SUZANO

3Q23 Review: The certainty of an uncertain result

LatAm Pulp & Paper

(i) Pulp sales down marginally, with volume adjustments for better profitability but offset by stronger Chinese demand; **(ii)** With commercial strategy focused on positive 2H seasonality, paper volume showed recovery; **(iii)** Hardwood realized price continues to shrink, despite better expectations for the coming quarters, given the continued price increases on the curve; **(iv)** Top line fell again, reaching -2.3% q/q and -36.7% y/y; **(v)** EBITDA suffered -5.7% q/q, pulled down by pulp while paper showed improvements; **(vi)** In a negative effect of the currency hedge, bottom line clocked in at -R$729mn, with a loss reversing the R$5bn profit of last quarter . **(vii) 12M Target Price reinforced at R$60.00** with a **NEUTRAL rating**, implying an **upside** of **+13.83%.**

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Company

SUZB3 BZ Equity
Neutral

Price: R$ 52.71 (26-Oct-2023)
Target Price 12M: R$ 60.00

SUZ US Equity
Target Price 12M: US$ 12.60

Suzano reported its 3Q23 results yesterday after the market closed. The figures released reflecting **a more challenging quarter for the company**, given that **pulp prices are still falling sharply**, with part of the production capacity being shut down to try to improve price dynamics going forward, as we quoted in our preview report, which is attached below (2Q23 Preview: A bird in the hand is worth two in the bush). **Some operating indicators came in slightly above our projections**, but we still reiterate a **troubled short-term bias** and some uncertainties, which we will mention throughout the report.

We expected a reversal of last quarter's net income of R$5bn into a loss in 3Q23, given the still anemic operating dynamics and the financial result loaded with expenses related to debt and currency hedging. **Although our projection already showed pessimism regarding the bottom line, the situation was worse**, with Suzano reporting a loss of -R$729mn (vs. -R$280mn Genial Est.). Despite this, **capacity adequacy pushed costs down**, mainly affecting inputs expenses. On a consolidated basis, we still have lower costs with stoppages, due to the maintenance of a plant with greater technology and with a more recent start-up.

Table 1. Income Statement Summary (3Q23 vs. Genial Est.)

(R$ millions)	Reported	Genial Est.					
Income Statement	**3Q23A**	**3Q23E**	**% Diff.**	**2Q23A**	**% q/q**	**3Q22A**	**% y/y**
Net Revenue	8.949	8.233	**8,7%**	9.160	**-2,3%**	14.143	**-36,7%**
Proforma EBITDA	3.695	3.398	**8,7%**	3.919	**-5,7%**	8.596	**-57,0%**
Net Income	(729)	(280)	**160,7%**	5.078	-	5.448	-

Source: Suzano, Genial Investimentos

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

(Thousand Tonnes - kt)	Reported	Genial Est.					
Summary	**3Q23A**	**3Q23E**	**% Diff.**	**2Q23A**	**% q/q**	**3Q22A**	**% y/y**
Pulp Shipments	2.486	2.315	**7,4%**	2.513	**-1,1%**	2.797	**-11,1%**
Paper Shipments	331	324	**2,2%**	294	**12,6%**	324	**2,1%**

Source: Suzano, Genial Investimentos

Valuation and rating. We believe in a challenging scenario for new price increases (in addition to the price pass-through that have already been made), since the most positive dynamic was seen on the supply side, with Suzano totaling shipments of 2.5Mt in 3Q23 (+7.4% vs. Genial Est.). Shipments being less affected than initially projected indicates a movement contrary to the -4% production cut announced by the company itself in June. The 400kt reduction in production would correspond to ~1% of global pulp supply.

Our assessment is that the capacity cut would cool costs, considering that the production that would have been cut would have been directed to capacities that required more spending. But beyond the COGS benefit, we believe that cutting capacity and, consequently, reducing shipments, would help create a feeling of less oversupply, by encouraging other market peers to do the same. With a less elastic supply, customers would be more likely to accept price pass-throughs.

Since this didn't happen, and the larger volumes were slightly above our expectations, we believe that the price pass-through scenario could be compromised. This dynamic is unstable, as prices continued to be weak in the quarter. In fact, the market curve for BHKP has been rising, so we are more optimistic about 4Q23 and 2024, as we described in the preview report**. However, the volatility in the face of uncertainties regarding price vs. oversupply, coupled with a loss 2.6x higher than our already pessimistic bottom line estimate**, makes us reticent about a margin of safety that could attract investors.

We should remember that our previous buy recommendation on the company was based on price asymmetry (the "Value Investing" thesis). **We no longer see this price asymmetry in the short term** precisely because investors have shaken off the bad mood of the last 3 months, and the shares have risen by ~15%. So, for us, the **upside is starting to become more restricted** without all the variables being completely clear. We prefer to wait, and reiterate our **NEUTRAL rating**, with **a 12M Target Price of R$60.00**, on an **upside of +13.83%.**

3Q23 Review

Despite capacity adjustments to prioritize profitability, drop in shipments was subtle. After the announcement in June, adjusting by -4% vs. normal working installed capacity (representing ~400ktpa), pulp sales came in at 2.5Mt in 3Q23 (+7.4% vs. Genial Est), marking a slight sequential drop of -1.1% q/q, and a slightly stronger one of -11.1% y/y. Our expectation was that the sequential drop would be stronger, in line with the capacity restriction imposed by Suzano. However, we were surprised by sales volumes being little affected by the cutback mentioned by the company.

One of the reasons we found that could explain this would be the hypothesis that Suzano was overstocked, which would have led to a decoupling of production and sales. In other words, the company actually reduced production, but shipments didn't feel this effect, using part of the stock created previously. However, it is very difficult to test this hypothesis given the scarcity of data released by the company. According to Suzano's justification, shipments remained resilient mainly due to a stronger resumption of orders in China.

Regardless of successive adjustments since June, prices still suffered. Pulp sales prices were realized by Suzano at US$ 544/t (+1.7% vs. Est. Genial), a drop of -4.7% t/t, but contrary to the BHKP commodity curve, which stood at US$ 530/t in 3Q23 vs. US$ 520/t in 2Q23, an increase of +1.9% t/t. We believe that price pass-throughs should start to be seen more intensely in Suzano's realization process from 4Q23 and throughout 2024, considering that the company operates with contracts that are ~1 month behind the spot market.

The outlook for the future is for the realized price to recover. As we commented above, and as we said in our preview report, with the price increases in pulp, with +US$ 50/t for October, and another round of +US$ 50/t for November (both for BHKP China), which will probably be fully accepted by customers, we arrive at a spot curve of ~US$ 630/t in 2024, implying a recovery in the realized price going forward.

Commercial strategy focused on 2H23 begins to bring positive effects to the paper segment. Suzano's commercial strategy to maximize its top line, by holding back part of the supply to the market during 1H23, managed to partially "stem" the need and search for price discounts for paper, given the situation of lower inventories on the part of non-integrated producers. As a result, we had a lower volume in 1H23, but it already started to grow in 3Q23 with a total of 331kt (+2.2% vs. Genial Est.), showing an improvement of +12.6% t/t in sales. As a result of this strategy, prices reversed their downward trend and reached R$7,085/t (+1.2% q/q; +0.5% y/y).

Revenue above expectations. On stronger volumes than initially projected in the pulp segment, consolidated revenue came in slightly better than we expected, coming in at R$8.9bn (+8.7% vs. Genial Est.). Even so, we reinforce a slight retraction on a sequential basis of -2.3% q/q and a stronger one on an annual basis, at -36.7% y/y. So even though the higher-than-expected volume helped somewhat to make up revenue, the result didn't escape a contraction, especially given the weak pricing dynamics realized for 3Q23.

COGS/t cooled by production cuts, in line with projections. By removing the productive part that was tied to a higher cash cost, we see a connection in the significant cost reduction in 3Q23, with COGS excluding stoppages reaching R$861/t (-1.5% vs. Genial Est.), basically in line with our estimates. In addition, Suzano benefited from lower downtime costs (R$74/t in 3Q23 vs. R$87/t in 2Q23), due to the maintenance of Três Lagoas (MS), a newer mill, as we were already projecting. So, COGS including stoppages came to R$935/t (-7.0% q/q; +4.6% y/y), also in line with our estimates.

EBITDA shrinking and a loss 2.6x higher than estimates. Reported Adjusted EBITDA of R$3.7bn (+8.7% vs. Genial Est.), down -5.7% q/q and -57.0% y/y. Among the aggregators, we see R$2.9bn for pulp and R$0.8bn for paper, given the business divisions with opposite dynamics. The paper segment, although not very representative, ended up performing better than pulp, in line with our sector preference stated in our preview report. Below the EBITDA line, the currency hedge made both via derivatives and dollarized debt, resulted in a loss of -R$2.7bn (vs. -R$2.0bn Genial Est.) with the appreciation of the USD/BRL exchange rate during the period.

Therefore, with the **(i)** retraction in the operating result, **(ii)** maintenance of the high gross debt bringing a still strong financial expense, and **(iii)** negative exchange rate hedge, the company had a loss of -R$729mn in the bottom line (+2.6x vs. Genial Est.). Despite some indicators being slightly above our projections up to the EBITDA line, this didn't translate into a better profit, on the contrary. The reported loss was more intense than we were expecting, consolidating for us a weak result, and justifying our short-term bias for the downgrade we made in the preview report.

Table 3. Income Statement Suzano (3Q23 vs. Genial Est.)

(R$ millions)	3Q23 Reported	3Q23E Genial Est.	% R/E	2Q23 Reported	% q/q	3Q22 Reported	% y/y
Net Revenue	**8.948**	**8.233**	**8,7%**	**9.160**	**-2,3%**	**14.143**	**-36,7%**
COGS	(6.104)	(5.895)	3,5%	(6.228)	-2,0%	(6.473)	-5,7%
Adjusted EBITDA	**3.694**	**3.398**	**8,7%**	**3.919**	**-5,7%**	**8.596**	**-57,0%**
EBITDA Margin (%)	41,3%	41,3%	0,01p.p	42,8%	-1,5p.p	60,8%	-19,49p.p
EBIT	**1.683**	**1.465**	**14,9%**	**3.069**	**-45,2%**	**6.947**	**-75,8%**
EBIT Margin (%)	18,8%	17,8%	1,02p.p	33,5%	-14,69p.p	49,1%	-30,31p.p
D&A	(1.939)	(1.933)	0,3%	(1.846)	5,0%	(1.903)	1,9%
Financial Result	(3.494)	(1.924)	81,6%	4.536	-	(1.528)	128,7%
Net Income	**(728)**	**(280)**	**160,3%**	**5.078**	**-**	**5.448**	**-**
Net Margin (%)	-8,1%	-3,4%	-4,74p.p	55,4%	-63,57p.p	38,5%	-46,66p.p

Source: Suzano, Genial Investimentos

Our take on Suzano

We witnessed the confirmation of the turning point in pulp, with the lowest point of the curve for hardwood (BHKP) at ~US$480/t in mid-May, which was followed by successive price increases that lifted the curve to ~US$580/t, with a high possibility of maintaining the trend to reach ~US$630/t in 2024. So, we don't deny the existence of better days for the company's performance in the coming quarters. However, we are still not very comfortable adjusting our Target Price to more optimistic assumptions than the one we are using now, considering that we already predicted an improvement for 2024 in our model, and until then, we were seeing a price/risk asymmetry due to the way Suzano's shares fell between the end of last year and the middle of this year. This asymmetry, however, diminished for us as the shares began to rise again after July and intensified their rise following the announcements of price increases.

Successive price increases could cause a drop in demand. At this point, we see it as likely that the price increases announced will be accepted in full (more on this in our preview report, which is attached). However, despite having this certainty for the round of rebates that has taken place so far, we believe it is important to highlight the risk of an inflection in the adherence to more rebates in 2024. Resale prices in China stand at ~US$660/t, and although they only represent a small volume, they usually indicate that there is an appetite for consumption at these price levels. From this point onwards, each price increase means lower marginal demand, due to the paper producer's trade-off between integrating production with their own pulp or buying from the market.

To make matters worse, the risk of oversupply has not gone away. We see production volumes growing over the next two years, due to the capacity increase projects underway, such as the Cerrado Project itself (+2.55Mtpa) scheduled for June/24, which incidentally reached 78% of physical progress and 68% of financial progress in the quarter. This should result in supply outstripping demand for some time, making further price increases difficult.

New projects, same CAPEX. Suzano announced three projects, of which we will provide more details. Among them is **(i)** the construction of a tissue and toilet paper converting plant in Aracruz (ES), with a capacity of 60ktpa, for a total investment of R$650mn and expected start-up in 2026. Seeking to reduce the project's CAPEX, the company will use ICMS credits amounting to ~R$130mn.

We like the initiative, since we see Suzano as not very diversified, and until then, it had been a point of criticism for us, because we thought it was too exposed to the dynamics of market pulp prices and ended up having a very low percentage of its revenue tied to paper sales. So, in addition to the purchase of Kimberly Clark Brasil, new initiatives in paper, especially tissue, are seen as positive by us.

Another project announced was **(ii)** a new biomass boiler to replace the current one, to come on stream in 4Q25 after an estimated CAPEX of R$520m. The last project announced was **(iii)** the production of fluff pulp from eucalyptus wood (Eucafluff), with a total capacity to be increased to 440ktpa in 2025, with an outlay of R$196m in 2024 and R$294mn the following year. It's important to note that all the projects mentioned were already in the scope of the expected **CAPEX** for the respective years, disclosed by Suzano itself previously and **already included in our model**.

The certainty of an uncertain result. We saw Suzano deliver a result up to the EBITDA line that was slightly above what we expected, with an increase in sales that was better than expectations for pulp, but which carries with it a questionable factor about the -4% production cut for 2023. If the overstocking hypothesis we raised is correct, it's also possible that 4Q23 will have to come with a bigger drop in sales to fall within the production cutback regime, which was announced in June by the company. If this happens, the factor that helped Suzano exceed our EBITDA projection in 3Q23 will be exhausted next quarter.

In addition, there was a very weak bottom line, with the reversal of R$5bn in net profit in 2Q23 to a loss of -R$729mn in 3Q23 (vs. -R$280mn Genial Est.), a performance 2.6x worse than our projection. We were previously pessimistic about the last line of the result, because our model pointed to **a significant loss in the quarter from the currency hedge operation**, which amounted to -R$2.7bn (vs. -R$2.0bn Genial Est.). In addition, leverage (which stood at **2.7x Net Debt/EBITDA** in BRL) ended up weighing on financial expenses. To top it off, we saw **a cash flow burn (FCFE) of -R$1.8bn in 3Q23** (vs. -R$2.1bn Genial Est.).

With the company burning this level of cash and a reversal from profit to loss of this magnitude, it is difficult for us to consider that the shares could continue to react well from now on in the short term, remembering that in the last 3 months the shares have already performed at an appreciation rate of over +10%. For us, the investment thesis in Suzano is linked to value investing, so we will only recommend buying when we see that there are price distortions with attractive margins of safety, which is what we were seeing until then. However, in view of some uncertainties and because **we assume that the shares have already moved in reflection of the improvements that could happen in 2024**, we think it's too early to re-evaluate the assumptions in our model for a more bullish sentiment. We therefore prefer to leave the **12M Target Price** of **R$60.00 unchanged**, and reiterate our **NEUTRAL rating**, on a **24E EV/EBITDA** of **6.7x**, and an **upside** of **+13.83%**.

Appendix: Suzano

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**38.195**	**40.241**	**47.198**	**49.792**	**50.805**	**51.017**
(-) COGS	(24.208)	(26.411)	(29.309)	(29.481)	(29.308)	(29.431)
Gross Profit	**13.987**	**13.830**	**17.888**	**20.310**	**21.497**	**21.586**
(-) Expenses	(3.944)	(4.138)	(4.691)	(4.823)	(4.909)	(4.929)
Adjusted EBITDA	**18.784**	**18.702**	**22.500**	**24.706**	**25.646**	**25.562**
(-) D&A	(7.557)	(9.010)	(9.303)	(9.218)	(9.058)	(8.905)
EBIT	**11.227**	**9.692**	**13.197**	**15.488**	**16.588**	**16.657**
(+/-) 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)
Net income	**9.948**	**1.523**	**6.799**	**7.873**	**10.075**	**11.022**
Profitability						
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)

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**38.195**	**40.241**	**47.198**	**49.792**	**50.805**	**51.017**
(-) COGS	(24.208)	(26.411)	(29.309)	(29.481)	(29.308)	(29.431)
Adjusted EBITDA	**18.784**	**18.702**	**22.500**	**24.706**	**25.646**	**25.562**
EBIT	**11.227**	**9.692**	**13.197**	**15.488**	**16.588**	**16.657**
(-) 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)
FCFF	**(5.077)**	**2.773**	**10.184**	**13.768**	**14.355**	**13.832**

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under Review	Under review	**5%**

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