Q2 2012 Earnings Call

Company Participants

- Alberto Monteiro, CFO and IR Director
- Alexandre Yambanis, Executive Officer, Pulp Business Unit
- Antonio Maciel Neto, CEO and Strategy
- Ernesto Pousada, COO

Other Participants

- Carlos de Alba, Analyst
- Juan Tavarez, Analyst
- Marcos Assumpcao, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to the Suzano Pulp and Paper 2Q '12 earnings conference call. All participants are in a listen-only mode during the conference's introduction that will be made by Mr. Alberto Monteiro, CFO and IR Director. And later, we will conduct a Q&A session when further information will be given.

We inform you that each participant can only make two questions. (Operator Instructions) Now I'd like to pass the call over to Mr. Alberto Monteiro, who will begin the conference call. Thank you.

Alberto Monteiro {BIO 1527328 <GO>}

Good morning, everyone, and thank you for participating in Suzano's conference call to discuss Second Quarter 2012 results. I will start explaining the financial shield package structure that amounts to BRL10 billion. The equity offering was only one of the components of the financial shield package that provided the Company with sufficiently comfortable structure in terms of cash flow until at the end of 2016.

This -- it's important to say this financial shield strengthens the Company's liquidity during the investment phase of the construction of the Maranhao plant until it starts to generate cash. The Company ended June with cash position of BRL2.8 billion and concluded an equity offering of BRL1.5 billion.

Moreover, the Company renegotiated BRL1.2 billion in debt contracts, postponing the associated maturities from 2012 and 2013 to 2016 and 2018, which strengthens the cash position for the Company's growth.

These renegotiations were extremely important to lengthen the debt profile, with the short-term portion of debt decreasing from 28% in March to 16% at the end of the Second Quarter '12. The Company contracted a standby facility of up to BRL2 billion that may be disbursed in tranches through March 31st, 2014.

And it's important to remind you that the funding of the Maranhao project was resolved through BRL2.7 billion in loans from the Brazilian Development Bank -- it's BNDES -- which had already been contracted up to BRL750 million in loans from export credit agencies, which are in the advanced stage of negotiations.

The Company is also analyzing opportunity to divest non-strategic assets and on partnerships with the aim of strengthening its capital structure. In addition, a series of operational initiatives are also being implemented, such as a general review of the cost structure and a review of the logistic and industrial process.

The Company's deleveraging process will start with the start up of Maranhao unit, which will have annual capacity of 1.5 million tons of market pulp and 100 megawatt in surplus power scheduled for fourth Q the next year, 2013.

And this facility -- slide four, shows Suzano's cash inflows and outflows as of July 2012 until December 2013. We start in June 2012, with this huge cash position of BRL2.8 billion, as I have said. The outflows are BRL2.2 billion on debt amortization and interest and BRL3.8 billion on CapEx, that includes investments on Maranhao project, the sustain CapEx and the investment on sustaining the forest in Piaui.

The inflows are BRL2.3 billion on the remaining BNDES loan contracted; BRL2.1 billion of EBITDA, considering the last two years average excluding the non-recurring items and first half 2012 results. So this is matching with our guidance and the number is conservative.

Another one is BRL1.5 billion on equity offer -- everybody here know about that. And the inflows and outflows shown will lead the Company to a BRL2.5 billion in cash position in December 2013. Adding the standby credit line -- that may or may not be withdraw -- the cash position would be BRL4.5 billion.

The next slide shows the debt amortization schedule. The cash position of BRL4.5 billion in the end of 2013 will be enough to pay out debt until 2016. The debt amortization shows -- does not include neither operational and investment cash generation or interest expenses. It includes the payment of the standby facility of BRL1 billion in 2016 and 2017, because it is included in the cash outstanding of December 2013.

The financial shield, debt and the liquidity can mitigate our refinancing needs until 2016. Therefore the high-end parting [ph] can realize that it -- so important was our financial shield to support it will give the Company -- to support the Company, because we have taken many measures to strengthen our balance sheet and so give the important support to the Company through and up to 2016.

And right now let's see the results of the Company, and I will now comment on our results in the Second Quarter of this year. Suzano sold 448,000 tons of market pulp in the quarter in line with the First Quarter of this year. The main destinations of the Company shipments were Europe with 36%, Asia with 31% and Brazil with 24%, with the share to Europe and Brazil increasing from the previous quarter.

In the Second Quarter, shipments of eucalyptus pulp were down 5.9% on the First Quarter because of the strong demand in the previous quarter and were stable compared to the Second Quarter of 2011. Suzano's sales in the year to date grew by 3.6% while eucalyptus pulp shipments increased by 1.8%.

Suzano's paper sales totaled 353,000 tons in the Second Quarter, growing by 27.4% driven by the seasonality in the industry. Comparing to the Second Quarter of 2011, sales grew by 62%. Domestic sales accounted for 61% of the total sales in the Second Quarter and remaining stable from the First Quarter.

South and Central America, Suzano's main markets, accounted for around 80% of the Company's sales in the quarter. And it is important, in the Second Quarter domestic demand for printing and writing paper and paper boards grew by 11% from the previous quarter and by 3.6% from the Second Quarter of 2011.

The share of imports in the domestic market fell in all lines in which the Company operated in the Second Quarter comparing to the First Quarter. The imported coated paper line recorded the greatest fall of 2.7percentage points comparing to the First Quarter and of 6.4percentage points comparing to the Second Quarter of 2011. Suzano's papers sales in the year to date grew by 8.8% from the same quarter last year while Brazilian demand contracted by 1.9%.

On slide nine, I will comment the consolidated result of the Second Quarter. And the first chart is, net revenue was BRL1.3 billion, increasing 28% from the First Quarter and mainly driven by the higher paper sales volume and the stability in pulp sales volumes.

The increase of 21% in the average net pulp price in Brazilian reais; the increase of 4% in the average net paper price in Brazilian reais; the share of the paper sale in domestic market of around 61%; the exchange rate variation with average local currency depreciation of 10.9% in the period, which impact our revenue from export.

And we can see, the cash cost in the quarter of BRL582 per ton was mainly due to the higher wood cost due mostly to the increased use of third-party wood to supply the Mucuri unit; the higher raw material cost due to the higher consumption of quicklime as a result of the scheduled downtime for improvements to the lime kiln, which increased our operating stability; and the other one is the higher fixed costs, which reflected increased expense with the repairs during the general downtime.

EBITDA in the quarter was BRL298 million with EBITDA margin of 22.5%. EBITDA was positively impacted by the higher price for both pulp and paper, the higher paper sales volume and the exchange rate variation with the real depreciating 10.9% in the period, as I told you -- for everybody. EBITDA was negatively impacted by the cost with the scheduled downtime on line 2 of Mucuri units and at Suzano unit.

I'd like to point out that in June EBITDA margin was 27%. The chart on the right shows the recovery in pulp price in the last -- over the last six months.

The next slide, on slide 10, I will cover the composition of Suzano's debt. And we would like to call your attention to Suzano's adequate debt profile, which has competitive cost and average term of four years -- it's around four years and a half, as well its comfortable liquidity horizon of around 60 months, which already considers the funds from the offering.

In June 2012, Suzano's gross debt was BRL9.6 billion. And the increase in gross debt was mainly due to the exchange rate variation in the quarter with the real depreciating by around 11% in relation to March. Since (inaudible) 50% [ph] of our debt is denominated in foreign currency. Note that the Company lengthening its debt profile is the BRL1.2 billion; this rollover transactions, which is one of the Company's -- of the financial shield package mentioned earlier.

These renegotiations were extremely important for lengthening the debt profile with the short-term position of debt decreasing from 28% in March to 15% at the end of the Second Quarter. The net debt-to-EBITDA ratio ended in June at 4.5 times with a cash balance of BRL4.2 billion, including the funds from the offering.

The Company is working on various fronts to improve its EBITDA with projects to increase productivity and reduce cost as well as the deleveraging initiatives such as the capital increase.

The net capital expenses -- and this slide shows Suzano's investments in the quarter, which came to BRL811 million which was mainly allocated to the Maranhao pulp unit and to maintain work at the acquisition operation.

It is important -- between 2012 and '13 growing CapEx is expected to grow by BRL3.9 billion, which is composed of, first one, is investment in forest formation, industrial efforts of Maranhao unit and the minimum investment required for maintaining forest of Piaui. Note that investment in Suzano Energia Renovavel continues to depend on the final definition of the capital structure.

And right now, I will pass to my colleague, Ernesto Pousada, Director, our COO to explain about the strategy of our Maranhao project.

Ernesto Pousada {BIO 15951890 <GO>}

Okay. Thank you. So good morning to everyone. I'm on slide 13, and talking about the Maranhao project. So I would like to mention that the Maranhao project is on time and on budget. The start-up is scheduled for the Fourth Quarter, 2013, and the production is to be 1.5 million tons of market pulp, 100% to export.

Just to highlight some of the main aspects of the project; first of all, the forestry base, we expect an average yield of approximately 42 cubic meters per hectare per year. This is based over 25 years of experience of the Company in that region. We have been since the early '80s studying the right clones to be adapted to the soil and to the climate of Maranhao.

We have an annual capacity of 15 million nursery seedlings in the region and we expect to have a long-term and sustainable wood supply for the mill that will be located in Imperatriz, the second largest city in the Maranhao state.

So the industrial, I mentioned before, so this is scheduled for the Fourth Quarter, 2013 to start up. Besides the 1.5 million tons of pulp, we are going to have an excess capacity to produce energy of 100 megawatts that will be available for sale in that region.

Also I like to mention that we actually -- we partnered with all the main technology equipment suppliers for the project. So this should be really a state of the art project in terms of equipments to have a very, very competitive cost and quality in terms of producing the pulp.

In terms of logistics, the inbound should be based on existing highways and we continue to study opportunities to use highways for inbound of raw materials. I should mention as well that we are going to have a lot of the chemicals produced onsite. So this will be another competitive point for the project.

And one of the key aspects is the outbound logistics that will be done only through railcars, so we are going to have a branch of the main railway getting inside our mill. And from there we go straight to the Port of Itaqui in Sao Luis, running approximately 600 kilometers through rail cars. So no -- there is not a need for transshipment. So very, very competitive in terms of cost of outbound logistics.

Also to mention that the Maranhao location is strategically positioned for pulp distribution to Europe and North America markets, where we are going to have a four day shorter lead time to our customers in those continents.

And the other important aspect is the management. We have a professional management with a superior project execution expertise. The team that has implemented the Mucuri line 2 project that actually started 30 days ahead of schedule is the same that is implementing this project.

And also to mention that our partners, our suppliers are the ones that have being delivering in the last few years projects all of them on time, so we're very confident that we have the best team available to be able to implement this project on time and on budget.

On the slide 14; so we talk a little more about some of the differentials of the project. So especially with our learnings from Mucuri we built in this project an additional operational reliability. So we got two dryers machines in this project, both smaller than actually we have in Mucuri.

And the lime kiln as well. It's -- we got two lime kilns. This is probably one of the only projects in Brazil that has -- have two lime kilns. And this will increase the flexibility; therefore, we're going to have more stability and as a consequence, smaller costs.

We're going to have -- we expect to have lower downtimes since we designed it with Metso, our key supplier, a service center in Imperatriz to reduce the time to service our equipments. We also have in contract a learning curve that is guaranteed. And additionally, a support from our suppliers that should stay on site 18 months after the start-up, during 18 months. So this will help us to have a very strong and fast learning curve.

In terms of infrastructure, I already mentioned the outbound logistics, which is really a plus. I should mention that the mill is located in a large city comparing to many other projects in Brazil. Imperatriz is a city of about 250,000 inhabitants. So it's an average size city with a lot of resources there, which is actually making it much easier for us to find the labor force locally.

Approximately, 80% of the labor that we have right now in the mill, in the construction of the site is from the region, which is very positive and very good. And I think this will also continue throughout the project.

The other aspect is the fiscal incentive. It's important to mention that we have a 75% reduction in income tax rate for 10 years. So this is -- this represents a substantial amount of our project return, so this is very important to understand.

Then on the right side of slide 14, you have a few pictures. So you can see that in the second picture from the top -- you see that the recovery boiler is already in construction, is on the erection phase.

We already built all the civil structure for the recovery boiler, and the majority of the areas and equipments right now we're under a major work with the civil. And erection of the equipments and assembling of the equipments should happen in the coming months.

Right now we're with about close to 5,000 people working in constructing the site. So basically, that's the review of the Maranhao project. So I'll turn the floor back to Alberto.

Alberto Monteiro {BIO 1527328 <GO>}

Yes. On the next slide is the key message of the Second Quarter 2012 -- were mainly BRL10 billion of the financial shield. Its renegotiation leads to only 15% of the short-term debt, BRL4.2 billion in cash, and as Ernesto told you all, Maranhao on time and on budget. I like to start the Q&A session. Please, operator?

Questions And Answers

Operator

(Operator Instructions) Thiago Lofiego, Merrill Lynch, Brazil.

Q - Thiago Lofiego {BIO 16359318 <GO>}

I have two questions. First one is on the pulp market. In the Portuguese call you mentioned you guys have a positive bias towards the pulp market in the second half of this year. So could you comment a little bit more on that and also put into perspective the low spread between softwood and hardwood?

So in other words, do you think this spread is sustainable? Do you think there will be fiber substitution? Do you think the spread will prevent price increases on the hardwood side? So what's your view on that? That's the first question, please.

A - Alexandre Yambanis {BIO 16470785 <GO>}

Yes. Hi, Thiago. This is Alexander. And I'll try to address your questions in the best possible way.

Number of your question -- your question number one concerning the market and how -- the positive twist that we gave to the reply. In fact, we see -- we are quite upbeat about the market given the fact that there are nothing less than 7.5 million tons of paper coming on-stream between 2012 and 2013, out of which 42% will be in China. We are very confident those start-ups are taking place and indeed they are; we are monitoring this whenever we can and the best way we can.

If you consider a rough calculation that would represent a need of around 4 million tons of pulp going forward -- I mean, going forward between 2012, 2013 to service those paper machines, those new paper machines. We are outlining this scenario in the current circumstances, i.e., in a very, very delicate international macroeconomic scenario.

You're very well aware of what's going in Europe. China has slowed down a little bit. They are now trying to prop up the economy again. We believe this will happen towards the end of the Third Quarter and in the Fourth Quarter. The US -- well, they just created 164,000 jobs in the US in July, so the perspectives for the second half look, I would say, brighter than those in Europe.

But anyway, the international macroeconomic scenario is not so bright, but still paper machines are starting their operation. Those are large modern machines that require firstclass good pulp, especially hardwood. Hardwood is a key element today in many paper making kind of paper.

So we believe that -- we're quite confident that what happened in the Second Quarter, which was more of a, I would say, a mini cycle happening in China where they consumed their inventories -- very high inventories they had created in the First Quarter in anticipation of the price increase. We believe those inventories are being consumed as we speak and that China will come back to the market buying pulp, virgin pulp as of September.

Now the second leg of your question, if I'm not wrong, related to the spread between softwood and hardwood, which has indeed decreased and stood in July at a meager $28. I say meager because in the face of the 10 year average, which was $65, $28 is really a very, very low spread.

Well that happened basically, once again, because of the very high destocking in China from the part of the traders. As you probably know, the traders in China hold mainly softwood pulp in lieu of hardwood, and by destocking that softwood pulp they created a very peculiar situation whereby softwood pulp in China was priced below hardwood, even below -- I mean, within a negative spread, if you wish.

We don't believe this spread is sustainable in the long-term simply because most of the projects coming on-stream in the next medium-term horizon are hardwood projects. And that will mean that the spread will tend to go back to its long trend average of $65 or so, I would say, in the next quarters. In the next two three quarters it should be back there, which is not bad -- which is not bad.

We like to have a big spread because a big spread means that hardwood becomes more attractive than softwood and given the new technologies and the new paper machines, paper makers do not hesitate in replacing hardwood with softwood. So in a nutshell, this is it; we see the spread going back into the long-term territory.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay, that's clear. Thank you, Alex. So just -- the second question is regarding the cash costs, the expected cash cost for the Maranhao pulp project. Could you confirm that number? I guess it was above BRL500 per ton if I am mistaken, but if you could please confirm that number?

A - Ernesto Pousada {BIO 15951890 <GO>}

Yes, Thiago. Here's Ernesto. We are expecting to have the cash cost approximately at BRL530 per ton.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Ernesto, this -- yes. Sorry, go ahead.

A - Alberto Monteiro {BIO 1527328 <GO>}

Thiago, the range is from BRL500 up to BRL550.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Yes. That's what I was trying to guess. Previously, the guidance was for slightly lower cost, right?

A - Ernesto Pousada {BIO 15951890 <GO>}

Yes, Thiago -- no, no. Your question is regarding Maranhao, correct?

Q - Thiago Lofiego {BIO 16359318 <GO>}

Maranhao.

A - Ernesto Pousada {BIO 15951890 <GO>}

Yes. Maranhao cash cost we are expecting at around BRL530, could be a little lower as we get closer to the project. But we didn't have any guidance before. This is what we have now as we are developing more the projects. Of course, we have a lot of opportunities to reduce this as we approach. This is the first number we have.

And also, like to remember that we have, as we mentioned before in the other call, that we are going to have -- and the cash cost is being impacted by a higher amount of wood that we are going to buy from third-party, in this case Vale, that goes straight to the cash cost. From the other hand, we don't have the CapEx on the lands and on the plantation.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. That's clear. Thank you, guys.

Operator

Carlos de Alba, Morgan Stanley.

Q - Carlos de Alba {BIO 15072819 <GO>}

Alex, I really struggle to reconcile your views with the views of some industry experts, right, that they have long-term supply-demand models and they are a little bit more concerned than I think I understood you guys are regarding the supply-demand balance in the new mills that are scheduled to come in, in the next few years, at least in the next few years in hardwood.

Could you help me clarify this situation, this debate? Why are you more optimistic than -- if you believe -- than these people that looked at the industry supply-demand?

A - Alexandre Yambanis {BIO 16470785 <GO>}

Sure, Carlos. Alex here. Well our optimism is two-fold. Number one is that we track very closely those new paper start-ups and that gives us quite an upbeat impression about the market. As I mentioned in the previous question, 7.5 million tons of paper just this year and next is very, very significant.

And most of this paper -- I'm excluding news print here -- and most of this paper new capacity will absorb virgin pulp and especially hardwood pulp, because you have a big chunk of that which is tissue and tissue likes eucalyptus. As we know, eucalyptus is the fiber of choice for tissue makers. So that's the first fold of my reply.

The second fold is that we are certainly going to see more closures as we progress, closures of old capacity. And I'm referring here to not only in the west, not only in North America, where costs are very high -- and at current prices, softwood current prices were already in some cases below cash cost. So it is amazing; prices are not so low and already below cash cost of some producers, especially in the Canadian interior and coast.

Now not only that, the Chinese authorities have decreed the closure of around 8 million tons of old and very polluting paper and pulp capacity. That pulp capacity is mainly straw, bamboo, non-wood pulp but also -- and also of course some very, very old paper mills that are being replaced by the newer modern mills that are coming on-stream in China.

So we see a better balance, maybe, as compared to some of the people you mentioned. We probably see a better balance because, number one, the start-ups and number two the high likelihood of shutdowns in North America because of cost and also -- and especially, in China, because of environmental issues.

Q - Carlos de Alba {BIO 15072819 <GO>}

Understood. Thank you. The next question, if I may, is on the EBITDA margin and the performance of the business in general. In your release you mentioned that the EBITDA margin in June reached 27%, which is remarkable given that the average for the quarter was 22.5%.

Can you talk a little bit about what you see for the second half of the year, the third and the Fourth Quarters? Do you expect that the 27% is the new level where you should operate in the remaining of the year? Or you have some more sort of a timing of the end of the maintenance that you had in Q2 and the start of the maintenance that you will have in the Third Quarter?

A - Ernesto Pousada {BIO 15951890 <GO>}

Okay. Here is Ernesto, Carlos. Actually, what we expect in general for the second half of the year -- of course, a lot of the variables can vary. But in general -- we mentioned before that we expect some reduction in our cash cost going down to BRL560 approximately. Alexandre Yambanis just mentioned that we expect some stability or even some prices going up in the second half of the year. The paper market typically is -- seasonally is a better time for the paper market as well.

And also, the Second Quarter we had a significant amount of our planned shutdowns in Mucuri and Suzano mill. Therefore, considering that the macroeconomic variables remain as they are, we would expect a better second half of the year comparing to the first half of the year.

Q - Carlos de Alba {BIO 15072819 <GO>}

Fine. Thank you very much, Ernesto.

Operator

Juan Tavarez, Citi.

Q - Juan Tavarez {BIO 15083199 <GO>}

My first question is also on the pulp fundamentals for the very short-term. I'm trying to reconcile your statements that you believe there's been an inventory drawdown in China. I've been hearing on my side, actually, there's been some shutdowns in paper capacity. So I guess you can also say that the slowness in shipments was because that paper capacity was shutting down and not necessarily because they were absorbing their own inventories. Have you been hearing any of that on your side?

And the last part of the question on pulp is, also given that you are expecting 7.5 million tons of new paper mills to kind of absorb some of the new capacity in pulp, wouldn't that also just trigger a new wave of paper mill shutdowns as well before we get the capacity to be absorbed?

A - Alexandre Yambanis {BIO 16470785 <GO>}

Yes. Okay. Hello. This is Alex. Hi. The first part of your question, well, yes, we believe that the supply-demand is gearing towards a more balanced situation in China.

You are correct; there have been some paper machine closures in China. But that has been short-term and circumstantial because of demand. The Chinese economy has been kind of winding down on a controlled way and, well, the Chinese economy grew at 7% only -- I put only between brackets --only 7.6% in the Second Quarter.

But those -- we hear that those shutdowns which were motivated by lack of demand in China, and that was mainly printing and writing. That didn't touch tissue producers, for example. We sell -- most of our sales in China are destined to tissue producers.

But anyway, coming back to printing and writing, those shutdowns were circumstantial and they were destined to -- designed to cope with the short-term situation in the Second Quarter.

We hear that those machines are up and running again. The correction, let's say, in paper inventories has taken place somehow. And we believe that the Chinese economy -- of course, there is a certain lag time there, but we believe the Chinese economy will pick up steam.

You saw already the Chinese PMI jumping up to 50.4% or 50.3%, if I'm not wrong; i.e., again in positive territory, denoting an expansion in industrial production. So all this tailgates with what I'm saying, which is that the paper production in China is slowly but surely coming back.

In terms of -- your second question was related to the inventories in China, right, and the depletion of those inventories, if I'm not wrong. In that regard, yes, the Chinese have accumulated inventories in the First Quarter, inventories of pulp. There are -- closures of paper capacity are happening in China, small paper mills, very polluting paper mills.

Most of those paper mills, though, are integrated with non-wood very, very little -- very, very small pulp mills as well, which are closing together with those paper mills. There are no big paper mill -- or if you -- let's put it, modern paper mill in China being closed at all. So yes, some old paper capacity, you're correct, will shut down in China, but will be immediately replaced by the new capacity coming on-stream.

So we see a very agile market going forward. The destocking has practically taken place because, of course, traders wanted to get rid of their inventories and make a buck out of it. We believe as of September and through the Fourth Quarter, Chinese demand should pick up and they will have to rebuild their inventories which have fallen to very low levels.

Q - Juan Tavarez {BIO 15083199 <GO>}

Okay. Great. And my last question is just regarding the standby facility. If you were to use that credit line what would be the cost on that debt?

A - Alberto Monteiro {BIO 1527328 <GO>}

The cost will be CDI plus 2.75% per year.

Q - Juan Tavarez {BIO 15083199 <GO>}

Okay. Great. Thank you.

Operator

Marcos Assumpcao, Itau.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

First question to Alex as well. You mentioned in the Portuguese call that there were some lower pulp imports from China in the Second Quarter. I'd like to check with you if that considers imports reduction in Indonesia as well?

And the second question is regarding the current profitability of the paper units, the capacity in China with current effective paper prices. So the point here is, if you are seeing a declining gap between paper prices and pulp prices, what's the current profitability levels from the Chinese paper mills? Thank you.

A - Alexandre Yambanis {BIO 16470785 <GO>}

Yes. Marcos, we have -- I had a bad connection with you right now. I'm sorry. But I guess I understood your questions. The first one relates to the production of paper in China which has increased in the Second Quarter and has reached 30.8 million tons or an increase of 9.1%, correct? And whether those -- that paper --

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Alex, however, you mentioned in the Portugal call that the paper production increased in the Second Quarter, at the same time pulp imports declined and that's why you believe that there was an inventory destocking, right? There was a destocking cycle. And I was wondering if in this number of lower imports you're considering the Russian and Indonesia purchases as well?

A - Alexandre Yambanis {BIO 16470785 <GO>}

Okay, now, I got your question. Sorry. Yes. There is destocking in the Second Quarter and that explains why the pulp shipments to China in the Second Quarter decreased by 15.5%, okay. Your question is an excellent one.

No. That does not include Indonesian -- that does not include Indonesian pulp or, if you prefer, pulp produced in China, if you wish, which is simply because there are no statistics there. And statistics will come -- Indonesia statistics come with a lag normally, with -- they lag sometime to be available. So no, there are not included.

But again, the destocking is -- the proof is in the pudding and the destocking is taking place simply because despite an increase of 9.1% in paper production, export pulp shipments to China decreased by nearly 16%. So they definitely used their inventories. And once again, the traders have destocked their -- what they had accumulated in the First Quarter.

Your second question concerning the paper and the pulp gap prices in China. Yes. There has been a certain narrowing of that gap. This is true.

And the reason is very simple, it's because of paper demand in China that in the first half of the year fell short from expectations and that is simply because of the Chinese macroeconomic behavior that had a slowdown, if you wish, in their very aggressive growth.

And as you know, paper in a way tracks GDP and in an economy as vibrant as China, this is particularly true. So yes, there has been a narrowing gap there and we hope that the economy in China picks up and the Chinese, who are very, very fast in increasing their prices of paper -- they are as fast in decreasing the price of pulp, believe me -- we believe that prices of paper will pick up in the second half.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Okay. And just a follow-up here, Alex. The pickup in prices will be from current levels of $640 that we can follow through FOEX or from $700, which is the last unofficial price -- listed [ph] prices?

A - Alexandre Yambanis {BIO 16470785 <GO>}

Well there has been a dual price in China -- that's a very good question you're asking. And FOEX has a methodology, whereby they exclude the bottom 10% and the top 10% players. It is with pride that I can tell you that Suzano is usually among the 10% of the players. So our prices are in principle excluded from FOEX.

But you're correct -- so therefore, there has been a dual pricing in China and prices have been hovering around, I would say, anywhere between $640 -- I'm generalizing here, hardwoods -- I'm including acacia, mixed hardwoods and eucalyptus -- between $640 and $700.

So I think there will be a recovery, first, from the low players which will try to reach -- try to and, hopefully, achieve -- try to reach the top player prices and then we will move from there. Hello?

Operator

Thank you, sir. Ladies and gentlemen, the Q&A session has now concluded. I'd like to pass the call back over to Mr. Antonio Maciel, CEO, for his last statements.

A - Antonio Maciel Neto {BIO 16703850 <GO>}

Guys, thank you very much for the presence in our call. This is the first time that we are doing -- long time that we are being able to talk about deleveraging because the strategy now is completed, and also about the Maranhao Project.

For many, many calls we have been talking about the leverage situation and as you know better than me, the leveraging -- if you have too high a leverage process, the Company could face problems to renegotiation to roll over debt with the banks.

And so, this was a very fair concern from the analysts before. Now we try to -- we have -- everybody knows that we have a deleverage process that's very strong, that will come up with the start-up of the Maranhao Project. We are less than 18 months from the start-up, the deleverage will happen. However, in the between, we needed to maintain our ability to continue to roll over our debts to continue to have credit with the banks.

We tried first to sell some assets. We didn't see any attractive proposals. We ended up with the alternative of raising capital in a very comprehensive strategy that we called financial shield up to 2016.

With that, today, just to remind some of the numbers that Alberto mentioned, we have BRL4.2 billion in cash; we have BRL2.3 billion coming from the contracts that we have with BNDES to support the Maranhao Project or 0.7 -- BRL700 million from the ECA that's being -- will be signed during the quarter. We have renegotiated BRL1.2 billion of the debt that was coming in 2012 and '13, and we have the standby facility of BRL2 billion.

So we have BRL10.4 billion, not counting here with the EBITDA that's going to be generated during this -- after 2014 that will -- going to allow us to go to this economic environment up to the start-up and three years after the start-up. So up to 2016, end of '16 with the conditions that we have built along with the banks.

We will not need any additional rollover or any additional credit lines to maintain the Company running and moving up to the very good position with regard to the leveraging. So is good news. This is, I think, is most important communication that we wanted to transmit during this call.

The second point is about Maranhao Project. That, we have -- as we have been in discussions with potential partners, we avoided to read too many pieces of information about the Maranhao Project.

Now I think it was the first day that we -- Ernesto had the opportunity to tell where we are, how we are progressing; and we will continue during the coming weeks with this communication. Please feel free to call us to -- we are going to set up events or conversations to tell how great is Maranhao Project.

We are on budget, on time, very well professionally conducted and we are very happy with the evolution of the project as we see here. It is a very good project; returns of the project above the EVA plus 2%. That is our threshold with -- in our Board of Directors conversation. Very strong fiscal incentive that we have a reduction of 75% of the income tax during 10 years at least.

The project is almost 80% debt and about 20% equity. So for shareholders the returns are much better and above of -- an excess of 13.5%. So we have a very good project in Maranhao. This will be the key element to increase substantially our EBITDA and also to help on the deleverage process.

In the call, in November, we will address some other aspects of our Suzano 2024 plan, giving more details about Suzano Energia Renovave, Renewable Energy, about FuturaGene -- that's our Company in biotech that's progressing very well with an interesting program, a very transformation project that's coming on -- and also cost reduction.

We have a very big and a very comprehensive productive project being implemented in the Company and we will be able to talk about that in November to give you more colors about how we are progressing and also the expectation that we will see on this cost reduction there.

For the short-term, as Alex mentioned and Carlos Anibal mentioned in the Portuguese call, good news coming in the paper business. Now we have seasonality in our favor. Volumes are growing very fast. We don't see any new capacity coming in during 2012, just beginning of next year.

So probably the market will continue tight and we don't see any downside for the price as we speak up to end of the year. In fact, we see some potential upside in the Fourth Quarter.

EBITDA margin is improving. We had the 22% or 23% in this quarter. However, we had BRL557 million of costs in this quarter related to maintenance, the program planned maintenance shutdowns, especially in Mucuri and Limeira as well. Without this cost, our margin would have been about 26%, 27%, exactly what we had in June.

So we have seen good progress in the margins as well. We have good position in the prices. If you look at the revenue side, top line of our business compared to competitors, we have a good position.

In the cost side we have had some maintenance problems. We had engineering problems during -- some years with the line 2; that now we are seeing in June, July much more stable production.

Then, we are considering that we are going to benefit from the exchange rate now as well. The exchange rate -- our debt is marked now at BRL2.02. So if we continue to see this level of exchange rate, we are not going to continue to be penalized on the debt side -- the accounting at least, debt side.

And we are going to start to see the benefits of this in our revenues in the exports from the pulp business, the paper business and as well some contribution for the internal domestic markets for paper, because then the unfair competition that we have seen in the paper business coming from tax evasion and from exchange rates position that is going to go away.

So thank you very much. We continue -- we will be always available for continued conversation. And from now on we will be able with the closing that we had yesterday of the distribution of the capital increase that we had, we are going to be more better conditions to communicate along with you and give more data for you to understand better the Company. Thank you very much.

Operator

Thank you. The Suzano Pulp and Paper conference call is now over. We thank you for your participation and have a nice day.