FitchRatings

Fitch Affirms Suzano and Fibria's IDRs at 'BBB-' Following Merger Announcement

Fitch Ratings-Rio de Janeiro-16 March 2018: Fitch Ratings has affirmed Suzano Papel e Celulose S.A. (Suzano) and Fibria Celulose S.A.'s (Fibria) Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-' following the merger announcement of Suzano and Fibria. The Rating Outlook for Suzano's Foreign and Local Currency IDR is Stable. The Rating Outlook for Fibria's Foreign and Local Currency IDR was revised to Stable from Positive. At the same time, Fitch has affirmed the national scale long-term rating of Suzano and Fibria at 'AAA(bra)' with a Stable Outlook. A full list of rating actions follows at the end of this release.

Suzano and Fibria's ratings were affirmed following the announcement that Suzano entered into the Voting Agreement and Obligation Undertakings with the controlling shareholders of Fibria, Votorantim S.A. and BNDES Participacoes S.A. (BNDESPAR), to combine the operations of Suzano and Fibria. The proposed transaction incorporates a corporate restructuring, which will result in the ownership by Suzano of all the shares issued by Fibria. Total amount of the transaction is BRL29 billion, plus shares exchange, and will be financed by USD9.2 billion of new debt. The transaction is expected to close within the next 12 months.

The merger of Suzano and Fibria will create the world's leading producer of market pulp, with 11 million tons of bleached eucalyptus kraft (BEKP) market pulp capacity in an industry of 62 million tons. The excellent business position as a low-cost producer of market pulp and its ability to dilute fixed costs would further strengths the company's capacity to generate strong cash flow during cyclical pricing downswings.

The ratings incorporate an expected increase in net leverage for the combined company to 3.6x in 2018. Fitch projects net leverage to fall to 3.1x in 2019 and to 2.5x in 2020. Better pulp prices, new sales volume from the Horizonte II pulp mill, a more competitive cost structure and important synergies will contribute to strong FCF generation and support the investment grade ratings of the combined entity.

KEY RATING DRIVERS

Solid Business Position: Combined, Suzano and Fibria will have a production capacity of 11 million tons of market pulp per year, with an estimated market share of about 18% in market pulp, 32% in hardwood pulp and 46% in the subset of this category, eucalyptus pulp. Suzano and Fibria's competitive advantage are viewed as sustainable due to its modern pulp mills, high-yielding forestry plantations, and low average distance from the forests to the mill and its efficient logistics. Both companies have a very competitive cost structure, which placed it firmly in the lowest quartile of the cost curve. The transaction will allow Suzano and Fibria to capture important synergies, including lower distance from forest to mill, reducing wood costs; logistics optimization; gains of scale with suppliers; and reduced SG&A.

Quick Deleveraging Trend: Fitch projects net leverage to peak at 3.6x at the end 2018 and to fall to 3.1x in 2019 and to 2.5x in 2020. Base case projections incorporate synergies of around BRL1.2 billion and new debt of USD9.2 billion to finance the acquisition. On a pro forma basis, the combined company had a net leverage of 2.8x at Dec. 31, 2017, as per Fitch's calculations, while Suzano's net leverage was 2.3x and Fibria was 3.2x. The merger will result in a significant increase in net debt to about BRL53.5 billion at the end 2018, from a pro forma position of BRL26.2 billion at the end 2017. Fitch projects net debt to reduce to about BRL36 billion by the end of 2021.

Strong FCF: Fitch projects that Suzano and Fibria, together, will generate BRL14.7 billion of EBITDA in 2018 and BRL15.6 billion in 2019, compared with a pro forma position of BRL9.3 billion in 2017. Combined, exports will reach BRL18 billion, or 81% of total revenues. Base case projections considered dividends of 25% of net income and limited investments, leading to FCF between BRL4.5 billion and BRL6.5 billion from 2019 to 2021. Higher investments are expected for 2018 due to the acquisition of Facepa and land and forest by Suzano, as well as final investments in the expansion project of Tres Lagoas pulp mill.

Forestry Assets Key to Credit Profile: A key credit consideration that supports the investment grade credit profile is its significant forestry holdings, which assures a competitive production cost structure. As of Dec. 31, 2017, the accounting value of the biological assets on the forest plantations owned by Suzano and Fibria together was about BRL8.8 billion. The nearly ideal conditions for growing trees in Brazil make these plantations extremely efficient by global standards and give the company a sustainable advantage in terms of the costs of fiber and transportation between forest and mill.

Positive Industry Consolidation: Fitch views the consolidation of the pulp industry as positive, as it would likely add more discipline to the market. The market pulp industry is very cyclical; prices move sharply in response to changes in demand or supply. Suzano and Fibria's sales volumes are less volatile than prices, as sales are carried out under long-term supply agreements. Market fundaments for pulp producers have turned favorable, as strong demand from China has helped the market absorb new capacity from Asia Pulp and Paper and Fibria seamlessly. Prices from 2018 through 2020 should be healthy do to the lack of new projects, which should help issuers build cash positions for new projects or reduce debt accumulated during recent pulp mill projects. China will continue to play a key role in supporting prices, and demand should be driven by a growing economy and the closing of pulp mills that relied upon non-wood fibers.

Rating Pierces Country Ceiling: Suzano and Fibria's FC IDR of 'BBB-' are two notches higher than Brazil's 'BB' Country Ceiling due to a combination of the following factors: estimated EBITDA in hard currency of about USD3.8 billion, and approximately USD1.2 billion of cash held outside of Brazil. EBITDA from exports will likely trend up in the next few years given the shortage of new pulp projects relative to demand growth. Fitch projects the ratio of exports, plus cash held abroad to cover hard currency debt service over the next 24 months by around 1.7x at the end 2018. In line with Fitch's "'Rating Non-Financial Corporates Above the Country Ceiling Rating Criteria", this allows the company to be rated up to three notches above the Brazilian Country Ceiling.

DERIVATION SUMMARY

The merger of Suzano and Fibria will result in the world's leading producer of market pulp, with an annual pulp production capacity of 11 million in an industry of 62 million tons of market pulp. Together, Suzano and Fibria would have an estimated market share of about 18% in market pulp, 32% in hardwood pulp and 46% in the subset of this category, eucalyptus pulp. The second largest producer of market pulp is Celulosa Arauco y Constitucion S.A. (Arauco, BBB/Negative), followed by International Paper (not rated) and Empresas CMPC S.A. (CMPC, BBB/Stable). Suzano is also the leading producer of printing and writing paper in Brazil, as well as paperboard.

Similar to Latin American pulp producers Arauco and CMPC, Suzano's pulp production cash costs are among the lowest in the world, ensuring its long-term competitiveness. The combined company will have a significant scale of operations. It will have less geographic and product diversification that Chilean peers Arauco and CMPC, which are leaders in the wood products segment and tissue markets, respectively.

Suzano's ratings incorporate the expected increase in leverage, which positions the company with a higher leverage than Arauco and CMPC. However, the investment grade ratings is supported by the expectation that net leverage will quickly decline in the next three years due to strong cash flow generation. Liquidity is historically strong for pulp producers and Suzano's strong access to debt and capital markets should support high debt refinancing requirements, especially in 2021 when the bridge loan matures. Suzano's operating margins are higher than the Chilean companies that operate in lower-margin business segments such as tissue, packaging and boards.

KEY ASSUMPTIONS

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

--Conclusion of the transaction by the end of 2018 for BRL29 billion.
--New debt of USD9.2 billion to finance the transaction.
--Dividends limited to minimum regulatory requirements.
--Pulp and paper sales close to full capacity.
--Average hardwood net pulp price of USD675 per ton in 2018, USD700 per ton in 2019, USD725 per ton in 2020, and USD675 per in 2021 and afterwards.
--FX rate of 3.3 BRL/USD.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action

--A positive rating action is not expected in the medium term. However, higher than expected cash generation in 2019 and 2020, allowing a consistent and faster deleveraging, may positively affect the ratings.
--Net leverage below 2x through the cycle.

Developments that May, Individually or Collectively, Lead to Negative Rating Action

--An expectation that net leverage will remain above 3.0x in 2020;
--Significant and unexpected increase in refinancing risk in 2021;
--Sharp deterioration of market conditions with significant reduction in pulp prices.

LIQUIDITY

Strong Liquidity: Suzano and Fibria have historically maintained a strong cash position. On a pro forma basis, Suzano and Fibria had BRL9.5 billion of cash and marketable securities and BRL35.7 billion of total debt at year-end 2017. Combined debt maturities totals BRL7.5 billion in 2018, BRL3.8 billion in 2019 and BRL4.7 billion in 2020 and Fitch expects Suzano to use its strong cash flow generation to reduce debt.

Fitch expects a successful takeout of the USD6.9 billion bridge loan in 2021. In the proposed transaction, Suzano will have up to three years to access the market, which gives the company adequate flexibility. Fitch considered that Suzano will be able to extend debt amortization profile and preserve conservative liquidity. Financial flexibility is enhanced by the potential sale of forestry assets and/or less strategic mills, if necessary.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings:

Suzano Papel e Celulose S.A.
--Long-Term Foreign Currency IDR at 'BBB-', Outlook Stable;
--Long-Term Local Currency IDR at 'BBB-', Outlook Stable;
--Long-term National scale rating at 'AAA(bra)', Outlook Stable.

Suzano Trading Ltd.
--USD650 million senior notes due Jan. 23, 2021 at 'BBB-' (guaranteed by Suzano Papel e Celulose S.A.).

Suzano Austria GmbH
--USD700 million senior notes due in 2026 at 'BBB-' (guaranteed by Suzano Papel e Celulose S.A.);
--USD500 million senior notes due in 2047 at 'BBB-' (guaranteed by Suzano Papel e Celulose S.A.).

Fibria Celulose S.A.

--Long-Term Foreign Currency IDR at 'BBB-', Outlook revised to Stable from Positive;
--Long-Term Local Currency IDR at 'BBB-', Outlook revised to Stable from Positive;
--Long-term National scale rating at 'AAA(bra)', Outlook Stable.

Fibria Overseas Finance Ltd.
--USD600 million senior unsecured notes, due 2024 and guaranteed by Fibria, at 'BBB-';
--USD700 million senior unsecured notes, due 2027 and guaranteed by Fibria, at 'BBB-';
--USD600 million senior unsecured notes, due 2025 and guaranteed by Fibria, at 'BBB-'.

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Summary of Financial Statement Adjustments -
Suzano:
--Debt adjusted by debt factoring.
--Fitch excludes changes in biological assets from EBITDA.
--In 2016, Fitch excluded provision for land loss from EBITDA.

Fibria:
--Debt adjusted by debt factoring.

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Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017)
National Scale Ratings Criteria (pub. 07 Mar 2017)
Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria (pub. 23 Jan 2018)

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