



# Conference Call

Nov, 10, 2016

**OPERATOR** – Ladies and gentlemen, thank you for waiting and welcome to Eucatex’s conference call to discuss its results in the third quarter of 2016. 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 call, please press \*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 the information currently available. Forward-looking statements do not constitute a guarantee of performance. They involve risks, uncertainties and assumptions, since they relate to future events and are therefore dependent on circumstances that may or may not occur. Investors are cautioned that general economic conditions, industry conditions and other operating factors could affect the future performance 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 Antonio Goulart de Carvalho. Mr. Carvalho, you may proceed.

**JOSÉ ANTONIO GOULART DE CARVALHO** – Good morning everyone. Thank you for joining us in the conference call this morning, during which we will present Eucatex’s results for the third quarter of 2016.

Well, a simple comparison between these periods, 3Q16 and 3Q15, makes us optimistic despite the difficulties we are facing. Looking at last year, the situation involving the country's administration was very complicated, and the fact that we now have a team that is, if not the dream team, at least has a good discourse, especially the economic team whose discourse is more aligned with good practices and the market, should somehow lead Brazil back to a path of growth. This will certainly make the country be seen, as has been happening, as a country of opportunities once again due to the size of its consumer market, and we will attract investments once again. But what you will see during this presentation is that the 3Q was very challenging. In a way, it was a frustrating quarter. We came from a recovery after a very difficult 1Q, it looked like we were recovering. 2Q was a much better quarter than 1Q, but this recovery sort of stagnated and did not continue into the 3Q. Still, as I said, I think we need to have an optimistic outlook for the future, meaning that the company is well-positioned, confidence is returning, which is crucial for recovery of growth, exports continue to grow, so we have reasons to remain somewhat optimistic.



Let's begin our presentation on slide 2. As usual, we have the highlights for the quarter. This quarter, as I said, was not easy, as we saw revenue declining by about 2.2%. This decline is mainly due to the results of the furniture and wood reselling industry. The panels sector, considering the domestic market only, not Eucatex, declined by more than 6.0%. This volume contraction, given the vast supply of panels that we have, leads the market towards commodities and creates a sort of price war. The company's strategy was to stay out of this more commoditized segment, of the price war, and ended up stocking the product, selling less in this market and saving a little bit of the product for 4Q. This is what actually explains this revenue decrease. In the year, we saw a slight growth compared to 2015. Recurring EBITDA, both in Real and as a percentage, decreased in relation to the same period last year. We will look into that later. Anyway, we will see that our operation this quarter and last quarter was relatively stable. What happens is that, contrary to other periods, we ended up acquiring a significant volume of wood in the market and this impacted EBITDA calculation. We will talk about this later on. Net income continues to grow. This quarter, the main cause of this growth was the foreign exchange rate, when compared to last year, and the lower financial expenses. Exports continue to grow - we will show a few numbers later on - increasing slightly over 36% in volume and 12.6% in revenue.

Slide 3 shows a breakdown of net revenue. As we mentioned, net revenue decreased 2.2% in the quarter, This is more informative, there are no major changes. Distribution of revenue by product and by segment is practically unchanged from previous periods, except for a small decrease in the share of the furniture industry and resale, precisely because of the aspect mentioned in the previous slide.

Slide 4 shows the performance of our exports, which continue to grow. On the left we can see the evolution comparing the 9 months of each year since 2013, an average annual growth of around 33.6-34.0%, and with the share of exports in the Company's overall revenue went from 8.0% in 2013 to 15.0% in 2016. We have been saying that the Company expected to end the year with percentage of exports at around 20.0% of total revenue. This will probably not happen. In fact, due to this contraction in the exchange rate, some of the projects we had for exports are being reassessed, therefore growth will be more modest. Today, it is much more likely that we will end the year at more or less the same level we are in this quarter that just ended.

Slide 5 shows an analysis of the wood segment's performance. The pie chart on the right includes MDP panels, T-HDF and MDF panels, fiber sheets and laminated flooring. We did not highlight it, but the percentage of T-HDF and MDF panels also includes wall partitions for offices and doors for construction. A table on the upper left shows that net revenue contracted by around 8.3%. In the charts below we can see that volume contraction was around 11.2% in the wood segment. As we mentioned, all this was due to our strategy of not participating in this commoditized segment, which was very strong in 3Q. So, despite this contraction of 11% in revenue, we can see that prices slightly benefitted in the quarter, since revenue contraction was lower than volume contraction. Note that this recovery took place in a scenario in which the dollar was declining significantly, meaning that our exports, when included in the revenue calculation, from the standpoint of the



exchange rate, suffered a significant devaluation. From 3Q15 to 3Q16, the dollar depreciated by almost 20.0%. So the fact that we still register revenue that falls less than volume reveals the preservation, or even recovery, of prices in the domestic market. As for 9M16, looking at the chart on the right, we see that the company's performance is in line with the market. We can see a decrease resulting from the last quarter, 1.4% in 9M, while the market is growing 0.7%. So this impact is much more related to performance in 1H, which helped us to be relatively in line with the market.

On slide 6 we have information related to the use of installed capacity in the wood segment by various lines where we produce panels. The slide doesn't show it, but I have information related to 2015 and we can see that generally, for the three panel lines, capacity utilization was lower than in the same period last year. For instance, fiberboard was 76% versus 83% in 2015, while HDF was 82% this year against 89% last year. The MDP and flooring line posted 86% this year versus 93%. So, overall, installed capacity utilization was lower compared to 2015. One of the reasons for this decline in capacity utilization was mainly the slower pace of the lines. For different reasons, mainly due to the wood issue, we had slower pace in all 3 production lines as a result of a certain misalignment related to forests, not due to a lack of volume but to the harvest age of the forest. We ended the period with a very young forest mix supply, which impacts the performance of our lines. To balance this supply of young forests we acquired a significant volume in the market. We bought wood from third parties, which we will explain later on, and that also impacts our EBITDA. We bought a significant volume of wood in the market, which helped offset the effect of these young forests. As a measure to improve installed capacity utilization in the upcoming quarters, we also intensified harvest activities in the field to have a larger stock of wood drying in the field and reducing its humidity when the time comes for consumption in the lines. In the laminated flooring line, contrary to others, utilization was still relatively low, although better than last year. At the bottom of the slide, we have information about our cost distribution, which is always more informative to build the models. What we can point out, looking at the pizza chart at the center of the slide, is the resin issue. Looking at previous periods, resin had a 25% share of cost distribution and it dropped to 20%. This is the result of negotiations we had during 2016, where we had significant reductions in the cost of resin, which now reflects in the share of resin in the cost distribution.

Moving forward, on slide 7 we have information about the paint segment. We had a very difficult quarter, as we can see in this table on the upper right. Although, the quarter was difficult for the entire market. We can see volume decrease of 7.8% in the quarter and 9.3% in the year, which is very significant. Eucatex also suffered a decline, but performance was a lot better: while the market dropped 7.8%, we had a decrease of 1.3%. In the year, the market also registered a steeper decrease. Looking at the table on the upper left we can see a recovery. There is a price recovery in this segment, seeing that volume decreased 1.3% in the quarter but revenue grew 5.3%. In a more modest manner, this also happened in 9M, where despite the decrease in volume we saw an increase in paint revenue. The bottom charts are more informative, showing capacity utilization and cost distribution.



Slide 8 shows, as usual, a summary of the income statement. We've already commented on most of the information shown here. We will start with net revenue. We posted net revenue of R\$304.0 million in the quarter, a decrease of 2.2% from last year. As mentioned, in 9M we had a scenario of small growth, or near stability, in revenue. Then, looking at gross margin below, we can see a decrease of almost 3 p.p. from the same period last year. Two lines above we can see the cost of goods sold, and from the standpoint of operating performance, this year's and last year's operations were very similar, in terms of production. We noticed a change in biological assets, and this variation in biological assets between one quarter and another explains most, if not all, the decrease in gross margin. As you know, this is an assessment of the evolution of our forests and an estimate of wood market prices discounted to present value. There is a series of elaborate calculations, but either way these calculations are more related to the statement of equity and don't have a cost or a direct relationship to the operation per se. Looking down, administrative expenses behaved quite similarly to inflation, which is basically services and payroll. Growth has been slightly higher than inflation when compared to last year, but this growth is impacted mainly by two aspects: this quarter we decided to take out credit insurance for our exports, which created a number of opportunities and expedited our export activities. And the good news is that we were successful in tax issues, we had to pay the tax and the attorney fees. So these two aspects ended up impacting administrative expenses. Selling expenses declined significantly, as shown below. This is the result of a restructuring we are carrying out at the Company, as well as a rationalization of promotional expenses and other costs. As for recurring EBITDA, it was a consequence of these elements we mentioned. We have been saying that the operations are very similar and so is the sum of administrative and selling expenses. Regardless, recurring EBITDA decreased 1.4 p.p. from last year, 15.7% versus 17.1%, thinking back to the beginning of the presentation when I mentioned the acquisition of wood in the market. When we use our own wood, it is also at market cost, but we reverse depletion, meaning that the costs we incurred in relation to the forest were reversed for EBITDA calculation. In this case, market wood is also priced at market price, but depletion won't be reversed, therefore the impact on recurring EBITDA. Below we can see the financial result, with financial expenses decreasing significantly from the previous quarter, as previously mentioned. Further below we can see the growth of non-recurring results. This was due to terminations, the restructuring carried out by the Company, resulting in severance pay. Lastly, at the bottom line is recurring net profit. As I mentioned, there is a positive evolution and the main impact of this evolution is financial expense.

Slide 9 shows information about our debt. When compared to the end of September 2015, there is a significant decrease in debt, but mainly related to the lower exchange variation. As at the end of June, in 1H, there is an increase of approximately R\$30 million in our net debt, and that is basically explained by the higher investment in working capital. Looking at Accounts Receivable we can see a growth of more than R\$30 million resulting from concessions, especially term concessions for the furniture industry, which is facing a challenging time. Regardless of this growth in net debt, when we look at the net debt to EBITDA ratio for the 3 periods we see that it remained virtually stable at 1.8 this quarter versus 1.7 in previous periods. The pie chart on the left shows the debt



ratio in the short and long term. The ratio increases in the short term. This quarter we paid some structural loans we had, which is the CDCA from Bradesco and debentures, and we ended up having an interregnum there, turning these more structured lines into short term lines until we structure them, and we are working with new long-term financing with the same creditors. We also have some balance in the pre-payment line that hasn't been withdrawn, they are long-term lines. Foreign and domestic currency ratio suffered no big changes compared to previous periods.

Slide 10 shows information about investments made in the period compared to the year-ago period. Our focus, as we have been saying since the beginning of the year, has been fully on sustainability at forest and factory. This year we plan to have total investments of R\$80 million, and compared to investments made in 2015, which totaled R\$88 million, this would be a reduction of 10%. Investments over the course of the year have been in line with this target of R\$80 million.

Slide 11 is the final slide of the presentation. It's also more informative, but quite important because, as we always say, around 80% of the Company's revenue comes from the forest base, so it's interesting to learn these numbers and information. We have 79 farms, all in the state of São Paulo, totaling 46,000 hectares. In this period we harvested in an average radius of 180 km in Salto and 40 km in Botucatu. On the left, charts show the evolution of plantation and management of forests. This year we plan to keep our planting program the same at around 4,500 hectares, and around 85% of this target has already been reached. On the right we have information regarding our recycling process, which is in full steam, with significant growth in comparison to the same period last year. With this growth, the idea is to cover all thermal energy generation at the MDF and fiberboard units without consuming the forests.

With that we conclude the information we wanted to give you about 3Q. We are now available for questions. Thank you.

**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 #.

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

Remember: to ask any questions just press \*1.

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

**RUAN PIRES** – Good morning José Antônio. I have a question regarding non-recurring results. Over the course of the year, when you show adjusted EBITDA, there was an adjustment of around R\$17 million and this quarter had non-recurring results of around R\$4.6 million. Could you please give me some color on whether this is all from terminations, or if this non-recurring result this quarter was affected by anything else, because of how you bought wood from third parties. And as a





complement to this question, what was the impact on EBITDA from buying wood from third parties this quarter instead of using own wood? Thank you.

**JOSÉ ANTÔNIO GOULART DE CARVALHO** – Good morning Juan. Thank you for your questions. With regard to non-recurring results, they are mostly due to the restructuring that the Company is carrying out. We had a significant number of terminations and replacements, and continue to have, at all levels of the company, from the Board of Executive Officers to forklift operators, so there is a significant volume of severance pay. It's also important to point out that this year we also had a slight increase in the number of labor disputes compared to previous years, especially with third parties – although I don't have the exact figures with me. Since the economy is not doing well, some third parties were facing difficulties this year. As you know, we end up being supportive of these third parties. If they happen to face labor disputes and are unable to fulfill their obligations, the company that contracted them is held responsible. Evidently we will seek compensation from the third party in the future. But we had an increase in labor disputes resulting from the engagement of third parties for services. As for the purchase of wood from third parties, it amounted R\$11 million. This is what happens: we ceased to reverse around 50% of this amount, which would correspond to depletion. This is basically what makes the difference, or made the difference, between the EBITDA percentage this quarter compared to the previous quarter. I hope this is clear.

**RUAN PIRES** – Just a follow-up: looking at non-recurring expenses, which are basically related to terminations and problems with third parties, what can we expect looking ahead? Can we expect more non-recurring expenses as a result of the restructuring? And do you expect any cost saving for next year? Thank you.

**JOSÉ ANTÔNIO GOULART DE CARVALHO** – Yes, we still have important adjustments to make. In the 4Q, this year-end, we still have important structural adjustments to make, which will certainly impact indemnities due to these expenses. So, we will have more significant figures in this line. Thank you.

**OPERATOR** – Remember: to ask any questions just press \*1.

Remember: to ask any questions just press \*1.

Ms. Luciana Oliveira Azevedo, a USP student, would like to ask a question.

**LUCIANA OLIVEIRA AZEVEDO** – I have been following information about the panel market, which is my field of study, and I'd like to know what your expectations are regarding the price this year-



end, given the lower capacity utilization related to the arrival of new players in the market, because it seems very concerning. We're seeing new plants and people reducing capacity. Thank you.

**JOSÉ ANTÔNIO GOULART DE CARVALHO** – Luciana, the scenario is not easy, that's what we tried to show you here. We had some continuity, a quarter with significant decrease in domestic demand. I don't know if I mentioned, but the panels sector in 3Q compared to last year contracted 6.2% and, at the same time, during this year 2016. We had the startup of two new plants, one by Werneck and one by Guararapes, further increasing the supply of products, so this leads to a challenging scenario for the companies. I believe if it weren't for exports, which this year are already significant, not only for us but the market in general, the scenario would be even more challenging. That's why it's important for the exchange rate to at least stay at this level, otherwise exports will become even less attractive, making the situation in the domestic market even more complicated. But, anyway, there was a problem of excess supply in 3Q and it is still happening in 4Q, which makes companies fight harder in the commodities segment. When we say commodity we are referring to panels with no finishing, or those with very simple finishing, particularly white, and this, as commodities, leads to this situation. They are all comparable and all with excess supply, in the middle of a fierce price war and what we noticed at the end of the year was that the increase seen in 2Q and early 3Q fell back, prices increased, and this increase is coming back strong at the end of the year. Thank you.

**OPERATOR** – Remember: to ask any questions just press \*1.

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** – Like I said in the beginning, we have responsible optimism about the future, because we have a more appropriate guidance for our economic policies, which will certainly get us back on track. I also understand that we will once again attract a higher volume of foreign capital, so I think the future, in a way, is promising, but the present is very challenging. We continue to focus on the present, the short and medium terms, making difficult but necessary adjustments to maintain a reasonable level of profitability for the Company. 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.



## About Eucatex

Eucatex S.A. Indústria e Comércio completes 65 years in 2016 and is one of Brazil's largest manufacturers of laminated flooring, wall partitions, doors, MDP/MDF/T-HDF panels, fiberboard, and paints and varnishes. It operates five modern plants in Botucatu and Salto (both in São Paulo) and Cabo de Santo Agostinho (Pernambuco), employing 2,432 people. Its products are exported to more than 37 countries. For more information, visit [ri.eucatex.com.br](http://ri.eucatex.com.br).

*This release contains forward-looking statements related to the business prospects, estimates of operating and financial results, and those related to the growth prospects of Eucatex. These are merely projections and as such are based exclusively on the expectations of Eucatex management concerning the future of the business. These forward-looking statements substantially depend on market conditions, the performance of the Brazilian economy, the sector and the international markets and therefore are subject to change without prior notice.*