FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Rio de Janeiro - 28 Apr 2021: Fitch Ratings has affirmed Klabin S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) at 'BB+' and national scale long-term rating at 'AAA(bra)'. Fitch has also affirmed the 'BB+' rating of Klabin Finance S.A. and Klabin Austria Gmbh's senior notes, guaranteed by Klabin. The Rating Outlook for Klabin remains Stable.

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 will improve due to higher pulp and packaging prices, strong demand in the paper and packaging segment and additional volume from the Puma II project, which is expected to go live in July 2021. This should enable the company to complete its expansion cycle in 2023 with around USD4 billion of net debt, which remains consistent with the 'BB+' rating and Stable Outlook.



## KEY RATING DRIVERS

Leading Packaging Market 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 company has market shares of 24%

and 50%, 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 42% and 50%, respectively. The Puma II expansion project will add 920,000 tons of annual production capacity of kraftliner and/or coated board by 2023, which will further strengthen the company's leading market position.

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. 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.

Pulp Mill and Forestry Assets: Klabin's strength in packaging is augmented by its forestry assets and modern 1.6 million-ton pulp mill. The company sources much of its fiber requirements from trees grown on 270,000 hectares of plantations that it has developed on 578,000 hectares of lands under management; this ensures a competitive production cost structure in the future. In 2020, Klabin's cash cost of producing pulp was USD140 per ton, which placed it firmly in the lowest quartile of the cost curve. The value of the biological assets of its forest plantations was BRL4.7 billion as of Dec. 31, 2020. If needed, some of the forestry assets could be monetized to lower debt and improve liquidity.

Elevated Pulp Prices: The market pulp industry is cyclical; prices move sharply in response to changes in demand or supply. Pulp prices have increased sharply during 2021 after two years of low prices, supported by supply and logistical constraints caused by mill closures, maintenance downtime and the shortage of containers. Fitch projects average BEKP prices of USD650/ton in 2021, an increase from USD460/ton in 2020. The movement of prices away from the marginal cost levels of recent years will provide producers with a window of opportunity to generate strong cash flow from operations (CFFO) before 2022 and 2023 when the next round of capacity expansions become operational.

Stronger Cash Flow: Klabin's EBITDA is expected to be around BRL7.5 billion for 2021 and BRL7.0 billion in 2022, compared with BRL4.5 billion in 2020. This growth is supported by about 30% grow in revenues from the packaging business this year due to price increases and sales volume from the start-up of the Puma II project, in addition to higher pulp prices. Klabin is expected to generate an average of BRL5.3 billion of CFFO during this period. FCF is projected to remain negative in 2021, at BRL235 million, and reach breakeven in 2022. FCF is expected to be strong, and above BRL1 billion, in 2024, following the completion of the second phase of Puma II project. Fitch's projections incorporate elevated investments of BRL9.2 billion in 2021 and 2022, while dividends should increase next year to 20% of EBITDA.

Leverage Reduction: Klabin's leverage will be lower than previously projected during the investment cycle, due to an important recovery of pulp prices combined with the good moment of the packaging business. Klabin's net leverage ratio is expected to fall to about 3.0x in 2021, from 4.4x in 2020, and should remain close to 3.0x during the period of high investments in Puma II project. Klabin's net debt, excluding factoring transactions, was BRL19.8 billion as of Dec. 31, 2020, and should remain relatively stable until 2023, despite investments of BRL12.4 billion, as the company will be able to finance greater portion of the project with operating cash flow, as per Fitch's projections.

Rating Above Country Ceiling: Klabin's FC IDR of 'BB+' is one notch higher than Brazil's Country Ceiling due to a combination of exports of USD1 billion, approximately USD200 million of cash held outside of Brazil and an undrawn USD500 million offshore credit facility. EBITDA from exports, plus cash held abroad and a revolving credit facility covers HC debt service in the next 24 months by more than 1.5x. 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 paper and packaging segment. Klabin's size, access to inexpensive fiber and high level of integration relative to many of its competitors give it competitive advantages that Fitch view as sustainable. Its business profile is consistent with a rating in the 'BBB' category.

Like Suzano (BBB-/Stable) and Celulosa Arauco (BBB/Negative), Klabin's leverage increased due the period of high investments, and is higher than Empresas CMPC (BBB/Stable). Klabin's leverage increased as a result of the construction of the Puma pulp mill and low pulp prices following the completion of the mill have prevented a quick deleveraging process before entering into a new investment cycle. 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, which is also a negative

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consideration. 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, adds stability to operating results.

## KEY ASSUMPTIONS

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

--Paper and packaging sales volume of 2.3 million tons for 2021 and 2.4 million tons for 2022;

--Pulp sales volume of 1.6 million tons in 2021 and 2022;

--Average hardwood net pulp price of USD650 per ton in 2021 and USD600 per ton in 2022;

--Average FX rate of 5.4 BRL/USD in 2021 and 5.1 BRL/USD 2022;

--Investments around BRL9.2 billion during 2021 and 2022;

--Dividends around BRL355 million in 2021 and 20% of EBITDA from 2022 on.

## 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 USD4.5 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. 30, 2020, the company had BRL6.5 billion of cash and marketable securities and BRL29.1 billion of total debt, including about BRL2.8 billion of factoring transactions as per Fitch's criteria.

The company has an extended debt amortization profile, with BRL721 million of debt maturing in 2021, BRL1.3 billion in 2022 and BRL1.1 billion in 2023, excluding factoring transactions. 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, 2020, about 65% of total debt was denominated in U.S. dollars. Total debt consisted of bonds (40%), export credit notes and export prepayments (15%), Agribusiness Receivables Certificate (CRA, 14%), factoring (10%), debentures (6%) and others (15%).

## 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

## RATING ACTIONS

| ENTITY/DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| Klabin Finance S.A. | | | | |
| • senior unsecured | LT | BB+ | Affirmed | BB+ |
| 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 | | | | |

**VIEW ADDITIONAL RATING DETAILS**

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## APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 22 Dec 2020)

Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria (pub. 08 Jan 2021)

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## APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Klabin Austria Gmbh | EU Endorsed, UK Endorsed |
| Klabin Finance S.A. | EU Endorsed, UK Endorsed |
| Klabin S.A. | EU Endorsed, UK Endorsed |

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Corporate Finance: Leveraged Finance   Latin America   Europe   Austria   Brazil

Luxembourg

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