genial | Equity Research

SUZANO

1Q24 Review: The enemy hides in the shadows

LatAm Pulp & Paper

(i) Volumes fell q/q due to the need to restock in line with **the weak seasonality of Q1** and **the increase in lead time** due to logistical restrictions; **(ii)** Astros aligned for price pass-throughs guided Suzano to present pulp realized price advancing high single digit in the quarter (+9% q/q); **(iii)** New price pass-throughs should take effect in 2Q24; **(iv)** Paper unit advancing significantly on y/y with K-C; **(v)** Revenue slightly below expectations; **(vi)** COGS/t with a marginal increase (+1.3% q/q), reaching R$827/t (+0.1% vs. Genial Est); **(vii)** EBITDA was delivered as we expected, stable q/q and down y/y; **(viii)** Net income in strong deceleration (-95.1% q/q; -95.8% y/y), even so it ended up being reported above expectations. **Exchange rate variations** are responsible for the **brutal gap between EBITDA and Net income**; **(ix)** Cash flow **(FCFE) burn of -R$2,6b**, which was already expected; **(x)** Leverage rising to **3.5x Net Debt/EBITDA** (vs. 3.1x in 4Q23), with more details on the **pace of deleveraging going forward** in the **"Our take" section**; **(xi)** The shares may lack bullish catalysts in this short term, given these uncertainties related to the **potential takeover bid for International Paper.** Even so, via a material fact, Suzano argued that there has been **no official binding proposal**, so **we remain focused on the fundamentals**, which are positive; **(xii)** We see Suzano trading at an **EV/EBITDA 24E** of **6.3x** (vs. 7.5x historical average). We reinforce our **BUY rating**, with a **12M Target Price** of **R$72.00**, reflecting an **upside** of **+36.62%**.

Suzano reported its 1Q24 earnings yesterday (May 9), after the market closed. The result was **within expectations**, as previously mentioned in our report (1Q24 Preview: Opposite directions). Sequentially, the figures showed a quarter of stability in the operational sphere, with **pulp shipments falling due to seasonality** but offset **with prices compounding positive impacts from the rounds of pass-throughs**. In paper unit, we can already see the addition of K-C's capacity and, therefore, there is a major advance in sales on an annual basis.

Table 1. Shipments Summary (1Q24 vs. Genial Est.)

(Thousand Tonnes - kt)	Reported	Genial Est.					
Summary	**1Q24A**	**1Q24E**	**% Diff.**	**4Q23A**	**% q/q**	**1Q23A**	**% y/y**
Pulp Shipments	2.401	2.507	**-4,2%**	2.761	**-9,2%**	2.455	**2,1%**
Paper Shipments	313	323	**-3,0%**	386	**-16,5%**	280	**15,1%**

Source: Suzano, Genial Investimentos

Table 2. Income Statement Summary (1Q24 vs. Genial Est.)

(R$ millions)	Reported	Genial Est.					
Income Statement	**1Q24A**	**1Q24E**	**% Diff.**	**4Q23A**	**% q/q**	**1Q23A**	**% y/y**
Net Revenue	9.459	9.896	**-4,4%**	10.372	**-8,8%**	11.276	**-16,1%**
Adjusted EBITDA	4.558	4.410	**3,4%**	4.505	**1,2%**	6.054	**-24,7%**
Net Income	220	86	**156,0%**	4.515	**-95,1%**	5.243	**-95,8%**

Source: Suzano, Genial Investimentos

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Company

SUZB3 BZ Equity
Buy

Price: R$ 52.70 (10-May-2024)
Target Price 12M: R$ 72.00

SUZ US Equity
Target Price 12M: US$ 14.30

Valuation and rating. Suzano faced some challenges in 1Q24, with a cash flow burn (FCFE) of -R$2.6bn, driven by high CAPEX, as well as a significant level of debt interest, in addition to equity interest (JCP) and share buybacks. The burn was already expected by us and was at a slightly lower level than our estimates. In addition, leverage also increased, with the **Net Debt/EBITDA ratio rising to 3.5x** (vs. 3.1x in 4Q23), but our projections indicate a deleverage in the future, especially after the completion of Cerrado's financial progress execution. For more details on the pace of deleveraging, **see the "Our Take" section** at the end of the report.

Although the pulp market has seen a rapid sequence of price increases, driven by global supply problems and a resilient demand, however, there are indications that these **price adjustments may slow down**, suggesting a **possible stabilization**. In addition, the entry of the Cerrado project into the global pulp supply raises questions about the market's ability to absorb the increase in production, especially in China, where tissue producers' margins are tight.

Even with investors' doubts regarding the potential end of the BHKP price pass-through cycle, we still believed that the **competitive advantages of the Cerrado project were not embedded in Suzano's share prices**, and an upside was imminent when the project's results appeared in the company's figures. However, the company's name has ended up involved in strong speculation in recent days that is making it difficult for the shares to appreciate.

These speculations are wrapped up in the news leaked by the press of a possible acquisition of International Paper (IP) by Suzano. The news, circulated in several highly reputable media outlets, and with a negative reaction from investors, with **(i)** concerns about leverage, **(ii)** diversification strategy and **(iii)** responsible capital allocation. We assess that the synergies in the operation are doubtful and the inopportune timing of the transaction, in the midst of the Cerrado Project, raise doubts about the future impacts on Suzano's competitiveness and financial health. The market is waiting for more information on the unfolding of this potential transaction and its effects on the company's shares.

As everything is just a rumor for now, **we continue to focus on the fundamentals**, which are positive. We see Suzano trading at an **EV/EBITDA 24E** of **6.3x** (vs. 7.5x historical average), with a reasonable degree of discount. We believe that share prices do not seem to reflect the improvement in indicators after the start-up of the Cerrado Project in 2H24, including the **drop in COGS/t to R$500/t in 2025+** (vs. ~R$800/t today). We therefore reinforce our **BUY rating**, with a **12M Target Price** of **R$72.00**, reflecting an **upside** of **+36.62%**.

1Q24 Review: In detail!

Volumes down q/q due to the need to restock. After selling significant volumes at the end of last year, the company had to restock. This, together with the weak seasonality typical of Q1 and the increase in lead times due to logistical restrictions, resulted in shipment volumes of 2,401Kt (-4.2% vs. Genial Est.), down -9.2% q/q, with a slight rise of +2.1% y/y, consolidating a slightly cooler figure than we had expected.

Stars aligned for price pass-throughs. In line with our expectations, Suzano's realized price advanced sequentially by a high single digit (+9.0% q/q; -18.2% y/y) and reached R$3,066/t (-0.3% vs. Genial Est.). This was because the scenario lined up for price pass-throughs to be made, since there was **(i)** a workers' strike at important pulp mills in Finland, resulting in lower supply of BHKP, **(ii)** the crisis in the Red Sea, among other factors. In addition, **(iii)** the company has made several price transfers in recent months, the last one for 1Q24 at the end of February, which ended up taking the reference prices for short-fiber pulp (BHKP) to ~US$656/t in China and ~US$1,126/t in Europe.

New price increases should take effect in 2Q24. We mentioned in the preview report that, after having succeeded in 2 surprising rounds of price increases in 2024 and 6 rounds in Asia and 4 for Europe and the USA in 2H23, the company announced another one in April, valid for the current month. The readjustments announced, which were +US$80/t for North America, +US$60/t for Europe and +US$30/t for Asia, have not yet taken effect and should be included in 2Q24. The price for BHKP in China reached US$720/t vs. US$480/t at the bottom of the cycle, which took place in May 2023.

Paper unit advanced significantly y/y, benefiting from K-C's assets. The Paper unit felt the sequential effect of a slowdown in demand due to seasonality but benefited from the addition of capacity acquired from Kimberly-Clark (K-C) to accelerate y/y. As a result, the company, which became the national market leader in toilet paper and tissue-related products after the acquisition, reported paper sales volume of 313Kt (-3.0% vs. Genial Est.), which represents a fall of -16.5% q/q and a rise of +15.1% y/y. As for the realized price, in line with our expectation, the value presented was flat on a quarterly basis, after a drop in the price in the printing & writing category and increases announced by Suzano in other categories, offsetting each other, and ended up at R$6,713/t (-1.0% vs. Genial Est.), basically stable at -0.3% q/q, but with a drop of -9.4% y/y.

Revenue down q/q and y/y, slightly below expectations. Consolidated net revenue totaled R$9.5bn (-4.4% vs. Genial Est.), down -8.8% q/q and -16.1% y/y. Analyzing the drop in revenue by business unit, we found that the paper business felt the seasonality more than the pulp unit. This is because, although we saw a standard reduction in volume in 1Q24, figures followed the numerous price transfers at BHKP, offsetting the effect of lower volumes and somewhat and generating pulp revenue with a slight slowdown q/q, reaching R$7.4bn (-4.5% vs. Genial Est.), down -5.3% q/q and -20.0% y/y. The paper unit, on the other hand, came in at R$2.1bn (-4.0% vs. Genial Est.), comprising a stronger drop of -19.3% q/q, but advancing low single digit on an annual basis by +1.1% y/y due to the additional volume of K-C, despite weaker prices compared to 1Q23.

Table 3. Net Revenue Suzano (1Q24 vs. Genial Est.)

(R$ millions)	1Q24 Reported	1Q24E Genial Est.	% R/E	4Q23 Reported	% q/q	1Q23 Reported	% y/y
Net Revenue	**9.459**	**9.896**	**-4,4%**	**10.372**	**-8,8%**	**11.276**	**-16,1%**
Pulp	7.360	7.710	-4,5%	7.770	-5,3%	9.201	-20,0%
Paper	2.099	2.186	-4,0%	2.602	-19,3%	2.075	1,1%

Source: Suzano, Genial Investimentos

COGS/t up marginally, as we anticipated. Just as we mentioned in the previous report, COGS/t increased marginally on a sequential basis, even though there was an increase in the price of brent crude oil, inflating the fuel line and affecting the cost/km of transporting wood. However, the figure remained more stable due to measures to reduce COGS, such as **(i)** increasing asset efficiency, **(ii)** reducing the need for chemicals and **(iii)** purchasing less wood from third parties. As a result, the company reported a COGS/t of R$827/t (+0.1% vs. Genial Est.), with a slight advance of +1.3% q/q and a fall of -15% y/y, resulting in a nominal COGS of R$5.7bn (-9.7% vs. Genial Est.), down -15.9% q/q, due to lower volumes and -4.5% y/y due to greater cost efficiency.

EBITDA stable sequentially, in line with our estimate. Consolidated EBITDA remained stable q/q, but fell y/y after a drop in revenue and a slight increase in COGS/t. The paper unit reported EBITDA of R$656mn (-11.1% vs. Genial Est.), down -12.3% q/q and -19.8% y/y, while the pulp business reported R$3.9bn (+6.3% vs. Genial Est.), up +3.9% q/q and down -26.9% y/y. Individually, we noted differences in the SG&A attributed to each business unit, but we calculated a unified result in line. Therefore, consolidated EBITDA stood at R$4.5bn (+3.4% vs. Genial Est.), basically flat at +1.2% q/q, but down -25.9% y/y.

Table 4. EBITDA Suzano (1Q24 vs. Genial Est.)

(R$ millions)	1Q24 Reported	1Q24E Genial Est.	% R/E	4Q23 Reported	% q/q	1Q23 Reported	% y/y
Adjusted EBITDA	**4.558**	**4.410**	**3,4%**	**4.505**	**1,2%**	**6.155**	**-25,9%**
Pulp	3.902	3.672	6,3%	3.756	3,9%	5.336	-26,9%
Paper	656	738	-11,1%	748	-12,3%	818	-19,8%

Source: Suzano, Genial Investimentos

Anemic net income, but still above expectations. The company reported a financial result of -R$3.0bn (+23% vs. Genial Est.) made up of a high exchange rate variation of -R$1.7bn, distributed by -R$2.1bn (-3% vs. Genial Est.) related to the variation arising from the debts issued in USD, together with a positive effect of +R$373mn from exchange rate variations on other balance sheet items in foreign currency, which were not part of our estimate. Operations with derivatives, including the zero-cost collar and NDF, ended up bringing negative results in the amount of -R$635mn. After such accounting, the reported bottom line was R$202mn (2.5x higher vs. Genial Est), but still showing a sharp decline of -95.1% q/q and -95.8% y/y.

Table 5. Income Statement Suzano (1Q24 vs. Genial Est.)

(R$ millions)	1Q24 Reported	1Q24E Genial Est.	% R/E	4Q23 Reported	% q/q	1Q23 Reported	% y/y
Net Revenue	**9.459**	**9.896**	**-4,4%**	**10.372**	**-8,8%**	**11.276**	**-16,1%**
COGS	(5.700)	(6.311)	-9,7%	(6.776)	-15,9%	(5.969)	-4,5%
Adjusted EBITDA	**4.558**	**4.410**	**3,4%**	**4.505**	**1,2%**	**6.054**	**-24,7%**
EBITDA Margin (%)	48,2%	44,6%	3,63p.p	43,4%	4,76p.p	53,7%	-5,5p.p
EBIT	**2.552**	**2.573**	**-0,8%**	**3.158**	**-19,2%**	**4.306**	**-40,7%**
EBIT Margin (%)	27,0%	26,0%	0,98p.p	30,4%	-3,47p.p	38,2%	-11,21p.p
D&A	(1.982)	(1.837)	7,9%	(1.788)	10,9%	(1.748)	13,4%
Financial Result	(3.040)	(2.470)	23,1%	2.269	-234,0%	2.470	-223,1%
Net Income	**220**	**86**	**156,0%**	**4.515**	**-95,1%**	**5.243**	**-95,8%**
Net Margin (%)	2,3%	0,9%	1,46p.p	43,5%	-41,2p.p	46,5%	-44,17p.p

Source: Suzano, Genial Investimentos

Our take on Suzano

Cash flow burn, but to a lesser extent than we expected. Nothing to be alarmed about. In 1Q24 Suzano burned -R$2.6bn of cash flow (FCFE), in contrast to a positive generation of +R$876mn in 4Q23 and +R$384mn in 1Q23. Breaking down the 1Q24 figure, we see -R$1.6bn earmarked for the payment of dividends/JCP and share buybacks. **Excluding this amount**, we see **FCFE of -R$993mn** (-19% vs. Genial Est.), representing a lower cash flow burn compared to our expectations, to the detriment of a **CAPEX slightly lower** than we projected, **at R$4.2bn** (-6.4% vs. Genial Est.). Working capital and EBITDA dynamics were in line with expectations.

Leverage is up. Investor reaction may be negative, but it's according to our model. The company reported higher leverage in 1Q24. The Net Debt/EBITDA indicator **rose to 3.5x (vs. 3.1x in 4Q23)**, as there was a contraction in LTM EBITDA to R$16.7bn (-8.2% vs. previous LTM), as well as an increase in net debt to R$59.6bn (+7.3% vs. 4Q23). The vectors in opposite directions ended up stretching the leverage multiple. We believe that the indicator should rise over the course of the current year due to the remaining disbursements with the Cerrado project schedule, which closed 1Q24 with a financial progress of 87%. We believe that FCF generation will continue to be pressured by high CAPEX this year, in addition to the fact that the start-up of the Ribas do Rio Pardo (MS) plant should raise COGS/t in the first few months of operation until a slightly more robust ramp-up levels came along in 2025, bringing additional short-term pressure on EBITDA 24E.

We believe that the deleveraging process will only come in 2025. After start-up and a normalization of the initial production phase of the Cerrado project, of course, we should see a large positive effect on EBITDA driven by the increase in volume and a considerable reduction in COGS/t in 2025+, as we have already advanced in several past reports. We considered in our model a leverage of **3.2x Net Debt/EBITDA 24E**, slightly higher than that presented at the end of 2023, so that 2024 does not seem to us to be the year in which the company will reduce the indicator, even if it opens Cerrado in June.

Our no deleveraging assumption in 24E already consider a positive EBITDA effect of the price pass-troughs rounds. The increases in pulp prices should probably lead to an improvement in LTM EBITDA in order to lower leverage from the current level of 3.5x in 1Q24 to 3.2x in 4Q24E. However, we still believe that the company should reach the end of 2024 slightly higher than at the end of 2023. Only from 2025 onwards, according to our estimates, would the company begin the deleveraging process, reducing the indicator to **2.7x Net Debt/EBITDA 25E**. That's if Suzano doesn't get involved in another investment cycle, such as the one rumored in the news about the acquisition of IP.

Will the pace of pulp price pass-through slowdown from now on? 2Q24 should bring good results, since the adjustments of +US$80/t for North America, +US$60/t for Europe and +US$30/t for Asia will only have an effect by then, which in turn will end up taking advantage of a weak y/y base, unlike 1Q24. With this latest pass-through on April 19, the price for BHKP in China reached US$720/t.

During these periods of price transfers by the big players, we witnessed a promising scenario for the pulp industry, as they coincided with **(i)** production interruption problems in Finland, **(ii)** a supply system pressured by logistical bottlenecks due to geopolitical conflicts, leading the European market to consume less Chinese product **(iii)** the lingering consequences of the forest fires in Chile, as well as **(iv)** the slower than initially expected ramp-up of UPM's Paso de Los Toros asset.

However, we believe that there is a possibility that price adjustments will become less frequent, indicating a **possible stabilization or even a slight reduction**, especially with the entry of the Cerrado into the global supply panorama. Therefore, the rapid sequence of price increases that occurred between the end of last year and the first months of 2024 seems to be more of a passing circumstance than a solid structural trend, subject to change soon.

With Cerrado starting up, will paper producers absorb the new pulp supply? Cerrado will add 2.5Mt at the end of the ramp-up, and many investors have doubts about the absorption capacity of non-integrated paper producers in relation to the increase in supply. At the same time as we see tissue producers in China with tight margins after the cost of raw materials increased, we also noted new machines still in ramp-up, which could reduce costs by generating operating leverage after completion, bringing margins back up again. China therefore seems to us to be a more complicated destination for new Cerrado production in the short term. As for Europe, it seems more feasible. Paper producers are enjoying healthier margins and domestic production is increasing to the difficulty of importing Chinese products following the clashes that are disrupting the Red Sea route.

IP bid: The market didn't like it, and neither did we. Investors were surprised by news suggesting an offer from Suzano to acquire International Paper (IP) for US$15bn, with US$42/share, entirely in cash. This information, initially leaked by Reuters, generated negative reactions, with Suzano's shares falling -12.3% on B3 on the day the news went public. Suzano's official response denied the existence of any formal agreement but left room for speculation about the company's studies in this direction. The possible acquisition of IP by Suzano is seen as complex and questionable, given the size of the transaction and the lack of clear synergies.

While Suzano is looking to diversify geographically and reduce its dependence on the pulp market, the offer faces investors criticism due to its high leverage and inopportune timing, with the imminent conclusion of the Cerrado Project. Our analysis suggests that the transaction would compromise Suzano's leverage and could reduce its cost competitiveness, drastically affecting the investment thesis we see for the company. For more information on the potential deal, we strongly recommend reading our report on this topic, which is attached below (Alleged purchase of IP: Bermuda Triangle).

Faced with negative market reactions, the scenario for Suzano's shares may lack bullish catalysts in the short term, since uncertainty over capital allocation **may create an overhang in the shares**. The company has officially stated that it has not made a binding proposal for the acquisition of International Paper (IP), but the market remains attentive to developments, considering the potential impacts of this transaction on Suzano's strategy and deleveraging process.

The enemy hides in the shadows. With the 1Q24 presenting a sequentially flat EBITDA, without many surprises, investors' eyes are turning to the rumors of IP's takeover bid, a topic that, for the time being, is hiding in the shadows due to the market's lack of belief in Suzano's official response, which may have sounded vague to many investors. For now, let's wait for further market movements and official statements from the company about the case. The 1Q24 conference call with analysts today may provide further indications of what happened. We believe it will be discussed in the Q&A and the shares may react depending on what management says.

As everything **is just a rumor for now**, we continue **to focus on the fundamentals**, which are positive. We see Suzano trading at an **EV/EBITDA 24E of 6.3x** (vs. 7.5x historical average), with a reasonable degree of discount. We believe that share prices do not seem to reflect the improvement in indicators post start-up of the Cerrado Project in 2H24, including the **downward trend in COGS/t to R$500/t in 2025+** (vs. ~R$800/t today). We therefore reinforce our **BUY rating**, with a **12M Target Price** of **R$72.00**, reflecting an **upside** of **+36.62%**.

Appendix: Suzano

Figure 1. Suzano – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**44.034**	**51.068**	**53.783**	**56.737**	**57.702**
(-) COGS	(27.659)	(31.324)	(31.487)	(30.557)	(30.374)
Gross Profit	**16.375**	**19.745**	**22.297**	**26.180**	**27.328**
(-) Expenses	(5.251)	(6.155)	(6.620)	(7.074)	(7.191)
Adjusted EBITDA	**18.953**	**21.703**	**23.749**	**27.164**	**28.172**
(-) D&A	(7.829)	(8.113)	(8.072)	(8.059)	(8.035)
EBIT	**11.124**	**13.590**	**15.677**	**19.105**	**20.137**
(+/-) Financial Result	(5.031)	(1.661)	(3.534)	(1.342)	143
(-) Taxes	(1.024)	(2.006)	(2.042)	(2.987)	(3.410)
Net income	**5.068**	**9.923**	**10.101**	**14.776**	**16.870**
Profitability					
Net margin (%)	11,51%	19,43%	18,78%	26,04%	29,24%

Figure 2. Suzano– Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**44.034**	**51.068**	**53.783**	**56.737**	**57.702**
(-) COGS	(27.659)	(31.324)	(31.487)	(30.557)	(30.374)
Adjusted EBITDA	**18.953**	**21.703**	**23.749**	**27.164**	**28.172**
EBIT	**11.124**	**13.590**	**15.677**	**19.105**	**20.137**
(-) Taxes	(1.024)	(2.006)	(2.042)	(2.987)	(3.410)
(+) D&A	7.829	8.113	8.072	8.059	8.035
(+/-) Δ WK	(867)	(634)	(474)	(114)	(116)
(-) Capex	(13.547)	(8.244)	(8.065)	(7.791)	(7.954)
FCFF	**3.514**	**10.818**	**13.169**	**16.273**	**16.692**

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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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