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OUTUBRO 2010
OCTOBER 2010

TRANSAMERICA EXPO CENTER
SÃO PAULO - BRASIL

Tissue Business- Increasing Opportunities for Latin American Producers?



1º Simpósio e Exposição Latino-Americano de Tissue

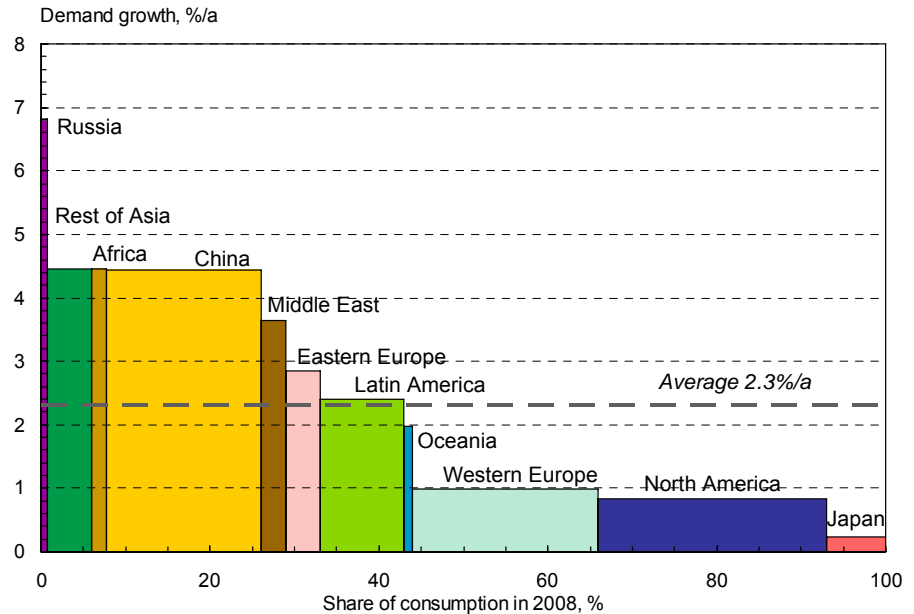
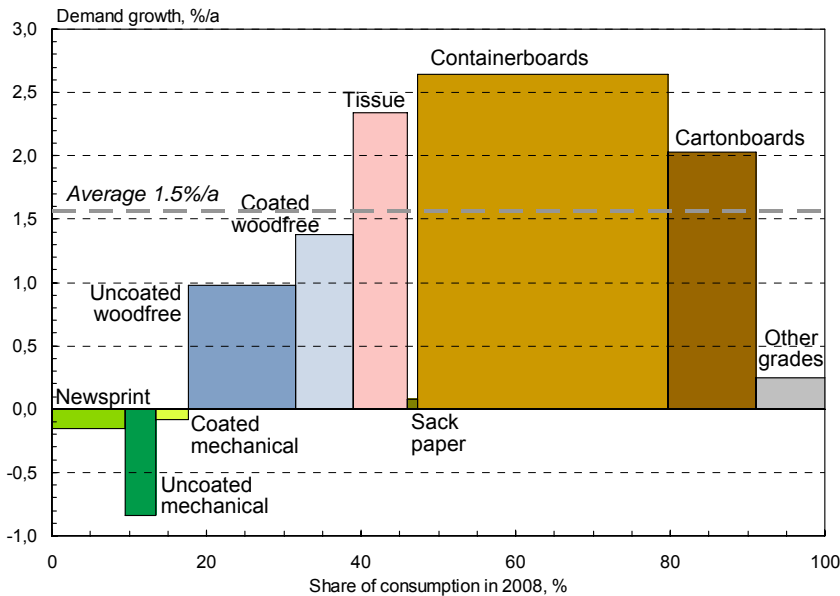
1st Latin American Symposium and Exhibition on Tissue

Tissue is globally a continuously growing market

- Tissue market is globally growing, according to a long term forecast at some 2,3 % rate per annum.
- Tissue is one of the fastest growing pulp and paper segments and especially the growth is more steady than that for the other grades as it has continued even through recession years.
- The growth is the strongest in the east; especially Asia, lower in mature markets in Western Europe and North America. Latin America tissue growth is at long term slightly higher than the global average. The historical growth has exceeded 5 %/a and at medium term (some 10 years perspective) the growth is closer to the historic levels at some 4 %/a.
- Population growth is the key driver for tissue growth in many regions. However, the growth is the strongest where in addition there is plenty of potential for increased consumption per capita. Per capita consumption is boosted by economic growth and increasing living and hygiene standards.
- The latest severe recession had an impact on tissue growth; nevertheless tissue demand did not decline on annual basis even if the production growth leveled out.

Tissue long-term demand growth by region 2008-2025

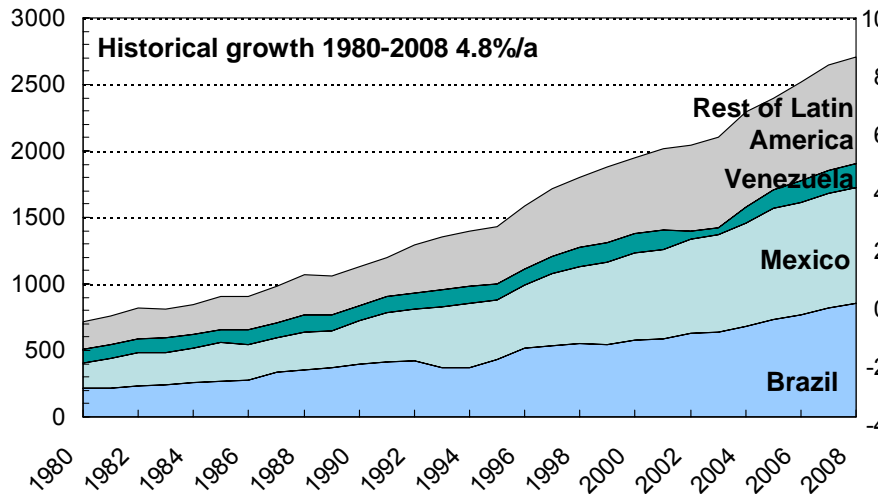
The world Tissue paper demand is expected to grow by 2.3%/a in the long term. Eastern Europe, Russia in particular, and Asia are forecast to show the strongest growth in the long term (average growth 4%/a through 2025). Latin America will grow slightly over average rate 2.4%/a.



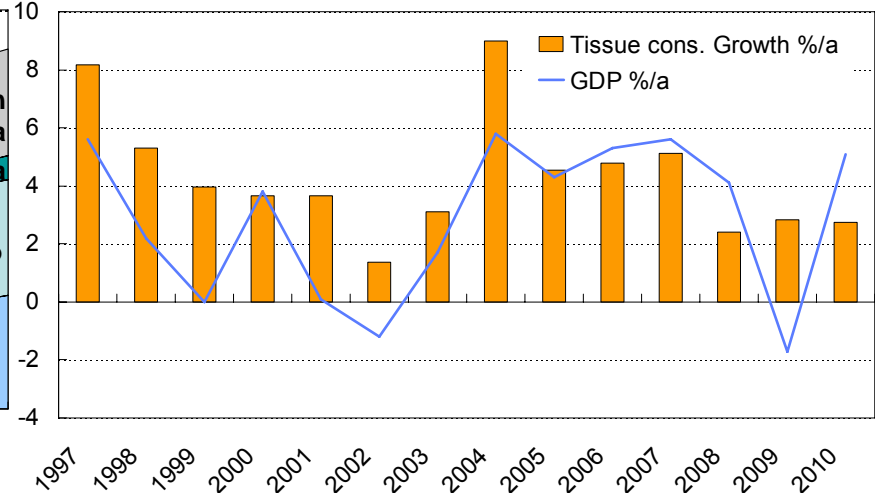
Since 1980, tissue consumption in Latin America has grown positively also during the economic downturns.



Tissue paper demand in Latin America, million tons

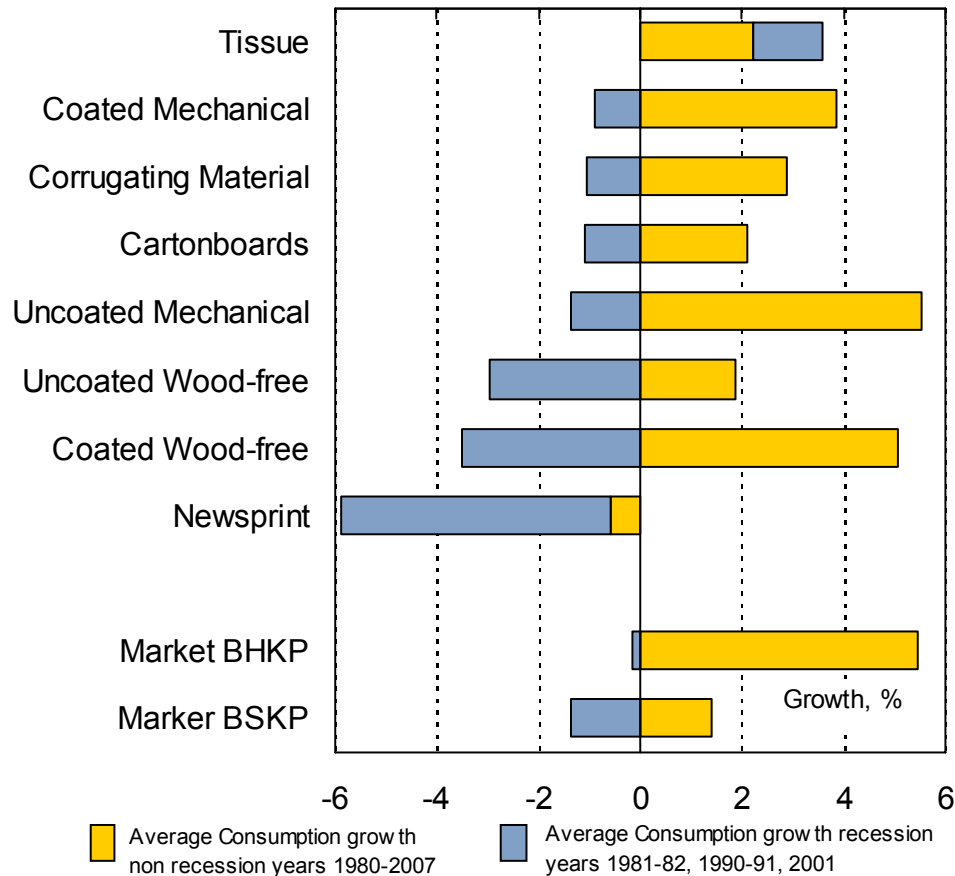


Change in tissue paper demand vs. change in GDP, %



Recession response – tissue is resilient

Tissue consumption development reflects recession years – but no drastic changes evident. Hardwood market pulp and tissue are the most resilient grades.

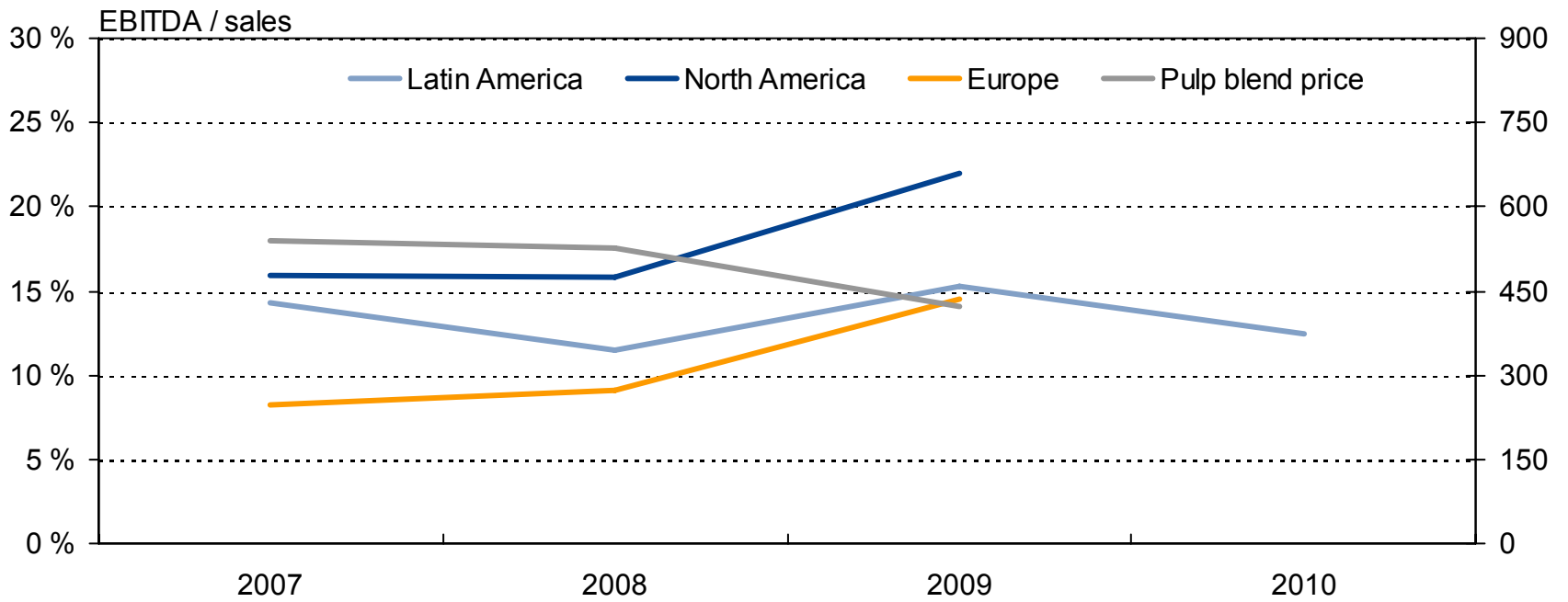


Tissue offers higher and more stable margins than many other paper grades

- Overall the tissue margins have been higher and more stable than in many other paper industry segments. The cycles impact only through raw material prices, but have less impact on demand and product prices.
- The recession year 2009 was actually a year of high margins for the tissue makers when the pulp and recycled fiber prices went rapidly down the first half of the year.
- All this is making tissue an attractive low-risk alternative for investments. Other paper and pulp industry sectors are eyeing opportunities in tissue and also more financial investor money seems to be finding its way into the tissue sector. In addition other industrial companies than paper and some other interest groups have recently been active in investigating opportunities in tissue.
- Latin America offers good margin opportunities for tissue producers; faster growing market than North America, some strong (also some North American) companies have gained market power and impact the product quality and prices, higher tissue industry consolidation level than in most countries i.e. Europe, economies of scale for the largest producers and finally benefits of BEKP, the local high quality raw material.

North American vs. European and Latin American margins

The brand-oriented North American companies have shown consistently higher margins than the European companies. Both the North American and European markets have been affected by pulp price cyclicality, but is the impact stronger in Europe ? Latin American references position in-between.



Note: based on yearly averages of selected North American and European tissue companies/segments, limited number of Latin American companies and North America may include also Latin American results.

Presence of North American companies and partly similar market fundamentals increase opportunities in Latin America

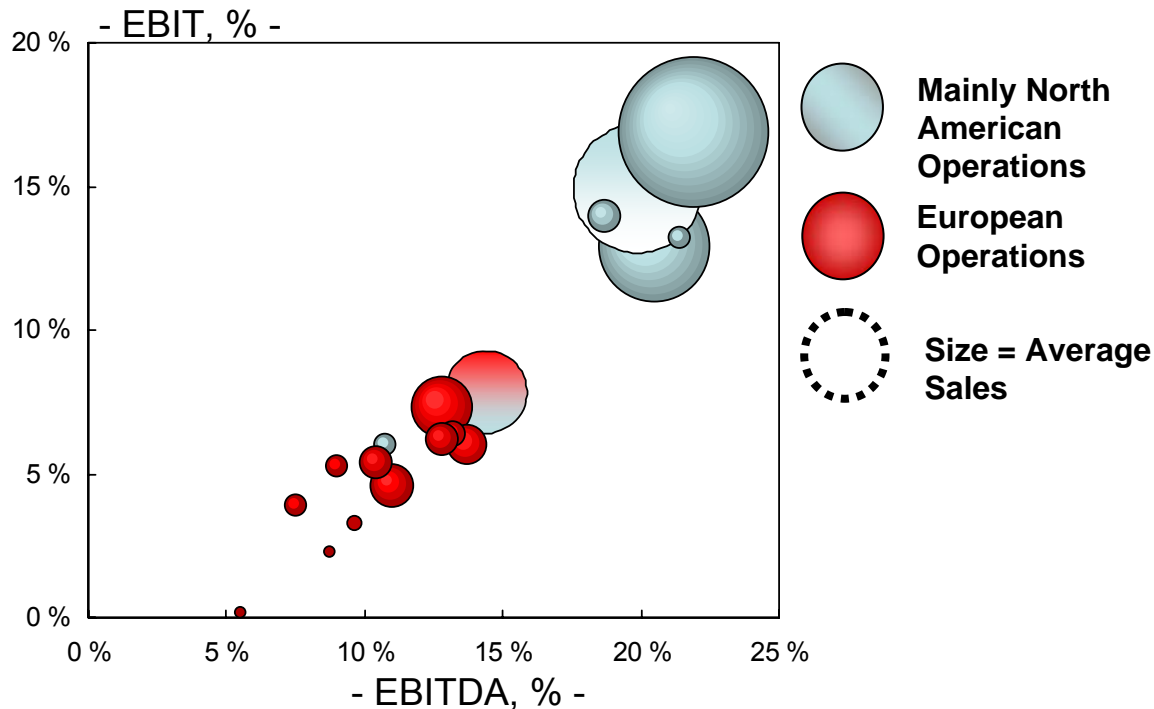
- In tissue margin levels there are great variations between companies, regions and different business models.
- The North American tissue sector has the highest profitability. Better profits seem to correlate with large size and dominant position i.e. high market power and consolidation level. Also 'brand power' is suggested to be a key to the higher profitability. High integration to converting offers chance to capture value available throughout the value chain.
- The North American large market, homogenous consumer groups, the same language throughout the nation, large order sizes, feasibility of large units etc. offer more possibilities to benefit from scale economies in production, converting, logistics, purchasing and procurement.
- North American markets are different, and the winning concepts cannot be copied directly, but there are some key fundamentals that drive the profitability and are similar also in Latin America. Latin America offers increasing opportunities for the tissue producers.
- The presence of N-A tissue companies in Latin America is demonstrated in product quality, increasing offering of TAD-based tissue products and other premium quality. There is potential to gain from the high quality offering and global brands.

Why is tissue business more profitable in North America ?

European tissue business is struggling with lower margins than the North American companies. In addition to the different markets, better profits seem to correlate with large size and dominant position. Also “brand-power” is suggested to be a key to the higher profitability.



Average 2000-2009 sales and margins for selected tissue companies

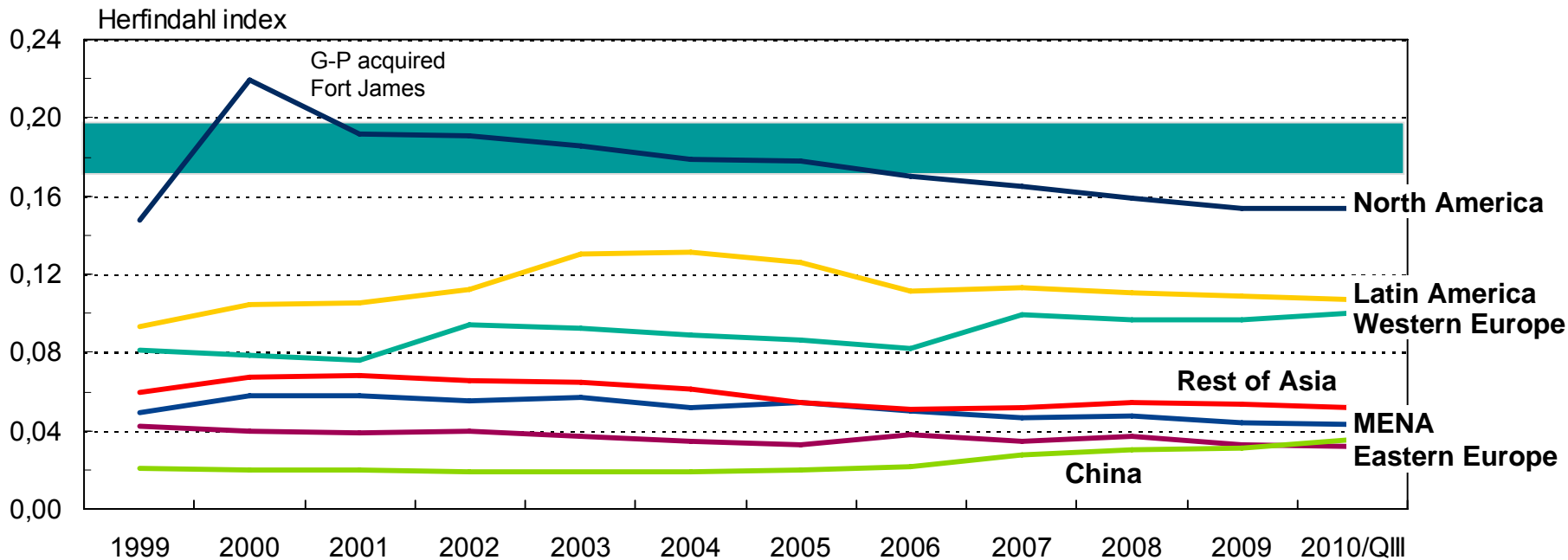


Note: figures are averages of available periods

The industry concentration level in Latin America is higher than for instance in Europe

- North America has the highest industry concentration across global regions although the concentration level has declined below what is typically considered the critical level for market power (0.18-0.20 Herfindahl Index.). The decline has been driven by the trend for independent tissue converters to integrate backward into tissue manufacturing.
- The Latin American consolidation level is higher than for instance the European and the established players are continuously expanding and strengthening their position in the region (K-C, SCA, CMPC, Mili)
- In addition many of the Latin American companies are also global and able to leverage scale economies, brand and market power at a Pan-American level.
- However, truly local players have still a significant share of the Latin American tissue capacity, almost half and decline the H-index.

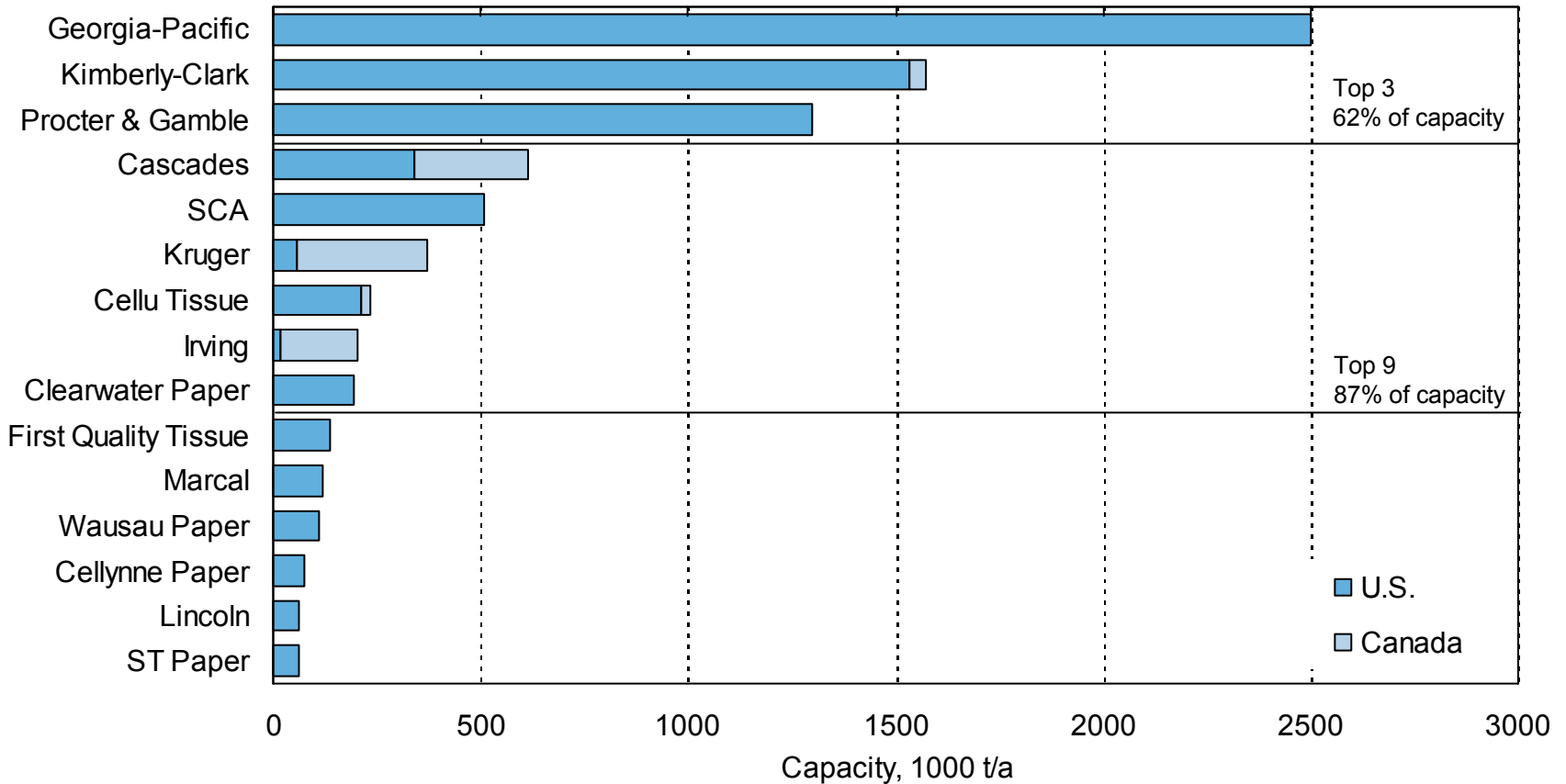
The relatively rapid growth of the tissue paper market has moderated the speed of concentration in most regions. North America is the only region where the tissue paper market can be considered comparatively concentrated, however challenged recently.



Note: Base on production capacity. Decreases in the Herfindahl index (H) generally indicate a loss of market power and increase in competition, while increases imply the opposite. An industry is considered to have market power if seller concentration exceeds the level of 0.18 – 0.20. $H = \sum s_i^2$ where s_i is market share of i:th firm

Leading producers of tissue paper in North America 2010/III

The North American tissue industry has a three layer structure ruled by the million ton producers.

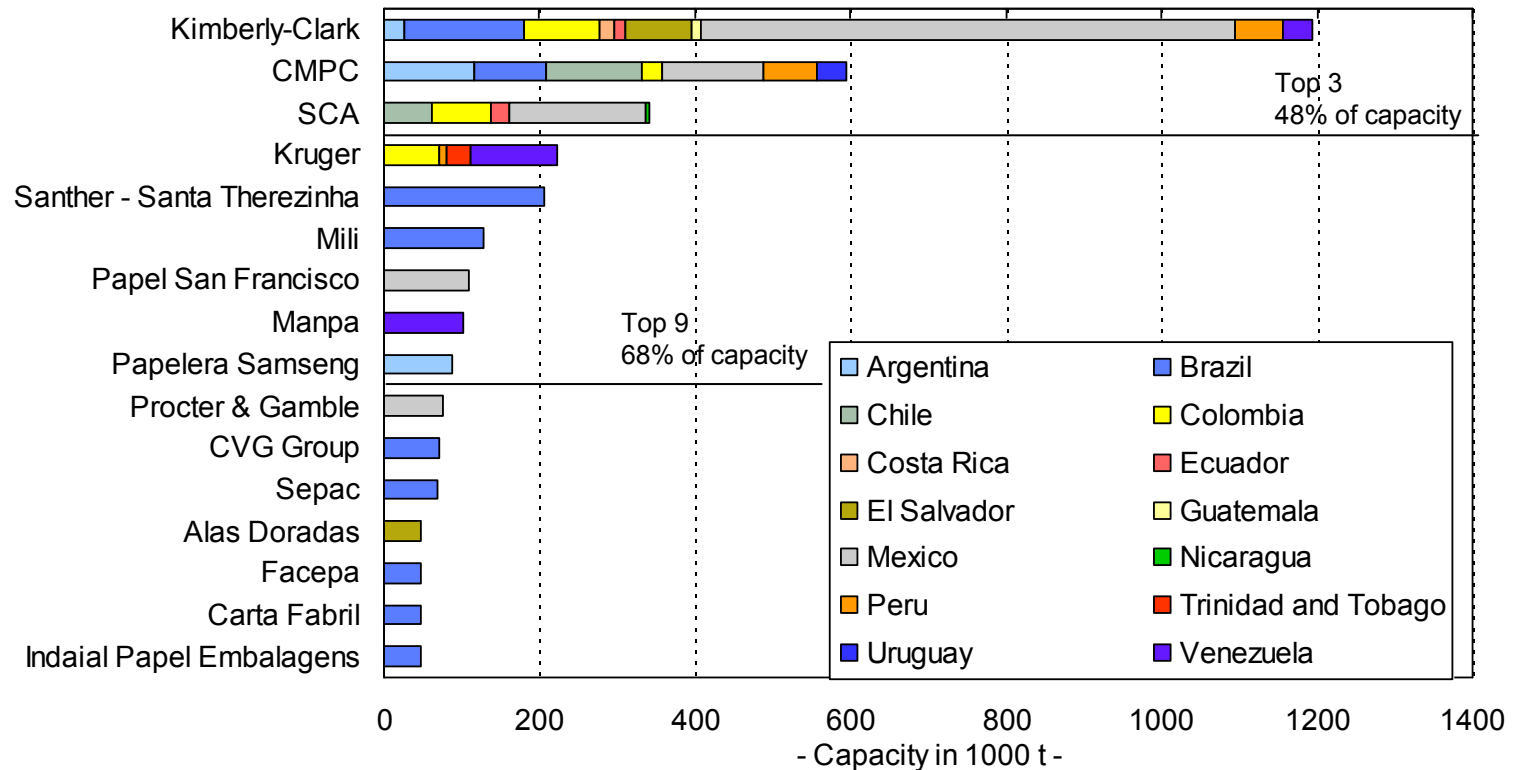


Leading tissue producers in Latin America

The consolidation level is lower in Latin America but many players are strong in a Pan-American perspective. The largest groups are expanding and strengthening their position.



2010/Q3

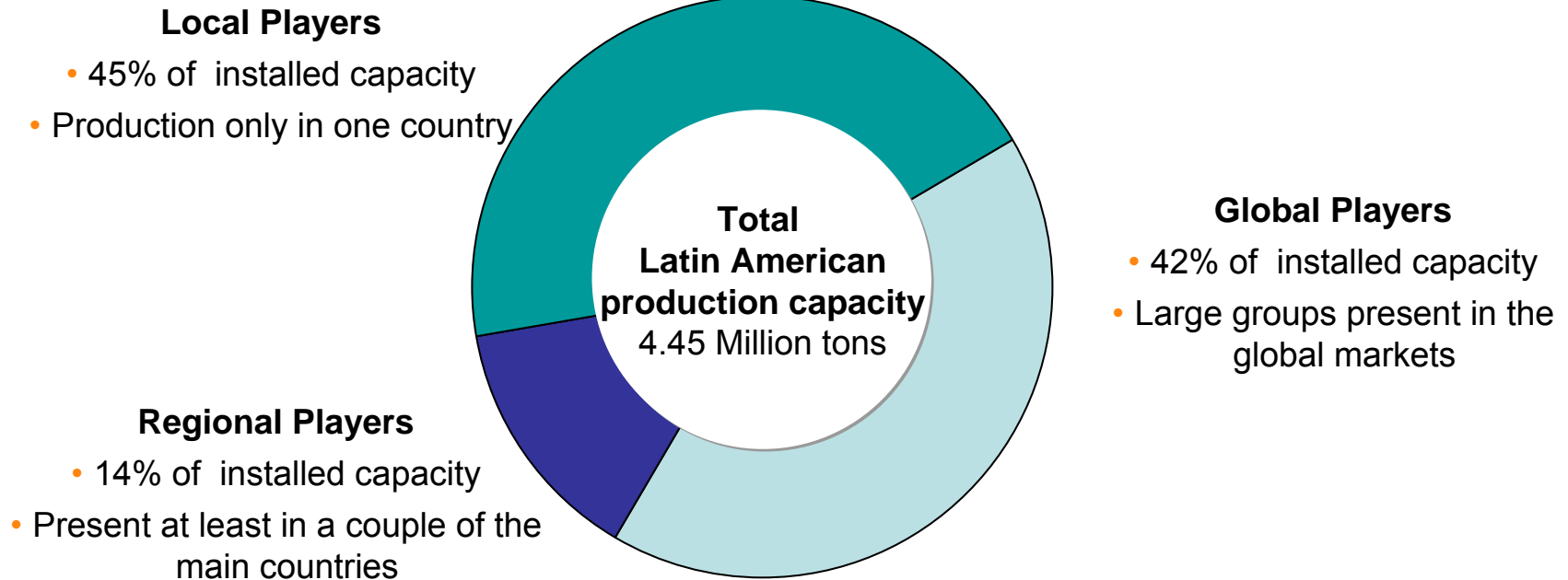


Geographic spread of Latin American tissue capacity

Almost half of the Latin American capacity is, still within the small, local tissue companies.



Installed Capacity by Geographic Spread



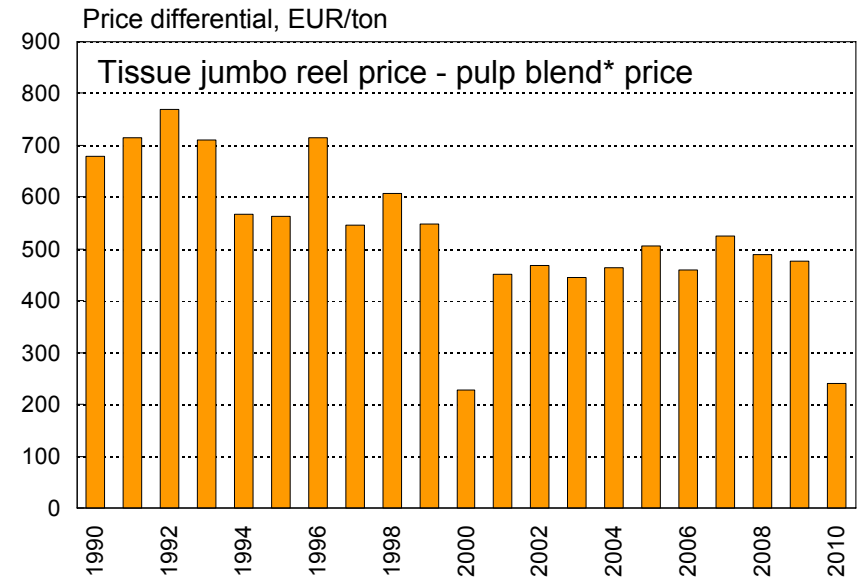
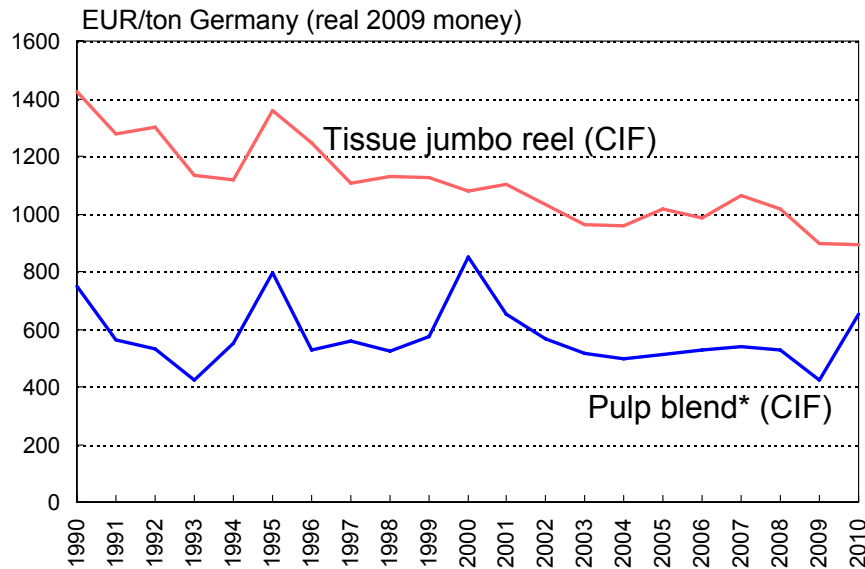
*The survey includes 245 Latin American PMs

Pulp prices have a significant impact on tissue margins

- Pulp prices represent 40-60 % of jumbo roll manufacturing input costs. The stable margins of tissue producers have been impacted by fluctuations in pulp prices as it has been difficult to (timely) transfer the pulp price changes into tissue prices.
- Especially the prices of final, converted tissue products react to pulp prices slow and with less amplitude.
- The heavy dependence on pulp prices has had reactions from some companies and for instance K-C has announced its intent to limit dependency on paper products prone to fluctuating commodity prices and competition from store brands. K-C has shifted focus to 'high margin growth areas' such as workplace safety and medical devices.
- P & G has shifted focus away from the capital intensive Paper and Food business whose share has decreased from 42 % in 2000 to 25 % in 2009 and P & G sold the European tissue business to SCA in 2007.
- However, pulp price is not the only factor impacting tissue margins and the business is not fully dependant of the mercy of the fluctuating commodity prices, but there is plenty of potential to create more value throughout the whole value chain starting from raw material, product and quality strategies.

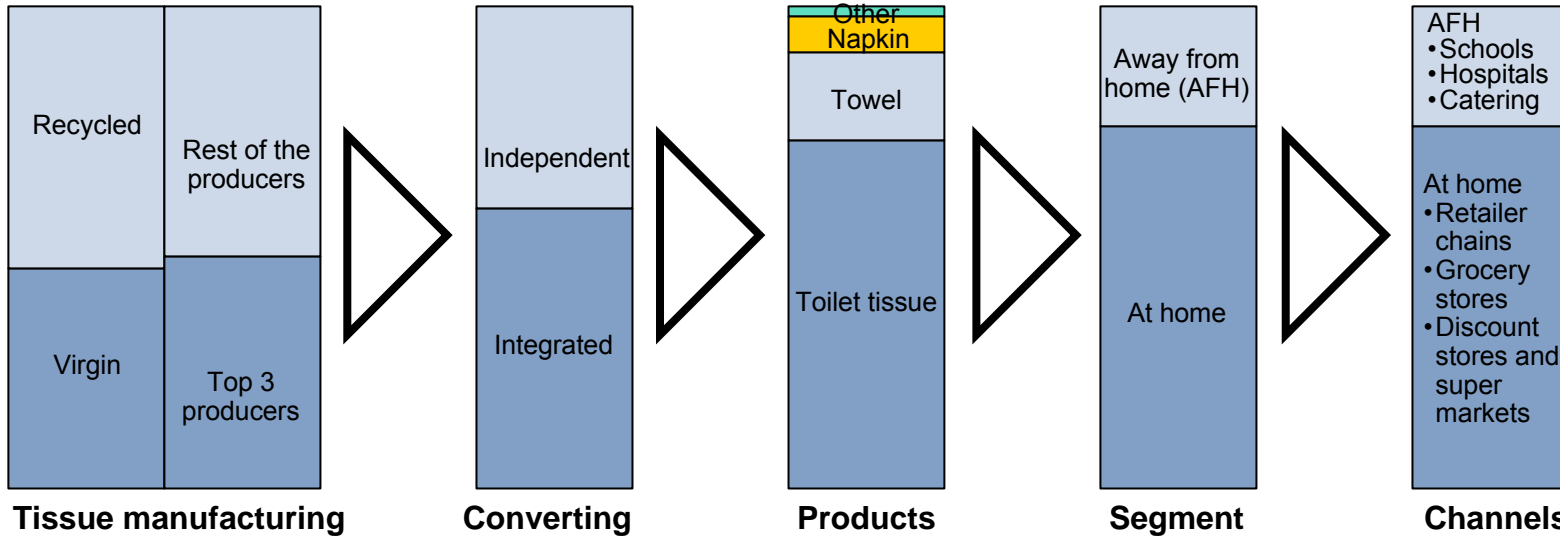
Development of price differential tissue jumbo reel price/pulp price

Is the trend a declining difference between pulp price and tissue jumbo reel price ?



* Pulp blend = 70% BHKP, 30% BSKP

Value chain steps – from fiber to channels, Europe



Capacity 4.4 million tons

Recycled fiber accounts for almost half of the raw material need

The virgin pulp is almost entirely market pulp

Fairly high industry consolidation level

Integrated capacity rules. Large companies targets full integration. Market entrance via independent converting

Converting trends: Major part still single ply, upper class papers multi-ply, color printed

Toilet tissue accounts almost 75 % in Latin America. Towels are gaining ground. In volume terms toilet increases the most

Quality has improved in both segments in all categories.

AFH has historically grown with slightly higher growth rate than AH.

Steady future growth for both segments.

Driven mostly by per capita consumption, where there is plenty of potential in many countries

Global brands present Being pushed to AFH as well – exit from general low value AFH to high value specified and branded products

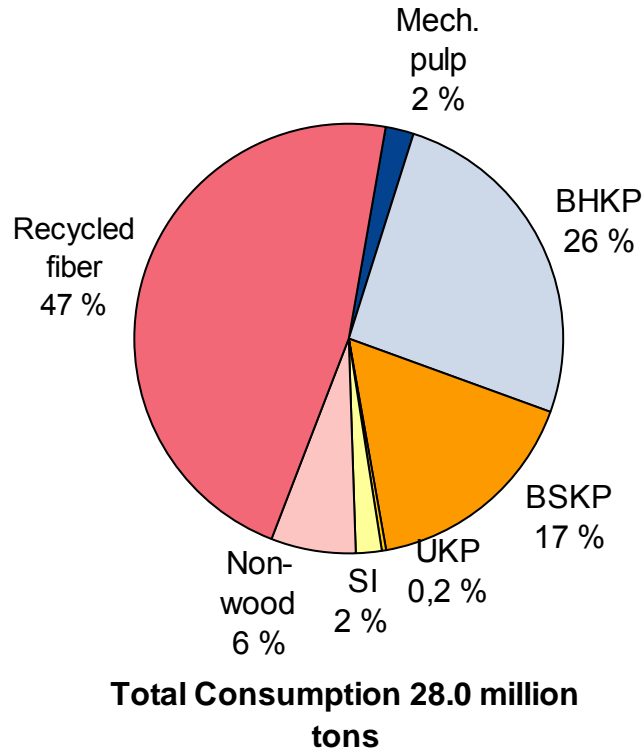
There is plenty of potential to impact the margins throughout the value chain

- Raw material/fiber strategy is one of the key elements driving the margins. Recycled fiber accounts for about half of the global raw material needs in tissue, though the share has already peaked.
- In Latin America the recycled fiber share is over 50 % due to the 'dual' nature of the quality structure. There is still plenty of local low quality production based on recycled fiber, though at the same time the higher quality end is growing and premium products, even TAD are gaining share in the markets.
- Long term cost and availability of recycled fiber remains the key question. China's appetite to import recycled fiber shows no signs of slowing down. Also the collecting base of qualities suitable for tissue (high grades) is getting smaller due to declining demand of printing and writing papers in North America and Western Europe.
- Several main tissue producers (for instance in North America) have attained ownership in the fiber recovery and recycling business in order to better control recycled fiber supply.

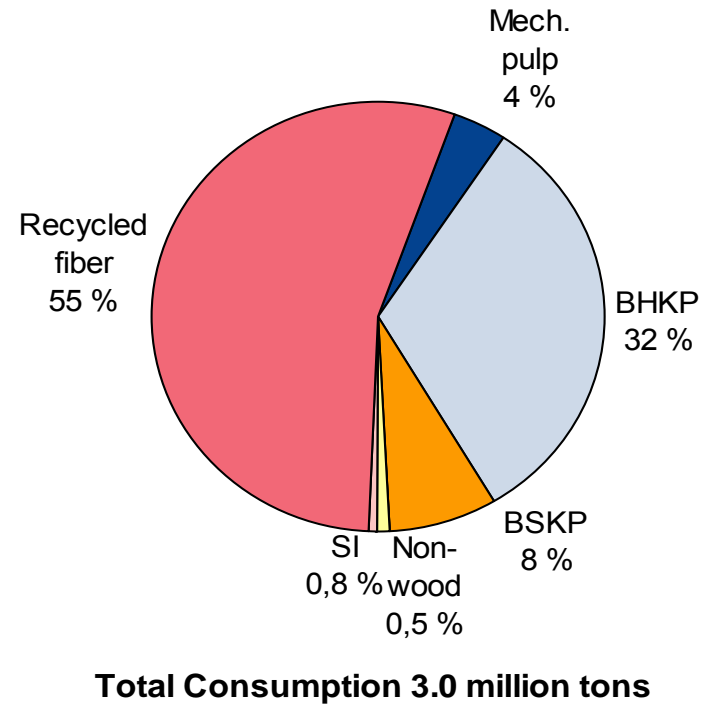
Globally recycled fibre is important – will there be enough of this fibre?



World



Latin America



Latin American BEKP is suitable and especially fine tuned for tissue end use

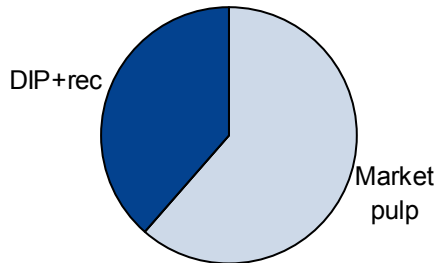
- Market pulp plays an important role. Its share of virgin pulp used in North American tissue is some 80 % and in Latin America almost 100 % if captive pulp is considered market pulp. In the past tissue companies had the trend to exit their own pulp business, but the current cyclical rise in pulp prices has taken a toll on tissue producers and access to own integrated pulp has given an edge.
- The Latin American tissue producers are well positioned due to local supply of high quality BEKP especially suitable (and fine tuned for) tissue end use. BEKP increases especially tissue softness, primarily required in toilet tissue. Pulp transport costs are low and there are benefits of the technical development and know how.
- Many especially American tissue producers and Latin American pulp producers have strong partnerships. Will this kind of partnerships be strengthened and spread as tissue clients are becoming more and more important for the pulp producers ?
- Latin American pulp producers are well positioned to serve the global tissue industry benefiting of the technological development of BEKP fiber to tissue end use and the partnerships with the multinational tissue producers.
- Developments of the fiber furnish are used to fight for the margins – increasing share of short fiber pulp has an impact due to both lower fiber and refining energy costs.

Top producers are different in terms of overall fiber strategy, but when producing at-home products focus is on virgin fiber. Latin American integration to pulp is minimal.

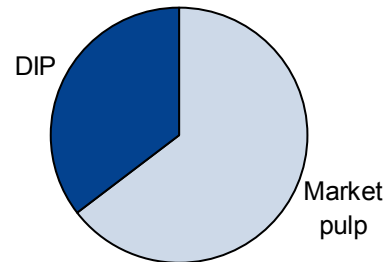


Latin America

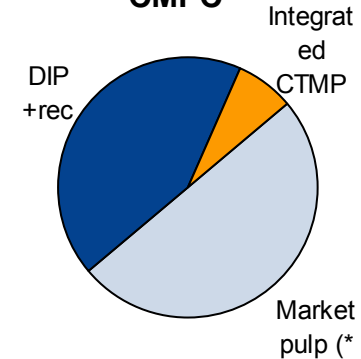
Santher



Kimberly-Clark

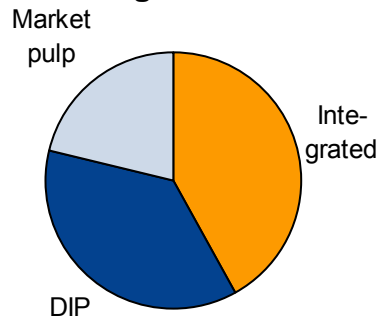


CMPC

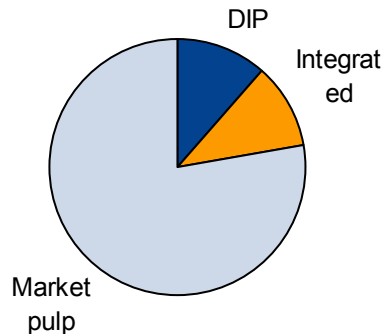


North America

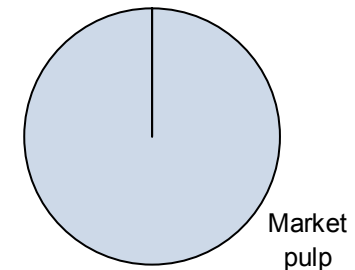
Georgia-Pacific



Kimberly-Clark



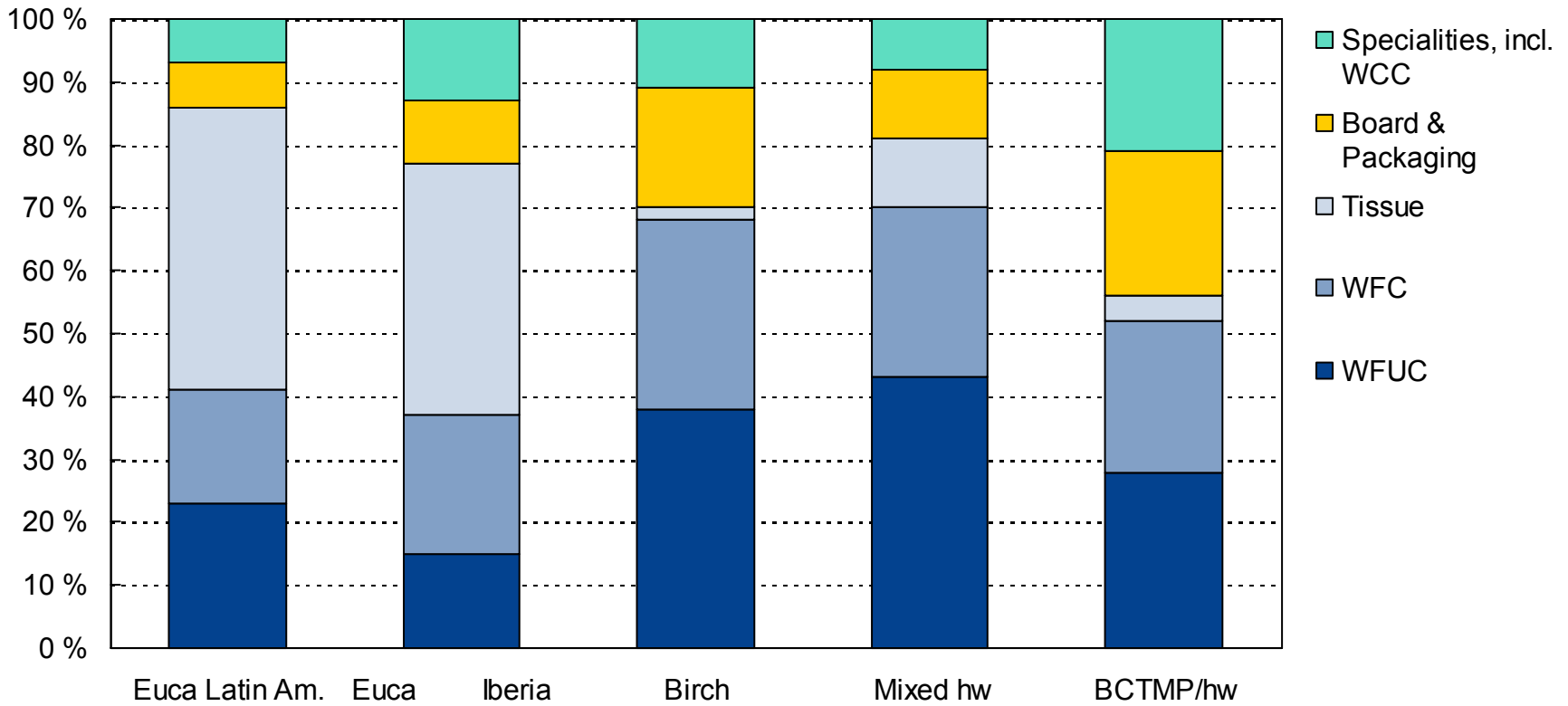
Procter & Gamble



*)Including captive kraft pulp





Typical end uses for market hardwood pulps

End uses vary between hardwood pulps, even between euca pulps from different sources. The use of Latin American BEKP is especially concentrated in tissue.



Opportunities for Latin American tissue producers in growth and right quality/product strategy

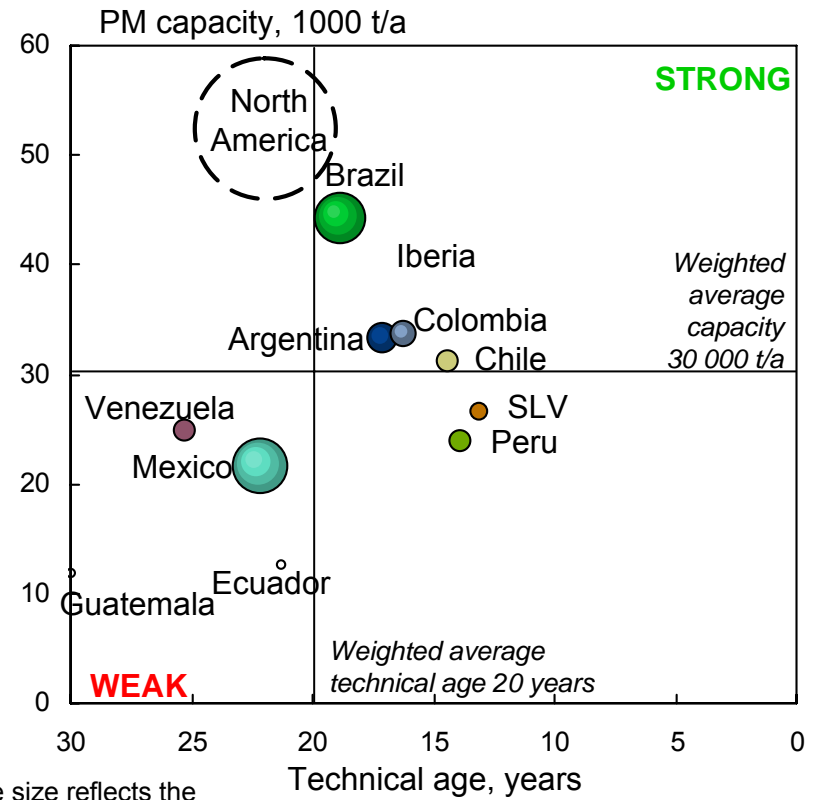
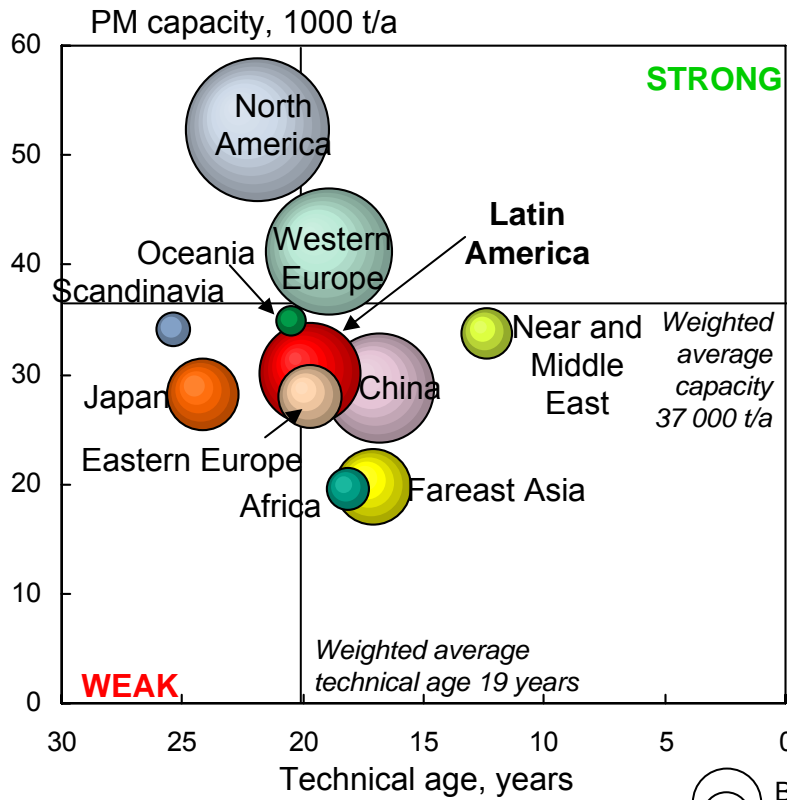
- Margin creation potential increases through right product and quality positioning and strategy. Integrated converting, premium quality and brand products have less exposure to raw material fluctuations, when fiber forms a lesser share of the end product price. Market structures, however, should guide the quality strategy most.
- Not all tissue end uses have equal growth expectations, but there are pockets of opportunities for those who focus on the right end-use products and niches. Especially in mature markets new and differentiated products, growing popularity of premium products and different packaging variations increase the demand.
- In emerging markets strong economic growth has still the strongest impact
- Towels are expected to have a stronger than average outlook also in Latin America, but from a fairly small base
- There are towels for specific end uses both in AH and AfH segment that boost consumption in mature markets. In emerging markets just penetration of the category increases usage. Kitchen towels spread out from kitchen also in AH; in the North American markets the Kleenex Hand Towels are increasing paper towel usage in bathrooms.
- Toilet still offers by far the highest volume opportunity as the penetration of other products is still low.

Mature markets		Emerging markets	
	<ul style="list-style-type: none"> • Rising standards of living • Changing buying habits → larger package sizes increasing the volumes → growing popularity of premium-quality/multi-ply products • Development of new products • Increasing tourism and eating out 	<ul style="list-style-type: none"> • Population growth • Strong economic growth • Rising disposable incomes and standards of living • Fast urbanisation • General westernisation → e.g. fast food restaurants • Increasing tourism and eating out • Rising hygienic standards • Development of retail trade • Increased availability of tissue products • Dynamic growth in Away-from-Home segment 	
	<ul style="list-style-type: none"> • Ageing population • Stagnating population growth • Cost-cutting in business and government spending • Competing products (e.g. non-woven) 	<ul style="list-style-type: none"> • Cultural patterns limiting the growth in some emerging regions • Competing products (e.g. non-woven) 	

High quality local equipment suppliers boost tissue producers in Latin America

- Technical improvements and investments can also be a way to reduce costs and improve margin potential and new advantageous technology can boost the profitability of tissue producers. Latin American high quality equipment suppliers offer excellent support for the local tissue suppliers.
- Currently the modernity of Latin American tissue producers is globally on average level. Machines have as an average a capacity somewhat below the global average.
- All cost savings potential in operations should be utilized. The performance should meet the potential of the assets. Improvements in consumption figures and efficiencies impact directly the bottom line and thus increase the margin potential.
- Organic and inorganic company growth boost the margins; large units and companies have better possibilities to benefit from scale economies in production, converting and logistics.
- A more consolidated industry has also higher market power against the strong retailers that may squeeze weak for them less important suppliers with costly requirements and price pressure.

Tissue – industry structure by country 2010/III



○ Bubble size reflects the allocated grade capacity

- Tissue market is globally growing, even through regression years.
- Tissue offers higher and more stable margins than many other paper grades
- Presence of North American companies and partly similar market fundamentals increase opportunities in Latin America
- The industry concentration level in Latin America is higher than for instance in Europe
- Pulp prices have a significant impact on tissue margins
- There is plenty of potential to impact the margins throughout the value chain
- Latin American BEKP is suitable and especially fine tuned for tissue end use
- Latin American tissue producers should benefit of the growth and right quality/product strategy
- High quality local equipment suppliers boost tissue producers in Latin America

Finally – Questions to think about?

- Does your company understand the opportunities and challenges an increasing tissue demand offers?
- What proprietary know-how or assets does your company have or could develop to grow in tissue business?
- What critical choices are needed in the next few years to secure targeted position?
- How to ensure capturing the value throughout the value chain?

THANK YOU!



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