

Q4 2016 Earnings Call

Company Participants

- Carlos Aníbal Fernandes de Almeida, Jr., Executive Officer - Pulp and Paper Business Unit
- Ivano Westin, Analyst
- Marcelo Feriozzi Bacci, CFO & Director-Investor Relations
- Walter Schalka, Chief Executive Officer

Other Participants

- Bruno Giardino, Analyst
- Carlos F. De Alba, Analyst
- Juan G. Tavaréz, Analyst
- Karel Luketic, Analyst
- Leonardo Correa, Analyst
- Lucas Ferreira, Analyst
- Marcos Assumpção, Analyst
- Thiago Lofiego, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Suzano Papel e Celulose Conference Call to discuss the results of the fourth quarter of 2016. All participants will be in listen-only mode during the presentation to be made by Mr. Walter Schalka, CEO of the company. Afterwards, we will have a question-and-answer session when further instructions will be given. We would like to clarify that each participant will be allowed two questions only.

We would like to inform that some statements made during this call are projections or assumptions about future expectations. Such forward-looking statements are subject to known and unknown risks and uncertainties, which might lead these expectations not to materialize or be substantially different from what is expected.

These risks include, among others, changes in the factors that impact both domestic and international prices in the products, changes in the cost structure, changes in the market seasonality and changes in competitors' prices, exchange rate variation, changes in the Brazilian emerging markets and international markets, political and economic scenarios.

Now, we would like to turn the conference over to Mr. Schalka, who will start the presentation. Thank you.

Walter Schalka {BIO 2099929 <GO>}

Good morning, everyone. It's a great pleasure to be with you. Thank you very much for your presence during our presentation about the fourth quarter of 2016 Suzano Papel e Celulose. Today, we have Marcelo Bacci, our CFO and IRO; Renato Tyszler, Strategy, Innovation and Business Development Officer; Alexandre Chueri, our Forestry Business Officer; Carlos Aníbal, our Pulp and Paper Business Unit Officer; and Carlos Griner, our Human Resources Officer as well as Sustainability Officer.

We have 8,000 employees in Suzano and we're very proud together with them to present the result of 2016 to all investors and analysts. This was a year in which once again Suzano showed its perseverance, looking for value creation for our shareholders. We had an operating cash generation of BRL 2.7 billion, EBITDA slightly higher than BRL 3.9 billion and CapEx sustaining of BRL 1.16 billion.

We believe and we reiterate our thesis that this indicator is the best indicator that evaluates the industry, as the CapEx sustaining of the different companies are very significant and different businesses are very significant as well. We have to look at that and ROIC – for this reason, the company's ROIC last year was 11.9%, close to 12%, lower than the previous year. And the main reason for that is the variation of the pulp prices that impacted at about BRL 1.2 billion, our result.

In order to make this even more clear, if we were to replicate the price of 2015 in 2016 for pulp, with all the other parameters being equal, we would have BRL 1.2 billion more in our result. So, the volatility of the prices of pulp impacted directly our operation cash generation and even in this environment, we were able to get a ROIC of 11.9% and an operating sort of (04:13) cash generation of BRL 2.7 billion.

Now, looking at pulp, we had record production and sales in the last quarter, 935 tons, 957 tons. All the units – the four main units had increases in volumes, vis-à-vis, the previous year, which shows the evolution across the board in all the areas. And we broke sales record, reaching 3,530,000 tons of sales in this year with a production of 3,473,000 tons.

Just to remind you, we have been repeating that our capacity of 3.4 billion tons, but last year, we have already exceeded that as the first stage of the debottlenecking of our plants and this year, we have a second stage of the debottlenecking of Imperatriz Unit with the conclusion in the second half after the general stoppage.

I think I should also mention the increase in the volumes of Eucafluff quarter-on-quarter and already in the first (05:32) quarter of 2017, we will see a new increase in sales and we are increasing our exports of Eucafluff. One important highlight in our result is our cash cost and I would like to devote a few minutes to this matter. We had a cash cost of BRL 642 in 2015, in 2016 BRL 623, and we reached BRL 570 in cash cost in the last quarter. BRL

570, as a coincidence, was exactly at the values of 2016 what we wanted to reach in 2018, which means that we have brought forward by 18 months our objective that we had already established for 2018.

And I would like to give you a very clear view of the following, in a nominal fashion, we expect for 2017, a cash cost lower than the one achieved in 2016. Besides offsetting inflation, we are nominally decreasing our cash cost. This will not be in a linear fashion. The participation of our own wood and third-party wood and the average rate is changing (6:53) during the year. So, you should not expect a downward curve all the time, but the trend will be a downward trend, and this is a very positive data (7:04).

And even more positive than that, in 2016, we took the necessary actions to prepare ourselves to reach our objective cash cost in 2021, 2022, which is BRL 475. The reduction in consumption of chemicals with the projects that we are carrying out and the work regarding forestry with the reduction of average wages and yield increases, and the acquisition of forests that we made in the last quarter of 2016 are the preceding conditions. And we have (7:39) all of them, so that we may reach 2021 and 2022 at a cash cost of BRL 475 at values of 2016. And this is part of the first pillar of our strategy to have the optimal structural cost showing the constant evolution of our structural cost. And this structural competitiveness is something that is already a part of the company's DNA, as you will see in other indicators of the company as well.

Due to the volatility of the exchange rate and the price of pulp last year, in the fourth quarter, we had an EBITDA of BRL 678 per ton for pulp and consolidated for the year BRL 778 (8:28), lower than the previous year. But even more important than the EBITDA is the operating cash generation, which is the main factor - the main KPI for Suzano. Last year, BRL 506 per ton in operating cash generation, ROIC of 10.5%, lower than the 15.7% that we had in the previous year. And the reasons are basically the price of pulp, as the cash cost was lower than the previous year.

Paper also brought us excellent news last year. Production was very similar to the production of the previous year and sales also similar to the production of the previous year. We had a major growth in the Brazilian market coming from the Suzano Mais program that we have implemented and also coming from the actions that we have been taking to get closer to our client base. So, this generated an export volume which was lower in 2017 (9:40).

And the result for paper came from the increase in the EBITDA per ton, which last year was BRL 970 per ton and the operating cash generation of paper that is becoming consistently better, BRL 803 last year per ton for paper. It's also important to mention that in the fourth quarter, we had the stoppage of the Limeira Unit, and it affected the operating cash generation in the quarter, because ultimately it reduces production and it increases costs specifically in that quarter of the downtime. And I think there is another very important highlight, the fact that the paper ROIC has been growing consistently, in 2014 9.3%, 2015 11.8%, and 15.6% in 2016.

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Paper gives a major contribution to our results and consistently going up, and we believe that it will continue to go up in the next few years due to the measures that we have been putting in place. And the consolidated result of Suzano Papel e Celulose, net revenue slightly lower than BRL 10 billion. Operating cash generation BRL 581 per ton consolidated for the year.

And I would like to make a special mention to two indicators, SG&A and COGS, in the last two years growing at much lower rate than inflation effort productivity gain for our operations of 5% (11:31). One of the predominant factors in our strategy in terms of structural competitiveness are these recurrent gains in yield that we had and that we have been achieving in the last two years and we have already contracted for the next two years, 2017 and 2018, with the actions that we put in place. We had operating efficiency and with the new productivity gain in our operations for these years.

On the capital side, we continue to have a very relevant CapEx discipline. At the beginning of last year, we had given a guidance of BRL 2.4 billion of CapEx. And as the macroeconomic scenario and the exchange rate scenario and the product price scenario were lower than we expected, we were more conservative in our CapEx policy reducing this to BRL 2.1 billion at a certain point in time and then BRL 1.9 billion and we closed at BRL 1.85 billion. We are giving a guidance for this year of BRL 1.83 billion of CapEx.

And last year, we had the acquisition of forest in Maranhão in the last quarter, less than BRL 800 million in investments. And it's important to mention that these forests in 2017 will not yet bring expressive benefits. We decided to save the forests during the beginning of this year and we will only start to use them more intensively at the end of this year. So, we will not be deriving the benefit from the forests acquired still in 2017, but we will have the full benefit in 2018. So, we will have one additional benefit already contracted in terms of gain in cash cost as of 2018 by means of this important acquisition that we made.

Financial strength is something very important. We reached investment grade. All the metrics that we have in operations should already allow us to reach investment grade. We continue to carry out actions of liability management, and last year we had two issuances, important issuances, two green issuances, one abroad in a 10-year bond and one CRA in Brazil of 96% of the CDI. And, therefore, we have a cost of debt that is 100% dollarized and unfortunately, we were right by doing that because the real has been appreciating at a cost of 4.7% a year.

Our debt has been dropping consistently year-on-year. And even with the investment that we made last year of BRL 2.6 billion with the acquisition of forests, once again, we were able to reduce our debt to 2.6 times net debt/EBITDA ratio. And we had a dividend policy that was more conservative this year in spite of the huge cash generation that we achieved and we are preparing in our General Assembly (14:51), BRL 371 million to be paid out as in dividend related to 2016.

I think it's very positive, the fact that we've recognized the results and the evolution of our results in 2016, with the evolution of the operating cash generation, cash cost discipline in

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capital and in expenses, everything backed by – everything that we have done both in pulp and paper, but with a lot of financial discipline. The acquisition of forest assets that will generate more competitiveness for Suzano and the combination with the debottlenecking of Imperatriz will make Imperatriz a even lower cash cost plant. And a gradual increase in Eucafluff and we are more and more enthusiastic about Eucafluff that has been growing mainly in terms of female sanitary pads and adult diapers, not only in Brazil, but also abroad. And this allows us to think about some future moves regarding Eucafluff.

We have not defined anything in this regard, but we're very pleased with the evolution of the results that we have been achieving with our clients besides all these reasons. It's also important to mention that we already have a lot contracted for 2017. We will continue to strengthen our balance sheet with CapEx of BRL 1.8 billion, financial expenses of BRL 600 million, and BRL 375 million in dividend.

And this year, we will see an additional reduction in our net debt. So, this is all very positive, all the actions that we have been taking to repair (16:50) and to strengthen our balance sheet and we will conclude the debottlenecking of Imperatriz this year. We will continue to focus on cost and expenses. This is something that is really part of our DNA and it has to do with structural competitiveness, which is one of our pillars, and the second are our adjacent businesses.

Like the beginning of the tissue and lignin operations in the second half, which is also very positive and we will have a higher volume of Eucafluff in our operations, grow Eucafluff. So, everything that we have been doing at Suzano gives us the dimension of an evolution of value creation for our shareholders, still recognizing that we have volatility into relevant factors that are the exchange rate and the price of pulp.

And over time, we will try to mitigate this reliance on these two factors that are not really under our control. So, Suzano has been evolving and this is due to the group of 8,000 employees that have been working hands-on to achieve all that. And more important than that is the cultural transformation and the obsession for evolution that we see in all areas of the company. So, we are very pleased with the results, but very humble recognizing that we still have many opportunities that have to be tapped.

I would like to thank you now. And you may now ask your questions either to myself or to other members of our Executive Committee.

Q&A

Operator

Ladies and gentlemen, we will start the Q&A session. Thiago Lofiego, Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you. Good morning. Congratulations. Two questions, Walter. I apologize if you have talked about that, the downward review for the productivity in all the regions that you operate should generate an impact on your pulp cash cost expectation. Or is it already expected? Had you already included that in your cash cost curve?

And the second question, Carlos Aníbal, about the domestic paper market. We have been seeing some positive remarks from some other companies in this sector, and in other sectors as well about a gradual recovery of demand in Brazil. So, I would like to know if you can confirm the price increases that we have been hearing about for some types of paper, coated, uncoated and paperboard.

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

This is Marcelo Bacci. I will answer your first question about forest yield. No, it was not in all the regions. In the São Paulo region, yield went up and has been going up in the last few years. There was a small reduction, almost a marginal reduction in the state of Bahia, very much because of the weather conditions this year. And there was a slightly higher growth in Maranhão and also in Piauí, which is a region that is not part of our supply plan. So, any change of yield in Piauí has no impact on the current situation of the company. These changes were already included in our estimate for cash costs and they do not change the outlook that we have been mentioning regarding the supply of wood and, therefore, cash cost as well.

A - Carlos Aníbal Fernandes de Almeida, Jr. {BIO 6275986 <GO>}

Thiago, this is Carlos. Good morning. About your question, 2016 had a drop in demand for printing and writing, and also for paperboard of 2.8%. And from the viewpoint of demand, our expectation is that in 2017 we will have a similar demand to the one that we saw in 2016. We do not believe there will be a major variation in this regard. We do not see this beginning of this year, no sign or any factor pointing to a different scenario than the one that I have just shared with you.

From the prices viewpoint, we announced at the beginning of this year price increases for cut size, for uncoated and also for paperboard. Not differently from the previous years, we designed a strategy for implementation observing the characteristics of each product and each channel and we expect to see the result of the second half, these price increases really being in force.

Q - Thiago Lofiego {BIO 16359318 <GO>}

What level of exchange rate are you considering in terms of risking not having these price increases?

A - Walter Schalka {BIO 2099929 <GO>}

The exchange rate is only one of the factors considered in our pricing policy. Beside the exchange rate, we have - beside the dollar, we have euro, we have the renminbi, we have logistics cost, we have the availability, the supply of paper, our competitors in international markets. So, the dollar is not the only factor for our pricing. Today, we are working with prices around 3.2 (22:54) more or less in terms of exchange rate. But we

cannot limit ourselves to the dollar because the other variables ultimately have an important impact on our pricing policy as well.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you.

Operator

Marcos Assumpção, Itaú BBA.

Q - Marcos Assumpção

Good morning, everyone. Walter, you put as the main objective of the company working with structural competitiveness and you place a very clear objective, which is the cash cost reaching BRL 570 in 2018 and BRL 475 in 2022. And two other objectives are adjacent businesses and consolidation of the market. Walter, could you tell us about your target for adjacent businesses, a ballpark figure, maybe lignin and tissue and fluff will become a major percentage of the company in the future regarding the cash generation or the EBITDA of the company, and also regarding the third point which is the transformation of the industry? Because I know it does not depend on you alone, but what will be a target for the future for the sector? What would be the company's objective, more consolidation or that X% supply in the hands of next number of companies?

And, Carlos Aníbal, could you talk about the pulp market? We have been hearing that the market continues to be very strict, because OKI has not yet really started its activities. The clients have not seen any offers from OKI in the market. And do you believe this will bring an opportunity for further increase in prices, because inventories in Asia are normal or even below normal?

A - Walter Schalka {BIO 2099929 <GO>}

(25:04) good morning. Thank you for the question. I will put in perspective Suzano's view, our objective is value creation for our shareholders in a sustainable fashion, and we believe that structural competitiveness is a must in order to make this happen. And we will continue to invest looking for this competitiveness and not only because of the cash cost, but also working with the top line. We have been working with geographies in a very intensive fashion in pulp and also another relevant product, which is paper that will allow us to increase our top line, as we have been showing year after year.

On the adjacent businesses side, we are not going to give a disclosure to the market about our objectives. Of course, we do have our objectives, but what I can mention is the following. We will not be investing in businesses that do not have relevant potential or businesses have to have scalability, specifically fluff, a 5.6 million ton global business. We didn't get into that to be a small player, 95,000 or 100,000. This is just an introduction of the product and should we be successful, we will be growing in this market. Lignin is still crawling, I would say, not very relevant at the beginning, but with a very good potential. And tissue, by the end of the first quarter, we will be announcing the market which will be

our position in this product, whether we will be only in jumbo-roll or if we will start to convert and operate in B2C.

The company will be working in each one of these businesses and others that might arise always based on the concept that they create value in the short run. But even more important than that, scalability and creating sustainable competitive advantages in other businesses. We're very encouraged with the product that we have underway right now and that show that we have a potential to grow there.

And the last pillar of our strategy, but not less relevant is that we are very bothered by the fact that our industry has volatility in terms of ROIC, due to the factors that are well known to all of us. And over time, in a consolidated fashion, we have a low profitability industry. So, we have to redesign the whole industry.

You mentioned consolidation, consolidation is one of the alternatives, however, it's not the only one. So, we will be looking for ways to redesign this industry, so that the industry may have a more sustainable profitability. It will be very difficult to attract long-term capital to an industry that has a low profitability. And we want to give investors, both present and future, a level of profitability that may be more linear and not with ups and downs. So, this is what I would like to say about the strategy of the company.

A - Carlos Aníbal Fernandes de Almeida, Jr. {BIO 6275986 <GO>}

Marcos, this is Carlos. Thank you for the question. In last October, we saw an improvement in the market fundamentals, mainly in China, and this allowed us to open a whole series of price increases for pulp. And 2016 had a growth of 30.8% vis-à-vis 2015, according to the PPPC more than the one from 2015 to 2014. Hardwood dropped 10 days vis-à-vis December 3 days in relation to December 2015, the inventories. And this shows, once again, very favorable fundamentals and there are other price increases, four price increases announced in China since October. We see a high degree of confidence in the implementation of these increases, \$600 in China for February and we started to receive some orders with this amount. And new increases will be analyzed during this month.

The main message is that China continues to have low inventories, be it in the port or in the hands of our clients and the paper market in China is living a good moment, demand is going up. China is exporting more printing and writing paper, tissue growing, pulp, mainly eucalyptus pulp continues to replace non-virgin fibers. And we continue to see clients looking for a higher utilization of our fibers and because of all that, we have a positive outlook for the short run. In the second quarter, we have one concern about a reversal of this trend, because of new capacities coming to the market. But in the long run, our expectation is still very positive and orders from China have already started to come in at the levels that we mentioned.

Q - Marcos Assumpção

Thank you very much.

Operator

Karel Luketic, Bank of America Merrill Lynch.

Q - Karel Luketic {BIO 16467278 <GO>}

Good morning, everyone. Thank you for the questions. I have two questions. The first one to Walter. During the Suzano Day in December, you mentioned that you could be starting a possible unification of stocks during 2017. Walter, could you give us an update about that? Do you have any idea regarding the timing for that, any details regarding this?

And the second question is about cash cost, it's more a follow-up question. It was a big highlight of the quarter in my opinion and we've reached the levels of 2018 already in 2016. So, could you tell us, Walter, what kind of improvement would be reasonable to consider for 2017 and 2018?

A - Walter Schalka {BIO 2099929 <GO>}

Karel, good morning. Thank you for the question. Regarding your first question, it's not in the hands of the Executive Committee, it's in the hands of shareholders, mainly the controlling shareholder. And this is a discussion that is going on as we speak and it's very difficult to give you any visibility regarding timing, because it does not depend on the company, it depends on the shareholders' decision. So, we have no additional information to give you besides the one that we have already given you during Suzano Day in December.

Regarding the cash cost, our trend is a downward trend in cash cost, but it's not quarter-on-quarter. As I said before, we will see some variations in terms of the use of our own wood and third-party wood and the average radius, and also stoppages. In the first quarter this year, we have the stoppage of Line 1 of Mucuri, for instance. And this could lead us to have differences or variations quarter-on-quarter, but the whole of the cash cost is in a downward trend.

If you take a curve and you take the last 12 months, you will see that the cash cost is going down and we continue to maintain our objective of BRL 570 for 2018. For 2021, 2022, our challenge is very big, BRL 475 and a significant part of that comes from the forestry area. We have been making major endeavors, and the quality of our forestry operations are improving as we showed during the Suzano Day. We have been investing quite a lot in new areas and the increase of our forestry base in areas and the acquisition that we made recently is very relevant.

On the industrial side, we have been investing in the debottlenecking of our operations, but even more important is the reduction of specific consumption of chemicals for instance that has been going down. This has an economic and environmental impact, a very relevant one. So, we are very pleased with that and we will continue to invest in that. We believe that the objective that we placed of BRL 475 in 2021, 2022 is possible to be reached, and we have a very contracted structural issues for that. All we have to do is look for efficiency to get there. So, I'm very motivated by our cash cost. This is not the only parameter and it's not the most relevant parameter for the company. However, it's a parameter that gives us a very big resilience in our results over time.

Q - Karel Luketic {BIO 16467278 <GO>}

Thank you.

Operator

Lucas Ferreira, JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Good morning. Two questions to Carlos Aníbal. Going back to the pulp market, we see that the spot price for pulp in China is already higher than \$600, \$620, and this gives the impression that it is \$50 higher than the net price counting with the implementation of February. I don't remember having seen such a big difference in the spot price to the net list price before. Do you believe that the February increase could have been higher than \$30?

And do you think there is room for additional increases or does it have to do with European market that is more reticent with fundamentals that are not as good as China's? So, could you draw a comparison between Europe and China in pulp? And regarding paper, we do not have the figures for January yet, but numbers of December show that the import of printing and writing paper has already reached something like 15% of domestic consumption. Do you think there could be a risk of this figure continuing to go up and go back to a higher competition with imported product?

A - Carlos Aníbal Fernandes de Almeida, Jr. {BIO 6275986 <GO>}

Hello, Lucas. Our figures for January are according to what we expected. We do not foresee a big difference in demand between January 2017 and 2016. When we look at imports, imports dropped in 2016 vis-à-vis 2015 approximately 15%. Coated papers, which are the main products with which we compete with imported product, 10%, 12% (37:02) drop in the year. The comparison base will be more and more strict, because we are comparing figures this year with figures that from now on - with figures that dropped quite a lot in 2016 and 2015. Nothing should point to the fact that we will have more competition from imported product. They are similar to what happened in 2016.

Demand in China and the spot market, we have no indication - concrete indication about the spot market prices in China for eucalyptus pulp. It is bigger in softwood because most of the softwood is sold by trading companies. So, I don't have a lot of visibility about this figure. I believe that the increase announced for February was correct. Let's observe the evolution, so that we can see if we have room for an additional increase in March.

Prices in Europe and in North America announced for January were effectively implemented. Today, we have China going forward faster in price implementation than Europe and North America. China reacts more quickly whether it's upwards or downwards. China started to drop at the end of 2015, dropped very quickly. Europe and North America took longer to drop. And China started recovering in October, and the trend is that North America and Europe will follow suit.

Operator

Carlos De Alba, English.

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

Yeah. Good morning, everyone. Walter, a question for you. You mentioned that definitely the industry needs more discipline on investing. But the reality is the situation of the industry not generating returns above cost of equity is not new and yet we have seen a lot of new supply coming online in the last few years in South America and Southeast Asia. So, just what is your high level thoughts as to how or what will make the mindset of the industry leaders change, so they are more disciplined? Because again, time and time again, we see low cost producers continue to invest, and even not following some of them, the leadership that - in your case, Suzano has tried to establish in becoming even more disciplined. So, just wanted to hear your thoughts, because again this is not that is really new in the industry.

A - Walter Schalka {BIO 2099929 <GO>}

Carlos, thank you very much for your question. I think you are right in your remarks. We still lack more discipline regarding investment in new capacity, and the good news is that (40:40) we have no visibility regarding major projects right now. And this might lead to a certain degree into pressure over the increase in supply in the market. On the other hand, it's very important to say that, Suzano's thinking is always focused on value creation. We do not believe that the EBITDA margin is the right criterion.

And many people say, well, you are in an industry of high EBITDA margin, but what happened is that you have the flip side of the coin. We have a very high sustaining CapEx in our industry, and the right criterion is the criterion of operating cash generation, which is EBITDA minus sustaining CapEx divided by the asset base allowing us to see our ROIC. And we believe that this is the metric that should be tracked by the whole of the industry, and discipline should come as a natural consequence of that, because EBITDA margin and even EBITDA, they do not pay debt.

What really pays our debt is the operating cash generation, and you can see in the volatility of results of many companies in this sector, you can see how much the industry depends on the exchange rate and the price of pulp. So, we have to create value in the long-run, and because of that, we have to be very strict regarding placing brown or greenfield for the future. We have nothing to say right now about that, and we are looking more at a disciplined way of creating value in the industry.

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

All right, thank you. And then, a follow-up on Eucafluff. You mentioned that you didn't get into the fluff business to be a small player. So, what are the options for growth that you have? Is the fact that you're making fluff out of eucalyptus a limiting factor in your potential expansion? Would you consider getting into long fiber or softwood to allow you to grow more rapidly there? Would you consider expanding into other geographies to growth that business?

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A - Walter Schalka {BIO 2099929 <GO>}

Carlos, our competitive advantage stems from our eucalyptus hardwood fiber. We have no intention of growing in fluff with softwood. We want to grow in hardwood, and this is where we have our competitive advantage. And hardwood allows our clients to generate some benefits, major benefits regarding features in their products. We have a re-wrap rate (43:41) which is much better than softwood, and because of that, we have a higher protection against liquids for babies or adults or women, and this is very important. So, this is a major benefit that we have from hardwood and it's a feature of our product. On the other hand, if we wish to grow in this market, and we will be growing, should we be successful, we will not - no longer convert paper machines to Eucafluff.

We will be converting paper grade to Eucafluff. And this is the trend that we see for future investments. We have not made any investment decisions yet. But we see the level of acceptance that we have mainly in the female sanitary pads and adults diapers that are accepting (44:41) today in female sanitary pads, some players already run with 100% hardwood. In geriatric diapers, 50% hardwood already, better quality products than when they were 100% softwood. So, we are very pleased with the evolution everywhere (45:02) working on that. And we believe that in the future, this market could become - and this is not a projection. This is just a wish on our part that this market could be a market of over 2 million tons of hardwood fiber globally.

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

All right. Thank you, Walter. Just a clarification. You mentioned that you would no longer convert paper machines into Eucafluff. I didn't get that point.

A - Walter Schalka {BIO 2099929 <GO>}

Yes, exactly. We transformed one of our machines in the Suzano Unit in order to be a flex machine. It has been running part time Eucafluff and part time with paper for coated paper. And gradually over time, this machine will become 100% Eucafluff. And we will not be doing that with other paper machines, because we do not want to reduce our presence in papers. We will convert market pulp paper grade to Eucafluff.

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

Understood. Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

This is the way we foresee our future investment, and we have not defined any investment in this regard and where this is going to happen.

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

Perfect. Thank you very much.

Operator

Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good morning, everyone. Thank you. Regarding the pulp market, Carlos Aníbal, based on what you said and all the data that we track, in the short-run, the situation is still difficult. But the major debate has to do with the level of pressure and when this level of pressure will change. In the second half, we will see a new project coming on-board in Brazil and some acceleration on the part of the (47:02) 2018, there will be a more complicated supply and demand scenario. So, Aníbal, could you tell us from the supply and demand viewpoint, do you think 2017 will be more favorable for the full-year or should we be more concerned for the second half of this year?

And Bacci, regarding working capital, and I apologize for the very detailed question. You disclosed a very expressive use of BRL 500 million (47:37) in working capital. When looking at the major lines, accounts receivable, inventory, suppliers, we do not see a major variation. So, could you talk about the sustainability of this result because of the expressive help in this quarter? And Walter, maybe you have already answered that, but regarding discipline in Suzano, what about the closure of capacity scenario, should the scenario deteriorate? Are you considering this possibility? Thank you.

A - Carlos Aníbal Fernandes de Almeida, Jr. {BIO 6275986 <GO>}

This is Carlos, Leonardo. I reiterate our positive view for the short-run supported by the fundamentals and the price increases that we put in place recently. And regarding the year as a whole and 2018, I would rather not make any projection. What I can share with you is what we have in terms of knowledge from the analysis carried out by consultancy companies that cover our sector that show this supply and demand scenario that could bring about higher pressure on prices. So, I would like to limit myself to that, sharing with you only what the consultancy companies point for 2017 and 2018.

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

This is Marcelo, Leo. Regarding working capital, this is not a recurrent effect. In fact, it has to do with the calculation method and the major change in the BRL 500 million, rather BRL 370 million in dividend, which is in our accounts payable. Besides that, the variation of the additional BRL 100 million or so has to do with the inventory reduction that we had in the quarter.

And the last question that you asked, Leo, about discipline - commercial discipline, we reiterate our position. Our objective is not to break a record of reduction. We will continue to do that if it creates value to our shareholders. If a moment in time comes, which is not now, but let's say the industry, as a whole, has inadequate prices that do not remunerate capital sufficiently in spite of generating cash, we could make a unilateral decision of reduction of volumes. So, our position continues unaltered. The scenario now is very benign and the prices are going up and we are operating at full capacity.

Q - Leonardo Correa {BIO 16441222 <GO>}

Thank you.

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Operator

Juan Tavarez, English.

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

Hi, thank you. Good morning, everyone. My first question is on paper margins. I was surprised to see that you did see better volumes and your prices were quite flat, but your margins did contract quarter-over-quarter. So, I'm curious what drove that contraction in paper margins specifically.

And then, second, maybe if you can a little bit about the comment you made about looking for alternatives for the industry affecting consolidation. I'm curious what that could include. Is it further supply agreements similar to what Fibria and Klabin have or what other alternatives could there be to help discipline the market? Thanks.

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

Juan, good morning. This is Marcelo Bacci. I will talk about paper margins. As Walter said during his presentation, it has to do with the fact that we had downtime in this unit. So, our costs went up as there was a lower dilution of fixed costs and other expenses. In paper manufacturing in this quarter, we also had a slightly higher participation of the external market on our total sales and as you know, the margin is smaller in the external market. So, these two factors explain the fact that we had a lower margin for paper this quarter vis-à-vis the previous one.

A - Walter Schalka {BIO 2099929 <GO>}

This is Walter, Juan. About the industry redesign, people tend to imagine that the only alternative is consolidation. It is one of the alternatives, in fact, and it's creates a lot of value. However, it is not the only alternative, because it depends on factors that are not under the control of the companies' officers, specifically, Suzano's. So, we are looking for other alternatives.

And it could be a verticalization process or projects, as you mentioned, that were made by competitors and that generate a lower risk of price volatility. So, we are working on all these alternatives and they require time and they are unpredictable in terms of implementation timing, but we are very pleased by the fact that the other two pillars, structural competitiveness and adjacent businesses, have been growing. And they are opening new horizons for us, so that we look for other solutions.

In the meantime, Juan, we will maintain our balance sheet very strong and very well prepared for more significant moves in the future. Our intention is to continue to have a reasonable degree of liquidity and having long-term debt and with a low cost. Our average cost is 4.7% now and the - working to continue reducing our indebtedness over time. So this is what we have been doing at the company.

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

Okay. Thank you very much.

Operator

Ivano Westin, Credit Suisse

A - Ivano Westin {BIO 17552393 <GO>}

Good morning. Thank you for the question. The first is about the acquisition of land and forest. In October, you bought 75,000 hectares in Maranhão and Tocantins and making it very clear your strategy regarding increasing the supply of wood in Imperatriz and decreasing the average radius and assuring higher competitiveness. Could you quantify the reduction that you expect for 2017 in your average radius?

And the second question is about the outlook for the sector for M&A in pulp. It is clear that for the short run, the outlook is still positive, price wise, and for the medium run, the consensus is that the prices will be going down. So, could you tell us your view for consolidation in this sector? And mainly your net debt to EBITDA ratio is 2.6 times and there is a clear trend of deleveraging over time. Should the opportunity arise, I would like to know if the indebtedness level is already comfortable for you for the possibility of an acquisition?

A - Walter Schalka {BIO 2099929 <GO>}

Ivano, thank you for the question. This is Walter. I will answer about forests and land and Marcelo Bacci will talk about consolidation of the sector. Land and forests are fundamental. The acquisition that we made was the last relevant one in terms of acquisition of land and forests so that we may reach our BRL 475 cash cost in 2021 and 2022.

We do not envision any relevant acquisitions. Small operations might happen, but it's very clear for us that we have to decrease the average radius of the Company, of our operations and increasing our participation of our own wood vis-à-vis third-party wood.

And I would like to open a parenthesis here. Many analysts ask me if using a third-party wood couldn't reduce our asset base and, therefore, improve our ROIC. When we can have access to capital at a lower cost than the third-party capital that we have today in order to make this move, then we might do that.

In the meantime, as the cost of opportunity is much higher today than the third-party capital cost that we have and our leverage is low, we are choosing to increase the participation of our own wood. And by doing that, we will be increasing our operating cash generation, because if you have more third-party wood, this means that you have a higher sustaining CapEx and ours is BRL 1.1 billion, which is rather adequate for our operations. And approximately BRL 800 million of that comes from forestry area. So, in my opinion, we are taking the necessary measures to maximize return to our shareholders, increasing our operating cash generation.

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In summary, there will be no significant move regarding new acquisitions of land and forests, but we could have some small operations, not very significant ones, in order to continue to reduce our average radius. Regarding the perspective of our average radius, we are not giving a guidance right now about the average radius for 2017. However, it goes down vis-à-vis 2016. And these lands and forests, as I said at the beginning of the presentation, we acquired the 75,000. The impact will be very low on our 2017 operations, because, as they are young, we are waiting for them to grow and this will only happen at the end of this year. So, we will only see the effect of this acquisition in 2018.

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

This is Marcelo, Ivano. I will answer about leverage and consolidation. We have 2.6 times leverage and our comfort level is between 2 times and 3 times. Once our sectors, due to the volatility of the sector, naturally makes this figure oscillate, even if the indebtedness itself doesn't change. The major potential consolidations that you could see in pulp will not be made with debt, because the companies are too big and it's very difficult for one company to acquire the other.

This would have to be by means of a stock swap or some level of indebtedness, but this shouldn't be the main resource in this operation. The fact that we are carrying a major cash position does not mean that we are preparing ourselves for a specific acquisition. We believe that having a robust balance sheet and capacity and bankability is important, so that we may place ourselves as a major player in a consolidation process, which is our intention.

Q - Ivano Westin {BIO 17552393 <GO>}

Thank you. Very clear.

Operator

Bruno Giardino, Santander.

Q - Bruno Giardino {BIO 15974970 <GO>}

Good morning, everyone. The first question is about the inventory level of finished products. Can you keep the same volume because of the favorable price conditions? And the second has to do with line one Mucuri stoppage. Do you have an estimate about the cost from this stoppage?

A - Carlos Aníbal Fernandes de Almeida, Jr. {BIO 6275986 <GO>}

This is Carlos. Both in pulp and paper we have satisfactory levels, so that we may continue to - with our sales plan. This wouldn't be any restrictive factor, so that we could achieve a good performance.

A - Walter Schalka {BIO 2099929 <GO>}

Regarding the stoppage, Bruno, this is Walter. The Mucuri stoppage is happening as we speak and it should be resumed in three days. A ballpark figure, normally a downtime has

a cost of about BRL 20 million, just a ballpark figure for stoppages in general. So, I do not have an exact figure to tell you, but this is around this magnitude. Thank you.

Operator

The Q&A session is closed. We would like to give the floor back to the company for the closing remarks.

A - Walter Schalka {BIO 2099929 <GO>}

I would like to thank you all very much. Especially all the employees of Suzano who have been carrying out this transformation and mainly the cultural transformation for Suzano that we have been talking about and that we have been bringing by means of a executive committee, increasing empowerment and reduction in higher key levels and higher degree of approximation with all the links and the chain and all working together hand-in-hand and very successfully looking for better and better results.

And the beauty of all that is that the spirit and this energy are contracted at Suzano and we will continue to see an evolution in our results. Our strategy is very clear. We always look for value creation and we will continue to go after that quarter, after quarter, after-quarter. We are humble enough to recognize that we still have many opportunities and we will continue to work on these opportunities and we do not want to become arrogant because of the good results.

We should not rest, we should be proud of the results achieve, however, we have to continue to face all the challenges and we will be delivering better and better results. And with a recurrent value creation for our shareholders, I would like to thank you all very much and wish you all a very good day. Thank you very much.

Operator

Suzano Papel e Celulose conference is close. We thank you for your participation and wish you all very good day.

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