

The North American Pulp & Paper Industry



~ Value Destruction, Creation & Capture ~

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PaperWeek ~ Montreal, Canada

Center for Paper Business and Industry Studies (CPBIS)

& The Sinclair Group

~ Dr. Jacquelyn McNutt ~

Overview

North American Forest Products Industry *Value Destruction, Creation & Capture*

A Historical Look at Value Destruction

Commentary on Value Creation In Today's Market

Perspective on Where Long Term Value Is

Necessary Ingredients For Capturing Value Long Term

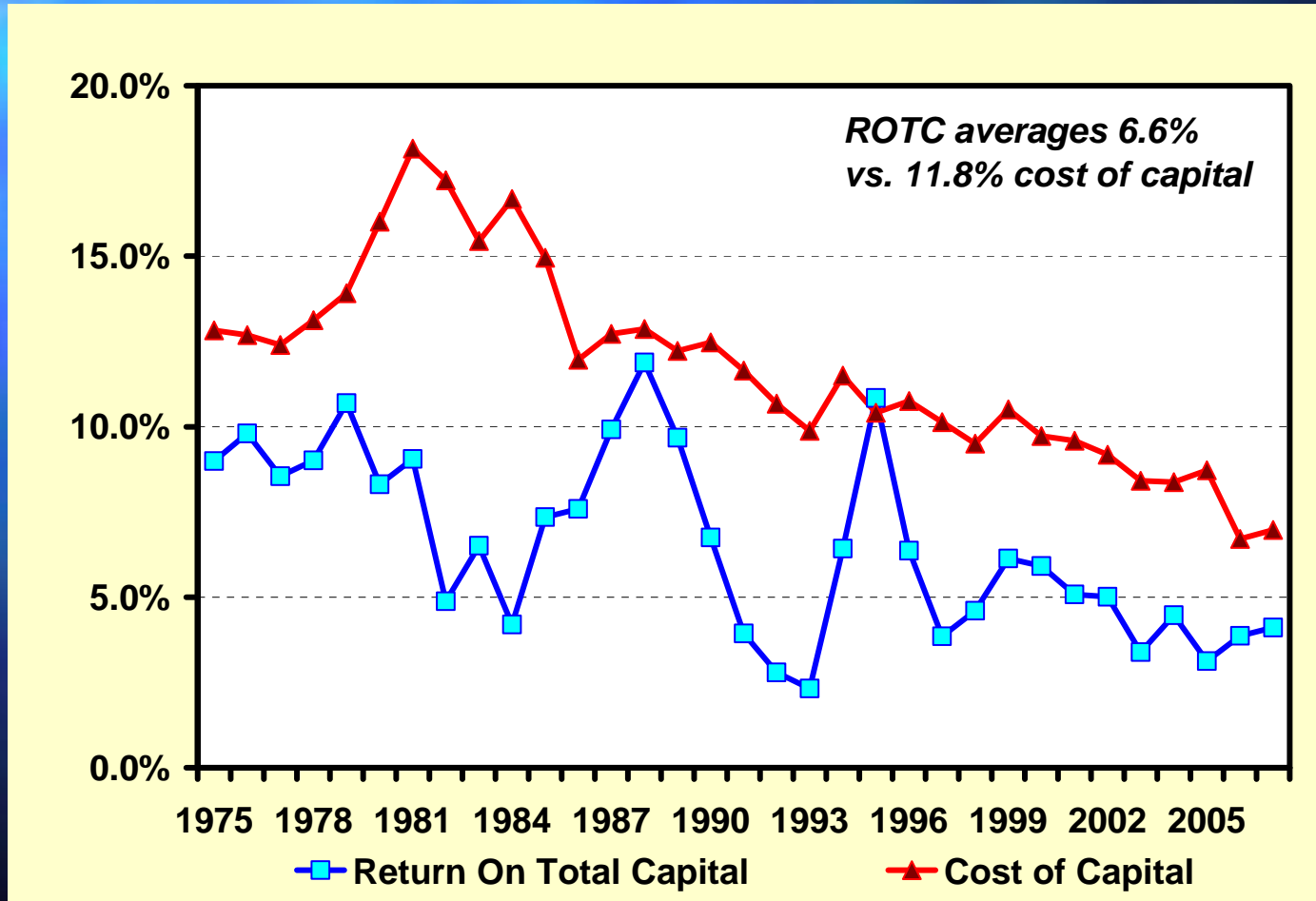
Key Takeaways

Final Thoughts

Value Destruction ~ 30 Year Look

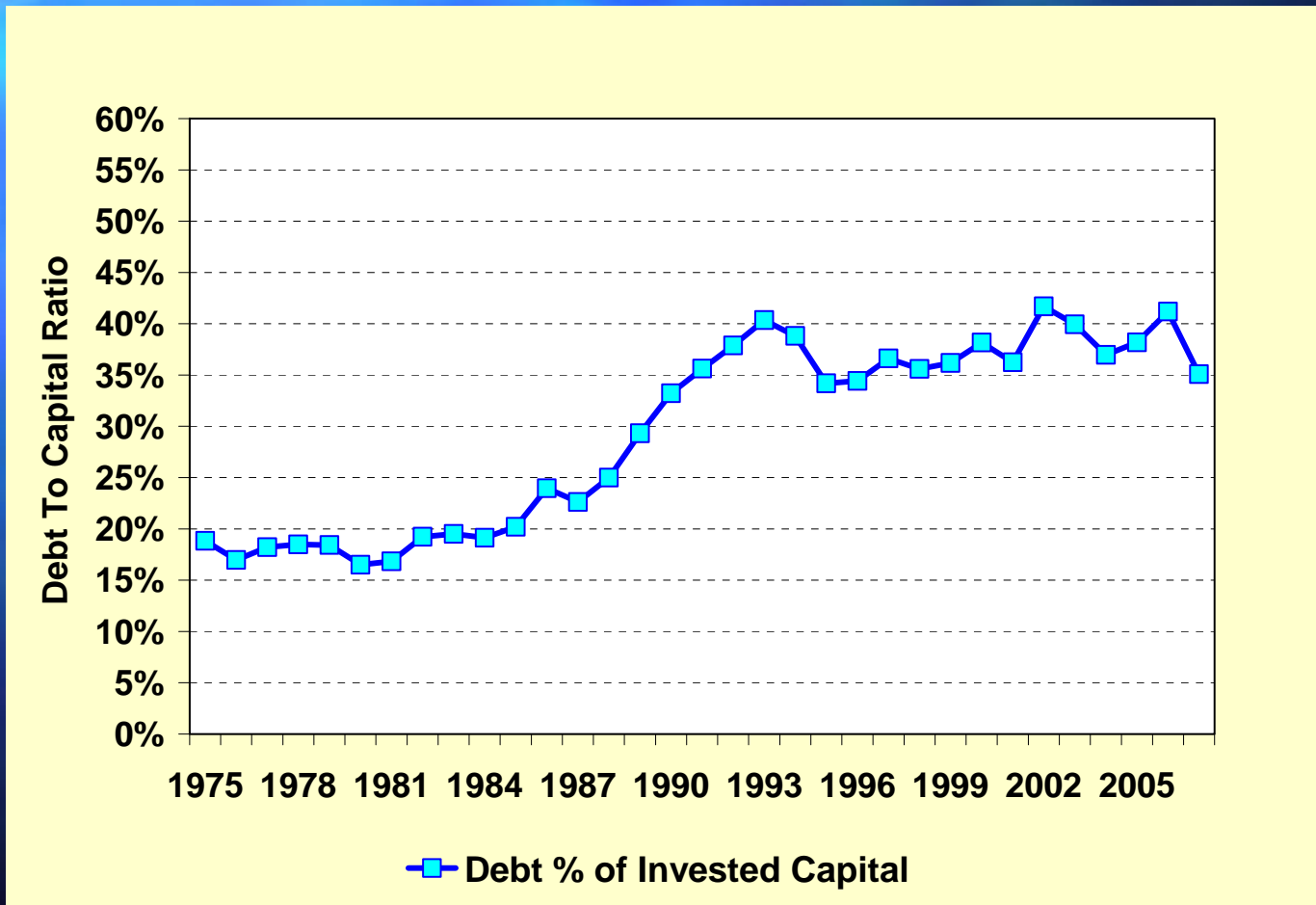
Returns on Total Capital Employed ~

Met/ Exceeded Cost of Capital But Twice Since 1975



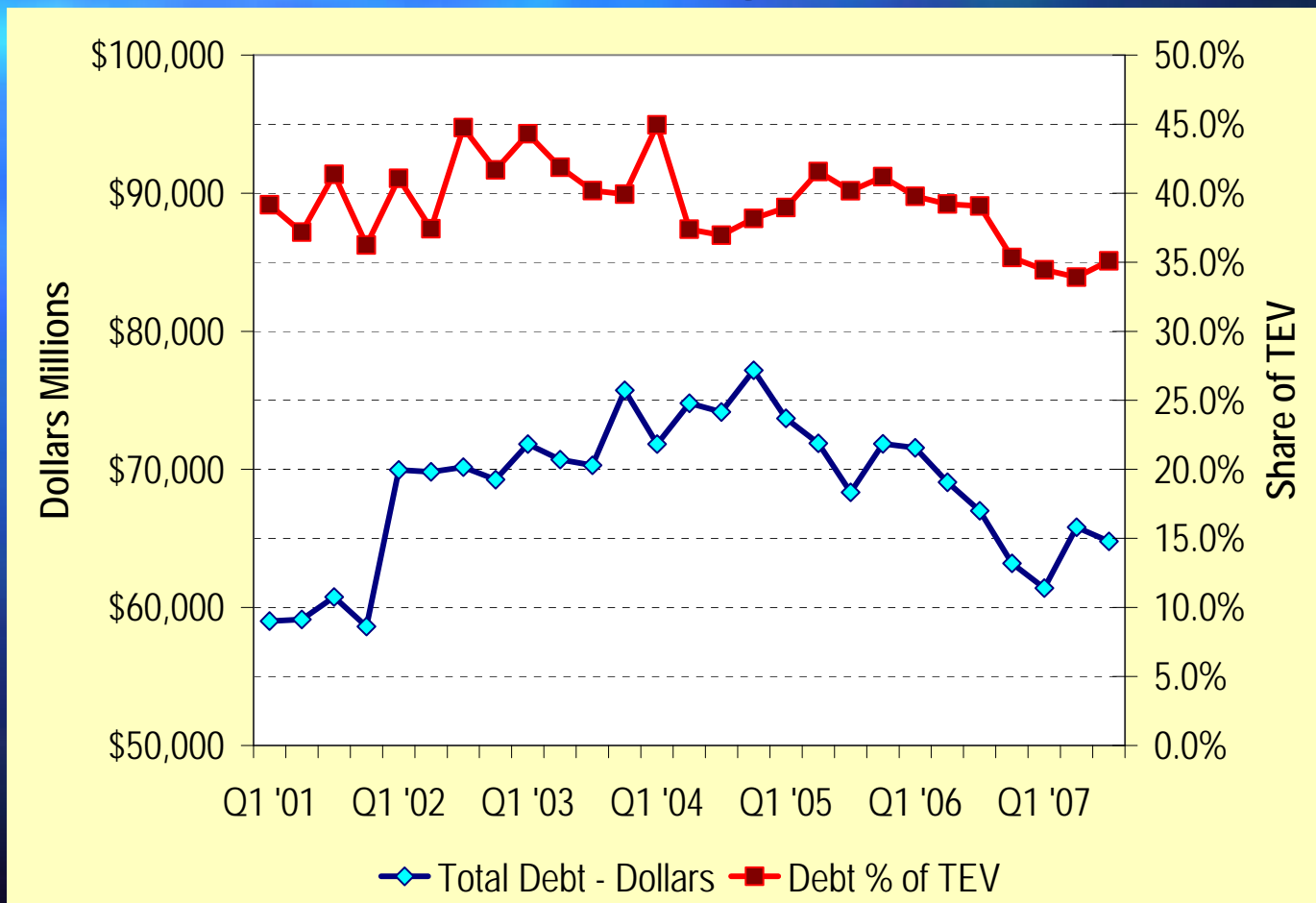
Value Destruction ~ 30 Year Look

Increased *Debt Levels* Across Time ~ *In Response to ROTC Deficiencies = Lost Value*



Value Destruction ~ Recent Look

Pulp & Paper *Debt* Is Finally Being Paid Down ~ *But Not Enough Yet . . .*



Value Creation ~ *Today's* Market

- Some say ~ paper manufacturing is one of those *laughably bad* industries
 - ✓ *Value Creation & Stocks have gone nowhere for over a decade*
 - ✓ *As such ~ it's hard imagining investing in paper*
- Yet ~ some really bad industries turned 180 degrees with *consolidation/ discipline* ~
 - ✓ *Steel & Can Industries examples of going from down in the dumps to shareholders' delight*
 - ✓ *But can they hold this position on consolidation & asset management discipline alone?*

Value Creation ~ *Today's* Market

- Could paper be a next "*turnaround industry*"?
- Some Private Equity Investors *seem to think so*
 - ✓ *Ten years ago, the UCF market was a free-for-all, with 10 ~ 14 major producers slugging it out*
 - ✓ *Today, three firms control 70% of the market*
- And good things have happened to industries when *supply becomes extremely constrained*
 - ✓ *Consider crude oil refining and today's windfall profit taking . . .*

Value Creation ~ *Today's* Market

- A new NA P&P mill hasn't been built in *12 years*
 - ✓ *Even with zoning/ environmental/ regulatory clearances ~ cost would almost be economic suicide for major players*
- Private equity is paying about *30-40%* invested capital costs for assets ~ *and*
 - ✓ *Returns on capital for new capacity are so low ~ no one can justify this type of investment now*
 - ✓ *In not-too-distant-future ~ all of this will = supply constraints, helping paper companies be better positioned to earn healthy returns on capital*

Value Creation ~ *Today's* Market

- *Other drivers provide tailwinds for NA paper industry ~*
 - ✓ *Currently ~ UCFS costs 10%-20% more to import into the US ~ previously around 10%-15% of total supply*
 - ✓ *Asia's huge appetite for commodity & pulp + rising shipping costs = an unprecedented situation ~ it's now more expensive to import paper products from Europe & Asia than to manufacture them domestically*
 - ✓ *And unlike the US automotive industry ~ paper makers don't have major legacy issues ~ pensions, health care, or environmental headaches*
- *Some now then think all of this = bullish future for our industry . . . But there is more to this story . . .*

Value Creation ~ *Today's* Market

- This has been a *30+ year journey*
- Creating and capturing value once again *is not an event or a series of short term events ~*
 - ✓ *As the private equity folks are expressing ~*
 - ✓ *But a much longer term process . . .*
- As such, current industry moves toward ~
 - ✓ *M&A, assets' consolidation, product line focus & related assets management + first order synergies extracted are necessary steps to create value going forward*
 - ✓ *. . . Yet, they are not sufficient alone to capture value over the long haul*

Value Creation ~ *Today's Market*

- The limits of these “*today's market*” short term steps are being demonstrated by ~
 - ✓ *The flattening of cost curves that go with consolidation and asset closures . . .*
 - ✓ *Which can in turn actually wreck new havoc on a commodity industry . . .*
 - ✓ *The lackluster stock markets reactions to these *today's market moves* ~*
 - ✓ *In spite of the private equity senses noted herein . . .*

Value Creation ~ *Today's* Market

- As such ~ Our stakeholders want ~
- And in fact ~ *demand more* ~ where they seem to say these upfront steps are ~
 - ✓ *Fundamental* near term/ one time event *positive fixes* that will often generate certain stakeholder value creation, however . . .
 - ✓ *They can* create their own value destruction *themselves alone . . . and*
 - ✓ They are not enough . . . *To truly* capture value *long term* ~ and hence our stakeholders improved and sustained investment *focus . . .*

Value Capture ~ Today & Tomorrow

- What goes beyond *today's market* value creation shorter term steps *to better capture real value potential over time?*
- At least *two other arenas* of reality:
 - ✓ Externalities (*over which we have little control but can position ourselves to respond to favorably if we are wise*); and
 - ✓ Operations Management transformation/*enhancement* (which we do control) *across the entire production platform . . .* For differentiation

Value Capture ~ Today & Tomorrow

- Without positioning ourselves to understand critical externalities such as ~
 - ✓ *Strength/ weakness of the dollar, or China's economic growth impacts there ~*
 - ✓ *We do not have a prayer of truly capturing the value across time that our asset management moves will have put before us*

Value Capture ~ Today & Tomorrow

- And without a total makeover of how we run our businesses day-to-day ~ Not just extract one time event consolidations and synergies (e.g.) ~ we will fail to ~
 - ✓ *Effectively put in place mechanisms we control crucial to capturing value consistently across time . . .*
 - ✓ *Change the way we work from the mill floor up, not just as driven from top down macro structural changes*
 - ✓ *. . . And ~ drive out a needed internal enterprise transformation within a given or set asset mix and product line/ customer mix focus*

Value Capture ~ A Case Study

- *At the restarted Flambeau River Papers operation ~ new ownership/ leadership set a new table ~*
 - ✓ *Mill floor workers told the business is restarted*
 - ✓ *... BUT it was up to them to improve or shut it down again ~*
 - ✓ *And doing the right things to transform the way they work at the mill floor level took precedent over all else . . .*
 - ✓ *No big one time synergy or asset management steps . . .*

Value Capture ~ A Case Study

- OK ~ *what happened* without central staff guidance and support from above on big one time ideas?
 - ✓ Record tonnage in paper and pulp
 - ✓ Record Xylos concentration in the red liquor (a key economic factor)
 - ✓ Record quality (fewest complaints in history)
 - ✓ Lowest cost *in history*

Value Capture ~ A Case Study

■ More . . . The Mill ~

- ✓ ***Used to get ~ 145,000 pph steam from biomass & 20% coal***
- ✓ ***Now gets ~ 150,000 pph from biomass and 5% coal ~ & going to zero coal with new energy pellet developed at mill***
- ✓ ***Used to require 150,000 pph steam from natural gas (about 1.2 trillion BTUs)***
- ✓ ***Now requires 90,000 pph steam & has low cost projects to take this to 60,000 pph***
- ✓ ***Uses significantly less fresh water***

Value Capture ~ A Case Study

- More . . . The Mill ~
 - ✓ *Won the 2007 Governors award for energy conservation.*
 - ✓ *Has not a one single major labor issue to date*
 - ✓ *Has two proposals submitted to DOE ~ one finished 9th of 44 submittals and the other is pending*
 - ✓ *Gets in the energy/ pellet business with a very high BTU content pellet*
- And why all this long term success ~ a differentiating “*way they work*” enterprise transformation has taken place . . .

Key Takeaways

Our industry has experienced *3 decades of value destruction*

Realizing this, we have been *seeking to create value via asset management related steps*

This in turn = a better foundation, *but it is not enough to capture this value long term*

We need to look very long term *and transform the way we work from the mill floor up to truly capture the value potential created . . .*

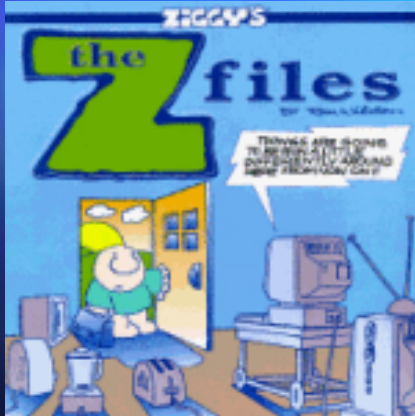
Final Thoughts

The essential focus we should have now is that ~ the future is ours to create ~ and capture . . .

*Our challenge is to realize that getting here was a **long pathway in** and it will be a **long pathway out** ~ where true value capture requires **transforming the way we work** long term as well as smart asset management*

And Remember

Even Though Today's Market is Still Not Responding in a Wonderful Way ~ *As that Famous Arm Chair Philosopher Ziggy Once Said*



“You can Complain Because Your Roses have Thorns, or You Can Rejoice Because Your Thorns have Roses”

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