

Q1 2017 Earnings Call

Company Participants

- Carlos Anibal de Almeida Jr, Executive Officer - Pulp and Paper Business Unit
- Marcelo Feriozzi Bacci, Chief Financial Officer and IR Director
- Walter Schalka, Chief Executive Officer

Other Participants

- Bruno Satini, Analyst
- Carlo Lukativ, Analyst
- Carlos De Alba, Analyst
- Ivano Westin, Analyst
- Jonathan Brandt, Analyst
- Lucas Ferreira, Analyst
- Marcos Assumpcao, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

Good morning ladies and gentlemen and thank you for waiting. Welcome to Suzano Papel e Celulose Conference Call to Discuss the First Quarter of 2017 Results. All participants will be in listen-only mode during the presentation to be made by Mr. Walter Schalka, Suzano's CEO.

Afterwards, we will start the question-and-answer session when further instructions will be given. (Operator Instructions)

We inform you that some statements that might be made during this call are projections or assumptions about future expectations. Forward-looking statements that are subject to known and unknown risks and uncertainties as well, which might lead these expectations not to materialize or be substantially different from these projections or assumptions.

These risks include among others, changes in the future demand for the company's product, changes in factors affecting domestic and international prices of these products. Changes in the cost structure, in market seasonality, in prices charged by competitors, exchange rate variations, changes in the Brazilian political and economic scenario, as well as in the emerging and international markets.

Now we would like to turn the floor over to Mr. Schalka who will begin the presentation.
Thank you.

Walter Schalka {BIO 2099929 <GO>}

Good morning, everyone. It's a great pleasure to have you here, during this conference call about the results of the first quarter of 2017 for Suzano Papel e Celulose. I would like to mention the presence [ph] our officers, Alexandre Chueri; Forestry Business Unit Officer; Carlos Anibal, Pulp and Paper Business Unit Officer; Marcelo Bacci, our CFO and Investor Relations Officer; Carlos Griner, Human Resources; Renato Tyszler, in charge of New Businesses and Strategy, and Development; and Michelle Corda, our Investor Relations Manager.

In order to give you an overview about the results of the first quarter of 2017, I would like to start by saying that I bring very good news and even better perspectives. I believe that the results achieved by Suzano in the first quarter show a consistency and resilience of result which is very to the point and this has been shown quarter-after-quarter, always in the direction that we announced the three strategic pillars that we announced and I'm very positive regarding the future based on these consistent results coming from the actions that we are putting in place and that are preparing us to new conquests [ph].

I believe that the macroeconomic scenario is very positive and benign as far as pulp is concerned, and this will allow us to achieve better and better results over the next few quarters.

I would like to say that we continue with our philosophy and our discipline both in the financial area, and capital area, the product portfolio more and more encompassing and hedging the possible volatility that might happen in the exchange rate or in the price of pulp. We continue with our philosophy of discipline in terms of our supply should this be necessary, and a very strong focus on cost discipline, expenses discipline as we will be showing during this presentation.

Starting by financial discipline, I would like to mention that it's important to say that we had a reduction of BRL600 million in our debt in this quarter going to BRL9.7 billion of net debt.

Also it's important to mention that we extended our average debt maturities, which is now 62 months, with the issuance of the 30-year bond in very favorable conditions issued by the company.

And that we prepaid -- and we amortized future debt, we created an amortization schedule, which is much more balanced for the next few years.

Our success with liability management efforts that we have been putting in place over the year and increasing the debt maturity and reducing the cost of debt which is 4.9% in dollars, a 100% dollar denominated, this allows the company to have a stronger and stronger balance sheet and better prepared to face the future.

Our financial expenses, net financial expenses dropping consistently quarter-on-quarter due to our success of liability management effort, and we have two things to announce to the market. The first is the approval by the Board yesterday of an exchange rate policy in our cash flow going from 40% to 75% and just to remind you, we had a policy to protect our flow limited to 40% in the first 18 months.

And now, we continue to maintain the 18 month of protection of hedging, but we increased the limit to 75% and we have been doing this by means of zero collars cost.

And this has allowed us to have additional gains and additional protection to our results. Our net debt-EBITDA ratio was 2.8 times and we are also announcing to the markets that yesterday, the Board approved an indebtedness policy limiting our indebtedness to a net debt EBITDA ratio of three times in some [ph] moments in investment cycle moving to 3.5 and should we have a higher figure than that, we will have to have an adjustment policy immediately proposed by the Executive Board to the competent agents.

This financial discipline that we are making evident over time, lead us to have fundraising compatible with other investment grade companies. Today, they are traded in the secondary debt market as parameters that are very similar to other investment grade companies, and this proves that the company has all the conditions that are recognized by the market in order to have this investment grade recognized by the industry.

On the CapEx discipline side, we continue to work with flexibility in our investments, we announced to the market at the end of last year through the Suzano Day that we will be giving a guidance of BRL1.8 billion in investment for this year and BRL1.1 billion in sustaining CapEx and 0.7 in structural competitiveness and adjacent businesses.

And we are keeping this guidance. We had investment of over BRL300 million in the first quarter, a little bit more than that. And we concluded in this quarter the investments of the new Mucuri lines, a 100,000 tons increase in capital. We have a 150,000 tons of capacity, conversion capacity in Mucuri now.

We have the new crystallizer of Mucuri, which is part of the 5.1 Mucuri project that we split in order to capture value immediately in Mucuri and this was concluded now at the beginning of April. We will have the debottlenecking of Imperatriz going to 1,650,000 tons in Imperatriz and (inaudible) general downtime that we will have in the second half of this year, and the idea is to conclude Mucuri in the third quarter according to our schedule.

And the two tissue machines of Mucuri and Imperatriz are on schedule and we will be operating the first Mucuri machine in the third quarter, and after Imperatriz [ph] machine in the fourth quarter of this year.

I would like to highlight the fact that the company is always looking to the future and is always making investments thinking about capturing value and at the end of this year, we will have invested BRL1.5 billion approximately with no capture value at the end of the year.

We acquired the (inaudible) forest and purposely, we are not harvesting expressively in this forest, because we are waiting for a high degree of maturity in the forest, so that we may have a lower cash cost in the future.

After the end of this year, we will have invested BRL540 in the tissue project without having captured any value, yes. So this means that the company could consider that this project that we are doing are projects that will be capturing value over time.

So the company always looks to the future preserving the Mucuri forests in the past and always looking at a VPO [ph] and not the maximization of the immediate results of the company. We would like to mention that the maintenance CapEx, which is very (inaudible) We are looking at the efficiency of investing these resources, we have BRL1.1 billion per year invested in sustaining CapEx and BRL250 million on the industrial side and approximately BRL850 million in replanting our forest areas.

BRL221 per ton of sustaining CapEx per volume produced and up -- this way of gaining efficiency in lines is also reproducing the maintenance CapEx that is reasonably constant in spite of inflation in the last few years, the sustaining CapEx.

We are always looking to have a portfolio of products that might give us more added value and less volatility in our results, one critical example that we have is Tissue.

We decided and we made investments in two tissue machines, one in Imperatriz, and one in Mucuri, as I said before, and they should be started up by the end of this year and then we made the decision of make investment so that we may produce finished product and not only jumbo rolls.

So we have hired four conversion machines, two for each one of the sites and we will be doing conversions with our own brand in the market when we start this product and this should be generating as we said to the market before, this should generate quite a lot of value, we have in industrial competitiveness that is very high, a very good logistic position.

And we will be investing in the creation of trade marketing brand and a better and more encompassing relationship with our clients also in the tissue area. Both Mucuri and Imperatriz are on time and on budget.

I would like to mention one important difference of Suzano, which is our focus on cost efficiency and expense efficiency. We are showing you this chart with a very expected figure in terms of productivity gain.

Between 2013 and 2017, we had inflation in the period [ph] about 26.4% and our COGS per ton went up 6% in this period and this shows more than 5% increase in productivity per year and this is the target that we are establishing to continue in the next few years. This is an efficient -- an ongoing efficiency gain that the company intends to continue having.

On the SG&A side, this figure is even stronger during this period. We had a nominal reduction of 8.7% -- reais per ton sold whereas inflation was 26.4%. And this gives the dimension of how the concept of cost and expenses and discipline is built into the company's culture and it's part of our actions, actions with investment and structuring gains on one side and operating efficiency on the other side. And this should continue to reproduce.

And as you can see on the next slide, we had a cash cost of 585 and we have actions in place that allow us to have a level of comfort about the target that we have established for ourselves, which is BRL570 for pulp in 2018 and BRL475 between 21 and 22.

And the next step that we have to cater are the debottlenecking of Imperatriz, the crystallizer of Mucuri and the optimization of the average radius of our forest. It's very important to mention that a company that had 3.5 million tons of capacity today for pulp production, a BRL100 of variation in the cash cost represent BRL315 million more in our EBITDA over time.

Therefore, this creates a very significant value for our shareholders and the trend that we have in terms of cash costs already in the last few quarters should continue to happen in the next few years with the actions that we have been putting in place.

And we are very pleased with the evolution that the company has been delivering. Now talking about each one of our businesses, the paper business had a slight decrease in sales vis-a-vis the same quarter of last year and everybody knows that seasonally, this is the worst quarter of the year for paper and the EBITDA per ton was slightly lower due to non-recurring expenses in the Suzano unit.

And a downtime that we had in Mucuri (inaudible) stoppage of the whole plant show affecting the paper businesses as well.

It's important to mention the resilience in the paper business in ROIC. ROIC, the last 12 months was 14.5% and this is in the Mais program. It's something that has been increasing significantly quarter-after-quarter, we had a new progress this quarter as well. We would like to highlight the volumes in the quarter. The volume of coated paper was a positive result in volume this quarter.

In relation to pulp, we are very bullish about this market and we would like to make it clear that we were surprised positively by a better price condition that we did not foresee at the end of last year and the price of pulp has been going up month after month.

And therefore, we will have the second quarter much better than the first quarter in terms of pricing. We also had the production according to the parameters that we expected, because we had the scheduled stoppage in Mucuri this quarter and we had a slight gain of EBITDA per ton in pulp going to BRL723.

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Of course, pulp depends very much on the exchange rate and price and 9.4% was our ROIC because of that, and the positive news that I would like to give you is that we are looking at the market for the next few months with a very important volume and with better and better prices.

And this should bring about very good results to Suzano in the second and the third quarters of this year.

And the operational performance improvement of the company allows us to mitigate the impact of external factors in the presentation that we published for the market, we presented an adjusted EBITDA per ton in the last 12 months of BRL737.

Even though it dropped vis-a-vis previous years because of price and also because of exchange rate. It is rather resilient compared to the industry and the operating cash flow of 522. So the company is very good in terms of operating cash flow divided by the base of our assets, even though [ph] our consolidated ROIC, in this quarter in the last 12 months, I'm sorry was 10.6%, below what we would like to see, but very well placed, in relation to the market as a whole.

And this shows once again, consistency and resilience in our results. Having said that, I end the presentation of our results for the first quarter and I place myself and all my colleagues at your disposal in order to answer your questions.

Questions And Answers

Operator

Ladies and gentlemen, we will start now the question-and-answer session. (Operator Instructions) Our first question comes from Thiago Lofiego, Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning and thank you for the question. Walter, could you talk about the cash cost dynamics for the next quarters? And the average radius in this quarter and what is the evolution that you expect for the next two quarters?

To understand when and where you will get to your objectives. So maybe now we can have maybe a slight volatility, maybe not with a very strong drop that we had in the last few quarters, but could we expect volatility or not?

And the second question to Anibal, what about the acceptance of prices in China and Europe? And what is the company bias [ph] in this regard for the next few months, especially because of seasonality in demand and more supply from the market in the second half.

And Walter, I'm not sure I understood correctly, but you said that you're very bullish about the pulp market, what has changed in your mind? What changed in your mind regarding this? Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you for your questions. And we will be talking about the cash costs and the average radius. The average radius in the first quarter were 177 kilometers and it should be close to what we will see over 2017, a 184 kilometers of average radius for the whole year 2017, this downward trend for the next few years will happen. We have deliberately made a decision to utilize more distant forests in order to preserve the forests that are closer, so that they may achieve a higher maturity, so that we may have a growth in the average in the company.

With the reduction in the average radius of forests, and with the gains that we are achieving in the industrial area, we believe that it will be possible to reach 570 next year.

This year, we will have some slight variations regarding what we had in the first quarter, it will be around the figure that we are at today, which means that we will have an additional year of a nominal reduction in the cash cost in relation to last year.

Another year of efficiency gains showing our consistency in results. Now, I would like to give the floor to Carlos and then afterwards, we will -- I will come back.

A - Carlos Anibal de Almeida Jr {BIO 6275986 <GO>}

Good morning, everyone. Thank you, Lofiego for your question. I will take this opportunity to share with you our broader understanding of the market fundamentals. These fundamentals have been showing very sound in the last few months, and we believe that the next few months will not be different but a sound demand from all regions highlighting also the strength of China in the numbers recently published by the PPVC [ph] reported demand in the first quarter this year growing 6% around 6% if we compare to the same period last year.

China, 21% growth, on the supply side, we had scheduled maintenance stoppages and we will have more in the second half, mainly in the second quarter, maybe in the Northern Hemisphere delay in the start-up of new capacities and other grades of pulp with a higher volume that the market estimated and all these factors contributed to reduce the availability of pulp and the same will occur in the next few months.

In inventories, we have the understanding and the perception that inventories are at low levels and a point of equilibrium in the supply chain in many region than the PPVC numbers reported 33 days in March, a reduction of 5 days, vis-a-vis the close of 2016.

Hardwood, 38 days, 8 days less vis-a-vis March 2016 and our prices does not reflect yet fully the increases announced over the quarter and the prices realized came from our geographic mix and mainly from a dynamical price evolution for each one of the region. The prices in the first quarter went up quicker in China than in other regions. The market

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fundamentals, as we said, continue to support our announcements and we were totally successful in the implementation of the increases that we announced for April, and we believe that we will have no difficulty whatsoever to implement the prices announced for May.

So we work with a positive price scenario for the second quarter and the numbers should reflect our view and for the second half of the year, as we have seasonality in the northern hemisphere, there will be no big variation in demand and the new entrants could impact the -- also supply-demand ratio, so corroborating what Walter said before, we are bullish about the pulp market for the next few months.

A - Walter Schalka {BIO 2099929 <GO>}

Thiago, Carlos summarized the reason why we are bullish because we did not estimate the growth and demand of this magnitude and of course we didn't know of the delay of the start-up of new capacities and specific problems in some other companies regarding capacity.

So on the demand side, we generated the number which is higher than we expected on the supply side, a lower figure, creating a very positive situation for pricing. And by means of the increases, we have been evidencing this -- the increases that we have been announcing.

And today, I have a perspective that it is different from last year, more bullish than I had at that time.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you, very clear.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you.

Operator

Ivano Westin, Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Good morning, Walter and other officers. Thank you for the call and for the questions. About the Paper segment, looking at the sales volume in the first quarter, we see a drop year-on-year and quarter-on-quarter as well and Walter at the beginning of your presentation, you mentioned seasonality.

So could you talk about your outlook for the remainder of the year? The evolution for the next few quarters in terms of volume and also the outlook for prices in the domestic market for paper.

And also you referred to non-recurrent expenses during your presentation that impacted the results of the first quarter with the adjusted EBITDA, which was slightly lower than the one that you have been achieving, so excluding the non-recurrent effect and looking at the possible volume increase and maybe price increase, what do you -- when do you think the paper market will go back to normal?

A - Carlos Anibal de Almeida Jr {BIO 6275986 <GO>}

This is Carlos Anibal, good morning, Ivano. We published the IBA data very recently about the domestic demand in the first quarter for printing and writing paper and also paperboard and we saw a reduction of about 2.3%, a reduction that was much smaller than the one that we saw in the third quarter of 2016 and also of 2015.

We understand that the domestic demands.

Once again for Printing & Writing and also paperboard have already reached their lowest level and we believe that the supply chain where we operate is already with a very low inventory. So any sign of concrete recovery of the economy, we believe that we will be seeing an immediate recovery in the volumes of paper.

So, we have a positive view, a positive outlook with a concrete recovery of our economy provided there is a recovery of our [ph] economy.

I would like to draw your attention to another victory that we had in the first quarter in our paper business which in 2016 was very important in terms of advancing our client base, we reached over 35,000 clients in our paper business and the first quarter this year even more progress, in the volume sold for what we call more scattered account and the new expansion of our client base.

We were able to grow the number of clients in the first quarter approximately by 10% vis-a-vis the growth that we had already achieved in the first quarter of 2016.

Now talking about prices, we announced prices for non-coat -- uncoated paper and for paperboard and this is still underway, and we always pay attention to the market conditions, exchange rate conditions and also the level of imports.

A - Walter Schalka {BIO 2099929 <GO>}

This is Walter, I would like to answer your second question about non-recurrent costs. We are investing in our operations in all areas, also in paper and specifically in Suzano we had an impact on the Suzano unit, I mean higher impact of costs in the first quarter and that weakness is in the cogs per ton, but allocate that basically to the paper business, which in the Suzano Unit is the main unit of production and this led to a reduction of the EBITDA per ton in the quarter and we will clearly as of this quarter, we will see a recovery in this figure that should be equal or higher than the last quarter of last year.

So we will have again a normal EBITDA close to BRL800 per ton.

Q - Ivano Westin {BIO 17552393 <GO>}

Very clear. Thank you, Walter and Carlos Anibal. Could we go back to one point, you talked about the positive outlook that you have for the market, and the number of client that you have in your base, I would like to know if you already see demand increasing and talks with clients.

We do not have any concrete signs of recovery of demand yet. Just to make it very clear and we believe that there is a very low inventory in the whole chain. So any sign of improvement in demand at the end, this will have repercussions in our chain.

And we will see a quick recovery of our volumes. But this is condition to a recovery of the economy as a whole. We have no concrete signs yet.

Very clear. Thank you.

Operator

Marcos Assumpcao, Itau.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good morning, everyone. My first question is about the debottlenecking of Mucuri. Do you know when you will be able to go back to this project? And the second question to Schalka, looking more to the future, we can see very clearly results improving and companies already generating cash and deleveraging happening in terms of the company's reaches [ph].

And this seems to be a very clear trend, and no way back. So what is the perspective for the use of your cash generation relative [ph]?

A - Walter Schalka {BIO 2099929 <GO>}

Marcos, thank you for the question. About Mucuri first, the investment in debottlenecking of the line one of Mucuri, we decided to split this investment in part that we are doing this in part and we have just started out the first stage which is the crystallizer.

This is an investment that we made of about BRL60 million in the Mucuri unit. And we will start to capture value as of the second quarter already with a certain ramp-up of course.

And there are other investments underway and the final phase of the project has not been defined yet. We will be defining this by June, which is the deadline for us to finalize the last part of the Mucuri project.

It always giving more importance to investment that may give us a higher ROIC and that depends less on volume increases. There could be some covenants regarding volumes with the startup of new capacities.

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Regarding deleveraging, you are correct. We will continue to deleverage the company and we believe that we have already reached the peak of the net debt/EBITDA ratio this year with these 2.8 times. And as of now, we will have an EBITDA higher than the one that we had in equivalent quarters last year. So our total EBITDA for the last 12 months will resume growth [ph], because it was dropping and now we have lower EBITDA because of impact of the price of pulp and the exchange rate and as of now considering that the exchange rate remains stable, and with the pulp price going up and the cost and the expense metrics improving, we will see EBITDA going up vis-a-vis last year.

Therefore the adjusted [ph] EBITDA for the last 12 months will be going up and the net debt/EBITDA ratio will be dropping, because net debt is dropping as well.

So this trend is true and we will continue to invest in the development of our plants, our mills, our forests and our balance sheet will become more and more robust preparing the company for the future, preparing ourselves for any changes that might happen in the industry.

So this is the policy that we have been adopting, our dividend policy is very reasonable. We are paying out about BRL370 million in dividends and this should not be changed significantly for the next few years.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Thank you very much, Schalka. Another question, please. You said in your presentation that Suzano has not yet reached the ROIC level that you want. What is your target in terms of ROIC?

A - Walter Schalka {BIO 2099929 <GO>}

This figure Marcos, we do not disclose to the market but we can give you the following, we have been analyzing the industry, you analyst on the sales side in general, you know that the average of our industry is a WACC between 10 and 10.5.

Therefore 10.6 of ROIC in my opinion is quite poor so to say. We are above the WACC with a positive spread, but we want to have a much higher spread than the one that we are having right now. Thank you very much.

Operator

Next question Lucas Ferreira, J.P. Morgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Good morning, everyone. My first question is to Carlos Anibal. Carlos, how do you see the paper market in China and in Europe? I would like to understand if you believe this price movement is sustainable for paper, how much of that is sustainable?

And what will help these prices to stay at these high levels? Do you believe there will be some speculations regarding prices or do you believe there is demand to sustain this because of more operations in China or lower capacity? This is my first question.

And regarding the working capital of the company, how much do you believe would be the expected working capital level for this year, maybe you have to use it partly for tissue or for the debottlenecking. So could you talk about working capital for this year?

A - Walter Schalka {BIO 2099929 <GO>}

Good morning, Lucas. And thank you for the question. As far as we understand, we do not expect any major growth in demand of printing and writing paper in China. What happens in fact, is a migration of demand for papers produced by non-virgin fibers to virgin fiber.

And we are benefiting from this move. So we see our clients who work with virgin fiber gaining market share in the Chinese market as a whole.

Although, this growth is not very big and also because of this movement, there is a very expressive increase in prices, prices in China for Printing & Writing Paper produced with virgin paper and also paperboard went up 20%, 30%, 35% since October.

This has been helping to sustain this wave of price increases in pulp. And also coming from the price increases in pulp, we've seen price increases in Europe as well, mainly printing and writing producers and paperboard and tissue.

In Europe, we have already announced price increases, which is very good for pulp. I would like to remind you, as I said before that we announced in the last few weeks also price increases for our printing and writing paper and paperboard in Latin America about \$30, \$50 increase.

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

Lucas, this is Marcelo, talking about working capital, our need for working capital is around 2.2 billion and we do not foresee any relevant change looking ahead, although there might be some small change in the inventory level that we have for pulp is quite low today, maybe in a normal situation, we could have a higher inventory. But it is low because of the market dynamics that my colleagues have already explained to you.

In the relation to coal price as the price goes up, the need for capital -- for working capital goes up because accounts receivable goes up, and this is more an accounting effect than anything else and tissue should consume some working capital. But as we believe there will be a very gradual ramp up. I do not believe it will be a very relevant impact for the next few years.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you very much.

Operator

Jon Brandt, HSBC in English.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Hi, good morning, thanks for taking my question. First, I wanted to touch up on the tissue segment. You mentioned that you would be ramping up slowly. Could you give us an idea as to maybe what 2017 and 2018 tissue volumes, sales volumes will look like, what sort of an acceptance you have for the tissue?

And then, I'm curious as to your decision to go into branded tissue rather than private label, if you could give us an idea as to why you decided to do on branded tissue rather than private label tissue.

And then my second question relates to something that you mentioned back in the Suzano Day, late last year.

Could you give us an update as to where things stand with the potential Northern Mercado listing, or ADR [ph] listing is that something that's still being discussed at the shareholder level and is there an expectation as to when that will be decided? Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Jon, thank you very much for the question. This is Walter answering the tissue question. We made the decision to start producing the final product and this means that we will have branded products yet, but we could also operate with private label. So we can work in those categories. No problem. And in terms of volume, we understand that our competitiveness in the north and the northeast will be very significant.

And we do not want to create a disruption in the market, a very significant one. Of course, we will be creating certain turbulence in the market, and for this reason, we will have a gradual ramp up. We are not giving guidance about the volume for the next year, yet, but the margin per ton that we've delivered in Suzano Day is very relevant the one that we presented in Suzano Day for tissue, the operating cash flow because besides having an expressive gain on the pulp price, it's important to mention that we will not transfer the pulp at cost, it will be at price, prices of the international market to tissue, but in spite of that this has still achieved an operating gain and logistic gain, working with pulp and utilities [ph] inside our company and all the logistics in order to have expressive margins and a higher monetization of the VAT tax that we have accumulated in both plants, the VAT and the ICMS. So it will be a product with a very high cash generation per ton, in relation to the no mercado, this is being discussed, the shareholders are discussing this and we are waiting for their decision about how and when to go when continuing in this direction.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Thank you, Walter, just quickly to follow up on the Tissue side. With your decision to produce the final product, was there any pushback from your pulp clients that you are

now competing with them or are they more understanding?

A - Walter Schalka {BIO 2099929 <GO>}

John, we are being extremely careful in regard to this, we are getting into the market in the North and the Northeast and all the client in the North and the Northeast that we supply with pulp they know about our intention of completing the final market and we might have some loss in terms of pulp volumes, however these volumes are very small and we will be able to reposition these volumes and channeling them to other markets, either locally to other clients or abroad. We do not believe we will have problems with our clients, many of them that we will continue to buy pulp normally from us, but let's say one client decides not to buy pulp from us anymore, it would be very easy for us to allocate this volume to other regions.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Great, thanks a lot.

Operator

Carlo Lukativ from Merrill Lynch.

Q - Carlo Lukativ

Good morning, everyone. Thank you for the question. Walter, my first question has to do with what you said about supply discipline considering that the exchange rate will be stable. What will be the range of prices, that would be critical and that could really make you go ahead with your supply discipline regarding EucaFluff what about the test that declined and what about the possibility of ramp-up of volumes. Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you, Carlo for your questions. The first one has to do with the supply discipline. I believe it's mandatory to mention to all of you that 9.4% ROIC, which is what we had in for -- for the last 12 months, it's insufficient and below what is necessary to compensate or to remunerate the investment that we have been making.

So ROIC has to go up, of course, during the last 12 months the price increase that we started to practice is not totally reflected yet because prices were dropping last year and only as of October last year, they started to go up again. So they are not reflected yet, so if you look at this snapshot of April and May about our pricing, you will see that our ROIC will be much higher than 9.4%.

In anyway, we believe that our gauge should be the one off price, price, that brings adequate remuneration to the company as a whole.

A good return to the company and we will be tracking this consistently and of course, we cannot say anything about that, because this could lead our competitors to change their pricing strategy and make some moves in the direction.

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So this is the reason why we cannot bring this information to the market. However, we will be tracking this that all time and the level of prices that we have in place today do not justify any rigorous supply discipline. We are very comfortable with the price levels that we have.

Regarding EucaFluff we have broken the record of sales once again in the first quarter and once again we will be breaking this record in the second quarter, we are exporting EucaFluff to many countries and we have approval in many markets and many different industries. And we are doing this gradually EucaFluff will be very, we have a long-run as of April.

We will start producing EucaFluff again, because orders keep coming in and acceptance is increasing. Its importance Carlos to mention that this is an innovative product, so we must be very resilient and understand that this will not be accepted immediately.

We have to carry out market tests, we have to approve -- have the approval of our clients and this happens with hardwood pulp in the past, and we are very comfortable with that when hardwood pulp got into the market, everybody said well it doesn't work, it's not good, and only softwood is good.

And today after many years, you can see that the hardwood pulp represent over 50% of the total market for pulp. And growing expressively in the last few years and it will continue to grow in the next two years.

And many applications that people said, well this cannot be done with hardwood like tissue today it is produced with 100% hardwood.

And it's the same in EucaFluff. There are clients that do not accept it first and some competitors say that it doesn't work, and we are very comfortable with that. This is a gradual process and we are consistently improving the quality of our products and the acceptance of the local client base and global client base because we're already exporting to Europe to China to the US shows that is the product that will be successful over time.

So we are very comfortable. In terms of the reaction on the part of competition, which is very normal vis-a-vis our clients. But looking in the long-term, this product could be very important in the pulp and paper industry, EucaFluff will be a big hit.

Q - Carlo Lukativ

Thank you, Walter.

Operator

Bruno Satini with Santander.

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Q - Bruno Satini

Good morning, everyone. I would like to know about price, paper prices, is there a lot of pressure because of the import of paper with the exchange rate that we have today? And regarding tissue, what about your first talks with potential buyers for the product? Thank you.

A - Carlos Anibal de Almeida Jr {BIO 6275986 <GO>}

This is Carlos Anibal. Imports of paper are stable in the first quarter and the fourth of last year and the first show the price increases are still underway. And as you said, we are paying keen attention to the market conditions and the exchange rate and levels of imports.

So we are working to implement the prices that we have announced.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you. This is Walter. We have a lot of experience in the production of paper and production of pulp, Bruno, but we have a small experience in the B2C business exception made to the report that brings a certain level of experience, our experience is not long and we recognize that and for this reason, we will be bringing to our business somebody who has this experience.

So we are bringing to our executive committee somebody who has experience in B2C. We have not started the contact with our clients yet. We are working with all variables in the process. However, we still have to mature this to operate this business.

You must not forget that in the third quarter we have a ramp up of the jumbo rolls production and in the fourth quarter, we will see the finished product in the market. So we do have some time to develop this and we are working on that.

And we will certainly have tissue as a relevant product for us with an upward curve for volume and market share as well. Undoubtedly, we will be the market share leaders in the north and the Northeast market in the next two years.

Q - Bruno Satini

Thank you, Walter. Just a follow-up, so you're looking for somebody, an officer to be in charge of that?

A - Walter Schalka {BIO 2099929 <GO>}

Yeah, that is correct.

Q - Bruno Satini

Thank you.

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Operator

Next question in English from Carlos De Alba, Morgan Stanley.

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

Yes, good morning. Walter, have your views on the pulp business changed? Do you think that it is possible to generate ROICs above the cost of equity -- cost of capital over the cycle? And if not then, what, how do you see the situation could potentially be improved or fixed.

And then second, could you comment about the certainty about the strength of the Chinese export demand, how do we know that a big part of the imports of pulp into the China in the last few years have not gone to inventories to meet the inventory levels, because the Chinese economy is growing, it has already signed to tighten up some military policy and also reduce the level of growth to probably a more sustainable situation.

So, I would appreciate if you can comment on that. And then just finally maybe for Anibal, if you could repeat or let us know, how much were prices in the domestic paper business increase, which you mentioned the company is in the process of -- of implementing. Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Carlos, thank you very much for your question. Just to remind you in the beginning of the year, we announced increases of about 10% for paper, and coated paper and the implementation is other way and we are paying attention to all the market condition. Carlos, thank you for your question, about pulp and paper. Your first question has to do with the ROIC over the cycle. Carlos, we are working on the two sides of the variables. The cost side to guarantee that even in situations in which prices are lower, we will have a better ROIC for pulp.

And the dimension of that is very significant and I said that in my presentation, I said that BRL100 of cost reduction per ton and we had more than that in the last few years and we will still have it in the next few years representing BRL315 million, representing over two points of ROIC gaining in our business.

So on the cost side, we have something very important that we are working on. And on the price side of course it depends on supply and demand and demand now is very strong.

And I will start to answer your second question demand from China is real, personally together with Carlos, we were in China in the last few weeks and we talk to our whole client base and our whole client base has been gaining market share overall recycled fiber, not only in tissue, but also in paper.

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So it's matter of demand and not inventory, the inventory levels that our client mentioned to us are low, and the inventory level at the board mentioned in all the analysis that we have are low.

So it is not a matter of storage or inventory on our client base, all our clients, all of them have been requesting, ordering, higher volumes and the ones that we have in our contract with them.

So demand is very strong right now. And going back to the supply side, the supply of pulp is less predictable, because we have the entry of new project coming and the impact of these new initiatives will tell us about the impact that we will have in the next few quarters.

The scenario is very positive. I understand that the work that our Asian competitors are doing, going to dissolving pulp or even converting to the sale of paper, some of our competitors having a ramp up much lower than, we expected in their plans, all that allows Suzano to have a very positive pricing environment.

Taking into account the industry as a whole. On the demand side, I'm consistently bullish and on the supply side, of course we will have different situation depending on the entry of new capacities that could impact the supply side.

We expect to have ROIC for pulp with a positive spread over the WACC. And a very positive spread it would be non-sense for us to have the size of investment that we make in order to have ROIC close to the WACC. So we must have a much more positive spread and we are working on that.

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

And is it possible to quantify, or you have a guidance on the potential improvement on the product on company's [ph] ROIC from the integration into tissue?

A - Walter Schalka {BIO 2099929 <GO>}

Carlos, it's very significant ROIC because based on the capital investments that we have over BRL22 billion, an investment of BRL540 million is not too big, it's 2.5% of our investment base. But the ROIC for tissue will be very positive, very positive because it not only integrates the chain as a whole and therefore we will not be selling products in the hundreds of dollars but in thousands of dollars. The conversion cost that will be very low because we are investing in the state of the art technology for that with little labor involved it's not labor-intensive and at the same time, we will be bringing the monetization of the ICMS or VAT credit. So the operating cash generation of the tissue business is very significant.

And the ROIC of tissue is very high, but as it only represents 2.5% in this initial phase of our overall investments, it's not going to bring about a very deep change in the consolidated ROIC of the company.

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

Thank you very much.

Operator

The question-and-answer session is closed. We would like to give the floor back to the company for closing remarks.

A - Walter Schalka {BIO 2099929 <GO>}

I would like to thank you very much for participating and I would like to also to thank all the associates of Suzano who consistently have been delivering better and better results every single quarter. So it's really a reason for us to be very proud to see the implementation of the strategy that we decided and the actions and the tactics and the structuring and operational changes and the results out there.

We are showing the market that it is not a one-off results for one quarter, it's a consistent results cost and expenses going down, revenue management, very precise in the paper area with consistent gains in the paper business, bringing adequate ROICs and creating new path for the future, such as EucaFluff and the Tissue business that we will be starting this year.

So there is a whole range of actions that are very positive in all areas of the company with the better balance sheet and results in the financial area that deserves to be congratulated by all of us. This is all very positive and I'm very happy, I'm very proud and very bullish regarding the future of the company.

Thank you very much and wish you all very good day.

Operator

Suzano Papel e Celulose conference call is closed. Thank you very much for participating and have a good day.

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