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Research Update:

# Empresas CMPC S.A. Upgraded To 'BBB' From 'BBB-' On Improved Metrics And Supportive Financial Policy, Outlook Stable

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## Rating Action Overview

- Chilean pulp and paper producer Empresas CMPC S.A. (CMPC) has had a strong performance and improved credit metrics in the past two years.
- Although we forecast lower pulp prices, the consolidation of recent acquisitive and internal growth, a supportive financial policy, and manageable capital allocation should result in CMPC's healthy credit metrics going forward.
- On April 5, 2023, S&P Global Ratings raised its issuer credit and issue-level ratings on CMPC to 'BBB' from 'BBB-'.
- The stable outlook reflects our view that CMPC will maintain its solid competitive position and low-cost structure, leading to net debt to EBITDA between 2.0x and 2.5x and funds from operations (FFO) to net debt of about 30% in the next two years.

## Rating Action Rationale

**We expect the company's solid operational and financial performance to continue.** CMPC's sound operational performance amid favorable pulp prices helped the company reduce leverage and strengthen its overall credit metrics in 2021 and 2022. Debt to EBITDA fell to 2.1x in 2021 and 2022 from 3.0x-4.0x during the previous five years (with the exception of 1.8x in 2018). In our view, the company will be able to maintain its improved financial profile with debt to EBITDA between 2.0x and 2.5x, even factoring in weaker global economic conditions and lower pulp prices as new capacity enters the market. This is supported by our expectation of higher volumes and cost efficiencies in the company's three business segments after completing internal and acquisitive growth in the past few years, which should boost EBITDA and cash flow. In 2022, CMPC's EBITDA jumped to $2.1 billion. We expect it to fall to about $1.7 billion in the next two years in line with lower pulp prices, but still to be 70%-80% above 2020 levels.

**CMPC's credit profile benefits from recent acquisitions as well as internal growth.** The company has already made 68% progress in its Guaiba pulp mill expansion, which will increase capacity by 350,000 tons, and has invested $255 million out of an investment plan of $530 million. The project includes modernizing the mill, and management expects this to reduce cash costs by $20 per ton in production line 1 (mainly related to the replacement of the recovery boiler) and $5 per ton in line 2. CMPC expects to complete the expansion during the fourth quarter of 2023.

In addition, through acquisitions mainly in the tissue segment, the company has been deploying a consistent growth and diversification strategy that allows for EBITDA expansion and gradual margin improvements. Since 2021, CMPC has added new capacity in tissue, personal care, sack-kraft and other papers, and bio-packaging through the acquisitions of Carta Fabril and Iguaçu in Brazil and PI Mabe in Mexico.

**Record of financial discipline, commitment to its financial policy, and no major greenfield expansion projects in the next two to three years underpin the sustainability of CMPC's lower leverage.** Our base-case scenario does not consider any pulp mill construction or major greenfield expansion projects in the coming years. Furthermore, we think that CMPC has a supportive financial policy framework and the discipline to commit to its financial policy. Even in a new expansionary cycle, we would expect the management to take actions to contain leverage without materially deviating from its policy threshold (including a debt-to-EBITDA ratio between 2.5x and 3.5x) for a prolonged period.

Although the company has not embarked on large investment projects in the past four years, it has faced one of the longest pulp price downturns in the past 10 years, when debt to EBITDA peaked at 3.2x in 2019 and 3.5x in 2020. While CMPC didn't need to adopt extreme stringent measures to keep its leverage under control in those years, management reduced the dividend payout to the 30% minimum legal requirement, postponed provisory dividends, and slowed capital expenditures (capex) to weather the price downturn. We would expect this type of discipline in upcoming years, if needed.

**New pulp capacity additions and the global economic slowdown will pressure pulp prices, but we expect CMPC to have a cushion on its metrics.** Although China's reopening after it relaxed COVID-related mobility restrictions was positive for pulp producers, demand has been weaker than we expected. At the same time, worldwide high interest rates are fueling a global economic slowdown. Therefore, demand for pulp and paper is weakening and pulp prices have already fallen sharply. Moreover, we also think pulp prices will be pressured by new supply, such as MAPA (1.3 million tons of bleached eucalyptus kraft pulp [BEKP]) and Bracell's (2.8 million tons of BEKP or 1.5 million tons of dissolving pulp) ramp-up completion, and the start-up of the new UPM mill (2.2 million tons of capacity) in Uruguay. In addition, Suzano has a 2.55 million ton BEKP project in Mato Grosso, Brazil, that we expect to start up in the second half of 2024.

As a result, we anticipate lower prices in the coming years, translating to consecutive average realized pulp prices for CMPC dropping 12%-15% to about $750 per ton in 2023 and 10%-12% to about $670 per ton in 2024. In our opinion, there's a risk the price correction could be sharper than we consider in our base case. Nevertheless, CMPC's debt-to-EBITDA ratio should remain between 2.0x and 2.5x in the forecast period, leaving some cushion for further price volatility. We estimate that all else being equal, pulp prices would have to remain persistently about 15% to 20% lower than in our base case for CMPC's leverage to remain consistently very close to or above 3.0x.

## Outlook

The stable outlook reflects our view that CMPC will maintain relatively low leverage in the next two years while keeping its solid competitive position and low-cost structure, leading to net debt to EBITDA between 2.0x and 2.5x and FFO to net debt around 30%. The outlook also indicates that even if pulp prices are more volatile, we expect CMPC to remain committed to its financial policy.

### Downside scenario

We could lower the ratings in the next 24 months if the company favors growth and/or shareholders' remuneration at the expense of leverage discipline, or if there's a much sharper drop in pulp prices than we expect. In these cases, we would see debt to EBITDA consistently above 3.0x and FFO to net debt below 30% on a three-to-five year moving average. That could happen, for instance, if pulp prices remain 15%-20% lower than our base-case assumptions.

### Upside scenario

Although unlikely, we could raise the ratings in the next 24 months if we think the company will maintain net debt to EBITDA consistently below 2.0x and FFO to debt very close to or above 45%, even during periods of high investment. An upgrade would also depend on the company's ability to maintain some cushion in its debt level that would allow it to absorb significant pulp price volatility without spiking its leverage.

## Company Description

Chile-based CMPC is a forest products company. The company has industrial operations in eight countries and operates in three segments: pulp (81% EBITDA contribution as of December 2022), paper-based packaging (9%), and tissue (under the Softy's brand; 11%). CMPC is one of the world's largest pulp producers (4.4 million tons of pulp production capacity) and is among the largest tissue and sanitary products producers in several Latin American countries. The company benefits from a substantial land base that encompasses close to 1.3 million hectares, 764,000 of which were planted as of the end of 2022. About 63% of CMPC's productive land is in Chile, and the rest is in Brazil (30%) and Argentina (7%). The Matte family, which owns one of Chile's leading economic groups, controls the company through a 56% stake.

## Our Base Case Scenario

### Assumptions:

- Global GDP growth of 2.9% in 2023, 3.3% in 2024, and 3.5% in 2025. GDP in Latin America to grow about 1.2% in 2023, 2.4% in 2024, and close to 2.5% after that.
- Average exchange rate of CLP822 per $1 in 2023, down from CLP873 per $1 in 2022, and CLP900 per $1 in 2024 and 2025. In addition, we expect currencies across the region to depreciate, resulting in minor average tissue paper price increases in 2023 and 2024.
- Average realized pulp prices of about $755 per ton in 2023 compared to $865/ton in 2022,

declining about 10%-15% in 2024 and further declining 10%-15% in 2025.

- BEKP volumes close to 2.9 million tons in 2023 and 3.2 million tons in 2024, and bleached softwood kraft pulp (BSKP) volumes of about 700 million tons in 2023 and 2024, considering Guaiba's expansion of 350,000 tons of BEK to be completed in the fourth quarter of 2023.
- Tissue volumes to grow 2.5%-3.5% annually in 2023-2025, including the 100,000 ton capacity of Carta Fabril.
- Personal care volumes to grow 1.5%-2.5% annually in 2023-2025, including the new capacity from the PI Mabe acquisition.
- Growth of 3%-4% per year in bio-packaging volumes, including Iguaçu's production in Brazil, because demand for paper packaging remains healthy amid increasing use of paper-based packaging to replace plastic packaging.
- Capex of about $550 million in 2023-2025. This includes about $180 million in 2023 and $50 million in 2024 to complete the Guaiba mill expansion, maintenance capex, investments to build up the forest base in Brazil, and some efficiency projects.
- Payment of $270 million in 2023 for the PI Mabe acquisition.
- Guaiba II recovery boiler insurance collection of $200 million.
- A dividend payout ratio of 60% on 2022 net income and 40% afterward, resulting in a dividend payment of $350 million-$400 million in 2023, $230 million in 2024, and $200 million in 2025.

## Key metrics:

| | 2021A | 2022A | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|
| Revenues (Mil. $) | $6,323.0 | $7,821.3 | $7,233.5 | $7,338.5 | $7,227.1 |
| Adjusted EBITDA (Mil. $) | $1,647.6 | $2,051.6 | $1,729.2 | $1,673.6 | $1,496.8 |
| EBITDA margin (%) | 2605.8% | 2623.1% | 2390.5% | 2280.5% | 2071.1% |
| Operating cash flow (Mil. $) | $977.7 | $592.2 | $1,283.7 | $1,120.9 | $1,149.0 |
| Free operating cash flow (Mil. $) | $553.8 | $49.6 | $733.7 | $570.9 | $599.0 |
| Capex (Mil. $) | $423.9 | $542.6 | $550.0 | $550.0 | $550.0 |
| Dividends (Mil. $) | $491.9 | $482.9 | $390.6 | $227.8 | $193.4 |
| Adjusted debt (Mil. $) | $3,490.0 | $4,272.3 | $3,999.3 | $3,686.2 | $3,280.6 |
| Gross debt/EBITDA (x) | 2.1x | 2.1x | 2.3x | 2.2x | 2.2x |
| EBITDA/Interest expense (x) | 7.5x | 9.3x | 6.8x | 7.0x | 6.7x |
| FFO/debt (%) | 39.9% | 34.1% | 27.5% | 31.2% | 33.0% |
| Free operating cash flow/debt (%) | 15.9% | 1.2% | 18.3% | 15.5% | 18.3% |

## Liquidity

We view CMPC's liquidity as strong. Considering the $500 million bond maturity in May 2023, we expect the company to have a more limited liquidity cushion, but still to have sources over uses of liquidity slightly above 1.5x in the next 12 months. In addition, we expect the company to raise fresh funds in the next 12 months. CMPC has a proven ability to tap international and domestic debt markets and has solid relationship with banks. We also consider CMPC's management as prudent, as illustrated during periods of higher uncertainty in which CMPC reduced capex, postponed provisory dividend payments, or reduced dividends, and made efforts to improve working capital.

Principal liquidity sources:

- Cash position of about $855 billion as of Dec. 31, 2022;
- Cash FFO of $1.1 billion in the next 12 months;
- Committed revolving credit facilities totaling $300 million, available until 2024;
- Working capital inflows of $150 million-$200 million in the next 12 months; and
- Guaiba II recovery boiler insurance collection of $200 million.

Principal liquidity uses:

- Short-term debt maturities of $591 million as of Dec. 31, 2022;
- Capex of about $550 million in the next 12 months;
- Net cash outflow for the acquisition of PI Mabe for $270 million in the next 12 months; and
- Dividend payment of $350 million-$400 million in the next 12 months.

## Covenant Analysis

### Requirements

Covenant restrictions on certain obligations, including the following limits:

- Debt to equity of a maximum of 0.8x;
- EBITDA and dividends received and interest income/interest expenses of at least 3.25x;
- Equity greater than UF71.6 million; and
- CMPC is required to maintain at least 70% of its fixed and biological assets in the main sectors in which it operates.

### Compliance expectations

Inversiones CMPC S.A. (not rated; the company's finance arm) is subject to financial covenants on some bank loans and domestic issuances. As of Dec. 31, 2022, the company was in full compliance with those covenants, and we expect it to remain so. Based on our forecasts, we expect a comfortable covenant cushion for the next two years: about 140% EBITDA headroom for the interest coverage covenant and 35%-45% debt headroom for the debt-to-equity one.

## Issue Ratings--Subordination Risk Analysis

### Capital structure

As of December 2022, CMPC's capital structure consisted of about $3.7 billion in senior unsecured bonds issued by its nonoperating financial vehicle, Inversiones CMPC, which CMPC guarantees, and $1.1 billion in bank loans. Short-term debt represented 14% of total debt and dollar-denominated debt represented 97%. Almost all debt bears a fixed interest rate at an average expense rate of 4.19%.

### Analytical conclusions

In our view, investors in the senior unsecured notes don't face a significant disadvantage as creditors of the group's financing vehicle because CMPC unconditionally guarantees this debt, and thus it ranks pari passu to all of the parent's current and future senior unsecured debt. Furthermore, we don't believe there are material financial obligations that would rank ahead of CMPC's unsecured debt by way of structural or contractual subordination in a default scenario. CMPC holds minimal secured obligations, and debt at the level of its operating subsidiaries is less than 10% of total debt.

## Ratings Score Snapshot

| Issuer Credit Rating | BBB/Stable/-- |
|---|---|
| Business risk: | Satisfactory |
| Country risk | Intermediate |
| Industry risk | Moderately High |
| Competitive position | Satisfactory |
| Financial risk: | Intermediate |
| Cash flow/leverage | Intermediate |
| Anchor | bbb |
| Modifiers: | |
| Diversification/Portfolio effect | Neutral |
| Capital structure | Neutral |
| Financial policy | Neutral |
| Liquidity | Strong |
| Management and governance | Satisfactory |
| Comparable rating analysis | Neutral |
| Stand-alone credit profile: | bbb |

## ESG credit indicators: E-3, S-2, G-2

## Related Criteria

- 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

**Upgraded; CreditWatch/Outlook Action**

| | To | From |
|---|---|---|
| **Empresas CMPC S.A.** | | |
| Issuer Credit Rating | BBB/Stable/-- | BBB-/Positive/-- |

**Upgraded**

| | To | From |
|---|---|---|
| **Inversiones CMPC S.A.** | | |
| Senior Unsecured | BBB | BBB- |

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.