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Research Update:

Empresas CMPC S.A. Outlook Revised To Positive On Stronger Forecasts And Track Record Of Consistent Financial Policy

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PRIMARY CREDIT ANALYST

Amalia E Bulacios

Buenos Aires

+ 54 11 4891 2141

amalia.bulacios
@spglobal.com

SECONDARY CONTACT

Luisa Vilhena

Sao Paulo

+ 55 11 3039 9727

luisa.vilhena
@spglobal.com

Rating Action Overview

- Strong momentum in the pulp market will boost Empresas CMPC S.A.'s (CMPC) results in 2021. We anticipate the company's financial metrics will improve considerably, with its debt-to-EBITDA ratio remaining between 2.0x and 2.5x in the next two years.
- The company has shown an ability to maintain credit metrics within its financial policy boundaries, even during a considerable market downturn and its recently announced expansion gives better visibility on potential capital expenditures (capex).
- On Aug. 18, 2021, S&P Global Ratings revised the outlook on CMPC to positive from stable and affirmed the 'BBB-' ratings on the company and its senior unsecured notes.
- The positive outlook reflects the one-in-three chance we will raise our ratings on CMPC in the next 12 to 24 months if the company's operational performance remains solid and its financial discipline continues cushioning price volatility.

Rating Action Rationale

We revised the outlook to positive because we believe continued sound operational performance will help CMPC deleverage in 2021-2022. We expect the company will decrease leverage to levels consistent with a stronger financial risk profile for at least the next three years. The pulp market has completed an extraordinary turnaround from trough to peak in the first half of the year. Following a prolonged downturn on pulp prices during 2019 and 2020, we believe 2021 will register a strong recovery. We expect CMPC's averaged realized prices to rise to about $660-$680 per ton in 2021, compared to $500 per ton in 2020, which--combined with good operational performance in the company's tissue and packaging segments--will result in a considerable drop in leverage. Additionally, although we expect a gradual correction in prices in 2022 and 2023, we anticipate pulp prices will remain above the historical minimums observed during 2020. Combined with the company's efficient cost structure and diversification into more stable business lines such as tissue and packaging products, that should result in persistently sound EBITDA and operational cash flow generation.

Capital allocation should remain manageable through 2023, leaving room for debt reduction. We estimate CMPC will devote annual capex between $500 million and $800 million per year, which should result in leverage levels remaining consistently between 2.0x and 2.5x through 2023. The company has announced a brownfield expansion project in its Guaiba plant, which would result in an increase of 350,000 tons in capacity and improved cash costs along with improvements in greenhouse gas emissions and water usage. We also expect further organic and minor inorganic investments in the other two businesses.

The rating action also reflects our view of the group's ability to sustain credit metrics comfortably within its financial policy boundaries. The company has built a track record of consistently maintaining leverage metrics in line with its financial policy (such as debt-to-EBITDA ratio between 3.5x and 2.5x). 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 and lowest average pulp prices in the past 10 years while S&P adjusted debt-to-EBITDA peaked at 3.2x and 3.5x in 2019 and 2020. While CMPC didn't need to adopt extreme stringent measures to keep its leverage under control in 2020 and 2019, management reduced the dividend payout to the 30% legal minimum, postponed provisory dividends, and slowed capex to weather the price downturn. We expect the company to keep up this financial discipline and maintain leverage within the lower end of its financial policy range, remaining consistent with a stronger financial risk profile.

The company should be able to support price corrections beyond those in our base case. In the first few months of 2021, prices rallied well above our expectations for a combination of reasons (stronger demand, increased downtime, logistics issues, a weaker dollar that favored paper producers' margins, and likely some speculative demand based on futures). Since mid-second quarter 2021, we have seen some minor downward pressure on pulp prices in China but prices in Europe and the U.S. continued to increase or remained stable. Although we assume a correction in the second half of the year amid seasonality and the impact of some start-ups (the start-up of the MAPA project from Celulosa Arauco and Bracell's new mill), we expect average benchmark prices to be about 40% higher than in 2020. 2022 should start with strong pulp prices and largely balanced supply and demand at the beginning of the year could result in some minor seasonal increases. However, we anticipate stronger downward pressure starting in mid-2022 because of seasonality, MAPA and Bracell's ramp-up completion, and approach to startup of the new UPM mill in Uruguay. We expect this to translate to consecutive average realized pulp prices for CMPC dropping 5%-7% to about $630 per ton in 2022 and 6%-8% to about $580 per ton in 2023. This means our base case 2022 prices would still be about 25% higher than the 2020 historical low or 18% higher than 2016 (previous market downturn) average prices. Similarly, our base case 2023 prices would still be 17% and 10% higher, respectively. While 2020 was an unprecedented year and we believe it's highly unlikely those market conditions would replicate in the medium term, we believe that there are risks the price correction could be sharper than contemplated in our base case. Nevertheless, CMPC's debt-to-EBITDA would remain between 2.0x and 2.5x in the forecast period and funds from operations (FFO) to debt between 32% and 38%, leaving some cushion for further price volatility. We estimate that, all else equal, pulp prices would have to remain persistently about 12% to 15% lower than in our base case for leverage to remain consistently very close to or above 3.0x or FFO/debt close to or below 25%.

We revised our assessment of CMPC's management and governance to satisfactory. Our view is underpinned by the company's good transparency and reporting, and higher board engagement than in other Chilean companies, although offset by lower board independence and diversity than global best practices. In 2016, the company publicly admitted to fixing the price of tissue paper with another player between 2001 and 2011; however, CMPC has since replaced top-level executives and its board of directors, and implemented several measures in line with guidelines provided by the Free Competition Defense Court.

Outlook

The positive outlook reflects our view that, amid higher pulp prices, CMPC will continue to reduce leverage in the next two years while maintaining its solid competitive position and low-cost structure, leading to FFO to net debt between 30% and 35%, and net debt to EBITDA between 2.0x and 2.5x. It also reflects that even under potential pulp price volatility scenarios, we expect CMPC to remain committed to its financial policy.

Upside scenario

We could raise the ratings in the next 12 to 24 months if we believe the company would maintain net debt to EBITDA comfortably below 3.0x and FFO/debt very close to or above 30% in a three-to-five year moving average withstanding high investment periods and pulp prices. An upgrade depends on the company's ability to maintain some cushion in its debt levels that would allow it to absorb significant pulp-price volatility without hurting its leverage significantly. An upgrade would be consistent with the company maintaining leverage between 2.0x and 2.5x and FFO/debt close or above 30% the next two to three years in which we expect average realized pulp prices to remain at least between 10% and 15% above prices of cycle downturn like 2016 and 2020.

Downside scenario

We could revise the outlook back to stable if the company favors growth and/or shareholders' remuneration at the expense of leverage discipline or if there is a much sharper than expected drop in pulp prices. At the same time, we would foresee debt-to-EBITDA remaining very close to or above 3.0x and FFO to net debt close to or below 25% in a three-to-five year moving average. That would happen, for instance, if pulp prices remain persistently 15% lower than in our base case.

Company Description

Chile-based CMPC is a forest products company. The company has industrial operations in eight countries and operates in three segments: pulp, biopackaging (paper-based packaging), and tissue (under the Softy's brand). CMPC is one of the world's largest pulp producers (4.3 million tons of pulp production capacity), and a leading tissue and sanitary products producer in several Latin American countries. The company benefits from a substantial land base that encompasses more than 1.3 million hectares, 760,000 of which were planted as of the end of 2020. About 65% of CMPC's productive land is in Chile, while the rest is in Brazil (26%) and Argentina (9%). The Matte family, owner of one of Chile's leading economic groups, controls the company through a 56% stake.

Our Base-Case Scenario

- Average realized pulp prices of $660-$670 per ton in 2021, about $630 per ton in 2022, and $580 per ton in 2023.
- Steady bleached eucalyptus kraft pulp volumes of close to 3 million tons and bleached softwood kraft pulp volumes of about 700 million tons for the next three years amid no expectations for additional capacity.
- Chile's annual GDP to grow about 6.9% in 2021 and about 3.0% the following two years. GDP across Latin America to grow about 6.0% in 2021 and 2.5% the following two years.
- Appreciation of the Chilean peso and only minor depreciation in most other regional currencies in 2021, which will result in minor improvement in average prices for Softy's. But we expect slight depreciations of currencies across the region resulting in a minor drop in 2022.
- After extraordinary demand for tissue products in 2020 amid the pandemic, we expect volumes to drop about 4% in 2021. As of 2022, a recovery in away-from-home products and consistent economic and consumption growth in the region would support gradual volume growth of about 2%-3%
- Growth of 2%-3% per year in biopackaging volumes as demand for paper packaging remains healthy amid economic growth in the region and increasing use of paper-based packaging to replace plastic packaging.
- Considerable recovery in EBITDA margins amid much higher pulp prices and, to a lesser extent, better margins in the biopackaging business.
- Capex of about $550 million in 2021 including about $100 million for the Bio CMPC project, $750 million in 2022 including about $350 million for the project, and $550 in 2023 including about $80 million for the project. This assumption also incorporates annual maintenance capex of $260 million-$280 million, some minor investments for other tissue projects, efficiency projects, and streamlining pulp projects.
- A dividend payout of 100% of 2021 net income, with three provisory dividends during 2021, in line with the revised policy for this year and we expect a distribution of 40% of previous year net income in the coming years in line with the company's recent track record of maintaining dividends between 30% and 40%.

Key metrics

Table 1

Empresas CMPC--Key Metrics*

	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021e	2022f	2023f
(Mil. $)					
Average realized pulp price ($/ton)	600.4	500.7	660-680	~630	~580
Revenue	5670	5287	6000-6200	6000-6100	5850-6050
Revenue growth (%)	-9.6	-6.8	15.1	~(1)	(2)-(1)
EBITDA	1122	964	1500-1600	1400-1500	1200-1400
EBITDA margin (%)	19.8	18.2	25-26	23-24	20-23

Table 1

Empresas CMPC--Key Metrics* (cont.)

	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021e	2022f	2023f
(Mil. $)					
Funds from operations (FFO)	573	795	1150-1300	950-1100	900-1000
Capital expenditure	248	331	550	750	550
Free operating cash flow (FOCF)	252	256	450-600	150-300	300-500
Dividends	203	17	350-400	200-250	100-150
Debt	3580	3374	3150-3300	3150-3300	2900-3100
Debt to EBITDA (x)	3.2	3.5	2.0-2.3	2.2-2.5	2.2-2.5
FFO to debt (%)	16	23.6	35-40	30-35	30-35
FOCF to debt (%)	7.1	7.6	15-18	5-8	10-15

*All figures adjusted by S&P Global Ratings. Debt includes operating leases and is net of cash and equivalents. a--Actual. e--Estimate. f--Forecast.

Liquidity

We view CMPC's liquidity position as strong, the sound cash position as of June 2021 and strong cash FFO forecast amid recovering pulp prices ensure it will comfortably cover liquidity needs in the next 12 months. We expect liquidity sources to exceed uses by more than 50%. We also incorporate in our liquidity analysis CMPC's proven ability to tap international and domestic debt markets for financing, its solid relationship with banks, and its adequate financial flexibility, considering the company has already refinanced next year international bond amortization. We also believe CMPC's management is prudent, as illustrated during periods of higher uncertainty in which CMPC reduced capex, postponed provisory dividend payments or reduced dividends, and made working capital efforts. Finally, we consider the company's ability to withstand unexpected liquidity stress events without needing to refinance, given we believe the company could once again reduce dividends or capex or make use of the committed credit facility.

Principal Liquidity Sources:

- Cash position of around US$1.48 billion as of June 30, 2021;
- Cash FFO ranging around US$1.0 billion-US$1.2 billion in the next 12 months; and
- Committed revolving credit facility for US$300 million.

Principal Liquidity Uses:

- Debt maturities of $710 million as of June 30, 2021;
- Capex of about $650 million in the next 12 months;
- Working capital needs of around $150 million in the next 12 months; and
- Dividend payout ratio of 100% in 2021 and 40% in 2022. Total dividend payment of around

US$300 million in the next 12 months

Covenants

Compliance expectations

Inversiones CMPC S.A. (the company's finance arm) is subject to financial covenants on some bank loans and domestic issuances. As of June 30, 2021, 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: 40%-60% headroom for the interest coverage covenant and 40%-70% headroom for the debt-to-equity one.

Requirements

Covenant restrictions on certain obligations include limitations of:

- Debt to equity of 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
- Fixed and biological assets: the company is subject to maintain at least 70% of its fixed and biological assets in the main sectors it operates.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 2021, CMPC's capital structure consisted of almost $3.9 billion in senior unsecured bonds, issued by its non-operating financial vehicle, Inversiones CMPC, which CMPC guarantees, and about $1.2 billion in bank loans and finance lease obligations, of which $130 million are also at the level of Inversiones CMPC and the remainder at the level of other operating subsidiaries.

Analytical conclusions

We don't believe that investors in the senior unsecured notes face a significant disadvantage as creditors of the group's financing vehicle because CMPC unconditionally guarantees this debt, and thus 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:

Foreign currency: BBB-/Positive/--

Business risk: Satisfactory

- Country risk: Intermediate
- 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: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- 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. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Empresas CMPC S.A.		
Issuer Credit Rating	BBB-/Positive/--	BBB-/Stable/--
Ratings Affirmed		
Inversiones CMPC S.A.		
Senior Unsecured	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.