

## Q2 2016 Earnings Call

### Company Participants

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

### Other Participants

- Carlos F. De Alba, Analyst
- Jonathan Brandt, Analyst
- Juan G. Tavaréz, Analyst
- Karel Luketic, Analyst
- Lucas Ferreira, Analyst
- Marcos Assumpção, Analyst
- Thiago Lofiego, Analyst
- Vincenzo Paternostro, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, and welcome to Klabin's Audio Conference. At this time, all participants are in listen-only mode. Later, we will conduct a Q&A session, and instructions will be given at that time.

As a reminder, this conference is being recorded and broadcast live via webcast and maybe accessed at <http://cast.comunique-se.com.br/klabin/2Q16>, where the presentation is also available.

Before we proceed, I would like to clarify that any statements eventually made during this audio conference in connection with Klabin's business outlook, projections, operating and financial targets, and potential growth, should be understood as merely forecast based on the expectations of the company's management in relation to the future of Klabin. Such expectations are highly dependent on market conditions, on Brazil's overall economic performance, and on the industry and international market behavior. Therefore, they're subject to change.

With us today in São Paulo are Mr. Fábio Schvartsman, CEO; and Mr. Antonio Sergio Alfano, CFO; and IR Officer.

Initially, Mr. Fábio and Mr. Sergio will comment on the company's performance during the second quarter of 2016, after that they will answer any questions you might have.

Now, I would like to turn the floor to Mr. Schvartsman. Please.

## Fábio Schvartsman

Good morning, everyone. Welcome to our conference call for the second quarter of 2016. We are very happy to say that we are delivering these results in the quarter with positive performances in all relevant aspects of the company. Therefore, Puma has shown an adequate performance, paper is still performing continuously. Cash generation was also positive and consequently the company's debt has already begun showing reduction in fines, as expected.

To be more clear, I would like to stress the sale of a 181,000 tonnes of pulp, the first one by Puma Project and they represent only 50% of its capacity or a little bit less of installed capacities and that is normal in that ramp-up process. And of those, less than 10% were sales of softwood because of the mismatch between the startup of the hardwood machine and the softwood line. It's also important to highlight an increasing 4% in sales volume for paper and packaging. This is an adequate performance, especially if we take into consideration the difficult situation in which we are operating.

We had exports of Kraftliner that have increased 12% in volume and this period representing the action we have taken to convey better results benefiting from the FX in this last quarter. Therefore, the general EBITDA of the company has increased 37% in the second quarter of 2016 vis-à-vis 2Q 2015. And therefore, we were able to take in remotely the general shutdown of the two most important paper factories of the company; Monte Alegre and Otacílio Costa plants. And that for the first time, people didn't even notice that the factories had to be shutdown once their results were totally took in with no problems by the company.

As usual, I like to give you an idea of what we expect ahead. The scenario starts to change from now on in the third quarter, because of a series of factors. One of them is that the exchange rate, as you know, is dropping a little. At the same time, we see that domestic market has ACL (05:01) improvement signs. So we open a little bit the capacity of the domestic market to take in our products and Puma Project, still is in its ramp up. So much so that our expectation for the third quarter is that our sales growth and 80% volume vis-à-vis the second quarter of 2016 that will help significantly the results of the company.

It's important also to say that this takes us to approximately 900,000 tonnes of production and sales in that quarter, which is an upward review of our production expectation vis-à-vis prior quarters. Also, I should say that our fluff operations are advanced. And I'm very happy to tell you that right now we have 80% of consumers of fluff in Brazil, have already approved Klabin's product. Obviously, along the next months and quarters, that will start turning into significant volumes as we have expected, obviously then, improving the company's performance.

Considering the scenario I have just mentioned, we are taking several actions in the company, suiting (06:43) what Klabin always had that is best, its capacity to adjust to the different scenarios. Therefore, we are working on a set of actions that aim to keep that

favorable performance of the company. The first one of them, the change and the focus from the domestic market to the foreign market and we are preparing ourselves to expedite the process, that is when real's appreciation happens, we'll then concentrate more in the domestic market then.

We are also stressing and improving actually, the mix of our products. For instance, if we are able to produce more fluff in that pulp fat (07:35), that will get better results to the company just as if we are able to produce more converted products that also will translate in better results for the company.

We also are working on our efforts of improving the production of our existing paper machines, so that we can have total full production capacity in all of them, once again, helping in the company's performance. And finally, we are doubling our efforts in terms of cost reduction, especially with Professor Falconi consulting services. We have had his help before. We are working with him again, and we also have an expectation of relevant gains in terms of cost reductions there.

I would like to remind you that with this whole set of actions, we hope that in this third quarter we'll keep on showing a significant growth in the EBITDA of the company such as we had in the second quarter of this year.

Finally, I would like to say something about machine 10, a coated board machine. It has not stopped. On the contrary, we are working with our suppliers in order to optimize our CapEx, which is a healthy measure that has everything to do with analyzing where we should go in terms of FX as well as the Brazilian economy and international economy. All of them relevant factors when we consider this new machine. So we expect it to continue, the optimization of this project, so that it can be as successful as Puma Project was.

So that's what I had to comment. Now, I will turn the floor to Mr. Alfano, and he will tell you more details of our performance.

### **Antonio Sergio Alfano** {BIO 4337533 <GO>}

Good morning, everyone, and thank you very much for being with us in this conference call relating to the second quarter of 2016. Very well (09:56). About sales volume, we had the beginning of pulp sales for Puma Unit and the volumes sold by Klabin in the second quarter has reached 631,000 tonnes, 45% higher than 2Q 2015. As Fábio had mentioned, the paper and packaging sales also increased 4% in the second quarter vis-à-vis 2Q 2015 and they were at 450,000 tonnes. That growth is also thanks to that debottlenecking that we have done on the two paper machines, one of sack kraft in Correia Pinto and the other one a new machine (10:46) recycled paper machine in the Northeast, where we are working at our full capacity.

Also an important topic that Mr. Schvartsman mentioned is the company's flexibility to be able to sell more in the domestic market or in the foreign market, adjusting itself to the market conditions. The sales volume for pulp was 181,000 tonnes, especially sales of hardwood that were driven especially to foreign markets. So for the first time in the

company, the exported volume represented 50% of total sold volume in the prior year, and the second quarter of prior year the volume of exports was of 33%.

The net revenue for the second quarter including wood and pulp sales have reached R\$1.7 million, a growth of 27% vis-à-vis 2Q 2015.

About cash cost, after a better analysis of the results with the new pulp unit starting this quarter, the unit cash cost for pulp production considers all production of hardwood, softwood and fluff pulp and the cash cost of production does not include the general SG&A expenses.

They are only the production cost itself, especially thanks to the Puma unit production, the cash cost has reached R\$890 per tonne, and remember that we have started, and we are still in the learning curve there. Considering the sales of all products in this quarter, the cash costs of Klabin was R\$1,856 per tonne, 15% lower vis-à-vis the same period of the prior year and that is explained by the dilution because of sales in pulp and also lower costs linked to this new sales mix of Klabin.

As, for instance, a lower share of converted products that more than offset the costs of the plant shutdowns of Monte Alegre and Otacílio Costa, that happened during the second quarter of this year. The adjusted EBITDA was R\$538 million, 12% increase vis-à-vis the second quarter of 2015. The consolidated net debt at the end of June totaled R\$11.0 billion, R\$627 million lower compared to the first quarter of this year. That reduction is because of the effect of the debt in the (13:57) foreign currency, the lower FX rate, and also the cash generation of the company that more than offset investments of R\$650 million that were done.

Therefore, at the end of June, our net revenue EBITDA ratio was up 5.2 times vis-à-vis 5.9 times in March 31. With the new cash generation in Puma, Klabin should, as we have been saying, should expedite this deleveraging in the next quarters.

Once again, it's important to say that Klabin has no financial covenants linked to its debts, and we also have no cash effect in the short term because of the FX. In terms of investments, Klabin has invested R\$650 million in the second quarter, R\$505 million exclusively Puma project, in the first quarter, investments totaled R\$1.5 billion and R\$1.240 billion in the pulp plant, in the review that we finalized this morning and it's also important to bring to you our prior expectation of R\$650 million that we had in our release for disbursements to be made along the second half of this year, except for (15:31) Puma project, we'll have a reduction of 20%.

So, now Fábio and me are available to answer your questions.

## Q&A

## Operator

Ladies and gentlemen, we will now start the question and answers session. Our first question is from Mr. Thiago Lofiego, Bradesco BBI.

### **Q - Thiago Lofiego** {BIO 16359318 <GO>}

Thank you very much and good morning. I have two questions. If you can comment on the domestic market, especially prices for coated boards. Do you see any price pressure from clients considering that we had a stronger appreciation of real and also is it sustainable to work with high premiums for imported products? And I don't see that you're importing coated board, but does it make sense to work with the premium there and if you can tell us a little bit on where the premium is.

And my second question is about costs improvement. You mentioned 25% after the second quarter of 2016 up to R\$670 per tonne. When do you expect that we should reach that level? When do you have room to have lower costs than that?

### **A - Operator**

Thank you very much for your questions, Thiago, welcome back. So, I will start with your question about the coated board, but so just to let you know we do not charge premiums in the domestic market, vis-à-vis the international market. We do a careful follow-up of the priorities and we take into consideration the fact that there is a cost to import both in terms of tariffs and also logistics. So, when you compare our product sold in Brazil with an imported (18:00) product placed in Brazil, we are still more competitive than the imported product. So, there is no question about it, at least not so far, and we are very far from that situation.

Now, about your second question, very interesting on how is the curve of cost reduction for Puma project. The main initial factor for cost reduction is to reach higher volumes of production in the plant. And that will happen continuously, the third quarter, fourth quarter and the next year. We should have the production and volume growing, therefore, the cost dropping. So, the main cost reduction that is forecasted, it should happen along that period. And still there is something else that should come from maturing (18:58) from the forestry areas that will supply Puma, where we should reach an optimal logistics for Puma supplying and that should happen in 2018. Therefore, in 2018, we also should have an important and significant cost reduction.

Your question about if we still could go beyond that, and Klabin is always very careful in those types of assessments. When we defined those figures, we defined them because we do believe that the company will be able to meet them along the years. But obviously we work at the same time in different fronts and the forestry is one of them actually and we expect to have a benefit.

In addition, when we gain more domain, when we learn more about Puma's operation, we start to have a better visibility of the real physical limits of its operations, and little by little we increase the belief that we have - and we know that we have additional volumes to go after, but this is a natural process that will come with time. What we really expect is to have

those 25% in cost reduction and I am here talking about the weight average cost between hardwood, softwood and fluff.

**Q - Thiago Lofiego** {BIO 16359318 <GO>}

Thank you.

**Operator**

Our second question is from (20:31), Bank of America.

**Q - Karel Luketic** {BIO 16467278 <GO>}

Good morning. Actually, this is Karel and I have two questions. The first one is about the deleveraging perspective for the next quarters. You mentioned that you expect to have a quick deleveraging and taking into consideration the current scenario for prices and FX and from its ramp up (20:50), what is reasonable to assume in terms of deleveraging for the next months? And my second question is about the new coated board machine as you were saying, Fábio, about the projects optimization, what is reasonable in terms of timing for this new coated board machine? Should we expect anything this year, next year, and if possible, what is the main hindrance to make decisions about this new machine? Thank you.

**A - Antonio Sergio Alfano** {BIO 4337533 <GO>}

Karel, hello. This is Alfano. About the deleveraging, obviously all of that is going to be depend on the FX scenario, but we expect to have an exchange rate of R\$3.30, R\$3.35, up to the end of the year, and we expect to reach a deleveraging at the end of this year of 4.2 times and 3.3 times at the end of next year.

**Q - Karel Luketic** {BIO 16467278 <GO>}

That's perfect.

**A - Operator**

Now about your question on the machine. What we have this huge investment that we did in Puma, a lot of billion reais have been invested there, the company is deleveraging itself and we are facing an economic scenario that to summarize in word is uncertain, no one can say with any convection what will happen both in the Brazilian economy as well as in the world economy and consequently - and evolve to where (22:29) FX is going to be at. All of these issues in fact will influence on the machine. The machine is good, is (22:38) in practically almost any scenario. And your question on when this is going to be done is that we are working hard to optimize this project because it is evident that, one way of making this project bulletproof is to reduce everything as possible to be reduced in terms of CapEx, and even then having all the benefits of the coated board machine, and that's what we're doing.

Our suppliers are extremely committed to this process with us, we are working in an expedited fashion and as soon as this is completed we'll bring it to a final approval. And

your question when this is going to happen? If this could happen this year, I hope so. Yes, I hope, we could still have it this year. But that's something that is remained to be seen in the next month.

**Q - Karel Luketic** {BIO 16467278 <GO>}

Perfect. Thank you very much.

**Operator**

Next question is from Marcos Assumpção, Itaú BBA.

**Q - Marcos Assumpção**

Good morning everyone. Congratulations on the results. Mr. Schvartsman, the first question about the pulp cash cost, you mentioned that you expect to have a strong reduction for the next quarters. Can you comment on how was cash cost in July in the last 15 days so that we can have an idea of how much it could drop in the short term. And my second question is that we saw that you hired FALCONI in the quarter. I don't know if you have already mentioned anything about that, what is the main object there? What are you planning here in terms of implementation any major gains in the company after these services? Thank you.

**A - Fábio Schvartsman**

Thank you for your questions Marcos. About pulp cash cost, what I can tell you is that as I said in the beginning, we expect to sell approximately 80% more in the third quarter. Those 80% more actually they do not mean that we'd be producing 80% more because our only restriction in sales actually is production, and considering that, that is our expectation and that's what we are doing already in June. We are working on this ramp-up that will allow us to bring this type of growth in the third quarter, and therefore, a cost reduction that is going to be possible with this additional volume.

About Professor Falconi's consulting services, we are working and checking all the plants, the difference of the work that we are doing now from the work that has been done before by FALCONI is that this is no longer something intra-plants, it's inter-plants; that is, we actually are comparing the best practices among all plants of the company, now including for the first time the recycle plants that had never taken any participation in these efforts. So we expect to have significant gains both in our Paraná plants as well as Santa Catarina, and also in the recycle plants. So we will have a result that will be proportional in these three categories of plants and that is the expectation we have. We hope the results will start showing in the fourth quarter of this year.

**Q - Marcos Assumpção**

Thank you very much.

**Operator**

Next question is from Lucas Ferreira, JPMorgan.

### **Q - Lucas Ferreira** {BIO 16552031 <GO>}

Good morning, everyone. Schvartsman, about Puma, you had the expectation of maybe of being operating with a higher production other than the nominal one at the end of the year, I don't know if you would have the shutdown that happens normally a few months after the startup of operation, if that's going to happen actually. But do you think in the fourth quarter, you would be operating with a volume over 1.5 million tonnes or would that do any bottlenecking in the factory. Can you do it for this year, beginning of next year, and also, I would like to understand if possible, how the acceptance of fluff - you said it's excellent, that many of the clients approved it, but commercially the contracts are according to your expectations, what about their premiums? You are pushing out of the market the imports that have always happened and the negotiations according to your expectations, the premiums, are those the same ones that we see in the market, and that's what I'd like to know. Thank you.

### **A - Fábio Schvartsman**

Thank you for questions, Lucas. I would love to say that we are going to go over 1.5 million tonnes in terms of capacity by the end of the year, but I think that physically that's not going to happen. It will take a little longer for us to have a total control of the process. Actually, I will be very happy if we are operating at our nominal capacity by the end of the year. Our expectation was never higher than that.

On the contrary, about the curves that we have done, we now have more aggressive curves than what we had before. So, we will not go beyond the nominal capacity this year, but even then we're above our own expectations and the expectations we have already brought to you before. This is a natural process. Well, nominal capacity is something that you reach in a normal ramp-up. To go beyond the nominal capacity, you have to have a full domain, full control of the factory and that takes time. And it would be foolish of the company to try to go for extreme volumes ahead of time.

About that intermediary stoppage that you do after a few months, the company has chosen not to do any type of shutdown or stoppages in the first months. We will do a stoppage after a year of operations. So, that doesn't mean we don't have any stoppages in the horizon, much on the contrary, we'll raise production (29:37) non-stop. So, that is another interesting news.

About contracts, we are not charging more for our fluff because - and it is better than imported fluff, here in Brazil. Because we are just going into the market, and I think that addresses your question. It is obvious that the regular premiums - that fluff we have, when we consider other fibers, we realized that and I expect that when - it's clear the advantage. When the client sees the advantage of our fluff, I hope that they allow us then to have even more competitive fluff or a fast forward fluff or (30:33) commercial conditions are going very well.

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We still have the targets we had before with no problems there. Actually, the main problem we would have would be approval and just assume companies will approve still our product. And we should expect then a continuous growth of sales reaching very significant volumes next year.

**Q - Lucas Ferreira** {BIO 16552031 <GO>}

Thank you.

**Operator**

Our next question is from Vincenzo Paternostro from Credit Suisse.

**Q - Vincenzo Paternostro** {BIO 17670256 <GO>}

Good morning, everyone. Thank you. My first question is about the exchange rate. Actually, I would like to divide this question in two parts. First, do you foresee any type of risk for dollar price for any paper cycle because of a possible devaluation of the (31:46) because of the Brexit and any other problems in Europe? That's my first question.

And second, what is the profitability today of exports when compared to the domestic market, considering that we have recently seen a significant appreciation of real? So I would like to better understand the FX impact in these two variables, the dollar price of some types paper and also in the profitability here considering the current FX. And actually I would like to listen you from you, again, Alfano, about the CapEx reduction that you have done now at the end, because it was not very clear for me if this is a clear reduction and in fact a reduction or if you postponed and what is the magnitude of it? If you can comment on it again, I would appreciate.

**A - Fábio Schvartsman**

Okay. About FX, Vincenzo, what I can tell you is it is obvious that the fact that euro lately has devaluated vis-à-vis dollar. It does impact international prices, because a market that has little Kraftliner in the world, and that it takes in - Kraftliner is in the European market, therefore once the euro devaluated, of course, it will impact the dollar value of imports, but that has been happening continuously a long time. That's not new.

About profitability of exports, right now we're seeing an interesting phenomenon. The average profitability of imports is no different from the average profitability of sales in the domestic market. But in the margin, it starts to become better to sell the domestic market. So comparing averages, it doesn't make much of a difference. There is nothing too serious that will show some movements to one side or to another. But as I said in the beginning, we are preparing ourselves to migrate volumes to the domestic market.

Whilst the FX rate is still appreciating, it is the FX movement that will define a larger footprint in the domestic market or not. Right now considering the margin, it would be more profitable to sell in the domestic market.

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**A - Antonio Sergio Alfano** {BIO 4337533 <GO>}

Okay, Vincenzo. About my comment on CapEx, the balance that we still have to disburse (34:31) is explained as this. In our budget, we have an amount for contingencies and the projects. So we asked our personnel to review this amount, and this morning we saw that - informed the amount of R\$650 million was reduced for R\$520 million that will be disbursed for Puma Project. So it is not a postponement. It's only a reduction of the total value that we'll have to do disbursement for the project.

**Q - Vincenzo Paternostro** {BIO 17670256 <GO>}

So it's a reduction of R\$130 million, right?

**A - Antonio Sergio Alfano** {BIO 4337533 <GO>}

Yes. We had informed R\$650 million, but those are going to be actually R\$520 million.

**Q - Vincenzo Paternostro** {BIO 17670256 <GO>}

Thank you very much.

**Operator**

Next question from Jon Brandt, HSBC.

**Q - Jonathan Brandt** {BIO 17988091 <GO>}

Hi. Good morning. Thanks for taking my question. Fábio, I wanted to ask you about the production of pulp for the rest of this year and next year and then sales volumes. What did you actually sell in terms of volumes of pulp fluff in the second quarter and can you give us a breakdown of sort of what the expectation should be for the rest of 2016 in terms of total pulp and broken down by hardwood, softwood and fluff? It seems like at least according to the translation that production might be a bit better this year than what you were originally expecting.

And then secondly, Sergio, I wanted to ask you about the leverage. You had mentioned the 4.2 times and 3.3 times for this year and next year. I'm wondering how much of that is actually being debt that's actually paid down or a shift in (36:25) increase in EBITDA generation and how much high cost of debt there is? My understanding is that it's just the mandatory convertible debentures that have a high cost of debt associated with it. If you could talk a little bit about when we should expect those to actually be converted that will be great. Thank you.

**A - Fábio Schvartsman**

(36:53) I think I should address your question in Portuguese and it will be then interpreted. The connection was not very good and I will answer what I was able to understand from your question. So if I miss anything please let me know. But anyway, I understood that your main question is about our pulp operation this year and next year

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### **Q - Jonathan Brandt** {BIO 17988091 <GO>}

Yes. I'm wondering in terms of production if anything has changed from the previous guidance in terms of total production and then broken down between hardwood, softwood and fluff production.

### **A - Fábio Schvartsman**

Well, to be very specific about the third quarter, I said that our volume of all pulp will increase in 80% vis-à-vis the second quarter and that softwood should reach 25% of that total. Approximately one-third of those 25% should be a fluff already sold in this quarter. And from then on, we'll grow the sales of fluff up to all softwood turns into fluff along next year. That was our prior expectation and that's what we are working and things are happening aligned to that.

If I well understood that was your main question. And hardwood, we have nothing new here. We are working with Fibria. Fibria has proven to be a excellent partner. They are working with us. They're placing our products in all their clients with no restrictions and this is going very well. So it should fulfill fully all volumes contracted with then (39:11) difference is that the hardwood is already sold for Brazilian producers and South American or clients actually from Brazil and South America and then that also should happen with no problems at all along the year, that is we would not be able to deliver more volume to see if we have more than what we already committed with the sales in the domestic markets and also in the South America market.

### **A - Antonio Sergio Alfano** {BIO 4337533 <GO>}

Now, also addressing your question on the leveraging of the company and that expediting of the leveraging process, basically it will happen in two processes. A natural process, which is the EBITDA growth. Our net debt tends to decrease a little, but the main effect is going to come by the EBITDA growth and now. So when we have the credit recovery, especially from the HT (40:16) we'll be able to recover credits from ICM, and we will be able to get them back as we sell pulp in the domestic market. So we will have those tax credits that will help us in the deleveraging process. Basically that is it.

### **Q - Jonathan Brandt** {BIO 17988091 <GO>}

Okay. And just a follow-up. So it doesn't sound like there's actually going to be a reduction in growth. It's more a function of increasing EBITDA. And then, what about the mandatory convertible redemption. Is there enough bandwidth till (40:51) when they will actually be converted?

### **A - Operator**

The mandatory debenture conversion will happen in January of 2018. We estimated that we'll reach the 300,000 tonnes we have forecasted in the contract for the debentures issuing at the end of this month. And we'll then do the mandatory conversion of the debentures and new shares a year before, not in January of 2019, but rather in January of 2018.

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**Q - Jonathan Brandt** {BIO 17988091 <GO>}

Great. Thank you very much.

## Operator

The next question is also in English. Carlos de Alba, Morgan Stanley.

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

Yes, good morning. Thank you very much. First question has to do with what are the expected savings, if any, are from the consulting firm you've (41:56) just started. Or if you don't have at this time a rate on (42:01) those savings, could you at least give us some light that the base from which the total (42:08) savings would be achieved? And then finally, the inflation of the domestic market with cost sometimes (42:18) of recovery, is there any prospects of debenture increases year-end and what has been happening in the domestic positive market? Thank you.

**A - Fábio Schvartsman**

Carlos, this is Fábio here. The connection is breaking. I well understood the first question. You asked about the FALCONI Consulting Services and what is our savings estimate, right?

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

Correct.

**A - Fábio Schvartsman**

And we have already mentioned that we expect to have a three digits of savings in the (43:01) space. That is our expectation in terms of benefit from Mr. Falconi's Consulting Services. About second question, please repeat it because it was impossible to understand - I understood it has something I couldn't capture it very well, so if you can repeat it, please.

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

Yeah, no worries, Fábio. Sorry about that. The second question is regarding the potential for price increases in the domestic market. On the one hand, OCC prices in Brazil continued to increase; and on the other hand, the domestic conditions - domestic demand conditions seem to be stabilizing. So, I wonder if there is any scope of higher prices in Brazil for paper.

**A - Fábio Schvartsman**

Okay, Carlos, now I understood your question. It's about recycle paper, and now more or less repeat your question so that everyone else can understand it, because the connection was breaking down. The question is about the fact that OCCs (44:17) having price increases in the domestic market. So, if the Brazilian economy stabilizes itself then that means that we'll have room for price changes in papers in the domestic market.

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Answering your question, it depends, depends on what happens to the paper supply in the market. The price of paper is already very high in the domestic market, considering the high price of OCCs. Consequently, this is an excellent opportunity for Klabin to place more virgin fiber paper in the Brazilian market, both in the market itself as well as in our own conversion instead of exporting depending on the FX rates.

So answering your question, depending on the paper supply - it depends on the supply of paper in the domestic market and on what is going to happen to FX. The FX is such that, it is better to bring products to the domestic market that's not going to translate into price increase. On the other hand, if FX favors exports that probably considering the paper scarcity in the domestic market then the prices could go up. I hope I have addressed your question.

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

Right. Thank you very much, Fábio.

**A - Fábio Schvartsman**

Yes. Thank you.

**Operator**

Next question in English from Juan Tavarez, Citi.

**Q - Juan G. Tavarez** {BIO 15083199 <GO>}

Hi. Good morning, everyone. My question is more around demand. I guess the first point is on the new machine 10 - the potential (46:10) machine 10. Could you discuss how these discussions are going with your clients and where would you see most of the demand coming from for that new plant?

And then secondly, could you discuss about the local market demand trends. If you are considering shifts of volumes to Brazil, maybe just mention that there could be some substitution of virgin fiber paper from recycled paper, but I'm curious how the end market of the conversion side is looking? Are you seeing any signs of improvement there in box demand? I mean, if you could give us some color there that'd be great.

**A - Fábio Schvartsman**

Juan, thank you for your question. About the machine 10 contracting, negotiations with our traditional clients are going very well, that's not an issue that we're concerned about market uncertainties. But even if our traditional clients have a good appetite, they will just take a share of the machine. The remainder of the machine is still in the market and that's going to depend on the market's performance. So that this will happen with no price sacrifices.

So, when I say that we continue with the studies on machine 10, and while we wait a little bit more visibility of the market scenario, when I say that it's because we don't want to

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place ourselves in a situation where we have to sell additional volumes in depressed markets, because that does not depend on what I'm going to contract with our key clients. Everything is fine. This will happen, but what about the rest; that is going to depend on the regular market condition, that is the fundamental question here.

And about how this works in terms of bringing in more paper to the domestic market, considering that the demand is not as high, although it is stabilizing itself. Actually what happens is, because of high prices of OCCs that ended up bringing up also the prices of recycled paper in Brazil – and the price and the cost of recycled paper in Brazil. Consequently, we have there an opportunity of replacing recycled paper by virgin fiber, if bring these products to the domestic market. So, that's how we do it. That would be the movement that is much more protected by the umbrella of the high price of the OCCs. I hope I have explained it.

**Q - Juan G. Tavaréz** {BIO 15083199 <GO>}

Yes. Thank you.

## Operator

Next question is from (49:16), JPMorgan.

Good morning. I would like to understand how do you see the ratings of the company? Recently, you were downgraded by S&P because of a lower leveraging, and Fitch also had a negative rating, if you would decide to invest in the new coated board machine. So, what is your commitment with this investment grade and if you're already talking to have a third rating there?

**A - Fábio Schvartsman**

Well, I would like to comment on this. The conditions that make the rating agencies do what they do, have much more to do with the Brazilian situation than with Klabin's situation. So much so that – look, this is a paradox. As you said it yourself, you had this movement by the rating agencies, but it's interesting that the bonds of Klabin have appreciated they have better prices immediately after our announcement. So, that makes me believe that these two things are not connected.

Second, Standard & Poor's said themselves that they did not see where we would have lower debt levels. They were not secured about that. As Sergio mentioned in his presentation not long ago, we should be lower than the expected level by Standard & Poor's next year. So if Standard & Poor's is fair in their analysis, they should be preparing themselves to revise us upwards to upgrade us once again, because that's what they said themselves that we should reach a specific level, and we're going to reach that level very soon.

So I believe that Klabin keeps following its trajectories, no changes and their rating agencies do have their own internal policies that make them of late a little bit. But at the

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end of the day, what Klabin delivers is going to be clear to everyone and the results will turn into the correct rating.

## Operator

If we do not have further questions, I would like to turn the floor to Mr. Fábio Schvartsman, for his final remarks.

### A - Fábio Schvartsman

Thank you very much, for being with us in this conference call. It was very interesting to see here a large number of investors with us this time. Thank you very much for being with us again. Klabin is still working the same way we have been working in all these last quarters in order to deliver value to deliver results. Our path is clear. Puma is here and is performing even better. Our paper areas are still delivering with the same continuous results, and Klabin is still using its flexibility in a way that we can deal with the differences and the economic scenario.

Once again, thank you very much for being with us in this conference call. And I hope to have you back in our third quarter 2016 call, or anytime when there is something new to bring to you. Thank you, again, have a nice day.

## Operator

The conference call of Klabin SA has concluded. Thank you very much for your participation and have a nice day. Thanks.

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