FitchRatings

Fitch Downgrades Suzano's Ratings to 'BB-'

11 Oct 2012 11:46 AM (EDT)

Fitch Ratings-Sao Paulo/Chicago-11 October 2012: Fitch Ratings has downgraded the following ratings of Suzano Papel e Celulose S.A.'s (Suzano) and its subsidiary Suzano Trading Ltd.:

Suzano
--Long-term foreign currency Issuer Default Rating (IDR) to 'BB-' from 'BB';
--Long-term local currency IDR to 'BB-' from 'BB';
--Long-term national scale rating to 'A(bra)' from 'A+(bra)';
--3rd Debentures Issuance, in the amount of BRL500 million, due in 2014 and 2019, to 'A(bra)' from 'A+(bra)'.

Suzano Trading Ltd.
--Long-term foreign currency IDR to 'BB-' from 'BB';
--USD650 million senior notes due Jan. 23, 2021 to 'BB-' from 'BB'.

The Rating Outlook for the corporate ratings is Stable.

The downgrades reflects Suzano's high leverage and Fitch's concerns about the company's ability to deleverage quickly following the completion of its Maranhao pulp mill at the end of 2013 due to the expectation of a low pulp price environment in the next couple of years. Fitch projects Suzano's net leverage to reach about 6.5x before the mill is complete from 5.7x as of June 30, 2012. This leverage is higher than that previously projected for Suzano during the construction phase of its project.

Suzano's manageable near-term amortization schedule and its strong business position support the ratings at the levels of 'BB-'/'A(bra)' despite credit metrics that remain high for these categories. Suzano recently took steps to improve its liquidity. During July, the company completed a BRL1.5 billion equity offering, obtained a BRL2 billion stand-by credit facility and extended the maturity of about BRL1.2 billion of debt.

The company has a strong position in the bleached eucalyptus kraft market pulp (BEKP) industry. Its position is supported by a large forestry base, which assures it of a competitive production cost structure in the future and provides it with organic growth opportunities. The value of the company's land and forests as of June 30, 2012 was BRL6.3 billion. Suzano is also the leading producer of printing and writing paper in Brazil, as well as paperboard.

Suzano Trading Ltd. is a wholly owned subsidiary of Suzano and is incorporated in the Cayman Islands. The USD650 million senior notes are unconditionally and irrevocably guaranteed by Suzano. The credit quality of Suzano and Suzano Trading Ltd. have been linked according to Fitch's 'Parent and Subsidiary Rating Linkage' criteria report dated Aug. 8, 2012.

Leverage Expected to Increase:
As of June 30, 2012, Suzano had BRL9.8 billion of total debt and BRL2.8 billion of cash, resulting in net debt of BRL7 billion. These figures compare with net debt of BRL5.6 billion at the end of 2011 and BRL3.6 billion at the end of 2010. Suzano's net debt-to-EBITDA ratio of 5.7x is higher than a ratio of 4.5x that was previously projected by Fitch due to weak pulp prices, new debt and the appreciation of the U.S. dollar versus the Brazilian real - as about 50% of Suzano's debt is denominated in U.S. dollars. Suzano has historically operated with a higher level than its Latin America peer group. Between 2008 and 2011, Suzano's net leverage ratio averaged 3.6x.

Suzano's leverage should continue to increase, pressured by depressed pulp prices and its expansion plans. Fitch expects Suzano's net debt-to-EBITDA ratio to increase to 6.5x by the end of 2013. Deleveraging is not anticipated until at least 2014 or 2015. The company should invest about BRL2.6 billion in the second half of 2012 and BRL1.4 billion in 2013, financed with BNDES line of credit and ECAs loans. Higher than expected leverage ratios, negatively affected by weaker cash flow generation could result in higher leverage ratios that could breach covenant levels. Suzano may choose to use some of its cash to prepay these obligations.

Sustainable Competitive Advantage; Low Production Cost Structure:

Suzano is the leading producer of printing and writing paper in Brazil, as well as paperboard, with 1.3 million tons of annual production capacity. The company's market shares of 35% in uncoated printing and writing paper and 26% in paperboard allow it to be a price leader in Brazil. Suzano also produces 1.9 million tons of market pulp, which makes it one of the 10 largest producers of market pulp in the world. Suzano's new pulp mill at Maranhao should begin operations at the end of 2013 and will add an annual production capacity of 1.5 million tons.

Like other producers of hardwood pulp in Brazil, Suzano enjoys a production cost structure that is among the lowest in the world. This enables Suzano to generate positive cash flows during troughs in the pulp and paper cycle. Suzano's competitive advantage is viewed as sustainable. The company owns and leases 802,000 hectares of land in Brazil, of which 436,000 are used for the development of eucalyptus plantations (349,000 own planted area).

Strong Liquidity:
Suzano has historically maintained a strong cash reserves. As of June 30, 2012, cash and marketable securities was BRL2.8 billion. Liquidity covered short-term debt obligations by a ratio of 1.9x. This compares with cash to short-term debt ratios of 1.4x in December 2011 and 2.6x in December 2010. Suzano has manageable debt maturities of BRL1,017 million during the second half of 2012, BRL929 million in 2013 and BRL1,145 million in 2014. The company's liquidity strengthened during 2012 as the company concluded its equity offering in the amount of BRL1.5 billion in July, restructured and extended debt amortization profile (about BRL1.2 billion) and closed a BRL2 billion stand-by credit facility.

Cash Flow Generation Pressured by High Investments and Weaker Pulp Prices:
Suzano generated BRL1.2 billion of EBITDA and BRL770 million of funds from operations (FFO) during the latest 12 months (LTM) ended June 2012. This compares with a high of BRL1.7 billion of EBITDA and BRL1.2 billion of fund from operations (FFO) during 2010. With investments of BRL2.2 billion and dividends of BRL96 million, free cash flow was negative BRL1.4 billion during the LTM. Suzano's high capital expenditures and weak pulp prices should further pressure free cash flow for the next 18 months. The company's cash position could benefit from the sale of non-core assets or partnerships.

Potential Rating or Outlook Drivers:
Negative rating actions are unlikely in the near term. If the company's ratios continue to decline beyond levels anticipated by Fitch, additional negative rating actions could follow. A weakening of the company's liquidity position could also result in negative rating actions. A positive rating action is not likely due to Fitch's view that pulp price will remain at low levels in the near term, which limits cash flow generation capacity. Additional pro-active steps by the company to materially bolster its capital structure in the absence of high operating cash flow would be viewed positively and could result in a positive rating action.

Contact:
Primary Analyst
Fernanda Rezende
Director
+55-11-4504-2618
Fitch Ratings Brasil Ltda., Alameda Santos, 700 - 7th andar
Cerqueira Cesar - Sao Paulo - SP - CEP: 01418-100

Secondary Analyst
Joe Bormann, CFA
Managing Director
+1-312-368-3349

Committee Chairperson
Ricardo Carvalho
Senior Director
+55-21-4503-2627

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:
--'Corporate Rating Methodology' (Aug. 8, 2012);
--'National Ratings Criteria' (Jan. 19, 2011).

Applicable Criteria and Related Research:
Corporate Rating Methodology