



ELDORADO DISCLOSURE

# Good performance for Brazilian pulp in 2013

Perspectives for 2014 point to a stable first semester and pressure on prices in the last six months of the year

Having overcome the pricing loss suffered in 2012, due to the international crisis, Brazil's pulp industry has reasons to celebrate its 2013 results: with a better exchange rate and stable volumes, export revenues stood out as the main gain for the year. The latest *Bracelpa Report* divulged by the Brazilian Pulp and Paper Association shows that the production of hardwood kraft pulp between January and December 2013 amounted to 15 million tons, representing an increase of 7.3%. From January to December of last year, exports of the commodity increased 10.2% in relation to revenues for the same period the year before, having totaled US\$5.1 billion in 2013.

This positive balance, however, is not only due to a better exchange rate and bigger volumes. Quality raw materials, cutting edge technology and highly qualified professionals are also important factors for the

Brazilian industry's performance, which currently occupies the #4 position in the global ranking of top pulp producers.

Carlos Monteiro, Technical and Industrial Director at Eldorado Brasil, points out that, in addition to high technological equipment, which stands as key assets of the company, the valorization of human capital is also another important factor. "One of our competitive advantages is that the productive chain is insourced. In the forestry area, for example, we plant on leased land, but all labor belongs to Eldorado. This ensures quality, increases efficiency and competitiveness."

Monteiro also said that the Eldorado system is the opposite of what is commonly adopted in the market. "We own only 30% of the land we use, while the other 70% is leased. This way, the company maintains the landowner in the region but, at the same time, we are responsible

for all the labor, machinery and planting and harvesting processes. This allows people to have an income, recover their properties from a productive and environmental perspective and not be excluded from the business.”

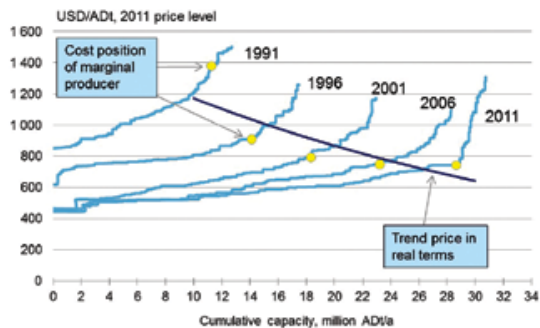
Lwarcel Celulose credits a good part of its competitive advantages to the forest. “Forestry is still one of Brazil’s biggest competitive advantages. In our case, the forests are located in the middle of the state of São Paulo, at an average distance radius of 63 km from the mill, constituting a very competitive transport value. Our productivity is also excellent, since we have genetic material that has been developed for many years. At present, it amounts to roughly 54 m<sup>3</sup> per hectare/year, which allows us to reach a production of 12.2 tons of pulp per hectare/year,” said Luis Künzel, the company’s managing director.

For Bahia Specialty Cellulose (BSC), a highly productive forestry base is a key factor for competing in the global specialty cellulose market, which possesses very different demands from market pulp, particularly due to the need for higher levels of purity. Technology Director Marcelo Moreira Leite says that the company has two research centers: one dedicated to production processes and another to forestry. “The combination of these two centers allows us to develop genetic material appropriate for each segment we do business.”

According to Pöyry Tecnologia, there is a growing trend in the global pulp industry: production cost curves are becoming horizontal, which factor exponentially increases the competition level among players. The **figure**, here reproduced, shows how the most competitive mills have been improving over the years.

### DEVELOPMENT OF THE COST CURVE FOR HARDWOOD MARKET PULP SINCE 1991

Production cost curves throughout the world are becoming horizontalized, significantly boosting competition intensity:



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Even though the linearization trend in the forestry area of the global industry has already aroused the attention of key Brazilian players, Walter Lídio Nunes, CEO of CMPC Celulose Riograndense, bets on the competitive margin conquered over the last years. “In a certain way, advances in the forestry area still overlap systemic factors that reduce competitiveness of Brazil’s industry. These aspects do deserve all our concern, since they affect enormously the country’s entire processing industry,” he said regarding tax and infrastructure problems we currently see today.

Cenibra’s CEO, Paulo Eduardo Rocha Brant, agrees: “Brazil’s corporate environment is still very unfriendly. In 2013, we had an attenuating factor, which was a more favorable exchange rate, but this does not exclude the need to fight for institutional improvements. The government needs to act more intelligently in order to develop and attract investments for Brazil’s industry.”

In order to circumvent structural bottlenecks and maintain competitiveness on the rise, Fibria possesses a complex logistics system, utilizing everything from more traditional transportation modes, such as railroad and highway, to the use of barges, which is cheaper, safer and offers a lower environmental and social impact. “The wood that supplies Fibria’s industrial units is, most of the time, transported by trucks, as is natural in Brazil, where highways are the main transport alternative. Barge transporting is used between the Caravelas Maritime Terminal in Bahia and the Portocel Barge Terminal in Espírito Santo”, said the industrial director Paulo Silveira.

Another logistics advantage of Fibria is the fact that the company is part owner of the Portocel ship terminal, located adjacent to the company’s mill in Aracruz (ES). The specialized terminal, which belongs to Fibria (51%) and Cenibra (49%), is responsible for approximately 70% of all pulp exported by Brazil and is recognized throughout the world for the quality of its operation and moving of goods. Silveira points out that the company’s logistics system transcends the borders of Brazil: “When the pulp arrives at the country of destination, it is up to the company to receive the cargo, store it and arrange different means of transportation to deliver the product to the distribution centers or plants of clients.”

The port’s efficiency also contributes to significantly increase Cenibra’s competitiveness. “Roughly 90% of our production is earmarked for the international market. And our mill is located practically on Vale’s railroad that goes from Vitória to Minas, and is considered the best railroad in Brazil. The freight wagons enter the mill, load the pulp and then head to Portocel,” said the CEO.

Besides logistics, Cenibra bets on continuous technological improvements and efficient management to maintain a good level of competitiveness. "Since our industrial plant is old (the first line was inaugurated in 1977 and the second in 1994), it has the disadvantage of not having a series of evolutions seen in current plants, such as more compact sizes and less energy and raw material consumption. Therefore, we continuously invest in replacements with an eye on increasing performance and we work under very rigorous management, which follows the Japanese culture," said Brant.

In search of greater competitiveness, investments in technological modernizations extend to the company's forestry base. Brant informed that, just a few years ago, eucalyptus harvesting in Cenibra's forests was not totally mechanized. "Technologies at the time allowed harvesting to be mechanized up to 27° of inclination. The problem is that we are located in a mountainous state (Minas Gerais) and a good part of our forests is located on slopes. This caused 35% of harvesting at Cenibra to be done the conventional manner, that is, manually," he said.

Very inefficient, this hard work, which involves a certain risk to employees, needed to be substituted. Therefore, in 2012, Cenibra introduced some technological innovations, using more modern equipment and adaptations developed by the company team. "The results were very positive and the expectation is that, starting this year, 100% of our harvesting will be mechanized, significantly reducing harvesting costs," said Brant.

### Entry of new capacities requires caution in 2014

Pöyry Tecnologia says that demand for BHKP continues growing at an average rate of 1 million tons per year, whereby short-term growth continues concentrated on eucalyptus pulp in Latin America. The reasons for this projection are the closing down of non-wood pulp plants and small pulp and paper mills in China, as well as noncompetitive mills in developed nations; changes in the composition of fibrous raw material for paper, which favors the use of BHKP, and the use of pulp outside the paper industry, which has been growing rapidly particularly in the hygiene sector (non-woven and fluff pulp), textile sector (soluble pulp), chemical specialties and cellulose derivatives.

In 2014, however, the scenario is one of caution among players in the segment. "Due to the delay in certain projects that were announced for last year, we will see stability, a very tight ratio between global



LWARCEL DISCLOSURE

demand and supply. Until the end of the first semester, we will still see a positive scenario. For the second semester, the situation reverses with the end of the learning curve of new capacities and supply slightly greater than the normal growth in demand," said Fibria's industrial director.

Also according to Silveira, because of this pressure, we could see a price slightly below what's considered healthy for the market in the second half of the year. "Historically, these 'valleys' in the price curve do not tend to last more than two or three months, since the industry does not sustain this. Less competitive players hold off on production, capacities are closed down – as well as the possibility of new delays in the start-up of mills already announced –, and the market adjusts itself on its own." He guarantees that Fibria does not run this risk, since it has a very advantageous cost position. "Certainly, this scenario is not positive for the industry overall, as it creates stress and volatility in the market, but the trend is that everything adjusts itself," he said.

As representative of one of the new capacities entering the market this year, Alexandre Nicolini, vice-president of Sales & Marketing at Stora Enso, commented about the joint venture operation with Arauco, in Montes del Plata, Uruguay: "The plant's start-up was postponed due to a delay on the part of an equipment supplier. The start-up of operations, which was scheduled to occur in September 2013, ended up being postponed until the first quarter this year. We are currently concluding all plant commissioning phases and we are at an advanced stage."

Regarding expectations of the start-up moment, Nicolini agrees with Silveira. "The market expected that the two mills (our joint venture and Suzano's new mill - *O Papel* magazine's January 2014 Cover Story) could impact the market already in the first semester of the year, but this did not happen due to some minor delays.

Lwarcel Celulose credits a good part of its competitive advantages to the forest

Therefore, the current expectation is that prices will remain at a reasonable level in the first semester of the year." **See the complete list in this edition's Price Indicators column.**

Nicolini says that Stora Enso already has contracted volumes for the 650 thousand tons/year it is entitled to from the total production of 1.3 million tons/year in Montes del Plata. "These long-term contracts ensure that this volume will move. With the exception of exogenous factors that are beyond our control, such as price and exchange rate variations, we are looking to move our production in a balanced manner and in various regions, with the objective of ensuring the best return on capital invested," said the executive about the strategy.

In a recent interview to **O Papel magazine** regarding Suzano Papel e Celulose's strategies upon starting up production at its new mill in Imperatriz (MA), with an installed capacity of 1.5 million tons of pulp year, COO Ernesto Pousada emphasized the role of the global economic situation. According to him, the impact of extra production entering the market is natural, however, if the global economy remains warm, the risks of an eventual excess supply and the ensuing impact on pulp prices drops. "These issues are much more related to performance of the global economy than the start-up of new mills. If the world economy continues to grow and segments such as tissue continue growing, the market will be able to absorb this pulp without major impacts on price," he said.

The CEO of Cenibra also believes there won't be any cataclysm in terms of price. "Obviously, the entry of new capacities in the market causes some initial turbulence, which may lead to a slight drop in prices compared

to 2013, but I do not see a disastrous scenario ahead of us," said Brant, pointing out that quantifying the average price this year is a difficult task, since there are also some mills being closed down. "Overall, I envision a positive balance."

Eldorado's perspective about market absorption is equally optimistic. The technical and industrial director guarantees that the youngest player of the sector is a solid company with well-grounded feet. "Since the construction and start-up of our activities, we have been exceeding performance expectations, breaking records and introducing trends," he said. "In less than two months of operation, through process innovations and systems that are completely inverse to those in the market, the company has achieved export quality," said Monteiro.

With plans of reaching revenues of R\$1 billion in the first year, Eldorado exceeded the goal projected for the first nine months of 2013. Such context leads the company to bet on a growing pulp and paper market, which has maintained the expected rhythm and found new applications, such as the tissue and decorative paper market, particularly in emerging countries "The Eldorado's first line, it will only be necessary to keep up demand growth in the global market throughout 2014 and early 2015.

CMPC Celulose Riograndense's CEO is following the increase in volume with the same outlook. "The 2 million tons that will enter the pulp market during the year should be easily absorbed by the consumer market. In addition to the historical average annual volume of 1.5 million that we need to supply the market to satisfy natural growth, pulp producers will continue to benefit from the closing down process of small pulp producing mills in China. We believe that this process alone, being conducted by the Chinese Central Government, could represent an opportunity of roughly 2 million tons for global pulp producers during 2014," he said.

The Asian nation will focus on another significant front throughout the year. "Given the growth of its paper industry, China will continue appearing as the main consuming country of Brazilian pulp. For starters, what stands out are the new printing and writing paper machines, but the significant participation is also the result of new tissue paper machines that were installed," said Nunes.

Performance of the paper industry also made 2013 a very productive year for Lwarcel. The company registered sales of \$450 million in the last 12 months, representing an 18% increase in relation to 2012. Künzel said that the increase in revenues is due to variations in the exchange rate and in the market throughout the year. "The exchange rate began to improve in the second semester

STORA ENSO DISCLOSURE



Nicolini says that Stora Enso already has contracted volumes for the 650 thousand tons/year it is entitled to from the total production in Montes del Plata

of 2013 and, at the same time, we saw a drop in prices. We had a scenario of increasing demand, mainly due to the tissue segment. The expectation for 2014 is that we will have an adequate exchange rate level and, therefore, we will be able to maintain a good business volume, said the managing director.

BSC's plans for 2014 are to give continuity to the dual commercial strategy of growing in the specialties market and continue servicing the viscose plants the company has in China with standard cellulose. The main difference between the two products manufactured by the company resides in the degree of purity. "Specialty pulp is much purer than standard pulp. While the first is used for a plethora of applications, including cellulose acetate, used in cigarette filters and eyeglass frames, standard pulp caters to the textile industry, acting as a cotton substitute," said the technology director. "Since the standard cellulose market is very volatile and the specialty pulp has a more stable demand, making it a more profitable and stable segment, our strategy for this year is to continue supplying raw material to these different market niches," he said about the company's short-term plan.

### Long-term planning focuses on expanding the current portfolio

Data gathered by Bracelapa shows that certain current aspects could cause important impacts to Brazil's forest base industry. One is the increase in production costs, which includes higher expenses with labor, raw materials, fuel and inflation. In fact, inflation played an important role in the competitiveness of Brazilian players. Over the last three years, inflation increased by an average of 9.9%, compared to Brazil's official inflation rate of 6.1%. For the year, inflation in the sector is expected to reach 6.1%, which is slightly higher than the projected inflation rate for Brazil measured by the IPCA (5.8% p.a.).

Determined to face these and other challenges that hover over the forest base industry through the next years, players in the pulp and paper sector are already seeking new opportunities. Fibria is one such player that has its eyes on innovative possibilities. In 2012, upon establishing a strategic alliance with Ensyn Corporation (Ensyn), the company advanced in its mission of leveraging its forestry expertise in order to develop high value-added alternatives that allow complementing its global leadership position and excellence in pulp production.

Ensyn is a US-based company that detains the technology used to produce renewable liquid fuel. Biobusiness is a complementary activity to the production of pulp and is part of Fibria's strategy of maximizing its knowledge and experience in



developing, implementing and managing high-performance forests. This year, Fibria's Board of Directors shall come to a decision regarding the implementation of a bio-oil plant in Brazil, as part of the joint venture it established with Ensyn.

Also regarding partnerships, the industrial director revealed that Fibria established an agreement with Embraer to develop high-performance renewable materials. "Embraer possesses knowledge of advanced materials and Fibria has experience in the productive process of biomass. We are advancing rapidly in this field of wood besides pulp, but it doesn't mean that we will lose focus on our core business. The new products will not be competitors of pulp, but rather complement the commodity within our strategy," said Silveira.

According to him, Fibria is also expanding its line of diversification in sectors that complement the company's core business. "In partnership with Cenibra, we are giving continuity to our Portocel expansion plans. The priority of ships that operate out of Portocel is pulp – from Fibria and other companies in the sector –, but there exists other types of cargo that can be imported or exported through this operation," he said. Cargo examples include steel products, fertilizers, ornamental stones and coffee. This contributes to the economic growth of Espírito Santo and optimizes logistics costs of companies in the region, as new alternatives are offered for exporting production and importing raw materials.

Also looking to boost its profitability, Cenibra has its eyes on two distinct areas. "In the forestry area, transgenics stands out. The production of eucalyptus plants via genetic engineering is evolving and promises to come up with some practical breakthroughs in coming years, offering advantageous productivity gains. Another interesting area refers to the better

Besides logistics, Cenibra bets on continuous technological improvements and efficient management to maintain a good level of competitiveness

utilization of wood. Our expertise in the use of this raw material opens doors for many other paths. Even though pulp is our main business, we keep a close eye on new wood-based alternatives," said Brant.

Even though it isn't directly investing in the expansion of its current portfolio, BSC is another company in the sector that has its eyes on ramification trends. The many opportunities stemming from the implementation of biorefineries are being closely watched, since makers of specialty pulps combine advantages within the current production process. "Our production process offers numerous possibilities, since we remove all the hemicellulose from wood. Certainly there are

different forms of making better use of it, such as in the production of biochemicals," said Leite.

The fact is that the technological advancements in the last few decades have already transformed industrial plants of the sector into true biorefineries. Nowadays, in addition to pulp and paper, many players produce sufficient energy to feed their own mill as well as distribute the excess energy to the grid. "Today's plants naturally produce excess energy, which ends up being an important complement to the core business. This practice of selling excess energy to the grid has become a common activity among Brazilian players," said Lwarcel's managing director. ■

## SECTOR CONTINUES EXPANDING

In addition to the start-up of two major productive capacities in Latin America (Suzano, in Imperatriz, Maranhão state, and the joint venture between Stora Enso and Arauco, in Montes del Plata, Uruguay), which should add an average of 2 million tons of pulp in the market in 2014, Brazil's pulp and paper industry will be seeing several other expansion projects over the next years.

**CMPC Celulose Riograndense:** The Guaíba 2 Project, which comprises a 1.3 million tons expansion of the company's industrial unit in Rio Grande do Sul, is being executed according to schedule. The second line is projected to begin operating in May 2015.

**Klabin:** In November 2013, company shareholders approved the proposals necessary to successfully capitalize the company for Project Puma. With the new pulp mill in Ortigueira, Paraná state, Klabin's production capacity shall double in three years. The mill will have an annual production capacity of 1.5 million tons, that is, 1.1 million tons of hardwood pulp and 400 thousand tons of softwood pulp, part of it converted into fluff pulp. The new unit is expected to be inaugurated in the first quarter of 2016.

**Fibria:** The company already has authorization from the Board to carefully study the feasibility of expanding its Três Lagoas unit in Mato Grosso do Sul state. The idea is that the new line, if approved, will begin operating in the beginning of the fourth quarter of 2016. For such, it is necessary that a decision be made by the end of the first semester of 2014. The expansion is subject to market conditions, but the company believes that, should the current fundamentals continue as are, a good window to begin operating the new line would be in 2016.

**Eldorado:** The company is already adapting its current production (in Três Lagoas, MS) in order to increase its annual nominal capacity from 1.5 million to 1.7 million tons of pulp. Line two, in turn, will already be born with a production capacity of 2 million tons of pulp per year. Since the beginning, Eldorado Brasil was projected to undergo two expansions: one in 2017, integrated with the current mill, and a new one in 2020/2021.

**Lwarcel:** Utilizing its entire productive capacity in Lençóis Paulista (SP), the company is giving continuity to its mill expansion project, which shall produce 1 million tons/year. By the end of the first quarter of 2014, the basic engineering of the project should be concluded. The company also expects to have the financial structure and new partner defined this year. Start-up of operations is scheduled for 2017.

For the vice-president of Sales & Marketing of Stora Enso, Alexandre Nicolini, caution is necessary when betting on the perspective of strong growth in global pulp demand, particularly due to the fact that the capital intensive industry has longer term returns. "Players consider investments according to the competitive advantages that Brazil still presents, but it is necessary to keep in mind that low structural costs exist in other regions also. In Indonesia, for example, there are players interested in building bigger mills than those installed in Brazil, with volumes of 2 million tons. This represents a very big challenge," he said.

He believes that the sector needs to better organize itself as a cluster in order to avoid future problems. "The pressure on results is considerable, and this imbalance between supply and demand could affect the industry as a whole further down the road. Therefore, I believe there lacks greater commitment on the part of the industry towards organizing itself to not jeopardize future results."

Nicolini also pointed out the role of the National Bank of Economic and Social Development (BNDES) within this context. "Regarding this theme already addressed previously, I do not agree that the BNDES should play the role of controller of the industry, since the objective of the bank is to support projects that contribute to Brazil's development and can improve competitiveness of its economy. However, I believe that the bank should pay more attention to the financial health of companies and the return of these new projects in the medium and long-term," he said. He defends that there should be greater criteria in loans for capital intensive investments, based on solid market and return analyses, in view that the bank is the main instrument of long-term financing for carrying out these investments. "The lack of adequate infrastructure for moving current and future productions, without losses for the country, is even more important and urgent at this moment," he said.