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Out of the woods?

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From pulp producers to tissue manufacturers, all of the high performers in this industry are focused specialists with a close connection to their customers.

The forest products industry is taking a beating. Chronic overcapacity, mounting price volatility and slackening growth in core products like newsprint have put a drain on the sector's strength. As companies have struggled to be profitable, shareholder returns have lagged well behind those in the broader equity markets. In fact, in the past decade, only about a quarter of the forest products companies in Accenture's research group have managed to generate returns greater than their cost of capital.

At the same time, this cyclical, capital-intensive industry is experiencing a dramatic shift in its sources of competitive advantage—a shift that can only intensify in a multi-polar world, where rapidly emerging economies are playing an increasingly important role in shaping industry dynamics.

More than two-thirds of the sector's profitable companies are based not in the industry's traditional heartlands of Europe and North America but in emerging markets. Southern Hemisphere eucalyptus tends to grow much faster than the short-fiber hardwood species native to northern climates, giving upstream pulp producers in countries like Brazil a considerable advantage.

In fact, three of the four upstream companies to emerge from Accenture's research (see sidebar, page 3) as high-performance forest products businesses hail from South America.

Market focus and position

But geographic advantage is only part of what it means to be a high performer in forest products. Two other high-performance businesses are from developed markets and are leaders in personal and specialty paper products—downstream players that have leveraged their proximity to the consumer to develop a keen understanding of strategic advantage. That understanding, which their upstream counterparts share, is the core of market focus and position—the most important of the three building blocks of high performance in this industry. And the keys to its mastery are specialization and differentiation.

For the four upstream high performers, that plainly means specializing in pulp. For the two downstream players, it means specializing in personal paper products like bath tissues, paper towels and napkins, which is the sector's most consistent growth segment. Manufacturers that focus solely on undifferentiated products like general copy paper or packaging materials are conspicuously absent from the list of high performers.

All the high performers are well ahead of an ongoing industry trend away from trying to be all things to all customers and toward long-term, value-driving focus. Deals like Domtar Corp.'s 2007 purchase of Weyerhaeuser's fine paper interests exemplify this development. Both companies moved to a more focused market position, with Domtar assuming leadership in white paper and Weyerhaeuser continuing its shift away from commodity grades.

The trend, moreover, is set to gather steam as outside capital and private equity enter the sector. Take privately held outsiders like Texas Pacific Group (now TPG), which bought US-based Smurfit-Stone's Consumer Packaging Division (now Altivity Packaging) in 2006, and CMP Holdings (an affiliate of Apollo Management), which bought International Paper's coated paper business (now Verso Paper Holdings), also in 2006. They expect to generate value over a three- to five-year time frame by improving operational performance and through strategic and operational initiatives that focus on differentiated product offerings and organizational capabilities.

The high performers have recognized that successful portfolio management is about actively shaping the future to ensure balanced growth; it is not about shrinking the business, as many companies are now doing in the aftermath of the ill-considered buying binge of the 1990s, when some multinationals acquired assets whose subsequent sale destroyed considerable shareholder value.

The high performers, by contrast, actually shed more assets than they acquired in that period. Instead, they have used a mix of organic growth strategies and capital expansions, product diversification and innovation to carefully evaluate market dynamics and strategic advantage.

Meanwhile, their acquisitions, while rationalizing capacity when necessary, are designed to increase market share or influence through segment focus. Georgia-Pacific, for example, having sold a portion of its pulp and paper assets (to Domtar) back in 2001 and its building products distribution business three years later, has steadily acquired important tissue-making assets that position the company as a leader in the segment.

High performers don't hesitate to enter new areas—even when their current businesses are doing well. Chile's Empresas CMPC, for example, though still thriving as a paper business, has dramatically increased its investments in pulp production. The company's proximity to the Pacific Coast has enabled it to launch a bid to become a leading pulp supplier to the burgeoning Asian market.

Sweden's Svenska Cellulosa Aktiebolaget (SCA), meanwhile, which makes

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About the research

We selected publicly listed forest products companies with annual revenues in excess of $1 billion and with a focus on at least one of the major industry segments—lumber, pulp, paper or packaging. This gave us a peer group of 57 companies.

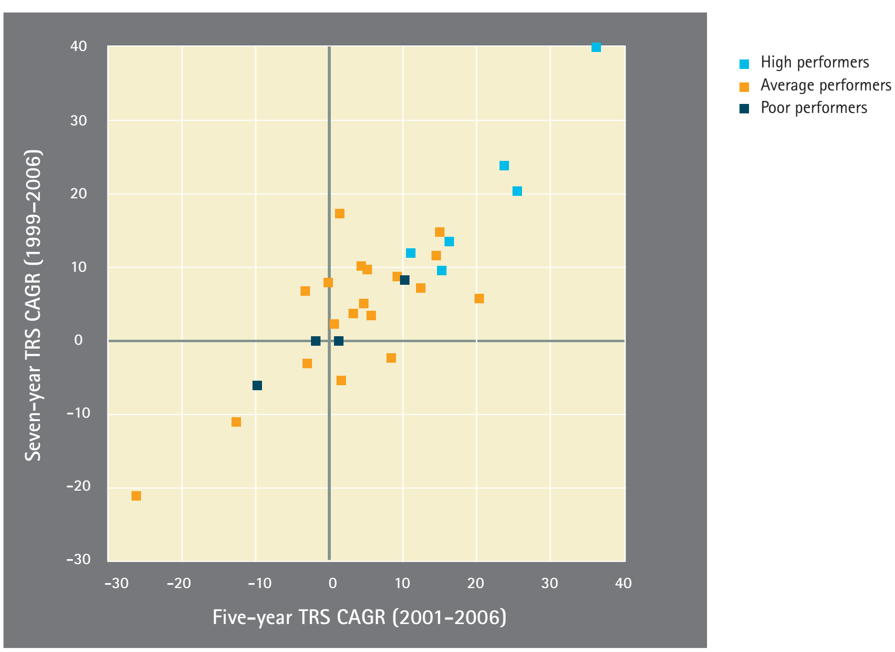
We then applied Accenture's proprietary, five-dimension High Performance Business methodology to determine which of these companies had outperformed their industry peers over economic and business cycles, as well as over changes of leadership.

The six companies that emerged as high performers—four upstream pulp producers and two downstream personal and specialty paper makers (the lumber companies could not compete on profitability or future value)—all generated higher, more consistent free cash flow than their peers. All, moreover, had significantly higher margins, thanks largely to a strategy of active portfolio management that emphasizes operational excellence and innovation (see story).

Our research also revealed that higher ROIC is considerably more important than revenue growth in achieving high performance in this capital-intensive industry—especially for upstream pulp producers. Thanks to a business model that puts them much closer to the consumer, downstream personal and specialty paper producers enjoy a much higher spread.

Total return to shareholders is merely one aspect of high performance. Profitability and future value are key characteristics for companies in forest products. A company's business practices will also tell the story of its commitment to achieving and maintaining high performance.

Seven-year TRS versus five-year TRS



Source: Accenture analysis

Georgia-Pacific: Focusing on customers' interests

Founded as a wholesaler of hardwood lumber back in 1927 and now one of the world's leading tissue products manufacturers—its brands include Angel Soft toilet tissue, Brawny paper towels, and Dixie disposable cups and plates—Atlanta-based Georgia-Pacific exemplifies the differentiated customer-centricity that so distinguishes high performers in forest products (see story). Its Innovation Institute ensures that focus is sustained.

By creating an environment that simulates real-life retailing and packaging situations, and the collaborative brainstorming that can facilitate problem solving, the institute has helped Georgia-Pacific customers meet challenges ranging from how to reduce supply chain costs to how to increase shelf turnover. With sustainability increasingly at the forefront of customer concerns, the institute responded yet again—this time with a Web-based tool that helps its customers estimate what effect particular scenarios will have on sustainability, taking into consideration the costs.

The Packaging Systems Optimization (PSO) microsite provides a rigorous, five-step process in which a team of packaging experts and engineers uses the PSO Calculator to analyze a customer's entire packaging supply chain, from package design and shelf impact to line productivity, material handling and distribution. It then delivers a detailed report outlining potential areas of improvement in costs, profitability and sustainability.

Georgia-Pacific attributes the more than $180 million in annual savings for its customers over the past five years to its PSO program, which focuses on cutting energy consumption and emissions from shipments.

(Continued from page 2)

Tempo, one of Europe's best-selling tissue brands, has responded to flattening growth in developed markets by more than doubling its sales to emerging markets in the past decade through investments in Asian, Australian and Latin American subsidiaries. And Portugal's Portucel Soporcel Group, a producer of low-cost, high-quality pulp, has esponded to similar changes in its sources of competitive advantage by moving to become Europe's leading manufacturer of especially high-quality grades of premium office paper—grades that carry watermarks and letterhead.

Customer-centricity is critical to the market focus and positioning of high performers in forest products. Brazilian pulp producer Aracruz Celulose has teamed with customers, including large international tissue makers like Kimberly-Clark, to develop long-term commercial relationships that give them a stable product supply while helping Aracruz manage its cost structure more efficiently. US-dollar-denominated sales protect Aracruz from mismatches between the currency of its debt and the currency of its revenues. This also helps reduce the company's exposure to volatile ocean freight costs.

Winning companies excel, moreover, at turning the insight gained from customer focus into differentiating action. They commercialize new ideas, markets and channels more swiftly than their competitors because they integrate business intelligence into their planning cycles and short-term decision making, aligning their assets and resources to maximize value potential.

Consider, for example, how Votorantim Celulose e Papel (VCP), another Brazilian pulp and paper producer, uses the insight gained from monitoring customers' buying preferences, usage and cost-to-serve factors to

Aracruz: A paradigm for procurement

As the world's largest producer of cellulose derived from fast-growing eucalyptus, Brazil's Aracruz Celulose benefits from the natural advantages that accrue to Southern Hemisphere pulp producers. But the company's customized e-procurement system is just as significant a factor in its success.

The Aracruz system was derived from one used by Sistema Usiminas, the Brazilian steel producer, which had cut its paper, mail and fax costs by 70 percent in just three years, and was implemented in partnership with one of Latin America's leading software organizations. Aracruz's system broke new ground when it was launched in 2003. Not only did it automate the purchasing process, but it also allowed the company to automatically select suppliers with the best prices and conditions.

segment them according to profitability and growth potential—then leverages this insight to provide high-value customers with targeted service offerings. The company's printing industry customers, for example, enjoy the benefits of a direct B2B channel. At the other end of the industry value chain, Georgia-Pacific has launched a Packaging Systems Optimization microsite to help its customers reduce total packaging costs (see sidebar, page 4).

Distinctive capabilities

Distinctive capabilities in the forest products industry support the active portfolio management that distinguishes the sector's high performers. They all, for example, boast world-class operational management.

Using centralized, integrated databases to provide accurate real-time information and share knowledge across the organization, these companies tend to eschew excessive analysis in favor of implementing business intelligence solutions that shorten decision-making cycle times and facilitate timely action. They employ standardized and consistent business processes that enable them to scale quickly, expand and integrate new entities smoothly and systematically, and disseminate clear and consistent processes across their product portfolio. They also continually enhance their supply chain, eliminating waste and fine-tuning procurement, planning and transportation. Brazil's Aracruz has a customized e-procurement system that is setting industry standards (see sidebar, above). And Georgia-Pacific has outsourced its finance and accounting functions.

Financial flexibility is the second distinctive capability common to high performers in this capital-intensive industry—and the strong, free cash flow that is its hallmark allows these companies to plan for the future without jeopardizing current performance. Brazil's VCP, for example, uses its cash flow to sustain a bold long-term growth strategy that calls for tripling its pulp-making capacity in the next five years. And Aracruz has played the capital markets especially astutely, issuing long-term bonds to extend its debt profile and grow without compromising its balance sheet.

Performance anatomy

High-performance businesses are outstanding at embracing and managing change, largely because they foster organizations and cultures that facilitate innovation. Leading forest products companies display exactly this organizational mindset—a key component of performance anatomy—

SCA: Training for leadership

Svenska Cellulosa Aktiebolaget is one of Sweden's most popular employers. But it is the company's leadership development program that helps explain why SCA is such a successful innovator.

The Leadership Academy was launched in 2004 in an effort to ensure that SCA would have the talent to meet all its current and future needs. Senior members of SCA management, including the presidents of all of the company's business groups, were involved in designing the program, helping to identify objectives that would ensure continuous improvement across the organization. At the academy, employees get coaching on their personal and professional development, while learning how to enhance their influence and improve group dynamics.

The academy supports the mobility of managers between business groups by creating a common base of core leadership skills. It also builds internal networks of developing and potential leaders across those business groups. Although most of the academy's programs are delivered in Europe, it is being steadily expanded—as are the rest of SCA's recruitment and training programs—in an effort to improve talent management.

especially in regard to investing in their people. Their management teams support measured risk taking and provide employees with clear objectives, a comprehensive review process and accountability for results.

As a group, the high performers have paid considerable attention to sales force compensation. Many have reassessed the balance of their fixed and variable compensation structures and corresponding performance metrics, marrying volume and profitability incentives, for example. Some have made organizational changes to more closely align their human-capital management with company needs and strategy. Sweden's SCA is well known for training programs that not only focus on traditional business concepts but also emphasize leadership skills (see sidebar, above).

The future will not be easy for the high performers in forest products. Private-equity firms and other outside interests will intensify the competition by accelerating the pace of change, while the industry as a whole will grapple with the dramatically altered economic and business dynamics of a multi-polar world. Distinctive capabilities like operational excellence will become a prerequisite for survival. The high performers of the future will be those companies that can best manage their portfolios, constantly aligning, adjusting and innovating to meet their particular customers' needs.

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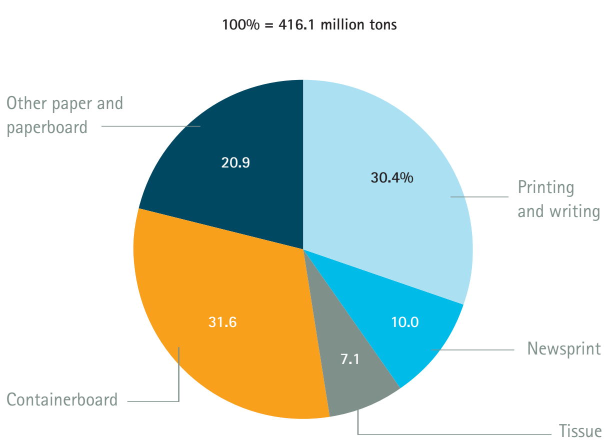
By the numbers

Paper trail

Over the next five years, there will be a major shift in the forest products industry, as production moves from the United States and Europe to low-cost producers in Latin America, Eastern Europe and Asia.

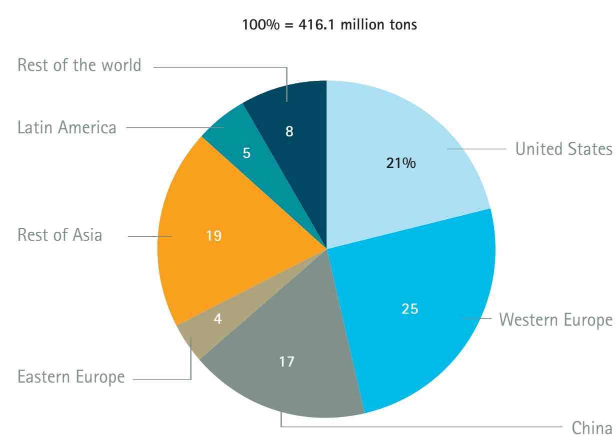
Containerboard is the largest segment (32 percent) of the 416 million-ton paper and board industry, followed by printing and writing papers (30 percent).

2006 global paper and board capacity, by type



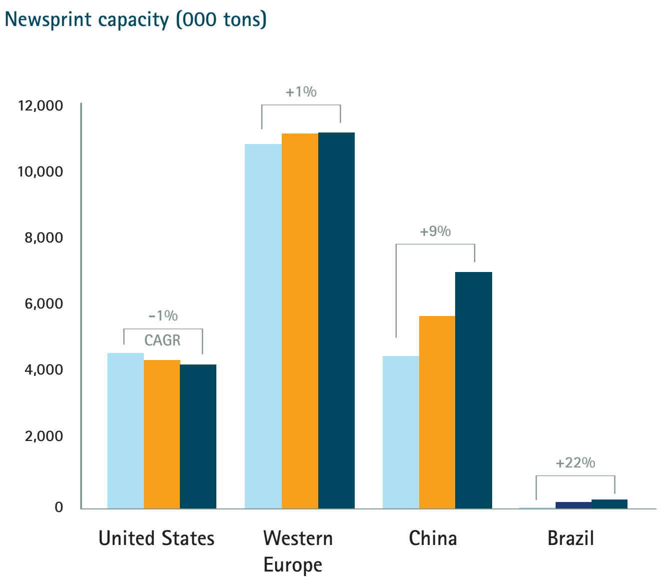
Almost half of the capacity the industry produced was in the United States and Europe. However, this share is expected to fall in the next few years as production shifts to lower-cost areas such as China, and to Brazil with its abundant forests.

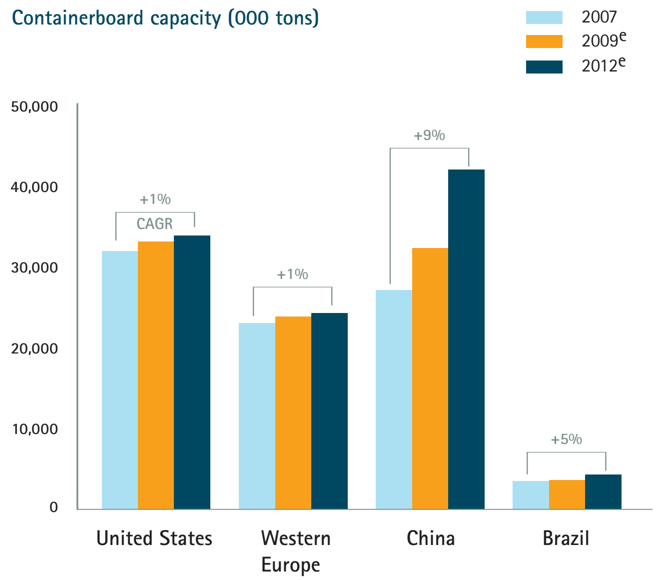
2006 global paper and board capacity, by region



Source: RISI, World Pulp Annual Historical Data—International Paper & Board, January 2008

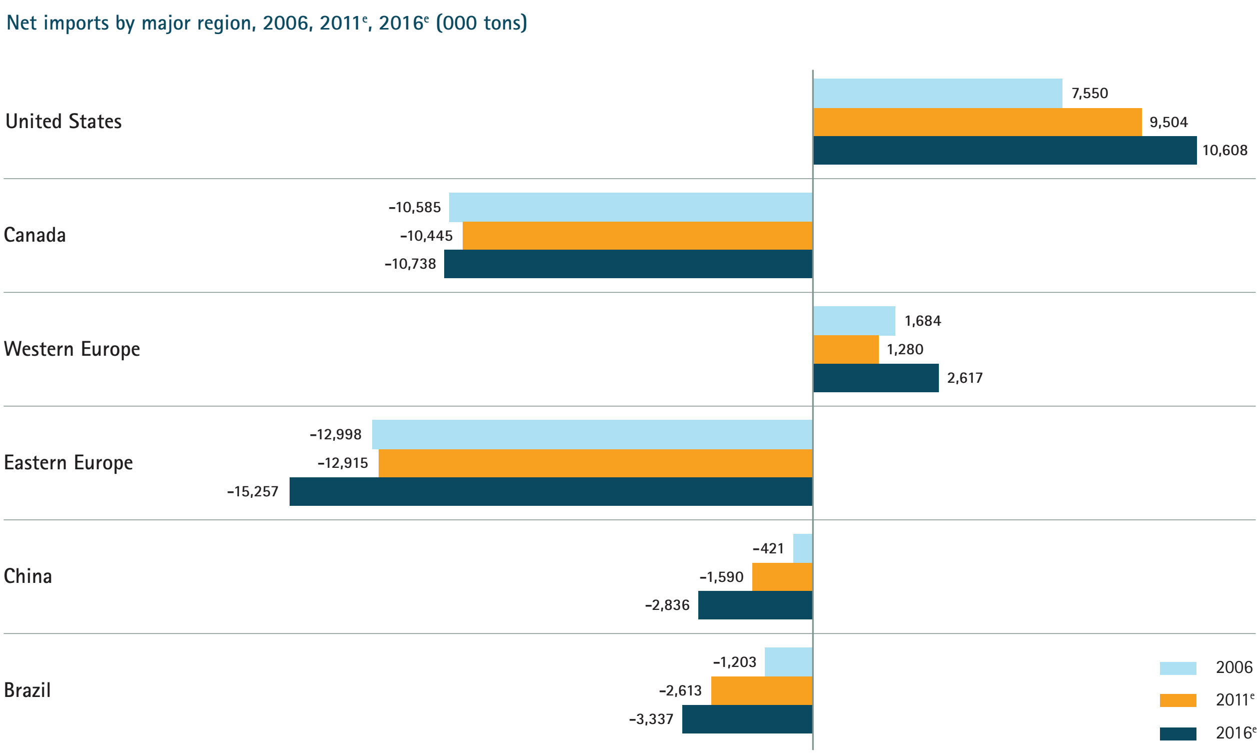
In fact, China's and Brazil's growth will surpass that of the United States and Europe in both the high-growth (containerboard) and low-growth (newsprint) segments.





Source: RISI, World Pulp Annual Historical Data—International Paper & Board, January 2008; Accenture analysis

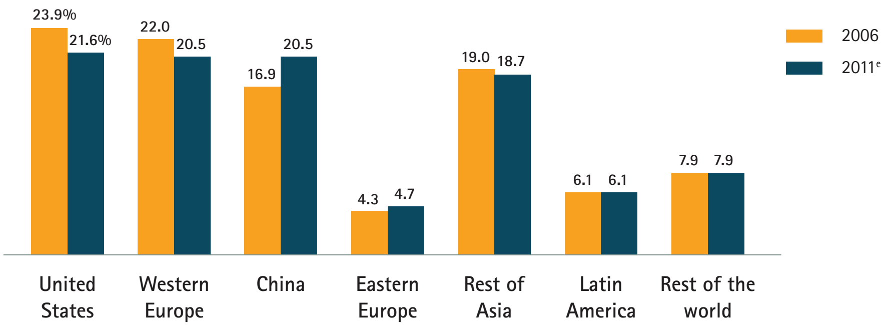
Exports from Canada are projected to remain steady, while Brazil and Eastern Europe will strengthen their net export positions. The United States is expected to continue to be a major net importer. Although North America historically has been a major supplier of paper and board products to world markets, these exports recently have decreased while imports have increased.



Source: RISI, World Pulp Annual Historical Data—International Paper & Board, January 2008

China's consumption is expected to significantly increase over the next five years; in the United States and Europe, consumption should decline.

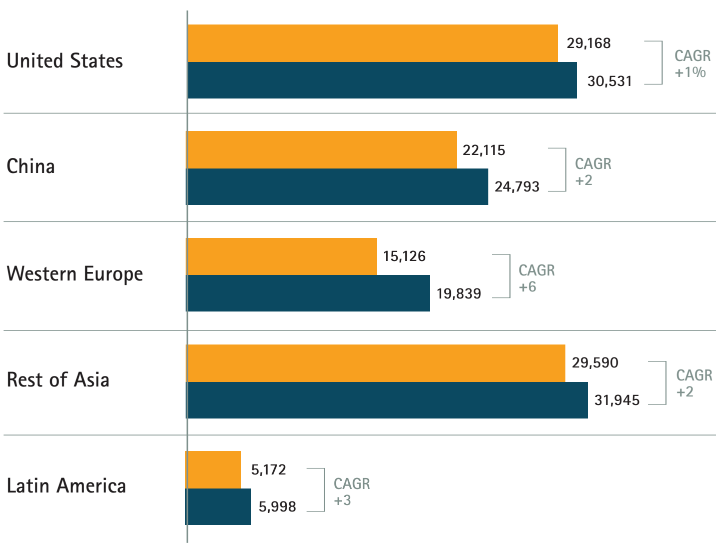
Global paper and board apparent consumption, 2006 vs. 2011
100% = 380.3 million tons in 2006; 100% = 438.7 million tons in 2011e



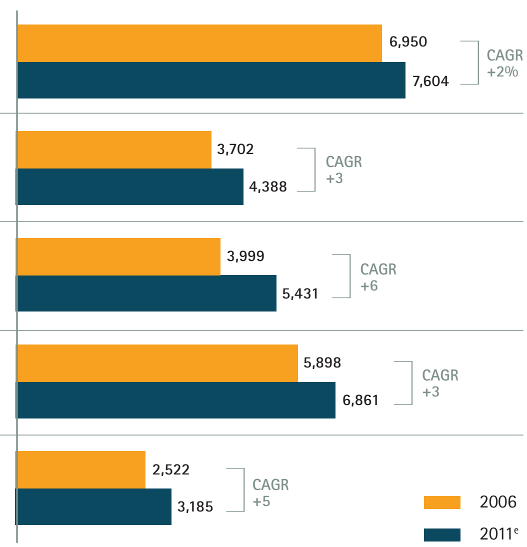
Source: RISI, World Pulp Annual Historical Data—International Paper & Board, January 2008

The tissue segment will drive overall growth for the United States, Western Europe and Latin America.

2006, 2011e global printing and writing papers apparent consumption
(000 tons) (100% = 114.7 million tons)
CAGR 2007–2012e



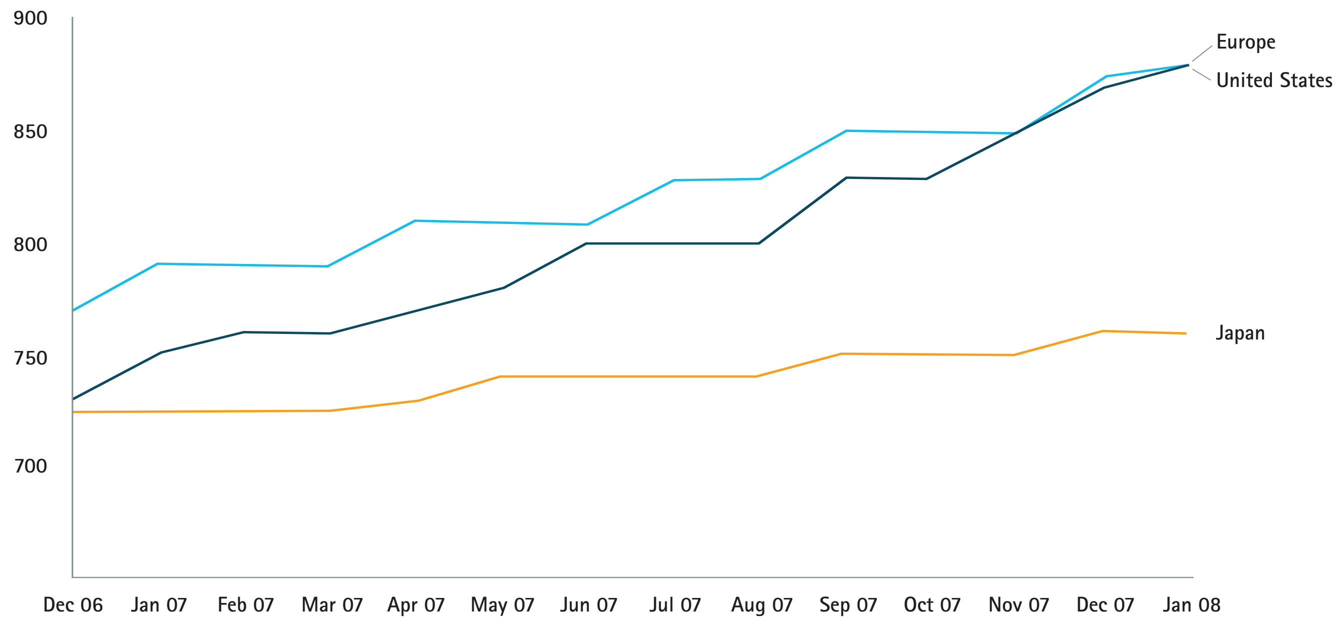
2006, 2011e global tissue papers apparent consumption
(000 tons) (100% = 26.3 million tons)
CAGR 2007–2012e



Source: RISI, World Pulp Annual Historical Data—International Paper & Board, January 2008

Market pulp price volatility is expected to continue, which will lead to volatile production costs for paper producers. Market pulp prices show less volatility in Asia.

Monthly market pulp prices ($/ton) Dec 2006–Jan 2008



Source: RISI, Market Pulp Price Summary, January 2008