

Q1 2015 Earnings Call

Company Participants

- Antonio Sergio Alfano, Chief Financial & Investor Relations Officer
- Fábio Schvartsman, Chief Executive Officer

Other Participants

- Alan Glezer, Analyst
- Caio Ribeiro, Analyst
- Carlos F. De Alba, Analyst
- Jonathan L. Brandt, Analyst
- Lucas Ferreira, Analyst
- Marcos Assumpção, Analyst
- Thiago Lofiego, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Klabin's Conference Call. At this time, all participants are connected in listen-only mode. Afterwards, we will have a question-and-answer session when further instructions for you to participate will be given. We would like to remind you that this call is being recorded and it is also being broadcast simultaneously on the Internet via webcast and it may be accessed at cast.comunique-se.com.br/Klabin/1Q15, where you will find the respective presentation.

Before proceeding, we would like to clarify that forward-looking statements that might be made during this call related to the company's business perspectives, projections, operating and financial targets related to its growth potential are forecasts and assumptions based on the company's management expectations regarding the future of Klabin. These assumptions are highly dependent on market conditions, on the general economic performance of the country, of the industry and also of international market. Therefore, they are subject to change.

Today with us in São Paulo, we have Mr. Fábio Schvartsman, CEO; Mr. Antonio Sergio Alfano, CFO and IRO. First, Mr. Schvartsman and Mr. Alfano will make remarks about the operating performance of the company in Q1. Afterwards, they will be answering questions that you might have.

Now, we would like to turn the conference over to Mr. Schvartsman. Mr. Schvartsman, you may proceed.

Fábio Schvartsman

Good morning, everyone, and thank you very much for participating in our call about the first quarter of 2015. I would like to start by saying that this quarter was especially challenging, and this is the reason why it is a great pleasure for us to show you another evolution of our quarterly results with a 9% growth in our EBITDA on a year-on-year basis.

This result was achieved in spite of a whole series of negative circumstances that hit the Brazilian economy, which performance was very weak in Q1. And I would like to remind you that Klabin sells in the domestic market about 70% of all our products. Besides, we had successive increases in the energy, those of the company as well as all energy consumers of Brazil, energy consumptions of Brazil and, of course, it had a negative impact on cost.

Besides, there were non-recurring factors such as an unexpected stoppage for the Turbo Generator 8 revamping and also maintenance stoppage in the Otacílio plant that didn't occur last year. And the consequence of that is that we had to absorb all these factors. And one of the positive factors that we will have during the year will be the additional volume due to the capacity increase. And that was not still available in Q1 due to the fact that we had the stoppages that were scheduled for Q1. And because of that, there was an impact on the overall volume. So we had to work against all these factors. And the only positive factor in the quarter, and that helped us externally was the exchange rate that undoubtedly helped us as far as our exports were concerned.

And also I would like to reiterate the fact that in the expenses that are under our control, and especially administrative expenses and also selling expenses, we are taking additional care so as to prevent these expenses from having a negative impact on our earnings.

So I think it will be only fair to celebrate this 9% increase in our result that, by the way, corresponds to about what was already mentioned in our last call during which we said that 2015 was a year where we saw two positive factors; production and exchange and negative impact of the domestic market mainly and also successive cost increases that would make our job very hard.

And this is the reason why we maintained our view that we will see an increase in our earnings for the year in line with the increase in our production capacity as we had already said in our last quarter, so nothing different in this front.

At this moment, we have already closed our cycle of investments in machinery pre-Puma, and the last one was the debottlenecking of the Piracicaba machine and, it was very successful, it was done in the month of April. And as a consequence now, we are operating with a total annual capacity of 2 million tonnes, nominal capacity. And, of course, we must be careful because there is still the ramp-up of many machines that were recently invested by the company.

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And there is a natural learning curve in these machines. And, nevertheless, more and more, these machines have been giving their cooperation, giving us additional volume and that will ultimately become higher exports for the company as the company products, in general, are very well accepted in the international markets.

Thus, we are very comfortable when we reaffirm our view that in spite of a very challenging year 2015, the company will continue to deliver results in line with our forecast with successive increases quarter-on-quarter in our results; and this is our objective.

Regarding the Puma Project, this is going very well, in line with what we expected for this moment. And at the end of this quarter, we reached 58% of construction of the Puma project, approximately according to what was forecast. And we still have eleven months to start up. So this is the time for the company to make additional efforts in order to have this all going very smoothly.

And this project is a source of great joy for the company as the bulk of the CapEx of the project was contracted in domestic currency, in reals, and the bulk of our revenues from Puma will be in U.S. dollars. And as a consequence, the results of this operation will benefit as of next year from this situation that I have just described.

So this is what I had to say. And I know that we always give you an idea of what we expect for Q2. So for Q2, we expect to continue the process with growth in our earnings the same way we had during the last quarter, and maybe even slightly better than the last quarter.

Having said that, I will give the floor to my colleague, Sergio Alfano, who will give you more information about our performance in the last quarter. Sergio?

Antonio Sergio Alfano {BIO 4337533 <GO>}

Thank you, Fábio. Good morning, everyone. It's a great pleasure to address you once again to talk about the results of Q1 2015 for Klabin. I will start by mentioning the volume. And in spite of the bad situation of our domestic economy in the first quarter of 2015, the total volumes sold by the company was 437,000 tonnes, 1% lower on a year-on-year basis. And during this period, we had a lower availability of paper with the maintenance stoppage of the Otacílio Costa plant and also the ramp-up for the capacity increase for the Angatuba machine that we have just ended investments in at the end of December. So it is on its learning curve right now. All that was partially offset by the higher sales volume of coated board in the quarter.

With this lower availability of paper, the volumes sold to the domestic market in spite of the situation of the weak domestic market, we were able to sell 292,000 tonnes, 1% higher on a year-on-year basis. And as far as the exports are concerned, the volume was 145,000 tonnes, 6% lower on a year-on-year basis, mainly due to the stoppage of Otacílio Costa which is the main producer of export kraftliner.

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In the quarter, the participation of the domestic market in the total was 67% and exports were 33%. The net revenue of the company including wood was BRL 1.308 billion and 9% growth on a year-on-year basis.

Unit cash cost came to BRL 1.957 per tonne, a 10% increase vis-à-vis the first quarter of 2014, impacted mainly by the higher cost for the energy acquisition and by the revision stoppage of the Turbo Generator in Monte Alegre. We also had to buy energy at the market. And with the Turbo Generator stopped, we didn't have this energy for a few days and the maintenance stoppage of the Otacílio Costa plant.

The stoppages did not occur in Q1 2014. So net of these effects, the unit cash cost would have been BRL 1,900 per tonne, 7% higher on a year-on-year basis. Besides the effect that we have just mentioned, the exchange rate variation and inflation brought pressure on cost component prices such as chemicals, fuel oil and other materials.

And they were partially offset mainly by the lower selling expenses and also SG&A. EBITDA in the first quarter, adjusted EBITDA stood at BRL 461 million, 9% higher than the first quarter of 2014 with a 35% margin. And this is the 15th consecutive quarter of evolution in this topic.

Consolidated net debt at the end of December amounted to BRL 7.4 billion, a BRL 2.2 billion increase compared to the end of 2014. And this increase is due to the investments in the quarter and also the strong accounting impact of the exchange variation in the U.S. denominated debt, partially offset also by the higher cash generation from our exports.

I would like to mention that this effect of the exchange rate variation is only accounting and impacts most of them, the export prepayment financing, and they are not linked to the Puma Project and they are backed by future exports of Klabin.

Net debt adjusted EBITDA ratio closed at 4.2 times, vis-à-vis 3 times at the end of 2014. We had a 0.7 time impact of the exchange rate variation. And measured in dollars, if we consider the EBITDA in dollars for the last 12 months and the debt in dollars as well, our leverage is 3.3 times.

I would like to mention that the exchange rate when we started the Puma Project, we had said that the exchange rate at the time, when we started, it was 2.3 times. And we said that the exchange rate would be reaching 4.5 times. And if we admit that it is 90% higher today than the 2.30 times, this means one-time more net debt EBITDA, which means that it wouldn't be 4.2 times, but 3.2 times.

But the most important positive impact here is that the exchange rate increases the cash generation for the company in dollars with this positive effect of accelerating the deleveraging of the company and, especially, after the Puma Project is started up, which has practically 100% of its revenues in dollars.

In terms of investments, Klabin in Q1 continue to invest very strongly in the Puma Project. Total investment for the quarter amounted to BRL 1 billion, being BRL 880 million spent on the Puma Project. And the project continue to advance in the quarter and they are on schedule and on budget. Until the end of March, that site counted approximately 11,500 people working on that site, 58% of the physical evolution of the project already completed and 41% of the total CapEx already disbursed.

At the beginning of February, on February the 2nd to be more precise, the new recycled paper machine in the Northeast, in Goiana, was started out with a capacity of 110 million tonnes per year, and it is producing its top-quality paper in its learning curve.

And the objective of Klabin is to no longer transfer kraftliner to that unit and the Goiana unit will be using more the recycled top-quality paper, thereby releasing kraftliner from the south, especially for exports. And this extension tripled the capacity of recycled paper of Goiana going from the 50,000 tonnes to 160,000 tonnes.

Now, Fábio and I will be available to you to answer any questions that you might have.

Q&A

Operator

[Operator Instruction] Our first question comes from Mr. Thiago Lofiego from Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning, everyone. I have two questions. The first, if you can talk about the domestic market, which product in your product line is being more impacted by the current situation? And the second question has to do with cost. What can you expect in terms of the cost evolution? For instance, energy already reflects the new reality, or do you expect any additional pressure for the next quarter? And could you talk about the cost of chemicals? Could you give us a bird's-eye view about costs in general?

A - Fábio Schvartsman

Good morning, Thiago. Thank you for the questions. The domestic market is weak in general. And it's very difficult to say which part of the market is the weakest. But anyway, in all our business lines, Klabin has the closest relationship with the food sector, which is always more resilient than the other sectors. And as a consequence, we are suffering less, let's say, the effect of the slowdown of the Brazilian economy and the average of the Brazilian economy. And I believe that this kind of situation will continue unaltered. And we do not have any product line that is being more negatively hit by the others. I have no knowledge about any situation that I could tell you about in this regard. So I believe that all the lines are behaving in a uniform fashion vis-à-vis this issue that I have just mentioned.

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Now, regarding the pressure on our prices, we have not noticed any problem yet in this area. We continue to operate normally with our usual policy, our usual pricing policy, without having to waive anything in this regard, quite the opposite. And I would like to remind you that Klabin is an exporting company. As a consequence, we are always evaluating which is the difference between selling to the domestic market and to foreign market. And besides, the Klabin products in general are totally exportable. Since the end of last year, we have been exporting also sack kraft and we have been exporting also cement bags, which are products that traditionally we didn't really export in large amounts. And now as we have new equipment, which give us a very good quality in these products, even these lines are being exported at quite good prices.

Regarding pressure on costs, we had already anticipated the pressure coming from energy costs. And I cannot tell you whether this has come to an end or not because there is an ongoing action of energy prices re-composition, and this is being conducted by ANEEL which is the agency. And probably this could represent new price increases from now on. But there is no way we can tell you or forecast what will come. And on the other hand, as I mentioned during the call, Klabin starts to have access to the total volume of machines after all the investments and because of that there will be a higher cost dilution because we will have a higher production which also helps us to obtain the results that we are seeking.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you, Fábio.

Operator

Lucas Ferreira from JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Good morning everyone. About the demand in the domestic market continuing on Thiago's question. Do you see a difference in the trend for volume for the second quarter compared to the first quarter, more specifically in the coated board line? At least what we have been seeing for the first quarter was a very weak result overall. Maybe it didn't really hit you because your mix is slightly different from the market mix. But I would like to know if you believe there will be an improvement, a recovery in coated board for this quarter?

A - Operator

Lucas, I mentioned our big relationship with the food industry. And as far as coated boards are concerned, it is even more strong because of our relationship with liquids packaging. For the second quarter, things are not very much different from the first quarter. But certainly we will be seeing a proportional increase in exports by clubbing because of the new capacities that we have installed. And in fact, machine 24 which is operating in the Northeast with excellent results should be supplying that region and should be replacing kraftliner that Klabin used to send to the Northeast. And this kraftliner will be fully channeled to exports which means that the company's exports will be increased in the second quarter. And so the situation in the domestic market helps.

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Q - Lucas Ferreira {BIO 16552031 <GO>}

What about the CapEx of the Puma Project? How much do you expect to invest this year and in the next quarter?

A - Operator

Lucas, could you repeat your question?

Q - Lucas Ferreira {BIO 16552031 <GO>}

The Puma CapEx, how much will you invest this year?

A - Operator

Our budget for this year was a disbursement of BRL 3.4 billion and BRL 700 million in Klabin currently. So we are on budget. In this first quarter, we have spent BRL 1 billion which is about 25% of our figure for the year.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you.

Operator

Marcos Assumpção, Itau BBA.

Q - Marcos Assumpção

Good morning. My first question has to do with your leveraging. When measured in dollars, it is 3.3 times and I would like to understand what is the peak of this metrics that might reflect the reality of the company a little bit better and thinking about the peak of your leverage and the potential cash generation that the Puma Project will be bringing. Maybe my question will be to Fábio. Fábio, when will you feel comfortable regarding taking new steps for the growth of the company?

A - Fábio Schvartsman

Thank you, Marcos. Regarding leverage, Marcos, we are still seeking and we always measure the exchange rate at 2.3 times, or the leverage measured in dollars, our peak is 4.5 times. So this is our target. And of course, in nominal dollars at 3.2 times or 2.9 times, the leverage is different. However, the de-leveraging is much faster on the other hand. So measured in dollars, we expect to get to 4.5 times at the peak of the project.

Regarding the next steps, we are working in this direction. We have been discussing this internally of course, and we have been seeking actively the opportunities that stem from the Puma expansion. And, of course, it is a little bit too early to talk about that, but as soon as we conclude these processes, we will come back to you with new information. But it's fundamental for you to understand that right now all our efforts, all our attention are focused on the execution of the Puma Project in the best possible manner. So we have to do one thing at a time. This is the way we work. And we want to guarantee, we don't want

to just speculate, we are working to guarantee that we will be delivering the Puma Project as we have planned. So this is where we focus our attention.

Q - Marcos Assumpção

Thank you, Fábio. And looking at the volume for the next quarters, you said that the company, the investments are not yet bringing fruit, but what should be the mix that we should expect regarding sales to the domestic market and to export? You talked a lot about the cost of energy. How do you see that? Okay, I know that we do not have the figures, very detailed figures for your competitors, but how do you see your competitive advantage vis-à-vis the other players in the market that depend more on energy than you do?

A - Fábio Schvartsman

Thank you, Marcos. But we don't like to draw comparisons with competitors because we don't think this is right. I think we have a very good energy metrics and this will become excellent when Puma is started up because then we will become self-sufficient in electric energy and we will be net sellers of energy. And I think that the issue of energy to Klabin is a plus, and I don't know whether it is a plus or a minus for the other players. So you are in a better position to evaluate that than ourselves.

Q - Marcos Assumpção

And what about the sales mix?

A - Fábio Schvartsman

This year, we are adding 200,000 tonnes of production capacity this year, and there are two points. We still need three quarters to end the year, and we still have the ramp-up of the machines ahead of us. So a major part of these 200,000 tonnes will be obtained still before the end of the year, a hundred and some thousand tonnes, I cannot tell you more precisely. And this will be earmarked for the external market. So we will have a proportional increase in our exports.

Q - Marcos Assumpção

Thank you very much. And again, congratulations on the results obtained.

Operator

Leonardo Correa from BTG Pactual.

Q - Caio Ribeiro {BIO 18420483 <GO>}

In fact this is Caio. Good morning. I would like to understand the margin trend that you expect for the next quarters with the price increases in the product and the Piracicaba, Goiana volumes that will come on stream, could we expect a recovery of your EBITDA margin in the next quarter. And some new players intend to get into the fluff market. I would like to know if in a way this has any impact on your ramp-up.

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A - Operator

Starting by fluff, the Brazilian market, the Brazilian fluff market is of about 400,000 tonnes and our fluff machines will be able to produce 400,000 tonnes, which means that there is a very natural compatibility between the size of Klabin's operation and the size of the Brazilian market. And these announcements of additional capacity, most of them, are for the international market.

And as a consequence, this is a market where we will have a very small participation, a marginal participation. And as a consequence, I do not see any interference of these new capacities on our operation. You talk about recovery of margins, and it should have dropped in fact. But it has not dropped. So I do not think it's going to go up. But we will continue to work to increase the total EBITDA of the company and this will continue to go up.

Carlos de Alba from Morgan Stanley.

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

Yes. Good morning, gentlemen. First question is regarding have you seen any change in the order intake for exports with the currency strengthening in the last few weeks? And, clearly, you already mentioned that exports will increase, will go up in the second quarter relative to the first quarter. But if you can tell us what are you seeing a little bit beyond the second quarter perhaps with the order intake, that will be quite useful. And second, if you can just guide us in terms of the remaining CapEx for Puma, do you expect this to be around - what is the sequence of disbursement that you expect to have in your CapEx in Puma for the remaining of the project? Thank you.

A - Operator

Could you repeat the question please? The second question, could you repeat it because the company has not understood your question.

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

Sure. The second question is just the sequence of disbursement for the Puma CapEx in the remainder of that project. Is it likely to continue around the same level of Q1, or is it going to accelerate in the rest of the year?

A - Operator

Well, this is very easy. According to our schedule, we are having the disbursements that we had already forecast. We will have neither an acceleration nor a slowdown of the disbursements until the end of the project.

Regarding your question about the order intake for exports, we see no sign of change in this process whatsoever. And anyway, we will continue to export naturally. You should take into account that in the second quarter of the year, we will be having a stoppage of the Monte Alegre plant for maintenance and, of course, our volume will be slightly reduced in the quarter such as happens every second quarter every single year.

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

And in the domestic market, you mentioned the situation in Q1 was really difficult and even so the company was able to post a 9% increase in EBITDA year-on-year. What are you seeing in the domestic market in the second quarter? Is the rate of change improving, or continues to be similar to what it was in the first quarter?

A - Operator

Carlos, we don't see any change in the market yet. The market is not deteriorating vis-à-vis the first quarter; neither is it improving vis-à-vis the first quarter. And, as a consequence, from the view point of the domestic market, we see a similar situation to the first quarter. And the only different in the case of Klabin is that as we will have a little bit more capacity than we had in Q1, this will be translated into more exports from the company during the second quarter.

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

Thank you very much.

Operator

It's Jon Brandt from HSBC.

Q - Jonathan L. Brandt {BIO 17988091 <GO>}

Hi. Good morning. Thank you for taking my question. I first wanted to ask you again about the domestic market. IPEMA (34:56) announced some price hikes in box boards recently, but what it seems like you're saying is that you don't see room for further price increases because the domestic demand is fine as it is. I'm wondering if you could comment a little bit on that. And then secondly if I can ask you, at what point do you start signing some top contracts either for hardwood or for fluff? Should we expect that coming in the second quarter or later this year? Thank you.

A - Operator

Jon, thank you for your questions. About restrictions regarding price increases because of the situation in domestic market, I think it is important for you to take into account the fact that there are two factors that are important. One is demand of course, but the other one is the pressure on costs because the company has alternative regarding what to sell to the domestic market, this is the situation of Klabin. Klabin continues to work, so always aiming at increasing our earnings which means that we will continue with the same pricing policy that we had so far.

Nothing is being changed regarding our pricing policy. And, by the way, one of the major strengths of the company is the flexibility to operate in many different markets which allows the company to look for the right balance in order to prove its performance. And this is the reason why our performance has been improving quarter-on-quarter, and it should continue to do so.

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Regarding the pulp contract, of course we are working very hard in this direction and I can tell you that in the short-run, in the very short-run, in fact we will be announcing to the market what our commercial policy will be for Puma as we are just about to finish this definition.

Alan Glezer, Bradesco BBA.

Q - Alan Glezer {BIO 17508681 <GO>}

Good morning, everyone. My question is about Puma. What is the CapEx, the overall CapEx that should still be disbursed to conclude the project? And the second question has to do with the coated board business. I understand that you went from 36% in Q4 to 45% in Q1 2015 in exports for coated board. So what is the difference regarding the profitability that you see in the domestic market vis-à-vis the export market, more specifically for the coated board market?

A - Operator

We apologize for the interruption. Have you listened to the answer of the BRL 4.5 billion that we still need to invest in the project? Anyway, BRL 4.5 billion in investments still to be invested in the Puma Project, okay?

Regarding your second question, to draw comparison between the profitability of exports and the domestic market for coated boards, at the current level of exchange rate, it's really the same, the profitability is the same. And of course, we try to supply more to the domestic markets because we really want to support this market because we are local suppliers, local manufacturers. But today, exports are as good as sales to the domestic market.

Q - Alan Glezer {BIO 17508681 <GO>}

I would like to have a follow-up regarding your strategy for pulp sale. Would you consider a partnership with another player in the market in order to make this process more agile, or would you be developing this in-house by yourselves?

A - Operator

Thank you for the question. As I have already said, I think your previous colleague had already asked that. In the next few weeks, we will have the full disclosure of how we will operate commercially with Puma, and this is when we will be informing you. This is not the right time for that still.

Q - Alan Glezer {BIO 17508681 <GO>}

Thank you.

Operator

As there are no more questions, we would like to give the floor back to Mr. Fábio Schvartsman for his closing remarks.

A - Fábio Schvartsman

Gentlemen, thank you very much for participating in this call. As I said before, this has been a rather challenging quarter and we rose to the challenge and we delivered very positive results. And we believe that the process will be continuing in the second quarter.

And I would like to take this occasion to make a very fair remark to our colleague, Paulo Petterle, who is retiring at the end of April after 44 years working for Klabin. And the work that he did during these 44 years was excellent, was outstanding, helping Klabin quite a lot. So we are paying tribute to him right now. And saying that, we will make our best endeavors to keep the same kind of performance that we achieved when you were with us. If you are listening to us, please know that we are paying this tribute to you right now.

Thank you very much. Thank you for participating in the call, and we hope to see you again in three months' time when we will be talking about our second quarter results. Klabin's conference call is closed. Thank you very much for your participation and we wish you all very good day. Thank you.

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