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Research Update:

Suzano Papel e Celulose Outlook Revised To Stable From Negative, 'BB' Ratings Affirmed

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

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Overview

- After the successful start-up of its Maranhão pulp mill in December 2013, Suzano's discretionary spending should materially shrink, allowing it to gradually reduce its debt.
- We are revising our outlook on Brazil-based pulp and paper producer to stable from negative and affirming our 'BB' ratings.
- We expect the company's adjusted debt to EBITDA to remain below 5x and funds from operations (FFO) to debt above 10% in 2014 and to improve in 2015 and 2016.

Rating Action

On Sept. 17, 2014, Standard & Poor's Ratings Services revised its outlook on Suzano Papel e Celulose S.A. (Suzano) to stable from negative. We also affirmed all our ratings, including the 'BB' corporate credit rating on the company.

Rationale

The outlook revision and rating affirmation reflect the successful start-up of Suzano's new 1.5-million ton pulp mill in Maranhão, which is in line with our expectations. The new mill should contribute about 900,000 tons of Bleached Eucalyptus Kraft Pulp (BEKP) this year and 1.5 million tons in 2015. The incremental cash flows from the Maranhão mill would help the company reduce its debt, although free cash flow generation is likely remain negative this year.

Market conditions for Suzano's pulp division remain somewhat challenging as currently low prices make it difficult for pulp producers to generate free cash flows from exports to Asia, even for Brazilian producers that rank at the bottom of the hardwood pulp cost curve. This trend will probably remain through 2015 as pulp supply is expanding rapidly in South America. However, gradual improvements may occur as European and U.S. producers decide to shut down inefficient operations, as seen in the proposed closures for around 1 million tons (about half of the scheduled increase in capacity for 2014) during the past nine months of this year.

We expect Suzano's pulp division to contribute about 60% of total EBITDA, up from 50% in the past. As a result, we expect volatility in profits and cash flows to slightly rise, but the company's more conservative financial profile

and traditionally robust financial flexibility should mitigate this risk.

Despite Brazilian softening economy, we believe Suzano's paper and paperboard divisions will continue to perform well because the company benefits from substantial pricing power, as supply is relatively concentrated among few domestic players. Also, we don't expect competition from coated and uncoated paper imports to become a concern, because incentives for paper producers to increase capacity are rather low due to the abnormally high prices for softwood pulp, which is the main raw material. Our base case for Suzano also incorporates:

- Brazilian GDP growth of 1.2% in 2014 and 2015, and 2.5% in 2016.
- Inflation levels of 6.5% in 2014, 6.3% in 2015, and 6.0% in 2016.
- Annual pulp production levels of 2.8 million tons in 2014, and 3.4 million tons in 2015 and 2016.
- Paperboard and printing and writing paper volumes stable at about 1.3 million tons through 2016.
- Benchmark prices for BEKP of \$730 per ton through 2016.
- Paper prices in line with Brazil's inflation levels.
- Capital expenditures of \$760 million in 2014 (excluding Vale Florestar's acquisition), and around \$470 million in 2015 and 2016.

Based on those assumptions, we reach the following credit ratios:

- EBITDA margin of 33% in 2014, 34% in 2015, and 36% in 2016.
- Adjusted debt to EBITDA of 4.7x in 2014, 3.9x in 2015, and 3.3x in 2016.
- FFO to debt of 13% in 2014, 17% in 2015, and 21% in 2016.

Liquidity

We continue assessing Suzano's liquidity as "adequate," because we consider its robust cash reserves offsetting its large debt. We expect the company to increasingly use its cash reserves to reduce gross debt. We expect Suzano's cash sources to exceed cash uses in the next 24 months, even under harsher market conditions. Our analysis incorporates the following assumptions, for the next 12 months:

Cash sources

- Cash reserves of \$1.4 billion as of June 2014
- Cash flow from operations of at least \$400 million

Cash uses

- Capital expenditures of \$760 million
- Acquisition of Vale Florestar assets for \$230 million (R\$529 million)
- Scheduled debt payments of \$485 million
- Dividends of \$60 million

The company is subject to financial covenants on some of its bank loans. Those covenants are measured every 60 and 120 days after the closings of June and December. As of December 2013, the company was in full compliance with those covenants, and we expect it to remain so.

Outlook

The stable outlook reflects our view that Suzano can gradually reduce its debt under our set of assumptions, and that its financial flexibility will remain robust even though free cash flow generation will probably be negative this year.

Upside scenario

A positive rating action would largely depend on Suzano's maintenance of debt to EBITDA below 4x and FFO to debt above 20%. Such event will not only require favorable fundamentals for its businesses but also more conservative financial policies.

Downside scenario

Although unlikely for the moment, a potential downgrade would also be consequence of its inability to reduce discretionary spending to achieve positive free cash flow generation and therefore, reducing its financial leverage.

Related Criteria And Research

Related Criteria

- Industrials: Key Credit Factors For The Forest And Paper Products Industry , Feb. 12, 2014
- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Suzano Papel e Celulose S.A. Corporate Credit Rating	BB/Stable/--	BB/Negative/--
Suzano Trading Ltd. Senior Unsecured	BB	

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