genial Equity Research

KLABIN

2Q23 Review: Whispers of Irony

LatAm Pulp & Paper

Main takeaways:

(i) Maintenance in Puma I brings down volumes for pulp; **(ii)** Gradual recovery of paper and packaging sales; **(iii)** Diversification in fluff brings resilience in realized prices; **(iv)** Kraftliner in large price retraction following the international trend; **(v)** Net revenue down -11.1% q/q, driven by the pulp unit; **(vi)** COGS/t exc. stop with a slight advance, still below guidance for 23E in a low double digit increase; **(vii)** maintenance strongly impacts COGS/t inc. stop; **(viii)** flat EBITDA in paper and packaging, with a drop in the pulp part; **(ix)** Profit stronger than expected, but still falling q/q. **(X)** Trading at an **EV/EBITDA 23E of 7.1x**, below its historical, we reinforce our **BUY rating**, with a **12M Target Price of R$26.50**, implying an **upside** of **+15.92%**.

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Company

KLBN11 BZ Equity
Buy

Price: R$ 22.86 (01-Aug-2023)
Target Price 12M: R$ 26.50

Klabin released its 2Q23 results today, August 1ST 2023. The numbers reported set the tone for a **weaker quarter**, with **maintenance stoppages** at Puma I limiting pulp volume, while the **paper and packaging segment sustained some level of revenue** in an attempt to **partially offset the declining EBITDA momentum (-30% q/q**), also driven by a COGS/t including maintenance stoppages higher than we expected.

Still, we believe there is a mismatch in how consensus prices the cost increase in the medium term, given the need for higher penetration of third-party wood to supply the MP28 ramp-up, and the effect on share prices. In our view, **Klabin's resilience due to a less cyclical exposure to paper** compared to non-integrated pulp producers, coupled with a deleveraging process due to the delivery of the Puma II project, should build a support to **partially mitigate the loss of profitability** in the coming quarters. To such an extent that reported **net income came +33% above our expectations** precisely because of a better-than-expected financial result, indicating signs of a financial expense at softer levels than our estimates.

2Q23 Review

Maintenance at Puma I brings down volumes for pulp. Delivering total sales at 334kt (+1.5% vs. Genial Est.), the scheduled maintenance at Puma I during the quarter reflected in a volume loss, regressing by -10.5% q/q and -21.2% y/y. Of the pulp grades shipped by the Company, hardwood was reported at 244kt (+4.3% vs. Genial Est.), down -10.0% q/q and -20.3% y/y, while softwood came in at 90kt (-11.8% q/q; -23.7% y/y), coming in -5.3% vs. Genial Est, below our projection.

Table 1. Net Revenue Klabin (2Q23 vs. Genial Est.)

(R$ Millions)	2Q23 Reported	2Q23E Genial Est.	% R/E	1Q23 Reported	% q/q	2Q22 Reported	% y/y
Net Revenue	**4.293**	**4.143**	**3,6%**	**4.831**	**-11,1%**	**5.039**	**-14,8%**
Paper	1.338	1.337	0,1%	1.374	-2,6%	1.575	-15,1%
Packaging	1.608	1.603	0,3%	1.571	2,4%	1.523	5,6%
Pulp	1.270	1.051	20,9%	1.711	-25,8%	1.797	-29,3%
Wood	38	31	23,1%	21	81,1%	54	-29,4%
Others	39	122	-68,1%	154	-74,7%	90	-56,7%

Soure: Klabin, Genial Investimentos

Gradual recovery in paper and packaging sales. Increasing sales in both units, the paper business unit reached a volume of 268kt in 2Q23 (+1.9% t/t; -17.0% y/y), in line with our estimates. The recovery seen in the consolidated can be explained by improvements in kraftliner, being reported at 98kt in the quarter (+3.7% vs. Genial Est.), up +7.7% q/q but still below historical values. We believe that Klabin is giving preference to integrate the product in its packaging chain and performing maintenance stops favoring future profitability. On the other hand, paperboard clocked in at 170kt (-3.1% vs. Genial Est.), down -1.2% q/q mainly due to price adjustments, despite rising +3.7% y/y.

In the same dynamics, total volume for packaging came in at 252kt (+1.8% vs. Genial Est.), up +3.3% q/q driven by higher sales of corrugated paper, the category that represents the largest percentage of sales, reaching 216kt (+5.4% q/q; -1.8% y/y), while industrial bags had a volume of 36kt (-10.4% vs. Genial Est.), reported at -7.7% q/q, negatively surprising us due to our expectation of better seasonality for cement, aiming a recovery for demand after the rainy season at the beginning of the year.

Diversification in fluff pulp brings resilience in realized prices. Although hardwood and softwood showed a strong price drop in international markets, some of Klabin's characteristics provided support for better-than-expected price realization, including the Company's exposure to **(i)** fluff pulp, and **(ii)** markets that concentrate pricing in Europe, which slowed down less than prices in China.

Despite a certain level of resilience, prices were not exempt from retreat in the quarter, with Klabin's realized price for hardwood fiber at ~US$640/t, or R$3,164/t (-21.9% q/q; -16.6% y/y), and softwood fiber at ~US$1100/t, or R$5.500/t (-8.4% q/q; +2.4% y/y), above our expectations due to the highlight that fluff prices had, remaining at high levels against the others; highlighting the benefits of the Company's diversified virgin fiber portfolio.

Kraftliner suffering from corrections in international markets. Penalized by the corrections in international prices, with the reference curve in Europe (FOEX) standing at US$785/t (vs. US$873/t in 1Q23), Klabin's realized price for Kraftliner reached R$3,950/t (-3.3% vs. Genial Est.), falling -11.9% q/q and -19.2% y/y. Also, sequentially, paperboard saw its prices go flat at R$5,600/t (-0.5% q/q; +15.1% y/y), even in the face of discounts that did not enter the previous quarter being effective in this one.

COGS/t ex. stop continues to surprise positively, but we remain pessimistic for the medium term. Contrary to management's own expectations for 2023 so far, COGS/t continues without the expected low double-digit increase commented by Klabin, which generates upside in relation to its costs in the short term. However, we maintain our pessimistic assumptions regarding the increase in costs in the medium term, explained in our last sector report, in the chapter on Klabin (Pulp & Paper: After all, are the theses growth or value?). Therefore, COGS/t excluding stoppage stood at R$1,363/t (-1.8% vs. Genial Est.), up +0.6% q/q and +7.1% y/y. The main reason for the lightweight upward movement comes from an increase in wood costs and worse dilution capacity, given a lower sales volume.

Maintenance strongly impacts COGS/t inc. stop. In addition to decreasing the dilution capacity in costs, the maintenance carried out in Puma I resulted in an additional cost of +R$542/t (+101% vs. Genial Est.), with 61% of this amount referring to the higher use of inputs and auxiliary material during the stoppage, and the remaining portion expenses associated with the resumption of the operation. Including the effect of stoppages on COGS/t, Klabin's costs reached R$1,905/t. Overall, costs at their nominal values stood at R$3.1bn (+14.6% vs. Genial Est.), up +9.3% q/q although down -6.5% y/y.

Pulp's EBITDA down by half, with paper and packaging remaining resilient. On a consolidated adjusted EBITDA of R$1.3bn (vs. -10.2% Genial Est.), we see a decline of -30.8% q/q and -32.5% y/y, feeling a heavier weight on cash cost with maintenance coming in higher than expected. Pulp unit showed a strong decline, clocking in at R$389mn (-58.8% q/q; -61.2% y/y), suffering both in price and volume, while the paper and packaging unit came in at R$956mn (-4.2% q/q; +13.8% y/y). In our view, the low sequential decline, coupled with a low double-digit y/y increase in packaging EBITDA demonstrate a low correlation with the international commodities market, and lower volatility of results, positive points that we see in Klabin's investment thesis.

Net Income in double-digit retraction, but better than expected. From a financial result clocked in at R$156mn vs. -R$40mn Genial Est., net income for the quarter stood at R$971mn (+33.1% vs. Genial Est.). However, despite coming in better than our estimates, the figure shows a drop of -23.1% q/q and -0.1% y/y. The stronger sequential reduction occurred, in our assessment, due to maintenance shutdowns impacting COGS/t in a more loaded way than expected, as well as the result more pressured by pulp dynamics (which makes up ~30% of revenues) and consumption slowdown hindering price realization in Kraftliner.

Table 2. Income Statement Klabin (2Q23 vs. Genial Est.)

(R$ Millions)	2Q23 Reported	2Q23E Genial Est.	% R/E	1Q23 Reported	% q/q	2Q22 Reported	% y/y
Net Revenue	**4.293**	**4.143**	**3,6%**	**4.831**	**-11,1%**	**5.039**	**-14,8%**
COGS	(3.123)	(2.726)	14,6%	(2.858)	9,3%	(3.341)	-6,5%
Adjusted EBITDA	**1.344**	**1.496**	**-10,2%**	**1.943**	-30,8%	**1.991**	**-32,5%**
EBITDA Margin (%)	31,3%	36,1%	-4,8p.p	40,2%	-8,91p.p	39,5%	-8,2p.p
EBIT	**1.128**	**894**	**26,2%**	**1.619**	**-30,3%**	**1.615**	**-30,1%**
EBIT Margin (%)	26,3%	21,6%	4,7p.p	33,5%	-7,23p.p	32,0%	-5,77p.p
D&A	(794)	(742)	7,0%	(711)	11,7%	(962)	-17,4%
Financial Result	156	(40)	-	58	167,7%	(303)	-
Net Income	**971**	**729**	**33,1%**	**1.263**	**-23,1%**	**972**	**-0,1%**
Net Margin (%)	22,6%	17,6%	5,01p.p	26,1%	-3,52p.p	19,3%	3,34p.p

Soure: Klabin, Genial Investimentos

Our Take on Klabin

In a mixed dynamic, Klabin brought shrinking results, but still shows a level of resilience that we find interesting. We positively highlight that the prices realized in the pulp unit did not follow entirety the sharp fall in the Chinese reference curve, given the stronger relationship with the European reference, which decelerates more slightly, while the diversification between the three types of fibers (hardwood, softwood, and fluff), brought greater resilience to the numbers, with a positive emphasis on the fluff's dynamics.

We see that one of the biggest detractors of results was the maintenance stoppage at Puma I, which resulted in an additional cost of +R$542/t (+101% vs. Genial Est.), well above our projections for increased stoppage inclusions, due to: **(i)** sales falling double digit, reducing dilution capacity per ton and **(ii)** higher use of inputs and auxiliary material during the stoppage.

Dividends announced, expectation is for progression. Reinforcing its footprint of remunerating shareholders' invested capital, the Company announced the distribution of R$269m in the form of dividends, equivalent to R$0.24 for the units. The payment corresponds to ~1% of its current market cap and will be made for the August 7th positions. We have a **23E Dividend Yield** expectation of **5.55%**, aligned with an **EPS** of **R$3.20** at the end of the year. It is worth mentioning that if we normalize EPS with the 2Q23 earnings level, we will find R$3.52, +10% vs. Genial Est, which leads us to consider a hypothesis that Klabin can exceed our dividend distribution expectations in 23E, although it is too soon to say .

The expansion of Dividend Yield in our model shows an interesting progression, reaching a ~2x increase in 4 years. Our assumptions for this expansion are linked to Klabin's deleveraging process, from the current **3.3x Net Debt/EBITDA 23E** to **2.2x 26E**, after the end of the investment cycle for the Puma II project, reinforcing our growth investment thesis, based on the gradual improvement of profitability, causing a dividend distribution higher than the current levels.

Even with q/q reduction, non-cyclical composition makes a difference. We believe that, despite the sequential slowdown in 2Q23, results in the coming quarters should remain more resilient than Pulp & Paper peers, with **(i)** paper and packaging units indicating a relative stabilization of results, expunging part of the cyclical character related to pulp price dynamics, added to **(ii)** the withdrawal of production shutdowns and increase in COGS/t that the scheduled maintenance for this quarter brought (which hit cash costs more intensely than the history of previous stoppages); with **(iii)** COGS/t excluding stoppages coming in lower than our estimates, indicating that the cost increase guidance for 2023 may not be necessary, and **(iv)** eventual ramp-up of MP28, which should further help dilute costs in 2H23 by increasing production volume.

Considering these setlist, we believe that there are sufficient reasons to be o**ptimistic about Klabin**, even in the face of a scenario of **accommodation by the consensus of worse cost pricing in the medium term**, linked to the **substantial increase in the average radius due to the penetration of third-party wood** (normalizing between 2026/2027), considering the 14-year cycle of pine and the low availability of wood near the MP28 geographic region.

Whispers of Irony. Undoubtedly, this will affect Klabin's result in some quarters ahead, and we believe that a portion of the market is already inflecting this dynamic in share prices. Despite being something that involves a more elastic time horizon, top line resilience by correlation with less cyclical products should help to hold some level of margin in this period, while we see non-integrated peers suffering more than Klabin with slowing results in pulp. Despite showing a q/q broad deceleration, probably the 2Q23 should have been worse if Klabin was not a verticalized company… Whispers of Irony. Trading at an **EV/EBITDA 23E of 7.1x**, below its historical, we reinforce our **BUY rating**, with a **12M Target Price of R$26.50**, implying an **upside** of **+15.92%**.

Appendix: Klabin

Figure 1. Klabin – Income Statement in R$ Millions (Genial Est. 2023-2028)

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**18.242**	**19.803**	**20.870**	**21.748**	**22.597**	**23.102**
(-) COGS	(11.889)	(14.312)	(15.239)	(15.045)	(14.602)	(14.154)
Gross Profit	**7.261**	**6.010**	**6.155**	**7.232**	**8.530**	**9.487**
(-) Expenses	(2.779)	(2.710)	(2.906)	(3.023)	(3.144)	(3.224)
Adjusted EBITDA	**6.527**	**5.781**	**5.662**	**6.574**	**7.710**	**8.552**
(-) D&A	(2.950)	(3.000)	(2.937)	(2.894)	(2.859)	(2.829)
EBIT	**4.483**	**3.299**	**3.249**	**4.209**	**5.386**	**6.263**
(+/-) Financial Result	(139)	(197)	(265)	(325)	(147)	(46)
(-) Taxes	(828)	(478)	(460)	(597)	(803)	(953)
Net income	**3.543**	**2.655**	**2.555**	**3.318**	**4.466**	**5.295**
Profitability						
Net margin (%)	19,42%	13,41%	12,24%	15,26%	19,76%	22,92%

Figure 2. Klabin– Cash Flow in R$ Millions (Genial Est. 2023-2028)

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**18.242**	**19.803**	**20.870**	**21.748**	**22.597**	**23.102**
(-) COGS	(11.889)	(14.312)	(15.239)	(15.045)	(14.602)	(14.154)
Adjusted EBITDA	**6.527**	**5.781**	**5.662**	**6.574**	**7.710**	**8.552**
EBIT	**4.483**	**3.299**	**3.249**	**4.209**	**5.386**	**6.263**
(-) Taxes	(828)	(478)	(460)	(597)	(803)	(953)
(+) D&A	2.950	3.000	2.937	2.894	2.859	2.829
(+/-) Δ WK	(243)	(273)	(140)	(72)	(79)	(42)
(-) Capex	(5.239)	(3.103)	(2.847)	(2.876)	(2.904)	(2.912)
FCFF	**1.122**	**2.446**	**2.740**	**3.559**	**4.458**	**5.185**

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Neutral	Expected return between +10% and -10% relative to the Company's industry average	**44%**
Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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