

JORMA VAAJOKI

Case Metsäliitto – Serving the Strategic Needs of the Finnish Forest Owners

1. INTRODUCTION

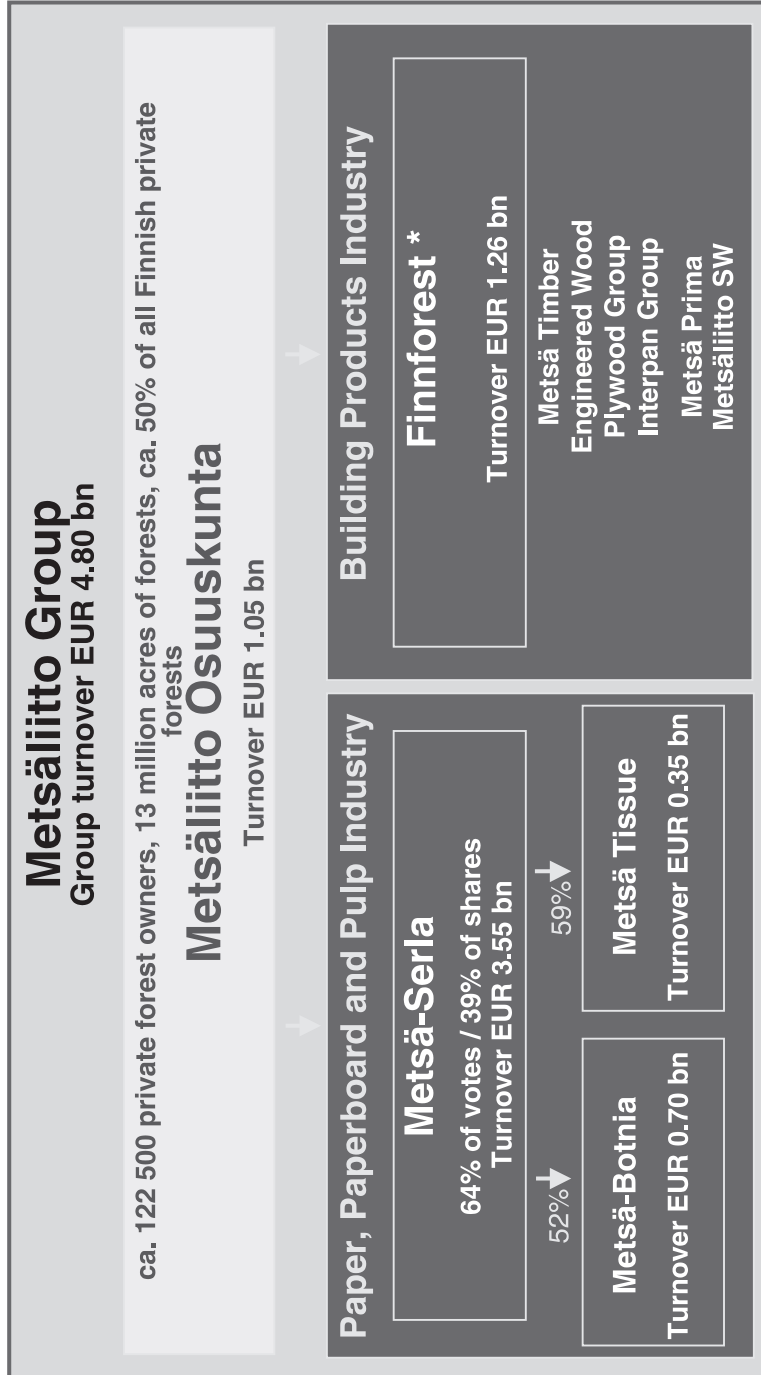
This article describes the path of Metsäliitto, the forest owners' Cooperative, from its original role in handling the export of logs to the successful Group it is today, with operations in Europe and products marketed worldwide. During the past few years, the Group's structure has been streamlined, as a result of which the companies within the Metsäliitto Group are now amongst the major players in the forest industry in Europe, some even on a global scale.

The article is based on a presentation given by the author at the International Cooperative Seminar in Finland June 11, 1999. The seminar was held as a part of the centenary year of Pellervo.

2. BACKGROUND AND STRUCTURE OF THE METSÄLIITTO GROUP

The Metsäliitto Group, as it stands today, is divided into two groups.

First, the major part is the Paper, Paperboard and Pulp Industry Group, Metsä-Serla – the public company, in which the Cooperative Metsäliitto holds 64% of the voting rights and al-



* A stock exchange bulletin from June 17, 1999.

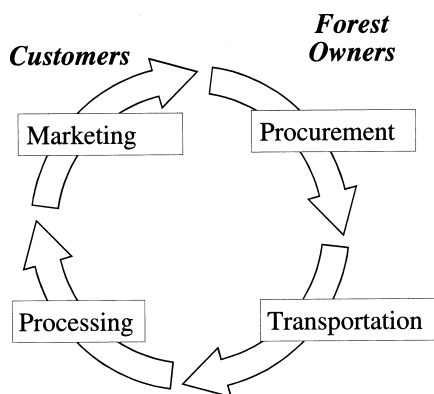
SLIDE 1. Metsäliitto Group Companies 1999

most 40% of all shares. The other group, Building Products Industry, consists of Finnforest, the panel product business, and Metsä Timber, the sawmill operator.*) They are both more or less 100% owned directly by Metsäliitto Cooperative. The Cooperative is owned by 123,000 private forest owners in Finland. Together those forest owners own 13 million acres of Finnish forest land – practically 50% of the private forests in Finland. This gives the Group a prominent standing.

When Metsäliitto Cooperative was established in 1934, the idea was to buy and sell wood grown by the forest owners, to give them an opportunity to better understand and control what was happening to their product. Later the idea was also to ensure that forest owners as insiders in the forest industry, among other things, have a clearer understanding of the cost structure of this business.

Nowadays the forest owners not only supply the raw material but are also involved in logistics (i.e. transporting the forest products to the various paper mills, saw mills, plywood and pulp mills), processing, manufacturing and at the end of the day, participating in marketing the end products to customers worldwide. Thus, we can say that Metsäliitto has a two-tier strategy. One is to procure and supply wood from the forest owners for the industry and the other is to act as a holding company that plays a major role in the wood utilizing industry.

Historically, there are some major milestones. Metsäliitto Cooperative was formed in 1934. One of the first activities after the war in 1949 was to get involved in the saw mill business by acquiring saw mills. In 1952 the first plywood mill was purchased. So, it all began with the mechanical forest industry. The first pulp and paper mill acquisition took place in 1953. 1986 was a very important year because Metsäliitto Industries, as it was then called, merged with a



Metsäliitto

- ▮ Procures and markets competitively its members' wood to the industry
- and
- ▮ As a holding company, actively participates in developing forest industry.

➔ ***To increase the owners' wealth.***

SLIDE 2. Metsäliitto's Business Idea

family-owned company, Serlachius. The Serlachius company was involved in the manufacture of paper, pulp and paperboard. At that point the public company, Metsä-Serla, was established. At first Metsäliitto did not have a majority ownership position in Metsä-Serla.

As the business was further developed a joint-venture company, Metsä-Botnia, was formed with another major Finnish forest industry player, UPM-Kymmene, to produce pulp for both parties. The first stage of the major restructuring programme was undertaken in 1990. The panel product business, Finnforest, was then formed. Finnforest was at first a part of Metsä-Serla, its Panel Products Division, but was later spun off into a separate company, more or less in the ownership of Metsäliitto. The Metsäliitto Group, in its present legal form, was established in 1992. Metsäliitto Cooperative acquired the majority of the voting rights of Metsä-Serla, which was thus consolidated into the Metsäliitto Group. Further restructuring was completed in 1995, when the sawmill industry of Metsä-Serla was placed within a separate Metsäliitto owned company, Metsä Timber – the equivalent of Finnforest.*)

The process continued and in 1998 Metsä-Serla became one of the very few clearly focused large companies in the forest industry, as we no longer had the panel product business nor the sawn timber business. We are now largely concentrated on the pulp, paper and paperboard sector.

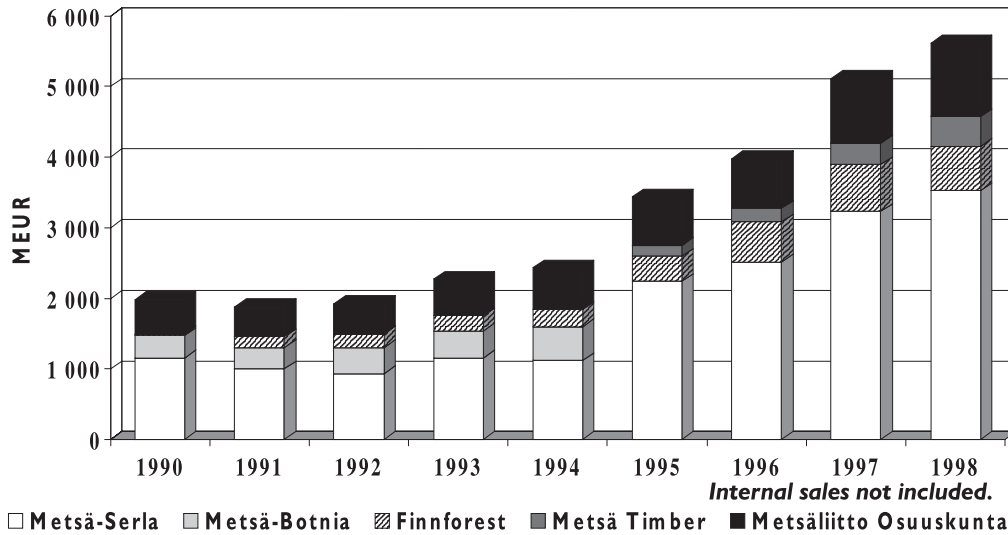
3. KEY FIGURES FOR THE GROUP'S BUSINESS

Looking at the assets of the Metsäliitto Group, we can see that a major part, 76%, is in Metsä-Serla, the paper, paperboard and pulp industry. Finnforest and Metsä Timber each have around 5% of the assets and Metsäliitto Cooperative the remaining 14%, which consists of shares in the companies within the Group.*)

Let's take a look at the round wood deliveries from the forest owners' point of view. The building products industry, (i.e. sawn timber and panels), takes around 40% of the volume, with 60% going to the paper, paperboard and pulp businesses. The stumpage price is a key factor for the forest owners. Only 45% of the stumpage income comes directly from the paper, paperboard and pulp businesses, because the price of logs is much higher than that of fibre-wood. 44% of the income is directly generated by logs, which either go to the sawn timber business or for panel products and 11% of the income comes from chips, which are basically a by-product of the sawn timber and panel product processes and are used as raw material for the pulp and paper businesses.

Regarding turnover, the development over the last few years has been extremely rapid.

Sales have doubled in a period of only three years. Looking at the operating profit, based on the 1998 results, we can see that a major proportion of profits comes from the so-called



SLIDE 3. Metsäliitto Group Turnover by Companies

'chemical forest industry', meaning paper, paperboard and pulp. In assessing the level of operating profits, it can be seen that there have also been difficult years in the industry as a whole as well as for the Metsäliitto Group. The situation, however, is developing smoothly and the restructuring of our company has brought positive results.

4. MAJOR SUBSIDIARIES OF THE METSÄLIITTO GROUP

The main subsidiaries of the Metsäliitto Group are: Metsä Timber, Finnforest and Metsä-Serla.*)

Metsä Timber*)

Metsä Timber is Europe's number 2 sawn timber operator with a turnover of EUR 420 million. It has recently gone through a thorough restructuring programme. Operational efficiency has been improved substantially following Metsä Timber's consolidation into an independent company. Products go mainly to the joinery industry, the furniture industry, for planing products and naturally to the construction industry. Whilst Metsä Timber's market is worldwide, the company concentrates mainly on Europe.

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Finnforest*)

Finnforest has a turnover of slightly less than EUR 700 million. It is active in plywood, LVL

and particleboard products. But the biggest part of Finnforest is the merchanting business. The strategic idea was that if Finnforest can become a major player in wholesaling wood-based panel products, it can also have a better chance of making the right investments and expanding its own business in Finland, thus increasing profitability. This strategy has worked well for Finnforest. Although the production units are all situated in Finland, the company's merchanting business stretches across Europe. The wholly-owned merchant subsidiary, Interpan, is the largest panel products' distributor in Europe. This has given Finnforest the opportunity to be profitable, even during difficult years in the industry.

Metsä-Serla

Metsä-Serla, which is a public company, is the biggest and perhaps the most complex part of the Group. We at Metsä-Serla have been playing a game of catch-up with our competitors during the last three years. During this time we have gone through an extensive restructuring programme, which has changed the company's operations and profile.

Earlier practically all of Metsä-Serla's manufacturing operations were situated in Finland but today we have expanded to Central Europe: to Germany, Switzerland and England.

There has been a good reason for this. Our business has come to the stage at which serving the customer, marketing and market shares have become the most important key success factors. Therefore, as a local operator, it is easy to keep in touch with customers and to provide them with good service, which is something that we have been targeting as our strategy.

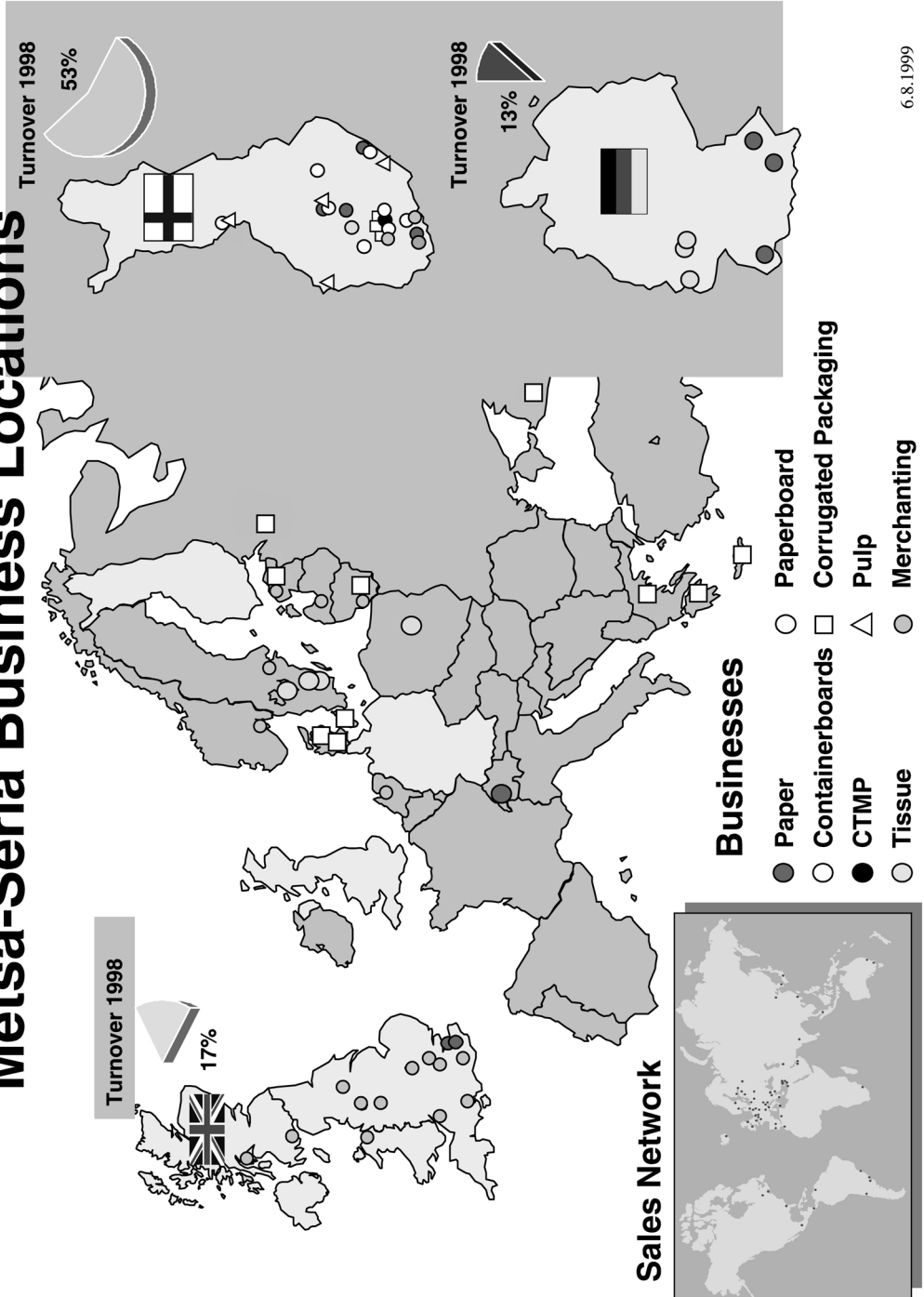
Metsä-Serla today employs around 16,000 people, more than half of whom are already employed abroad. Roughly half of our turnover is already generated outside Finland, and around half of our production capacity is also outside Finland.

This does not mean that we have not invested in Finland in recent years, but as Finnish raw material resources are now becoming limited, we cannot think of increasing the usage of wood, or making further major wood utilizing investments in Finland.

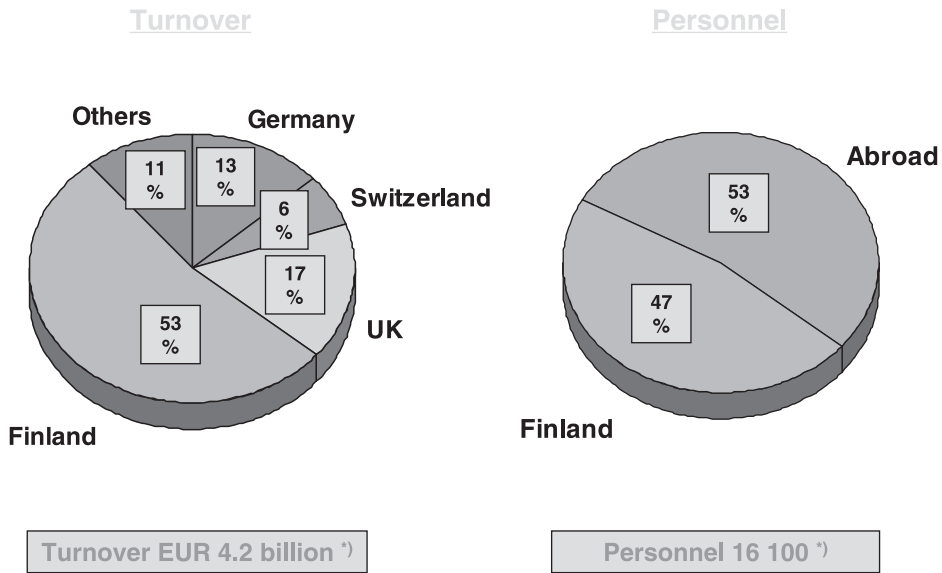
Metsä-Serla's strategy is to concentrate on the printing and packaging businesses – whereas pulp, which we make efficiently in cooperation with UPM-Kymmene in joint ventures, Metsä-Botnia and Metsä-Rauma, is a raw material. Basically we are a net buyer of pulp, using roughly everything we make ourselves.

As mentioned before, marketing is a major focus. Market shares, serving customers and providing them with added value have become key success factors. We are also a major tissue operator in Northern Europe. In Scandinavia and in Finland we have a market share in excess of 40% and we intend to expand this business further. Our tissue operations, which are strategically not so tied to the rest of the Metsä-Serla, have been concentrated within a public company in which we still hold a 57% controlling interest. We have thus received new capital to

Metsä-Serla Business Locations

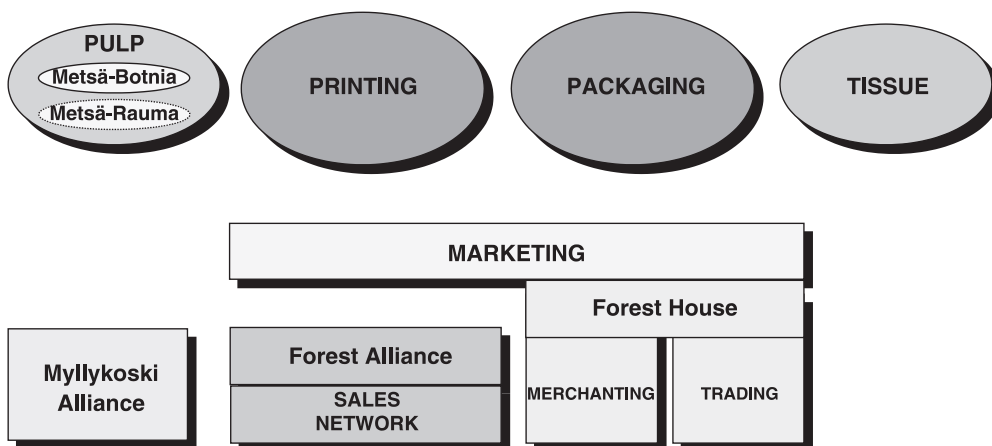


SLIDE 4. Metsä-Serla Business Locations



*) Includes UK Paper, Halstrick and Strepp.

SLIDE 5. Metsä-Serla 1998



SLIDE 6. Strategic Business Structure

go beyond Scandinavia, to Poland, and at the end of last year we also acquired two German tissue companies. In paper we have made an alliance with a Finnish family-owned company, Myllykoski. We sell our products jointly through a sales network called Forest Alliance, which is a worldwide network we inherited from the famous Finnboard and Finnpap organizations.

An example of Metsä-Serla's rapid growth is the largest industry group, the Paper Group. In 1995 customers saw it only as a 700,000 tonne supplier of paper products. Today our market network, Forest Alliance, offers its customers over 4 million tonnes of paper products. This is due to acquisitions, internal growth and the alliance with Myllykoski. In coated magazine papers we used to be number 9 in 1995, now we are number 3 – not only in Europe but also worldwide. In coated fine papers we used to be twelfth; today we are number 3 in Europe. At the end of last year we made the acquisition of UK Paper in the United Kingdom. This made us the number 1 player in this world's biggest fine paper market.

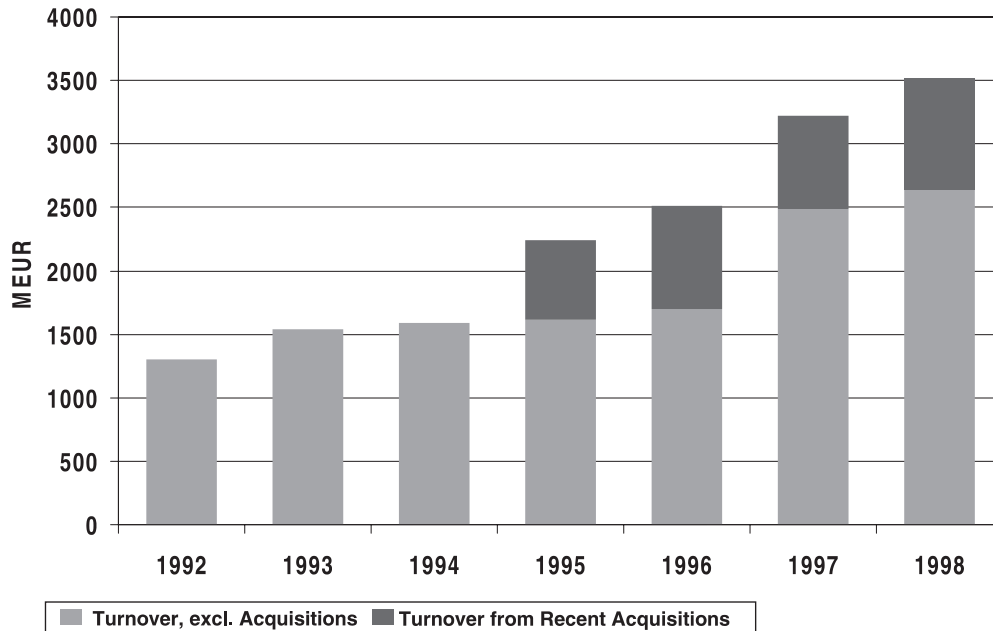
In folding boxboard we have maintained a strong position in Europe as number 2, regardless of the growth resulting from the consolidation process within the industry.

On the capital expenditure front we have both invested and made acquisitions in Finland and abroad. In Finland we have built a modern paper mill that uses a new type of wood raw material – aspen. We are the only ones in Finland currently using it. We have also renovated one of the major pulp mills in Finland, the Joutseno pulp mill. Altogether Metsä-Serla has spent roughly USD 2.5 billion on these investments.

During the restructuring process Metsä-Serla has made both acquisitions and divestments. We have got out of the sawn timber business and the chemicals business. We have also sold our large portfolio of shares in our competitor, UPM-Kymmene, and listed the minority interest in Metsä Tissue, our tissue business. This has meant that turnover and sales have not been the most important elements in our business to optimize. This has also meant quite rapid growth – in three years we have practically doubled our sales. That indicates to you how big the changes in the company have been.

Our profitability is now in a much better shape than previously. A year earlier our profits were not very good in comparison with our competitors. Now we have moved to a much more competitive level. The last quarter of 1998 and the first quarter of this year indicate the industry's effort in taking downtime rather than letting prices slide. For our part, we have refused low-priced orders and have therefore had to curb production. This has affected profits, but things are moving towards better times again.

Our financial backbone has become healthier as well. At its lowest, during the first quarter of 1997, our equity ratio was close to 32%; now we are already close to 45%. Following the three acquisitions – UK Paper and the tissue companies Halstrick and Strepp – at the end of 1998 our equity ratio fell by 3% but we are working our way back again. In net gearing we



SLIDE 7. Group Turnover Development

were previously at 118%. We have performed a hat trick in managing to get the figure down, because at the same time, we have spent 2.5 billion US dollars on investments and acquisitions. We are now below that 80% line which we have tried to keep as our long-term goal.

Metsä-Serla’s liquidity is good. We are now quite comfortably at EUR 1.5 billion in liquidity, counting in committed credit facilities and liquid funds. This provides us with opportunities to participate in the ongoing consolidation of the industry.

5. CONSOLIDATION AND COMPETITION

The forest industry is consolidating rapidly. If, for example, we look at the list of the 20 largest forest industry companies, we can see that the latest acquisition by Georgia-Pacific of Uni-source in the States was larger than Metsä-Serla altogether. The most reputed consultants in the industry forecast that in eight years there may be eight main companies left. It is, of course, a tremendous challenge for us to maintain our position in the industry and to be one of the survivors that come through this stormy consolidation process.

When we said that we have been playing a game of catch-up, we at the same time confessed that our profitability was not quite as good as that of our competitors. However, our

profitability is now in order. Looking at the published information on our competitors – Stora-Enso, UPM-Kymmene, AssiDomän, MoDo and SCA – and comparing the arithmetic average of their results with Metsä-Serla's performance, in return on capital employed (ROCE), it can be seen that we have caught up with them. We have moved up thanks to the structural change and increase in internal efficiency we have implemented in the company. Which, more or less, means a permanent change. ■

*) Addition:

Please note that on June 17, 1999, after this seminar, Metsä-Serla Corporation released a bulletin stating that Metsäliitto is combining the units of the Group's mechanical forest industry. Finnforest and Metsä Timber, together with their subsidiaries and associated companies, and Metsäliitto SW, will form a single group named Finnforest.