

## Q2 2017 Earnings Call

### Company Participants

- Cristiano Cardoso Teixeira, Chief Executive Officer
- Eduardo de Toledo, Chief Financial Officer & Investor Relations Officer
- Francisco César Razzolini, Executive Officer & Planning, Project & Industrial Technology Officer

### Other Participants

- Carlos F. De Alba, Analyst
- Ivano Westin, Analyst
- Lucas Ferreira, Analyst
- Milton Sullyvan, Analyst
- Paulo Guimaraes Valaci, 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 have a question-and-answer session, when further instructions for you to participate will be given. As a reminder, this conference is being recorded and also being broadcast live via webcast and may be accessed at <http://cast.comunique-se.com.br/Klabin/2Q17>, where the presentation is also available.

Before proceeding, we would like to clarify that forward-looking statements that might be made during this call in connection to Klabin's business outlook, projections, operating and financial targets, and potential growth should be understood as mere assumptions based on the company management's expectations in relation to the future of Klabin. Such assumptions are highly dependent on market conditions, on Brazil's overall economic performance, on the industry, and international markets, therefore they are subject to change.

With us today in São Paulo, we have Mr. Cristiano Teixeira, Mr. Eduardo de Toledo, and Mr. Francisco Razzolini. Initially, Mr. Teixeira and Mr. Toledo will comment on the company's performance during the second quarter of 2017. After that, they will be answering questions that you might wish to ask.

Now, I would like to turn the floor over to Mr. Teixeira.

## Cristiano Cardoso Teixeira {BIO 17567319 <GO>}

Okay. Thank you very much and thank for your presence in Klabin's call referring to the second quarter of 2017. This is my first call as CEO of Klabin, therefore a special moment for me. In Klabin, my first for me. In Klabin, my first big challenge was to guarantee with my direct people, the executive committee, as well as all the associates of Klabin, the sense of an impressive company, a very strong one, and in movement, and always seeking better and better results guaranteeing the continuity of the achievements of the last few years. And it is with great pleasure that I bring to you another quarter of consistent and important growth, keeping the broad base for the next few quarters as well.

Now I would like to talk about the highlights of our businesses. First, in pulp, in our very well-known Puma Project, where we delivered a strong performance, where cash cost and production levels in-line with the best expectations at the beginning of the Puma Project. And I would like to mention that the trend for the cash cost in the third quarter which is just starting is better than the one that we saw in the second quarter.

As to the market, I would like to say that in our hardwood fiber, we still have good expectations to maintain the prices for a longer period than we imagined. And this will also help us in the estimate for the results of the third quarter in relation to fluff. The demand for the product is maintained, and even more important than that, we are already ratified globally with the main players and we also reached the milestone of over 30 countries that have already received the softwood fluff of Klabin.

Now about the paper market, we have positive signs in all these markets. In coated boards, very much driven by the higher demand for LPB. Kraftliner international demand continues to be very strong, and this has been giving us good margins. And in sack kraft, also active international market, also giving us excellent margins.

Now, regarding conversions. We maintained growth of 8% in the second quarter vis-à-vis the second quarter last year, probably more than the market in corrugated boxes. We had an excellent pace of shipping of corrugated boxes, and as you know, very much supported by our key accounts.

In industrial bags, in spite of deterioration of the civil construction market in Brazil, Klabin has been maintaining the diversification strategy in this business area, extending sales to new markets preferably food in the domestic market, but also exports to some markets such as the U.S. All in all, with these two conversion businesses, we had 8% growth as I said before.

In terms of views (05:14), I would like to mention two. First, the important inauguration of our technology center, an investment of BRL 70 million, and what we believe is a milestone for Klabin, a milestone because it consolidates and strengthens the culture of research and science in Klabin. And with that, we are trying to strengthen all the technology initiatives of Klabin in one single site with dedicated researchers from the different routes of research such as forest productivity, fibers, products and processes for pulp, for papers, for packaging, environment, and utilities.

Now the second point that I would like to bring to you, and some of you have already read about it in Valor Econômico newspaper, what we were calling a new growth cycle, Klabin positions itself as one of the main contenders to investments in packaging paper in the world, be it by the quality of our products or due to the relationship that we have with our clients or due to the productivity or the yield of our forests, our logistics, our technology.

And I would like to strengthen the fact that we believe more and more in the strengthening of paper packaging for the future due to the unquestionable advantages because it is a recyclable material, but above all, due to the fact that it is biodegradable. And with that, our engineering areas and market intelligence, and the economic area are dedicated to studies about investments in the kraftliner and coated board markets. I always bring to you our view of investments in fluff, which is an excellent news, because it opens another path for growth for Klabin.

Ladies and gentlemen, this new growth cycle of Klabin has the same size of Puma, however with lower market risks, because we already operate and we are already benchmarking all these markets, including fluff. Beside the fact that Klabin today is twice the size of Klabin when the Puma Project was announced.

Well with that, I would like to give the floor to Eduardo de Toledo, our officer here and he is going to talk about the figures.

### **Eduardo de Toledo** {BIO 2067933 <GO>}

Cristiano, thank you very much. Good morning. It's a pleasure to be with you. Talking about the figures for the quarter, we obtained an EBITDA of BRL 595 million, 11% growth vis-à-vis the same period last year. And now the highlight, are the sales of pulp we reached (08:22) 337,000 tonnes in the quarter, an increase of 12% vis-à-vis the first quarter. So we are continuing our ramp up very successfully of the Puma Project and revenue from sales reached almost BRL 2 billion our net revenue, 17% growth vis-à-vis the second quarter of 2016 and finally, the conversion sales volume in boxes and bags 190,000 tonnes, 8% increase vis-à-vis the second quarter of 2016.

Now, going to the next slide, slide number 3 about our sales volume. We reached 777,000 tonnes this quarter and I would like to highlight that the division between domestic and external market is 50%, 50%, so it's a 50-50. And this differentiates Klabin from the other players in this sector because we have a higher degree of balance between domestic and external markets, and this generates further resilience in the results of the company. In terms of net revenue, this proportion changes to 60% domestic market and 40% foreign market, because in the domestic market we have conversion that has more added value.

On the next slide, we talk about the cash cost, an excellent evolution in this quarter. We were able to reach BRL 673 (sic) [BRL 663] per tonne, a reduction of BRL 70 per tonne vis-à-vis the first quarter of this year in the cash cost of Puma, is the cash cost that we have mentioned. In the first quarter of the Puma operation, we said that we would be reaching a reduction of 25% in that cash cost, and until the end of 2017 or by the end of 2017, and

in fact we were able to reach this target in the second quarter of 2017. And I think this is evidence of the success of Puma's ramp up that I was referring to.

And we also reached 363,000 tonnes of production in the quarter, a very significant volume taking into account the fact that this is a quarter in which we are exiting the first general stoppage of Puma that happened in the end of March and going a little bit towards still into April.

Now cash costs for the company as a whole. The cash cost had a reduction of 4% in the quarter, in line with our expectations, and show the evolution of the company and the constant search for cost reduction on our part.

On the next slide, we talk about the consistent performance of the company. We have already reached the 24th consecutive quarter of growth, and I think this is a real feat and from the viewpoint of our sales volume as Cristiano said, reaching 3.1 million tonnes in the last 12 months. I think these are very important milestones in this consistent growth of the company.

On the next slide, we talk about our net debt and our deleveraging. Net debt EBITDA ratio in the last 12 months was 4.9 times, the same level of the previous quarter, in spite of a higher final dollar exchange rate, and the net debt of Klabin is basically in dollars, denominated in dollars and of course the final dollar of each quarter has an impact on our net debt. In this ratio, you will see this kind of effect and in this quarter, more specifically, the final dollar was BRL 3.31 (12:48). So of course, you have this kind of impact. And this is the reason why it was maintained, and did not drop. But anyway, the downward trend is a very clear one and it will be even stronger in the next few quarters, due to the stronger evolution of the EBITDA that we will have as of the next quarter.

On the next slide, we talk about dividends. Klabin has a consistent policy of dividend payout linked to the EBITDA of the company on a quarterly basis, and of course, with the evolution of the EBITDA that we have been delivering, dividends have also been evolving in such a way that our dividend yield has already reached 3.2% and it should continue on the stat (13:41) with the evolution of the company's EBITDA.

So these were my first remarks, and now we would like to open for questions, to answer any questions that you might have.

## Q&A

### Operator

Ladies and gentlemen, we will start now the Q&A session. The first question comes from Karel Luketic (14:10) from (14:11).

Good morning. Thank you for the questions. I have two questions. The first one has to do with Puma and the Puma cost. Can you give us a guidance regarding this cost, how much it

could go down in the second half and the growth strategy?

Cristiano, when do you believe your strategy will be defined in this regard and do you have an idea of what would be the priority of your next project including kraftliner and fluff, so that we may imagine the potential for growth and the timing for that?

### **A - Eduardo de Toledo** {BIO 2067933 <GO>}

Thank you very much, Karel (14:57). I will answer the first one and Cristiano will answer the second one about the strategy. The first part regarding cash cost, we must remember that in this quarter, as I said before this quarter - the second quarter, similar quarter in which we still suffer the effect of the first general stoppage which is a major one during which you make many adjustments in this first year of operation of Puma.

So, in fact we still expect an evolution in the cash cost. However, this will be smaller than the one that we saw between the first quarter and the second one, but they will still be important. So we will see progress in this area and I imagine that the level that we will be reaching, will be in the third and the fourth quarter, and after that it will stabilize but there's still room to reduce this cost in the third quarter.

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

Thank you for the question, and I will answer your question about growth. I would like to help you and all the others. Making a remark that has nothing to do with the last five or six years, it was - it's a longstanding thing and we inherited it, had we knew that (16:22), they would have to give a very important step forward in the greenfield project, Puma which was mandatory for the utilization of the forest, and the growth that we see now. Well, in the past Klabin, already wanted to make the current site that our significant sites already. And they are champions of cash cost in the segment, both in kraft and in coated board.

And we already knew that these sites could be further improved by new technologies and new investments. And the same team, that made Puma we'd be confident (17:16) that they do that, the same team is dedicated to these Klabin sites in order to further improve them, to dilute fixed (17:29) cost and put more capacity in these sites and gain in the quality of the papers.

And bringing more capacity to these sites, and this means that we will be improving these sites a lot, through this new cycle. And that our brownfield investments and we are very much dedicated to these brownfield investments and they are very much focused on kraft and coated board. And we cannot really tell you what is the timing for that, the timeframe, and whether one will start in a certain quarter or one year or the other one in another year or another quarter or maybe together. So this is not possible. Our IT officer has already - everybody contracted, all the engineering contracted and by the end of the year, we will be able to answer your question. And besides we have our market team observing everything regarding the price and demand of these products to understand the timing for these investments. So there is a priority between these two investments and it is important to tell you that by the end of this year and beginning of next year, we will have a

lot of information in our hands to bring to you, to share with you and then, everything will be brought to our board to discuss that.

So, about fluff. Now, fluff, does not have this historical view that I mentioned that existed for kraft and coated board in the past, but fluff is a good news and a great news for all of us. The productivity of our time (19:27) and the dedicated machine for fluff allowed us to produce a fluff that is now present in over 30 countries, and practically all the other players in the sector and we were able to place our fluff directly in the higher end of this product. And so we are extremely pleased that we are very comfortable knowing that this is a great path for growth for Klabin.

## Q - Operator

Great. Thank you very much

Thiago Lofiego, Bradesco BBI.

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

Good morning. I have two questions Cristiano. One regarding the coated board project and what is the dynamics of the market that you imagine for the machine? Has anything changed because you talked about focusing more on exports and also the U.S market?

Yeah. There was a strange noise but it's okay. You said you would focus more on the U.S. market and I would like to know if anything has changed in your mindset regarding the machine, do you intend to focus more on the domestic market and still talking about projects, yeah, I know that everybody asked that. But I would like to know the rationale for the three projects that are potentially relevant and how do you believe the balance for that (21:08). And regarding the domestic market, could you talk about the performance of the third quarter, how do you see the performance of the products that are more focused on the domestic market so far?

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

Thank you, Thiago. Thiago, I will talk about the coated board and the domestic market and then I will turn the floor over to Eduardo Toledo and he will talk about the debt okay?

So, it's about the coated board machine. This is a machine dedicated to the external market, the foreign market, the exports. And there'll be probably - it will have white product and today, our product is there is one side white and one side brown. So, we will have the two sides in white and so part of that will come to the domestic market, but it's the smaller part, because most of that is really for export. And the configuration of the machine continues (22:22) very much linked to our big partner in this area of liquid packaging board. And they are going to say when this will happen, when the demand - the world (22:38) demand for this product and when (22:40) the market demand, we will be prepared to deliver the product. And this refers basically to one-third of the machine, and the other third of the machine continues to be dedicated to the demand for coated board for consumption. Our supply is not enough to cater to the whole demand that we have, be it for carrier or the other consumer items for folding boxes.

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So, we intend to cater to the demand that we are not able to cater to today not only in Brazil, but for exports as well. And then a very important part, which is food service, more and more we believe in this segment. And I'd like to make my examples more material so to say and I think you recognized that ice cream for instance is going towards paper more and more in the world and in Brazil as well. So, this is the trend in Brazil and in other countries it's almost completely coated board. So we believe in the food service sector and the machine. We'll have these three main lines of product, liquid packaging board, folding, and food service that includes the cap stock (24:22).

Now to talk about the domestic market, well, let me say a few words about the domestic market and then I will give the floor to Eduardo. In the domestic market, we do not want to be, like strangers in this area because our capacity is practically full already and in conversion, this is exactly same case. I can tell you that starting by the corrugated boxes, we have a very important brand and we are in the main global brands in Brazil and we are present in all of them with our corrugated boxes. So the growth of these brands, strong brands is translated into stability of consumption and we are very pleased with the corrugated box volumes in Brazil.

It is true that the Corrugated Box Association of Brazil (sic) [Brazilian Corrugated Board Association], if you only look at that, the ABPO, keep the pace of growth vis-à-vis last year. I don't remember now but I believe that the estimate for the end of the year is close to 3% of the Corrugated Box Association (sic) [Brazilian Corrugated Board Association]. So the association itself has growth vis-à-vis last year and Klabin has a substantial growth higher than that, and a little bit because of the acquisitions made.

And now talking about the domestic market and sacks or bags, we're very proud to say that when our packaging is compared to any other, we have a sustainable environmental basis which is really unbeatable. And when we talk about flower and wheat and seeds, and animal feed, we can have a very good rationale for all of that. So, no problem of volume because we diversified a little bit, leaving a little bit civil construction and going towards these markets, and our volumes also in the domestic market for industrial bags, due to the diversification is very strong.

And finalizing the two things together, are delivering 8%, and what do we expect for the end of this year for corrugated boxes? The pace of growth that ABPO has and our pace will be maintained in our view higher than the ABPO itself. And in the industrial bags, we lost a certain adherence (27:14) to civil construction with the new developments in the market. But nevertheless, we are very comfortable knowing that by the end of the year, we will be delivering the same growth that we have already shown you, which is a good problem because when civil construction goes back, recovers, of course, the margins for industrial bags for cement, will have to play the margins that I am obtaining in other markets.

Now, I would like to give the floor to Eduardo.

**A - Eduardo de Toledo** {BIO 2067933 <GO>}

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Thank you, Cristiano. Thiago, thank you for the question. In relation for the balance sheet of the company and indebtedness, I have been talking about this with many analysts and investors. And our view is that, one can only really understand the company's indebtedness post Puma, when we have 12 months of Puma operating close to the rated capacity, the nominal capacity and this will only happen around the middle of next year, the first quarter or the second quarter of 2018. And this is when we will have 12 months of Puma operation, and it will be then that we will be able to have a more clear view. And our view about the theme (28:45) is that this clear view will be a level of indebtedness that will allow us to make these new investments, because once the decision is made to make the investments, the disbursements are made one year afterwards or 18 months afterwards, after the decision is made.

So, there is no immediate impact on the company's cash. So, we understand that you can deal with that over time, that is to say the balance sheet of the company. And what Cristiano said, we believe that possibly all these projects will have a certain order over time, so this will be diluted over time. However, if we reach a conclusion that this is so important that we want to rush with the three projects, of course, we will have to study other mechanisms to fund these investments, but as Klabin has already done in the past with Puma. And should the situation repeat itself, I am pretty sure that we will be able to get the right funding for this new cycle of investment.

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

Very clear. Thank you, Eduardo.

#### **Operator**

Carlos De Alba in English.

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

Yes. Good morning, everyone. Thank you for the opportunity. I just wanted to maybe, Cristiano, if you could comment a little bit more on the fluff project, and I understand this is probably the latest project that the company would be with investing on. But in future and probably focused in the export market, do you have already an idea of what regions, geographical regions, of private customer (30:47) (30:49)? And just to give us a better idea for us to understand, what is behind the rationale of this project? And then finally, if you could comment on any potential price increase in your domestic market for the different products. Thank you very much.

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

Thank you, Carlos. The rationale for the fluff machine, I'm going to separate things, because we work in a certain order. So let me start by saying that, the first - but it doesn't go faster than the others. But the first point that we like to stress is the fact that the fiber or our forest, our (31:49) and the productivity of our pine (31:51) and the quality with which we have transformed it with the technology that we obtained that was a state-of-the-art technology for conversion into fluff, make us be (32:06) very certain that our fluff has global acceptance. So this is the first point. And for me it's the most important and this is where we started. We have the fiber and our fiber - for our fiber, we obtained a



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technology to deliver a product that is accepted globally and not only that, but that got directly into the high-end of this product. So, this is the first point of our rationale and the second one is the future.

You will see that all investments made by Klabin have a very consistent view of the future, and I could talk about the future of other products as well. But if we take fluff as the example because I mentioned it and you have access and this is public information. The way the market grows for diapers, for adult diapers in the world, in the first world, not to mention the growth of diapers for babies and female pads in other countries as well. So, of the two, the future of consumption are female pads, hygienic pads, and baby diapers in the first world countries, so to say and added to that we see a growth in elderly people in both, that is to say in the first world and peripheral countries. We are very sure about the possibilities for this product for the future. So the rational is the following, we are champions, I'm sorry to say this, but we are very competitive in cash costs. We are champions and we are very good in fiber, very competitive in cost and we are recognized by our clients as having the necessary quality to really be players in this market globally. So this is about fluff.

The second question, I think it was about price in the domestic market was it?

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

Right, that's correct.

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

Okay. Going to the more sensitive one and I don't really like to measure my words but the most difficult one to place prices is the corrugated box segment because although we are leaders in this sector in Brazil, we have 18% or 19% of the market share and the second has half of what we have, the second ranking. But in spite of being the leaders this is a very scattered market from the fourth and the fifth player on, and the size of the market is about 1% for each player or less. So you can see that it is very scattered and in spite of that, we are rather sure that the level of service that we deliver to accounts in Brazil, with this level of service we can ensure the transfer of the inflation cost in this market. But it's a tough market because of all the competition and mainly because the corrugated box sector still has a low occupancy, compared to 2013 and the level in 2013. And in a bullish view, we believe that we will go back to this level in 2019-2020 then the prices will be better.

In the bags area, the alternative is exports of sack kraft. And today we are very sure of the margins obtained with sack kraft. So the domestic market will have to pay for the cost of opportunity and its pain (36:19), so without being able to transfer the necessary adjustments.

**Operator**

Ivano Westin, Credit Suisse.

Bloomberg Transcript

## Q - Ivano Westin {BIO 17552393 <GO>}

Good morning, Cristiano and Eduardo, Francisco, thank you for the questions. First I would like to ask a question about Puma, the explanation about the cash cost is very clear. Now with relation to volumes, you're already running at 100% capacity after the stoppage and what could we expect in terms of volume for the second half of the year? And there is an internal discussion about a possible investment to increase capacity, an additional 10%. Are you going to make this investment and how much would be the risk stated amount for this investment?

And the second about kraftliner, the global market is very positive. We see prices increasing 15% in the second quarter vis-à-vis the first. So, what do you expect in terms of your sales with this breakdown between domestic and external market in prices?

## A - Operator

Ivano, thank you for the question. I'm not having a lot of discipline here. I'm going to start by the second question and then I will give the floor over to Francisco and he will talk about the volumes and therefore, pulp.

Talking about kraft, what is the dynamic of kraft, I think you know this very well, it's simpler than you can imagine. So, let's just cooperate. International market okay, international prices for kraft have significant points in terms of consumption, in periods of the year per harvest because kraft is very much in demand, mainly for protein (38:31) and food stuff, but a very strong relation, a major one in terms of the American supply of kraft.

When the U.S. offers a higher volume of kraft, there is an impact on prices, unless the global demand is very strong. But the fact is that the U.S. and you see this together with us. The U.S. (39:01) since the second half of last year and continuing this year has been delivering or shipping more corrugated boxes vis-à-vis the previous periods and this has been consuming more kraftliner in the U.S. (39:18) and thereby, avoiding a surplus in the supply of this product in the world. And this product mainly the 100% virgin fiber kraft at Klabin and the Americans are the most important in this sector. This product is very elastic in terms of pricing, because the supply, well (39:45) the demand is very big as well, but very much in line so to say. Supply and demand are very close, they're a big match. If you see supply going down for instance, the price reacts very quickly as you were able to see in the last couple of months. So, this is a little bit of the price dynamics that we expect for kraft, and we have - and the case of the U.S. is very specific as I said.

Now, Francisco will answer your question about the pulp volume.

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

Good morning, everybody. Puma has been having a very good performance according to what we expected. Maximum capacity was achieved in the period and having reached the maximum production, we can identify where the bottlenecks are in the plant mainly. And we have been working on some engineering in order to solve these bottlenecks and potentially getting an additional capacity gain. So, we have not gotten there yet, we are still working with this engineering in product and (41:02) parallel with the studies that were

mentioned by Cristiano and Eduardo. But we believe that around 10% is feasible. And in these cases of debottlenecking, they are modular investments and this makes it very attractive. Potentially, this should be done during the next year. And in 2019 you should be seeing the result.

**Q - Ivano Westin** {BIO 17552393 <GO>}

And how much would that investment be?

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

We do not have the figure yet because we are working at maximum capacity and we have already identified the potential bottlenecks and we are still working with engineering and with our suppliers, trying to work out a budget for this debottlenecking and see what is feasible. So together with the other project, we should have this prepared to be discussed in terms of budget for the next year. And probably by the end of the year, we will know the size of the investment and Puma as well.

**Q - Ivano Westin** {BIO 17552393 <GO>}

Thank you very much, Francisco and Cristiano.

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

Lucas Ferreira from JPMorgan. Good morning, everyone. My first question is a follow-up on the questions about expansion and Puma and fluff and kraftliner. How much wood do you have available to support all these expansions? If you could debottleneck one and make one coated board machine, how much fiber do you have available to support this growth and maybe you would have to increase your planting or do you have third-party wood available? And could you talk about softwood as well? Do you have enough softwood for your fluff production? And now international prices, how much OCC has gone up and kraft has gone up in all the regions, China, U.S., Europe, and export prices seems to be going up as well. And we see you focusing a little bit more on focus and exporting less kraft in order to convert for the domestic market. So, should you be doing the opposite movement now, taking advantage of the positive right scenario in other regions of the world?

**A - Operator**

Thank you, Lucas. Okay. Let's talk about the wood or the fiber that we have available. The first positive point that I would like to stress to you is productivity or yield. Klabin here, every single year we improve the yield of our forest consistently, and we are very satisfied and pleased to say that our technology center that put these fronts together in research and science will be continuing this. So the first point is forest yield.

The second point is - well, it is a fact that we might need some additional area. And this is not something - this is not a point of concern to us because we are rather conservative in this regard. We are practically self-sufficient in Paraná and very close to self-sufficiency in Santa Catarina as well. But we already have a very reasonable situation in terms of

negotiation, and we know where we can grow in terms of availability of wood in the future. And I can guarantee to you that this is not an issue, this is not a point of concern.

Now, talking about the wood market and the increases of prices in OCC, and if the time has come for us to export more. Okay, I'm going to give you a more structural answer the way we see it, and then I will talk about the market on the more structural part of your question. We have been seeing this for quite some time but there has been a major growth in the last few years in the supply of recycled paper all over the world.

Europe has done this quite a lot and the U.S. started to increase this as well, not to mention Asia or maybe China. And this increase in the production of recycled paper in the world, of course, brought a lot of pressure on the demand for OCC. And this is not something happening in one country or one continent. This is global.

And we are very comfortable saying that the marginal supply of OCC anywhere has a much higher price than historically have been the prices of OCC because of - I don't remember the exact figure, I can look for it and give it to you afterwards, but the paper, OCC, together with aluminum are some of the most recycled materials in the world. So the rate of recycling is very high, and in spite of that, really the marginal price of OCC is becoming higher and higher. Kraftliner exists in this world of container board where kraftliner is smaller start of this market because the major volume of this market is recycled paper, and the price and market dynamics is something very close, a little bit independent but very close.

So what we see on the more structural part, what we see for the future is an ongoing pressure on OCC prices, and the cash cost of recycled paper manufacturers will have a high cost. And it seems to me that we're very hopeful about technology always.

But I would say that technology to convert OCC into a high-quality paper that has been improving every year and the size of the fiber for recycling is reaching a level in which you've to put a lot of chemicals in the cash cost because of this need for chemicals or due to the price of OCC itself. I would say that the market of recycled paper that has a very complex dynamics in the world, in spite that, there is an outward trend in the cash cost, and the kraftliner ride this wave, so to say, because once the recycled paper - it has different characteristic from the virgin fiber paper. The virgin fiber paper is the only one that can get in contact with food and other requirements that you cannot replace it, that is to say. And as I've said in one of the answers that I gave to a previous question, the supply is very balanced with demand. So what we see is that the pressure for the future in terms of prices for kraftliners as well as recycled paper due to this big demand for OCC will continue, and we are rather bullish about kraftliner and prices for the future.

Of course, this is a commodity product and it suffers cycles, but we are bullish about the prices for this product in the future. Thank you.

## **Q - Paulo Guimaraes Valaci {BIO 18268142 <GO>}**

Paulo Valaci from Citi. Good morning, Cristiano, Eduardo. Thank you for the questions. I have two questions. The first one is about the new cycle of growth. Do you have an

internal target about the return for each project in terms of internal rate of return? And is the return more attractive in kraft or industrial or what? And still talking about OCC, do you believe that the migration of retail to e-commerce could limit OCC because the original packaging is discarded at the homes? So do you think it will also contribute to an increase in OCC prices?

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

Eduardo is going to answer your first question, and then I will come back.

**A - Eduardo de Toledo {BIO 2067933 <GO>}**

Good morning, Paulo. In relation to returns, we use the parameters that we used when we approved Puma. Basically we work with 12%, 13% IRR or we return (51:18) for the project as a whole, a return on equity higher than that. And from the viewpoint of products, which one is more attractive? This is the point that we will be working on during the next few months. And as Cristiano said, all of them, the three projects, the three pillars that Cristiano announced, all of them undergo changes, that is to say they have brownfields, so the plants have to be adapted so engineering in each one of the plants and even in the choice of where or which plant is going to receive this investment, all this has impact on the CapEx. And only when our CapEx is clear will we be able to have a clear idea about returns. So we will only be able to say this like in the first half of next year, as Cristiano said.

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

Paulo, taking about the OCC dynamics with the new reality of e-commerce and the fact that the OCCs are going more to homes than - well, this is not something new, okay, but it is still difficult to evaluate. I'm going to tell you our view. We talk about that in the executive committee here among us. We were not sure and we have been reading some text some experts say that the OCC that goes to homes loses contact with recycling.

And I confess that I'm not quite sure about that. As I said before, OCC with aluminum, they are items that have a high level of recycling, even the ones that are disposed by homes. So there might be some limitation in the supply because of that because they are not returning. However, I believe recycling is a reality not only in the first-world countries, but again in peripheral countries as well because it ends up being an important point even for employment. And there is a big question mark here still.

We know that e-commerce is growing very fast in the world. This is a new reality in terms of services, et cetera, and there is a little bit of waste of boxes because when you get into the website, you buy about one, two, three, four different items of totally different sizes and you have to standardize the size of the box, and most of the time the corrugated boxes have to have enough space for you to put the product inside and fill the rest of the box with something else.

So, what we see is an exaggeration in the e-commerce packaging. However, we are, together with so many people in e-commerce, we have a group inside Klabin that is dedicated to that about how to cater to this market in a better manner because they

need high volumes of one single unit and e-commerce requires many units with little volume. So, this is an important dilemma that we are discussing on an ongoing basis and we look for solutions and we have excellent ideas in order to balance this a little bit.

But I would like to reiterate that e-commerce is a major opportunity and it brings a lot of pressure on demand for corrugated boxes in the world, mainly Europe and the U.S., but China has two-digit growth in e-commerce as well. So this has been helping demand for corrugated boxes and bringing pressure, of course.

**Q - Paulo Guimaraes Valaci** {BIO 18268142 <GO>}

Very clear, Cristiano. Thank you.

## Operator

Renato Maruichi from Santander.

**Q - Renato Maruichi** {BIO 17847481 <GO>}

Good morning, everybody. I have two questions. The first one has to be with kraftliner. What about the margin of kraftliner compared to the conversion market and the domestic market currently? And the second one about CapEx? A follow-up question on a previous one. I understand that the forest CapEx would be under pressure because of the Puma start-up. And I would like to know if this level could be reduced in the major run (56:39), of course, not mentioning future targets for growth.

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

Thank you, Renato. Let me recap here. I'm going to repeat your question because I don't know whether I understood it or not. You're talking about the opportunity to export kraftliner vis-à-vis the domestic markets and conversion? Okay. Perfect. I think somebody asked this question, and maybe I did not answer it, I apologize for that, but the fact is that prices improved gradually for kraft with a good performance in the last 12 months, and because of that, basically now, and I say now, because mid-June we started with this attitude of focusing more on exports. So until the middle of the second quarter we saw advantages in terms of converting vis-à-vis exports. And as of June or as of July or mid-June, we started to see this opportunity of better margins in exports, and you will be seeing this in the next few quarter, that is to say a higher volume dedicated to export. And now I will give the floor to Eduardo, who will talk about the CapEx.

**A - Eduardo de Toledo** {BIO 2067933 <GO>}

The forest CapEx, this new level is a level that is here to stay. Of course, due to the volume that we have, we almost doubled the size of the company in terms of total production. And, of course, our forest investment has to follow because we increased a lot the harvesting of forest so we have to replant more. So this level of CapEx is more permanent from the forestry viewpoint. And what is exceptional this year and that will not repeat itself is the completion of Puma. And as Francisco said on the other hand, now we will be beginning at the beginning of next year investments, and the order of magnitude

should be similar. So this level of CapEx that you saw this year of Klabin should remain stable for the next few years. Thank you very much.

**Q - Renato Maruichi** {BIO 17847481 <GO>}

What is the margin of kraftliner for export?

**A - Operator**

We do not disclose this information. We only say whether it is better or worse than another market, that's all we can say about it.

Milton Sullyvan, XP.

**Q - Milton Sullyvan** {BIO 19085202 <GO>}

Good morning, everyone. Thank you for the questions. My first question to Cristiano about the benchmarking metrics. As CEO of the company but already having a lot of experience in the company when you have one single asset in the best cost, it is difficult to challenge your team regarding operating targets. So in order to establish your benchmarks, what do you do, how do you do that, and what is your view about the current situation in terms of efficiency of Klabin? And what is your view regarding where you could get to in terms of efficiency, okay?

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

Thank you, Milton. The first point is a following. How do we see ourselves today? We have a supply and a quality of fiber and forest yield that we're very proud of, and we like very much to talk about that with you, and we see the possibility of the further improvements even with the current situation. Klabin is one of the most important benchmarks in forest production, not only in pines and also in eucalyptus. And the second point is that we are 100% sure that in pine and eucalyptus that we have the best technology. Puma brought to us and to the controller shareholders the certainty that the technology associated to this quality of fiber can deliver quite a lot more to Klabin.

So we challenge ourselves all the time in terms of technology. We know that it is the association of modern machines for the production of both paper and pulp, and plus the fiber that we have. The association of all that lead us to this possibility of further improving our productivity. So it has a lot to do with the way we seek efficiencies by means of technology.

And there is one point that has been a big challenge, and our technology area together the investment that we have been making in research and development are the barriers because we are sure that paper is the packaging of the moment and will be the packaging of the future, and also the paper with those barriers made by pulp. So we're very sure about that, we are very motivated and we are challenging ourselves in technology because fiber, we know very well what we have.

**Q - Milton Sullyvan** {BIO 19085202 <GO>}

Perfect. Second question, more regarding the market, pricing in the domestic market, the prices in Brazil for fluff. And could you divide this into two different aspects? The possibility of selling at a premium because we know that most of the products is imported. So can you sell this product at a premium as we are already at the high end of consumers to have territory with the imported product? And regarding the quality of the product, we saw that the quality of the product generates gains for the client, and can this be transferred to the price so that you could be more competitive yourselves?

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

Well, Francisco and I will be answering together, okay? The first part you talked about the premium in the domestic prices. Let's talk about the market dynamics. We have always raised a flag saying that we would have 400,000 tonnes of fluff which is already bigger than the domestic market. And all the equipment of Klabin has a focus on exports as well. And they are totally available to cater to the domestic market as much as we can and as we are very proud of talking about the key account of big clients that we have in the box market. The competitors that are selling to these key accounts in the world, so part of these accounts are linked to these global contracts and, of course, we are not going to fight for price, that is to say giving discounts in order to get to this market. But what I can tell you is that we already have 50% of the fluff market in Brazil, and we are very pleased with this market share. And the difference, that is to say the other half of the fluff market, we are exporting to certain countries with very reasonable margin, so we're very comfortable with that and we are very consistent in our strategy. And Francisco is here and he will talk about the quality, okay?

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

Just to reinforce the delivery to domestic market, most of these clients, fluff clients, they are already our clients with packaging, so our level of service is very intense for these clients in the domestic market, and top quality, better than the service that they had from imported products. So they know that it's difficult to keep the levels of imports because of the jurisdiction, the exchange rate variations in Brazil, all this makes it difficult.

About quality, the fluff line was the first one in the world exclusively designed for fluff. We worked a lot in the development of the fiber for that, and the wood that we have here is basically the same species that is used by the main fluff producers in the world. And quality is equal to or even better. And when we designed the machine, we wanted to produce a pulp that could really meet the more demanding clients, and we were able to get at a top quality very quickly. So now we play - with our peers, we're the best in the world, and in terms of Brazil, we gave a better quality of service than the ones that also sell in the Brazilian market today.

**Q - Milton Sullyvan** {BIO 19085202 <GO>}

Thank you.

**Operator**

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



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

I would like to leave with you a view that we will have accelerated growth, significant growth in the third quarter of 2017 vis-à-vis the third quarter of 2016. And the capacity will be full in all machines and the positive effect will appear substantially in our cash cost. So I thank you, all, very much, and I hope to be with you in the next call as well. Thank you very much.

## Operator

Klabin SA conference call is closed. We thank you for participating and wish you all a very good day. Thank you.

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