Q2 2019 Earnings Call

Company Participants

- Carlos Anibal de Almeida, Executive Officer - Pulp Commercial Business
- Leonardo Grimaldi, Executive Officer - Paper Business
- Marcelo Feriozzi Bacci, Chief Financial Officer and Investor Relations Director
- Walter Schalka, Chief Executive Officer

Other Participants

- Caio Ribeiro, Analyst
- Carlos De Alba, Analyst
- Daniel Sasson, Analyst
- George Staphos, Analyst
- Jonathan Brandt, Analyst
- Leonardo Correa, Analyst
- Marcio Farid, Analyst
- Thiago Lofiego, Analyst
- Thiago Ojea, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for holding, and welcome to Suzano's Conference Call to discuss the results of the Second Quarter of 2019. We'd like to inform that all participants will be in a listen-only mode, during the presentation of Mr. Walter Schalka, Chief Executive Officer; Marcelo Bacci, Financial and Investor Relations Executive Officer; Carlos Anibal, Pulp Commercial Executive Officer; and Leonardo Grimaldi, Paper Executive Officer. After the Company's remarks are completed, there will be a question-and-answer session, and further instructions we'll be giving. (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 circumstances that 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 of Suzano, and could cause the results to differ materially from those expressed in such forward-looking statements.

Now I would like to turn the floor over to Mr. Walter Schalka. Please, Mr. Walter Schalka, you may proceed.

Walter Schalka {BIO 2099929 <GO>}

Good morning, everyone. It's a pleasure to have all of you at Suzano conference call of -- in the second quarter results. I'd like to welcome everybody and tell that we have with us as well, in addition of the names that was listed before, we have Aires, we have Christian, Alexandre Chueri, Pablo, and (inaudible). All of us will be ready to answer your questions in the end of the session.

I would like to start the presentation mentioning that we are very pleased with the results of the second quarter that presents, that Suzano even on a very difficult and turbulent market pulp scenario, we can deliver extremely good results to our shareholders. We are proving our resilience in one side and our financial and operational discipline. At the first quarter -- at second quarter, we had volumes of -- sales volumes on pulp of 2.2 million tons, and paper, a little bit less than 300,000 tons, 281,000 tons, we have much -- more volumes on exports. We are presenting an adjusted EBITDA per ton on pulp of a little bit more than BRL1,300 per ton.

And on the paper side, a record number of BRL1,237 (sic) per ton. This as a consequence we have an operating cash flow that we understand that the right KPI to be tracked on our industry that represents EBITDA less CapEx, sustaining of BRL2.2 billion at this quarter. We have been increasing our financial leverage since the last 12-month EBITDA is going down, due to the finance to the market pulp scenario. And now we have a 3.5 times -- 3.5 times net debt-to-EBITDA in this quarter. It's very important, and Marcelo is going to talk to you a little bit that what are the main measures that we are taking to prepare the Company for the future.

One of the measures is the reduction in CapEx for this year, we are announcing our guidance going down from BRL6.4 billion to BRL5.9 billion. And Marcelo is going to disclose the details of this reduction. And I would like to share with you a very important information that we keep the same target on synergies that we established in the beginning of the merge of the two entities that we are going to deliver between 40% this year between BRL800 million and BRL900 million in the synergies, compounding on OpEx plus CapEx and not including the tax shields that we have in addition to that. Then synergies are on track and on time, on budget.

Now I'm going to hand over to Leo De Grimaldi, who is going to explain a little bit about what is our view on the paper side.

Leonardo Grimaldi

Thanks, Walter, and good morning, everyone. I would like to present the results of Suzano's paper business unit for the second quarter of '19. The figures presented on this next slide are specific for our paper business unit. Therefore, excluding Suzano's consumer business units results, which enables us to have a better comparison with the past quarters. Beginning with the top-left graph, we can see our production figures. We have produced 298,000 tons during the second quarter, achieving a total of 1.2 million tons in the last 12 months. With our focus on operational efficiency, we were able to increase our production by 2% during this period.

Moving on to the top-right graph, and looking at our sales figures, we can note that we have sold 281,000 tons in the second quarter, which is a 10% increase compared to the 1Q '19, and a 6.4% increase compared to the 2Q '18. As you can note, in the darker section of the graph, our paper sales in Brazil decreased during this quarter and have performed much in line with the latest statistics issued by Iba, our pulp and paper association. According to these statistics, the total demand of printing and writing and paperboard grades have decreased 4.7% in the first semester '19 when compared to the first semester '18. Our sales in Brazil have decreased 2.9% in the same period. By anticipating this challenging scenario for our domestic market, we have used our commercial flexibility to best allocate our volumes in several international markets, consequently, our paper exports have increased 45% compared to the previous quarter.

Now looking at the lower right side, you can observe that our average prices have moved up during the quarter, reaching BRL3,855 per ton. This is a 1% increase compared to the 1Q '19, and a 11% increase compared to the same quarter last year. Our average prices in Brazil have increased an additional 2% in the quarter, and now international prices increased 1% in real. In this case, due to our currency depreciation, compensating low export prices in U.S. dollars. When you add up our operational efficiency, our positive sales volumes and new price implementations, we can note on the lower left side of the slide that our EBITDA margin has reached BRL1,237 per ton, a 24% increase compared to the same quarter last year.

Our EBITDA margin for the last 12 months totaled BRL1,260 per ton, which as Walter has said, has added a record for our paper business unit and also a 40% increase to the same period last year.

I would now like to invite Carlos to present the results of our paper -- for our pulp business unit.

Carlos Anibal de Almeida {BIO 19090865 <GO>}

Thanks, Leo, and good morning, everyone. So let's move to Page 5 of our presentation. Before going over to the main figures of our pulp business, I'd like to start by providing where was the business environment in the first half of this year. When updated for a change in this landscape characterized by weak market fundamentals. Oversupplied pulp market, coupled with geopolitical uncertainties, trade wars and worse than expected macroeconomic conditions, ended up affecting the business. The pulp fundamentals were not favorable, and that we have to deal with a major price correction for both hard wood and soft wood fibers in the first month of the year.

On the demand side, the global pulp demand growth has slowed down in the period. The macroeconomic backdrop and pulp customers' destocking that process begun late last year, limit the demand growth so far this year. Future demand has shown resilience despite challenging economic scenario and has grown in the first five months of the year by 2.8% in the period according to PPPC.

I would like to highlight Asia, where the growth was more than 5% during the same period. On the supply side, the staggering amount of unplanned downtime that severely limited, in fact, of the new supply in the market in 2017 and 2018, fell considerably lower in 2019, almost all producers run at full capacity, maximize the output. On top of all of that, we also understand that some integrated European players delivered more market pulp volumes to compensate a weaker graph paper market. The supply and demand imbalance scenario that I have just described, explains the aggressive and an expected price correction seen so far. Oil prices have been sliding throughout the whole year in all the regions.

Now I'll go through some of our main figures. And let's start by the top line. In the second quarter of 2019, the pulp business delivered revenues of BRL5.45 billion, which is about $1.4 billion. Revenues were 9% higher versus Q1 on more volume and lower prices. We produced 2.2 million tons in the second quarter and in the first half of this year, our production amounted 4.4 million tons. That compares to over 4.9 million tons we produced in the same period last year, which means, the production dropped, a production reduction of over 0.5 million tons in the first six months of 2019.

On the sales side, our volume was 2.2 million tons for Q2, that was almost 30% higher than Q1. For the first half of the year, sales amounted 3.9 million tons, and that compares to 5 million tons that we sold in the same period of last year. Our sales, mainly to Asia, were stronger in the end of the second quarter, which explains the higher price drop quarter-on-quarter. During Q2, as Leo disclosed, we concluded the following planned maintenance shutdowns at Aracruz Line I, Line A and partially Line C, Imperatriz, Tres Lagoas Line 1 and partially Line 2. For our Q3, we still have Mucuri Line 1 and Jacarei. Our average net pulp price to the export market for Q2 was $630 per ton. Given slowing of the market conditions during Q2, prices dropped 11% when compared to Q1, which was $711 per ton. Despite the price pressure, we're able to deliver revenues again 9% [ph] higher in Q2 versus Q1, supported by higher volumes. In Q2, we're able to deliver total adjusted EBITDA of BRL2.74 billion, an increase of 11% when compared to the last quarter, mainly supported by higher volumes. The EBITDA per ton was BRL1,305.

Our inventories at the end of June were close to the end of March, and we expect it, to start going down throughout the second half of this year. We expect to close 2019 with lower pulp stocks. Our price points for the coming months, I mean for the second half of this year, will always be adjusted to the prevailing market conditions, so we can move our target volumes. A combination of higher volume sold in the second half, the expiration of the agreement with Klabin, and a lower production volume when compared to the second half of last year. We'll drive our stocks down again until the end of this year. To sum up, although, there is no question we are operating in a more challenging environment, we expect market conditions to improve in the short, medium term, structural and long-term market fundamentals have not changed and that we should start seeing the market finding its balance over the coming months and quarters.

Now I turn it over to Marcelo Bacci, who will cover our cash cost.

Marcelo Feriozzi Bacci {BIO 17648865 <GO>}

Good morning, everyone. Still the pulp business, I'd like to comment that we are under temporary pressure on our cash costs, due mainly to this lower production rates we are having at this moment. Our cash cost in the quarter was BRL697 per ton, which is BRL30 above the number of last quarter and about BRL70 above the number of the same quarter last year. The two main factors here driving the pressure on cash costs are fixed cost dilution because of the lower production rate and an increase in wood costs. That comes from the fact that we're still privileging the long-term over the short term. There are some wood in our portfolio that we are saving for the future due to the highest growth rate, and we are still bringing more third-party wood in terms of the mix than we had planned before. So we are still privileging the long-term.

Moving on to the financial side. We have been preparing the Company for the challenging scenario we're going through in the pulp business. Still in a quarter that we had, a lot of pressure on the prices, our net debt on a total basis went down from $13.8 billion to $13.7 billion. Remembering that in this quarter, we have paid dividends related to last year. Our net debt-to-EBITDA measured in real is 3.5 times, 3.6 times when measured in dollars, especially -- mainly due to the fact that the EBITDA went down, still -- the net debt went down, but the EBITDA went down on a larger scale. Our amortization schedule for our debt has improved significantly in the quarter. We now have an average term of 87 months in our debt when compared to 75 months in the previous quarter. And we have 77% of our debt maturing in 2023 and onwards. And that number compares to 55% in the previous quarter.

The cash position that we have today, plus the available funds on standby facilities amount to BRL10.8 billion, which is enough to cover for the liabilities that mature in the next 3.5 years, which is a very comfortable position to be in. So on the financial side, we have been working on giving a more robust situation to our balance sheet that we'll enable the Company to continue to perform its commercial and operational strategy without any financial restriction. It's important also to mention that we have, during this quarter, -- prepaid all of our debt that had financial covenants. So we -- today, 100% of our debt is in contracts that have no financial covenants. In addition to that, we have, as Walter mentioned in the beginning, worked on our CapEx in order to reduce the number for this year by BRL500 million. So the new number is BRL5.9 billion.

We are reducing BRL200 million in the sustaining CapEx, basically coming from the fact that given the reduction in production, we are harvesting less, so we need to replant less. And in addition, we have worked in several smaller projects on the modernization and expansion side to reduce the impact of the CapEx this year without any long-term impact for the Company.

We still -- moving on to the next page, we still consider a production for this year of 9 million tons, so we have mentioned in the previous quarter, a range from 9 million to 9.4 million. So we are now mentioning that the number will be closer to the bottom of this range, about 9 million tons. And we will continue to work on the production reduction in the same way that we have been working in beginning of the year, which means that we will continue to preserve the more productive forest space. We will work on the wood supply mix, given the restrictions we have in the contracts that are already signed, and the volume reduction will continue to be implemented gradually throughout the year.

So I'll hand over to Walter to continue the presentation.

Walter Schalka {BIO 2099929 <GO>}

On the internal side, we are devoting our efforts on three major pillars, three major projects that we are doing. First, related with the synergies. As I mentioned before, we are reinforcing to everyone that we will -- we are on track, on time, on budget, and we will deliver the expected synergies between BRL800 million and BRL900 million this year, 40% of that will be delivered this year, 90% of that will be delivered next year. I would like to tell that our team is highly engaged on this project, and we are performing extremely well on our operations in all different areas, on procurement, on the forest side, on industrial side, on logistics, every single area of the organization, we are performing accordingly with our plan as expected.

On the process and systems, we have been working to harmonizing -- unifying this distance of the two entities. This is going to be done at -- in a Big Bang at January 1st next year. We are, at this point of time, on time with this project, and we expect to have -- to go live with no problems next year. They're going to allow us to operate on a single environment that we allow to have further synergies on the organization. We are very pleased with the development of this project as well. And last but not least, the culture. We are very pleased to show you that the engagement level that we have in the organization is very high.

We have right now 88% of adherence on a survey that we did on the last few months on the organization, and that's very positive and it's across all the organization, in the meaning that we are -- have been able, direct a team to create one single company, to create the single entity, to create a single culture that would be based on the three major pillars that we announced to the market. People that inspire and transform, we integrate and share value with all stakeholders. And it's only good for us, if it's good for the world. This is mantra that we have been working and the organization have been very positive and have been consolidating all the population, all of our employees. We are very pleased with the development on the three major pillars, synergies, precedents, systems and culture, but we'll keep an eye on these issues because that's quite important for all of us.

Now we'll be ready to answer your questions.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Mr. Leonardo Correa from BTG Pactual would like to ask a question.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hello, gentlemen. Good morning everyone. Thank you. My first question for Anibal, still on the inventory management on the pulp side. Carlos, we saw very little inventory destocking in the second quarter. And this obviously has been, I think, a major overhang for the entire industry, the level of inventories that Suzano has been carrying and as visibly, we can see peak high inventories in Europe and in China, right? So I think it's important for us to try to understand exactly the direction of Suzano. You announced some weeks ago production cuts from 9% to 9.4%. Now it's clear. And Bacci just mentioned that you're indicating 9 million tons, which is the lower the range of the target. So I just wanted to see how you balance the possibility of an additional production cut, assuming the market continues weak, with the possibility of some pricing discounts and a bit more of an aggressive commercial strategy, which is what the media has been reporting over the past days. So I just wanted to see what the inclination is from Suzano on the commercial strategy, whether it would be for another production cut or for more aggressive commercial strategy, which would imply a potential reduction in prices or higher discounts? That's my first question.

The second one is for Bacci. Marcelo, I mean, clearly, I think this was a very decent result in terms of balance sheet management, and we saw a reduction in net debt and absolute reduction in net debt with leverage ratio still unchanged quarter-over-quarter at 3.5 times. I think the fact that you don't have any covenants on your debt is clearly positive. But on the other hand, this is past looking, right? Because if we think of the current environment with where prices are now and the possibility of Suzano being a bit more aggressive on the commercial side. Unfortunately, the reality for the second semester is that could be weaker in terms of EBITDA generation, and we could be seeing net debt-to-EBITDA ratios move up to north of 4.5 times net debt to EBITDA, right? That is a possibility. In that context, and I know you do have some time. In that context, I just wanted to explore some of the possibilities that you're evaluating, right? You just announced the CapEx cut of BRL500 million, which is very welcome. But some are speculating that, that could be insufficient, right? Suzano is a huge company. We're talking about thousands and thousands of forestry assets, hectares of forestry assets with several producing plants, logistics, operations. I just wanted to understand exactly where -- what are the levers that you could be considering, assuming markets remain weak and leverage continues rising. What are the possibilities of deleveraging showing up the balance sheet? Those are the questions. Thank you very much.

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

This is Carlos speaking. So let me start answer your question, talking about our price policy. As I said before, we will adjust our price policy according to the prevailing market conditions, so we can move our product volume. We believe that a combination of higher sold volumes, the expiration of the agreement that we have with Klabin and a lower production volume when compared to the second half of last year, that is why our stocks down until the end of this year. It is true that we produced in Q2, 2.2 million tons, and they are still roughly the same, okay? But again, we should see that the number moving down mainly, mainly there in China. In China, we're going to see a reduction or in Asia, we're going to see a reduction of our shipments to that region over the coming months. By a reduction of shipment, I mean, we going to load less vessels to China, to the whole Asia region over the next three or four months. That means less arrivals in the same period, which combine us with more sales we're going to see a reduction there.

A - Walter Schalka {BIO 2099929 <GO>}

Leo, it's Walter. We are not planning any change on the production guidance that we mentioned to you. We will stick with volumes on this year around 9 million tons on production.

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

Leo, this is Marcelo speaking. On your second question, it seems to us inevitable that the leverage will go up in the second half, just looking by the realized prices we have in the first half of the year. Clearly, in the second half, we're going to have a lower number, at least in this quarter, so the net debt-to-EBITDA ratio will go up. The way we're dealing with this, in addition to what we have already done is first to further reinforce our liquidity, we are still looking for other opportunities to maybe reinforce the liquidity and reduce the already very low liquidity risk we have. The second is, we are starting to work on what our CapEx for 2020 will look like, and there is a significant room for reduction in relation to the number of this year. We are not considering, at this point, any asset sale. It is not necessary, given our financial strength, we are in a cyclical industry. It is normal that we go through the cycles from time to time. We have the balance sheet prepared for that, and it's not the best moment to sell any assets.

Of course, we consider, and we continue to evaluate any transaction, any financial transaction that could involve our assets in terms of optimizing our balance sheet, but we are not considering any sale on a significant way of plant or forest. We have some spare parts that are dedicated through potential future growth that will be kept. And of course, we have some spare parts in other areas that we don't use that we normally sell, and we will continue to look for potential buyers for those, but those are not extremely significant numbers.

Q - Leonardo Correa {BIO 16441222 <GO>}

Thank you. If I may, Carlos, just to elaborate a little bit on your answer. The media has been reporting that Suzano has been more aggressive on the commercial side and has been granting some discounts to accelerate destocking in China. The price range that the media has been commenting has been from BRL480 to BRL500, or maybe BRL470 to BRL500. So there is a slight discount to current market pricing. Can you confirm that the media reports are in the right direction? Or that's something that Suzano was not doing? So I just wanted to get a little bit more clarity on the new reports recently, please?

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

Well, I'm not going to comment on pricing. All I can say to you is that we have changed our commercial strategy. Our commercial approach there in China, offering our customers the option to close the bond for the whole quarter at a fixed price. This movement has been successful, and we are pleased with our achievement so far.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay. Thank you very much.

Operator

Mr. George Staphos from Bank of America would like to ask a question.

Q - George Staphos {BIO 1495442 <GO>}

Hi, everyone. Good morning. Thanks for taking my question and thanks for all the details. Congratulations on the quarter. I had two or three questions. First of all, I recognize it's difficult to talk to this live microphone on a conference call, and things can change. If you look at your early third quarter shipments and you assume normal trends from here. Do you think that you can be flat with second half 2018 volumes on a pro forma basis? Is there a way that you can provide us any color on how your shipments are running, and what kind of inventory reduction we're seeing so far in the third quarter? That's the first question.

Relatedly, on production, we noticed that Aracruz Line B, the maintenance for next year has been pushed out about 1.5 quarters. Given that inventories are still high, I was wondering why you're pushing out the maintenance, when it would seem pulling forward maintenance would be a better thing to do, given that you need to reduce inventories. And time allowing, I'll have a follow on.

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

George, this is Carlos.

Q - George Staphos {BIO 1495442 <GO>}

Good morning, Carlos.

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

Good morning. We expect for the second half of this year, growing volumes in all the regions compared to what we had in the first half. So again, the combination of growing volumes, the end of our agreement with Klabin and a lower production when compared to the second half of last year, they'll allow us to drive stocks down by the end of this year. Just so we're on...

Q - George Staphos {BIO 1495442 <GO>}

Can you talk to what it is year-on-year, what you'd expect to be second half '19 versus second half '18? If you can't, I understand, but just figured I'd try to clarify.

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

This is -- are sensitive, so I'm not going to disclose that information. But just one last remark on production and considering what Walter said on Slide 9 of our presentation. Actually, myself said, we will produce in the second half of this year close to 700 -- same

2,000 tons less than what we produced in the second half of last year. So that is a very important number to have in mind. So growing sales and -- will allow us to come up with a lower stock at the end of 2019.

Q - George Staphos {BIO 1495442 <GO>}

Thank you. And on the maintenance with Aracruz - Line B being pushed out a bit, when it would seem you want to pull forward maintenance to try to reduce production, just curious about that.

A - Walter Schalka {BIO 2099929 <GO>}

George, it's Walter answering. We are adjusting the maintenance shutdown of our plan according with the wood supply, accounting for how much we are going to produce. And we are doing that in -- not only in Aracruz plant, but in all of the plants. Then you cannot just relate it with maintenance shutdown, related with the 15 or 18-month period that we have between the shutdown. But we are doing that to adjust the production depending on the wood supply in the quarter. So we have been adjusting the production in the plant depending on the biological asset value creation long-term. Then what we are doing is that -- and probably you realized that on our presentation that we have biological asset gain on the second quarter of this year, and we are going to have even more on the second half of this year. And then we are preparing the Company to have lower cash cost in the future. This is the mindset that we have. We are not trying to maximize short term, we are trying to maximize the net present value of the cash cost of our operations.

Q - George Staphos {BIO 1495442 <GO>}

Thank you Walter.

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

George, this is Marcelo speaking. You're probably referring to the fact that in our maintenance schedule, there is six quarters between the two Line B maintenance shutdowns from first quarter this year to third quarter last -- next year, right? This is a small change of a small number of days only, it's not that we're postponing a full quarter.

Q - George Staphos {BIO 1495442 <GO>}

Okay. Yeah, I was just comparing it Marcelo to the slide from last quarter, that's all. And my last question, if I may, very quickly, there was some news reports recently that some of the tissue companies in Brazil are changing hand. Will that affect your shipments at all in terms of some of these companies changing hands? Thank you very much and good luck in the quarter.

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

We do not expect any change, George. This is Carlos.

Q - George Staphos {BIO 1495442 <GO>}

Thank you very much Carlos.

Operator

Mr. Thiago Lofiego from Bradesco BBI would like to ask a question.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you. Carlos, going back to the production, commercial, inventory strategy, just in terms of rough math here, your inventories are now closer to 3.1 million, 3.2 million tons. That's in excess of -- in our view, of approximately 1.7 million tons that you're holding. So could you give us more color on what's the pace of destocking that you're expecting for the second half? And then another math, another calculation we did here is for you to destock 500,000 tons [ph] in the second half. Demand needs to be -- or your shipments need to be 15% higher in the second half versus what it was in the second quarter, right? In terms of the average shipments. So how confident are you that this -- are you that this can happen. And also back to a question that has already been asked, why not take a more aggressive commercial spend, pressuring the high-cost producers to ship down and then eventually, we could see a quicker price rebound. That's the first question. Second question about cash costs per ton. Going forward, should we expect the second quarter level to be the new normal for Suzano considering the 9 million ton production rate? Or are there any variable that we should think about here on the cash cost per ton? Thank you.

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

Well, good morning, thanks for your question. This is Carlos speaking. As I have said, we will adjust our commercial policy to the Brazilian market conditions, so we can move our target volume. So again, this is very commercially sensitive. I can say to you that we are confident that it's going to close the year with the lowest stocks. This is what I can say to you. We are very confident in that.

A - Walter Schalka {BIO 2099929 <GO>}

And to answer your question, there is the cash cost per ton. We are considering that we are not going to have major changes on the cash cost on the coming quarters. But we are preparing the companies to have a lower cash costs in the future. It's very clear that when we are going to operate with a different wood supply, more -- our own wood compared with third-party wood and with higher volumes, we will mitigate and/or eliminate the issues of fixed costs and energy that is impacting us and the wood side as well. We are very pleased with the industrial synergies that we are seeing. The specific consumption per ton of several chemical products are going down, and this will allow us to have lower cash costs on the future.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you, Walter. And if I may, Carlos, jumping back to your answer, what are the signs that you're seeing on the demand side in both regions, China and Europe? And also, if you could give us some color on July and August, have shipments materially improved from your June levels? Or only if you got weeklies and if you could give us some color, that would be helpful. Thank you.

FINAL

Bloomberg Transcript

A - Walter Schalka {BIO 2099929 <GO>}

So in order to answer your question, Thiago, let me talk a bit about China, okay? Although there is a news showing increased the trade war tensions between U.S. and China. Pulp demand there in China has been improving since March. We have been seeing that, of all the grades. Definitely, we see a much better operating rates for graph paper, paperboard and a very robust demand coming from the Tissue segment. So in terms of demand, all I can say is the global economic activities that has accelerated a bit and all the geopolitical uncertainties making any forecasts in China at this point in time. Demand in Q3 usually is a bit softer in the north hemisphere, but we believe that the improving market conditions and customer restart might boost the growth in the coming months. I can say to you that we see, in all the regions, customers operating hand to mouth, okay? We believe that when the covenant is reestablishing, we should see or we could see a quick restocking. For July, the business took place as expected, okay? We still see some price pressure, but the volume came in according to our expectation. So as I said before, Thiago, we are confident that we're going to see our stocks moving now towards the end of this year.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you, Carlos.

Operator

Mr. Daniel Sasson from Itau BBA would like to ask a question.

Q - Daniel Sasson {BIO 19234542 <GO>}

Hello, everyone. Thanks for the opportunity. My first question is actually a follow-up on your previous answer. So you mentioned that paper producers' inventories remain below normalized levels, right, from hand to mouth. Do you think we will see at some point a reversal to the (inaudible) or that is paper producers having more inventories throughout the supply chain? Or do you think that this new lower inventory levels for paper producers is actually the new normal going forward? And regarding your medium to longer-term supply-demand expectations, how comfortable are you with the long-term trends of the industry in light of the recent capacity expansion announcements, especially from UPM for 2022? There are some of -- other projects also coming online between '21 and '22. So if you could give us some color on whether you think demand and supply are balanced for -- not considering 2019 or 2020, but for 2021 or 2022 onwards? That would be great. Thanks for the opportunity.

A - Walter Schalka {BIO 2099929 <GO>}

So, we still keep our forecast that over the coming years, we're going to see the demand growing around 7 million tons, which is roughly 1.4 million tons per year. So far, we just have two projects announced. So we do expect a balanced market for the period. Regarding your question about China, we understand that the finished product inventory for the major grades, printing and writing, (inaudible) board and tissue are at the normal level in the whole value chain. And I do not foresee any change for that with all the credit restrictions that we see in China today.

We have had, since late last year, a big destocking, both on finished products and pulp. And I believe that on finished products, that is the new normal at least for the time being. Although stocks are -- stand today at a much higher level, I should say, what should -- review that half of the access that we have in the value chain today, remain on the producers' side, is the result of a destocking of our customers. I would say that around 50% of the access that we have today, one year ago, that was in customers' hands. So customers' destock, so only with that, we could or we might expect the reversal of 1.2 million, 1.5 million tons. Moving back to our customers to the paper producers, as soon as the confidence is reestablished.

Q - Daniel Sasson {BIO 19234542 <GO>}

Okay. So just to clarify, if I understood correctly, so you do expect the customers' inventories to go back to then maybe 50 to 60 days of pulp inventories, either at the annuals and throughout the supply chain once things normalize, right?

A - Walter Schalka {BIO 2099929 <GO>}

I'm saying that, that we're going to see customers -- restocking. I'm not say that they're going to come back with the previous level due to all the credit restrictions that we see in China today.

Q - Daniel Sasson {BIO 19234542 <GO>}

Okay.

A - Walter Schalka {BIO 2099929 <GO>}

But that's they cannot go on operating hand to mouth when the market gets better there in China. They need to have -- they need to work with a more comfortable stock level.

Q - Daniel Sasson {BIO 19234542 <GO>}

Okay, very clear. Thank you.

Operator

Mr. Carlos De Alba from Morgan Stanley would like to ask a question.

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

Great. Thank you very much. A good sequence, I guess, because the question I have is also on the inventories. The inventory reduction from your customers or on the pulp buyers. So can I understand something, Carlos, if the -- if half of the, say, 3 million, 3.5 million excess inventories in the world are in the hand -- are due to the reduction or the destocking of pulp on the buyer's hand -- so assuming that at some point in time, they come back, they restock. Inventories come down by that time. But then don't demand -- or doesn't demand can grow by the 1.4 million tons that you just said, just to reduce -- or has to grow by 1.4 million tons just to reduce the other half of the excess inventories? And that means that we don't really need more -- much more pulp production in the next 18 to -- 12 to 18 months?

And the problem then is, in 2021, you start to see demand -- supply coming again into the market with MAPA[ph], and then again in 2022 with UPM. So why would prices recover much more than where we are today? The market seems to be balanced. You have -- no capacity is coming online in the next 18 months but you have excess inventory. And then you have capacity coming into the market, around 1.2, 1.4 per year, which is what demand is going to grow at. So why would prices move up from where we are? Or maybe -- yeah, I see why prices can go up a little bit more, but then stabilize at that level as opposed to increase to higher levels that we were expecting before. That's my first question. And then the second question, maybe Walter, you can break down from the BRL800 million to BRL900 million per year in our synergies, how much is OpEx and how much is CapEx? At least a ballpark figure would be great. Thank you very much.

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

Carlos, good morning. This is Carlos speaking. Our estimate for excess is much lower than your number, okay? But to answer your question, I should -- we should talk about the supply side. And I want to share with you some information. So both of our consultants expect market and integrated deals in the (inaudible), we will be forced to stop at least temporarily during the next two months, mainly those dependent on imported wood chip. Just to add on that, average wood chip costs in China today is roughly $200 per BDMT, which means about $400 per ton of wood cost to produce 1 ton of pulp.

According to information just (inaudible) for soft wood price at 560 and hard wood price for 485, around 1 million ton of softwood and 5 million tons of hardwood capacity would be operating below cash cost. So market-related downtime announcements have been already made in some countries and some regions. And announced that shutdown might be taking place as well. I think we cannot expect and reduce it, pulp outputs for the coming months due to these challenging market conditions, especially for those high-cost producers. So the adjustment would come from the supply side to answer your question.

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

Understand. Carlos, why do you think that they are taking so long to -- I mean I know in softwood there has been a little bit more aggressive or at least more advanced of the shutdowns, but hardwood has been much more limited. What do you think is taking so long?

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

I think they still have no raw material in their supply chain. So they need to finish with that raw material in order to start reducing the output.

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

Understood.

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

Carlos, this is Marcelo speaking. On your second question, according to what we have already disclosed, between 75% and 80% of the synergies will be on the OpEx side, which includes the cash cost and SG&A and 20% to 25% CapEx.

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

Thank you very much, Marcelo. Thank you.

Operator

Mr. Marcello (Sic - Marcio) Farid from J.P. Morgan would like to ask a question.

Q - Marcio Farid {BIO 21017394 <GO>}

Thank you. Good morning, everyone. I have a few follow-up, quick ones for me. So you mentioned you're going to be shipping less to China over the next months, right? Basically because you probably have enough inventories to cover demand needs for the next months. So considering your guidance for production, right, it would imply production increase of about 5% in the second half versus the first half. So I'm just trying to understand, is production is going to increase and you're going to be shipping less to China, which is basically the largest consuming region, which regions we will we be shipping more and would the demand for, for those extra volumes into those new regions?

And also, how should we think about Suzano's operating levels for 2020? I know it's probably too early to talk about it, but I'm just thinking if management considers running -- it's still below operating rates in 2020? Or there was -- it started for this year, and next year, we're going to be back into the normal rates and normal market share as well? And maybe the last one for me, so I mentioned that about half of the excess inventories that will have to be on the supply chain was basically a destocking. So what do you think would trigger a restocking over the next month, just considering where we are in terms of a global economic cycle and sentiment in China as well? Those are my questions. Thank you.

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

Marcio, good morning, this is Carlos. Just to avoid any kind of confusion, when I said shipment from Brazil, I'm talking about the vessels that we're loading and sailing to China, okay? We already have enough stock in China to serve our growing sales for the coming months. So once we're going to send less vessels to Asia, once we have the start already seated there and once we are planning to grow our sales, that's why we should see -- or we're going to see a reduction of our stock there in China throughout the whole second semester of this year. Regarding restocking, I think that's going to happen when buyers realize that prices hit the bottom and the market conditions are favorable, so they can start working again with a higher inventory level.

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

And this is Marcelo speaking. About 2020, we will observe how we will perform in the coming quarters in order to define the strategy for 2020. We have no guidance on that at this moment.

Operator

Mr. Jon Brandt from HSBC would like to ask a question.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Hi, good morning. So just a quick follow-up on the commercial strategy that you announced for the third quarter. Could you give us more details surrounding that? How much volume was done with this offer to all clients? Or is it just the international paper producers? My obvious concern is if it's the local Chinese customers, so they've been known to break contracts. So my concern would be if pulp prices continue to fall, that they would re-neg on some of those (technical difficulty) contracts. Anything you could give us on that, any more details on that agreement would be great. And then second, Bacci, I just wanted to ask about the pressure from the wood cost and your strategy there, just to make sure I understand it? It seems like you are preserving maybe some of your lower cost areas and utilizing more of the higher costs wood. Is that right? Can you just sort of elaborate on that strategy? Thanks.

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

Hey Jon, good morning, this is Carlos. We are very pleased with our achievements, with our new strategy. And I can say to you that, that came -- the volume came according to our expectation.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Okay. Is it something that you're going to offer again in the fourth quarter? Or is this a one-off event?

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

We have not defined yet what we're going to do for the second quarter. As I said before, we always adjust our commercial strategy, our commercial policy according to the prevailing market conditions.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Okay. Thank you.

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

Jon, this is Marcelo speaking. On the wood cost, that is exactly the case. We are preserving the high-growth forest that we have, and we are using proportionally more third-party wood this year. In a combination of a strategy to maximize long-term value and also given the restrictions that we have with the contracts that we already signed for buying some of this wood and also for the transportation of it.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Okay. So is it fair to say that we should expect maybe a continuation of pressure from the wood cost in the coming quarters?

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

We expect a flattish cash cost in the coming quarter and a better number for next year, when we normalize the mix and also because of the synergies kicking in more significantly next year.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Thank you. Very helpful.

Operator

Mr. Caio Ribeiro from Credit Suisse would like to ask a question.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Hey, good morning, everyone, and thank you for the opportunity. So my first question regarding some of the recent announcements in terms of expansions for hardwood without Alco [ph] and UPM moving forward their projects. I just wanted to see whether this impacts in any way, any decision that you might take to expand further in the medium term? And was there you still believe that it makes sense to add more capacity into the market from 2021 onwards? And then my second question regarding working capital, I just wanted to see if you could talk a little bit about -- specifically the receivables line. And whether you did carry out a significant amount of prepayment of receivables this quarter that could have helped the working capital variation. Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

On the first question, Caio, this is Walter talking. Thank you for your question. This announcement did not change our strategy for the future. We understand that we have a very competitive position in the market. And if we proceed with new investments in the future, it's going to be even better in terms of competitiveness. We have been working to -- we have access for us, and we are preparing the Company for the future. But at this point of time, we are not going to announce any specific project on CapEx expansion, due to the financial discipline that we have, and we have been announcing that for a long time ago.

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

Caio, on -- this is Marcelo speaking. On working capital, the strategy we have in terms of discounting receivables and letter of credit has not changed. Of course, as we had a higher volume on the quarter, we had more discounted at the end of the quarter. And it's important to emphasize that the strategy also deals with the credit issues. So we are discounting, not only to improve the position in the balance sheet, but also to manage the credit exposure that we have. So the larger amount of receivables discounted is coming from the fact that we had higher sales.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Perfect. Thank you.

Operator

Mr. Thiago Ojea from Goldman Sachs would like to ask a question.

Q - Thiago Ojea {BIO 17363756 <GO>}

Thanks. Good morning, everyone. So my first question is regarding, again, on the CapEx side, we saw a reduction on your CapEx estimates for the future. If you can elaborate a little bit more on the reasons for that. And also, we saw some announcements from competitors of new capacity additions, namely UPM and also (inaudible), before we had estimated that. By 2022, we would have only MAPA project coming and now we have two extra projects coming. So how do you see long term the supply and demand evolving? And if I can -- just following up on Marcio's question, so what you are saying regarding shipment is that you are not sending more vessels to China, but this does not mean that you're selling less this quarter because you have already positives [ph] inventories there? Is that's the point? Thank you.

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

Thiago, this is Marcelo speaking about the CapEx. The idea is to improve our financial discipline with some reduction in our CapEx that we consider will not impact in any significant way our long-term strategy. So it's just a combination of adjustments in our CapEx plan to deal with a more asset scenario. And we are still -- are discussing what we're going to do for next year, with room for additional reductions in CapEx when compared to the number of this year.

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

Thiago, this is Carlos speaking on China. You're right. We kind of maximize our sales from the stocks that we already have seated at the major Chinese ports. So we're going to do that. On your question about supply and demand, as I said before, we still give the forecast that the demand is going to grow about 1.4 million tons for the coming five years, which means around 7 million tons. And so far, we just have the true project that I just mentioned. So at least, we're going to see the market balance for the coming years, this is what we have for the time being.

Q - Thiago Ojea {BIO 17363756 <GO>}

Thank you.

Operator

As there are no questions, I would like to turn the floor over to Mr. Walter Schalka for final considerations. Please, Mr. Walter Schalka, you may proceed.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you very much to be attending our second quarter results. We are very pleased with the development of the Company. We'd like to share with you that our team is highly engaged to pursue all the potential value creation alternatives that we have at this point of time and enhancing the culture of the Company, preparing the Company for the future.

In my closing remarks, I would like to reinforce the point to you that even on this adverse markets scenario, we have been performing accordingly to the expectations. And we understand that we will deliver the expected results to their market. Thank you very much, and have a nice weekend.

Operator

Thank you. Suzano second quarter results conference call is finished. Have a nice day.