genial Equity Research

SUZANO

4Q23 Review: Metamorphosis

LatAm Pulp & Paper

(i) Even with production cuts, pulp sales volume was a highlight; **(ii)** Pulp prices rising after a delay in the effect of pass-throughs; **(iii)** Outlook for the future allowed for more price adjustments as early as the beginning of 2024; **(iv)** Revenue accelerating +16% q/q, within expectations; **(v)** COGS/t with a decrease, both sequentially and y/y; **(vi)** EBITDA with double-digit sequential growth; **(vii)** Net income higher than expected (+18.8% vs. Genial Est.); **(viii)** We believe that the Cerrado project could start up before June; **(ix)** Cash flow generation above estimates (+21% vs. Genial Est.); **(x)** End of the Schalka era, start of the Abreu phase; **(xi)** We see Suzano trading at an **EV/EBITDA 24E** of **6.5x,** still below historical levels, when in our view it would make sense to trade at a slight premium due to the entry of Cerrado in a few months' time. This indicates that the market **is not pricing all the project's gains** into the valuation, mainly due to the price conditions of BHKP. Asymmetry becomes interesting again. After revising the assumptions in our model, **updated in our preview report**, we have moved our recommendation back to **BUY rating**, with a **12M Target Price** of **R$68.00**, implying an **upside** of **+18.51%**.

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Company

SUZB3 BZ Equity
Buy

Price: R$ 57.38 (28-Feb-2024)
Target Price 12M: R$ 68.00

SUZ US Equity
Target Price 12M: US$ 14.30

Suzano reported its 4Q23 results yesterday, February 28, after the market closed. The figures released reflected the **beginning of the resumption of operational performance** for the company, as **pulp prices showed progression** (as expected) and **sales volume** with **low double-digit growth** (totally in line with our estimates). Revenues had a robust performance**,** accelerating +15.9% q/q (+1% vs. Genial Est.), with COGS/t (without stoppages) shortening -5% q/q (total reduction was even greater if you consider that there were no stoppages in 4Q23), which led to an **EBITDA** with a **great recovery** of +21.9% q/q. Although slightly below our estimates in the EBITDA line (-7.9% vs. Genial Est.), Suzano showed that it was paving the way for a **healthier result**, with a net income greater than our projections (+18.8% vs. Genial Est.) due to a higher than estimated increase in the exchange rate hedge.

Table 1. Shipments Summary (4Q23 vs. Genial Est.)

(Thousand Tonnes - kt)	Reported	Genial Est.					
Summary	**4Q23A**	**4Q23E**	**% Diff.**	**3Q23A**	**% q/q**	**4Q22A**	**% y/y**
Pulp Shipments	2.761	2.771	**-0,4%**	2.486	**11,1%**	2.759	**0,1%**
Paper Shipments	386	333	**16,1%**	331	**16,7%**	338	**14,1%**

Source: Suzano, Genial Investimentos

Table 2. Income Statement Summary (4Q23 vs. Genial Est.)

(R$ millions)	Reported	Genial Est.					
Income Statement	**4Q23A**	**4Q23E**	**% Diff.**	**3Q23A**	**% q/q**	**4Q22A**	**% y/y**
Net Revenue	10.372	10.273	**1,0%**	8.948	**15,9%**	14.370	**-27,8%**
Adjusted EBITDA	4.505	4.891	**-7,9%**	3.695	**21,9%**	8.175	**-44,9%**
Net Income	4.515	3.801	**18,8%**	(729)	-	7.459	**-39,5%**

Source: Suzano, Genial Investimentos

Valuation and rating. We believe that better days are ahead for Suzano, with price increases (in addition to the pass throughs that have already been made). This week, Suzano promoted another price increase, of +US$30/t for Asia. If it is fully accepted by the clients' base, the price could go up to US$685/t (vs. US$655/t nowadays). This increase comes as a **positive surprise to us**, since we published an opinion on the short-term equilibrium price for BHKP in China in our results preview, which is attached below (Suzano 4Q23 Preview). Until now, we believed that it should be around ~US$650/t, given that we expect the price to fall slightly in 2H24 in relation to the entry of the volume from the Cerrado project into the supply system.

In other words, this increase of +US$30/t at this time could **move this equilibrium point higher**, causing an upside in relation to the level of US$650/t Genial Est. post cerrado (2025 with the ramp-up). Despite of the possibility of reaching US$680/t, we believe it is unlikely that this level will be maintained in 2025, but **the equilibrium price could be higher than our model indicates today**, which is positive news. This is due to the fact that we didn't conjecture that nonintegrated players in China would have more appetite for price pass throughs at this time, and that our opinion had been reinforced by the fact that the previous round of adjustments (made in mid-January) didn't include Asia, only Europe and the USA.

The price scenario therefore looks promising for a recover. **On the sales side**, the situation also indicates an **optimization of production capacity**, since everything leads us to believe that there is a turnover of inventory. In 4Q23, Suzano's shipments totaled 2.8Mt (-0.4% vs. Genial Est.), an acceleration of +11.1% q/q, and stable at +0.1% y/y. These figures show that pulp sales continue to be less affected by the -4% production cut announced by the company itself in June. As we had already anticipated since our 3Q23 report, and as reinforced by our 4Q23 preview, production would fall as sales accelerated, suggesting that Suzano was burning off inventories.

Once again, we observed in 4Q23 that the capacity cut was able to **cool down costs**, considering that the production being cut is geared towards capacities that require the allocation of more expenses. But beyond the **short-term COGS/t benefit**, we believe that cutting capacity and, consequently, reducing shipments, helps to create a feeling of less oversupply, by encouraging other market peers to do the same. Through recent conversations with Suzano, we have received indications that **further old capacity cuts for 2024 are not ruled out**. Our opinion is that they should happen, especially with the entry of cerrado (new capacity). With a less elastic supply, customers would be more likely to accept price increases, just as has been happening. In addition to the +US$30/t announced for Asia, there was also +US$80/t for Europe, which could bring the European BHKP curve to ~US$1,350/t, as well as +US$80/t for the USA, stretching the North American curve to ~US$1,500/t.

Looking ahead, the start of the Cerrado project may cause a slight increase in costs in 2H24. This expected cost increase may occur due to lower volume during the initial phases of the machines at the Ribas do Rio Pardo (MS) plant, resulting in less extensive fixed cost dilution capacity vs. higher specific costs associated with initial activities.

However, **all indications are that the cost situation will improve a lot in 2025**, when we expect the project to spread out Suzano's fixed costs evenly and **significantly reduce COGS/t** (potentially reaching R$400/t when operating on Suzano's own forestry base, compared to R$500/t at project start-up). Our perception is that the **projected reduction doesn't seem to be currently factored into the stock price**, yet another indication that the upside in Suzano's case is relevant.

Although the situation on an annual basis shows that the road to recovery is long, **we are more optimistic about the investment thesis**, given a scenario of: **(i)** price improvement, with the equilibrium point likely to rise in relation to our recent projection of BHKP China with an average of ~US$550/t in 2025, after the Cerrado project is inaugurated, due to the surprising adjustment of +US$30/t announced for Asia now, as well as **(ii)** growing volume in 2024E (+5.5% Genial Est. vs. 2023), due to the start-up of the plant in Ribas do Rio Pardo (MS), added to **(iii)** cost reductions, both in the short term (cutting older capacity) and in the medium term (ramp-up of Cerrado, with greater capacity to dilute fixed costs). We assume that better days for stock appreciation are on the way. We see Suzano trading at an **EV/EBITDA 24E** of **6.5x** (vs. historical average of 7x), and we calculate a **12M Target Price** of **R$68.00**, as a result of the modifications we made to our model and which are explicit in our preview report, which makes us reiterate our recent **BUY rating**, with an **upside** of **+18.51%**.

4Q23 Review: In detail!

Even with production cuts, pulp sales were a highlight. Suzano reported pulp sales growth of +11.1% q/q, clocking in at 2.761Kt (-0.4% vs. Genial Est.), representing a step change in 4Q23, in line with our expectations. The company reduced a significant percentage of production in 4Q23, in order to achieve the guidance of a 4% annual capacity cut, indicating a prior inventory retention that would made the reported sales volume possible. Our opinion is that the strategy of reducing production by cutting capacity from older assets was assertive, since the company, in addition to optimizing production costs by shutting down machines that consume more wood and other inputs, also unlocked value in price. By withdrawing its offer, it managed to change the pricing scenario for BHKP in the market and influenced other players to do the same.

Pulp prices rising after a delay. Due to the various adjustments made in 2H23, and as we estimated in preview report, the realized pulp price showed growth of +4.0% q/q, standing at US$568/t (-1.5% vs. Genial Est.), despite the -31% y/y drop. This reduction on a year-on-year basis indicates that this more positive sequential performance is still the beginning of the recovery process. The figure is further boosted by the appreciation of the USD/BRL exchange rate, reflecting in +6.0 q/q, to reach R$2,817/t (-1.3% vs. Genial Est). In the paper segment, the realized price was R$6,718/t (-5.3% vs. Genial Est), representing a reduction of -5.2% q/q and -5.1% y/y. The realization came with a slightly broader deceleration than we had projected, due to less favorable conditions in the printing & writing segment, as well as a more pressured environment for paperboard, which makes it difficult to pass on prices.

Further realized price will continue to move upwards. Obviously, Suzano's 4% cut individually would not alter the supply/demand balance. However, it does fulfill its role of providing a set-up for the market in terms of discipline in the production allocation. With other production shutdowns (such as Arauco in Licantén), we believe that this atmosphere was essential to support the price increases that followed, in addition to the fact that the price in 2Q23 came close to the marginal producer's cost of production, making a bottom at ~US$480/t in the BHKP China benchmark. This explains the very quick rise to the current level of US$555/t (not considering the +US$30/t increase announced this week for Asia). Our view is that the dynamic of rising prices should bring more positive results throughout 2024, since the contracts have a delay in taking effect. In other words, although part of this effect has already been seen in 4Q23, we believe there is more to come.

Revenue accelerating +16% q/q, within expectations. As both variables (volume and price) suffered positive impacts, the consolidated net revenue presented was unparalleled, in line with our estimate, and grew +15.9% q/q, to reach R$10.4bn (+1.0% vs. Genial Est.). The -27.8% y/y drop shows the current pricing difficulty looking at the situation compared to 2022. Still, the strong sequential progress is a sign that the worst is left behind us. By proportion, this robust increase q/q is the result of an improvement in pulp conditions (which had been very weak on results until now), both in sales appetite and in price pass-through. Pulp net revenue clocked in at R$7.7bn (-1.7% vs. Genial Est.), up +17.8% q/q and down -35.0% y/y. Paper net revenue came at R$2.2bn (+9.9% vs. Genial Est.), up +10.7% q/q and +8.3% y/y, driven by higher-than-expected sales of 386Kt (+18% vs. Genial Est.).

Table 3. Revenue Suzano (4Q23 vs. Genial Est.)

(R$ millions)	4Q23 Reported	4Q23E Genial Est.	% R/E	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Net Revenue	**10.372**	**10.273**	**1,0%**	**8.948**	**15,9%**	**14.370**	**-27,8%**
Pulp	7.779	7.914	-1,7%	6.605	17,8%	11.975	-35,0%
Paper	2.593	2.359	9,9%	2.343	10,7%	2.395	8,3%

Source: Suzano, Genial Investimentos

COGS/t decreased, both sequentially and y/y. Just as we had mentioned in the attached preview (Suzano 4Q23 Preview), due to several factors, such as: **(i)** the absence of maintenance stoppages, accompanied by **(ii)** improved efficiency, since the company shut down capacity in old assets, with **(iii)** reduced wood consumption due to production cuts, accompanied by **(iv)** lower wood purchase prices, COGS/t ex. stoppages decreased -5% q/q and -12.9% y/y, reaching R$816/t (+0.2% vs. Genial Est.), totally in line with our estimate. COGS/t with stoppages decreased even more, by -13.2% q/q and -16.4% y/y, when comparing this quarter without stoppages with 3Q23, which had a stoppage in Três Lagoas (MS) and with 4Q22, consolidating the stoppage in Aracruz (ES).

EBITDA with sequential double-digit growth. In view of the information presented through the report, such as **(i)** growing shipment volumes (in both Pulp and Paper divisions), **(ii)** price adjustments (only in Pulp division) and **(iii)** a reduction in COGS/t, these three factors combined led to adjusted EBITDA progressing in both segments (Pulp and Paper divisions), with consolidated EBITDA reaching R$4.5bn (-7.9% vs. Genial Est.), reporting an increase of +21.9% q/q, despite the -44.9% y/y slowdown. Pulp EBITDA was R$3.8bn (-6.9% vs. Genial Est.), up a remarkable +29% q/q. As for the Paper segment, the business division posted an EBITDA of R$748mn (-12.5% vs. Genial Est.), showing a reduction of -4.4% q/q and -17% y/y, with a performance below our projections as a result of the increase in SG&A, which in turn suffered from personnel, commercial and logistics expenses arising from the acquisition of Kimberly Clark in Brazil.

Table 4. EBITDA Suzano (4Q23 vs. Genial Est.)

	4Q23	4Q23E		3Q23		4Q22	
(R$ millions)	**Reported**	**Genial Est.**	**% R/E**	**Reported**	**% q/q**	**Reported**	**% y/y**
Adjusted EBITDA	**4.504**	**4.891**	**-7,9%**	**3.695**	**21,9%**	**8.175**	**-44,9%**
Pulp	3.756	4.037	-6,9%	2.912	29,0%	7.274	-48,4%
Paper	748	855	-12,5%	783	-4,4%	901	-17,0%

Source: Suzano, Genial Investimentos

Net income above expectations. After the EBITDA line, we see an important impact on the financial result from currency hedging and exchange rate variation. As the company holds more than half of its debt in dollars, we believe that exchange rate variation plays an important role in the results. The company reported a foreign exchange variation result of ~R$1.3bn (-37.5% vs. Genial Est.). In relation to derivative operations (Zero Cost Collar and NDF), the result was R$1.5bn (+42.2% vs. Genial Est.), ending the year with a positive impact of R$3.6bn. As the company recorded a financial result of ~R$2.3bn, Net income clocked in at R$4.5bn (+18% vs. Genial Est.), higher than our expectation, reversing last quarter's loss by ~7x.

Table 5. Income Statement Suzano (4Q23 vs. Genial Est.)

	4Q23	4Q23E		3Q23		4Q22	
(R$ millions)	**Reported**	**Genial Est.**	**% R/E**	**Reported**	**% q/q**	**Reported**	**% y/y**
Net Revenue	**10.372**	**10.273**	**1,0%**	**8.948**	**15,9%**	**14.370**	**-27,8%**
COGS	(6.776)	(6.214)	9,0%	(6.104)	11,0%	(6.793)	-0,2%
Adjusted EBITDA	**4.505**	**4.891**	**-7,9%**	**3.695**	**21,9%**	**8.175**	**-44,9%**
EBITDA Margin (%)	43,4%	47,6%	-4,18p.p	41,3%	2,14p.p	56,9%	-13,46p.p
EBIT	**3.158**	**2.900**	**8,9%**	**1.683**	**87,6%**	**7.299**	**-56,7%**
EBIT Margin (%)	30,4%	28,2%	2,22p.p	18,8%	11,63p.p	50,8%	-20,35p.p
D&A	1.788	(1.991)	-	(1.940)	-	(1.910)	-
Financial Result	2.269	2.521	-10,0%	(3.494)	-	2.000	13,5%
Net Income	**4.515**	**3.801**	**18,8%**	**(729)**	**-**	**7.459**	**-39,5%**
Net Margin (%)	43,5%	37,0%	6,53p.p	-8,1%	51,68p.p	51,9%	-8,38p.p

Source: Suzano, Genial Investimentos

Our take on Suzano

What's happening with pulp prices? The trend for the hardwood price curve (BHKP) is upwards in the short term, mainly due to the market's exacerbated anticipation of the pulp capacity expansion announced by companies in the segment, which could lead to an oversupply. In other words, a change in the operation, such as inventory turnover, was made by market pulp clients, in addition to trading companies operating the commodity, shifting the price downwards between 1Q23 and 2Q23. Even so, as the price came down much more than the fundamentals pointed to as rational, considering that it reached levels close to breakeven for average players, it ended up giving us a feeling that there would be greater scope for price adjustments in favor of recovery throughout 2H23, especially in BHKP. While many became more pessimistic about Suzano's case, given the uncertainties about when and how fast the price curve would recover, we were on the opposite side, with Suzano buy rated.

This situation, combined with a capacity cut in older assets, initiated by the company itself (-4%) along with other peers, benefited the players in the segment to jointly pass on prices throughout 2H23 (Suzano began readjustments in June, and other peers followed). We therefore believe that there are better conditions for 2024 compared to last year. As a result of these dynamics, Suzano's shares rose by +18% between June and mid-October. From late October onwards, we began to see a narrower valuation gap and downgraded Suzano's rating to Neutral, with no harm to the Target Price calculated at the time, which remained at R$60.00, as can be seen in this 3Q23 Preview report.

From November to February, the share prices were basically stable vs. an appreciation of the Ibovespa (end-of-year rally), demonstrating our assertiveness in seeing the specific bullish catalysts of cyclical stocks and **understanding the most favorable moments to recommend investors to create a long position**. As recent as this week, in our preview report, which is attached (Suzano 4Q23 Preview), have **we reintegrated a slightly bullish price outlook** into the model for 2024 and 2025 in relation to the BHKP curve vs. our previous estimates, which resulted in an increase in the Target Price to R$68.00, at a price asymmetry level that led us to upgrade it back to a buy rating.

Why do we change our ratings on Suzano so much? The change in ratings in a short space of time (Buy vs. Neutral vs. Buy in 8 months) reveals our perception of the mentality of investors in commodities-related companies: **short-term bias**, aimed at ensuring the best position in the **price cycle**. Unlike Klabin, as we have discussed in previous reports, we see Suzano's thesis as **value investing**. We discuss the differences between the two theses in our sector report (Pulp & Paper: Are the theses growth or value?).

Therefore, we look for moments when the stock is undervalued due to a cyclical market penalty in relation to the pulp prices (which accounts for ~75% of the company's revenue). If there is no asymmetry, even though it's a company we like in terms of execution, we don't see the opportunity to recommend a buy stance to investors.

However, although we have seen the absence of very short-term catalysts over last 4M, in view of the 4Q23 disclosure outlook showing a very interesting recovery, we have reassessed the assumptions to a more optimistic tone. These changes to our model have once again created the perception of asymmetry and unlocking of value in the stock for the coming months, with Cerrado helping to deliver volume growth by expanding capacity by +2.5Mtpy. In the medium term, we believe it is possible that there will be a correction in BHKP China's price curve due to the capacity expansion, but this change will probably only be noticed during the more solid ramp-up process, scheduled for 2025 (2H24 volume will still be small compared to the power of the Cerrado project).

We believe that the Cerrado project could start up before June. The Cerrado project has already reached an accumulated physical progress of 86% and a financial progress of 78%, making us consider a certain optimism regarding the development of the industrial design and possible early start-up of the new plant in Ribas do Rio Pardo (MS), perhaps in May (or even earlier). We believe that COGS/t will tend to increase at the start of operations, although the new plant should help to dilute the fixed cost from 2025 onwards. As we pointed out in the preview report, COGS/t can be reduced to ~R$500/t vs. R$820/t currently with the ramp-up in 2025 and reach ~R$400/t when Suzano starts activities with its own forests, from the cycle of cutting standing timber. As we mentioned, at the current valuation level, this cost reduction does not seem to be reflected in share prices.

Cash flow generation above estimates. Suzano reported a cash flow generation (FCFE) of R$876mn in 4Q23. If we exclude derivatives adjustments, which amount to R$1.1bn, FCFE would have clocked in at -R$298mn (+21% vs. Genial Est.), above our projections, given that CAPEX was R$4.3bn (-15% vs. Genial Est.). Considering that the physical progress of the Cerrado project is greater than the financial progress *(*a gap of ~8%), part of the CAPEX curve may slip towards 2025. Even so, Suzano demonstrated a quarter with a more composed dynamic in terms of cash flow, and with the effect of derivatives, it inverted the sign to the positive zone (avoiding the FCF burn seen in 3Q23).

End of the Schalka era, start of the Abreu phase. Along with the release of the 4Q23 results, Suzano announced the hiring of a new CEO, Mr. João Alberto Abreu, former CEO of Rumo. Mr. Walter Schalka will leave the company's management after 11 years to take a seat on the board. Mr. Abreu worked for 18 years at Shell, took on the position of director at Cosan and started as CEO of Rumo in 2019. During his tenure, Rumo increased EBITDA up to R$7.5bn (vs. R$2.8bn previously), reflecting a large cap experience with a culture of expansion, which aligns well with the Cerrado project, which is close to start-up. We believe that the change is positive, keeping Mr. Schalka still close for advice and decision-making in the company, since he has deep knowledge of the pulp industry and the specifics of Suzano, while breathing fresh air with the entry of Mr. Abreu in the position of CEO, who has extensive experience in expansion projects in capital-intensive activities.

Metamorphosis. The change of CEO consolidates in practice the effect of the transformations that the company will undergo in 2024. With the start-up of Cerrado, perhaps the most important project in Suzano's century-long history, and in the face of data that contributes to partial optimism regarding market conditions, we believe that 4Q23 marks a metamorphosis for the company. The sequential improvement in EBITDA of +21.9% q/q, reaching a margin expansion of +2.14p.p up to 43.4%, demonstrates assertive strategic decisions, such as cutting 4% of capacity in older assets, with a substantial improvement in COGS/t, as well as leading the price recovery in BHKP, moving the curve upwards faster than our previous forecasts. Now that the company is seeing a price rebound, presenting solid results, and succeeding in its supply-cutting strategies, the market should be optimistic and confident about the company, especially with the start of the Cerrado project knocking on the door in a few months' time. Therefore, we calculate a **12M Target Price** of **R$68.00**, and reiterate our **BUY rating**, with a **24E EV/EBITDA** of **6.5x** (below historical), and an **upside** of **+18.51%**.

Appendix: Suzano

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**39.657**	**42.065**	**49.177**	**51.186**	**52.326**	**52.682**
(-) COGS	(24.515)	(26.006)	(29.124)	(28.846)	(28.624)	(28.769)
Gross Profit	**15.142**	**16.059**	**20.053**	**22.341**	**23.703**	**23.913**
(-) Expenses	(4.353)	(4.682)	(5.310)	(5.397)	(5.501)	(5.537)
Adjusted EBITDA	**19.483**	**20.262**	**23.916**	**26.046**	**27.189**	**27.251**
(-) D&A	(7.525)	(8.886)	(9.173)	(9.103)	(8.988)	(8.875)
EBIT	**11.958**	**11.376**	**14.743**	**16.943**	**18.201**	**18.376**
(+/-) Financial Result	6.033	(5.459)	(3.168)	(4.136)	(2.307)	(1.084)
(-) Taxes	(4.598)	(1.768)	(3.458)	(3.827)	(4.749)	(5.167)
Net income	**13.393**	**4.149**	**8.116**	**8.981**	**11.145**	**12.126**
Profitability						
Net margin (%)	33,77%	9,86%	16,50%	17,55%	21,30%	23,02%

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

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**39.657**	**42.065**	**49.177**	**51.186**	**52.326**	**52.682**
(-) COGS	(24.515)	(26.006)	(29.124)	(28.846)	(28.624)	(28.769)
Adjusted EBITDA	**19.483**	**20.262**	**23.916**	**26.046**	**27.189**	**27.251**
EBIT	**11.958**	**11.376**	**14.743**	**16.943**	**18.201**	**18.376**
(-) Taxes	(4.598)	(1.768)	(3.458)	(3.827)	(4.749)	(5.167)
(+) D&A	7.525	8.886	9.173	9.103	8.988	8.875
(+/-) Δ WK	(951)	536	(795)	(194)	(79)	(40)
(-) Capex	(19.528)	(14.402)	(9.114)	(8.337)	(8.062)	(8.228)
FCFF	**(5.595)**	**4.628**	**10.549**	**13.688**	**14.300**	**13.817**

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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