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Research Update:

Suzano Papel e Celulose S.A. Upgraded To 'BB+' From 'BB' On Stronger Financial Performance, Outlook Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Rating Score Snapshot

Recovery Analysis

Related Criteria And Research

Ratings List

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Overview

- The Brazilian real's depreciation, stable pulp prices, and higher scale from the ramp-up of Maranhão pulp mill have bolstered Suzano's cost position and prospective cash flows.
- We're raising our global scale ratings to 'BB+' from 'BB' on Brazil-based pulp and paper producer. We're also revising our recovery rating on Suzano's issue-level rating to '3H' from '4H'.
- The stable outlook reflects our belief that Suzano will continue to benefit from favorable conditions for Brazilian exporters while it posts net-debt to EBITDA below 3.5x on a sustainable basis.

Rating Action

On Aug. 26, 2015, Standard & Poor's Ratings Services raised its ratings on Suzano Papel e Celulose S.A. (Suzano), including the global scale corporate credit rating to 'BB+' from 'BB'. The outlook is stable. We also revised our recovery rating on Suzano's issue-level rating to '3H' from '4H', indicating our expectation for meaningful recovery (50%-70%) of principal in the event of a payment default.

Rationale

The upgrade reflects Suzano's stronger capital structure and less leveraged balance sheet following the ramp-up of Suzano's 1.5 million ton pulp mill in Maranhão and the weaker Brazilian real (which depreciated 55% in the past 12 months). Those factors boosted EBITDA generation to R\$3.3 billion in the 12 months ended June 2015 from R\$1.9 billion in the year-earlier period. Our expectation is that the favorable environment for Brazilian exporters, including Suzano, will persist due to the strengthening of the dollar on the back of a stronger U.S. economy.

Prices for Suzanos's pulp (bleached eucalyptus kraft, or BEKP) have remained fairly stable ranging between \$730 and \$750 per ton in the past three years (delivered in Europe). We believe these prices will remain in that range for the short term because scheduled global capacity additions would likely force inefficient producers to close or to switch to dissolving pulp mills (an alternative use for high-cost pulp mills). In light of these factors, we expect Suzano to continue benefitting from higher operating cash flows, which

would allow it to keep its debt at reasonable levels.

Despite Brazil's softening economy, we believe Suzano's paper and paperboard divisions will continue to perform well because the company benefits from substantial pricing power because domestic 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 incorporates the following:

- Brazil's GDP contraction of 2% in 2015, no growth in 2016, and 1.5% in 2017;
- Brazil's inflation of 8.8% in 2015 and 6.5% in 2016 and afterwards;
- Year-end exchange rate of R\$3.3/\$1.0 in 2015, R\$3.5/\$1.0 in 2016, and R\$4.0/\$1.0 in 2017;
- Annual pulp production of 3.4 million tons and paperboard and printing and writing paper volumes stable at about 1.3 million tons in 2015 and afterwards;
- Benchmark prices for BEKP of \$750 per ton in 2015, \$730 in 2016, and \$700 in 2017, and the average discount is in the 20%-24% range;
- Paper prices rising at the same pace as Brazil's inflation (for sales in the domestic market) and foreign currency exchange rates (for exports);
- Cash costs of \$210 per ton, which might decrease to \$190 per ton in 2016, in line with the lower wood costs; and
- Capital expenditures (capex) of R\$2 billion in 2015 and R\$1.3 billion - R\$1.5 billion starting in 2016.

Based on those assumptions, we reach the following credit ratios in 2015 and 2016:

- EBITDA margin in a range of 43%-45%;
- Adjusted net debt to EBITDA in a range of 2.5x-2.8x; and
- Funds from operations (FFO) to adjusted debt at about 30%.

We continue to incorporate in our assessment of Suzano's business risk profile its advantageous cost structure for pulp production thanks to its access to highly productive forests and its solid position in the global pulp market and Brazilian market for uncoated and coated printing and writing paper and paperboard. These factors offset pulp price volatility, which we expect to remain significant in the next few years.

Liquidity

We continue assessing Suzano's liquidity as "adequate" because we expect that cash sources will exceed uses by 20% in the upcoming 12 months. Moreover, even if EBITDA were to be 15% lower than our expectation, we expect cash sources to be still higher than uses.

In addition, Suzano enjoys access to diverse financial institutions. Also, given its ample operating cash flows, coupled with its ability to reduce

capex, we believe Suzano can absorb high-impact, low probability events with limited need for refinancing.

Principal Cash Sources:

- Cash reserves of R\$2.9 billion as of June 2015
- Annual FFO of at least R\$3.2 billion

Principal Cash Uses:

- Capex of R\$2 billion, which might drop to the maintenance capex of R\$1 billion
- Working capital outflows of approximately R\$400 million, although intra-year working capital variations might be higher
- Short-term debt of R\$1.5 billion as of June 30, 2015
- Dividends at a 25% payout ratio, according to company's bylaws

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 June 2015, Suzano was in full compliance with those covenants, and we expect it to remain so.

Outlook

The stable outlook incorporates our view that the company will post net debt to EBITDA lower than 3.5x and FFO to net debt in excess of 30%. This will mainly depend on the company's growth strategy and the evolution of pulp prices in the short to intermediate term.

Downside Scenario

We could revise the outlook to negative if the company's financial metrics deteriorate to net debt to EBITDA above 4x and/or FFO to net debt below 20%. That would happen, for instance, if pulp prices decline to about \$580 per ton, having the currency rate according to our base case scenario, or if the company embarks on significant investments.

Upside Scenario

A positive rating action will be mostly linked to an improvement in the company's operating efficiency, mainly by decreasing its dependence on third parties' supply of wood. In addition, if that happens, we expect to see clear and sustainable financial policies that support conservative leverage levels in the long term.

Rating Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Satisfactory

- Country risk: Moderately high

- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Recovery Analysis

Key analytical factors

- The issue-level rating on Suzano's senior unsecured notes is 'BB+'.
- The recovery rating of '3H' indicates our expectation of a recovery of 50%-70% (in the high band of the range) for unsecured lenders under a hypothetical default scenario.
- In our default scenario, EBITDA would decline by about 60%.
- We have valued the company on a going-concern basis, using a 5.5x multiple applied to our projected emergence-level EBITDA, which results in an estimated gross emergence value (EV) of about R\$12 billion.
- Our recovery analysis assumes that under a hypothetical default scenario, the senior unsecured notes would rank pari passu to the company's existing and future senior unsecured debt, which is also subjected to statutory priorities as tax and labor obligations.

Simulated default assumptions

- Simulated year of default: 2020
- EBITDA at emergence: R\$2.2 billion
- Implied EV multiple: 5.5x
- Estimated gross EV at emergence: R\$12 billion

Simplified waterfall

- Net EV after 5% administrative costs: R\$11.5 billion
- Priority claims: R\$27.8 million
- Senior secured debt: R\$4.5 billion
- Unsecured debt: R\$10.7 billion
- Recovery expectation: 50%-70%

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- Corporate Methodology, Nov. 19, 2013

- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Credit Factors For Corporate Entities And Insurers , Nov. 13, 2012
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt , Aug. 10, 2009

Ratings List

Upgraded

	To	From
Suzano Papel e Celulose S.A. Corporate Credit Rating	BB+/Stable/--	BB/Stable/--
Suzano Trading Ltd. Senior Unsecured Recovery Rating	BB+ 3H	BB 4H

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