

Q3 2018 Earnings Call

Company Participants

- Cristiano Cardoso Teixeira, CEO & Member of Executive Board
- Douglas Dalmasi, Packaging Director
- Gustavo Henrique Santos de Sousa, CFO & IR Officer
- JosÃ© Gertrudes Soares, Commercial Director of Pulp

Other Participants

- Carlos De Alba, Equity Analyst
- Gabriela Elerati Cortez, Banco de Investimento S.A., Research Division
- George Leon Staphos, MD and Co
- Gerard Roure, Research Analyst
- Marcos AssumpÃ§Ã£o, Sector Head
- Renan Criscio, Research Analyst
- Renato Damaso Maruichi, Research Analyst
- Thiago K. Lofiego, Research Analyst

Presentation

Operator

Good day, ladies and gentlemen. Welcome to Klabin's conference call. (Operator Instructions)

As a reminder, this conference is being recorded -- this conference call is being recorded and also being broadcast live via webcast and may be accessed at the website, cast.comunique-se.com.br/Klabin/3Q18, where the presentation is also available.

Before we proceed, I would like to clarify that any statements that might be made during this conference call in connection with Klabin's business outlook, projections, operating and financial targets and potential growth should be understood as merely forecasts based on the expectations of the company management in relation to the future of Klabin. Such expectations are highly dependent on market conditions, on Brazil's overall economic performance and on industry and international market behavior. They are, therefore, subject to change.

With us today in SÃ£o Paulo are Mr. Cristiano Teixeira, Mr. Gustavo Sousa and officers of the company. Mr. Teixeira and Mr. Sousa will comment on the company's performance during the Third Quarter of 2018. After that, company officers will be available to answer questions that you might have.

I will now turn the call over to Mr. Teixeira. Please begin, sir.

Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you. Welcome to Klabin's conference call to discuss Third Quarter '18 results.

We bring you a number that reflects what we consider to be an optimal pace of Klabin, as I mentioned in prior calls, that we normally achieved in the third and Fourth Quarters. This Third Quarter, in particular, reached an adjusted EBITDA of almost BRL 1.3 billion, an increase of 66% in relation to the same period of 2017, with a 44% EBITDA margin. Puma presented a production of more than 400,000 tonnes, up almost 15% vis-À-vis last year, showing that it is running at its full capacity. This allowed us to reduce our leverage by 0.5x with a strong cash generation, thus, confirming what we have been saying, the declining trend of Klabin's leverage.

Now I would like to take this initial remarks to highlight what we've been saying over and over again about Klabin's flexibility, showing you that not only because we operate 50% in the domestic market and 50% in the exports market approximately, we still have the possibility of integrating our conversions, selling paper directly to export markets and domestic market. And when we talk about the ability to produce paper, we would like to highlight our portfolio that has Kraftline, semi chemical kraftliner, kraft and flat paper, all types of coated board and now in food service, not to mention our softwood, hardwood pulp. And in softwood pulp, the possibility of having bales and fluff.

So this possibility of acting in all markets, converting or not (is present), particularly in mainstream Brazilian and international markets. All of this makes Klabin a company well positioned to take advantage of the best results, of the best market, thus, optimizing our margins.

I will now turn the floor to Gustavo, who will go over our figures in more details. And I will be back to join the Q&A.

Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Thank you, Cristiano. Good morning, everyone.

To start our presentation, we're on Slide 2. And as Cristiano mentioned, we had an adjusted EBITDA, which was an all-time high at the company of BRL 1.248 billion, with 66% increase over what we posted in the Third Quarter '17. Our pulp production totaled 404,000 tonnes, a record high since Puma's startup. Our sales revenue was BRL 2.807 billion, 26% up over Third Quarter '17. And EBITDA margin, which was also a record margin of 44% versus 34% stated in the Third Quarter '17. And we already mentioned reduction in leverage of 3.9x to 3.4x at the end of September of 2018.

Please go to Slide 3. Looking at our net revenue. We posted a 26% increase, mainly due to a generalized improvement of our prices. Looking at our EBITDA, this mark of BRL 1,248,000,000, a 66% increase. And also looking in our EBITDA margin of 44%. This is not

only an all-time high record. But in this chart, we see a consistent steady growth trend of Klabin's margin.

Please go to Slide 4. Here, first, we'll address our pulp business. We had a 12% increase in sales volume because of an increased production at Puma unit. As commented by Cristiano in the Third Quarter, Puma went above its nominal capacity. That also allowed a 72% increase in our net revenue. The prices of our pulp product had stronger price increases in dollar. Short fiber pulp, a 20% increase. And long fiber pulp, 37% price increase.

Looking at the Kraftliner business, we had a 3% increase in sales volume and also a price increase in dollars of around 11%, which contributed to an increase in net revenue up 39% -- a net revenue increase of 39%.

We go to Slide 5. We look at our pulp highlight. In pulp production in the Third Quarter, we had an excellent Puma operating performance. As I said, it produced above its nominal capacity. We totaled 404,000 tonnes. We also had a very good cash cost performance, the lowest cash cost ever in the history of Puma, BRL 628 per tonne. In the Second Quarter conference call, we showed you the metric of cash cost for the month of June, which was BRL 651 per tonne. So in this quarter, we had a 4% reduction in cash costs.

On Slide 6, we give you more on our debt. We ended September with a gross debt of about BRL 20 billion. Cash and cash equivalents of 7.3 billion and a net debt of BRL 12.8 billion. Our leverage measured by net debt over EBITDA ratio in this chart represented in the green line ended the quarter at 3.4x, confirming our declining trend of leverage at the company. Also looking at the green column in the chart, we see metric of EBITDA -- accumulated EBITDA in the last 12 months in this quarter, in particular, we are at the 29th consecutive increment of this metric.

Now moving to Slide 7, please. Here, we have our debt maturity schedule. Gross debt of BRL 20 billion with an average tenor of 48 months. 73% of this is dollar-denominated, 27% in local currency. Average tenor for local currency, 38 months. Average tenor for foreign currency debt, 48 months. The company has been following market when there are opportunities to lessen the maturity. We issued 700 million in CRA and maturing in 2025.

On Slide 8, we see our free cash flow. I will be making comments about the last column, last 12 months column. We had an adjusted EBITDA, BRL 3.7 billion. A free cash flow of BRL 1.3 billion and an adjusted free cash flow excluding dividends and expansion projects of BRL 2.2 billion. This adjusted free cash flow has a yield of 11%.

Moving to Slide 9. Here, we have our dividends. In the chart, we see that in the last 12 months, involving third and Fourth Quarters of last year and the first and Second Quarters of 2018, we paid total dividends of BRL 650 million, a dividend yield of 3.2%. Including payment of dividends of the Third Quarter of this year, yesterday, we announced a payment of BRL 340 million, a payment to be made on November 14. This payment is

broken down into BRL 265 million of interest on equity and BRL 75 million of dividends in the Third Quarter.

The company started using interest on equity as one of the instruments to remunerate investors. This perspective was not included looking at the third and Fourth Quarter of 2018. As a period of transition, the company chose to best show fully the fiscal benefits generated by IOC to shareholders. As of 2019, we'll maintain the cash generation conditions of the company and the current tax standard the company seems to use dividends and IOC. Specifically, again in IOC, we grossed up the retention of income tax for individuals.

With this, we complete our presentation and move now to the Q&A. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Gerard Roure with BTG Pactual.

Q - Gerard Roure {BIO 20414838 <GO>}

I have 2 questions. The first is about cash cost of pulp. This caused you the movement reduction in the cash cost in this quarter reaching BRL 628 per tonne. I would like to hear from you, do you think that this cash cost level is sustainable looking forward? Is there a further potential for reduction? How feasible it is to expect this number looking forward? My second question has to do with consolidation in the industry. How do you see possible consolidation move in the sector? In recent weeks? Or with some players talking about divesting in the country? And I would like to understand if Klabin could be a player in a possible, faster consolidation move in the industry.

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Gerard, this is Gustavo. To answer your first question on pulp cash cost, it is important to highlight that we had a record Puma production. When that happens, we are strongly impacted by a reduction of fixed costs. We understand that this level of production tends to be maintained. In that regard, this variable was very important to us. It represented a reduction of cash cost in reais per tonne of about BRL 24 per tonne compared to the same period of last year. Maintaining these conditions, yes, this is the trend. The biggest factor to drive reduction and to improve performance in terms of our pulp cash cost, the rapid generation of electricity. It has reduced the cash cost by about BRL 57 per tonne. We have to remember that our production is 70% sold in long-term contracts. The remaining 30% is sold in the spot market. Specifically in the Third Quarter, we had a spot price of BRL 500. And it's a variable we do not control. So to answer your question, the trend is that we will maintain production at these levels excluding the power variable. We understand that we are at an adequate level of cash cost for the company. I will turn the floor to Cristiano to answer your second question about possible consolidation.

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A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you, Gerard, for your question. I think that an important fact to highlight is that Klabin is absolutely paying attention to moves happening in our industry. Klabin always say that we will see possibilities of consolidation in the market. If there are any opportunities in our radar, we will inform you. We can only say that we are paying attention to what's happening in our industry.

Operator

Second question from Thiago Lofiego with Bradesco BBI.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

I have 2 questions. The first has to do with the next steps regarding CapEx and growth. I'd like to understand what is the time line now that the political cycle is a little clear. What would be the next steps? When should we expect approval of project? And it would be kraftliner, cardboard and fluff in that order? And as part of this question, thinking about kraft, the kraftliner project, we heard some recent news about Chinese looking for production units of recycled paper in the U.S., which could be -- could have a negative impact on the global kraft market. There are some restrictions in China that could contribute to revert the trend. I would like to understand what you're thinking about that. And the second question has to do with the domestic market. We have seen volumes gradually picking up both for paper and conversion. What is your expectation for the Fourth Quarter for your mainlines or primary lines and for 2019 as well?

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you, Thiago. Thank you for the questions. Regarding our expansion and growth project, we continue conducting our study to optimize and get the best return on our projects. This is still being analyzed at the management level. Very soon, we will feel prepared to submit this for approval and for analysis. As for the order of priority, the kraftliner machine continues in the same order as the first investment that we are focusing on. And as for the second project, coated board is a probable option. But we would like to underscore, as we always say, that this investment, at least one of them, the investment, for example, in the (Ultra geta) unit, we are considering a production unit of brown fiber possibly integrating the 2 paper machines, the first in kraftliner; and the second one, we are considering an option. It will probably be coated board. But we will have an option of using it for kraft. So there's an opportunity in the design of this project because the first machine -- I apologize for being too technical. But it is important for your analysis. So the first machine would have lower rates. And the second of kraftliner would have heavier weight. And it is exactly the design of the second machine with heavier weight that offers us an option, kraftliner or a coated board. I would just like to point out that this study is still being considered by the management of the company. And we are considering other options as well. We are at a phase of optimizing the figures to submit them for approval. As for fluff, I prefer to talk about long fiber, softwood. We have some projects that are being considered, that are still under analysis. As for the move of the Chinese in the United States, I prefer to look at this in a more structured way. The demand for fiber worldwide is, structurally speaking, increasing. If we also start in the long term, no one has any questions or doubts about this. Paper is being very much recycled. What is driving

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now is a process of choosing the best fibers, which to me has to do with better pricing of fiber. The fiber is no longer going to China with a high level of dirt. And if they only allowed cleaner fiber, this means that somewhere else, this fiber will need to be better treated. That's why the suppliers recycle paper. In the container -- in the corrugated box world, we've been living with this since the initial conversions of printing and writing machines to corrugated board. This has been addressed by the industry. We don't see any risk of changes in this structural curve because of the supply. What we see is a balance. So that, as you all know, the amount of times that we use a box made of these papers, it can be used to 5, 6 even 7 times. And we always make -- using virgin fiber. At Klabin, all of the studies that we conduct focused in the case of virgin fiber investments always focus on this recyclability index, to what extent virgin fibers are necessary to maintain this market as well as markets that are regulated for food, protein, et cetera, that will always require virgin fiber. So we have many studies about these markets. And we are quite safe about the structural view of these paper option. As for the domestic market, I think you asked about the forecast for the Fourth Quarter. We have third and Fourth Quarters in the domestic market. They're quite good in the Third Quarter. We prepare for the holiday season. The Fourth Quarter continues strong until the month of November, ensuring a volume of shipment which is high. That's when we achieve our peaks of container shipping. So of course, we have to see this moderately because we are in a cycle of economic ramp-up. But we envision good volumes for the domestic market, both for packaging and paper.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

And a follow-up question. For 2019, can you speak a little about 2019? And going back to the first question about approval, is there any possibility that it will take this -- you submit this to the board only in the First Quarter of next year? Or do you think it's more likely that you will do it still this year?

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

First, regarding our 2019 forecast. So we've been working on our budgets. And we have the same expectations as you do regarding the dollar exchange rate. And we'll wait for the new administration in terms of fiscal policies, policy measures. So we can't really do or make any forecasts for 2019 yet.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

As for the projects, we don't -- if not 3 to six months, they won't change anything at this point. We are talking about investments that will be -- will last for 30, 40 years. So we need to ponder a lot. The management is working on optimizing these projects. And as soon as this is consolidated in our mind, then we will submit the plans to the board. Then they will take us as long as it is necessary to approve. The second message here is Klabin because it is a reference in cash cost and in profitability. I always like to underscore this. Klabin is not just a low-cost producer. We are, above anything, the most profitable company in the industry. And this is what we pursue all the time. Since this is our primary characteristic and because it is easy for us to access fiber, we are always a candidate of large investments in the industry.

Operator

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Next question from Marcos Assumpção with Itaº BBA.

Q - Marcos Assumpção

Cristiano, my first question has to do with the preliminary impact in the reduction of plastic packaging consumption. Can this impact Klabin's business in the future? And to what extent? The second question, you did excellent work of diversifying your sales mix in bags. If the economy is stronger next year because cement market picking up again in Brazil, what should be the company's strategy? And if you comment -- if you could comment on the difference of margin when you sell domestically and when you export for the bags market.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you, Marcos. And thank you for the opportunity of asking about solid waste more specifically about plastic. You probably saw last week that the European Parliament approved with more than 570 votes to ban of single use or one-way plastic. You might say the product got to be forward. But they should enter into force by 2021. When asked before about this, I always answered saying that in addition to behavior -- consumer behavior in this category, as I normally call, I can't really remember now, the profile of these consumers. But it's younger consumers that work for more sustainable products. Well in addition to these consumer behavior -- oh, the millennials. Yes. The millennials. I ended up forgetting that's the terminology. But in addition to millennials' consumer behavior, these are young people, more connected with sustainability. In addition to that, there is a behavioral change that is coming. It's not just saying that paper will continue to replace all plastic manufactured worldwide. But I have a strong reference in my mind, which is regulation. When you have a strong regulation, such as this one approved in Europe last week, we saw several moves by large players worldwide. But when a powerful continent like Europe, when they say that they're going to ban in a few years this fast-consuming plastic, then we are no longer speculating, then we start working on the valuation of companies. I have consulted some consultants. And we were all rather cheerful. They would always wait for regulation coming from government. But now that we have this regulation approved by the European Parliament, I think that consulting firms will start calculating which products can replace one-way plastic in paper. No doubt about it. It is a product that is biodegradable, manufactured from renewable sources, which are certified. And so paper is definitely upgrade candidate to replace one-way plastic. At this point, we haven't done official calculations through this growth in terms of substitution potential. But I can assure you that the upside for our industry is huge after this regulation. I would like to turn the floor to Douglas, our Packaging Officer. And he will speak a little bit about bags.

A - Douglas Dalmasi

Marcos. Good morning. Thank you for the question. This flexibility that Cristiano mentioned at the beginning is just part of Klabin's business. It's also part of the bags business as well. So in bags in the domestic market, we have civil construction and all of the other markets that we've been developing in recent years, the food market and others. And we have the exports market. Looking at our margin, the margin in the exports, it is higher than the margin in the domestic market for bags. The civil construction market and the domestic market resuming growth at higher rates, we definitely have a challenge

of finding the right adequate mix. We have projects for, number one, debottlenecking and increasing our volumes in our paper units to supply the converters and investing in conversions to supply this market. Other companies want to follow this growth. We want to move fast in this growth so that we can meet the goals of the developments we've made in recent years. So I'd like to say internally, we have a good problem. We developed the markets. And now we have to invest to follow this growth.

Q - Marcos Assumpção

Excellent. And if I may ask a follow-up question. Cristiano, regarding these corrugated box as they might be available for sale. Would anyone have a geographic complementarity with Klabin? Or are most of them in regions where Klabin is already present?

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

We haven't gotten to this level of analysis, Marcos. We went about one asset in a call that we got last week. And there's another one in the market. But we haven't done any analysis to disclose to you regarding that. It is important to say that overlapping is something to be evaluated. We have to analyze this based on our footprint and where there is an overlap. We always have to consider that consolidation even in a same given region tends to favor the industry. So we're not going to be looking just at the overlap if it exists. But we will consider consolidation in different regions of the country. We'll look at this as an opportunity.

Operator

Next question is in English, comes from George Staphos with Bank of America.

Q - George Leon Staphos {BIO 1495442 <GO>}

Two questions for you, Cristiano and Gustavo. From our perspective, there has been some deceleration in the kraftliner market when we look at export pricing at the same time that there's been some increase in supply in terms of export from the U.S. Is this one of the factors that has been leading you to see some reduction in your own shipments on kraftliner? Or are the 2 unrelated? The second question I had for you, I think there was an earlier question regarding plastic versus paper. In our survey work, where we talk to many of the independent box makers over time, we are finding that they, too, are expecting more move to fiber-based packaging from plastic because of the environmental trends, yet it is not actually happening in terms of production and demand statistics at present. Why do you think the rate of change has been, at least from our vantage point, comparatively slow?

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you. Thank you for the questions. I will continue in Portuguese. I'm sorry. But this is how we normally conduct our conference call. Regarding a deceleration, a possible deceleration that you mentioned, the U.S. market of boxes, as you know very well, should close the year posting a growth of about 1% in the United States, or a little over 1% box shipments showing the bigger of the U.S. economy, given its size and possibilities,

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particularly strengthened by e-commerce. In the month of August, we did see an increase in exports. If this persists, you are right, this could impact. It could have some pricing effect in the short term. But we are always very attentive to U.S. exports. And my answer is yes, in the short term. But in the long term, I think our industry is a long-term factor. And structurally speaking, like I mentioned before, we envision a demand for natural fiber-based product, which are renewable, which can replace plastic. And now I will connect this with your second question. Again, I'll repeat, there's a trade-off between short and long term. I think in the short term, I agree with the information you gave us that box makers do not feel this substitution in practice. They are not seeing it happening. But I want to link this with what I said before about regulation. Again, we see the behavior is changing. Large brand are having a deadline for replacement where they needed the regulation. It wasn't there yet. But I think that now this newly approved regulation by the European Parliament just last week is a strong message. It creates important determining factors, structurally speaking, for this migration to happen to paper packaging. Like I mentioned, I believe there is a great upside in our industry. We are very excited about this. And one last point, talking about kraftliner cycles. As you know, container machines in the United States are between 97.5% and 98% of the installed capacity. U.S. assets are being studied by us. Up close, we look at the average age of assets. These assets are becoming more delicate in their general stoppages. They have recovery boilers that are over 30 years old. So this is a market that is right on the supply. So general stoppages have been in recent years an important factor of analysis and pricing. And you should also consider weather characteristics that are also creating greater concerns, particularly in the south of the United States already causing an impact on the market whose installed capacity is right, just right. So combining this long-term vision, which is favorable, with short-term issues, which are delicate, we continue to be optimistic at least for 2019 with our kraftliner curve.

Operator

Next question in Portuguese comes from Mr. Renato Maruichi with Santander.

Q - Renato Damaso Maruichi {BIO 17847481 <GO>}

I have 2 questions. I think you mentioned pricing negotiations starting in the end of the year. Could you give us some color about that? That would be interesting. And in fluff, the domestic market is basically dominated by 2 players, you and one more player. Could you please elaborate on your strategy to gain market share in this market without hurting your profitability? My second question is a follow-up of a prior question on consolidation of packaging in the domestic market. If M&A is an alternative, do you think that this would have a significant impact on the pace of your organic growth or on the balance sheet of the company? This question was asked in the Second Quarter conference call. I just want to evaluate whether this has changed in the mindset of the company, the quarterly comparison.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you, Renato, for the question. I will give the floor to Jos   Soares, our Pulp Commercial Officer. And then maintaining -- to answer your question about balance sheet, I'll turn the floor to Gustavo. Let's begin with Jos   Soares.

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A - JosÃ© Gertrudes Soares

Our export fluff, you are right. The order accounts are normally negotiated on a yearly basis. And it is at this time of the year that we sign contracts. For this year, we have negotiations at much higher levels than what we have last year. Last year, we had a weight of about \$1,100 per tonne. That was indication for fluff. This year, we started negotiating it, \$1,345. And in addition to this increase in the index itself, we now have 2.5 years of experience. Our quality has shown that our product is highly accepted, not only Brazil. But worldwide. So now we can price just like any mainstream manufacturer in the market. We are over in the qualification phase. So our price now is totally in keeping with large players. And we take the opportunity now to start selling the project at a level that we can reduce the levels of discounts that we were offering. So there's a trend of reducing discounts. In this year, we're negotiating at a level of \$1,345 as a starting point for 2019.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Now I turn the floor to Gustavo, who will elaborate on your second question.

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Thank you for the question, Renato, about the company's vision for potential consolidation moves in the packaging segment in Brazil. So to begin with, there is no change in the company's vision regarding any type of alternative or opportunity in this sector. It is important to underscore that Klabin has the largest packaging -- the largest company in the packaging sector in Brazil. We will always look at all possible -- all possibilities of consolidation in the sector. But this coin has 2 sides. One is it has to make commercial sense. The consolidation has to be attractive for the company with the right price and the right return on the investment. And the flip side is whatever the investment move, it has to make sense according to the financial policy of the company. So in a nutshell, given the size of Klabin, we'll always consider all alternatives. And we'll have to combine attractiveness of a possible consolidation with our financial policy.

Operator

Next question is in English from Mr. Carlos De Alba.

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

So Cristiano, I heard you mentioned that Klabin is the lowest-cost producer in the world for kraftliner, I guess. So why is it taking so long for a company to announce the project to go ahead? I mean, I see the Russians and other producers announcing projects. And I understand that U.S. is also growing. But if Klabin is the lowest-cost producer. And now that we see some relation in Europe benefiting the use of paper. So why not be more aggressive and expedite the approval of the process, I believe, the kraftliner? And my second question is, how are you thinking -- and maybe, Gustavo, it is more for you. How is the company thinking about the dividend payments once the projects are approved? Do you believe that you can sustain a minimum level of dividends and maybe even if that requires a little bit more leverage? Or would the company prioritize CapEx even if that means not paying dividends for a few years?

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A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Carlos, thank you for the questions. I will start answering your question about the speed. And then I will turn the floor to Gustavo. So regarding speed, I would like to mention again what I said before. This is an investment that will last for decades. And so the decision-making process has to consider a complex set of solution. We have devoted our best of our engineering group to make the best decision, always thinking about optimization, thinking about finding what is the best and the most resilient EBITDA to be generated by the company. And we are doing this analytics considering the necessary time line to submit the project with a higher level of safety to our Board of Directors. I will now turn the floor to Gustavo to answer your second question.

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Thank you, Carlos, for the question. Well to begin with, we are still talking about growth projects, under analysis and under discussion. As Cristiano mentioned, focus on optimization. And that has not been submitted for approval to the board. So it's important to make these preliminary remarks before we say anything about the future of project that are at a final stage of validation by the management. So I have to start talking about where we spend at Klabin today. What we have shown in the recent quarters is a strong journey of deleveraging. So whenever we consider an investment cycle that will happen in coming years and whatever the format that we put on the table, we are definitely talking about implementation of project in a time line of 4 to six years. So we are also talking about an increase in leverage that will happen in the future when Klabin will be at a leverage level, which is quite lower than the current one. So it is very important to take that into account. Having said that, we don't consider a change in the current practices of the company regarding dividend payout. In that regard, although the projects are still being discussed, considering the continuity of a trajectory of deleveraging, we are not planning or forecasting any change in the current practices of the company, specifically regarding dividend payout.

Operator

Question in Portuguese comes from Renan Criscio with CrÃ©dit Suisse.

Q - Renan Criscio {BIO 18747357 <GO>}

Actually, I have one question. We heard some news regarding the possible renegotiation of royalties with the Klabin family. Could you speak -- could you give us an update of that discussion? Is it moving forward? Is there a deadline for this to be resolved?

A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Renan, this is Gustavo. Thank you very much for the question. Indeed, there was news that generated a question from our regulators, CVM, a question they asked to the company. We answered that with a public answer to this official letter from CVM. This possible negotiation regarding the current mechanism of royalties that we have while we clarified in our advisories that there is some discussion. But nothing has evolved formally that would require communication to the market. We're still at this stage as we communicated to our regulator of the capital markets.

Operator

Next question from Gabriela Cortez with Banco do Brasil.

Q - Gabriela Elerati Cortez {BIO 18801371 <GO>}

I would just like to confirm, Carlos asked about deleveraging. Considering in the future, when these projects enter the phase of investment, the leverage level will be lower, as you said. What is the level that you would consider to be optimal to start investing? What is the target for the company? And just to confirm, a question regarding Puma unit. What is the expected annual nominal capacity of that plant, please?

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Gabriela, thank you. Starting to answer your question about deleveraging. This is a very relevant question, particularly when we consider our growth cycle. The company works with a policy or a guidance to be communicated together with the approval of project, if and when this happens. Although, we have an internal view of what would be an adequate debt level in a cycle of project implementation. We haven't disclosed this yet. We are working on optimizing the metrics of the project. But together with that, we are working on what would be the leverage level along the cycle -- the life cycle of the project. Unfortunately, I cannot give you figures, policies or details. As for the second question regarding nominal capacity of Puma, at this moment, in the 12 months, we expect the capacity of 1,550,000 tonnes being produced at Puma.

Operator

Ladies and gentlemen, if there are no further questions, I would like to turn the floor to Mr. Cristiano Teixeira for his final remarks.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you very much for your questions. I would like to make some final remarks about this moment of the packaging paper segment and what the segment is going through. We are living in a unique moment in the sector, perhaps one of the high points of this sector, where opportunities are out there in front of us. We are considering a more responsible world that is asking questions. And we are positioned as an industry that offers packaging that can allow composting and recycling, favoring a circular economy because our product is already highly recyclable.

So a little bit about Klabin in this context. I would like to highlight what you already knew as a strength of Klabin in our forestry assets. We are an absolutely competitive company in our industry. We are a company that seeks optimal efficiency of our machines trying to be modernized with new assets. In the last two years, the company has been very operational in research and development. This was a little dispersed at the company before. But now this is all in one single location. We're investing heavily in R&D, trying to overcome natural barriers for our packaging paper, in addition to all other researchable aims that we are exploiting.

And I'd like to mention the pillars of our business. Klabin is a company that is more and more integrated in its chain of production, trying to consolidate the industry, trying to work closer together with end users, always ensuring services. And above all, better returns on our assets and better return to our shareholders. So Klabin is positioned at a historical moment with the industry as a great player that is well positioned to move ahead with great projects of growth.

FINAL

Talking a little about expectations, as we always do, regarding the Fourth Quarter. As I said before, the third and the Fourth Quarters are strong quarters for Klabin. And we expect a pace to be as good as in the Third Quarter. So we expect a great pace in the Fourth Quarter.

Thank you very much for your questions. Thank you for participating in this conference call. And I expect you to join us again in the next quarter. Thank you very much.

Operator

This does conclude Klabin's conference call. Thank you very much for your participation. And have a nice day. Thank you for using Chorus Call.

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