genial | Equity Research

KLABIN

Investor Day 2023: Higher CAPEX, lower cash flow

LatAm Pulp & Paper

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Company

KLBN11 BZ Equity
Buy

Price: R$ 22.57 (30-Nov-2023)
Target Price 12M: R$ 26.35

Main takeaways:

(i) Transition from a cycle of greater expansion to better efficiency; **(ii)** Wood supply strategy continues to focus on third parties in pine; **(iii)** Costs should remain stable in 2024, with the rise in the cost of third-party wood being offset by the cooling of other expenses; **(iv)** CAPEX should be lower than expected in 2023E, but still at a high level in 2024E, which was the negative highlight of the presentation; **(v)** There are still projects up our sleeve to be executed in a better macro scenario; **(vi)** we maintain our **BUY rating**, with a **gentle cut in the 12M Target Price** to **R$26.35** (vs. R$26.50 previously), due to **lower cash flow generation** equalized between the **differences in CAPEX from 2023 to 2024 vs. Genial Est.**, providing the shares with an **upside** of **+16.75%**.

Klabin held its 2023 Investor Day on November 30th, demonstrating some points to strengthen its long-term growth thesis in paper and packaging. However, the highlight (with a **slightly negative bias**) was the announcement of a **still high level of investments in the short term**, above what was expected by us and the street. This increase is mainly aimed at speeding up the implementation of the MP28 ramp-up in 2024, as we will discuss throughout the report.

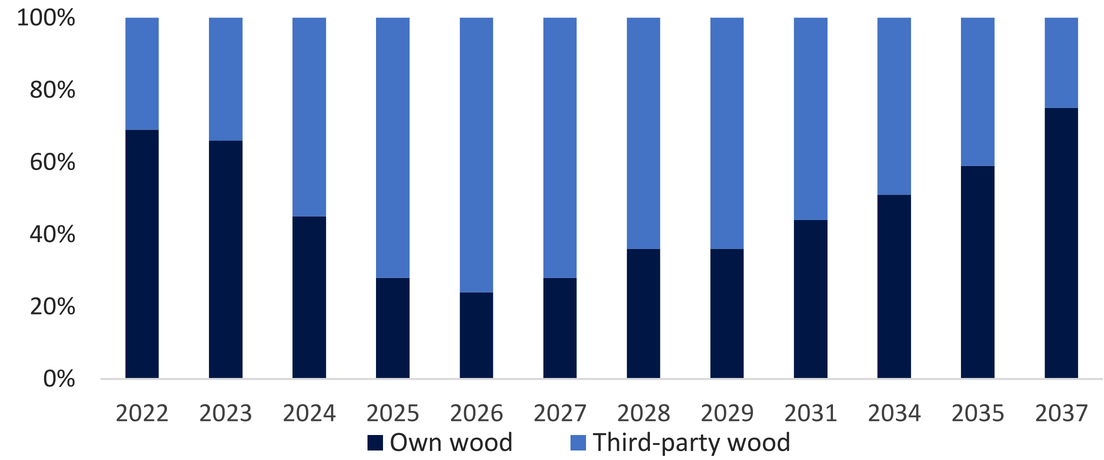
Straight to the point...

Cycle shifts. After a production capacity expansion cycle focused on: qualitative and quantitative improvement in the forestry base, investments in conversion, progression on Puma II project, with the delivery of MP27 and start-up of MP28, Klabin enhanced its product mix, focusing more on higher value-added products, such as paperboard and fluff pulp. The company is currently undergoing a change in strategy to improve its efficiencies, mainly in **(i)** strategic opportunities, **(ii)** operational efficiency in the forestry base, **(iii)** fixed cost reduction initiatives, and **(iv)** administrative efficiencies.

In general, this is due to a strategy of sourcing from Paraná (PR), which increases the importance of third parties in the composition of the wood used in the production process, which can lead to greater cost volatility. Despite the expansion of some forestry assets, the strategy of increasing the share of third-party wood for pine by ~2026 remains intact, until the turning point of the planting cycle that leads to self-sufficiency in a very long time. We have already highlighted this dynamic in previous reports.

Wood mix vs. rising costs. At the same time as the increase in the penetration of third-party wood for 2024E from pine, the company emphasized in the presentation a strong increase in its own eucalyptus wood, which can help mitigate the effect of rising costs. In addition, Klabin's management team also focused on some measures that could result in a flat cash cost in 2024E vs. 2023E.

Graph 1. V-shaped wood mix



Soure: Genial Investimentos, Klabin

It's worth noting that Klabin's cost guidance for 2023 already represented a rise of almost double-digit y/y. We can't deny that we've recently become more optimistic about this year's cost dynamics, which should end with a rise amounted at high single digit. In other words, an increase of slightly less intensity than was expected at the start of the year. However, the theme of costs from 2024 to the inflection point in 2026 has continually become a major topic in our discussions with institutional investors.

Although the consensus expected that this rise in costs would reduce the company's margin, Klabin has been working on some counterpoints to cut costs and offset this effect as soon as possible, in order to guarantee a stable COGS/t, at least for next year. Among these measures are some aspects of efficient asset management in the forestry base, such as optimized operational planning, regionalization of harvesting and reduction of operating costs. When adding up the effect of initiatives to reduce fixed costs (personnel, third-party services, and overheads), further boosted by expected improvements in the efficiency of administrative expenses, through the migration of software and the implementation of new tools, we believe in the possibility of a reduction in COGS and SG&A relating to a portion of routine expenses.

Klabin's argument during the presentation was that this should offset the increase in costs with the purchase of wood from third parties in 2024, in addition to the dilution of fixed costs due to the ramp-up of Puma II, which will also help this offset process.

CAPEX revised downwards for 2023E, and a stable forecast for 2024E. The main point of attention at the event was the announcement that CAPEX may remain at high levels for the next few years, given that the guidance for 2024E was published as R$4.5bn, consolidating investments at an apartment amount in relation to 2023E. We see this as a negative point, fundamentally because the figure surprised investors, who were expecting lower investment next year. Considering that the Puma II project was delivered this year, even if there was a residual left over, the market's expectation was that CAPEX for next year would be significantly lower.

To partially offset the bad news, the CAPEX guidance for 2023 was revised to R$4.5bn (vs. R$5.4bn previously). One of the reasons why the indicative amount invested that year has decreased compared to the initial forecast (-16% vs. Genial Est.), in parallel with the target released for 2024 coming in above our expectations (+32% vs. Genial Est.), is due to a certain amount of capital expenditures that have been pushed to 2024. These include some remaining investments relating to the Puma II project and its ramp-up.

Table 1. New CAPEX Guidance vs. Old Genial Est.

(R$ Millions)	New	Genial Est.		New	Genial Est.	
Guidance	**2023E**	**2023E**	**% Δ**	**2024E**	**2024E**	**% Δ**
CAPEX	4.500	5.351	-15,9%	4500	3.408	32,0%

Soure: Genial Investimentos, Klabin

However, it wasn't a zero-sum game. We believe that the market may react negatively to this information. Part of our preference for Klabin vs. Suzano in the short term was linked to Klabin's greater capacity to generate free cash flow (FCFE) in 2024 compared to its peers. This was mainly due to the fact that both companies are carrying out transformational projects with a high CAPEX commitment. Klabin with the Puma II project and Suzano with the Cerrado project.

As the Puma II project was due to be delivered this year and the Cerrado project in mid-2024, this put Klabin ahead of Suzano in the CAPEX reduction process. The consequence would be the end of a heavier investment cycle, opening up more space for generating free cash flow in the short term and deleveraging sooner.

However, due to the large need for CAPEX for standing timber, which according to management should remain close to ~R$1bn until 2028, incremental CAPEX 24E (ex. sustaining) was higher than expected. We believe that this need is explained by the speed of the MP28 ramp-up, which was anticipated due to a good perception of demand. According to the company's calculations, this will cause a stronger need for wood than the plantation itself is able to provide.

The result will be a replacement of wood through a higher CAPEX, and an increase in sentiment in relation to the appreciation of COGS/t, due to the anticipation of the pace of wood purchases from third parties. However, it will also have a positive impact on sales volume and an improved product mix. These points will help to strengthen revenue, as we mentioned in our previous report on the company, which is attached (Klabin: 3Q23 Review).

Our Take on Klabin

In a macroeconomic scenario that is still unclear, Klabin continues to find ways to boost its growth with new businesses, especially in the packaging vertical. We believe that this segment is less volatile than the direct sale of market pulp, bringing a little more predictability to results and being less affected by the still uncertain commodity cycle.

The strategic plan up to 2033 includes an expansion in **(i)** forestry assets, **(ii)** fluff pulp production, **(iii)** a stronger increase in the production of cardboard and recycled paper, and a softer increase in industrial bags and kraftiner. We also note the focus on **(iv)** converting for packaging. We see the investments as positive, due to the added value after the investment cycle, seeking a better mix that suits the funding structure for growth opportunities in the segments with the greatest potential.

However, in the short term, the high investment in the Puma II project, which will expand paperboard capacity in 2024, should put greater pressure on free cash flow than we initially expected, due to the increase in CAPEX. Dividends could also be affected next year due to the lower FCF Yield.

Higher CAPEX, lower cash flow. If we compare the CAPEX changes announced during Investor Day, the free cash flow (FCFF) for 2023E is now R$1.9bn (+79% vs. previous Genial Est), and for 2024E it is R$1.5bn (-41% vs. previous Genial Est). Although the rise in 2023E is greater than the fall in 2024E compared to our previous estimates, the nominal value shows a slight deficit of -R$245mn when we add up the cash flow for the two full years. Obviously, a large part of the 2023 cash flow has already been absorbed, so what's left is the negative surprise of the 2024 cash flow being lower than both we and the consensus had projected.

Even so, the operational dynamics emphasized at the event do not detract from our optimism about Klabin's investment thesis. The company is the market share leader in its main products in the domestic market, and we see value creation in the expansion projects, especially in the packaging sector.

Trading at an **EV/EBITDA 24E** of **7.2x** (vs. a historical average of 7.0x), depending on how Klabin's shares will perform going forward, after already outperforming Suzano YTD, we signal a valuation with a smaller gap vs. the historical average. This means that we may revise our rating at a later date. Despite this, we prefer to wait a while, given that there is some sense in the stock trading at no discount to the historical average due to the Puma II project being transformational.

For now, we maintain our **BUY rating**, but with a **12M Target Price** of **R$26.35** (vs. R$26.50 previously), **with a slight cut** due to **lower cash flow generation** equalized between the differences in CAPEX from 2023 to 2024, giving the stock an **upside** of **+16.75%**.

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	(12.587)	(15.234)	(16.716)	(16.865)	(16.273)	(15.852)
Gross Profit	**7.189**	**4.950**	**4.550**	**5.118**	**6.284**	**7.141**
(-) Expenses	(2.810)	(2.922)	(3.087)	(3.204)	(3.295)	(3.368)
Adjusted EBITDA	**6.491**	**6.672**	**6.259**	**7.095**	**8.132**	**8.904**
(-) D&A	(3.030)	(3.095)	(3.136)	(3.147)	(3.142)	(3.142)
EBIT	**4.797**	**4.133**	**3.868**	**4.650**	**5.698**	**6.477**
(+/-) Financial Result	214	(330)	(478)	(437)	(456)	(553)
(-) Taxes	(1.235)	(933)	(832)	(1.033)	(1.284)	(1.450)
Net income	**3.797**	**2.894**	**2.582**	**3.204**	**3.983**	**4.499**
Profitability						
Net margin (%)	20,60%	14,74%	12,58%	15,06%	18,23%	20,19%

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	(12.587)	(15.234)	(16.716)	(16.865)	(16.273)	(15.852)
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(-) Taxes	(1.235)	(933)	(832)	(1.033)	(1.284)	(1.450)
(+) D&A	3.030	3.095	3.136	3.147	3.142	3.142
(+/-) Δ WK	(179)	(238)	(121)	(83)	(42)	(45)
(-) Capex	(4.516)	(4.529)	(3.639)	(3.395)	(3.429)	(3.463)
FCFF	**1.897**	**1.527**	**2.411**	**3.285**	**4.086**	**4.662**

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	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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