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Klabin S.A.

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Table Of Contents

Credit Highlights

Outlook

Our Base-Case Scenario

Company Description

Business Risk

Financial Risk

Liquidity

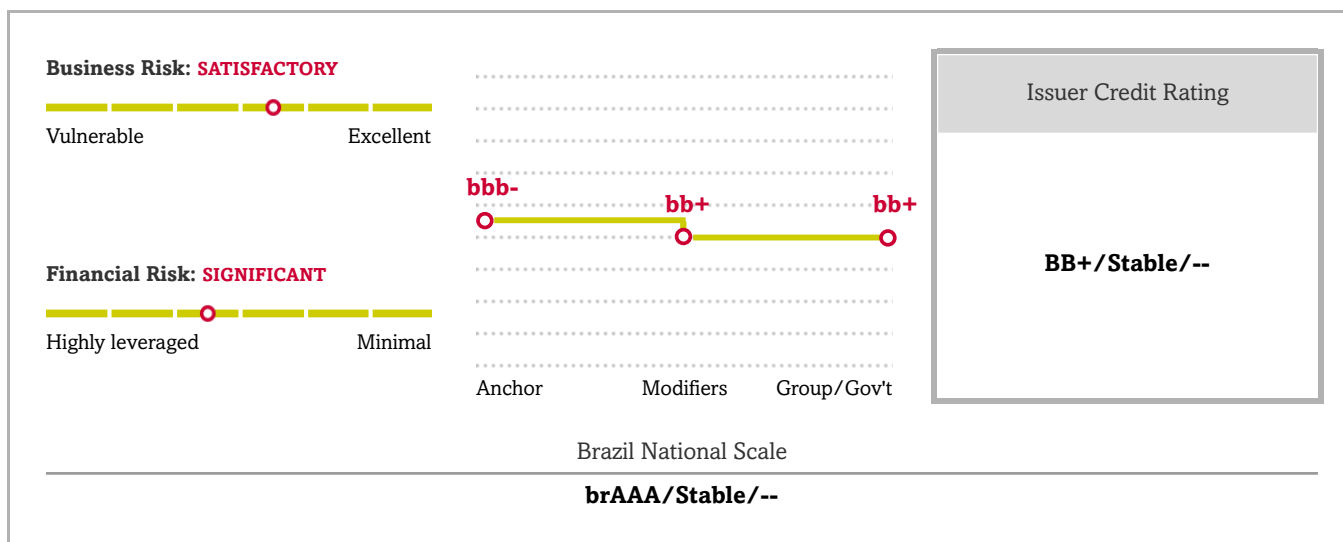
Environmental, Social, And Governance

Rating Above The Sovereign

Issue Ratings - Recovery Analysis

Ratings Score Snapshot

Klabin S.A.



Credit Highlights

Key strengths

- A leading position in Brazil's paper packaging production segment;
- Ability to adjust the sales mix and manage export volumes based on market demand; and
- Longstanding relationships with clients and vertical integration.

Key risks

- Exposure to cyclicalities in the forest and paper products industry, which has volatile input and selling prices; and
- Negative free operating cash flow (FOCF) expected due to significant investments for Puma II in 2020 and 2021.

Klabin's operational flexibility makes it feasible to switch production to basic necessity products despite a decline in overall industrial production during the pandemic. Despite the social-distancing measures amid the COVID-19 pandemic, Klabin's operations remained resilient. This is mainly due to operational flexibility in product portfolio and its client base. More than 80% of Klabin's pulp, paper, and packaging output is shipped to the food industry (industrialized and in natura), hygiene (toilet paper, tissues, toothpaste, soaps among others) and cleaning supply (soap powder, sanitizers among others) segments, which are all basic necessities. We forecast continued robust volumes and EBITDA in 2020 and 2021.

The new investment cycle (PUMA II project) is on track. Klabin expects to spend R\$9.1 billion in capital expenditures (capex) between 2019 and 2023 on the construction of two new paper machines capable of adding 920,000 tons to the company's capacity. We believe that investments will peak in 2020, resulting in a FOCF shortfall and net debt to EBITDA about 4.5x at the end of the year. Despite the temporary suspension of construction in March, we don't expect delays the planned start of operations in the second half 2021.

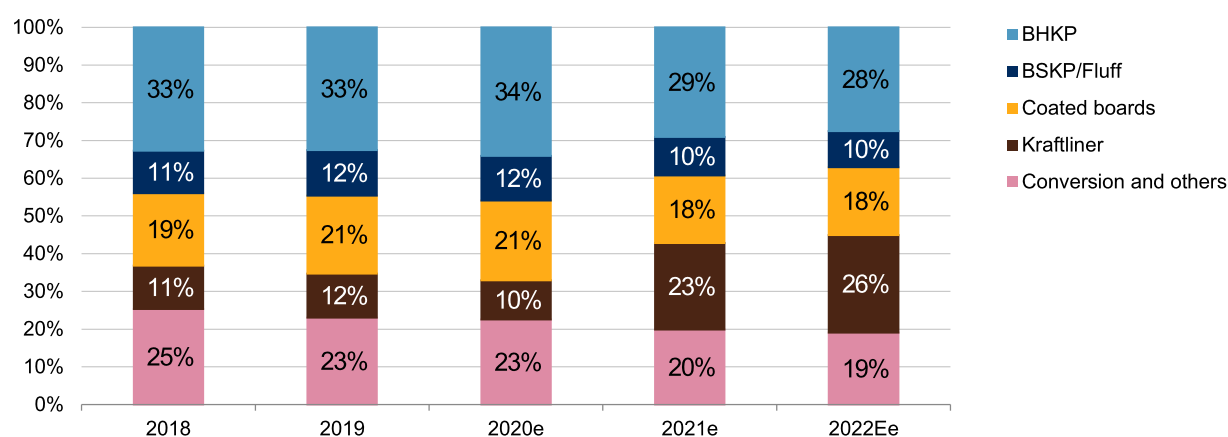
Acquisition of International Paper's Brazilian business will support growth strategy. In line with its expansionary strategy, the acquisition will contribute to Klabin's expansion in the Central-West region of Brazil. The acquired business has a capacity to produce 305,000 tons annually of corrugated boards and 310,000 tons per year of packaging

paper. The acquisition cost is R\$330 million and we expect its completion by the end of this year. At the same time, Klabin announced the sale of the Nova Campina unit, which would represent a production capacity of about 162,000 tons of kraftliner for R\$196 million.

Higher volumes should reduce leverage in 2021. With the ramp-up of the Puma II project's first machine lasting around one year, we expect the company's leverage metrics to drop. Although we expect pulp prices to gradually rise in the next few quarters, 710,000 tons of new capacity in 2021--consisting of 400,000 tons in kraftliner products and about 305,000 in corrugated boxes from International Paper--should boost Klabin's EBITDA in 2021 and 2022. We expect FOCF to turn positive in 2022 and debt to EBITDA to drop to around 3.5x.

Chart 1

Volume Sold*

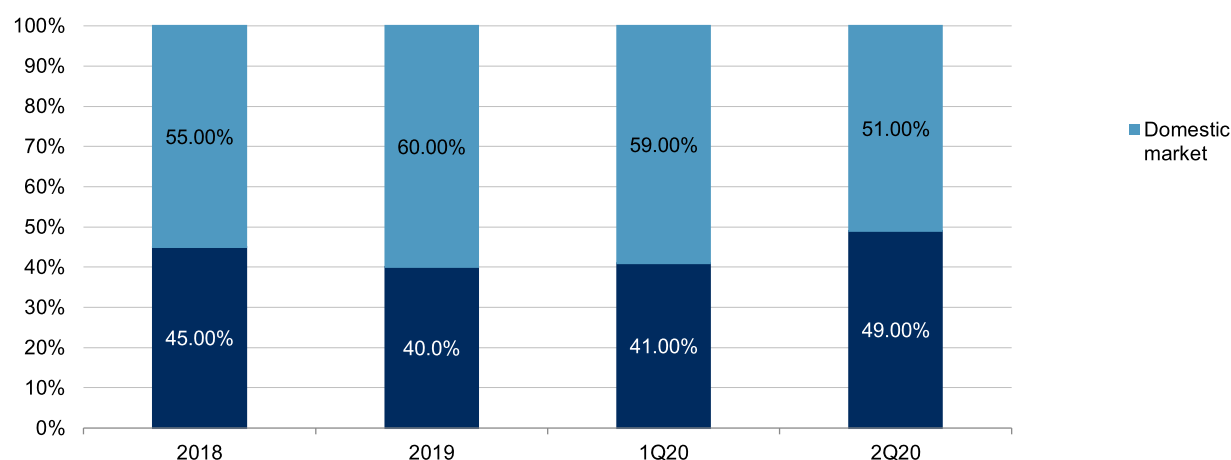


e--Estimate. *Except for wood. Source: S&P Global Ratings.

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Chart 2

Net Revenues By Market



*Except for wood. Source: S&P Global Ratings.

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Outlook: Stable

The stable outlook on Klabin reflects that, despite higher leverage metrics in 2020 due to the investment cycle, we expect the company to post debt to EBITDA close to 4.0x in 2021, excluding possible temporary foreign exchange mismatch effects. Our base-case scenario assumes a gradual rebound in pulp prices, a still weak Brazilian real, and higher volumes stemming from the ramp-up of Puma II starting in 2021.

Downside scenario

We would downgrade Klabin in the next 12-18 months if leverage metrics significantly deviate from our current expectations, with net debt to EBITDA persistently above 4.5x and funds from operations (FFO) to debt below 12% after the completion of Puma II investment. For example, this could occur in a scenario of Europe bleached hardwood kraft pulp (BHKP) pulp prices at or below \$500 per ton for 2021 or a more aggressive growth strategy.

Upside scenario

We would consider a positive rating action if we would expect Klabin's financial risk profile to strengthen consistently. We would also need to see the adherence to the recently published financial policies. Although not likely in the short term, an upgrade would depend on conservative leverage metrics, with maintenance of net debt to EBITDA below 3x and FFO to debt above 30% through the investment cycle.

Our Base-Case Scenario

Assumptions	Key Metrics																														
<ul style="list-style-type: none">• Brazil's GDP contraction of 5.8% in 2020, and growth of 3.5% in 2021 and 3.0% in 2022, with average exchange rates of R\$5.12 per \$1 in 2020, R\$5.1 per \$1 in 2021, and R\$5.02 per \$1 in 2022, mitigating the effect of lower pup prices.• Annual pulp production of 1.5 million - 1.6 million tons (mt) this year and next.• Average bleached eucalyptus kraft pulp (BEKP) listing in Europe at \$700 per ton in 2020, \$800 in 2021, and \$830 in 2022, compared with \$836 in 2019. We apply up to a 35% discount in listed prices.• Increasing paper and packaging prices according to inflation and the Brazilian real's depreciation.• Expected cash cost per ton of products sold of R\$1,600 - R\$1,630 in 2020 and 2021 following inflation and the depreciated real.• Annual capex of about R\$4.6 billion in 2020, R\$3.1 billion in 2021, and R\$2.45 billion in 2022. The capex is mostly for the Puma II project and maintenance.• Dividend distribution of about R\$225 million in 2020 and R\$750 million in 2021.	<table><tr><th colspan="5">Klabin S.A.--Key Metrics</th></tr><tr><th></th><th>2019a</th><th>2020e</th><th>2021e</th><th>2022e</th></tr><tr><td>EBITDA Margin (%)</td><td>36.5</td><td>40-43</td><td>43-47</td><td>46-49</td></tr><tr><td>FFO to Debt (%)</td><td>15.7</td><td>12-15</td><td>15-20</td><td>20-25</td></tr><tr><td>FOCF (bil. R\$)</td><td>0.4</td><td>(1.5-1.3)</td><td>(0.6)-0.4</td><td>2.3-2.5</td></tr><tr><td>Debt/EBITDA (x)</td><td>4.0</td><td>4.0-4.5</td><td>3.7-4.2</td><td>2.7-3.0</td></tr></table> <p>FFO--Funds from operations. FOCF--Free operating cash flows. a--Actual. e--Estimate</p>	Klabin S.A.--Key Metrics						2019a	2020e	2021e	2022e	EBITDA Margin (%)	36.5	40-43	43-47	46-49	FFO to Debt (%)	15.7	12-15	15-20	20-25	FOCF (bil. R\$)	0.4	(1.5-1.3)	(0.6)-0.4	2.3-2.5	Debt/EBITDA (x)	4.0	4.0-4.5	3.7-4.2	2.7-3.0
Klabin S.A.--Key Metrics																															
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Debt/EBITDA (x)	4.0	4.0-4.5	3.7-4.2	2.7-3.0																											

Company Description

Klabin is one of the largest Brazilian pulp and paper producers, currently focused on several forest products, and is the leading producer and exporter of paper packaging in the country. The company operates 19 plants in Brazil and one in Argentina. It owns 434,000 hectares (ha) of land with 258,000 ha of planted forests (157,000 ha of which are destined for long fiber and 101,000 for short fiber), enough to supply its current production. Klabin's business units include forestry (wood planted from pine and eucalyptus), paper (coated boards, commoditized kraftliner, and recycled paper), market pulp (hardwood, softwood, and fluff), and packaging (industrial bags and corrugated boxes).

Business Risk: Satisfactory

Our view of Klabin's business risk profile reflects the company's solid market position in the paper and packaging segments and its longstanding relationships with clients. The vertically integrated structure also allows the company to benefit from operational efficiencies that translate into higher margins than those of international peers. Despite these strengths, the volatile nature of the cyclical forest and paper products industry constrains the company's business. Klabin manages to diminish volatility through its capacity to increase exports or adjust its diverse mix of products sold based on what is more profitable. Although Brazil's paper and packaging segment is fragmented and competitive, Klabin has a leading market share of 40%-50% in kraftliner, paperboard, and industrial bags. We believe that longstanding relationships and the resilient nature of end markets (focused on food and consumer goods) mitigate the client concentration risk. In addition, Klabin's access to rapidly growing and high quality fiber gives it an advantage over international players in the paperboard and kraftliner markets. Domestically, the company's higher quality and better product mix enable it to hold a leading position.

Peer comparison

Table 1

Klabin S.A.--Peer Comparison							
Industry sector: Paper/Forest products							
	Klabin S.A.	Celulosa Arauco y Constitucion S.A.	Empresas CMPC S.A.	Suzano S.A.	WestRock Company	International Paper Co.	Packaging Corp. of America
Ratings as of Sept. 15, 2020	BB+/Stable/--	BBB-/Negative/--	--/--/--	BBB-/Negative/--	BBB/Negative/A-2	BBB/Stable/A-2	BBB/Stable/--
--Fiscal year ended--							
	Dec. 31, 2019	Dec. 31, 2019	Dec. 31, 2019	Dec. 31, 2019	Sep. 30, 2019	Dec. 31, 2019	Dec. 31, 2019
(Mil. R\$)							
Revenue	10,271.8	21,421.5	22,792.4	26,013.0	76,201.2	89,943.3	27,993.9
EBITDA	3,745.9	4,624.3	4,510.9	10,645.4	12,324.5	17,003.0	6,304.0
Funds from operations (FFO)	2,327.8	2,129.5	2,302.3	7,271.5	9,389.7	12,398.9	5,097.1
Interest expense	1,486.4	1,018.7	800.3	3,407.5	2,071.1	3,008.3	505.1
Cash interest paid	1,213.0	1,168.9	588.6	2,982.2	1,992.8	3,201.2	512.7
Cash flow from operations	2,935.5	1,707.2	2,011.6	7,572.2	10,073.0	14,871.0	5,081.0
Capital expenditure	2,546.2	4,917.6	997.1	4,864.2	5,605.2	5,012.5	1,592.2
Free operating cash flow (FOCF)	389.2	(3,210.5)	1,014.4	2,708.0	4,467.8	9,858.5	3,488.8
Discretionary cash flow (DCF)	(576.1)	(3,942.5)	198.9	2,100.5	2,149.1	4,508.4	2,255.2
Cash and short-term investments	9,730.9	6,270.7	2,490.6	9,399.8	631.6	2,054.0	3,084.7

Table 1

Klabin S.A.--Peer Comparison (cont.)							
Debt	14,856.9	18,799.2	14,388.7	59,296.1	45,442.2	45,748.3	9,378.8
Equity	6,501.3	29,622.3	32,702.0	18,088.0	48,690.2	31,023.5	12,344.3
Adjusted ratios							
EBITDA margin (%)	36.5	21.6	19.8	40.9	16.2	18.9	22.5
Return on capital (%)	12.9	5.5	5.3	6.0	6.5	14.8	20.1
EBITDA interest coverage (x)	2.5	4.5	5.6	3.1	6.0	5.7	12.5
FFO cash interest coverage (x)	2.9	2.8	4.9	3.4	5.7	4.9	10.9
Debt/EBITDA (x)	4.0	4.1	3.2	5.6	3.7	2.7	1.5
FFO/debt (%)	15.7	11.3	16.0	12.3	20.7	27.1	54.3
Cash flow from operations/debt (%)	19.8	9.1	14.0	12.8	22.2	32.5	54.2
FOCF/debt (%)	2.6	(17.1)	7.1	4.6	9.8	21.5	37.2
DCF/debt (%)	(3.9)	(21.0)	1.4	3.5	4.7	9.9	24.0

R\$--Brazilian real.

In the forest products segment, we compare Klabin mainly with regional companies because their costs are affected by the same climate conditions, and they benefit from access to superior natural resources. Compared with domestic peers, Klabin has a smaller production capacity than Suzano S.A., Empresas CMPC S.A., and Celulosa Arauco y Constitucion S.A. On the other hand, Klabin posts more stable and higher margins (mainly when compared with non-Brazilian companies). This is thanks to its strong presence in resilient end markets (both regionally and globally) and its self-sufficient and integrated production lines geared towards the paper and packaging sectors, which also grants the company a more diversified range of products.

Regarding packaging and containers, Klabin ranks behind peers in terms of geographic diversification and size of production and revenue base. However, Klabin's integrated and self-sufficient production lines help boost its efficiency and margins.

Financial Risk: Significant

Lower pulp prices have hampered margins in 2019 and 2020 while Klabin has been issuing new debt to fund its new investment phase. The sharp fall of the Brazilian real in 2020, along with the company's ability to adjust production to basic necessity products during the pandemic, have mitigated those factors and allowed revenue and EBITDA to increase in the first half of 2020. As a result, we expect net debt to EBITDA to be 4.0x-4.5x in 2020 compared with 4.0x in 2019. In 2021, higher volumes should push leverage down to 3.7x-4.2x.

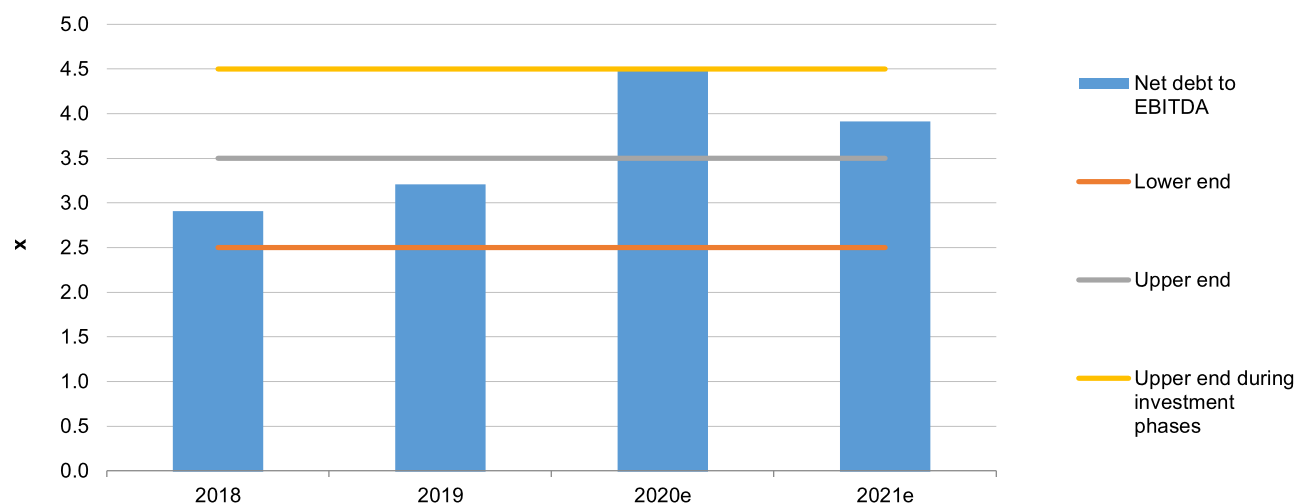
In June 2020, Klabin announced new financial policies, stating that it will seek to maintain net debt to EBITDA

(measured in dollars) at 2.5x-3.5x and potentially 4.5x during investment cycles in expansion projects (organic or inorganic ones totaling least \$1 billion). We understand such a plan signals commitment to maintain credit quality, and we will continue evaluating Klabin's adherence to such a goal.

At the end of 2020, we expect the company to be close to the upper limit of its leverage target during investment cycles, considering the PUMA II project. However, the company's leverage metric will likely return to around 3.5x at the end of 2021, within the target range.

Chart 3

Klabin's Leverage And Financial Policy



e--Estimate. Source: S&P Global Ratings and Company Filings.

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Financial summary

Table 2

Klabin S.A.--Financial Summary

Industry sector: Paper/Forest products

	June 2020	March 2020	December 2019	September 2019	June 2019
(Mil. R\$)					
Revenue	2,956.4	2,591.4	2,704.2	2,477.8	2,599.8
EBITDA	1,334.9	1,022.2	1,041.3	738.7	960.9
Funds from operations (FFO)	914.7	695.4	714.5	347.9	779.5
Interest expense	289.7	346.6	358.8	387.0	433.3
Cash interest paid	417.4	324.9	324.5	349.1	179.7
Cash flow from operations	985.1	627.3	1,033.6	938.1	531.5
Capital expenditure	954.9	819.1	823.8	844.9	580.6
Free operating cash flow (FOCF)	30.2	(191.8)	209.8	93.2	(49.1)

Table 2

Klabin S.A.--Financial Summary (cont.)

Industry sector: Paper/Forest products

	June 2020	March 2020	December 2019	September 2019	June 2019
Discretionary cash flow (DCF)	28.8	(451.6)	(85.3)	(102.0)	(251.5)
Cash and short-term investments	9,868.4	7,215.0	9,730.9	12,153.1	11,458.3
Gross available cash	9,868.4	7,215.0	9,730.9	12,153.1	11,458.3
Debt	21,498.3	20,872.1	14,856.9	15,501.9	13,507.4
Equity	3,373.8	3,420.8	6,501.3	6,213.6	6,203.4
Adjusted ratios					
EBITDA margin (%)	38.6	36.3	36.5	36.8	40.9
Return on capital (%)	11.9	11.8	12.3	14.4	16.6
EBITDA interest coverage (x)	3.0	2.5	2.5	2.6	3.2
FFO cash interest coverage (x)	2.9	3.2	2.9	3.1	3.9
Debt/EBITDA (x)	5.2	5.5	4.0	4.1	3.1
FFO/debt (%)	12.4	12.2	15.7	15.1	22.4
Cash flow from operations/debt (%)	16.7	15.0	19.8	16.6	17.8
FOCF/debt (%)	0.7	0.3	2.6	2.8	6.3
DCF/debt (%)	(2.8)	(4.3)	(3.9)	(3.7)	(1.1)

R\$--Brazilian real.

Reconciliation

Table 3

Klabin S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R\$)

--Rolling 12 months ended June 30, 2020--

Klabin S.A. reported amounts										
	Debt	Shareholders' equity	Revenue	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Dividends	Capital expenditure
Reported	30,673.2	3,373.8	10,729.8	5,377.4	2,903.2	1,310.5	4,137.1	3,642.0	751.6	3,514.2
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(48.9)	--	--	--
Cash interest paid	--	--	--	--	--	--	(1,344.3)	--	--	--
Reported lease liabilities	688.0	--	--	--	--	--	--	--	--	--
Accessible cash and liquid investments	(9,868.4)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	71.6	(71.6)	(71.6)	--	(71.6)
Dividends received from equity investments	--	--	--	13.6	--	--	--	--	--	--

Table 3

Klabin S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R\$) (cont.)										
Nonoperating income (expense)	--	--	--	--	627.7	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	13.6	--	--
Debt: Other	5.4	--	--	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	(44.9)	(44.9)	--	--	--	--	--
EBITDA: Valuation gains/(losses)	--	--	--	(656.1)	(656.1)	--	--	--	--	--
EBITDA: Other	--	--	--	(552.9)	(552.9)	--	--	--	--	--
EBIT: Other	--	--	--	--	656.1	--	--	--	--	--
Working capital: Other	--	--	--	--	--	--	--	475.5	--	--
Operating cash flow: Other	--	--	--	--	--	--	--	(475.5)	--	--
Total adjustments	(9,174.9)	0.0	0.0	(1,240.3)	29.9	71.6	(1,464.7)	(58.0)	0.0	(71.6)
S&P Global Ratings' adjusted amounts										
	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends	Capital expenditure
Adjusted	21,498.3	3,373.8	10,729.8	4,137.1	2,933.1	1,382.1	2,672.4	3,584.0	751.6	3,442.7

R\$--Brazilian real.

Liquidity: Strong

We view Klabin's liquidity as strong. We expect its cash sources to exceed uses by more than 2x in the next 12 months, with sufficient cushion to overcome any unexpected events. The company's large cash balance, R\$9.8 billion as of June 2020, reflects an increase in debt in 2020 to finance the PUMA II investment phase and provides financial flexibility to face unexpected downturns. In addition, Klabin isn't subject to financial covenants on its debt, and it enjoys well-established, solid relationships with banks.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> Cash reserves of R\$9.8 billion as of June 2020; Undrawn credit facility of about \$500 million; and FFO near R\$3.9 billion in the next 12 months. 	<ul style="list-style-type: none"> Short-term debt maturities of R\$670 million as of June 2020; Capex of about R\$4.0 billion in the next 12 months; R\$330 million for the acquisition of International Paper's Brazilian business in the next 24 months;

and

- Dividends of R\$750 million in 2020 and 2022.

Environmental, Social, And Governance

In our view, Klabin's overall ESG exposure is in line with that of industry peers. Environmental considerations are important to the sustainability of Klabin's business because sustainable forest management and obtaining the appropriate certifications are highly scrutinized by clients. Brazil, where the company's eucalyptus and pine trees are located, benefits from very favorable climate conditions, which result in high harvesting rates, compared with European or North American pulp producers. Klabin's high degree of energy self-sufficiency results in a very competitive cost structure. The company is currently investing in paper packaging operations. A higher contribution from this segment would reduce exposure to the more volatile pulp business, which would in turn reduce cash flow volatility. In the medium to long term, paper packaging could increasingly substitute plastic packaging, supporting volume growth prospects for Klabin.

Rating Above The Sovereign

The ratings on Klabin are two notches above our 'BB-' foreign currency rating on Brazil, reflecting our view that there's a notable likelihood that the company won't default upon a hypothetical sovereign default. In our view, Klabin has only a moderate sensitivity to the domestic economy due to its export-oriented business. As a result, but given the company's asset concentration in Brazil, we may rate Klabin up to three notches above the Brazil sovereign rating. Below are our main assumptions for a hypothetical Brazilian sovereign default scenario:

- GDP and paper and packaging domestic volumes fall 10% in 2020;
- Inflation doubles, and the company is unable to pass through all the resulting higher costs by raising domestic prices;
- A 50% depreciation of the real, which would double Klabin's servicing costs on its foreign currency debt (in domestic currency terms) but would raise its export revenue;
- Hardwood pulp prices of \$550 per ton, in line with those in mid-2009, when prices dropped to a 10-year low;
- A doubling of interest rates for floating loans;
- A haircut of 70% applied to investments and 10 for bank deposits; and
- Capex at maintenance levels of about R\$650 million

In our view, in this scenario, the company would maintain liquidity sources-to-uses of more than 1x in the next 12 months. We believe that Klabin's partly export-oriented business, its ability to redirect its paper production to other

markets if the domestic market deteriorates, and that the bulk of its costs are denominated in reals partly insulate the company from a potential Brazilian economic downturn.

Issue Ratings - Recovery Analysis

Key analytical factors

- The issue-level rating on Klabin's senior unsecured notes is 'BB+' and on its senior unsecured debentures is 'brAAA'.
- The '3' recovery rating indicates that we expect a recovery of about 65% for unsecured lenders under a hypothetical default scenario.
- In our default scenario, EBITDA would decline 50%-60% from currently projected EBITDA in 2023, after the completion of PUMA II.
- We've valued the company on a going-concern basis, using a 5.0x multiple applied to our projected emergence-level EBITDA, which results in an estimated gross emergence value of about R\$19.7 billion.

Simulated default assumptions

- Simulated year of default: 2025
- EBITDA at emergence: R\$3.9 billion
- Implied enterprise value (EV) multiple: 5.0x
- Estimated gross EV at emergence: R\$19.7 billion

Simplified waterfall

- Net EV after 5% administrative costs: R\$18.7 billion
- Senior secured debt: R\$3.8 billion
- Unsecured debt: R\$22.8 billion
- Recovery expectation: 65%

Ratings Score Snapshot

Issuer Credit Rating

BB+/Stable/--

Business risk: Satisfactory

- **Country risk:** Moderately high
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bbb-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+ / a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+ / a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of October 8, 2020)*

Klabin S.A.

Issuer Credit Rating

BB+/Stable/--

Brazil National Scale

brAAA/Stable/--

Senior Unsecured

Brazil National Scale

brAAA

Issuer Credit Ratings History29-Jun-2016 *Foreign Currency*

BB+/Stable/--

27-Oct-2015

BBB-/Negative/--

10-Sep-2015

BBB-/Watch Neg/--

29-Jun-2016 *Local Currency*

BB+/Stable/--

27-Oct-2015

BBB-/Negative/--

10-Sep-2015

BBB-/Watch Neg/--

16-Aug-2017 *Brazil National Scale*

brAAA/Stable/--

29-Jun-2016

brAA/Stable/--

27-Oct-2015

brAA+/Negative/--

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