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Research Update:
Klabin Ratings Raised To 'BB+' On Improving Financial Profile

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Overview

- Klabin's financial profile is improving with stronger cash flows helping it reduce leverage.
- We are raising the global scale corporate credit rating on Klabin to 'BB+' from 'BB' and the national scale Brazil rating on Klabin to 'brAA+' from 'brAA'.
- We are also revising Klabin's business profile to satisfactory from fair given Klabin's expanding position in higher value-added products.
- The stable outlook reflects our expectation that Klabin will continue deleveraging on a gross debt basis and improve net debt credit metrics further.

Rating Action

On Dec. 8, 2010, Standard & Poor's Ratings Services raised its corporate credit rating on Brazil-based paper company Klabin S.A. to 'BB+' from 'BB'. At the same time, we raised Klabin's ratings in the Brazil National Scale to 'brAA+' from 'brAA'. The outlook is stable.

Rationale

The rating upgrade reflects Klabin's continuing financial deleveraging projected for the next few years, a significant credit metrics improvement in the past two years, and a revision of our business profile score to satisfactory from fair. We believe that lower capital expenditures projected for the next three years (even considering that Klabin may seek to expand capacity with a new pulp and paper mill by 2014 or 2015) will free up cash, which will be used to pay down debt. We also expect Klabin to sustain strong liquidity, offsetting potential refinancing risks and its exposure to demand and price swings. An increasing position in higher value-added carton board products will also reduce exposure to volatility in the future. This will improve profitability and cash flow stability, which is also a positive and a way for Klabin to reduce leverage in the intermediate term.

Klabin continued improving credit metrics in the first nine months of 2010, with higher volumes and net sales stemming from the strong domestic demand and a recovering export market, boding well for an improvement in credit metrics in the remainder of the year. The satisfactory business profile reflects Klabin's leading position in the packaging paper business in Brazil, which is less risky and more stable than other paper segments. In addition, Klabin is increasing sales of higher value-added products, some of which benefit from barriers to entry based on quality, supply reliability, and customer service. The company's cost position is strong for pulp and very favorable in paper.

The financial profile is significant. Klabin's gross debt credit measures remain weak for the rating category, but we believe deleveraging will continue through 2013. On the other hand, we believe Klabin will continue sustaining strong cash reserves as a policy, and net debt credit metrics are comparable with many of its local and global peers. For the 12 months ended September 2010, its adjusted total debt-to-EBITDA and funds from operations (FFO)-to-adjusted total debt ratios were 5.8x and 15.0%, respectively, reflecting long-term debt used to finance its MA-1100 project. Adjusted net debt to EBITDA and FFO to net debt were 2.7x and 32% in the same period. We expect these ratios will fall to below 4.0x and about 20% by year-end 2011, equivalent to a net debt to EBITDA of about 2.0x.

Liquidity

Klabin's liquidity is strong. The company reported cash reserves of Brazilian reais (R$) 2.7 billion as of September 2010, compared with short-term debt maturities of R$694 million. There is some debt maturity concentration expected in 2012 and 2013, but we believe Klabin will either pay them down or refinance them opportunistically. We expect free operating cash flow (FOCF) to remain strong in the next three years, considering that market conditions are favorable and capital expenditures will be low, at maintenance levels only coupled with some marginal investments in timberland. Even with stressful assumptions, liquidity would remain strong in 2011 and adequate in 2012. Klabin's debt does not have financial covenants, which adds to its financial flexibility.

Outlook

The stable outlook reflects our expectation that Klabin will continue deleveraging on a gross debt basis and improve net debt credit metrics further as a result of a prudent financial stance. This is possible because of the company's sound FOCF and low capital expenditures in the next several years. A negative rating revision could come from material deterioration of market conditions, which would result from a combination of both weak domestic and global demand, or if Klabin starts investing aggressively in capacity expansion before deleveraging, in particular anticipating the start-up of its new pulp mill. A positive rating action depends on Klabin's improving further its financial profile, with total debt to EBITDA at about 2.5x and FFO to total debt at about 30%, assuming still that cash reserves remain sound.

Related Criteria And Research

- Key Credit Factors: Criteria For Rating The Forest Products Industry, Dec. 11, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May

27, 2009

Ratings List

Upgraded

	To	From
Klabin S.A.		
Corporate Credit Rating		
Global Scale	BB+/Stable/--	BB/Stable/--
National Scale	brAA+/Stable/--	brAA/Stable/--

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