

Fitch Downgrades Ratings of USJ to 'B+'

Written by Australian Business

SAO PAULO--([BUSINESS WIRE](#))--Fitch Ratings has downgraded the foreign and local currency Issuer Default Ratings (IDRs) of U.S.J. - Acucar e Alcool S.A. (USJ) to 'B+' from 'BB-' and the National Scale Rating to 'A-(bra)' from 'A(bra)'. Fitch has also downgraded to 'B+' from 'BB-' the rating for the company's USD275 million senior unsecured notes due 2019. A recovery rating of 'RR4' has been assigned to the bond.

The Rating Outlook for USJ is Stable.

KEY RATING DRIVERS

Negative Free Cash Flow

The rating downgrades are primarily due to the company's high cash burn during its fiscal year ended March 31, 2013 (FY13). During FY13, USJ's cash flow from operations (CFO) was negative BRL74 million. During the year, the company's investments in industrial and agricultural operations amounted to BRL125 million. As a result, USJ reported negative free cash flow (FCF) of BRL199 million in FY13. As of the last 12 months through June 30, 2013, USJ's free cash flow was negative at BRL132 million, showing that cash flow performance improved in the first quarter ended June 30, 2013 compared to the same period of the previous year.

High Leverage But Manageable Liquidity

As of June 30, 2013, USJ had BRL252 million of cash and BRL888 million of total debt. This high level of debt compares unfavourably with the company's negative cash flow from operations of BRL74 million in FY13. Liquidity is manageable in the near term despite negative CFO, as USJ has only BRL70 million of short-term debt. About 70% of the company's debt is comprised primarily of a USD275 million note that falls due in 2019.

Volatile Industry

USJ's ratings also reflect its exposure to the volatile sugar and ethanol industry and other risks inherent to the agribusiness sector. The ethanol industry dynamics are strongly linked to Brazil's regulated gasoline prices and government energy policies.

Improved Operational Performance

As a result of USJ's investments, it has been able to lower the average age of its sugarcane fields to around three years. In the 2012/2013 season, the company crushed 3 million tons compared to 2.7 million in 2011/2012. The agricultural yield, which is measured as tons of sugar cane crushed per hectare, has also reported improvements, as it went to 86 tons / ha in the 2012/2013 season from 75 tons / ha in the previous one. The investments in the sugarcane fields contributed to this improvement. USJ's technology allows it to switch between ethanol and sugar production. During FY13, approximately 65% of the company's production was for sugar, while the balance was for ethanol.

Differentiated Business Position

USJ's business profile is built on a product mix that leads to product differentiation compared to peers. USJ's sales are focused on crystal sugar, whose price carries a premium over VHP's, are carried out under medium and long term contracts with financially strong food and beverage companies. Though this aspect does not fully eliminate price volatility risk, it helps USJ to mitigate demand risks. This is possible because of the strategic location of the Sao Joao mill, near not only the food and beverage companies, but also the Santos port terminal (247 km) and Paulinia (70 km), a distribution hub for most of the fuel produced in the State of Sao Paulo. As to ethanol, sales are concentrated on anhydrous ethanol (to be domestically blended into gasoline), industrial ethanol (which carry a premium over anhydrous ethanol) and also exports.

JV with Cargill not Expected to Generate Dividends

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While USJ is focused on high value-added products, the company's growth should come from the two mills located in the State of Goias, which are owned and managed by SJC Bioenergia Ltda (SJC), a 50/50 Joint Venture (JV) with Cargill. USJ is operationally and financially independent from the SJC, which is not expected to generate meaningful dividend flows over the next three years. SJC's two mills, Usina Sao Francisco and Usina Cachoeira Dourada, which started operations in July 2013, have an annual capacity to crush 7.5 million tons of sugar cane. These mills are focused on producing more standardized products such as ethanol and VHP sugar that are exported as well as generating energy from sugarcane bagasse under long-term sales contracts. The JV has a total cogeneration capacity of 120MW.

Rating Sensitivities Additional negative rating action could occur if USJ fails to improve its cash flow performance and/or if its liquidity position deteriorates. A positive rating action will occur if a consistent deleveraging trend is achieved along with maintenance or improvement of its liquidity.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:--'Corporate Rating Methodology' dated Aug. 5, 2013.

Applicable Criteria and Related Research:Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139

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