Pulp, Paper and Packaging: from local to global
Is there a profitable growth platform in moving from local to global?

Is your regional market reach aligned to meet your growth expectations? Are you taking full advantage of export market opportunities? What is the best strategic path forward in terms of international presence and growth? Should you stay domestically focused or be more internationally diversified? How should you execute? In this Pöyry Point of View we explore the opportunities and investigate what it takes to go global.

ASSETS CLOSE TO HOME
Printing and Writing Paper, Packaging Board and Tissue production firmly takes place close to home markets. 90% of the top 20 North American and top 20 European headquartered paper producers’ asset footprint is in their domestic region. There are only a few global companies with a significant share of their asset portfolio spread over multiple continents – see Figure 1.

Figure 1. Global pulp and paper companies. Size and share of mill capacity outside domestic region.

GOING GLOBAL
STEP ONE: EXPORT
So, paper mill assets are typically concentrated in one manufacturing region. But what about paper shipments? Does the paper stay close to home or is it shipped around the world to meet the demand? There appears to be a difference in the intensity at which North American and European paper mills have embraced international business opportunities. North American mills exported 1.2 million metric tons of Printing & Writing papers (excluding newsprint) in 2011, and 2012 exports inched up closer to 1.3 million metric tons. This is only 6% of market production capacity. In comparison, European mills exported 8.4 million metric tons outside the region, which is close to 25% of market production capacity.

Although North American paper exports have increased partly due to favourable exchange rate, partly due to declining domestic demand, why do North American producers participate in global trade significantly less than their European counterparts? Are the export tons less profitable for North American operators? The logistics costs from major European or North American ports should be fairly similar to ports in emerging markets. In some cases European paper assets can be larger and newer than those across the Atlantic, leading to potentially better competitiveness, but especially the U.S. South enjoys one of the world’s lowest cost fibre baskets and energy supply.
The Europeans have a long history of extensive export business activity around the world. Conversely, North American paper companies appear to have been held back by a history of at the time seemingly continuous demand growth in what appeared to be the world’s largest paper market. That has unfortunately changed most dramatically for Printing & Writing papers. The fragmented country markets in Europe might have provided the cultural and psychological flexibility, business logic, and stepping stone for overseas business development.

**STEP TWO: TAKE SMALL STEPS, LOWER RISK**

First establishing converting and/or distribution presence in emerging markets is a low risk market entry step employed by many paper companies. Seventy per cent of international investments in 2012 involved investment in converting and/or distribution operations.

For example, UPM was busy opening UPM Rafiñac labelstock slitting and distribution terminals in Vietnam, Ukraine, Mexico and Argentina in 2012. In the meanwhile, Stora Enso acquired 51% of Inpac International, a cartonboard converter with facilities in China and India, and established a joint venture with a Pakistan cartonboard converter and producer in 2012. Both companies have since announced much bigger emerging market moves and, at the time of going to press, are in the process of building specialty (uncoated and freesheet paper plus label) mills and cartonboard mills, respectively, in China.

Domtar has had its recent focus on forward integration into the personal care market. At the end of 2011 Domtar acquired Attends North America, a manufacturer of adult incontinence care products, followed by Attends Europe in 2012, and Associated Hygiene Products, a North American private label diaper/nappy converter, and INDAS, another adult incontinence care product converter in Europe, in 2013. They grew Domtar’s personal care revenues from zero to estimated over $1 billion in just three years.
The traditional mature market Printing & Writing paper companies are not only after growth attainable from new (growing) market regions, but also growth available in packaging and hygiene product markets. The companies have also taken strategic note of the growth and smaller investment risk offered by moving down the value chain into converting and further processing of their traditional outputs.

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Smurfit Kappa is a mature market player with a focused approach on international growth. Their strategy has been to focus on acquisitions in emerging economies and high growth markets, and to only make acquisitions in developed markets if significant synergies exist. Since the late 1980s, Smurfit Kappa has been building a significant packaging paper presence in Latin America. Rapid growth in the overall economy and in packaging demand has attracted focus on Latin America. The Latin American strategy has worked well - EBITDA margins and ROCE for the Latin American business have consistently outperformed the company-wide performance.

Mondi can be considered one of the first movers in focused international expansion into the emerging markets of Eastern Europe. Mondi’s current paper mill platform includes 17 mills in 11 countries, including 9 mills in Eastern Europe (including one in Turkey).

“We are principally an emerging market player” says David Hathorn, CEO of Mondi, in Financial Times, September 6, 2012. “We’ve gone there for cost reasons and for growth reasons – we have structural growth in all of our products in emerging market...
The emerging markets of Eastern Europe and Russia will enjoy growth of 3-5% for some time to come.”

The emerging market strategy has also proved to be value generating for Mondi, which trades at a premium to peers. Mondi’s total shareholder return (TSR) in the 3-year period from January 7th, 2010 was 113%, compared to, for example, domestically focused DS Smith whose TSR was 87%. Mondi has achieved greater returns despite having also mature Printing & Writing papers in its portfolio, unlike DS Smith whose sole focus is containerboard.

**STEP FOUR: GO TRULY GLOBAL**

There are only about a dozen pulp and paper companies that have global paper mill operating platforms according to the schoolbook definition of “presence on three or more continents”. International Paper has the most impressive global pulp and paper mill base with 41 mills on 5 continents and 9 countries. Kimberly-Clark, UPM, and Stora Enso are other examples of wide global mill portfolios.

**PERFORMANCE METRICS – COMPARISON!**

Global business strategy has created significant value for some companies. But, can a global business strategy in the paper industry be concluded as universally better compared to a domestic focus? We investigated the link between global operating platform (i.e. paper mill assets on two or more continents) and ROCE. We included in the analysis the top 41 public paper companies headquartered in mature markets (North America, Europe, Australia, South Africa). We divided the group into those who have paper production only in the domestic region (i.e. “domestic focus”) and those who have production in two or more regions (i.e. “global”). We compared the ROCE average between these two groups (Figure 2).

The 2010 to 2011 ROCE average for the “domestic focus” group was 4.9% compared to 7.6% among the “global” companies. This would point to better returns for global companies. However, when we expanded the time frame of the analysis to 5 years (2007-2011), the difference in ROCE between “global” (5.5% 5-year ROCE average) and “domestic focus” (6.1% 5-year ROCE average) narrowed and turned slightly in favour of the “domestic focus” group.

**FIGURE 2. DOMESTIC AND GLOBAL MANUFACTURING PLATFORM AND ROCE.**

- Domestic Group average ROCE 2010-11: 4.9%
- Global Group average ROCE 2010-11: 7.6%
- Domestic Group average ROCE 2007-11: 6.1%
- Global Group average ROCE 2007-11: 5.5%
- Company average ROCE Std. dev.: 5.0
- Company average ROCE Std. dev.: 2.4
- Company average ROCE Std. dev.: 6.1
- Company average ROCE Std. dev.: 4.5

Outliers excluded from the graph.
What does the future offer for mature market players?

Such figures suggest global strategy is not the silver bullet to success. Both global and domestic business models can work. It takes time to enter the right markets, and find the right business partners and people to execute global growth well. Managing the soft dimensions of business culture compatibility and flexibility can take significant time and cause major headaches in global business management.

Globalisation can truly open opportunities for shareholder value creation, as demonstrated by the successes of companies like Smurfit Kappa, Mondi and International Paper. However, the global agenda needs to be planned and executed correctly, otherwise it will fail. Expanding in North America proved difficult for the Scandinavian paper giants, while North American tissue companies’ European market quest has been as challenging.

MOVING FORWARD

What will the future bring? Emerging market investments by mature market players will continue in terms of paper mills, converting operations, forward integration, and sales & distribution presence.

Many companies with existing international operations are likely to hunt for bolt-on acquisitions, such as converting operations or other incremental rather than radical growth in the selected emerging regions. Investments in countries such as India, Indonesia, Turkey and Brazil are likely to be in the headlines in the near future. Also, steps in “new” products, whether packaging, hygiene, specialty papers or even specialty chemicals or energy, are likely moves to expect in the future.

However, a mature market focus can also be a successful business strategy if supported by other fundamentals, such as leading market position, cost competitive supply or value added or otherwise unique product and service offering.

Poyry has extensive experience in international business and market strategy development – our network of offices around the world gives us unique insights and enables our clients to take advantage of our understanding of both the business opportunities and challenges in global markets.

Contact us for further details and to discuss which global strategy best fits your organisation’s requirements.
About the Pöyry Point of View

Staying on top of your game means keeping up with the latest thinking, trends and developments. We know that this can sometimes be tough as the pace of change continues...

At Pöyry, we encourage our global network of experts to actively contribute to the debate - generating fresh insight and challenging the status quo. The Pöyry Point of View is our practical, accessible and issues-based approach to sharing our latest thinking. We invite you to take a look – please let us know your thoughts.
Pöyry is an international consulting and engineering company. We serve clients globally across the energy and industrial sectors and locally in our core markets. We deliver strategic advisory and engineering services, underpinned by strong project implementation capability and expertise. Our focus sectors are power generation, transmission & distribution, forest industry, chemicals & biorefining, mining & metals, transportation, water and real estate sectors. Pöyry has an extensive local office network employing about 6,500 experts.