

# SUZANO

## 3Q23 Preview: A bird in the hand is worth two in the bush.

LatAm Pulp & Paper

(i) Following the reduction in production in an attempt to improve profitability in 2023, shipment volumes should decrease; (ii) We expect weak price realization for pulp, adjustments should only start to take effect in 4Q23; (iii) Paper unit recovering volume with stronger commercial strategy in 2H23; (iv) Revenue once again in compression; (v) Better cost dynamics helping to partially cool down the impact of a weaker revenue; (vi) We project a shrinking EBITDA; (vii) We are assuming that currency hedge will not play in favor of the bottom line either; (viii) We expect a reversal of the R\$5bn profit into a -R\$280mn Genial Est. loss; (ix) Trading at an **EV/EBITDA 24E** of **6.1x**, although still below the historical average of 8.7x, we have revised our rating, **downgrading the company to NEUTRAL**, given **the same 12M Target Price of R\$60.00** that we already had in our model. That leaves the shares with an **upside of +13.90%**.

Suzano will release its 3Q23 results on 26<sup>th</sup> of October, after the market closes. In general, **we expect weaker figures**, with a **volume loss** and **realized price retraction** in pulp segment, while the financial cost of the currency hedge mechanism will also bring a negative effect, given the appreciation of the USD/BRL exchange rate, unlike what happened last quarter.

Given our expectation of a weaker result in 3Q23, we believe that the short-term bias commonly linked to commodity company shares will speak louder, and the investors will tend to react negatively to the results, even with the potential improvements we see for 4Q23 and 2024.

**Table 1. Income Statement (3Q23 Genial Est.)**

(R\$ millions)	Genial Est.				
Income Statement	3Q23E	2Q23	% q/q	3Q22	% y/y
Net Revenue	8.233	9.160	-10,1%	14.143	-41,8%
Adjusted EBITDA	3.398	3.919	-13,3%	8.596	-60,5%
Net Income	(280)	5.078	-	5.448	-

Source: Suzano, Genial Investimentos

**Table 2. Shipments Summary (3Q23 Genial Est.)**

(Thousand Tonnes - kt)	Genial Est.				
Summary (Shipment)	3Q23E	2Q23	% q/q	3Q22	% y/y
BHKP Pulp	2.315	2.513	-7,9%	2.797	-17,2%
Paper	324	294	10,1%	324	-0,1%

Source: Suzano, Genial Investimentos

**Valuation and rating.** Suzano's shares appreciated after the 2Q23 results, by something close to +15% up to date. We believe that there are two compositions of factors combined that allowed this: (i) Although the 2Q23 result showed deceleration, the numbers were still better than the consensus imagined at the time; and (ii) bullish conditions for the coming months, after successive price pass-throughs for pulp, both to China and to the US and Europe.

Given our expectation of a weaker result in 3Q23, we believe that the short-term bias commonly linked to commodity company shares will speak louder, and the investors will tend to react negatively to the results, even with the potential improvements we see for 4Q23 and 2024.

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### Company

#### SUZB3 BZ Equity

Neutral

Price: R\$ 52.68 (25-Oct-2023)

Target Price 12M: R\$ 60.00

#### SUZ US Equity

Target Price 12M: US\$ 12.60

In our model, we already estimated a price curve for market pulp rising in 2024. Even though **our new BHKP updated curve is projecting a slightly higher price gain, from US\$570/t to US\$630/t in 2024E we still prefer to keep Suzano's Target Price unchanged**, given the impoverished dynamics we expect for 3Q23, with a drop in revenue, EBITDA and the reversal of a bottom line's profit from the previous quarter into a loss in this one.

In this regard, we are leaving our **12M Target Price of R\$60.00 unchanged**. Given the recent rise in the stocks that we have seen over the past 3M, we don't see any room for this pace of appreciation to continue in the very short term. We are more optimistic about 2024, but we believe that the market's reaction to the 3Q23 results will be negative. Therefore, with no safety margin due to the upside having been extinguished in the recent rise, **we are downgrading Suzano to NEUTRAL rating**. Even if this is the case, **we don't rule out reviewing the company's rating next year**.

### Straight to the point...

**Rounds of price pass-throughs won't make much difference in 3Q23.** We believe that Suzano's 3Q23 will see a volume's deceleration after announcing in June that it would cut production by -4% in an attempt to increase profitability in 2023. Our take is that the strategy of reducing production to generate some level of supply restriction will help balance the conditions of volume vs. demand and tend to increase pulp market prices.

However, we anticipate that the planned adjustments will probably only have a greater effect in 4Q23. In spite of consecutive pass-throughs, we expect a delay due to the dynamics of groups of Suzano's contracts, before these adjustments are applied and integrated into the company's pricing structure. Consequently, we forecast a weak performance in the realized pulp price for 3Q23, potentially even experiencing a decline in sequential dynamics to US\$535/t Genial Est. (-6.5% q/q; -34.2% y/y).

Although Suzano has a low cash cost, its 1H23 results were below the company's track record, due to unfavorable price dynamics affecting top line levels. However, its strategy may pay off, as we see the company having a significant influence on changing pulp prices, influencing peers to follow suit, and increasing the likelihood of successive price increases being accepted by clients.

**The adjustments vs. the price curve.** Pass-throughs began in May, to take effect in June, with +US\$30/t to Asia, when the hardwood pulp curve (BHKP) was at ~US\$480/t, close to the lowest point since December 2020. Another adjustment was made in June, of +US\$30/t to Asia, taking effect in July. In August, Suzano continued with the movement, making another repricing of +US\$20/t to Asia, effective as of September. On this occasion, the company also began to adjust for Europe and the USA, by +US\$50/t.

As September drew to a close, Suzano didn't stop, making a further price pass-through of +US\$30/t for Asia and +US\$50/t for Europe and the USA, which would be passed on in October. Then, in October, another adjustment: +US\$50/t for Asia and +US\$80/t for Europe and the USA, which would reach clients in November.

To recap, there were in total 5 adjustments for Asia and 3 for Europe and the USA. If we take look at the pricing curve today, we will see BHKP China at ~US\$580/t, which means that Suzano pulled the movement of global peers to pressure the price pass-throughs and throw the commodity curve upwards. This is a confirmation of our thesis. The movement of partial supply restriction and prices hitting the breakeven level of other producers were factors that helped the readjustments to be accepted and be reflected in the pricing curve mark-up.

If the fifth adjustment is fully accepted, we estimate that BHKP China curve will go to US\$630/t between 4Q23 and the beginning of 2024, which would be an increase of +32% vs. the price curve at the lowest stage of this cycle, about ~5 months ago.

**Pulp sales volumes are also expected to be lower.** In other words, we project that the pulp shipments in 3Q23 will be 2.3Mt Genial Est. (-7.9% q/q; -17.2% y/y). This reduction is a consequence of the capacity cut carried out in June, along with the equivalent reduction in annual volume. In addition, the maintenance stoppage sections carried out on Line 1 – Mucuri (BA), and Line 1 and 2 - Três Lagoas (MS), which collectively have a capacity of ~3,800ktpa, should also eliminate capacity, consequently reducing sales volume.

**We expect EBITDA to fall by double digits.** Our projections indicate that Suzano will still face hurdles in 3Q23, and the reported figures are unlikely to improve, due to the reduction in pulp volumes and prices. We forecast total net revenue of R\$8.2bn Genial Est. (-10.1% q/q; -41.8% y/y).

Amid dwindling revenues, even if our estimate is a cooled down COGS/t, this would only marginally ease the impact on adjusted EBITDA. We believe that the adverse effects of lower volumes and depressed prices should have more weight in the composition of EBITDA than lower costs, resulting in a projection of R\$3.4bn Genial Est. (-13.3% q/q; -60.5% y/y).

**Reversal of profit into loss.** We project that, in contrast to the previous quarter, the positioning of the currency hedge through derivatives and dollars debt will lead to expenses of -R\$1.2bn Genial Est. (vs. +R\$5bn gain in 2Q23) in financial result. This is due to the increase in the USD/BRL exchange rate, which was not the case in the previous quarter.

With an operationally weaker result, according to our projections, we believe in a reversal of R\$5bn profit in the previous quarter into a loss of -R\$280mn Genial Est. in 3Q23.

## In detail!

**After reducing production in an attempt to improve profitability in 2023, the shipments' volume is expected to decrease.** Suzano announced in June a -4% cut in 2023 production vs. capacity, which represents around 400ktpa in our calculations. We believe that the reduction follows a plan to try to balance supply and demand for the commodity. Reducing production and restricting supply, in an attempt to push the price up.

We know that market pulp prices, especially those for hardwood (BHKP), have been very close to the breakeven line for several producers. As Suzano has one of the lowest cash costs of non-integrated players, there was still some room of margin, but the 1H23 results certainly didn't reflect the best days for the company compared to its profitability history.

We believe that the strategy will most likely work, considering that Suzano is a major player and has the power to affect the pulp market pricing, mainly through the herd effect, where other peers try to use the same strategy to move upwards the price curve. As a result, the price pass-throughs attempts should be accepted almost in their entirety by clients, but the effect of this on results should only start to be seen in 4Q23 and along 2024.

In other words, as the capacity reduction took place in June, we estimate that the volume of pulp shipments in 3Q23 will be 2.3Mt Genial Est. (-7.9% q/q; -17.2% y/y), in line with the effect of the annual volume reduction. In addition to the maintenance carried out on Line 1 - Mucuri; Line 1 - Três Lagoas and Line 2 - Três Lagoas (aggregated capacity of ~3,800ktpa) probably lead to reduced shipments in the quarter.

**We expect weak price realization for pulp, and adjustments should only begin to take effect in 4Q23.** Even with several price pass-throughs in a row, due to the pricing dynamics of Suzano's contracts, there should be a delay before these adjustments become effective and enter into the company's price formation. We therefore expect price realization to continue to be weak for 3Q23, even losing parity in the sequential movement, at US\$535/t Genial Est. (-6.5% q/q; -34.2% y/y).

**Paper unit recovering volume with stronger commercial strategy in 2H23.** As the strategy sought to avoid major corrections in paper prices, the company opted to restrict supply to the market during 1H23, precisely during the negative season for paper sales, in order to take better advantage of the positive phase in 2H23, forcing prices to rise. This strategy is similar to that used in pulp production.

There for, our estimate is for a sales volume of 324k Genial Est. (+10.1% q/q; -0.1% y/y). Despite the commercial strategy, we still expect prices to fall, maintaining the trend seen during the year, reaching R\$6,800/t Genial Est. vs. R\$7,000/t in 2Q23, with the foreign market suffering more than the domestic market.

We believe that without the strategy, the price situation would have been even worse. However, we must remember that restricting supply in order to raise prices seems to work better for pulp, in Suzano's case, than for paper, considering that Suzano has shipments' flow size to pull a trend in the BHKP China price, while for paper, this is not true, since Suzano's paper sales volume is not very relevant.

**Revenue once again in compression.** We believe that 3Q23 will still be challenging for Suzano, and the company should not be able to report more favorable numbers, with pulp volumes and prices falling. We expect net revenue of R\$6.0bn Genial Est. (-15.3% q/q; -49.5% y/y), while the paper division is reaching in our model R\$2.2bn Genial Est. (+7.6% q/q; -0.7% y/y), a slight improvement on a sequential basis due to the seasonally more favorable period. As a result, we expect consolidated revenues of R\$8.2bn Genial Est. (-10.1% q/q; -41.8% y/y).

**Table 3. Net Revenue Suzano (3Q23 Genial Est.)**

(R\$ millions)	3Q23E	2Q23	% q/q	3Q22	% y/y
	Genial Est.	Reported		Reported	
<b>Net Revenue</b>	<b>8.233</b>	<b>9.160</b>	<b>-10,1%</b>	<b>14.143</b>	<b>-41,8%</b>
Pulp	6.018	7.101	-15,3%	11.913	-49,5%
Paper	2.215	2.058	7,6%	2.230	-0,7%

Source: Suzano, Genial Investimentos

**Better cost dynamics helping to partially cool down the impact of weaker revenues.** With COGS/t at R\$874/t Genial Est. (-4.8% q/q; -1.0% y/y), we project cash COGS excluding stoppages to decline, mainly due to the fall in the price of caustic soda and the retraction in the value of a barrel of oil, leading to lower spending on oils and fuels, considering the due delay. This line will inevitably suffer an impact of appreciation considering the conflict in the Middle East driving up the barrel of oil.

In addition, if we consider COGS/t including stoppages, the figure should also show a downward trend, given the maintenance at newer plants such as Três Lagoas (MS), therefore requiring fewer days of stoppages and less capital employed. Projected at R\$38mn Genial Est., we arrive at a COGS including stoppages of R\$913/t (-9.2% q/q; +2.1% y/y).

**We project an EBITDA shrinking.** At this conjecture, a downtrend COGS probably will help to mitigate the effect of a weaker revenue on Adjusted EBITDA. We believe that the consequences of worse volumes and deteriorating prices are going to be minimized, but not enough. We still expect a low double-digit decline on a sequential basis, with Adjusted EBITDA reaching R\$3.4bn Genial Est. (-13.3% q/q; -60.5%). The pulp unit would be the main driver of this drop, reaching R\$2.5bn Genial Est. (-20.3% q/q; -66.8% y/y), while the paper business division should be boosted on a sequential basis by the entry of the seasonally more favorable period, reaching in our model R\$854mn Genial Est. (+17.2% q/q; -8.2% y/y).

**Table 4. Adjusted EBITDA Suzano (3Q23 Genial Est.)**

(R\$ millions)	3Q23E	2Q23	% q/q	3Q22	% y/y
	Genial Est.	Reported		Reported	
<b>Adjusted EBITDA</b>	<b>3.398</b>	<b>3.919</b>	<b>-13,3%</b>	<b>8.596</b>	<b>-60,5%</b>
Pulp	2.543	3.190	-20,3%	7.665	-66,8%
Paper	854	729	17,2%	931	-8,2%

Source: Suzano, Genial Investimentos

**We are assuming that currency hedge will not play in favor of the bottom line either.** In contrast to the last quarter, we are expecting currency hedge positions through derivatives and debt to bring a negative result of -R\$1.2bn Genial Est. (vs. +R\$5bn in 2Q23), as the USD/BRL exchange rate rose again, unlike last quarter. In addition to a still strong financial expense, adding to a financial result of -R\$1.9bn.

**Reversal of profit into loss.** With a more negative financial result and weaker EBITDA, we expect a loss of -R\$280mn in 3Q23 Genial Est. vs. a profit of R\$5.0bn in 2Q23.

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

(R\$ millions)	3Q23E Genial Est.	2Q23 Reported	% q/q	3Q22 Reported	% y/y
<b>Net Revenue</b>	<b>8.233</b>	<b>9.160</b>	<b>-10,1%</b>	<b>14.143</b>	<b>-41,8%</b>
COGS	(5.895)	(6.228)	-5,3%	(6.473)	-8,9%
<b>Adjusted EBITDA</b>	<b>3.398</b>	<b>3.919</b>	<b>-13,3%</b>	<b>8.596</b>	<b>-60,5%</b>
EBITDA Margin (%)	41,3%	42,8%	-1,52p.p	60,8%	-19,51p.p
<b>EBIT</b>	<b>1.465</b>	<b>3.069</b>	<b>-52,3%</b>	<b>6.947</b>	<b>-78,9%</b>
EBIT Margin (%)	17,8%	33,5%	-15,71p.p	49,1%	-31,33p.p
D&A	(1.933)	(1.846)	4,7%	(1.903)	1,6%
Financial Result	(1.924)	4.536	-	(1.528)	26,0%
<b>Net Income</b>	<b>(280)</b>	<b>5.078</b>	<b>-</b>	<b>5.448</b>	<b>-</b>
Net Margin (%)	-3,4%	55,4%	-58,83p.p	38,5%	-41,92p.p

Source: Suzano, Genial Investimentos

## Our Take on Suzano

We note the confirmation of the arrival of the lowest point of the curve for BHKP at ~US\$480/t, since after that, there have been continuous price rebounds that have brought the commodity curve close to ~US\$580/t today.

Although the resale price level in China is close to US\$620/t, from this point on, further increases could result in a reduction in demand, due to the trade-off between own production and consumption of market pulp by Chinese paper producers.

On the other hand, the supply-side situation continues, with major capacity addition projects starting up and ramping up in the short term, including the Cerrado Project itself (+2.55Mtpa), which is expected to be completed by June 24. Supply is still expected to outstrip demand for some time.

**A bird in the hand is better than two in the bush.** The dynamics seen in the price should be reflected in better figures for Suzano only in 4Q23 and especially throughout 2024. Although we point out a potential bearish outcome: Price pass-throughs for BHKP China may subsequent force downwards the demand, as China macro data are being release below what was expected at the beginning of 2023.

Also, our projections are consolidated in anemic figures for 3Q23, and there are still some uncertainties about the improvements to be translated from the price of the commodity curve to a breakthrough in Suzano's EBITDA. The truth is that, with the FED still being hawkish in its speeches, we expect further interest rate increases in the US, which would shape the continuity of the aversion to risk assets that we are witnessing in the global economy.

Against this backdrop, in conversations we have with institutional investors, we are noticing greater selectivity and a preference for investment theses with less risk asymmetry. Given the negative reaction we expect investors to have to the 3Q23 results, we believe it is too early to make more optimistic adjustments to our Target Price. We prefer to wait for a little more clarity on whether there will be resistance in the elasticity of demand in the face of so many price adjustments.

Trading at an **EV/EBITDA 24E** of **6.1x**, albeit still below the historical average of 8.7x, we have revised our rating, **downgrading the company to NEUTRAL**, given the same **12M Target Price of R\$60.00** that we already had in our model, leaving the shares with an **upside of +14.26%**.

## Appendix: Suzano

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

<b>Income Statement</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>	<b>2027E</b>	<b>2028E</b>
<b>Net Revenue</b>	<b>38.195</b>	<b>40.241</b>	<b>47.198</b>	<b>49.792</b>	<b>50.805</b>	<b>51.017</b>
(-) COGS	(24.208)	(26.411)	(29.309)	(29.481)	(29.308)	(29.431)
<b>Gross Profit</b>	<b>13.987</b>	<b>13.830</b>	<b>17.888</b>	<b>20.310</b>	<b>21.497</b>	<b>21.586</b>
(-) Expenses	(3.944)	(4.138)	(4.691)	(4.823)	(4.909)	(4.929)
<b>Adjusted EBITDA</b>	<b>18.784</b>	<b>18.702</b>	<b>22.500</b>	<b>24.706</b>	<b>25.646</b>	<b>25.562</b>
(-) D&A	(7.557)	(9.010)	(9.303)	(9.218)	(9.058)	(8.905)
<b>EBIT</b>	<b>11.227</b>	<b>9.692</b>	<b>13.197</b>	<b>15.488</b>	<b>16.588</b>	<b>16.657</b>
(+/-) Financial Result	2.600	(7.656)	(4.106)	(4.960)	(3.116)	(1.918)
(-) Taxes	(3.880)	(513)	(2.292)	(2.655)	(3.397)	(3.716)
<b>Net income</b>	<b>9.948</b>	<b>1.523</b>	<b>6.799</b>	<b>7.873</b>	<b>10.075</b>	<b>11.022</b>
<b>Profitability</b>						
Net margin (%)	26,04%	3,78%	14,41%	15,81%	19,83%	21,61%

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

<b>Cash Flow (FCFF)</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>	<b>2027E</b>	<b>2028E</b>
<b>Net Revenue</b>	<b>38.195</b>	<b>40.241</b>	<b>47.198</b>	<b>49.792</b>	<b>50.805</b>	<b>51.017</b>
(-) COGS	(24.208)	(26.411)	(29.309)	(29.481)	(29.308)	(29.431)
<b>Adjusted EBITDA</b>	<b>18.784</b>	<b>18.702</b>	<b>22.500</b>	<b>24.706</b>	<b>25.646</b>	<b>25.562</b>
<b>EBIT</b>	<b>11.227</b>	<b>9.692</b>	<b>13.197</b>	<b>15.488</b>	<b>16.588</b>	<b>16.657</b>
(-) Taxes	(3.880)	(513)	(2.292)	(2.655)	(3.397)	(3.716)
(+) D&A	7.557	9.010	9.303	9.218	9.058	8.905
(+/-) Δ WK	(298)	(793)	(815)	(189)	(61)	(19)
(-) Capex	(19.683)	(14.623)	(9.208)	(8.094)	(7.833)	(7.994)
<b>FCFF</b>	<b>(5.077)</b>	<b>2.773</b>	<b>10.184</b>	<b>13.768</b>	<b>14.355</b>	<b>13.832</b>

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	Definition	Coverage
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under Review	Under review	5%

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