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Research Update:

Suzano Papel e Celulose Upgraded To 'brAA+' From 'brAA'; 'BB+' Global Scale Ratings Affirmed; Outlook Still Stable

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Overview

- We expect Brazil- based pulp and paper producer Suzano to continue benefiting from its efficient operations and to show moderate leverage in the short term.
- We're raising our national scale ratings to 'brAA+' from 'brAA' and affirming the global scale ratings at 'BB+'.
- The national scale rating upgrade results from Suzano's improvement in its credit metrics, which result in a favorable comparison relative to other Brazilian issuers.
- The stable outlook incorporates our view that Suzano's low-cost producing assets, efficient operations and reduced investment needs will support solid free-operating cash flow generation and an overall comfortable liquidity profile. It further reflects our expectation that Suzano will post FFO to debt in excess of 20% and debt to EBITDA around 2.5x.

Rating Action

On Aug. 12, 2016, S&P Global Ratings raised its national scale rating on Suzano Papel e Celulose S.A. to 'brAA+' from 'brAA'. In addition we affirmed our 'BB+' global scale ratings on Suzano and our 'BB+' issue-level ratings on the financing vehicles Bahia Sul Holding GMBH and Suzano Trading Ltd, which Suzano guarantees. The outlook is stable. We also affirmed our '3' recovery rating on the issue-level ratings, indicating our expectation of meaningful recovery (50%-70% in the higher range of the band) of the notes under a hypothetical default scenario.

Rationale

Suzano's global scale ratings continue to reflect the company's advantageous cost structure for pulp production thanks to its access to highly productive forests, efficient pulp mills and a satisfactory level of self-sufficiency in wood and energy. Furthermore, it incorporates the company's 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, as well as the company's exposure to printing and writing paper products, which have been showing demand declines due to digital substitution. The national scale rating upgrade, on the other hand, is based on Suzano's improvement in its financial metrics, which result in a favorable comparison relative to other Brazilian issuers.

The ratings also reflect Suzano's stronger capital structure and lighter balance sheet following the ramp-up of the company's 1.5 million ton pulp mill in Maranhão, as well as high pulp prices and a weaker Brazilian real, which boosted Suzano's adjusted EBITDA generation to R$4.8 billion in the past 12 months ended in June 2016 from R$3.3 billion in the same period of 2015. In 2016 and 2017, we anticipate a stable EBITDA generation of around R$4.5 billion as expected cash cost reductions (mainly due to a lower dependence on third-party wood and lower average distance between the mills and the forest base) will compensate for the negative effects on profitability associated with lower pulp prices and a stronger local currency--which has appreciated almost 30% in 2016. In this context, we expect adjusted net-debt to EBITDA to range from 2.5x to 2.7x in 2016 and 2017. In the long term, leverage will depend on the company's expansion plans and its financing strategy. We currently see Suzano's lack of robust, clear, and sustainable financial policies as a rating constraint for an investment grade level, since we lack guidance as to whether the company will maintain financial risk at this level or whether it will take advantage of its increasing free-operating cash flow generation to engage in shareholder friendly actions or an organic/inorganic growth strategy that could materially increase leverage.

Our base case for Suzano incorporates the following assumptions:

- Brazil's GDP contraction of 3.6% in 2016 and growth of 1% and 2% in 2017 and 2018, respectively;
- Brazil's inflation of 7.5%, 6% and 5% in 2016, 2017 and 2018, respectively;
- Annual pulp production of 3.6-3.7 million tons and paperboard and printing and writing paper volumes ranging from 1.2- 1.3 million tons per year in the next two years;
- Benchmark prices for BEKP of $700 per ton in 2016 and 2017 and average discounts in the 25%-30% 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 R$600- R$620 per ton in the next two years, including the maintenance stoppage, which might decrease even further in 2018 due to the cost reduction measures in process of implementation;
- Capital expenditures (capex) of R$2.1 billion in 2016 and R$2.3 billion in 2017, including the R$1.1 billion investment in retrofitting and debottlenecking in Imperatriz and Mucuri mills to optimize the cost structure; and
- Dividend payout ratio at 25% of net income.

Based on those assumptions, we reach the following figures and credit ratios in 2016 and 2017:

- EBITDA margin near 45%;
- Adjusted net debt to EBITDA in a range of 2.5x-2.7x; and
- Funds from operations (FFO) to adjusted debt in a range of 20%- 30%

Ratings Above The Sovereign

The ratings on Suzano are one notch above the sovereign foreign currency rating (BB/Negative/B) of Brazil, reflecting our view that there is an appreciable likelihood that the company won't default even in the simulated stress scenario of a sovereign default. In our view, Suzano has a moderate sensitivity to country risk, due to its export-oriented business. As a result, we may rate Suzano up to three notches above the sovereign rating on Brazil, subject to the company's ability to pass a stress test related to the restrictions on access to foreign exchange to satisfy its operating and financial needs (which is translated through the sovereign's transfer and convertibility assessment, currently 'BBB-').

We stressed the company in 2017 under a sovereign default scenario, which includes the following assumptions:

- A 10% decline in GDP and domestic paper and packaging volumes in 2017;
- A doubling of inflation; the company would pass through the resulting higher costs to domestic prices;
- A 50% depreciation of the real, which would double Suzano's debt service costs related to foreign-currency debt (in local currency terms), but also a raising in its exports revenue;
- Hardwood pulp prices of $550 per ton, in line with those in mid-2009, when prices reached a 10-year low;
- A doubling of interest rates for floating loans;
- A haircut of 70% applied to cash holdings and investments in Brazilian government securities or domestic banks that aren't systemically important;
- Capital expenditures at maintenance levels;
- Dividends at a 25% payout ratio.

In our view, under this hypothetical scenario, the company would maintain liquidity sources over uses of more than 1x in the next 12 months. We believe that Suzano's export-oriented business and most of its costs denominated in local currency partly insulate the company from Brazil's country risk.

Liquidity

We continue assessing Suzano's liquidity as adequate. We expect that cash sources will exceed uses by 20% in the upcoming 12 months, supported by large cash balances, significant operating cash flow generation, manageable working capital needs and a reduced investment program. Moreover, even if EBITDA were to be 15% lower than our expectation, we expect cash sources to still be higher than uses, so we believe it can absorb high-impact, low probability events with limited need for refinancing. Suzano also enjoys diversified funding access and solid relationship with banks, in our view.

Principal Cash Sources:

- Cash reserves of R$2.7 billion as of June 30, 2016;

- Annual FFO ranging from R$3.3 billion to R$3.5 billion;
- Proceeds from the recently issued bond of R$1.6 billion ($500 million already converted to local currency and held in Brazilian financial institutions).

Principal Cash Uses:

- Capex of R$2.5 billion in the next 12 months, which might drop to the maintenance capex of R$1.2 billion if required;
- Short-term debt of R$1.8 billion as of June 30, 2016; and
- Dividends at a 25% payout ratio, according to company's bylaws.

Financial Covenants

Suzano's bank loans include certain financial covenants that require maintaining a net debt to EBITDA ratio below 4.35x in December 2016. Those covenants are measured every 60 and 120 days after the closings of June and December. We expect Suzano to keep compliance with those covenants, and we expect a 40% cushion for this ratio in the next 12 months.

Outlook

The stable outlook incorporates our view that Suzano's low-cost producing assets, efficient operations and reduced investment needs will support solid free-operating cash flow generation and an overall comfortable liquidity profile. It further reflects our expectation Suzano will post FFO to debt in excess of 20% and debt to EBITDA around 2.5x.

Downside scenario

We could take a negative rating action over the coming 12 months if the company's financial metrics weaken significantly from the current level, with net debt to EBITDA of more than 3.5x-4x and FFO to net debt of less than 20%. This could happen if, for example, pulp prices decline to about $650 per ton and the foreign exchange appreciates to an average of R$3/US$, or if the company enter in an aggressive shareholder remuneration program or an important capex plan.

Upside scenario

A higher rating is currently constrained by Suzano's financial policy which, in our view, is weaker than that of investment grade peers. In particular, for a rating upgrade, we would expect Suzano's financial risk profile to permanently strengthen and the company to have clear and sustainable financial policies, that support conservative leverage (for instance at a level of net debt to EBITDA below 3x and FFO to debt above 30%) in the medium to long term.

Ratings Score Snapshot

Corporate Credit Rating:
- Global Scale Rating: BB+/Stable/--
- National Scale Rating: brAA+/Stable/--

Business risk: Satisfactory
- Country risk: Moderately High Risk
- Industry risk: Moderately High Risk
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Recovery Analysis

Key Analytical Factors

- The issue-level rating on Suzano's senior unsecured notes is 'BB+'.
- The recovery rating of '3' 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 65%. 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$11 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: 2021
- EBITDA at emergence: R$1.9 billion
- Implied EV multiple: 5.5x
- Estimated gross EV at emergence: R$10.5 billion

Simplified waterfall

- Net EV after 5% administrative costs: R$10 billion
- Priority claims: R$25 million

- Senior secured debt: R$3.3 billion
- Unsecured debt: R$9.6 billion
- Recovery expectation: 50%-70%

Related Criteria And Research

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 01, 2016
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Corporate Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Industrials: Key Credit Factors For The Forest And Paper Products Industry , Feb. 12, 2014
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt , Aug. 10, 2009
- 2008 Corporate Criteria: Rating Each Issue, April, 15, 2008

Ratings List

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Upgraded
                                        To                 From
Suzano Papel e Celulose S.A.
 Corporate Credit Rating
 Brazil National Scale                  brAA+/Stable/--    brAA/Stable/--

Ratings Affirmed

Suzano Papel e Celulose S.A.
 Corporate Credit Rating
  Global Scale                          BB+/Stable/--


Bahia Sul Holdings GmbH
 Senior Unsecured                       BB+
  Recovery Rating                       3H
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Suzano Trading Ltd.	
Senior Unsecured	BB+
Recovery Rating	3H

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.