SOUTH AFRICA

AN OVERVIEW OF THE SOUTH AFRICAN PULP AND PAPER INDUSTRY

JANE MOLONY

SOUTH AFRICA'S EMERGENCE FROM post-apartheid isolation has not affected the pulp and paper industry as adversely as other local industries (e.g., the shoe and textile industry) This is because tariff and trade protectionism has been lower than in other industries and investment in technology has kept pace with world standards. This, combined with a severely weakened rand, has helped keep the country's two main pulp and paper producers (Sappi and Mondi) globally competitive since South Africa's re-entry into world markets.



SOUTH AFRICA'S PULP AND PAPER MAKERS HAVE BECOME MAJOR WORLD PLAYERS

Viewed historically, South Africa has grown from a net importer of board and paper in 1970 to a major exporter in 1997. According to 1997 figures it is the 12th largest producer of pulp in the world and the 24th largest in paper and board.

Of the total capital invested in South Africa's forest products industry (US$ 3.3 billion) 80% was accounted for by the pulp and paper industry. While the world production of paper and board has grown by an average of 3% per annum since 1970, the South African industry achieved an average growth rate of 5.2% per annum. It nevertheless suffers from the same problems as the rest of the world as far as releasing inherent value to shareholders. Sappi is listed on the Johannesburg (primary listing) London and New York stock exchanges and Mondi's parent company, Anglo, will move its primary listing to London during the first quarter of this year.

CURRENT DOMESTIC MARKETS

Markets have softened on the domestic front and as a result more uncoated woodfree paper has been exported than normal. In fact during 1998 local demand for scholastic papers was 75% lower than anticipated. This is largely due to non-delivery on educational spending by government. With projected demand for office papers a factor of GDP and the projected growth rate of 3.5% having stagnated during the last two quarters of 1998 to 0.5% or lower the local market is somewhat flat. A cynic close to the market commented, "When the government wants more votes they'll start printing text books again." The truth is that macroeconomics and politics do affect paper demand. And, South Africa is due to have its second democratic elections in 1999.

Other problems plaguing the local market include dumping. Where competition is free and fair, local manufacturers have no quarrel. But, where disreputable importers bring paper in using incorrect tariff codes, they facilitate dumping. In 1998 anti-dumping petitions have been upheld by the board of tariffs and trade against companies in Sweden, Brazil, Poland and Indonesia. Ultimately, both the end user (printers) and manufactures are the losers as depressed local prices mean unprofitable companies and shareholders lose interest in investing in the local market. Companies go out of business, and as surpluses dry up, the "dumpers" simply leave customers in the lurch.

MAIN PLAYERS IN THE PAPER INDUSTRY

Mondi

With limited scope for expansion existing at home it was natural that Sappi and Mondi embark on an acquisition trail. However, their *modi operandi* are very different.

Mondi, the smaller of the two (ranked 67th in PPI's recent top 150 world producers of paper and board – up from 68th the year before) has diversified in order to avoid exposure to the roller coaster of persistently volatile prices in the pulp and paper industry. It has achieved vertical integration at home with the purchase of Paperlink, a paper marketing company, and Consol, a local packaging group. Mondi also owns the largest waste-paper collection and recycling operation in South Africa, operates 12 sawmills, owns an interest in PGBison Ltd., producer and distributor of chipboard products, and recently increased its stake in Finewright Holdings, a South African producer and distributor of wood veneers.

Mondi's international investments are all joint ventures and speak of a cautious operator. Probably its most important purchase was 11.8% of Aracruz, in Brazil, the worlds largest and lowest cost producer of bleached eucalyptus pulp. Mondi also holds 50% of Aylesford Newsprint in the UK, (Sweden's SCA holds the other 50%). During 1997, they increased their European interests by investing US$ 200 million in Eastern Europe, acquiring control of Swiecie, Poland's largest paper and packaging company; Dunaujavros the Hungarian pulp producer; and a 19% stake in Syktyvkar in Russia. This was done through Anglo's international subsidiary Mondi Minorco Paper (MMP). Other interests include MMP's ownership of 49% of Neusiedler (the Austrian fine paper specialists) and 50% of Frantschach, which in turn owns the other 51% of Neusiedler.

Anglo recently announced that it will merge with its offshore company Minorco and create Anglo American plc, with a primary listing in London. Mondi and Mondi Minorco's holdings will fall under the forest products unit which Mondi's chairman Tony Traher says will have a turnover of US$ 2 billion a year and an operating profit of US$ 200 million. Access to cheaper capital, unlocking shareholder value and less exposure to emerging market currency and political risk are cited as some of the reasons for the restructuring.

At present, Mondi is wholly owned by AMIC, a subsidiary of Anglo while MMP is owned 29% by Mondi, 20% by Anglo, and 60% by Minorco. MMP had an excellent first half with operating earnings increasing 52% from US$ 44 million to US$ 67 million. When AMIC published its interim report and notice of dividend for the six months ending June 30, 1998. Mondi contributed 31.1 % towards these earnings.



One of Mondi's mills in South Africa.

Further news from Mondi is that the Mondi board has approved an investment of US$ 100 million at its pulp and paper mill in Richards Bay. Work on the project started in the second half of last year. The project will increase pulp capacity by 60,000 tons per annum and includes the rebuild of its PM2 linerboard machine which produces high quality packaging papers for the domestic and export markets.

Sappi

Sappi is the larger of the two groups and is ranked 21 in the recent PPI survey of the top 150 pulp and paper manufacturers. Sappi's acquisition trail has left it with a high gearing ratio and its focus has been to dominate the market for coated papers rather than diversify. Their most recent acquisition, KNP Leykam, makes them the largest player in the coated wood free paper market. Eugene Van As, Sappi's Executive Chairman, described the purchase of KNP as "the last piece in the jigsaw of Sappi's plans to become a global business by 2000." The US$ 746 million acquisition effected a year ago last October, following Sappi's US$ 1.4 billion purchase of SD Warren. Other companies purchased to form part of the Sappi group include Hannover Papier, Schwabische Zellstoff and Star Paper.

Globalization strategies have been further implemented with the restructuring of operations and the strong branding of the trade name Sappi. Van As described the structural changes and new identity launched during 1998 as follows: "Sappi will, in future, trade as two tightly focused operations, as Sappi Fine Paper, with a head office in London and with regional offices in America, Europe and South Africa, and as Sappi Forest Products, with a head office in Johannesburg. In southern Africa, Sappi Kraft, Sappi Fibres and Logistics, Sappi Timber Industries, Sappi Saiccor and the Usuthu Pulp Company, as divisions of Sappi Forest Products, will share our common identity...Sappi."



As a group Sappi has a production capacity of over 4.89 million tons of paper and 3.05 million tons of pulp. Fine paper contributes 80%, and pulp 9%, to the annual turnover. According to Sappi, market share in woodfree coated papers is 26% in the United States, 22% in Europe, and 60% in Africa. Sappi Saiccor, situated down the coast from Durban, in Umkomaas, is the world's largest producer of dissolving pulp, meeting 15% of world demand. At the beginning of 1999 construction of a lignosulphonate plant at Saiccor was completed. This is a joint venture with Norwegian chemical multinational Borregaard Industries Ltd. and it is expected to earn South Africa approximately US$ 19 million a year in foreign exchange.

SAWMILLS, CHIPPING, ETC

The second largest sector in South Africa's forest product industry is the sawmilling industry. With capital investment in the sector estimated at US$ 720 million, the in-

Forests, conservation and plantations

South Africa is a country populated with a people rich in cultural diversity living their lives out in circumstances as diverse and extreme as the nature of our climate, flora and fauna. This climatic variety extends from the Mediterranean climate in the Western Cape with its winter rainfall, to the rolling midlands of KwaZulu-Natal and the dry bushveld of the Far Northern province. Natural forests in this generally arid county are few and far between forming a total of 350,000 hectares out of a total land area of over 1.2 million km^2. In spite of that, or perhaps because of it, South Africa implemented conservation laws as early as 1888, well over a 100 years ago.

CONTROVERSIAL LEGISLATION?

These laws are currently being challenged by the dilemma created by squatters in the Dukuduku forest in KwaZulu-Natal. The problem is largely political. Jabu Mjawara, director of conservation forestry in the Department for Forestry and Water affairs has gone on record as saying, "without political will, we cannot solve this problem as conservators." Kadar Asmal, minister of forestry and water affairs, has signed an agreement with the provincial environmental minister which ensures that all squatters will be moved out of the forests. This is a huge step forward. The new National Forests Bill became law at the end of 1998. This bill gives the minister enormous powers, allowing for jail sentences for those who destroy or cut down specially protected trees and for the minister to withdraw the delegated management of any forest if it is not protected adequately by provincial authorities.

It would seem that some of the powers that the minister receives with the new bill do not sit that well with industry. John Barton, deputy managing director of Mondi Ltd. and general manager of Mondi Paper said in his key note address at the 1998 TAPPSA pulp and paper conference, that the proliferation of new legislation is posing a "unique challenge for the South African industry and could have a negative effect on the rate our industry develops." He also said of the National Forest Bill that "the introduction of the so-called 'rain levy' will be complicated and probably unenforceable." The levy is designed to tax foresters on the difference between actual runoff from plantations and that from ordinary grassland.

Further recent legislation that may adversely affect the countries thriving forest and forest product industry is a water bill. According to opposition parties, the bill has been "frog marched" through parliament and will almost certainly be challenged by organized agriculture in the constitutional court. Sentiments behind the law are that water should belong to all and that existing landowners ought to view the removal of riparian rights currently enjoyed in this light. However, most players will object to having to pay for something which was previously a right. Implementation of the bill will probably take as long as 8 years, so effects will be felt in the longer term.

CONSERVATION AND WATER USE

Almost 30% of forestland owned by the two largest forestry landowners in South Africa, Sappi and Mondi, is managed for conservation. Land use includes propagation of rare plants and recreation, including eco-tourism. Forests are managed intensively and to reduce effects on water flow planting is restricted to 30 meters from rivers and 50 meters from wetlands.

South African paper mills are also efficient users of water, recycling it up to 7 times and aiming at 10 times. It must also be remembered that the oxygen bleaching process was developed in South Africa more than 30 years ago and that in 1970 the first commercial Sapoxyl reactor was built at Sappi's Enstra mill. The development of the oxygen bleaching process benefited mills worldwide and the production of ECF (elemental chlorine free) pulp helped solve mills effluent problems as well as reducing the amount of water required. South Africa's main source of fiber is its plantations.

dustry accounts for 22% of the country's roundwood intake. A market decrease in the demand for mining timber due to a decrease in gold mining activity has had a positive effect on the wood chip industry.

Hardwood (eucalypts and wattle) have been diverted into this market. Two chipping plants in Richards Bay, one owned by Mondi and the other by Central Timber Co-Operative Ltd (CTC) process a combined total of more than 2 million tons of hardwood a year. All of this is exported, generating in excess of US$ 120 million a year. The quality of wood chips is extremely good and consequently world demand for this local product is high. CTC exports 100% of its production to Nippon Paper, the 5.4 million-tons-a-year Japanese papermaker. Current production at CTC is 4100 tons a day. A large portion of Mondi-owned SilvaCel's 850,000 tons of exported chips are also sent to Japan. South Africa is Japan's fourth largest supplier of wood chips.

Commercial plantations play a vital role in South Africa's economy. Commercial plantations are grown on 1.5 million hectares and account for 1.2% of South Africa's total land area. A variety of species are grown primarily in the Eastern and Southern regions. These include the Pinus species (53% of the area), Eucalyptus species 39% (primarily Eucalyptus grandis), wattle 7% and other hardwoods 1%. An average of 80,000 hectares are harvested annually with 90,000 hectares being planted annually (i.e. 10,000 hectares of new afforestation and 80,000 of replantings) This gives an indication of future resource sustainability.

The industry has a distinct advantage over northern hemisphere countries in terms of its production potential. Plantations are managed intensively to take advantage of ideal climactic conditions. In certain parts of the country growth rates are exceptional, and in Zululand, eucalyptus trees grown for pulpwood can mature in 6 years and achieve growth rates of 40 to 50 m^3 per year per hectare. Although South African plantations constitute less than 0.1% of the world's afforested area, they produce 0.5% of the world's roundwood production. This indicates that they are five times more productive than the average forest worldwide.

Although there are 1,800 registered tree growers the three largest companies own 60% of forestry (Mondi 26%, Sappi 17% and SAFCOL 17%) while private farmers and small companies own a further 27% and the State 13%. However, approximately 11,000 small emergent black farmers who grow trees on a micro-scale with plots averaging less than one hectare in size are not included in the above statistics. With forestry controlled by a permit system and water resources being limited, future expansion will look more to these emergent farmers for future fiber supply.

At the beginning of 1998 British-sponsored community afforestation projects were launched in the Eastern Cape. The chief director of forestry was quoted as saying, "We want to develop a pilot project in the Eastern Cape that would be a pilot for the whole country and would consist of extending existing woodlots and new afforestation." In keeping with this trend, Sappi recently announced the opening of its Tiphilise Project in Swaziland. The program encourages local Swazis to plant pine trees in order to supply Sappi Usuthu Pulp. Usuthu, which is the lowest cost producer of unbleached softwood kraft pulp in the world, supplies 12% of the world market.

The forest industry is labor intensive, with direct jobs amounting to around 73,936 (excluding small growers) and employment in process plants providing approximately a further 60,000 jobs, according to the Forest Owners Association. The paper industry provides 13,000 jobs, and when the job multiplier is taken into account and overall dependants are looked at, a grand total of more than 2 million people are supported by the integrated forest and forest products industry. So it is clearly an extremely important part of the South African economy.

ROOM FOR EXPANSION?

Although demand for forest products is set to double in the next 25 years, the area under forestry will manage to increase production over the same period, from 19 million m^3 to 30 million m^3, according to Roger Godsmark of the Forest Owners Association. He goes on to say, "Most of the optimum areas for forestry development have already been planted (with the exception of the Eastern Cape region) It is therefore likely that the industry would only be able to expand by 300,000 to 400,000 hectares over the next two decades or so. However, considerable sums of money are being invested in research by the industry to try and improve the yields attainable from the industry's existing plantations."

It is also possible that expansion of forestry will go ahead in neighboring states, but so far, efforts by both Mondi and Sappi have been fraught with difficulty. While forestry forms the basis of the paper industry's fiber needs (72% of furnish used) other sources include 23% reclaimed paper and 5% bagasse (sugar cane waste).

– Jane Molony



Inside one of Sappi's mills

Other sectors in the forest products industry include the panel products, pole treating, match and charcoal industries. Combined sales from these sectors totaled US$ 188 million during 1997. Of these sectors the one with the most potential for growth is the panel board industry with growth in demand for MDF products set to increase.

TISSUE

During 1998 the local tissue market was 15%-20% over supplied. Production was about 160,000 tons a year and consumption per capita around 3.8 kg. This compared with a world average in 1996 of 3 kg/capita and at the other end of the scale the average U.S. citizen consumes more than 21 kg/year of tissue products.

Nampak (predominantly a packaging company) and Kimberly-Clark are the industry's main players. During 1998 a number of interesting developments took place. The probable combined market share of smaller independent companies had grown to as much as 43% with Nampak and Kimberly-Clark having the balance. (Sappi Stanger also produces a bagasse-based product, but sells it to other players who then market it under their own brands). However, the market was very competitive and few companies were making money.

At the end of 1998 Nampak announced that it had acquired the tissue wadding and tissue products businesses of Swazi Paper Mills Ltd., National Tissue (Pty) Ltd., and Paarl Paper Mills Ltd. It is also in the process of creating a totally new entity to which both Nampak and Dynamo investments will sell their tissue interests, creating a new company. Changes to date have involved closing the Paarl mill and some of the machines at Swazi Paper. It is estimated that the national tissue production will now be around 150,000 metric tons/year.

Generally speaking, the tissue market in South Africa is a fiercely price conscious commodity market. An informal retail trade selling toilet rolls at traffic lights has seen an increase in attempts to regulate the market. SABS standards, as listed in South Africa's Trade Metrology Act, are very specific as to sheet count, minimum length, width, etc., for the various plys of toilet tissue. However, even more legislation is on the cards to close loopholes in existing legislation. Illegal short sheet counts are common and the industry is difficult to police.

On a more positive note, both Nampak and Kimberly-Clark have shown faith in the country's future with multi-million rand investments to increase capacity and improve quality being implemented by both companies during 1997. Nampak's restructuring should also have a stabilizing effect on the industry.

CONCLUSION

Although South Africa has had difficulty realizing the economic growth projected when launching its macro economic strategy in 1996, it had nevertheless achieved a reasonable growth of 2%-3% in GDP up until the recent global crisis experienced in emerging markets. The rand has since firmed and the specter of further increases in interest rates is receding. In spite of the fact that South Africa has just experienced two quarters of negative growth officially placing the country in a recession, most players, including Sappi's van As, feel market conditions will improve during the second half of the year. The economy will hopefully hit an even keel and local demand for paper and related products will improve. The country's social fabric has changed and as literacy rates improve and a new middle class emerges with greater buying power, South Africa's per capita consumption of paper must increase. Currently it is only 49 kg, compared with other countries where individual annual rates range between 190 kg and 230 kg per capita. This means that the potential for growth is enormous and that the future for the South African Forest and Forest Product industry looks promising. **TJ**

Molony is editor of TAPPSA's journal.