

UPM-Kymmene to Continue Expansion in China, Meet Challenges in North America

President/CEO of company discusses strategies and near-future growth plans in exclusive PaperAge interview.

— By DAVID PRICE, EUROPEAN EDITOR

Since being formed by a merger of Finnish giants Kymmene and Repola in 1996, UPM-Kymmene Corp. has continued the aggressive growth/expansion strategies of its parent companies, today operating 22 pulp and paper mills in eight countries. Together with its converting operations and solid wood plants, the company has production facilities in 17 countries worldwide.

Acquisitions in recent years include Blandin Paper Co. in the U.S. (1997) and Repap Enterprises of Canada (now known as UPM-Miramichi Inc.) in 2000. In 1998, the company acquired 49% interest in a paper mill project in Changshu, China, acquiring the remaining 51% in 2000. Currently it is pursuing a second paper machine project at this mill (to startup in mid-2005). The company is also evaluating a pulp mill project in the Guangdong province of China.

The largest acquisition in the company's history was completed in 2001, bringing four of Haindl's six paper machines in Germany into the UPM-Kymmene fold. The company reported a turnover of EUR 10 billion in 2002.

It has some 36,000 employees worldwide and spent about EUR 6.6 billion for capital improvement and expansion during the past three years.

To explore its operating strategies in more detail and to gain some insight into where and how the company will be expanding and modernizing in the near term, PaperAge recently interviewed Juha Niemelä, president and CEO of UPM-Kymmene Corp. His views and perspectives are summarized below.

PaperAge: In the March interim report, you said the target is to save EUR 200 million (U.S. \$175 million) by the beginning of 2005. How do you plan to do that?

Juha Niemelä: During the year we have taken steps to streamline operations and improve cost-efficiency, selling and closing unprofitable businesses. In addition, the company has optimized paper production e.g. by focusing annual summer shutdowns to fewer production sites. The cost savings are also focused on fixed costs, raw materials procurement and logistics. So far we're on target.



Blandin Papers's PM 6.

Can you update us on progress at Shotton (UK), Pietarsaari, Rauma and Jamsankoski (Finland)?

JN: The new recycled fiber pulp facility is under construction by Voith at Shotton and production will begin, as planned, in November 2003. There is also an extensive rebuild of the existing RCF1 plan, which came on-stream in June. The rebuild of Pietarsaari pulp mill is under construction as well. The new recovery line will begin operations in April 2004. The rebuild of PM2 at the Rauma mill will be completed in 2004. The investment in the rebuild of PM 3, which produces label papers at the Jämsänkoski mill, was finalized in April.

Any other large projects in progress?

JN: Building the second paper machine in Changshu, China, is currently our biggest ongoing investment.

China has been portrayed as the market that will save us all. Do you think Chinese mills can achieve the quality of European mills?

JN: Those Chinese mills that are equipped with modern machinery, wood pulp-based raw materials and sufficient business know-how, are in a similar position to any mill in the developed world to produce top quality products. I cannot see that geography, raw materials or technology would put Chinese mills at any disadvantage in this respect. The Chinese are also extremely dedicated and hard working. And we have been able to recruit people with appropriate training.

Is it likely that too many papermakers will saturate this market, especially at a time when no one seems to be making any money in that country?

JN: China is the market that exhibits the highest growth rates in paper consumption in the world. Last year China reached the No.2 position as a paper & board market in the world after the United States. The structure of the Chinese paper markets is evolving rapidly and many end-uses that are already mature in Europe and North America are only starting to emerge in China, i.e. magazines, catalogues and office products.

This high market growth attracts a lot of interest for further capacity expansions. Traditionally, there have been many rumors and even new project announcements in China, some of which have never come to fruition. So far, actual capacity growth has been more or less in line with the growth in paper demand in the whole Asia Pacific region. Balancing supply with future demand must undergo strict evaluation before any new paper machine contracts are awarded.

We believe that if the fundamentals are right—a viable cost structure, companies work to their strengths and competencies and do not over-stretch their leverage—investment projects in China should be very profitable.

The UPM pulp mill project in Guangdong province in China is largely dependent on wood supply. Are the forests growing?

JN: To be precise, at this point we'd rather talk about a joint forestation project than a pulp mill project. The



Aerial view of Changshu mill. The facility has a production capacity of 350,000 tpy of fine paper.

Chinese government has introduced and promoted eucalyptus plantations in the southern part of Guangdong since the early 1980's. There are large-scale forest farms as well as a common practice among the local farmers to have a plot of eucalyptus, in addition to their fields, for farming crops. The latter have not been intensively managed until now, and a major task is to improve their productivity.

What other factors will influence this project?

JN: The first step in the project is to establish a joint venture company—in which we have 45%—with the two Chinese partners (45% and 10% each) to develop the forestry and the future wood supply of the pulp mill. A decision to build the pulp mill will be made separately and at a later stage. It really depends on progress in the forestry operations.

What's the latest progress on the Changshu mill?

JN: The Changshu fine paper machine investment in China, which was temporarily halted during the SARS epidemic, continues as planned. The machine is scheduled to start up in the summer of 2005.

What regional markets will the new machine serve?

JN: The new paper machine will produce high quality fine paper mainly for the Chinese market, and also for Japan and other Asia Pacific countries.

Russia is of growing interest to UPM-Kymmene. What prospects do you see in that market—in addition to wood supply?

JN: Russia accounts for less than one per cent of our turnover. Russia is a vast potential market for UPM-Kymmene, but the risks are also still considerable. So far, UPM has limited its projects to the wood products industry, which involves smaller investments and a tolerable risk level. At present we are building a sawmill in the town of Pestovo. About 80% of UPM-Kymmene's production of sawn timber and plywood is now exported, but as economic growth continues, demand will also grow.

The U.S. Department of Justice Antitrust Division has blocked your acquisition of the U.S. label stock maker MACtac. Any comments?

JN: The U.S. District Court approved, in late July, an injunction to block the acquisition of MACtac. Consequently, UPM-Kymmene has terminated its agree-



Miramichi's PM 2, one of the most modern magazine paper machines in North America. Miramichi mill produces 450,000 tpy of coated magazine paper.

ment with Bemis Company on the transaction. UPM-Kymmene decided not to appeal against the court decision.

During the past few years you've invested considerably in developing your operations in North America. How do you plan to utilize your position in the future?

JN: We feel that we have a solid and competitive market position in the businesses we are in to serve our American customers.

What are UPM-Kymmene's biggest challenges in North America?

JN: Weak profitability due to low prices is undoubtedly our biggest challenge in North America at the moment. There are signs of recovery, but there are some uncertainties as well and we have to be extremely focused in everything we do. Naturally it is not only UPM-Kymmene's operations that suffer; the whole industry is hurting.

Another specific challenge for UPM-Kymmene is building awareness among customers, and other stakeholders, about who we are. We have not been on the North American scene as a major local producer for very long and it is clear that, although our name might be known, fewer people know what UPM-Kymmene really stands for, what are our values and principles. Developing the industry's image—and ours as a company—will be a challenge in North America. ■