genial Equity Research

KLABIN

Plateau Project: Positive, but has hidden risks

LatAm Pulp & Paper

Main takeaways:

We believe that the Plateau is focused on **three specific points**: **(i)** early monetization of forestry assets, **(ii)** accelerated deleveraging in return for **(iii)** the presumption of self-sufficiency in wood production. Through the creation of **4 SPVs** controlled by Klabin and with the participation of a **Timber Investment Management Organization** (TIMO - investment fund focused on forestry assets), the project seeks to optimize the company's forestry portfolio in the states of Paraná (PR), São Paulo (SP) and Santa Catarina (SC). We believe that the company is **transferring the right to use its land to SPVs** and will enter into a contract with TIMO agreeing to the **right to purchase wood extracted from these lands**, thus guaranteeing supply for Klabin. Precisely based on the positive short-term impact of the perception that investors would have of **deleveraging**, in addition to the **good momentum** that we see for the execution of the company's other projects, such as **Figueira** and the **MP28 ramp-up**, the **BUY rating** is maintained, with a **12M Target Price** of **R$27.00**, taking the shares to an **upside *of* +29.87%**. However, we may revise our medium-term projections as more information on contractual agreements emerges, **mainly related to wood purchase**.

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Company

KLBN11 BZ Equity
Buy

Price: R$ 20.79 (30-Oct-2024)
Target Price 12M: R$ 27.00

Klabin announced the **Plateu Project** yesterday morning, **October 30th**. Our **initial perception is positive**, especially given the arrangement of the deal and the company's crystal-clear **commitment to accelerating the deleveraging process from 2025 onwards**. The indicator closed **2Q24** at **3.2x Net Debt/EBITDA**. It is important to put into context that the company will now have a significant cash flow write-off in 3Q24 (to be announced next week). We expect a **FCFE burn** in **3Q24** of **-R$5.6bn**, due to the payment for the Caetê Project (~R$5.8bn for land acquired from Arauco). This situation will cause leverage to jump significantly, which in our accounts would rise to **3.7x Net Debt/EBITDA 24E**.

What are the conditions of the agreement between Klabin and TIMO? Klabin would receive an **injection from TIMO** into its **cash flow** of **R$1.8bn** (paid in 2 installments - 1Q25 and 2Q25) **+ R$900mn potential**. This reinforces the company's commitment to discipline in capital allocation and the potential increase in ROIC. The project is expected to generate synergies by integrating harvesting and forestry operations, potentially reducing the cost of timber extraction.

A priori, we understand that the company sewed up the deal maintaining a shareholding that **would infer control of the SPVs** (57% of the total capital will be held by Klabin, 92% of which will be ordinary shares). This corroborates the thesis that the company's bargaining power will increase regarding the **cost of paying for** TIMO's **wood supply** (we'll go into this in more detail in the “Our Take” section). **TIMO** would become part of Klabin's share capital and **would be entitled to the dividends flow paid**, since it accumulates preferred shares.

In this sense, Klabin could end up improving its gross margin by **reducing COGS/t** of wood purchasing and consequently increasing EBIT. It is also worth mentioning that the agreement between the company and TIMO provides for **future flexibility** in the use of forestry assets, justified by the possibility of Klabin repurchasing shares and/or assets in the **SPVs**.

Breaking down the deal

The short-term consequence will be a reduction in leverage. The deal structure provides for the contribution to the 4 SPVs of 23k ha of planted forests and 4k ha of productive land that were already registered by Klabin, in addition to the 37k ha of planted forests and 39,000 ha of productive land that came from the Caetê Project. TIMO, on the other hand, will contribute R$1.8bn. This resource will be injected into Klabin's cash flow, paid in 2 tranches by 2Q25, with the possibility of an additional disbursement of up to R$900mn, under undisclosed conditions. If the amount is paid in full (**R$2.7bn**), our proprietary model suggests that the **company's leverage could fall** to **3x Net Debt/EBITDA 25E** vs. 3.3x 25E previously. This structure, therefore, aims to strengthen **(i)** short-term liquidity and **(ii)** adjust the projected leverage (**-0.3x Net Debt/EBITDA**), via the anticipation of asset monetization, improving the balance sheet.

What are the potential risks? We would like to highlight some of the risk factors intrinsic to the project, such as: **(i)** being subject to regulatory issues, approval by the competent bodies and execution; as well as **(ii)** variations in the exchange rate, logistics costs for transporting the wood and forestry setbacks. It is also important to note that **(iii)** possible changes in land use policies and seasonality in the forestry markets may imply a deviation from of the deleveraging processes and operational synergies. Last but not least, we highlight the **main risk we see** as being **(iv)** the **undisclosed conditions of the agreement** between Kabin and TIMO for the **wood purchase.**

We understand that there is a **possibility that TIMO will demand a higher return** on the project **via the payment for the wood supply,** if the dividend flows earned do not sustain a good level of NPV from TIMO's own perspective (we will explore this point later). This, on the other hand, would reduce the NPV from Klabin's point of view, with fewer synergies and less potential for cooling down COGS/t, as it would be buying the wood from the SPVs and paying an additional price to its cost compared to the scenario in which it still owned the land.

The new dividend policy reduces yield but shows commitment to deleveraging. The new dividend policy, **reduced to 10-20% of adjusted EBITDA** (vs. 15-25% previously), aims to retain cash flow in the company itself, reducing the amount to be distributed to other shareholders. As a result, Klabin's Dividend Yields will undoubtedly be lower. We revised our model to reflect the new policy and arrived at a **24E Dividend Yield** compression to **5.1%** (vs. 5.5% previously). We also highlight the **larger contraction** to **5.5% 25E** (vs. 7.0% previously) and **5.7% 26E** (vs. 7.1% previously). The impact on our modeling is such that, with the new policy, we don't see any time when Klabin shareholders would earn a Dividend yield above 6.5% over the next 5 years.

New policy conveys two messages: **(i)** the company's greater commitment to deleveraging, reducing spending on dividends, which were paid even in quarters when FCFE was negative. We didn't see that attitude as the best one for allocating capital. With a lower level of spending to be applied to shareholder remuneration, there is greater preservation of cash flow and, therefore, retaining the resource would help improve the Net Debt indicator, reducing leverage. In addition, we believe that **(ii)** by limiting the flow of dividend payments, Klabin would try to increase the NPV of the Plateau project from its perspective, since it would reduce the cash outflows that would increase the NPV from TIMO's perspective.

Our Take on Klabin

So far so good, but... From Klabin's point of view, the deal seems to make sense. In principle, we can see: **(i)** an early monetization of forestry assets; in addition to **(ii)** accelerating the deleveraging process and signaling greater discipline in capital allocation. In addition, we like the **(iii)** condition of future optionality, with the possible repurchase of assets and/or an increase in the SPVs stakes, while also pointing out that **(iv)** the change in the dividend policy encourages optimistic speculation as to the reduction in the perception of risk in relation to the generation of FCF.

However, we would like to **draw the investor's attention** to the potential increase in ROIC, justified by the **(v)** risk implicit in the reduction in the cost of paying for the wood supply, conditioned by synergistic assumptions between Klabin and the controlled shareholder (TIMO). In other words, the logical rationale of every deal is the “win-win” situation. For TIMO, the agreement to the deed must be supported and the perception we have is that Klabin structured the deal to indicate a dividends flow for TIMO, but at the same time, reduced the policy of paying dividends.

Does it make sense for TIMO? As a proxy for rationality, we did an exercise to calculate the NPV that TIMO would be earning from the project, considering only the inflow from dividends. As we have already mentioned, TIMO would receive dividends as a result of gaining a stake in Klabin's share capital after disbursing the combined amounts. To arrive at this figure (which is obviously an approximation), we made some assumptions, such as: **(i)** holding **4%** of Klabin's **total capital in 1Q25**, obtained through the contribution of +R$900m (50% of the agreed R$1.8bn) and relative to Klabin's market cap on the day before the announcement (R$25.4bn); and **(ii)** an increase in participation to **12% in 2Q25**, which would be justified by the contributions of +R$900mn (or another 50% of the agreed R$1.8bn) added to the +R$900mn (undisclosed performance conditions).

In addition, we considered **(iii)** the change in Klabin's dividend payment policy. Regarding the **time horizon** for calculating the NPV, we assumed that **(iv)** the dividends flow would begin to be **received** by TIMO in **1Q25**, corresponding to its participation in the total amount of dividends that we are estimating for Klabin in our model **until perpetuity**, brought to present value by **Ke** of **~11%**. It would be logical to assume that the NPV would be attractive, but that's not the conclusion we reached, with the NPV being close to zero. In other words, **only via dividends**, **the deal doesn't seem to make sense for TIMO**.

How can this negatively impact Klabin? The hypothetical exercise indicates that if TIMO is not getting an acceptable return via dividends**, it will probably do its best to squeeze out returns** via other forms of profitability, such as the **sale of timber from the SPVs to Klabin**. So, the idea of increasing Klabin's ROIC would become uncertain, while the wood supply agreement is subject to certain **unspecified conditions**. Our analysis suggests that, in order to confirm whether the deal was attractive to Klabin in the medium and long term, we would have to be more open about the price and availability conditions of the wood that the company would be buying from SPVs. This has not been disclosed by Klabin to date.

Despite the risks, the general outlook is positive. We believe that the Plateau Project is a strategic step towards improving Klabin's risk perception in the market. This should help, for example, to re-evaluate the discount rates applied to the company, presenting a **clear decision to focus on the deleveraging process**. Therefore, precisely on the basis of the positive short-term impact of the perception that investors would have of deleveraging, in addition to the **good momentum** that we see for the execution of the company's other projects, such as **Figueira** and the **MP28 ramp-up**, the **BUY rating** is maintained, with a **12M Target Price** of **R$27.00**, taking the shares to an **upside *of* +29.87%**. However, we may revise our medium- to long-term projections as more information on contractual agreements emerges, mainly related to wood purchase.

Appendix: Klabin

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

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**19.341**	**20.440**	**21.627**	**21.924**	**22.142**
(-) COGS	(11.969)	(12.253)	(12.584)	(12.927)	(13.079)
Gross Profit	**7.690**	**9.118**	**10.025**	**9.496**	**9.213**
(-) Expenses	(3.562)	(5.046)	(5.065)	(4.552)	(4.273)
Adjusted EBITDA	**7.411**	**7.673**	**7.808**	**7.866**	**8.279**
(-) D&A	(3.715)	(4.833)	(3.830)	(3.421)	(3.489)
EBIT	**4.122**	**4.072**	**4.960**	**4.944**	**4.941**
(+/-) Financial Result	(1.173)	(904)	(573)	(491)	(244)
(-) Taxes	(903)	(981)	(1.381)	(1.089)	(1.125)
Net income	**2.061**	**2.202**	**3.020**	**3.378**	**3.587**
Profitability					
Net margin (%)	10,66%	10,77%	13,97%	15,41%	16,20%

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

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**19.341**	**20.440**	**21.627**	**21.924**	**22.142**
(-) COGS	(11.969)	(12.253)	(12.584)	(12.927)	(13.079)
Adjusted EBITDA	**7.411**	**7.673**	**7.808**	**7.866**	**8.279**
EBIT	**4.122**	**4.072**	**4.960**	**4.944**	**4.941**
(-) Taxes	(903)	(981)	(1.381)	(1.089)	(1.125)
(+) D&A	3.715	4.833	3.830	3.421	3.489
(+/-) Δ WK	(318)	(192)	(153)	(56)	(3)
(-) Capex	(3.368)	(3.086)	(2.972)	(2.510)	(2.075)
FCFF	**3.248**	**4.647**	**4.285**	**4.710**	**5.226**

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