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EDITED TRANSCRIPT

Q3 2020 Stora Enso Oyj Earnings Call

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PRESENTATION

Ulla Paajanen-Sainio *Stora Enso Oyj - Senior VP of IR & Head of IR*

Hello. This is Ulla Paajanen from Stora Enso. You have now joined Stora Enso Q3 Earnings Conference Call. I have here today with me our CEO, Annica Bresky; and our CFO, Seppo Parvi. So Annica will start now. Annica, please go ahead.

Annica Bresky *Stora Enso Oyj - President & CEO*

Thank you, Ulla, and welcome to our Q3 report. We delivered a solid quarter under very challenging business environment. If you could just change slide, please.

Our focus remains on cash flow and profit protection, and I think that is the important thing to keep focus on during these uncertain times. We see a strong performance from Packaging Materials, Wood Products and Forest division. If I give you just an overview now of our group results, compared to last year, our sales decreased by 13%. But if we exclude Paper, we see a 6% decline in sales. Our operational EBIT decreased to EUR 175 million. Excluding Paper, our operational EBIT remained roughly at the same level as a year ago. Operational EBIT margin landed at 8.4%. And excluding Paper, we reached 11.8%, a slight improvement compared to a year ago, showing also the resilience of our growth businesses.

We delivered a solid cash flow from operations, close to EUR 400 million (sic) [EUR 399 million], and cash flow after investing activities was EUR 250 million. Our net debt to operational EBITDA is at 2.4x, above our target of being less than 2x, but we have been able to decrease our net debt by over EUR 700 million.

We continue to have a strong liquidity at EUR 2.2 billion, including cash and committed credit facilities,

and we have good access to funding sources. Our operational return on capital employed landed at 6.7%, and this is, of course, below our strategic target of 13%.

We also announced good progress in our profit protection program. And therefore, we have increased our target from EUR 350 million to EUR 400 million for this coming period. The target for onetime savings remains at EUR 85 million.

Next slide, please. So if we now look at our bridge for our EBIT result, we can see that our active cost management continues. The biggest decline has been in sales prices and mix and volume. But we have partly been able to mitigate that through good cost control in our profit protection program and lower fiber costs.

Next slide, please. Market conditions continue, though, to be mixed for many of our products and businesses. Our primary focus is the health and safety of our employees, and that continues to be our key priority. Q3 has been a quarter with maintenance shuts in many of our mills, and we have taken extensive precautions to ensure the safety of both our employees and contractors. And for the upcoming Q4, we have 7 mills that we are doing maintenance shuts in.

I will just now give you a brief divisional overview before handing over to more details for Seppo on divisional level. But briefly, we can say that Consumer Board stayed strong, while Containerboard had a continued weak quarter. We can see a clear recovery in our corrugated volume sequentially. And for our pulp business, we see on the market that the low market pulp prices and the global high inventory levels, they persist. In our Biomaterials division, we had high deliveries for the quarter, but the division was negatively impacted by the pricing level and, of course, mill maintenance.

For Wood Products, we have seen a very strong U.S. market and European market. And for our Forest division, we have seen a solid and stable results continue. We are working very hard here to make sure that we have good control of our working capital to support our cash flow.

And then in Paper divisions, we returned to a positive cash flow. This is due to very good cost management and taking capacity adjustments to adapt to the decline in paper demand on the market.

Next slide, please. We have chosen after an evaluation to change our valuation principle for our forest assets to reflect the market value. And this was a natural time for us to review the valuation method. As you might remember, we created the new Forest division in the beginning of 2020. And the acquisition of our Bergvik Forest Holdings in Sweden has significantly increased our assets in the balance sheet.

The changing market practices for evaluating forest assets in the Nordics give us a better opportunity to be more transparent in the values that we have for our forest assets. So as of Q4 2020, our forest assets will be determined by using market transaction-based valuation method. This applies to our Nordic forest assets. Nordic forest land, currently held at cost, will be revaluated.

Our plantations. They are a different asset class, and they are excluded due to lack of sufficient transactional data and also shorter harvesting cycles. It takes about 6 to 12 years to harvest a eucalyptus but between 60 to 100 years to harvest our qualities in the Nordics. So this valuation method provides better transparency and, of course, is less subjective compared to this year's valuation method.

Next slide, please. So as of Q4, we predict or estimate that the asset value of our forest will be between the range of EUR 6.5 billion to EUR 7 billion after the revaluation.

We move to next slide, please. Coming back now to our profit protection program. We have been progressing in a very good pace over all the divisions, and we see that we have further opportunities. Therefore, we increased our target from EUR 350 million to EUR 400 million to be delivered until the end of 2021. As you can see here in 2019, we delivered a little bit above EUR 100 million. For this year, we estimate around EUR 180 million of annual savings; and for next year, around EUR 120 million. And you can see here the distribution varies across the divisions.

We move to next slide, please. Coming back now to some key events driving our Q3 results, and that might be of interest to you. The conversion of Oulu Mill is continuing. We are now in the machine construction phase. We stopped our paper production at end of September, and the packaging board production is estimated to start around the New Year.

We also made the decision to invest in new CLT production at Ždírec sawmill in Czech Republic, and this is to capture the growth in the wood and construction market in Central Europe. Ždírec Mill is a very cost-competitive mill with good access to wood supply, and the production is estimated to start during third quarter in 2022.

We also made the decision to shut down one of the paper machines in Hylte Mill, and we have successfully completed the negotiations. So the machine will be shut down in end of 2020. And the deinking plant at the same mill will be shut down in Q2 2021 to adjust for the declining paper market that we see.

Regarding some of our innovation projects, we continue our efforts to develop new barrier technology. So we have done an investment decision of EUR 10 million for new dispersion barrier technology at the Forshaga site mill in Sweden that can serve Skoghall Mill with new barrier technology. And these products will be adapted for a circular bioeconomy and commercially available during the second quarter in 2021.

In Hylte Mill, we continued the ramp-up of our formed fiber products called PureFiber. This is the next-generation of eco products to replace plastics in food service applications. And now they are commercially available, and the demand for these are strong. So we will continue investing in Hylte and also looking at expanding our capabilities in Qian'an in China.

In Fors Mill, we are starting up a pilot facility for producing biofoam. Biofoam is based on pulp and is a

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material that is renewable and used as a protective packaging and cushioning to replace fossil-based materials such as polystyrenes, which are very difficult to recycle.

And then last but not least, coming back to previous investment in Launkalne sawmill in Latvia. In saw, plane and pellet production that has been fully ramped up and operationally in the right position.

With that, I hand over to you, Seppo to give us a little bit more flavor on the financials.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Thank you, Annica, and I will start by going through some of the key figures from the report that we have published earlier today.

First of all, sales line was down 13.5% year-on-year or 1.7% sequentially, and reached about EUR 2.079 billion sales. Operational EBITDA margin was 15.9% during the quarter and operational EBIT 8.4%. Earnings per share EUR 0.11 per share. And operational return on capital employed 6.7% and excluding Forest, 8%.

Cash flow from operations continued strong despite lower profitability and reached EUR 399 million, very much thanks to good working capital management during the quarter. And net debt to last 12 months' operational EBITDA was at 2.4.

Then moving to divisional overview, and I start with Packaging Materials. The good cost control has resulted in improved profitability. Sales decreased by 4% and were at EUR 771 million. That is a reflection of clearly lower containerboard prices as well as an effect from closure of a small packaging paper machine at Imatra Mill in Finland.

Operational EBIT increased by EUR 25 million and was EUR 111 million. And that is a result of clearly lower variable costs, especially pulp, chemicals and energy; and positive impact from profit protection program actions implemented. Clearly, lower containerboard prices had negative effect on the profitability.

Operational return on capital increase that was 15.6% compared to 11.9% a year ago. Our conversion project at Oulu Mill to kraftliner production is according to plan. And we plan to start production around New Year. Designed capacity is expected to be reached by end of Q2 next year. And commercialisation of product portfolio expected to be reached by end of next calendar year.

And Oulu Mill has been included now in Packaging Materials starting from Q4 onwards this year. So in Q3, it was still included in Paper division.

Then moving to Packaging Solutions, where competitive market situation is affecting sales and margins. Sales decreased by 13% to EUR 145 million. But you have to remember that last year was a record high Q3 level. Lower box prices in Europe were visible due to decreased raw material prices. Also negative

sales, FX had an effect on the top line. And we have some lower deliveries in China packaging unit.

Operational EBIT decreased by EUR 7 million; it was EUR 8 million. Lower sales there due to lower box prices as well as negative foreign exchange rates as well as lower deliveries in China packaging, as mentioned also relating to top line.

We are accelerating efforts in new business related projects that have impacted operational EBIT negatively. This relates to formed fiber project that we are running as well as biocomposites and Box Inc. Lower variable costs were there due to lower containerboard market prices, having positive effect on the margins and lower fixed costs, mainly due to profit protection program actions were also visible.

Operational return on capital decreased to 13.2%, mainly due to lower profitability during the quarter. Then in Biomaterials, their profitability was still affected by challenging markets and planned maintenance stops. Sales decreased by 8% due to significantly lower pulp prices, foreign exchange rates and higher pulp deliveries had positive effect, but that was offset by lower prices.

Operational EBIT decreased by EUR 29 million and reached EUR 10 million. That is due to pulp prices despite higher deliveries. Lower production impacted by increased maintenance activity and additional costs related to COVID-19 precautionary measures. This was partly offset by clearly lower variable cost and positive FX impact on the costs.

Operational return on capital decreased and was only 1.6%, driven by clearly lower profitability in the division during the quarter.

Then moving to Wood Products, where we have second highest Q3 profitability this year. Sales decreased 10% and was at EUR 341 million level. There were some negative effects from COVID-19 related delivery restrictions, especially in Europe and lower classic sawn prices. These were partly offset by improved mix as well as a very strong U.S. market during the quarter. Also structural changes at Pfarrkirchen, Uimaharju and Kitee sawmills reduced the sales.

Operational EBIT increased by EUR 11 million and was EUR 38 million. Lower sales were more than offset by improved margins, especially thanks to the strong U.S. market. And lower net raw material costs and good fixed cost control improved profitability.

Operational return on capital increased and was actually clearly above long-term target of 20% at 25.2% level.

Then moving to Forest. The expected efficiency improvements are coming through. Sales decreased by 12%. This is due to lower wood prices and clearly lower deliveries in Finland as a result of lower production volumes. The reason is maintenance activity during the quarter as well as COVID-19-related market impacts. Operational EBIT increased by EUR 13 million to record high Q3 level. This is, thanks team, for profitability from our own forest holdings as well as Tornator. Our profitability in the Finnish

and Swedish wood sourcing units improved also due to increased efficiency and inventory management. And operational return on capital increased to 3.6%.

Then Paper division produced positive cash flow in continuously difficult market conditions. Sales decreased by 32% to EUR 468 million. There was visible still COVID-19 pandemic accelerated demand decline in all paper grades, as well as divestment of Dawang Mill in China and discontinuation of paper production in Oulu Mill in Finland. Those had a total negative impact of EUR 21 million on top line.

Operational EBIT decreased by EUR 66 million. This is due to lower sales, partly offset by lower fiber costs and good fixed cost management in the division. Cash flow after investing activities to sales ratio decreased to 3.2% due to lower profitability but remained positive thanks to good working capital management in the division during the quarter.

One newsprint machine at Hylte Mill, Sweden is to be shut down by end of the year and deinking plant latest in Q2 2021. And we are committed to support the employees who will be affected by the close at the mill.

Then summary of the strategic financial targets before I hand over to Annica. There, we are pretty much on red due to challenging market conditions, as mentioned already earlier. To highlight a couple of key figures, net debt-to-operational EBITDA up 2.4%, about a 2.0% targeted level, but net debt-to-equity at 42%, clearly below the maximum target level of 60%.

As we look at the divisions, very positive development visible especially Wood Products, where we had 25.2%, return on capital level compared to targeted 20%. Also Packaging Materials improving clearly and being a bit of short of 16%. And Paper, as mentioned earlier, positive cash flow is visible at 3.2% level, below the targeted level of 7%, but positive.

With that, I hand over back to you, Annica.

Annica Bresky Stora Enso Oyj - President & CEO

Thank you, Seppo. And if we now take a look on some Q4 key events, it's fair to say that market conditions continue to be exceptional uncertain. And therefore, we continue not giving any guidance. If we look at Q4, as Seppo mentioned before, the Oulu Mill conversion is planned to be completed by the end of the quarter. This has an impact of EUR 30 million to EUR 40 million negative impact on operational EBIT for Packaging Materials as the mill moves into that division as of Q4 this year.

We are also taking, as mentioned, extensive precautions to limit the impact of COVID-19 in our operations and during annual maintenance shuts. And we have 7 mills of maintenance shuts during upcoming quarter, one mill more compared to last year. And the total negative impact of maintenance is estimated to be EUR 10 million less compared to Q3 2020 and EUR 15 million less compared to Q4 last year.

Then as we kind of end the paper business in Oulu, we are selling inventories, which will impact the result of Paper division negatively on operational EBIT by EUR 5 million to EUR 10 million.

So if we move now to a summary, we have had a solid performance for this quarter with continued focus on cash flow and profit protection. Our result is based on a strong performance from Packaging Materials, Wood Products and Forest division. And we could also see that Paper division delivered a positive cash flow, which is very well done during these very difficult circumstances.

Our Forest assets will be valued between EUR 6.5 billion and EUR 7 billion as of Q4 2020, based on a new market transaction-based valuation method, and that will give transparency for our investors. And the market conditions continue to be mixed if we make an outlook for Q4.

And then, I would like lastly to welcome you all to our Stora Enso virtual Capital Markets Day on 11th of November. And hopefully, I will talk and hear many of you there.

And with that, I think we can open for Qs and As.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from the line from Alexander Berglund from Bank of America.

Alexander Berglund BofA Merrill Lynch, Research Division - Analyst

Two questions from my side. One on Forest revaluation and the second one on graphic paper. But maybe I start with the Forest revaluation. And just got a couple of questions on the tax treatment here. So I just wonder if you can clarify if this range of EUR 6.5 billion to EUR 7 billion, if that is net of deferred tax or not. And then what does your new assessment now apply for a price per hectare in the Swedish forest holdings, compared to the EUR 5,700 per hectare number that you gave us from the LRF consult with -- in your previous presentation? So that's my first question. I'll let you answer that one, and I'll follow-up with graphic paper.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. First of all, on the deferred tax question, the figure we had given at the range we are giving is after netting the deferred tax effect today. So it is a net value. And when it comes to more details on the hectare price, et cetera, we will come back to those details in our Capital Markets Day on 11 November.

Alexander Berglund BofA Merrill Lynch, Research Division - Analyst

Okay. Can you give us anything on the deferred tax amount? If I want to do a gross value, so to say, on the forest, how much higher is that than the EUR 6.5 billion to EUR 7 billion?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. Yes, deferred tax is about EUR 1.2 billion.

Alexander Berglund BofA Merrill Lynch, Research Division - Analyst

Okay. That's very clear. I appreciate that. So moving on to graphic paper. I just wonder what your current assessment is on the market, if you think from a supply and demand perspective. And specifically then, do you think that the amount of capacity closures that have been announced so far is enough or do we need to think to see -- do we see more? And also, is there any specific grade where you think we really need to see more closures? And then finally on that, how do you think about Stora Enso's role here? Have you done enough, or do you think that you might need to do more?

Annica Bresky Stora Enso Oyj - President & CEO

If we see kind of the demand, it's down by 18% compared to year-on-year for the full year. It's primarily standard newsprint, coated, mechanical and wood free coating, which is impacted the most, but all of the grades are heavily impacted.

Long term, we do expect a bounce back during 2021, between 3% to 5%. But we have structurally had a long term decline, about 5% to 6% annually. So there is an overcapacity on the market. We estimate it's around 20%. So, I would expect that we would continue to adapt to a lower demand by either market curtailments or continued restructuring actions. And if we look what we are doing, we were proactive with converting Oulu Mill into packaging by the decision we took last year. The closure of Hylte is another step that we took this quarter. And that takes down our annual newsprint capacity by 26% roughly and the total kind of reduction in paper capacity for us by 25%. So this is what we have done. Totally, if I may say, our sales after kind of base actions will be 18% of our total sales revenue coming from Paper division and 82% from our other businesses.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Sorry, I have to correct my comment on this deferred tax rate. But actually, it is a gross figure that we have given, not net of the deferred tax.

Alexander Berglund BofA Merrill Lynch, Research Division - Analyst

Okay. So then that would imply that actually the -- your assessment now is a bit lower than the LRF consultants, EUR 5,700, am I reading that right?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Well, I don't have the figures there. We'll actually come later back to those details in Capital Markets Day.

Alexander Berglund BofA Merrill Lynch, Research Division - Analyst

Yes, that will be very appreciated. Because we have a lot of questions on that.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

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Yes.

Operator

Your next question comes from the line from Lars Kjellberg from Crédit Suisse.

Lars F. Kjellberg *Crédit Suisse AG, Research Division - Research Analyst*

I just want to have a couple of questions on Oulu conversions specifically. You're talking about incremental cost to be EUR 30 million to EUR 40 million range. Just curious how that works? I mean the machine isn't up and running yet. So what sort of operational costs would you have? And wouldn't you capitalize those as you invest in machine and then you start to cost things as you ramp it up? So just some clarity on what those costs are? And equally, so how should we think about start-up costs in the first quarter of next year? That's my first question.

Annica Bresky *Stora Enso Oyj - President & CEO*

What we have is that we move over, of course, the Oulu kind of the fixed cost that we have in the asset as such. And then, of course, we do the conversion and the machine kind of building there. And if we look at Q1, we will come back when we see how the ramp-up looks like with more details on that.

Lars F. Kjellberg *Crédit Suisse AG, Research Division - Research Analyst*

And when you talk about the commercialisation of the product portfolio, not until the end of '21, what you're saying -- you're also saying that you expect to be ramped up fully by the second quarter. What does that really mean?

Annica Bresky *Stora Enso Oyj - President & CEO*

Well, if we look at the technical kind of capacity of the mill to reach the capacity that we want, that is the work that we're doing the first quarter. And then since the product that we are introducing is targeting food kind of end uses, that means that we need qualification period with customers and then to reach the optimal quality that we want and develop the product range that we want. And that usually takes 1 year or 2 to get to the best level.

Lars F. Kjellberg *Crédit Suisse AG, Research Division - Research Analyst*

Got it. And then finally, on wood products. Obviously, very good progress. I just wanted to get some sort of color on how much U.S. strength was part of that significant improvement in earnings? And what you're seeing into Q4? And also, if I may, just very quickly on China. It seems to be a better consumer board market as we speak. Are you seeing that as well in your particular segment? And what is driving that? And especially with the backdrop of you still seeing weak packaging markets in your China business?

Annica Bresky *Stora Enso Oyj - President & CEO*

If I start with wood products, you're right. The U.S. market was very strong, both in Q2 and Q3. We think that the U.S. market has reached a peak now, so it's normalising, if we look forward-looking. European construction market also remained active. But of course, as pandemic is increasing, the uncertainty of

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that is increasing as well.

If I look at the other key markets that we have, we see a slow recovery also in Australia, where the governments are supporting the recovery with quite a lot of kind of financial support.

And then if we look to China and Asia, that market for wood products is picking up. As well as Middle East and North Africa, which has been quite slow over the summer, but now coming back. So it is really a mixed bag that we see in wood products.

And then if I go to your second question regarding Consumer Board, yes, you are right that the China market is picking up. There is a drive for consolidation in the folding boxboard area, which -- where we have seen then price increases because of that, which is positive for us. The domestic market is strong in China or stronger and recovering. However, we still see, from a China perspective that the export market is still lagging behind. So for us, what is driving improvement is, of course, a better kind of consolidation on the packaging market in China. I don't know if that was an answer to your question or not.

Lars F. Kjellberg *Crédit Suisse AG, Research Division - Research Analyst*

It was. So just one final point on that. One of your customers, SIG have highlighted a relatively sluggish return in beverage packaging, specifically in China. Has that in any shape or form been reflected in your sort of product mix in China? Or do you continue to drive a better product mix?

Annica Bresky *Stora Enso Oyj - President & CEO*

Yes. I don't comment on specific kind of customers. We have more than one customer in our portfolio. So we have not seen that for our liquid business. If we look then at kind of totally and have an outlook of how Consumer Board is developing, we can see a slight decline in demand by end of Q3. So how that development in Q4 is uncertain.

Operator

The next question comes from the line from Robin Santavirta from Carnegie.

Robin Santavirta *Carnegie Investment Bank AB, Research Division - Head of Materials Research & Financial Analyst*

Now looking at the Packaging Materials division in Q3 and especially the Consumer Board, you're generating really strong margins despite of actually Consumer Board declining deliveries, EBITDA margin of 24.5% now in Q3 and 24% in Q2. Now seasonally, normally, Q4 is a bit of a weak quarter for you. I expect that to be the same pattern this year. But is there something exceptionally good in Q2 or Q3 in this division, especially in Consumer Board this year?

Annica Bresky *Stora Enso Oyj - President & CEO*

Well, we have had good cost control over all our divisions, and Packaging Materials is not any exception to that. So that is mitigating the decline -- the small decline that we see in sales in that division. As you also know, the contract structure is that we have long-term contracts for our Liquid Packaging Board

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business, which, of course, is good in these market conditions that we have right now. So some end uses have had a strong development during Q2 and Q3, such as Liquid Packaging Board, to some extent, Folding Boxboard, whilst other end uses like Food Service Board have been weaker.

So I think that we have worked very well with our operational efficiency. We have made sure that we have a good control of our operating working capital. And then our situation in kind of the end uses that we have been favorable for Q2 and Q3.

Robin Santavirta Carnegie Investment Bank AB, Research Division - Head of Materials Research & Financial Analyst

All right. What about -- I guess, you said that prices are increasing in the domestic market in China. What about the situation now in Europe going into the end of the year and then next year? I guess you have some annual contracts for next year. Is the market tight enough for higher prices? Or is it stable or lower? What is sort of the pricing outlook in Consumer Board for 2021?

Annica Bresky Stora Enso Oyj - President & CEO

Well, I don't normally comment on prices, but we have about 1 million tonnes of negotiations that will start for the upcoming quarters. We do see kind of price pressure in Folding Boxboard, but that is what we see. So that is what I can say at this point.

Robin Santavirta Carnegie Investment Bank AB, Research Division - Head of Materials Research & Financial Analyst

All right. And then just on this Oulu conversion. How is it with the net position of pulp of that mill? I assume it has changed a bit now when you will produce far less of end product with the new machine?

Annica Bresky Stora Enso Oyj - President & CEO

Well, as you know, we have a pulp mill there that can support both this machine and converted machine. And if we would like to expand and take a second step for the second machine when the market conditions allow us. So we have about 150,000 tonnes of unbleached craft pulp that we would supply to the market at this point.

Robin Santavirta Carnegie Investment Bank AB, Research Division - Head of Materials Research & Financial Analyst

All right. And then just finally on this Forest valuation thing. So two questions. First, you now, again, write-up the DCF value to EUR 5.4 billion from 5.1 billion. Why is that? And then secondly, to sort of just check, EUR 6.50 billion to EUR 7.5 billion is the gross value; it's not netted of deferred tax liabilities. That would then imply a quite significantly lower price of the Swedish forest assets that you have shown before. Any comment on the reason behind that?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. Of course, first of all, the increase from EUR 5.1 billion to EUR 5.4 billion is mainly driven by the fact that we included now the leased forest lands also in the total. They have been, of course, in the balance

sheet earlier. And then there were some FX changes minor included in the new valuation. And yes, it is a gross value and of course, earlier statistics have been more sort of average prices in Sweden in the region. Now we have more specific data that we are using and available. But you should also remember that we have increased fair value over the past year already before this changed by EUR 1 billion.

Operator

The next question comes from the line of Mikael Doepel from UBS.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

Can I come back to the graphic paper markets? Just briefly, a follow-up there. You mentioned that you expect to see a slight rebound next year in volumes, given the quite severe slump this year, which is, of course, encouraging. But have you seen any improvement now as of late right now in terms of the demand trends? I think your volumes were down by close to 30% year-over-year in Q3. Are you seeing a clearly improving trend already now in Q4 and then improving even more from there?

Annica Bresky Stora Enso Oyj - President & CEO

No, we don't see an improvement as of Q4, to be short.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

Okay. That's fair. That's fair. Okay. So it's still down clearly double digit, I guess, then on a year-over-year basis?

Annica Bresky Stora Enso Oyj - President & CEO

Yes, it's going to be down compared to last year. Yes.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

But the question is how much, is it down by 10%...

Annica Bresky Stora Enso Oyj - President & CEO

What we see demand, if we compare to last year, about minus 16%.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

Okay. That's very precise.

Annica Bresky Stora Enso Oyj - President & CEO

Yes.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

Then in terms of the pulp market, what do you see there right now? I mean, both in Europe and China, how do you see demand and pricing tracking there? And how would you describe the inventories in the value chain overall right now?

Annica Bresky Stora Enso Oyj - President & CEO

Well, let me start with the inventories. They are still on a high level, even though we have seen some decline in some of the pulp qualities. We are about 5 days above the 5-year average. So even though we have had maintenance shuts in many of the pulp mills around the world, we do not see a clear decline in the inventories.

And then if I look at China pulp side, we see that there is a healthy demand. But depending on end uses, of course, end uses within paper or graphical, end uses also within retail are down. The demand is down there, whilst hygiene and tissue has seen kind of growth and packaging is more on stable. And for us, we have about 40% of our supply towards end uses within hygiene and tissue, for instance. And that is up compared to last year where we had about 30% of our deliveries to that end use. So we are shifting also to customers within the areas where we have a competitive advantage.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

Okay. And in terms of the European market, what are you seeing there in terms of demand and pricing? How is that tracking? I think there are a few price, like, announcements out there, for example, on the softwood side, do you see any traction there? Or is demand still too weak for prices to gain in Europe?

Annica Bresky Stora Enso Oyj - President & CEO

I think the demand is too weak. We have seen some kind of attempt to increase prices. But I'm not sure that we would see any kind of major changes for Q4. We do believe still that the prices have bottomed out. And there are many producers out there that are running on a negative kind of performance. So we would expect that, that restructuring also has to happen within the pulp side.

Mikael Doepel UBS Investment Bank, Research Division - Executive Director & Analyst

Okay. And then just finally for me on the Capital Markets Day, which you already flagged there. I guess a lot of things were brought up there. But what would you say would be the key focus of today?

Annica Bresky Stora Enso Oyj - President & CEO

I will spoil the surprise then. No. But I think if we look at Stora Enso, we will talk about the growth businesses that we have. We will give more insight on the Forest valuation, as Seppo alluded here and how we work with our Forest division. So hopefully, it's also an opportunity for you to ask more questions on the long-term view of our business and our focus areas.

Operator

The next question comes from the line from Harri Taittonen from Nordea.

Harri Taittonen Nordea Markets, Research Division - Senior Director & Sector Coordinator

On the pulp market, not so much in the market overall, but I'm just looking at your division, there was a sort of big increase in volumes quarter-on-quarter and year-on-year. And I understood that your intention, you sort of wanted to take down the inventories. And just -- could you just confirm that was that the reason why the average price came down so much on the portfolio segment. And in that sort of

side, do you now have like more normalized inventories so that you will be more selling to the market at that sort of the market prices rather than kind of below the market prices in Q4?

Annica Bresky Stora Enso Oyj - President & CEO

Yes, we have taken down inventories for Q3.

Harri Taittonen Nordea Markets, Research Division - Senior Director & Sector Coordinator

So it will be more like back to normal after this third quarter?

Annica Bresky Stora Enso Oyj - President & CEO

Yes. We have, as Seppo said, we are working a lot with our operating working capital to kind of have good control of our inventories.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

We have also in Q3, maintenance stops. We have Q4 as well maintenance stops at the pulp mills, and that is also putting down the inventories then.

Harri Taittonen Nordea Markets, Research Division - Senior Director & Sector Coordinator

Okay. Okay. And related to that, I mean, usually, Q4 is sort of a normally very good working capital-wise. But now you have had strong development already. I mean, is there some difference this year compared to typical annual pattern? Or do you still see scope for working capital reduction in Q4 in the same way as in the previous years?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. We have...

Annica Bresky Stora Enso Oyj - President & CEO

I think -- yes, sorry, you take it, Seppo.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. We have the special working capital this year because of COVID-19 crisis protects the effort on managing inventories, receivables and payables. But I still believe that there is potential for further reduction towards year-end, maybe not as much as normally in the Q4, but still there is potential.

Harri Taittonen Nordea Markets, Research Division - Senior Director & Sector Coordinator

Great. Okay. Maybe just a last quick question on the wood cost because at least looking at the lease prices, it seems that prices have continued to come down in the Nordics. I mean, but where do you see cost -- wood cost inflation/deflation in the foreseeable future?

Annica Bresky Stora Enso Oyj - President & CEO

We see a stable end-of-quarter situation.

Operator

The next question comes from the line from Cole Hathorn from Jefferies.

Cole Hathorn Jefferies LLC, Research Division - VP

Please, could you talk a little bit about what you're seeing in the containerboard markets? I know Oulu is ramping up next quarter. But what are you seeing on the pricing side and demand for the containerboard grades? And then on the Paper business, how are pricing negotiations going into the New Year? Is there any color you can give, particularly on the uncoated woodfree or fine paper market at the moment?

Annica Bresky Stora Enso Oyj - President & CEO

If I start with containerboard, well, demand in Q3 was down by 2% year-on-year, and that is driven by for instance, a stagnating retail area and also some lower agricultural activities, reducing the need for corrugated boxes. On the other hand, we have had a strong demand from e-commerce side. So prices have been lower in Q3 compared to Q2, but we do think that they have bottomed out.

And if I look a little bit ahead, there is testliner and kraftliner new capacity coming on the market. So short term, there might be an oversupplied situation. But Central Europe, and the growth that we see there will absorb the capacity increases that we have there. So I think there is likely a positive kind of sentiment for Q4 regarding containerboard that we have bottomed out somehow.

And then the second question you had was, if you remind me?

Cole Hathorn Jefferies LLC, Research Division - VP

Just looking into next year on uncoated woodfree or fine paper, there's not much capacity is being closed in the industry. And I was just wondering how you see that market developing?

Annica Bresky Stora Enso Oyj - President & CEO

Yes. I think for all the paper grades, it's going to be a tough year. So restructuring is needed in all the grades.

Operator

The next question comes from the line from Linus Larsson from SEB.

Linus Larsson SEB, Research Division - Analyst

I'll start to follow-up on the previous question. You said that 2021 will be a challenging year for Paper, and there will be restructuring needed in all grades. Is that how you see your activities as well within Paper in 2021?

Annica Bresky Stora Enso Oyj - President & CEO

Well, we have been and will continue to work to make sure that we have a positive cash flow from our Paper operations. That has been the way that we have worked kind of throughout the last years, and

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that will, of course, continue. And we look at if there are opportunities to convert to something else for a reasonable investment cost. If not, then we either divest or close down the mills, unfortunately.

And I think that if we look back to when there was kind of a more balanced supply demand situation in 2018 and 2019, we saw that the competitive mills that were on the market, there, we were able to push up the prices and have fairly good cash flow from our Paper division. I think it's -- if we look at this quarter, we managed to get back to a positive cash flow, and that is kind of the way we will continue to work.

Linus Larsson SEB, Research Division - Analyst

And you have no doubt that in 2021 and beyond, Paper will remain a good cash cow business for you the way it has been over the past few years?

Annica Bresky Stora Enso Oyj - President & CEO

That is the way that we work continuing to make sure that, that is the case.

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

And Linus, it's all about market balance, and we believe that with the actions we and the industry takes to balance to market and come back to situation we were before the crisis. But obviously, we had to wait and see how much of the lost demand is recovered, now that situation hopefully starts to normalise in the coming months.

Linus Larsson SEB, Research Division - Analyst

And if I may ask, in what type scenario would you revisit -- or let's say, review your strategy within Paper, and reconsider potentially whether to own or not?

Annica Bresky Stora Enso Oyj - President & CEO

This is something that we are constantly looking at, how our paper assets fit into our strategy as a whole, but this is not something that I comment. We take it when it becomes and make a decision.

Linus Larsson SEB, Research Division - Analyst

Sure. Sure. May I also ask a couple of follow-up questions? Firstly, on the Forest revaluation, you say that you are now using market valuation, at least, in the Swedish part of your Forest holdings. How do you define market value? Is that on a 3-year average basis, or is it on current -- most recent quarterly market prices? What sources are you referring to? And any references that we could use there?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. As one source, we are using Ludvig and Co. as I think other companies using the same method are using as one source for the data. When it comes to other details we use, we will come back with those details in the Capital Markets Day, as I said earlier.

Linus Larsson SEB, Research Division - Analyst

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Okay. Fair enough. And then just one final question, and that's a follow-up to on Oulu and the EUR 30 million to EUR 40 million that you are referring to in the fourth quarter. Do I understand it right that part of that is depreciation and other fixed costs that are just being transferred from Paper to Packaging Materials, i.e., no extra costs for the group?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

See, maybe I can take that. Yes, it is sort of fixed cost that are inherited from Paper to Packaging Materials.

Linus Larsson SEB, Research Division - Analyst

And how much is that? How much is depreciation to start with of the EUR 30 million to EUR 40 million? And how much is other fixed costs?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

I don't have that detail now, but it's in total, EUR 30 million to EUR 40 million. Then we have additional, it is EUR 5 million to EUR 10 million in Q4 in Paper when they are selling down the inventory costs. That is relatively small part of the cost (EUR 30 million to 40 million). So it's mainly fixed cost and personnel cost.

Operator

And the last question for now comes from -- from Markku Järvinen from Handelsbanken.

Markku Järvinen Handelsbanken Capital Markets AB, Research Division - Analyst

I just had a few more questions on the topics that have been quite a bit discussed already. So the Oulu conversion, you're saying EUR 30 million to EUR 40 million for Packaging Materials and EUR 5 million to EUR 10 million for Paper. Now are you saying that it's sort of EUR 35 million to EUR 50 million negative impact compared to Q3? Or how should we read this?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes, correct.

Markku Järvinen Handelsbanken Capital Markets AB, Research Division - Analyst

That's very clear. And then that sort of for group in total?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

Yes. Correct.

Markku Järvinen Handelsbanken Capital Markets AB, Research Division - Analyst

Okay. Very good. And then on graphic paper, you've said that you expect Q4, not much of a recovery compared to Q3. I suppose that means that your deliveries for this year in Paper will be roughly 3 million tonnes. Could you quantify how much coated woodfree is from that roughly?

Annica Bresky Stora Enso Oyj - President & CEO

I don't have that number right now. Seppo, do you have it in your head?

Seppo Parvi Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland

No, I don't.

Annica Bresky Stora Enso Oyj - President & CEO

Can we come back on that?

Markku Järvinen Handelsbanken Capital Markets AB, Research Division - Analyst

Sure, sure, absolutely. Just a follow-up on that. I guess, since you're exiting coated woodfree and after all the closure and the machine closure, you're still left with almost 4 million tonnes of paper capacity. Do you expect your paper deliveries to recover that much that 4 million tonnes will be reached?

Annica Bresky Stora Enso Oyj - President & CEO

Well, it is an uncertain situation, as we know. So if we look at kind of what we expect for next year, it is a rebound of about 3% to 5% increase next year. Of course, we will adapt our operations according to the demand and make sure that the mills that we have, they are competitive on the market. And then, of course, if there is a big overcapacity, many players will need to take actions. But we are working on what we can influence by making sure that we have a very good cost control, that we drive down our working capital and have a very good inventory management and make sure that we manage our customers, that we don't have any risks there. So this is what we can do. And then we act as we see the market develop.

Markku Järvinen Handelsbanken Capital Markets AB, Research Division - Analyst

I guess you're basically saying that you're not planning to close any other capacity right now, but you see competition in weaker position who may need to do so and you can possibly gain some market share. Now that has, in part, already happened with UPM and SCA taking out capacity. Do you expect to gain some of those volumes?

Annica Bresky Stora Enso Oyj - President & CEO

We are kind of working on the market, and we are very active on that, of course. And so we are a good option for our customers that want to have our products. And if I come back to your question with on the number now for coated woodfree, it's about 20% of our capacity. So roughly 20% of the deliveries.

Markku Järvinen Handelsbanken Capital Markets AB, Research Division - Analyst

Okay. And then finally, still on Oulu, you already alluded to the plan that you could possibly convert also the other line there. What's the sort of situation with that now? What are the sort of key decision-making criteria on that for you right now?

Annica Bresky Stora Enso Oyj - President & CEO

I think, first of all, we need to make sure that we have a successful ramp-up of line one before we take any such step. Oulu Mill is an integrated mill with its own pulp supply and very good logistics situation.

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So when we look ahead, and when we have done the ramp-up and have a good quality position for the kraftliner, and depending, of course, how the market develops, which long-term is growing, we see that we have a very good position for Oulu Mill, but the second step that we need to come back to when it's kind of closer to implementation.

Operator

There are no further questions. Please continue.

Ulla Paajanen-Sainio *Stora Enso Oyj - Senior VP of IR & Head of IR*

Okay. Thank you, everyone, for joining our earnings conference call and hope to see many of you at our CMD, as Annica already wished during the presentation. So thank you for today.

Seppo Parvi *Stora Enso Oyj - CFO, Deputy CEO & Country Manager of Finland*

Thank you.

Annica Bresky *Stora Enso Oyj - President & CEO*

Thank you. Bye.

Operator

That does conclude the conference for today. Thank you all for participating. You may now disconnect.

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