

Suzano

Brazil, Paper

Accounting		Climate Assumptions		Audit		Date of analysis: May 10 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2020 Report date: April 29 2021 AGM: April 29 2021
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Some concerns	CA 100+ company, so seen by investors as key to driving global net zero emissions
<p>Summary view:</p> <ul style="list-style-type: none"> Suzano faces significant climate risks both from the impact of climatic changes on biological assets and the increased costs associated with anticipated stricter environmental regulations. However, the discussion of climate risks in the narrative reporting of the 20-F is relatively brief, while the other reporting (such as the website and last year's Sustainability Report) instead highlights the stated strengths of Suzano in this area. Suzano claims to have significantly negative net carbon emissions (i.e. to be climate positive) and the company identifies a number of strategic opportunities related to climate change. 						

Background

The Business

- Suzano is an integrated pulp and paper company. In 2019, it merged with Fibria to become the largest pulp producer in the world with an installed capacity of 10.9m metric tons of eucalyptus pulp per year. The company has 1.3m hectares of renewable forests of eucalyptus.
- Suzano is based in Brazil with a primary listing on the Novo Mercado listing segment of the São Paulo Stock Exchange (B3) and ADRs listed on the NYSE. Suzano is controlled by the Feffer family, whose controlling bloc of 46% is held both directly and through Suzano Holding. The remaining 54% is free float. It has two segments:
 - Pulp (2020: 84% of sales; 88% of operating profit): comprises the production and sale of hardwood eucalyptus pulp, mainly to supply the foreign market, with any surplus sold domestically. Global hardwood pulp demand is forecast to grow from 35.8m tons in 2020 to 40.4m tons in 2025 as demand for tissue and packaging (including plastics substitution) more than off-sets declining use for printing and writing paper and as hardwood pulp gains share from softwood pulp. By destination, 43% of pulp exports were to Asia, 22% to Europe and 35% of production was for the Americas. Chinese demand, which is already 39% of the global market, is expected to drive growth of pulp consumption in the years ahead, with a compound annual growth rate of 9.4% since 2005 against the global average of 2.5%.
 - Paper (2020: 16% of sales; 12% of operating profit): comprises the production and sale of paper for domestic and foreign markets, with end-products including paperboard for packaging, printing and writing paper and tissue paper. Suzano has capacity to produce 1.4m tons of paper.
- Suzano has significant exposure to climate risk both through the potential impact of climate change on planted forest areas and through anticipated stricter environmental regulations. However, the company asserts that climate is a key part of its competitive position and that it has net negative carbon emissions.

Approach to climate change

- The company's articulation of climate risks in both narrative reporting and other disclosures is relatively brief, with the emphasis instead on Suzano's comparative advantage from climate change, and sustainability credentials in general. It states that it is preparing a technological roadmap with actions to quantify the risk and impacts on forest productivity, so it may be that more comprehensive discussion of climate risks will be published this year.
- The Risk Factors in the narrative reporting refer to climate change risk working through both physical and regulatory routes. On physical risk, the company notes that "changing global

climatic conditions may impact planted forest areas ... may increase liabilities and CAPEX and adversely affect the company's operations and financial condition". Climate change is noted as a potential risk to wood availability. On regulatory risk: "we may be materially affected by more restrictive environmental laws and regulations related to greenhouse gases and climate change, to the extent that such new laws or regulations may cause an increase in capital expenditures and investments to comply with such laws, and indirectly, by changes in prices for transportation, energy and other inputs."

- Suzano's stated aim is to be a "benchmark in the sector for efficiency, profitability and sustainability" and a "reference in sustainable and innovative solutions". Management all have at least one KPI related to sustainability (although not necessarily climate change).
- Emphasizing the upside risks from climate change, renewable materials and carbon capture are both highlighted as strategic opportunities. By-products, such as lignin, could also be a potential replacement for fossil fuels. Biotech is mentioned both as a means to address new markets, with plastics substitution, construction, animal nutrition and textiles mentioned as possibilities, and as a route to enhance the resistance of trees to the effects of climate change.
- The Climate Strategy announced in February 2020 includes two targets for 2030: (i) "Even more climate positive" – remove 40m tCO₂ from atmosphere (Scopes 1, 2 and 3); and (ii) reduce specific emissions by 15% (Scopes 1&2) (baseline 2015).
- Suzano states that it has net negative carbon emissions, with the 2019 Sustainability Report giving the basic breakdown: total absolute emissions (Scopes 1, 2 & 3) 3.7m tCO₂e; forest base net removal of 15.5m tCO₂e¹ (3.3m of which were from native areas); giving negative net emissions of 11.8m tCO₂e.
- Approximately 86% of Suzano's energy needs come from renewables, such as black liquor (a by-product of cellulose manufacturing) and biomass. Some paper mills are self-sufficient in terms of energy needs, with 193MW of surplus energy sold back to the national grid in 2020. Suzano has set a target to increase these energy sales by 50% to 2030 (baseline 2018).
- In September and November 2020, Suzano issued Sustainability-linked Notes, which raised a modest total of \$1.25m. The Notes have a Sustainability Performance Target of reducing GHG intensity of production by 2025 (0.19 tCO₂e per ton of product). If this Target is not satisfied, the interest rate payable will be increased by 0.25% to the maturity date in 2031.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns
<ul style="list-style-type: none"> • Suzano reports using IFRS as issued by the IASB. • There is no reference in audited financial statements that accounting judgements have been impacted by climate-related considerations. This is despite there being several subjects on which management were required to make judgement or estimates that might be expected to be impacted by climate risk, such as future prices of eucalyptus pulp or increased risks to biological assets. 		
Consistency with other reporting		Significant concerns
<ul style="list-style-type: none"> • There is a disconnect between the consideration of climate issues in the narrative report and other reporting and the apparent lack of consideration of climate risk in the judgements and assumptions used for the financial statements. • Suzano publishes an annual Sustainability Report, although the 2020 Report has not yet been released. The 2019 Report covered a wide spectrum of ESG issues, with one relatively brief section devoted to Climate Change. This Report emphasises the company's strengths in relation to climate change, rather than any real discussion of climate risks. The disclosures on carbon emissions are basic, outlining the company's stated negative net carbon emissions. 		

¹ Calculated by stock difference, which represents the balance between forest carbon flows in the atmosphere (removals by the growth of native and eucalyptus trees, and emissions from the harvest of eucalyptus wood).

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns
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- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.

Paris alignment		Significant concerns
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- With no visibility, there can be no alignment with the goals of the Paris Agreement.
- Although Suzano claims to have targets beyond the Paris Agreement, with a climate positive impact by 2030 (increased net negative carbon emissions), this is distinct from the question of what climate assumptions, if any, are used for financial reporting.

Audit: visibility in CAMs and consistency check

Audit firm: PricewaterhouseCoopers	Responsible partner: José Vital Pessoa Monteiro Filho
Audit standards: PCAOB standards	

Visibility in Critical Audit Matters		Significant concerns
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- There is no reference to climate change in the auditor's report.
- There are four CAMs identified: (i) Goodwill impairment test – Pulp Cash-Generating Unit; (ii) Deferred tax assets; (iii) Provision for judicial liabilities relating to tax; and (iv) Valuation of biological assets.
- The goodwill impairment test relates to the R\$7.9 billion goodwill arising from the Fibria acquisition. Potential impairment is determined by comparing the carrying amount on the balance sheet with the value in use. This calculation of value in use requires several significant judgements and assumptions by management that could reasonably be expected to be impacted by climate change, such as future pulp prices and growth rates.
- Biological assets have a carrying value on the balance sheet of R\$11.2 billion. Under IFRS, these biological assets are measured at fair value minus estimated costs to sell, which requires certain judgements and assumptions by management.

Consistency check		Some concerns
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- PCAOB audit standards require the auditor to read other information that is presented together with financial statements and the auditor's report thereon. The auditor's report is silent on the outcome of the review, which implies that no material inconsistency was identified in the other information within the 20-F.
- The apparent absence of climate considerations in the audited financial statements is at least consistent, in a minimal sense, with the limited discussion of climate risks in the narrative reporting of the 20-F and annual report (although it does not sit comfortably with the company's broader emphasis on sustainability in other reporting).

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.	Key
	Good practice
	Few concerns
	Some concerns
	Significant concerns

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