

MOODY'S

RATINGS

Rating Action: Moody's Ratings affirms Celulosa Arauco's Baa3 ratings; outlook changed to stable

15 Aug 2024

New York, August 15, 2024 -- Moody's Ratings (Moody's) has affirmed the Baa3 ratings of Celulosa Arauco y Constitucion S.A.'s (Arauco) Senior Unsecured Global Notes. The outlook changed to stable from negative.

RATINGS RATIONALE

The outlook change to stable from negative reflects our view that Arauco will be able to achieve a significant debt reduction by year-end 2024, aided by around \$967 million in cash proceeds from a forestry asset sale in July 2024; and improved operating performance. Key to this improved performance is the increase in pulp production volumes, thanks to the expanded capacity at Arauco's mill (Line 3, with 1,560,000/year BHKP capacity), and a resurgence in pulp prices. Our prior estimates suggested that Arauco would achieve a gross debt levels of around \$6.1 billion by the end of 2025. However, the blend of proceeds from the asset sale and the improved performance throughout 2024 has led us to adjust our forecast, now expecting the company to reduce its gross debt to approximately \$6.0 billion by the end of 2024 (\$5.3 billion in net debt), a significant decrease from \$7.2 billion in June 2024 (\$6.4 billion in net debt) and \$7.1 billion in December 2023 (\$6.4 billion in net debt). This in turn will allow Arauco to lower leverage, as measured by the gross debt to EBITDA ratio (Moody's adjusted), to around 3.0x by the end of 2024, which is consistent with its Baa3 rating and represents a substantial improvement from 4.8x as of the last 12 months (LTM) ended in June 2024 and 5.4x for the fiscal-year ended in December 2023.

On 16 July, 2024, Arauco sold \$1.17 billion of forestry assets to Brazilian pulp and paper packaging producer Klabin S.A. (Ba1 stable). Arauco received about \$967 million after taxes from the sale, generating a post-tax profit of around \$174 million, which it will recognize this year. The sold assets comprise 150,000 hectares of land, including 85,000 hectares of productive land, and 31.5 million tons of wood, mainly in the state of Paraná, Brazil. The transaction ended a sale process that was announced in December 2023. By early August 2024, \$725 million of cash proceeds had been

used to repay \$500 million in senior unsecured notes and \$225 million to pay down Arauco's revolving credit facility.

Arauco's operating performance in 2024-2025 will be aided by higher pulp production volumes and better pulp prices relative 2023, but this will be partially balanced by lower wood and panel's prices. Arauco's sales volumes will increase to around 4.8 million tons starting 2024, from 3.8 million in 2023, because of the ramp up of additional capacity at Arauco mill. At the same time, we expect average bleached eucalyptus kraft (BEK) pulp prices to be about 9% higher over the next 12 months through mid-2025 following the run up in the first half of 2024 mostly on supply disruptions and good demand. Northern bleached softwood kraft (NBSK) pulp prices will rise by around 17% in the same period. But we expect a 5%-10% price declines for wood products, such as lumber, oriented strand board (OSB) and plywood, and still soft timber prices, reflective of weak repair and remodeling activity with sales of existing homes in the US remaining near historical lows.

As a result, we expect Arauco's EBITDA (Moody's adjusted) will rise to about \$2 billion in 2024-2025, from \$1.3 billion in fiscal-year 2023. It's worth noting that the company's 2023 EBITDA was reduced because of a unique combination of unfavorable circumstances. The prices of pulp and wood products plunged to levels close to the last decade's lows in the second quarter of 2023, though they recovered somewhat in the second half of the year. At the same time, Arauco incurred additional costs from unusually severe forest fires early in the year as well as from plant stoppages and Licancel mill's shut down. As of Q1-Q2 2024, Arauco's reported pulp EBITDA had recovered to around 41%, which is in line with historical levels and well above 12%-18% achieved in Q1-Q3 2023.

A decrease in capital spending and dividends will free up cash flow (FCF) worth around \$200-300 million in 2024-2025 and allow for further debt repayment. However, a potential downside to this scenario could be a sustained decrease in pulp prices or substantial capital expenditures financed by debt. These factors could impede the company's debt and leverage reduction efforts.

The Baa3 ratings continue to incorporate the company's position as the second-largest market pulp producer globally, good product and geographic diversification, and ability to maintain adequate liquidity in periods of market downturn. In addition to pulp, Arauco has a substantial position in the wood products segment. The company is the second-largest wood panel producer globally, with an important presence in well-established markets, such as North America.

The ratings are also supported by the company's liquidity position. As of June 30, 2024, Arauco had about \$889 million in cash and marketable securities. Additionally, after repaying \$225 million of its \$375 million committed credit facilities (unrated) in July 2024, the facility became fully accessible by August 2024. We expect around \$1.3-\$1.5 billion in cash flow from operations in 2024-2025. These compare favorably with \$1.5 billion in short term debt as of June 2024, including \$500 million in senior

unsecured notes due in August 2024 which have already been repaid using asset sale proceeds.

The company's ratings consider its reliance on cash flow and susceptibility to fluctuating market pulp prices, largely influenced by China and demand in developed markets, especially Europe. The rating is also constrained by Arauco's exposure to the highly competitive landscape for the wood business and volatility inherent to the housing market, particularly in the Americas.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upward rating movement would require Arauco to maintain a strong liquidity position and sound credits metrics even in a lower pulp price environment. Quantitatively, the rating could be upgraded if debt to EBITDA (Moody's adjusted) is sustained at around 2.0x or below and retained cash flow to debt remains consistently over 30%.

The ratings could be downgraded if Arauco's financial policy becomes more accepting of leverage and/or liquidity risks. This is especially likely if projects financed through debt and/or activities related to mergers and acquisitions result in increased volatility in its credit metrics. In terms of metrics, the ratings could be downgraded if Arauco's gross debt to EBITDA (Moody's adjusted) consistently exceeds 3.0x (even though it may surpass this level during the low points of the pulp cycles) and if the ratio of retained cash flow to debt stays below 20%.

Headquartered in Santiago, Chile, Celulosa Arauco y Constitucion S.A. (Arauco) is engaged primarily in the production of pulp, wood products and forestry products. Arauco is one of the world's largest producers of pulp and wood products in terms of production capacity, and it is among Latin America's largest forest plantation owners. The company has industrial operations in Chile, Argentina, Brazil, Mexico, the US and Canada. In addition, Arauco has industrial operations in Uruguay through a 50% joint venture in the Montes del Plata pulp mill; and in Spain, Portugal, Germany and South Africa, through a 50% joint venture with Sonae, named Sonae-Arauco S.A.

The principal methodology used in these ratings was Paper and Forest Products published in August 2024 and available at <https://ratings.moodys.com/rmc-documents/426539>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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