



Brazilian paper: What are the paths towards global competitiveness?

There's no lack of quality pulp and cutting edge technology for the domestic paper sector to become more competitive at a global level, however, a series of challenges still need to be overcome by Brazil's paper industry in order for it to grow in the international market

By Caroline Martin

Whoever survived the turbulence in 2009 knows how welcome it is to face a projected growth rate of 4.5% to 6.5% in the paper sector by the end of this year. "The sector is about to recover completely", says Manoel Neves, Pöyry Tecnologia's Economic Studies Manager.

That's because the production volume at the end of the first semester of 2010 is very close to the amount registered by the sector before the global economic crisis.

According to the Brazilian Pulp and Paper Association (BRACELPA), between January and June, Brazil produced 7% more than the same pe-

riod a year ago. This is an outstanding performance, due mainly to the growth posted in the paperboard and packaging paper segments, of 31% and 12.5%, respectively, compared to the figures registered in the first half of 2009.

An indicator that this growth in the paper sector follows the line

of sustainability can be seen in the RISI Annual Review. The report published in August presents the list of The World's Top 30 Producers and Consumers 2009, ranking Brazil #9 among paper producers worldwide.

In addition to a production volume of 9.4 million tons in 2009, the production drop in Italy and France generated competitive advantages for our country, which until then occupied 11th place in the ranking. The domestic market also stands out as a major lever of the country's paper industry. Considering all types of paper, apparent consumption increased roughly 10.9% in the first semester of 2010, compared to the same period a year ago.

The reason? "The increased supply of credit and the resulting consumption growth resulted in a more expressive supply to the food, pharmaceutical, personal hygiene, electric-electronics industries and other sectors", answers Elizabeth de Carvalhaes, BRACELPA's CEO.

In fact, this increase in consumption per capita is a trend, says Marcel Moreno, Business Director of Pöyry Tecnologia's pulp and paper area. However, the executive points out the following: "Just like other developing countries, Brazil still has a huge consumption per capita gap. If the country maintains economic activity on the rise, the domestic market potential may be explored much more".

"Since paperboard is closely linked to purchasing power, the increase in product consumption also means an increase in paperboard demand", says Adriano Canela, Strategy and Marketing Manager of Suzano's Paper Unit. In this segment, Klabin further reinforces the paper sector's excellent performance, having posted a sales volume of 165 thousand tons of paperboard in the second quarter of this year – a high of 44% in relation to the same period a year

ago. In terms of corrugated paperboard containers and corrugated paperboard sheets shipped by the company in the quarter, the sales volume totaled 134 thousand tons, representing a 17% increase over the year before.

AN EYE ON THE POSITIVE OUTLOOK

The good performance phase of Brazilian paper led Klabin to invest in new equipment acquisitions and improvements. Of the R\$ 98 million invested in these items in the second quarter of 2010, half went to the paper unit.

Especially in relation to the segment of packaging paper, Klabin's Finance and Institutional Relations Director Sergio Alfano informed that certain projects aimed at increasing the speed of the corrugators and boosting capacity have already even been concluded. Four new 4-color printers will also be installed yet this year, concluding the investment cycle in this area.

Not only the packaging paper and paperboard segments are experiencing a good phase this year: the tissue paper niche expects to grow even more. "Investments to increase production capacity amount to around US\$ 1 billion until 2015. The capital will be sufficient to boost Brazil's current production by another 200 thousand tons/year, an amount equivalent to roughly 25% of the volume currently produced", says Neves, from Pöyry Tecnologia.

In the national tissue scenario, Santher's production exemplifies successful business cases. "Comparing the volume produced by our mills in the first semester of this year against the same period in 2009, the increase amounts to 17%", says Carlos Zuccolo, the company's Marketing Director.

Once again, the main factor responsible for this positive performance was the increase in the Brazilian population's

income, which in the tissue segment case elevated class C consumers to demand for higher value-added products. The volume of Santher's two-ply toilet paper brand posted a 43% increase in the first half of 2010 compared to the same period the year before.

"This paper stood out, but growth is also observed in other lines, such as wet naps", says Zuccolo. In 2010, Santher will complete a US\$ 100 million investment cycle that started back two years ago. The capital was invested to increase capacity and renew mills.

According to Zuccolo, the capacity expansion opportunity was already expected for some time by Santher and now the time has come to put plans into practice.

The pick-up in the economy is also noted in the printing and writing paper, as shown in the figures presented by RISI. According to the data, the apparent consumption of this segment increased 11% in the second quarter of 2010 compared to the previous quarter. "The greater turnover in products leads companies to invest more in communication and advertising, boosting demand for coated paper", says Canela, from Suzano.

Suzano's line of uncoated papers registered a smaller increase, says the executive. He points out that the variables that compromise demand in this niche are directly associated to their applications. "Used considerably in the production of notepads and government book programs, uncoated papers present a lower growth rate due to seasonal factors."

For 2010, RISI's economist for Latin America, Patrícia Perez, points out that the growth expectation for print papers is 10%. The new re-registration required by the federal government for tax exempt paper and the monitoring of state authorities regarding the proper use of this product promise even better results for

the domestic market by limiting imports on a wide scale. Concluding the analysis of opportunities this year are the positive expectations for specialty papers, which shall grow 15% in the period.

BEYOND THE COUNTRY'S TERRITORY

Expanding the horizons of the paper market to a global vision, BRACELPA's indicators for the first semester of this year show that exports increased 14% in relation to the same period a year ago. The printing and writing, packaging and paperboard segments were responsible for the highest percentages that formed this positive result.

"The economic improvement in Europe and United States helped turn around last year's scenario", says Elizabeth. However, Latin America still leads the ranking of main destinations for Brazilian products. While exports to Latin American countries totaled US\$ 548 million – between January and June 2010 –, sales to Europe amounted to US\$ 190 million, and to the United States US\$ 105 million during the same interval analyzed.

In the comparison of exports – pulp versus paper –, the commodity is way ahead in terms of results and perspectives. According to Brazilian executives in the paper industry, the reason for this difference resides in regionalization, which consists in a key competitive factor in paper sales, contrary to the commodity. "Each type of paper possesses its own logistical system. Of course, some papers are exportable, but overall, the majority of production in Brazil is earmarked for the domestic market", analyzes Neves, from Pöyry.

On the list of "exportable" items, the executive includes paperboard, kraftliner and printing and writing paper. For Neves, exports in these segments will tend to grow over the next few years, but involve a much more complex

process. Suzano, for example, is going to introduce seven papers yet this year. The focus is not only limited to the domestic market, informs Canela, but also opportunities in the export market.

With the 9% increase in export volume during the first half of 2010 compared to the same period a year ago, Klabin has scheduled the installation of a new paperboard machine. "The machine may begin operating when we inaugurate our new pulp mill at the end of 2015, or even before, depending on market positions", said the company's Managing Director, Reinoldo Poernbacher, when announcing the company's financial results.

The expansion justifies itself, says Poernbacher, in view that the international demand for these papers is above Klabin's current production capacity. The participation of Asian countries was very important in the first semester of this year, having accounted for 33% of the company's total net export revenues, compared to the 17% registered in the same period the year before. The volume exported to Asia was boosted by the increase in paperboard sales for packaging liquid products.

"Klabin's exports of paperboard have already exceeded our expectation for period", said the company's Operations Director Paulo Roberto Petterle. The positive indicators for paperboard worldwide need to be analyzed with a certain amount of caution when projecting future expectations. "The balance between supply and demand needs to be well consolidated when focusing heavy investments such as this one projected by Klabin. Any additional paperboard machine would have its production entirely earmarked for export, since the domestic market is fully serviced", says Poernbacher.

According to Manoel Neves at Pöyry Tecnologia, the drivers of the paper mar-

ket are quite complex and advance at a slower pace in the international market. "Each type of paper calls for a different sale. I'm not talking only about internal logistics for unloading production, but also the logistics in the countries of destination."

THE LABYRINTH OF COMPETITIVENESS

In Petterle's opinion, Brazil's nature conditions are unbeatable when the subject is competitiveness. The production of high quality pulp at costs lower than traditional markets provides the paper industry some breathing room. "Additionally, we no longer lack technology; we are capable of competing with any of the top players", he said.

The difficulties in unloading production, however, represent major obstacles. "Brazilian exports have only not been further affected because international prices are high", he said. Marcel Moreno, Pöyry's Business Director for the Paper Area adds: "It's not by chance that paper producers are located near their consumer markets. Transportation is an important price component".

Ralph Lima Terra, Executive Vice-President of the Brazilian Association of the Infrastructure and Capital Goods Industries (ABDIB), says that, despite the advancements that have taken place the past few years, with the federal government's participation through the Economic Growth Acceleration Program (PAC), there still exist structural deficiencies the Brazil's cargo transportation grid.

In order to expand the transportation corridors, increase integration between transportation modes and improve cargo moving efficiency, Terra defends better planning through appropriate public policies. "However, it is important to acknowledge that investments are underway", he said.

In the opinion of BRACELPA's CEO, the international competitiveness scenario becomes even more complex with the lack of lower cost and longer term financing lines. To identify the investment difficulties faced by Brazilian businessmen, the Federation of Industries of the State of São Paulo conducted the FIESP Survey of Investment Obstacles, with the participation of 318 companies of all sizes. The results divulged in early June by the entity's Competitiveness and Technology Department shows that the list is quite extensive.

Among the headaches pointed out by the survey, the high tax load stands out as it applies directly to investments and, most importantly, because it removes resources that otherwise could be invested. "Brazil is one of the few countries in the world that tax investments. In the case of the pulp and paper industry, the load reaches 17% of the investment", says Elizabeth de Carvalhaes.

High interest rates appear as factors responsible for the increase in financial risks. RISI economist Patrícia Perez believes that the lack of a favorable exchange rate for exports discourages producers to invest in new paper capacities. "Investors in the sector still prefer to direct their capital to market pulp, thanks to the raw material's competitiveness abroad."

While large companies lose competitiveness with an overvalued exchange rate, coupled with a poor quality infrastructure, the main obstacle for small businesses resides in the lack of own capital for investing. Access to credit was also pointed out in the survey. The excess of bank requirements and the lack of guarantees for companies were mentioned as factors that hinder investments.

André Biazus, Head of the Pulp

and Paper Industry Department at the National Bank of Economic and Social Development (BNDES), alleges that the difficulties in granting credit many times are due to the lack of transparent financial information on the part of companies. "Some projects end up compromised due to registration criteria that affect the risk rating, making it difficult to obtain support", he said.

Among BNDES' requirements for a beneficiary to be able to operate with the bank's traditional lines of credit, we have: payment ability, satisfactory commercial registration, good tax and social security standing, no loan recovery regime (former bankruptcies and arrangements with creditors), availability of guarantees to cover the transaction risk and compliance with environmental legislation in effect.

In addition to these competencies, the Sectorial Manager of BNDES' Pulp and Paper Industry Department, André Barros da Hora, informs that

a minimum own capital of the entrepreneur and of other sources of funds is necessary – which limits the bank's stake in each project.

Over the last five years, the BNDES invested approximately R\$ 6.7 billion in the pulp and paper segments. Of the entire amount, roughly R\$ 1.2 billion went towards forestry projects. "In the paper segment's case, we see very little investing over the past ten years, mainly due to the low per capita consumption of paper in Brazil and the need of scale for new projects", says Biazus.

The Head of BNDES' Pulp and Paper Industry Department informs that capital investments over the next years will depend on the plans of companies in the sector. "We have participated in various forums and meetings to discuss the competitiveness of Brazil's paper segment. If projects on the current agenda become a reality, investments will without a doubt exceed the average seen in past years", he said. ▲

IN FAVOR OF PAPER!

A joint initiative by the paper production chain and print communication led to the Print Paper and Communication Valorization Campaign, launched back in June. With the slogan "Printing gives Life", the initiative aims to inform the population about the origin and production process of paper used for printing. "Our goal is to show that paper has no relationship with the destruction of forests and environmental damage", explains Fabio Arruda Mortara, President of the Brazilian Printing Industry Association (ABIGRAF), in São Paulo.

Mortara says that the lack of awareness regarding the production process, generated by the disclosure of incorrect information, has led other types of media to build public opinion against print communication. "The involvement of the entire chain is fundamental in order to demystify the product", said ABIGRAF São Paulo's President.

The campaign involves 21 Brazilian entities representing various sectors, including the pulp and paper, books, magazines, machinery and raw material. One of the actions is the launching of the www.imprimedarvida.com.br website, which includes explanations, articles by specialists and videos on the subject. A series of ads is also being divulged by the media of participating entities. "In addition, we have done some public relations work with the communication means and civil entities", said Mortara.