

Q2 2015 Earnings Call

Company Participants

- Fábio Schvartsman, Chief Executive Officer
- Tiago Brasil Rocha, Manager, Investor Relations

Other Participants

- Alan Glezer, Analyst
- Caio Ribeiro, Analyst
- Carlos F. De Alba, Analyst
- Lucas Ferreira, Analyst
- Marcos Assumpção, Analyst
- Thiago Lofiego, Analyst
- Vincenzo Paternostro, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Klabin's Conference Call. At this time, all participants are in listen-only mode. Later, we will have a question-and-answer session, when further instructions will be given for you to participate. As a reminder, this conference is being recorded and broadcast live via webcast and may be accessed at <http://cast.comunique-se.com.br/Klabin/2Q15>, where the presentation is also available.

Before proceeding, I would like to mention that forward-looking statements that are made during this conference in connection to Klabin's business outlook, projections, operating and financial targets and potential growth should be understood as mere (01:04) assumptions based on the company's management expectations in relation to the future of Klabin. Such forward-looking statements are highly dependent on market conditions, on the general economic performance of the industry and international markets as well. Therefore, they are subject to change. (01:24) exceptionally, we do not have (01:27) for personal reasons.

Today with us in São Paulo we have Mr. Fábio Schvartsman, Chief Executive Officer; and Mr. Tiago Brasil Rocha, Investor Relations Manager. Initially, Mr. Schvartsman and Mr. Rocha will comment on the company's performance during the first quarter. After that, they will answer questions that you might wish to formulate.

Now, I would like to turn the conference over to Mr. Schvartsman. Please you may begin.

Fábio Schvartsman

Good morning. Thank you very much for your presence. It's a great pleasure for us to have you here in another conference call of Klabin. This quarter was a very challenging one for the company due to the ongoing weakening of the domestic economy, but maybe represented by the deterioration that we saw in the volumes of ABPO, 2.5% drop in this half year vis-à-vis the same period last year in coated board, which is followed by IBÁ, which showed a drop of 6% in the coated board market in comparison to the same period last year.

So, it was against this backdrop that Klabin had to work and adapt, taking advantage of its flexibility in order to be able to continue to deliver good results as we have been doing in a long sequence of quarters.

So, it is a pleasure for us to reach the end of this quarter, being able to tell you about the 17% evolution in our EBITDA compared to the same period last year, very much focused on the increase of our exports. And as you all know, the company has this flexibility, because there is no domestic consumption of the papers that are produced by us, we normally try to develop our deliveries to the export markets of these products, which is what we have been doing.

Also, I would like to mention the evolution of the Puma Project that reached 75%, already executed. So, already very well advanced, especially in the last quarter, the advancement was very positive, reinforcing our certainty that this project will be ready. We should be producing pulp by the end of the first quarter of next year.

So, it is a double satisfaction for us, because this has always been a concern in our minds that the execution of the projects should be very well done and that it should not interfere in the operation of the company. And I believe that we have been achieving this goal, executing the project and, at the same time, maintaining the operation of the company, the total focus on our better and better results.

As we usually do, we say a few words about what we see ahead of us. I would say that it's a little bit more of the same, because the economy continues to be weak. We see no signs of recovery, and as a consequence, Klabin will continue to be more focused on exports in order to be able to offset this inadequate situation in the domestic market.

And we strongly believe that we will continue to deliver increasing results such as we have been doing so far. And the best evidence of this flexibility that the company has is the fact that we are ending the review of our budgets for the year. And as you may well imagine, there have been very deep changes in all our assumptions. And what I would like to share with you is that this review of our budget gives us the same results as the budget that we have drafted in September last year, which means that we have a very favorable situation.

We have a very unfavorable situation, and notwithstanding this unfavorable situation, thanks to our agility and thanks to our mix of products, we are able to offset all that and

deliver exactly the same results that we had forecast. So, we can tell you that we will continue to deliver the results that we have been delivering to you.

So, in a nutshell, this is what I wanted to say. And now, I would like to give the floor to Tiago, and he will be going more in-depth into the results of the second quarter. And then afterwards, we will come back to answer your questions. Tiago, you have the floor.

Tiago Brasil Rocha

Good morning, everyone. In the second quarter, the total volume sold by the company was 435,000 tonnes, a 4% growth on a year-on-year basis, notwithstanding the stoppages for addition of capacity in the Piracicaba plant and the ramp-up of the recycled paper machine in Goiana. And with this higher availability of papers and with markets going down in Brazil, the volume for the domestic market was 296,000 tonnes, stable on a year-on-year basis, whereas the volume exported grew by 13%, also year-on-year, and reached 139,000 tonnes.

In this quarter, the participation of exports was 32%, a 3 percentage point increase. In a comparison with the same period of 2014, net revenue in the second quarter of 2015, including wood, was R\$1.338 billion, a 16% growth on a year-on-year basis and this was impacted by the higher average exchange rate that we had in the period as well as the higher volume.

With relation to the unit cash cost, net of non-recurring effects of other operating expenses and revenue was R\$2,193 per tonne, a nominal increase of 9% in relation to the second quarter of 2014, impacted mainly by higher energy acquisition cost and also dollar impact, raw materials and also higher cost due to the higher volume of wood in the quarter and the effect of collective bargaining agreement during the periods that are being compared. During the second quarter, we also had the annual stoppages for maintenance in Monte Alegre and Correia Pinto.

Regarding the EBITDA, in the first quarter, the adjusted EBITDA amounted to R\$391,000 (sic) [R\$391 million] (8:59), 17% higher than the second quarter of 2014 and 16th consecutive quarter of the evolution in our results. The consolidated net debt at the end of December amounted to R\$8.1 billion, a R\$704 million increase compared to the end of March 2015. And this increase is due to investments made in the quarter in the Puma Project, partially offset by the accounting impact of the exchange rate variation on the dollar-denominated part of the debt and also the cash generation by the company. And I think we should mention that the effects of the exchange rates variations doesn't have cash effect in the [ph] fulcrum (09:52), the significant one.

And the adjusted EBITDA/net debt ratio closed the second quarter 4.5 times vis-à-vis 4.2 times at the end of the first quarter of 2015, and the same ratio when measured in dollars goes from 3.3 times in March to 3.8 times at the end of June.

Investments, Klabin made R\$1.2 billion in the second quarter of 2015, the R\$1.009 billion spent in Puma and the remainder in the other expansions (10:33). The Puma Project work

advanced in the first quarter according to schedule. And up to the end of June, the site had 75% of the physical evolution completed and 54% of the total CapEx already disbursed.

In April, we had stoppage to add capacity in the Piracicaba plant and this update will make available additional 15,000 tonnes to the recycled paper capacity at this unit, and completes our investment cycle in paper capacity increases that we started in 2013. Ever since then, investments in the Correia Pinto, Monte Alegre, Angatuba, Goiana, Piracicaba plants increased Klabin's production capacity from 1.7 million tonnes to the current 2 million tonnes in kraft paper and coated board.

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

Q&A

Operator

Ladies and gentlemen, now we will start the Q&A session. Our first question comes from Caio Ribeiro from BTG Pactual.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Good morning, everyone. Thank you for the call. And could you please give us the guidance about your export mix. Exports are getting to 32% of your sales already. So, do you see more room to grow your exports in the second half of the year or do you believe it will be kept at this level? And with the current exchange rate, the - your profitability from exports and from sales into domestic market, are they more similar? And could you tell us if you see a potential to increase prices for some product lines in the short run due to the higher pressure on your costs, because of dollar, raw materials, the price of energy? And do you see the possibility of price increases for some of your products?

A - Operator

Thank you for your several questions, Caio. Regarding the mix between exports and domestic market sales, we plan to increase our exports in this (13:06) mix. I wouldn't be surprised if we reached figures higher in the next few quarters. And answering already your second question, at the level of the exchange rate that we see today, the profitability of our exports is even higher than the profitability in the domestic market sales. So, we have a double incentive to continue and increase our sales to the export market. Regarding price increases in domestic market, there is a mixed situation for some products, we still have room to increase prices and the products are the one that are more directly related to our export prices and other products that are more focused on the domestic market, we don't see a lot of room. Recycled paper, for instance, which is not exported, it will be difficult to see an increase in prices for recycled paper during this period. So, I think this covers your questions.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Yes. Very clear. Thank you.

Operator

Marcos Assumpção from Itaú BBA.

Q - Marcos Assumpção

Good morning, everyone. Congratulations for the results. First question, Fábio, regarding the competitive environment. Could you talk about how you see some of your competitors? And in some sectors, we can see the best and the biggest companies benefiting from market share gains and the guarantee to supply products. And does this happen in some sectors where Klabin operate?

A - Fábio Schvartsman

Marcos, of course, we believe that Klabin benefits when you have this market situation, a more difficult one, because of the better quality of its products as well and because of the confidence that consumers have in our products. Whether this is going to be translated into an increase in market share, well, this will be directly correlated to our exports, because as we focus more and more exports, this might not happen in the domestic market. So, I can't tell you if we will see a significant increase in Klabin's market share.

Q - Marcos Assumpção

And the second question has to do with risks – business risks. How do you see inflation, unemployment and the impact, because of the reduction in the purchasing power and real income? Do you see an impact of that already on demand? Do you see this as a risk looking forward or do you think the situation's already getting a little bit better?

A - Operator

No, no. I don't think it's getting better. Quite the opposite. I think even the crisis is getting deeper and it is in this environment that we are basing our operations in the second half, this is why we are emphasizing our exports. And our answer is direct, is very straightforward. As the domestic market cannot absorb our products with the adequate margin, then we just channel our products to exports, and this has been working very well. And from this combination, we have the results obtained by Klabin and this should continue to be the same in the next few months.

Q - Marcos Assumpção

Thank you. One last question regarding liquid packaging. With the drop in oil prices and plastics becoming more competitive, do you see a risk of a higher competition from other kinds of product?

A - Operator

Marcos, this risk has always existed, because these are two different concepts of packaging plastics, it's traditionally (17:27) cheaper than coated board. However, coated board, it's safer, especially when you consider dairy products and mainly milk. And what we see in a moment of crisis is that the consumption of milk tends to increase, replacing

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other products. And as a consequence, I see a resilient demand on the part of liquid packaging paper, especially for the Brazilian domestic market.

Q - Marcos Assumpção

Thank you.

Operator

Lucas Ferreira from JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Good morning, Fábio, Tiago. My question is about volumes in the second half. I have a few doubts. On one hand, the market is deteriorating; and on the other hand, you have more available capacity and you showed 180,000 tonne, for instance, in coated board in 2013 and last year was weaker, because if you were revamping the machine. So, are you going to bounce back to the previous level, like the volume that you produced in the past?

And my second question has to do with the economic crisis in Brazil that seems to last longer than we imagined. And does it impact your strategy in terms of your product portfolio or assets that you might, maybe, acquire or even divest from? So, does it change Klabin's stand regarding the paper market?

A - Operator

Regarding coated board, volume of coated board grew vis-à-vis last year. So, the answer is positive. So, about the - (19:35) this is the answer. And we have more demand than capacity, both in the domestic market and export market. So, coated boards are having a very good performance, a very good situation and this allows us to choose the best set of products to be sold.

And regarding the impact of the crisis on our portfolio, Klabin doesn't have an opportunistic stand. We follow a strategy, a very well-thought strategy, and by means of which we build our competitive position. Just to remind you, we increased our capacity for paper from 1.7 million tonnes to 2 million tonnes in the last couple of years, and this gives us more flexibility to cope with the crisis, and better conditions to export, we can place different product mixes than we had before. So, this is a benefit that we build ourselves.

And now, our total focus is on completing the Puma Project. The Puma Project should be started up by late March 2016. And our next move, from the viewpoint of new machines or acquisitions, will not occur before that. They will only occur after that, because we do one thing at a time at Klabin. We do not like to have an overlapping of risks. And we're not going to change our focus and our path because of the crisis.

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Of course, we examine all the opportunities that we see in our radar screen, because this is our obligation. But our strategy is already set and we have been executing it consistently in the last two years. And I believe the evolution of our results is evidence of that. And our intention is to continue exactly like that.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you.

Operator

Thiago Lofiego from Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning, everyone. Congratulations for the results. Fábio, I have two questions. One regarding consolidation of the paper market in Brazil, do you see an opportunity, especially now when some of your competitors, smaller players in some specific lines are going through some financial distress? So, do you believe Klabin would take advantage of these opportunities? And the second question is what product line do you see that demand is deteriorating and which one is not?

A - Fábio Schvartsman

Very good question, Thiago. Consolidation, typically when you see a deterioration in the market, such as in the case of Brazil now, this is when consolidation opportunities arise. So, the answer is theoretical, okay? I have no fact, no element that might evidence what I'm saying. But I think it's probable as smaller players get under more and more stress, the chances of consolidation increase. As I said before, we always target opportunities, but we will never be rash in the sense of putting more things inside the company at the same time. After Puma is up and running, then we will be able to observe the market.

And regarding your second question about which markets are suffering the most and the least, I think that the market that is weakening is corrugated box market, because we still see no prospective of stabilization there. And on the plus side, the coated board for liquids, as I said before, is the market that is developing the best among all. So, I think, in a nutshell, this is the global (24:10) situation that we have.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Going back to the third (24:15) question, Fábio, along the same lines, do you think you might go back to the possibility of placing the second coated board machine to the detriment of consolidation move? Do you believe you could revisit the possibility of the second machine vis-à-vis consolidation if you had to choose?

A - Fábio Schvartsman

No. The answer is no. We might add something, but I have no intention whatsoever of removing the coated board machine from our strategy. As I said before, even in the moment of crisis, we have an excess demand for our coated board. So, there is strong

indication that the market is very favorable for Klabin. And as a consequence, Klabin will continue to invest in this market. There was a restriction for us to advance in this market, which was the availability of pulp, because Klabin didn't have it. And of course, this situation changes drastically with the start-up of Puma, giving us the opportunity to go after that. And Klabin sees itself as a company that produces packaging, and among packaging, our main products are the coated boards.

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Q - Thiago Lofiego {BIO 16359318 <GO>}

So, you wouldn't consider a high ticket in these?

A - Operator

Could you repeat the question?

Q - Thiago Lofiego {BIO 16359318 <GO>}

You do not intend to spend a lot of money in an acquisition because you are going to have the other coated boards machines.

A - Operator

Well, Thiago, this is a theoretical question that you're asking. There is no big company or big player that I could even think about buying. So, it's difficult for me to answer your question that is only theoretical. After Puma is up and running and when Klabin reaches a new cash-generation level, of course, the possibilities of moves on the part of Klabin will increase and, of course, we will be considering more than one possibility of growth in our business lines. It could be the development of new machines or acquisitions, if the acquisitions are interesting at the time. But this is all theory. And this can only be discussed later on. Certainly, over next year, we will be debating internally and, afterwards, with you what we will be doing after Puma is up and running.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Very clear. Thank you.

Operator

Carlos De Alba, Morgan Stanley.

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

Yeah. Good morning. Thank you very much. My question is regarding cost and SG&A. If you can comment, what are the inflation pressure trends or inflation trends that you're seeing in your major cost categories, like labor or maintenance, perhaps electricity and chemicals? And also, what do you expect to see a sustainable level of selling expenses now that exports are, perhaps, going to increase as well as G&A expenses? Thank you.

A - Operator

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Carlos, thank you for your questions. In your question, you mentioned precisely the cost items where we see more pressure coming from, which are electricity, of course, also pressure coming from chemicals, especially due to the exchange rate effect, and some pressure seen on the labor side of the operations, because of inflation increase. But this is just a transfer of the inflation rate.

As I trust that from now on, Klabin, up to the end of the year - we do not believe that we will have cost increases higher than the inflation in the period. I think the situation is quite well under control in this regard here at Klabin. And very soon, maybe by the end of the year, Klabin will start to produce electric energy at Puma. So, we have the possibility of producing electricity even before the pulp operation is up and running, because we have a biomass boiler that will be ready before the project is ready.

And we also have a turbo-generator that is ready and will be completed in the next few months. So, we have the possibility of starting producing energy before the end of this year, which means that next year, the energy equation of Klabin will have a positive change and a dramatic one. And we will see the beginning of that at the end of this current year.

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

All right. And any comments on SG&A?

A - Operator

Could you repeat your question about SG&A, please?

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

Yeah. Sure. I was just making the point that maybe selling expenses will increase going forward together with exports. So, if you can help us quantify or put up dimension to this (30:39) potential increase, that would be helpful, as well as any comment that you may have on general and administrative expenses.

A - Operator

Okay. Now, I understood. Well, let's separate expenses. Selling expenses, first. Selling expenses, typically, they follow the increase in sales. So, especially the export endeavor brings about a proportion of increase in selling expenses. So, we see selling expenses growing in the same proportion as sales grow. G&A, this is a different story. We only expect increases related to inflation increase. We have no reason whatsoever to expect any increases in G&A and Klabin is doing everything possible not to have any cost increases in this regard.

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

All right. Thank you very much.

Operator

Alan Glezer, Bradesco BBl.

Q - Alan Glezer {BIO 17508681 <GO>}

Good morning, everyone. I have two questions. The first one has to do with corrugated box. What about the margin pressure that the smaller players have been suffering, because of the slowdown of the Brazilian corrugated box market? And the cost pressure with higher kraft paper cost and higher energy cost, how do you see this pressure that smaller players are suffering in terms of corrugated boxes?

And the second question has to do with kraftliner, we have been increasing export and I would like to know how you see the kraftliner export market that was very healthy so far. How do you see this market for the second half?

A - Fábio Schvartsman

Thank you for your questions, Alan. Regarding corrugated boxes, I can only imagine that our smaller competitors, mainly the least integrated ones, are suffering a very big cost pressure. And on the other hand, transferring this increase in this economic situation is not very simple. So, I think it's reasonable to consider that the margins are being reduced in their operations. And the same situation does not occur at Klabin, because if we see this kind of situation in some circumstance, we just shift our focus to exports.

And this leads us to the second part of your question, kraftliner. The kraftliner market is a big market, a good one. And it is good, the quite reasonable prices and the exchange rate is helping us a lot there. We will continue to expand, you will see in Klabin's figures, and then growing expansion of our sales of kraftliner in the next few months, this is what you will see.

Q - Alan Glezer {BIO 17508681 <GO>}

Thank you, Fábio.

Operator

Vicenzo Paternostro, Credit Suisse.

Q - Vicenzo Paternostro {BIO 17670256 <GO>}

Good morning, Fábio, Tiago, everyone. My question has to do with your indebtedness. You know that the exchange rate is very positive. It generates value not only for your current business, but also contributes to Puma to net present value. But right now, it has a negative impact on your debt. So, what do you believe will be your peak leverage up to March, because then you will have disbursed almost all the CapEx and you'll not have the Puma EBIT to offset that? So, what do you believe will be the peak leverage during this investment cycle?

And the second question, still related to the consolidation opportunity of the market. In principle, remember back in the past, this theme has already been discussed. And the

company's position was, well, we believe, there will be consolidation, but our preference is to gain market share from companies that might exit the market than acquiring somebody. This preference for organic growth or – have you changed this position? I would like to better understand your growth strategy for the domestic markets.

A - Operator

Thank you, Vincenzo. First about indebtedness, as you said, correctly so during your question, it depends on the exchange rate. And as I cannot foresee what the exchange rate will be in the future, it's very difficult for me to talk about any future indebtedness. And if you look at our release, if you read our release, you'll see that we've started to mention our indebtedness measured in dollars, because this way we can exit those discussions about the exchange rate. Usually (36:51), as a reference to dollar, our indebtedness was 3.8 times at the end of this quarter and our expectation is that the information that we gave you in the past that we will be reaching 4.5 times continues to be maintained. We believe that with best indicator, we will reach 4.5 times. How much of that will be indebtedness, in real, it will depend on the exchange rate and we have no idea where it will be. So, anyone can do guesswork in this regard.

Now, regarding consolidation. It is true that Klabin has always preferred to have organic growth. In order to achieve organic growth, you have to have a growing market. If the market is not growing, how can you grow organically? If you want to continue growing in a slouchy market, the only opportunity is via acquisition. So, in the future, Klabin – in the future, we will be considering possibilities in this area, unless we see a recovery of the domestic market, and then immediately this will change our perception.

Q - Vincenzo Paternostro {BIO 17670256 <GO>}

It's just a question of adapting to the circumstances. It's crazy to talk about organic growth in a market that is in a downturn. Of course, you need to consolidate in this kind of situation. Well, in this difficult situation, some companies could go down the drain, that's what I mean, because I remember that in the past, you said you could think about acquiring a company that had an inefficient plant or that was an informal, quote-unquote, company, but that's okay.

A - Operator

Yes, you are right, because in formality, of course, it would never cross our minds. I mean, we would never be interested in a company that is not totally formal.

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

Once again, thank you very much. And I would like to reiterate our satisfaction on behalf of the whole team of Klabin for the ongoing evolution of our results and the challenging scenario lead us to make even more and more endeavors to deliver good results. And Klabin, due to its own characteristics, is able to give us the necessary instruments to cope with the situation.

So, it is with great joy that in spite of the difficult moment of the Brazilian economy that we are living, in spite of all that, we see that Brazil is totally capable of continuing evolving gradually such as it has been doing for the last 16 quarters. And we hope to have all of you on our next call, so that we can talk about everything that happened in this quarter.

Thank you very much. Have a very good day.

Operator

Klabin's conference call is closed. We thank you for participating and wish you a good day. Thank you.

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