Q1 2020 Earnings Call

Company Participants

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

Other Participants

- Carlos De Alba
- Daniel Sasson
- George Staphos
- Marcio Farid
- Thiago Lofiego

Presentation

Operator

Ladies and gentlemen, thank you for holding, and welcome to Suzano's Conference Call to discuss the Results for the First Quarter of 2020. We would like to inform that all participants will be in a listen-only mode during the presentation of Mr.Walter Schalka, Chief Executive Officer; Marcelo Bacci, Chief Financial and Investor Relations and Executive Officer; Carlos Anibal, Pulp Commercial Executive Officer; Aires Galhardo, Pulp Operation's Officer; and Leonardo Grimaldi, Paper Executive Officer. After the company's remarks are completed, there will be a question-and-answer session when further instructions will be given. (Operator Instructions)

Before proceeding, please be aware that any forward-looking statements are based on the beliefs and assumptions of Suzano's management and that information is currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. We should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Suzano, and could cause results to differ materially from those expressed in such forward-looking statements.

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

Walter Schalka {BIO 2099929 <GO>}

Good morning to everyone. And welcome to the participation on the first quarter results of Suzano 2020. I would like to mention to you that all of us will be ready for a Q&A session after the presentation of the company.

Let me start telling you about the three major pillars that -- and bring it to your attention the three major pillars that we have in our culture. The first part of our culture is related with people that inspire and transform, the second is create and sharing value among all the stakeholders and the third one is related with the -- it's only good for us if it's good for the world. This is the major pillars that we are working right now to go through this pandemic that we are living at this point of time. And the consequence of that is related with our resilience. It's very important to mention to you that we enhanced our competitiveness during this period. We have 15,000 people engaged on the process of transforming, of inspiring, of helping and supporting and mitigating the effect to all the stakeholders and affecting the world on a positive manner.

On the business resilience and the robust balance sheet that we have right now, we are operating with higher pulp volumes on the first quarter of this year. It is a record pulp volumes that we had with roughly 2.9 million tons of pulp and 240,000 tons of paper. On this scenario, we were able to deliver in this quarter when an EBITDA of BRL3 billion on the quarter. And mainly to reduce our inventory, and Carlos is going to tackle on this point, on roughly 500,000 tons bringing our inventory to normalized level.

We had operating cash generation of BRL2.3 billion on this quarter, and this is the most important KPI that we are tracking because it's showing that we are keeping generating cash even on this difficult market environment. We are very pleased and Aires is going to share with you to the fact that we are keeping reducing our cash cost. We had a cash cost of BRL596 on this quarter. And we are going to be even more conservative on our CapEx policy reducing from BRL4.4 billion to BRL4.2 billion on this quarter.

On the liquidity and Marcelo is going to tackle on this point with you. We have a very high liquidity on this point of BRL2.4 billion on a pro forma basis, considering the withdraw of the revolving credit facility that we have of $500 million end of March. Our net debt has gone down to $12.7 billion. Our leverage on dollars have been from 4.9 times to 4.8 times. And our debt is very low. Our average terms is 82 months -- almost 7 years.

On this situation that we had on this quarter, on this Slide number 4, we decided to tackle the situation with three different dimensions; on the people, to support the society, and keep running our essential business to the society.

On the people, we have been working in the dimensions of hygiene and wealth and health. On this we have been protecting our people under sanitary situations with all the necessary measures to protect our teams. We have people -- there is over 60 and with pre-existing conditions that is not on the operations, they are at home. We have people, since the beginning 4,000 people we are working on home offices at this point of time. And we are supporting our people as well, anticipating the 13th salary -- 50% of the 13 the salary last month and supporting with several other conditions, our team.

In the society, we decided that we are going to invest BRL50 million to support bringing new ventilators, importing ventilators, importing hospital masks and distributing this in several states where we operate. But on top of that we are helping a Brazilian company to produce 6,500 ventilators in the period of three months and serving these to the federal government that is going on a discretionary basis to distribute on different states of Brazil. But we are helping our suppliers, the small suppliers with working capital and we are supplying as well. We've been guaranteeing and 100% of the salaries of everyone that is not able to be on our operations.

On the business continuity. We are very happy to mention to you, there is very smooth operation right now that we are doing. Until today, May 15, all of our operations are doing on a very positive manner. Our forest team, our industrial team and logistics team have been operating extremely well at this point of time. We are able to reach this record volumes on pulp even on this very difficult scenario that we have all over the world and we keep the situation in April and May. And on a very conservative manner, we are in the process of reducing our CapEx and OpEx at this point of time. And we do have a very robust credit structure right now. We are not facing any major problems on the credit side as well.

Now, I'm going to hand over to Leo that is going to explain a little bit about our Paper business.

Leonardo Grimaldi

Thanks, Walter, and good morning, everyone. I would now like to present the results of Suzano's paper business unit for the first quarter of 2020. The figures presented on Slide number 5 are specific to our paper business units. Therefore, excluding Suzano's consumer business units results and enabling us to have a better comparison with the past quarters.

Beginning with the top left graph, we can see our production figures. We have produced 278,000 tons of paper and paperboard during this quarter, which is a 3% increase compared to the first quarter of 2019. During the first quarter of 2020, we have performed maintenance downtime only at our Limeira mill resulting in higher production and lower costs in comparison with the same period last year when we had maintenance downtimes in Limeira and Suzano mills.

Moving on to the top right graph and looking at our sales figures. We can note that we have sold 239,000 tons in the first quarter, which is a decline from the levels of the fourth-Q '19 due mainly to the seasonality effect of the demand in the Brazilian market. Our total sales were 6% below the first-Q '19, within which our international sales grew 9% and our sales in Brazil were 13% lower in a year-over-year comparison. As of mid-March, we have started to feel the first effect of the printing and writing unprecedented demand reduction caused by the COVID-19 pandemic and quarantines in many cities in Brazil. I will return to some sales statistics in Brazil in few moments.

Now looking at the lower right side, we can note that our average prices during the quarter totaled BRL3,825 per ton. Our prices in Brazil increased 4% during this quarter, and our export prices fell 1% in U.S. dollars, but posted an increase of 7% in reais due to our currency depreciation. Our average price therefore increased 5% compared to the fourth-Q '19 and was quite steady compared to the first-Q '19.

Looking at the lower left side of the slide, we can note that our lower costs during the quarter as well as price recovery compensated the lower sales volumes. Our EBITDA margin during the first-Q '20 was BRL1,212 per ton and totaled BLR290 million in the quarter and BRL1.4 billion for the last 12 months.

Now coming back to sales. We foresee every challenging scenario concerning the demand of print & writing papers in many regions of the world and also in Brazil due to the COVID-19 pandemic and consequences of the lockdowns and quarantines. In Brazil, the first effects were felt on the week of March 23. Consumption dropped significantly across all printing and writing grades even further than the 12% decline accrued by our European Paper Association EBA, for January and February. Printing & writing demand fell 23% in March, with Brazilian domestic sales dropping 22% and the imports 24%. The resulting compounding statistics were 15% drop in the Brazilian demand in printing & writing papers in the first-Q 2020.

Now our expectation is that the demand will see further declines during the second quarter even below March levels. As a consequence of this drastic decline in consumption, our stocks have risen significantly and we have decided to stop paper production at our Mucuri and Rio Verde mills during the months of May and June, totaling approximately 50,000 tons paper production curtailment which will enable us to match production with market demand. Our operational flexibility will allow us to redirect the resulting pulp from the stoppages to other markets and products. Despite this commercial downtime, we do not foresee any interruptions on the paper supply to our customers in Brazil or internationally, as our stocks are fulfilled and our four paper machines at the Suzano and Limeira allow us to have production flexibility between paper grades in this sites.

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

Carlos Anibal de Almeida {BIO 19090865 <GO>}

Thanks, Leo, and good morning, everyone. Hope everybody's well. So let's start with pulp business going to Page 6 of our presentation. I'd like to start by sharing with you some comments about our pulp business and the pulp marked in Q1. Despite increasing challenges in our global operations due to the COVID outbreak in Q1, our teams have done an incredible work. We did run our mills and supply chains very effectively, while benefiting from strong cost control, Aires will provide later details on production and cash cost figures. Having had such good performance in our industrial operations, we successfully executed our business course. We produced more. We sold more than what we produced and therefore our inventories were again substantially reduced by around 0.5 million tons at the end of Q1. Our pulp stocks are back to the normal levels and were considerably reduced across our value chain. We ended up with very low inventory in Asia, but enough to support local key customers with the required contractual service level. Our stocks have been reduced in Brazil, North America and Europe again across the whole supply chain, and we are very pleased with that.

Now, let's talk about market fundamentals as demand and supply and I'm going to start with the demand side. The demand development was positive in all key markets and notably strong on the second half of March, driven by the tissue segment. The surge in demand for tissue, hygiene products and cartonboard has not changed the pace and remains still today quite strong across all the major markets. Still on the demand side, zero cost of for recycled fibers and very restricted availability in some regions are likely to support extra demand for virgin fiber in the near term as well. It is also true that unexpected stronger contraction in print & write demand will have a negative impact on pulp demand onwards. So far, higher pulp demand from the tissue segment due to pantry loading, recycled fiber replacement and also some structural higher consumption in some regions have more than compensated any decline in the print & write sector.

On the supply side, several unexpected events ended up removing from the market around 1 million tons of pulp so far. That includes events in Asia, Europe and more recently also in South America. Some of them related to COVID, but also related to weather, strikes and lack of fiber. The lack of fiber in British Columbia, Canada, the current poor profitability for some producers in Northern Hemisphere and COVID unexpected related events can change drastically, the supply equation in the second half of 2020. British Columbia producers are highly dependent on residual from lumber manufacturing and extended downtime could render many mills and economic. At the same time, we cannot ignore some moving parts that could increase the pulp supply, dissolving pulp producers possibly migrating to paper grade pulp, paper integrated producers increase market pulp sales volumes and also extra availability due to maintenance defferals.

On the logistics side, our number one priority has been to allocate resources and put in place a plan to protect our customers for an eventual supply chain disruption. Our team has worked relentlessly to move our pulp close to our customers worldwide, seeking to increase safe stocks at the major ports. Despite our actions stocks at the ports located in Europe and North America have gone down lately due to higher than expected demand. Europe pulp data related to stocks at the major European ports at the end of March '20 shows a 30% plus reduction compared to March '19 and also 11% reduction compared to the previous months. It has declined there in Europe for the seventh straight month.

For Asia, since a couple of months ago, we have shipped only the sold volume which means we carry very little local inventory. We have no and committed stocks there, what means that any new order must be shipped out of our stocks in Brazil. The volumes to be shipped for contract customers in Asia have been stored at our ports in Brazil as much as we can to avoid the vessels -- to make the vessels loading faster, according to their needs minimize any potential domestic logistics disruption arising form any sort of lockdown or other restrictions. This combination of lingering supply constraints and solid demand across all the key markets have supported our price initiatives. We announced it for April in Asia $30 more and all the business concluded fully captured the $30 that we announced. We also announced $30 list price increase for Europe and North America and we believe the conditions are in place to support full implementation.

Look at our major figures at the right-hand side of our slide. We realized solid sales numbers. Record sales volumes for Q4 '19, Q1 '20 and also for the last 12 months with a a remarkable 10.5 million tons. Export price in U.S. Dollars pretty well aligned with less work and again over BRL 150 per ton due to a weaker real. On the left side, in terms of geographic and end use mix, we realized a very powerful setup, Europe plus America's volumes are similar to Asia and sales into the Tissue segment accounts for over 60% of our total sales. In Q1, we have strong volumes in all the regions.

Finally, looking at the end of 2020 and comparing that to the end of 2019, we have not changed our plans as we speak. We plan to produce more to sell more and close the year with a much lower pulp inventory.

Now, I turn over to Aires who will cover Pulp cash costs and production.

Aires Galhardo {BIO 17954886 <GO>}

Thank you, Carlos. In terms of industrial performance, Suzano once again, has demonstrated its resilience in times of great challenges. Our industrial production spread over several different industry sites with fourth place in different regions of the country and export logistics distributed among our three different ports certainly do provide Suzano with unique flexibility in the pulp sector. Our pulp production in the first quarter was 2.337 million tons. This result represents an increase of 7.5% considering the same period in 2019. Such increase in production is mainly due to the lower effects of scheduled maintenance shutdowns. When compared to fourth quarter '19, we can identify an increase of 3% in total production and such increase is resulted from a higher production rate at our factories, aligned with the company's objective of gradually increasing the production of the current year as privileged decided to the market.

With respect to cash costs, Suzano has increasingly competitive assets due to the synergies resulting from the merger and the improvement of this operational performance. Cash cost in the first quarter '20 was BRL596 per ton. When comparing the cash cost of first quarter '20 to the same period of 2019, we identify our reduction of 11%, and such reduction derives from two main drivers. The first one is the lower wood cost, due to the smaller average distance between the forest and the mill as well as the lower necessity of third-party wood. The second one of no lesser importance, better dilution of fixed costs due to higher production.

With regards to the chemicals, the consolidation of synergies was the main factor for better performance despite a pressure resulting from the 18% exchange rate devaluation in the period. The cash cost in the first quarter '20 in relation to the first quarter '19 decreased by 6%. Likewise, the reduction in the average distance forest to the mill, the reduction in the share of third-party wood and the dilution of fixed costs as a result of higher production rate were the main drivers to this reduction.

Regarding chemicals, despite a better operation performance in the period due to the synergies, the average appreciation of the dollar by 8% in the period concealed this better performance. The most important messaging in relation to the cash cost is that the reductions present in the comparison to the previous quarters are structural and will remain benefiting the company in the next few years.

Now, I would like to invite Marcelo to continue the presentation.

Marcelo Feriozzi Bacci {BIO 17648865 <GO>}

Thank you, Aires. I would like to move on -- good morning to everyone. I'd like to move on to Page 8 to discuss with you the FX effect on our results. This quarter has been marked by a very sharp change in the FX rate of the real in relation to the dollar and that has had a very significant impact in our operation and financial numbers. First, it's important to clarify that our cash flow profile is a lot dollar-based. You can see on the left hand side of the table here that our revenues are 88% in dollars and our costs are out of cash outflows including costs, expenses and CapEx ranges from 11% to 27% in dollars. So, when we look at the cash flow profile of the company, we have been -- and we will continue to be a net generator of dollar cash flows.

So the current at the current pulp prices, the sensitivity of our EBITDA to FX is in the order of magnitude of BRL500 million of EBITDA change for each $0.10 of FX variation on a yearly basis, which means that in this quarter, we had a BRL1.2 per dollar change. So you can imagine the magnitude of the change that we're going to see in the coming quarters if the FX stays where it is in terms of cash flow generation. For this specific quarter, this was one of the main drivers for the performance of our pulp business. Our margin in the pulp business went from a 38% to 49% EBITDA margin in the quarter. And still we're talking about a quarter where the average FX rate that marked our sales was BRL4.46 per dollar which means that there is a significant upside in relation to the current level of the currency at this point. In the last 12 months, the margin was 45% with an average FX of 4.12, again significantly lower than where we are today.

Moving to the following page. I'd like to emphasize that our balance sheet remains very robust. We have decided to increase our cash position with the withdrawal of one of our revolving facilities of $500 million that is included in the table on the right hand side of this page, despite of the fact that we did this transaction in the first day of April. So you don't see that number in our balance sheet, but we did a pro-forma here to better understand our liquidity situation.

So we today have 2.4 -- we had on 1st of April $2.4 billion of cash at hand, more than half of it in U.S. dollars held outside of Brazil. And we keep having another $200 million of revolving credit facilities that we can still withdraw if necessary, totaling $2.6 billion of liquidity. That liquidity is enough to pay for the next two to three years actually of maturities. We have total maturities of $2.1 billion between now and the end of '22. And if we don't generate a single dollar in terms of cash flow, which is unthinkable in our situation, even in that scenario, we would have enough cash to pay all the maturities of this period without having to roll over any piece of debt. 91% of our debt matures from 2022 onwards with an average cost in dollars of 4.5% a year average tenor of seven years. 100% of our debt is free of financial covenants. So the combination of the absence of financial covenants with the long-term profile of our debt and a sizable liquidity position gives us a very robust situation to deal with the leverage that is still relatively high but coming down.

On the left hand side of the page, we see that our net debt to EBITDA ratio measured in dollars came slightly lower from 4.9 times to 4.8 times. It is indeed in the direction of being reduced. We keep our guidance of reducing this to 3 times until the end of 2021. And of course, a weaker real will help us on that direction.

On the following page, this quarter has been marked by as I said a very sharp variation of FX of BRL1.2 per dollar. And that variation generated a sizable accounting effect on our results. It's important to remember our FX strategy before discussing these results. On the left hand side of the page, we see that our FX management policy has two main components. The first is the-dollarization of our net debt. We continue to carry and we will continue to carry 100% of our net debt in dollars. And that's because of what I showed to his might be before which is the fact that more than 100% of our cash flows are dollar-based. So we consider that we need to have dollar-based that because the cash flows debt we will generate to pay down this debt is are all dollar-based.

In addition to that, we have a short-term hedging strategy that looks into a horizon of 18 months, where we try to increase the predictability of our cash flows in local currency and also in foreign currency. We look at the gap of dollar based revenues and expenses that we have in this period of 18 months and we hedge up to 75% of that gap. The combination of these two policies which have been applied with consistency over the years gives us the result that we see on the right hand side of the page. We had a financial result of negative BRL22.4 billion in the period, which is composed of several different items, and I'd like to go through each one of them to provide a better understanding and a lot of transparency in relation to these results. We have first the interest over the debt which is a very simple calculation, is the application of the interest rate over the size of the debt for a single quarter, and that's BRL800 million.

The second component here is two-fold. First, we have the FX variation on the debt that is originally contracted in dollars. Out of our total debt $11 billion roughly is dollar-based debt original. So if we apply BRL1.2 times $11 billion that gives us a loss -- accounting loss of BRL13.2 billion in terms of mark-to-market of this debt. In addition to that, we have part of our debt originally in reals hedged into dollars using swaps as the mechanism. That provided another BRL5.7 billion negative result on the financial result coming from the mark-to-market of those swaps. So the fact that we carry 100% of our net debt in dollars created BRL18.9 billion of negative accounting impact in our cash -- in our results in the quarter. Moreover, we have the -- as I said, the cash flow hedges for the short-term. Those cash flow hedges, they cover the period of 18 months and it is a portfolio of about $3.5 billion of hedges. And given the delta below one that those hedges have the negative result was BRL3.2 billion in the quarter.

Important to emphasize that from all these numbers that I mentioned only BRL200 million, which is the second to last on this page, is actually what we disbursed on the quarter, which means that there is a perfect matching in our hedging strategy. And also on our debt, between the cash flow generation. And the maturities. As I said in the previous slide, 4.46 was the average FX rate for the first quarter, which means that we have not benefited significantly from the FX yet. And on the other hand, the negative effect on cash outflows to settle those hedges is also a small number eaning that in the second quarter, if we continue to have the FX at the level where it is today, of course, we're going to have a much greater benefit on our revenues and also a much greater cash disbursement to settle the hedges that matures in the period.

Important to emphasize our hedging operations, they have all maturities that match perfectly with the flows that they protect first. And second, zero of our hedging contracts have margin calls. We don't have to make any cash disbursement that could be mismatched from the cash flow generation of the company. Of course, if FX comes down during the coming quarters, we're going to have the opposite accounting effect with the gain. But of course this would mean that the prospects of our margins for the future will be to the opposite relatively negative.

Moving on to the following page. I'd like to show to you what is the structure of our hedging transactions and our debt and what this means in terms of protecting our cash flow. It's important to come back to when our cash flow hedges, that are generating these accounting effects now have been built. Back on the second half of 2018, we had a spot rate of about 370, 380 and a concern that a potential appreciation with the real could come after the result of the presidential election. The prospects of the real rate for 2020 and 2021 back then was between 360 and 370. So when we build this portfolio of zero cost collar, we had a concern that an appreciation of the currency could lead the company to reduce the cash flows that it generated over time.

So, we needed to protect our cash flows as we've always been doing for several years. So when you look at this table here, let's first focus on the left hand side which shows the situation for 2020. If we had the real at 4 during the whole year of 2020 as a base case, we would already have of cash disbursements related to the hedges of BRL1.1 billion negative which comes from the fact that part of our zero cost collar and part of our swaps have been contracted at a rate below. So the situation would be a given EBITDA with a negative adjustment of BRL1.1 billion.

All the numbers that you see to the right are deltas in terms of the original situation. So let's see what would happen if the real went to 3 for the rest of this year. In that case, our EBITDA would reduce from the initial number by BRL3.8 billion conversely if the real went to 5 and stayed at 5 until the end of the year, our EBITDA would improve by BRL3.8 billion. And the swaps, the zero cost collars and of course the dollar-based interest would go in the opposite direction. So with a dollar at 3, we would lose -- we would reduce our EBITDA by BRL3.8 billion, but we would compensate part of that with a positive result of the hedges resulting on a cash flow net effect of negative BRL1.2 billion.

On the other hand, if the real goes to 5 or to 6 in these two scenarios, let's say 6 which is closer to where we are today, our EBITDA for the rest of the year would be BRL7.5 billion above where we would be at 4. And on the other hand, our hedging strategy and our debt strategy would compensate lead to a net cash flow gain of BRL1.9 billion. So what we've been trying to do successfully over the years is to reduce the volatility of our cash flows in the short-term, short-term meaning up to 18 months. And of course, we keep having the profile that in the long-term the company is a dollar-based company.

For 2021, that impact would be larger because we have relatively lower amount of hedges for '21 than we had for 2020. So when we compare what would happen with the real of six in '21 vis--vis a real of four, we would have an EBITDA of BRL10 billion above what would be at 4. And on the other hand, we would pay BRL2.7 billion of zero-cost collars for BRL400 million of swaps and BRL1.1 billion of additional net interest, which would mean that our cash flow would be BRL5.8 billion above where would be with the real of four.

So the takeaways of this are the following. First, we have a very conservative and very consistent policy that we've been applying over the years. And by coincidence, the policy that the two companies that form the current Suzano and in the past were very similar and also had been applied very consistently over the years.

Second, directionally, a more depreciated FX is always better for us. So -- and the more you go into the future, the more that is true because we have short-term hedges up to 18 months only. Third, we've been protecting short-term downside, giving up part of the upside and that's part of our strategy to reduce the volatility and to increase predictability. Fourth, liquidity is always preserved. We work in a way that the maturity of our hedges perfectly match what we're trying to hedge. So we don't have in any situation, any cash disbursement caused by the hedging strategy or the hedging position that would mismatch from the cash flow generation of the company.

Fifth, on the long-term, we are a dollar-based company. The more depreciated the real is the better it is for us in the opposite. And sixth, which is informed in fifth point, a weaker BRL means that we deleverage faster. Our deleveraging pace at the real close to 6 where we are today is way faster than it would be with the real of 4. So as a result of all that we keep seeking leverage below 3 times before the end of 2021 and (inaudible) it is going to be faster than we have been envisioning before.

Moving on to the following page and is the last piece of information that we're giving related to the robustness of our balance sheet. We also decided to enhance our financial discipline by reducing by 5% our CapEx guidance for this year. We keep having the same scope for the sustaining CapEx that we -- it's very important for us that we keep our operations up and running. And the source of this reduction in CapEx is basically a better conditions and the review of some schedules for the different CapEx programs that we have for the year. So, this will increase our financial discipline and help us go in the direction of bringing our net debt to EBITDA leverage ratio to 3 times up to the end of 2021.

I turn back to Walter after that.

Walter Schalka {BIO 2099929 <GO>}

Thank you, Marcelo. Now, I'm going to have the takeaways in the last page of our presentation. We will keep our focus on people, society and business. This is quite important, these three dimensions to us. We are essential to the society. We will keep working and keep producing, keep delivering the products to our customers. it's very important to mention that with our global presence we will keep our volumes running to different markets and to different applications. And we will have very important volumes on the last 12 months reaching 10.5 million, 10.6 million tons in the last 12 months.

Our competitiveness is enhancing all the time. We will keep working to reduce our costs. We are reducing our cost and delivering the synergies and it's very important focus on our organization. FX is always helping our cash generation. We have a very good cash position at this point of time and we will keep this liquidity in order to protect the company of uncertain conjuncture. Our debt is very long, roughly seven years with no financial covenants and we will keep our financial austerity. It's very important that the combination of culture competitiveness and financial robustness giving a very important resilience to the company on this current and uncertain environment.

Now we are going to the Q&A session.

Questions And Answers

Operator

(Question And Answer)

Thank you. The floor is now open for questions. (Operator Instructions) Our first question comes from Daniel Sasson, Ita BBA.

Q - Daniel Sasson {BIO 19234542 <GO>}

Everyone, good morning, thanks for taking my questions. First of all, congrats on the measures you announced to help fighting the current crisis in the communities where you operate and operationakkt in for concluding the de-stocking process during this quarter. My first question is regarding your deleverage strategy. I was wondering if it makes a sense at this point to rethink your hedging strategy or at least the size of your free cash flow that you want to protect that today hovers around 75%? Maybe part of your investors would like to have exposure to a dollarized commodity indeed. So, do you think that makes sense? In the same lines, do you consider start doing hedge accounting maybe to soften the impact of the FX variations in your income statement, right? Maybe trying to move that impact? So that would be my first question to Bacci.

And my second question is still on the free cash flow generation. If you could comment a bit about your working capital you're likely -- you're not going to have further positive impacts from your inventory reduction, right? Which is a good could have problem given that you are now at normalized inventory levels. But your receivables have actually increased. So if you could comment on how you see that evolving and I mean have you -- are you giving more time for your clients to pay you? Is that part of the effect of the end of the commercial agreement with Klabin. So if you could comment on these two topics that would be great. Thanks a lot for taking my question.

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

Thank you, Daniel. We have reviewed with our management and financial committee and also with the board our hedging strategy and it is not the idea to change it, and it's important to emphasize the following. As we have more dollar cash flows, then -- as our real cash flow is a negative one, meaning that we pay more reals in our costs and expenses than we receive in our real sales. Actually, we would have to have some sort or some level of short-term hedging to make sure that we have a dollar-based company and not a leverage dollar-based company. So meaning that if we have zero position of short-term hedging, our leverage to the FX would be excessive. So we -- and we consider that that level is probably something like 50% of the gap. So, by having 50% of the gap hedged into dollars, we have -- we make sure that we have a fully dollar-based company. If we have more than 50%, like we have today about 75%, we have part of our short-term cash flows in dollars and part in reals. And we believe this is important to have the room to manage this between around 75% to make sure that we give more predictability to the cash flows. So it is not our intention to be to change the hedging policy and we will keep being in the short-term company that part of the cash flow will be the real-based and part dollar-base. And in the long run we are a dollar-based company.

In terms of hedge accounting, we don't see at this point the benefit of using that. That adds a lot of complexity and adds also some noise to the operational results that would be make it more difficult to explain and to compare with our competitors. The effect on the P&L, of course, would change, but the effect on the balance sheet is exactly the same. So at this point we don't see a benefit from using hedge accounting.

On your question on working capital, it is very simple to explain. As we have increased the pace of our sales, part of the inventory became accounts receivable and most of those accounts receivable are dollar-based. So when you apply an FX rate to the receivables you increase the size of the receivables, which means that it's accounting effect that doesn't mean that we are using more working capital. It's just the fact that it is a dollar-based receivable.

Q - Daniel Sasson {BIO 19234542 <GO>}

Thanks a lot. Thanks a lot Bacci.

Operator

Our next question comes from Marcio Farid, JP Morgan.

Q - Marcio Farid {BIO 21017394 <GO>}

Thank you. Good morning, everyone. I have a few follow-up questions. First one to Bacci. Bacci, you mentioned the to get the 3 times net debt-to-EBITDA by next year, year-end, right? When I run a sensitivity here, in order to get to that level, need to see pulp prices average $600 per ton next year which affected BRL6, right? I mean it's anybody guess what's going to be priced next year. But is there anything else being considered on this de-leverage pace for next year? I mean, lower CapEx maybe asset sales or anything else that could help you get to the 3 times next year, which are more conservative approach.

And maybe the second one to Carlos Anibal. Carlos, can you tell us, you mentioned that demand in Europe and in China is still relatively -- or very good still in May similar to what it was in the first quarter. Can you just highlight to us how has been the conversation so far for the price increases in Europe? What are the buyers telling you? And what are you hearing from the Chinese customers as well? Thank you very much.

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

Okay. Marcio, of course, we're not going to give any guidance on pulp prices, but we need to consider that with an FX at the level where it is today. And if we consider some reasonable recovery on pulp prices which doesn't mean in our account to reach $600 it is less than that. We would reach 3 times by the end of next year. And the other factors that will help us push the indebtedness into that direction is first the CapEx that will probably continue to be closer -- very close to the sustaining level up to the point that we reach 3 times. And also that the asset sales that we announced, which are basically transactions related to land and forestry of which we made a small part and we're still working on completing the additional transactions to reach the number that we called to the market last year.

Another part of the delevering process which was the reduction in the inventory is already completed. The inventory is at a normal level right now. But part of that is still in the accounts receivable. So we still have -- going to have a gain on working capital that will help in that direction. And again, we need to emphasize that when we talk about 3 times net debt-to-EBITDA, we're always talking about the ratio in dollars. If you look in reals, there's a lot of noise involved in that. But in dollars, we keep the guidance that we're going to reach 3 times by the end of next year.

Q - Marcio Farid {BIO 21017394 <GO>}

And just a follow-up sorry, Carlos. Just to make sure on one point before you start, sorry about that. Bacci, you mentioned on your speech as well about the hedges being part of a strategy to make the company more dollarized. This might be a bit -- maybe if you please, called stupid question, but why not having a balance sheet in U.S. dollars instead of real? Maybe the headline would volatility would be reduced. Sorry again Carlos.

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

You're right. It's something that we've been analyzing for a long period of time. It is a very complex change to make, but it's something that we consider for the future.

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

So good morning, Marcio. Thank you for question. So I'm going to split my answer in two parts demand and after that I'm going to talk about price. So on the demand side, we see it as solid in all the regions mainly for the tissue segment that has shown, as I mentioned before, a strong uptick since the second-half of March in all the major markets. That ARPU trend year-on-year has not changed so far. So we still see that.

We have some customers in North America saying that they expect the demand to continue for several quarters and of course at a lower rate than a 9% increase they face between end of March and beginning of April. Also important to say or to share with you our view on the supply chain and that applies mainly to U.S. and Europe. We believe that the supply chain has been quite empty. And we have all the players working on hand to mouth basis, which means, in our view, that the pulp and finished product stocks are pretty low throughout the entire chain. So even after the demand cools down, if that is the case, we're going to have the opportunity to fulfill all that, again with pulp and finished products.

For print & writing we didn't see any major change in April, but we believe that it will be the case for May and afterwards. But so far, all that we have been seeing on the tissue side has more than compensates what has happened on the print & writing specialties. Still on the demand side, I want to bring to you two relevant information first about recycle fiber that has played out an important role. It has been a short supply since all the local governments issued those shut-in-place orders in March keeping people at home rather than going to arts, going to school. That has impacted the recovered paper generation and collection and arts, have been seen since then tissue producers migrating from recycled fiber to virgin fiber.

Last but not least important, it is information that the spread between the long fiber and the short fiber stands still today above $100, and that creates additional incentive for a higher short fiber consumption. And that's where we believe that the Suzano Pulp makes even more difference with our special characteristics that provide to our tissue customers much more softness as compared to the competition.

On price, we announced for Europe and North America $30 more. The discussions are taking place now and we believe the market fundamentals support the full implementation. In Europe, all the discussions will be concluded by the end of the month. But again, the conditions are in place and that we're going to pursue the full implementation of the $30. In Asia, as I said before, we concluded 100% of our business in April with an additional $30 taking our minimum net-net price in Asia for 480. We didn't have any price lower than 480. And also there in Asia, the discussions for the May business are still taking place.

Q - Marcio Farid {BIO 21017394 <GO>}

Perfect. Thanks. Thank you very much.

Operator

Our next question comes from Thiago Lofiego, Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you. Good morning, everyone. Two questions here, one on the inventory side, so and also looking at production strategy. By our calculations your inventories are now close to 1.5 million tons, which seems to be within a normalized range. So, what should we expect in terms of production and shipments in the coming quarters? Should we expect those two data points being closely matched in the coming quarters? Or could we think about Suzano working with even lower inventory levels ahead?

And also considering the fact that most of the maintenance shutdowns are going to be concentrated in the second half of the year. So how do we think about those variables here? Second question about your operating cost guidance of BRL1,300 per ton for 2024. How does that change given the new currency level in Brazil? Those are my questions. Thank you.

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

So, Thiago, good morning. I can take the first one. This is Carlos speaking. As I said in the beginning of my presentation looking at the end of 2020 and comparing that to 2019 we will produce more, we will sell more and therefore we're going to close 2020 with a much lower inventory. We will not give any guidance besides that.

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

Thiago, thank you for your question. I'm going to answer the second part of your question. Our guidance that we gave on operation cost, we will track this once in a year. But of course, it's impacted by some of the issues are impacted by the FX. When we made that analysis, the FX was completely different than today. But we are tracking on the right direction on the cash cost as you saw during the presentation. Even on FX rate of 4.46 that we had in the first quarter of this year, we had an operational cash cost -- sorry a cash cost of BRL596 per ton. We are very pleased with the developments that we are doing. And we are going south in terms of total cost of the system on the previous FX analysis.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Thank you.

Operator

Our next question comes from George Staphos, Bank of America.

Q - George Staphos {BIO 1495442 <GO>}

Hi, everyone good morning. Thanks for taking my question. And thanks for all that you're doing with COVID. Gentlemen, a couple of questions and a lot of them have been answered already. Can you comment to the degree that your shipments to customers in the first quarter you think represented true consumption true take away by your customers and the degree to which your customers might have been stocking up. I recognize Carlos, you said that you think the supply chain is relatively lean. But if you could provide any more discussion around that point.

Secondly, in terms of wood cost for the quarter, again congratulations on the progress there. Was there anything aberrational in 1Q on wood cost? Or should we assume that was a relatively normal level of performance. And whatever happens in terms of production synergies et cetera that is the appropriate level to base from to start? And my last question, I apologize for the very basic question. Marcelo, thank you for the review on hedging. It was really, really good and appreciate it. Could there be any time within a quarter short-term where in fact the hedging could create a mismatch of cash. I recognize that's ultimately the goal of the hedging traction to avoid that. But what circumstances could create a short term mismatch of cash flow, if anything at all, perhaps around working capital. Thank you, guys. Good luck in the quarter.

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

Hey George, this is Carlos. Thank you for your question. So let me share with you our view on the pulp stocks. So as we mentioned before, pulp inventories at the major European ports fell again in March, and that has been the case for seven months straight. So we believe that the ports the stocks there iin Europe are at a normal level. When you go to China and when I look at the inventories at the major Chinese ports like Qingdao and then Changshu, in those ports, it's certainly lower in March and April after having jumped higher in Feb.

We understand that most of the stock at the Chinese ports, they are wanted by customers and producers they hold very little, almost no position in that total. We agree that the volume at those Chinese ports are still a little bit above what should be the normal level. And the way that we explained that, that has to do with the production loss related to the COVID outbreak that took place between end of Jan and beginning of March. So at that time there was a big production loss and somehow that impacted the pulp demand. And I mentioned that to you before. At the same time, we had all the Chinese ports working very well and the incoming pulp did not change the pace. So that combination of lower production and unchanged incoming pulp volume explain the stock that are still above what should be the normal level at those ports today.

Very important to mention that we believe the Chinese buyers they seem to want to hold a higher than normal stocks due to potential supply chain disruptions. They are facing containers availability issue and that has been reportedly critical issue in pulp shipping from Canada and Europe to China. Any possible COVID related production loss or port issue anywhere in the world might represent a big risk for the Chinese buyers due to a much longer transit time. And we believe that is the reason they are today trying to hold a higher than normal position at the ports as well. So this is how we see all that.

A - Walter Schalka {BIO 2099929 <GO>}

Related charge, related with the wood cost is Walter answering, we believe that we are at a normalized level. We do not believe any major changes on the wood cost in the coming quarters.

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

George, in relation to the potential mismatch. The thing is designed not to have it. The only situation where we could have a slight mismatch, it's in a situation where we have sales below what we had projected. Remember that we forecast the cash flows in dollars as a base for the hedging strategy 12 to 18 months in advance. So if our sales even in volume or in price significantly differ from what we had projected we can have a bit more or less hedges. But that those changes tend to be minor. And the fact that we can go up to 75% makes sure that even if we have a 25% change in the projection, we still are going to be protected from being overhedged.

Q - George Staphos {BIO 1495442 <GO>}

Thank you very much. Good luck in the quarter.

A - Walter Schalka {BIO 2099929 <GO>}

Thank you, George.

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

Thank you.

Operator

Our next question comes from Carlos De Alba, Morgan Stanley.

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

Good morning, everyone. Thank you very much. So a few questions if I may. First on pulp, Carlos, we have seen the spread between softwood and hardwood at an elevated level for some time already. How long do you think it takes for the substitution effect to actually kick in and see people switching more towards hardwood and therefore reducing potentially the spread? And then sticking with the pulp, the dynamics, just maybe a clarification for me and maybe for the audience. When you mentioned that you see better or higher volumes this year in production and shipments and lower inventories, are you talking at the end of 2020 versus the end of 2019 or the end of 2020 versus the end of the first quarter? Because I understood that you have already reached or Suzano has already reached the normalized or the normal level of inventories, which that would imply that maybe you don't see too much destocking in the remainder of the year.

And then maybe just this is a naive question from just an analyst, but how does the conversation with clients go when the pulp margin that a company reached in Q1 is 49% and it's probably much higher in the second quarter? And also when the share I understand that the share that printing & writing represents of total paper business and therefore pulp demand is greater than tissue. How does the conversation to high prices go? That's what I'm a little bit puzzling and any of your perspective would be really helpful. And then one last one if I may for paper. Given the situation that is happening in the world and also in the Brazilian market, how do you see the evolution not only in Q2 but beyond? And what would you need to see in order to restart those two lines that were shut down and do you expect a double-digit decline in paper production and shipments this year in Brazil? Thank you very much.

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

Okay, Carlos. Thanks for your questions. I'll try to answer all. But before that, just to complement one information that was asked by George. George we believe that all customers mainly in Europe and North America are working with lower than what should be their normal level for pulp stocks, okay? So on pulp price, increase with the situation that you just described, we believe that pulp price is a matter of market fundamental. It is supply demand.

As I said, we have a combination of those two factors favoring, creating conditions to increase the prices and this is the conversation that we are having with our customers in Europe, in North America and there was a conversation that we had last month there in China. And as I said all the businesses that we concluded were at the new price level, representing a $30 price increase.

It is hard to quantify what is the price spread between longer and short fiber that will change the demand. I would say at $40, $50, we should see customers pay more or buy more softwood or reducing their hardwood consumption moving back to softwood. Important always, always to remind we have in the short fiber special characteristics that give tissue products a much better performance mainly in terms of softness.

And your last question and let me rephrase that or repeat that. When we look at the end of 2020 and compare that to the end of 2019, and this is what I said, okay? We plan to produce more, we plan to sell more and close 2020 with much lower inventory. This is what we have been saying to you, since late last year. We will not give any guidance about what we are going to do on a quarterly basis.

A - Leonardo Grimaldi

Carlos, good morning. This is Leonardo talking about your -- answering your question related to paper. As I have mentioned we have seen in Brazil a demand decline of 23% in March and our expectation is that demand in the second quarter will decline even further. Even though some of our products our printing & writing papers were classified as essential and they're used in hospitals, clinics, medical, leaflets and also food packaging. Obviously, the general effect of the reduced demand in offices commercial businesses schools is generating an unprecedented decline in demand.

There are no official forecasts for Brazil or Latin America concerning demand in the second quarter. But as a comparable reference, (inaudible) market has just posted their paper traded report dated April 30 regarding North America. And their expectation is that this decline in the second quarter will be of 42%. In Brazil, there are additional uncertainties such as the level of investments of the Brazilian government in public education and the national textbook program as well as the maintenance of the municipal elections, which are originally scheduled to take place this October. We believe that the production curtailment that we have done so far is enough, but we will further track timing of demand recovery, speed of this recovery and to what levels the recovery will be in order to make future decisions on production curtailment.

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

Thank you very much. I appreciate it. All the best

Operator

As there are no additional questions, the Suzano first quarter 2020 results conference call is finished. Have a nice day. Thank you.