

Change for the better

Stora Enso's CEO Jouko Karvinen discusses the key events of 2009 and looks ahead to 2010 and beyond.



How did the organisation deal with the challenges of 2009?

Timing was the most critical element – we started the year three months early. In October 2008 we realised that 2009 would be different to anything that we had seen in the past 10 or 15 years. We had a clear focus: strong cash flow. We minimised operational costs and maximised cash flow through effective working capital management and reduced capital expenditure. I believe our results for 2009 show that these were the right actions at the right time.

We stopped what we thought was not really critical almost immediately. We became more selective, and focused on investing only where we saw sustainable long-term returns. Some areas of our organisation were tasked with cutting most of their spending while others were asked to cut almost nothing at all, because we see them as central to our future. Specifically, we made a point of not saying, “Everyone must save x% for the annual cost control programme of 2009.”

Our Next Step programme, which we launched in April, means that we are committed to building our future in the toughest operating environment imaginable – hence this year we have held onto our plantations in Uruguay and China. In the spring we acquired the majority of ENCE’s operations in Uruguay in partnership with Arauco. This gives us a strong position in low-cost plantation-based pulp and increases our strategic options in Latin America dramatically. Perhaps no one expected that in the current environment.

Why was the management team able to respond quickly and early to the crisis for demand?

Because by 1 January 2009 we had already put one quarter of maximising our cash flow behind us. That meant there was no discussion. We knew exactly what we were going to do as we had had practice. Furthermore, the management team of the company had worked together for more than a year. There was no need for introductions or big speeches; we just faced the reality and implemented.

I cannot emphasise enough how important this was. The tougher the environment – and it was really tough in 2009 – the more important it is that you do not end up talking and negotiating, that you hit the ground running.

Aside from good cash flow, what other benefits have there been from these early actions?

The cost structure is clearly lower. We have taken significant costs out of the system. As a result, our people and external observers have seen that this company can reduce its debt and generate cash in even the most brutal of circumstances. They understand that when some of the demand comes back – which it will – the positive returns of a lower cost base will be there.

In the autumn we said publicly that we had proof that our actions are working. The real news is that by the third quarter we had shown only one third of the impact of our announced

“For Stora Enso, change is not an option – it’s a necessity born of the need to prosper today and tomorrow.”

Jouko Karvinen | CEO of Stora Enso

programmes. So anyone watching us knows that there is some positive momentum in the company, and that this will help carry us through the challenges of 2010.

There have been permanent and temporary lay-offs in 2009 too. How have people in the company responded?

Those people who have faced permanent or very long temporary lay-offs are obviously disappointed and even angry. That is not a surprise and is very understandable. When we make hard choices to protect the company and the majority of its employees, some individuals and groups of employees suffer. We make these difficult choices to ensure that our mills with potential for a long-term competitive cost structure survive and improve through selective investments.

Very early in the year when demand went down by a fifth, we said that if we have paper machines for five paper rolls and customers for four paper rolls, then one would have to stand. I have been open and said that this is not about sharing the pain equally. Clearly it has been really difficult for the Stora Enso people who were most affected by this.

Unfortunately cost structure issues in Finland hit us, mostly outside our mill gates. This has led to closures and plans to cut down our capacity ever further. Curtailments were very dramatic in 2009 too. As a result our Finnish organisation had to take more downtime and temporary lay-offs than other parts of Stora Enso.

As angry and emotional as people are, however, I believe that there is also an understanding that in tough times sometimes you have to do things that hurt a minority of people to secure the future of the company and, with it, the future of the majority of its people.

Back in 2007 we took early actions with difficult consequences for our own organisation at a time when almost everyone else said that there was no need for action. People asked what we were doing. Now that we have all seen the trauma in the world economy and our industry, I sincerely hope people understand that the longer you wait, the bigger the damage tends to be.

Our people have shown resilience and loyalty. They have been willing to go through very tough times, more so than I had ever expected. To do that they need to believe that we are working for a better future, even if they do not see the impact yet. I hope the signal from both inside and outside the company is that we are fighting not just to get through the storm, but also to build our long-term future.

Are you satisfied with the way the company has responded to the challenges of 2009?

There is a saying that you should never be satisfied. The moment you say that you are satisfied, you go backwards, you give up on making tomorrow better than today, you give up on improving productivity, quality, cost and customer service. That is why I



The Stora Enso Leadership Forum was held in Stockholm in November 2009.

do not want to use the word “satisfied” but I do want to say that the people in our organisation impress me. Not only by their loyalty and resilience, but also by how well and quickly they responded when we had to restructure the company. I am not easily impressed, but this did impress me. Our speed is one of our competitive strengths, and I want us to maintain and even increase that speed.

I say that with a footnote. At a recent Leadership Forum, one of our younger colleagues said to me, “Jouko, as a company we are still an elephant, but at least this elephant now runs very fast.” I was glad to hear that. However, I am sure my young colleague agrees with me that to get where we want to be in a few years we had better not remain an elephant.

Is that why the theme for this annual report is “change for the better”?

Yes. It takes time to get 27 000 people to hear, understand, challenge and act on any idea. It is not a question of people’s willingness; it is the challenge of being truly understood, of working together effectively, of overcoming the inertia in getting things done.

Accelerating change comes from the thought that a big company is like a big flywheel. It takes time to get moving, but once it moves, nothing will stop it. We need to continue to push so that the flywheel moves faster.

I have experienced this energy of moving faster in our Leadership Forums with our top management and younger talents, the latter of which made up almost half of the participants in 2009. Every year more people seem to understand this message, which suggests that it is taking effect.

Another big event last year was restructuring from six business areas to four.

We consolidated Publication Paper by merging Newsprint & Book Paper and Magazine Paper, and we merged Consumer Board and Industrial Packaging to create a single unit called Packaging. Now we have four business areas: Packaging, Publication Paper, Fine Paper and Wood Products.

The goal of consolidating the business areas was to create more significant and powerful organisations without adding new layers to the Group. One of the first things we did when I came to the company was to remove an organisational layer to ensure fewer steps from top to bottom. This was an intentionally temporary change to get close to the business areas, learn more about them and start accelerated change. Later we reconsolidated – it was not an accident that we put Packaging together like it used to be, or created Publication Paper.

This consolidation is about far more than cost saving, although that is one clear benefit. When you change your structure, you open the door to rethinking what you really need. That is a lot more effective than the more traditional approach of identifying



cost cuts and then asking everyone to cut 20%. Actually that's suicide for any company because you kill the good along with the bad – it does not work in a market economy.

So the business areas will be more autonomous – why?

They will be interdependent and part of the Group, and the Group's priorities will always come first, but now they have true accountability and responsibility for managing their own profit and loss. I believe that in the past too many of the costs of the profit-and-loss responsible business areas were actually managed by a corporate function. We wanted to change that through the user boards in critical areas like Wood Supply, Logistics, Purchasing and Energy.

Our business area people serve third-party customers in competition with other companies, so they should drive our competitive strategies too. Everyone else is there to support the business, be it the corporate organisations or myself. All Group functions serve the business areas – the same business areas that earn our salaries by serving their customers and competing with our competitors.

For a company of our size, the reorganisation is not only about economies of scale. It is about focus, finding synergies that are mostly within the segments. The fact that we do paper in one business area, board in the other and mechanical wood processing in a third is not that exciting. Focus is what's exciting – focus on the customers and how to win their minds, focus on

the channels to market and the resource base, meaning the fibre base, energy and all of that.

The priority for our people and their teams is to serve their customers better than the competition, rather than to worry about losing the last ten euros through the Group's economy of scale. I believe that there are also *d*iseconomies of complexity to consider. If you start controlling and co-ordinating too much across a big company, you lose much more than you will win by focusing on customers of the individual businesses. And yes, that means the business areas will compete internally for resources – where the company should and should not invest, expand, grow – as elements of the Group. Those choices are critical for the Group's future.

This underlines our theme of accelerating change. Some say that we have been hasty in our actions over the last two-and-a-half years, with the implication that we should have worked for at least two years to complete our strategy before acting. My response is that if I had sat in my office and thought about strategy for two-and-a-half years, we would be in big trouble by now. Change will never stop.

So are the business areas better able to differentiate themselves in the market now?

They have the focus and accountability, and the duty and the right to ask for what they need from the Group and its support functions. The role of the small top management team is more

Langerbrugge Mill in Belgium produces newsprint and uncoated magazine paper from 100% recovered fibre, sourced from the surrounding area. The mill is currently undergoing extensive upgrading with a revolutionary waste and biofuel burning boiler for energy production.

about strategic dialogue, managing performance to ensure that we deliver what we promise, and making portfolio choices on where to invest. As I have said, the future of this company is not about cutting costs or investing evenly and equally. I think we are getting better at discarding investment proposals that do not offer competitive differentiation or a return that clearly exceeds our cost of capital by quite a margin.

Turning to the individual business areas, have Wood Products managed to turn things around from year 2008?

Wood Products turned a profit by mid-year through really hard work and tough, aggressive capacity cuts – to the credit of the team, as it was not simply a recovery in the market. When that happened we started talking strategy, because I had promised that we would do so when they stop burning money, which they did!

If you look at their macro-economic factors and their market fundamentals, they are one of our really interesting businesses, because wood is a sustainable construction material today and even more so tomorrow. The strategic path for Wood Products is more added-value products – plus my favourite question: what can we do that cannot be copied overnight by every small competitor? Whether we are thinking about engineered wood products, Latin America or China, there's a common thesis across the business areas: are we – or can we become – the best in the world to do this?

I have high hopes that the Wood Products team can move on from merely restructuring to building a successful future.

Pharma DDSi is an intelligent packaging for pharmaceuticals. This highly advanced solution is based on an embedded microchip and conductive printing. It enables monitoring of a patient's compliance with their drug prescription, a prerequisite for effective medication.

How did Packaging perform in 2009? Innovation seemed to be particularly important.

We have some very strong packaging businesses that I sincerely believe have sustainable competitive differentiation. We have unique product know-how and long-term customer relationships. That means we can develop new solutions together with customers, which is not typical in our industry.

We have developed and launched new lighter board materials and consumer packaging solutions in 2009, such as DeLight Solution, a new paperboard tray packaging for the food packaging industry, and intelligent Pharma DDSi packaging for pharmaceuticals. DeLight Solution is based on our own Trayforma food packaging board that preserves food longer. Some 40% of food is thrown away uneaten, would you believe? Or did you know that 100 million tonnes of PVC is used every year for packaging, of which 90 million tonnes ends up in landfill?

In innovation, one of our challenges is getting to market quickly and effectively. We are a big company. It is very nice to tell innovation stories but if we do not see revenues of hundreds of millions of euros in the medium term it will not really make a difference to the Group. We have learnt that in Packaging, and sharpened our organisation to ensure that our new research and development agenda is based on value-driven innovation and consists of a portfolio of selected projects aligned with our business strategy.

Trayforma is a fibre-based food packaging material. It protects food, keeps it fresh longer, can be heated in a microwave or conventional oven, can be printed on and shaped for enhanced brand differentiation, and is environmentally friendly.

I see Packaging as one of our future cornerstones, given their strong strategy, new market development plans and track record. If anything, I would like Packaging to accelerate their own change.

I am also pleased with the way Packaging – and in particular Consumer Board – managed in 2009, especially the multiple challenges in the first half of the year. They had to face a sharp decline in demand due to both the financial crisis and the aftermath of the milk scandal in China, and prepare themselves for a potentially sharp increase in Russian duty on wood. Thanks to early capacity cuts and careful capacity management they improved price quality and increased profitability in some key segments. The consumer board market rebounded earlier than the paper market; we noticed that the third quarter was the same as the year before, and that the fourth quarter was above the same period in 2008.

That brings us to Publication Paper. Can you tell us about the new investments at Langerbrugge Mill and Maxau Mill?

We continued our power plant investments at Langerbrugge in Belgium and Maxau in Germany in 2009, even though it was a tough year and we cut capital expenditure dramatically. This was not an automatic decision, because we knew that it was going to be tough, but we stuck to our plans and now the beauty of it will be positive impact in 2010. As well as the environmental benefit, there will be material cost savings in early 2010. The lesson is that you have to be selective in your investments and not cut your future, which means that there will be deeper cuts in other areas, unfortunately.

What about the challenge of paperless media to Publication Paper?

What bothers me about this paperless media story, the idea that with the growth of digital media people need dramatically less paper, is that it is very much an emotional discussion, trying to copy-paste onto our European business the structural changes in North America. The underlying drivers are very different. Newspapers in the US are more media and advertising funded than in Europe, and adverts are a lot more of the actual physical content delivered to readers. We see a clear difference and bigger potential in Europe, where subscription is the greatest source of funding. So I do not quite buy the idea that we will see an identical repeat of the US situation in Europe for the same reasons.

The second issue, which is perhaps more important, is the notion that if a market does not grow you cannot make money out of it.

I heard a saying recently, a variation of a very old saying: "In God we trust; everyone else bring data." Every data set that I see says that we will have a newsprint market in Europe for decades to come. Will it be a smaller market? Yes, but that is okay because in newsprint, and selected areas in magazine paper, we have strong total cost positions and will keep improving them with investments like Langerbrugge and Maxau. You have to look at the total cost structure, not just the speed and width of your paper machine. It is no longer just about the assets; it is about resources, the total cost of production.

I am proud of what our team has done in a market that is not growing, as well as what our magazine paper people have been able to achieve in selected areas. I think that the newsprint team has done well against our peers for cost, managing our customer relationships and pricing quality.

Finally, how was the year for Fine Paper?

Fine Paper is one of the most challenged business areas because in the past couple of years a significant part of the virgin fibre base has effectively disappeared due to Russian wood duties. Fine paper is short fibre essentially, of which Russian birch wood used to be a significant source of supply for uncoated office paper. For coated paper we have been able to make use of our investment in the best pulp mill in the world at Veracel in Bahia, Brazil, which has been vital.

Fine Paper faces structural issues because of existing over-capacity in Europe, as well as EU-supported subsidies to build new capacity, which really does not help. Full credit to the Fine Paper team – they fought hard to maintain price quality and market share, and worked diligently with their channel partners and customers to make the best of the situation. Against the reality that we are in, which is pretty brutal, I am convinced that this team knows how to deal with any situation.

Customer relationships are crucial in Fine Paper because we sell a significant amount through merchants. Here we are talking about both channel relationships and relationships with big customers. Our Fine Paper business benefits from strong customer relationships.

Why has the Group begun using a Net Promoter Score in 2009?*

We have introduced a Net Promoter Score (NPS) to understand our customers' top five buying criteria and how we rank against these in comparison to our competition in all business areas. More importantly, we want to build competitive differentiation further by looking at criteria like service quality, product quality, delivery reliability and new product development – issues that really matter to our customers. The excitement for me is what actions we can take based on a better understanding of what our customers want and need.

Paper is a commodity product and there is nothing wrong with that. Our cost and quality position has to be good, and improve every year; we must never stop that. But I do think that we need to consider other aspects from the customer's point of view even more. NPS is a good tool for us to understand what really matters to our customers.

Can you comment on the Group's new strategy, which began to take effect in 2009?

In 2008 we set three strategic priorities: fibre-based packaging; cost-competitive plantation-based pulp as a raw material for paper and board in growth markets; and focusing on selected paper grades.

First, fibre-based packaging has an amazing story to tell of why it is important, why it will grow, and why we need to get rid of

plastics and replace these with renewables in areas such as consumer food, liquid and consumer electronics. I think people understand this story and it is a very strong fit with Stora Enso, both for industrial and consumer packaging.

Second, investing in growth markets. I think this story is well understood and even wows people. The company invested early, not only in the joint venture pulp mill and plantations at Veracel in Bahia, but also in good growth options in China, Brazil and Uruguay. The investment case is pretty solid. We know what we are doing, our plantations are very productive and we are proud to say that we are doing things the right way. We have invited non-governmental organisations (NGOs) to see our plantations, which is an important part of our work. We have worked together with Brazilian NGOs, holding discussions and receiving support from many of them. As a result, we are in a very interesting position to consider the when, where and how of our next investment.

Third, the most challenging part of our strategy has been focusing on selected paper grades. This means becoming stronger in fewer paper grades. It takes considerable diligence to find opportunities to make this happen structurally in terms of consolidation or synergy. So far we have not found anything that would really make sense to our shareholders. That does not mean we are giving up, but the most important message to our people in the different paper grade businesses – like everybody else – is that we cannot wait while we try to find structural solutions that realise our strategy. Every day we have to improve. The good thing is that the team has understood this. Everything we do on our own now will make us a more interesting partner and create more value for our shareholders.

I think we have a good understanding of how to add value in consolidation, and what is and is not true synergy. We should keep doing everything we can on our own. We are not waiting for anything or anyone, nor are we giving up; we are trying to find solutions that will be effective, and create value for our shareholders.

Wood Products has very attractive market characteristics in terms of the planet, people and – when done right – profitability. There is quite a bit more work needed on the strategy, but if you look at the potential of wood-based solutions in both private and public construction, even in multi-storey buildings, then there are real opportunities for us to develop.

Related to that are solid biofuels. We have a liquid biofuel demonstration plant and we are one of the significant players in the Nordics for solid biofuels too, both for biomass and pellets. This is another interesting opportunity for the Wood Products team.

Are you concerned that all this talk of strategy could divert the Group from profitability?

There is an old saying about strategy that you do not need it if you cannot eat. I think we need to keep the crew improving operationally so that we are financially sound, and to maintain

* Net Promoter is a management tool that quantifies the loyalty of a company's customer relationships.



Jouko Karvinen met with plantation workers in Guangxi province, China, in August 2009.

a balance sheet so that we can control our own destiny for events such as the need to invest in something rapidly when the opportunity comes.

Our investment in Uruguay in 2009 was a great example of that. It was important that we had the freedom, ability and credibility to make such an investment. And vice versa: we need to have the ability to take out capacity when required.

Can you tell us why Stora Enso made the investment in Uruguay?

The investment case for Uruguay is simple. Plantation-based pulp is one of those products for which cost curves are steep – in other words, you can build sustainable material cost differentiation. Fibre is a commodity but it is a global commodity, unlike paper and board. For instance, we use pulp from Veracel in Brazil at our Oulu fine paper mill in Finland and in Suzhou Mill in China. This is cost competitive even after the pulp has travelled from Latin America.

The challenge is that our investment decisions are 30-year bets. You need to consider not only the risks, but also variables like currency sensitivities, pricing, volume and timing. So good preparation is very important. Uruguay is a very interesting location for us. It has well developed legislation, education and land ownership regulation. Given the sheer size of our project there, if we invest in a mill, I think you'll see it reflected in Uruguay's gross domestic product.

The investment case in Brazil is very clear too. We know the country and the region. We have the support from the state and national organisations – albeit with some challenges. We feel very good about our corporate responsibility – a lot better than some of the media feels about it, to be precise. We are working with partners to give us more investment opportunities and avoid having to take all the risk on a single investment.

Why do you describe Stora Enso as a renewable materials company and not a forestry company?

The underlying challenges for the planet are to reduce its dependency on fossil resources, spend less on resources and reuse resources. "Renewable materials" captures all of those.

For some reason this industry has always been called the forest industry, whereas I think we should define ourselves by the value that we add. The car industry does not call itself the sheet metal industry – it is not there for sheet metal; it is there to build cars for consumers.

We have taken a step forward by saying that we are about renewable materials, instead of this or that product. We need to create customer and consumer value out of this in products, of course, but I do think that it is a very down-to-earth and honest statement of what this company is all about. It is also intentionally rather wide, as we do not know precisely where innovation and external factors will lead us.



In the past two-and-a-half years we have come up with many small examples of our focus as a renewable materials company, such as renewable paint cans, furniture made from corrugated board, and small houses for emergency use in natural catastrophe areas. I am not pointing them out as brilliant business but each is at least a conscious choice to focus on renewable materials.

Change never stops: it is a path. We are on a journey to figure out what this company will make money from and create value out of in 5, 10 and 20 years' time. We are not going to simply put a "bio" stamp on everything because to me that is not serious. I think that putting the word "bio" in front of everything is fairly dangerous because we could lose its real value if people start calling our product "bio-paper" as they now use the term biofuels. We will see additional tangible examples of our focus on renewable materials in 2010.

I think we have been reticent in areas that are totally new for us, like biodiesel or bio-gasification. Strategically, our biodiesel plant at Varkaus, which I hold in the highest regard, is actually a large-scale demonstration plant. I have been holding back my own team from over-publicising it, telling them to first walk before we talk too much.

Can you explain what you mean by the term "global responsibility"?

It is about being responsible for our actions worldwide. Our actions affect many people and we are responsible for this.

I do not want to hear that something is not our problem, even if it is a sub-contractor or a local village issue. Plus, social responsibility is not only about land rights; it is also about people affected by mill closures in Finland and Germany going through hell. When we take responsibility for these situations we can make a difference.

At Baienfurt Mill in Germany, which we closed at the end of 2008, 220 out of 350 people who lost their jobs have gone on to further employment. At Summa Mill in Finland, which ceased production in January 2008, we have helped 30 entrepreneurs who lost their job to start their own ventures. It is never going to be a perfect fit, but these examples at least show that we can – and must – help the people affected to rebuild their lives.

We had curtailments and lay-offs last year, for example at both Sunila Pulp Mill and Varkaus Mill in Finland. By late August, just after publishing the potential shutdowns, we were already hard at work finding ways to support the local communities. Our thought was: why on earth should we wait before taking action to help these people? The sooner you act, the better.

We also need to think and act proactively about other challenges. One example is a long-running dispute about old-growth forests in Finnish Forest Lapland. This was resolved in November 2009, partly due to our efforts to facilitate an open dialogue involving Greenpeace, the Finnish state forestry

Jouko Karvinen (on the right) in discussion with Oliver Salge, Head of Forest Campaign Greenpeace Germany. They met in Peurakaira, Finland, in October 2009.



enterprise Metsähallitus and local stakeholders. What really struck me about this case was the importance of learning from each other and the fact that we all came out of our trenches and found a basis for consensus.



Global responsibility means that we need to make sure we are doing the right thing every day, and value transparency and fairness in all that we do. For this reason, global responsibility cannot be a separate department in the company. I need to see myself as the Group's leader of global responsibility.



Global responsibility also means that we need to listen before we talk. In Guangxi, for example, we have to be clear that we are not there to teach people. We must respect the people and challenges there and recognise that our starting points are very different.

But lots of companies claim sustainability, don't they?

Sustainability is most often understood as the legal license to operate – but for us I would like to see it at the heart of everything we do. It should be a way for us to differentiate ourselves competitively one day.



We have not communicated well enough how exceptional this company is in global responsibility, which is a shame, as it is something for which the Group has worked very hard for a long time. In the Dow Jones Sustainability Indexes, we are the only forestry and paper company in the European DJSI STOXX index, and have been included since its launch in 2001. This is just one example of the awards that we have received and the rankings that list us. Awards do not make us a perfect company, but one of their great virtues is that the minute you stop working for them the awards body will throw you out. This fits very well with my basic belief that you have to improve, improve, improve.



In December 2009, I had the honour of signing the UN Global Compact's CEO Water Mandate, confirming Stora Enso's strong commitment to prioritising sustainable water use. Water scarcity is a global concern that is becoming increasingly important for Stora Enso and the whole paper and packaging industry. We will focus on this more in the future.



In 2009 I travelled to China to meet villagers in Guangxi and discuss our impact there. They told me that the plantations were making their lives better. The reality is that China is complex, particularly its land ownership issues, but I sincerely believe that we have a strong opportunity to make tomorrow better than today for our people and local business partners. I am passionate that we will get even better at this.

In Uruguay we must first do everything that we did right in Brazil and China, and then we must improve, do better than ever before. That will include communities and other stakeholders being part of the process of assessing the impacts of our efforts on the larger community. Technically, environmentally and socially, I want this to be the best project we ever did. And yes, I will say the same thing to our teams in China and Brazil too – improve, improve, improve.