



Suzano Papel e Celulose reveals the strategies for its business segments

Positive results in 2017 and a favorable outlook anticipate investment plans in hardwood pulp, printing and writing paper, tissue, fluff pulp, lignin, nanocellulose and soluble cellulose

With an operating cash generation of R\$ 906 million in the third quarter of 2017 (3Q17), Suzano Papel e Celulose registered an increase of 78.6% in relation to the same period last year. The adjusted EBITDA for the period was R\$ 1.186 billion, representing a 54.5% increase. In turn, adjusted EBITDA margin for the 3Q17 was 45.7% compared to 35.3% for the same quarter in 2016. The third quarter of 2017 also posted a 13% Return on Invested Capital (ROIC), which the company attributes to pulp prices, its cost control discipline and continuous focus on productivity gains.

The operating cash generated between January and September 2017 totaled R\$2.438 billion, representing an increase of 14.3%, which explains the adjusted EBITDA increase for the period (R\$ 3.190 billion for the year). Pulp and paper sales in the first nine months of 2017 amounted to 3.5 million tons, slightly better than 2016 figures. In turn, cash cost excluding downtime was R\$ 594 per ton, 7.6% lower than last year. With a net income of R\$ 800.9 million in the 3Q17, the company totaled R\$1.45 billion between January and September 2017.

"Many believe that Suzano is doing well on account of pulp prices. This is partially true," said Suzano Papel e Celulose's CEO

Walter Schalka, in a meeting that gathered company directors to present market perspectives to analysts, investors, journalists, etc. "In reality, our figures demonstrate advancements over time, since they're a combination of external numbers (pulp prices) and internal numbers, considering that all Suzano indicators are evolving," he said. "In the last five years, the company has registered recurring productivity gains at a rate of 5.3% a year.

This constant evolution is part of our day-to-day operations," said Schalka, emphasizing that developing new ways of operating and creating value are key factors of the company's culture.

The good operating and financial results obtained by Suzano over the last years, and again in 2017, led the company to pay closer strategic attention to the next developments and even anticipate a few plans. "Suzano has been generating cash well above projections, which raises the issue of capital allocation," said Marcelo Bacci, Suzano Papel e Celulose's CFO and Investor Relations Director.

When presenting the value-creation alternatives that Suzano has been betting on, Bacci pointed out that the company's macro objective is always to increase business profitability and reduce return volatility. To do this in a perennial manner, the company

analyzes investment possibilities in terms of four key aspects. "The first is return on invested capital. Each initiative analyzed has to have its own return and must be greater than the cost of capital," he said. The second aspect, said the CFO and Investor Relations Director, refers to scalability. "We are a company with annual revenues of R\$10 million, therefore, we don't invest in businesses that aren't representative. New projects may be small, but they need to have growth potential," he said. The third aspect corresponds to sustainable competitive advantages. "These advantages can be of many sorts, be it technology, logistics or cost related, but it must prevail that we'll be the natural owners in the segment we choose to do business in," said Bacci. Lastly, the fourth aspect determines that the new business must be difficult to replicate, so Suzano can stay ahead of its market competitors.

Besides the combination of these four aspects, all projects analyzed by Suzano must comply with the company's financial policy. "In addition to the criteria pointed out, we follow the indebtedness limits recently established, respecting the prudent manner how we've conducted the company's financial management in recent years," said the CFO and Investor Relations Director.

Based on these criteria, Suzano seeks opportunities in its three business units: Pulp, Paper and Consumer Goods. The Innovation and New Business area, another work front the company focuses on, also presents short, medium and long-term potentialities, as detailed by the company's directors.

Consolidation is the best strategic alternative against volatility in the pulp segment

The pulp industry scenario includes volatility, excess supply and a lack of discipline regarding new capacities. "These factors combined are leading the industry to results well-below necessary, and inadequate returns," said Carlos Aníbal, Suzano Papel e Celulose's Executive Officer of Pulp Business. "If we analyze the sector's behavior over the last 15 years, we can see that new capacities are totally misaligned with demand growth. In practice, the result of this is pricing that does not reflect capital invested in the business," he said.

Given this scenario, Suzano identified the need to create value and is working to change the current paradigm. "The industry is more aware about the importance of value, not volume. As such, we



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understand that the main metric for the segment is not EBITDA, but rather ROIC," said Aníbal, referring to the influence of Maintenance Capex which is high and recurrent in the pulp industry due to forestry activities, and the importance of analyzing cash conversion, which determines the EBITDA result minus Sustaining or Maintenance Capex.

With a significant quantity of owned forests, Suzano is able to reach a lower Sustaining Capex index than the competition. In the paper segment, the company has

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an even lower Sustaining Capex than pulp. The combination leads to an operating cash generation per ton greater than the competition, as shown in the graph below.

Focusing on the need to create value, Suzano's Executive Officer pointed out what the ideal market price would be for the business based on two different scenarios: A Capex per ton to expand an existing production unit, of around US\$ 1,200, and a Capex to build a new plant, represented by an average value of US\$ 1,500. "Generating the operating cash necessary to begin remunerating this business would be between US\$ 125 and US\$ 160 per ton. If we add to this value all the taxes, maintenance Capex (approximately US\$ 100 per ton), SG&A, a cash cost close to what we have today (US\$ 170) and logistics, we would arrive at a net price necessary to match ROIC and WACC (Weighted Average Capital Cost) between US\$ 565 and US\$ 595. From 2012 to 2017, our average net price was US\$ 578. Therefore, during this period, we did not create the value we needed. We did not provide an adequate return on invested capital," he said.

Today, however, the level is different: in the third quarter of 2017, Suzano's net average price was US\$ 624 per ton. "This is a tremendous evolution and the beginning of value creation for our business," said Anibal. Even though results for the last quarter of 2017 reflect a level that Suzano considers acceptable for the pulp segment, volatility still appears as a challenging factor. In the company's vision, betting on consolidation is the best manner to overcome such challenge. "Our value-creation alternatives include, first of all, consolidation, since this movement would allow us to capture important synergies," he said.

In a market scenario such as now, with prices at a high, and more

importantly, with the perspective of a better balance between supply and demand over the next 3 to 4 years, Suzano does not waive the possibility of developing brownfield or greenfield projects. "We are analyzing these three possibilities. Even though we prefer consolidation, since it creates value in a more sustainable manner, current market conditions also allow us to consider growth via expansion or a new mill," said Anibal, underscoring that all of the possibilities must comply with the criteria mentioned by Bacci for new projects at Suzano.

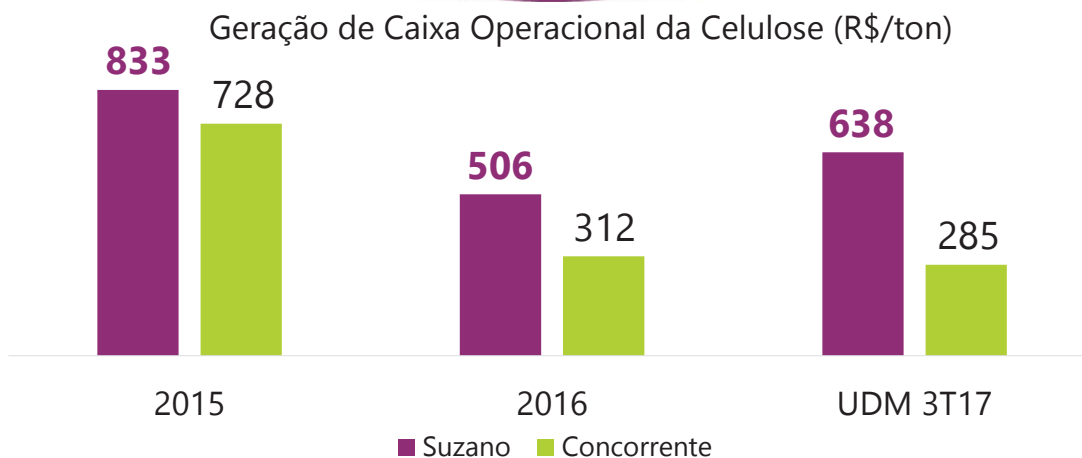
"Clearly, our preferred alternative is consolidation, but this doesn't only depend on Suzano, it also depends on other industry players. So, if we have Capex at these competitive levels or below them, in order for Suzano to be able to create value even if there's volatility, we will consolidate the new investment," said Schalka about the decision that's expected to be announced yet in the first quarter of 2018. The company has even selected the production unit that will undergo capacity expansion, in the event the alternative to develop a brownfield project is chosen. Suzano also has immediate forest maturity to invest in a new pulp mill.

Disintermediation of commercial channels through the use of digital technologies has generated positive results in the paper segment

Demand for printing and writing paper and board in Brazil is strongly related to the country's economic activity — "short-term and highly unstable", defined Leonardo Grimaldi, Suzano's Executive Officer of Paper Business. To overcome demand instability in the domestic market and create value for the paper business, the company developed

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Conversão de caixa é a melhor métrica de criação de valor



commercial channels in several countries over the last years. "With this, we have flexibility to allocate our volume within Brazil and many other regions in the world," said Grimaldi about strategy.

At present, Suzano brands of paper & board products are present in more than 60 countries. "Combining our international expertise and flexibility with our structural competitiveness, considering the extremely-low cash cost of pulp, we envision the possibility of internationalizing the paper business," said Suzano's Paper Executive Officer. Grimaldi informed that internationalization can occur two ways: integration with local producers, shipping pulp, and through merger and acquisition movements.

Grimaldi guarantees that, regardless of the strategic front chosen, Suzano's expertise and the disintermediation of commercial channels through the use of digital technologies have yielded positive results and are expected to strengthen over the next years. "While our domestic and international competitors continue operating in the traditional manner, where large paper manufacturers cater to a few big clients or use intermediaries to serve medium and small sized clients, Suzano created a disruption in this model several years ago. Today, we sell paper directly to big, medium and small clients in the Brazilian market through our program *Suzano Mais*," he said about the initiative of bringing the company closer to end consumers.

To achieve such objectives, the program continuously

seeks more efficient ways to serve clients through disintermediation and reproduction of distributor activities using technology, automation, process routine and artificial intelligence. "With this strategy, we have almost 40 thousand clients being directly served in Brazil," he said, pointing out that the project provides competitive advantages, a high return on invested capital with stability, a model that's difficult to be replicated from both an industrial-cost perspective as well as technology, and significant scale, satisfying all Suzano criteria.

Startup of two new mills and the Facepa acquisition mark the company's entry in the tissue segment

Entering the Consumer Goods market, more specifically the tissue segment, is Suzano's latest bet. In September, the company began operating its first tissue plant in Mucuri (BA). With a capacity to produce 60 thousand tons of tissue jumbo rolls per year, Suzano plans to convert 30 thousand tons into finished products. In turn, the Imperatriz (MA) unit, which is Suzano's second tissue production line, started up in November. The Maranhão unit has the same production capacity as the Bahia plant and the production-breakdown plan between jumbo rolls and finished products is also the same.

With an estimated investment of R\$540 million, the

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To overcome demand instability in the domestic market and create value for the paper business, the company developed commercial channels in several countries over the last years

units are earmarked to supply the tissue paper markets in the North and Northeast regions of the country. "Suzano's objective is to enter the market with a lot of speed. We are very satisfied with the quality of our product," said Fabio Prado, Suzano's Executive Officer of Consumer Goods, about the production of rolls. "In the first quarter of 2018, we will introduce our own brand. The launching will occur in the toilet paper market and the natural process is to pursue not only geographic expansion within Brazil, but also an expansion of our portfolio," he said about next steps. He pointed out, however, that current production capacity is already sufficient to serve the North and Northeast regions, and also an even more expanded area, which should occur over the next two years.

In explaining the plan for producing finished goods and launching its own label, Prado said that in addition to work related to brand development, Suzano is also developing the entire market route it will adopt. "We contracted a group of people with consumer experience and we're concluding the brand design and commercial strategy," he said about the project's status.

Prado pointed out that this segment has registered constant growth above GDP levels. "And just as, or even more, important is the fact that the market is undergoing

transformation. In the toilet paper segment, for example, consumers are seeking higher value-added products. We have, therefore, observed a major shift from single-ply to double-ply products," he said. "Given the price differences between these products, if we do the math, we'll come to the conclusion that the cost per use of a single-ply product is higher than double-ply or even triple-ply. Each time a consumer migrates from single-ply to double-ply, we have 10% savings in the cost per use. From double-ply to triple-ply, another 10%. In other words, the better the product quality, the lower the cost per use. The consumer obtains a major advantage with this migration, as does retail, since the profit per square meter increases tremendously," he said, pointing out that Suzano wants to explore this migration opportunity to take advantage of higher prices and obtain better margins.

Continuing with the analysis of the tissue market, Prado pointed out that consumption per capita in Brazil has major exploration potential. "While consumption amounts to around 6 kg/inhab/year in Brazil, developed countries like the United States have an average consumption of 25 kg/inhab/year, which reflects an enormous difference and a huge growth opportunity." Comparing Brazil to Latin American countries, the

difference is smaller, but still expressive: we are below the Latin American consumption average and below Chile and Mexico, which have a per capita consumption of 13 kg/inhab/year and 9 kg/inhab/year, respectively. "The comparison with Mexico is interesting, in view that the country has an income per capita very similar to Brazil and, even so, consumes 50% more tissue than we do," said Suzano's Executive Officer of Consumer Goods.

Focusing on Suzano's initial target market, i.e., the North and Northeast, Prado points out that tissue consumption per capita is even lower: less than half the Brazilian average; roughly 2.5 kg/inhab/year. According to him, this figure provides an idea of the per capita consumption growth potential in these regions. "It is estimated that consumption per capita in Brazil could reach 9 kg/inhab/year in 2025. If this in fact occurs, we will add roughly 700 thousand tons of product to the current market," he said.

Another aspect that demonstrates the tissue market's growth potential is market structure, currently made up of many producers and brands. "The top four companies control only 47% of the Brazilian market, while the remainder is very pulverized. This scenario offers Suzano two opportunities: the first is acquisition, using our competitiveness to seek synergies, and the second, organic growth. We can not only use our installed

capacities in Bahia and Maranhão, but also expand them to explore the organic growth we aspire," said Prado.

Suzano has already initiated acquisitions in the tissue segment. In December, the company acquired Facepa (Fábrica de Papel da Amazônia S.A.), the biggest tissue producer in the North and Northeast of Brazil, which produces and markets a wide array of tissue products, including paper towels, napkins, toilet paper and facial tissue under several brand names. With production units in Belém (PA) and Fortaleza (CE), Facepa's installed capacity amounts to around 50 thousand tons per year.

The operation, valued at R\$ 310 million, accelerates Suzano's strategy of entering the consumer goods segments. In practice, the combined operation of both companies will create operational and logistics efficiencies for Suzano in the production of jumbo rolls, since the production of tissue will be integrated with pulp production. Additionally, the operation will expand Facepa's distribution network as well as create a more robust capital structure.

According to legislation, the agreement will be submitted for approval to Brazilian competition-protection authorities. Once the transaction is approved by said authorities and other preconditions are satisfied, the acquisition will be concluded, at which time Suzano will divulge further details about its plans for Facepa's assets.

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Fluff pulp, lignin, nanocellulose and soluble cellulose stand out in the portfolio's expansion over the next years

In the Innovation and New Business area, Suzano is working on four projects, two of which are in a very mature phase and the other two in their development phase. According to Renato Tyszler, Suzano's Executive Officer of Innovation and New Business, the production of fluff pulp, the first in the world to be made using eucalyptus, is one of the already mature projects. "We are selling fluff pulp to all continents in the world and obtaining a very interesting penetration rate at this moment of qualification. In 2017, we posted triple-digit growth in sales volume," he said.

Tyszler pointed out that fluff pulp has a very different characteristic from market pulp: "at the same time that we have a greater number of clients, the tonnage quantity per client is smaller". Additionally, the Executive Officer of Innovation and New Business said that sales are extremely technical, respecting the specifications of products they're intended for.

The second project in a mature stage being spearheaded by Suzano is lignin production. "We are making an investment in an industrial plant at our Limeira (SP) unit. Startup of operations is scheduled to occur in September-October 2018," said Tyszler. As with fluff pulp, lignin sales are highly technical, coupled with the fact that they're earmarked for the chemical industry. "We will have to enter the chemical world and apply our product in a competitive manner in relation to those that already exist in the market. For such, we are bringing in professionals from the chemical industry. They are helping us select potential clients and develop joint applications so that we can start up the plant in an already well-planned manner," he said about Suzano's strategy to master this initial challenge.

Fluff pulp and lignin stand out as the most mature projects in Suzano's Innovation and New Business area

In relation to the two projects that are in their development phase and with no forecast of entering the market, Tyszler informed that they are to produce nanocellulose and soluble cellulose. "Nanocellulose has very interesting application potential for improving the quality of market pulp, making changes to its characteristics. With paper, its applications can target productivity improvements through an additive, and also cut costs by reducing the use of energy in the paper production process," he said. Suzano's R&D team is also studying other applications for nanocellulose in sectors totally different from pulp and paper. "In these niches, profitability will certainly be even more interesting," said the Executive Officer of Innovation and New Business.

The innovation aspired by Suzano for soluble pulp has to do with converting a market pulp line into a soluble pulp line. "In converting a traditional pulp line into a soluble pulp line, there's a significant loss in production yield. Our challenge — and where we have focused our R&D efforts — is to develop a process where this migration loss from market pulp to soluble pulp is the lowest possible and at the lowest cost possible. When we achieve this objective, we'll have structural competitiveness in soluble pulp also," said Tyszler about the project that's in its technical and market assessment phase.

Another innovation strategy put into practice by Suzano can be seen in the operating routine at all production units and forest activities. "We have made major digital incursions" said Tyszler, mentioning as examples the use of sensing to improve mill maintenance and productivity and the use of images for better forestry control. "We apply innovation in all areas of the company with operating efficiency as our common target. It's along this path that we seek differentiation in the market," he said.

Suzano's CEO highlights the pride felt for the company's trajectory and achievements of recent years. "We are very proud not only for the financial results recently presented, but for having a team of 8 thousand employees thinking and transforming Suzano," he said, emphasizing that the focus today and into future is the same: to create and share value with all stakeholders. "Suzano is and will continue undergoing transformation over the next years. We still have many evolution opportunities to pursue. Each one of our business areas has ways to do things differently, with investments in innovation, technology and other growth strategies to create value. Increasing our level of profitability and at the same time reducing our level of volatility is the combination we aspire for the long-term. We believe we need to work every day to continue transforming Suzano and achieve this target in a sustainable manner, building a better company and a better society," said Schalka. ■



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