

## Equities

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# Empresas CMPC SA (CAR.SN)

## Alert: 2Q11: Volume Recovery Continues, Yet Below Expectations

### ■ Company Update

|                              |               |
|------------------------------|---------------|
| <b>Hold/Medium Risk</b>      | <b>2M</b>     |
| Price (10 Aug 11)            | ChP21,301.00  |
| Target price                 | ChP26,500.00  |
| Expected share price return  | 24.4%         |
| Expected dividend yield      | 2.8%          |
| <b>Expected total return</b> | <b>27.2%</b>  |
| Market Cap                   | ChP4,686,220M |
|                              | US\$9,914M    |

### Price Performance (RIC: CAR.SN, BB: CMPC CI)



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- **Initial Takeaways** – We are neutral on CMPC's 2Q11 results as our disappointment in sales volumes was offset by stability in margins. 2Q11 adjusted EBITDA of \$281 millin was 4% below our forecast due to lower than expected sales volumes related to a shipment delay. Similar to the previous quarter, stronger pulp volumes explained attractive y-o-y sales growth. However, when compared to 1Q11, volumes declined in most of CMPC's divisions implying a 3.5% q-o-q revenue decline. We maintain our Hold rating and will comment further following tomorrow's conference call with management.
- **2Q11 Results** – Total revenue reached US\$1,199 mln (-3.5% q-o-q and +19.1% y-o-y; -4.9% below our forecast). Adjusted EBITDA reached US\$281 mln (-5.8% q-o-q and +4.4% y-o-y), 4.0% below our estimate. EPS came in at US\$0.77, above our estimate of US\$0.58 (+18.9% q-o-q and +37.7% y-o-y) mainly due to lower than expected tax expenses. Additionally, the US\$46 mln q-o-q decline in 2Q11 taxes that drove net income expansion was the result of the effect of the FX fluctuation over deferred tax assets and liabilities.
- **EBITDA Margins In-line** – Although significant cost pressures continued in 2Q11 (energy, labor costs), CMPC was able to maintain its consolidated margins quite steady. Adjusted EBITDA margin showed a slight q-o-q contraction, from 24% to 23.4%. Average effective pulp price increased 2% q-o-q, with hardwood and softwood pulp prices reaching US\$746/t (vs US\$741/t in 1Q11) and US\$877/t (vs US\$829 in 1Q11), respectively.
- **Volume Activity** – On a Q/Q basis, sales volume declined in most of CMPC's divisions (-12%, -10%, -10% and -19% in Forestry, Pulp, Paper and Paper Products, respectively). Scheduled maintenance downtime at Guaiba and some delays in exports from Chilean ports during June translated into lower pulp sales volume compared to 1Q11. Forestry volume contracted because of lower fiber exports (now sold directly to CMPC's Santa Fe pulp mill). Also, sawn wood exports to the U.S. were lower than the previous quarter (as retailers started to reduce its inventory level). Lower output of newsprint paper drove the decline in consolidated Paper volumes, while Paper Products volume were negatively affected by the seasonality of the fruit export season in Chile. Finally, Tissue volume growth was explained by a more efficient utilization of the new tissue machines in the Mexican and Colombian markets.
- **Conference Call Details** – CMPC will host a conference call on Thursday (August/11th) at 9:00am (EST), dial-in: +1 (617) 847-3007.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. 2Q11 CMPC Earnings Summary

| In US\$ million                        | 2Q11A        | 2Q10A        | Y-o-Y<br>Growth | 1Q11A        | Q-o-Q<br>Growth | 2Q11E        | %<br>Diff    |
|--|--------------|--------------|-----------------|--------------|-----------------|--------------|--------------|
| <b>Net Sales</b>                       | <b>1,199</b> | <b>1,007</b> | <b>19.1%</b>    | <b>1,242</b> | <b>-3.5%</b>    | <b>1,260</b> | <b>-4.9%</b> |
| Gross Profit                           | 351          | 315          | 11.3%           | 354          | -1.0%           | 357          | -1.9%        |
| Gross Margin                           | 29%          | 31.3%        |                 | 28.5%        |                 | 28.3%        |              |
| EBITDA                                 | 303          | 281          | 7.9%            | 317          | -4.4%           | -            | #DIV/0!      |
| EBITDA Margin                          | 25%          | 28%          |                 | 26%          |                 | 0%           |              |
| <b>Adjusted EBITDA</b>                 | <b>281</b>   | <b>269</b>   | <b>4.4%</b>     | <b>298</b>   | <b>-5.8%</b>    | <b>293</b>   | <b>-4.0%</b> |
| <b>Adj. EBITDA Margin</b>              | <b>23.4%</b> | <b>27%</b>   |                 | <b>24.0%</b> |                 | <b>23.2%</b> |              |
| Operating Income                       | 223          | 206          | 8.3%            | 229          | -2.8%           | 205          | 8.9%         |
| Operating Margin                       | 18.6%        | 20.5%        |                 | 18.5%        |                 | 16.3%        |              |
| Net Income                             | 170          | 123          | 37.7%           | 143          | 18.9%           | 128          | 32.5%        |
| Reported EPS                           | 0.77         | 0.56         | 37.7%           | 0.65         | 18.9%           | 0.58         | 32.5%        |
| Adjusted EPS                           | 0.71         | 0.57         | 24.5%           | 0.54         | 30.4%           | 0.72         | -2.4%        |
| <b>Operating Data</b>                  |              |              |                 |              |                 |              |              |
| Pulp Sales (000 tonnes)                | 480          | 386          | 24.3%           | 533          | -9.9%           | 520          | -7.6%        |
| Paper Sales (000 tonnes)               | 202          | 218          | -7.3%           | 226          | -10.6%          | 225          | -10.0%       |
| Tissue Sales (000 tonnes)              | 125          | 115          | 8.7%            | 122          | 2.5%            | 128          | -2.4%        |
| Net Pulp Price (\$/tonne)              | 799          | 834          | -4.2%           | 769          | 3.9%            | 803          | -0.4%        |
| Avg Paper Price (\$/tonne)             | 949          | 785          | 20.9%           | 879          | 8.0%            | 918          | 3.5%         |
| Avg Tissue Price (\$/tonne)            | 3,260        | 2,801        | 16.4%           | 3,155        | 3.3%            | 3,257        | 0.1%         |
| <b>Other Financials (US\$ million)</b> |              |              |                 |              |                 |              |              |
| Net Debt                               | 2,362        | 2,175        | 8.6%            | 2,158        | 9.5%            | 2,254        | 4.8%         |
| Net Debt/EBITDA                        | 2.2          | 2.8          |                 | 1.9          |                 | 1.9          |              |
| Average FX rate                        | 469          | 531          | -11.6%          | 481          | -2.5%           | 469          | 0.0%         |
| Period-end FX rate                     | 467          | 546          | -14.4%          | 478          | -2.2%           | 467          | 0.0%         |

\* Adjusted EPS excludes FX and monetary variations.

\*Adjusted EBITDA = EBIT + Depreciation & Amortization (does not adjust for stumpage)

Source: Citi Investment Research and Analysis

## Empresas CMPC SA

### Valuation

We set our target price of ChP26,500/share is based on our DCF model (ChP27,370) and multiple valuation (ChP24,080).

#### DCF Valuation

In our DCF analysis we use a WACC of 7.3%, and a 3% terminal growth rate to arrive at a DCF value of ChP 27,370/share. The main assumptions of our DCF include: 4.9% risk free rate and a 3.5% risk premium rate (CIRA LatAm Chartbook) and a 0.80 unlevered beta. In our model we project pulp prices over one cycle (trough to peak). After this we use normalized pulp and paper prices. Our current assumption for list hardwood pulp prices in the long-term is US\$680/tonne.

#### EV-to-EBITDA Multiples

We apply an EV/EBITDA multiple of 11.5x to our 2011 EBITDA forecast and derive a value of ChP\$24,080 per share for CMPC. Our 11,5x target multiple is a 10% premium to CMPC's 5-year historical average multiple. We believe CMPC deserves to trade at a premium to its historical trading multiples given that it has opened a new frontier for growth with its acquisition of Guaiba in Brazil, and continues to add value through expansions in tissue capacity

### Risks

We rate CMPC Medium Risk as the company exposure to pulp prices is offset by the following factors: 1) low share price volatility, 2) its location in Chile (Investment Grade), and 3) geographic and product diversification of its sales. The main risks that may cause the shares to materially underperform/outperform our target price are the following:

**Pulp Prices** — With about 32% of company revenues from market pulp sales, CMPC earnings are sensitive to pulp prices. Therefore, If pulp prices decline more than expected, this would negatively affect our earnings forecast for CMPC. On the other hand higher pulp prices would be positive for the shares.

**Tissue Growth** — We expect the tissue business to continue to grow in the upcoming years, supported by economic growth and higher per-capita consumption. Should prices and volumes be higher than our forecast, there could be upside to our estimates. Competition in Chile is not significant at this point (CMPC 85% market share); however, should a large international company decide to enter this market, a tissue price war could lead to downward pressure on Chilean tissue profitability. While we place a low probability on the entrance of a new competitor into the market, it remains a risk.

**Chilean Peso** — CMPC earnings and valuation are exposed to changes in Chilean peso. Higher than anticipated Chilean peso depreciation would result in upside to our estimates, while a stronger Chilean peso would be negative.

**Share Liquidity** — While support from Chilean pension funds result in less volatility CMPC shares are less liquid than some its peers.

## Appendix A-1

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Analyst: Juan G Tavaréz

Covered since December 5 2009



|   | Date      | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 1 | 14-Oct-08 | 1M     | *19,458.44   | 12,671.34     |
| 2 | 23-Dec-08 | 1M     | *14,593.83   | 9,892.67      |
| 3 | 19-Mar-09 | *2M    | *13,134.45   | 11,390.00     |
| 4 | 17-Jun-09 | 2M     | *16,247.80   | 14,010.08     |

\* Indicates change

|   | Date      | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 5 | 16-Aug-09 | 2M     | *17,707.18   | 16,170.94     |
| 6 | 12-Oct-09 | 2M     | *21,404.28   | 19,430.23     |
| 7 | 4-Dec-09  | *1M    | *23,500.00   | 19,400.00     |
| 8 | 17-Mar-10 | 1M     | *27,000.00   | 22,700.00     |

|    | Date      | Rating | Target Price | Closing Price |
|----|-----------|--------|--------------|---------------|
| 9  | 30-Jun-10 | *3M    | *25,000.00   | 23,900.00     |
| 10 | 5-Jan-11  | 3M     | *26,000.00   | 25,900.00     |
| 11 | 18-Apr-11 | *2M    | *26,500.00   | 23,800.00     |

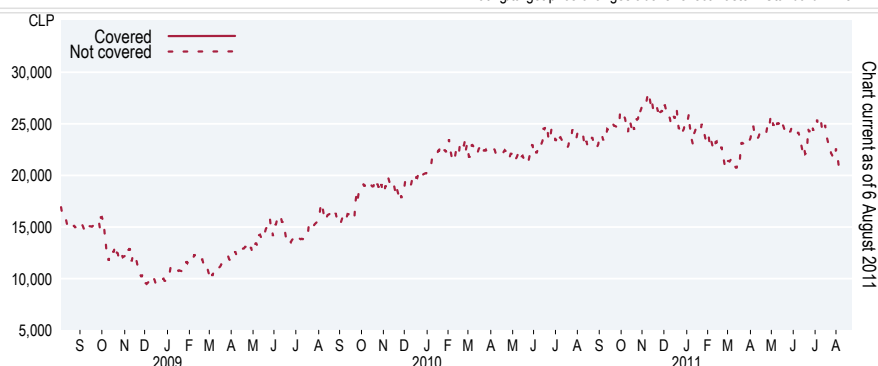
Rating/target price changes above reflect Eastern Standard Time

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##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Juan G Tavaréz

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