KLABIN

Caetê Project: Looking good

LatAm Pulp & Paper

Analysts

Igor Guedes
+55 (11) 3206-8286
igor.guedes@genial.com.vc

Lucas Bonventi
+55 (11) 3206-8244
lucas.bonventi@genial.com.vc

Company

KLBN11 BZ Equity
Buy

Price: R$ 21.75 (21-Dec-2023)
Target Price 12M: R$ 26.35

Main takeaways:

(i) Klabin acquired the Caetê project, a set of forestry assets in Paraná, for R$5.8bn; **(ii)** We expect the deal to reduce costs, specifically those related to the acquisition of wood from third parties and CAPEX expenses; **(iii)** The project has an expected NPV of R$2/per share or ~8.5% of Market Cap; **(iv)** Klabin projects cash cost synergies of R$350-400mn from 2025-28, resulting from a **decrease in logistics and harvesting costs** due to a reduction in the average radius to 108km (vs. 139km previously), an important structural change; **(vi)** The short-term curve for pine should show a notable improvement, with a reduction of -6 p.p. in dependence on third-party wood in 2024 and a substantial drop of -29 p.p. in 2025, while the long-term curve remains similar; **(vii)** On the downside, we forecast an **increase in leverage to 3.9x 24E Net Debt/EBITDA**, up from the previous estimate of 3.0x; **(viii)** We see the **acquisition as structurally positive**, however, even with 2024 **CAPEX now downtrends to R$3.3bn** vs. R$4.5bn presented at Investor Day ~2 weeks ago, the increase in leverage will probably offset the effect on cash flow; **(ix)** We therefore maintain our **BUY rating**, with an **unchanged 12M Target Price** of **R$26.35**, giving the shares an **upside** of **21.15%**.

Klabin announced the acquisition of a set of forestry assets, called the Caetê project, located in the state of Paraná (PR) for R$5.8bn (US$1.16bn). According to the outlook given by management this morning in a conversation with analysts, during the presentation of the agreement to purchase Arauco's assets, the deal aims to reduce costs. Among the reductions, we quote: **(i)** lower costs of acquiring wood from third parties (a critical point for Klabin's thesis) and; **(ii)** a drop in CAPEX expenses, something that has also become an important discussion, gaining momentum after the Investor Day promoted by the company, just two weeks ago.

Straight to the point...

Initial perception is positive but increases leverage in 2024. The transaction has an implied real IRR of 13%, with an expected NPV of R$2/per share (~8.5% value over market cap). The acquisition, despite looking sensible numerically, may initially receive a negative reaction from a portion of investors due to its size and potential impact on Klabin's deleveraging process in 2024. As usual with structurally important acquisitions, we expect leverage to increase to 3.9x 24E Net Debt/EBITDA (vs. 3.0x in our previous projection).

To arrive at this leverage expansion, we are considering financing of 60% of the acquisition value as an initial assumption. This may be revised as the company provides more information on the incorporation of the asset. Even if leverage stretches next year, in a move contrary to deleverage assumption that was in force until the announcement, it seems to converge back to the old projection within 2 years.

In the presentation slides, Klabin mentions that leverage should reach the projection before the acquisition of the Caetê project by 2025, but this seems to us to be an optimistic bias and we prefer to be more conservative. For 2025, our projection is 3.5x Net Debt/EBITDA, which is still higher than the current 3.2x. So, deleveraging would only happen in 2026 onwards.

Quality of the asset acquired and change in CAPEX. The Caetê project covers 150k ha of land, mainly in Paraná, and 31.5Mt of standing timber. After the first harvest, Klabin expects to exceed its target of 75% self-sufficiency in its own wood by around 60k ha, given the quality of the asset acquired from Arauco. The deal is expected to be concluded in 2Q24. In addition, the company indicates a lower price for the land purchased (R$33k/ha), compared to prices practiced in the region and to recent negotiations, based on data from FNP consultancy.

Considering that the main value driver we see is the reduction in the need to purchase wood from third parties to support the production volume of the recently opened Puma II project, Klabin's CAPEX guidance for 2024 will be reduced to R$3.3bn vs. R$4.5bn presented at the Investor Day ~2 weeks ago, with further decreases in the following years as well.

Although surprising, given that the Investor Day event took place very recently, the change in assumption is based on the announcement of the acquisition. We imagine that, as the deal was complex and the result of 18 months' work, Klabin had not yet closed all the details by Investor Day. For this reason, the company presented a plan and went back on the guidance to incorporate the effect, having made the acquisition official days after the event.

Self-sufficiency accelerating, rebutting a point of criticism of the thesis. Klabin is accelerating its goal of 75% self-sufficiency in wood, which would previously have been achieved only in 2037 for pine, to 2036. Although it is not moving its hands much in the long term, the short-term curve is considerably better, with a -6p.p drop in dependence on third-party wood in 2024 and an important -29p.p in 2025 vs. previous estimations. The company plans to do this with a ~R$2bn NPV transaction through the assets acquired from the Caetê project.

The package acquired from Arauco comprises a forestry asset with a maturity of 2.5 years for eucalyptus and 5.1 years for pine. Klabin expects cash cost synergies of R$350-400mn between 2025-28 due to the reduction in logistics and harvesting costs resulting from the decrease in the average radius to 108 km (vs. 139 km before the project and after Puma II), another important change. An expected reduction in 2024 in cash costs (COGS/t) of 4% vs. Klabin's situation before the project, also becomes viable. This is precisely in line with what we expected in relation to the company's efforts to create a slight surplus between increased revenue and increased expenses, in relation to the Puma II project next year.

Obviously, we had no way of predicting the M&A, but given that the company surprised positively in its cost management during 2023, we believed in Klabin’s ability to improve efficiency for 2024. Updating our projections, COGS/t ex. stoppages is now up ~10% y/y in 24E vs. 14% previously, with revenue up +11% y/y, creating a 1% surplus. It's a marginal figure, but we believe that the consensus expected a deeper deficit for 2024, around ~7%.

We've been saying all along that it was possible for the company to find solutions to promote a soft offsetting effect between rising costs and revenue for 2024, in a position contrary to what the consensus expected. This can be seen in some past reports, such as this one published in October (Klabin: Volume should recovery and tomorrow it's going to be the price turn).

Our Take on Klabin

Contrary to the recent movement seen by the market, we still maintained our buy rating for Klabin after the Investor Day, held on November 30, as can be seen in our last publication (Investor Day 23: Higher CAPEX, lower cash flow).

We knew that the market would react negatively to the announcement of a large amount of CAPEX for 2024 compared to an expected reduction after the start-up of the Puma II project, which was the company's major investment driver in the short term. As the CAPEX announced at the event remained stable between 2023 and 2024, the consensus, including us, began to project a lower FCF for next year. This led to a reduction in our 12M Target Price to R$26.35 (vs. R$26.50 before the Investor Day).

However, days after the market's terrible reaction, with the company's shares losing ~10% in less than 15 days, the company announced the acquisition of the Caetê project, which is of significant strategic importance and, in our view, could change the pessimism that has surrounded Klabin's name in recent days.

So, is the news positive? Yes... Here are the main points: **(I)** After the inaugural harvest cycle, Klabin will exceed its self-sufficiency target of 75% of its own wood with an additional 60Ha of production, which can be monetized through land sales or joint ventures with financial investors. **(ii)** Of the 31.5kt wood harvest in the first cycle, 31% is eucalyptus and 69% pine. In terms of cultivated area, the split is 41% eucalyptus and 59% pine, with FSC certification for 98% of the land.

In addition **(iii)** we are adopting as an initial assumption a financing of 60% of the acquisition value, or R$3.5bn, which would increase leverage to ~4x Net Debt/EBITDA 24E (vs. a reduction to 3x before the update). **(iv)** The CAPEX guidance, which has worried investors who are looking to the short term, was reduced to R$3.3bn in 2024 (down from the R$4.5bn announced during investor day), with an additional anticipated cut of between R$1-1.2bn in 2025-26 and R$500mn for 2027-28, a point that is super favorable to our decision to sustain a buy rating vs. the downgrade we have seen from other analysts.

It's also important to mention that even if we opted for a debt increase assumption, **(v)** despite the transaction, Klabin maintains sufficient liquidity in the wake of a R$3.7bn debt raised in recent months. Consolidating both our assumption and the recent debt raised, Klabin should still not exceed its leverage limit of 4.5x Net Debt/EBITDA.

Looking good. Klabin has undoubtedly shown that those looking in the short term can be wrong. Consolidating a structurally positive acquisition with clear value levers, COGS/t will rise less than the consensus expected over the next few years. This point has been the Achilles heel of Klabin's thesis ever since our assuming coverage in the Pulp & Paper sector.

Of course, the Caetê project doesn't solve the problem entirely. There is still a need to buy wood from third parties, but the reduction in this need over the next five years will be substantial, as we pointed out throughout the report. On the other hand, even with the lower CAPEX now being updated, the increase in leverage will unload a higher financial expense through the P&L/FCFE and therefore cancel out the effect of the short-term improvement, so we remain comfortable with our previous valuation. We therefore reinforce our **BUY rating**, with a **12M Target Price** of **R$26.35**, giving the shares an **upside** of **21.15%**.

Appendix: Klabin

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**18.463**	**19.924**	**20.784**	**21.469**	**21.959**	**22.307**
(-) COGS	(12.698)	(15.097)	(16.201)	(16.326)	(15.705)	(15.265)
Gross Profit	**7.106**	**5.008**	**4.949**	**5.377**	**6.525**	**7.213**
(-) Expenses	(2.814)	(2.965)	(3.124)	(3.231)	(3.311)	(3.373)
Adjusted EBITDA	**6.414**	**6.993**	**6.777**	**7.525**	**8.476**	**9.152**
(-) D&A	(3.030)	(3.027)	(2.970)	(2.943)	(2.892)	(2.848)
EBIT	**4.720**	**4.146**	**4.171**	**4.816**	**5.854**	**6.475**
(+/-) Financial Result	214	(517)	(595)	(467)	(597)	(671)
(-) Taxes	(1.216)	(891)	(878)	(1.066)	(1.287)	(1.421)
Net income	**3.739**	**2.763**	**2.723**	**3.307**	**3.994**	**4.408**
Profitability						
Net margin (%)	20,25%	13,87%	13,10%	15,40%	18,19%	19,76%

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

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**18.463**	**19.924**	**20.784**	**21.469**	**21.959**	**22.307**
(-) COGS	(12.698)	(15.097)	(16.201)	(16.326)	(15.705)	(15.265)
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(-) Taxes	(1.216)	(891)	(878)	(1.066)	(1.287)	(1.421)
(+) D&A	3.030	3.027	2.970	2.943	2.892	2.848
(+/-) Δ WK	(209)	(232)	(110)	(72)	(30)	(33)
(-) Capex	(4.516)	(3.339)	(3.176)	(2.757)	(2.854)	(2.547)
FCFF	**1.810**	**2.712**	**2.978**	**3.863**	**4.575**	**5.322**

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under Review	Under review	**5%**

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