

BY STORA ENSO

# Brazilian paper seeks global scale

*While Brazilian eucalyptus pulp is by far the most competitive in the world, the paper produced in the country still faces challenges that go beyond internal infrastructure and technical quality aspects, such as the maturing of markets abroad and the consolidation of companies*

**By Marina Faleiros**

**W**ith a climate and soil favorable for forestry activities, cutting edge technology and specialized labor, Brazil has conquered the leading position worldwide in eucalyptus pulp production, having produced more than 10 million tons in 2008. However, on the other side of the chain a question that always triggers heated

debates in the sector: what's missing for the paper produced locally to become just as competitive as pulp? There isn't just a single answer to this question, but several, depending on which product segment one looks at.

According to Pöyry director Carlos Farinha, Brazil's advantages in the pulp and paper sector reside in areas where

virgin fibers are used the most. "Our cash cow is eucalyptus pulp and we also have pine production integrated to paper mills. Therefore, papers linked the closest to these nuclei are extremely competitive since the advantage begins in the forest base", he said. Every product that potentializes the use of wood fiber makes Brazilian paper more attractive. "In



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**IP's new mill: Latin America has significant potential in the sector**

turn, papers that require more of other materials, like energy or chemicals, are generally part of a product segment that Brazil is less competitive.”

According to RISI 2007 data, Brazil ranks number 12 in paper production. Last year, paper makers installed in the country placed 9.1 million tons in the market, a figure well below the United States statistic of 83.5 million tons in 2007, for example. The external market for pulp and paper markets is also configured differently. According to Bracelpa 2008 figures, 55% of Brazil's pulp production is exported, especially to Europe, with 52% of the total. In the case of paper, only 21% is exported, of which 61% to Latin America.

To have a better idea of the destination of each product, Latin America consumes only 1% of the pulp exported by Brazil, while the Chinese market, which is much further away, absorbs 18%. “If we look at theory, in the case of pulp, the mill needs to be located within a close radius to forests in order to be competitive, as well as have good export logistics. On the other hand, paper needs to be close to consumers”, says Carlos Anibal, executive director of Suzano's Paper Business Unit.

And it is precisely because the country consumes a small amount that Brazil's paper industry does not invest in

new mills. While the worldwide annual average of paper consumption is of 61.6 kilos per inhabitant, according to RISI 2008 data the consumption in Brazil amounts to only 45 kilos/year. “In mature markets, like Germany, consumption per capita totals 368 kilos”, summarizes Máximo Pacheco, CEO of International Paper Brazil.

Nonetheless, the executive who heads Brazil's newest printing and writing paper mill – in test phase in Três Lagoas (MS) – believes that the region has significant potential in the sector. “We have our eyes set on Latin America, so much so that this machine, which is capable of producing 200 thousand tons of paper per year, is the first one the group installs outside the United States”, he said.

According to Glaucio Affonso, VP of Operations at Stora Enso in Latin America, the configuration of the global paper market has changed, and today 38% of the world's paper production capacity is already in Asia, which just a few decades ago was not a traditional player in the sector. “The saturation observed in more traditional markets, like Europe and North America, may be compensated with the growth in new regions, such as in Brazil and the Asian market”, he asserts. Latin America, however, still lags in this process, producing only

4.8% of the paper worldwide.

According to Pacheco, several factors shall lead to an increase in paper consumption in Brazil, as income increases, as people have more access to computers and printers, as well as the National Textbook Program (PNLD). “Brazil reached the 12 million computer mark in 2008 and people are printing much more information. Additionally, the government is studying the possibility of including notebooks in the PNLD program, which could increase demand for paper between 50 thousand and 60 thousand tons/year”, says Pacheco.

### **MARKET STRUCTURE**

While Brazil experienced a construction boom of new pulp mills, things were quite different in the paper area. In 2008 alone, two machines were installed, one at International Paper, in Mato Grosso do Sul, and another at Klabin, in Telêmaco Borba (PR), the latter with a production capacity of 350 thousand tons/year of paperboard. “The productivity of our forests put the company in a very competitive position”, explains Reinoldo Poernbacher, managing director at Klabin.

During the press conference held to divulge the company's results in March, the executive said that despite the economic crisis, the company was able to market 150 thousand of the new

tons, especially due to the technical improvements of its products. "These paperboards stand out from the competition in the international market because they have a lower basis weight, offering the same performance with 5% less weight."

Klabin is a good example of a company seeking to become a global player, having sold 39% of its 2008 production to the external market. For analysts and executives in the sector, it is precisely the conquering of markets abroad that has allowed companies in Brazil to grow. "What we have in Brazil today is a production capacity much greater than the domestic market, but we need greater penetration in the external market, since we already have a good product and good competitiveness with low pulp cost", asseverates Anibal, from Suzano.

And what do we need to sell internationally? In the opinion of Suzano's director, the main restrictions refer mostly to logistics disadvantages, with a very high cost of getting goods to a port and shipping them abroad and the fact that mature markets are relatively distant. "The limitations are in terms of infrastructure in general, since our ports are not that efficient and all this ends up generating a relatively high 'Brazil cost'", he emphasizes.

Though its distant location, China has however managed to make its papers to reach the most diversified markets. According to Anibal, the Chinese invasion is not only due to the fact that they have very large paper machines and a greater production scale, but mainly because a major part of the Chinese paper entering into Brazil is declared as for editorial purposes (printing of books, newspapers and magazines) and therefore free from taxes. But, in actual fact, this paper is diverted to unrelated applications, thus giving rise to an unfair competition. "Meanwhile, the Brazilian producer keeps on paying taxes", stresses the Suzano's executive. (Read more on this issue in the *Bracelpa* article, in this very edition).

According to Farinha, at Pöyry,

the country also lacks appropriate infrastructure for distributing to clients, for it to be possible to make a machine in Brazil that is totally export oriented, as is the case with pulp. "Additionally, we need to resolve long-standing problems in the sector, such as high taxes. In the logistics area, things are already improving, but we need the government to do its part too", he said. With the new exchange rate and a stronger US dollar, there's an advantage for Brazilian producers who are earning more with external sales.

During the Roundtable about the competitiveness of paper produced in Brazil, which was held at ABTCP headquarters in March, various professionals in the sector gathered to discuss this and other subject matters. At the meeting, Afonso, from Stora Enso, also mentioned the need of companies that produce paper in Brazil to focus on specific markets. "Even us, when we acquired Inpacel, we produced six types of products with their brands, and today we have only two, since the gain in scale reduces our costs", he said. During the discussion, Sheik Rashid, from VCP, also added that the machines in China sometimes produce an entire month online without changing paper grade. "In order to reduce our price, a machine can't keep being altered in order to produce a different type of paper", he argues.

In the current scenario, however, Anibal still believes it is not the moment for major capital investments in paper machines in Brazil. "When we analyze investments, we see that there's a much higher logistics cost and a much lower profit margin when compared to a new pulp mill. That's why growing our paper export capacity is still unviable in the country".

Nonetheless, for Suzano, which stands as a key pulp player and plans on building three new mills over the next ten years, paper is still an important business in the group. "Paper is less volatile: while the price of pulp currently drops, the price of paper remains stable,

that's why we continue believing in this product, for it provides stability in times of market volatility."

And there are plenty of ways for becoming a global paper competitor in Farinha's opinion. He believes that it's quite possible that companies down here will become international, where they will do the paper converting abroad or acquire foreign companies. Pöyry's director explains that there's a consolidation trend going on of groups within their own countries, as we see happening in the pulp sector, where large groups are joining forces and buying one another, in order to then conquer the world. "The window of opportunity is being taken advantage of and is currently favorable for pulp, but with time more products will be added to the chain. It will be possible to conquer the market in a very solid manner, it's just a matter of time and opportunity", said Farinha.

With the crisis, Farinha also commented that assets may be put for sale outside Brazil at interesting prices, and that this could be the chance for a Brazilian company to dare and be bold. When asked about this possibility, Anibal said it is possible and an option that Brazilian companies have, since they possess the knowledge and qualified people to manage mills abroad. "I'm not saying that Suzano is going to do this, but it is certainly an option for growing, and with this current crisis we may see some good assets for sale at interesting prices", he asseverates.

## **FOCUS ON PAPER**

With so many varieties of products, the paper segment in Brazil gives evidence of different needs for each of the paper grades. In the pulp sector, Brazilian soil and climate conditions are the best, in addition to the great biotech knowledge already accomplished. These two factors support the high productivity of the Brazilian forests. In the paper manufacturing chain there are other more complex factors, and not yet well enough developed by the domestic companies, that is, the extension of the supply

network and costs of processing materials, such as chemicals, and energy.

Even so, from a technical stand point, Brazilian production is not second to anyone worldwide. "We have much better opacity and printability on account of the eucalyptus pulp, besides the far superior whiteness and brightness. Thereafter, I do judge the Brazilian paper technically fairly competitive."

According to Farinha, from Pöyry, Brazil is a strong exporter of writing and printing papers, but national trademarks still don't have projection on a global level, by now. "To be really competitive, there is need of a local machine running 100% for exports, with support service to the client and a well established distribution system, he comments. In his view, a profitable paper machine should have an annual output capacity of 400 thousand tons, at least. "Local producers continue undergoing many difficulties because exporting in fragmented, small scale".

When the matter comes to paperboard, Brazilian manufacturers put on view enthusiasm, especially with the Brazilian currency devaluation, which has brought significant growth in export revenues. "This has been, in some cases, compensation for the reduction in prices" states Poernbacher, from Klabin. Additionally, he points out that technical characteristics developed by the company in Brazil allowed taking advantage on competitors, since the basis weight has been decreased as much as 5%, but retaining stiffness, which means cost reduction for our clients.

"We do believe we have enough tools, by way of our paperboard quality and general competitiveness, for attaining new markets."


The harder challenges are, however, in areas of products demanding for large amount of power, as is the case of the newsprint and magazine papers – the supercalendered, for instance – and the wood containing papers. "There are energy difficulties, and its price evolution is always an uncertainty. In this, we do not achieve same competitiveness as that of the Canadian companies", says Farinha. He still makes reference to specialty papers, as is the liquid packaging board, of a very high quality, and in a market niche where Brazil is doing very well. These products, however, perform in a completely dissimilar area from that of typical commodities, as the A4 cut size printing and writing paper, for instance.

In the coated papers field, were much less fibers are taken, a great scale paper machine reaches the 600 thousand tons in China, as states Farinha. "To attain such a production level is rather more difficult for domestic producers, since this paper requires much more chemical load, and there exists an implicit economics scale in the business, i.e., machines must be actually big", says.

"It is still extremely difficult for a company to be competitive in Brazil in this sector, due to the lack of demand and, furthermore, because the high taxes to pay", claims Affonso, from Stora Enso, which core product is the LWC paper.

Still another problem is the non devolution of the accumulated ICM credits, generated by the exemption from taxation that benefits the production of papers for editorial use.

Now, with reference to newsprint papers, domestic production lies below the national demand and, as a result, two third of the country's consumption is supplied by imported product. "However, power costs and the non devolution of the ICM credits are not encouraging any new investments", asseverates Francisco Saliba, director at Bracelpa's Sectorial Negotiations.

About tissue papers in Brazil, there is an increasing trend in both, users number and higher value-added products demand, as is for the two-ply grade. Here, about 80% of the total consumption is still related to the one-ply paper, while in the neighboring countries - Colombia, for example -, 95% of the sales consist of the two-ply grade. Due to logistic reasons and sales value, tissue production is always domestic market oriented, with exports limited to the neighboring countries. The eucalyptus pulp once more represents, in this segment, a great differential, favoring a still higher competitiveness, and Brazil, thereafter, is attracting attention from foreign people. "We know about some coming attempts by Chileans in Brazil, and the market has been more active in seeking Brazilian companies acquisition by foreign groups than national companies in acquiring new mills in Brazil", remarks Farinha. 

**WHICH ARE THE MAIN OBSTACLES TO THE GROWTH OF THE BRAZILIAN PAPER COMPETITIVENESS?**

Tissue	Internal market is hardly developed and highly oriented towards low value-added products.
Newsprint	High energy costs and non devolution of ICMS credits, a benefit due to the production of taxation-free papers (because for editorials uses).
Printing and Writing	Brazilian trademarks not yet known overseas, lack of organization in the supply chain, and unfair competition from imported paper, which enters into Brazil taxes-free because declared as for editorial purposes, but afterwards turned to different applications. In the LWC paper case, furthermore to this problem, there also subsists the high power cost, and the non devolution of ICMS credits for producing taxes-exempt papers.
Packaging	Still demanding for improvements in exports logistic and taxes burden reduction. Paperboard exports are already present all over the world, and the product, with lower basis weight but retained stiffness, is indeed valued.