

Notice to the Market – Fitch upgrades in two notches Portobello Grupo's (PBG) National Rating to A- (bra)

Tijucas, SC, December 3rd, 2021 - Portobello Grupo (PBG S.A) (B3: PTBL3) (Company), pursuant to the Brazilian Securities and Exchange Commission ("CVM") Resolution No. 44 of August 23rd, 2021, hereby informs its shareholders and the public in general that in press release issued today, credit rating agency **Fitch Ratings** (Fitch) **upgraded the Company's Long-Term National Scale Rating to "A-(bra)", elevating in two notches at the same time**, with stable outlook.

According to Fitch's report, "The upgrade reflects PBG's **stronger than anticipated operating performance**, which has allowed the company to reduce net leverage to below 2.0x. **Strong demand and significant price increase bolstered operating cash flow generation during 2021**, and Fitch expects EBITDA margin to remain above 17%, as **the company should continue to benefit from the strong homebuilders' demand due to high volume of projects launched in the last couple of years**. Also factored into the rating is **PBG's adequate liquidity and lower refinancing risk**, with a more extended debt amortization profile."

"Our rating's upgrade, climbing two notches at once, demonstrates that we are on the right path. The ceramic tile market remains strong, as a result of the strengthening of civil construction, driven by the large number of real estate launches in 2020 and 2021. Our internationalization strategy through Portobello America and exports expansion also have contributed to improving revenues and margins. The Company remains focused on the execution of its strategic planning, continuing the cash management and working capital discipline and maintaining the strength of its balance sheet, while we continue to invest in strategic projects, such as the new plant in the United States and opening/expansion of Portobello Shop stores", said Ronei Gomes, PBG's Chief Financial and Investor Relations Officer.

Fitch's report follows attached to this Notice to the Market.

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Fitch Upgrades PBG's Rating to 'A-(bra)'; Outlook Stable

Fitch Ratings - Rio de Janeiro - 03 Dec 2021: Fitch Ratings has upgraded PBG S/A's (PBG) Long-Term National Scale Rating to 'A-(bra)' from 'BBB(bra)'. The Rating Outlook is Stable.

The upgrade reflects PBG's stronger than anticipated operating performance, which has allowed the company to reduce net leverage to below 2.0x. Strong demand and significant price increase bolstered operating cash flow generation during 2021, and Fitch expects EBITDA margin to remain above 17%, as the company should continue to benefit from the strong homebuilders' demand due to high volume of projects launched in the last couple of years. Also factored into the rating, is PBG's adequate liquidity and lower refinancing risk, with a more extended debt amortization profile.

The Stable Outlook incorporates the expectation of continued strong CFFO in the next two years, despite the more adverse macroeconomic environment and the cyclicity of the Brazilian ceramic tile industry, and that net leverage should remain below 2.5x during the period of higher investments in the new plant in U.S.

Key Rating Drivers

Leadership in the Ceramic Tile Sector: PBG is the leader in the fragmented and competitive Brazilian ceramic tile industry, with two production facilities and annual production capacity of 46 million square meters (sqm). The company's business model benefits from a high added-value product portfolio, multichannel sales, and a diversified client basis. About 20% of sales is exported, benefiting from the weaker Brazilian real.

PBG's business model should also benefit from the new investment cycle. The company's new production facility in the U.S. will help diversify its geographical footprint and improve revenue flow in hard currency in the long term. The new unit will increase production capacity by 7.2 million sqm annually, with one oven expected start operations in 2023, and the second, in 2024. Total investments amount USD160 million, of which USD80 million should be funded through a long-term built-to-suit (BtS) agreement, and USD80 million with long-term lines with suppliers.

More Challenging Business Conditions in 2022: PBG is exposed to the volatility of the ceramic tile industry, strongly related to the domestic macroeconomic conditions. After strong momentum for the sector in 2021, Fitch expects relatively steady demand in 2022, due to the weaker economic environment and consumer confidence. During 2021, demand for building materials was bolstered by the autorepair segment and homebuilders pipeline. PBG's sales volume is expected to increase by 9% in 2021, and revenue per unit to increase by 33%, benefiting from significant price adjustments,

improved product mix, and sharp local currency depreciation.

For 2022, Fitch projects flat sales volumes and revenue per unit increasing by 6.5% in the domestic market. While demand from homebuilders in 2022 and 2023 should remain supported by high volume of projects launched in the last couple of years, the unstable business conditions, with higher inflation and interest rates, could pressure demand in the retail segment. Fitch forecasts that Brazilian GDP will increase by 2% in 2022, after expected 5% growth in 2021.

Volatile Operating Margins: PBG has a track record of reporting volatile operating margins, pressured by the exposure to gas prices and demand for ceramic tiles. However, the company has demonstrated strong capacity to pass cost increases into final prices during 2021, supported by strong demand during the year. EBITDA margins are expected to improve to 19% in 2021 from 12% in 2020, and an average of below 10% from 2017 to 2019, according to Fitch's calculations.

For 2022 and on, EBITDA margins should remain high, between 17% to 19.5%. A deterioration of the economic environment could limit PBG's capacity to pass cost increases into final prices, and may add additional challenges for the company to preserve operating margins.

Ceramic tile companies are exposed to gas prices fluctuations, which are indirectly linked to variations in oil prices and exchange rate. Gas represents about 25% of PBG's cost structure, and the company is also indirectly exposed to the impact of FX fluctuations in other raw materials, like enamel, ink and past, that represent less than 10% of costs and is partially mitigated by the exports.

Improved EBITDA Generation: PBG should generate about BRL360 million of EBITDA and BRL257 million of CFFO in 2021, and BRL351 million and BRL239 million, respectively, in 2022. This represents an important improvement compared with BRL160 million of EBITDA and BRL200 million of CFFO in 2020.

PBG's FCF should be negative BRL53 million in 2021, and BRL16 million in 2022, due to its new investment cycle, compared with positive FCF of BRL73 million in 2020. Base-case projections considered investments of BRL150 million in 2021 and BRL240 million in 2022, and high dividends of BRL160 million and BRL15 million, respectively.

The rating case also incorporated a BRL154 million stock repurchase in 2021. PBG's strategy for dividends and stock repurchase is aggressive, as the company will face a period of elevated investments and a more challenging macroeconomic environment.

Leverage to Remain Low: Stronger than expected EBITDA resulted in a fast deleveraging process during 2021, from a track record of high financial leverage. PBG's net debt/EBITDA is expected to fall to 1.8x in 2021, from 2.8x in 2020 and an average of around 6.0x from 2017 to 2019. Net leverage is expected to remain below 2.5x during the period of higher investments in the U.S. production facility, supported by maintenance of strong EBITDA generation. Fitch's metrics are adjusted to reflect the classification of leasing expenses as operating expenses, according to the criteria for treatment of leases in non-retail companies.

Net debt is expected to increase to approximately BRL720 million in 2022 and BRL885 million in 2023, including equipment payables with suppliers as debt, from BRL534 million in September 2021, due to higher investments. Net debt should decline after 2024, as the new plant will start operations.

Derivation Summary

PBG's closest competitor is Dexco S.A. (Dexco; AAA(bra)/Stable), through the brands Portinari and Ceusa. PBG has significantly lower scale compared to Dexco, which has a more diversified business profile, with dominant position in the local wood panels market. Dexco's financial profile is superior than PBG's, with a long track-record of robust FCF generation, conservative capital structure, and strong liquidity and access to the capital market.

Key Assumptions

Fitch's Key Assumptions Within the Rating Case for the Issuer:

- Total sales volume to increase by 9% in 2021 and relatively flat in 2022;
- Average ticket in domestic market to increase by 39% in 2021 and 6.5% in 2022;
- Investments of BRL150 million in 2021 and BRL240 million in 2022;
- Dividends of BRL160 million in 2021 and BRL15 million in 2022.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Longer track record of adequate performance in different business cycles, with EBITDA margins above 15%;
- Net debt/EBITDA ratio below 3.0x on a recurrent basis;
- Improvement in liquidity profile.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Net debt/EBITDA ratio above 4.0x on a recurrent basis;
- Higher refinancing risk;
- EBITDA margins consistently below 12%.

Liquidity and Debt Structure

PBG's liquidity and debt profile improved in 2021, mainly through the BRL430 million long-term debt issued during second-half of the year. As of Sept. 30, 2021, PBG had BRL341 million of cash and marketable securities and BRL205 million of debt maturing up to the end-2022. During the 4Q21, PBG

amortized BRL90 million of debt, reducing debt maturities in 2022 to about BRL90 million. PBG's cash position is expected to decline in the medium-term as it moves forwards with its capex plan.

In September 2021, total debt of BRL875 million consisted of debentures (34%), export credit notes (NCEs, 26%), FINAME and FINEP credit lines (15%), loans with Banco do Nordeste (15%) and others (10%). PBG's debt is mostly secured and denominated in local currency.

Issuer Profile

PBG is the largest Brazilian ceramic tile company, with annual production capacity of 46 million sqm. It has two production facilities, and sell ceramic tiles through its own stores and franchises, distribution to retailers, direct sales to engineering companies, and exports.

Summary of Financial Adjustments

--Investment payables considered as debt.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
PBG S/A	Natl LT	A-(bra) 	Upgrade	BBB(bra) 

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Corporate Rating Criteria \(pub.15 Oct 2021\) \(including rating assumption sensitivity\)](#)

[Metodologia de Ratings Corporativos \(pub.15 Oct 2021\)](#)

[Metodologia de Ratings em Escala Nacional \(pub.22 Dec 2020\)](#)

[National Scale Rating Criteria \(pub.22 Dec 2020\)](#)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 [\(1\)](#)

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