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SUZANO

Site Visit: Limeira plant, now its feast or famine

LatAm Pulp & Paper

(i) A few days ago, we visited Suzano's Limeira (SP) plant, which opened in 1959 and has been operated by the company since 2005, with some investors. As well as expanding our knowledge of the company's operations in the interior of the state of São Paulo (SP), **(ii)** we came across new proposals that are being studied to add greater value to the company's business, through studies in the R&D laboratory, which is attached to the production plant. **(iii)** The expansion of the Fluff operation at the Limeira plant drew attention on the positive side. **(iv)** However, although the company didn't comment on the potential acquisition of International Paper (IP), the conversations we had with investors after the visit were partly focused on this subject. More details throughout the report. **(v)** Trading at an **EV/EBITDA 24E** of **6.0x** (vs. 7.5x historical average), with a **very reasonable degree of discount**, the share price does not seem to reflect the improvement in Suzano's indicators after the start-up of the Cerrado Project in 2H24. We therefore reinforce our **BUY rating**, with a **12M Target Price** of **R$72.00**, reflecting an **upside** of **+52.83%**.

Limeira plant operations in a nutshell. The Limeira plant (SP) has the capacity to produce 690Ktpa of pulp and is one of Suzano's 4 integrated plants, which can produce **(i)** market pulp (~400Ktpa), **(ii)** integrated pulp (~290Ktpa) and **(iii)** paper (~400Ktpa). The production process begins in the forests around various areas of the state of São Paulo. When the wood arrives in logs in the plant yard, after measuring and weighing, the wood is cut, and the logs are rested to lose moisture.

After a rest period, the log is sent to the chipper, where it is transformed into chips to undergo a better reaction with the chemical products, increasing the contact area. This chip goes to the continuous digester in order to dissolve the lignin, which represents 30% of what could be extracted from the wood. From there, the process is divided into two different destinations: **(i)** the paper machine and **(ii)** the production and set up of market pulp.

New technologies. In addition to the pulp and paper production areas, we were also introduced to the R&D sector, which is attached to the Limeira (SP) unit and carries out research applied to products, including those from other Suzano plants in different states of Brazil. Our first impression of the sector was very positive. Throughout the explanations we received about the niches in which they operate, they confirmed the viability of innovations, patents, and different forms of production processes, both for pulp and for different ways of using lignin, and also for consumer goods. One example that impressed us were the boxes made from bleached cardboard, derived from BHKP, an innovation that is opposed to the cardboard boxes made from kraftliner, derived from BSKP, which are normally used. We were also surprised by the project to obtain fluff from BHKP. Although it's not a complete novelty, with Suzano having already started producing the product some time ago, on the visit we learned a little more about the financial viability and advantages that BHKP can generate for making fluff.

Analysts

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

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

Rafael Chamadoira
+55 (11) 3206-1457
rafael.chamadoira@genial.com.vc

Company

SUZB3 BZ Equity
Buy

Price: R$ 47.11 (03-Jun-2024)
Target Price 12M: R$72.00

SUZ US Equity
Target Price 12M: US$ 14.30

Converting a pulp dryer in Limeira to fluff. Fluff pulp is usually used in consumer goods for diapers (geriatric and children's) and personal hygiene utensils, such as feminine pads. It is usually produced using pulp from softwood (BSKP), derived from pine trees, which are restricted from being grown in Brazil on a large scale due to the country's tropical climate.

If, on the one hand, Pinus is more common in countries with a dry and cold climate, such as the Nordic countries (mainly Finland), on the other hand, Brazil seems to be suitable for growing Eucalyptus, from which Hardwood (BHKP) is obtained, since there has been stronger adaptation of planting in different regions throughout the country. Pinus was only viable in the southern regions of Brazil, such as Parará (PR) and Santa Catarina (SC). Therefore, in addition to eucalyptus reaching its cutting age much earlier than pine (~7 years vs. ~15 years), Suzano is aware of the importance of large-scale volume viability, by being able to produce fluff from the wood of Brazil's predominant trees. Today, the company already produces 100Ktpa of Eucafluff, the world's first eucalyptus fluff, at its plant in Suzano (SP).

However, the company is investing in converting another of its machines to produce Eucafluff, precisely at the Limeira (SP) plant, which we visited. The total CAPEX to convert the dryer will be R$490mn, which currently produces 100% BHKP as market pulp (~400Ktpa). The machine will have a total output of 340Ktpa acting as flex capacity (fluff or market BHKP), which would represent ~77% of installed capacity, with start-up in 4Q25. So, unfortunately, we were unable to witness this operation, as the conversion project won't be ready until the end of 2025. However, thinking that the cost of manufacturing a product with rising demand trends may fall and the volume produced rise, we believe in wider margins in the near future.

How much can the dryer conversion increase EBITDA figures? In order to get an approximation of how much the EucaFluff business at the Limeira (SP) mill can add to the company's figures, we inferred a greater added value in the price of market pulp traded from 2026 onwards, assuming premium assumptions based on the representativeness of the plant in relation to all the company's mills. The delta margin is equivalent to +US$70/t converting BHKP into fluff, which gives us a premium of ~10% vs. the spot price of BHKP China.

We know that Suzano has 13 lines and a total capacity of ~14,5Mtpa of pulp (incl. Cerrado). The Limeira (SP) mill, where the EucaFluff project will be ready in 4Q25, represents 4.8% (~690Ktpa) of the company's total capacity. We assume that ~20% of this 690Ktpa will be transformed into fluff at the beginning of 2026, so ~140Ktpa Genial Est. will be activated in relation to the 340ktpa flex capacity that we have already mentioned throughout the report. We are considering that **82% of the flex capacity** will be reached at the end of 2028. So, we use a ramp-up of ~51Ktpa, until we achieve in our model ~**2% of EucaFluff production vs. total capacity** (incl. Cerrado) at the end of 2028, which represents ~280Ktpa Genial Est.

Putting these assumptions into the model, we see an increase of **+0.6% in 26E EBITDA**, **+0.7% in 27E EBITDA and +0.9% in 28E EBITDA** vs. our previous estimates. It is worth mentioning that no cost assumptions were changed, apart from CAPEX (already included in the guidance) and the level of normal inputs for the production volume. The aim of the exercise was to measure the added value that fluff production in Limeira could generate.

Table 1. Change in EBITDA with fluff conversion

DATE	EBITDA ex. Fluff Ops (R$)	EBITDA incl. Fluff Ops (R$)	Δ
2026	**26.508**	**26.664**	**0,6%**
2027	**29.841**	**30.059**	**0,7%**
2028	**30.840**	**31.118**	**0,9%**

Source: Genial Investimentos

Our Take on Suzano

The expansion of the Fluff operation at the Limeira (SP) plant drew attention on the positive side. However, although the company did not comment on the potential acquisition of International Paper (IP), the conversations we had with investors after the visit were partly focused on this subject. While we probed investors' optimism about obtaining fluff through short fiber (BHKP), which was discussed during the visit to the Limeira (SP) plant, on the other hand we saw pessimism about the bid offer for IP. As IP is focused on BSKP mix and is allocated to temperate climate countries (USA and Europe), its assets do not show a clear synergy with Suzano's corebusiness in BHKP.

Recalling the recent events. We have seen very negative market reactions since May 7, after Reuters reported a potential acquisition of International Paper (IP) by Suzano for US$15bn (equivalent to its own Market Cap, before the announcement). The stock has suffered a cumulative drop of -20% in ~25 days, and the scenario lacks consistent bullish catalysts in the short term, since the uncertainty over capital allocation has created an overhang. The market has interpreted that the acquisition potentially has a size that is difficult to justify, and the synergies are not obvious. On May 22, as a result of the high volatility of the shares, Suzano went public to confirm that it is, in fact, interested in IP's assets, but that it has not yet made an official bid for the acquisition (biding or non-binding offer).

IP's CEO, Mr. Andy Silvernail, stated on May 23 that the company is not engaged in Suzano's potential takeover bid and that it remains focused on the acquisition of DS Smith, expected for 4Q24, in a deal that is valued at ~US$10bn. However, on the same day, Bloomberg published an article mentioning that Suzano is in talks with Japanese banks (Mizuho, Nomura and Mitsubishi UFJ), to acquire a bridge loan and prepare an official offer, increasing leverage, which is precisely what investors fear.

The transaction would take place in a similar format to Fibria's in 2018, involving **(i)** cash and **(ii)** shares swap. In our view, the news is negative as it reinforces Suzano's interest in the deal, but on the other hand, we believe that the option to share swap may cool bearish sentiment a little, since previous news was considering a 100% cash operation. If there is no share swap, we assess the need to raise debt of ~US$12bn, which would increase leverage to **4.6x Net Debt/EBITDA 24E**. vs. 3.5x in 1Q24, generating investor misgivings. For more details on our opinion regarding the potential acquisition of IP, we strongly recommend reading our report dedicated to this specific topic, which is attached (link).

Now its feast or famine. We believe that a significant percentage of justified fall for unexpected storyline change has already occurred, so part of the negativity that the market sees in the acquisition has already been priced in. Although we also think that the shares could fall a little more when the official announcement is made (if it comes), we are not downgrading our rating at the moment, due to the possibility (which still exists) that the deal will not go through, since IP is not interested in disposing of the DS Smith acquisition and Suzano does not seem to have the structure to make an offer that includes IP + DS Smith together.

We believe that if the deal is confirmed, the shares will continue to suffer losses, this time at softer levels, and will be left without any bullish catalysts even with Cerrado's debut in the coming days. On the other hand, the long position flow will return to the shares if IP consistently denies its interest in accepting Suzano's offer. And in that case, the shares could rise sharply in the coming months. Today, investing in Suzano has become **feast or famine dilemma**, since we know that the market is mostly short-term in nature and doesn't react positively to changing narratives (especially applied in commodities companies).

Thus, there is a potential divergence between what the market would like to see happen after Cerrado's start-up and management's decision to proceed with an attempt to acquire IP's assets. Investors expected: **(i)** deleveraging, **(ii)** strong FCF generation, **(iii)** share appreciation and **(iv)** dividend distribution. On the other hand, if the company decided to follow through with a bid to acquire IP's assets, it would inevitably lead to a more leverage stance and this situation would call into question the effective allocation of capital that the company has shown in recent years. We believe that focusing on geographic diversification through a potential deal with IP may not be ideal at the moment. Therefore, the best option would be a smaller acquisition, more similar to the M&A carried out with Kimberly-Clark (K-C), even if it is outside Brazil.

On the **fundamentals side**, last week **Suzano announced a new increase in BHKP prices for June** orders and it will be the sixth readjustment in 2024. In Europe and North America, the increase will be US$60/t, raising prices to US$1,500/t and US$1,730/t, respectively. In Asia, the increase will be US$30/t, which could take the price in China to **US$770/t if the May adjustment has already been applied**. Even though there is a lack of confidence about the addition of pulp capacity, we believe that, in the short term, the supply problems in Finland and the crisis in the Red Sea can still guide pulp prices to a positive scenario.

Trading at an **EV/EBITDA 24E** of **6.0x** (vs. 7.5x historical average), with a **very reasonable degree of discount**, the share price does not seem to reflect the improvement in Suzano's 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). However, the market continues to pay more attention to the possible agreement with IP, and disregards the company's operational side, which is in a positive moment. We therefore reinforce our **BUY rating**, with a **12M Target Price** of **R$72.00**, reflecting an **upside** of **+52.83%**.

Appendix: Suzano

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

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**31.703**	**50.900**	**53.772**	**56.775**	**57.801**
(-) COGS	(18.492)	(28.523)	(28.468)	(27.361)	(26.973)
Gross Profit	**13.211**	**22.377**	**25.303**	**29.414**	**30.828**
(-) Expenses	(3.888)	(6.430)	(6.924)	(7.402)	(7.531)
Adjusted EBITDA	**21.125**	**24.413**	**26.664**	**30.059**	**31.118**
(-) D&A	(6.163)	(8.467)	(8.284)	(8.048)	(7.820)
EBIT	**14.961**	**15.947**	**18.380**	**22.012**	**23.297**
(+/-) Financial Result	(5.147)	(3.077)	(3.959)	(2.043)	(654)
(-) Taxes	(861)	(4.376)	(4.903)	(6.789)	(7.699)
Net income	**8.953**	**8.494**	**9.518**	**13.179**	**14.945**
Profitability					
Net margin (%)	28,24%	16,69%	17,70%	23,21%	25,86%

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

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**31.703**	**50.900**	**53.772**	**56.775**	**57.801**
(-) COGS	(18.492)	(28.523)	(28.468)	(27.361)	(26.973)
Adjusted EBITDA	**21.125**	**24.413**	**26.664**	**30.059**	**31.118**
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(-) Taxes	(861)	(4.376)	(4.903)	(6.789)	(7.699)
(+) D&A	6.163	8.467	8.284	8.048	7.820
(+/-) Δ WK	(4.003)	(781)	(612)	(140)	(140)
(-) Capex	(11.155)	(7.783)	(6.550)	(6.220)	(6.324)
FCFF	**5.106**	**11.474**	**14.600**	**16.910**	**16.955**

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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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