FitchRatings

Fitch Downgrades Klabin's Ratings to 'BB+'; Outlook Revised to Stable

Fitch Ratings-Rio de Janeiro-16 May 2017: Fitch Ratings has downgraded Klabin S.A.'s (Klabin) Long-Term Foreign and Local Currency Issuer Default Rating (IDR) to 'BB+' from 'BBB-', and its national scale long-term rating to 'AA+(bra)' from 'AAA(bra)'. At the same time, Fitch has downgraded the rating of the USD500 million senior unsecured notes due in 2024 issued by Klabin Finance S.A. and guaranteed by Klabin to 'BB+' from 'BBB-'. The Rating Outlook for the corporate ratings was revised to Stable from Negative. A full list of rating actions follows at the end of this release.

The downgrades reflect the company's high leverage following the start-up of the Puma pulp mill and the fact that deleveraging has been slower than expected due to weaker pulp prices, a strong Brazilian real, and a weak consumer market for packaging products. Fitch's base case leverage projection for 2017 has been revised to more than 4.0x and to around 3.9x in 2018. This compares with expected net leverage for 2017 and 2018 of 3.6x and 3.1x, respectively,during the 2016 rating review at which time the investment grade ratings were affirmed.

KEY RATING DRIVERS

Leverage Reduction Slower than Expected: Leverage reduction has been slower than previously projected due to the strong Brazilian real, weak pulp prices and soft demand for packaging products in Brazil. Fitch expects Klabin's net leverage to remain elevated at about 4.3x in 2017, falling to 3.9x during 2018. Key assumptions are net BEKP prices of USD550 and USD575 per ton in 2017 and 2018. Consolidated EBITDA for 2017 and 2018 is expected to be BRL2.7 billion and BRL2.8 billion, respectively. Fitch's base case scenario incorporates a period of lower capex before entering into a new investment phase. If the company decides to go forward with a new investment cycle, its deleveraging will be delayed beyond Fitch's base case expectation. During the LTM ended March 31, 2017, net debt/EBITDA was 5.3x.

Leading Position in the Brazilian Packaging Segment: Klabin is the leader in the Brazilian corrugated boxes and coated board sectors with market shares of 18% and 50%, respectively. In the Brazilian market, the company is the sole producer of liquid packaging board and is the largest producer of kraftliner and multiwall and industrial bags. Klabin also has a 1.5 million-ton pulp mill that started operations in March 2016. Klabin sources much of its fiber requirements from hardwood and softwood trees grown on 230,000 hectares of plantations it has developed on 489,000 hectares of land it owns; this ensures a competitive production cost structure in the future. The accounting value of the land owned by Klabin was about BRL2 billion as of March 31, 2017, and the value of the biological assets on its forest plantations was BRL4 billion.

Free Cash Flow Positive in 2017: During the LTM ended March 31, 2017, the company generated BRL2.2 billion of EBITDA and BRL1.1 billion of cash flow from operations (CFFO). FCF was negative BRL1.3 billion as a result of BRL2 billion in investments and dividends of BRL457 million. Fitch expects positive FCF of about BRL600 million in 2017 as investments are scaled back. Fitch calculated total investments of BRL1.9 billion during 2017 and 2018, including maintenance and investments in projects to improve efficiency and reduce costs, and dividends of 20% of EBITDA.

Operational Performance to Remain Strong: The slowdown in demand for packaging products and weaker pulp prices had a negative impact on Klabin's EBITDA generation. However, the company's flexibility and product diversification softened the impact of the severe economic downturn in Brazil. Klabin's EBITDA margin was 29.9% in the LTM ended March 31, 2017, which compared unfavorably to 31.6% in 2016 and 33.8% in 2015. During 2016, Klabin sold 1.9 million tons of paper, up 1% compared to 2015, 2.5 million tons of wood and 797 thousand tons of pulp. Coated boards remained the company's main source of revenues, representing 31% of the total in 2016.

DERIVATION SUMMARY

Klabin has a leading position in the Brazilian packaging segment. Klabin's size, access to inexpensive fiber and high level of integration relative to many of its competitors give it competitive advantages that are viewed to be sustainable. Compared to other Latin America pulp & paper companies, Klabin is more exposed to the demand from the local market, as about 60% of the company's sales are in Brazil. Klabin's leading position in the industry, the concentration of its sales to the food industry which is relatively resilient to downturns in Brazil's economy, and its position as the sole producer of liquid packaging board also adds stability to operating results. Klabin's exposure to the volatility of pulp prices is also lower. Klabin's leverage is high compared to other Latin America companies, such as Fibria ('BBB-'/Outlook Stable), Suzano ('BB+'/Outlook Positive), Empresas CMPC ('BBB+'/Outlook Negative), and Celulosa Arauco ('BBB'/Outlook Negative), as the company concluded heavy investments in the new Puma pulp mill which started operations in March 2016.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
--Flat sales volume excluding pulp in 2017;
--Pulp sales volume of 1.4 million tons in 2017 and 1.5 million tons in 2018;
--Net hardwood pulp price between USD550 and USD575 per ton;
--FX rate at 3.2 BRL/USD in 2017 and 3.3 BRL/USD in 2018;
--Dividends: 20% of EBITDA.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

A positive rating action is not expected in the medium term. However, higher than expected cash generation during 2017 and 2018, allowing consistent and faster deleveraging, may positively affect the ratings. Proactive steps by the company to materially bolster its capital structure in the absence of higher operating cash flow could also lead to an upgrade.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

--Expectation that net leverage ratio will remain above 5.0x by 2018;
--More unstable macroeconomic environment that weakens demand for the company's packaging products as well as prices;
--Sharp deterioration of market conditions with significant reduction in pulp prices;
--A debt-financed acquisition.

LIQUIDITY

Klabin's solid liquidity position and low refinancing risk remain key credit considerations. As of March 30, 2017, the company had BRL7.3 billion of cash and marketable securities and BRL19.2 billion of total debt, of which BRL2.7 billion was short-term debt. Klabin does not have a standby credit facility.

The company's debt maturity schedule is manageable and evenly distributed. Klabin faces debt amortizations of BRL1.8 billion up to December 2017, BRL2.4 billion in 2018 and BRL2.9 billion in 2019. Fitch expects Klabin to continue to preserve strong liquidity, conservatively positioning it for the price and demand volatility which is inherent to the packaging industry.

FULL LIST OF RATING ACTIONS

Fitch has downgraded the following ratings:

Klabin S.A.
--Long-Term Foreign Currency IDR to 'BB+', from 'BBB-';
--Long-Term Local Currency IDR to 'BB+', from 'BBB-';
--Long-term National scale rating to 'AA+(bra)', from 'AAA(bra)'.

The Outlook for the corporate ratings was revised to Stable, from Negative.

Klabin Finance S.A.
-- USD500 million senior unsecured notes, due in 2024, to 'BB+', from 'BBB-'.
The transaction was issued by Klabin Finance S.A. and guaranteed by Klabin.

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Summary of Financial Statement Adjustments - Financial statement adjustments that depart materially from those contained in the published financial statements include:

--Fitch gives a 50% equity credit for Klabin's 6th debentures, mandatorily convertible into shares, subordinated. Total amount of the transaction was BRL1.7 billion, mandatory convertible in 5 years (January 2019).

Additional information is available on www.fitchratings.com.

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)
National Scale Ratings Criteria (pub. 07 Mar 2017)
Non-Financial Corporates Hybrids Treatment and Notching Criteria (pub. 27 Apr 2017)

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