Producers in emerging regions post promising financial results; European and Canadian producers impacted by market forces. The world's 100 largest forest, paper and fibre-based packaging products companies posted mixed financial results in 2007, reflecting the significantly different business and economic situations across regions.

According to the PricewaterhouseCoopers' (PwC) 11th annual Global Forest, Paper and Packaging Industry Survey the three top regions in terms of return on capital employed (ROCE), a key measure of performance, were: Latin America (7.8%), Emerging Asia (7.3%) and the US (5.5%). Canada's producers earned the lowest average ROCE - a negative 0.1%, reflecting the financial crisis experienced in the Canadian forest products sector. The overall average ROCE of the companies surveyed was relatively flat compared to the previous year at 4.8%, and a long way from the industry's 10 - 12% target range.

"The global forest, paper and packaging products sector continues to be shaped by shifting business and environmental factors, creating opportunities for some regions and challenges for others," said Craig Campbell, leader of PwC's Performance Improvement practice for the global forest and paper industry, and author of the PwC survey. "Mills with the lowest production cost structures are the ones that are best able to manage currency fluctuations and rising costs, allowing them to take advantage of new opportunities and markets."

High performers in 2007 included Setra Group in Sweden, holding the top spot in terms of ROCE at 25.2%, Kimberly-Clark Mexico was second with 20.3%, and Kimberly-Clark in the US held third spot with a ROCE of 15.2%.

According to the survey, the capital reinvestment ratio for the PwC Top 100 companies was 1.2, up from less than 1.0 in previous years. The positive trend is largely due to the increasing weighting of Chinese and Latin American producers, where ratios were 3.08 and 2.84 respectively. At the other extreme, Canada had a 2007 reinvestment ratio of 0.4. The reinvestment ratio is capital investment as a percentage of depreciation, measuring the extent that capital investment is replacing aging assets. According to Campbell, "We would expect to see more consolidations and closures in regions like North America, where there are some smaller, older mills that cannot compete with high tech, low cost producers in Latin America."

Indeed, the forest products companies based in emerging markets, primarily China, Latin America and Russia, remain the growth drivers. On the supply side, the competitive advantage continues to shift towards South America, and China remains a major influence on the demand side. Further, the number of companies from emerging markets in the PwC Top 100 is growing, with Sino Forest and Lee & Mann Paper from China and Ballarpur Industries in India entering the list in 2007.

In terms of revenue, the number one spot in the 2007 PwC Top 100 list is held by U.S.-based International Paper, with sales of US$21.9 billion, down slightly from US$22.0 billion in 2006. Number two is Finland's Stora Enso, with sales of US$18.32 billion, rising 12% from US$16.27 billion in 2006. US-based Kimberly-Clark holds third position with US$18.27 billion, up 9% from

US$16.75 billion. The largest 20 companies in PwC's 2007 list of 100 companies account for nearly 60% of total sales.

"Of the many economic factors which have affected the industry, the continued depreciation of the US dollar against other world currencies, the rising costs of transportation, raw materials (especially fibre supply) and energy have had the greatest burden on financial results," said Campbell.

PwC's 2008 Global Forest, Paper and Packaging Industry Survey summarizes the 2007 year-over-year financial information of the PwC Top 100 - the 100 largest forest products companies in the world with publicly available data. Companies are ranked by annual revenues.

Canadian Results

2007 was a challenging year for Canadian forest, paper and packaging companies. The total sales of the 13 Canadian companies in the Top 100 grew, but only from US$25.6 billion in 2006 to US$28.5 billion in 2007, an increase of 12%, reflecting acquisitions, notably the Domtar Weyerhaeuser transaction. Net losses climbed to $1.1 billion from $166 million in 2006.

Ten of the 13 companies reported losses; the largest were at AbitibiBowater and Canfor, totalling $827 million. AbitibiBowater's losses were heavily impacted by facility closures whereas Canfor's loss was the result of asset write downs related to lumber and panel operations.

A bright spot was NBSK pulp, where producers enjoyed good profits due to the tightening of supply through mill closures and increasing Asian demand.

US Results

There were 24 US-based companies in the PwC Top 100 in 2007, one less than in 2006, reporting aggregate sales of $106.7 billion. Without merger and acquisition activity, 2007 sales would have been down from the previous year. Net income increased by 31% from $4.2 billion to $5.5 billion. Among US companies, the net income was dominated by Temple Inland's $2 billion gain from the disposal of its 1.55 million acres of timberlands to Campbell Group. Weyerhaeuser's net gain of $700 million on the sale of its fine paper business to Domtar was also notable.

Losses increased with eight companies reporting a total of $500 million in losses in 2007 compared with five companies and $205 million in 2006.

Western Europe Results

There were 28 European companies in the Top 100 in 2007, including four new entrants: Setra Group (Sweden) in wood products, Heinzel Holding (Austria) in pulp, Corticierra Amorin (Portugal) in cork and Otor (France) in packaging. Sales of the European companies increased 13% from $109 billion to $123 billion. For the first time in the history of the PwC survey, the aggregate sales of European companies were higher than US companies, due mainly to the appreciation of the Euro (10%) against the US dollar.

The net income of the European companies was $3.2 billion, down by 18% from the previous year. Svenska Cellulosa (SCA) had the highest profit with net income of $1.1 billion (2006: $739 million).

ROCE averaged 4.9% in 2007, a modest increase from 4.6% in 2006. Setra Group had the highest ROCE in 2007 at 25.2%, up from 12.3%, with much of this attributable to strong sawn timber prices during the most part of 2007. Portucel was in second place with a ROCE of 10.2%, up from 7.4% in 2006.

Latin America Results

Sales of the nine Latin American producers in the Top 100 rose by 18% to $17.1 billion in 2007 from $14.4 billion in 2006, reflecting growth and the appreciation of domestic currencies against the US dollar. Net earnings were substantially higher at $3.8 billion in 2007, up 58% from $2.4 billion in 2006. Votorantim Cellulose e Papel (VCP) recorded the highest net income at $1.2 billion, boosted by net gains of $955 million from an asset swap with International Paper.

Although ROCE decreased by 1.5% from 9.3% to 7.8% in 2007, Latin America remained the best performing region compared to the prior year. Kimberly-Clark Mexico had the highest ROCE in 2007 at 20.3%, up from 2006's 17.7%. Arauco was in second place with 2007 ROCE of 11.9%, up from 11.3% in 2006.

The strongest improvement came from Chile's CMPC, where sales increased by 40% and with net income more than doubling, and ROCE almost doubling in 2007 compared to prior year.

The appreciation of the Brazilian real has narrowed Brazil's cost advantage, and reduced the operating margins of Brazilian producers since most of their production is exported. Nevertheless, with the country's strong forest base, favourable climate, and land availability it is expected to retain its position as a major supplier of fibre. "With average pulp prices reaching record highs, and the increasing demand from Asia and Europe, Latin American countries are expected to continue to set the pace in market pulp," said Campbell.

For more information on the survey, or to arrange an interview to discuss the survey findings, contact Jim Nelson, PwC, Vancouver, Canada at jim.nelson@ca.pwc.com, +1 (604) 806 7047; or Carolyn Forest, PwC, Toronto, at Carolyn.forest@ca.pwc.com, +1 416 814 5730. A pdf copy of the survey is available from the PwC global website at: www.pwc.com/fppsurvey08.

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