genial Equity Research

KLABIN

3Q23 Preview: Volume should recover, and tomorrow it's going to be the price turn

LatAm Pulp & Paper

Main takeaways:

(i) We believe that Kraft liner may partially recover sales, up to 106kt Genial Est (+8,5% q/q), despite the fact that the price environment continues to deteriorate, down to R$3.700/t Genial Est. (-6,0% q/q); **(ii)** Paperboard should see a slight drop in volume (-2,2% q/q); **(iii)** Corrugated boxes will probably be driven by seasonality, project to 229kt Genial Est (+5,8% q/q); **(iv)** Industrial bag production running at full capacity; **(v)** Pulp volume may be higher than normal, up more than +20% q/q for both BHKP and BSKP; **(vi)** Realized pulp prices should still fall q/q, although there is a prospect of improvement going forward; **(vii)** We project revenue to expand slightly, +4,5% q/q; **(viii)** We expect COGS/t ex. stoppages rising gently q/q, but flat y/y **(ix)** COGS/t inc. stoppages should fall more sharply q/q; **(x)** We believe that pulp EBITDA will recover by +26.6% q/q, driven by the volume's normalization after maintenance at Puma I, but falling -59% y/y, due to weak price dynamics. Paper and packaging EBITDA should be boosted by the entry into the seasonal period for paperboard and packaging, driving volume, but once again pricing is still below inflation/GDP, mostly for Kraft liner, preventing further gains on a sequential basis (-7.6% q/q). On a consolidated basis, we expect EBITDA of R$1.4bn Genial Est. (+2.3% q/q; -40.5% y/y); **(xi)** High probability of net profit in double-digit retraction.; **(xii)** Trading with a **24E EV/EBITDA** of **6.7x** (vs. a historical average of 7.0x), we reiterate our **BUY rating**, with a **12M Target Price** of **R$26.50**, which implies an **upside** of **+17.36%**.

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Company

KLBN11 BZ Equity
Buy

Price: R$ 22.58 (20-Oct-2023)
Target Price 12M: R$ 26.50

Klabin will release its 3Q23 results on October 25, before the market opens. Our estimate is for a **stable consolidated result**. Looking at the units separately, we believe that the **paper and packaging segments** should take the lead in the face of **expectations for higher volumes**, with an **upward trend q/q**. As for the **pulp segment**, we expect the figures to still demonstrate the **fragility of the commodity pricing system**, and Klabin to continue to lose realized price, in a **downward trend y/y**. Recovery in volume due to the return of Puma I, adding to pulp production, should boost the business division's EBITDA q/q.

Table 1. Shipments Summary (3Q23 Genial Est.)

(Thousand Ton - Kt)	Genial Est.				
Summary (Shipments)	**3Q23E**	**2Q23**	**% q/q**	**3Q22**	**% y/y**
Kraftliner	106,1	97,8	**8,5%**	141,3	**-24,9%**
Cardboard	166,2	170,0	**-2,2%**	182,5	**-8,9%**
Corrugated boxes	228,8	216,2	**5,8%**	237,0	**-3,5%**
Sack kraft	36,3	36,0	**0,8%**	39,5	**-8,1%**
BHKP Pulp	294,3	244,1	**20,6%**	295,2	**-0,3%**
BSKP + Fluff Pulp	116,3	90,3	**28,8%**	116,0	**0,2%**

Soure: Genial Investimentos, Klabin

Table 2. Income Statement Summary (3Q23 Genial Est.)

(R$ millions)	Genial Est.				
Income Statement	**3Q23E**	**2Q23**	**% q/q**	**3Q22**	**% y/y**
Net Revenue	4.485	4.293	**4,5%**	5.488	**-18,3%**
Adjusted EBITDA	1.375	1.344	**2,3%**	2.311	**-40,5%**
Net Income	802	971	**-17,4%**	2.053	**-60,9%**

Soure: Genial Investimentos, Klabin

Valuation and rating. Although the pace of COGS increases in 2023 it is still being less elastic than initially expected by the company itself, our take is that Klabin's costs will in fact tend to increase significantly in 2024 and 2025, due to the greater use of third-party wood driving up the average radius. This is because the pine cycle is 14 years, and there is not enough forested area near MP28 to feed production. This upscaled cash COGS could put pressure on EBITDA for the next couple of years (2024 and 2025).

However, we expect to be a slight offsetting effect between the increase in revenue and the rise in costs in 2024, caused by better pricing for both paper (with the increase in the volume of paperboard within the consolidated realized price) and pulp (given the new transfers to China). We believe that the **consensus was seeing a scenario with no offsetting effect in the medium term**, which pushed the market valuation down, creating a gap in how we valued Klabin and how the market was pricing the company. Although lower than last quarter, we are still seeing this asymmetry, and with a **24E EV/EBITDA** of **6.7x** (vs. a historical average of 7.0x), we reiterate our **BUY rating**, with a **12M Target Price** of **R$26.50**, which implies an **upside** of **+17.36%**.

Straight to the point…

Paper and packaging segment enters stronger seasonal period. Although we not yet witnessed good perspective for the paper segment in 3Q23, due to the inflationary process deteriorating consumer appetite, we still believe in a sequential improvement, due to the entry of the segment's best seasonal period. 2Hs are usually better than 1Hs in terms of volume, so we have positive expectations for the short term for paperboard and packaging. However, weak kraft liner dynamics should prevent the quarter from better sequential figures. As a result, we have arrived at an EBITDA projection for paper and packaging of R$883mn Genial Est. (-7.6% q/q; -20.0% y/y).

Pulp segment still hampered by price, but with considerable volume gains. Similarly, pulp is also suffering from a challenging environment, but without any kind of seasonality that could interfere in favor of a better result, we believe that Klabin will suffer strong negative impacts in 3Q23 on a y/y basis. Even if this is the case, the outlook is a little better from 4Q23 onwards, mainly due to the successive prices pass-through being made by market pulp major players', helping in the ongoing process of re-establishing a healthier level.

Looking at the sequential basis, the result for pulp tends to improve due to the full return of Puma I to production, which was stopped for maintenance and connection to MP28 last quarter, drastically affecting pulp shipments. So, considering that we expect a cleaner quarter in this sense, with the maintenance stoppage at Monte Alegre being of much smaller proportions, the volume of pulp should re-establish itself within the normal range and boost the result on a quarterly basis. However, pulp conditions still remained quite challenging during 3Q23 in terms of price dynamics. We therefore project an EBITDA for pulp of R$492mn Genial Est. (+26.6% q/q; -59.3% y/y).

In detail!

We believe that Kraftliner can partially recover sales, despite the continued deteriorating price environment. With US exports increasing, representing a driver for international demand, we expect the volume to recover in the sequential context, to 106kt Genial Est (+8.5% q/q; -24.9% y/y). But this will probably be offset by a lower realized price, reaching R$3,700/t Genial Est (-6.0% q/q; -23.5% y/y).

Paperboard should see a slight drop in volume due to maintenance at Monte Alegre. Considering the maintenance at the Monte Alegre (PR) plant, which we estimate should last 12 days of scheduled downtime, we expect a slight drop in paperboard volume, reaching 166kt Genial Est. (-2.2% q/q; -8.9% y/y). In addition, after price adjustments, which are routine during Q1 and Q2, there are unlikely to be any new pricing pass-through now, so we maintain our expectation of flat prices q/q at R$5,600/t Genial Est.

Corrugated paper probably being driven by seasonality. As we believe that volumes will increase sequentially, but not enough to escape the downtrend y/y, corrugated paper should be reported with a total volume of 229kt Genial Est (+5.8% q/q; -3.5% y/y). Despite being continually readjusted for inflation/GDP, we expect price pass-throughs in the quarter to be lower, potentially opening up some level of gap in the short term, with values stable at R$5,900/t Genial Est (+0.1% q/q; +3.1% y/y).

Industrial bag production running at full capacity. We expect the volume of industrial bags to come in without major news, being in our model with a sales volume of 36kt Genial Est. (flat vs. 2Q23), stable in the face of an operation that was already using maximum production capacity.

Pulp volume may be higher than normal, following the maintenance stoppage last quarter. Klabin usually brings in shipments of around ~400kt per quarter, given its installed capacity of 1.6Mtpa, distributed between hardwood (BHKP) and softwood (BSKP). After the stoppage of Puma I during 2Q23, which lowered total volume to 334kt last quarter, we expect an increase in 3Q23 to 411kt Genial Est. (+22.7% q/q; -0.2% y/y). Therefore, BHKP is projected at 294kt Genial Est. (+20.5% q/q; -0.3% y/y), with BSKP and Fluff at 116kt Genial Est. (+28.7% q/q; +0.2% y/y).

Realized pulp prices are still expected to fall q/q, although there is hope for a better future. With the price adjustments made to the market curves still not significantly affecting 3Q23, we expect a drop in the realized price for both of Klabin's fibers. We expect softwood (BSKP) to have a realized price of US$1,041/t Genial Est. (-8.1% q/q; -11.4% y/y), and hardwood (BHKP) at US$546/t Genial Est. (-16.0% q/q; -34.2% y/y).

Looking ahead, our take is that, given the adjustments made practically month after month by the biggest market pulp players (including Suzano), Klabin will ride the wave of the commodity curve appreciation movement, leading to an increase in the realized price, considering that customers will be more willing to accept them. In fact, new adjustments were recently announced by Suzano, accompanied by the market at +US$50/t BHKP China and +US$80/t BHKP Europe and North America, arriving at a market price close to ~US$630/t in China (vs. a bottom of ~US$480/t previously), in the event of full acceptance by clients.

Table 3. Net Revenue Klabin (3Q23 Genial Est.)

(R$ Millions)	3Q23E Genial Est.	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**4.485**	**4.293**	**4,5%**	**5.488**	**-18,3%**
Paper	1.326	1.338	-0,9%	1.679	-21,0%
Packaging	1.687	1.608	4,9%	1.674	0,8%
Pulp	1.393	1.270	9,7%	2.016	-30,9%
Wood	25	38	-32,8%	50	-49,3%
Others	54	39	38,4%	69	-21,7%

Soure: Genial Investimentos, Klabin

We project revenue to expand slightly q/q. We believe that the seasonal upward movement in packaging volumes will be enough to create a slight revenue gain on a sequential basis, offsetting the still weak price dynamics. As a result, we are projecting revenues of R$1.3bn Genial Est. (-0.9% q/q; -21% y/y) for paper and R$1.7bn Genial Est. (+4.9% q/q; +0.8% y/y) for packaging, with an improvement in packaging due to the start of the seasonal year-end holiday period, where products and filling are carried out in the 3Qs to reach distribution and retail in the last quarter of the year (4Qs).

For pulp, the revenue formation this time is similar to that of packaging, in the sense that the rising volume will be more than enough to offset the falling price sequentially. But main difference has to do with the reason of why this should happen. While for packaging, the driver is the entry of a more favorable seasonal period, for pulp it would be the return to production at Puma I, as we described. In 2Q23, Puma I was down for a period for scheduled maintenance. With the end of maintenance and the return of production activities, volume should rise considerably.

Therefore, despite the drop in pulp prices, both sequentially and y/y, the re-establishment of full capacity vs. the -36Kt that were removed from capacity last quarter, should boost pulp revenues to R$1.3bn Genial Est. (+9.7% q/q; -30.9% y/y). On a consolidated basis, our model points to revenues of R$4.5bn Genial Est. (+4.5% q/q; -18.3% y/y)

We expect COGS/t ex. stoppage to rise gently q/q, but flat y/y. After a 10% y/y increase in COGS/t during 1H23, Klabin is likely to raise the cost slightly in 2H23, considering the company's own expectations for 2023 of a low double digit annual increase, until then.

Even so, after the most recent conversations we've had with Klabin, we expect the low double digit increase to be lower, closing 2023 with a high single digit instead (+7.5% y/y Genial Est.). We had already suspected that this might happen and had been anticipating this information since last quarter, when the company had been surprising us with a relatively good performance in relation to cash COGS excluding stoppages. Therefore, for 3Q23 we projected a COGS/t of R$1,415/t Genial Est. (+4.0% q/q; -0.1% y/y).

Our optimism for a lower cost than initially forecast by the company is mainly linked to **(i)** better dynamics for chemical inputs, which represent ~18% of the COGS structure, and is the second largest cost line, behind wood. In addition, we also see a **(ii)** downward trajectory in spending on recycled paper chips, reflecting 12 consecutive months of falling chip prices, and **(iii)** freight, which during the months of April each year the company carries out a price survey for containers, closing contracts until the following year. Considering that this April's prices were much cheaper than Klabin initially expected, this factor also helped the company to perform better than the initial low double digit.

However, we maintain our pessimistic assumptions regarding the increase in costs in the medium term, explained by the increase in the penetration of third-party wood purchases for the MP28 ramp-up at the Puma II project, with a stronger degree of increase until 2026, when the cost of wood at COGS will begin to decelerate. In addition, we believe that in 4Q23, costs will rise again, due to diesel oil being pressured by the increase in the value of a barrel of Brent crude oil, related to the war in the Middle East. Klabin does not hedge its fuel prices.

COGS/t inc. stoppages, on the other hand, should fall more sharply q/q this quarter. Bearing in mind that the stoppage scheduled for this quarter at Monte Alegre (PR) affects production capacity much less than the one that took place at Puma I (PR) last quarter, not only because of the complexity of the maintenance itself, but also because of the length that the last stoppage ended up taking, since MP28 in the project with Puma II was connected on that occasion. So 2Q23 in fact had a cost including stoppages that was higher than the historical average. As for Monte Alegre now in 3Q23, we expect the maintenance stoppage to have lasted 12 days, with the plant already operating normally nowadays. Therefore, we project a COGS including stoppages of R$1,523/t Genial Est. (-20.0% q/q; +7.5% y/y). Overall, nominal costs are projected in our model at R$3.2b Genial Est. (+2.7% q/q; +1.2% y/y).

We believe pulp EBITDA to be down -54% y/y but recovering q/q, with paper and packaging q/q trend less favorable. We expect that the results in the packaging segment should not be enough to compensate for the still weak price dynamics in the paper division. On a sequential basis, the result tends to be a little worse, even considering the entry into the seasonally more favorable period, the dynamics of prices and kraft liner still get in the way. As a result, we have arrived at an EBITDA projection for paper and packaging of R$883mn Genial Est. (-7.6% q/q; -20% y/y).

As for pulp, the situation remains complicated. Although there we also expect an increase in volume due to the return of Puma I to full production, this probably won't be enough to compensate for the price drop we've seen for the commodity on an annual basis, followed by a wood cost that is still exerting pressure. Obviously, the volume improvement will help the sequential basis to come in stronger in 3Q23, but investors must remember that this is just a normalization of production. Pulp conditions still remain challenging in the short term. We therefore project an EBITDA for pulp of R$492mn Genial Est. (+42.8% q/q; -54.0% y/y).

Consolidating, we expect an adjusted EBITDA of R$1.4bn Genial Est. (+2.3% q/q; -40.5% y/y), feeling a relief in cash COGS sequentially with maintenance at Monte Alegre generating much less cost than the stoppage of Puma I, which occurred last quarter, in addition to an improvement in pulp volumes due to the return of production capacity and the entry of the most favorable period of the year in relation to seasonality for packaging.

Table 4. EBITDA Klabin (3Q23 Genial Est.)

(R$ Millions)	3Q23E Genial Est.	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Adjusted EBITDA	**1.375**	**1.344**	**2,3%**	**2.311**	**-40,5%**
Paper & Packaging	883	956	-7,6%	1.103	-20,0%
Pulp	492	389	26,6%	1.208	-59,3%

Soure: Genial Investimentos, Klabin

High probability of net profit in double-digit decline. The fortunes are likely to repeat themselves once again, and we believe that Klabin will report falling double digit net income on both a quarterly and annual basis. The short-term fundamentals for pulp still hurt the company's figures, due not only to the commodity price dynamics, but also to the rising cost of wood. Although pulp has a smaller weight in the company's EBITDA, paper pricing isn't helping either. The only segment that should see a bigger gain in the quarter will be packaging.

Even so, considering that we believe in a reduction in the variation of biological assets (R$383mn Genial Est. vs. R$573mn 2Q23), a figure which does not appear in the composition of adjusted EBITDA, our projection indicates a loss of profit q/q despite EBITDA remaining with slight gains. We are projecting a net income of R$802mn Genial Est. (-17.4% q/q; -60.9% y/y).

Table 5. Income Statement (3Q23 Genial Est.)

(R$ millions)	3Q23E Genial Est.	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**4.485**	**4.293**	**4,5%**	**5.488**	**-18,3%**
COGS	(3.210)	(3.124)	2,8%	(3.169)	1,3%
Adjusted EBITDA	**1.375**	**1.344**	**2,3%**	**2.311**	**-40,5%**
EBITDA Margin (%)	30,7%	31,3%	-0,65p.p	42,1%	-11,45p.p
EBIT	**990**	**1.125**	**-12,0%**	**2.474**	**-60,0%**
EBIT Margin (%)	22,1%	26,2%	-4,13p.p	45,1%	-23,01p.p
D&A	(762)	(794)	-4,0%	(792)	-3,8%
Financial Result	65	156	-58,3%	319	-79,6%
Net Income	**802**	**971**	**-17,4%**	**2.053**	**-60,9%**
Net Margin (%)	17,9%	22,6%	-4,74p.p	37,4%	-19,53p.p

Soure: Genial Investimentos, Klabin

Our Take on Klabin

We believe that Klabin's performance will show a slight upward trend in adjusted EBITDA on a sequential basis, driven mainly by the entry into the seasonal period for packaging, with the 3Qs representing the time when the paper industry sells more to the food and packaging industries, in the face of a stronger sales period for these respective industries, pre end of the year festivities.

Added to this factor, we see a recovery in the volume of pulp sales, following the scheduled maintenance last quarter at Puma I, which removed a large part of the commodity's production capacity and drastically affected the company's sales. We therefore expect 3Q23 to be a quarter of improvement in pulp EBTIDA, boosted sequentially by the normalization of volume, even though the pricing dynamics of market pulp remained weak in the quarter.

Pulp: Volume rose in 3Q23 and for 4Q23, we expect prices to improve. On this point, we believe that 4Q23 should also see an improvement. While in 3Q23 the improvement will be due to the recovery in volumes, due to the return of Puma I to full production, in 4Q23 it should be due to the recovery in prices, given that many strong players of market pulp (including Suzano) have passed on the prices of the commodity and Klabin should take a ride on this movement.

In addition, the partial resistance of the company's pulp unit prices deserves recognition, considering that ended up not giving in as much to the general fall in the Chinese benchmark curve due to its stronger ties with the European benchmark, which until last quarter was more stable.

Looking at 4Q23, Klabin's order backlog for pulp is full, both for China and Europe, with September ending up with a better shipment performance than July and August. Considering the US$50/t increase for China, prices between China and Europe would start to become similar, if the pass-through is fully accepted. We believe that this will be the case, since previous prices in China were running very close to the breakeven line for most producers, so that pass-throughs would be the most likely way forward, without major difficulties in acceptance by clients.

In addition to the US$50/t move, there was a more recent US$30/t adjustment to China. If the latter is fully accepted, the spread between Europe and China seen in 2Q23 will reverse. As a result, we expect Klabin to start redirecting more volume to China and less to Europe, entering into a different ordering strategy than what had been done until now. This is important in Klabin's case, as the company has signed 1-to-2-year volume contracts (not price contracts) with Europe, so our analysis is that sales to Europe should remain stable and shipments to China should start to increase, which should rise the company's total pulp volume.

Paper: We expect that the MP28 ramp-up will also help to improve results. In the last conversations we had with the company, Klabin commented that it already has a good part of the MP28 volume contracted within the order backlog. We believe that 70% of the volume with the ramp-up is already being signed with its own pricing dynamics, with a smaller part (~30%) being sold on spot prices.

Throughout 2H23, Klabin is expected to sell 175Kt of MP28, with 20% of this volume going to paperboard and 80% to Kraft liner. So, although it has a better margin due to more favorable price dynamics than Kraft liner, we should see a very marginal volume of the machine destined for paperboard sales in 3Q23. However, in 2024, with the ramp-up being more effective, Klabin should boost sales of paperboard, which has a more resilient demand and more stable prices. The company usually works with closed contracts for this type of paper, taking advantage of our investment thesis in the company, given the less cyclical behavior of prices.

This will also help to improve the realized price in the paper segment, since the company will be able to direct more volume to paperboard and reduce its initial exposure to Kraft liner.

Volume should recover, and tomorrow it's going to be the price turn. As we have described, both segments (pulp and paper) have more positive trends for the coming quarters. We believe that 3Q23 still points to some short-term challenges, but better days are to come. We are optimistic about the effect of MP28 on the company's top line, and the reduction in CAPEX due to the completion of the investment cycle in Puma II, which may leave more room in the cash flow to distribute more dividends.

However, costs are an imminent problem. Even so, Klabin will face a considerable cost upward movement due to the increased penetration of third-party wood for the production of MP28, which should elevate the average radius. Considering that the pine cycle is 14 years, our estimate is that the use of third-party will increase until 2026, when it should reach 76% of the total (vs. 31% in 2022). Given this, we expect wood-related costs to rise significantly until the turning point of 2027.

So, our expectation is that, at least in the medium term (2024 and 2025), there could be greater pressure on EBITDA due to costs. It's still too early to say whether the better price compositions will offset the increase in costs and create a spare positive effect. This will depend on the reaction to pulp price movements, especially in China, and the level of contractual price conditions for paperboard, resulting from the MP28 ramp-up. We are currently projecting a +2.8% y/y increase in EBITDA for 2024, i.e. a slight offset between the increase in revenue due to better pricing and the increase in costs due to the greater average radius distance.

Considering this, we still believe that there is **price asymmetry, unlocked by how the consensus sees the increase in costs and vs. our projections**. Trading at a **24E EV/EBITDA** of **6.7x** (vs. a historical average of 7.0x), we reiterate our **BUY rating**, with a **12M Target Price of R$26.50**, which implies an **upside** of **+17.36%**.

Appendix: Klabin

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**18.435**	**19.629**	**20.522**	**21.281**	**21.849**	**22.277**
(-) COGS	(12.592)	(15.239)	(16.684)	(16.817)	(16.220)	(15.793)
Gross Profit	**7.189**	**4.951**	**4.405**	**5.037**	**6.207**	**7.068**
(-) Expenses	(2.810)	(2.922)	(3.087)	(3.204)	(3.295)	(3.368)
Adjusted EBITDA	**6.498**	**6.678**	**6.221**	**7.038**	**8.068**	**8.833**
(-) D&A	(3.042)	(3.105)	(3.065)	(3.042)	(3.025)	(3.013)
EBIT	**4.797**	**4.134**	**3.723**	**4.569**	**5.621**	**6.405**
(+/-) Financial Result	201	(345)	(419)	(408)	(449)	(526)
(-) Taxes	(1.232)	(929)	(811)	(1.020)	(1.267)	(1.439)
Net income	**3.788**	**2.884**	**2.517**	**3.165**	**3.930**	**4.464**
Profitability						
Net margin (%)	20,55%	14,69%	12,27%	14,87%	17,99%	20,04%

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

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**18.435**	**19.629**	**20.522**	**21.281**	**21.849**	**22.277**
(-) COGS	(12.592)	(15.239)	(16.684)	(16.817)	(16.220)	(15.793)
Adjusted EBITDA	**6.498**	**6.678**	**6.221**	**7.038**	**8.068**	**8.833**
EBIT	**4.797**	**4.134**	**3.723**	**4.569**	**5.621**	**6.405**
(-) Taxes	(1.232)	(929)	(811)	(1.020)	(1.267)	(1.439)
(+) D&A	3.042	3.105	3.065	3.042	3.025	3.013
(+/-) Δ WK	(180)	(237)	(120)	(83)	(41)	(44)
(-) Capex	(5.351)	(3.408)	(3.155)	(3.187)	(3.218)	(3.230)
FCFF	**1.076**	**2.665**	**2.702**	**3.321**	**4.121**	**4.705**

Disclosure Section

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Genial Rating

	Definition	Coverage
Buy	Expected return above +10% in relation to the Company's sector average	49%
Neutral	Expected return between +10% and -10% relative to the Company's industry average	41%
Sell	Expected return below -10% in relation to the Company's sector average	5%
under Review	Under review	5%

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