Earnings Conference Call
5/16/2017

OPERATOR:

Ladies and gentlemen, thank you for waiting and welcome to Eucatex's conference call to discuss its results in the first quarter of 2017. We inform that participants will be in listen-only mode during the Company's presentation. Afterwards, we will begin the Question & Answer session, at which point further instructions will be given. If any participant requires assistance during the conference call, please dial *0 to reach the operator.

Before proceeding, we would like to clarify that any forward-looking statements made during the conference call related to the Company's business prospects and its operating and financial projections and targets are based on the beliefs and assumptions of Eucatex's Management and on information currently available. Forward-looking statements are not a guarantee of performance. They involve risks, uncertainties and assumptions as they relate to future events and are therefore dependent on circumstances that may or may not occur. Investors must understand that general economic conditions, industry conditions and other operating factors could affect the future results of the Company and, consequently, actual results may differ materially from those expressed in such forward-looking statements.

I will now pass the call over to Mr. José Antônio Goulart de Carvalho. Mr. José Antônio, you may proceed.

JOSÉ ANTÔNIO GOULART DE CARVALHO:

Good morning to everyone who is here with us this morning for the presentation of Eucatex S/A 1Q17 results. We are finishing the quarter and, let's put it this way, still without any clear sign of whether we have in fact entered a period of recovery. I mean, while we can't say "yes", neither can we "no" about the economy, but our segment has stopped to move backwards. I think it was yesterday, or the day before that, I was reading the Estado de São Paulo newspaper and I read an interesting article that said "we've been able to identify some positive economic indicators, but for each of these indicators there's still a much greater number of negative indicators," which I think illustrates this uncertainty. On the other hand, the newspaper says: "sometime ago, even these few positive indicators didn't exist, all were negative." So, although things are still a bit foggy, the impression we have is that a period of recovery is commencing. The challenges, of course, still are huge. We still have a high unemployment rate, families are highly indebted, credit is highly compromised, there's the issue of the government's lack of investment capacity, several states are on the brink of bankruptcy. But, on the other hand, we have some very positive aspects, perhaps the main is the issue of inflation, which has been kept under control and which has enabled the reduction in interest rates, which end up reflecting in the general mood of consumers and companies, which are starting to gain some perspective, a higher level of confidence in relation to the economy. So, we believe that if the government is able to deliver the much talked about labor and social security reforms, even if they are different from their original proposals and, in addition to delivering these reforms, conduct a more austere, conservative management of public finances, we could have a better year in 2017 than in recent years.

To start with our presentation, let's go to slide 2 as usual. The format of the presentation is very similar to the previous ones, so as usual let's start with some highlights in the period. The first is net revenue, we'll detail further on, we had a series of shutdowns of our lines in Salto/SP. All of them were stopped for long periods. Nevertheless, we were able to earn revenue higher than in the same period last year, with a 2.8% increase in revenue from last year to R$283.0 million. EBITDA, both in terms of amount and percentage, in this case recurring EBITDA, improved from previous years. This is mainly due to the higher domestic sales volume, improved mix across diverse lines, price increases, to some extent, reductions in costs, especially electricity, an important decrease of 20%, and resins, resins for the T-HDF, MDF and MDP plants. We signed an agreement with a resin supplier at the start of the year, which was an attractive deal. Moreover, the company has employed intense efforts to reduce expenses, as we will show later on, and we registered higher EBITDA also due to lower administrative and selling expenses. Net income decreased not sharply from last year, mainly due to a slightly higher financial expense compared to in the same period last year.

On slide 3 - another slide we've presented several times - we have net revenue breakdown, by product, the pie chart on the left, and by segment on the right. Perhaps the not-so-positive news here is the reduction in the share of exports of total revenue. In the same period last year, what is now 12% on the pie chart on the right was 17%. The main reason, as we said, were the shutdowns of lines at the plants at the Salto unit, which affected exports.

On slide 4, is the breakdown of what happened and the evolution of exports. On the left side, showing since 2014, with 2013 as base 100, and we'll compare this revenue in reais and its evolution. So, we see that this evolution was positive in recent quarters and has now declined 27.7%. This decline is due to lower volumes, once again due to the shutdown of lines. Volumes decreased 13.5% from the same period last year, also due to exchange variation, which was negative at around 19% on average in the quarter, and 12% comparing the closing rate of both periods. So, the sum of this lower volume and a weaker dollar impacted export revenues in reais. On the right side, we have the evolution in the share of this revenue in the Company's total revenue, showing that in 1Q17 we interrupted a cycle of increases. This interruption, once again, did not result from market difficulties or lower prices in dollars, but due to the unavailability of product caused by scheduled maintenance shutdowns. Now, in 2Q17, we will already recover these export volumes.

On slide 5, the performance of our Wood segment which, as we saw previously, corresponds to 77% of the Company's total sales. In this segment, we have MDP and MDF panels, fiberboard and laminated flooring, as shown in the pie chart on the right. Within MDF panels, we don't usually break it down, but we0020also have products such as doors for construction and office wall partitions. Perhaps the news on this pie chart, which I took a look at last year, the share of MDF was around 30% and now it's at 33%. This increased share of MDF is mainly due to the healthy performance of wood resales, not just in volumes, but also with a better mix. We sold more Lacca and more BP. On the left side, we have a comparison of revenues in this segment, which grew 5.5%. If you look at the bar chart at the bottom, you can see that revenue growth was not just due to volume growth, of 2.2%, but also to some price increase as revenue growth outpaced volume growth. Below that is the comparison of our volume growth in m³ with the market as a whole. We lagged the market, i.e. we grew 2.2% while the market grew 7.3%. The main impact here came from exports, because when we compare our performance in the domestic market with the market as a whole, in Brazil, you can see the company outgrew the market. But when we compare the performance in export markets, our results were inferior and hence the result is 2.2% against 7.3%.

Moving to slide 6, we provide information regarding capacity utilization at the various lines of the Wood segment. Starting with the chart at the top left, you can see that the two Dura lines, which are fiberboard lines at the Salto unit, registered low utilization rates. As we said earlier, we scheduled for the start of the year, maintenance shutdowns of these two fiberboard lines and stopped the Dura I line for 21 days and the Dura II line for 12 days. This caused overall capacity utilization to reach 55%, while the usual rate - these lines are older and tend to stop a little more - would be around 80%. Next, to the right, capacity utilization of the MDF line was 86%. We also stopped this line at the start of the year, a shorter shutdown, but which also affected performance. The usual number is expected to be around 90%. Moving on, at the MDP and flooring line, we used 84% of the time for MDP and 8% for flooring. It's a press that shares production of substrate for these two lines. This gives 92%, which is a healthy utilization rate. And finally, laminated flooring, on the right, we have capacity for 12.0 million meters. This rate now is the rate of 1Q, usually the weakest quarter of the year, but anyway we see this low utilization rate more as an opportunity, I mean, it's something the company has a lot of room to grow without having to invest. We see it more as an opportunity than as a problem, as this line can be very easily managed, to turn on and turn off, as opposed to presses, the lines on the left, this line is very easy to manage by interrupting shifts. Below that, the breakdown of our costs, more for the record, is to help put together a model.

On slide 7, we have the performance of the Paint segment. Starting with the bar chart on the right, we see that both Eucatex and the market remained flat, we didn't grow but we also didn't shrink in this market. This is good because, it isn't here, but when we compare 1Q16 with 1Q15, we sew a decline not just at Eucatex but also in the market of around 15%. So the comparison basis is very bad. The market is relatively down, it hasn't deteriorated, but it is relatively low in 1Q since in

2015 it was much bigger. In terms of net revenue, the table on the left, we see growth of 3.5%, although volume didn't growth, which is due to price. On the right side, we have a bar chart showing installed capacity utilization, which came to 48% in the quarter. Once again, this is the weakest quarter in the year, so capacity utilization should grow during the year but, as in flooring, this is much more of an opportunity than a problem. An opportunity to grow in this segment without necessarily having to invest. On the left side, we have the breakdown of costs, like we had for the Wood segment, which is merely for your information, to eventually create a model.

Moving to slide 8, we have a summarized income statement. We've already commented on some of the lines. Starting with net revenue, we had growth of 2.8% in the quarter, as already discussed. Looking at gross margin, you can see a decline of 1.0 p.p. in 2017 compared to 2016, but if we look at COGS, we can see it was stable, i.e. the Company's operation in these two quarters was very similar. Cost of goods sold was very similar, despite the long shutdown of the lines at the Salto unit, which reduced the dilution of fixed costs and we were able to deliver stable COGS. What changed for this 1 p.p. reduction was the issue of biological assets, which is more of an accounting impact. We take into consideration the market price of wood, future interest rate, but this number affected our gross margin negatively by 1 p.p., it wasn't COGS itself. An interesting observation, like we said at the beginning of the presentation, is the matter of administrative and selling expenses which, when we add other income and expenses and compare between the quarters, we had a decline of nearly 9%. So, when you think these expenses are highly influenced by inflation, wages, etc. and the net revenue growth itself influences selling expenses, the nominal decline in these expenses is very important. This resulted from the work we are carrying out, cutting several hierarchic levels and reducing the headcount. I'm here are the company's office in São Paulo, where we are returning one of the towers we occupied previously and rationalizing the space in a single tower, sending some employees to the plant in Salto. So, a series of rationalizations has helped to reduce this expense. Then we have EBITDA, which is a consequence of the figures above. There was an improvement, EBITDA in 1Q was 16% compared to 14.6%, and R$45 million compared to R$ 40 million. We had already presented these figures at the beginning. Net income fell slightly, the figure to be published is higher than in the previous quarter, but recurring net income is slightly lower. But this is perhaps more closely related to the financial result, or the financial expense, which was a little higher this quarter than in previous quarters.

On slide 9, we present debt. You can see that for several quarters we remained stable, our debt position hasn't worsened, but we were not able to improve the debt level. We closed the period with net debt of R$ 327.4 million, which represents 1.9 times annualized EBITDA. EBITDA in 1Q is usually the weakest in the year. But these numbers are relatively aligned. What has been happening, as we are presenting constant debt, is that the company is settling its debt that could be more structured, and has been contracting more short-term debt, as you can see on the pie chart on the bottom left. We've been working since the beginning of the year and we expect, before the next earnings season, to have this chart slightly more aligned in terms of cost and long term. On the right side, the breakdown of foreign and domestic currency debt. We always like to remind you that foreign currency debt comprises mostly ACCs or prepayments, which are supported by exports. Most of our exports are of fiberboard, a product that gives us a natural hedge as there are practically no dollar-denominated items in its cost, i.e. they represent our planted forests, electricity, thermal energy and labor. So, we have support in terms of exchange rate.

On slide 10, the investments we made and what we've planned for the year. Investments in 2017 are planned at R$81 million. Last year, we invested R$93 million, so we're highly focused on just maintenance and on sustaining our activities. These R$81 million that are planned, compared to R$93 million, correspond to a reduction of 130%. On the left side bar chart, we present investments in 1Q last year and this year and notice an important reduction and within this focus of investing more conservatively in 2017.

Slide 11 is the last one in our presentation, but contains a lot of information. It's also a slide we include in all our presentations, but we always like to point out its importance, because nearly 80% of the company's revenue comes from or is related to its forest areas. We have 79 farms, totaling 46,000 hectares, all of them in São Paulo. Our average radius in the period was 164 km for Salto and 24 Km for Botucatu. On the top left side, we have this year's planting schedule. We have a total of 4,800 hectares, relatively flat compared to previous years. You can see a difference between what we intend to manage and what we intend to plant as new forests. This depends a lot on the characteristics of the clone and the farm, and, to some extent, we are being more conservative in renovations in order to ensure future wood supply. That's why we are reducing management a little. We have a small bar with 227 for 1Q17, which is how much we renovated in 1Q, we were very conservative. Since we had several shutdowns and, hence, would require a lot of investment, we tried to plant a little less so as not to burden the Company's cash position too much. In the coming quarters, we will resume the program for the year to close at 4,800 hectares. On the right side, the recycling program. You can see a decline in the volume of recycled products, but this has a lot to do with shutdowns at the Salto line, which is where recycling takes place, i.e. we had lower demand for steam because of the shutdowns and therefore recycling activities were lower.

That's what I had to present. Thank you. We're now available to answer your questions.

OPERATOR:

We will now start the Question & Answer session. To ask a question, please dial *1. And to remove your question from the queue, dial #.

Mr. Paulo Valaci from Citi would like to ask a question.

PAULO VALACI:

Good morning everyone. Thank you for the opportunity. José Antônio, could you comment a little bit about the competitive environment in the panels segment? In your last call, you mentioned that the market had learned a lesson in the past, focusing less on competing through prices. Do you believe the market is still behaving this way? Will this support the price environment for the domestic panels market in 2017? And, finally, I'd appreciate if you could add some color to the profitability of exports versus the domestic market, now that the BRL is stronger. Thank you.

JOSÉ ANTÔNIO GOULART DE CARVALHO:

Good morning Paulo and thank you for your question. The price question, I didn't present. Yesterday, we had a Board meeting here and we could have brought this too, showing a chart with the breakdown of installed capacity in the industry, at least what we believe, as the figures we have from each of the competitors' plants may not be accurate. We have the exact number of the market through the association and an estimated capacity of each plant. In any case, on a comparative basis, this quarter - 1Q17 - was better. Sector exports grew a lot, by around 42%, and therefore utilization rates were also higher. We saw an important price recovery in the panels segment, especially in comparison with the end of last year. Regarding the sustainability of these prices, like you said, I hope the industry learned its lesson, in the sense of realizing the relatively low elasticity of our sector and that we can't focus too much on prices because it won't reflect in volumes. So, there are two side: 1Q was better, it helps sustain this price movement. Now, the month of April was terrible. I don't have the stats with me, but April probably registered a decline of 15% from April last year. It was very bad. But again, it was an atypical month. We had many holidays in April, which made it a shorter month and the market didn't perform well either. May seems to be normal, so that the environment is adequate for … I don't think we can make more progress in terms of price than what we had in this period but, I hope, because of this environment and of what I said regarding the expectation for improvement, not to move backwards. Regarding the profitability of exports, this foreign exchange rate we have for some of the company's products, we've been able to maintain more or less the same margin. As for margins with the FX rate, last year in this same period, we had an FX rate of R$3.55/US$1.00. It was another level, another profitability, and today it is adequate and relatively aligned with the domestic market. Exports are still profitable and continue to grow. This quarter we had a reduction, but it's still growing in the market. Like I said, the market grew 42%, but this is obviously a rate that has to improve. Inflation changes, interest rates change, the dollar also has to change. At its current level, at least for now it is compatible with what we have for the domestic market. I hope I answered your question.

PAULO VALACI:

You did. Thank you José Antônio.

OPERATOR:

Ms. Cláudia Silva from USP would like to pose a question.

CLAUDIA SILVA:

Good morning. Regarding your restructuring initiative, should we expect even more reductions in costs and expenses?

JOSÉ ANTÔNIO GOULART DE CARVALHO:

As I told Paulo, Cláudia, there's no doubt the furniture market, specifically, is very important for the industry. The industry is actually composed of other important channels, or other segments, such as the wood resale segment, which performed very well this quarter, especially for us. I even mentioned the growth in MDF's share of total revenue and also exports. But it's true, the furniture segment suffered, maybe more than the other ones. But, it is being offset by the performance of other sectors. So, if we look at 1Q17, we grew in comparison with 2016, I think of around 7-7.3%. So, not just the modest growth in the domestic market, but there was strong growth in exports. This is what has been supporting, or giving sustainability, sustaining prices. So, I don't believe there's an evolution in prices, like I said before, but I don't believe there will be any contraction from the current levels. Thank you.

OPERATOR:

Mr. Juan Pires from Charles River would like to ask a question.

RUAN PIRES:

Good morning José Antônio. We saw this quarter the utilization of MDF and MDP slightly higher, again, than throughout 2016. My question is whether you expect to maintain this rate of utilization of the lines, more fiberboard, in the coming quarters. How do you see margins, with the resumption of fiberboard and end of scheduled shutdowns, for the coming quarters? Thank you.

JOSÉ ANTÔNIO GOULART DE CARVALHO:

Good morning. Thank you for the question. Like you said, the utilization of the MDF and MDP lines was very adequate. MDF utilization rate is slightly lower than expected, because it was also shut down in the beginning of the year. In fiberboard, the low utilization rate have no relation to demand. Demand, especially from export markets, was present and we had difficulty in meeting demand because of lack of production due to the shutdowns. Now we have no new shutdown planned for the year, so we should resume regular capacity utilization rates. In this line, we are normally not close to 90% like we have in the other, more modern and newer lines, but capacity utilization should be around 80%. So, we should resume in the coming quarters. Thank you.

RUAN PIRES:

Just a follow-up question. When you look at the impact of the scheduled shutdown in your lines, what would be the additional impact of EBITDA on this line considering the resumption of fiberboard? Thank you.

JOSÉ ANTÔNIO GOULART DE CARVALHO:

It’s hard to calculate this from the top of my mind, but one effect we mentioned is the export rate. If we have a reduction in export revenue, I think it was around 27%. Virtually half of this decrease in revenue was due to exchange variation. So I can’t predict whether the dollar will go up or down, but the other half came from lower production. We could consider that half of this loss of revenue could be recovered with the line's return to normal production. And that, since you don’t have a part of the associated cost, should reflect on the Company’s EBITDA.

RUAN PIRES:

Excellent. Thank you.

OPERATOR:

Once again, as a reminder, to post a question, please dial *1. To remove your question from the queue, dial #.

There being no further questions, I'd like to call on Mr. José Antônio for his closing remarks. Mr. José Antônio, you may proceed.

JOSÉ ANTÔNIO GOULART DE CARVALHO:

I'd like to thank everyone who was with us today and for the questions. In general, I think the comment I could make is that the company has been capable of showing tremendous resilience in its results. Since 2015, the economy in general has been going through an increasingly tougher period and the company has been showing, like I said, tremendous resilience in its results. This is the result of the work we've been doing to develop new markets, clients, products, as well as the reductions in costs and the structure we've done internally. So, we'll continue with this work. We believe the company is well prepared and we are responsibly hopeful that we'll see in 2017 everything we talked about, if not better, or at least not a worse scenario. I think we'll see an improvement. And, therefore, I hope we'll deliver better results throughout the year. Once again, thank you very much and have a good day.

OPERATOR:

That concludes Eucatex's conference call. Thank you for participating and have a good day.