Q3 2021 Earnings Call

Company Participants

- Aires Galhardo, Executive Officer - Pulp Operation
- Carlos Anibal de Almeida, Executive Officer - Forestry, Logistics and Procurement
- Cristina Gill, Chief Sustainability Officer
- Fabio Almeida de Oliveira, Executive Officer - Paper and Packaging
- Leonardo Grimaldi, Executive Officer - Commercial Pulp, People & Management
- Marcelo Feriozzi Bacci, Executive Officer - Finance and Investor Relations
- Walter Schalka, Chief Executive Officer

Other Participants

- Daniel Sasson, Analyst
- George Staphos, Analyst
- Isabella Vasconcelos, Analyst
- Jonathan Brandt, Analyst
- Leonardo Correa, Analyst
- Marcio Farid, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for holding, and welcome to Suzano's Conference Call to discuss the results for the Third Quarter of 2021.We would like to inform that all participants will be in a listen-only mode during the presentation that will be addressed by the CEO, Mr. Walter Schalka and other Executive Officers. After the company's remarks are completed, there will be a question-and-answer session and further instructions will be given. (Operator Instructions)

Before proceeding, please be aware that any forward-looking statements are based on the beliefs and assumptions of Suzano's management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events and therefore, depend on the circumstances they may or may not occur in the future. You should understand that general economic conditions, industry conditions and other operating factors could also affect the future results after Suzano and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I would like to turn the floor for the company CEO. Please, Mr. Schalka, you may proceed.

Walter Schalka {BIO 2099929 <GO>}

Good morning and good afternoon to everyone, and welcome to the conference of third-quarter results of Suzano. It's a great pleasure to be with you. I would like to start just telling you with that we have today -- we have here today, we have several officers of the company and we have -- I would like to introduce to you our new Chief Sustainability Officer of Suzano, Ms. Cristina Gil, has joined us at this moment would participate on the event with us today.

Today is an historical day for Suzano. We are announcing at the same time the best ever record EBITDA, quarter EBITDA on our history. We have BRL6.3 billion of EBITDA. We have -- in addition to that, it's a very important day as well because we are announcing the new project Cerrado that yesterday was approved by our Board of Directors.

In November 5th, we are going to announce the details of this Cerrado project. We are just released with you -- shared with you today some information that will be a project of 2.55 million tons of pulp. There is going to be an investment of BRL14.7 billion in defense and the commissioning of this project will happen on the second half of 2024. All the additional information will be provided to you on a special event that you are invited to join us on November 5th next week.

We are very pleased to announce to you today the results of the third quarter. In addition to the record BITDA, we had extremely good volumes on pulp and paper. Our inventory levels on the pulp side, it's below the normal levels. We are operating all of our logistics on a very good way, despite the shipping problems that the world is facing, we had very good volumes. We have a very good price realization and the combination of good volumes of price and price realization creates the situation that we have in our record EBITDA. In addition, in the consequence of that, we had a very good free cash flow on this quarter and we deleverage at very fast pace.

Our net debt came down from $11.4 billion to $10.7 billion on this quarter. And our net debt over EBITDA right now it's 2.7 times in dollar terms. Our liquidity, it's extremely good. We have right now $3.5 billion of cash in hand and additional standby line of $500 million.

And in addition to that, we had ESG. Last week we announced that we are -- Cristina is going to share with you the information related with the anticipation of our carbon sequestration targets from 2030 to 2025. And this is related with our call to action to the work. We are going to be part of the COP26 next week and we -- it's very important that all of us, 8 billion people work together on the direction of the carbonization of our world. This is a must. We cannot procrastinate anymore the situation and we are going to advocate this position during the COP26.

Now I'm going to hand over to Fabio, there he is going to talk about our Paper Division. Fabio, the floor is yours.

Fabio Almeida de Oliveira {BIO 22179839 <GO>}

Thanks, Walter, and good morning, everyone. Let's look at the Paper and Packaging business unit results for the third quarter of 2021. During the quarter, market conditions have improved significantly in all major Latin economies, with the advance of COVID-19 vaccination. Demand for print and write papers in Brazil according to IBA has grown 29% until August when compared to the same period of last year, recovering to pre-pandemic levels.

Demand for paperboard has grown 21% in the same period, showing that the above historical growth trend for the sector is persistent. On the supply side, paper markets have been forced to adapt to the constraints in global supply chains, which has reduced paper products flows between regions and strength intra-regional trade. Demand for uncoated wood-free papers in the mature markets has grown on a year-over-year basis when compared to 2020, yet, still below 2019 levels.

Now focus on slide four, the Paper and Package business unit has delivered strong operational performance into the quarter. Our sales were 6% higher when compared to Q3 2019, demonstrating solid growth even when compared to pre-pandemic levels. Domestic sales represented 69% of our total sales in the quarter, totaling 209,000 tons, an 8% increase compared to the same quarter of 2020, reinforcing the improvement on market fundamentals. On a quarter-over-quarter basis, our domestic sales improved 50% in volume due to better seasonality and the continuously strong demand for packaging papers.

I would like also to highlight that our export volumes were 13% [ph] higher on a quarter-over-quarter base even with severe and persistent headwinds in international logistics. Our average net price during the quarter was 22% higher than our price in Q3 2020, and 5% higher quarter-over-quarter.

During the period, Suzano has successfully completed the implementation of all of previously announced price increases for our product lines and all markets we serve. At the same time, we have also announced the fall in price increases, 14.6% for paperboard and 21% for cap stocks for the Brazilian market as of November 21st. $50 per ton for all LatAm [ph] exports and 6% to 8% for all North American export as of October 21.

As a result of strong volumes and prices, revenue management and operations stability, our EBITDA has reached a new record of BRL545 million in the quarter, a 31% increase quarter-over-quarter and a 53% increase year-over-year. Our EBITDA margin reached BRL1,789 per ton, also marking a new time high.

Looking ahead, on the short term, we see a better seasonality in Q4 in our challenge resided successfully managing the exogenous pressure of inflation and continue to find alternatives to international logistics bottlenecks. On the long term, we will keep working our unique go-to-market strategy with investments on technology and digitalization as well as boosting our robust innovation pipeline to keep benefiting from market trends that were accelerated by the pandemic as we can already be seen by demand recovery profile.

Now, I'll turn over to Leo, who will be presenting our Pulp business results. The floor is yours, Leo.

Leonardo Grimaldi

Yeah. Thanks, Fabio, and good morning, everyone. I will invite you all to move to page five of our presentation. The results of our Pulp business were quite positive for the third quarter 2021, supported by strong sales volumes, despite all logistics challenges and also supported by increasing prices. As you can note in the top graph, sales performance totaled almost 2.7 million tons in the quarter, marking a record third quarter since the merger.

I would like to emphasize that our inventories are well below optimum operational levels. Now our teams were able to successfully overcome supply chain constraints to guarantee high service level to our customers and consequently also maximizing our invoicing during the quarter.

Pulp consumption has exceeded our expectations across all paper grades in Europe and has rebounded in North America. In China, our order intake levels from our strategic customer base recovered back to normal and the steady rates despite the slower than expected paperboard demand recovery in the region.

We would like to highlight as published by AeoPulp, that pulp stocks in the European ports close the quarter 14% below the historic monthly average since 2018, placing a significant challenge to paper and paperboard producers who are running in this region at higher trading [ph] rates. In China, as per UM statistics, six pulp stocks remain quite flattish also during the quarter.

Our average prices for export markets as you can see has increased to $654 per ton, having major markets behaved in different directions, in turn due to each specific region's fundamentals. Our prices in Europe and in the Americas increased compared to the second Q and are in line with our announced price levels, while in China prices have started to correct to adjust since July. Our average price was influenced by a strong sales volume in Asia during the quarter.

Looking at our EBITDA performance, the all-time high of BRL5.7 billion in the quarter with a 63% EBITDA margin was also favored by the FX, contributing to high price levels in BRL terms even higher than our prices in local currency in the third quarter '18, when the pulp market was especially tight.

Now looking forward, we expect that fundamentals will continue to be tight in Europe supported by stronger paper demand than hardwood pulp stock replenishment. In North America, demand is healthy in all segments, including tissue where we see the end of the channel destocking, as well as improving of the away-from-home segments. In China, we recognized a lower visibility as macroeconomic environment is becoming more challenge -- more challenging.

Nevertheless, we would like to point out some factors that might contribute to a more positive pricing dynamics going forward. In the demand side, we see stable downstream paper consumption and consequently lower intermediary paper stocks after the recent production curtailments triggered by the energy crisis. The same time we've seen intense to quickly improve operating rates as paper producers are getting prepared for a high seasonality quarter and the Double 11, the November 11 Shopping gala [ph] few weeks from now. Price increases are also be announced and implemented across all paper and packaging rates, improving paper margins.

In the supply side, logistics is expected to impose even higher risk for global market players and also for upcoming capacities. We also might see above average and expected downtimes as increasing energy, chemical and logistic costs should impact producers' operating rates, not only in China but also worldwide.

With that said, I would like to invite Aires, so that he can give us more information on our cash cost performance.

Aires Galhardo {BIO 17954886 <GO>}

Thank you, Leo. Good morning, everyone. We are in the slide number six. The third quarter '21 cash cost performance, both quarter-over-quarter and year-over-year was affected by the exogenous pressure off rising commodity price, mainly Brent affecting inputs and wood costs, followed by energy impacting chlorine dioxide again on input costs and issue in packaging wires.

The quarter-over-quarter performance resulted in a low-digit increase in line with our recent discussion image hours [ph]. As you can see, the impact of commodity price are accounted for virtually all the cash cost pressure. Other factors that negatively contribute to the third quarter figure is related to the higher fixed costs in turn due to more intensive maintenance routine that took place during scheduled on times in the quarter.

Looking now to year-over-year performance, commodities price also took a toll on cash production costs, representing 74% of the total increase. Here the fixed cost increase can be mainly explained by the record of COVID-19 pandemic impact previously recorded direct link COGS. For the coming quarters, the company expects that the cash cost production ex-downtime should remain about flat over (inaudible).

Now, I pass the floor to Marcelo Bacci to continue the presentation.

Marcelo Feriozzi Bacci {BIO 17648865 <GO>}

Thank you, Aires, and good morning, everyone. On page seven, we see that this quarter represented a significant step in terms of our deleveraging process. Our net debt went down by $700 million in this quarter alone, and $1.5 billion in the last 12 months, which is an exceptional performance that allow us to bring our leverage ratio back to 2.7 times, now well within the limits of our financial policy and creating the conditions for a new investment cycle.

Our liquidity position is extremely robust, we have $4 billion of liquidity at this point. And our debt amortization schedule is very comfortable till the end of 2024. 80% of our cash position is in hard currency and our liquidity is sufficient to cover all of our debt maturities in the next four years, even if we don't generate any more cash.

On page eight, we show our current FX cash flow hedge portfolio. In the last 12 months, we have been able to change dramatically the production levels, taking advantage of the opportunities that was presented to -- were presented to us by the market. Our average put is now at 532, and calls at 613, with a special note to the long-term hedges that we have that have been benefited especially by higher interest rate and a higher volatility scenario that we see today in the marketplace.

Turning to page nine, we see that our CapEx program has been evolving according to our plan. We dispersed BRL1.5 billion of CapEx last quarter, and we keep the same guidance for the year with total investments for 2021 of BRL6.2 billion.

With that, I call my new colleague Cristina, to the floor. Welcome, Cristina.

Cristina Gill

Thank you, Marcelo. It's a great pleasure to be here at Suzano. As Walter mentioned, we believe that tackling climate change is one of the biggest challenges of our generation. And if we wish to leave a better world, we must embrace board and coordinated measures now. COP26, the Climate Change Conference starts next week. It is indeed an opportunity for world leaders together and become true global pioneers. This must be achieved through mutual agreement on a concrete framework from which our nations can move forward together to combat the climate emergency. Among the measures that we expect is implementation of a regulated carbon market, included in the Paris agreement.

The former is fully aligned with the imperative to collectively preserve biodiversity through financing nature based solutions. Aware of Suzano's potential and convinced that addressing climate change must be a priority. We reinforce our commitment of capturing more carbon dioxide from the atmosphere than we emit, as we understand the urgency. Therefore, Suzano has advanced its long-term goal. We will remove 40 million tons of carbon dioxide from the atmosphere five years earlier. We will deliver this goal by 2025 instead of our original target year of 2030. The new goal will be supported by a combination of more efficient and expanded forest cover, as well as an increase in designated conservation areas from degraded land to be restored. Very importantly, Suzano will maintain its focus on reducing carbon emissions across its own operations and supply chain. This is in fact, fully aligned with our joining the science-based target initiative, and the 1.5 degree business ambition.

In parallel, the company remains committed and engaged in discussing new methodologies for reporting greenhouse gas emissions and renewables such as the Greenhouse Gas Protocol guidance and land us. Avoiding climate disaster, however, it's not a task that we can be -- that we can tackle alone or that can be executed by one company or industry by itself. Hence, we are encouraging our peers in the business community to join us. This is a race where if we join forces, we will all win.

Walter, back to you.

Fabio Almeida de Oliveira {BIO 22179839 <GO>}

Walter, you are on mute.

Walter Schalka {BIO 2099929 <GO>}

Thank you, Cristina. It's a great opportunity to be with you here and work together in the direction of regeneration. This is a critical issue that we need to work on our society for the near future. I'm very pleased with you that we are sharing extremely good results, operational results. We are showing records to you. In addition to that, we have been working to mitigate our cash cost inflation that we are seeing from the commodity business.

But on the other hand, we are preparing the company for the future. We have a very robust balance sheet. We are very low cost of debt, very long-term debt. We are well prepared for the next cycle of growth that we are announcing today to you, that would be our Cerrado project. We are very pleased to see how robust is our engineering team that should be prepared for this target and for the new projects coming on stream. And more than that, the company will work on this environmental issue that we believe there it's our responsibility and our generation to work, to mitigate the climate change.

We are very committed with these projects and we believe that ESG is not only few words that we need to discuss on the various appendix area of our presentation. This is a mission, this is a critical of our generation and how we are going to address this issue in the years to come.

Now we are going for the Q&A session. Since Cerrado project, you're invited, we are going to deliver additional information only on November 5th, next week.

Questions And Answers

Operator

Now the floor is open for questions. (Operator Instructions) Isabella Vasconcelos from Bradesco BBI, would like to make a question.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

Hi, good morning. Congratulations on the results, and thank you for the opportunity. I have two questions on my side. First, could you please comment on your perception of how pulp inventories throughout the chain, and especially paper makers hands -- on paper makers hands in Europe and China are right now?

And the second question still on pulp market dynamics. I would like to hear view on how you're thinking about supply and demand dynamics in 2022? Of course, I know there are a lot of uncertainty still, but there would be great to hear your view. These are my questions. Thank you.

A - Leonardo Grimaldi

Hi, Isabella. This is Leonardo. Thank you for your questions. When I first addressed the one in the European inventories. We see actually a low hardwood stocks in European ports. As I mentioned in my presentation, they are ranging 14% below historic averages. We sense that the demands in Europe is very strong. Our sources show and our customers presents us with extremely high operating rate. At the same time, we see that the stocks are very, let's say, challenging to support this high operating rates. So we see that they are running below what was actually needed or what is actually needed to support European producers at the time. And this is mainly obviously to logistics constraints that we're seeing globally. It's very hard to diverge vessels from route A to route B.

Now in your question on the market for 2022, obviously, this will well depend on the fundamentals at the time, but since we have few months from there, let me try to give you my view of what should happen or what might happen in terms of demand and supply that will support the fundamentals. We are seeing, obviously, that some projects were delayed, and with this logistic constraints that we have, obviously, not only this, delays in projects, but existing volumes from current producers and also upcoming producers will be arriving at markets at a much slower pace. So that we think will contribute for a lower-than-expected supply at 2022.

In the demand side, we see several opportunities, addition to the organic growth of the market, which we all and you all follow. We see opportunities in terms of fiber substitution. Hardwood and softwood still have a significant gap in terms of pricing and regaining space and traction every day. And our customers are more and more interested in seeing how they can substitute softwood fibers by our fibers. And we are now seeing the same happening on recycled grades as well, especially the sorted office papers or the higher range recycled grades. Due to low availability of these fibers and increasing cost of these fibers, which are now very close to prices of bleach chemical pulps especially in Asia. There is also a huge intense to substitute recycled grades by virgin fibers.

On top of that, we also have the fossil to fiber initiatives that we talk about so much. A lot of brand owners are reaching our customers and also ourselves directly and to be able to develop projects that will substitute the single-use plastics that they have today as alternatives in their products or packaging by more sustainable alternatives like a paper packaging for example.

Additional to that, there are two other points that I would like to point out. First is the gap between the solving pulp and paper grade pulp. As you know, it's a way above historic averages, and we think that that's where we'd stimulate and speed up conversions of flex capacity between paper grade pulp and dissolving. So that will help also the fundamentals for our paper grade market in 2022.

And last but not least, the industrial inflation of costs. This is obviously not exclusive to Brazil, exclusively as we are seeing this across the globe. In China, resin producers being hit by increasing energy costs, also labor, wood costs, logistics, and all this will put a lot of pressure on the producers and the marginal cost producers will be certainly having a higher marginal cost, and this will put pressures in terms of unexpected downtimes in certain low operating rates than we saw on the cost side.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

That's very clear. Thank you.

A - Leonardo Grimaldi

You're welcome, Isabella.

Operator

Our next question comes from George Staphos from Bank of America.

Q - George Staphos {BIO 1495442 <GO>}

Good morning and good afternoon, everybody. Thanks for taking my questions and congratulations on the results. I had two or three questions. I'll ask them together. So for time efficiency. First Leo, thanks for the rundown on the pulp market. How do you gauge the impact that pricing is having in terms of the slower pace of supply from existing and new suppliers into the pulp market? Potentially at a higher price if you saw that we'd maybe be seeing more supply into the market.

On the paper side, Fabio, can you remind us what price increases you're in to the market with newly? You went through that very quickly in your remarks to review that? And why are you not worried that the continued escalation and paper pricing might at some point start to negatively affect demand?

And then Cristina, could you review quickly how Suzano is going to hit its goals five years earlier? You mentioned deficiency, I think it's silviculture and also conservation lands. But if you could give us a bit more details there, that'd be great. Thank you very much, and good luck in the quarter.

A - Leonardo Grimaldi

Well, thanks George. Let me take your first question. This is a very interesting question. We actually don't think that there's a very strong correlation to that. Most of the projects that we have seen announced comes from either one side of producers who are betting on the increasing organic growth and all the other fundamentals that can even further accelerate growth in terms of pulp demand as I have mentioned in my previous answer to Isabella. And the other side, we see a lot of action or interest in integrating capacity, especially in other kinds of fibers like for example, just solving into viscose and projects coming into that arena due to the opportunity of increasing viscose markets in the future as a substitute of cotton and polyester. So we don't see a lot of correlation for the time being, at least from this next cycle. If markets or projects will be announcing increase according to the pricing dynamics in a specific moment of time. Now I pass to Fabio.

A - Fabio Almeida de Oliveira {BIO 22179839 <GO>}

Thanks, Leo, and thanks, George, for your question. Regarding the price announcements that I went through in my presentation, we have announced a price increase for paperboard in the Brazilian market at close to 15%, 14.6% to be more precise as of November this year. And we have also announced a $50 per ton in our product rates for LatAm exports and 6% to 8% increase in all our North American exports. And this is all valid as of October 21st.

As of to your question regarding the price impact on the demand of paper, we have seen paper prices in Brazil operating below the international markets in dollar terms. So the trend is that the paper prices and business [ph] trend recover see a gap there that we can come back to international price levels. And also we see lots of pressure from the international markets for logistics, and also raw materials inflation, which is also pushing paper prices to a different price level. So we believe that in order to come up with the adjustments for inflation, logistics, paper prices will continue to move forward in the international markets and also in Brazilian market.

Q - George Staphos {BIO 1495442 <GO>}

Thank you.

Operator

Our next question comes from Leonardo Correa from Bank BTG Pactual.

A - Walter Schalka {BIO 2099929 <GO>}

Sorry, we didn't answer the third question. Cristina, the floor is yours.

A - Cristina Gill

Thank you, Walter. George, thank you for the question and it is a complex answer. We are expanding our eucalyptus plantations to Cerrado project. So we're going from 150,000 hectares to 290,000 hectares more or less. Also we have a 500,000 hectare biodiversity target and we now include in the calculations we refined our methodology and we're including carbon removal from nature or natural cover of our preservation areas. And also we are reducing emissions in our own operation. So that will be also included. We're thinking of around 5,000 -- 5 million tons of carbon dioxide per year removal more or less. There will be variations a year and also we had a 15 million reduction in 2020. So we're pretty confident we will achieve the goal.

Q - George Staphos {BIO 1495442 <GO>}

Thank you.

Operator

Our next question comes from Leonardo Correa from Bank BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hello, everyone. Good morning. Can you hear me?

A - Walter Schalka {BIO 2099929 <GO>}

Yes, we hear you, Leonardo.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay. Thank you guys. Yeah. So my first question is still on the market outlook guys. I'm going to keep my two questions on the market outlook. So first, today, we received always right, on Fridays, we see the weekly numbers coming from resin [ph]. The -- an interesting trend that's emerging is that the reselling prices now for the first time in many weeks and months above the fixed price in China, right. So, Leo, I just wanted to hear you on what you make of this difference, right. I mean, clearly the spot price in China now a little bit above the weekly price. Do you think this signals that we could be close to a bottom or close to floor levels on the pricing side? I think that would be interesting to hear.

And the second question on my side, still sorry guys to insist on the market outlook. But I think this has been important and, of course, it's been a very confusing year for all of us. I think we made a mistake on the Chinese demand outlook, right. I think the big mistake we made in the year was to probably overestimate the demand outlook in China. And some months ago, the narrative was that the Chinese paper mills were destocking, right. That generated that first leg down in prices. And now the narrative has shifted towards a narrative of the Chinese paper mills not wanting to restock given the fact that there is supply coming in and also given the fact that there is weak demand in the short term on a series of rationing effects and all that, right.

Leo, also to hear from you, I mean, what exactly are you seeing on the ground in China? Why is demand so weak? Why are things so different in China than what we're seeing in Europe and in North America? I mean, are you seeing any signs of stabilization? Any signs of potential green shoots of demand recovering at the margin? I think it would be also very interesting to hear. Thank you guys. I'm sorry for concentrating both questions on the market outlook.

A - Leonardo Grimaldi

Okay. Well, thank you for both questions. Regarding reselling prices, we agree that that is usually one of the trends and one of the best proxy to show the direction that the market is going. So when we say as it is now is trending over the fixed levels for China prices. Certainly that shows a good trend for price stability or even price increases in the short term. We believe that the main reason for that, that might explain a little bit as well my view on the second question is that there was destocking throughout paper grades and paperboard grades in China in the last three or four weeks due to the restriction on production in several mills. So that's our first consume. And now in the fourth quarter of the year where we have a good seasonality and also the Double 11 or the November 11 Shopping gala which is huge for tissue as you know. There is a push from producers to recover the stocks as quick as possible to be ready for the season, especially producers in the northern part of China, which were waiting for this opportunity to recover the upgrading rates.

So we see that this push, obviously, they are quickly assessing all available book stocks in China and the ones available are from resale. That's why prices are steady and we also see a bigger interest in terms of new pulp order intake levels. So we are very positive that the situation has changed during the last three, four weeks after the restrictions to production that generated an effect that I think that we were also not expecting. But we see us more positive than negative.

Demand to answer your questions, everything I think is kind of correlated. We expected the higher demand coming end of August, early September as usually seen in China, which didn't happen, in our view, due to still a little bit of COVID outbreaks and then the restrictions to some further education. And then obviously, the impact in printing and writing that that generates, and then later the energy related production curtailments.

But then, one important fact is that we are seeing even after the curtailments no impact at the downstream demand. And I think this is the most important KPI. We are not seeing that the demand for tissue packaging, or even printing, writing as we are approaching the publicity of the Winter Olympics have been impacted during this past weeks. So as we're coming into the fourth quarter again, we see this push and this intense or this need from paper producers, packaging producers, tissue producers to recover operating rates to be able to be prepared for this higher seasonality season. So it's very important I think that to focus on downstream demand, because by the end of the day, that's what's going to drive the whole chain in the market.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay, thank you very much, Leo.

Operator

Our next question comes from Daniel Sasson from Itau BBA.

Q - Daniel Sasson {BIO 19234542 <GO>}

Hi, everyone. Good morning. So my first question comes maybe to Cristina or Walter, if you could share your expectations for the main outcomes of the COP26. What do you think will be the main or the most interesting topics? And if you have any developments that you could share with us in regards to your assessments of eventually tapping voluntary carbon markets, that would be great.

And my second question, maybe to Leo, I think it's fair to assume that you -- your own inventories declined further during this quarter because you basically had very strong sales volumes and there were some maintenance stoppages during the quarter. So my question is, and you were already saying that you were working with below normalized inventory levels. So Leo, has Suzano maybe learn to work with an inventory level, much lower than historical levels, or than what you used to call normalized levels or do you think that at some point, you will, your own inventories will increase and this trend could be maybe reversed? Those are the two questions from my side. Thank you guys and congratulations on the results.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you, Daniel, for your question, and thank you for raising this so important question that is related with COP26. We -- I think as a precedent conditions, we need to address in the COP26 what would be the NDC standardization, because the NDC on different countries are related, not including some specific areas of the sectors of the emissions and is not sometimes it's not absolute numbers. We need to set one standard for NDC for every single country.

In addition to that, we need to have more -- both targets and more short term targets. We need to anticipate the targets that have every single country and this is the commitment that we expect from different countries on that agreement on Glasgow. And more important than that, that we create a global regulated carbon market. If you have this, we have a cap and trade system where we can reduce the -- sorry, the allowance for emission for every single country and every single company the word we will have a force or dimension of a new investments on decarbonization of the world market.

We need to do it right now. Then, if you have short term and more both targets and if you have more investment on the decarbonization through a global carbon market, I think would be very positive. Last but not least, we need to fulfill the agreement, the Paris Agreement, where developed countries will invest at least $100 billion for developing countries. We believe that should be a more higher number than the $100 billion and we expect that they reach an agreement on that during the COP26. And now I'm going to pass to Leo.

A - Leonardo Grimaldi

Thanks, Walter. Hi, Daniel. Thanks for your question. Obviously, I will have to refrain from answering it because, obviously, our inventory policy looking forward or going forward is very much related to our commercial strategy. And we cannot give guidance in that way, if we will operate at higher or lower levels. Let me try to answer it in a different way. I think first of all, it's important to say and I think it's clear by now that after two consecutive quarters, that Suzano and we are all following very actively the market, particularities the fundamentals, and supporting our customers. And we are capturing all opportunities possible and therefore selling at very high rates and according to our plan. This is number one.

Second, I would like to reconfirm that our stock levels are really at very low levels across our global supply chains. We have from one side our customers in several regions having over than expected operating weight and having a bigger pool on our pulp and on the other side, the more difficult supply chain and logistics scenario. So when we add those two factors together, we are at the situation that we are today. But I'm very happy to say that the work that our team has been doing together and this is industrial supply chain, logistics and sales, and is enabling us to be able to service all customers with very high service level agreements, which we had before and which are maintained, and also to be able to deliver very high sales volumes for the quarter, as you saw in my previous presentation.

Q - Daniel Sasson {BIO 19234542 <GO>}

Thank you, Leo. Thank you, Walter.

A - Walter Schalka {BIO 2099929 <GO>}

Thanks, Daniel.

Operator

Our next question comes from Jonathan Brandt, HSBC.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Hi, good morning. Thanks for taking my questions. First, I wanted to ask you about Europe and European demands. Obviously, the prices in Europe are very high relative to China. I guess, I'm wondering if you could share any insight you have into that how long do you think something like that might last? And if it's possible for you to put more into Europe to get some of the incremental pricing there? And if there's any concern as we head into winter in Europe given higher natural gas prices and energy prices in Europe? Is there any concern about European demand falling because of higher energy and manufacturing costs there?

And then my second question relates to freight. Obviously, I know you have long term contracts and you haven't noticed any disruption. But I believe most if not all of your freight is on contract. I'm just wondering, as we sort of roll forward a year or two, my understanding is that the freight situation is unlikely to get much better at least over the next year or so. So if you could sort of share what we should be expecting on freight rates going forward? Should we expect some pressure there or very well situated?

And then lastly, and Walter, forgive me, I know you didn't want to talk about the Cerrado project. But I'm just wondering what was behind the timing change? Originally, you're expecting 1Q and the statement last night you're saying it's delayed to the second half. Is that just more supply logistics issues and not being able to get the equipment in? Or is this sort of your decision given the pulp market fundamentals? If you could share anything there, that would be great. But if you want to wait until November 5th, obviously, I understand. Thanks.

A - Leonardo Grimaldi

Okay. Jonathan, this is Leo here. Let me start with the first one regarding European demand. Our view is that the European demand for all kinds of paper, grades and also packaging grades are very strong. And the reason is not only related to continental Europe, but also to the markets around continental Europe, mainly in Northern Africa, in the Middle East. This markets were serviced by Asian producers in the past and also from producers from Latin America and North America. But due to the logistics constraints, the lack of containers and the cost of containers this markets today are being mostly sold or attended by European producers who then are running at very high operating rates.

We were recently at a forum together with all our customers in Europe and they report order books fully taken until the end of November and in some ways, until the end of December. So very-very high order books and operating rates at a time, which makes them the supply chain a big challenge because it is very hard today to reroute or reroute vessels from other markets into Europe, or to speed up the supply of hardwood pulp into Europe. So this creates this kind of unbalanced that is then making the fundamental strong and supporting prices and change in Europe since some months ago already. And it's also very hard to precise, just to end my response to your question, on when that's going to change because that's related to this logistic challenges that we have today. We believe that it's a moment of time when logistics ease off, and we have more supply coming into Europe. Eventually, this market can start correcting if fundamentals don't change at the time.

A - Walter Schalka {BIO 2099929 <GO>}

Good morning, Jon. This is Schalka speaking. Thanks for your question. Just to remind of the buddy for break bulk use it to the transport both abroad, we have long term contracts. We have a sort of agreed or definer rates. There are just only by the bunker. It is hard to predict what's going to happen with the freight rates in the coming year. But I can tell you that we have a new vessels being built to transport pulp mostly there in Asia. So we foresee additional vessel capacity coming online in the coming years. But again, it's hard to predict what is going to be the freight rate trends.

A - Leonardo Grimaldi

Jonathan, thank you very much for your question related with Cerrado project. After we approve, we've set the precedent conditions the project on the last quarter. We approached the several suppliers and we are going to announce next week the winners of the supply is going to supply for us and realize that their delivery times would be higher than we expect for different reasons for the commodity for the logistics, and for several other factors. And this is the reason that we postponed the commissioning of this project to the second half of the year. We are very confident the quality of our suppliers. But it's important that we keep the market on the right information regarding the commissioning period. This is the reason that we decided to postpone from the first quarter to the second half of the year 2024.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Great. Thank you very much, everyone.

Operator

Our next question comes from Marcio Farid from Goldman Sachs.

Q - Marcio Farid {BIO 22379440 <GO>}

Thank you. Good morning, everyone. Thanks for the opportunity. I have a couple of questions. The first one on cost inflation with something that we've seen across segments and for different companies as well. Just wanting to hear from you and understand if you have reached a turning point in terms of cost inflation, are we at a peak? Are we seeing any potential carriers into the next quarters? And Carlos, maybe if you can add here in terms of how you're seeing a cost inflation on the forestry and plantation side as well and what are the expectations going forward?

And then my second question may be to Bacci. Bacci, how should we think about hybrid financing? Again, sorry, I understand that there's going to be more details provided next week. But just if you can give us some color in terms of how your capital allocation going into the next CapEx cycle is going to be looking like? That will be great as well. Thank you.

A - Marcelo Feriozzi Bacci {BIO 17648865 <GO>}

Hi, Marcio, good morning. Thank you for your question. It's not easy to predict the commodity price for coming quarters. But we are not carrying any delay implementation in terms of costs. That's the reason to believe that coming quarters will be flat with the third part of 2021. And, in the medium term, we continue to work in our initiatives to reduce the structural cash cost such as energy efficiency, lower average distance between forest and the mill and reduction of third party wood. And additionally, the Cerrado project we contribute to with this driveway of our avenue to be -- have been best in class in terms of cash cost. I think that we are on track. And probably we are in the peak of the commodity price and we believe that the coming quarters in this level or if you have a better scenario in the commodity to decrease something.

A - Carlos Anibal de Almeida {BIO 19090865 <GO>}

Hey, Marcio, good morning. Thank you for your question. On the forestry side, we are facing a high impact coming from mainly fertilizers and service. So that is the reality that we have right now. And the way that we look at that is that we need to improve our efficiency. We need to go after other ways of operating in order to mitigate to minimize this situation. We look at that as an opportunity to find ways or different ways to operate in the forest side. So it is a reality and that we are trying to maximize our efficiency in order to overcome this situation that in our view should not improve in the short term.

A - Marcelo Feriozzi Bacci {BIO 17648865 <GO>}

In regards to your question about the Cerrado financing, we will not go into details right now. But the general idea is to finance the project with internally generated cash and with the cash position we have today. We have no plans at this point to take on specific financings for this project.

Q - Marcio Farid {BIO 22379440 <GO>}

Great. Thanks, Marcelo.

Operator

There are no more questions. I would like to turn the floor over to the company's CEO for the final consideration. Mr. Walter Schalka, you may proceed.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you very much for the opportunity to be with us here during this third quarter call. And we are very pleased with the moment that the company is in. We are preparing the company for the future. We have been working on several different avenues of value creation to our shareholders. We are discussing about our relevance on the pulp market, our structural costs, we have been working on our integration, vertical integration and our consumer goods are performing very well on this area.

We have been working on the bio-economy and different avenues of addressing new markets with our biomass competitiveness and environmental impact. And carbon would be a market for us on the near future. We are very positive from what we are doing. We have been delivering the expectations of the market. We have been working on impacting the world, impacting the society. Thank you very much. And let's keep in touch.

Operator

Suzano's third quarter results conference call is finished. Have a nice day.