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FBR.N^A19 - Q2 2003 Votorantim Celulose e Papel S.A. Earnings
Conference Call

EVENT DATE/TIME: JULY 18, 2003 / 2:00PM GMT

CORPORATE PARTICIPANTS

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Raul Calfat *VCP - CEO*

Kirk Hayes *VCP - Thomson Financial*

CONFERENCE CALL PARTICIPANTS

Thomas Sosa *Merrill Lynch - Analyst*

Christiano - *Analyst*

Daniella - *Analyst*

Marcelo Kaya *CCSB - Analyst*

Eduardo Valentine - *Analyst*

PRESENTATION

Operator

Ladies and gentlemen thank you for standing by. 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. If you should require assistance during the call please press (*) followed by (0). As a reminder this conference is being recorded. I would now like to turn the conference over to Kirk Hayes [ph] of Thomson Financial. Please go ahead sir.

Kirk Hayes - VCP - Thomson Financial

Good morning ladies and gentlemen and welcome to VCP's conference call to discuss second quarter 2003 results. If you do not have a copy of the relevant press release, it is available at the company's website at www.vcp.com.br at the investor's link. Before proceeding let me mention that forward looking statements are being made under the Safe Harbor of the Security Litigation Reform Act of 1996. Actual performance could differ materially from unanticipated and any forward-looking comments as a result of macro-economic conditions, market risks and other factors.

With us today in Sao Paulo this morning is Mr. Raul Calfat, CEO, Mr. Valdir Roque, CFO and Investor Relations Director. First Mr. Calfat will comment in the company's second quarter results, and after that we will open for questions and answers. It is now my pleasure to turn the call over to him. Mr. Calfat, you may now begin.

Raul Calfat - VCP - CEO

Good morning ladies and gentlemen. Thank you all for joining us on today's second quarter 2003 earnings. Before I reveal the company's performance for the quarter, I would like to begin with some commentary on the recent behavior of the pulp and paper markets. During the second quarter we have seen pulp prices rising in response to inventory reductions in the international markets that occurred in the first quarter. This happened as a result of an imbalance in supply that was atypical for the period. Towards the end of the second quarter, supply returned to normal levels allowing producers to build inventories once again, which began to place downward pressure on prices. So, in the third quarter, prices had begun to pull back from their recent peaks. [national] paper-Brazilian paper markets experienced significant contraction during the second quarter as a result of diminished purchasing power brought on by inflation. As well as an [inaudible] monetary policy characterized by high interest rates. The drop in demand in the domestic markets particularly for cut size and coated papers reflected an 8% average retraction in the overall Brazilian paper markets during the first half of this year. I would like to emphasize that despite the appreciation of the Real, domestic paper prices remain stable, especially printing papers. The only product group that suffered any price reduction was carbonless and thermal papers. High prices were adjusted downward by 5%. However, this affect was partially offset by lowest costs as a proportion of production input are imported. We expect that domestic demands

in the third quarter will continue to be soft as a result of current economic measures. However, in the fourth quarter, the impact of seasonality could drive demand higher, aided by a lower interest rate environment, according to signals given by the current administration.

Moving back to VCP. During the second quarter our production continued to progress according to expectations, and we reached 80% of total production capacity. At the end of the second quarter, we initiated our 14-day maintenance shutdown. We expect that full production capacity will be reached within the next three months. I would like to also remind you that during the second quarter, the Real appreciated 14% which had a negative impact on our exports. However, our sales in the domestic markets, when translated into US [GAAP] were positively affected, offsetting the impact of the stronger Real on exports.

This confirms the strategic importance of VCP's diversified market exposure. A combination of a focus on market pulp, which is a global product, directed to export markets, and printing papers, mostly directed to the domestic markets, allowed us to produce strong earnings despite the low exchange rate environment. Just a final note on our CAPEX budget for the year-we had originally planned for investment of approximately \$220m in 2003. We have reduced this amount to \$190m. Why? We will continue to proceed with our main project, the lower amount reflects an adjustment to certain investment schedules as well as lower expected overall costs [for] investments. At this time I would like to turn over the call to our CFO, Valdir Roque who will comment on financial items for the quarter.

Valdir Roque - VCP - CFO

Thank you Raul. Good morning everyone. And thank you for joining us today. I would like to point out just a few items on the income statement and balance sheet, before we open the call to answer the questions. On the income statement we'll see that there are [net] financial expense in US GAAP [remaining practically] and [changing] despite the appreciation of the Real during the period. This is an important point because it shows that VCP's positions are [inaudible], and even during periods of higher exchange rate volatility.

The 14% appreciation of the Real during the period also had an impact on our income tax rate which you will notice was lower in the second quarter of this year. VCP is participating with [inaudible] the company has been taxed at 3% of sales revenues and 34% of financial revenue. Before the Real appreciation, the tax rate was lower. By year-end, we expect that our tax rate will be around 15-16% depending on the exchange rate level.

On the balance sheet side I would like to point out that after the apparent increase in our main debt position, our US debt, was actually a function of the Real appreciation on Real denominated debt. In real terms we had a reduction, even considering the payment of the dividends of \$40m. We also expect the continuation of this reduction by the year-end. That concludes our opening remarks, on the second quarter earning. And we will now be happy to take any questions you may have. Operator please continue.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we will now begin the question and answer session. If you have a question please press the (*) followed by the (1) on your touchtone phone now. If at any time you would like to remove yourself from the question queue, press (#). Please restrict your questions to two at a time. Our first question comes from Mr. Marcel Kaya [ph] with CSSB [ph].

Marcelo Kaya - CCSB - Analyst

Hello gentlemen, good morning, congratulations on the strong results. My question really is about the cycle, and how you see downtime versus accumulating inventories in the coming months. How this might be a bit unfair of a question, but as a major shareholder, in Attacruz [ph] when you go to the board meetings, how do you see this decision from Attacruz [ph] to accumulate inventories instead of taking down time? And then, how do you see VCP in the second half of the year? Do you see VCP taking more down time? Or if the cycle does not improve do you see VCP also going for a policy of accumulating some inventories?

Valdir Roque - VCP - CFO

Thank you for the question, Marcelo. As we see, we should have some sliding pricing during the third quarter of the year on account of the summer vacations in the Northern Hemisphere. But we see some kind of rebound during the fourth quarter. Mostly on account of macroeconomic conditions in the US. That may be pushing other economies as well. Also, China. If you looked at Chinese statistics during the first 5 months of the year, they have been importing at a rate that is lower than expected. Last year they imported something about 5 million francs and during the first 5 months of the year they have imported approximately 40% of what they did in the same period of last year. So, as we see, stocks are not at the high level at the moment. Although [inaudible] are situated at something like 1.7 [million] tons. You can consider overall stocks, also taking into account consumer stocks, they are not high at the moment. And as demand recovers during the fourth quarter, we may see prices going back to the previous levels. So, answering your question about down time, or accumulating stocks-we think that the decision of accumulating stocks for this period, and a rebound is foreseen for the near future, is a proper decision. I would say the decision of downtime should be taken [inaudible]. So this accumulation will remain in stock for a long period, and maybe present prices [inaudible]. But this is not the case. So I think that accumulating stocks at this moment is the right decision.

Marcelo Kaya - CCSB - Analyst

How, if we don't see any improvement in the cycle, in the second half of the year. Let's suppose that things don't work out the way we would like. Do you see VCP also going for that policy?

Valdir Roque - VCP - CFO

If we don't have a rebound in the international economy, and the demand doesn't move up, and we continue to have an imbalance between supply and demand, I would say that our decision would be going for some kind of downtime. But of course [inaudible] just in case we don't see a rebound coming during the fourth quarter, which in our opinion is not the case.

Marcelo Kaya - CCSB - Analyst

Okay, the second question I had, very quickly, is about the trend in the paper market in Brazil given the state of the economy which continues to be weak. Do you see any pressure on prices, especially when you look towards the end of the year?

Valdir Roque - VCP - CFO

Well, domestic prices have been stable during the second quarter despite a drop in demand. You are quite right when you say that domestic markets for every good in Brazil is actually suffering at the moment from macroeconomic conditions. We expect that the market won't recover during the third quarter. And only during the fourth quarter, on account of seasonal reasons. And also because we believe that the government will start dropping interest rates from next week. So, we believe that the markets will move up. So, during this period, Marcelo, I don't see any movement in prices for the domestic market. My opinion is that they will remain stable, provided of course, domestic, or the exchange rate between the Real and the US Dollar remains at this level. I don't believe that the Real will further strengthen against the US Dollar, on the opposite, the Real should actually maybe weaken during the coming months, reinforcing domestic prices. But if they remain, the exchange rate remains as it is now, I believe prices are going to remain flat.

Marcelo Kaya - CCSB - Analyst

That is helpful. Thanks a lot.

Valdir Roque - VCP - CFO

Thank you.

Operator

Our next question is from Mr. Thomas Sosa [ph] with Merrill Lynch.

Thomas Sosa - Merrill Lynch - Analyst

Yes, good morning. How are you? And congratulations on a very strong result. Quick question on your pulp production ramp up. We noticed that production didn't increase much in the second quarter, versus the first quarter, and I was wondering if you could elaborate a little bit more on the learning curve of the new fiber line. And your inventory, number of days of inventory in production, you have on hand. And also, if you could give us some sense regarding your pulp cash cost, it went up substantially year-on-year despite the higher production and therefore dilution of the cost that was [profitable] and the weaker Real. So, if you could maybe talk to us about what's going on with the new line. What are your expectations in terms of production for the second half of the year? If you continue [inaudible] 700,000 ton target for pulp sales and on your cost side what's going on?

Raul Calfat - VCP - CEO

Thank you for your question, Thomas. During the second quarter our production of market pulp was about 170,000 tons in comparison with 162,000 tons during the first quarter. But you have to take into account that during the second quarter we stopped our pulp line for a week on account of the yearly maintenance. So, this has actually affected production. But during the quarter, we operated with an average capacity of about 80%. We have had some profit adjustments, and during the maintenance which took 14 days, it was actually 7 days during the second quarter, 7 days will affect the third quarter. But after this maintenance, we have changed some equipment in our digester and we have done some fine tuning also in other areas of the pulp mill. So, our expectation is that along the third quarter, by the end of the third quarter, we may reach the nominal capacity. I would also like to mention that pulp inventories have raised. They've been 54,000 tons by the end of last quarter, and they climbed to 62,000 tons. They are now at 42 days. But, actually we have increased inventories mainly on accumulation for the yearly maintenance in order to serve our customers during the yearly stoppage of the pulp mill. Concerning the cash cost. The cash cost actually raised and this is a deliberate policy for bringing wood supplies from third parties. The average distance has raised also to 350 kilometers as opposed to 215 kilometers at the same period of last year.

We are bringing our wood supplies representing roughly about 20-25% of our needs. And what we are doing actually, is to save our wood resources for a possible future bottlenecking. As you know we have a possibility in the near future to do with the bottlenecking, which we estimated between 150,000-200,000 tons. But we can only do that if we have enough wood supplies. So we are saving our forests for that purpose. In addition to the wood costs, but, just to finalize on the wood costs, I believe that due to this strategy, Thomas, we may continue having this kind of average distance and this kind of proportion from third parties along next year as well. So that we have enough wood for the bottlenecking. Concerning other costs, and focusing on materials, we had also an increase in chemicals, mostly caustic soda, on account of prices which had raised in the international markets. And also on account of contracted supplies for peroxide and ozone. In view of the learning curve effect on the take or pay arrangement. So, these raw materials have a take or pay arrangement as long as we don't produce a nominal capacity, we of course had to pay for the full quantity of these raw materials. So, this has affected somewhat, the cost during the second quarter.

And other variable costs, we also had additional costs associated with the new recovery boiler, where [inaudible] has been temporarily replaced by natural gas. Our learning curve adjustments have been introduced. On fixed costs, we had a reduction associated with the higher volume. So, this actually covers every item of the cash costs.

Thomas Sosa - *Merrill Lynch - Analyst*

Raul thank you very much. And could you, or maybe Valdir, explain the selling expenses that they were quite high despite stable volumes. Could we what should assume going forward, is it 10% of net revenues, or can we assume that there were some unusual items that impacted some expenses?

Raul Calfat - *VCP - CEO*

Tomas, Valdir is going to answer, but we don't have a percentage actually. But Valdir is going to give you a comment on our freight expenses which have affected variable costs.

Valdir Roque - *VCP - CFO*

Thomas, let me comment a little bit on this. [Selling and market] expense, you see, is higher expense [inaudible] with \$2m being the effect of the lower [devaluation] on the Real, the [pressure] of the [devaluation]. And the \$2m is basically regarding higher freight costs, along the period. Okay. Regarding general and administrative expense, you can see this difference is mostly regarding the effect of the devaluation of the Real [appreciation].

Thomas Sosa - *Merrill Lynch - Analyst*

Fair enough. Thank you very much, gentlemen.

Operator

Ladies and gentlemen, as a reminder, if you would like to pose a question, please press the (*) followed by the (1) on your touchtone phone now. Again, ladies and gentlemen, if you would like to pose a question please press (*) (1).

Our next question comes from Mr. Eduardo Valentine [ph] with [inaudible].

Eduardo Valentine - *- Analyst*

Hi how are you, this is actually Christiano [ph], good to talk to you. Can we understand then about what you mentioned about the bottlenecking, that you decided to go through with it? And if you have, could you give us some more details on the CAPEX and expected timing for the new pulp capacity to go online? And, it wasn't quite clear to me the tradeoff of buying, now, third party wood, to conserve the wood that you would need because of the bottlenecking. Couldn't you do the opposite and use your wood now, and then after the bottlenecking buy from third parties? It wasn't really clear to my why the tradeoff is positive the other way around.

Valdir Roque - *VCP - CFO*

Thank you Christiano for the question. Actually, we have no decision taking place so far for the bottlenecking. But we see a clear opportunity in the near future. Once we get some [inaudible] on our pulp line, which we expect to have by the end of this year, we are going to watch closely all possibilities for the bottlenecking [within] our profits and equipment. And then take a decision for the [profit side], when the market permits this additional quantity. So by that time we will have a decision being made. We estimate that the cost for this additional capacity will be lower than \$500 per metric ton per year. So, a very attractive project. We have decided to bring some wood at the moment, from third parties because there was an opportunity and the cost was also attractive, although we have this burden of the average distance affecting the final cost.

But we think that by buying this wood at this time, and saving our forests, would be a better decision for reducing costs overall and also for allowing the bottlenecking, if the market permits at the proper time.

Christiano - - Analyst

Okay. I got it. Another question concerning your capital structure and your debt level. Considering that you pay because of the fiscal structure, that VCP is set up in. Since you pay 35% in income tax on financial revenues, do you think that it is the best idea right now to start reducing that debt and accumulating cash? Or would it be wiser to maybe increase the dividend payout, lower the cash position, the gross cash position, so that you wouldn't have to incur any very high taxes as the financial revenues take place?

Valdir Roque - VCP - CFO

It's a very good comment, Christiano, but I should explore a little bit more the explanation regarding, the explaining of VCP. Remember when I said that if financial-financial increased the tax about 34%, but that's all part of overall tax planning. Remember that in [inaudible] you are being taxed 3% of sales, but, when you create a [inaudible] [inaudible] we move all the cash and all the expenses to the back. That means, this amount has been compensated to other-to avoid the 34% on the financial revenues. Because that has been taxed in real, real terms-not [inaudible] Okay?

Christiano - - Analyst

That's right, that's right. I remember that now.

Valdir Roque - VCP - CFO

Yeah, we have [inaudible] VCP but we don't have a [inaudible] in that. That's the reason what we're tax planning now, is working very good. You know?

Christiano - - Analyst

Perfect. Yeah.

Valdir Roque - VCP - CFO

Okay, one thing compensates the other.

Christiano - - Analyst

Yeah. Thanks a lot.

Valdir Roque - VCP - CFO

You're welcome.

Operator

Our next question comes from Ms. [Daniella] [inaudible] with [inaudible].

Daniella - - Analyst

Hi, good morning. My question is also regarding costs. After the downtime, due to some fine tunes, can we expect any cost reductions?

Valdir Roque - VCP - CFO

Yes, Daniella, for sure. As I mentioned, for this period of time, not on wood, but on other items. Especially in chemical products. So, what we expect is that by the end of the year, chemicals will represent a saving of something around \$7 per metric ton on the current level.

Daniella - - Analyst

Okay, thanks.

Operator

Our next question comes from Mr. Thomas Sosa with Merrill Lynch.

Thomas Sosa - Merrill Lynch - Analyst

Just as a follow-up. Could you confirm that the company continues to expect a target sales of paper of maybe 580,000 tons for this year, and 700,000 tons of pulp-market pulp?

Valdir Roque - VCP - CFO

Yes, Thomas. We are considering something around those figures.

Thomas Sosa - Merrill Lynch - Analyst

Okay, and you mentioned CAPEX for this year will be something like \$190m. Do you have a sense of what CAPEX is for 2004 please?

Valdir Roque - VCP - CFO

We think that for 2004 it will be something like \$130m not considering new initiatives.

Thomas Sosa - Merrill Lynch - Analyst

I'm sorry, how much?

Valdir Roque - VCP - CFO

\$130 dollars, but this does not include any new initiatives.

Thomas Sosa - Merrill Lynch - Analyst

Okay, thank you very much.

Operator

Ladies and gentlemen if you would like to pose a question please press (*) followed by the (1) on your touchtone phone.

This concludes today's question and answer session. Mr. Calfat, at this time you may proceed with your closing statements.

Raul Calfat - VCP - CEO

Well, thank you very much for your attention. Thank you all.

Operator

This concludes our VCP second quarter 2003 results conference for today. Thank you very much for your participation. You may now disconnect.

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