

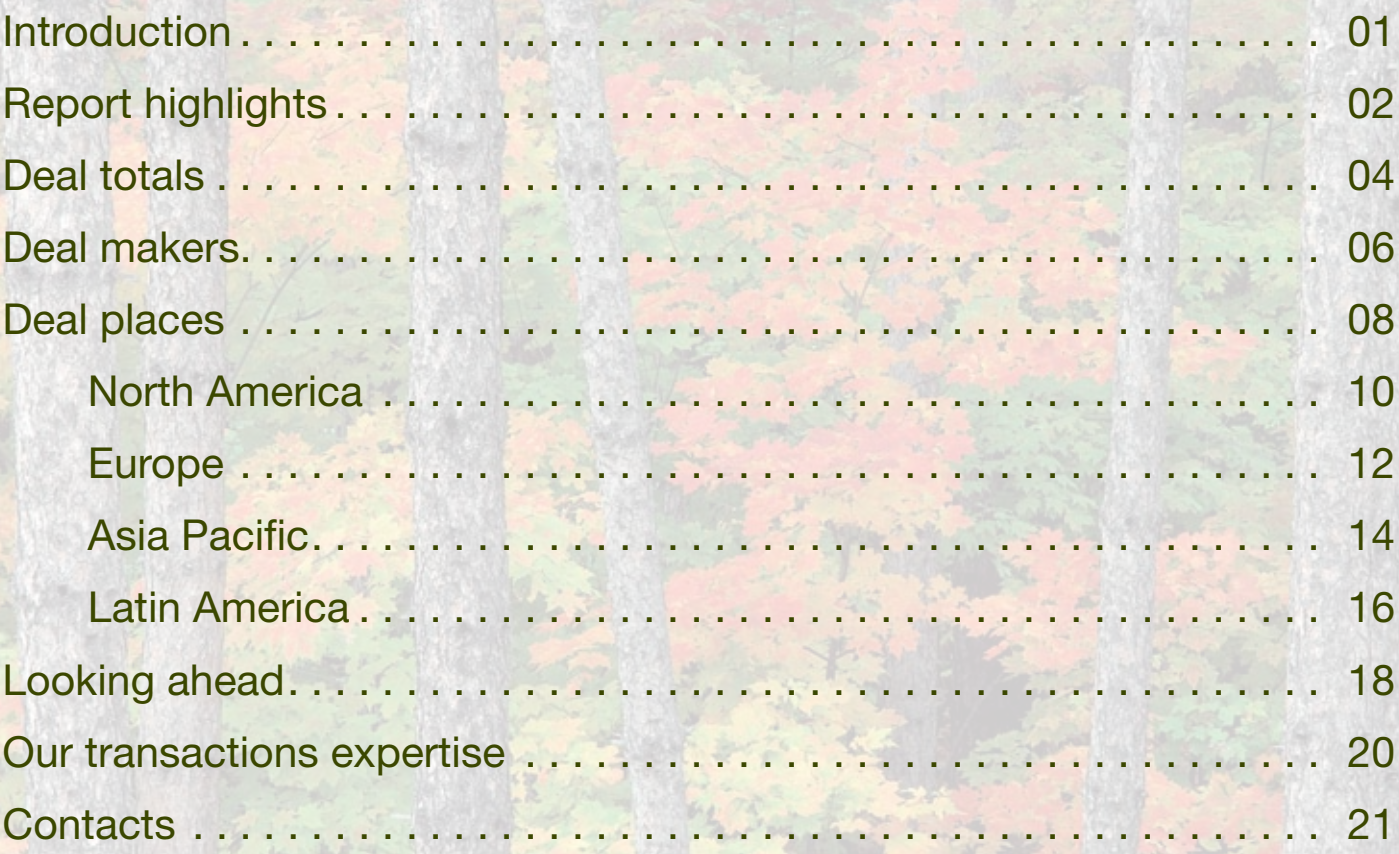
Forest, paper and packaging deals

Branching Out – 2008 Annual review

Mergers and acquisitions activity in the forest, paper and packaging industry



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Methodology

Forest paper and packaging deals is based on published transactions from the Dealogic ‘M&A Global’ database, January 2009. Deals are included on an announced basis, adjusted to include only accepted offers. Deal values are the consideration value announced or reported including any assumption of debt and liabilities. Figures relate to actual stake purchased and are not multiplied up to 100%. The geographical split of the deals refers to the location of the target company or assets. The analysis relates to the forest, paper and paper based packaging sector and therefore excludes related sectors such as printing and plastic, glass and metal packaging. The sector and subsectors analysed include: forestland/forestry (e.g. standing timber, nurseries, harvesting and logging operators), wood products (e.g. sawn timber, wood-based building materials), pulp & paper (e.g. pulp, primary paper producers) and converting (incl distribution) (e.g. packaging and tissue product producers, paper converters, paper merchants).

Introduction 01



Many companies in the forest, paper and packaging (FPP) industries are facing unprecedented tough market conditions. The financial crisis and economic recession comes after a series of years in which companies in the mature markets have struggled to cut capacity and improve

margins but found their efforts offset by rising input prices.

The response of the industry has been a reshaping of business models but, for significant parts of the sector, such reshaping has not come fast enough. The recession has dramatically heightened the urgency of existing challenges and, for some companies, brought them to a final head. In contrast, companies positioned to take advantage of significant demand growth in Asia Pacific and the potential for quality fast growth plantation fibre in South America have been able to gain from more dynamic conditions.

Forest paper and packaging deals 2008 reviews deal activity in the FPP industries. The report is the latest edition in our annual series on deal-making in the sector, previously titled Branching Out. The report is one of a range of deals publications from PricewaterhouseCoopers¹ (PwC), covering sectors including aerospace & defence, mining, metals, renewable energy, power, and oil & gas, as well as FPP. Together the family of deals reports provide a comprehensive

analysis of M&A activity across industries world-wide. Our FPP deals analysis is also complemented by our regular CEO Perspectives report, which analyses the viewpoints of a number of leading players in the FPP industries and explores many of the pressing imperatives facing the sector – overcapacity, cost control, the need for simpler, more flexible business models.

We examine both the rationale behind the overall trends and look at the key individual deals. We look at the year under review, the context of the preceding years, and ahead to the future direction of deal-making in the sector. We also highlight, in our deal dialogue and sustainability spotlight panels, some of the critical issues for companies engaging in deal activity within the sector. Drawing on our global experience as an adviser to FPP M&A players, our commentary addresses all key markets in the sector.

Looking ahead, we examine the effect of a fragile economic outlook on deal-making in the sector. We look at the imperatives that will continue to underpin activity as well as the factors that will inhibit deal-making. We see a sector on a course to undergo an intense round of painful distress-led transformation and likely to emerge in two to three years time looking very different from today.

A handwritten signature in blue ink, appearing to read 'Clive Suckling'.

Clive Suckling
Global Leader
Forest, Paper and Packaging
PricewaterhouseCoopers UK

¹PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

02 Report highlights

Deals chill takes hold in a year of two halves

2008 deal value fell away rapidly during the course of the year. Total deal value in the first half of 2008 surpassed that of 2007 which itself had been a high point in recent years. Buoyed by International Paper's US\$6bn purchase of businesses from Weyerhaeuser, first half total deal value across the sector in 2008 was US\$16bn, up 42% from US\$11.4bn in the first half of 2007. However, second half total value fell to just US\$5.3bn, down a massive two thirds from the US\$16.2bn recorded in the second half of 2007.

Values move from highs to lows

After the highs at the start of the year, total FPP deal value fell 23% in the year as a whole, from US\$27.6bn in 2007 to US\$21.3bn in 2008. The decline accelerated in the last quarter of 2008 with the US\$1.9bn last quarter deal value in 2008 barely a tenth of the value recorded in the first three months of 2008. The fall in overall FPP deal value takes M&A back to the underlying level seen in 2005 and, if it continues, puts it on course to rival or surpass lows last seen in 2003. Were it not for International Paper's US\$6bn transaction, North American deal value in 2008 would have already been down to its 2003 low.

The centre of deal-making gravity tilts east

2008 saw the centre of deal-making gravity shift away from North America, as its share of worldwide deal value fell seven percentage points to 55% while Asia Pacific's share rose nearly six percentage points to 18%, its largest recorded share since the inception of our data series in 2003. Europe's share remained broadly unchanged at 23%. The crisis in the Nordic pulp and paper industry was at the heart of a string of deals to divest assets and rationalise operations both in Europe and in Asia Pacific, with Norske Skog's divestment in Korea. If negotiations between Brazil's Votorantim and Aracruz had come to fruition in 2008, the gravity shift would also have encompassed Latin America, if completed in 2009, it will transform the world pulp market.

An industry on the edge

As 2009 unfolds, many companies in the sector find themselves on a knife-edge and the industry looks set to undergo an intense round of painful distress-led transformation. The consolidation deals that have been slow to come, particularly in Europe, in earlier years, are likely to be forced on a shrunken northern hemisphere sector in the coming period. In the US, Smurfit-Stone's move into Chapter 11 bankruptcy protection is one of a number of triggers opening up an intriguing chapter in the changing shape of the industry. In Europe, the difficulties facing companies in the Nordic countries look set to trigger a major round of long overdue consolidation.

04 Deal totals

2008 was a year of two halves. Total deal value in the first half of the year surpassed that of 2007 which itself had been a high point in recent years. However, deal value plummeted in the second half of 2008 with the intensification of the financial crisis and the fast deterioration in world economic outlook. First half total deal value across the sector in 2008 was US\$16bn, up 42% from US\$11.4bn in the first half of 2007. In contrast, second half total value fell to just US\$5.3bn, down a massive two thirds (67%) from the US\$16.2bn recorded in the second half of 2007.

The contrast in the first and second half of the year was matched by a contrast between value and volume. While total FPP deal value fell 23% in the year as a whole, from US\$27.6bn in 2007 to US\$21.3bn in 2008, deal numbers only dropped 6% and, indeed, remained well above the levels seen before 2007 (figure 1). Indeed, deal volume in the pulp & paper production and the wood products sectors rose year on year, by 17% and 3% respectively. As in previous years, pulp & paper production delivered by far the largest average deal size and, in turn, the largest total deal value. With US\$11.9bn worth of deals, pulp & paper production accounted for 56% of total FPP deal value. Average pulp & paper production deal value was down 19% to US\$233 million from an average of US\$288 million recorded in 2007 and total deal value was down 10%.

Behind pulp & paper production, deals in converting comprised the second largest segment of deal value, with a total US\$3.8bn of deal value or 18% of all FPP deal value. Converting's total deal value was 35% down on 2007 levels and average deal value was down from US\$82 million to US\$61 million. Even bigger was the fall in the total value of forestland and forestry deals which fell 45% on 2007 levels to US\$3.5bn in 2008. Average forestland and forestry deal size fell 16% from US\$188 million to US\$159 million.

Wood products was the sector where total deal value was most resilient, edging down just 1% or US\$21 million to US\$2.1bn in 2008. The 3% rise in wood product deal volume continues a trend of significant increases in deal activity in recent years. Deal numbers in this sector are running at twice the level of two and three years ago, albeit with smaller deal sizes and without any corresponding rise in total value. Wood products accounted for 34% of all deals in the sector in 2008 but, with an average deal size of just US\$38 million, only 10% of total deal value.

The themes underpinning the deals reflected the starkly contrasting fortunes of companies in declining mature markets and those in growth areas. In the mature markets, companies are moving to divest non-core activities and achieve greater focus from which they can deliver future growth or, in some cases, simply survive the present. Focus and consolidation has been slow to come and some companies are paying the price and face acute distress. In contrast to the retrenchment that characterises much of the deal-making in mature markets, growth strategies lie behind the various consolidation, expansion and vertical integration deals seen in countries such as China and Brazil. We look in further detail about the deal motivations in different territories later in this report.

The fall in overall FPP deal value takes M&A back to the underlying level seen in 2005. In that year, a single exceptional deal – Koch Industries' US\$22bn purchase of Georgia-Pacific – skewed total deal value, but the underlying total of US\$21bn, excluding this deal, was close to 2008's US\$21.3bn. However, US\$6bn of the 2008 total was also attributable to a single deal – taking 2008 underlying value down to US\$15.3bn. Moreover, as figure 3 shows, the rapid fall in total deal value during 2008 could take FPP deal value quickly back down much further to rival or surpass lows last seen in 2003, when deal-making bottomed out at US\$11.4bn after a US\$72bn peak in 2000. The US\$1.9bn last quarter deal value in 2008 was barely a tenth of the value recorded in the first three months of 2008 and, if it continued into 2009, would lead to a new annual low.

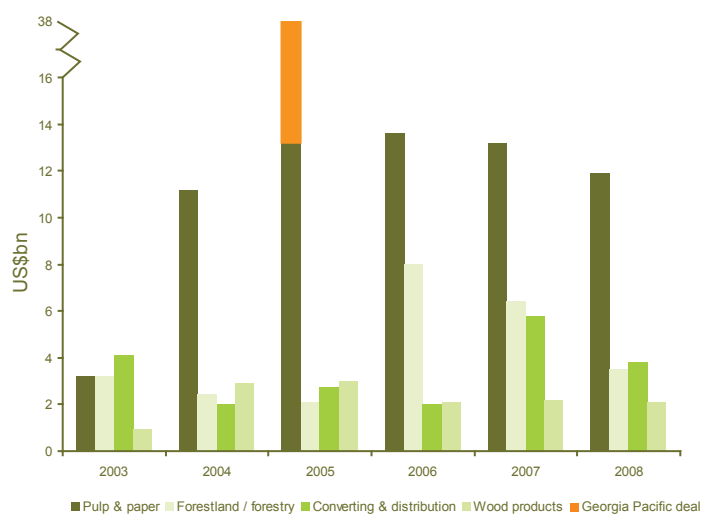
Figure 01: Total FPP deals, 2003-2008 (year on year % change in parenthesis)

	2003	2004	2005	2006	2007	2008
Total deal value (US\$bn)	11.4	18.5 (+63%)	21.0* (+13%)	25.7 (+23%)	27.6 (+7%)	21.3 (-23%)
Total deal numbers	224	254 (+13%)	295* (+16%)	280 (-5%)	370 (+32%)	350 (-6%)
Average value (US\$m) (based on deals where value is reported)	90.0	132.3 (+47%)	128.0* (-3%)	169.4 (+32%)	134.6 (-21%)	111.0 (-18%)

* 2005 data excludes exceptional US\$22bn acquisition of Georgia-Pacific (GP) by Koch Industries in the US

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

Figure 02: Sector deal; value trends (US\$bn), 2003-2008



Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

Figure 03: Quarterly deal totals, 2007-2008

	2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Deal volume	83	91	106	90	83	90	98	79
Deal value (US\$bn)	9.4	2.0	11.3	4.9	11.8	4.2	3.4	1.9
Average deal value (US\$m) (deals with reported value only)	261	37	171	102	303	74	58	50

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

06 Deal makers

Three US\$1bn plus deals, led by the table-topping US\$6bn International Paper / Weyerhaeuser transaction, headed the top ten deals list in 2008. However, this was in contrast to 2007 when eight of the top ten largest deals were valued at US\$1bn plus. Despite the big purchase by International Paper, the combined total of the three US\$1bn plus deals in 2008 was US\$8.8bn, less than half of the US\$18.1bn from eight such deals in 2007 and short of US\$11.9bn from five such deals in 2006.

International Paper's acquisition of Weyerhaeuser's containerboard, packaging and recycling business was the largest FPP deal since Koch Industries' massive US\$22bn purchase of Georgia-Pacific in 2005. The deal is the latest move in a major strategic realignment by International Paper which has seen it overhaul its former business model, which was vertically integrated from forest through to a broad spectrum of pulp and paper, wood products and fibre-based chemicals businesses, to become a product specialist with an increasingly global reach, focused on uncoated papers and packaging.

In a microcosm of strategies at play in the wider market, Weyerhaeuser and International Paper have chosen opposite paths to achieve the same goal of developing a focused strategy. International Paper has sold most of its forestland holdings and all of its wood products businesses to focus on paper and packaging while Weyerhaeuser has spun-off its paper and packaging and other businesses in order to concentrate on a forestland-based strategy. Another Weyerhaeuser disposal, the US\$0.5bn sale of its Australian wood products business, which also features in the 2008 top ten FPP deals, signifies another reverse strategy to International Paper's, namely a continued retreat from international operations. Weyerhaeuser has also been considering conversion to a real estate investment trust (REIT) but has made it clear that it does not consider this to be tax-efficient in 2009 although it does not rule out such a move in 2010.

The second largest FPP deal of 2008 had its origins in International Paper's divestment programme. A portfolio of around 900,000 acres (around 365,000 hectares) of forestland and related assets had originally been purchased by US-based commercial real estate finance company iStar from International Paper in October 2006 for around US\$1.2bn. In April 2008, iStar completed its US\$1.7bn sale to Hancock Timber Resource Group (HTRG). iStar had bought the assets in a joint venture

between iStar subsidiary TimberStar and equity investors MSD Capital. HTRG is the world's largest timberland investment manager for institutional investors and the acquisition adds to its globally diversified portfolios of timberlands.

Consolidation in the paper and packaging industry in the US, as evidenced by the International Paper deal, has advanced much further than in Europe. Whilst companies in North America have been facing a long-term decline in demand for some time, this is now repeating in Western Europe. In both regions this trend has been exacerbated by rising input costs, forcing them to reduce capacity and to realign. In the third US\$1bn plus deal in the top ten table, one of Finland's three large paper producers, M-real, sold its coated graphic paper business interests for US\$1.1bn to South Africa's Sappi, a leading global producer of coated graphic papers and specialty papers.

In a complex deal, Sappi acquired four mills, with M-real entering into a long-term contract to supply the output of two further coated paper machines that remained under its ownership to Sappi, as well as discontinuing the production of standard coated woodfree papers at its other mills in Austria and Germany. As such, the deal signalled both a much needed consolidation and capacity reduction in the coated papers segment in Europe. Sappi has used this strengthened market position as a platform to manage supply side adjustments coming into 2009 as the demand for coated papers has slid during the economic downturn.

It enabled a highly geared M-real to realise some significant cash from a core but loss-making business, although as a group it still remains highly focused on cash generation. The core of M-real's business has now shifted more strongly to its high-quality packaging board interests.

We review the other top ten sub-US\$1bn deals in the regional sections later in this report. Pure private equity (PE) players featured in three of the top ten deals and the PE influence on deal-making in the sector remained very strong in 2008. Excluding forestland and forestry where real estate investment trusts (REITs) and timber investment management organisations (TIMOs) play a dominant role, PE played a part in 18% of all deals, accounting for 24% of deal value. REITs, TIMOs and PE together were involved in 19% of all FPP deals and 34% of total FPP deal value in 2008 (figure 5). We look at some of the principal transactions in more detail in the regional sections.

Figure 04: The global top ten – FPP deals 2008

No.	Month announced	Deal value (US\$m)	Target name	Target nationality	Acquirer	Acquirer nationality
1	Mar 2008	6,000	Weyerhaeuser Co (containerboard, packaging and recycling business)	United States	International Paper Co	United States
2	Feb 2008	1,710	iStar Financial Inc (portfolio of forestland and related assets)	United States	Hancock Timber Resource Group	United States
3	Sep 08	1,096	M-real Oyj (graphic paper business)	Finland	Sappi Ltd	South Africa
4	Mar 08	974	Papyrus AB	Sweden	Altor Equity Partners	Sweden
5	Jan 08	851	Southern Container Corp	United States	RockTenn Co	United States
6	Aug 08	783	Plum Creek Timber Co Inc (Timberlands)	United States	Campbell Group LLC	United States
7	Jun 08	621	Norske Skog Korea Co Ltd	South Korea	Morgan Stanley Private Equity Asia; Shinhan Private Equity Inc	South Korea
8	May 08	493	Weyerhaeuser Co (Australian timber manufacturing and distribution operations)	Australia	Rank Group Investments Ltd	New Zealand
9	Apr 08	485	MeadWestvaco Corp (North Charles Kraft Division and related assets)	United States	Kapstone Paper & Packaging Corp	United States
10	Jun 08	390	Ainsworth Lumber Co Ltd	Canada	Creditors; Tricap Partners Ltd; HBK Master Fund LP; Barclays Bank plc	Canada

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

Figure 05: Analysis by PE involvement

	2006		2007		2008	
	Total PE (US\$m)	% share	Total PE (US\$m)	% share	Total PE (US\$m)	% share
Forestland/forestry	-	-	10	neg.	193	5%
TIMO/REITs	7,684	96%	2,913	46%	3,021	87%
Wood products	866	42%	99	5%	567	26%
Pulp & paper	2,786	20%	5,934	45%	1,625	14%
Converting & distribution	1,140	57%	1,471	25%	1,818	48%
All deals	12,476	48%	10,427	38%	7,224	34%

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

08 Deal places

The majority of worldwide FPP deal value continued to come from North America deals, in part stemming from the more advanced pace of realignment taking place in the pulp and paper industry in the region. However, 2008 saw a slight shift in deal gravity to the East, as Asia Pacific recorded the biggest rise in deal value share. Bucking the general trend, Asia Pacific also saw a small rise in deal value in absolute terms between 2007 and 2008. Asia Pacific's share of worldwide deal value was up six percentage points to 18%, its largest recorded since the inception of our data series in 2003. However, in absolute terms, the total Asia Pacific FPP deal value of US\$3.8bn fell short of the region's highs of US\$5.1bn and US\$4bn recorded in 2005 and 2006.

The proportion of worldwide deal value in Europe remained broadly unchanged at around 23%. Together North America, Europe and Asia Pacific accounted for 95% of all worldwide deal value and 94% of deal numbers. While North America dominated in terms of deal value, the greatest volume of deal activity was in Europe and Asia Pacific which together accounted for 77% of all FPP deals. In North America there were just 61 deals but US\$11.6bn of disclosed deal value. In contrast, there were more than twice as many – 133 – deals in Europe but their US\$4.8bn value was well under half the North American total and was even below it when the large US\$6bn International Paper deal in the US is taken out of the comparison. Deal sizes were smaller again in Asia Pacific where there was a total of 141 deals.

Figure 07: Deal numbers and value by continent, 2007-2008

North America	2007	2008	% change
Number of deals	53	61	15%
Value (US\$bn)	17.1	11.6	-32%
Average deal value (deals with disclosed values (US\$m))	777	430	-45%

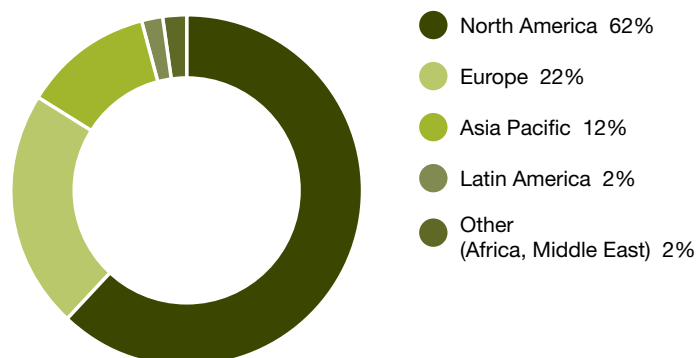
Latin America	2007	2008	% change
Number of deals	14	11	-21%
Value (US\$bn)	530	997	88%
Average deal value (deals with disclosed values (US\$m))	66	111	68%

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

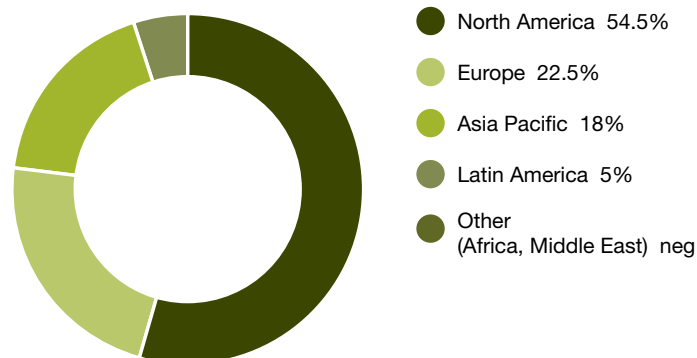


Figure 06: Value share of all worldwide FPP deal value by continent, 2007-2008

2007 Total US\$27.6bn



2008 Total US\$21.3bn



Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review



Europe 2007 2008 % change

Number of deals	147	133	-10%
Value (US\$bn)	6.1	4.8	-21%
Average deal value (deals with disclosed values (US\$m))	121	120	-1%

Other (Africa and Middle East) 2007 2008 % change

Number of deals	7	4	-43%
Value (US\$bn)	546	45	-92%
Average deal value (deals with disclosed values (US\$m))	78	15	-81%

AsiaPacific 2007 2008 % change

Number of deals	149	141	-5%
Value (US\$bn)	3.4	3.8	14%
Average deal value (deals with disclosed values (US\$m))	29	34	19%

10 North America

The volume of North American FPP deal-making rose in 2008 but, with the notable exception of International Paper's acquisition of Weyerhaeuser's packaging assets, the vast majority of deal-making was focused on smaller transactions than in the immediately preceding years. Thus, while deal volume was up 15%, total value declined by a third (32%), from US\$17.1bn in 2007 to US\$11.6bn in 2008. The decline is even greater given that US\$6bn of the US\$11.6bn total was derived from the lead International Paper/Weyerhaeuser deal. Underlying deal value was at its lowest since 2003.

The North American market, in the US in particular, had moved into the downturn ahead of other parts of the world. The sub-prime mortgage crisis was already very evident ahead of 2008 and the FPP sector was suffering from the impact of rapidly falling GDP growth. Housing starts had fallen 35% in the preceding year and an overall slump in residential construction added to the more long-term market contraction attributable to the growth of electronic media and the decline in paper-based communications. The financial crisis intensified dramatically during 2008, putting a further brake on deal-making and tipping some companies into distress as they struggled to manage debt.

Against this background, the IP/Weyerhaeuser deal was a major milestone in International Paper's move to become a global leader in uncoated papers and packaging. Over the past three years, International Paper has disposed of many of its non-core operations, while expanding the company through investments in South America and Eastern Europe. The acquisition from Weyerhaeuser makes it North America's largest corrugated box maker with around 30% of the US containerboard market. With the paper and packaging industry in North America and Western Europe facing rising raw material costs and dwindling demand, consolidation, capacity reduction and extension into faster growing markets is a key trend.

Consolidation, although more advanced than in Europe, still has some way to run and looks set to take many twists and turns. Weyerhaeuser had announced the possible sale of its packaging business in May 2007. Temple Inland, with around 10% of the market, and Smurfit-Stone, with around 19%, had also been linked with a possible bid. Like International Paper, Temple Inland has been unbundling its forestlands. Distress factors in the market took a high profile turn when, early in 2009, Smurfit-Stone moved into Chapter 11 bankruptcy protection under US\$5.6bn of debt. This has opened up an intriguing chapter in the changing shape of the industry in the US.

We discuss the second largest US deal – Hancock Timber Resource Group's US\$1.7bn forestland purchase from iStar – in our deal makers section. With the sell off of forestland by the major forest products producers to institutional investors largely complete, a tail off in large value deals in forestland was to be expected. However the continued buoyancy in timberland asset values was reflected in a number of other secondary deals in forestland, the most notable being that between Plum Creek, the largest timberland REIT and The Campbell Group (TCG), one of the larger TIMOs. Plum Creek contributed 454,000 acres (around 183,000 hectares) of prime southern US timberlands and TCG, US\$783 million cash to a joint venture through which Plum Creek was able to realise significant cash for general corporate purposes.

The third largest deal was another significant consolidation move in the packaging sector. Paperboard packaging producer RockTenn completed its US\$851 million acquisition of Southern Containerboard. The move transformed RockTenn from a relatively marginal player in the North American containerboard market to being firmly in the top ten producers. Further consolidation in the paper and packaging sector was evident with KapStone Paper and Packaging Corporation's completion of its US\$485 million acquisition of the Charleston Kraft Division (CKD) of MeadWestvaco Corporation in mid 2008. In Canada, the distress caused by a critically weak timber market led Canadian producer Ainsworth to recapitalise US\$390 million of its debt to avoid insolvency.

Moving beyond the North American deals featuring in the global top ten, Potlatch Corporation restructured by spinning off its pulp-based businesses into a publicly-traded company called Clearwater Paper (figure 08). The move enables the new company to focus on pulp-based manufacturing leaving Potlatch as a pure-play timber REIT. Another REIT, Rayonier, with approximately 2.6 million acres (around 1.1 million hectares) of timberlands in the US and New Zealand, bought a large tract of Pacific North West timberlands from Sierra Pacific Industries for US\$215 million.

Distress in the newspaper industry was brought into sharp relief by two deals. A US\$350 million deal saw White Birch Paper acquire SP Newsprint from a trio of media companies seeking to raise cash to pay down debt. AbitibiBowater, North America's biggest newsprint maker, sold its Snowflake Arizona recycled-newsprint mill for US\$161 million to Catalyst in April 2008. The sale was a condition of regulatory approval of the 2007 combination of US-based Bowater and Canada's Abitibi-Consolidated but the move also came as AbitibiBowater sought to raise cash for debt and reduce capacity faced with an ailing newsprint market. The combination has faced continual debt problems and, in March 2009, amid rumours of bankruptcy possibilities, they were able to refinance. In turn, the buyer of the mill, Catalyst, has seen values come crashing down such that by Spring 2009 their whole portfolio of four mills was worth less than the sum paid for the Snowflake mill.

Figure 08: North America: Beyond the global top ten – the three next largest deals

Month announced	Deal value (US\$m)	Target	Target nationality	Acquirer	Acquirer nationality
Jan 08	350	White Birch Paper Ltd	United States.	SP Newsprint Co	United States
Mar 08	215	Sierra Pacific Industries Inc (Timberland in southwestern Washington)	United States.	Rayonier Inc	United States
Apr 08	195	Clearwater Paper Corp	United States.	Existing Shareholders	United States

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review



PwC deal dialogue: Making the most of M&A opportunities in the downturn

Excess capacity in traditional geographies, coupled with increasing market globalisation, has long marked out the FPP industries as a hot sector for consolidation. The current economic downturn is likely to deliver new opportunities for deals. The resulting cash and margin pressures, together with reduced asset values, look set to bring more targets into play. However, integrations in calmer economic waters are rarely easy and integrations in the coming period are likely to be even more challenging, not least as acquisition timescales are likely to be much reduced.

More than ever, a very clear pre-deal strategic and operational rationale for the purchase and what the integrated strategy and operating model will look like is vital. Reduced acquisition timescales, distress situations and attractive asset pricing can distract deal-makers and management teams from focusing fully on this vital first step. There is the potential danger that future consolidations, in such circumstances, may not only fail to realise the expected level of synergies but also do real damage to the core business of the acquirers.

While these challenges should not be underestimated, there is a potential silver lining. Integrations in 'normal' economic conditions can be light touch and shy away from deep seated transformational change. Crisis or distress situations can create the business climate where transformational change is more acceptable to shareholders and employees alike.

Integrations in the coming years will create significant challenges for acquirers. Addressing these challenges and grasping the opportunities, however, can turn challenging situations into very profitable ones.

PricewaterhouseCoopers is a leading global advisor on post merger integration. We advise clients across a wide range of sectors and have deep insights into how to make integration succeed in the FPP industries.

12 Europe



PwC sustainability spotlight: Reenergising the forest products industry

The current downturn has accentuated the plight of much of the forest and paper industry in traditional producing regions, already battered into mill closures through competition, cost pressures and weak markets well before the credit crisis broke. For pulp and paper producers in these regions, the longer term outlook looks very challenging.

On the other hand, developments in renewable energy and sustainability provide opportunities to revitalise the industry by making use of available wood feedstock and industry infrastructure to generate new sources of revenue from bioenergy, biofuels, biochemicals and other bioproducts. PricewaterhouseCoopers has been helping identify such opportunities in one of the more stressed traditional producer areas, the Atlantica region comprising the Canadian provinces of New Brunswick and Nova Scotia and the US state of Maine.

The Atlantica BioEnergy Task Force, a broad coalition of regional governments, federal and regional organisations, industry and utilities, was established to look at how best to ensure the future sustainability and prosperity of the region's forest products industry. In a report commissioned by the Task Force, PwC made a number of recommendations for action in the areas of sustainable forest management, wood biomass management, energy policy, education, R&D and technology implementation that could enable the Atlantica region to be at the forefront of the renewable energy economy and to provide the direction to become a bio-sensitive economy.

(continued opposite)

European FPP deal volume declined 10% year on year from 147 in 2007 to 133 in 2008. Total deal value fell more sharply by 21% from US\$6.1bn to US\$4.8bn, much in line with total worldwide FPP deal value. Given that more than a third of the previous year's total was attributable to the US\$2.3bn acquisition of SIG Holding by Rank Group, deal values in 2008 were more evenly spread. The biggest 2008 deal was Finland's M-real's US\$1.1bn sale of its coated graphic paper business to South Africa's Sappi (see Deal Makers section).

Developments at Europe's largest paper company Stora Enso highlighted the difficulties facing many northern hemisphere paper producers. In a move rich with irony, the company sold one of its mothballed Finnish plants to Google in February 2009. The Summa mill had been shut down in January 2008 after 53 years in operation. It is expected to have a new life as a data centre and is likely to be a symbol of how electronic communications are eclipsing print media. The shutdown had been one of three mill closures which the company described as necessary to "safeguard its cost and competitive position, and thereby the future of the Group" (Stora Enso Oyj Stock Exchange Release 17 January 2008).

The second largest 2008 European FPP deal saw Stora Enso sell its wholly owned paper and packaging merchant, Papyrus, to the Swedish private equity company Altor Partners for US\$974 million in April 2008. As well as raising much-needed cash, the deal included a long-term supply agreement with Papyrus. Eight months earlier, Stora Enso had announced that it would be accounting for a €1.3bn impairment charge. In early 2009, the company announced a further €870 million impairment charge, also outlining how it had moved to cut production by 15% to 30% according to segment and reduce planned capital expenditure by 25-30%.

Stora Enso is far from alone in a Nordic paper industry that faces possibly its most difficult environment in living memory. Norwegian newsprint producer Norske Skog gained breathing space by selling its two Korean paper mills to private equity funds during 2008 (see Asia Pacific section). Stora Enso's Finnish counterpart M-real has been making major production cuts and job lay-offs. Finland has special problems. Until a few years ago it had the highest value-added fibre processing sector in the world.

This was focused on graphic papers which have been hit by secular as well as cyclical decline. The industry became over reliant on cheap Russian wood which is no longer available. The strength of the euro has exacerbated the industry's plight and next door neighbour Sweden, outside of the euro zone, has benefited at its expense.

Moving beyond the deals featuring in the global top ten and away from the Nordic countries, Spain-based paper manufacturer SAICA (Sociedad Anonima Industrias Celulosa Aragonesa) expanded its European packaging operations by acquiring Svenska Cellulosa's UK and Ireland conventional corrugated business for US\$196 million. Elsewhere, US private equity firm One Equity Partners acquired a US\$167 million (15.02%) stake in German wood products and building materials manufacturer Pfleiderer and French investment firm Financiere Agache bought a US\$155 million (37%) stake in Orly-based paper recycling company Group Paprec (figure 09).

Figure 09: Europe: Beyond the global top ten – the three next largest deals

Month announced	Deal value (US\$m)	Target	Target nationality	Acquirer	Acquirer nationality
Jun 08	196	Svenska Cellulosa AB – SCA (Conventional Corrugated Business)	United Kingdom	Sociedad Anonima Industrias Celulosa Aragonesa SA – SAICA	Spain
Jan 08	167	Pfleiderer AG (15%)	Germany	One Equity Partners LLC	United States
Jun 08	155	Groupe Paprec (37%)	France	Financiere Agache	France

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review



PwC sustainability spotlight: Reenergising the forest products industry (continued)

An understanding and assessment of technologies was a vital first step. Four technologies, in particular, were identified that were in the process of commercialisation and which offered the greatest opportunity for the region, in terms of economic value, employment and reduction in GHG emissions. Three would provide the opportunity to reduce energy costs of existing processing facilities as well as giving the option to generate alternative 'biorevenue' streams. The most costly to implement, but also the one capable of bringing the greatest benefits, would be the development of biomass refineries integrated with existing pulp mills to produce Fischer-Tropsch liquids, a diesel-type fuel. This would provide significant energy cost savings in pulping as well increasing revenue and market diversification from a wider product offering.

The fourth technology is torrefaction of biomass which would require standalone processing. Torrefaction is a thermal pre-treatment technology for woody biomass that can create a clean burning, readily transportable feedstock with a similar calorific value to coal. This new 'green' fuel could be used to create new economic activity across the region.

The issues and opportunities in the Atlantica region are not unique. They apply across the traditional forest products regions of North America and Europe and, indeed, the technological opportunities have relevance in all parts of the world.

A full copy of the report and further information on the Task Force can be obtained via www.atlanticabioenergy.com.

14 Asia Pacific

Asia Pacific saw total FPP deal value grow between 2007 and 2008, rising 14% from US\$3.4bn to US\$3.8bn. Nordic distress contributed to the rise with Norske Skog selling its Korean newsprint mills for US\$0.6bn. Year on year deal volume was down 5% – from 149 deals in 2007 to 141 in 2008.

The Norske Skog mill sale to private equity buyers Morgan Stanley Private Equity Asia and Shinhan Private Equity completed in September and was the biggest 2008 deal in the region. It enabled the Norwegian company to cut debt and improve liquidity. The second largest Asia Pacific deal saw Carter Holt Harvey (CHH), a subsidiary of Rank Group, acquire the timber manufacturing operations and timber distribution business of the Weyerhaeuser Australian Group for US\$493 million.

The deal continues a stream of deal-making by Graeme Hart's forest products group and gives the company around 40% of Australia's softwood market. The deal originated in talks to actually sell CHH's wood products and building materials business but, when the opportunity arose to instead add to these operations, CHH switched from seller to buyer. However, CHH is still seeking to sell its wood products and buildings materials business. Early in 2008, Japanese interest from Sumitomo had faced opposition from the Australian Competition and Consumer Commission and, since then, the potential sale has been clouded by the deterioration in the financial markets.

The two largest Asia Pacific deals featured in the global top ten FPP deals. Moving beyond the top ten, GIC Special Investments, the private equity investment arm of the Singapore government's investment corporation, teamed up with Morgan Stanley to acquire a US\$175 million 21% stake in Ballarpur Paper Holdings, part of the Indian BILT group. In South Korea, Moorim Paper took a US\$159 million (50.76%) stake in Korean pulp mill operator Donghae Pulp from the Korea Development Bank and other shareholders. Elsewhere, there was consolidation in the diaper maker sector with Japan's

Unicharm buying Australian Pacifica Paper Products, the second largest manufacturer of disposable hygiene products in Australia after Kimberly-Clark (see figure 10).

China continues to account for the largest share of global growth in demand of forest-based products, although in the packaging sub-sector 2008 has been a difficult time for paper companies as Chinese exports experienced their slowest growth in the last 30 years. The sector is highly fragmented and progress towards consolidation has been relatively slow. The biggest 2008 move was Shanghai-listed Yueyang Paper's US\$195 million deal to buy Hunan Juntai Pulp & Paper which remained pending at the close of the year. Juntai is a subsidiary of Tiger Group, which is also the controlling shareholder of Yueyang Paper, so this is not a consolidation deal per se but more a case of a large state-owned paper group rationalising its business.

There is a growing role for private equity players to spur rationalisation of the sector and PE players have begun to take a profile, in addition to strategic investors, in deal-making. In July 2008, for example, CVC completed the US\$112 million acquisition of a stake in Hung Hing Printing Group. This followed earlier similar sized deals by CVC in the Chinese FPP sector in which the group acquired Asia Dekor (MDF and flooring business) and Plantation Timber Products and combined them into Asia Timber Products (ATP). These deals look set to presage future PE consolidation moves in the region.

In common with many other Asia Pacific producers, such as Japan and India, there is a lack of adequate domestic supply of fibre, both virgin and recovered. In response Chinese companies have sought to vertically integrate within China. There have been some moves to secure fibre supply outside the region although the limited size of companies in a fragmented sector has inhibited moves overseas. Effort has been put in to extend plantations within China but the whole of east Asia has a massive and growing resource deficit necessitating the need to secure feedstock around the world. Domestic developments are unlikely to be sufficient and Chinese fibre requirements are a driving force across the entire global industry. Thus far, this has manifested itself primarily in greenfield development rather than M&A.

Figure 10: AsiaPacific: Beyond the global top ten – the three next largest deals

Month announced	Deal value (US\$m)	Target	Target nationality	Acquirer	Acquirer nationality
Jun 08	175	Ballarpur Paper Holdings BV (21%)	Netherlands.	Morgan Stanley; Government of Singapore Investment Corp	India
Apr 08	159	Donghae Pulp Co Ltd (50.76%)	South Korea	Moorim Paper Co Ltd	South Korea
Sep 08	142	Australian Pacific Paper Products Ltd	Australia	UniCharm Corp	Japan

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

16 Latin America



PwC funding spotlight: The widening scope of funders' sustainability screening

Access to and the cost of capital is increasingly influenced by how well a project or company is able to meet sustainability criteria. Sustainable finance policies of global banks have historically focused solely on lending activities, but in recent years have often been extended to capital markets activities, project finances and advisory services. At a time when access to finance is tight, a company's sustainability performance can make a vital difference.

The sustainable finance policies of global banks vary in both sectoral coverage and level of sophistication. A PricewaterhouseCoopers project with the World Business Council for Sustainable Development revealed a general lack of disclosure by banks on how forestry policies are implemented. Implementation is very much a developing area and, for many financial institutions, is one requiring focus. Environmental and social issues have in the past resulted in, or contributed to, loan defaults and loss of investment value. Also, poor performance on sustainability grounds is often an indicator of poor management, and financial institutions will wish to avoid providing services to, or being publicly associated with, clients running undue environmental and social risks.

Forestry policies, such as those developed by HSBC and Citigroup, have primarily been developed to address this and ensure funding organisations are not exposed to undue credit and investment risk through lack of due diligence when providing a financial service. These policies currently apply mainly to forestry and paper companies but will almost certainly extend to packaging in the not too distant future. Given that most board packaging is currently based on fibre, it is inevitable that banks' forest products policies and lending criteria will be extended and applied as appropriate to packaging companies. In fact, packaging companies with forest assets or large pulp purchasing operations may already be subject to sustainability screening. Moreover, the sustainability credentials of packaging are becoming a major issue for consumers and retailers.

PricewaterhouseCoopers has a team focusing on sustainable forest financing, as part of a wider team of specialists in the sustainable forest products sector. We advise financial institutions on strategy and implementation in this area.

FPP deal activity in Latin America, which had been subdued in 2007, turned up in 2008. The region has become the world's fibre basket with significant greenfield investment by both homegrown and inward investors. Although deal volume fell 21% in 2008, with just 11 deals compared to 14 in 2007, total deal value in the region was up sharply, rising 88% – from 2007's US\$530 million to US\$997 million in 2008.

Despite the surge in deal value, most of the deal interest centred around one that did not happen in 2008. This was the negotiations between Brazil's Votorantim Celulose & Papel (VCP), part of the Votorantim Group a large industrial conglomerate, and Aracruz Celulose to merge the two companies. Following the expiry of a standstill agreement between VCP and the two other shareholders representing the Lorentzen and Safra families respectively, which together controlled 84% of Aracruz's common shares, VCP announced the acquisition of the Lorentzen shares in August 2008. However that deal was put on hold when Aracruz revealed significant losses on foreign currency derivatives stemming from the sharp devaluation of the Brazilian real against the US dollar.

Subsequently, Aracruz announced a settlement payment with its banks of around US\$2.6bn payable over nine years, thereby enabling the merger to be revived. In January 2009, VCP announced the acquisition of the Lorentzen stake for US\$1.15bn. At the same time, VCP stated that it expected the Safra family to exercise their 'tag along' right to sell at the same total price i.e. US\$2.3bn combined. It also announced a wide ranging corporate restructuring plan including a major recapitalisation of VCP and compensation terms for the minority shareholders, that would result in Aracruz coming under VCP's full control. On the assumption that full control would be obtained, VCP outlined the first steps to integrate Aracruz, as well as ambitious future growth plans. As at the end of March, the Safra family had announced they would sell their stake.

If completed, the deal would see the combined company become the world's largest producer of market pulp by some margin. It would control eucalyptus pulp capacity of some 5.8 million tpa, or approaching 40% of global market bleached eucalyptus kraft pulp (BEKP) capacity, enabling it to cut costs and improve margins. It will give Brazil a large national company of a scale to compete impressively on a global stage in pulp supply.

In the absence of the VCP-Aracruz deal coming to the table in 2008, by comparison the three biggest deals done were all for relatively small values (figure 11). In October 2008, Kimberly-Clark agreed to buy the 31.3% minority in its Colombian disposable hygiene products subsidiary for US\$289 million in a deal that completed in January 2009. Ontario Teachers Pension Plan, a Canadian investment pension fund, acquired the timber tracks of Brazilian timber producer and farmer, Grupo Zogman, for US\$200 million. Masisa was involved in a trio of 2008 deals. US building materials and industrial wood products company Louisiana-Pacific bought a US\$75 million 75% stake in Masisa's Brazilian Ponta Grossa oriented strand board mill in June 2008 and this was followed by Masisa itself moving for a US\$70 million 45.68% stake in Brazilian wood board manufacturer Tafibras Participaciones. A third Masisa deal remained pending at the end of the year with the company selling its Rio Negrinho sawmill in Brazil, to Brazilian wood manufacturer Renova Floresta for US\$70 million.

Figure 11: Central and South America: Beyond the global top ten – the three next largest deals

Month announced	Deal value (US\$m)	Target	Target nationality	Acquirer	Acquirer nationality
Oct 08	2895	Colombiana Kimberly Colpapel SA (31.3%)	Colombia.	Kimberly-Clark Corp	United States
Jun 08	200	Grupo Zogman (timber tracks)	Brazil	Ontario Teachers Pension Plan	Canada
May 08	74	Masisa OSB Industria e Comercio SA (75%)	Chile	Louisiana-Pacific Corp	United States

Source: PricewaterhouseCoopers Forest Paper & Packaging Deals 2008 annual review

18 Looking ahead

Continuing financial market uncertainty, economic slowdown and a collapse in worldwide demand set the stage for a challenging deal-making environment for the immediate future at least. Recession and the crisis in financial markets have come to a pulp and paper sector which, for some years, has been characterised by two worlds. On the one hand there are the players in the mature, mainly North American and European markets for some of whom the downturn could potentially trigger the final distress call. On the other hand, there are the growth region players in Asia Pacific and Latin America for whom the current environment poses a different set of challenges.

The crisis facing companies in the Nordic countries looks set to trigger a major round of long overdue consolidation in Europe. Indeed, it is difficult to see how the further significant reductions in primary papermaking capacity necessary in Europe of perhaps 25-30% in some grades can be achieved in isolation from sector consolidation. The timing and form of the major moves is less certain. Acquirers will be wary of buying in a context of falling values and acute distress may well be the dictating factor. Similar forces are likely to spur further consolidation in North America. It is likely that the coming period will see major casualties and a significant shake-out of the sector in the northern hemisphere with the pulp and paper industry looking very different in two to three years from now.

The outlook for forestland and forestry is more mixed. There is certainly still plenty of investment money lined up looking for high quality assets. Whilst there might be a surplus of fibre today, scarcity continues to loom in the longer term. A quest for global sourcing and security of fibre from the major processors, particularly from Japanese and other Asia Pacific players, can be expected to spur future investment strategies and that includes deals. The growth of wood-based energy and entire biochemical value chains derived from wood fibre could also provide a spur for deals although, to date, this has resulted in joint venture or other partnership arrangements rather than

outright M&A. The development of this part of the sector will also hinge on the political will of governments to continue to give priority to the development of renewable energy against a backdrop of economic recession.

In this respect, 2009 is set to be a watershed year. The deliberations of governments in the run up to and at the Copenhagen Climate Summit in December 2009 will decide whether or not agreement can be reached on a successor to the Kyoto Protocol. A crucial question will be whether the emission reduction contribution of forestry will be included in the mandatory elements of any new global scheme. Already, we have seen the introduction of new CO₂ trading legislation in Australia which has spurred interest in the sector and the carbon rights linked with, in the Australian case, new forest establishments.

As we have seen, the quarterly trend of deal-making in 2008, if continued, is plunging the sector towards a record M&A low in 2009. Many acquirers are on the sidelines because of the uncertain outlook and the restricted access to capital. In many cases, where there are potential deals, consensus on valuation is preventing agreement. The result, however, is significant pent-up demand which, with any easing of the financial markets or positive economic signals, could result in a pick-up in deal making.

Private equity will continue to play a major role in the sector with PE players seeking to capitalise on distress situations. PE is also likely to play an increasing role in the consolidation of the sector in the growth markets. In China, for example, there has been increasing involvement of PE players and this looks set to gain momentum although, hitherto, mismatches in valuation have restricted deal activity.

Government privatisations of forest assets might also boost deal activity in the coming period. In Australia, the state governments of New South Wales, Queensland, Western Australia and South Australia are discussing the possibility of privatisations. In Europe, the Scottish government also proposed the partial privatisation of much of its productive timber estate to help meet a budget deficit, although those plans have been withdrawn due to popular opposition. Nevertheless, as governments become increasingly concerned with raising funds to manage the considerable budget deficits arising from financial rescue and economic stimulus initiatives, forest privatisations may be on the cards.

In summary the deal-making environment is beset with many and varied challenges and opportunities. Ultimately, deal-making is driven by relatively few factors, the most important of which are the existence of benefit and/or need and the availability of the required finance. With the industry on course towards significant restructuring, the first of these exists in abundance. It is the second which will determine the level and pace of activity in the period ahead.

20 Our transactions expertise

PricewaterhouseCoopers Transaction Services and Corporate Finance teams bring core strengths – in people, knowledge and services – to ensure your deal decisions are informed ones and your investments are successful. Our financial, operational, strategic, structuring and corporate finance specialists work alongside our other specialists within the firm including tax M&A, pensions, valuation, IT and environmental.

Transactions Services

Across our global Transaction Services network, our FPP capability comprises consultants, accountants and experienced industry practitioners with first-hand knowledge of the FPP industry. Territory teams are connected via the network to access local knowledge and contacts across the world. Our regional teams have deep functional experience and a breadth of skills that enable you to extract maximum value from your business before, during, or after a transaction. Due diligence has increasingly become an exercise not only in preserving value, but in identifying and testing the upside opportunities that may be contained within the business which may be crucial to winning the deal. Our integrated service combines financial, operational, and commercial due diligence and can help you interrogate and justify your vision for a deal.

We can provide a single report that provides a 360-degree perspective of the state of the business today, its future prospects, and the prospective shape of the business and its marketplace. Alternatively, you can choose to benefit from individual elements of our experience and expertise. Our Operations experts can help identify value in the predeal phase and capture that value in the post-deal 100-day planning phase of the transaction. In addition, our industry specialists bring with them the experience and knowledge of having handled international manufacturing plant transfers in a range of environments. Our Strategy specialists can help you to develop acquisition, disposal and growth strategies by considering key everyday issues

including market drivers and the impact of the economy, new market opportunities, reviewing performance across a business portfolio and diagnosing drivers of underperformance. Our exit support and vendor assistance services help clients avoid the pitfalls of going to market under-prepared. Value can be lost if the vendor has not anticipated or cannot articulate the strategic, operational, or financial analysis needed to satisfy bidders' requirements. Poorly prepared disposals often fail to generate auction tension, with today's bidders keen to apply an uncertainty discount if information is inconsistent or incomplete.

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