

WHERE'S OUR SUMMER VACATION?



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Summer used to be the doldrums for news—including business news. Not much newsworthy used to happen in summer, with September seeing a noticeable pickup in news volume. Not anymore. The volume of news in the summer seems about the same or more than non-summer months as business becomes more of a non-stop, year round activity. Our global economy apparently pauses, well, never.

BLOCKBUSTER RESTRUCTURING

In the paper industry, International Paper chose the summer to announce an enormous restructuring that will see it shrink by about 30%, based on current sales volumes. According to IP, the three-part transformation plan will improve returns, strengthen the balance sheet and return cash to shareowners. The plan will narrow the company's portfolio to two key platforms: "improving shareowner returns through mill realignments in those businesses and additional cost improvements; and exploring options to sell or spin-off other businesses," said IP. The company's intention is to exit the coated paper business to focus on its core uncoated business (packaging, uncoated printing and publication papers such as copy paper).

IP wants to get smaller to get better. Hmmn. Doesn't it seem like only yesterday when everyone was saying consolidation was the name of the game, and that the salvation of the paper industry was going to be bigger and bigger players? I guess IP is rewriting this to mean getting bigger in a smaller number of markets in the paper industry. Like Georgia-Pacific a couple of years ago, IP wants to refocus on selected—presumably more profitable—areas of the paper industry. In other words, since plan A didn't work, let's go to plan B.

Of course if International Paper successfully carries out its plan, it will likely give up its title as the single largest forest products company in the world. IP has decided that higher profitability is more important than high sales volume, and who can blame them? Paper companies have been talking about improving profits for almost two decades now and have little to show for it. Despite a seemingly steady economic recovery in the United States, pricing is slipping and paper company stocks—at least in North America—are sagging. As analyst Mark Wilde said, "July 4th has passed and we're still looking for the picnic."

As we all know, the overall economy does not accurately measure the health of individual industries. I'm not

sure how much of the current economic recovery is made up of builders and homeowners cashing in on the epic increase in home values and oil companies reaping truly astonishing sales and profits from skyrocketing oil prices, but it has to be substantial. Meanwhile, the North American paper industry trails behind, trying to figure out how to make money in a nearly static market for paper products.

So IP will be selling its supercalender, coated papers and kraft papers business, beverage cartons, its Arizona Chemical and Carter Holt Harvey subsidiaries, and nearly all of its forest products business (sawmills and timberlands). Sales proceeds are estimated to be US\$ 8 billion to US\$ 10 billion, with the businesses to be sold representing sales volume of about US \$6.9 billion—27% of IP's 2004 sales of US\$ 25.5 billion. About 40%-50% of the proceeds will go toward debt reduction, another 20%-25% will go to shareholders, and the remaining 20% to 25% will be invested in the uncoated paper and packaging businesses. IP will also close certain facilities and convert others to lower its unit costs and support costs to save US\$ 400 million annually.

Fitch Ratings noted that the businesses on the selling block generated an annual operating profit of more than US\$900 million by company calculations. According to Fitch, "The challenge for IP will be to replicate these operating margins in the uncoated papers and packaging markets. Part of that challenge comes from the high returns that will be jettisoned with IP's substantial timberland operations, which have been a significant earnings contributor and which will account for a majority of business sales proceeds. The risk in the transformation strategy is that with the new capital structure, cost savings fail to sustainably improve margins and create a sufficiently large earnings stream."

STATUS QUO? NO!

For the world's largest forest company to make changes of this magnitude shows that the status quo in the paper industry is simply not good enough. The new Chairman and CEO of IP, John Faraci, wants to shake things up in order to find a better business model. Whether that model will work or not remains to be seen, but it certainly won't be the last epic change undertaken by paper companies large and small as they try to find their way in the brave new world of papermaking. **S!**