

Q2 2018 Earnings Call

Company Participants

- Cristiano Cardoso Teixeira, Chief Executive Officer
- Douglas Dalmasi, Director-Industrial Bags
- Flavio Deganutti, Paper Commercial Director
- Francisco César Razzolini, Executive Director, Industrial Technology, Innovation, Sustainability & Pulp Business Officer
- Gustavo Henrique Santos de Sousa, Chief Financial Officer & Investor Relations Officer

Other Participants

- Carlos F. De Alba, Analyst
- Marcio Farid, Analyst
- Marcos Assumpção, Analyst
- Milton Sullyvan, Analyst
- Renato Maruichi, Analyst
- Thiago Lofiego, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Klabin's Conference Call. At this time, all participants are in listen-only mode. Later, we will hold a question-and-answer session when further instructions for you to participate will be given.

As a reminder, this conference is being recorded and broadcast live via webcast, and that may be accessed at cast.comunique-se.com.br/Klabin/2Q18, where you will find a presentation as well for download.

Before proceeding, let me mention that forward-looking statements that might be made during this call in connection to Klabin's business outlook, projections, operating and financial target, and potential growth, our belief and assumptions based on the management's expectation in relation to Klabin's future, these expectations are highly dependent on market conditions on the general economic performance of the country, of the industry, and of international market. Therefore, they are subject to change.

Today with us in São Paulo, we have Mr. Cristiano Teixeira, Mr. Gustavo Sousa, and other officers of Klabin. First, Mr. Teixeira and Mr. Sousa will make remarks about the operating performance of the company in the second quarter. Later, the officers will answer any questions that you might have.

Now, I would like to turn the floor over to Mr. Cristiano Teixeira. Mr. Teixeira, you may proceed.

Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you very much, and welcome to Klabin's conference call about the results of the second quarter of 2018. The second quarter was very challenging for all companies in Brazil, mainly those having to do with consumption, and Klabin was not an exception, and we did feel the impact of the truckers' strike. And despite of that, Klabin was able to deliver cash generation measured by the EBITDA, 49% increase in relation to the second quarter of 2017.

And during the last call, we talked about Klabin's reaching its optimum efficiency of productivity in the third and the fourth quarters, which can also be seen already by us in June and July, and therefore this will remain over the second half of this year.

Cash generation in the third and the fourth quarters will have an impact - strong impact on our deleveraging, and Gustavo will be talking about that, therefore keeping the preparation of Klabin for another growth cycle.

Now, I would like to give the floor to Gustavo, and he's going to talk in detail about our figures, and then we will come back when we have the Q&A session.

Gustavo Henrique Santos de Sousa {BIO 20558478 <GO>}

Thank you, Cristiano. Good morning, everyone. Starting our presentation on slide number 2, as Cristiano said, we delivered BRL 884 million EBITDA, which means a 49% increase vis-à-vis the same period last year. And even during this period that had the truckers' strike, we were able to deliver the highest quarterly EBITDA in the history of Klabin. Our revenue from sales, BRL 2.2 billion, a 13% increase vis-à-vis the second quarter of 2017, driven by the increase in the average prices of our main products.

The average price of the second quarter 2018 vis-à-vis the second quarter of 2017 of short fiber grew 33% and Kraftliner 31% increase. Our sales revenues of Kraftliner, BRL 239 (sic) [BRL 219] (00:04:15) million, a growth of 33% vis-à-vis the same period last year. Production of pulp in June totaled 139,000 tons which is a record production since the beginning of our Puma operation which shows the stability of the operation after the strike. Our EBITDA margin reached 40% in this third quarter vis-à-vis 30% last year.

Now, going to slide number 3, we have our net revenue and the adjusted EBITDA breakdown. As I said before, the improvement in international prices, together with the exchange rate, allowed us to increase our net revenue by 13%, and our adjusted EBITDA with that is growing consistently, once again with 49% vis-à-vis the same period last year and also with a very important 40% march (00:05:21).

Now, going to slide number 4, we had in the second quarter first the stoppage of our plant which is a recurring event in the second quarter. So, the Puma had the stoppage,

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and this led us to an increase – or a drop of 13% sales of pulp. Net revenue, due to the exchange rate and the prices of our products, grew 29%. And as I said, the average price went up 33% and long fiber, 35%. Kraftliner, and increasing the average price of 31%, which was one of the major drivers of the growth of the net revenue, 33% for Kraftliner.

Going to slide number 5, we have some remarks about our performance. In pulp, the stoppage and the strike – the stoppage of the Puma, of course, they had an impact on the quarter. But when we look specifically at June remember that the stoppage for maintenance purposes occurred at the end of March, and that the strike had an effect mainly on May. So, in June, we see a stabilization of our operation with a record production by Puma, 39,000 (sic) [139,000] (00:06:53) tons. And another important point related to the Puma plant is our cash cost for the production of pulp, which in June reached BRL 651 per ton.

On slide 6, we have a view of our debt. So we closed the quarter with a gross debt of BRL 19.5 billion, our cash and cash equivalents, BRL 6.9 billion, and the net debt practically BRL 12.5 billion. And it is important to see that as our gross debt is 64% in foreign currency where we have oscillation in the exchange rate, they generate an impact on a mark-to-market at the end of the period. This is exactly what happened at the end of June. Especially in the last week of June, we saw a hike in the dollar and we closed the quarter at BRL 3.86 vis-à-vis the closing of (00:07:58) in 2017. And this effect of mark-to-market of the debt of the company, which is U.S. dollar-denominated, led to a slight increase in our leverage which closed June by 3.9 times. And if we look at our leverage – and this is what the yellow curve shows in the chart already measured in U.S. dollars – we see the trajectory, the downward trend of our leverage.

In our release that we published yesterday, we have a specific chart that shows that if we were to discount this one-off effect of increase in the exchange rate in the last week of June, our leverage would have been lower than 3.4 times. And although we do not give a guidance for our leverage, there is a simulation that all investors and analysts can do.

On slide 7, (00:09:13-00:09:20) and this is enough to cover 34 times amortization of this debt.

Now going to slide number 8 where we have the free cash flow. We see the improvement of this metric, especially due to the operating performance which is growing increasingly. So the increase in the EBITDA have been – making it possible to us to increase our free cash flow with a stable CapEx already stabilized in June. And with that, in the last 12 months, we had a free cash flow – adjusted free cash flow of BRL 2.0 billion (00:10:08), which is the free cash flow of 10.4% in the last 12 months.

Now going to slide number 9, we have a view of our yield, dividend yield, 3.4% in the last 12 months. And we see that here, we also include in the figure of the last 12 months BRL 650 million. We already included the payment of dividends that will be made on August 15, and that refers to the second quarter of 2018 which is BRL 175 million.

With that, we finalize our presentation, and we open for questions. Thank you.

Q&A

Operator

Ladies and gentlemen, we will start the Q&A session now. Our first question comes from Thiago Lofiego, Bradesco BBl.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning. I have two questions, Cristiano: The first one in relation to the next steps towards growth. You have already mentioned your leverage that is going to a more reasonable level, and I believe that this will support the new cycle of growth. And what is the timing for that in order for you to make the announcements, and what are the next steps so that you may be able to announce that? And the project, both of kraft and paperboard or coated board, not together, but separately, but maybe you could make this announcement at the same time and what about the CapEx?

And the second question has to do with the cash cost for pulp. This level of June could be considered as a normal level, do you think, without the stoppage, or do you believe there is more so to take from the machine?

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you, Thiago. Let's talk about growth, and then I will ask Francisco to talk about the cash cost for pulp (00:12:40) about growth (00:12:47) the talks are happening in a very positive way with the controlling shareholders, and we have this method of deleveraging of the company that we are complying with, and this was the mandate for us for these two years to generate the highest possible cash. And we are being very much helped by the price of pulp and by the U.S. dollar as well.

So, (00:13:22) at the end - or by the end of the year, this - or the projection that you make yourselves, it should read to about 3 times. And this ratio already places Klabin due to its history of stability and consistency, and results already places Klabin as a strong candidate looking at the world trend regarding investments in packaging board, which is our DNA. And we are sure - well, we are very comfortable with the study that we are tracking and we know very well about all the price trends and the product mixes, and CapEx for this investment is going very well. And we, in fact, should be delivering to the controlling shareholders around August all the necessary information so that we may start to debate with a lot of content. And, of course, we have already sorted these stocks (00:14:34), but we will have more content by the end of the year. And we keep our forecast that we would be ready for that provided these stocks are successful and we will lead (00:14:46) the end of the year with the possibility of announcing a new cycle of investment.

And I would like to take the opportunity to clarify to you a point that I see is not yet clear because we ourselves were telling the story a little bit differently a few years ago. With Puma ready and generating results higher than our expectations regarding output and efficiency, in fact, we were prepared already to start the studies regarding the new project, and we did study quite a lot of them. And in fact, as we had already been saying, even based on world market trends, Kraftliner, it really took the place - and I think this

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should be made very clear, it took the place of the paperboard machine and the coated board machine. And with this change, there is a new need for pulp, and the new investment starts with a new line of brown pulp together with the current Puma. And this new brown pulp line will be integrated the first moment should it be approved. It will be integrated to a kraft machine and afterwards to a coated board machine, and in practice, this means that Puma will be the same. It will be kept the same.

And when we think about the cycle of investment that we start discussing with you and that we have already been discussing with our controlling shareholders, we are talking about an additional line for pulp or brown pulp around 1 million tons integrated to paper machine. So, this is the project. And I apologize for the long answer, but I took the opportunity to clarify something that was not really very clear yet.

Now, I would like to give the floor to Francisco and maybe Gustavo as well, if you want to add to the cash cost – the pulp cash cost.

A - Francisco César Razzolini {BIO 16565930 <GO>}

Thiago and other members of our conference, I wish you good morning. This is Francisco Razzolini. And about the pulp plant, our unit, it has been performing very well after the stoppage. We had a slight reduction in the capacity during the strike period, but we resumed at full steam, and the plant is operating about 7% higher than its nominal capacity.

Power generation went back to very good levels, excellent performance in this area as well. And this has been giving us the possibility to reduce the cash cost in a significant fashion, as was said during the conference, BRL 650 and our average cost for manufacturing. And I would like to remind you that this is a mix of the production of hardwood and softwood and fluff, and this is a very good level and a very satisfactory result. We still have the potential for some slight improvements, but it should continue along the same line for the next few months.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you. And could you please add something to what you have just said? I understand what you said about the project, but the IRR will certainly be better than having the paper projects integrating directly with Puma. But way back then when Puma was designed, I think it was based on the optimization of your forest and the integration of the new paper machine. So what about the strategy and how could we think about Puma from now on, 5, 10 years horizon? Will you continue with this business line of market pulp?

A - Operator

Well, we do a very long strategic evaluation, and Puma remains as it is. We will keep in the market pulp with 1.5 million tons in the market. And this new line will be integrated to paper machines and it is by means of this brown pulp that we have now integrated with the paper machines and we reinforce our DNA of more added value products, and mainly in the concept of integration and in the near future up to the integration with paper in

conversion for packagings as well. So Puma will continue to be about 1.5 million tons and will not be integrated in principal in paper. Integration with paper will be in the new lines.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you, Cristiano.

Operator

(00:20:29) from JPMorgan.

Good morning, everyone. My first question has to do with the price of paper in the domestic market, and you announced an increase in Kraftliner prices in June. So, could you talk about the implementation of this price increase, and do you see any room for additional increases also for prices of other products?

And secondly, could you talk about the environment for domestic demand today? What is your expectation regarding the different product lines, corrugated paper and Kraftliner, et cetera in terms of the growth that you're expecting, demand after the effects of the trucker strike?

Thank you, (00:21:21), for your questions. Continuing the format that we are proposing to you, I'm going to bring first Flavio Deganutti, in charge of the Paper area, to talk about the dynamic of the paper market. And afterwards, Douglas will be taking the floor, and Douglas Dalmasi will be talking about packaging and the domestic market demand.

A - Flavio Deganutti

Good morning, everyone. Thank you for the question. We continue with being moderately bullish, and this has to do with the domestic market, mainly, and we try to make the fluff (00:22:04) product more profitable, Kraftliner and coated board. We have already announced some increases in June and July. This is mostly driven by the external market by exports. In the two products that I represent, Kraftliner and coated board, we expect a virtuous growth in Europe, in the United States, which are the main producers and exporters in the world. And so the prices can - have price increases because of that. So we expect a long cycle around two years of valuation of appreciation of these two papers.

Now, I would like to give the floor to Douglas, and he will talk about the packaging market.

A - Douglas Dalmasi

Good morning. This is Douglas. Good morning, everyone. In the second half - corrugated paper is always stronger than the first half of the year due to some seasonal factors such as the fruit harvest and also the increase in demand. We are projecting a stronger market for the second half, with a moderate demand from Brazil, but with a higher volume due to the factors that I have just referred to. In the bag market, the domestic market does

not show a direction (00:23:34) from civil construction yet. However, we are rather successful in other markets that we have been developing recently, in the last couple of years, and we are being rather successful in terms of replacing other products. So, our expectation is to continue a major growth in the second half of this year, but still giving preference to the margins of the other products that Klabin sells.

Q - Operator

Perfect. Thank you.

Renato Maruichi, Santander.

Q - Renato Maruichi {BIO 17847481 <GO>}

I would like to talk about leverage. In terms of size, et cetera, the (00:24:38) is not trivial and the leveraging reached 6 times the EBITDA. So, what lessons have you learned from Puma, and that you could be applying to the new round of growth? What level of leverage becomes a concern to you?

And the second question is whether you intend to have any M&A activity in the corrugated box market domestically, so - because of cost pressures and some companies are not able to transfer this increase to the final product, and maybe this could lead you to have an inorganic growth by M&As in the domestic market.

A - Gustavo Henrique Santos de Sousa {BIO 20558478 <GO>}

Renato, thank you for the question. This is Gustavo. Well, your point is very clear and we practice and there are many lessons that we have learned. There are some points that you have to place into perspective. Puma was a transformational project so the proportion of this new investment vis-à-vis what was the cash generation of the company at that time tends to be much higher vis-à-vis what we are studying right now, the company.

When we look at the market consensus for EBITDA this year, BRL 4 billion - close to BRL 4 million, and we compare this to the volume of investment that Cristiano has already referred to in the previous question. These are totally different projects, of different proportion. Nevertheless, this doesn't mean that we look at these projects without taking into account our concern with leveraging. But as the projects are still being studied, we do not have the financial policy defined and this will be announced together with the project. But what we can say for the time being is that we wouldn't like to exceed during the cycle, even considering the oscillation of prices in our main project, the level of 4.5 times leverage.

So, this is why I want to make this very clear. When we look at our leverage chart, the downward trend is there for this year, for next year, and even if we consider a certain level of price stress and simulations that we do for the next two years, we understand that, first, the level of 4.5 times would be an interesting level in a moment of price stress. And then, it would go back to normal levels.

But right now, preliminarily, this will all be communicated once the projects are approved. What you can expect is that if we approve the projects close to the end of the year, you will receive a very clear communication about the financial policy that will be supporting this growth.

Regarding your second question, I would like to give the floor to Cristiano.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Regarding M&As and - more specifically M&As, and as you asked, every time we have a call, we reinforce the following: Klabin believes in a consolidated packaging market, mainly in order to cope with the demand from the large companies that are here in Brazil. And a large company or a large corporation in order to be able to comply with this high demand reinforces the fact that Klabin is already present in this market.

In the bags area, we hold over 50% market share already, in fluff we also have over 50% of the domestic market. And in packaging, we have around 18% market share specifically in corrugated boxes and - corrugated boxes packaging, we see a strategic need in the future to increase our market share and further consolidating the sector. We believe that this consolidation is healthy and it should come from acquisitions. So we are always mentioning this to you. Nevertheless, given the limitations that all companies face, this is a moment in which we have to focus on cash generation to invest in paper, which is our major strength, together with our competitive fibers that we produce.

So our focus now is grow in our paper machines. However, this does not remove our focus from consolidation mainly in corrugated box market, and we are paying attention to that. And if the opportunity arises, then we will be consolidating.

Q - Renato Maruichi {BIO 17847481 <GO>}

So you do have some scenarios in which you consider organic growth and growth by acquisition as well?

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Well, let me understand your question. I didn't understand your question. Organic? Yes. It is growth in paper in our current base - or production of packaging papers, and this is what establishes the strength of Klabin in order to continue growing in conversion in Brazil and abroad. But the second part of your question, I couldn't hear.

Q - Renato Maruichi {BIO 17847481 <GO>}

My point is maybe M&A will happen when the opportunity arises and not really in the best timing. So if the opportunity arises for you to carry out an M&A together with your organic growth, you will go after it. Is this what - this is my question.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

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Well, let me establish a caveat here about our leveraging policy. Provided we protect our leveraging policy, the opportunities will be studied. Priority number one, growth in paper. But this does not remove Klabin from the possibility of studying possibilities for M&A, focusing on results, be it from consolidation or from synergy. But as I said before, always protecting the leveraging policy of the company. You have to, first of all, respect the leveraging of the company, and then you turn your eyes to our priority which is paper for packaging and then the consolidation of the sector.

Q - Renato Maruichi {BIO 17847481 <GO>}

Very clear. Thank you.

Operator

Our next question is in English, Mr. Carlos De Alba from Morgan Stanley.

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

Yes. Good morning. Thank you very much. So, first question is on volume growth. I mean, when I looked at the year-on-year growth for the different divisions, pulp, packaging and - or conversion and packaging paper, there doesn't seem to be growth really, it's more declining year-on-year. Could you comment as to why do you think this is the case? Is the company losing some market share, or is the company just trying to prioritize margin or average realized price rather than volumes? And what can you expect in the second half of the year and for the year as a whole? Can this volume growth improve in the second half of the year?

The next question I have is regarding total cash cost. Francisco already mentioned about Puma production cash cost having some additional room for improvement. So what about total cash cost for the company? It grew 6% in a quarter year-on-year. What do you expect going forward in the second half?

And then if I may squeeze a third question in here, what can you comment, Cristiano, regarding the company's plan B in case (00:33:57) decides to - or to ask Suzano and Fibria in their combination to cancel the Fibria and Klabin contract? Is the company prepared - what do you see as options for the company to sell its pulp outside Latin America? Thank you.

A - Operator

Thank you, Carlos, for your question. So let's start by talking about growth in packaging paper. And in fact, in the first half of this year, we gave preference to margins and this meant slightly reducing our offer of papers at home to our conversion areas. This does not mean that we are going to disregard the contract. Quite the opposite, we keep the major brands and we keep very high TC (00:35:15) that is to see a very high level of service and never leaving aside our major brands and our major contracts with any risk of supply. And we obtained this market. We conquered this market and we will continue to keep it and we will continue to grow the market for packaging paper in Brazil.

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But it is true that at least in this quarter when international prices are very high, we change a little bit the very well-known flexibility that we have. And we slightly change our traditional dynamic because we start to buy more recycled paper in the market and Klabin was a major buyer of recycled paper in - (00:36:09) virgin fiber paper for our conversions, giving preference to the sales that give us better margins. But it's really a very small variation. It never disrespects our contracts. It never goes against those contracts and we (00:36:27) in spot transactions.

Regarding our cash cost, now talking about Klabin, I would like to ask Gustavo to help me in order to keep the dynamic of our presentation and then I will come back about the contract with our pulp client.

A - Gustavo Henrique Santos de Sousa {BIO 20558478 <GO>}

Carlos, thank you for the question. I will repeat your question because it was not very clear, so that I can answer adequately. But I believe you mentioned the total cash cost of the company that had a 6% increase, and as Francisco said, specifically in relation to the pulp cash cost, we closed the second quarter with BRL 743 per ton.

If we were to take June, which was free from the strike effect, it would be BRL 631 per ton and as Francisco said, the trend is to maintain this level and the possibility is to have some improvements over the next periods. And for the remainder of February, we had a relative stability of cost which is something that tends to happen with one important point we have to keep in mind that one of the things that our truckers' strike brought about was the reduction of the Reintegra tax rate. It was 2% and it became 0.1%, and this already has some effect as of the second half of this year. So this is any - an item that impacts one cost line that we will see in the next quarters. And also we have the intention of keep cost at this level.

Another important point that should be mentioned is that historically Klabin schedules the stoppages for the first half. So in the third quarter and the fourth quarter, we will not have cost impact related to maintenance stoppages Carlos.

Now I come back to talk about the contract. Klabin today differently (00:38:38) from when we started the Puma operation, Klabin today has a commercial area that is very robust. Once we had to establish sales of fluff and softwood in international market and hardwood for Latin America, Brazil included. So the commercial area is ready, it is prepared and it is a rather straightforward decision and it's based on opportunity, and this is what we are turning our eyes to. We look at the advantages and the disadvantages of contracts and what are the pros and cons of going to a market where we already have an operation, always, always taking into account the best possible margins for Klabin.

So, what I can say is that we are currently evaluating and - in order to be able to make a decision. And we are very comfortable with the structure put in place should we decide to go ahead without the contract. But we would also be very happy with - to continue with the contract such as we have until today. So what we have to check is what is best for Klabin. And we are right in the middle of this evaluation now.

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

Thank you very much. If I may just, Gustavo, let me just mention what I understood regarding what you said on the total unit cash cost for the company. So, it was BRL 1,895 per ton in the second quarter. It increased 6% on an annual basis. And what you mentioned if I understood correctly is that the company expects these unit cash costs to remain relatively stable in the second half of the year. Is this correct?

A - Gustavo Henrique Santos de Sousa {BIO 20558478 <GO>}

It is correct.

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

All right. Thank you very much, everyone.

Operator

(41:04), Credit Suisse.

Good morning, everyone. Thank you for the opportunity. My question has to do with the sales mix. For paper vis-à-vis the domestic and the foreign market, there was an increase in the participation of the domestic market, so I would like to know about the profitability at the current prices, exports vis-à-vis domestic sales and what kind of change could we expect for the future?

And what about the mix in the production of fluff in your total production? And what about the price dynamics for fluff from now on?

Thank you, Gener (00:41:57). I would like to give the floor first to Flavio, then to Francisco Razzolini.

A - Flavio Deganutti

Hello, Gener (00:42:03), thank you for the question. There is an important thing about the results in June specifically because we chose to use passive logistics, because we were still affected by the strike in May. And once again compared with the 2017 base, the base was lower and it brought a lot of growth for the domestic markets in this quarter.

However, profitability is very similar for both. A small disadvantage for the domestic markets and we will be trying to fine tune this over the next quarter or half year.

A - Francisco César Razzolini {BIO 16565930 <GO>}

Gener (00:42:50), good morning, this is Francisco. About our fluff, as you know, the acceptance of our fluff was very good and is very good. We work with our fluff portfolio totally for and we are totally sold for the year in the mix that proposed (00:43:10) our self in terms of softwood/fluff for the markets where we are positioning ourselves.

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The price dynamics for softwood, while the growth was extraordinary, and fluff, even because of demand and the pipeline of products in 2015 and 2016 was a little bit different than what we see now, is a realignment of prices. Fluff bouncing back to the levels that we believe it should be. And right now, we are renegotiating the volumes and prices for the next year.

And in our outlook, we see the possibility of implementing prices for the near future as well. So, we are very bullish regarding our fluff agenda for the next few months. Thank you.

Operator

Marcos Assumpção, Itaú BBA.

Q - Marcos Assumpção

Good morning and congratulations for the result. Kraftliner first, we saw that the price went up over 70% in dollar in the last year in the international market and at the same time Klabin increased sales in the domestic market. Maybe you could say a few words about the price dynamic in the domestic market and also the difference in profitability between the Kraftliner sales in the domestic market and for exports?

And the second question has to do with the pulp cash cost. Could you give us some more color about the difference of the cash cost that you had in June BRL 650 per ton. How much the hardwood should be lower and how much the softwood to be higher than that?

A - Operator

Thank you, Marcos, for the questions. This is very much aligned with the previous question. We had a special move in June for the domestic market because of the strike in May. So, this was the fastest way that we had. So, we had a good volume in the domestic market in June and we closed the quarter the way you saw, you have the figures.

Profitability today is very similar, a little bit less in the domestic market. So, we do sell mainly Kraftliner volumes in the external market and if - and the external market price continues to be - if it continues to be stable or higher, and if the exchange rates continue the same in the long run, respecting everything we have in terms of our commitments in the domestic market, we will buy more recycled in order to supply our plants and sometimes export as much as possible according to the contract that we still have in force.

Marcos, good morning. Regarding the cash cost, as we had already mentioned, we are very positive in terms of at least keeping the same levels. We see some upside potential domestically. But as you know, we are living a moment of very high energy prices - power prices in the spot market as a total power that we sell to the system, about 30% float, but it has already reached the peak. So maybe if we have more rainfall, then the result will be a little bit lower in energy production. But we believe that the cash cost will continue to be in line with what we performed in June.

Regarding the difference between hardwood and softwood, we have around \$50 difference - there is around a \$50 gap between one and the other.

Q - Marcos Assumpção

Thank you.

Operator

Marcio Farid, UBS.

Q - Marcio Farid {BIO 21017394 <GO>}

Thank you for the opportunity. I have one question to Luciano (00:47:51). You have recently been mentioning how Klabin can add revenue with services to clients. And what about your strategy in the last couple of years vis-à-vis your expectations and what potential gains could we expect coming from that in the next few years?

A - Operator

Thank you, Marcio. Well, Marcio, this is maybe one of the major themes started by Klabin. Klabin pays a lot of attention to value adding and also solutions or by means of solutions, be it from services or products that we have been working on very strongly. Working with lighter products for instance and maintaining the physical resilience of the papers and working very strongly with R&D in what we call bio-barriers, so that we may have a product that may replace fossil barriers and this will bring a lot of added value to Klabin papers or packaging papers besides improving the yield in our machines.

Now, in terms of services, we are also turning our eyes to the e-commerce area and how we can cater to this market in a dynamic fashion, in an agile fashion in this market that is a big challenge. We have been trying to put together our services to key accounts, engineering projects and the development of packaging bringing differentiated products and this market in the whole world is the very challenged by renewable packaging and this demand has already arrived at Klabin some years ago.

And we were already anticipating this and we are comfortable to say that we anticipated this trend of renewable packagings and paper. Packaging is maybe the major solution for renewable packaging, mainly for food.

And as we pay a lot of attention to all these movements and we've also received all these requests from our clients, we are developing products that in a future strategy for Klabin, we focus on these products or new products that may add value, be it developing other services or other products regarding - or the way I have just described. Thank you.

Milton Sullyvan, XP.

Q - Milton Sullyvan {BIO 19085202 <GO>}

FINAL

Good morning. Thank you for the question. I would like to go back to the pulp theme. As we're seeing this new view so to say with Puma remaining as a producer of pulp - of market pulp, could you talk about the commercial area of Puma? When you answered to Carlos' question, you said that you are analyzing the pros and cons of the contract. And you said that, from the viewpoint of the decision to be made by Klabin. So these are two different points. So maybe, I don't know whether you can mention some of the pros and cons regarding terminating the contract with Fibria. And could you tell us if the contract could be terminated just for the fact that the deal which Suzano has already been announced and not concluded. So this is my first question about Puma, okay?

A - Operator

Thank you, Milton. Well, you mentioned a "new view." And I think it's important to say it this way. This is a new view or a new vision. And I just want to mention this. It does not - Puma remaining for a longer time this way. What we can say officially to you now is that Puma will remain the way it is now. And Puma will not be integrated to papers in the 1.5-million-ton volume. So Puma is a unit that is turned to the market, is market oriented and this is the way we see it in the short and medium and the long run, that is to say market pulp.

Okay. So the second question about the commercial area and the contract. The commercial area as I said before is ready to go Klabin. You follow Klabin very closely and you know very well that Klabin operates in both markets, domestic and international, and it operates with sales to end users with a lot of experience as well in this kind of relationship. It sells to small packaging manufacturers and we compete with ourselves in many sectors and that compete with us in many sectors.

And with this commercial expertise, which is very complex, we were able brilliantly, I would say, we were able to get into the fluff market with a recently created commercial area reaching over 50% market share in Brazil and having fluff approved by all major brands internationally with no restriction whatsoever, and softwood as well and hardwood due to the strategy of this contract as a first time for this market outside Latin America.

The area was established for sales in Latin America and the clients that are the buyers of fluff and softwood are mostly the clients who also acquire hardwood fiber. So this is a very well-established channel. It's a very safe one. And this is not a challenge as far as we are concerned. I would like to remind you that the Klabin brand, and this was in our agreement and is mentioned in the contract with a major client of hardwood at the time, the brand - the Klabin brand was preserved and it was placed on all bales distributors all over the world. So, we are very comfortable regarding the recognition by the market of our products and also the commercial expertise of Klabin.

However, this does not decrease, and I'm just telling you about the relevance of the fact, we have the capacity of choosing the path that we want to follow, be it to stay directly in the market selling this product as Puma, as Puma remains forever as a market product, so we are not going to integrate Puma. We will have a new line for brown fiber (00:56:02) around 1 million tons and this new line will be integrated to the packaging paper line and Puma will remain with 1.5 million tons.

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Now, regarding the contract, the timing is the end of the closing. So, this means that we still have some months ahead of us. And we still have time to think about that and this is a decision to be made by Klabin alone as established in the contract and changing focus now.

Q - Milton Sullyvan {BIO 19085202 <GO>}

When you talk about corporate governance and royalties and the Novo Mercado (00:56:48), all the presentation that you are submitting to the board is it being done at the same time as the discussions about corporate governance or are they totally separate?

A - Operator

They are totally, totally independent. They are totally separate. One thing has nothing to do with the other. What I can assure you is that the controlling shareholders see even (00:57:24) the improvement of governance that we have carried out in the last few years, and knows that this is an ongoing exercise on the part of a controlled company. And the controlling shareholders see the improvement in corporate governance as something totally better for everybody.

And they talk about this very comfortably. And they direct Klabin to be a company better and better positioned in terms of governance. So, regarding corporate governance, you can be sure that Klabin today is better than it was in the past and Klabin in the future will be better than Klabin today, always improving governance. But they are totally different issues or separate issues. The ownership on the part of the controlling shareholder that is totally important right now and the entrepreneurship of the family of, dating back to 120 years, is extremely important, mainly now when we are discussing our growth and we must see this ownership as a major value for the company. And this does not exclude the improvement in governance which is another organic ongoing theme that we have.

Q - Milton Sullyvan {BIO 19085202 <GO>}

Thank you.

Operator

As there are no more questions, I would like to turn the floor over to Mr. Cristiano Teixeira for his closing remarks.

A - Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Thank you very much. We have reached the end of another call. And I would like to convey a very quick message to all of you and about our expectations as well. First, those who follow Klabin closely know how much we are tuned to the major trends in our sector. And mainly in packaging, it is very much linked to the megatrends of our consumers, and Klabin is totally tuned to that.

FINAL

Recently, we made important investments in R&D, because of that, and Klabin believes that the future, that is already being built, and that we already see how this future will look in our business. This will mean, above all, creating value for our shareholders in a sustainable fashion always.

And the whole context of the discussions that we have with the controlling shareholders is for this company creating value, be it because of the product or be it because of the service solutions, always maximizing returns to our shareholders.

And now, turning our attention to our expectations regarding the third quarter. What I can tell you is the following. If the current conditions are maintained, so you could expect a very strong quarter with a strong cash generation - strong cash flow further accelerating Klabin deleveraging, and bringing us to the levels that we mentioned so often and that I'm sure you're all expecting to see. So we expect a strong third quarter and lower leveraging.

Thank you very much and see you next time.

Operator

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

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