FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Outlook on Empresas Copec, Arauco and AntarChile to Negative

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Fitch Ratings - São Paulo - 04 Oct 2024: Fitch Ratings has affirmed the Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) for Celulosa Arauco y Constitucion S.A. (Arauco) and Empresas Copec S.A. (Empresas Copec) at 'BBB' and their National Long-Term Ratings at 'AA(cl)'. The Rating Outlook for the corporate ratings has been revised to Negative from Stable. Fitch has also affirmed Antarchile S.A. (AntarChile)'s National Long-Term Ratings at 'AA(cl)' and revised the Outlook to Negative from Stable. A full list of ratings follows at the end of this release.

The revision of the Outlook to Negative follows the approval of Arauco's Sucuriu project that will pressure the group's net leverage, which is expected to remain above 3x for an extended period. The new investment cycle follows the recent completion of the Modernization of the Arauco Plant Expansion (MAPA) project and will delay the leverage reduction as previously projected. Empresas Copec and Arauco have shown a willingness to maintain higher leverage for a longer than expected periods, driven by a more aggressive investment strategy. The group benefits from strong financial flexibility, with the potential to raise capital or sell assets, if necessary.

The Sucuriu project, with its 3.5 million-ton pulp capacity, is strategic for Arauco, positioning the company as the second-largest pulp producer with a competitive cost structure. However, it carries high execution risks and spans a lengthy investment cycle from 2024 to 2027, while the volatility of pulp prices adds to the financial uncertainty.

increase from Empresas Copec for up to USD1.2 billion, including USD300 million during 2024. Both companies will reduce dividends payout ratio to 30% from 40% during the construction. The mill is expected to start operations in the 4Q27 and will position Arauco as the second largest pulp producer in the world, reducing its average cash cost of production.

Leverage Will Not Reduce As Anticipated: Arauco's net leverage is projected to remain above 3.0x during the construction of the new pulp mill, peaking at above 4.0x in 2027, according to Fitch calculations, above the company's rating sensitivities. The new investment cycle will also pressure Empresas Copec's net leverage above sensitivities, peaking at 3.5x in 2027. This comes after Arauco peaked at 6.2x net leverage and Empresas Copec at 3.7x in 2023, without allowing sufficient time to deleverage after MAPA expansion.

The sizable project reflects a more aggressive investment approach compared to Arauco's historical trends. This could lead to higher leverage than projected if pulp prices fall below expectations or if the company encounters additional challenges, such as unexpected stoppages, forestry fires, or reduced cash flow generation from Empresas Copec's other businesses.

Arauco's FCF Will Remain Negative: Arauco's FCF has been negative for the past four years due to MAPA project and is expected to remain negative until 2027. Fitch projects that Arauco will generate about USD1.9 billion of EBITDA in 2024 and USD1.7 billion in 2025, benefiting from higher pulp prices during this year and increased pulp capacity. Cash flow from operations (CFFO) should be close to USD1.1 billion in 2024 and USD1.3 billion in 2025. This compares with USD979 million of EBITDA and USD712 million of CFFO in 2023. FCF is projected to remain negative in 2024, and reach between negative USD1.1 billion and USD1.5 billion in 2025 and 2026, as investments in the new mill increase.

Credit Linkage Incorporated: Fitch incorporated in the analysis its "Parent and Subsidiary Linkage Rating Criteria" and considers the parent, Empresas Copec, has a stronger credit profile than Arauco. This is due to higher diversification and a more stable distribution business, which makes cash flow less volatile. Strategic incentives between Arauco and Empresas Copec are high, as Arauco represents about half of the group's consolidated EBITDA, with strong growth potential.

Sustainable Competitive Advantage: Arauco's ratings are underpinned by a strong business position, with an annual pulp production capacity of 5.1 million tons (8.6 million tons considering Sucuriu project). The company has one of the industry's lowest cost structures, which allows it to generate strong operating cash flows in market downturns, ensuring long-term competitiveness.

Fitch views Arauco's competitive cost advantages in these products as sustainable due to productive forest plantations, modern production equipment, energy self-sufficiency and low logistic costs from the close proximity of plantations, mills and ports. The new project should reduce average cash costs, given its location in Brazil.

Strong Record of Dividends Receipts: Empresas Copec's credit profile is supported by a strong and diversified asset portfolio underpinned by leading market shares in its key business segments of forestry products, liquid fuel distribution and liquified gas (LG). Empresas Copec maintained a solid record of dividends received from Arauco, Copec and Abastible. The company also benefited from cash flow from a minority investment in AGESA (40% participation) and from its Mina Justa investment in Peru.

Dividends averaged about USD600 million in the last five years, and Empresas Copec received USD264 million of dividends in 1H24. Dividends are expected between USD550 million and USD650 million during the Sucuriu project construction, considering Arauco's dividend policy reduction to 30%.

DERIVATION SUMMARY

Arauco, the third-largest market pulp producer globally, accounted for 55% of Empresas Copec's EBITDA, in the LTM ended June 30, 2024. Another 35% of EBITDA is from Copec, a diversified fuel business with operations in Chile, Colombia, Peru, Ecuador and the U.S. The diversification and stability of the fuel business allows the company to have more leverage for its rating level than pure forestry and pulp peers, such as Suzano S.A. (BBB-/Stable), Empresas CMPC S.A. (BBB/Stable) and Klabin S.A. (BB+/Stable).

Similar to other Latin American pulp producers, Arauco's cash production costs are among the lowest in the world, mainly in softwood pulp, ensuring long-term competitiveness. In the fuel business, the company is the market leader in Chile and Colombia and has a

KEY ASSUMPTIONS

--Consolidated capex in Empresas Copec, including acquisitions, of USD2.4 billion in 2024, USD2.8 billion in 2025, USD3.4 billion in 2026 and USD3.4 billion in 2027, including investments in project Sucuriu;

--Pulp sales volume of 4.8 million tons in 2024 and 2025;

--Average net hardwood pulp prices of USD675/ton in 2024 and USD625/ton in 2025. Spread of USD125 to USD175 per ton between hardwood and softwood pulp;

--Fuel volumes around 23 million cubic meters in 2024 and 21 million in 2025 due to the sale of assets in Peru and Ecuador. Margin of between USD35 and USD38 per cubic meter;

--Dividend pay-out ratio of 30% of net profit in Arauco and Empresas Copec in the following three years;

--Capital increases from Empresas Copec to Arauco for USD300 million in 2024, USD700 million in 2025 and USD200 million in 2026;

--No asset sales considered in the base case.

RATING SENSITIVITIES

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

Empresas Copec:

Although unlikely, positive rating action could occur if Empresas Copec is able to maintain consolidated net leverage below 2.0x on a sustained basis.

Arauco

--Average net debt/EBITDA remains below 2.0x throughout the pulp price cycle;

--Sustained net debt at Arauco of less than USD3.5 billion.

Empresas Copec

--Net debt at the holding level to dividends received above 3.0x;

--Consolidated net leverage above 3.0x for a sustained period;

--Additional debt at the holding level to finance Project Sucuriu.

Arauco

--Downgrade of Empresas Copec;

--Average net debt/EBITDA above 3.0x throughout the pulp price cycle and weakening of strategic incentives between Arauco and Empresas Copec.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Empresas Copec maintains a strong liquidity position at the individual and consolidated level. The company had USD500 million of cash and marketable securities at the holding company and USD1.9 billion on a consolidated basis as of June 30, 2024.

Empresas Copec maturities in the short term as of June 2024 were mainly related to Copec and Arauco. Arauco paid its main short-term maturities with proceeds from the forestry asset sale in Brazil, and has USD710 million debt maturities in 2024 to be refinanced, and USD250 million in 2025, compared to a cash position of USD861 million. Liquidity is further improved by a committed credit facility at Arauco for USD450 million due 2027, and one in Empresas Copec for USD375 million due in 2026.

ISSUER PROFILE

Empresas Copec S.A. is a pure holding company that is controlled by the Angelini group through its 75.1% stake in AntarChile, who in turns owns 60.8% of Empresas Copec. Through its wholly owned subsidiaries, Empresas Copec has a strong presence in the forestry, fuel oil distribution, and fishing industries.

Arauco is the third largest market pulp producer globally, with an annual production

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

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

Empresas Copec and Arauco have an ESG Relevance Score of '4' [+] for Energy Management as Arauco sells excess energy to the grid from cogeneration based upon a renewable resource, which has a positive impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

Empresas Copec and Arauco have an ESG Relevance Score of '4' for Exposure to Environmental Impacts as Chilean forestry companies are exposed to forest fire risk, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Empresas Copec S.A.	LT IDR BBB Rating Outlook Negative	BBB Rating

	LC LT IDR BBB Rating Outlook Negative Affirmed	BBB Rating Outlook Stable
	Natl LT AA(cl) Rating Outlook Negative Affirmed	AA(cl) Rating Outlook Stable
	Nat Equity Rating Primera Clase Nivel 1(cl) Affirmed	Primera Clase Nivel 1(cl)
senior unsecured	Natl LT AA(cl) Rating Outlook Negative Affirmed	AA(cl) Rating Outlook Stable
Celulosa Arauco y Constitucion S.A.	LT IDR BBB Rating Outlook Negative Affirmed	BBB Rating Outlook Stable
	LC LT IDR BBB Rating Outlook Negative Affirmed	BBB Rating Outlook Stable
	Natl LT AA(cl) Rating Outlook Negative Affirmed	AA(cl) Rating Outlook Stable
senior unsecured	LT BBB Affirmed	BBB

senior unsecured	Natl LT Affirmed	AA(cl) Rating Outlook Negative	AA(cl) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Chilean Equity Rating Criteria (pub. 22 Jul 2024)

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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