ARACRUZ COMES OF AGE: AN INTERVIEW WITH CARLOS AGUIAR

WAYNE H. GROSS

TAPPI'S EXECUTIVE DIRECTOR WAYNE H. GROSS MET WITH Carlos Augusto Lira Aguiar, President and CEO of Aracruz, and conducted the following interview for TAPPI JOURNAL *during a recent visit to São Paulo, Brazil.*

TAPPI JOURNAL: What major challenge does Aracruz, as a South American pulp producing company, face in the next five years?

Aguiar: We are not much different from other industries around the world. But the pulp and paper industry of South America has some natural advantages due to its low-cost wood, mainly through the use of fast-growing tree species such as eucalyptus. I think the big problem today in the world pulp and paper industry is excess capacity, low demand, and the subsequent depression of prices. This time, the down cycle was aggravated by the Asian crisis which now affects the entire world industry, providing us with very poor returns. The returns to our shareholders have not been good, which is a problem for all of the companies.

TAPPI JOURNAL: In the context of challenges that the industry faces, what specific challenges does Aracruz face as a company?

Aguiar: I think our challenge is to add value for our shareholders. One way we can do that is by improving our cost structure. We are seeking to reduce costs by all means available. We are looking to process technology to lower operating costs and to information technology to help manage overhead costs. By doing this, we believe we can move forward in the near future. The other challenges are related to the high fragmentation that is typical of our industry.

We expect that, for the next decade, there will be more concentration, with mega-companies having more control over supply and demand.

TAPPI JOURNAL: Since you are a relatively new CEO, I would like to ask if, as you begin your term, you foresee major structural changes in the Aracruz organization during the next 10 years or so?

Aguiar: Yes. We are still reducing layers of our organization, trying to find answers to problems and speeding up actions when we know the answers. We are now focusing on more simplicity throughout our organization, and on more value for the shareholders. On the other hand, we are also looking to the future. We are starting new fiber projects to keep up with the changes in the industry and in fiber technology. We are strong in forest engineering and we can work on genetic materials to prepare for the development of new timber products we may want to introduce in the next decade.

TAPPI JOURNAL: What is Aracruz doing to enhance its strength as a low-cost producer of hardwood pulp in the long term?

Aguiar: Currently, our plan is to improve our plantations even more through genetic selection. We are starting development in biotechnology to change our basic fiber source, thus making our forests even more valuable. We are investigating ocean transportation, via barges, for logs that come from more distant plantations. Also, we are looking at other measures, like our overhead structure, and we are seeking further improvements in the scale of our operations.

TAPPI JOURNAL: Strategically, how do you see Aracruz in relationship to other market pulp producing companies in terms of potential?

Aguiar: Aracruz is quite well positioned to enter the next century. We have good forest technology and good results in timber production. We have doubled our forestry yields, and we are still investing in research and development to grow more fiber per hectare. Our main competitive edge is our fiber supply. In addition, we are also prepared to produce 100% ECF and TCF pulps in our mills, in terms of environmental demands. We are meeting tougher regulations or rules, ones that are even tougher than the Cluster Rules in the United States.

In terms of scale, our mill can produce about 1.3 million [metric] tons per year and still has recovery boiler capacity to produce up to 1.8 million [metric] tons per year. We have large economies of scale in operations on one site. So we believe that, strategically, we are a company that will best be able to face the challenges of the next century – with a large scale of production, good environmental performance, and sustainable and high-technology forestry.

TAPPI JOURNAL: You painted a pretty positive picture in terms of your own situation, but we see new pulping operations coming on-line in Asia, particularly in Southeast Asia. How do you see Aracruz in relationship to some of these new competitors, primarily in Indonesia?

Aguiar: I believe that these new companies in Asia will have some of the advantages we have in the Southern Hemisphere. They are located in the same type of climate and their weather is very similar to what we have here. I think our advantage today, over these new mills, is our more than 30 years of experience in forestry production and in forest technology.

At the moment in Asia they are still using a lot of native trees. They are just starting their eucalyptus and acacia plantations. As you know, new species require a lot of experience and a lot of knowledge to make them practical, and we already have more than 30 years of this type of experience. It may take some time for them to guarantee the quality of their fiber. On the other hand, I believe that Aracruz must always be looking to see what is coming from this new competition. Meanwhile, we are also looking at what we have in terms of our seven-year fibers, to see how to improve our trees so we get as much lead time on the competition as possible over the next few years.

TAPPI JOURNAL: Has the instability in Indonesia, particularly with the currency devaluation, created any special problems for a producer like Aracruz?

Aguiar: I don't think it created a special problem for Aracruz. I think what created the problem was the deep decline in demand in Asia. We sell 18% of our pulp to Asia, 35% to the United States, and 35% to Europe. So, we were just following the falling Asian demand. But, on the other hand, the U.S. mills, which produce mixed hardwood for the Asian market, were also very much affected by the drop in demand. Once the Americans lost that market in Asia, they began to export to Europe and created a lot of competition in the same arena.

Over the short term, I believe the main problem is the low demand is putting pressure on prices due to the over supply and a lot of competition in the same arena. Even the Indonesians, with their low costs, are trying to sell pulp and paper all around the world, and even if that pulp is not what the people prefer they also want to decrease their cost mix. Aracruz is more focused on quality, in some special market niches.

In the long-term, I think the crisis has worked for us because there is a lack of new investment in the industry. Therefore, it is easier to get a clear picture of supply and demand for the future. This fall-off in investment will eventually increase prices as demand rises. We finally will obtain the return on investment that our shareholders want. In the long-term, this crisis is going to be good for our sector, because it's going to put more discipline into the investments from industry and into financing from the banks and governments. This will help all of the sector.

TAPPI JOURNAL: It sounds like Aracruz wants to compete on the quality issue. Is that the direction you are taking in terms of how you want to approach the market?

Aguiar:: Quality is a key part of our marketing strategy. About 50% of our pulp goes for tissue production, mainly in the United States, where it is used by producers of high quality tissue. About 20% goes for special grades of paper. Because of this, we try to be a little bit different than the others, not only in price but also in quality. We cannot pretend that price does not matter. But for the same price people prefer a pulp that has better fiber quality and a company that gives better service – technical service and logistical service. This is part of our strategy, to be different in quality of the fiber, quality of our technical assistance, quality of our logistics, and also with our technological center, where we can develop new ideas to better fulfill our customers' needs.

We have increased our market share in many product segments in North America and Europe because of quality. We see our eucalyptus pulp in their fiber mix. Some customers are asking to go from 65% to 75%-85% of eucalyptus in their fiber mix. So here is the issue: while we cannot control price with quality alone, we can hold on to the best customers during the bad times, like we have today. Quality means we still can sell most of our pulp and maybe obtain some return for the shareholders, even in the difficult years.

TAPPI JOURNAL: You talk about service and quality but you also just mentioned R & D investment as something that's important to your company.

Aguiar: Yes. R & D for us is quite important. We have a different tree species in our plantations, and we don't find much data in the literature about eucalyptus timber because this is not a traditional, standard fiber. So we have to develop a lot of know-how regarding this fiber. In addition, our trees are ready for harvesting in seven years, and for the future we perceive that other fibers may grow as fast. So the seven years that is currently the standard is something we are working on right now. We may need a quicker growing fiber in the near future.

Our R&D team is also focusing on timber management for solid wood products, with our first lumber unit starting up next year.

TAPPI JOURNAL: So you have a quicker turnaround in your plantations?

Aguiar: Yes. We have a shorter fiber rotation timeframe compared to the Northern Hemisphere, although not compared to other places in the tropics. In North America, softwood trees may take up to 70 or 80 years to reach harvesting time. That takes a lot of land and logistics for fiber. But we have a sustainable forest on much less land due to the high yields and shorter rotation. In addition, we always plant trees to meet a specific quality of pulp. I believe this is where we make a difference, because we can change the composition of our forest in order to comply with our customers' needs.

TAPPI JOURNAL: Aracruz has been primarily an exporter from its production base in Brazil, but we see other companies in the forest products industry and in other industries that will locate production facilities in other parts of the world. Has Aracruz given any thoughts to possibly having production facilities in other parts of the world besides Brazil?

Aguiar: In our strategic planning, of course, we recognize that Indonesia is a new area. But we still believe that Aracruz has to be in South America, and primarily in

Brazil. This is mainly because here there is a similar, Western way of thinking and doing business.

TAPPI JOURNAL: You bring a technical background to your position as the new CEO. Do you feel your technical background and training better enables you to serve as the CEO, or gives you a unique perspective?

Aguiar: I follow what's happening in Scandinavia and North America in terms of management of companies, and I believe the Scandinavian companies are more long-term driven than the American companies. Sometimes the companies are too production driven, but in my mind it's not only that. In fact, it's not unusual to see projects being financed without thinking of the possible supply/demand balance.

Mainly the question is one of not going deep enough into the necessary studies to know the effective market needs, because the companies are too self-sufficient by themselves. Also the banks finance projects that show a good return, but they don't have the understanding of what the markets for the product really are. In some cases they set up a project when there is no market at all for the product. The right timing and reverse engineering are not taken into consideration, and the final outcome is what we are seeing now.

Coming from the technical side of the business, I believe I'm going to give Aracruz the leadership to focus our company on adding value for the shareholders. The key factors are focus, simplicity, speed and knowledge of the basics. The short-term focus cannot jeopardize the long term. Investment at the right time, good quality, good services and sensibility for market needs are our goals. Good, committed technical people are our fundamentals.

TAPPI JOURNAL: Certainly, you're fully cognizant of the problems that beset our industry right now, but you seem to have an optimistic perspective on the future. I think that certainly speaks well for you and for the company. Although your tenure has been fairly short thus far as the CEO – what do you see as the biggest challenge facing Aracruz?

Aguiar: I think the challenge is to increase the value to our shareholders, to get higher returns on the investment. If you look at the basics, you have to get the economy of scale, low costs, quality, and to invest at the right time to get the best return. We have to remain simple. We cannot add more sophistication than we already have by the nature of our business. So, in short, my goal is to help our company grow with focus on value, with simplicity.

TAPPI JOURNAL: What can TAPPI do to be of better service to our members in Brazil and, specifically, to your employees?

Aguiar: TAPPI, for me, is a place of know-how and knowledge. It also has a very good technical magazine and is a world-class organization which provides classes and education. I did a lot of my training at TAPPI seminars and conferences.

During my early years in a pulp mill, the TAPPI magazine was the basis of my training for solutions to my day-to-day problems. Today, I still read the technical articles, the editorials, and all the other parts of the journal.

At some point we need to have a more global technical association, an organization that is broader in scope. We could also use some type of association to organize our knowledge so we could be more cooperative. We also could use some more information from you.

In the future, we also look forward to even more cooperative efforts between the associations of Brazil and TAPPI. **TJ**

Gross is Executive Director of TAPPI