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Research Update:

Empresas Copec And Celulosa Arauco Ratings Affirmed On Expansion; Empresas Copec Outlook Revised To Negative

September 27, 2024

Rating Action Overview

- We believe Empresas Copec S.A.'s significant investment in a new pulp mill in Brazil will weaken its financial metrics.
- We also expect the credit metrics of pulp and wood products division Celulosa Arauco y Constitucion S.A. to weaken, but we think Arauco will benefit from support from Empresas Copec (E-Copec).
- On Sept. 27, 2024, S&P Global Ratings revised the outlook on E-Copec to negative from stable and affirmed the 'BBB' issuer credit ratings on E-Copec. We also affirmed the 'BBB-' issuer and issue credit ratings on Arauco. The outlook on Arauco is stable.
- We expect E-Copec's leverage to be around 2.6x in 2024, and 3.0x in 2025 and 2026 due to the large capital expenditure associated with the new mill. Arauco's growing contribution to E-Copec's EBITDA and growing relevance in the group's future growth could lead the credit quality of the two companies to become increasingly intertwined.

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Rating Action Rationale

We believe E-Copec's balance sheet will suffer from its planned $4.6 billion investment in the new pulp mill in Brazil (the Sucuricu project). We anticipate the investment will bring E-Copec's leverage very close to our 3.0x debt/EBITDA downside trigger on a five-year moving average, pressuring our assessment of the company's financial risk profile.

E-Copec continues to diversify, increasing the size and the cash inflow from other segments, such as its Mina Justa copper project or expanding Abastible through the August 2024 acquisition of Gasib--a butane, propane, and autogas business in Spain and Portugal--for approximately €275 million.

However, the group is entering the investment phase with a modest cushion on its credit metrics. Although we expect the company to lower its dividend payout ratio to 30% from 40% and perhaps eventually sell some non-core assets, small deviations from its initial plan or weaker pulp prices than we expect could easily result in leverage persistently above 3.0x.

We anticipate Arauco's financial position will weaken but benefit from parent support, and the project will strengthen Arauco's competitive position and strategic relevance for the group. Following improvements in its operational performance and the sale of forest assets in Brazil, we expect Arauco's leverage to drop below 3.5x by the end of 2024.

We then expect leverage to reach 3.8x in 2025 and around 4.0x in 2026. Parent company E-Copec has already committed to capital contributions for up to $1.2 billion in the next three years, which we believe will contain leverage despite the massive investments.

We also believe the project will increase Arauco's importance within the group. As a result, the credit quality of parent and subsidiary will be increasingly intertwined.

We believe expanding into Brazil is a natural step in Arauco's strategy. The project will add 3.5 million tons (40% of total pulp capacity once completed) of low cost euca pulp, which will increase the company's EBITDA and strengthen margins. Furthermore, the project will have a highly digitalized production process and be energy self-sufficient since inception and wood self-sufficient as of the second year after termination.

Given recent projects, we could see deviations from the plan. In the latest high investment cycle involving Arauco Line 3, Arauco materially deviated from its initial plan. Final capital expenditure (capex) exceeded the initial plan by 25%, and plant construction took 4 years, rather than the planned 2.5 years. However, disruptions from the pandemic played a significant role in these deviations.

The Sucuriu project is much larger--it will be the largest pulp project implemented in one phase and will require a peak of 14,000 workers. Thus, we believe deviations in terms of costs and timing are a risk. However, we acknowledge the engineering, procurement, and construction contract with the vendor, Valmet, is designed to reduce potential deviations.

We believe this expansionary cycle will test the group's financial policy. In September 2021, E-Copec disclosed a new financial policy that established guidelines on debt limits, types, and currencies, among other terms. The policy established a consolidated net financial debt to EBITDA target of 2.0x-3.0x. If the ratio exceeds 3.5x, it designates contingency measures to avoid reaching 4.0x.

It also established a consolidated net financial debt to equity target of less than 1.0x, with a maximum of 1.2x. Additionally, no more than 30% of the total debt should mature during a specific year, and maturities for the current year and the next four years should not exceed 70% of gross debt. Finally, the parent company should maintain a minimum cash balance equivalent to 0.5% of consolidated assets.

Outlook

E-Copec:

The negative outlook reflects the expected higher leverage for the next two to three years given the company's large investment plans, reducing its credit metrics cushion in case of deviations.

Upside scenario

We could revise the outlook to stable if the company's subsidiaries improve operating and financial performance or if pulp prices are stronger than we expect, reducing leverage and increasing headroom on E-Copec's credit metrics.

Downside scenario

We could lower the ratings in the next 12 to 24 months if we expect debt to EBITDA to remain persistently above 3.0x, for example due to deviations in investment plans, lower dividends from affiliates or weaker performance at subsidiaries. We could also lower the ratings if the group's cash sources-to-uses ratio falls below 1.2x in the next 12 months.

Arauco:

The stable outlook reflects the higher relative importance of Arauco within the group, prompting us to believe that E-Copec would support Arauco's credit quality. We expect leverage below 3.5x in 2024 and around 3.8x-4.0x in 2025-2026. We also expect funds from operations (FFO) to debt of around 20%-25% in these years.

Upside scenario

An upgrade is highly unlikely in the short term. An upgrade would require successful execution of the project while leverage is consistently below 3.0x and FFO to debt consistently above 30%.

Downside scenario

We could downgrade Arauco if we believe it will lose strategic relevance within the group or if the parent doesn't grant it the financial support we expect while stand-alone leverage exceeds 3.5x on a five-year moving average. We could also lower the ratings due to weaker liquidity, with its cash sources-to-uses ratio falling below 1.2x in the next 12 months.

Company Description

E-Copec is one of the largest private industrial holding companies in Chile, with revenue of about $30 billion in 2023. It owns pulp, wood products, forestry, energy, fuel distribution, fishing, and mining businesses. The group holds large market shares and benefits from favorable cost positions at most of its subsidiaries.

Its main operating assets are:

- Arauco: Arauco has three main businesses--pulp, wood products (panels and solid wood), and forestry--and a complementary energy business. Arauco is one of the world's largest pulp producers, with a capacity of 5.1 million tons of bleached and unbleached kraft pulp (on an attributable basis), which will increase to 8.6 million with the new mill. We expect the company to generate around 60% of group's total EBITDA in 2024.
- Copec (stand-alone credit profile of 'bbb-'): The largest Chilean gas and fuel distributor. Copec has an indirect controlling stake of 58.5% in Organizacion Terpel S.A. (not rated), which is the

leader in the Colombian fuel and lubricant distribution market. It also operates in Panama, Ecuador, the Dominican Republic, and Peru. The company is increasing its nonfuel business through convenience stores, last-mile courier services, and renewable energy and electromobility projects. We expect Copec will account for around 35% of the group's EBITDA in 2024.

- Abastible (not rated): One of the largest liquefied petroleum gas distributors in South America. It operates in Chile, Colombia (through Norgas with a 51% stake), Peru (under the Solgas brand), and Ecuador (through Duragas). It also operates in Spain and Portugal through Gasib, a butane, propane, and autogas business it acquired in August 2024. We expect Abastible and its assets to represent around 5% of the group's total EBITDA in 2024.

Our Base-Case Scenario

Assumptions

- Average realized pulp prices per ton of about $695 in 2024, $645 in 2025, and $705 in 2026, versus $670 in 2023. Pulp production of 4.7 million tons in 2024, and 4.8 million tons in 2025-2026, versus 3.8 million tons in 2023.
- Panels volume of 5.0 million cubic meters in 2024, 5.2 million cubic meters in 2025, and 5.4 million cubic meters in 2026.
- Arauco's EBITDA of $1.7 billion in 2024, $1.6 billion in 2025, and $1.9 billion in 2026, compared with $1.1 billion in 2023.
- Volume growth of about 1.7% at Copec and 1.6% at Terpel in 2024, and volume growth on pace with GDP growth after 2024.
- Declines in fuel prices of about 8% in Chile and 4% in Colombia in 2024. Fuel prices in Chile to decline another 1.2% in 2025, and 0.6% in 2026, and rise in Colombia about 1% in 2025, and 1.2% in 2026.
- Copec's EBITDA of about Chilean peso (CLP) 865 billion in 2024, CLP915 billion in 2025, and CLP970 billion in 2026.
- Abastible's EBITDA of $185 million in 2024, $245 million in 2025 following the acquisition and consolidation of Gasib operations, and $250 million in 2026.
- Dividends from subsidiaries (registered under the equity method) Metrogas S.A. and Agesa (not rated) at $40 million per year. Igemar dividends at $20 million per year. Mina Justa dividends of about $100 million in 2024, and $150 million in 2025 and 2026.
- Dividend payout ratio of 30% in 2024-2026.
- Capex of $1.8 billion in 2024, $2.8 billion in 2025, and $3.2 billion in 2026.

Key metrics

Empresas Copec S.A.--Key metrics

	--Fiscal year ended Dec. 31--					
(Mil. $)	**2021a**	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**
Revenue	24,786.6	30,765.2	29,179.3	30,216.9	31,901.9	33,492.6
EBITDA (Adjusted)	3,390.1	3,606.8	2,353.4	3,120.1	3,203.2	3,516.2
Funds from operations (FFO)	2,980.0	3,759.7	1,625.5	2,193.1	2,277.6	2,479.5
Interest expense	366.4	401.9	684.4	615.2	600.4	644.3
Cash flow from operations (CFO)	2,623.1	1,776.1	2,001.5	2,007.0	1,990.6	2,207.5
Capital expenditure (capex)	1,912.0	2,033.6	1,743.9	1,806.8	2,756.8	3,223.7
Free operating cash flow (FOCF)	711.2	-257.4	257.6	200.2	-766.2	-1,016.2
Dividends	796.6	575.9	458.8	386.5	322.7	372.3
Discretionary cash flow (DCF)	-85.4	-833.3	-201.2	-186.3	-1,088.9	-1,388.6
Debt (Adjusted)	7,549.0	8,707.1	9,030.2	8,169.1	9,226.7	10,584.0
Cash and Equivalents (reported)	1,827.4	1,569.4	1,927.5	1,863.6	1,239.0	911.8
Adjusted ratios						
EBITDA margin (%)	13.7	11.7	8.1	10.3	10.0	10.5
Debt/EBITDA (x)	2.2	2.4	3.8	2.6	2.9	3.0
EBITDA interest coverage (x)	9.3	9.0	3.4	5.1	5.3	5.5
FFO/debt (%)	39.5	43.2	18.0	26.8	24.7	23.4
CFO/debt (%)	34.7	20.4	22.2	24.6	21.6	20.9
FOCF/debt (%)	9.4	-3.0	2.9	2.5	-8.3	-9.6
DCF/debt (%)	-1.1	-9.6	-2.2	-2.3	-11.8	-13.1

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

E-Copec

We view E-Copec's liquidity as adequate. We expect the group to maintain sources to uses of cash comfortably above 1.2x in the next 12 months. The group and its main subsidiaries have maintained solid liquidity amid investments and acquisitions, without short-term pressure or limits on access to banks and capital markets. These factors underscore ECopec's sound relationships with lenders and standing in the markets.

Moreover, we believe the group and its subsidiaries could absorb high-impact, low-probability events with limited need for refinancing, given that capex and dividends are flexible, the group can sell several assets, and the operating subsidiaries can count on group support--as seen in capital injections and intercompany loans to Arauco and Copec, respectively.

The group also benefits from generally prudent risk management. We think management can anticipate potential setbacks and take necessary actions, such as accessing committed credit lines.

Principal liquidity sources:

- $1.9 billion in cash holdings as of June 2024
- E-Copec's revolving credit facility for $375 million
- Arauco's revolving credit facility for $450 million
- FFO of about $2.2 billion net of operating leases
- Forestry asset sale of about $960 million after tax

Principal liquidity uses:

- Short-term maturities of about $2.3 million as of June 2024
- Maintenance capex of $900 million the next 12 months
- Working capital needs of $400 million in the next 12 months (including intra-year requirements)
- Dividend payments of about $350 million the next 12 months, in line with a 30% dividend payout ratio

Arauco

We assess Arauco's liquidity as adequate. In the next 12 months, we expect liquidity sources over uses to be more than 1.2x and liquidity sources to cover uses even if EBITDA were to fall 15% from our base-case scenario.

We assess Arauco's standing in domestic and international debt markets as positive. We think Arauco can absorb high-impact liquidity events with limited need for refinancing given its flexibility to postpone capex or reduce dividends, some flexibility to sell forest assets, and the availability of revolving credit facilities.

Moreover, its parent, E-Copec, has shown a strong commitment to support the company if needed, mainly through capital injections. Arauco also has generally prudent risk management given its record of anticipating potential setbacks and taking necessary actions.

Principal liquidity sources:

- Cash and cash equivalents of $888 million as of June 2024
- Undrawn bank lines of $450 million
- FFO of $1.3 billion in the next 12 months
- Net proceeds from forest sale for $960 million

Principal liquidity uses:

- Short-term maturities of about $1.4 billion as of June 2024
- Maintenance capex of about $850 million in the next 12 months
- Working capital requirements for $100 million in the next 12 months
- Dividend payments of about $60 million in the next 12 months, in line with a 30% dividend payout ratio

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 2024, Arauco's capital structure consisted of about $4.9 billion in senior unsecured bonds issued by Arauco, $1.8 billion in bank loans, $171 million in financial derivatives, and $544 million in financial leasing. Its secured obligations were minimal.

Analytical conclusions

We rate Arauco's senior unsecured notes at the same level as the issuer credit rating because we don't think there are material financial obligations that would rank ahead of the company's unsecured debt by way of structural or contractual subordination in a default scenario. Arauco's secured obligations represent less than 1% of consolidated debt, and unsecured debt at the operating subsidiaries is less than 10% of total debt.

Ratings Score Snapshot

	Empresas Copec S.A.	**Celulosa Arauco y Constitucion S.A.**
Issuer Credit Rating	**BBB/Negative/--**	**BBB-/Stable/--**
Business risk:	Satisfactory	Satisfactory
Country risk	Intermediate	Intermediate
Industry risk	Moderately high	Moderately high
Competitive position	Satisfactory	Satisfactory
Financial risk:	Intermediate	Significant
Cash flow/leverage	Intermediate	Significant
Anchor	bbb	bbb-
Modifiers:		
Diversification/Portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Neutral (no impact)	Neutral (no impact)
Financial policy	Neutral (no impact)	Neutral (no impact)
Liquidity	Adequate (no impact)	Adequate (no impact)
Management and governance	Neutral (no impact)	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)	Neutral (no impact)
Stand-alone credit profile:	bbb	bbb-

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed		
Celulosa Arauco y Constitucion S.A.		
Issuer Credit Rating	BBB-/Stable/--	
Celulosa Arauco y Constitucion S.A.		
Senior Unsecured	BBB-	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Empresas Copec S.A.		
Issuer Credit Rating	BBB/Negative/--	BBB/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.