

Q2 2013 Earnings Call

Company Participants

- Antonio Sergio Alfano, CFO, IR Director
- Fabio Schvartsman, CEO

Other Participants

- Diogo Miura, Analyst
- Josh Milberg, Analyst
- Juan Tavaréz, Analyst
- Lucas Ferreira, Analyst

Presentation

Operator

Good morning. Welcome to Klabin's audio conference. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and also being broadcast live via webcast and may be accessed through website at webcall.riweb.com.br/klabin/english where the presentation is also available.

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

With us today in Sao Paulo are Mr. Fabio Schvartsman, Chief Executive Officer, and Mr. Antonio Sergio Alfano, Chief Financial Officer and Investor Relations Director. Mr. Fabio and Mr. Sergio Alfano will comment on the Company's performance during the Second Quarter. After that they will answer any questions that you may wish to formulate.

Now, I will pass back the call over to him. Mr. Fabio, please begin.

Fabio Schvartsman {BIO 2067677 <GO>}

Good morning, to everybody. Thank you for joining the call. We are here to comment on the Second Quarter's results of Klabin. And I would like to start mentioning that Second Quarter was precisely according to forecast. We are expecting exactly the performance

that we delivered. And this was a growth in EBITDA terms of 10%. It was enabled by a still strong domestic economy but actually weakening because the demand, according to Bracelpa and ABPO, of paper packaging in Brazil went up in volume in 4% in this Third Quarter -- Second Quarter, in comparison to Second Quarter of last year. But June itself showed a reduction of 1.5% in comparison to the same month of last year. That is the sign of weakness that I mentioned.

The Company nevertheless expanded our sales in converted products, converted meaning sacks and boxes but of 11% in volume in comparison to the same period of last year. Therefore reduction -- reducing the sales of paper because we have capacity limitations.

So as you were all informed we have the regular stoppage for maintenance of Monte Alegre mill and Otacilio Costa mill during the Second Quarter of this year affecting the cost as expected. And we had the very important reform of one of our biomass boiler -- the Biomass Boiler 6, that was completed during the quarter. But as a consequence we had more costs during the Second Quarter.

Now, I want to -- I would like to make some comments on what we expect for the Third Quarter. The Third Quarter will show another important aspect of Klabin. Klabin is a very flexible company because of its product lines. That means that Klabin will be able to shift some of the production to export during the quarter taking advantage of very high international prices of our products plus the devaluation of the exchange rate. This flexibility of Klabin together with our continuous effort towards cost reduction will enable Klabin to deliver in the Third Quarter of this year a better performance that was delivered in the Second Quarter of this year in comparison to the same quarter of last year. That is a very important fact, that means that Klabin is very sound in the fact that independent of what's going to happen with the Brazilian economy during the Third Quarter, if it is going to be weaker or not, Klabin will deliver that strong performance that I am anticipating to you.

Finally, I would like to make a quick comment on Puma Project. As you are all aware the project was approved by our Board last quarter. And it is accordingly moving ahead. We are basically focused on solving technical and financial issues associated with the project. And we are a 100% committed to this process that represents a capital raising for helping financing the construction of the mill. And obviously the market conditions, we are following very carefully and we are not -- as we said, we told you a number of times already, we are only going to make this deal with the market capital raising if it's at a reasonable price, and therefore if it's good for everybody. If it's going to create value, that's the purpose of the management of this Company.

So the project is moving ahead. Actually, we do have alternatives. We are analyzing these alternatives in parallel to the offering to the market. Nevertheless, the focus of the Company is the capital raising. The alternatives are -- we are -- they are technically necessary and we are taking care of it because this is the way it should be done.

As a consequence, the Company is not going to make any further comments on these alternatives or on relation to this public offering, for this very simple reason that it's public. And if there is something -- anything new that is relevant it will be immediately informed to the market as it is the normal behavior of this Company.

So let's concentrate now in the results -- in the discussion of the results of the Company. And I will pass to Sergio Alfano who's going to make further comments on the performance of the Second Quarter.

Thank you very much.

Antonio Sergio Alfano {BIO 4337533 <GO>}

Good morning, everyone. Thank you for participating in our conference call. The first half of the year was marked by improvements of Klabin's results, reflecting the increased efficiency of the news and the improved markets and product mix. EBITDA increased by 17% over the first half of 2012.

In the Second Quarter, the higher exchange rate affected imports of finished goods in Brazil, which fell by 13% in the year through May, over the same period of last year. The signs of the slowdown of the Brazilian packaging paper market which maintained the same growth trend observed in the previous three month. In addition, the higher US dollar improved the results and the cash flow of Klabin exports in the quarter.

Sales volume of Klabin remained flat over the Second Quarter and concentrated in the domestic market. Second quarter sales volume, excluding wood, totaled 429,000 tons reflecting the drop of 8% of sales of paper and the increase of 11% in the sales of converted products.

In the first half of the year sales volume moved up by 1% over the same period of 2012 to 860,000 tons. 70% of this total went to Brazilian markets, versus 66% in the six months of 2012.

Net revenue including woods had a growth of 6% over the Second Quarter of 2012 and reached BRL1.1 billion. This 1% reflected the approach of -- selective approach to sales to the various markets. They improved the product mix and appreciation with the dollar against the real.

Net revenue from paper sales increased 1% over Second Quarter 2012, while net revenue from converted products moved up 13%. The total net revenue was BRL2.2 billion in the first half of the year, 8% up from the same period of last year, despite 1% increase only in sales volume.

Unit cash cost totaled BRL1,848 per tonne, an increase of 5% compared with the Second Quarter of 2012. This cash cost was negatively impacted by the annual maintenance shutdowns of Monte Alegre paper plants and the Otacilio paper plants in May, which

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lasted for 11 days in Monte Alegre and seven days in Otacilio Costa. And also we added the renovation of the Biomass Power Boiler 6 in Monte Alegre, which lasted in maintenance for 14 days.

In addition to pushing up the fixed cost, the stoppage resulted in higher fuel oil consumption in the mills and additional energy purchases. Exclude the expenses with stoppage and renovation of the boiler, the unit cash cost stood at BRL1,665 per tonne.

EBITDA was BRL309 million in the Second Quarter with a margin of 28%. In the first half of the year, EBITDA was BRL693 million with a margin of 32% and a growth of 17% compared with the six months of 2012.

Net debt ended June at BRL3.4 billion, BRL300 million more than March 31st. The variation in the exchange rate which closed June at BRL2.22 per dollar increased the foreign currency debt while the net debt EBITDA reached 2.4 times compared to 2.2 times in the first half -- First Quarter of 2013. (inaudible) to that, we would like to clarify that the exchange variation has an exclusive accounting effect in the Company's balance sheet with no significant cash effect in the short term.

In terms of investments, Klabin invested BRL194 million in the quarter. Of this total, BRL107 million went to expanding sack kraft paper and recycled paper capacities. The installation for the new sack kraft paper machine in Correia Pinto in Santa Catarina remains on schedule, and the sack kraft is forecasted for the Fourth Quarter of this year.

In the northeast of Brazil, the installation of the recycled paper machine at the Goiana unit is also advancing within schedule and is forecasted to start up the operation in the second half of 2014.

Now, Fabio and I, we are available to take any questions you may have.

Questions And Answers

Operator

(Operator Instructions) Juan Tavarez, Citigroup.

Q - Juan Tavarez {BIO 15083199 <GO>}

My first question is regarding cost, and specifically the cost initiatives that you announced last year. I think you targeted a cost base of around BRL400 million within your packaging business. Could you share with us any progress there and should we see anything notable for the second half of the year in terms of cost improvements?

A - Fabio Schvartsman {BIO 2067677 <GO>}

Yes. The movements towards cost reduction in the packaging division moving ahead accordingly and we are going to see important cost reductions during the second half of

this year.

Q - Juan Tavaréz {BIO 15083199 <GO>}

All right. But more than what we've been seeing so far, is there anything specific that we should see or in terms of energy costs or --

A - Fabio Schvartsman {BIO 2067677 <GO>}

Actually, there is a combination of factors. The Third Quarter, our costs will be significantly lower than the Second Quarter because of many things. And therefore, it will be very difficult to separate and identify specifically what is happening with the packaging. But what I can anticipate that our performance in the packaging division is the best ever. We never had figures of the same level that we are seeing these days. And it is continuously improving and here is a combination of cost reduction itself plus the fact that we are now operating at full capacity in the packaging division, therefore better absorbing all the costs of the division. So unfortunately, in the figures of the Company there is no way of separating that other than seeing that all the costs will go down in a very important way in the Third Quarter.

Q - Juan Tavaréz {BIO 15083199 <GO>}

Okay. Great. And just regarding pricing. I know some of your peers that use more recycled fiber are starting to raise prices. I'm curious if you've announced any price increases for your products that should be implemented in the coming months?

A - Fabio Schvartsman {BIO 2067677 <GO>}

Juan, the answer is yes. All -- there is a cost pressure across the chain that comes from the OCC prices in Brazil that are very high. As a consequence, the recycled prices are going up. And as a consequence kraftliner prices have to go up because to sustain the difference because people will rather prefer to buy everything from kraftliner if they have at the same price. So what has already happened is that prices were announced and will increase across the board in all of our packaging products.

Q - Juan Tavaréz {BIO 15083199 <GO>}

Could you share a specific percentage? I don't know if that's something you would want to share but --

A - Fabio Schvartsman {BIO 2067677 <GO>}

But Juan, I hope you understand that this is more delicate given the fact that we have different customers. And so I suppose it's not very good for them if we can tell you how much we are increasing prices.

Q - Juan Tavaréz {BIO 15083199 <GO>}

No, fair enough, fair enough. All right. Thank you very much.

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Operator

Lucas Ferreira, JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

My first question relates to a announcement that you made a couple of quarters ago, actually I think last quarter regarding the new timber yard in Monte Alegre mill. You were saying that it would be starting operations by the end of the year with a significant improvement in cost and in the site. So just wondering if you have an update on these projects, and if it's indeed starting in the end of this year? Thank you.

A - Fabio Schvartsman {BIO 2067677 <GO>}

Regarding the wood yard, we started the revamp of the wood yard of Monte Alegre with varied improvements and also cost savings after the start up of this project. And the intention of the Company is to do all the things in the wood yard in next annual shutdown by the mid of next year.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Okay. Great. Sergio, my second question is regarding your CapEx plans for this year and next year. If you could give us an update on the numbers that you have in mind, and also if you, as you were mentioning before, the debottleneck of the board machine. If you already have an estimate on how much that could cost for you next year? Thank you.

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

Well regarding the CapEx for this year, we continue to forecast the total CapEx, approximately of BRL750 million. Why because through this year we have -- we are in the construction of two new paper machines. One is Santa Catarina, with the start-up will be October, and in July next year, the recycled paper machine in the Northeast of Brazil. Then the total CapEx forecast for this year is around BRL750 million.

Q - Lucas Ferreira {BIO 16552031 <GO>}

And next year should be lower right, when considering the boiler machine?

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

Next year, we can -- excluding the Puma Project, we have the continuation of some of these investments regarding the recycled paper machine to July. Then we don't have -- then we can have also the CapEx for the debottlenecking of the board machine.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Which you don't have already an estimate of how much that could cost?

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

Yes. It's under study together with the suppliers. We are studying that.

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A - Fabio Schvartsman {BIO 2067677 <GO>}

We are in the final struggle with our suppliers to define how much it's going to cost.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you very much, Fabio and Sergio.

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

Okay.

Operator

Diogo Miura, Goldman Sachs.

Q - Diogo Miura {BIO 17360784 <GO>}

I have a question in kraftliner prices. You mentioned about the environment for kraftliner abroad. And I was just wondering if we should see the impact of this higher price in the Third Quarter if this has been fully implemented in the Second Quarter?

A - Fabio Schvartsman {BIO 2067677 <GO>}

Well actually the price -- the international price of the kraftliner is high and remains high. So it's not that it's going up dramatically, it's not. But actually it enable us to export with very good margins, and we -- that's one of the reasons why we are expecting a very strong quarter in the Third Quarter, because everything that we decide to export instead of trying to sell in Brazil, we have more or less the same level of margins that we have in Brazil.

Q - Diogo Miura {BIO 17360784 <GO>}

Okay. Great. And just a second question. I mean in terms of the Puma Project in the offering, what would be the next step to be taken when that's going to happen?

A - Fabio Schvartsman {BIO 2067677 <GO>}

There is -- there's no definitions which are going to be next steps. What we have to -- we're basically doing is waiting to see how the market evolves from that one. It is obvious that there is -- the market is very difficult for Brazil right now. But there are signs that it's going to improve. And actually we are basically waiting to see what's going to happen.

Q - Diogo Miura {BIO 17360784 <GO>}

Okay. Thanks very much, Fabio.

Operator

Josh Milberg, Deutsche Bank.

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Q - Josh Milberg {BIO 2004065 <GO>}

I had a question on your sales mix, domestic versus export and the assertion that you just made that profitability is now similar for local and foreign sales. The data I have shows price levels aren't far-off at the current FX, but with freight cost one might imagine that export sales would still present a lower profitability. So I was just hoping you could provide a little more color on that issue and differentiate when you discuss it between kraftliner and coated boards?

A - Fabio Schvartsman {BIO 2067677 <GO>}

Actually, that's a good point, Josh. But the advantage that Brazilian companies like ourselves have today for exports is that we have return freights from China. Actually the Chinese are coming back with -- in the containers. And therefore, it opens a window opportunity of low prices, and actually it is making the cost of transportation to go down across the board. That helps in our profitability as well.

Q - Josh Milberg {BIO 2004065 <GO>}

So what you're saying though today that definitively the profitability, the margins are basically the same both on exports and domestic sales or is there still a difference?

A - Fabio Schvartsman {BIO 2067677 <GO>}

There is still a marginal difference. You remember that in Brazil we actually convert a large part of our paper into packages, to boxes and to bags. And therefore we have a creation of value here. But of course, if we export, we don't have it. So actually, I think that to really maximize profitability, is always better to sell more in Brazil. Nevertheless, in comparison to the level of profitability that the Company has today, it is going to improve exporting. And that's why we are exporting now.

And as I mentioned before, we are planning to increase the stake of exports in volume, from 20 -- sorry from 32% in the Third Quarter of last year to 28% this quarter, that is -- sorry, it's the reverse, from 28% to 32%. Therefore, we are increasing exports by a lot.

Q - Josh Milberg {BIO 2004065 <GO>}

Okay. Thanks for that color.

Operator

Ladies and gentlemen. there being no further questions, I would like to pass the floor to Mr. Fabio for the final considerations.

A - Fabio Schvartsman {BIO 2067677 <GO>}

Well once more, thank you very much for joining our call of the Second Quarter results. We are very pleased to see that things are moving ahead in Klabin. In the operational side we are going to have a very strong Third Quarter with better results, no matter what's

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going to happen with the Brazilian domestic economy. I suppose not many people can claim that at this moment.

And secondly, our strategy is moving forward with our Company focusing the developing of -- development of the Project Puma that is very important for the future of the Company. So I hope to have you very shortly with us in the new call. And thank you very much for taking this one. Bye-bye.

Operator

This is the end of the teleconference promoted by Klabin SA. Thank you very much for your participation and have a nice day.

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