Sao Martinho S.A.

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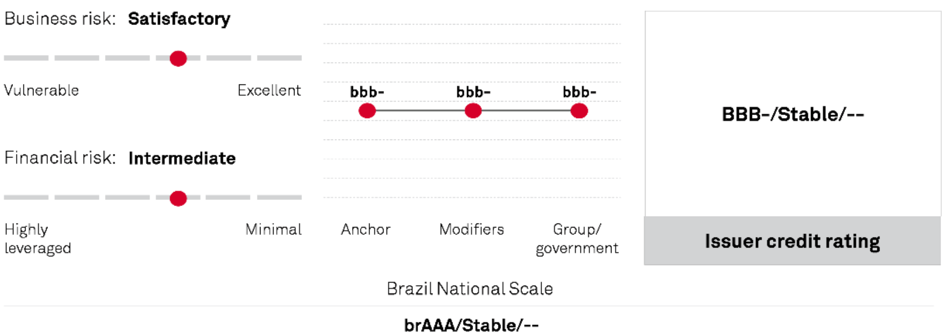
Ratings Score Snapshot



Credit Highlights

Overview

Key strengths	Key risks
Cash cost in the first quartile of the industry makes Sao Martinho S.A. (SMTO) competitive even amid periods of weak sugar and ethanol prices.	Exposed to the inherent volatility of the sugar and ethanol industry, including commodity prices, weather conditions, and foreign exchange (FX) rates.
Conservative financial policy, historically maintaining debt to EBITDA below 2.0x.	Capital-intensive business, with seasonally high working capital needs to carry inventories and sizeable recurrent capex.
Solid liquidity position thanks to consistent free operating cash flows (FOCF) throughout industry cycles, with adequate long-term sources to fund capital expenditures (capex).	We limit the number of notches we can rate SMTO above the rating on Brazil. A downgrade of the country would trigger the same action on SMTO.
Ongoing investments to maintain benchmark operating performance.	

Strong sugar and ethanol prices offset high inflationary costs and idle capacity because of adverse weather conditions. SMTO crushed 19.9 million tons of sugarcane in fiscal 2022 (ended on March 31, 2022), a drop of 11.6% from 22.5 million tons crushed in the previous harvest due to the severe drought and frosts that slashed the productivity of the plantations. Despite better rainfall levels during the off-season period and beginning of the 2022-2023 harvest, the output recovery will be modest, given that the plantations have been damaged. Therefore, we expect SMTO to crush about 20.3 million tons in fiscal 2023. In this sense, idle capacity remains high (SMTO has capacity to crush more than 24.5 million tons), which coupled with inflationary pressures on inputs such as fuel and fertilizers, high leasing and cane costs, and labor expenses, should increase unitary cash costs. On the other hand, sugar prices remain strong, given the tight global supply and demand balance and the depreciated Brazilian real, while ethanol prices are getting a boost from ballooning oil prices and a weak domestic currency, given the maintenance of Petrobras' oil pricing policy in Brazil that aims to maintain parity to global prices. Therefore, we expect SMTO's EBITDA to increase to about R$3.8 billion in the current fiscal year from about R$3.2 billion in fiscal 2022.

Leverage remains controlled despite higher capex. SMTO's main expansion projects currently underway are its corn ethanol plant, which should add about 200 cubic meters (m3) of ethanol production, and the second phase of its energy cogeneration capacity in the São Martinho mill, which should add about 177 megawatt hours (MWh) of energy generation, both fully starting in fiscal 2024. These, coupled with minor projects and higher maintenance investments—given inflationary pressures and the effects of the drought and frosts on SMTO's plantations—will raise capex to about R$2.6 billion in the current fiscal year from R$2.4 billion in the previous one. SMTO is also considering investing in biogas/biomethane and in the second phase of expansion of its corn ethanol mill plant, but those haven't been approved yet and our forecast excludes them. Even with higher investments and dividend distributions, adjusted leverage fell to 1.2x in fiscal 2022 and should remain below 1.5x in the next few years, given that prices will remain supportive.

Medium-term price fundamentals are favorable. The adverse climate conditions in Brazil's Center-South region that slashed crushing levels by more than 15% in the country, coupled with higher ethanol production because of high domestic fuel prices, have bolstered international sugar prices. India's target of achieving a 20% ethanol blended gasoline by 2025, diverting part of its sugar production to ethanol, also supports sugar prices. Current forward curves point to more than 17 cents per pound in the next two years, which along with an average exchange rate of R$5.00-R$5.20 per $1 will allow SMTO to hedge sugar at profitable levels—the company has already hedged more than 500,000 tons at R$2,220 per ton. We also expect favorable ethanol prices given our Brent oil forecast in the $85-$100 per barrel range in the next two years, keeping ethanol prices well above R$3 per liter. SMTO may carry over most of its ethanol production in order to sell it in the off-season period (January-March) given the temporary reduction of PIS/Cofins tax on gasoline until December—which also tends to reduce ethanol prices. Our base-case scenario assumes that Petrobras will maintain the import parity pricing policy that it established in 2016 and that the ICMS tax differential between gasoline and ethanol will remain the same in the next years.

Wide access to long-term funding from bilateral lenders and capital markets. SMTO has secured long-term funding for its expansion projects from BNDES (the Brazilian Development Bank) and International Finance Corporation (IFC), and has recently issued a green infrastructure debenture of R$1.1 billion. Its sound cash position of almost R$3 billion as of March 31, 2022, and funds from operations (FFO) for the current fiscal year are enough to maintain a strong cushion in the cash sources-over-uses ratio for the next 12 months, despite high capex (the expansion projects) and working capital requirements (the raw materials for its corn ethanol plant).

Outlook

The stable outlook reflects our expectations that SMTO will benefit from favorable prices that will bolster EBITDA and free cash flow even amid high idle capacity due to adverse weather conditions and significant expansion capex for the new corn ethanol plant and energy cogeneration capacity. Moreover, SMTO's liquidity should remain solid, allowing us to rate it above the sovereign and withstand our stress test under a hypothetical sovereign default scenario. We expect SMTO to keep adjusted debt to EBITDA in the 1.0x-1.5x range over the next few years and positive FOCF, even after expansion capex.

Downside scenario

A negative rating action could stem from a long period of adverse weather conditions, leading to consecutive crop losses amid lower ethanol and sugar prices, which would lead to a FOCF shortfall and weaker liquidity. In this scenario, SMTO's adjusted debt to EBITDA would approach 3.0x and FFO to debt of 30%. We could also take a negative rating action if SMTO's liquidity position worsens, with significant currency mismatch or high working capital and capex requirements, which could jeopardize its ability to pass the stress test to be rated above the sovereign, triggering a multiple-notch downgrade to the sovereign level. Likewise, a downgrade of the sovereign would trigger the same rating action on SMTO.

Upside scenario

An upgrade is unlikely because the rating on SMTO is now at the maximum amount of notches above the sovereign rating on Brazil. Although metrics are trending towards a stronger stand-alone credit profile (SACP) category because debt to EBITDA is below 1.5x, FFO to debt above 60%, and FOCF is rising to above 25%, an upward revision of the SACP is unlikely in the next two years. We believe that SMTO still lacks scale, geographic, and product diversification of its higher rated peers.

Our Base-Case Scenario

Assumptions

- Brazil's GDP to grow 1.2% in 2022 and 1.4% in 2023, and inflation rate of about 10.5% in 2022 and 5.0% in 2023.
- Average exchange rate of R$5.05-R$5.20 per $1 in the next couple of years.
- Average VHP prices of R$2,190 per ton in fiscal 2023 and R$2,200 per ton in fiscal 2024.
- Ethanol prices above R$3.8 per liter in fiscal 2023 but slipping to R$3.2 per liter in fiscal 2024, reflecting international oil prices and FX rates, assuming Petrobras will maintain its current pricing policy and the ICMS tax differential between gasoline and ethanol will remain the same.
- Crushing volumes to recover slightly to about 20.3 million tons in fiscal 2023, compared with 19.9 million tons in fiscal 2022, and rise to slightly more than 21 million tons in fiscal 2024 and 22 million tons in fiscal 2025.
- Corn processing volumes of 150,000 tons in fiscal 2023 and 495,000 tons in fiscal 2024, leading to 55,000 m3 and about 200,000 m3 of ethanol production for respective years.
- Dried distiller grains (DDG) production of 150,000 tons and corn oil production of about 8,000 tons starting in fiscal 2024 .
- Corn prices at the mill of R$60-R$70 per bag, already reflecting the logistics discount in the state of Goiás.
- Capex of R$2.6 billion in fiscal 2023 and R$2.1 billion in fiscal 2024 for the new corn ethanol plant and cogeneration capacity expansion, as well as for higher maintenance and crop treatment requirements.
- Dividend payment of about R$600 million per year in fiscals 2023 and 2024.
- Annual net cash inflows from Copersucar's legal claims of about R$200 million in fiscals 2023 and 2024.

Key metrics

Sao Martinho S.A.--Key Metrics*

Mil. $	2021a	2022a	2023e	2024f	2025f
Revenue	4,305	5,720	7,000-7,200	7,500-7,700	6,600-6,800
Revenue growth (%)	16.5	32.9	20-25	5-10	(7-15)
EBITDA	2,261	3,200	3,700-3,900	3,800-4,000	3,200-3,400

EBITDA margin (%)	52.5	56.0	53-56	51-54	48-51
Funds from operations (FFO)	2,018	2,971	3,100-3,300	3,300-3,500	2,700-2,900
Capital expenditure	1,508	2,472	2,500-2,700	2,000-2,200	2,100-2,300
Free operating cash flow (FOCF)	279	576	200-300	1,100-1,200	400-500
Dividends	188	807	600-700	600-700	600-700
Debt	3,344	3,703	4,500-4,700	4,100-4,300	4,500-4,700
Debt to EBITDA (x)	1.5	1.2	1.0-1.5	1.0-1.5	1.0-1.5
FFO to debt (%)	60.4	80.2	65-70	80-85	60-65
FOCF to debt (%)	8.3	15.6	5-10	25-30	5-10
EBITDA interest coverage (x)	10.6	25.8	5-10	5-10	5-10
FFO interest coverage (x)	10.5	25.0	5-10	5-10	5-10

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Company Description

SMTO is a Brazilian sugar and ethanol (S&E) company that produces sugar, ethanol, and electricity through sugarcane crushing. Its sugar output is primarily directed to the export market, while the ethanol production is destined for the Brazilian market as a substitute for gasoline. SMTO is one of the largest sugarcane crushers in Brazil, operating four mills with a crushing capacity of 24.5 million tons per year, producing about 1.3 million tons of sugar and 900,000 m3 of ethanol in the last harvest. SMTO's revenue totaled R$5.7 billion and EBITDA of R$3.2 billion in fiscal 2022. SMTO is controlled by the family holding company LJN Participações S.A, which holds almost 54% of its shares. It's a public company with stock traded on the São Paulo Stock Exchange.

Peer Comparison

STMO's sugar and ethanol business, with nearly 25 million tons of sugarcane crushing capacity through four mills, is larger than that of Adecoagro, but the latter also has sizeable grain and dairy operations in Argentina, along with the three mills with 12 million tons of crushing capacity in Brazil. Both peers have favorable unitary cash costs, which have nevertheless increased due to the effects of the drought in Brazil. Raízen compensates for the higher cash cost at its sugarcane operations with massive scale of more than 100 million tons of capacity, development of cutting-edge technologies, such as biomethane and second-generation ethanol, ability to negotiate prices, and sizeable fuel distribution business in Brazil, Argentina, and Paraguay. Suedzucker is more diverse in terms of geography and portfolio (including food and beverages, and ingredients) than SMTO, but it has a much higher cash cost of production and is more leveraged.

Sao Martinho S.A.--Peer Comparisons

	Sao Martinho S.A.	Adecoagro S.A.	Raizen S.A.	Suedzucker AG

Sao Martinho S.A.--Peer Comparisons

Foreign currency issuer credit rating	BBB-/Stable/--	BB/Stable/--	BBB-/Stable/--	BBB-/Stable/A-3
Local currency issuer credit rating	BBB-/Stable/--	BB/Stable/--	BBB-/Stable/--	BBB-/Stable/A-3
Period	Annual	Annual	Annual	Annual
Period ending	2022-03-31	2021-12-31	2022-03-31	2022-02-28
Mil.	R$	R$	R$	R$
Revenue	5,720	5,962	191,270	44,035
EBITDA	3,201	3,104	12,783	4,022
Funds from operations (FFO)	2,971	2,793	11,257	3,388
Interest	335	348	1,880	306
Cash interest paid	124	299	720	164
Operating cash flow (OCF)	3,048	2,045	14,260	2,732
Capital expenditure	2,472	1,484	7,309	1,922
Free operating cash flow (FOCF)	576	561	6,951	810
Discretionary cash flow (DCF)	(231)	189	4,170	232
Cash and short-term investments	2,973	1,113	8,322	2,314
Gross available cash	2,984	1,113	8,353	2,314
Debt	3,703	4,818	24,252	14,064
Equity	5,318	5,838	22,259	19,543
EBITDA margin (%)	56.0	52.1	6.7	9.1
Return on capital (%)	21.1	18.5	17.5	5.3
EBITDA interest coverage (x)	9.6	8.9	6.8	13.2
FFO cash interest coverage (x)	25.0	10.4	16.6	21.6
Debt/EBITDA (x)	1.2	1.6	1.9	3.5
FFO/debt (%)	80.2	58.0	46.4	24.1
OCF/debt (%)	82.3	42.5	58.8	19.4
FOCF/debt (%)	15.6	11.6	28.7	5.8
DCF/debt (%)	(6.2)	3.9	17.2	1.7

Financial Risk

Sao Martinho S.A.--Financial Summary

Period ending	Mar-31-2017	Mar-31-2018	Mar-31-2019	Mar-31-2020	Mar-31-2021	Mar-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	R$	R$	R$	R$	R$	R$
Revenues	3,003	3,436	3,360	3,694	4,305	5,720
EBITDA	1,349	1,811	1,692	1,901	2,261	3,201

Sao Martinho S.A.--Financial Summary

Funds from operations (FFO)	1,105	1,488	1,426	1,704	2,018	2,971
Interest expense	322	330	314	277	186	335
Cash interest paid	237	298	260	178	213	124
Operating cash flow (OCF)	1,133	1,524	1,704	1,751	1,787	3,048
Capital expenditure	976	1,166	1,288	1,385	1,508	2,472
Free operating cash flow (FOCF)	157	358	416	366	279	576
Discretionary cash flow (DCF)	34	112	236	61	82	(231)
Cash and short-term investments	1,172	1,462	2,036	1,924	1,351	2,973
Gross available cash	1,172	1,462	2,089	1,962	1,364	2,984
Debt	3,030	3,161	3,044	3,488	3,344	3,703
Common equity	3,403	3,290	3,391	3,347	3,987	5,318
Adjusted ratios						
EBITDA margin (%)	44.9	52.7	50.3	51.5	52.5	56.0
Return on capital (%)	11.9	15.7	11.3	11.6	13.2	21.1
EBITDA interest coverage (x)	4.2	5.5	5.4	6.9	12.1	9.6
FFO cash interest coverage (x)	5.7	6.0	6.5	10.6	10.5	25.0
Debt/EBITDA (x)	2.2	1.7	1.8	1.8	1.5	1.2
FFO/debt (%)	36.5	47.1	46.8	48.9	60.4	80.2
OCF/debt (%)	37.4	48.2	56.0	50.2	53.4	82.3
FOCF/debt (%)	5.2	11.3	13.7	10.5	8.3	15.6
DCF/debt (%)	1.1	3.6	7.8	1.8	2.5	(6.2)

Reconciliation Of Sao Martinho S.A. Reported Amounts With S&P Global Adjusted Amounts (Mil. R$)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Mar-31-2022									
Company reported amounts	5,888	5,318	5,720	4,038	2,405	335	3,201	3,447	808	2,472
Cash taxes paid	-	-	-	-	-	-	(105)	-	-	-
Cash interest paid	-	-	-	-	-	-	(124)	-	-	-
Lease liabilities	622	-	-	-	-	-	-	-	-	-
Accessible cash and liquid investments	(2,984)	-	-	-	-	-	-	-	-	-

Reconciliation Of Sao Martinho S.A. Reported Amounts With S&P Global Adjusted Amounts (Mil. R$)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Nonoperating income (expense)	-	-	-	-	161	-	-	-	-	-
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(1)	-	-
Debt: other	178	-	-	-	-	-	-	-	-	-
EBITDA: other	-	-	-	(837)	(837)	-	-	-	-	-
Working capital: other	-	-	-	-	-	-	-	13	-	-
OCF: other	-	-	-	-	-	-	-	(411)	-	-
Total adjustments	(2,185)	-	-	(837)	(676)	-	(229)	(399)	-	-
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	3,703	5,318	5,720	3,201	1,729	335	2,971	3,048	808	2,472

Liquidity

We view SMTO's liquidity as adequate. We expect the cash sources-over-uses ratio to be more than 1.2x for the next 12 months from March 31, 2022. Despite higher expansion investments, the company keeps a large cash position and manageable debt maturity profile, with a low level of short-term maturities, which are mostly related to trade financing lines that are typically automatically renewed. We understand that STMO has an overall prudent risk management and a sound relationship with banks, which also supports our liquidity assessment.

Principal liquidity sources

Cash position of R$2.97 billion as of March 31, 2022; and

Expected FFO of about R$2.7 billion for the next 12 months from March 31, 2022.

Principal liquidity uses

Debt maturities of R$581.5 billion as of March 31, 2022;

Working capital outflows of almost R$500 million for the next 12 months and seasonal working capital requirements of about R$450 million;

Maintenance and expansion capex of R$2.6 billion for the next 12 months; and

Dividend payments of about R$630 million for the next 12 months.

Covenant Analysis

Requirements

SMTO has debt payment acceleration covenants on its loans from BNDES and IFC that require it to maintain net debt to EBITDA below 3.0x and 4.0x, respectively. The newly issued debentures also have a 4.0x net debt to EBITDA covenant.

Compliance expectations

We estimate SMTO will maintain over a 70% cushion on its most restrictive covenant requirements to maintain a net debt to EBITDA below 3.0x.

Environmental, Social, And Governance

ESG Credit Indicators

E-1 E-2 **E-3** E-4 E-5	S-1 **S-2** S-3 S-4 S-5	G-1 **G-2** G-3 G-4 G-5
- Physical risks	- N/A	- N/A

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1 - 5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary " ESG Credit Indicator Definitions And Applications, " published Oct. 13, 2021.

Environmental factors are a moderately negative consideration in our credit rating analysis of SMTO. Its exposure to environmental risk factors is in line with those of the Brazilian S&E industry, with climate events, particularly droughts, that erode crop yields. For example, last year's severe drought in Brazil slashed SMTO's sugarcane crushed volumes to less than 20 million tons from 22.5 million tons in the previous harvest. The mitigating factors are SMTO's large scale, given that it's one of the five largest sugarcane crushers in Brazil; efficiency, because it has one of the most competitive cash cost operations; and its portfolio of four plants. These factors, along with current ethanol and sugar prices, bolster SMTO's profitability. The drought's impact is more severe in the state of São Paulo, so the company's operations in the state of Goiás have been affected to a lesser extent. However, the sector is key to transitioning to a low-carbon economy because it produces renewable energy--ethanol and electricity through bagasse-fired boilers--substituting the use of fossil fuels and significantly reducing GHG emissions. The sector benefits from the government program, Renovabio, in which the mills can issue CBIOS according to the amount of ethanol produced.

Rating Above The Sovereign

We limit our ratings on SMTO up to three notches above our sovereign rating on Brazil (BB-/Stable/B) due to our assessment of the company's moderate sensitivity to country risk. We also limit it to one notch above Brazil's 'BB+' transfer and convertibility (T&C) assessment because of the company's export nature, which balances the risk of its asset concentration in the country. Therefore, we continue to test SMTO's ability to withstand a hypothetical default of Brazil. The company passes the test thanks to the large share of its revenue that comes from exports, very low exposure to short-term debt in foreign currency, and its sizable cash position. The strong export revenue due to depreciation of the Brazilian real in the hypothetical scenario offsets the effect of the weak sugar and ethanol prices, inflation's effect on costs, and the currency depreciation's effect on the short-term foreign currency debt.

We incorporated the following assumptions for the stress test:

- GDP decline of 10% in the next 12 months;

- Inflation at 15%, pressuring costs;
- Currency depreciation of 50%, doubling dollar-denominated debt and raising cash outflow for interest and short-term debt payments;
- Average sugar prices dropping to 10 cents per pound and affected by potential export duties, but prices in Brazilian reals benefiting from its depreciation;
- We don't adjust ethanol by international parity due to potential lower demand;
- Maintenance capex in stress scenario of R$1 billion; and
- No haircut to cash that the company holds outside Brazil, a 10% haircut in bank deposits in Brazil, and 70% haircut in the short-term investments in Brazil.

Issue Ratings--Subordination Risk Analysis

Capital structure

SMTO’s debt consists of BNDES loans (about R$900 million), IFC loans (about 800 million), agribusiness receivable certificates (CRAs; about R$1.7 billion), debentures (about R$1.6 billion), rural loans (about R$300 million) and PPEs (about R$600 million) as of March 31, 2022.

Analytical conclusions

We rate SMTO’s local senior unsecured debentures at the same level as the issuer credit rating because all of the company's debts are issued at the operating company level and only about 15% of its total debt is guaranteed by real assets.

Rating Component Scores

Foreign currency issuer credit rating	**BBB-/Stable/--**
Local currency issuer credit rating	**BBB-/Stable/--**
Business risk	**Satisfactory**
Country risk	Moderately High
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk	**Intermediate**
Cash flow/leverage	Intermediate
Anchor	**bbb-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bbb-**

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

Ratings Detail (as of July 08, 2022)*

Sao Martinho S.A.		
Issuer Credit Rating		BBB-/Stable/--
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA
Issuer Credit Ratings History		
23-Oct-2019		BBB-/Stable/--
24-Oct-2017		BB+/Positive/--
22-Dec-2011		BB+/Stable/--
16-Aug-2017	*Brazil National Scale*	brAAA/Stable/--
22-Dec-2011		brAA+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.