

Industrial Products  
Forest, Paper and Packaging

# Forest, paper and packaging deals

Branching Out – 2009 Annual review

Global deal activity in the forest, paper and packaging industry



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## Methodology

Forest, paper and packaging deals is based on published transactions from the Dealogic 'M&A Global' database, January 2010. In a few cases, notably in the forestland sector, we have supplemented Dealogics' data with additional publically announced deals. Deals are included on an announced basis, adjusted to include only accepted offers. Deal values are the consideration value announced or reported including any assumption of debt and liabilities. Figures relate to actual stake purchased and are not multiplied up to 100%. The geographical split of the deals refers to the location of the target company or assets. The analysis relates to the forestry, paper and paper based packaging sector and therefore excludes related sectors such as printing and plastic, glass and metal packaging. The sector and subsectors analysed include: forestland/forestry (e.g. standing timber, nurseries, harvesting and logging operators), wood products (e.g. sawn timber, wood-based building materials), pulp & paper (e.g. pulp, primary paper producers) and converting (including distribution) (e.g. packaging and tissue product producers, paper converters, paper merchants).

## Acknowledgements

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Market conditions for the Forest, paper and packaging (FPP) sectors remained very difficult in 2009. In the latter half of the year, conditions began to improve in some of the emerging markets, while demand in North America and Europe remained at historically low levels. Continued tight credit conditions and low valuations cast a damper on transaction activity, particularly in North America, where deal values dipped to around US\$1bn and the focus shifted to restructuring high debt levels. Already-modest deal values in Asia Pacific were slightly down, although deal volume stayed solid, largely due to interest in timberlands. The notable bright spot globally was Latin America, where pent-up demand and a quicker recovery helped spur an unprecedented level of deal activity, helping contain the drop in global deal value to around 12% versus 2008.

*Forest, paper and packaging deals 2009* reviews deal activity in the FPP industries. The report is the latest edition in our annual series on dealmaking in the sector. The report is one of a range of deals publications from PricewaterhouseCoopers<sup>1</sup>, covering sectors including aerospace & defence, mining, metals, renewable energy, power, oil & gas as well as FPP. Together the family of deals reports provide a comprehensive analysis of M&A activity across industries world-wide. Our FPP deals analysis is also complemented by our regular *CEO Perspectives* report, which analyses the viewpoints of many of the FPP industry leaders worldwide and explores some of the pressing imperatives facing the sector.

We examine both the rationale behind the overall trends and look at the key individual deals. This year we also add a discussion of restructuring activity in North America in order to address the impact of financial distress on that region's deal market. We look at the year

under review, the context of the preceding years, and ahead to the future direction of deal-making in the sector. We also highlight, in our PwC Spotlight and PwC Viewpoint panels, some of the critical issues for companies engaging in deal activity within the sector. Drawing on our global experience as an adviser to FPP M&A players, and on our experience in assisting in restructuring programmes, our commentary addresses the key markets in the sector.

Looking ahead, the immediate prospects for any significant recovery in deal value look limited until real confidence is restored amongst the mainstream players. The fundamental drivers for deals remain; indeed these have probably strengthened over the past two years. A return of confidence could release some level of pent up demand – however the timing of such activity remains difficult to predict. In the meantime we expect that distress and selective “voluntary” transactions will drive a continuing flow of small value deals.



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<sup>1</sup>PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

## 2 Report highlights



### Deal numbers up, but values drop sharply

This year saw just three billion dollar-plus deals in the sector; the same number as 2008, and down substantially from the eight billion-plus deals seen in 2007. Average deal value dropped to US\$96 million. The decline in deal values continued the trend we observed in the second half of 2008. Severe financial distress in North America sent deal values crashing, major consolidation in Europe remained elusive, and Asia Pacific remained relatively cautious, apart from the timberland sector. Latin America, in contrast, was the year's bright spot, accounting for around two-thirds of global deal value.



### Latin America leads the way

In recent years, Latin America has played an increasingly important role in the global FPP sector, particularly in pulp markets, as the development of advanced plantation forestry has turned the region into the world's fibre basket. Two of the region's biggest players, Votorantim Celulose e Papel (VCP) and Aracruz, merged in a deal valued at close to US\$8bn to form the world's largest pulp company by some margin in this year's blockbuster deal; a story that began in 2008. While this transaction led values by some distance, it was by no means the only major deal in the region – Latin America was home to four of this year's top five deals. Aside from the VCP/Aracruz merger, many of the other large deals also related to the pulp business, either a reshuffling of existing operating assets or laying the ground work for future pulp production.

## North America restructures high debt loads; Consolidation remains elusive in Europe

The trend towards insolvency proceedings that began in North America last year continued in 2009, with the face value of restructured debt reaching US\$17.5bn since 2008. North American companies were already highly leveraged before the downturn took its toll, so it is not surprising that de-leveraging is now dominating corporate activity. The minimal level of transactions which occurred in North America were primarily distress-motivated sales. In Europe, the significant consolidation which has been needed for several years failed to happen again in 2009; there also the focus shifted to de-leveraging.



## Interest in timberland investments continues

While the significant forestland divestitures by vertically integrated forest products companies that drove high deal values in the timberland sector in 2005-2007 have mostly been completed, interest from institutional investors remains high. Secondary deal activity was subdued this year due to the recession, but new timberland funds such as Phaunos helped drive transactions around the globe, notably in Australasia and Latin America. As the economic situation improves, the secondary deal market in the sector is likely to pick up, and government sales of timber assets should drive further significant activity in Australasia through 2010.



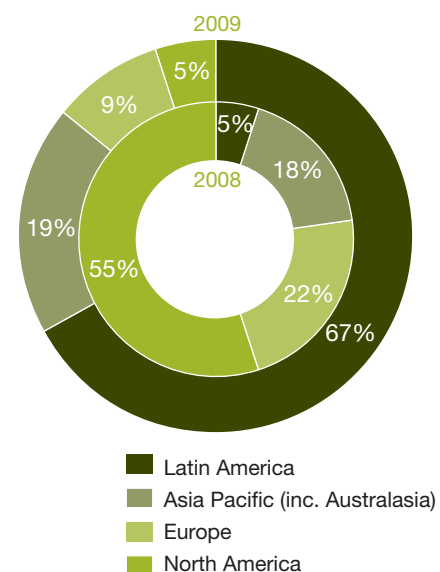
## 4 Deal totals



FPP companies continued to make deals in 2009, despite plunging demand in many segments due to the global recession. Most activity was on a fairly modest scale, with the average deal size this year dropping around 14%. Overall deal volume remained fairly stable, with this year's 369 deals slightly topping the 350 seen last year. Deal value dropped to US\$18.7bn from last year's US\$21.3bn, and substantially down from the high level seen in 2007, when deal totals reached US\$27.6bn (see Figure 1). However in comparison to the deal slump seen in 2003, both values and volumes were about 65% higher.

This year saw major changes in the regional breakdown of deals. Activity in North America virtually collapsed, with deal numbers down nearly a third, and deal values dwindling from an average of 55-70% to only 5% of global deal value (see Figure 2). In contrast, transactions in Latin America boomed, accounting for around two-thirds of overall deal value. All three of this year's billion-plus deals, and five of the top ten, involved targets in Latin America (see Figure 3). Europe saw an increase in deal numbers, but low values, with overall deal value declining 65% (see Figure 5), and the continent's share of the deal total shrinking to 9%. Somewhat ironically, the largest deals involving European acquirers actually took place in Latin America. In Asia, deal volumes and values remained steady compared to last year, representing around one-fifth of total volume.

Figure 2: Value share of all worldwide FPP deal value by continent, 2008-2009



Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

Note: negligible deals values from other regions not shown.

In pulp & paper deal values were 16% up on 2008, and in fact at their highest since 2005, due to the near US\$8bn VCP/Aracruz deal; otherwise deal values were well down in every sector (see Figure 4). Wood products is traditionally a smaller sector; 2009 saw US\$1.7bn in transactions, representing a decline of 19%. This year's US\$1.1bn in transactions in the converting and distribution sector

Figure 1: Total FPP deals, 2003-2009 (year on year % change in parenthesis)

	2003	2004	2005	2006	2007	2008	2009
<b>Total deal value (US\$bn)</b>	11.4	18.5 (+63%)	21.0 *(+13%)	25.7 (+23%)	27.6 (+7%)	21.3 (-23%)	18.7 (-12%)
<b>Total deal numbers</b>	224	254 (+13%)	295 *(+16%)	280 (-5%)	370 (+32%)	350 (-6%)	369 (+5%)
<b>Average value (based on deals where value is reported) (US\$m)</b>	90.0	132.3 (+47%)	128.0 *(-3%)	169.4 (+32%)	134.6 (-21%)	111.0 (-18%)	96 (-14%)

\*2005 data excludes exceptional US\$22bn acquisition of Georgia-Pacific (GP) by Koch Industries in the US  
Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

Figure 3: The global top ten – FPP deals 2009

Number	Month Announced	Deal Value US\$(m)	Target	Target Nationality	Acquirer	Acquirer Nationality
1	Jan 09 {note}	7.898	Aracruz Celulose SA	Brazil	Votorantim Celulose e Papel SA	Brazil
2	Sep 09	1.430	Fibria SA (Guaíba unit)	Brazil	Empresas CMPC SA	Chile
3	Oct 09	1.173	Botnia South America SA (49.013%)	Uruguay	UPM-Kymmene Oyj	Finland
4	Oct 09	787	Metsä-Botnia AB Oy (27.7%)	Finland	Metsäliitto Cooperative	Finland
5	Jun 09	736	Satipel Industrial SA	Brazil	Duratex SA	Brazil
6	Feb 09	460	Paper Australia Pty Ltd	Australia	Nippon Paper Group Inc	Japan
7	May 09	344	Grupo Empresarial ENCE SA (Uruguayan operations)	Uruguay	Stora Enso Oyj; Celulosa Arauco y Constitucion SA	Finland / Chile
8	Sep 09	301	Timbercorp	Australia	Global Forest Partners LP	United States
9	Aug 09	300	Weyerhaeuser Co (140,000 acres of timberland)	United States	Campbell Group LLC	United States
10	Feb 09	271	Daehan Pulp Co Ltd (60.3%)	South Korea	Heesung Electronics Co Ltd	South Korea

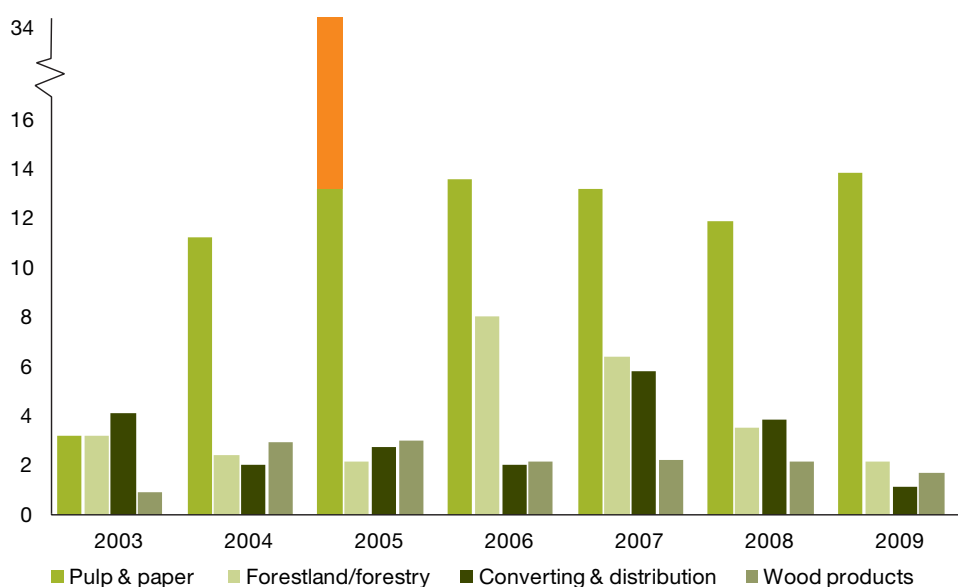
Note: Deal value represents the aggregate value of the consideration to Aracruz's Common and Preferred shareholders plus Aracruz's net debt as at 30 June 2009. The acquisition was undertaken in five discretely reported transactions beginning in January 2009 and which resulted in VCP acquiring 100% of Aracruz's share capital. The entire transaction value has been translated from Brazilian Reals into US Dollars at the June 2009 closing rate

Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

is off 71% from last year's numbers and is far below the averages of the past six years, at only about one-fifth of the deal values seen in 2007's peak, although deal numbers were actually up. Forestland deal values were also down 40% over last year, reflecting the diminishing number of deals driven by pulp and paper majors looking to divest forestlands and a dampening effect of low valuations on secondary deal activity. Nonetheless, the sector is still seeing interest around the globe and should drive substantial transaction activity in future years (see **Timberland, p19**).

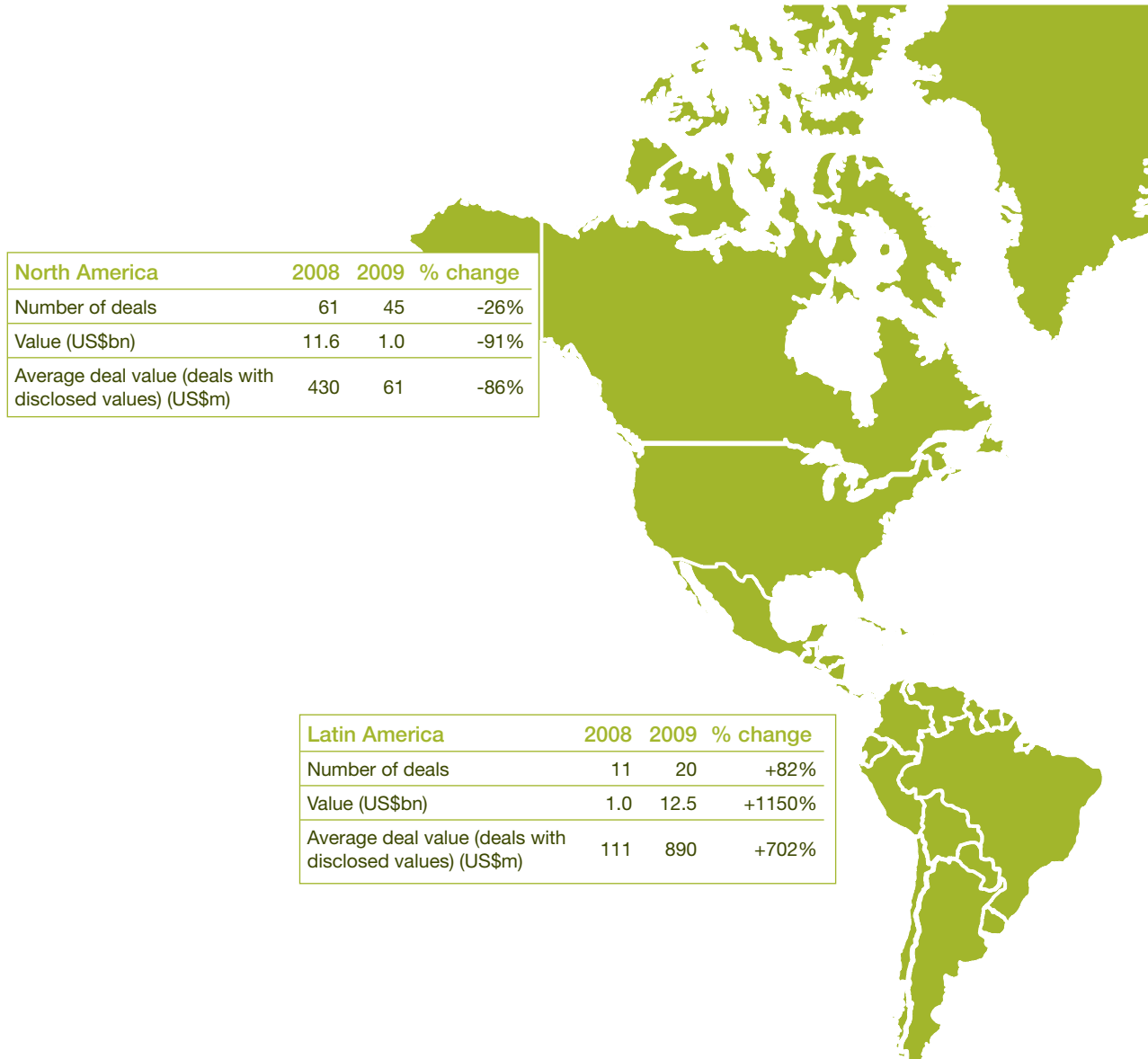
Private equity activity was down this year, accounting for only 11% of deal values, compared to an average 27% across the previous five years. This trend reflects a more widespread retrenching of private equity firms; as the global economic situation improves and liquidity increases, private equity is likely to continue to play a role in sector deal activity.

Figure 4: Sector deal value trends (US\$bn), 2003-2009



Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

Figure 5: Deal numbers and values by continent, 2008-2009



Note: negligible deals values from other regions not shown.

Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review





Europe	2008	2009	% change
Number of deals	133	157	+18%
Value (US\$bn)	4.8	1.7	-65%
Average deal value (deals with disclosed values) (US\$m)	120	46	-62%

Asia Pacific	2008	2009	% change
Number of deals	141	141	-
Value (US\$bn)	3.8	3.5	-8%
Average deal value (deals with disclosed values) (US\$m)	34	28	-18%

## 8 Deal places: Latin America

Latin America includes some of the best settings on the planet for plantation forestry. The region is favoured with excellent climate conditions which help it achieve very low fibre costs, as well as a number of local government regimes with favourable investment conditions. This year's exceptional level of deal activity reflects Latin America's growing role as the world's fibre basket; previous years' deal activity in the region has been modest, so the high level of transactions may indicate some level of pent-up demand. Further, it is likely that the economic crisis served as a spur to some deal activity. Brazil, the region's largest player, recovered faster from the impact of the economic recession than did many more developed economies. As a result, deal levels generally in Brazil soared in H2 2009.

One deal which was not triggered by Brazil's quick recovery, though, was this year's biggest deal, which actually began in 2008. Brazil's Votorantim Celulose & Papel (VCP), part of the Votorantim Group (a large industrial conglomerate), and Aracruz Celulose started negotiations in 2008 to merge the two companies. The deal was originally expected to move forward in August 2008, however it was put on hold when Aracruz revealed significant losses on foreign currency derivatives stemming from the sharp devaluation of the Brazilian real against the US dollar. Subsequently, Aracruz announced a settlement payment with its banks of around US\$2.6bn payable over nine years, thereby enabling the merger to be revived.

The transaction took place in several stages, with VCP first acquiring stakes from Arapar, a three-family holding company (Lorentzen, Moreira Salles and Almeida Braga families), for R\$2.7bn (US\$1.4bn) in January, and the Safra family exercising their 'tag along' right to sell at the same total price in March. Added to VCP's existing 28% voting stake, these two transactions brought their holding to 84% of the Aracruz votes. VCP then proceeded to acquire the remaining voting shares and all of the outstanding preferred (non-voting) shares mainly through a series of share-for-share exchanges combined with a major recapitalisation of VCP. The total enterprise value of Aracruz implied by these transactions including net debt of US\$3.9bn (R\$7.5bn) amounted to almost US\$8bn (R\$15.3bn). The deal concluded in August 2009 and the enlarged VCP was renamed Fibria. Following the recapitalisation, Votorantim relinquished direct control with its stake now standing at 29.3%. The equity branch of Brazilian Development Bank, BNDESPAR, which led the recapitalisation, holds a 34.9% stake in Fibria, with the remaining 35.8% in free float.

To help reduce debt, Fibria sold its Guaíba unit, in the southern Brazilian state of Rio Grande do Sul to the Chilean group CMPC

in a deal valued at US\$1.43bn, making this the second largest deal of 2009. The Guaíba Unit comprises a 450,000 tpa capacity eucalyptus pulp mill, a 60,000 tpa capacity paper mill and 212,000 hectares of owned or leased land.

Fibria has inherited ambitious expansion projects from its predecessor companies, and in order to facilitate these it wants to restore its investment grade rating. Reducing debt in the immediate aftermath of the Aracruz acquisition was therefore an important step. Commenting on the sale of Guaíba in a company press release, Carlos Aguiar, Fibria's president, stated: "It was a great and timely deal. Besides the injection of important resources on its cash flow to optimize Fibria's capital structure, the sale will allow Fibria to resume highly profitable projects aligned with its sustainable growth strategy." He added "This deal will allow Fibria to get back to doing its forestry investments in 2010 and its industrial investments in 2011, like Veracel II, according to market conditions at the time, for example."

Fibria is now the world's largest producer of market pulp by some margin. Adjusted for the sale of Guaíba, it controls world class, low cost eucalyptus pulp capacity of some 5.4 million tpa, or around one-third of global market bleached eucalyptus kraft pulp (BEKP) capacity. The merger enables it to further cut costs and improve margins; it has announced across the board post-merger synergies with a present value of almost US\$2bn (R\$4.5bn), 90% of which it expects to realise by 2012. Fibria has impressive scale to compete on the global stage in pulp supply and reaffirms Brazil's position as a reference point in the production and export of pulp sourced from sustainably managed plantations. It controls impressive forestry assets, extending to a total 1.1 million hectares, of which 604,000 is under eucalyptus and most of the remainder comprises native forest set aside for permanent conservation.

Planned pulp capacity expansions come to 5.2 million tpa, a near doubling of current capacity, mostly at existing sites. These expansions though will need funding through both enhanced operational cash flow and credit markets.

For CMPC, the acquisition of Guaíba increases their exposure to the pulp sector; given the fairly advanced development of plantation forestry in Chile, looking elsewhere in the region was a necessity. CMPC themselves announced in May 2007, that it would be unlikely for another new pulp mill to be built in Chile in the subsequent 10 years due to the shortage of productive forestland. The acquisition in nearby Brazil allows the company to help ensure sufficient fibre supply for paper operations and also gives the company a production platform in Brazil's larger market.

Tough times in Europe have provided opportunities for Latin American players and European companies with strong balance sheets. Metsäliitto, Grupo ENCE and Sonae Industries have all exited Latin America for strategic reasons and to help shore up their balance sheets – and UPM, Arauco, and Stora Enso have gained valuable, low-cost fibre assets or consolidated their local market shares.

In the past five or six years, Uruguay has emerged as the next frontier for South American pulp production, and as a favoured investment location for players from Europe. The country's climate and terrain make it suitable for plantation forestry and large areas of non-productive agricultural land remain available. Incentives offered from the government of Uruguay have also made investing in new plantations and production assets in the region attractive.

Several of the top deals in South America involved some reshuffling of assets in this emerging region. UPM-Kymmene (UPM), through its JV with Metsäliitto, Botnia, has long had a significant stake in the region. The short fibre pulp mill at

Fray Bentos, in South-West Uruguay, has a 1 million tpa capacity, and represented the largest industrial project ever undertaken in Uruguay and the largest overseas industrial greenfield project ever undertaken by the Finnish private sector. While the mill faced major environmental concerns from neighbouring Argentina during the period up to its start up in 2007, these have largely been addressed and the Uruguayan government is monitoring the project's environmental impact. The US\$1.2bn acquisition of Metsäliitto's share in Botnia marked an opportunity for UPM to gain full control of a new, low-cost, world-scale fibre source. Part of the consideration for the deal included an exchange of assets in Finland, upon which we comment later.

Chile's Arauco has also been following an expansion strategy, including increased exposure to the large Brazilian market. In May 2009 Arauco and Stora Enso announced the acquisition of Grupo ENCE's industrial forestry assets in Uruguay. The two companies have formed a joint venture to manage the operations and pool existing interests in the country. While the actual size of the deal is relatively modest at US\$344 million, it includes a site for a future pulp mill. Although Arauco and Stora Enso have not yet made a decision regarding the construction of such a pulp mill, such a mill would certainly be a world class asset with excellent fibre sourcing possibilities. It is not the only new mill which could come on-stream in Uruguay; in 2008, Portucel signed a Memorandum of Understanding with the Uruguayan government around a plantations, pulp mill and paper production project in Uruguay with an estimated investment of US\$3bn. At the time of writing, Portucel had not begun operations in Uruguay.

In August 2009, Arauco also announced its purchase, through its Brazilian subsidiary Placas do Paraná S.A., of the wood-panel company Tafisa Brasil S.A. (Tafisa) from SCS Beheer, B.V. and



Tafiber-Tableros de Fibras Ibéricos, S.L., (subsidiaries of Sonae Indústria, SGPS, S.A.) (see Figure 6). The deal consolidates Arauco's overall position in composite panels in the region's largest market and also marks an exit for Sonae from production in Latin America.

The composite panels segment saw further significant consolidation in the region when Latin American market leader Duratex, a Brazilian building supplies company, announced its takeover of its #2 competitor, Satipel for US\$736 million. The deal forms the southern hemisphere's largest producer of industrialised wood panels. Analysts predicted the deal would give the new combined company greater pricing power. The panels sector in Latin America had faced oversupply when demand fell due to the economic crisis, so the combined operations may be able to adjust capacity better to demand, and may benefit from additional production synergies.

Two other large deals in the region involved timber holdings. Brazilian pulp and paper maker Suzano purchased land and timber assets from the Brazilian mining company Vale for US\$133 million. The deal also includes an agreement to use Vale's railway which connects iron ore mines in the Amazon to the port of Sao Luis in northern Brazil and to purchase

reforested wood from Vale. According to the agreement, Suzano could set up a pulp and paper facility in the region as early as 2013. Later in the year, Suzano sold timberlands in the state of Minas Gerais, Brazil to Phaunos Timber Fund. The properties contain existing merchantable eucalyptus plantations and provide charcoal to the local mining industry. As with Fibria's sale to CMPC, this deal reflects a company looking to receive a good return on a valuable asset in order to free up cash to invest in even more promising projects – in Suzano's case, most likely developing the assets purchased from Vale.

Phaunos is a global timberland investment fund managed out of the US but listed in London and is representative of institutional investors who see strong potential in Brazilian forestlands. Similar transactions may represent a significant source of opportunity, both for land-rich Brazilian players looking to fund major pulp and paper or other fibre production projects, and for investors elsewhere looking at plantations as a sustainable investment opportunity. Such deals would probably include long-term wood supply contracts, which provide a secure fibre source for Brazilian producers and a consistent level of return for institutional investors such as pension funds.

**Figure 6: Other major deals in Latin America (not included in overall Top Ten)**

Month Announced	Deal Value US\$(m)	Target	Target Nationality	Acquirer	Acquirer Nationality
Aug 09	227	Tafisa Brasil SA	Brazil	Celulosa Arauco y Constitucion SA	Chile
Dec 09	177	Suzano Papel e Celulose SA (Fazenda Turmalina Timber properties)	Brazil	Phaunos Timber Fund Ltd	Guernsey
Oct 09	168	Pom Pom Produtos Higienicos Ltda	Brazil	Hypermarcas SA	Brazil
Dec 09	133	Vale SA (forestry assets)	Brazil	Suzano Papel e Celulose SA	Brazil

Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

Deal values in Asia Pacific were down about 8% this year, but deal numbers were identical to last year. The year's biggest stories were prompted by two factors – stagnant growth in the domestic market in Japan, and robust activity and interest in forest resources and market opportunities in Australasia.

The region's largest deal combines both themes. In February 2009, Japan's Nippon Paper Group announced the purchase of Paper Australia from struggling paper producer and merchant PaperlinX for US\$460 million (see Figure 7). The transaction was the result of a competitive bidding process; a strong yen and low interest rates may have given Nippon Paper the edge. Changing tax rules between Japan and Australia have also helped make deals more viable for Japanese players. The deal gives Japan's largest paper maker access to Australia's commercial publishing market, in line with its overall strategy, announced in 2005, to become one of the top five players in the global pulp and paper industry by accelerating development of overseas operations, given declining demand in domestic markets. Nippon Paper anticipates improving Paper Australia's production efficiency, for example related to the recently upgraded pulp mill in Victoria and helping the company better compete with imported paper. For PaperlinX, the deal marks a major step in its strategy to exit paper-making and concentrate resources on paper merchanting. The company is also currently divesting some small residual papermaking assets to complete its final exit from paper production.

In Japan, the merger of two mid-sized papermakers reflects the industry's need to increase production efficiencies and reduce costs in a mature market. In an interview with The Nikkei, the CEO of Hokuetsu Paper reiterated his belief that the Japanese industry would benefit

from a third core paper organisation, to complement #1 Nippon Paper and #2 Oji Paper. He believes the merger of complementary mid-sized players will facilitate further streamlining of their businesses; following the take-over of smaller rival Kishu, the company was renamed Hokuetsu Kishu to reflect the cooperative nature of the merger.

Hokuetsu successfully fended off a take-over bid from Oji Paper in 2006. As part of that process, the company established a partnership with Nippon Paper, including the acquisition of an 8.06% stake in Hokuetsu. In October, Nippon Paper sold the stake back for US\$95.7 million (8.7 billion yen); while the price reflected a drop in value from the original purchase price, Nippon was able to book a profit following a write-down on the holdings in fiscal 2008. The companies will continue their operational alliance, including cross-supplying products and jointly purchasing materials.

In Australasia, several factors are stimulating robust activity in the timberland sector. Two major timberland investment schemes collapsed in 2009. One of these, Great Southern, went into receivership after being unable to find a buyer. Gunns has entered into an arrangement to manage the standing timber as responsible entity, an agreement that should provide the company with greater access to fibre resources while conserving its own cash resources. The collapse of another such timberland investment scheme, Timbercorp, drove the second largest transaction of the year in the Asia Pacific region. US-headquartered TIMO Global Forest Partners (GFP) LP purchased Australia's Timbercorp for \$US301 million (A\$345 million). The purchase saw many investment growers breathing a sigh of relief as their situation stabilised; about 10,000 people had invested in the company's forestry scheme before it went into insolvency, and the overall purchase price included up to A\$198 million for





investment growers. For Global Forest Partners, one of the longest established TIMOs, the transaction complemented existing holdings in Australia. In a press release, GFP's CEO described the region as "an excellent business and investment geography and an important component of a diversified international plantation forestry investment strategy."

Australian chipmaker Gunns had also expressed an interest in Timbercorp. Gunns needs additional secure supplies of fibre as it makes plans to bring a controversial new pulp mill online in Tasmania, and while their bid did not succeed in taking over Timbercorp, their takeover of ITC Timber was another of the sector's major transactions. As noted, Gunns also took over as responsible entity for Great Southern later in the year, helping to enhance the company's access to fibre resources.

Overseas interest in Australasian Timberland extended to New Zealand, where US-managed, UK-listed Phaunos Timber Fund announced a US\$118 million (NZ\$167 million) investment in the Matariki Forestry Group at the end of 2009. Matariki is the third largest forestry company in New Zealand and this investment in a mature forestry estate makes Phaunos the largest shareholder

with a significant minority stake. It represents a partial exit for the current owners Rayonier New Zealand (the local subsidiary of Rayonier, a US timberland REIT), Rosenberg Real Estate Equity Fund and Australian Mutual Provident. Rayonier will continue to manage Matariki.

Looking forward, the next major trend in Australia is likely to be government sales of their timber interests. State-owned Forestry Plantations Queensland is subject to a sales process which commenced in 2009; the company received indicative bids in February 2010, with press reports suggesting a figure around US\$448 million (A\$500 million). Several bidders, including Hancock Natural Resources, GFP, Rayonier and an unnamed Chinese entity are said to have expressed interest. Other states with substantial timber holdings look likely to follow suit.

In China, significant consolidation of the country's high-growth, but fragmented FPP market failed to happen in 2009; the biggest deal involving China this year reflected a distress sale on the part of European giant Norske Skog, which sold its main Chinese newsprint producing subsidiary to local player Shangdong Huatai Paper for US\$135.5 million. Norske Skog also sold another Chinese production asset for an undisclosed

amount – the two deals represent the company's virtual exit from emerging Asia, apart from a small interest in Thailand. Major transactions in China's growing market seem likely to remain on the horizon for the next several years (see sidebar, **Consolidation in China still a way off**). Other smaller deals mostly concerned timber interests, as with the acquisition of 30% of Green & Good by Hong Kong based Superb Summit Timber International Timber Corp. The need to secure reliable fibre sourcing also motivated Bright Prosperous Holding, a Hong-Kong listed company involved in timber trading, to take over Brazilian timber assets from Amplewell.

Another large deal in the region involved Korea's Heesung Electronic, a maker of flat LCD displays, which purchased a 57.7% share of Daehan Pulp. The pulp company had been facing extreme financial difficulty due to raw material price increases and a serious down-turn in key markets. Daehan's chairman asked the Heesung group to acquire the company after it failed to find a buyer in an initial search which took place just as the economic crisis dampened investments. Analysts have criticised the deal, saying Heesung's rescue of Daehan lacks logical synergies.



### PwC viewpoint: Consolidation in China still a way off

In our recent analysis of the views of FPP CEOs, *CEO Perspectives*, a number of executives, both Chinese and non-Chinese, mentioned China as a region which could benefit substantially from consolidation. We believe that such consolidation will remain on the horizon for the next several years. Very few of China's smaller FPP players are in serious distress; while these companies may not be maximising potential returns, they are staying afloat. At the same time, many larger FPP companies in the region are taking a cautious approach to investments at the present time, preferring to conserve cash in the wake of the shake-up to demand experienced during the recent economic crisis. Taking both these factors together, we do not see a sufficiently strong economic driver to prompt major domestic consolidation in China in the immediate future. Given the hurdles facing foreign investors and the difficulties being experienced by most of the major FPP players globally, foreign direct investment also looks unlikely to drive significant activity.

Figure 7: Top deals in Asia Pacific (over \$100 million)

Date announced	Deal Value US\$(m)	Target	Target Nationality	Acquirer	Acquirer Nationality
Feb 09	460	Paper Australia Pty Ltd	Australia	Nippon Paper Group Inc	Japan
Sep 09	301	Timbercorp	Australia	Global Forest Partners LP	United States
Sep 09	271	Daehan Pulp Co Ltd (60.3%)	South Korea	Heesung Electronics Co Ltd	South Korea
March 09	245	Kishu Paper Co Ltd	Japan	Hokuetsu Paper Mills Ltd	Japan
March 09	240	Amplewell Holdings Ltd	Hong Kong	Bright Prosperous Holdings Ltd	Hong Kong
Sep 09	136	Norske Skog (Hebei) Paper Co Ltd	China	Shandong Huatai Paper Co Ltd	China
Dec 09	118	Matariki Forestry Group (minority stake)	New Zealand	Phaunos Timber Fund Limited	United Kingdom
Jul 09	110	Green & Good Group Ltd (30%)	China	Superb Summit International Timber Co Ltd	Hong Kong

Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

## 14 Deal places: Europe



In previous editions of *Branching Out* we have commented that consolidation is overdue in the industry, notably in the volume pulp and paper sector. With the focus upon cash flow and debt management, and in some cases sheer survival, little happened of strategic significance in 2009. Europe's deal activity this year was dominated by small transactions and distress-motivated sales of overseas interests (see Figure 8). The region's largest transaction, the purchase of a majority stake in Metsä-Botnia by Metsäliitto Cooperative, was part of a broader series of arrangements connected with the sale of Metsä-Botnia's and Metsäliitto's stakes in Uruguay to UPM that we discuss in the section on Latin America. The move takes the cooperative closer to its roots, as this long-standing representative of Finnish forest owners exchanged an interest in Latin American pulp production for a greater share of Finland's largest pulp producer, plus some cash.



Metsäliitto also sold their stake in Vapo Oy. Vapo, which is controlled by the Finnish State, is Finland's largest producer of peat, and also has a wood products business. However its strategy is focused on developing a portfolio of biomass fuel businesses in Finland and throughout the Baltic Sea region; it is already one of Europe's largest producers of woodfuel pellets. The Metsäliitto stake was acquired by Finnish utility EPV Energy for US\$219.6 million, in the region's second-largest deal that likely heralds similar transactions to come, particularly in Europe, as energy producers strive to meet ambitious goals in carbon reduction through a mix of renewable energy options, including biomass.

In a deal reflecting the perceived growth potential of Eastern Europe, Poland's Arctic Paper looked north to Sweden to acquire private equity-owned Grycksbo Paper Holding, a fine paper mill that was already producing speciality coated fine paper for Arctic. The company recently listed on the Warsaw Stock Exchange and has achieved above average results in recent quarters.

In another strategy driven by anticipated growth in Eastern Europe, Mondi sold its holdings in packaging businesses in France as part of the company's continuing move to shift its business emphasis from Western Europe to Central and Eastern Europe. The largest was the sale of two corrugated converting businesses in France to Europac, a Spanish paper packaging producer that was seeking conversion assets in that country.



## PwC viewpoint: “Sustainable” Packaging – Investor considerations

Under constant pressure from government, the media, customers and consumers, the packaging industry is increasingly being forced to consider how its products can be made more “sustainable”. Retailers and consumer goods companies have made numerous public pronouncements around their commitments to reducing the volume of packaging that they use and within the OECD at least 30 countries now have regulatory instruments aimed at reducing packaging waste. Of these countries, 13 have implemented some form of packaging tax.

Therefore it is increasingly important for investors in the packaging sector to carefully consider what risks and opportunities the trend towards more “sustainable” packaging presents to their investee companies. Packaging companies that are passive in addressing the trend are likely to see both profitability and market share ebb away. The companies that will succeed will be those that are attuned to the mood of the market and the regulators and develop compelling “sustainable” packaging propositions that still meet the customers’ fundamental functional and economic requirements.

Considering the following factors can help an investor come to an initial view on what impact the rise of more “sustainable” packaging is likely to have on their current or planned packaging investments and how well prepared those businesses are to mitigate the risk (or exploit the opportunity) of “sustainable” packaging.

- What regulations are on the horizon that could adversely (or positively) impact the demand for the packaging type the target company provides?
- What other market segments could your target serve where their packaging technology could legitimately be argued to be more sustainable than the competition?
- Does your target company understand which of its customers have made public announcements on their commitment to sustainability and if so how have they responded?
- Does its sales and marketing team understand and promote how “sustainable” their product is compared to competitors?
- Does it include sustainability as a key consideration in its new product development process?

PwC’s recent paper entitled “Sustainable Packaging – Threat or Opportunity” can be downloaded at [http://www.pwc.co.uk/pdf/sustainable\\_packaging\\_threat\\_or\\_opportunity.pdf](http://www.pwc.co.uk/pdf/sustainable_packaging_threat_or_opportunity.pdf)

**Figure 8: Top deals in Europe (over US\$50 million)**

Date announced	Deal Value US\$(m)	Target name	Target country	Acquirer name	Acquirer country
Oct 09	787	Metsä-Botnia AB Oy (27.7%)	Finland	Metsäliitto Cooperative	Finland
May 09	220	Vapo Oy (49.9%)	Finland	EPV Energy Ltd	Finland
Nov 09	128	Cham Paper Group Holding AG (65.8%)	Switzerland	BURU Holding AG	Switzerland
Nov 09	104	Herlitz AG (65.9944%)	Germany	Pelikan International Corp Bhd	Malaysia
Dec 09	91	Grycksbo Paper Holding AB	Sweden	Arctic Paper SA	Poland
Apr 09	55	Mondi Packaging Atlantique; Mondi Packaging Savoie	France	Papeles y Cartones de Europa SA - EUROPA&C	Spain

Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

# 16 Deal places: North America



The North American M&A activity in the FPP industry declined more than in any other region, dipping to around the US\$1bn level in 2009, with only 45 transactions (see Figure 9). Instead the focus in 2009 was on restructuring debt and operations.

Due to a poor economic outlook, declining US markets (e.g. newsprint) and the credit squeeze, pure-play FPP companies took time out from consolidation in 2009. US companies have been waiting for encouraging signs in the housing market before investing; some are focusing on paying down debt rather than making new acquisitions. Canadian companies were pressured by an increasing value of the Canadian dollar compared to the US dollar, coupled with a declining demand for most of their products. This led to historical low price trends and consequently limited interest from private equity and hedge fund investors.

With no viable methods of recapitalisation available, many North American companies had no other alternative than to formally restructure debt in order to access financing through Debtor in Possession (DIP) facilities. In the US, DIP financing is available to firms undergoing Chapter 11 bankruptcy; this type of

insolvency filing is complex and offers businesses with a viable opportunity to return to profitability and an opportunity to reorganise their operations. DIP financing is unique from other methods in that these creditors usually have priority over existing debt, equity and other claims; most is provided by asset-based lenders.

Since 2008, the face value of debt restructured in this way in the FPP sector in North America has surged to over US\$17.5bn. Leading the way were AbitibiBowater and Smurfit-Stone; the two companies restructured around US\$14bn of debt in 2009 alone. Formally restructuring debt enables companies to postpone payments to creditors, improves short-term liquidity and provides time to implement a long-term survival plan. Aware of these advantages, many firms are voluntarily filing before liquidity problems become too severe to rectify. In one recent example, newsprint producer White Birch announced in February 2010 that it is seeking approval for a US\$140 million DIP financing. In addition, there are other out-of-court restructurings in process, such as Catalyst's restructuring of approximately CAN\$950 million of its debt.

The majority of transactions in North America during 2009 stem from distress-

Figure 9: North American deal values and numbers – 2003-2009



Source: PricewaterhouseCoopers: Branching Out: Global deal activity in the forest, paper and packaging industry, 2008 edition; Forest, paper and packaging deals: 2008 annual review; Forest, paper and packaging deals: Branching Out – 2009 Annual Review

motivated sales, reflecting significant liquidity challenges and production curtailments faced by the industry. Several of the top transactions in North America involved divestitures of forest holdings not critical to on-going operations. Weyerhaeuser, AbitibiBowater and Smurfit Stone sold timberlands to The Campbell Group LLC (a Timberland Investment Fund), to local government and to labour-sponsored equity funds (see Figure 10). Other transactions were secondary deals, as distress funds which have already invested in the sector looked to consolidate their position in portfolio companies. Brookfield provided two examples of such actions when it increased its stake in struggling wood panels producer Norbord, and more recently provided DIP funds to Fraser Paper.

Unlike in other industries where market leaders and foreign investors are currently looking to capitalise on low valuations to pursue opportunistic acquisitions, FPP industry leaders in North America are likely to continue focusing on de-leveraging before resuming other M&A activity. North American companies went into the downturn already much more highly leveraged than those in any other region; they will need to improve their balance sheets before making other

types of deals. Indeed, the restructuring numbers in the US could have been even higher. A number of major US-based pulp producers have benefitted from “black liquor” tax credits for renewable energy production; these payments represented an important infusion of cash for many sector companies through to the end of 2009, although they have since expired. Information from SEC filings suggests that the overall pay-out for fiscal 2009 is at least US\$6.5bn.

Industry dynamics are indisputably difficult: many producers are facing going concern liquidity challenges and are putting themselves in survival mode. Many companies are radically cutting costs, closing mills and reducing headcounts. Those with the most liquidity will be fortunate enough to come out of the trough and will probably have many interesting opportunities to make strategic acquisitions or investments. However, this will not be easy since this trough is expected to last until at least 2011, if not until 2012. The industry’s safest course of action is to stay in survival mode and keep in mind that stakeholders are demonstrating a willingness to work with companies in the FPP sector and to determine creative solutions that will support the necessary rationalisation and consolidation in due course.

Figure 10: North American top deals (over US\$100 million) and selected other deals

Date announced	Deal Value US\$(m)	Target name	Target country	Acquirer name	Acquirer country
Aug 09	300	Weyerhaeuser Co (140,000 acres of timberland)	United States	Campbell Group LLC	United States
Dec 09	185	Fraser Papers Inc (Core Specialty Papers Business)	Canada	Brookfield Asset Management Inc	Canada
Jan 09	119	Norbord Inc (37.773%)	Canada	Brookfield Asset Management Inc	Canada
Nov 09	56	Smurfit Stone Container Canada, Inc. (389,000 hectares of timberland in Quebec)	Canada	Société générale de financement du Québec (SGF)	Canada
Sep 09	49	AbitibiBowater Inc (121,000 hectares (300,000 acres) of private timberlands in Quebec, Canada)	Canada	Investor Group (Societe de gestion d’actifs forestiers Solifor, s.e.c. and Amenagements forestiers Portneuf)	Canada
Sep 09	42	AbitibiBowater Inc (Private timberlands)	Canada	Undisclosed Acquirer	Canada

Source: PricewaterhouseCoopers Forest, paper and packaging deals: Branching Out – 2009 Annual Review

PwC spotlight: Biopathways to a greener future

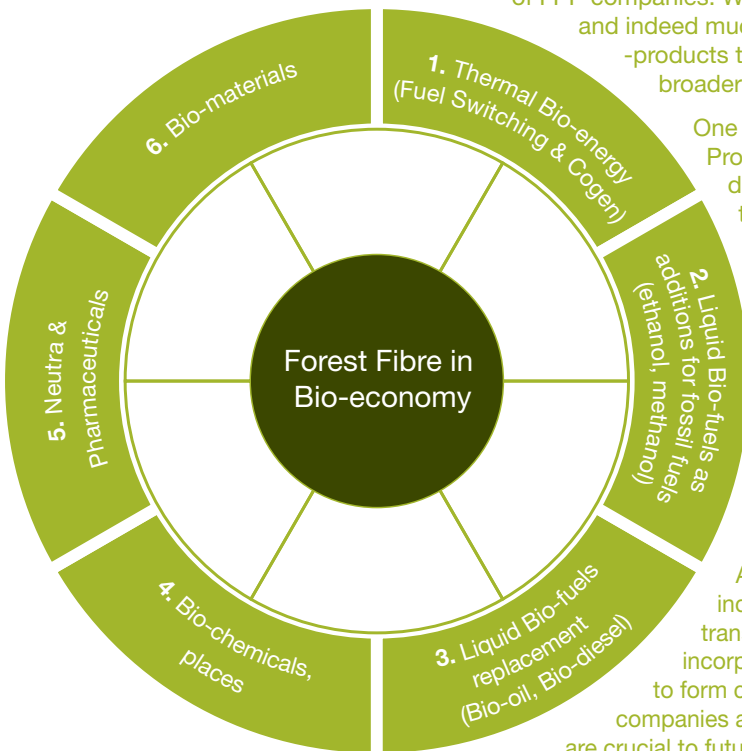
Figure 11: Forest bio-products continuum

Several of our recent publications and events have highlighted the importance that looking towards alternative products and uses for forest fibre may have for the future of FPP companies. While bio-energy production is the best known of these options, and indeed much of the FPP industry has long utilised the potential of its waste -products to generate heat and energy, it is only one aspect of a much broader spectrum of usages for forest fibre.

One recent study we would highlight is in Canada, where the Forest Products Association of Canada (FPAC) has sponsored an in-depth look at the economics of such collaborations, hoping to chart a path for the recovery of the Canadian industry. The results confirm what we have long suspected; forestlands can generate the most economic value, if traditional forest products manufacturing activities are integrated with new biotechnologies. FPAC's research shows that an integrated mill – one that produces wood, pulp or paper as well as bio-energy and bio-materials (see Figure 11) – might provide five times as many jobs as a stand-alone bio-operation. FPAC also estimates that Canada has the capacity to produce clean power on the scale of nine nuclear reactors; a critical factor as Canada and other nations look to shift to a low-carbon economy.

A bright future is not assured, though. FPAC states that the industry will need to mobilise for change and adopt and embrace transformation. Companies will need to transform business lines to incorporate the production of new bio-products. They will also need to form cross-sectoral partnerships – particularly among forest product companies and bio-technology providers, but also with other industries – which are crucial to future commercial success and businesses' ongoing competitiveness. Government incentives may also be necessary, given the industry's financial struggles.

If Canadian companies embrace the model proposed by FPAC, and are able to develop creative partnerships, broader business models integrating bio-products could prove to be a significant driver of deals in the future.



Source: Transforming Canada's Forest Products Industry: Summary of findings from the Future Bio-pathways Project, FPAC, February, 2010.

In this latest edition of *Branching Out*, we continue to track the development of timberland as an asset class.

In 2009, deal volume for timberland was down significantly; nonetheless, the sector continues to drive transaction activity and investor interest in timberland as an asset class remains high. A noticeable trend was the growing geographic diversity of sizeable timberland deals. This in turn reflects the broadening of the investor base which was once overwhelmingly concentrated in North America. A further trend has been the investment by timberland funds in young or development properties rather than just established timberlands; by their nature, these fall below the radar of this review but should provide the basis for new deal flow in the future – even if some years away.

Although timber prices have fallen, timberland values have not declined significantly in the wake of the global downturn, as valuations are generally based on anticipated long-term yields. On a year-to-year basis valuations are more sensitive to variations in discount rates than to timber prices. There is, however, some uncertainty in the marketplace around timber values. Cash-flow return on timberland has declined, as many forest-owners are choosing to ‘store on the stump’ and postpone cutting until prices on saw logs improve. This year’s numbers for timberland transactions were negatively impacted by a number of planned deals which didn’t happen; International Paper’s planned US \$275 million sale of 143,000 acres (around 58,000 hectares) to American Forestlands is one example; Great Southern Plantation’s (Australia) failure to find a buyer for its plantations, even though in receivership, is another.

Historically, strong deal volume in the timberland sector was driven by vertically integrated forest products producers selling major forestland assets as part of a strategic decision to focus on core operating activities, particularly in the US. This source of deal flow, in North America at least, has been largely exhausted, with nearly all companies interested in divesting these assets having sold already.

International Paper is the prime example of a company following this strategy. As we noted last year, secondary deals now account for a large portion of deal activity, and these types of transactions are largely down in North America, formerly the dominant region for such deals.

An example of the widening investor base and acquisition targets is provided by Phaunos Timber Fund. This UK-listed, closed-end investment company managed out of the US disclosed commitments to various timberland and related projects around the world totalling almost US\$700 million at the end of September 2009. It is investing in a diverse portfolio of assets in terms of geography, species and age class. During 2009, it had invested or had outstanding commitments to projects in North and South America, Africa, China, SE Asia, Australasia and Eastern Europe. As noted, it featured in some of the largest timberland acquisitions last year.

As another example of both the underlying institutional investor interest outside North America and also of the willingness of some such investors to invest directly rather than via established timberland fund structures, last year, ATP, a large pension fund in Denmark, announced that it had committed 3 billion Danish kroner (US\$582 million) to a portfolio of direct investments in timberland.

Some trends from 2009 point to future sources of timberland deal flow outside North America, including anticipated government sales in Australia and possible divestitures by Latin American companies seeking funds to invest in operating assets. We discuss these trends in greater detail in our regional reviews.

In conclusion, institutional investors are focusing on opportunities in the natural-resources sector by investing in timberland with its appeal as a renewable resource, providing a return over the long-term and as a hedge against inflation.

In doing so the range of opportunity is widening geographically and by type of timberland asset. This trend seems set to continue as investors look for alternative investments with solid asset backing.



## 20 Looking ahead



Given the mainly dire economic environment and restricted credit markets, total deal value held up remarkably well in 2009, due to the blockbuster transactions in Latin America. Without that, total 2009 deal value would have collapsed and the year would have been characterised by numerous small value deals. As we look ahead into the start of a new decade with economic conditions tepid at best, it seems unlikely there will be any factors that will drive larger deal activity in 2010.

In North America and Europe, the rationalisation of capacity, general cost cutting and deleveraging of balance sheets have still to run their course. The major consolidation needed in Europe especially to address shrinking demand is likely to remain as elusive as ever in the near term. Distress, selective acquisitions to enhance market positions and disposals to exit non-core businesses are the factors likely to drive a continuing flow of smaller value deals in the immediate future.

Looking further ahead, we believe there are a few dominant themes that will drive deal activity as the decade unfolds; these are not new and have been highlighted in previous publications:

- **Consolidation.** Most market structures within FPP remain fragmented and consolidation will continue to provide the opportunity to enhance returns. The financial imperative to consolidate remains greatest where end-markets are mature and consolidation would enable capacity and the cost base to be managed more effectively in the face of static or declining demand. European paper remains a prime example.

- **Product specialisation** has driven and will continue to drive transactions as companies seek to focus on or strengthen their chosen core businesses, through deals that bridge gaps in their core offerings or that expand or maintain market share.
- **Fibre resources.** The acquisition of fibre resources seems set to gain further momentum, driven by either the returns and/or the security to be achieved from controlling a sustainable and renewable resource. The attractiveness of timberland assets to financial investors will continue and drive deals, enhanced by recognition of the value represented by forest carbon, and even entire ecosystem value sometime in the future. Companies will also look to secure the resources needed to generate returns downstream from wood and paper products, as well as from energy and the bioproducts of the future. Paper producers may begin looking to move to strengthen ties with pulp producers, or perhaps even towards greater backwards integration. Similar considerations apply to waste fibre which is increasingly seen as a valuable resource and not as waste.

This pivotal role of fibre was emphasised in our 2009 discussions with FPP CEOs, published in *CEO Perspectives*. Many executives, particularly in Europe, flagged long-term fibre supply as a critical issue. At the time of writing, pressure on pulp prices looked likely to increase as a major earthquake in February 2010 is impacting Chilean pulp production and disrupting global supply. Further, government subsidies designed to promote green energy are affecting market dynamics as energy producers compete with pulp and panels producers for woody biomass.

Combined biomass/pulp plants may also become a viable model; innovative business cooperations will doubtless be needed. New investors will look to the fibre value chain for diverse opportunities which should provide the platform for growth strategies by existing players and new entrants alike, and underpin the established strategies of existing players.

In previous publications we have sometimes looked in detail at the potential impact of private equity (for which purpose we exclude TIMOs) on the FPP deals market. At present, private equity looks unlikely to play a transformational role in upstream businesses including large scale commodity wood and paper products manufacture. Private equity funds will, however, continue to be involved in transactions in downstream sectors, including secondary deals as current investors refine their portfolios.

These are themes that will provide the context for an upturn in deal activity, but the timing and pace of such an upturn remains uncertain. In 2010 at least we can expect to see small value deals in the ascendancy. In *CEO Perspectives*, we also concluded that many CEOs have been concentrating on short-term survival at the expense of longer-term strategies; only once genuine confidence about the future returns can we expect to see a return of larger value deals. Deal activity should therefore start to resume momentum when any combination of improved market fundamentals, strengthened balance sheets, and stronger credit markets makes target assets look to be not just good value, but also financeable again.

## 22 Our transactions expertise

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Our financial, operational, strategic, structuring and corporate finance specialists work alongside our other specialists within the firm including tax M&A, pensions, valuation, IT and environmental.

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