid periodic distribution amounts relating to such certificates.

- In a total loss event or partial loss event (unless the relevant lease assets have been replaced by Ittihad), if there is a shortfall from the insurance proceeds, Ittihad undertakes to pay the loss shortfall amount directly into the transaction account. If the service agent is not in compliance with the obligation to insure the assets against total loss or partial loss events, it will immediately deliver written notice to the trustee and the delegate of such non-compliance and the details thereof, and this will constitute an obligor event.

- Ittihad's payment obligations under the lease agreement, purchase undertaking, service agency agreement, and master murabaha agreement will be direct, unsubordinated, unconditional and unsecured obligations and will at all times rank at least equally with all other present and future unsecured and unsubordinated obligations of Ittihad from time to time outstanding.

-Additionally, Ittihad's subsidiaries (acting as guarantors) have agreed to unconditionally, irrevocably and jointly and severally guarantee, in favour of the trustee, the delegate and the agents, the due and punctual performance by Ittihad of all of its payment obligations under, and in accordance with the terms of, the transaction documents to which the Ittihad is a party. To the extent that Ittihad does not pay any sum payable by it under the transaction documents by the time and on the date specified for such payment, the guarantors will pay that sum as directed.

-The obligations of each guarantor under the guarantee will be direct, unconditional, unsubordinated and unsecured obligations of such guarantor, which at all times rank at least equally with all other present and future unsecured and unsubordinated obligations from time to time outstanding of such guarantor.

The sukuk documentation includes an obligation for Ittihad to ensure that at all times, the tangible asset ratio (defined as the ratio of the value of the lease assets to the aggregate value of the lease assets plus the outstanding deferred sale price) is more than 50%. Failure of Ittihad to comply with this obligation will not constitute an obligor event.

If the tangibility asset ratio falls below 33% (tangibility event), the certificates will be delisted and certificate holders will have the option to require the redemption of all or any of its certificates at the dissolution distribution amount. In this event, there would be implications on the tradability and listing of the certificates. Fitch expects Ittihad to maintain the tangibility ratio above 50% with support from the asset base held by the seller IPM (a wholly-owned subsidiary of Ittihad). IPM's tangible fixed assets totaled over USD300 million as of 31 December 2022.

- Ittihad's sukuk documentation includes a change-of-control clause. It also includes restrictive covenants and cross acceleration provisions; financial reporting obligations to the trustee/delegate; and certain Ittihad events. It also includes cross-default clauses.

- Certain transaction documents are governed by English law while others are governed by the laws of Abu Dhabi and the federal laws of the UAE. Fitch does not express an opinion on whether the relevant transaction documents are enforceable under any applicable law. However, Fitch's rating on the certificates reflects the agency's belief that Ittihad would stand behind its obligations. Fitch does not express an opinion on the certificates' compliance with sharia principles when assigning ratings to the certificates.

DERIVATION SUMMARY

Ittihad's asset portfolio consists of investments in various sectors including steel, copper, cement, paper, tissue, waste management, infrastructure, and medical services. It does not have close publicly rated peers. Ittihad has conservative financial and investment policies, strong operational oversight over subsidiaries and a high leverage profile, leading to commensurate leverage metrics for its rating category.

Unlike other commodity trading peers, Ittihad has stable margins and power in the value chain with hedged exposure to commodities. We analysed Ittihad's subsidiaries based on their respective peers in each sector. We used Mytilineos S.A. (BB+/Stable) and JSC Uzbek Mettalurgical Plant (BB-/Stable) for peers in the steel and copper segment. Mytilineos operates on a larger scale than Ittihad with a stronger financial profile and higher margins. JSC Uzbek has similar scale to Ittihad's but a stronger financial profile.

The sukuk's ratings are derived from Ittihad's Long-Term IDR and are in line with the company's senior unsecured rating.

KEY ASSUMPTIONS

- Revenue to decrease 2% in 2023 on copper price declines, before growing on average 3.5% for 2024- 2027

- Stable recovery of EBITDA margin to 2027 on an improved product mix and price increases

- Higher working capital outflow in 2024 and 2025 on increases in inventory and receivables, followed by flat working capital to 2027 after cash collection and destocking

- Increased capex for 2024 and 2025 due to expansion of new plants, followed by declines in 2026 to 2027

- No M&A planned

- Common dividends of AED20 million paid annually

- Release of AED184 million of restricted cash after debt repayment

- Gradual deleveraging to 2027 after debt repayments and on improved profitability

RECOVERY ANALYSIS

-The recovery analysis assumes that Ittihad would be liquidated rather than restructured in bankruptcy

-Our estimate of liquidation value (LV) available for creditor claims is about AED2.6 billion due to high-value assets in contrast to its low EBITDA margins

- A 10% administrative claim

- We estimate the total amount of senior debt claims at AED1.55 billion, which comprises the working capital facilities. AED2.1 billion of unsecured debt, assuming a fully drawn revolving credit facility, and the issued sukuk

- The allocation of value in the liability waterfall results in recoveries corresponding to 'RR2' and a 'BB' debt rating for the senior secured notes and 'RR4' and a 'B+' instrument rating for the senior unsecured debt.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- RMI-adjusted EBITDA gross leverage below 4x on a sustained basis

- EBITDA interest coverage above 3x on a sustained basis

- FCF margin above 2% on a sustained basis

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- RMI-adjusted EBITDA gross leverage above 5x on a sustained basis

- EBITDA interest coverage below 2x on a sustained basis

- Negative FCF margin on a sustained basis

- Adoption of a more aggressive financial policy with a lower percentage of inventories hedged or pre-sold

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: Ittihad had AED572 million of readily available cash as of June 2023, supported by an undrawn committed facility of AED385 million. We expect a further release of restricted deposits of AED184 million during 2023, which will strengthen the group's liquidity.

Low Refinancing Risk: The group has no significant maturities to 2027 post sukuk issue, given the refinancing of its term loans and partial repayment of its WC facilities. Its capital structure relies on working capital facilities as part of their commodity trading businesses. Those facilities are short term and generally self-liquidating on receipt of payments against commodity delivery. We assess the credit risk of these facilities as low, as they are marked to market and hedged. The refinancing risk for the short-term facilities is low as we assume them to be continuously rolled over each year.

ISSUER PROFILE

Ittihad is based in UAE, with investments in consumer goods (paper and chemicals), infrastructure and building materials (copper rods, steel bars and cement), healthcare and business services.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY	RATING			RECOVERY	PRIOR
Ittihad International Ltd					
senior unsecured	LT	B+	New Rating	RR4	B+(EXP)
Ittihad International Investment LLC	LT IDR	B+	New Rating		B+(EXP)
senior unsecured	LT	B+	New Rating	RR4	B+(EXP)

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub.03-Nov-2023)(includes rating assumption sensitivity)
Corporates Recovery Ratings and Instrument Ratings Criteria (pub.13-Oct-2023)(includes rating assumption sensitivity)
Country-Specific Treatment of Recovery Ratings Criteria (pub.03-Mar-2023)
Sector Navigators – Addendum to the Corporate Rating Criteria (pub.03-Nov-2023)
Sukuk Rating Criteria (pub.13-Jun-2022)

Applicable Models

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1 (https://www.fitchratings.com/site/re/10250028))

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Dodd-Frank Rating Information Disclosure Form

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