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Research Update:

Negative Rating Actions Taken On Six Brazilian Sugarcane Processors On Pressured Credit Metrics And Liquidity

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Rating Action Overview

- The combination of the COVID-19 outbreak in Brazil, which will hit fuel consumption at least in the current quarter, and the sharp decline in international oil prices, to which domestic ethanol prices are correlated, will sharply reduce the biofuel's profitability.
- International sugar prices have also declined amid global recession, although the Brazilian real's steep depreciation is supporting prices denominated in the domestic currency.
- The sector's players are attempting to shift to the production of sugar from ethanol, but they will have to cope with high working capital requirements to carry over most ethanol production volumes amid lower prices. In our view, this will pressure credit metrics and liquidity over the next quarters.
- As a result, on April 3, 2020, S&P Global Ratings took several negative rating actions on the sector. We revised our outlook on Adecoagro S.A. to negative from stable and affirmed our 'BB' issuer credit and issue-level ratings. We placed our 'brAA-' rating on Cerradinho Bioenergia S.A. on CreditWatch with negative implications. We revised the national scale outlook from stable to negative on Cocal Comercio Industria Canaa Acucar e Alcool Ltda, and affirmed our 'brAA+' issuer credit rating on it. We placed our 'B-' and 'brBBB-' ratings on S.A. Usina Coruripe Acucar e Alcool on CreditWatch with negative implications. We revised the global and national scale outlook on Jalles Machado S.A. to negative from stable, and affirmed our 'BB-' and 'brAA+' issuer credit ratings. We revised the national scale outlook from stable to negative on Vale do Tijuco Acucar e Alcool S.A., and affirmed our 'brAA-' issuer credit rating.
- The overall negative trend reflects the likelihood of downgrades depending on the companies' ability to adapt to higher working capital requirements, adjust capex, and roll over short-term maturities to preserve cash. Even though demand may recover in the second half of 2020, the uncertainty regarding its timing and magnitude will likely pressure the companies' liquidity and erode their credit metrics. Each company's flexibility to maximize sugar output, amounts of hedged sugar prices for the current fiscal year, and liquidity and covenant cushion will drive individual rating actions.

Our current base-case scenario is exposed to considerable volatility.

The sugar and ethanol (S&E) sector is exposed to numerous uncontrollable risk factors, such as commodity prices, foreign exchange (FX) rate volatility and weather conditions. Our main assumptions across the sector for 2020 and 2021 are as follows:

- An average FX rate of R$4.85 per $1 in 2020, which impact exported sugar earnings and ethanol pricing parity, which is correlated to global oil prices.
- End of period FX rate of R$4.80 per $1 in 2020, impacting dollar-denominated debt.
- Ethanol prices in the domestic market to drop 30%-35% in fiscal 2021 (which started on April 1, 2020), assuming Brent oil prices of $30 per barrel for the remainder of 2020, compared with over $60 in 2019.
- Mills are overall shifting their production mix towards sugar, reducing Brazil's ethanol output.
- NY#11 sugar contract forward curve at about 11 cents per pound, but cash flows will be mainly determined by amount of hedged sugar prices and FX rate.
- We expect higher seasonal working capital requirements to pressure the companies' liquidity this year, due to the increasing mobility restrictions in Brazil over the next few months, reducing volumes sold and requiring mills to carry over their biofuel production to be sold later in the year.
- We assume limited refinancing for the year, and capex closer to maintenance levels.

All eyes on liquidity.

The drop in ethanol demand is prompting fuel distributors to reduce their purchases below original amounts in the contracts over the next months, which will force the mills to carry higher-than-expected ethanol inventories. Many mills already hold their ethanol output to sell in the inter harvest period between December to March, to benefit from better prices, and operate with stronger liquidity. But refinancing conditions are currently much tighter and liquidity relief through the sale of hydrated ethanol in the spot market may not be available, while performance risks on existing long-term energy contracts and volatility in spot market prices could also pressure liquidity. Moreover, the uncertainty over the extent of the quarantine timeframe and demand recovery adds risks to this strategy, and mills could end up selling inventories at even lower prices later on.

Our rating actions were driven by comparing the companies' cash positions versus short-term debt maturities, and stressing operating cash flows and seasonal working capital requirements, gauging the impact on their liquidity positions in the next three to six months.

Production flexibility and sugar hedging will set the tone for cash

generation.
Most rated mills have fixed a significant portion of their own sugar production at favorable prices when the NY#11 contract was trading at 14-15 cents per pound a few months ago, versus current prices of 10-11 cents. Moreover, most of them have fixed FX rates at about R$4.50 per $1, supporting cash flows in fiscal 2021. In addition, the impact of the average drop in domestic ethanol prices could be softened, depending on the Brazilian real's depreciation, assuming Petrobras will maintain its international pricing parity policy.

Environmental, Social, and Governance (ESG) Credit Factors for this Credit Rating change:
- Health and safety and consumer related factors

Rating Action Rationale

Adecoagro

The outlook revision stems from our base-case assumptions for domestic ethanol prices to fall 30%-35% in 2020, which will likely push Adecoagro's debt to EBITDA closer to 3.0x. We believe Adecoagro is more exposed to ethanol than most of its rated peers, given that it has considerably maximized the biofuel's production over sugar, with its share of output at 85% at the end of 2019. We expect Adecoagro to gradually increase the sweetener's share of the output, which should soften the impact of the EBITDA decline. Nonetheless, the company is more exposed to sugar spot prices than some of its peers, because the majority of sugar output is currently unhedged. In December 2019, Adecoagro had only about 100,000 tons of sugar hedged at 15.6 cents per pound.

We currently don't detect significant pressures on the company's liquidity profile. Its current cash position was boosted by a recent issuance of a certificate of agricultural receivables (CRA) of about R$400 million (about $80 million). Our base-case scenario assumes that sources over uses of cash will exceed 30% in the next 12 months, including a seasonal working capital requirement of about 25% of the company's ethanol sales in the current fiscal year, approximately three months of inventories.

Outlook

The negative outlook reflects a potential downgrade in the next 12 months if Adecoagro's metrics deteriorate amid the turmoil in ethanol and sugar prices. This will depend on the company's ability to adapt its crushing mix to minimize the drop in margins and cash flows, while maintaining competitive cash costs.

Downside scenario
We could lower our rating on Adecoagro in the next 12 months due to persistent erosion of credit metrics, with debt to EBITDA consistently above 3.0x and

free operating cash flow (FOCF) to debt below 10%. This scenario could result from much weaker ethanol volumes in the year, if restrictions on urban mobility remain in place beyond the next several months. Also, higher-than-expected seasonal working capital requirements amid lower access to refinancing could pressure Adecoagro's liquidity position and trigger a downgrade.

Upside scenario

We could revise the outlook to stable if the company posts stronger-than-expected credit metrics and maintain a comfortable liquidity cushion under the current scenario. We would expect the company to maintain debt to EBITDA below 2.5x and funds from operations (FFO) to debt above 30%. A clear visibility on demand normalization should support the stability of the rating.

Cerradinho

Cerradinho is highly exposed to the current headwinds, because it's only a sugarcane and ethanol producer, with no flexibility to adjust its mix towards sugar like its rated peers, which has been a constraint to upsides in its business risk profile assessment and ratings. Although the company has significant by-product (energy, distillers' dried grain, and corn oil) sales, our base-case scenario of a 32% decline in average ethanol prices for fiscal 2021 would slash the company's EBITDA by about 35%, which would result in a spike in adjusted gross debt to EBITDA to above 5.0x. The uncertainty over the recovery in demand adds further challenges to Cerradinho's ability to contain leverage and preserve liquidity. An offsetting factor is Cerradinho's historically satisfactory access to bank and capital markets funding, which could enable it to contract working capital lines to store a sizeable part of ethanol to sell later in the year. Therefore, Cerradinho can soften the drop in sales prices. Another offsetting factor is that the company has already acquired nearly all its supply of corn for the current fiscal year, so it's not exposed to the currently higher prices of grain in Brazil.

CreditWatch

The CreditWatch with negative implications reflects the likelihood of a downgrade in the upcoming weeks, due to the company's exposure to the ethanol market in Brazil, with plummeting prices and demand following the COVID-19 outbreak. Liquidity pressures are heightened, as the current scenario will require more working capital to carry over inventories to be sold later in the year, while cash generation will tumble in the next few months, although we believe the company will continue to refinance short-term working capital lines.

Cocal

We believe Cocal is fairly prepared to withstand lower demand for ethanol in the next few months. The company has been enhancing its operating efficiency since the past harvest through a significant investment plan to expand agricultural productivity, resulting in total crushing levels of more than 8.5 million tons in fiscal 2020. The company has hedged most of its sugar production volumes for fiscal 2021 at very profitable prices (above R$1,400 per ton), and will increase the sweetener's share of the output to about 65%, which will mitigate the impact of the lower ethanol prices. However, we expect leverage to tick-up in fiscal 2021 to 2.0x-2.5.

Cocal has also strengthened liquidity by accessing the capital markets and longer-term bank lines, and its membership in Copersucar provides a cushion in terms of working capital requirements and access to the cooperative's short-term lines.

Outlook

The negative outlook reflects a one-in-three likelihood of a downgrade amid the uncertainties stemming from the COVID-19 outbreak in terms of lower cash generation and higher liquidity pressures, although Cocal's membership in Copersucar reduces working capital needs and provides access to short-term credit lines. We expect Cocal's adjusted debt to EBITDA to increase to nearly 2.5x and FFO to debt to fall to 30%-35%.

Downside scenario

We could lower the ratings in the next six to twelve months if the magnitude of the drop in prices and demand stemming from the COVID-19 outbreak is deeper than we currently expect, resulting in a significant FOCF deficit in fiscal 2021 and liquidity pressures. In this sense, debt to EBITDA would approach 3x and FFO to debt would reach below 30%, on a consistent basis, with a FOCF shortfall, and sources over uses of cash for the next 12 months would fall to below 1x.

Upside scenario

An outlook revision to stable would stem from ethanol prices and demand recovery, while Cocal continues to improve its operating efficiency by enhancing productivity levels and operating close to full capacity, generating FOCF. The company would also continue extending its debt maturity schedule, maintaining sources over uses of cash above 1x. In this scenario, debt to EBITDA would remain below 2.5x and FFO to debt above 35%, while Cocal generates FOCF.

Coruripe

In terms of operations, Coruripe would be one of the least exposed companies to our base-case scenario for the COVID-19 outbreak. This is because it could

raise the sugar's share of output to more than 65%, given that it's historically more oriented towards that product. Operating efficiency is also improving, which coupled with the sugar hedging (almost 100% of sugar volumes hedged for fiscal 2021 at about R$1,350) will translate in a minor EBITDA drop, according to our estimates. However, the company is exposed to sizeable refinancing needs. Coruripe has been trying to refinance its debt for several months, and its success and access to working capital lines to carry over inventories could be potentially jeopardized by currently difficult market and industry conditions.

CreditWatch

The CreditWatch with negative implications reflects a potential one- or two-notch downgrade in the next 30 days if debt refinancing takes longer than expected. This is because Coruripe would need to meet sizeable short-term maturities and higher working capital requirements amid more restricted credit environment following the pandemic.

Jalles Machado

Fiscal 2020 was Jalles' best in terms of crushing volumes, reaching 5.1 million tons, with the company maximizing ethanol production and benefiting from favorable prices until early March 2020, when the COVID-19 crisis and the plunging oil prices hit the domestic fuel market. The company will maximize sugar production in the current harvest season, reaching a mix of about 55% for sugar and 45% ethanol, which will mitigate most of the reduction in EBITDA stemming from the lower average ethanol prices. However, our forecast for organic sugar prices is down by about 10% to reflect potentially weaker global demand for this niche product.

Jalles has slightly lower ability to shift its production to sugar than other companies we rate, because it's operating at full capacity and one of its two mills has been historically an ethanol distillery only, although a sugar factory has been recently added. The company could also postpone some expansion investments, but this won't have a significant effect on metrics. In this sense, the leverage metric will increase by about 0.5x in our base-case scenario in fiscal 2021.

Despite the general credit crunch due to the pandemic, we believe Jalles has the ability to carry most of its ethanol production to be sold later in the year. It has a significant cash cushion compared with its short-term debt, and could access new working capital lines in the next months, as seen recently. Its CRA is also in the distribution process, and another R$90 million could be sold as well.

Outlook

The negative outlook reflects the rising risks following the COVID-19 outbreak that will cause ethanol prices and demand in the current harvest season to

tumble, which will weaken credit metrics and liquidity in the upcoming months. However, the company's production flexibility and current liquidity cushion to carry inventories will mitigate these risks. We expect Jalles' leverage to increase in fiscal 2021, with debt to EBITDA at about 2.5x and FFO to debt approaching 30%, but to deleverage afterwards.

Downside scenario
A negative rating action in the next 6-12 months could occur if COVID-19's impact on sugar and ethanol prices is steeper and for a prolonged period than we expect, which would result in significant FOCF shortfall, pressuring its liquidity position, with sources of cash insufficient to match its uses for next 12 months. In this scenario, debt to EBITDA would be above 3x and FFO to debt below 30%, with a FOCF deficit.

Upside scenario
We could revise the outlook to stable if ethanol sales gradually recover, while the company continues to operate close to full capacity and adjusts its capex and working capital, allowing Jalles to generate positive FOCF. In such a scenario, the company's sources over uses of cash would remain above 1x throughout the harvest season and even amid the low commodity prices. In this scenario, debt to EBITDA and FFO to debt would remain below 3x and above 30%, respectively, with positive FOCF.

Vale do Tijuco And CMAA

In our base-case scenario, Companhia Mineira de Açúcar e Álcool Participações (CMAA; a holding company that consolidates the two operations, Vale do Pontal and Vale do Tijuco) wouldn't be severely impacted by the plunging ethanol prices and demand. The company has flexibility to produce more sugar (reaching 60% of the mix in the starting harvest season), transporting the bulk of it through railways from the Vale do Tijuco mill to the port of Santos with a competitive cost structure. It has recently issued a R$300 million CRA and other longer-term debt, strengthening its liquidity position, which was tighter in the past few years. CMAA continues to ramp up its second mill, Vale do Pontal, while favorable climatic conditions enabled crushing close to full capacity at the Vale do Tijuco mill.

The outlook revision to negative reflects the current uncertainties which will spike CMAA's leverage for fiscal 2021, in our view. Although the company will have enough funds to withstand the effects of the pandemic in the upcoming months, including almost no ethanol sales in the next quarter, access to credit will be more restricted and CMAA's FFO could fall below our expectations due to further commodity price decreases or a prolonged weak demand for ethanol in Brazil, which could pressure the company's liquidity position.

Outlook

The negative outlook reflects the one-in-three likelihood of a downgrade amid the drop in prices and demand for ethanol, which could dent the company's cash flows and pressure its liquidity in the upcoming months if the urban mobility restrictions extend beyond July. We expect adjusted gross debt to EBITDA to reach 3.0x-3.5x in fiscal 2021 and to drop below 3.0x afterwards.

Downside scenario

We could lower the ratings in the next six months if the lasting effects of the pandemic on prices and domestic fuel consumption are greater than expected, resulting in significant FOCF shortfalls. In such a scenario, the company would struggle to continue rolling over its short-term debt amid the current credit scarcity, resulting in a material deficit in sources over uses of cash.

Upside scenario

We could revise the outlook on the company to stable if fuel consumption and oil prices recover faster than our current expectations, while the Vale do Tijuco mill continues to operate close to full capacity and crushing levels at the Vale do Pontal mill gradually increase. This would result in positive FOCF generation, which would diminish liquidity pressures in the next 12 months, with sources over uses of cash consistently above 1x. In this scenario, the company would maintain debt to EBITDA below 3x and FFO to debt above 30%, with positive FOCF generation.

Other Companies In The Spotlight

Sao Martinho S.A. (BBB-/Stable/--).

São Martinho, like its peers, is likely face a difficult scenario in 2020. Nonetheless, we expect the company to withstand it because of solid liquidity position and operating efficiency. In December 2019, its cash position was about R$1.4 billion, even with a peak inventory position of about R$1 billion, versus short-term position of R$580 million. We expect the working capital release from ethanol sales from January through March 2020 to boost cash position to about R$2 billion in March 30, 2020, which will support the company's ability to carry ethanol production within the next quarter at least. In addition, our previous base-case scenario assumed capex of about R$1.4 billion, adjusted debt to EBITDA below 2.0x, and FFO to debt of about 50% in 2021. We expect management to take a cautious approach in the current scenario, reducing capex closer to maintenance levels to about R$1 billion while postponing non-mandatory investment, such as the expansion of its cogeneration capacity and the corn ethanol plant.

Raizen Combustiveis S.A. and Raizen Energia S.A. (together Raizen; BBB-/Positive/--).

Raízen has some cushion in its ratings because its stand-alone credit profile is one notch higher then the 'BBB-' rating. We currently cap the global scale rating on Raízen up to three notches above the 'BB-' sovereign rating on Brazil and one notch above Brazil's 'BB+' transfer and convertibility (T&C) assessment. Raízen has sound liquidity position, in our view, and its business consists of the S&E production and fuel distribution. As of December 2019, Raizen's cash position consisted of about R$4 billion, undrawn revolving facilities of $1 billion, and sugar and ethanol inventory position at its S&E division of about R$4 billion, most of which we believe has been drawn by the end of March 2020. Similarly to the S&E sector, the impact to Raizen's operations will depend on the output mix and the hedged commodity prices. However, Raizen's fuel distribution business might face a significant volume decline over the next couple of months, pressuring cash flows.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | Industrials: Key Credit Factors For The Agribusiness And Commodity Foods Industry, Jan. 29, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

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* * * * * * * * * * * * * * *  Adecoagro S.A. * * * * * * * * * * * * * * *


Ratings Affirmed; Outlook Action
                               To                     From
Adecoagro S.A.
 Issuer Credit Rating          BB/Negative/--         BB/Stable/--
 Senior Unsecured              BB

* * * * * * * * * * * *  Cerradinho Bioenergia S.A. * * * * * * * * * * * *

Ratings Affirmed; CreditWatch Action; Downgraded
                               To                     From
Cerradinho Bioenergia S.A.
 Issuer Credit Rating
 Brazil National Scale         brAA-/Watch Neg/brA-2  brAA-/Stable/ brA-1+

* * * * * * * * Vale do Tijuco Acucar e Alcool S.A.* * * * * * *

Ratings Affirmed; Outlook Action
                               To                     From
Vale do Tijuco Acucar e Alcool S.A.
 Issuer Credit Rating
 Brazil National Scale         brAA-/Negative/--      brAA-/Stable/--

* * * * * * Cocal Comercio Industria Canaa Acucar e Alcool Ltda * * * * *

Ratings Affirmed; Outlook Action
                               To                     From
Cocal Comercio Industria Canaa Acucar e Alcool Ltda
 Issuer Credit Rating
 Brazil National Scale         brAA+/Negative/--      brAA+/Stable/--

* * * * * * * * * * * * * * Jalles Machado S.A. * * * * * * * * * * * * *

Ratings Affirmed; Outlook Action
                               To                     From
Jalles Machado S.A.
 Issuer Credit Rating
 Global Scale                  BB-/Negative/--        BB-/Stable/--
 Brazil National Scale         brAA+/Negative/--      brAA+/Stable/--

* * * * * * * * * * S.A. Usina Coruripe Acucar e Alcool * * * * * * * * *
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Ratings Affirmed; CreditWatch/Outlook Action

	To	From
S.A. Usina Coruripe Acucar e Alcool		
Issuer Credit Rating		
Global Scale	B-/Watch Neg/--	B-/Negative/--
Brazil National Scale	brBBB-/Watch Neg/brA-3	brBBB-/Negative/ brA-3

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