

## **RATING ACTION COMMENTARY**

# **Fitch Affirms Klabin's Ratings at 'BB+'; Outlook Stable**

Wed 19 Apr, 2023 - 10:58 ET

Fitch Ratings - São Paulo - 19 Apr 2023: Fitch Ratings has affirmed Klabin S.A.'s Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BB+' and its National Scale Long-Term Rating at 'AAA(bra)'. Fitch has also affirmed Klabin Austria GmbH's senior notes, guaranteed by Klabin, at 'BB+'. The Rating Outlook for Klabin remains Stable. Issuances from Klabin Finance S.A. have been transferred to Klabin Austria GmbH.

Klabin's ratings reflect the company's leading position in the Brazilian paper and packaging sector and its large forestry assets, providing a low production cost structure and a high degree of vertical integration. The company's solid liquidity position and low refinancing risk remain key credit considerations. Fitch expects Klabin's cash flow generation to remain strong due to the company's low cost position in the industry; strong demand in the paper and packaging segment; and additional volume from the Puma II second phase, which is expected to start operations in 2Q 2023.

## **KEY RATING DRIVERS**

**Increased Capacity Strengthens Position:** Klabin has a leading position in the Brazilian packaging sector and a high degree of vertical integration, which enhances product flexibility in the competitive but fragmented packaging industry. The Puma II expansion project added 354 thousand tonnes of production of kraftliner in 2022, which should reach 450 thousand tonnes in 2024. The second phase will add an additional 460 tonnes of annual production capacity of coated board by 2027, when it is at full capacity, which will further strengthen the company's leading market position.

**Strong Brazilian Market Share:** Klabin's strong market shares allow it to be a price leader in Brazil and to preserve more stable sales volume and operating margins during instable economic scenarios than its competitors. The company has market shares of 23% and 33%, respectively, in the Brazilian corrugated boxes and coated board sectors. Klabin is the sole producer of liquid packaging board in Brazil and is the largest producer of kraftliner and industrial bags, with market shares of 56% and 50%, respectively. Paper and packaging business represented 49% of Klabin's EBITDA in 2022, while pulp represented 51%. Fitch views the company's competitive advantage as sustainable due to its scale, high level of integration and diversified client base in the more resilient food sector, which represents about 67% of packaging sales.

**Falling Pulp Prices:** Average BEKP prices to China for 2022 were USD796/tonne, and Fitch projects a drop to USD650/tonne in 2023. The price spike was caused by unexpected mill maintenance downtimes, low inventories, strikes and logistical constraints. Pulp prices started to lose momentum during 4Q22, and Fitch expects them to decline further in 2023, pressured by increased supply from Latin American producers and potentially weaker demand from paper companies due to margin pressures. Chinese demand was affected by the country's 'Zero Covid' policy, as well as paper mill closures due to energy shortages, and it has only shown modest recovery so far in 2023.

**Lower Capex Projected:** Klabin has not announced any big investment projects after finalizing Puma II. The only significant individual project is a new corrugated boxes unit in Piracicaba, which would increase Klabin's total corrugated boxes conversion capacity to 1.3 million tonnes per year. The project has an expected total investment of BRL1.6 billion over three years, and Fitch projects total capex for Klabin during 2023-2025 of BRL13.4 billion. With this scenario and a stable dividend policy, Fitch forecasts CFFO of around BRL5.5 billion yearly during that time.

**Leverage to Decrease Post-Expansion:** Fitch expects Klabin's net leverage ratio to reach 4.1x in 2023 and to fall within the rating sensitivities after the completion of this investment phase. Fitch's calculations include total debt of BRL7.1 billion from factoring transactions as of December 2022. Klabin's net debt, excluding factoring transactions, was BRL27.5 billion as of Dec. 31, 2022. Fitch expects it to begin decreasing in 2024 after the PUMA II project is completed. The project has been largely financed with operating cash flow, thanks to the high average pulp prices of the previous two years.

**Rating Above Country Ceiling:** Klabin's FC IDR of 'BB+' is one-notch higher than Brazil's Country Ceiling. This is due to a combination of exports of USD1.2 billion, approximately USD184 million of cash held outside of Brazil and an undrawn USD500 million offshore credit facility. Hard Currency debt service for the next 24 months is covered more than 1.5x by 50% of EBITDA from exports, cash held abroad and a revolving credit facility. This suggests an uplift of up to three notches above Brazil's Country Ceiling. However, Klabin's FC IDR is constrained by a LC IDR of 'BB+', a reflection of its underlying credit quality.

## **DERIVATION SUMMARY**

Klabin has a leading position in the Brazilian packaging segment. Its size, access to inexpensive fiber and high level of integration relative to many of its competitors give it sustainable competitive advantages. Its business profile is consistent with a rating in the 'BBB' category.

Klabin's leverage remains high due to a period of investments that will continue during 2023. Its leverage is higher than Empresas CMPC (BBB/Stable), Suzano (BBB-/Stable) and Celulosa Arauco (BBB/Stable). Liquidity is historically strong for pulp and packaging producers, and Klabin has strong access to debt and capital markets.

Klabin is more exposed to demand from the local market than Suzano, CMPC and Arauco, as these companies are leading producers of market pulp sold globally. This makes Klabin more vulnerable to macroeconomic conditions than its peers. Positively, its concentration of sales to the food industry, which is relatively resilient to downturns in Brazil's economy, and its position as the sole producer of liquid packaging board, add stability to operating results.

## **KEY ASSUMPTIONS**

### Fitch's Key Assumptions Within Our Rating Case for the Issuer:

--Paper and packaging sales volume of 2.4 million tons for 2023 and 2.6 million tons for 2024;

--Pulp sales volume of 1.5 million tons in 2023 and 1.5 million in 2024;

--Average hardwood net pulp price of USD650 per ton in 2023 and USD600 per ton in 2024;

--Average FX rate of 5.3 BRL/USD in 2023 and 2024;

--Investments around BRL9.5 billion during 2023 and 2024;

--Dividends around 20% of EBITDA from 2023 onwards.

### **RATING SENSITIVITIES**

#### **Factors that could, individually or collectively, lead to positive rating action/upgrade:**

--Average net debt/EBITDA ratios of 2.5x or below throughout the pulp price cycle following completion of the expansion project;

--Sustained net debt at Klabin of less than USD3.3 billion after completion of the expansion project.

#### **Factors that could, individually or collectively, lead to negative rating action/downgrade:**

--Average net debt/EBITDA ratios of 3.5x or higher throughout the pulp price cycle following completion of the expansion;

--Sustained net debt at Klabin of more than USD6 billion after completion of the expansion project;

--More unstable macroeconomic environment that weakens demand for the company's packaging products as well as prices.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## LIQUIDITY AND DEBT STRUCTURE

**Strong Liquidity:** Klabin's solid liquidity position and low refinancing risk remain key credit considerations. As of Dec. 31, 2022, the company had BRL6.5 billion of cash and marketable securities and BRL34.6 billion of total debt, including about BRL7.1 billion of factoring transactions as per Fitch's criteria.

The company has an extended debt amortization profile, with BRL9 billion of debt maturing in 2023 (including BRL7.1 billion in factoring, as per Fitch methodology, which the agency expects to be treated as revolving), and BRL1.2 billion in 2023 and 2024. Financial flexibility is enhanced by a USD500 million unused revolving credit facility. Klabin plans to continue to finance the expansion project with a combination of debt and operating cash flow. Fitch expects Klabin to continue to preserve strong liquidity, conservatively positioning it for the price and demand volatility, which is an inherent risk of the packaging industry.

As of Dec. 31, 2022, about 67% of total debt was denominated in U.S. dollars. Total debt consisted of bonds (36%), factoring (20%), BNDES (9%), export credit notes and export prepayments (6%), Agribusiness Receivables Certificate (CRA, 4%), debentures (4%) and others (20%).

## ISSUER PROFILE

Klabin is the leader in the Brazilian corrugated boxes and coated board sectors. In the Brazilian market, it is the sole producer of liquid packaging board and the largest producer of kraftliner and industrial bags. It also has an annual production capacity of 1.6 million tonnes market pulp.

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			PRIOR ⚡
Klabin S.A.	LT IDR	BB+ Rating Outlook Stable	Affirmed	BB+ Rating Outlook Stable
	LC LT IDR	BB+ Rating Outlook Stable	Affirmed	BB+ Rating Outlook Stable
	Natl LT	AAA(bra) Rating Outlook Stable	Affirmed	AAA(bra) Rating Outlook Stable
Klabin Austria Gmbh				
senior unsecured	LT	BB+	Affirmed	BB+

[VIEW ADDITIONAL RATING DETAILS](#)

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## **APPLICABLE CRITERIA**

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Corporate Rating Criteria \(pub. 28 Oct 2022\) \(including rating assumption sensitivity\)](#)

[Corporates Exceeding the Country Ceiling Criteria \(pub. 08 Dec 2022\) \(including rating assumption sensitivity\)](#)

## **APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 ([1](#))

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Klabin S.A.

EU Endorsed, UK Endorsed

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