Y 2017 Earnings Call

Company Participants

- Carlos Anibal, Executive Officer of Pulp Business
- Fabio Prado, Executive Director for Consumer Goods
- Leonardo Grimaldi, Executive Officer of Paper Business
- Marcelo Feriozzi Bacci, Chief Financial Officer and Investor Relations Director
- Walter Schalka, Chief Executive Officer

Other Participants

- Carlos De Alba, Analyst
- Juan Tavarez, Analyst
- Karel Luketic, Analyst
- Lucas Ferreira, Analyst
- Marcos Assumpcao, Analyst
- Thiago Lofiego, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for waiting. Welcome to the conference call of Suzano Pulp and Paper to discuss the results for the fourth quarter of 2017. Participants will be in listen-only mode during the presentation of Mr. Walter Schalka, Chief Executive Officer; Carlos Anibal, Pulp Executive Officer; Leonardo Grimaldi, Paper Executive Officer; and Marcelo Bacci, Financial and Investor Relations Executive Officer. Afterwards, we will begin the question-and-answer session and further instructions will be provided. (Operator Instructions)

Be informed that certain statements in this call are projections and forward-looking statements. Such statements are subject to known and unknown risks and uncertainties that could cause the expectations expressed not to materialize or to differ substantially from the expected results. These risks include, among others, changes in future demand for the Company's products, changes in factors affecting the domestic and international prices of products, changes in the cost structure, changes in the seasonality of markets, changes in competitors' prices, foreign exchange variations, and changes in political and economic scenario of Brazil and in emerging and international markets.

I will hand over the call to Mr. Schalka, who will begin. Thank you.

Walter Schalka {BIO 2099929 <GO>}

Good morning, everyone. It's a great pleasure to have with you here. I'd like to thank you everyone for joining us for this presentation, where we are going to show the results and present the results of the fourth quarter and yearly results of Suzano in 2017. With us we have Carlos Anibal, Leonardo Grimaldi, Alexandre Chueri, Julia, Renato Tyszler, Fabio Prado, and Marcelo Bacci. We have all the management team at this conference. And please, in the end of the process, if you want to have Q&A session to any of our part of management committee, feel fee to make the questions.

We would like to start telling that we are very pleased with the results that we are delivering today. I think we had a record year in 2017 and the best-ever quarter on the fourth quarter in our history. And we are very pleased not only with that, but with the fact that we are paving new roads for the future and new alternatives in terms of creating optionalities to create value for our shareholders. I think the highlight that I'd like to mention to you is a very low cash cost that we had last year. It's the third year in a row on a nominal basis that we are going soft in terms of our cash cost. Our cash cost last year was BRL599 per ton. We -- end of the year, we've upgraded one notch on the Fitch to be investment-grade. And I think this is showing that we are building on our history a very strong balance sheet for the future.

Our cash-generation capacity, I think it's one of the highlights that we have. We had BRL3.5 billion last year on cash generation that we understand is the right KPI to be tracked within our industry. This CapEx is a very important part of our cost or our expenses. We need to have a much better view comparing not EBITDA as the right KPI of our industry, but the operating cash flow. And we had extremely good generation last year. And we have a very low income tax. Not only now, but for the future scenes, we have some fiscal benefits due to the fact that we have two of our major plants located in the North and Northeast part of Brazil.

And we continue to bring new alternatives in terms of value creation. Right now, we are very close -- and we are going to be more -- disclose information to you -- very close to the closing of our Facepa acquisition. And Fab is going to tell you a little bit about that. And we are preparing ourselves as an optionality to have a new pulp plant in Sao Paulo -- in the central part of Sao Paulo.

If you talk a little bit about our results of last quarter, as the the highlights, we have the cash generation, almost BRL1.1 billion in this quarter. The highest-ever EBITDA on a quarter is BRL1.4 billion. We have a very good EBITDA per ton in the pulp side. I think we are performing extremely well. And the prices going on, that is helping us. We have BRL1,222 per ton. The -- all of these numbers are much higher than last year and the last quarter as well. If you see the return on capital employed hike on the last quarter on annualized basis is going to be 19%. It's a very good number. And we understand this is feasible that we keep this level in the 2018, that is very positive. And we had record sales almost 1.3 million tons on a quarter.

If you see the full-year results of the Company, as I mentioned, the operational cash flow was BRL3.5 billion. EBITDA is BRL4.6 billion. The pulp cash cost, as I mentioned, it's below

BRL600. Record sales, almost BRL4.8 million tons of sales. The return on capital employed of 14.5%. And we understand that this number every quarter now is going north since we are delivering better results every quarter. And this is helping us to deleverage the Company at a very fast pace. Last year, we had 2.6 times net debt over EBITDA. And now, we are at 2.1 times net debt over EBITDA, very close to the floor that we disclosed to the market as our financial target, that would be below -- between 2 and 3 times net debt over EBITDA.

Now, I'm going to pass to Leonardo that is going to talk a little bit about the paper business performance.

Leonardo Grimaldi

Great. Thanks, Walter. And good morning, everyone. I'm going to comment on the paper business unit's results for the fourth quarter of 2017. We have presented a solid and positive quarter in terms of sale, with an 8% growth compared to the third Q '17 and a 5% growth compared to the fourth Q '16. These positive figures were achieved both in Brazil and internationally.

In Brazil, we had actually the best quarter in terms of sales since 2014. Our international sales, we have reached almost 100,000 tons in the quarter, very much in line with the third Q '17 and 7% higher compared to the fourth Q '16. Throughout last year, we have followed our strategy of using our commercial flexibility to serve 100% of our production, allocating volumes between the Brazilian market and more than 60 countries worldwide.

In 2017, we produced 1.16 million tons of paper and paperboard, slightly below 2016, mainly due to our flexed production of Suzano's Eucafluff in one of our paper machines. Last November, we had a maintenance downtime at the Suzano Mill, which is extremely relevant in terms of our paper and paperboard production. A maintenance downtime of this magnitude happens once every 30 months and must perform according to our expectations. It had, however, irrelevant impact on our cost of goods sold and, consequently, on our margins for the quarter. Our EBITDA margin was BRL780 per ton. And now, our ROIC for the last 12 months was 12%.

Now, moving on to the next slide. We foresee a positive pricing scenario for 2018, mostly due to increasing costs, which affected paper producers in general. We expect that non-integrated producers are being pressured even harder, especially due to the rising cost of pulp. We have put together a chart sheet to our right, which shows the correlation between pulp and uncoated paper prices in several regions in the world, according to RISI. In China, we have seen paper prices increasing in a similar way to pulp prices. European prices have risen in 2017, but still insufficiently to cover the cost increase in pulp. Today, pulp list prices in Europe are higher than offset prices. In our view, this is not sustainable.

Likewise, paper prices in Brazil have not moved sufficiently. Therefore, we believe there are two avenues for value looking forward, the first being new and higher price levels for our our exports volume and allocation. And the second being priced implementation in Brazil for all paper and paperboard grades.

I would now like to invite Carlos Anibal to present the results for the pulp business unit.

Carlos Anibal {BIO 19090865 <GO>}

Thanks, Leonardo. And good morning, everyone. We are very pleased with our numbers for Q4. Was another strong quarter for pulp business. And that was driven by strong operations performance and favorable market conditions. In fact, market fundamentals were very supportive. Average Q4 price was almost $680 per ton. And that is a plus $54 per ton on Q3 and almost $200 on Q4. Production sales were record in 2017. We grew production 2%, amounting 3.54 million tons. And our sales went up 2.5, reaching 3.61 million tons.

I want to take the opportunity to draw your attention, very important information here. Look at the difference between our sales and production in '17. So that means that we had a very important reduction in our stocks, 74,000 tons. We again reduced drastically our stocks compared to the end of '16. Important to say that we will be reducing our sales in the coming months, so we can bring our stocks to a still low but much more reasonable level. EBITDA per ton increased to BRL104 on Q3 and almost 5 bps on Q4. For the full year, we had an increase of 31%, reaching BRL1,077 per ton.

And finally, let's talk about the ROIC. That has increased all over the year. And we closed Q4 at 15.2%, which means almost 5 points over what it has achieved end of last year.

Moving to the next page. Our cash costs, excluding maintenance downtime for '17, was BRL599 per ton -- the lowest number of the last three years, a reduction of almost 4% compared to '16. Important to say that we keep our target for '18, BRL570 per ton. And looking at '21, '22, our number is still plus 475 of nominal values related to 2016.

Now, as I conclude my presentation, I hand over to Fab so can talk about our Consumer Goods business.

Fabio Prado

Okay. Thanks, Carlos. Good morning, everyone. We are happy to announce that we have already started our conversion operations in both sectors, Mucuri and Imperatriz. We have already started, I mean, making, I mean, finished products.

Our conversion capacity is 60,000 tons a year. And we just launched, I mean, our Max Pure brand. It's our first, I mean, consumer brand that Suzano launches in Brazil. It's a brand, initially is targeting North and Northeast, I mean, regions of Brazil, and offer consumers more softness, more absorption, and more performance.

A second brand from Suzano will be launched in Q2 2018. And from the second half of 2018, we are going to present segmented results for the consumer business.

If we move on, I mean, I'm very happy to announce too that we acquired the Facepa business in the North region of Brazil. Facepa is the largest toilet paper producer in Brazil's North and Northeast region. It is the market leader, with dominant shares in the North region and very competitive shares in the Northeast region. It has a capacity of around 50,000 tons and has mills in both Belem in the state of Para and Fortaleza in the state of Ceara. The products that Facepa manufactures are toilet paper, paper towels, napkins, and diapers.

Key data from Facepa is revenue BRL350 million and adjusted EBITDA around BRL58.3 million. The acquisition price was BRL310 million, which drives to a multiple of 6.17. The acquisition has already been approved by the antitrust agency in Brazil, CADE. And the completion expected to be done by the end of the fourth quarter 2018.

Okay. What are the key highlights for us? I think, I mean, the goal from our Consumer Goods business is to be the market leader in the North and Northeast of Brazil by the end of 2018. What would be the differentials? What would be our competitiveness? Basically, Suzano is going to be among the Brazil top three producers in capacity, around 170,000 tons. We will have consolidated brands and well-established distribution and sales channel. We expect to be operating Q4 2018 at an annual cash generation rate of BRL120 million and around BRL160 million one year after.

Now, I'll pass on to Marco, who is going to talk about the financial business.

Marcelo Feriozzi Bacci {BIO 17648865 <GO>}

Good morning, everyone. We are going to be talking here about our financial competitiveness and capital structure.

Starting with the capital discipline. We are showing here that in 2017, we completed the year with BRL1.8 billion of CapEx, pretty much in line with the guidance that we had given before. For 2018, we are now including the BRL300 million of acquisition of Facepa and also BRL300 million the 1st Tranche of the acquisition of land and forest from Duratex that we'll be talking about at the end. So the number for this year now is 2.4 billion. And we don't anticipate any new number at this point.

In terms of our sustaining CapEx, we would like to emphasize to you that we keep having a very competitive number that both on a nominal basis and also on a per ton basis has been performing very well over the last years. And last year, we had BRL234 per ton of sustaining CapEx. This year of 2018, we expect a similar number, BRL241 per ton, which is significantly lower when compared to any of our peers in the pulp business.

Also, on the tax side, we have some important points that I'd like to share with you. First, on the income tax side, we had a total tax payment -- income tax payment in 2017 of around BRL35 million, which is a very low number. And we expect this effective cash tax rate to go up a little bit in the coming years with the high profitability level that we have today. But we will not be above 20% in the long run, which is a very competitive level when compared to the average 34% we have in Brazil, given the benefits that we have, which are linked to the fact that we operate in the North and Northeast part of Brazil.

Also, on the VAT side, we have a very comfortable situation when compared to the industry. Everyone knows that any exporting business accumulates VAT in the chain. And by having a significant paper business and now tissue business that is becoming more significant over the next years, we're going to have a very comfortable situation in terms of monetization of VATs. That will not be an issue for us anymore.

On the debt side, we had very important improvements on the year of 2017. We closed the year with BRL9.5 billion of net debt, with an average debt maturity of 7 years, which is a significant improvement from the situation of last year. The average cost of that on a swap basis is 4.3% a year, which is very competitive, especially when taking into consideration the average debt maturity. Our net debt to EBITDA reached 2.1 times and gross debt to EBITDA 2.6, both of them reducing significantly from last year. And we accelerated the pace of reduction in gross debt because of the very healthy level of cash generation that we're having that allows us to work with less cash.

We achieved at the end of the year an investment grade by Fitch. We expect to have another investment-grade rating coming this year. And this was an important achievement. This was the first non-financial company in Brazil to achieve that kind of upgrade since the beginning of the Brazilian crisis.

Also, during this year, we did some innovative transactions, especially the 30-year bond, which was the first one in our industry. And those transactions allowed us to have a very comfortable amortization schedule, with around BRL2 billion of maturities in the coming three years and a significant part of our debt maturing after 2023.

With that, I will pass back to Walter that will talk about the acquisition of assets that we just announced.

Walter Schalka {BIO 2099929 <GO>}

Earlier this week, we announced one transaction on a relevant notice, where we acquired in the 1st Tranche 9,500 hectares in the Sao Paulo state an in addition to that, 1.2 million cubic meters of wood. The transaction was BRL308 million. The closing of this transaction will happen in the next 30-40 days, depending on the CADE approval, the antitrust regulator approval. And this is accretive to our operations in Limeira. Just with these acquisitions, we are going to reduce our average distance from our Limeira plant to our forest. And this is accretive to the Company. And this is on top of the BRL570 of cash cost that we announced. We have in addition reduction on the direction going south of the cash cost.

On top of that, we have one option that should be exercised by us till July 2nd of this year, where we could buy more 20,000 new hectares and 5.6 million cubic meters of wood. We are going to exercise that if we decide that we are going to have a new plant on that region. This would be subject to our Board-approved discussions, we didn't discuss yet. But we will bring to the attention to the Board these discussions. And if we decide that we are going to have a new plant on the region, then we will exercise this option.

You can see on the next slide the map of the region where you can see the different colors. The actual Suzano forest, we have right now 61,000 hectares on the region already. On top of that, the acquisition that we have just implemented and then now, this week, there is the 1st Tranche. And then, there, we have the option for the 2nd Tranche. And you can see that if we decided to have a plant on this specific region, we would have a very low cash cost. And this is one of the key drivers of value creation of our industries, to perform well in terms of cash cost. The idea is that if we decide to have a plant, we are going to have an average radius below 110 kilometers on the region. And this could enhance us -- could allow us to be much better prepared for the future with very low cash cost and enhance our total average cash cost of the Company. I think this is one additional optionality to what we consider to be the main criteria for capital allocation that we have.

As we mentioned during the Suzano Day, the first criteria that we have for new investments would be return on invested capital. Of course, scalability is a crucial, crucial thing for this. And this is -- as an example, we have the Consumer Goods that we start small. But end of this year, we are going to be a leader in one specific region or two specific regions. And we are going to be one of the top three companies in the country. And we will continue to invest on this business. And scalability is a quite important issue to have a sustainable competitive advantage, to create value, and to protect through difficult, to replicate all the key criterias that we have to decide for new investments. The Company will keep creating value to our shareholders. This is the mandate that we have from our Board. And we are going to keep delivering good results. I think we are very pleased with the results that we did this year. But looking forward to new options to create value to our shareholders.

With that, I would like to pass for the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions)

Our first question comes from Marcos Assumpcao, Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good morning, everyone. Congratulations on the strong results for the full year. First question about -- is on the exercise of the call option on Duratex? What are the factors that you are evaluating before you exercise that call? And if you go ahead with the project in the region, how much land do you already own in the region and how much would you need for a project in that -- in Sao Paulo state?

Second question is more on the M&A side. You mentioned what are the criterias for new investments for the Company? We believe (Technical Difficulty).

A - Walter Schalka {BIO 2099929 <GO>}

Marcos, thank you very much for the two questions. The first one related with Duratex deal is that we are going to exercise this option if we decide to have a new plant on the region. It's going to submitted to the Board. And our option exercise should be done before July the 2nd. Then it's going to discussed within the next few months on our Board. Of course, that we are just going to decide if we decide to have the new plant. We have already at the region around 70,000 hectares. And on top of that, we have the option to acquire 20,000 in addition to that. Then we would have around 90,000 hectares. And we could think in a possibility to have a plant ballpark number of 1.5 million tons on the region. We -- If necessary, we'll consider to acquire more land and more forests on the future.

Related with M&A, we prefer not to make any comment on that. We are going to pass this question. And related with the share class and the re-rating of the Company, we do not think that our shares right now represents the value -- the real value of the Company. If you see any kind of multiples that we have in -- related with EBITDA, related with operational cash flow that we understand there is a better criteria. With the discounted cash flow, our shares are not representing the future value that we are creating for this company. But this is a process that we understand that the market will realize that on the next coming quarters, since we a delivered good result. We -- in fact, we are going to see that the markets will reflect the value of the Company in our share prices in the coming quarters.

I think, with that, I'm going to go to the next question.

Operator

The next question comes from Lucas Ferreira, Banco JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi, good morning, everyone. So my first question is to Carlos Anibal. Carlos, how do we evaluate the supply and demand of the pulp markets now in the month of February since we have for the Chinese New Year? Apparently, if you look at the, like, the export numbers from Latin America in December, there maybe a lot of pulp coming to the market in the end of February. On the other hand, it seems like demand remains relatively stable, with the outlook of some price hikes -- paper price hikes in China in March. So my point is, do you guys expect prices in the region to remain flat? And what's your outlook for product [ph] marketing in March?

And then my second question is on the paper business. And regarding your expectations for 2018, if you can comment on both in terms of implementation of the price hikes that the Company has announced? How you have been evolving this far? It's a year where you are expecting a rebound of demand and, consequently, margins. So that would -- these would be my two questions. Thank you.

A - Carlos Anibal {BIO 19090865 <GO>}

Good morning, Lucas. Thanks for your question. (inaudible) and give a very broader view on the pulp market. And I want to do that starting from the demand. Actually, overall, we have a very positive view. And that is supported by the global economic growth expectation and by China. In China, we have the new paper capacities. We believe that between '17 and '18, we are going to have around 3.3 million tons of new additional capacities in printing and writing. We have the potential substitution of recycled paper. We have the ballooning CapEx disclosure. We have had that. We have seen that in the past several years. And again, we have the tissue growth itself. And that has been an important driver of the growth there in China.

For the short term, the demand is (inaudible) according to our expectation in US and Europe and seasonally weaker in China. And this is quite common now before the Chinese New Year. That will not be a point of concern for us right now. These in longer run, positive deals supported by the merger economies and fundamentally China have the Chinese government a cleaner China as a major goal, I think we can go on expecting positive impact on the pulp market, globally speaking.

Talking about the demand -- the supply side -- sorry, short term, in one hand that we see all the new products, additional capacity reaching the markets. We see the restart of some mills that were facing production technical problems restrictions. On the other hand side, we have several planned shutdowns -- maintenance shutdowns. And also important to mention, production reductions related to weather conditions and logistics constraints in the Northern Hemisphere. That combination, in my view, will determine the market behavior for the coming weeks. In the longer run, no major capacity is expected to start within the next three years. We also have -- we may have some surprise related to wood availability and cost, unexpected shutdowns, and conversions. All that can lead to a supply-constrained environment. Stocks, inventory is a little low, were in balance along the major supply chains from producers to consumer (inaudible) of different regions. And that was shown by PPDC [ph] numbers end of last year. So again, we have a positive view for the market.

Regarding the price announcements, we believe the conditions are in place and support our announcements for North America and Europe. In fact, we already are voicing customers and major customers in Europe at 1,030, which is the new price announced per ton. For China, we don't see the same support. And we expect price stability in the short term. So this is our view on the market fundamentals.

A - Leonardo Grimaldi

Okay, Lucas. Hi, this is Leonardo. I'm going to answer your question related to paper. For this year, for 2018, we expect that the domestic consumption in Brazil to be very much in line with 2017. We are forecasting growth in some product lines like paperboard, for example. But in quarter offset, we are considering a lower number due to the fact that the National Textbook Program, the PNLD, in 2018 will be 20% lower than what it was last year. And this volume was already confirmed by the government in the public (inaudible) presented in July 17. So all-in-all, we see the market very much stable. Therefore, we really believe that the big opportunity that we have is related to pricing. As I mentioned in my presentation, we foresee pricing upsides, both in international markets and in Brazil. Price implementations are going on in Brazil for all graphical grades in the month of January. They have started already and cut size [ph] , as you know. And we have announced for February, and that has started in the beginning of this month. So we are very positive that this trend will continue.

Q - Lucas Ferreira {BIO 16552031 <GO>}

And now, just a quick follow-up on the pricing -- price implementations here in Brazil, if you see imports as a threat to that?

A - Leonardo Grimaldi

It could have been in the past. But imports are now coming at a different level to Brazil. The imported products are trading much higher than they were in the beginning of last year. So that actually is helping our price implementation as well.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you very very much.

Operator

The next question comes from Thiago Lofiego, Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you. I have two questions. Walter, if you exercise the call option with Duratex, so how much more land do you -- would you need to be able to add new capacity, considering a potentially low-average distance level or low cash cost level for this potential new project? So just trying to understand how much more money you can or you will disburse if you decide to do the project in Sao Paulo?

The second question is also related to the project. Considering the land costs in the region are higher, I'm not sure about potential forest productivity -- if you could also give us some color on that -- inbound and outbound logistics, fiscal benefits. So just thinking about the project as a whole -- a potential new project in Sao Paulo as a whole, if a project in this region really the best option in your view? Or are there any other options that you guys can think of? And if you could compare maybe returns of this potential new project to the Maranhao project -- to the returns that you got in the Maranhao projects a few years ago? Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Thiago, thank you very much for the question. With this land, we have right now 70,000 hectares of land in the region. We have the possibility of exercise the call option, where we'll reach 90,000. There is enough to have a plant of 1.5 million tons if you consider that we have -- between 20% and 30% was from third parties. That is the ballpark number that we have in the Company right now. Then we will have enough land and forest to the project.

Comparing this project with other regions of the country. This area where we have excess forest and land right now have the highest forest productivity in the country, with (inaudible) higher than 50 cubic meters per year. Then we are -- and we decided that the most important thing to have on this plant is to mitigate or minimize the cash cost. Then the wood cost on the cash cost is the most representative part on that. And the cost of the wood on this process -- on this plant will be the lowest on our all plants -- the set of plants that we have right now.

Then we compare the alternatives that we have. And this is the highest return on capital employed with the alternatives. And the most hedged and protected reserves that we have since as we are going to have the lowest cash cost on our operations if we decided for this new plant.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Thank you, Walter. If I may, just still on that question, what is the timing that you think is reasonable for us to expect the potential announcement of your growth project?

A - Walter Schalka {BIO 2099929 <GO>}

As we mentioned, our option will be done -- the exercise time for this option is going to be July the 2nd. We need to have before that the decision if we are going to proceed or not with this new investment to the new plant.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Thank you.

Operator

The next question comes from Karel Luketic, Bank of America Merrill Lynch.

Q - Karel Luketic {BIO 16467278 <GO>}

Good morning, everyone. Thank you for the questions. I have two follow-ups actually. The first one is a follow-up on the recent question. Walter, if you could complement in terms of what you think would be the timing for the start-up of the potential mill, if you go ahead with the decision by mid year?

And the second follow-up to an initial comment you made, Walter, as well in terms of the recent acquisition from Duratex, the 1st Tranche, you mentioned the dilution in terms of cash cost in the region. Do you have an idea of how much that impacts your average cash cost per ton on pulp? And that will be great. Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Karel, good morning. Thank you very much for the question. If we decided for the new plant, usually, the timing for new project is around 26 months. It's what we considered between 26 and 27 months after the decision of the new plant.

Talking a little bit about the cash cost. As you may see, our cash cost numbers right now, it's below 600 from last year. We are targeting BRL570. But this project is going to be under BRL500 and close to BRL400, higher but close to BRL400, as the cash cost on the second round of plantation on the region. And then we are going to be in extremely good position on the average cash cost on our operations.

Q - Karel Luketic {BIO 16467278 <GO>}

That's right. Thank you.

Operator

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

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

Yes. Good morning, everyone. So, Walter, I have one question for you regarding the potential simultaneous actions of Suzano deciding to go ahead with a new pulp mill but is still pursuing an M&A opportunity with another pulp producer in Brazil. Is it something that you believe Suzano could do? Or you rather once you make the decision to go ahead with the pulp mill to exclusively focus on executing the construction and ramp-up of the plant initiating the potential idea of fundamental transaction?

Then, Marcelo, just a clarification, if I may, on the tax rate. Is that what would you call effective tax rate in that the cash rate or you -- the effective tax rate that should appear in the income statement? And then, finally, Carlos, you elaborated a very constructive outlook for pulp demand and that, that should support higher prices for pulp or at least stable prices. But what are the risks of substitution or demand destruction if we continue to see these kind of pulp prices and paper producers in -- around the world, maybe with the exception of China really struggling to push -- to pass through the higher raw material costs? Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Carlos, it's Walter talking. Thank you very much for your questions. I will start with the first one. I think it's very important to set the expectations for everyone. Our philosophy is a value creation idea. We are not going to be bigger. We want to be better. We want to be deliver better returns to our shareholders. If we want to be better, we must invest on new capacity look or going organically. This is one alternative that we are going to pursue. As it looks like to us right now that this potential new plant on the region with great value for our shareholders on a steady basis, even considering the volatility of pulp prices for the future.

As you -- as I mentioned before, we didn't decide for this investment yet. It's something that is going to be subject to Board approval and discussions on the Board. But be sure that if we decided for that, we will make all the sensitivity analysis based on pulp prices and exchange rate effects to consider if we are going to create value or not. We have a very high expectation in terms of spread of our work on every single project that we are doing right now. And it's not going to be different to that. We are not going to compare this with the alternative of M&A since, as I've mentioned before, we are not going to comment on M&A transaction. But we are very focused on value creation to our shareholders. And we are very disciplined on that and have just set this view to all our shareholder base right now.

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

On the tax rate, Carlos, we are talking about cash tax rate in this case.

A - Carlos Anibal {BIO 19090865 <GO>}

Carlos, this is Carlos Anibal speaking on virgin pulp substitution. Actually, we don't see that happening. We believe that our virgin pulp-based products will gain market share of plastics due to the sustainability of this product. And also, we believe that growing trends, driven by legislation and the environment, are encouraging more paper-based products. So again to summarize, we don't see that happening.

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

Thanks. Thank you very much, gentlemen.

Operator

The next question comes from (inaudible), Credit Suisse.

Q - Unidentified Participant

Hi. Good morning, everyone. Thanks for the opportunity. My first question is on the liability management. So we saw very interesting results in the risk management with the reduction of our cost of debt and increasing maturity. So just trying to understand if you think there is room to grow further in this regard. Do you think you can reduce further the --

or increase further the maturity of debts or decreasing the cost? Or are you comfortable with the current debt structure?

The second question is on the paper business. So can you talk a little bit more on the profitability this quarter. I understand that you had the higher cost because of the stoppage at Suzana units. But if you can isolate a sector and at least give a ballpark on where this EBITDA margin would stand if it wasn't for this downtime?

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

Okay, (inaudible). This is Marcelo speaking. I will talk about the liability management. There is room for more. Yes, of course, we have done a lot. So marginally, it's becoming more difficult. But I think now, with the upgrade that we got and the situation of the global markets, I think there is room to do more. This year, we've focused a lot on capital markets. Maybe on the bank markets, there is something that we can do in terms of both reducing the cost and increasing the average maturity. But it's becoming, of course, less impactful in terms of the global picture. And it doesn't make sense for us to increase the average debt maturity much more than seven years. But you can expect to see a bit more.

A - Leonardo Grimaldi

And (inaudible), this is Leonardo. Thank you for your question. And you are right. Our maintenance downtime at the Suzano mill is the key effect for our lower EBITDA margins per ton in the fourth quarter. We don't give guidance on the result of this maintenance downtime. But it would be much closer to the third quarter's results than what it was.

Q - Unidentified Participant

Okay. Great, Thank you.

Operator

Our next question comes from Juan Tavarez, Citi.

Q - Juan Tavarez {BIO 15083199 <GO>}

Hi, thank you. Good morning, everyone. So just my -- my first question is just a follow-up on paper profitability. And on the margin side, you mentioned that maintenance downtime was one of the main reasons why we saw that EBITDA per ton come down. But I'm curious just kind of looking over the last year or so, it seems like it's been more costlier than, let's say, the sales mix (inaudible). There has been a compression in your paper margin. I'm just curious if you can give us some visibility. Aside from maintenance, are there any other factors impacting your paper cost? And I guess, putting it in the context of your pulp cash cost targets, should this start to benefit? So should these initiatives reducing your pulp cash costs start to benefit this paper business at all? So just to get some visibility there.

And secondly, just on what, Walter, you commented on trying to be better at delivering returns. I'm curious if what your thoughts are on increasing dividends or doing share buybacks on use of capital that way? Thank you.

A - Leonardo Grimaldi

Okay. Well, thanks. This is Leonardo. And if we analyse the margins of the paper business '17 versus '16, actually, the key impact was exchange rates. The average exchange rate in '16, as you know, was 3.49; last year 3.19. And this affected very much the profitability of our exports, which represent close to 30% of our sales. So year-versus-year, the main factor was driven by exchange rate. And quarter versus third quarter, the main factor is maintenance downtime at the Suzano mill. We believe that we have reached the low end in terms of pricing. And as I mentioned before, this is much of an upside to it in that. So we are very positive that the future trends will now move in a different way than they have in the past months.

A - Walter Schalka {BIO 2099929 <GO>}

Well, thank you very much. This is Walter talking. I think capital allocation is the critical issue that we are facing right now. Of course, we understand that with this low leverage rate that we have right now, we can increase the dividend yield in the company. It's something that we are considering for the near-future. And now understand that even if we decide for a new major investment -- capital investment that would be the potential new plant, we are not going to increase the net debt or EBITDA over the financial targets that we gave to the market before. And then, we are going to be ready to increase the dividend yields. We are not considering a buyback program at this point of time. But of course, we are always going to consider this on our potential alternative that we have. We believe that our long-term view is that we are deleveraging the Company at a very fast pace. And right now, we don't need to deleverage anymore the company. And capital allocation is going and is right now the major issue that we are in discussions right now, how to keep creating value to our shareholders? We do not want to go south than 2 times net debt or EBITDA. I don't think that it is necessary to do it. I think it's a very comfortable position. Just remembering to everyone, our financial policies are between two and three times. And if we decided for a new major CapEx program, we would be in the maximum 3.5 times. And we will keep this financial targets and these financial policies right now.

Q - Juan Tavarez {BIO 15083199 <GO>}

Okay. Great. And just maybe just following up on the paper business and again tying it to your pulp cash cost targets. Will there be any benefit to your profitability in paper with the reduction in pulp cash costs or no? Are they two separate strategy?

A - Walter Schalka {BIO 2099929 <GO>}

Yeah. We have a certain benefit. You cannot forget that the Suzano plant, they are almost a 100% integrated that is affecting the results. On the other hand, just on the paper side, on Limeira and Mucuri, of course, there we are going to have the benefits since they are -- largely they are pulp plants that is delivering pulp to the paper business. We are going to have a minor impact on that. But we have other opportunities to reduce our cash cost in the paper side as well. And there, we focus to look for opportunities to enhance our profitability on the cost side as well on the paper business.

Q - Juan Tavarez {BIO 15083199 <GO>}

Okay. Great. Thank you.

Operator

Our next question comes from Lucas Ferreira, Banco JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi, thank you very much for the follow-up. My question is now on the cost side, for Walter. It seems like chemical prices have been going up a lot since oil is up. And we had some large inflation in chemicals. And I was just wondering, how your target for costs for this year is updated, given these large increases in chemical prices? Thank you.

A - Walter Schalka {BIO 2099929 <GO>}

Lucas, thank you for the question. We are facing, yes, some headwinds in terms of the chemical costs, that is going up. But even so, with this scenario, we think that it is achievable the targets that we are setting right now. Of course, we cannot forecast what is going to happen in the next coming months in terms of chemical products, since we have closing prices depending on international markets on this and Nasdaq. And this could affect our cost. But we cannot forget that more than 90% of our cost is real-related. And large part of our cost is wood-related. There is not going to be any major change, sorry, just going down because any major changes going there. Then we believe there is continue to be achievable the targets that we've set for this year.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you.

Operator

We are now closing the question-and-answer session. I'll pass the floor over to the Company for the closing remarks.

A - Walter Schalka {BIO 2099929 <GO>}

I'd like to thank everyone for participating on this session. I think it's -- we are very proud from what we are doing right now. Suzano is delivering year after year, quarter after quarter better results. And we are very proud of that. But we are looking for the future. We are looking for new opportunities to create value to our shareholders. We are looking for -- to enhance our operation on every single part of our organization, and to prepare our team, to prepare our employees. So it's a better (inaudible) want to grow we need to have a very clear plan of developing people in organization.

Thank you very much for participating with this session. And I hope you have a nice day.

Operator

That concludes the conference call of Suzano Pulp and Paper. Thank you for participating. Have a good day.