



The Big Money in the Industry

This is not about annual financials, record sales or jumbo contracts. It's about deals made in buying, selling, merging or closing of companies, and the big money it takes to do so.

By David Price

I never thought our industry was big business, up there with the oil and gas and aerospace, for example. Maybe I'm too close to it. But a new survey by PricewaterhouseCoopers has made me rethink my view.

The survey, *Branching out. Global activity in the forest, paper and packaging industry*, states that since January 2003 there have been 1,057 deals worth \$98.6 billion—most of them in North America. And, in 2006 alone, there were 283 deals worth \$25.7 billion.

The U.S. record is skewed a little because of the massive purchase in 2005 of Georgia-Pacific by Koch Industries for \$22 billion. (The whisper in Europe is that Koch will sell G-P's European assets.)

The North American share of global deals has been rising, reaching 67% of total deal values in 2006 and over 60% of deal values in the sector since January 2003. The main sector highlights were that pulp and paper deals were the main activity. Since January 2003, 479 acquisitions of pulp and paper businesses have been completed worth \$41.3 billion. And M&A activity among pulp and paper companies has risen from \$3.2 billion in 2003 to \$13.6 billion in 2006.

Forestlands have also been targets: 134 deals worth \$15.7 billion have been done in the last four years, making it the second largest sector in terms of dollar value. This sector has been steadily active as companies divest forestlands and sell them to outside investors, or TIMOs and REITs (Timber Industry Management Organizations and Real Estate Investment Trusts).

Driving Forces

So, what forces are driving these huge deals? Basically, factors such as: low-cost competition, energy costs, raw material prices, too many grades in the mix, changing customer

demand, on-line technology and so on have opened the door for non-traditional investors—many who see things differently than those in traditional pulp and paper companies.

These investors bring new money and new attitudes and they have now become familiar to readers. They include:

- Classic private equity houses who look for capital gain-based returns, usually over three to five years - and with an exit route
- Hedge funds which invest in order to drive potentially higher capital gains
- Real estate investment vehicles like TIMOs and REITs. These are cautious players who look for lower risk, stable but improving cash flow returns
- Strategic investors like Koch Industries who came from the energy sector, then took G-P from the public to the private sector. (Its strategy for G-P is still not clear.)

The PwC survey states that the drive to generate renewable energy from woody biomass will also drive M&A in this sector in the future. This has already attracted a diverse range of players into the industry.

U.S. firms have completed the biggest deals, with a wave of major M&A in the run-up to the new century. This journal's pages have reported on G-P/Fort James, IP/Champion International/Union Camp, Stone Container/Jefferson Smurfit, Weyerhaeuser/Willamette and Westvaco/Mead.

And more recent has been IP's divestment of forestlands, lumber mills, coated and SC paper and some of its Brazilian operations. At the time of writing, the \$2 billion merger of Bowater and Abitibi-Consolidated is still awaiting clearance by regulators.



The main result of all this domestic activity is that the top five North American papermakers increased their share of the market from a combined share of 25% to nearly 40%. But PwC points out that many of these deals didn't pay their way and traditional investors lost interest. However, the new, non-traditional investors saw where money could be made and moved in.

What Next?

The survey forecasts that North America will continue to be a center of deal activity because the industry is still highly fragmented and too many companies make too many products. As a result, more mergers can be expected in order to consolidate market positions. Companies will continue to remove forests from the bottom line, sell them to pension funds, and then buy back their fiber and lumber supplies. And papermakers, under pressure from customers, competitors and new owners, will have to focus even more fiercely on core products.

There will be an increased role for private equity. The industry is finding it difficult to persuade traditional investors

that it needs funds for upgrades, rebuilds or a new machine. So, new money from a new type of investor is beginning to re-shape the industry's conventional business model.

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Because North American papermakers badly need new investment the region will continue to be the main theater for deals, and private equity will be a pivotal player here.

The PwC survey also looks at a new element shaping the traditional pattern: energy. Established energy

companies are joining the forest industry to set up renewable energy deals from biomass. The survey is unsure what kind of deals will be struck. But one consequence will be greater competition for wood fiber.

The irony here is that if the industry successfully attracts new investment—or becomes a “deal”—it may find that its traditional role in making pulp, paper and board could evolve into energy production. ■

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