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THE ASSUMPTIONS BEHIND AN ACQUISITION:
CASE STORA ENSO - CONSOLIDATED PAPERS

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Abstract

The report studies the acquisition of Consolidated Papers by Stora Enso in 2000. In addition to reviewing the historical sequence of events related to the acquisition, the assumptions Stora Enso management made when contemplating the acquisition are listed. The aim is to assess which assumptions proved to be incorrect in order to systematically analyze why the acquisition did not bring the benefits intended.

The assumptions made before the acquisition can be classified into three areas: a) mergers and acquisitions as a strategic action in general, b) the certain geographical or business area where to make the transaction and c) the assumptions specific to the target company. They can furthermore be divided into 12 internal or external “dimensions”, which are factors or stakeholders whose future reactions or developments should be considered. It is argued that some of the assumptions made did not initially seem to be relevant to the deal, but nevertheless had an impact on its long-term success.

The Stora Enso – Consolidated Papers deal is an interesting case to study because it has received widespread media attention for failing to attain its preconceived benefits. Seven years after the acquisition of Consolidated Papers, Stora Enso divested its North American

operations incurring a significant loss. The report estimates the losses to have accounted to 2,0-2,7 billion Euros, depending on the method used.

The research includes 16 interviews with key players involved in the deal, including top management of Stora Enso, the chairman and main stockholder of Consolidated Papers, advisors involved in the deal as well as competitor representatives. The findings of the interviews have been validated using publicly available contemporary documents.

The conclusion of the study is that four factors were most significant in causing the loss incurred by Stora Enso as a result of the acquisition. These were:

- 1) The economic cycle turned suddenly and paper demand started to change fundamentally
- 2) The increasing presence of Asian paper manufacturers was a market disrupting threat
- 3) Consolidated Papers' weakening profitability would have required a turnaround in operations, and Stora Enso management was overconfident in its ability to halt the company's declining prospects
- 4) The US dollar weakened dramatically increasing the competitiveness of American production, but making production optimization, a key motive for the merger, harder. Although physical assets had been hedged against changes in currency exchange rates, the weakening dollar significantly affected the Euro-nominated valuation of Stora Enso North America upon divestment, causing a significant part of the losses.

Finally, the report discusses the effect of the acquisition on Stora Enso's other activities and discusses how the deal was supposed to create shareholder value. On a more general level, the research shows that the acquisition of Consolidated Papers is a good example of how difficult it is for managers to predict the future, although that is what they are expected to do when leading a company.

Key words: Merger assumptions, Managerial cognition, Pulp and paper industry consolidation

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Abbreviations used in the report

AGM	Annual General Meeting
CPI	Consolidated Papers Incorporated
CWF	Coated wood free paper
DCF	Discounted cash flow
FAO	Food and Agriculture organization
IT	Information technology
M&A	Merger and acquisition
SC	Supercalendered paper
SEC	Securities and Exchange Commission
SENA	Stora Enso North America
UFS	Uncoated free sheet paper

1. Introduction

The acquisition of Consolidated Papers by Stora Enso has stirred widespread debate. The company was acquired in 2000, and subsequently divested in 2007, causing substantive losses for Stora Enso. The deal and its executors have been criticized strongly in the media. Furthermore, as Stora Enso is partly owned by the Finnish government, the acquisition has been a theme of a political debate as well.

In this report, which is based on my master's thesis submitted in March 2010, I present a thorough assessment of the Stora Enso – Consolidated Papers acquisition. I explain the original rationale of the deal and show why it did not bring the benefits it was supposed to. I assess the deal as a prime example of the similar deals that were going simultaneously in the pulp and paper industry at the time. Finally, I also calculate the amount of Stora Enso's losses as a result of the deal, as this is a subject where public debate has also yet to conclude upon.

To assess the deal, I have reconstructed the view of the world of Stora Enso management at the time of the acquisition by listing 27 assumptions they made, implicitly or explicitly, on the industry, the North American market and the acquisition target. I then verify the correctness of these assumptions by looking at how they developed during Stora Enso's ownership period of Consolidated. This enables seeing which ones proved incorrect, and above all, which ones were critical constituents of Stora Enso's substantial losses resulting from the deal.

I feel confident that I have been able to interview most key players involved in the deal, and that the conclusions I draw are based on a balanced view of the situation. Interviewees span from Stora Enso top management, Stora Enso North America management, advisors, competitors, to the seller of Consolidated. My sincere thanks are in order to all interviewees involved for their time and effort in helping me assess this acquisition, which remains one of the most significant corporate transactions in Finnish and Swedish economic history.

1.1. Structure of the report

The report starts by explaining the research method and presenting the interviewees involved. The historical facts related to the acquisition are discussed, by providing an overview the

situations of both sides of the deal at the time, reviewing the negotiation process, the execution of the deal all the way to the divestment of Stora Enso North America in 2007.

The reader is then introduced to the research framework, which is justified and explained by reviewing literature on managerial cognition and on mergers and acquisitions.

The literature on managerial cognition helps us to understand how managers sense problems and how they react to them. Mergers and acquisitions are one possible strategic response to some of the identified problems the company faces in its external environment. The literature on managerial cognition also helps in formulating the interview questionnaire used.

The M&A literature reviewed includes studies on merger motives, factors that make companies prone to merger and acquisition activity as well as factors that affect merger and acquisition success. The findings from the literature review have been used to justify the research framework that lists and classifies assumptions behind a merger and acquisition transaction. Literature on pulp and paper specific merger and acquisitions is also reviewed and the framework developed is filled out with typical pulp and paper specific M&A assumptions.

The results of the study are reviewed in the order defined by the M&A assumptions framework developed. This means going through each assumption made by Stora Enso management when acquiring Consolidated Papers, explaining the rationale of the assumption and following up on whether it proved correct or not.

In the analysis section, the interdependency of the assumptions and their proving to be correct or incorrect are studied. Chains of assumptions are built which are then joined together with a company valuation formula. The most critical assumptions with respect to the value of the target company are identified and a list of the most important lessons to be learned from the case is formulated. The effect of the acquisition on Stora Enso's other businesses is also analyzed, and the final amount of losses to Stora Enso's shareholders calculated.

The report ends with a conclusion that summarizes what can be learnt from this acquisition.

2. Theoretical approach and methods

In this section, the research questions of the report are explained along with the theoretical background to looking at assumptions Stora Enso management made before the acquisition of Consolidated Papers as a way to assess the deal. The methodology of the research is explained, and interviewees involved are presented.

The Stora Enso – Consolidated acquisition is a prime example of a mergers or acquisitions that did not bring the benefits it was supposed to. Such cases are not rare, however. Research recognizes that a large proportion of mergers and acquisitions do not benefit the acquirer's shareholders. Instead, usually the target's owners benefit the most. Some transactions even fail to create any economic value. (E.g. Bruner, 2002) No manager, however, will willingly pursue such a transaction if he or she knows that it will fail. Instead, managers that pursue a merger or an acquisition assume that they are beneficial. The problem is that managers and their advisers are often overly optimistic about the benefits of the mergers they execute. (Tichy, 2001)

What are the decisions to acquire another company based on? Company performance depends on a multitude of factors, among the most crucial of which is the way management views its environment when contemplating important strategic decisions, such as acquisitions. The information upon which the decision to acquire another company is based, as well as the way the decision is made are crucial in determining the outcome of the strategic action. Hambrick and Mason (1984) suggest that background factors may cause differences in assumptions decision makers make and can hence affect decision making. March and Simon (1958) argued that each decision maker has bounded rationality and they are restricted to several assumptions he or she takes as givens. Mergers and acquisitions are a significant strategic decision, yet studies have not sufficiently looked at the effect of managerial cognition on merger and acquisition-related decision making.

In this report I combine theories of strategic decision making and mergers and acquisitions. I argue that the answer to why merger benefits fail to realize may lie in the assumptions management has made about secondary or even seemingly irrelevant matters. Therefore, it is important to investigate what assumptions, both explicit and implicit, management has made and based the acquisition decision on.

Interviewing the key players involved and examining primary literary evidence provides a good way for reconstructing why an acquisition has been carried out and what assumptions have been made by acquirer management. This enables us to systematically study the correctness of each assumption and determine which assumptions have been critical in determining the success of the Consolidated Papers acquisition.

Assumptions are most likely not independent of each other. Therefore, the report also examines the interrelationship between the assumptions, and their link to the value of the target company. This enables us to identify the critical assumptions, whose incorrectness resulted in the high loss for Stora Enso's shareholders.

The report contributes to existing literature by presenting a framework for gathering and following up on assumptions made by management in different stages of a merger or acquisition transaction. Looking at assumptions and their sources in such a systematic manner provides new areas of analysis to be done in conjunction with M&A decision making.

2.1. Formulation of research questions

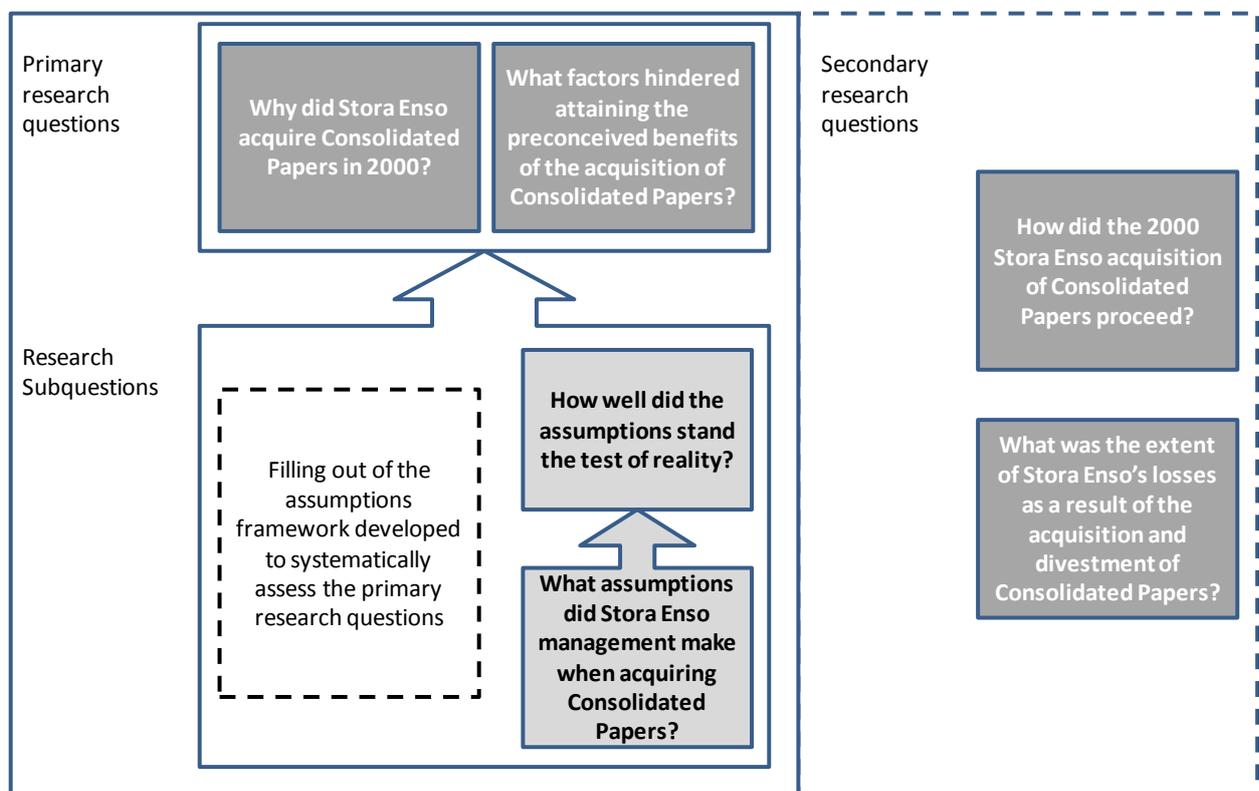


Figure 1 The hierarchy of the report's research questions

In this report, there are two primary research questions, which are based on the research approach presented earlier:

1.1 Why did Stora Enso acquire Consolidated Papers in 2000?

1.2 What factors hindered attaining the preconceived benefits of the 2000 Stora Enso acquisition of Consolidated Papers?

In order to systematically assess these research questions, the assumption framework, developed and reviewed later on the report, is used. In order to do this, one must answer two research subquestions.

1.a What assumptions did Stora Enso management make when acquiring Consolidated Papers in 2000?

1.b How well did the assumptions stand the test of reality?

Looking at the questions through these two sub-questions provides a way to judge the case acquisition objectively. This is important in an interview study where stated views reflect opinions and may be biased.

While the primary focus of the research is to use the case as material for contributing to M&A literature, the secondary objective is to document the historical events related to the acquisition, which is one of the largest M&A deals in Finnish economic history. The research questions of the report related to this goal are:

2.1 How did the 2000 Stora Enso acquisition of Consolidated Papers proceed?

2.2 What was the extent of Stora Enso's losses as a result of the acquisition and divestment of Consolidated Papers?

2.2. Research methods and interviewees involved

The report uses a case method that looks at assumptions made by management in a single acquisition case. The research method has been adapted from a road map presented by Eisenhardt (1989). The adapted road map describing the research done on this case study is presented first in table 4. Then, the interviews and source of documented evidence which form an important part of this study are discussed in further detail.

2.2.1. The adapted case method road map

Acquisitions are complex and involve a multitude of events, developments and factors that need to be taken into consideration. The method used must enable a systematic and analytical approach to analysis of acquisitions. The theoretical framework developed in chapter 4 suggests listing and verifying the assumptions acquirer management has made when contemplating an acquisition. The research consisted of the following steps, which broadly follow the “case method road map” suggested by Eisenhardt (1989).

Table 1 The case method road map, adapted from Eisenhardt (1989)

The first column depicts the high-level steps of the research, the second column some general guidelines followed in the research design, where as the third column depicts research phases specific to this research. The fourth column justifies these phases and guidelines.

Step	General Activity (from Eisenhardt: 1989)	Activity specific to this research	Reason
Choosing the case			
Getting Started		Preliminary discussion with key sources	Study would have been impossible without sufficient access to key decision makers
	<i>Definition of broad research question</i>	Identifying primary relevant literature	Focuses efforts The study could have involved different fields, but the one chosen enabled the most systematic assessment of the research question
Crafting instruments and protocols			
	<i>Multiple data collection methods</i>	Contacting interviewees and securing access to data Designing interview questionnaires coherent with literature Identifying appropriate document sources One investigator with support	Strengthens grounding of theory by triangulation of evidence Sufficient number of interviewees needed to get a reliable study Literature needed to be understood first to be able to ask the right questions and assess case systematically Enables triangulation of evidence Helps keep all data in one place
Field research			
	<i>Overlap data collection and analysis</i>		Speeds analyses and reveals helpful adjustments to data collection Allows investigators to take advantage of emergent themes and unique case features
	<i>Flexible and opportunistic data collection methods</i>	Conducting first wave of interviews with key players Verifying interview data through documents Conducting additional interviews with updated questionnaires	Enabled getting a preliminary idea of what had happened Enabled triangulation of evidence - interviews helped in finding the right things to look for Enabled asking more specific questions based on first interviews and documents
Analyzing data			
	<i>Within case analysis</i>	Comparing interview transcripts with one another Comparing interview transcripts with public documentation Identification of assumptions made by management	Gains familiarity with data and preliminary theory generation Enabled building a consensus view on what had happened Enabled checking reliability of interviews These are the key results
Shaping hypotheses			
	<i>Iterative tabulation of evidence for each construct</i> <i>Search evidence for "why" behind cases</i>	Verification of the truthfulness of the assumptions Analyzing Stora Enso's alternative courses of action Designing a model that captures the interdependencies of the assumptions	Sharpens construct definition, validity and measurability Builds internal validity These are the key results Enables understanding the context of the acquisition Shows how the assumption framework should be used
Enfolding literature			
	<i>Comparison with conflicting literature</i> <i>Comparison with similar literature</i>		Builds internal validity, raises theoretical level, and sharpens construct definitions Sharpens generalizability, improves construct definition, and raises the theoretical level
Drawing Conclusions		Identifying critical assumptions which affected the outcome of the case the most	

2.3. Semi-structured interviews

16 semi-structured interviews were conducted with people with different points of view to the Stora Enso acquisition of Consolidated Papers. By interviewing the key players involved in the deal, one was able to reconstruct the “view of the world” of the management team at the time. This method enabled more comprehensive exploration of the merger case than, for

example, plain questionnaires would have done. On the other hand, unstructured interviews were not used, because then interviewees belonging to the same group could not have been interviewed in a sufficiently consistent manner.

The interviewees were grouped according to their role, so that each group could be asked a set of predetermined questions relevant to their roles. Each interview lasted 60-90 minutes and revolved around the predetermined set of questions. All were interviewed separately. Group-interviews with several interviewees at a time would have been difficult to organize, and would have risked bias because of office politics and personal relations.

The interviews were carried out in several “waves”. Four Stora Enso key management interviewees were interviewed first. This made it possible to refine questions for other groups.

The aim of the interviews was to identify both explicit and implicit assumptions Stora Enso management had made, and discuss them to get an idea of the correctness of the assumptions. Interviews of people directly related to the deal were structured in such a way that the interviewee could be able to tell a chronological narrative related to the acquisition. The narrative started from events prior and ended in ones that occurred after the acquisition. Supporting questions demanding further clarification were asked. The discussion was allowed to roam rather freely, so that new interesting themes could be explored if they came up. All in all, the interviews left the interviewee with quite a lot of freedom in bringing up factors and events that he/she found most relevant.

The interviews were taped unless the interviewee requested otherwise, or if the interview setting was deemed unsuitable for recording by the author. Three interviews were not taped, but rather the author relied on taking accurate notes during the interview. After the interview, the tapes were transcribed *ad verbatim*, or the notes taken were typed out. The data collection methods used are well in line with the grounded theory approach, suggested by Strauss and Corbin (1998), used for example, by Nag, Corley and Gioia (2007).

A clear problem with the interview method is that interviewees can either remember things unclearly or incorrectly, or they might have a biased view on a subject touched upon in the interviews. These hinder the reliability of the interviews when looked at individually. These problems were mitigated by interviewing a large number of interviewees who had both similar and different roles in relation to the case. In addition, statements of fact given by

interviewees have been verified using secondary sources whenever possible, so that the study would not have to rely on potentially inaccurate accounts of historical facts. The interviews have mostly been used to get a sense of what the interviewee has felt at different times, and how he/she has viewed different events and actions. The interviews can be regarded as a valuable tool for finding out about the mindset and attitude of the interviewee groups at given times, especially since most groups have several representatives. The interviews also serve as a good tool for marking differences in attitudes and mindset between interviewees.

All the interviews were conducted by one and the same person. This reduced the possibility of attaining data “polluted by” differing ways of interviewing and interpreting the findings. Furthermore, the results of the study were shown to four Stora Enso management interviewees during the revision process, so that they could point out any factual errors in the data. This can also be considered to have improved the reliability of the study.

2.4. Interviewee listing and classification

The 16 interviewees involved in the research included members of Stora Enso top management, a source close to the board, implementing managers involved in post merger integration, advisers to Stora Enso in the acquisition, competitor representatives, independent industry experts as well as the seller of Consolidated Papers. The interviewees are further presented in the following table:

Group	Name	Title at the time of the acquisition and after	Date
Stora Enso management: Responsible for planning and executing the acquisition	Magnus Diesen	Senior Vice President, Corporate strategy and investments	22 September 2009
	Jukka Härmälä	CEO, member of the board	23 September 2009
	Esko Mäkeläinen	Senior Executive Vice President, Accounting and Legal Affairs	24 September 2009
	Kimmo Kalela	Senior Executive Vice President, Strategy and Business Development	25 September 2009
	Björn Häggglund	Deputy CEO and member of the board - also lead integration team following acquisition	10 February 2010
Other interviewees close to management:	A Source close to the Stora Enso board		5 February 2010
Implementers: Stora Enso managers who were involved in post merger integration	Kai Korhonen	Senior Executive Vice President, Stora Enso North America, following the acquisition	6 October 2009
	Asko Hyttinen	Senior Vice President, Investments and M&A, SENA, also member of merger operations team	7 October 2009
Advisers: Investment bankers and consultants who advised Stora Enso in the Consolidated Papers acquisition:	Rainer Häggblom	Chairman and CEO of Jaakko Pöyry Consulting at the time of the acquisition	6 October 2009
	Anonymous	An investor banker who advised Stora Enso	7 October 2009
	Peter Tague	An investor banker who advised Stora Enso	10 November 2009
	James Treco	An investor banker who advised Stora Enso	10 November 2009
Competitor interviewees: Representatives of Stora Enso's competitors	Jyrki Kettunen	Former future director, M-Real	22 October 2009
	Ainomaija Haarla	Former corporate strategy director, UPM-Kymmene	27 October 2009
Independent pulp and paper industry experts	Lech Buzalski	Independent pulp and paper industry expert	30 November 2009
The Seller	George W. Mead	George W. Mead: Chairman of the board and largest stockholder of Consolidated Papers, later member of the board of Stora Enso and chairman of the Mead-Witter foundation	12 November 2009
	with Susan Feith	Susan Feith: Vice-chairman of the Mead-Witter foundation and spouse of George W. Mead - Contributed significantly to the interview with G.W. Mead	

Table 2 The interviewees involved in the research

2.5. Literary evidence

To complement the interviews, data was also collected from literary sources.

This had two objectives:

- 1) Verification and complementation of the assumptions gathered in the interviews
- 2) Collection of data to explore the correctness of each assumption.

In the verification of the assumptions, it was important to find primary sources of evidence. For this purpose, Stora Enso's own publications were very good because they are usually

approved, if not done by management. These sources included Stora Enso investor presentations, annual reports, SEC filings, as well as direct quotes of Stora Enso executives in news articles. These materials were looked through, and examples portraying management thinking relevant to the case were picked out. Many of the key examples found are shown in this report.

To verify the correctness of the assumptions, a broader range of sources was used. Each assumption provided a small research theme of its own, requiring a tailored approach. Some assumptions demanded looking at statistical data, while others required a more qualitative approach. Sources for this included the above mentioned primary sources of data, scientific publications, US trade commission and FAO trade statistics as well as news articles.

The sources used can be considered trustworthy for the purposes of this report. The statements in Stora Enso's own publications are valuable in determining the views of Stora Enso management. Stora Enso is a publicly listed company with an obligation to honestly disclose its views and information on the market. The company's presentations cannot, therefore, be intentionally misleading with respect to the views of its management. The news articles, in turn, give a bit of historical atmosphere and an idea of what management wanted to talk about at a given time. The possibility of journalistic interpretation creeping in was minimized.

2.6. Data analysis

The structure of results and data analysis presented in this study are presented in the figure below:

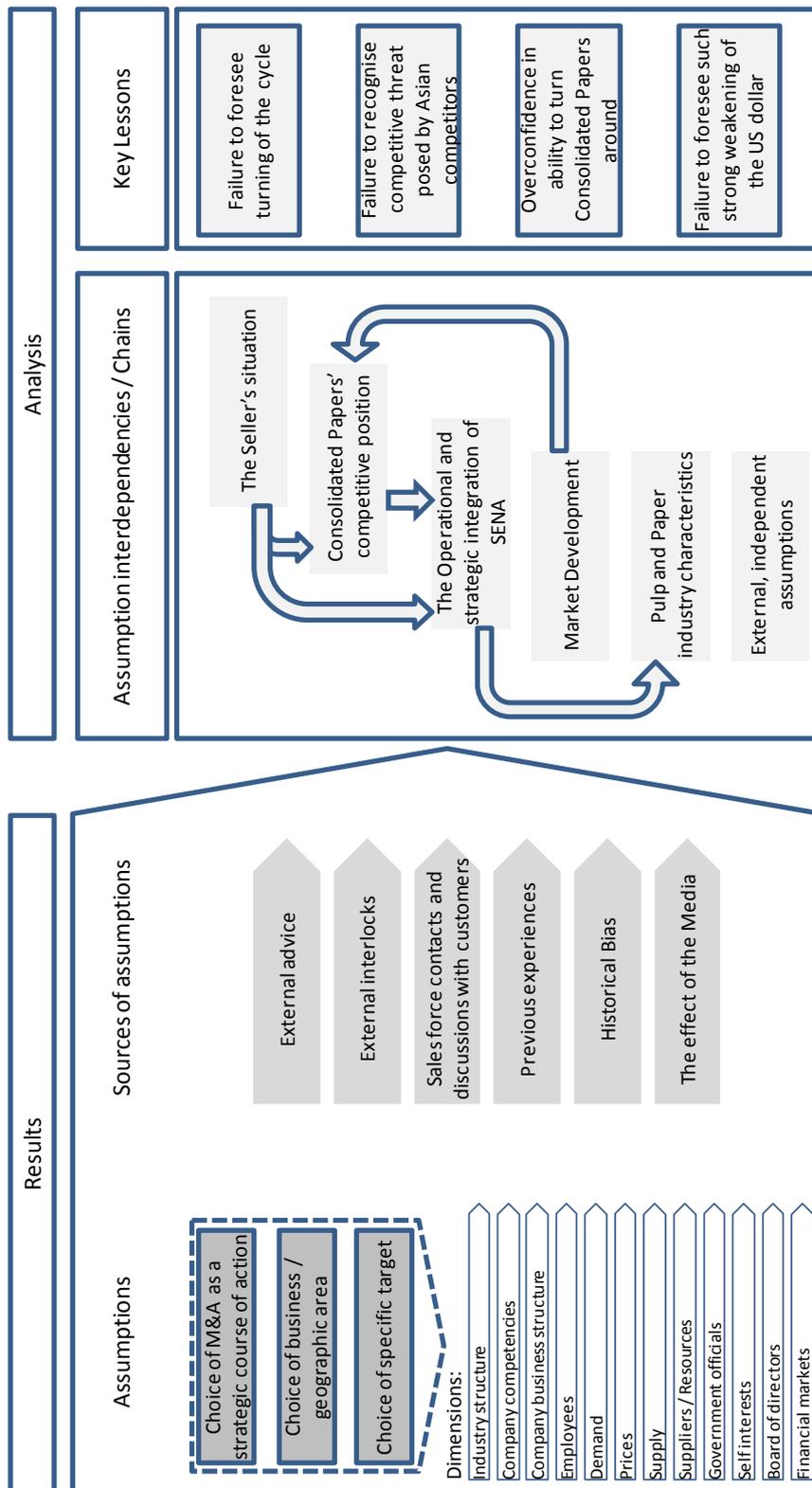


Figure 2 Structure of data collection and analysis

The main results of the study are the assumptions made by Stora Enso management before the acquisition of Consolidated, and a verification of the correctness of these assumptions. These results were used to draw further conclusions and answer the research questions.

2.6.1. Derivation of results

The interview transcripts were used primarily for filling out the assumption framework presented earlier. Interview answers were compiled by theme (open coding), compared and contrast with each other. Differences in answers were sought, and then a balanced view of each theme was conjectured. Based on these compilations, a list of assumptions made by Stora Enso management was derived. These include both explicit statements of the interviewees and some assumptions which the author has read “between the lines”. The assumptions, however, were verified using literary data as far as possible. The research question “*Why did Stora Enso acquire Consolidated Papers in 2000?*” could be answered by looking at the assumptions made by management, because they include the benefits sought after with the acquisition.

After filling out the framework with the assumptions made by Stora Enso management with respect to the Consolidated Papers acquisition, the assumptions listed were followed up on. The interview transcripts were re-read and analyzed to find evidence on whether the assumptions turned out correct. Other sources of data were also used to verify information given by interviewees in the interviews.

2.6.2. Drawing conclusions from results

It is important to try to verify where these assumptions came from. Part of the interview questions were aimed at finding out what influences management had been subject to, and what the role of outside advisers, for example, has been. Thus the analysis part includes an assessment of what factors have affected management cognition in this case.

The assumptions found were not independent from each other, but rather, a certain event could affect the correctness of several assumptions. Therefore it was important to analyze their interrelations and effect on the valuation of the target company. The assumptions were grouped into five “chains” based on the author’s judgment. These chains had assumptions that were inter-related, resulting in a dynamic model that describes the cross-influence of the assumptions. Based on this analysis, we could conclude which the most critical assumptions that caused the difference between the price paid and the real value of the target company were. Hence we could answer the research question, “*What factors hindered attaining the preconceived benefits of the 2000 Stora Enso acquisition of Consolidated Papers?*” This led us to a list of four key lessons – What developments did Stora Enso management fail to foresee in deciding to acquire Consolidated Papers.

3. The Stora Enso acquisition of Consolidated Papers – How did it happen?

In this section, the historical events related to the acquisition are presented by looking at the situation of both the buyer and the seller before the acquisition, reviewing the acquisition process and subsequent developments that ultimately led to the divestment of Stora Enso's North American operations.

To begin assessing the acquisition, it is first important to understand how the events related to it unfolded. The following historical narrative of events has been compiled both based on interviews with contemporary Stora Enso management, the chairman of the seller, and several advisers of Stora Enso. In addition, Stora Enso annual reports and SEC filings filed in conjunction with the acquisition have been used.

3.1. Stora Enso's background in going to the deal

According to interviews, the process of expanding to the United States became a relevant question after the Stora – Enso merger that had been concluded in 1998. Stora Enso was now a major player globally in the P&P industry. Growth was expected and necessary, however, organic growth through greenfield investments was largely deemed impossible because Stora Enso's main markets were already filled with capacity. Growth in Europe through M&A was difficult because that would lead to market share growing too large and potential anti-trust action. North America was the world's largest paper market, but Stora Enso had only one factory there including a recently opened SC mill that was inherited from Stora. In addition, Stora Enso had exports to the United States as well. Stora Enso was now financially also such a strong player, that a large acquisition was finally possible.¹ Stora Enso's strategy of growth through M&A was publicly stated. A good example is Stora Enso's annual report dated 10 February 1999 where Jukka Härmälä wrote: *“To keep pace with forest industry consolidation, the leading players must continue to expand their size in the future. Much of this growth will come through acquisitions, mergers and strategic alliances.”*²

Stora Enso management agreed that expanding to North America should be further investigated and hence formed a strategy team to explore it. This included looking at different paper grades, assessing market outlook in each and doing studies on what potential options

there were to acquire. This strategy work concluded that printing papers still showed growth, as they were strongly linked to economic activity and marketing, which were booming as a result of the ongoing IT boom. Stora Enso did preliminary studies with several investment banks regarding ideas on which players could be acquired and what the strategic rationale would be in each of them.³ In addition, Stora Enso had a study done with a management consultancy on what the technical condition of various US market players was. These studies showed that Consolidated Papers was the best fit for Stora Enso, with other options including Donohue, Champion and Mead Westvaco.⁴ Other options also included buying independent factories and putting them together, but this option was not considered a quick enough way of getting a foothold in the US market and attaining global synergies. Greenfield investments in the mature US market were also considered impossible, as market share would have had to be fought for using price, and because of the big risks. Stora Enso's previous experiences with Eurocan in Canada had a negative effect on that option in the minds of managers who had lived through that stage.

Stora Enso management brought up acquiring a company in the US with the board in early 2000. The board was hesitant to make another move because many members thought that the company needed more time to properly digest the Stora Enso merger.⁵ Yet, management convinced them that buying a company in the US would be the right strategic action to take.

Stora Enso made an offer for other paper industry companies in North America, including Donohue in the beginning of 2000. Donohue, however, was acquired by Abitibi-Consolidated in a deal published on February 11, 2000, as Stora Enso's offer had not been sufficient.⁶ The Donohue offer had been made without consulting the board and had been made subject to board approval.⁷ Then, in January 2000, Stora Enso was notified by Goldman Sachs representatives that Consolidated Papers, of which a large part was owned by George W. Mead and his family, was for sale. Stora Enso then hired Citibank as its adviser and decided to take part in the upcoming auction for the company. Stora Enso management also convinced the board that this was the right course of action.⁸

3.2. The seller's background in going to the deal

According to an investment banker involved in the deal, Consolidated Papers had been considered the "crown jewel"⁹ of the US P&P industry. It had not been for sale, as its major owner, George W Mead was still actively in charge and had controlling interest.

According to an SEC filing done in conjunction with the acquisition, Consolidated Papers started considering its strategic options in late October and November 1999 together with Goldman Sachs investment bankers. Opportunities for acquisitions, dispositions and other strategic alliances were considered.

Consolidated Papers' board considered a number of global paper industry trends, including the development of new low cost capacity, increased price volatility and customer and supplier consolidation. A wide range of options were reviewed, focusing particularly on whether the company should be an acquirer or should seek to be acquired by a larger company. Acquiring other companies was not deemed feasible because in the board's view, the company's stock was undervalued. After discussing alternatives, Consolidated Papers concluded that its value as an independent player probably wouldn't develop as well as if it were acquired. Hence ten major producers in the industry, who were deemed capable of attaining synergies from a merger and paying a significant premium were identified as potential buyers and were contacted by Goldman Sachs, following a decision to pursue this alternative on 4 January.¹⁰

3.3. The sale process

Following an initial contact by Goldman Sachs, six companies expressed interest in buying Consolidated Papers. The chairman and president of Consolidated Papers met representatives of all these companies. Stora Enso was one of these six, and according to a Stora Enso management team interviewee, they had seen the party also visiting UPM headquarters. At this time, Stora Enso hired its own advisers in the deal, including Salomon Smith Barney (later Citibank) as the investment bank and Pöyry as a management consultant.¹¹

From January 19 through January 28, 2000, Consolidated management held meetings with interested parties, after which interested parties were invited to present bids based upon a proposed form of merger agreement by February 17, 2000. On February 17, 2000, Consolidated received two bids, one from Stora Enso and one from a "*publicly-traded domestic paper manufacturer*". The other manufacturer's offer was fifty percent cash, fifty percent stock bid at a lower dollar value per share. Negotiations continued with both parties. The other bidder hinted that they could raise their offer, but never did so. Consolidated also tried to raise further the price offered by Stora Enso. Consolidated also asked for but did not receive the right to terminate the merger agreement if the value of Stora Enso Series R shares

fell below a minimum level. In the negotiations, however, the original terms of the merger offered by Stora Enso were accepted. This included buying the shares at \$44 a share, with 50% in cash, 50% in Stora Enso shares. This offer was worth \$4,0 billion dollars in addition to which Stora Enso would assume \$0,9 billion in debt.¹²

During the deal negotiations, Stora Enso used several external advisers. Pöyry carried out an outside-in study of Consolidated Papers, assessing its technical condition and market position followed by a valuation which was done interactively with Stora Enso management. In addition, Stora Enso received advice from its advisory bank, Salomon Smith Barney (later Citibank). Stora Enso top management also heard rumors on the presence of competing bidders as well as the approximate levels of the competitors' bids.¹³

There is some controversy over who the other bidders in the final rounds of bidding were. In the SEC filing, the other bidder was identified as an American pulp and paper industry player.¹⁴ According to some interviewed Stora Enso executives, this main other bidder was Mead Westvaco.¹⁵ A consultant familiar with the deal identified the other bidders as an even larger North American P&P player as well as a major Norwegian P&P player.¹⁶ At the time, Stora Enso management considered International Paper and UPM Kymmene as its most serious competitors. An interviewed UPM-Kymmene representative denied that UPM's interest in Consolidated Papers had been taken further than preliminary discussions.¹⁷ At Stora Enso, however, UPM was considered to be a serious potential competitor at the time, as the board had noted at a meeting that "*International Paper and UPM-Kymmene could pay up to \$47 a share*"¹⁸ (Stora Enso's final offer was \$44)

At the same time, several other acquisitions were also ongoing. Stora Enso management was more or less aware of this activity. It turned out that UPM was in the process of buying Champion International, which Stora Enso had also identified as a possible target candidate. According to interviewees from both Stora Enso and UPM-Kymmene, the fact that the acquisitions were published only about a week apart from each other, with UPM being first, was a pure coincidence.¹⁹ It does, however, imply how "hot" M&A activity was in the industry at the time, and also gives insight as to why asset prices were so high – There was a lot of demand.

The UPM- Champion merger never realized, however, because International Paper made a competing offer in May, 2000 after UPM had publicized the deal in February.²⁰ UPM made a counter-offer, but after International Paper made its final offer, which was considerably

higher than UPM's original offer, UPM backed out from the deal and received \$200 million in compensation because Champion had breached its exclusivity contract. The fact that International Paper came into the Champion picture only after the UPM-Champion and Stora Enso – Consolidated Papers deals had been made public allows for speculation that perhaps International Paper had also been interested in Consolidated Papers, but it had to set its sights on Champion after perhaps having lost the bidding war for Consolidated Papers to Stora Enso.

Stora Enso management realized that the Consolidated Papers acquisition was expensive. The decision-making process, according to one former Stora Enso management team member was such that a core group of 5-6 top executives took care of the deal and did not discuss it extensively. The rest of the top management team learnt about the price more in an informative manner, rather than as a subject open for discussion. Overall, the top management team was not fully in favor of the deal, and according to a manager involved, the decision was brought even to the board of directors in a way which acknowledged that the deal is strategically beneficial, but its price is too high.²¹ The initially reluctant board, however, decided that this step should be taken. Interviewees were of differing opinion as to whether there was a sense of urgency in doing a deal right then when there seemed to be a lot of US P&P companies for sale. One interviewee claimed that the feeling was that since Consolidated Papers was the best option according to studies in terms of its reputation and technical condition, it was then or never.²² According to a source close to the board, the unsuccessful bid for Donohue only a month earlier had increased pressure among management to make a high enough offer.²³ According to another manager, the offer put up for Consolidated Papers was the highest that they could justify²⁴ and it was considerably higher than the independent valuation they had received.²⁵ In fact, the price Stora Enso offered represented a 69% premium over Consolidated's market capitalization preceding the offer.²⁶ According to an adviser close to the deal, Stora Enso's offer was not significantly above the next best offer.²⁷

There is controversy over the attitude of the board towards the Consolidated Papers acquisition. According to a management interviewee, who also served on the board, the decision whether or not to expand in North America was not neutral. Since the other option was to divest the Nova Scotia factory which had just been ceremoniously opened in 1998 by Stora, the Swedish board members "*didn't require a lot of persuasion*" to approve going forward with the planning of acquisitions.²⁸ According to some management interviewees,

the board had been strongly in favor of the acquisition²⁹, while newspaper articles and other discussions claim that the board had had widespread concern also about the price, the truthfulness of the strategic benefits and the ability of the company to absorb such a large acquisition when the Stora – Enso merger was still being completed.³⁰ The chairman of the board had actually lectured in general terms about the dangers and possibilities of failures of acquisitions in the US.³¹ The CEO had attempted to reassure himself of the decision by discussing with a famed P&P equity analyst right before deciding on the offer. He had concluded that the strategic move is correct, the price is high, but that ultimately the deal is a risk worth taking.³² Ultimately the board was also convinced likewise and the offer was unanimously accepted³³.

Hence, on February 22 2000, Stora Enso announced its tender offer for Consolidated Papers at a price of \$44 per share, or a total of \$3,9 billion in addition to \$0,9 billion in assumed debt. Of the equity price, 50% was offered in cash, and 50% in Stora Enso ADRs which were to be listed in the New York Stock exchange as a result of the transaction.³⁴ Stora Enso's share dropped 15% on the day of the announcement, and the deal was considered expensive in the press. Overall, however, the decision was treated rather positively in the media.

The deal was concluded on 31 August 2000. By this time, Stora Enso's share had fallen to a lower level than in February, and the final equity price was \$3,6 billion in addition to around \$0,8 billion in assumed debt.³⁵ Stora Enso gave Consolidated shares that represented 18 % of economic interest and 5 % of votes. George W Mead, who became a significant owner in Stora Enso, also became a member of the Stora Enso board.³⁶

3.4. The Integration process

Interviewees agreed that the integration of the two organizations went well. Immediately after the deal was announced, Stora Enso appointed a five-member “merger operations team”, to oversee pre-integration before the deal is concluded.³⁷

In September 2000, when the deal had been closed, Consolidated Papers and Stora Enso's existing mill in Port Hawkesbury, Nova Scotia, were merged to form Stora Enso North America (SENA), a separate legal entity. A management team headed by Kai Korhonen, formerly the head of the Newsprint division, and a board of directors, chaired by Jukka Härmälä, were appointed to govern SENA.

As Stora Enso's presence in North America had been limited, there was little to integrate apart from marketing and sales offices, logistics from Stora Enso's limited exports as well as some administrative functions.³⁸ The success of post-merger integration in this sense can be measured in terms of SENA's market share in the North American market, which it managed to increase during its first years of operation.³⁹ Greater synergies, however, were expected to arise from synergies with customers who operated globally. Stora Enso expected to be able to optimize its deliveries by producing at the most beneficial place at each given time. In this sense, the acquisition could be thought of as a natural hedge against fluctuations in the US dollar / euro exchange rate.⁴⁰ In trans-Atlantic profit optimization, however, one interviewee, who had been part of the SENA management team, claimed that Stora Enso was not successful.⁴¹ Customers on the East Coast, for example, were reluctant to accept paper produced in Europe, as they were used to paper produced in the Midwest by Consolidated Papers.⁴²

Customer relationships with global customers did not become as global as expected even though customers continued to consolidate their sourcing into global sourcing organizations. Orders remained at a local level and hence Stora Enso did not gain the global synergies it had attempted obtain.⁴³

3.5. Market development

2000 and 2001 were still reasonably good years for Stora Enso. In 2001, however, the IT bubble burst, causing trouble for the IT industry, which was a major advertiser. The economy in general went into a recession as well between 2001 and 2003. The result was weakening paper demand and falling prices. At first Stora Enso managed to gain market share, but with lower prices, profitability was severely hit. In 2001 and 2002, cash flows were still positive, but earnings margins were negative due to the heavy burden caused by the high purchasing price of Consolidated Papers.

During 2001-2002, Stora Enso concentrated on integrating sales and marketing forces in Northern America and rationalizing production. As prices dropped even further, and no signs of improvement were in sight, Stora Enso decided to make a large impairment charge on its SENA arm, by writing off \$1,2 billion of SENA's book value.⁴⁴ This also marked the start of a major restructuring of SENA, which included closing down unproductive mills, radically reducing the number of employees and investing in mills with brighter prospects. These

investments caused a lot of down time and onetime restructuring costs, which caused even cash flow to be negative in 2003 and 2004.⁴⁵

Growing the North American platform was a goal, and the North American management team constantly searched new acquisition targets through which the original value creation idea of buying Consolidated Papers could be realized. By buying more capacity, the company could have created greater synergies and cut costs more aggressively. Asset prices, however, were deemed unrealistic. According to a Stora Enso North America management team member, asset prices still reflected old benchmarks, and were almost at the levels of the Consolidated acquisition. Hence no acquisition targets were found.⁴⁶

Markets started to improve in 2003, and prices started to recover. This enabled SENA to produce positive cash flows from 2005 onwards. According to an interviewee, 2005 was a year where results were already satisfactory. In 2007, Stora Enso's CEO Jukka Härmälä retired and was replaced by Jouko Karvinen in March 2007. Under Karvinen, SENA was first separated as its own reporting entity, and then quickly divested to NewPage corporation, a private equity-owned coated and fine paper producer that had been formed from Mead Westvaco. The SENA divestment was completed by the beginning of 2008.⁴⁷

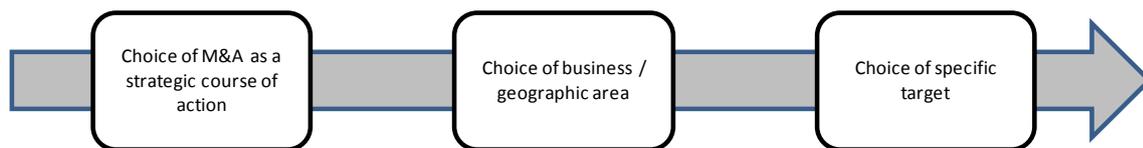
Although the divestment and specific factors that led to the decision are out of the scope of this study, it is worth mentioning that the management interviewees involved in the acquisition mostly disagreed with the decision to divest. In 2007, product prices were at good levels, and while the company's earnings were still close to zero, margins were at even better levels than at the time of acquisition. According to an interviewee who had previously worked in the SENA management team, the company would have required a couple of years of hard work, where costs would have been pursued with a heavy hand, for the results of the major restructuring work ongoing since 2002 to start showing. The company was, according to interviewees, in very good shape for American standards, and could have been able to compete well with other American players such as its acquirer NewPage.

On the other hand, 2007 also marked the beginning of a severe crisis in the financial markets that ultimately led to a recession felt especially hard by the United States and Europe. Recovery from this recession is still ongoing at the time of writing and financial results have been poor during this time throughout the industry. This in turn suggests that selling SENA in 2007 was a sensible action, as it enabled improving the company's financial position.

4. The merger assumptions framework and its literary background

In this section, the framework developed for assessing the Stora Enso – Consolidated acquisition is presented. This is followed by a review of the theory behind corporate strategic decision making and forming assumptions in relation to mergers and acquisitions.

In order to assess the success of the Stora Enso – Consolidated acquisition in a systematic way, we must decide upon a framework by which to conduct the analyses needed. Mergers and acquisitions involve a complex decision making process. In this section, the merger and acquisition assumption framework developed for carrying out this research is presented, after which relevant literature is reviewed. The literature review consists of three parts: managerial cognition literature, M&A literature, and studies specific to the pulp and paper industry M&A.



Assumptions with relation to internal or external dimensions:

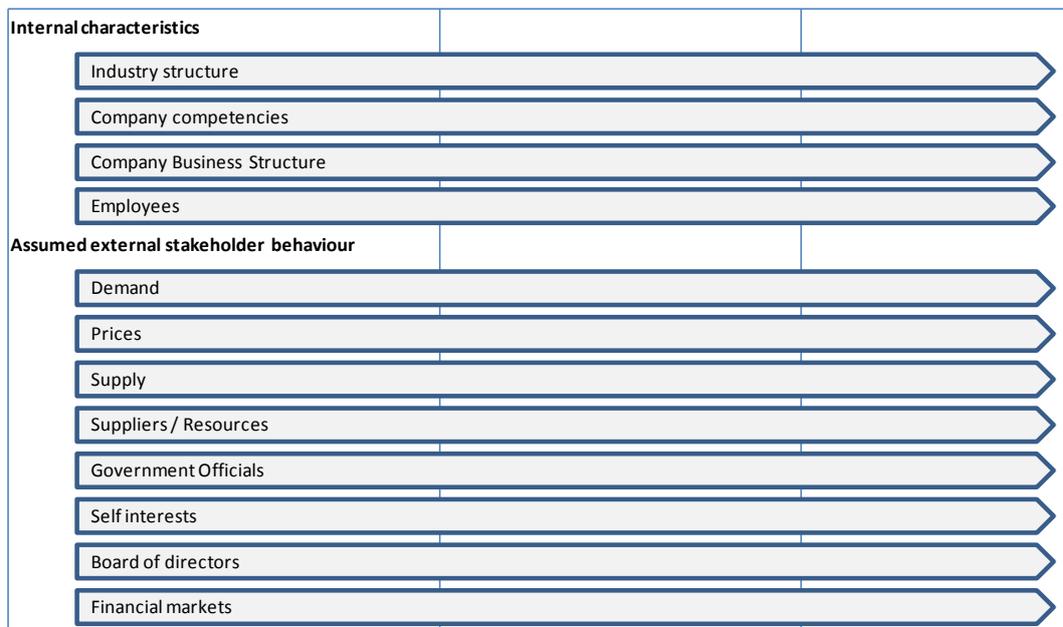


Figure 3 Assumption framework - The stages of the M&A decision and the assumption dimensions

A merger or acquisition is rarely a complete success or failure, but rather its success is determined by smaller elements. A good way to assess these smaller elements is to look at assumptions made by management when carrying out a deal, and later investigating whether they proved to be correct or not. The framework of this research presented above in figure 1 aims at capturing the complexities of the M&A decision making process. It looks at the different stages of the decision making process, and then at 12 dimensions, which aim at listing the different factors and stakeholders that should be taken into consideration when contemplating an M&A transaction. The framework looks at the assumptions made in each stage of the decision making process with respect to each of the dimensions. This provides a way to systematically assess the outcome of a deal.

Looking at the multitude of different merger benefits sought, it is clear that there is no single archetype of a merger or acquisition. Hence, the framework may look different for each M&A case: All dimensions may not be relevant in every merger or acquisition, and a lot of assumptions made by corporate management might not be included in the assumptions found in literature. Some assumptions might be made deemed irrelevant at the time of decision making, but might later turn out to be decisive for the success of the M&A transaction.

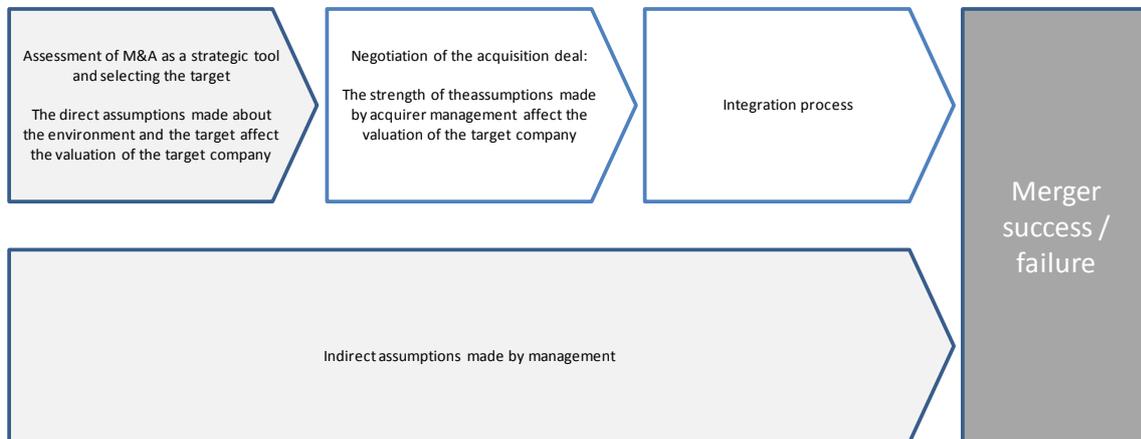


Figure 4 The relation of the assumption framework to M&A success or failure

The above figure gives an idea on how the M&A assumption model relates to the overall success / failure of a merger or acquisition. The other factors listed (negotiation, integration and indirect assumption follow-up) all derive from the initial assumptions. They determine the price the acquirer is willing to pay, and the integration process itself is also an assumption – The acquirer assumes that the post-merger integration can be carried out in a certain fashion.

In the following sections, the stages of the decision making process are conjectured through literature on managerial cognition. Examples of the significance of the dimensions are sought from M&A literature.

4.1. The three stages of the decision making process

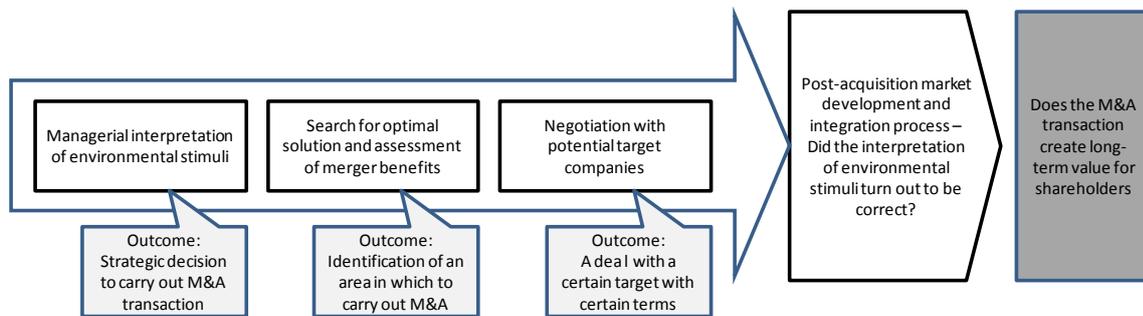


Figure 5 The M&A process model at a high level

The framework is separated into three different areas which reflect a hypothesis of the different stages involved in a deal. The reason for this split is that it enables dividing the assumptions made by management into these areas, and therefore facilitating the assessment of a merger and acquisition case. The different stages may or may not occur in chronological order.

- The first area is the contemplation over whether a merger or acquisition is the right course of action.
- The second part is the finding of a target in a certain geographical or business area.
- The third part involves assessing the perceived benefits of merging with a particular target, which enable setting the appropriate bid.
- After the merger comes post-merger integration and follow-up on actual market developments, which defines whether or not the deal brings the benefits intended. Usually this can be measured through the extent of value creation for existing shareholders of the acquiring company.
- The order of the three decision making stages may vary. The region can be chosen first, after which a suitable target is searched, or a target may come on offer. In this case the company first assesses the target and then the benefits of a merger in that area, or the suitability of a merger in the first place.

Each stage of the model has a certain end result, which reflects management decisions during the stages. The aim of the literature review is to elaborate on how the decisions are arrived at, and which factors affect decision making.

The basis of the model comes from Jemison and Sitkin (1986) who created an M&A process model (Figure 4) which assessed the factors that a manager must take into consideration before making a decision on an acquisition. These include strategic fit and organizational fit, which are assumptions a manager must make. Furthermore, Jemison and Sitkin propose considering the acquisition process as a factor, for example, how M&A tasks are divided among managers and the different aspects of a the transaction discussed, how secretive management must be about the transaction, how expectations are aligned between the buyer and the seller, and what the relationship will be between the buyer and the target's management after the deal.

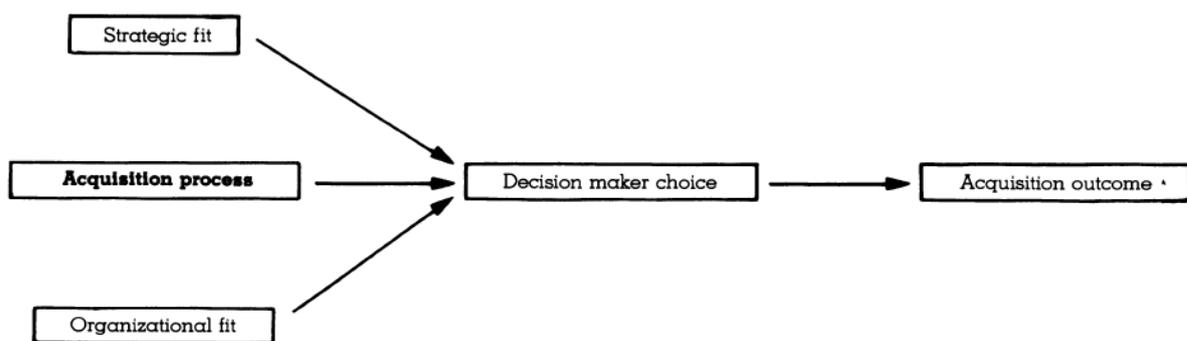


Figure 6 Jemison and Sitkin (1986) M&A process model

But what influences how managers perceive these different choices and where do managerial assumptions come from?

4.2. The effect of managers on corporate performance

Managerial behavior and cognition have been widely studied. According to one school of thought, differences in managerial behavior and responses to the environment are crucial determinants of success. This is opposed to the population ecology-based view, according to which organizations are swept along by events and basically run themselves (see, e.g. Hannan and Freeman, 1977). As this study studies the behavior of top management, it is assumed that top management actions matter in determining the success of a company.

Why are some companies able to adjust to changing circumstances while some do not survive? Barr et al. (1992) suggest that the ability for organizational renewal does not so much rely on whether managers are able to spot changes in their operating conditions, but on how those changes can be linked to corporate strategy and that linkage can be modified over time. Companies need to take actions that fit a changing environment. These actions are dependent on managerial cognition on causality and consist of three parts, each of which is reviewed in more detail:

- Attention to changes in the environment
- The interpretation of stimuli
- The matching of perceived problems with solutions

The factors that affect managerial cognition and the decision to a) carry out M&A as opposed to another strategic action b) choose a certain region or business area c) choose a certain target can be summarized into the following figure:

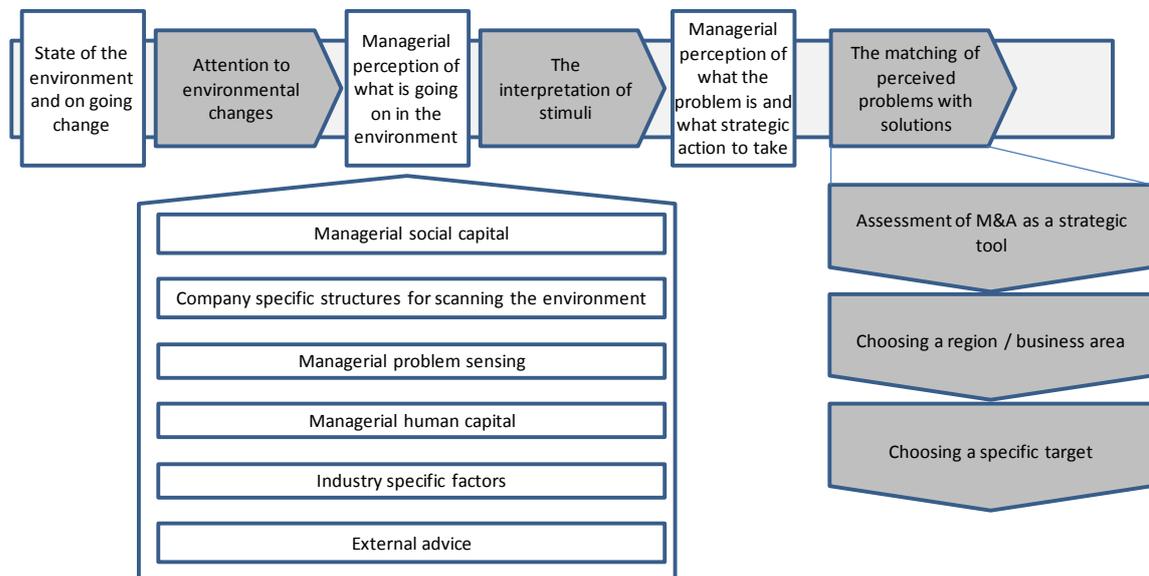


Figure 7 The M&A process model – How the decision to carry out a merger or an acquisition is arrived at

4.2.1. Attention to changes in the company environment

According to the concept of bounded rationality, (March and Simon, 1958; Cyert and March, 1963) each manager makes assumptions and decisions based on his or her subjective view of

reality. A manager's cognitive base for decisions consists of knowledge or assumptions about future events, knowledge of alternatives and knowledge of consequences of the alternatives. Managerial cognition has an influence on strategic decisions and outcomes, including responses to changes in the external environment. (Cyert and March, 1963)

Decisions can also be affected by differences in the dynamic managerial capabilities of managers. (Adner and Helfat, 2003) These differences cause differing performance. This is opposed to the idea that the external environment would dictate managerial decisions and hence all corporate managers in the same industry would make the same decisions. Dynamic managerial capabilities consist of three elements that work together:

- Managerial human capital, i.e. a manager's training and experience
- Managerial social capital, i.e. The social ties a manager has both internally and externally. These ties may provide certain information from the outside, hence diversifying the manager's knowledge base. This is generally deemed beneficial for decision making.
- Managerial cognition, i.e. A manager's beliefs and mental models

Empirical evidence suggests that differences in managerial cognition may lead to different strategic decisions and outcomes, which in turn generally reflect a need for change over time. (Adner and Helfat, 2003)

Other factors that may affect cognition of the environment include:

- Company specific formal structures for scanning the environment (Hambrick, 1982)
- External interlocks (Carpenter, Westphal, 2001)
- Presence of external advisers who may have differing interests in a project than corporate management (Jemison and Sitkin, 1986)

Depending on these factors, management gets a certain view of the environment. Analyzing the preceding market situation and managerial interpretation of the market landscape before the transaction helps to answer the question why company management believes a merger or acquisition in a certain field or geographical area is a beneficial course of action, rather than some other strategic action or taking no action at all.

4.2.2. Interpretation of stimuli

Problem sensing consists of noticing, interpreting and incorporating stimuli arising externally or internally. (Kiesler and Sproul, 1982) Individuals have a limited capacity to deal with all the information in their environments and to process what they do perceive. (Miller, 1956, Simon, 1957) Problem sensing is therefore prone to errors that may be caused by several factors:

Cognition theory	Proposition	Likely errors in problem sensing
Social perception	1 When managers actively infer causality, exaggeration and mono-causal reasoning will dominate their analyses	Illusory correction, assume events are correlated that in fact are not because they are similar Illusory causation, Assume events are causal that in fact are not because they are focus of attention
	2 When managers infer causality, then environmental changes rather than the actions of the managers' organization will appear causal	
	3 When managers infer causality, then vivid events and fortuitous associations will overcontribute to causal explanations of environmental change	
	4 Automatic search will influence causal inference based on the salience and frequency of events	
Information processing	5 Managers operate on mental representations of the world, and those representations are likely to be of historical environments rather than current ones	Gap creating, assume events did not occur that in fact did because they are schema irrelevant Gap-filling, Assume events occurred that in fact did not because they are schema relevant Ignoring overly discrepant information . Fail to code or store information that is extreme or highly surprising
	6 Since managers best incorporate information that is mildly discrepant, major environmental changes are unlikely to be incorporated	
	7 Only if managers develop schemas for extreme environmental change will they be likely to incorporate extreme environmental effects	
Social motivation	8 When managers encounter information about the environment that confirms their beliefs, they will believe that information is diagnostic	Preference for ambiguous information - Prefer ambiguous information to avoid self-deprecatory learning Preference for self-enhancing information, fail to code or stroe self deprecatory information
	9 When managers are heavily invested in any situation, they are relatively likely to discount information about environmental change detrimental to that situation	
	10 Only if managers are committed to operating within a rapidly changing social environment will they mentally incorporate information about extreme environmental events	

Table 3 Propositions of social cognition together with associated likely errors (Kiesler and Sproul, 1982)

The mistakes managers make in interpreting stimuli can be attributed to their own backgrounds, motives and desire to see matters in a certain way. For organizations, this means that one should not blindly trust managers' insight and judgment as rationality is bounded and prone to errors. The key questions arising from Kiesler and Sproul (1982) is what environmental stimuli has management noticed, how have they been interpreted and furthermore, how have these interpretations been incorporated to corporate decision making.

4.2.3. The matching of perceived problems with solutions

Finding solutions to the perceived problems may be affected by industry specific factors or issues such as imitation.

Industry-wide shared beliefs rather than technology-based economic factors are key determinants of industry structure. In some industries, industry-wide common beliefs are present, while in others beliefs vary. Competitive factors and managerial cognition co-act in influencing beliefs and firm-level strategies. Furthermore, they cause performance differences within an industry. (Johnson and Hoopes, 2003)

Sunk costs, or heavy capital investment, make companies less inclined to changing a strategic location. As the costs of changing a strategy increase, the more likely are companies to get “locked in” to a strategy. In such industries, differences between beliefs in different companies are larger, as a result of bounded rationality. In industries where changing costs and entry barriers are low, on the other hand, beliefs are highly similar. Socially constructed beliefs are not supported, and firms tend to converge to a shared set of ‘true beliefs’. (Johnson and Hoopes, 2003)

This research is particularly interesting for the pulp and paper industry, because it is a highly capital intensive industry. Having made a costly investment, such as an acquisition or opening a new production facility, managers are likely to stick to the belief that the strategic direction is correct even though contrary evidence emerges. In an industry with small entry barriers, however, companies are freer to experiment with different kinds of strategies until they find the “correct one”, which is then easily imitable by competitors.

Lu (2002) found evidence for institutional isomorphism in market entry. In her study of Japanese foreign subsidiaries, later entrants tended to follow the entry mode patterns established by earlier entrants. Firms were found to exhibit consistency in entry mode choices across time. In addition, a firm's investment experience was found to moderate the effect of other institutions on entry mode choice. This is a relevant finding in this case, as Stora Enso was not the only foreign company trying to enter the US pulp and paper market at the time of the Consolidated Papers acquisition. It is therefore interesting to see if there is evidence of corporations imitating each others' strategy.

Based on these factors, management now has information on its strategic alternatives, which may be, for example, doing nothing, carrying out an M&A transaction, pursuing new opportunities through organic growth or R&D, among others.

The important issues that arise from the reviewed literature are how managers attempt to scan their environment, and how emerging issues are analyzed. Are they analyzed using a rigorous analytical process, or do managers rely mostly on their intuition or previous experiences? Furthermore, when looking for solutions, how much time is spent on thinking about the implications of actions? Again do managers rely on their experience and intuition or seek further opinions from inside or outside the company?

4.3. The assumptions made by management in the different stages of the decision making process

In this section, the discussion focuses on assumptions that management makes in one of the three stages of contemplating an M&A decision. The framework, shown in figure 1, has been divided into 12 dimensions, which represent areas which have a significant effect on the decision to carry out an M&A transaction, but which can also have a significant effect on its success. First, each of the 12 dimensions is explained in further detail. Then, typical assumptions found in M&A literature related to each dimension are summarized into table. Thirdly, a table summarizing typical M&A assumptions specific to the pulp and paper industry is presented.

4.3.1. General assumptions made in conjunction with mergers and acquisitions

In addition to the specific dimensions, M&A literature includes general assumptions and classifications.

Berkovitch and Narayanan (1993) classify takeover motives broadly into three categories—synergy, agency and hubris. Converting these into assumptions, synergy means that managers assume that the combined value of the two companies is greater than the sum of the values of the two companies on their own. This may be due to cost savings, sharing of best practices as well as increased sales opportunities enabled by a merger or acquisition. The synergy assumption relates mostly to the dimensions “industry structure”, “company competencies” and “company business structure”, described later on in further detail. Agency refers mostly to mergers carried out in order to bring benefit to acquiring company management –

Management therefore assumes that it will benefit from the merger itself. Hubris theories suggest that mergers and acquisitions result from management overconfidence in its ability to create value from mergers, causing systematic overpayment for target companies. These kinds of assumptions relate mostly to the dimension “company competences”.

4.3.2. Internal factors

The four first dimensions of the framework are classified as internal factors. They have to do with the industry’s fundamentals and acquirer and target companies’ internal characteristics.

Industry structure means the fundamentals of the industry a company operates in. Important characteristics to consider can be, for example, whether the industry is dispersed or an oligopoly, or what the entry barriers are like. For example, in a capital intensive industry, entry barriers can be high and size is often thought to bring benefit.

Company competencies refer to the know-how located in the acquiring or target companies, and their fit with each other. Competencies can be, for example, the know-how the target or the acquirer has in technology in a certain area, in which case management could assume that sharing these competencies could create value. If the management team of the acquirer is experienced with acquisitions, they may assume that their experience will help in successfully carrying out future acquisitions as well.

Company business structure refers to assumptions related to existing resources or organization of the acquirer and target companies. These can have to do with, for example, a company’s product mix or the quality of the company’s production assets. A related assumption might also be that a company with significant marketing facilities in Asia could be a beneficial target for an American company that is trying to sell more of its products in that particular region.

Employee assumptions have mostly to do with their reaction to the deal and its potential consequences. Employee cooperation is crucial in mergers, and several mergers have been hindered when acquirer or target company employees or managers have become disgruntled.

4.3.3. External factors

In this section, the 8 dimensions classified as external factors are presented along with related findings from literature. External factors are ones that acquiring company management cannot directly control or influence, but have to be rather taken into consideration as givens.

Demand-related assumptions are related to, for example, consumption trends for the company's products, customer behavior and reactions to the merger or acquisition in question.

Price-related assumptions relate to the balance between demand and supply, and hence the development of the prices either as a result of the deal being contemplated or due to other factors. Price levels can be a significant determinant of merger success especially in capital intensive industries with high sunk costs.

Supply-related assumptions involve the development of competition and their reactions to the deal being contemplated. An example of such an assumption would be that competitors will launch a price war against the acquirer if it buys a company in the competitors' home market. Supply related assumptions can also have to do with whether competitors are interested in buying the same target.

Supplier / resource- related assumptions relate to, for example, the supply of a critical resource, or the increasing market power of suppliers.

Government official- assumptions relate to the expected behavior of government agencies, such as, for example, anti-trust action or the expectation of trade-barriers for the acquirer or its competitors' products.

Self interests relate to the self interests of the company's management. Such an assumption could be, for example, that the CEO's personal prestige in society will increase if the company he or she manages becomes bigger as a result of an M&A action.

The board of directors dimension means assumptions about the expected behavior or opinions of the company's board, which usually makes the ultimate decision in larger acquisitions. Such an assumption could be, for example, that the board is in favor of acquisitions and hence the company's management may feel more secure about its own position if it offers to take on mergers and acquisitions.

The financial markets dimension relates to the expected behavior or demands of financial markets. An assumption might be that, because markets seem favorable towards consolidation in the industry, a company's share price will rise as a result of an announced acquisition. Hence, the company's management may feel more secure about their positions.

4.4. Summary of merger and acquisition assumptions found in literature

In order to fill in the assumption framework with typical merger assumptions found in literature, three areas of mergers and acquisitions literature have been looked at:

- Merger motives. This area of strategic management studies the explicit motives managers have when they carry out an M&A transaction. It assesses the benefits that are sought after. Knowledge on what is typically sought after in mergers will help in developing interview questionnaires later on.
- Factors in the acquirer companies that make them prone to M&A activity. This field looks at managers and structural issues to see whether there are certain factors that make companies more prone to M&A activity than others. The presence of these factors affects management assumptions about their external environment and will also be tested for in the interviews.
- Merger success factors. This field looks at whether there are certain features in merger deals that make them more likely to be successful than others. This field is looked at in order to test the case acquisition for the presence of these factors.

Many academic fields have studied mergers and acquisitions because they are very important economic phenomena. These fields include finance, strategic management, corporate governance, organizational sciences, sociology etc.⁴⁸ For our purposes, the amount of literature to be looked at has had to be significantly narrowed down.

The themes relevant to this case have been identified by looking at comprehensive M&A literature reviews such as Parvinen (2003) Furthermore, articles have been sought after by looking in scientific search engines such as Google scholar using key words, such as “merger motives”, “merger benefits”, “mergers and cognition” etc.

Assumptions found in literature have been summarized into the table below, which follows the order of the M&A assumptions framework developed, shown in figure 1. The formulation of the assumption answers the questions “What does management need to believe in order to want to make an M&A transaction?”

Table 4 M&A assumptions found in literature

General assumptions necessary for M&A transactions found in literature	Strategic course of action	Choice of business / geographic area	Choice of specific target
Internal factors	Economies of scale and scope are a decisive competitive advantage (Walter and Barney, 1990) Size creates barriers to entry (Brouthers et Al, 1998) - Transfer of information within a larger entity yields benefits in optimizing production (Huck et Al. 2004) Factor markets are inefficient - Takeovers provide a way to transfer intangible assets such as knowhow (Seth, Song and Pettit, 2000)	Firms may use excess resources in a particular market for their present products - Growth in the home market is limited - Earnings in different markets are less than perfectly correlated (Seth, Song and Pettit, 2000)	Target is undervalued by the market compared to its value under acquiring company management (Trautwein, 1990 among others) Target may be extorted to yield wealth transfer (Trautwein, 1990) - Target has skills that can be used at home (S. S & P, 2000) - M&A can yield marketing and technical economies of scale (Brouthers et Al. 1998) M&A can enable replacing target's inefficient management (Brouthers et Al, 1998)
Industry Structure	Repetitive momentum, i.e. that company has taken on M&A before successfully and this behavior can be replicated (Haleblian and Finkelstein, 1999; Amburgey and Miner, 1992) - M&A provides a challenge for management (Walter and Barney, 1990)	Takeovers provide a way to transfer intangible assets such as knowhow (Trautwein, 1990)	M&A brings benefits into financing and taxation (Trautwein, 1990) - The target complements existing business structure and enables economies of scale and scope - There is room to consolidated joint, overlapping operations - Knowledge transfer is possible (S.S & P, 2000) The attainment of synergistic benefits is supported by the presence of complementary operations between the two companies (Larsson and Finkelstein, 1999)
Company competencies	M&A can bring cost savings (Brouthers et Al, 1998) M&A brings benefits into financing and taxation - Company assets are better used for something rather than paying them back to shareholders (Trautwein, 1990) - Cross border M&A enables quicker exploitation of potential synergies - Risks related to human capital are reduced - Risks are reduced with additional size (S.S & P, 2000) - Acquisitions which permit the bidder access to new but related markets (i.e. existing products), create the most value with the least variance (Shelton, 1988) M&A can reduce risks (Brouthers et Al. 1998)	M&A enables entering a new business (W&B, 2000) - Profits from one product / market area may be used to fight for market share in another (Trautwein, 1990) - Companies in certain areas may serve to reduce agency costs to arising from differences in corporate regulation (S.S & P, 2000)	Employee resistance may hinder M&A success - It is higher in mergers where synergies obtained by joining production and marketing facilities are crucial (Larsson & Finkelstein, 1999)
Company business structure			
Employees			

General assumptions necessary for M&A transactions found in literature	Strategic course of action	Choice of business / geographic area	Choice of specific target
External factors			
Demand	Size enables exerting more pressure on customers - Customers pursue M&A activities and become stronger (Öberg and Holtström, 2006) M&A can increase sales (Brouthers et Al, 1998)	M&A enables serving existing customers with new products or enables serving new customers (W&B, 1990; Shelton, 1988) - Customers in a certain region pursue M&A and become stronger (Ö&H, 2006)	
Prices	M&A can bring market power (Brouthers et Al, 1998)		
Supply	M&A may prevent takeover attempts by competition (Gorton, Kahl, Rosen, 2005; Brouthers et Al, 1998) M&A can enable buying out competition (Brouthers et Al, 1998)	M&A enables entering tacit collusion with competitors present in more than one market (Trautwein, 1990)	Target is a competitor that might otherwise pose a threat - Targets pursued by competitors as well are more valuable (Trautwein, 1990; Shelton, 1988) Competition over target may also cause a "winner's curse" (Varaiya and Ferris, 1987)
Suppliers / Resources	M&A enables dealing with critical and ongoing interdependencies in a firm's environment (W&B, 1990) - Without growth through M&A, the company itself will be taken over (Gorton, Kahl, Rosen, 2005) M&A can enable acquiring raw materials (Brouthers et Al, 1998)	Suppliers in a certain region pursue M&A and become stronger (Ö&H, 2006) This effect can be countered by M&A (Anderson, Havtia, Salmi, 2001)	Particular resource under target management differently valued by different parties (Trautwein, 1990; Gort, 1969)
Government officials			
Self-interests	Personal prestige and benefits is increased by growing size of company under management (Trautwein, 1990; Seth, Song and Pettit, 2000; Mueller, 1969; Brouthers et Al, 1998) M&A can bring a managerial challenge (Brouthers et Al, 1998)		Target may yield access to perks otherwise unavailable (Trautwein, 1990)
Board of directors	Board of directors support M&A action because they have seen successful M&A through their other responsibilities (Haunschild, 1993)		
Financial markets	M&A provides a way to most efficiently invest excess financial resources (Walter and Barney, 1990) - Equity transactions are typically viewed more favorably by investors (See e.g. Datta, Pinches, Narayanan, 1992; Martynova, Renneboog, 2006) - M&A can create shareholder value (Brouthers et Al, 1998)	Currency markets are imperfect, and some areas have more preferential currency rates than others - Having activities in a certain region reduces agency costs (S.S & P, 2000)	Markets have failed to show the true value of the target (Trautwein, 1990; Brouthers et Al, 1998) If synergies are more than price premium paid, share price will increase (Varaiya and Ferris, 1987) Market failure has opened up M&A opportunity (Brouthers et Al, 1998)

4.5. Pulp and Paper industry specific motives for mergers

In this section, the review of general merger assumptions is narrowed down to literature that specifically studies the pulp and paper industry. The assumption framework is filled in accordingly. Based on the literature reviewed, the pulp and paper industry specific

assumptions necessary for carrying out an M&A transaction are depicted in the following table.

Pulp and paper specific assumptions necessary for M&A transactions found in literature	Strategic course of action	Choice of business / geographic area	Choice of specific target
Internal factors			
	The industry is still fragmented - Consolidation of the industry will continue through M&A - M&A is preferential to organic growth due to structural overcapacity (Hämäläinen, 1999) The industry is cyclic - mills have to be acquired or divested to manage economies of scale and scope (Hämäläinen, 1999)		
Industry Structure		Expanding into a certain market enables optimizing production and exports to different regions (Seppälä, 2000)	
Company competencies	M&A facilitates R&D (Ojala, 2008)		
Company business structure	Too small sizes make ever larger investments impossible (Sittonen, 2003) M&A enables removal of duplicate operations (Pesendorfer, 2003) M&A enables economies of scope and less down time on machines due to mill specialization (Hämäläinen, 1999)	New business areas enable increasing economies of scope (Hämäläinen, 1999)	Buying target with suitable machinery enables reorganizing production and bringing down costs (Hämäläinen, 1999) - Targets with overlapping organizations enable value creation through elimination of duplication (Pesendorfer, 2003)
Employees			
External factors			
Demand	Customers are willing to work with fewer and fewer suppliers (Hämäläinen, 1999) - M&A will increase market power (Pesendorfer, 2003; Ojala, 2008) Customers are consolidating and operating more and more globally (Hämäläinen, 1999)	Customers require global operations, hence causing the need to diversify to new areas (Hämäläinen, 1999)	
Prices	Size enables better prices (Pesendorfer, 2003)		
Supply	Without M&A growth, companies will themselves be taken over (Sittonen, 2003)	Expanding geographically opens up new supplies of recycled fibers (Seppälä, 2000)	
Suppliers / Resources	Size enables more efficient purchasing (Pesendorfer, 2003)	M&A enables securing obtaining raw materials in certain areas (Seppälä, 2000)	
Government officials	Increasing regulation makes greenfield investments more and more expensive (Hämäläinen, 1999)		
Self-interests			
Board of directors			
Financial markets			

Table 5 Typical M&A assumptions in the pulp and paper industry

5. Results: Assumptions made by Stora Enso Management

In this section, results of the research are presented by explaining the assumptions made by Stora Enso management at the time of the Consolidated deal and following up on whether they proved correct or not. This is followed by discussion on where the assumptions made by management have come from and why.

The assumptions found have been divided according to the M&A assumption framework, presented in the previous chapter, into three parts. The first assumptions are the ones that led to the conclusion that M&A is the correct strategic choice. The second group consists of the assumptions that the correct market for M&A is North America. Finally, the third group consists of assumptions which resulted in the choice of Consolidated as the best target. Each assumption is coded according to which dimension it touches upon and whether it proved correct or not.

While stating whether an assumption proved correct or not is not always clear-cut, the color coding depicts their general correctness – If the assumption proved correct, it has been marked green, if it failed, it has been colored in red.

5.1. Assumptions made about mergers and acquisitions as a strategic move

Assumptions made about M&A as a strategic course of action		Did hold	Did not hold
Assumption	Dimension	Outcome	
Economies of scale and scope yield competitive advantage in the industry	Industry Structure	Examples of both large and small successful companies exist	
The P&P industry is consolidating with big players increasing market share	Industry Structure	2001 marked the end of the consolidation trend for now	
Value creation demands growth	Industry Structure	M&As in the industry have generally not proven to be very successful	
M&A are preferential to greenfield investments because the risk is smaller	Industry Structure, Prices	With declining prices and falling US dollar, greenfield would have made markets worse	
Customers are becoming bigger and bigger, and they negotiate with fewer suppliers	Demand, Supply	Customers became larger, but still kept many suppliers onboard	
Stora Enso had vast competency within the organization in pulling mergers through	Company competencies	Operational integration of CPI went well	
The owners and board of directors are in favor of STE's growth strategy through M&A	Board of directors	Yes, to begin with but later board rejected global strategy and divested SENA	

Figure 8 The assumptions about M&A as a strategic course of action made by Stora Enso management. While stating whether an assumption proved correct or not is not always clear-cut, the color coding depicts their general correctness – If the assumption proved correct, it is marked green, if it failed, it is colored in red.

5.1.1. Economies of scale and scope yield competitive advantage in the pulp and paper industry

Dimension: Industry structure

Result: Undecided, as examples of both small and large companies exist

Investments in the pulp and paper industry are capital intensive and they are always risky. According to a Stora Enso management interviewee: *“a bigger player is better able to tolerate large investments, where it takes a long time to build capacity and enter a market. Hence there are long periods with no cash flow.”*⁴⁹ As an example he mentioned Enso’s greenfield investment in Eastern Germany right after the reunification of Germany, Sachsen Papier, which *“almost took us under”*⁵⁰. According to another interviewee: *You need to be big, if you’re global then your big and then you can take on major decisions that would be too risky if you were too small.*⁵¹ If the investing company does not have the stability brought by size, risky but potentially profitable investments are impossible.⁵²

According to other Stora Enso management interviewees, *“Enso or Stora would not have gone to the US alone”*⁵³. The merger between Stora and Enso had created a company with sufficient size to handle an acquisition in the United States as large as the Consolidated Papers deal. For a smaller company, such as acquisition would not have been possible.⁵⁴

Stora Enso management thought at the time that large players would be successful in the industry in the future, while smaller ones would be left behind. Stora Enso was already perhaps Europe’s largest player in the industry at the time, but did not have a production foothold in the United States.⁵⁵ Management thought that the company was large enough to try and build a strong player in the United States. This would be done by first acquiring a foothold, as it did through the acquisition of Consolidated Papers, and then by strengthening it through further M&A transactions. Plans of further acquisitions existed for several years after the acquisition of Consolidated Papers, although the plans never realized.⁵⁶

Stora Enso’s thinking on the question of size is well depicted in the following investor presentation slide from 2004:

Why “Big is Beautiful” in the Forest Products Industry



- Customers grow bigger
- Production can be more disciplined
- A bigger actor has more choices in all respects
- Big companies have the resources for innovation and asset restructuring
- Mill specialization becomes possible
- Big companies can take the risks associated with geographical and/or businesswise expansion
- Economy of scale

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Figure 9 Stora Enso investor presentation slide from 12 March 2004.⁵⁷

There are several statements on the benefits of size in the above exhibit. They mostly have to do with market power (as customers grow bigger, a bigger actor has more flexibility in many respects), economies of scope (production can be more disciplined, mill specialization becomes possible), economies of scale (economies of scale, big company have the resources for innovation and asset restructuring) as well as risk tolerance.

The assumptions on market power overlap with management assumptions on customer behavior, which will be covered in a section to follow.

How good an analysis of the real situation this assumption was is a large fundamental question in the pulp and paper industry. There are examples of successful companies both large and small. At the moment, when the industry is in trouble, it seems that most of the big players (i.e. Stora Enso, UPM-Kymmene, and International Paper etc.) are in a good position to survive the crisis.⁵⁸ Other big players, meanwhile, have suffered severely. These include companies who have previously engaged in mergers, such as Abitibi Bowater or M-Real, which are struggling to survive.⁵⁹ On the other hand, a good example of a small but profitable newsprint company is Holmen. It is clear, however, that many of the consolidating actions seen in the 2000 have not created value at least directly, with Stora Enso – Consolidated Papers and International Paper – Champion being two good examples. On the other hand, large companies are generally in a stronger position to survive as independent players

because the amount of potential buyers is more limited. An adviser to Stora Enso in the case acquisition, for example, was of the opinion that without acquiring Consolidated Papers, Stora Enso would have remained such a small company that it would have been prone to be acquired.⁶⁰

5.1.2. The pulp and paper industry is consolidating, with big players increasing their market share

Dimension: Industry Structure

Result: Incorrect, as 2001 marked the end of the consolidation trend for now

In the year 2000, the ongoing trend was that the pulp and paper industry was becoming global.⁶¹ This led to more M&A transactions that increased the international presence of pulp and paper industry players. This is shown clearly in Stora Enso's investor presentation at the time of the Consolidated deal, where one of the key rationales presented to support the deal was the ability to serve global customers.⁶² In addition to increasing global reach, companies were seeking increased efficiency through size. One Stora Enso management interviewee showed a slide (Figure 9) done by Jaakko Pöyry Consulting, which in 2001 predicted the market share of the world's top five paper producers to grow significantly by 2005.

Vision of global paper and board industry 2005

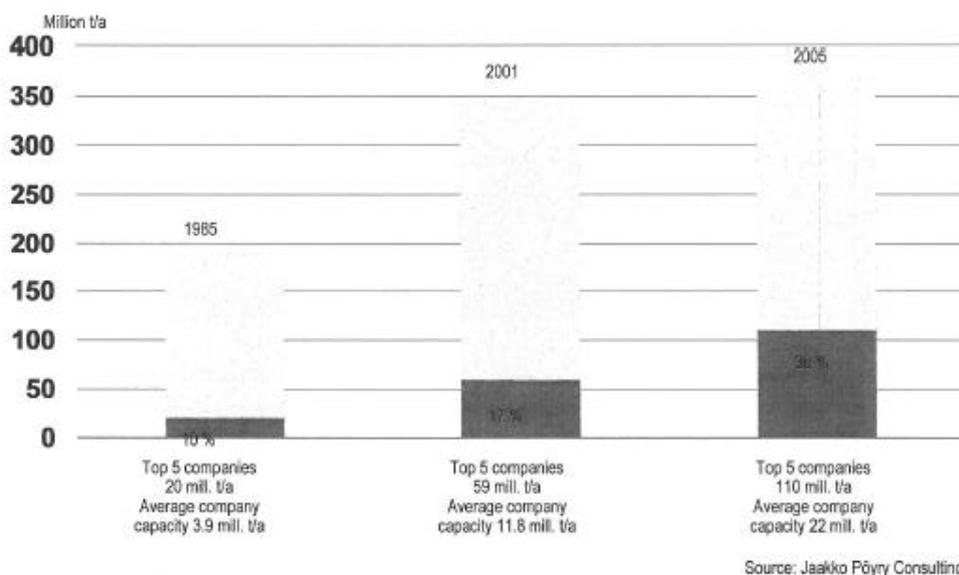


Figure 10 Stora Enso management slide from 2001 provided by an interviewee⁶³

In a contemporary research article studying the future of the industry, Seppälä (2000) suggested that the globalization of the industry was proceeding at a high speed. Factors that facilitated this development were, for example, moderate transportation costs, diminishing trade barriers as well as freer movement of capital. Knowledge transfer had also become easier, showing in the decreasing of the knowledge gap between different countries in pulp and paper technology.

Stora Enso, however, was already so large that its growth options in Europe were becoming limited.⁶⁴ Therefore it had to reach for other continents. Other players, however, continued to reorganize the industry in Europe for a couple of years. UPM-Kymmene and Norske Skog, for example, acquired Haindl of Germany in 2001.⁶⁵ Since then, however, the trend of regional consolidation in Europe, but also cross-continent mergers has significantly slowed

down. Companies have not wanted to invest in a declining market.⁶⁶ According to several interviewees, it seems like the leading companies are waiting for weaker competitors to go bankrupt and be forced to sell their best assets.⁶⁷

The reversal of the global consolidation trend is partly evident also in Stora Enso's decision to divest its North American business. In an interviewee given shortly before the divestment of SENA, Stora Enso's CEO Jouko Karvinen said:

*"Only a small part of Stora Enso's customers operate globally. Production sites, costs and raw material are local, not counting Veracel [Stora Enso's Brazilian operation]. That is why the company's size or its global market share are not that important now."*⁶⁸

After seven years of ownership, Stora Enso divested its North American subsidiary in 2007. This consisted of Consolidated Papers and Stora's old Port Hawkesbury mill in Canada. In conjunction with announcing this deal, Stora Enso's new CEO was quoted saying that *"this is not a global business"*⁶⁹, which is totally contradictory to research conducted in 2000, as well as the several cross-border M&A transactions that occurred in the 1990s and 2000s. The divestment of SENA, on the other hand, enabled the creation of a truly large player in the North American market, NewPage. This action was a major consolidation event in the industry, which has otherwise seen very few large mergers in recent years.

5.1.3. Value creation demands growth

Dimension: Industry structure

Result: Recent M&As in the industry have generally not proven to be very successful

In response to why growth was so important, a management interviewee said:

*"Creating value depends on there being also growth. It isn't enough to pay down debt. This was a thought supported by the owners as well. Also, all valuation formulas, even basic ones require a growth factor"*⁷⁰.

Another management interviewee said that in retrospect Stora Enso had been criticized for allegedly looking only at growth, no matter what the cost, however, he commented that growth also had to be profitable.⁷¹

This assumption is closely linked to the question of whether size is beneficial in the industry. As with that assumption, the answer is mixed – there are examples of both small and large pulp and paper companies that have been successful. Almost all paper manufacturers (not

counting consumer tissue paper), however, have lately destroyed value, if their financial results are compared with their costs of capital.⁷²

a) Mergers and acquisitions are preferential to greenfield investments because the risk is smaller

Dimension: Industry structure, prices

Result: Yes, with a greenfield investment in the US, Stora Enso would probably have done even worse

Stora Enso management deemed mergers and acquisitions to be a better way to grow than greenfield investments especially in Stora Enso's home markets which were mature. Management saw increasing signs of structural overcapacity in Europe. In the United States, minor growth was still expected, but it wasn't sufficient to warrant building new mills.⁷³

According to a competitor expert, greenfield investments are always very expensive and risky because building a paper mill is not enough. One has to build the entire surrounding infrastructure, too. This takes a lot of time.⁷⁴ According to Stora Enso management interviewees, greenfield investments in a mature market are difficult. To win market share, the new player has to compete with price to begin with, making it difficult to obtain good margins.⁷⁵ Major paper mill investments in the United States have not been seen during the 2000s.⁷⁶ It seems reasonable to conclude that with a greenfield investment, Stora Enso might have done even worse. A good example of a previous greenfield investment in the United States that went badly for Finnish paper companies was the Eurocan project discussed in further detail in chapter 5.2.1.

5.1.4. Customers are becoming bigger and bigger, and they negotiate with fewer and fewer suppliers.

Customers will expect suppliers to offer "one stop shopping", packaging different paper grades into single deals

Dimension: Demand, Supply

Result: Many customers became larger, but still kept several suppliers onboard.

Several Stora Enso management interviewees noted that publishers, the paper industry's major customers, had experienced major consolidation, and were getting bigger. They were

also increasingly demanding global delivery under a single contract, instead of having local contracts in each region.

*"Our deals became increasingly such that once a year we'd meet in New York with News Corp. about their paper supplies to Hong Kong, Australia... I don't know if it was their clever tactics, but they gave us the impression that they would very much appreciate it if we had local (US) production as well."*⁷⁷

Many publishers would no longer "negotiate with producers with less than a million ton capacity"⁷⁸. It was also assumed that deals would increasingly include several paper grades at once. This demanded that paper producers offer a variety of products.⁷⁹

According to a Stora Enso management interviewee, the acquisition of Consolidated helped Stora Enso gain access to sales to major customers it wouldn't otherwise have received. According to him, the company's global position helped to sell to US based customers in Europe, because these customers wanted to consolidate their supplier base.

*"Stora Enso had not really had any access to their (Global customers, such as Time Inc) European operations, but when we were present also in America, we managed to gain a proper foothold"*⁸⁰

While this is difficult to verify, because companies do not publish their customer specific sales volumes, other opinions about the matter exist as well. According to another management interviewee, the aforementioned was not true, but on the other hand Stora Enso's European production gained new customers in the United States through Consolidated's customer base.

According to competitor interviewees, paper industry consolidation can also be a negative issue for customers:

*"Size (of the paper company) isn't always beneficial to the customer...Customers may have guidelines that state that only a certain amount of a critical resource may be purchased from one supplier, so in this sense growth can also turn against you"*⁸¹

Many customers intended to make their purchasing more efficient by founding "global sourcing organizations". In spite of this, however, some Stora Enso management interviewees claimed that major customers did not manage to consolidate their global purchases.

*“The rationale of one stop shopping and global service was not a valid argument ... small customers buy where ever it’s cheap. This is a commodity.”*⁸²

The reason why purchasing did not become global was that, in spite of the signs, paper industry consolidation slowed down. In many places local competition did not disappear and continued to challenge global suppliers. Hence a competitive situation where global suppliers could compete against each other did not emerge, and competition for paper deliveries remained local.⁸³

Some interviewees claimed, however, that the trend of customers consolidating their purchases is likely to continue. If this is the case, then Stora Enso can be said to have been too early in its globalization. When this view is combined with that of the competitor interviewees, however, one may question whether this trend will signify additional volumes for any players, or whether this will just mean a change in how deliveries are geographically distributed among competitors.

5.1.5. Stora Enso had competency within the organization in successfully carrying out mergers

Dimension: Company competencies

Result: Yes, the operational integration of Consolidated Papers went well

During the 1990s, both Stora and Enso had carried out several mergers and acquisitions. Stora Enso itself is the result of the 1998 merger between Stora Kopparbergs aktiebolaget, a Swedish pulp and paper company with a history that dates back to the 13th century⁸⁴, and Enso, a Finnish government controlled company, which itself had carried out a series of acquisitions during the major reorganization of the industry in Finland during the 1980s and 1990s. (Lamberg, 2007)

Earlier in its history, governmental influence was strong in Enso. The Finnish state still remained the largest stockholder in Stora Enso at the time of the Consolidated Papers acquisition.⁸⁵ This influence is clearly visible in many of the company’s actions, which have not always been purely based on maximizing profitability as one would expect from a purely private capital-driven enterprise. Lamberg (2007) “The mixing of business and politics has been a characteristic feature which has separated the government-owned wood-refining companies from other forestry blocs. Enso-Gutzeit’s relationship with party politics has been a close one ever since it became government owned.” (Lamberg, 2007)

From the 1980s onwards, Enso took an active role in shaping the structure of the Finnish pulp and paper industry by taking part in several M&A transactions. The deals included taking over Ahlström's Varkaus mill in exchange for Enso-Gutzeit's metal industry assets, buying bankrupt Tampella's forest assets in 1993, but above all, the acquisition of state owned Veitsiluoto in 1995.⁸⁶

Veitsiluoto had also invested for other reasons than maximizing profitability. An example of politically motivated, "socially responsible" investments was the Kemijärvi pulp mill⁸⁷, built in the 1965. Stora Enso closed the mill with much public and political criticism in 2008. The original motives for the investment included reducing unemployment in Eastern Lapland.⁸⁸

The drag caused by such inefficient investments and political influence on management subsided when first Pentti Salmi and later, in 1993, Jukka Härmälä became CEO. More thought was given to improving rates of return on investment, and the company was managed in a more market-oriented way. The result of the divestments of non-core assets and the strategic transactions Enso-Gutzeit took part in was that the company became a profitable business after the recession in the early 1990s. An example of this is that productivity, measured as turnover per employees, grew by over 125% during the 1990s. These efforts enabled merging Enso on equal terms with Swedish Stora Kopparbergs aktiebolaget in 1998. (Lamberg, 2007)

Enso was an active player in shaping the industry at a European level. Major international investments included, for example, Enso's 1994 greenfield investment in Sachsen Papier in Eastern Germany, which produced specialty newsprint made from recycled fiber as raw material. This investment was complemented by the 1997 acquisition of a majority shareholding in E Holtzmann & Cie AG of Germany. This enabled Enso to take over responsibility of the company's business operations, while it gradually assumed a 100% stake in the company by October 1998. The Eilenburg investment and the Holtzmann acquisition were part of Enso's attempt to gain access to European recycled fiber and the related printing paper markets. By acquiring Holtzmann, Enso expected to gain synergies arising from consolidating its operations in Europe. These included the ability to purchase recycled fiber in vast quantities. (Lamberg, 2007)

The main reason for the internationalization of Finnish pulp and paper companies, however, was to transfer production closer to the main customers. One rationale of this was to get around existing or anticipated trade barriers. In addition, Finnish companies started to

increasingly experience problems with sourcing timber from Finland, where there are a lot of forests, but forest growth is slow due to the cold climate. (Seppälä, 2000) Therefore, it was also important to gain access to Central Europe’s vast sources of recycled fiber.⁸⁹

While Enso’s cross-border acquisitions and investments transformed it into a major European player, Stora’s experiences with M&A were not that positive. The 1990 acquisition of Feldtmühle, for example, was not seen in positive light by management interviewees. Nor were Stora’s previous ventures in North America, which included the Port Hawkesbury mill that Stora Enso in the Enso and Stora merger. *“Stora’s experiences of North America were not favorable, had never been.”*⁹⁰ The merger between Stora and Enso, however, was seen to be successful, both by Stora Enso’s Finnish and Swedish management team members.

Stora Enso’s major strategic M&A actions are well depicted in the slide below:

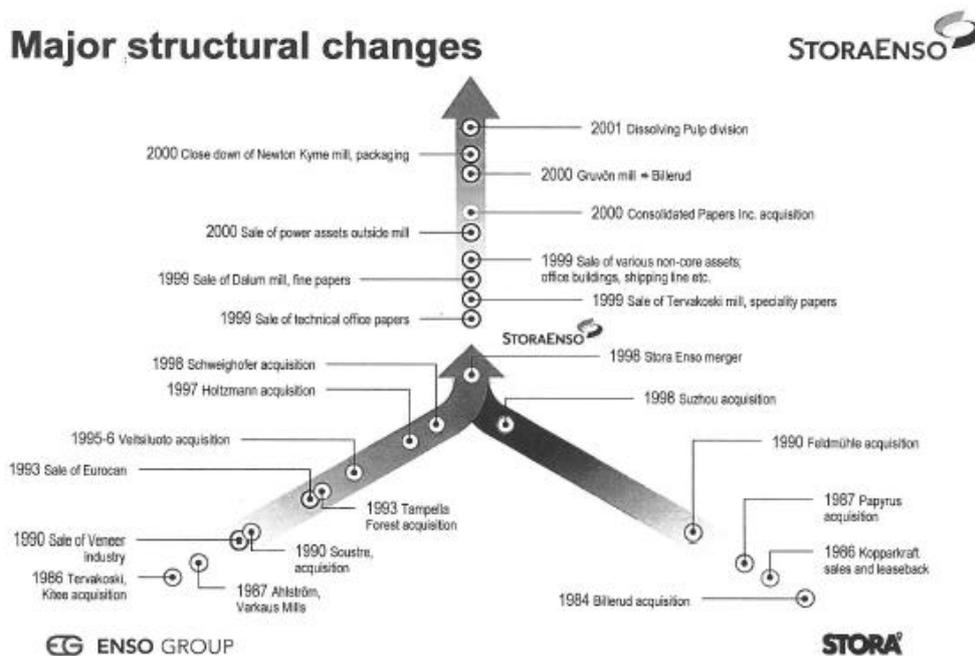


Figure 11 Stora Enso structural change, from 2001 management presentation, supplied by an interviewee⁹¹

Confidence in being able to carry through M&A transactions was clearly visible in the interviews with Stora Enso management interviewees. Previous experiences were mentioned in positive light by all five Stora Enso management interviewees, giving an impression that self reliance in acquisition competencies was really high.

The largest international merger, the one between Stora and Enso in 1998, had been seen as a very big challenge. Despite the differences in business cultures and difficulties, the merger was seen to have been a success and calculated synergies had been exceeded.⁹² According to interviewees, these factors increased the confidence management had in their ability to pull large mergers through successfully, and in their minds, diminished the risks of failure.

Management was confident that these skills would also help to pull through the Consolidated Papers merger and sent its “number one” team over to carry out the post-merger integration. According to all interviewees, the operational integration process went well, and major clashes with the Consolidated Papers organization were avoided, despite the drastic measures that were taken later to reduce capacity and increase operational efficiency. Overall, the team responsible for the PMI process had felt proud about their achievement, with the top management team also commending them for their successful work.⁹³

“We got a good reaction from management and employees. We rationalized the company a lot without creating big problems and turmoil etc. and the company worked as such very well.”⁹⁴

The operational synergies resulting from the acquisition of Consolidated were estimated to be around \$110 million a year. These synergies, however, were not realized.⁹⁵ The main reason was “difficult market conditions that restricted productivity related gains” following the merger.⁹⁶ In addition, there is some controversy over whether the strategic integration towards the customer end went well.⁹⁷

According to Burgelman and McKinney (2005) the phases of the post-merger integration process are the following:

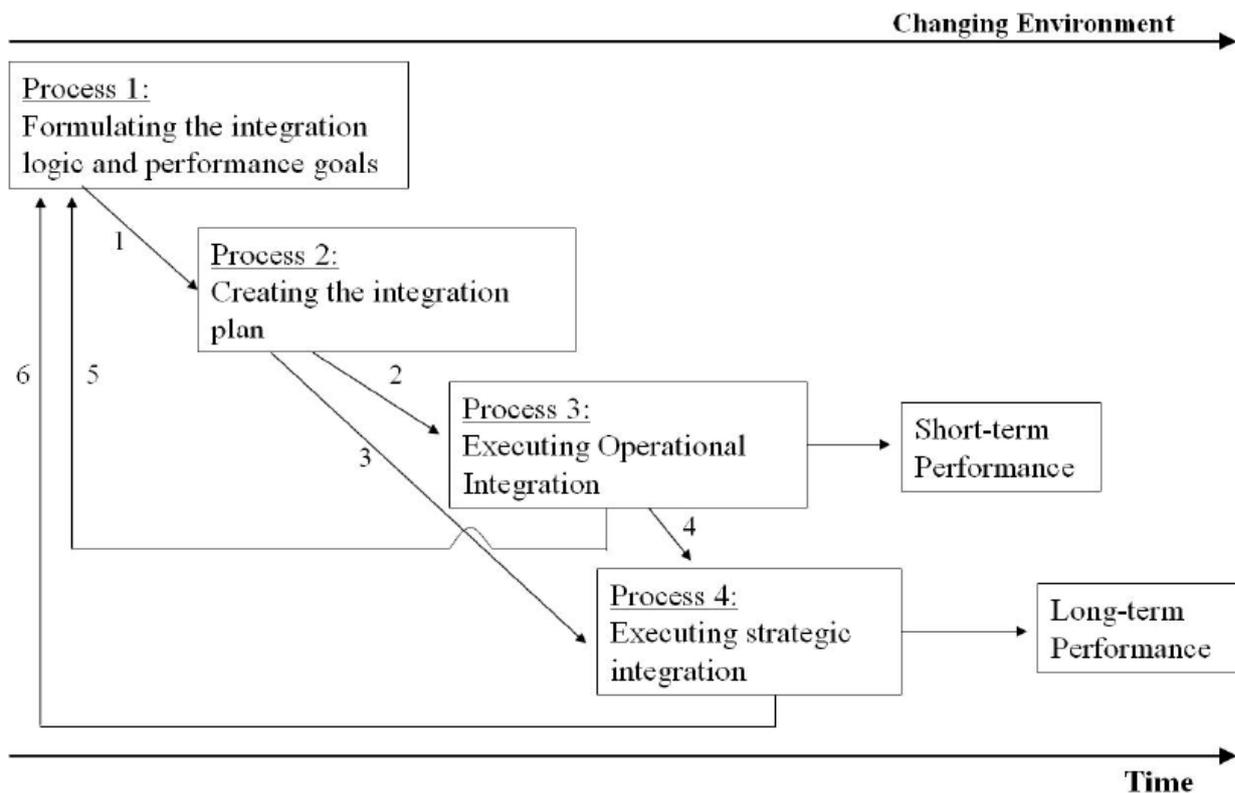


Figure 12 Burgelman and McKinney's (2005) framework for the different stages of post-merger integration

As seen, there is a clear distinction between operational and strategic integration. In this case, one interviewee involved with the integration process thought that the strategic benefits from the acquisition were not attained in the customer front. Deliveries from Europe and the United States to American customers were not optimized as had been planned, and customers also managed to take advantage of differences in sales cultures bringing margins down.

Europe was Stora Enso's home market, whereas North America was a newer and less well known territory for the company, as previous acquisitions had mostly been done in Europe. This type of strategic integration had not been done before. While the operational (short-term) integration went rather well, the strategic integration towards the customer end could have been done better. One reason was, according to an implementer interviewee, that giving equal management attention was more difficult because of operating in different time zones.⁹⁸ Stora Enso management had trusted their abilities too much.

5.1.6. The owners and board of directors are in favor of Stora Enso's growth strategy through mergers and acquisitions.

Dimension: Board of directors

Result: Yes, in the beginning, but by 2007, the view of the board had changed

The general view of management was that Stora Enso's major shareholder, the Finnish Government, was rather indifferent to Stora Enso's strategic questions. It left both the running of the company and strategy to management. Stora Enso's Swedish institutional owners, the most important of which was Investor, and their representatives on the board, however, were interested in supported Stora Enso's strategy, which formally stated that mergers and acquisitions were a source of growth in the future.

Both the chairman and CEO's letter in the 1999 annual report made references to M&A being an important source of growth. The chairman, Claes Dahlbäck stated: *Stora Enso will continue to participate in the expected future consolidation of the forest products industry worldwide*, while the CEO, Jukka Härmälä, stated: *Opportunities for growth will be exploited through acquisitions, by seeking simultaneously financial strength and flexibility.*⁹⁹

Naturally, as in any deal of this size, the final decision to purchase Consolidated Papers was taken by the board and confirmed by an extraordinary general meeting. In Stora Enso's case, acceptance by the general meeting and the board were practically the same thing, as its two largest owners, the Finnish government and Investor had solid representation on the board and a majority of shares.¹⁰⁰

While seeking consolidation opportunities was a part of Stora Enso's strategy, the price of Consolidated Papers was a serious issue for the board of directors. Management was convinced that the acquisition was the right move, but convincing the board to pay such a hefty premium and take on such a large acquisition was not straightforward.

According to a management team member who also served on the board: *"These matters had been talked through in a strategy discussion and the growth strategy was very clear. No one challenged it, and in this case (the acquisition of Consolidated Papers) no one challenged it, except for the price. It caused a lot of thought, how will we manage with it (CPI, after having paid such a high price for it), but whether or not we had the right approach, no one challenged that."*¹⁰¹

Another management team member, who also served on the board, stated that: “*the board agreed that this could be a good line of expansion but they also warned us that Nordic countries have had historically big problems in North America when they have expanded into that area, it’s a very difficult market and, we were told that.*”¹⁰²

In the media, it has also been noted that especially the Wallenberg family (represented on the board by Marcus Wallenberg) were worried about the price of the acquisition.¹⁰³

The board, however, also had concerns about taking on such a large acquisition in a relatively unknown market, when the merger between Stora and Enso that had taken place just two years earlier was still being digested. Most board members were not experts in the pulp and paper industry, and therefore, regarding industry trends and development, they had to rely on what management and their advisers told them.

The board ultimately agreed to the deal because

- a) Management was convinced that after two years, the effect of the deal on the company’s earnings per share would already be positive
- b) The company would receive significant synergies and strategic benefits
- c) The dilution of shareholdings would not be that great despite the diminished risk involved in paying partly with stock.¹⁰⁴
- d) Management had pushed hard, and in saying no, the board might have risked disgruntling management and weakening working relations, which is a common problem that boards must consider.

In the end the board unanimously accepted the deal, but according to a source close to the board, the decision was “*really not an easy ride. ... it could as well have gone the other way around.*”¹⁰⁵ After deciding, the board naturally stood behind its decision portraying strongly that the deal is the right move.¹⁰⁶

According to media reports even straight after making the deal public, it seems that there is some controversy among management and the board of directors as to who the main supporters and skeptics of the deal were, and what issues had been raised in the decision making process. This debate has been further stirred by the will of some journalists to put the blame for the unsuccessful deal on someone. It seems that management was of the opinion that the board was strongly in favor of the Consolidated Papers acquisition, although the price had initially raised some concern. At the same time, the chairman of the board said he had

given lectures about the dangers of acquisitions in the United States.¹⁰⁷ Many board members had warned management about the potential risks.¹⁰⁸ One might ask if management had been so eager to carry out the deal, could they have misunderstood and downplayed the board's warnings and hesitation.

During the ownership period, the pulp and paper market changed considerably, as can be seen in other sections of this research. The board of directors also experienced member turn-over. In 2007, only two members, Claes Dahlbäck and Marcus Wallenberg were still left from the board that had served in 2000. By 2007, the attitude of the board towards growth and consolidation as a primary means for value creation had changed. Many of the rationales that had convinced the board to accept buying Consolidated Papers had disappeared. The dollar had weakened and *"there was no reason to have ... global service presence"*¹⁰⁹

According to a source close to the board, the board had realized that Consolidated Papers wasn't an asset they needed, and the decision to divest was rather straightforward.¹¹⁰ After the divestment, chairman Claes Dahlbäck said in the 2008 AGM about the decision to acquire Consolidated Papers: *"... in hindsight this is undoubtedly the worst decision ever I have participated in. But surely, the decision to divest the North American business was the right one. The price we received was fair, as the market reaction at the time of the announcement indicated."*¹¹¹

Assessing the Consolidated acquisition later on, Dahlbäck said: *"It was a very bad deal, but several such deals were made in 2000. It was thought that the cycle would continue forever, it was a real super boom. We wanted to go to the United States to get good customers and because the dollar was high. But it was the wrong deal at the wrong price."*¹¹²

The board's view on the company's strategy has changed dramatically during the period between 2000 and 2008, from one which was strongly in favor of acquisitions, to one which supports down-sizing the company and pulling out from its global stance. This has been a response to unsuitability of the old expansion strategy to a market which is contracting, and where customers are also in trouble. Price has become a more important issue, and the overcapacity in the market has ensured that paper is more of a commodity rather than a product where one can differentiate with global presence or "a one stop shop".

5.2. Assumptions made when choosing the area where to carry the acquisition

Assumptions made about the US market as a region for M&A

Assumption	Dimension	Outcome
		Did hold Did not hold Unquantifiable
Enso's previous experiences in NA were different and mistakes irrelevant here	Company competencies	Yes, problems with SENA did not have to do with location nor trade unions
Having one paper mill in the US is useless	Company business structure	Yes, the Port Hawkesbury mill would not have succeeded on its own due to poor location
US magazine and fine paper markets are still growing, although growth is slowing down	Demand	Growth stopped to a large extent when the IT bubble burst
The development of the IT industry has a positive effect on paper demand	Demand	Technological development has started to reduce paper consumption
LWC and CWF prices will remain at good levels for at least two years	Prices	Prices fell strongly beginning in 2001
The US competitive situation will not change markedly	Supply	Asian players entered the market, disrupting the balances between demand and supply
Listing in the US provides access to a more efficient debt capital market	Financial markets	Yes, Stora Enso was readily offered credit
Pulp and paper companies listed in the United States are worth more than their European counterparts	Financial markets	The valuation gap diminished during the 2000s
STE's biggest customers are American, and STE will benefit from being in their home market	Demand	Benefit difficult to quantify, but market share did grow in the beginning
The dollar-euro rate will continue to fluctuate and local manufacturing presence will provide natural hedge	Financial markets	Yes, dollar-euro fluctuated, and strong Euro made American production competitive from 2005 onwards
US govt will continue to set up trade barriers	Government officials	Yes, strong Euro caused no need against Europe, but antidumping suits against Asians have been seen
With a local mfg footprint, STE can optimize its deliveries from Europe	Company business structure	Customers were used to receiving CPI paper, and did not want European paper
STE could not expand through M&A in Europe due to antitrust regulation	Government officials	True, EU commission has limited M&A action in the industry

Figure 13 The assumptions about choice of business/geographic area in which to perform M&A made by Stora Enso management. While stating whether an assumption proved correct or not is not always clear-cut, the color coding depicts their general correctness – If the assumption proved correct, it is marked green, if it failed, it is colored in red.

5.2.1. *Enso's previous experiences in the United States were completely different and previous mistakes are not relevant here.*

Dimension: Company competencies

Result: Yes, problems with Stora Enso North America did not have to do with location or with trade unions

Consolidated Papers was not Stora Enso's first attempt to enter the North American market. In fact, Stora Enso already had a presence in North America through the Port Hawkesbury mill in Canada, which had been acquired to the company by Stora in the 1960s.¹¹³ Enso (previously Enso-Gutzeit before the acquisition of Veitsiluoto in 1996) also had experience in operating in North America. The first attempt to enter the North American market was

through the rather small Pineville Kraft Corporation in the 1960s – early 1970s, which produced kraft liner. Enso-Gutzeit held a minority position together with Tampella. After concluding that the project was not profitable enough, the ownership was divested in 1972. (Ahvenainen, 2006)

Enso-Gutzeit's larger and more costly conquest in North America was the so-called Eurocan project, in Kitimati, British Columbia, which started in 1965 and ended in divestment in 1993, when Jukka Härmälä was already the CEO. (Ahvenainen, 2006) Looking at this project is therefore of special interest as it is likely to have affected managerial cognition of operating in the North American market and has also given experience to the management team responsible seven years later for the Consolidated Papers acquisition.

This Eurocan project was a joint effort by several Finnish paper companies to take advantage of North Western Canada's immense forest reserves and serve American customers. The Finnish consortium consisted originally of Enso-Gutzeit, Tampella, Myllykoski (which withdrew already in 1966) and Kymi. The consortium built a mill complex in Kitimati, North Western Canada, which produced sawn timber, newsprint and later also kraft paper. The plant also had its own pulp mill. At the time of construction, raw material was thought to cost only a fraction of what it did in Finland, although labor costs were much higher. (Ahvenainen, 2006)

According to Ahvenainen (2006), however, the project was problem-ridden throughout its existence:

Finding competent and committed managers for the factory was troublesome, as attracting people to work in such a remote location proved difficult. As a result, the company had many Finnish directors on a temporary basis, and a lot of manufacturing craftsmen also had to be moved in from Finland. (Ahvenainen, 2006)

The mill experienced severe technical problems right from its opening in 1971. Subsequently production targets were not met, destroying the benefits of scale advantage.

The price of timber rose significantly, while the prices of the mill's products in international markets declined, making profitable production impossible. This led to an enlargement plan in order to achieve greater economies of scale and scope. (Ahvenainen, 2006)

Sierilä (2006), furthermore, mentions that some of Eurocan's problems boiled down to differences in culture: Finns were not familiar with the differing government procedures and labor market practices in Canada compared to Finland.

The troubles with Eurocan were worrying, as the company did not see one profitable year in the 1970s. One by one, the Finnish members of the founding consortium pulled out, leaving Enso-Gutzeit as the sole owner from 1979 to 1981, during which time the company was mildly profitable for the first time. In 1981, Enso-Gutzeit found a new partner in West Fraser Timber Co. Ltd, a Canadian saw mill company. Towards the late 80s, Eurocan saw again some successful years financially, but the two owners' interests were different. West Fraser timber was more interested in developing the Eurocan's saw mill operations, while Enso-Gutzeit was more preoccupied with the troubled paper mill part. This caused trouble between the personal relations of the two companies' management. At the same time, Eurocan came under reputation-threatening pressure from environmentalist movements. In the early 1990s Enso-Gutzeit was more and more preoccupied with major investments in Europe and the severe ongoing recession, and subsequently decided to sell its share of the company to West Fraser. (Ahvenainen, 2006) The key question that arises from the Eurocan case is how Enso management saw North America as an operating environment after the immense trouble it had with Eurocan.

Stora Enso management interviewees dismissed the problems related to Eurocan as having to do with previous management generations' poor planning and preparation, the fact that the project did not have single responsible owner and that the mill was at such an unfavorable location.¹¹⁴ In fact, several management team interviewees acclaimed the CEO, Jukka Härmälä, for the skilful work he did in divesting Enso's share in the company and getting a reasonably good price for it.

*"The sale of Kitimati was a great and skilful operation on the part of Enso. It was very important because we wouldn't have managed to invest in Sachsen Papier without selling Kitimati. Sachsen is still a unit in operation today. It was a skilful sale because there was a company called West Fraser as a minority shareholder, and they started to see the possibility of there coming a Japanese or another partner coming in, so they were willing to buy the whole company. So we managed to sell it at decent price, enabling the creation of Sachsen Papier."*¹¹⁵

The Eurocan project clearly underlined the problem with greenfield investments in foreign markets. One interviewee claimed to have completed an extensive study in the 1990s on what could be learned from Eurocan and similar problems could be avoided in the future. The effect of the Eurocan experience may have, in part, strengthened the choice of M&A as the method to enter the North American market again. Indeed, the problems encountered with Consolidated Papers compared to those in Eurocan were very different, and were managed by different management generations.

When comparing Eurocan and Stora Enso's other North American experiences, however, there is a striking similarity between Eurocan and Port Hawkesbury. Port Hawkesbury was a venture that was inherited from Stora Kopparbergs aktiebolaget. Stora Enso management interviewees dismissed the rationale of Port Hawkesbury in no uncertain terms.

It seems that Port Hawkesbury was Stora's equivalent of Enso's Eurocan, although the paper grades produced were different. Both were greenfield operations in a foreign continent. They were in unfavorable locations logistically speaking. Both suffered from severe troubles with labor unions. Neither was hardly profitable.

5.2.2. A single paper mill concept in North America does not work

Dimension: Company business structure

Result: Yes, the Port Hawkesbury mill would not have succeeded on its own due to poor location

Before the acquisition of Consolidated, Stora Enso's Port Hawkesbury mill in Canada was not profitable and its prospects were seen as grim by management. It was therefore seen as a liability unless it could be complemented by enlarged operations in the continent. Both divestment and expansion options were on the table, but the view of Stora Enso management members was that since Port Hawkesbury had just been expanded by Stora before the Stora – Enso merger, it had sentimental value to Stora's side of owners.

An interviewee stated: *“The factory had just been opened, with the Swedes there ... celebrating, so the discussion on the board was far from neutral. It didn't require a lot of reasoning to why we should see the expansion option to the end”*¹¹⁶

The development of this assumption is difficult to measure. It would require speculating on an alternative set of events where Port Hawkesbury would have stayed as Stora Enso's only production facility in North America. What is known, however, is that the Port Hawkesbury

mill was unprofitable throughout the 2000s.¹¹⁷ One interviewee questioned Stora's decision to build a new SC paper mill there as late as 1998, despite the mill's unfavorable location. Relations with trade unions were also difficult, leading to a 10 month closure in of the mill in 2005-2006 due to a labor dispute.¹¹⁸ Despite being SENA's newest capacity, Stora Enso management interviewees claimed that it consistently produced negative cash flow.¹¹⁹

Stora Enso management also contemplated the idea of building their North American foothold by buying smaller units, even individual paper mills. This method, however, was deemed too slow to attain any synergies or generate value, especially as the mills for sale tended to be of very poor quality. Building a cost-efficient enterprise would have been very difficult.¹²⁰

Market-related assumptions

Since demand, supply and prices are strongly interrelated, corresponding assumptions are best analyzed by looking at the market situation as a whole. The three market-related assumptions are therefore first listed and explained, and then the development of the market is reviewed. The assumptions of market development are critical in assessing the success of the deal. When Stora Enso North America was divested, Stora Enso chairman Claes Dahlbäck, blamed misjudged projections both in the US market and the USD/euro exchange rate, which according to him, led to the failure of the acquisition.¹²¹ Several other interviewees also raised two critical factors above others – market price development and foreign exchange rates.

5.2.3. The United States magazine and fine paper market is still growing, although growth is slowing (as opposed to newsprint)

Dimension: Demand

Result: No, Growth stopped to a large extent when the IT bubble burst

The decline in demand for newsprint in North America was clearly foreseen by management in 1999. It was ruled out as a serious option. *“Investing in a declining market is not a viable option.”*¹²² Interestingly, Stora Enso did offer to buy newsprint maker Donohue right before the Consolidated acquisition, but according to a management interviewee: *“I think we never really wanted to have (Donohue), I think we just marked an interest and hoped to get a bargain, because Canadian newsprint makers, we were quite aware that they weren't the best.”*¹²³ On the other hand, Stora Enso's packaging business was too small for it to get a

“front row” seat in the US market. Magazine and fine paper were still seen as areas of minor growth, which made them a suitable area in which to acquire a foothold.¹²⁴ These assumptions of growth proved wrong. The true development of these markets is described in more detail in the following section. On the other hand, buying a different target would have had little effect as practically all US-based pulp and paper companies, with the exception of consumer tissue producers, have faced disappointing financial results during the 2000s.¹²⁵

5.2.4. The development of the IT industry has a positive effect on the demand of paper

Dimension: Demand

Result: No, technological development has started to reduce paper consumption

The general belief in the paper industry during the IT boom was that IT development will increase demand for magazine and fine paper.¹²⁶ Firstly, the industry was a big advertiser and secondly, its development was expected to keep up strong and sustainable growth in the economy, which had traditionally also meant increasing demand for paper because of a reasonably stable correlation between economic growth and paper demand growth. Stora Enso management therefore assumed there was still growth in the magazine and fine paper market, although they were part of a mature industry. Growth, in turn, would keep up good price levels. Stora Enso’s view on global growth for the demand of paper is presented in the following investor presentation slide. It has been prepared using data supplied by Pöyry consultants:

Estimated Global Demand Growth for Paper and Paperboard by Grade 1996-2010

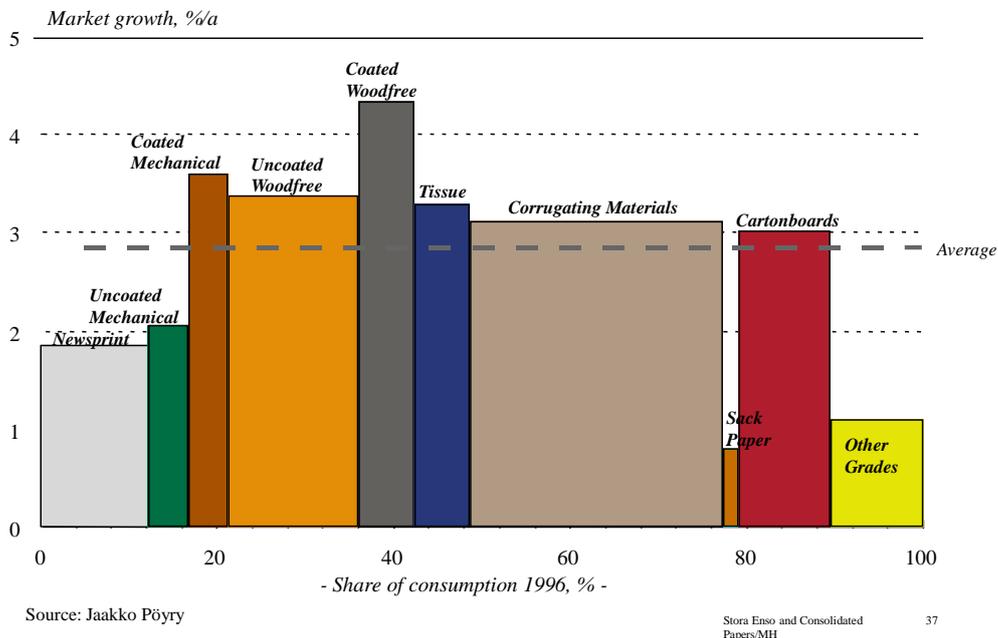


Figure 14 Stora Enso management's view on paper growth communicated to investors in an investor presentation on 14-17 March 2000¹²⁷

5.2.5. The competitive situation in the United States will not change markedly

Dimension: Supply

Result: No, Asian players increasingly entered the market, disrupting the balances between demand and supply

The acquisition of Consolidated Papers was not expected to affect the competitive situation in the US market. Asian players were small in the US market at the time of the acquisition, just after the Asian financial crisis of 1997-1998. Their imports were not expected to grow to become shapers of price. In the United States, the consolidation trend in the industry was expected to continue. Because local capacity was, on average, regarded as having low asset quality, it was estimated that US players would not significantly improve their competitiveness either.¹²⁸

5.2.6. LWC and CWF prices in the United States will continue to be at a good level for at least two years, after which they will dip somewhat.

Dimension: Prices

Result: No, Prices fell strongly beginning in 2001

At the time of the acquisition, the European paper industry had seen very good levels of profit for a couple of years.¹²⁹ At the same time, the world's stock markets were booming along with technology sector stocks.¹³⁰ Optimism about continuing economic growth was widespread, according to management interviewees.

When carrying out the acquisition of Consolidated Papers, Stora Enso management anticipated that good prices in LWC and CWF papers would continue to be at a good level for at least a couple of years. This was crucial for the profitability of the large investment done in North America, because applying a cost of capital on investment calculations means that cash flows from the first couple of years are proportionally very important.¹³¹

This optimism in the market can be seen in a Stora Enso investor presentation given on February 8, 2000.

Magazine paper

Stable demand for LWC and SC is expected to continue.

Producers' inventories lower than in the 1Q.

European new capacity is not expected to have any major impact on prices.

Newsprint

The outlook is good.

Producers' inventories below normal.

Supply and demand balance is expected to remain good.

No further increases in recycled paper prices are anticipated.

Market Outlook

Fine paper

The market is expected to keep firm.

Order stocks 5-6 weeks.

Further price increases may be expected in uncoated fine paper in the autumn.

Figure 15 Stora Enso investor presentation 8 February 2000, quoted in SEC databases¹³²

How did the market develop in the United States between 2000 and 2007?

Demand

When Stora Enso announced the acquisition of Consolidated Papers, the magazine and fine paper market were booming. Soon after in 2001, however, the United States entered a mild recession, which brought down paper demand.¹³³ After that until 2008, GDP continued to grow very strongly, but paper demand remained stagnant.¹³⁴ Interestingly, this change in the relation between economic growth and paper demand occurred right at the time of the Consolidated acquisition. This was not recognized by Stora Enso management interviewees at the time of the interviews in late 2009 / early 2010 when asked whether something fundamental had changed in the relation between economic growth and paper consumption. The change was, however, mentioned by an investment banking adviser who said that IT had caused the megatrend in paper usage to start declining. When asked about whether Stora Enso strategists had expected the rising IT industry to cause a decrease in magazine and fine paper consumption through the growth of “e-services”, a management interviewee answered that they had consulted several experts on the matter, but that this development had not been foreseen.

The change in the level of demand was clearly visible two years after the acquisition in Stora Enso’s demand projections communicated to investors. (Figures 15 and 16) Paper consumption had fallen sharply due to the falling demand of the end products.

Apparent consumption in the US for selected paper grades



1 000 short tons	1999	2000	2001	2002E
Coated Freesheet	5 535	5 632	4 902	4 924
% change	6.6	1.7	-13.0	0.4
Coated Groundwood	5 369	5 636	5 407	5 152
% change	-0.5	5.0	-4.1	-4.7
Uncoated Groundwood	5 172	5 484	5 158	5 070
% change	3.6	6.0	-6.0	-1.7

Source: RISI

27 August 2002

Profit Enhancement Plan/JH/HAM/k

Figure 16 Stora Enso US market forecast, presented in an investor presentation 27 August 2002¹³⁵

End use market indicators for publication papers



Following a sharp decline in 2001, the development for 2002 is continuing to be negative.

Change over previous year (%)	1999	2000	2001	2002E
Magazine Ad Pages	5.2	10.1	-11.5	-3.2
Commercial Printing	1.0	1.5	-3.3	-1.5
Printing & Publication	-1.0	1.5	-4.8	-4.9
Catalogues Mailed	2.3	6.3	-2.3	-2.4

Source: RISI

8

27 August 2002

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Figure 17 Stora Enso investor presentation slide on end use market indicators from 2002¹³⁶

The bursting of the IT bubble was a major reason for the decline in demand of magazine and fine paper. It is clearly visible in US stock market and economic macro data:



Figure 18 The Nasdaq composite stock index 1994-2007 The time of making the acquisition of Consolidated Papers public is market with a dot.¹³⁷

As can be seen in the above picture, (figure 17) the acquisition was made public right before the peak of the Nasdaq, after which the technology bubble burst. Asset values have still not recovered to their 2000 levels.

US GDP growth also stalled right soon after acquisition was announced:

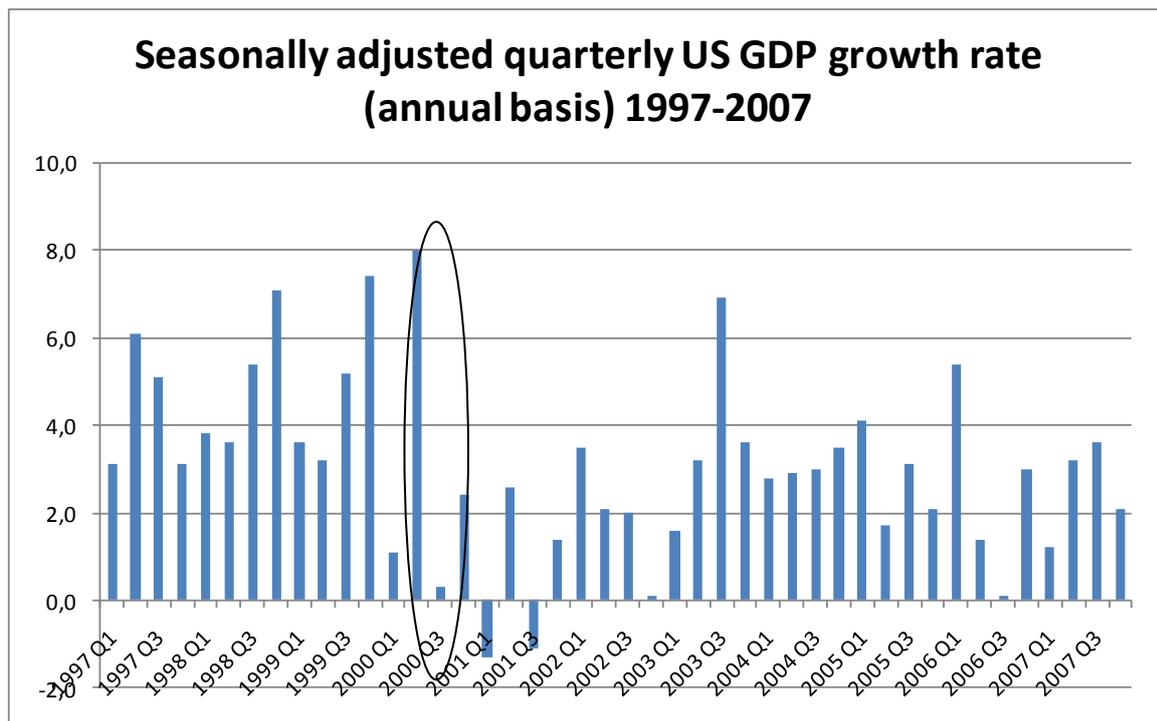


Figure 19 Seasonally adjusted quarterly US GDP growth rate (annual basis) 1997-2007¹³⁸

As can be seen, the Consolidated Papers acquisition was bought on top of the cycle. The economy started to slow down already during the deal process.

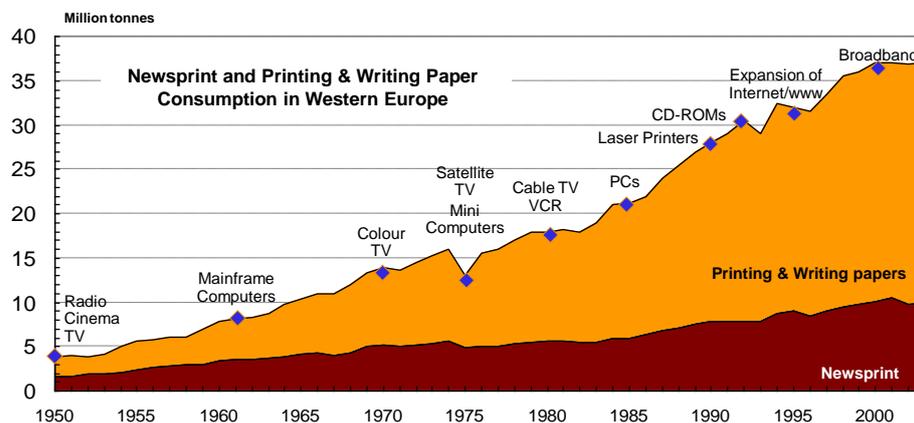
Traditionally, GDP growth had been a good indicator of paper demand growth in the United States. The link between paper consumption and economic activity, and the capital intensity of the industry have also made the industry very cyclical.

Stora Enso management believed that the fundamental connection between economic activity and paper consumption would continue in magazine and fine papers. They assumed that the rise of IT would continue to increase paper consumption in the form of advertising. These assumptions are well depicted in a study Stora Enso carried out with a management consultancy in 2003.

Co-existence of Media



Historically, electronic media has not threatened the growth of paper based communication – in many cases the paper industry has benefited from it.



¹⁹ Source: Jaakko Pöyry

Figure 20 A Slide from a Stora Enso management investor presentation from 2004, which reflects Stora Enso management thinking that electronic media does not reduce paper usage¹³⁹

In reality, however, electronic and internet based services, as well as trends such as “paper free office” and reading publications online have gradually reduced the demand for paper.¹⁴⁰

The chairman of Consolidated Papers stated the traditional mindset of the industry well in an e-mail written to the author, but also notes the fundamental change that did occur, but was left unnoticed by many for a long time:

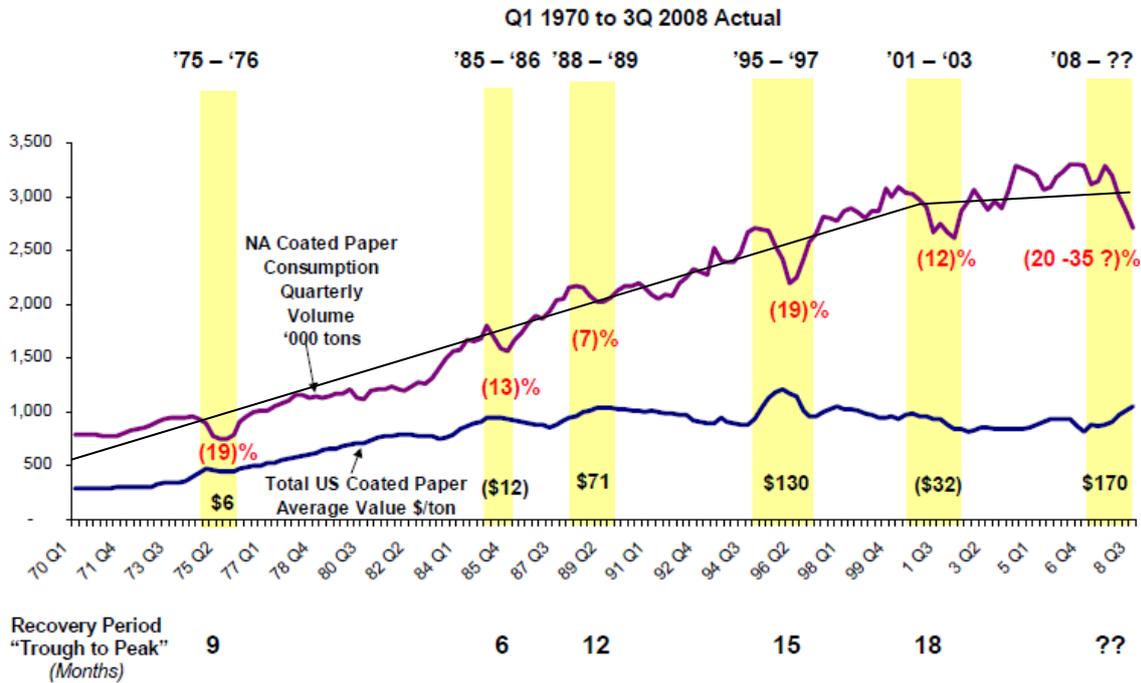
“During my active years as a paper industry executive, the consumption of paper, especially printing papers, pretty much followed the general economy, i.e. the "GNP" (the Gross National Product). This normally grew about 3-4% per year. Coated printing papers, such as we made, did a little better, maybe by 0.5% or so.

This leads to two results: there was room for growth overall, especially coated. And we would periodically suffer a temporary fall in business during a recession, or even a flat economy. Our customers were always looking for weakness where they could negotiate lower prices... But, up to 1999-2000, we always pulled out and returned to a growth pattern. The "dot.com" crash (which, like all crashes, was based on debt and speculation) was seen as temporary, like all the others previously.

This time, however, we were all wrong; paper consumption in Europe and North America was going to continue to drop.”¹⁴¹

This fundamental change was experienced in many paper grades. NewPage, the owner of what used to be Stora Enso North America supplied investors with the following graph, showing that in coated (fine) papers, demand has stagnated, and that growth stopped around the time of the Consolidated Papers acquisition:

North American Coated Paper Consumption Growth

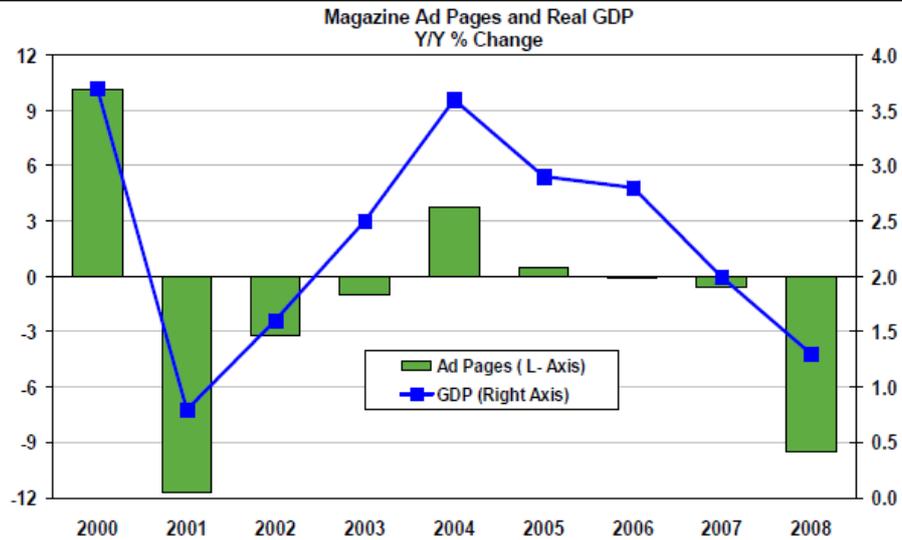


RISI North American Graphic Paper Quarterly Historical Data

Figure 21 The development of coated paper deliveries and value 1970-2008¹⁴²

NewPage's statistics also well depict how economic activity no longer necessarily means increasing paper advertising in magazines. The amount of advertisements is a key indicator of magazine paper sales.

After the last recession in 2001, it took magazine ad pages three years to return to growth, and the recovery was particularly weak. With the current recession forecast to continue thru H1 2009, magazine ad pages may not start to recover until late 2010, at earliest.



Source: PIB, BEA

Figure 22 A NewPage investor presentation showing how, despite economic growth in the 2000s, magazine advertising hasn't recovered properly from its 2001 fall¹⁴³

Stora Enso was not the only company who faced stagnant demand with its product portfolio. An International Paper investor presentation shows that the link between uncoated free sheet paper¹⁴⁴ (office paper, classified as fine paper, a paper grade SENA did not produce) and GDP was broken in 2000.

Understanding Demand

N.A. UFS Purchases vs. GDP

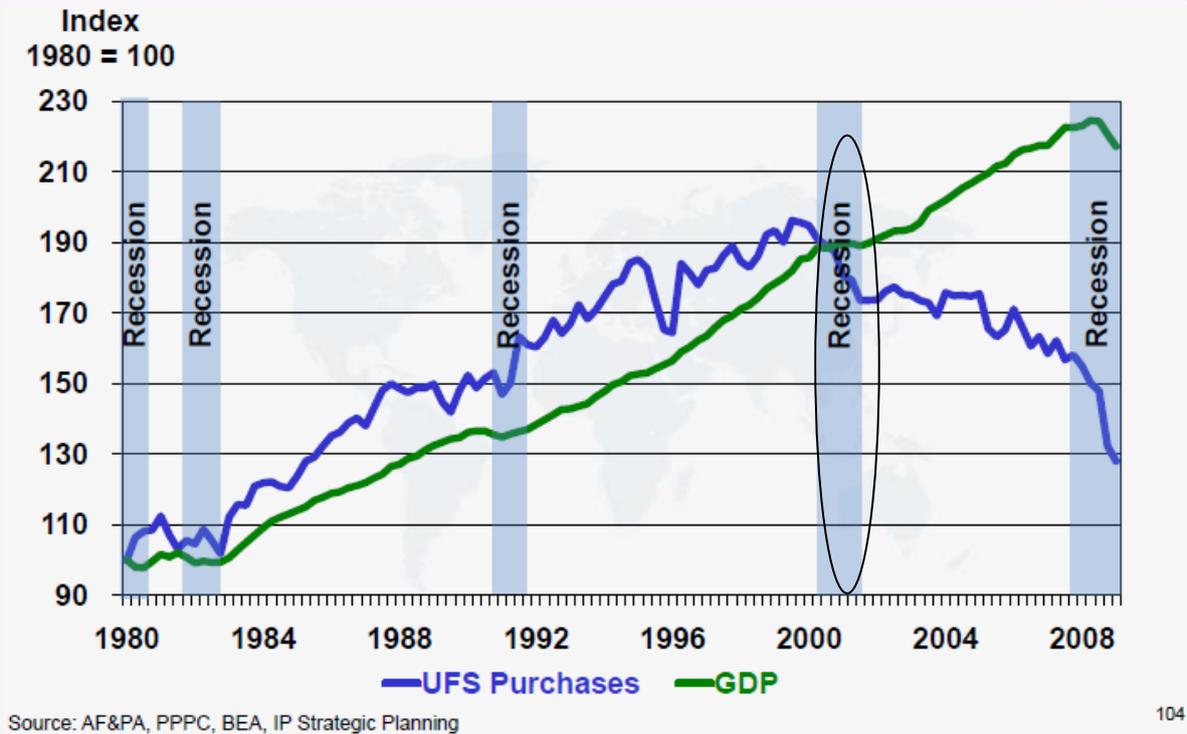


Figure 23 The relation between GDP and UFS purchases in the United States¹⁴⁵

Looking at the consumption of paper grades a bit more broadly, one can also see stagnant or falling demand during these years:

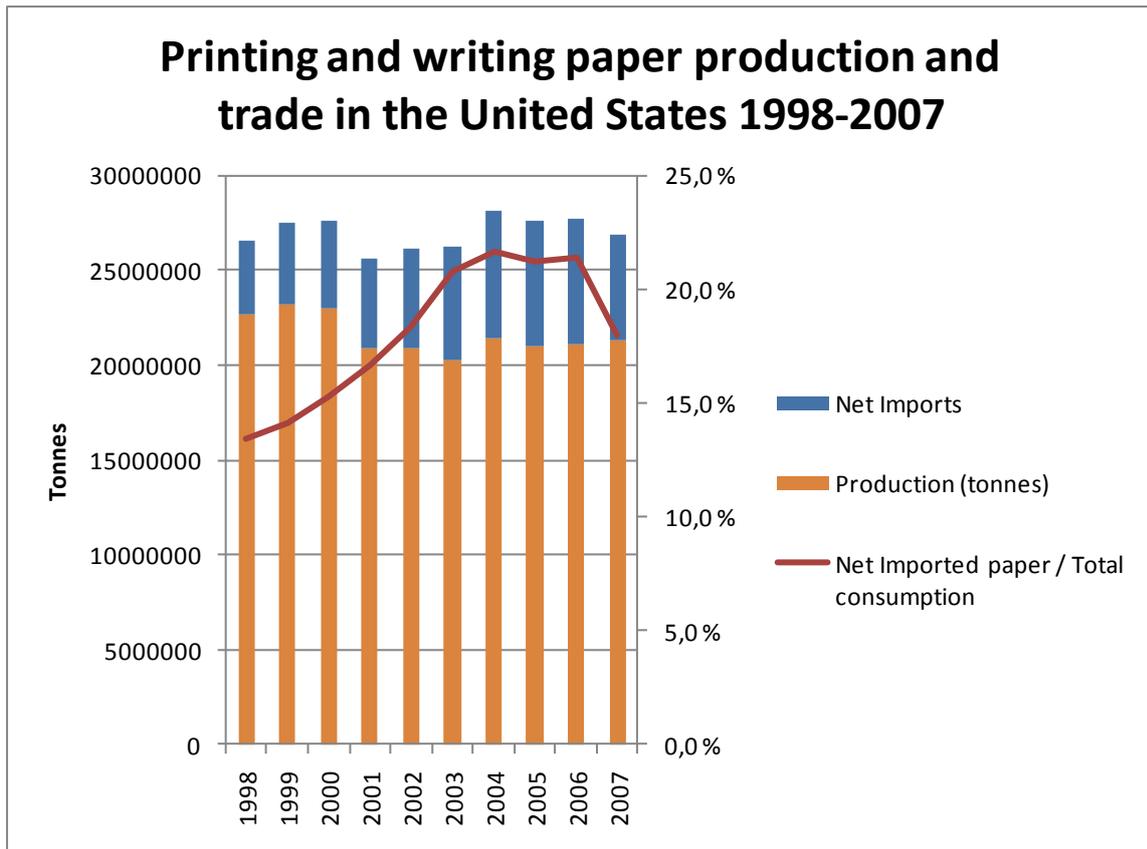


Figure 24 United States Printing and Writing paper production and net imports 1998-2007 ¹⁴⁶

According to FAO statistics, pictured in Figure 23, demand for printing and writing papers as a whole was roughly flat during the period between 1998 and 2007. As can be seen, 2000 was a peak year after which there was a drop in consumption and a simultaneous rise in the market share of imported paper. The recession of 2001-2003 is clearly visible in these data. 2004 was already a year when overall consumption was again higher than 2000, however. Demand for US domestic paper, however, was still lower than in 2000, as most of the growth between 2001 and 2004 was taken by imported paper. Between 2003 and 2007 US production remained stable, while net imports started to drop again. US production was, however, supported after 2006 by two factors: the continuing weakening of the US dollar and trade restrictions put in place to curtail the growing presence of Asian paper manufacturers.¹⁴⁷

Supply

During 2000-2007, the competitive landscape among American players stayed largely the same. Interviewees agreed that the deal itself did not cause hostile competitor action.¹⁴⁸

Foreign importers, however, started to play an increasing role in the American paper market, as shown in figure 23.¹⁴⁹

In 2000, importers covered only about 13% of the American printed papers market. In 2006, however, this figure had risen already to about 22%.¹⁵⁰ The reason for this substantial rise in imports was the rising influence of Chinese, South Korean and other Asian market players, who entered the US market with cheaper prices.

The US market is geographically segmented due to high freight costs, and can be roughly divided into three areas, the East Coast, the Midwest and the West Coast.¹⁵¹ While one could argue that to a large extent, the US market operates very locally, prices are, according to one interviewee, spread throughout the USA. There is always some extra tonnage that is shipped to another area. The Asian importers targeted the West Coast strongly, while SENA's main market was the Midwest and the East Coast. Asian producers caused price erosion throughout the country, because of nationally operating distributors. This was problematic for US producers, whose capacity was, on average, older and not as competitive as that of their Asian competitors.

Stora Enso management did not see the Asians producers as a threat at the time of the acquisition. In 2000 it was, however, known that there is an oversupply of paper in Asia. This is depicted in Stora Enso's Q3/2000 results presentation as well an investor presentation.¹⁵² According to an interviewee, however, the Chinese, for example, were at that time dismissed as a potential market player. At the time, Chinese had obsolete capacity for their domestic market. After "poor years" between 1996 and 2000, the Chinese started to build capacity at a strong pace. In 2003 alone, the Chinese industry grew by 50 new paper and broad machines, bringing 4.1 million metric tons of capacity.¹⁵³ This is the equivalent of two new Consolidated Papers, except that this capacity was state of the art, efficient and with significantly lower labor costs.

According to one interviewee, Chinese paper producers aimed at a 90% share of US West Coast fine paper markets, which they took within a couple of years by lowering prices. The interviewee added that many of the Chinese companies were small, privately held companies without similar return of investment targets as western public companies.¹⁵⁴

Consolidated Papers, however, had noticed the problems Asian competitors were posing. This is evident in Consolidated Papers' chairman's speech held at the final Consolidated Papers annual general meeting in June 2000:

Foreign paper came to our shores in abundance last year. And by the way, it continues unabated today. So much so that increased demand, the new business, created by the robust economy, was and is supplied by imports. On top of that, foreign paper has even taken away some of the domestic producers' long established business.

The dollar was strong compared with foreign currencies, especially the Japanese yen and Korean won. American papermakers, Consolidated included, lost domestic market share to foreign competition. Here's an example: Through the 1970s and 80s, Consolidated Papers was the dominant coated paper supplier in southern California. Our market share of free sheet coated grades (grades we produce here in Wisconsin Rapids) was over 20 percent. Today, we estimate that Japanese, Korean and other foreign paper manufacturers have 85 percent of the coated paper market in Southern California. Consolidated, Mead, SAPPI, Potlatch, Champion, and the other domestics are left to divide up the remaining 15 percent. Why? Because, we cannot compete with the Asian papermakers on our West Coast. Our delivered cost in 1999 and today is often higher than the purchase price of paper coming ashore from Japan and Korea.¹⁵⁵

The increase in Asian and Chinese influence in the US paper markets can be assessed in further detail by looking at balances of trade.

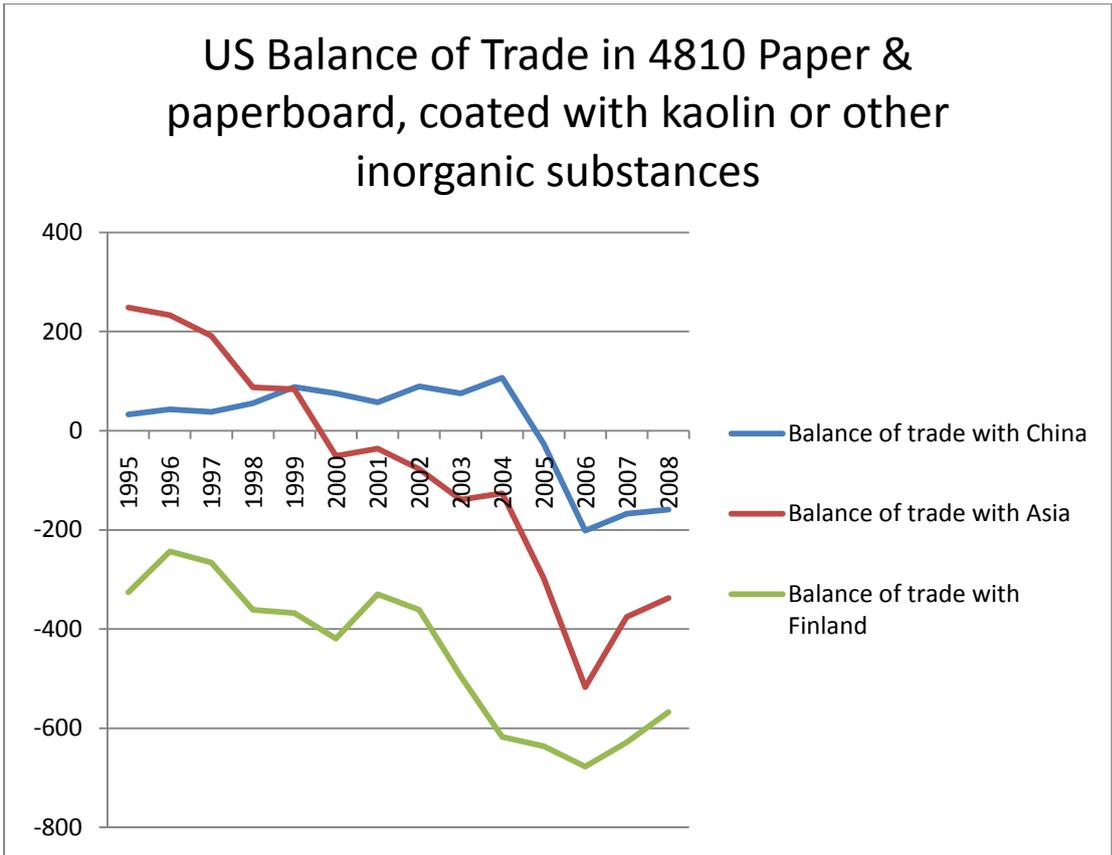


Figure 25 The US balance of trade in coated papers with China, Asia and Finland \$ MM¹⁵⁶

Looking at the US balance of trade with China, Asia overall and Finland between 1995 and 2008 in coated papers, one can see that from 2000 onwards, the balance of trade with Asia as a whole has turned negative gradually. With China, the balance shifts radically between in 2004-2005. It is worth noting that trade with China is much smaller than with Finland for example. The US balance of trade with Finland in 2008 is actually more negative in 2008 than in 2003, in spite of the strengthening of the euro during this time.

Products where Asians have been strong already in 1995 are notebooks, registers etc, which were the source of an anti-dumping filing in 2006.

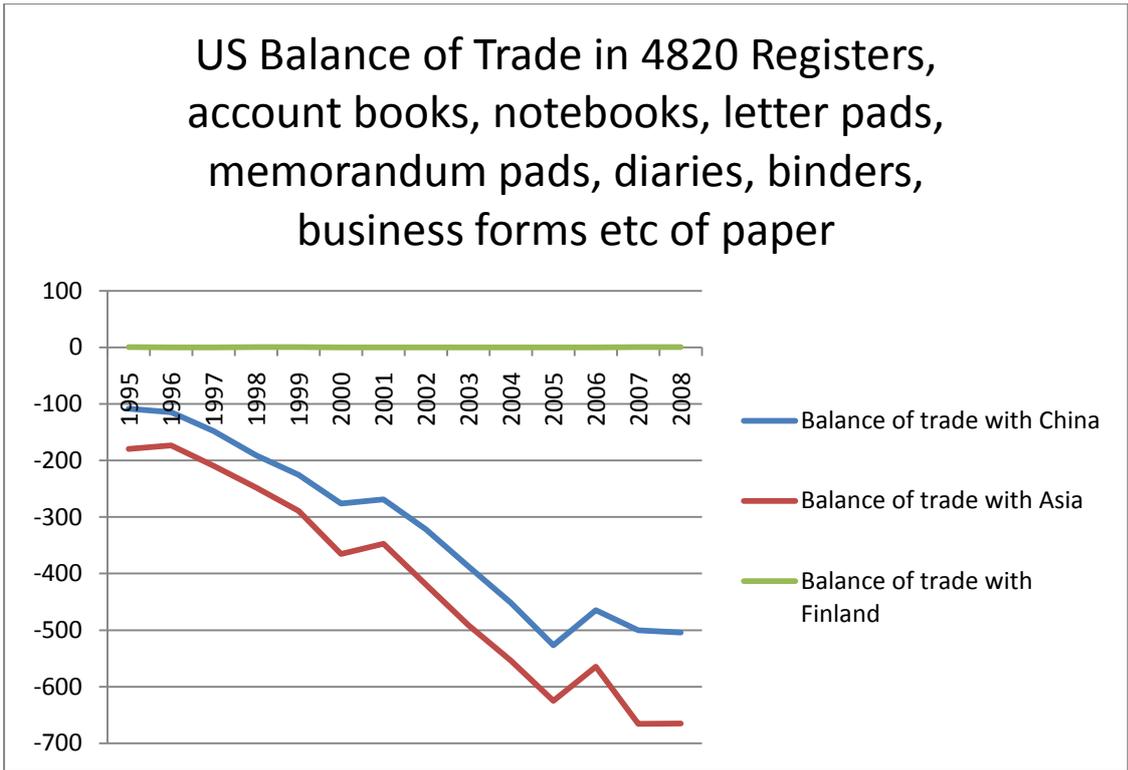


Figure 26 The US balance on trade in notebook papers with China, Asia and Finland \$ MM¹⁵⁷

Here, although the trade balance has constantly been negative, it has steadily grown since 1995. In these products, however, SENA was not a competitor, and Finnish companies (Stora Enso, UPM-Kymmene) do not produce these products.

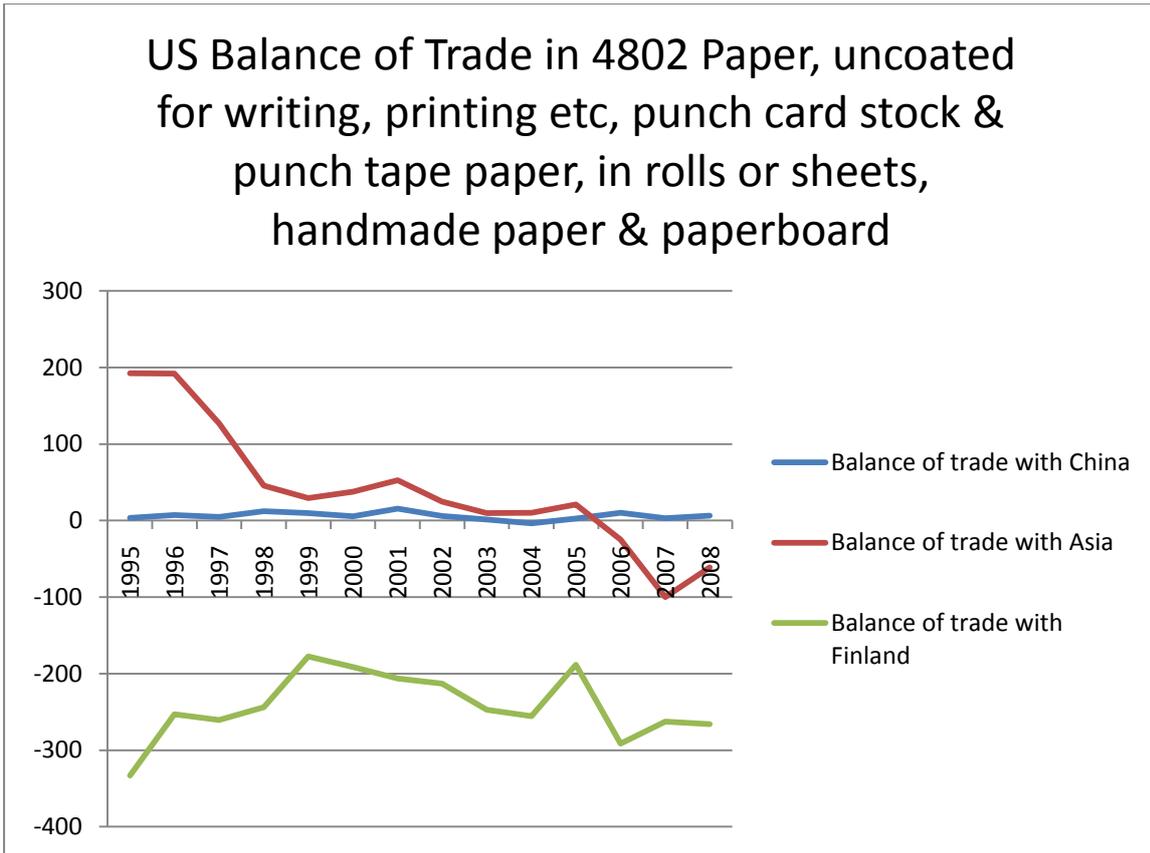


Figure 27 The US balance on trade in uncoated fine papers with China, Asia and Finland \$ MM¹⁵⁸

In uncoated and various specialty papers we can see that Asians have managed to turn the balance of trade to their favor between 1995 and 2008. The differences in absolute monetary terms, however, are minor. Finland’s trade with the US is much greater throughout the period.

All in all, US based supply declined during 2001-2 and then remained stagnant. Hundreds of obsolete mills were closed.¹⁵⁹ These closures, however, were compensated by an increase in supply, first from strong exports in Europe due to the weak Euro, and later from China and the rest of Asia. In absolute monetary terms, however, changes have been rather small except for in coated fine papers. Nevertheless, even small changes in the balance of demand and supply can be significant for prices in declining markets.

Market prices

The balance between supply and demand determines prices. The rise of the IT industry, which had started in the early 1990s and continued throughout the decade, had improved

margins for magazine and fine paper products..¹⁶⁰ Paper prices in the United States were considerably higher than in Europe, even after correcting for currency exchange rates. This can be seen well in the slide below, which shows a significant premium in US prices between 1999 and 2001.

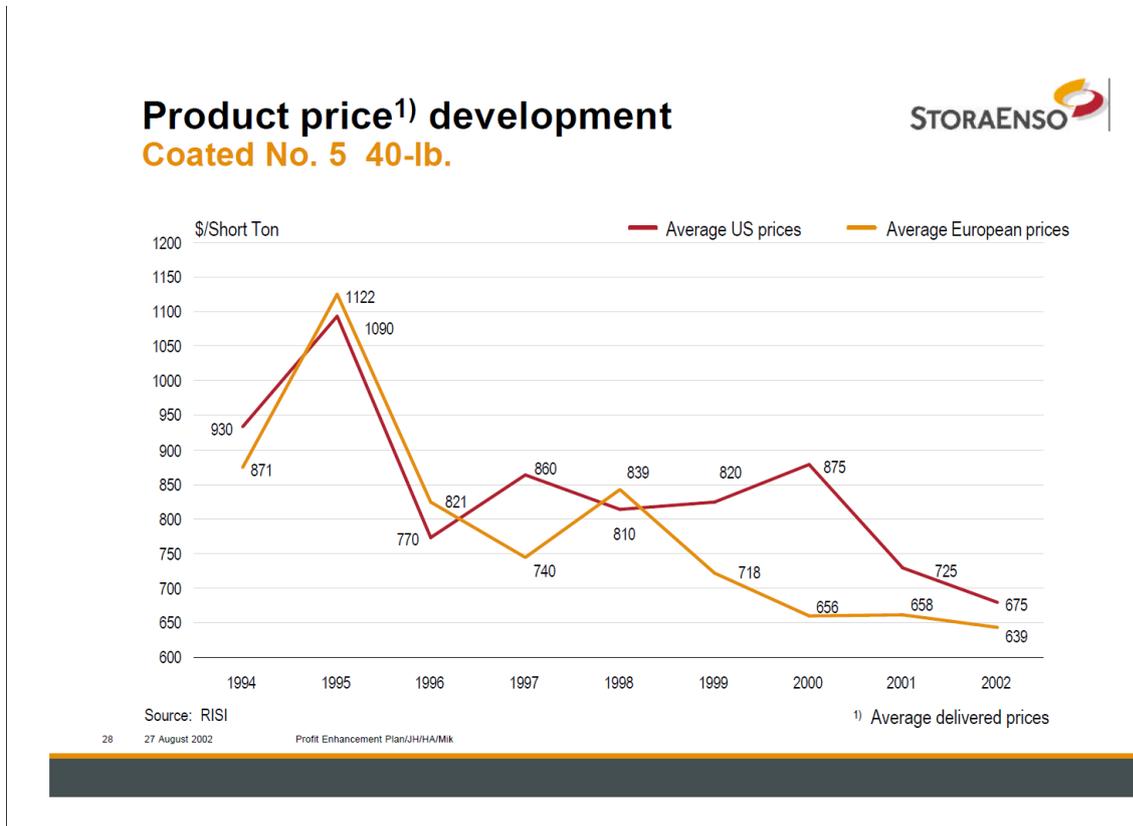
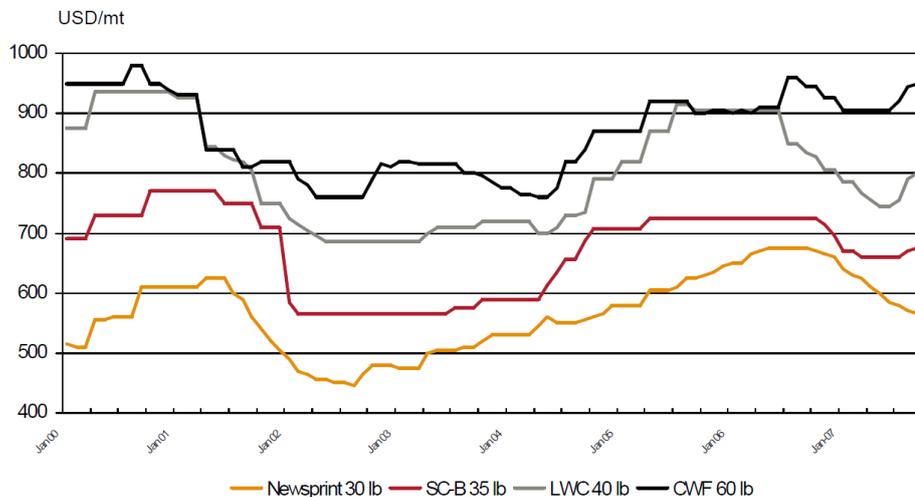


Figure 28 Stora Enso investor presentation given when a major SENA restructuring was announced in August 2002¹⁶¹

After the acquisition, however, the price differential diminished, and price levels deteriorated significantly. This can be seen in the following Stora Enso investor presentation slide:

Paper price development in USA 2000 – 2007



Source: Pulp & Paper Week

4 5 November 2007

Figure 29 Paper price development in the USA, taken from Stora Enso's 2007 Capital markets day presentation in 5 November 2007 by Jouko Karvinen¹⁶²

With stagnate or declining demand, and increased competition from importers with a beneficial cost structure, prices were under a lot of pressure between 2000 and 2007. Figure 28 shows that prices in CWF and LWC started falling around the same time as Stora Enso closed the Consolidated Papers acquisition on 1 September 2000. According to one interviewee, Stora Enso was such a large player in the North American market with a good reputation inherited from Consolidated Papers that it managed to slow down price erosion to some extent.¹⁶³

A consultant involved in the deal claimed that even in 2000, the expectation was that the general trend in printing paper prices would be negative.¹⁶⁴ Stora Enso management was also aware that the high prices experienced in 1999 and 2000 would not continue forever. They expected the good cycle to last at least two more years.¹⁶⁵ The speed at which the market and prices collapsed, however, took them by surprise. The steep decline continued until late 2002, when prices at last stabilized. Proper rises in prices were not seen until mid 2004, although the US economy had returned to the growth track already in 2002.

In 2007, prices in CWF reached acquisition time prices again. As for other relevant paper grades, SC and LWC, prices were almost at 2000 levels in 2006, but in 2007 eroded again. In late 2007, SENA was sold to NewPage.

Overall in terms of market development, since 2000 many of the assumptions made by Stora Enso management turned out incorrect, and many fundamentals in the paper industry have changed.

- The correlation between GDP and paper consumption is no longer positive.
- The paper market in the United States became more global than it was at the time of acquisition. New market entrants from Asian economies disrupted the balance between supply and demand, and compensated for efforts to close obsolete US capacity.
- While 2001 was still generally a rather good year for SENA, the September 11 attacks on the Pentagon and the World Trade Center in New York caused a further slump in the economy, which entered a recession. The subsequent fall in demand and prices was a surprise to Stora Enso management, which had expected the cycle to continue strong at least another two years.

5.2.7. Listing in the United States provides access to a more efficient debt capital market and hence more financing opportunities

Dimension: Financial markets

Result: Yes, Stora Enso was readily offered credit

Although this was not one of the main reasons for the acquisition, Stora Enso management did assume that listing their stock in the New York Stock Exchange would give them access to more debt capital. The US debt capital market was deemed a lot deeper and more liquid than the European one. This assumption proved correct. As an example a Stora Enso management interviewee mentioned that when Stora Enso in 2001 tried to raise a \$750 million global note, they were in fact offered over ten times as much.¹⁶⁶

5.2.8. Pulp and paper companies listed in the United States are worth more than their European counterparts

Dimension: Financial markets

Result: The valuation gap diminished during the 2000s

“One factor was that studies clearly showed that American companies had higher PE (multiples) than European ones. And so it was thought that if we can make Stora Enso at least in part American, it would be valuable.”¹⁶⁷

In conjunction with the merger with Consolidated, Stora Enso listed its stock in the New York stock exchange.¹⁶⁸ This provided Consolidated’s shareholders, which hence became Stora Enso shareholders, a market place for their stock.

Stora Enso management knew that European companies that listed in the United States were usually rewarded with increasing valuations. There was, however, some controversy among interviewees whether this was a key factor in the decision to list in the United States. Some saw it as a necessary step to be able to finance the deal partly with equity, which was beneficial because it caused a smaller drain on the company’s balance sheet. On the other hand, some interviewees regarded this as the primary method of increasing shareholder value in conjunction with the acquisition. Stora Enso already had a lot of American shareholders, and listing in the United States was thought to increase demand for the stock.

To verify this assumption, we can look at contemporary literature, which shows that the so called “valuation gap” between US and foreign companies existed, but has since become smaller.

Doidge et al (2003) show that companies that cross-list their shares in the United States “have higher valuations than other firms from their country that do not cross-list”. The reasons Doidge et al. present are that companies listed in the USA have better protection for minority stock holders and that growth opportunities are more highly valued for firms listed in the US. These are complemented by the traditional view that companies listed in the United States have easier access to US debt capital markets, where debt is more readily available and the market is more developed. Doidge et al.’s results show, however, that for Finnish companies, the average premium for listing in the United States is negative, although the sample is very small.

Forester and Karolyi (1999) show that foreign firms that cross-list in the United States earn cumulative abnormal returns of 19 percent during the year preceding the listing, but incur abnormal losses of 14 percent during the year after. For companies that simultaneously raise capital, however, the post listing decline is mitigated. As reasons for the premium gained from listing shares in United States, Forester and Karolyi (1999) suggest:

- Lowering of risk premiums associated with investment restrictions, which are lowered when the companies' shares are more readily available to foreign investors
- The expansion of shareholder base as this increases the number of shareholders sharing company risk
- The increase in share liquidity as this reduces the liquidity discount priced in the company's shares

Mittoo (2003) finds that the premiums arising from cross-listing in the United States have declined over the years as equity markets have become more globalised. This has also improved global access to debt capital markets, making the difference in being able to access US debt capital smaller. The effects, however, are still present to some extent.

The effect of listing the stock to NYSE is difficult to separate from other effects on the stock price, making the follow-up of this assumption difficult. The stock was listed in conjunction with closing the Consolidated Papers acquisition, at a time when the general trend in prices had turned down. As the literature reviewed earlier suggests, however, the effect of this phenomenon was diminishing, and was therefore probably overestimated by Stora Enso management.

5.2.9. STE's biggest customers are American, and STE will benefit from being in their home market

Dimension: Demand

Result: Benefit difficult to quantify, but market share did grow in the beginning

Customers expressed their wish that Stora Enso be present in more areas with local manufacturing capacity. The future seemed to go towards a single annual deal with major customers. These included large American publishers, such as Time, Murdoch etc. Local presence in the United States was thought to open up more business for Stora Enso also in their European sales.¹⁶⁹

This assumption is not possible to verify based on publicly available data because companies do not disclose their sales figures by customers. A Stora Enso management interviewee claimed, however, that this assumption proved to be correct. Having a North American foothold had helped the company get more orders from the global publishing houses and especially their subsidiaries in Europe.¹⁷⁰ According to news articles, Stora Enso managed to

increase its US market share in the declining markets of 2002.¹⁷¹ This implies that this assumption would have been correct.

5.2.10. The dollar – euro exchange rate will continue to fluctuate, with local manufacturing presence providing an efficient natural hedge.

Dimension: Financial markets

Result: Yes, the dollar-euro exchange rate fluctuated, and the strong euro made American production competitive from 2005 onwards. For the company as a whole, however, the dollar became too weak, making production optimization difficult.

When acquiring Consolidated Papers, the US dollar was close to parity with the euro.¹⁷² When asked, Stora Enso management interviewees stated that they did not make any specific assumptions on how the dollar – euro exchange rate would develop. Rather, they assumed that it would continue to fluctuate. They depicted two scenarios, the risks of which the Consolidated acquisition was supposed to minimize.

- a) A strong US dollar increases the competitiveness of European imports. Previously such situations usually lead to good profits for Europeans at first, but there was always the risk of an anti-dumping law suit, which could potentially lead to tariffs, but even if it didn't, they still caused harm for business
- b) A weak US dollar made European imports very unprofitable. One Stora Enso management team interviewee vaguely remembered a situation in the 1980s where the dollar – Finnish Markka rate had been so bad that Finnish companies had had to pull out of deals. This, according to the interviewee, had caused significant and long term harm to customer relationships. *“This is not an on-off business”*¹⁷³ where one can choose whether or not to deliver according to each situation, but rather one where one has to be a consistently reliable partner.¹⁷⁴

Since the acquisition, both scenarios were seen:

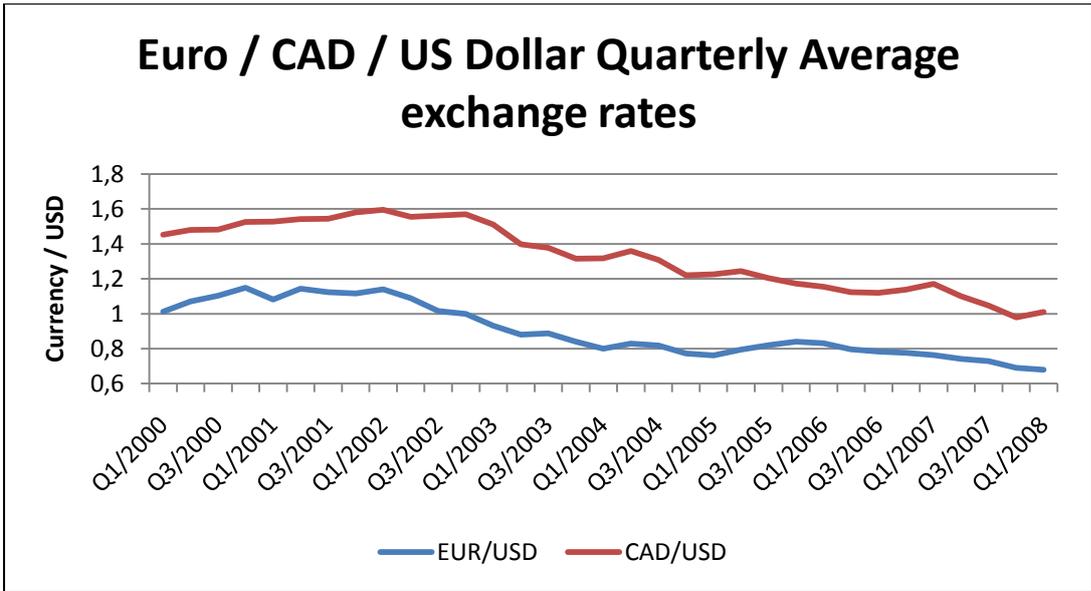


Figure 30 Quarterly euro / Canadian dollar / US dollar average exchange rates Q1/2000 - Q1/2008¹⁷⁵

Figure 29 shows that after the acquisition, the dollar strengthened against the euro. Since 2003, however, the dollar has weakened and has on average stayed at weaker levels. Throughout the period, the Canadian dollar, relevant due to SENA’s Canadian Port Hawkesbury mill, also strengthened against the US dollar.

The United States balance of trade in all paper products during the same time period did not develop quite as currency development would suggest:

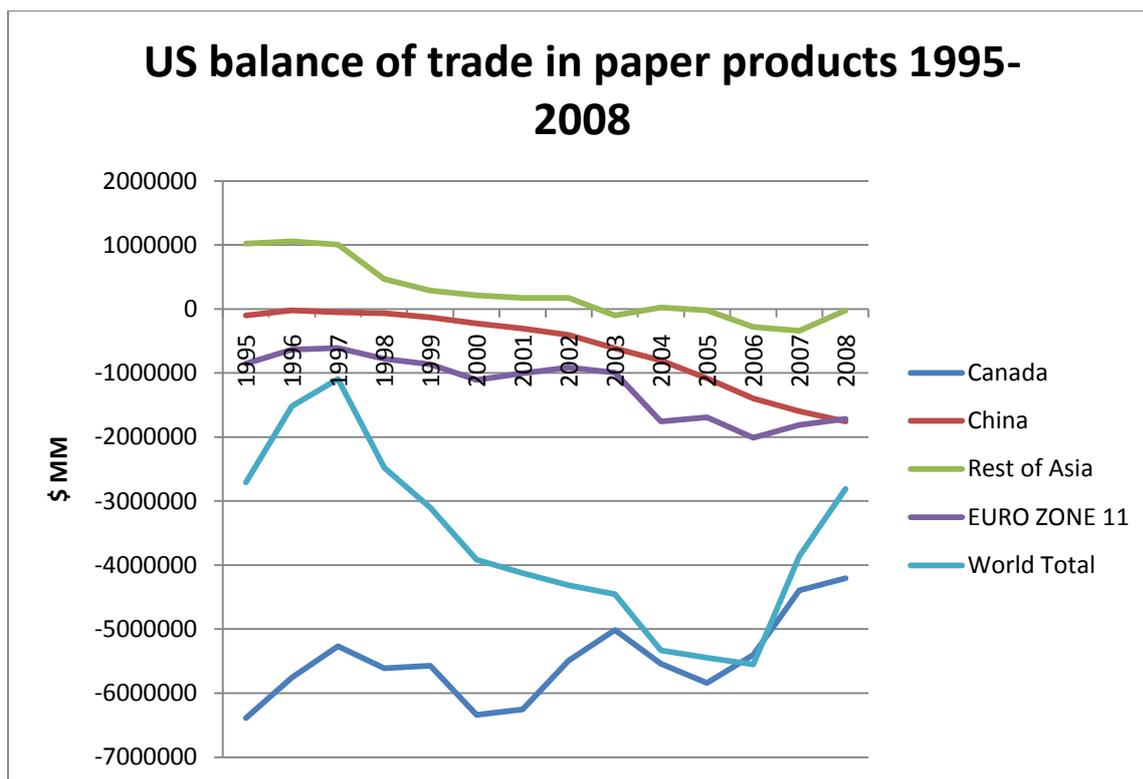


Figure 31 The US balance of trade in all paper products 1995-2008 with select regions and the world¹⁷⁶

Between 1995 and 2002, US exports of paper to Asia without China exceeded imports, but this changed in 2002. The role of imported Chinese paper has also grown strongly since 2000, but especially since 2005.

Between 2000 and 2007, the Euro zone managed to increase its paper exports to the US, despite the weakening euro. European producers sold more, despite getting a relatively smaller price for their products. Canada, on the other hand, has lost market share since 2000, coming down from a trade imbalance of over \$6 Bn in 2000 to just over \$4 Bn in 2008.

US total net imports grew strongly between 1998 and 2006, after which they have radically been reduced. With a reasonably stagnant market, US producers have lost market share until 2006, but since then they have regained ground. This is in line with FAO statistics cited earlier in figure 23, which showed a decrease in importer market shares. The biggest loser of market share has been the Canadian paper industry, not the European or Asian one, however.

The implications of these developments are that Europeans have managed to sell more and more to the United States, but with diminishing margins, whereas Canadians have lost both market share and margins.

In Asia, local producers have increasingly taken markets that were previously net export markets for the US, including Hong Kong and Singapore¹⁷⁷, whereas countries such as Indonesia and South Korea have managed to increase imports to the US.

Many synergies between Stora Enso and Consolidated Papers were based on the ability of the company to optimize its different production systems and to sell European paper in North America.

Stora Enso *“had to get to the North American market because ... it was a great possibility to sell some of the qualities (it had), especially then in coated magazine paper ... and the currency, the dollar was pretty high, compared to the Euro, and so it was interesting.”*¹⁷⁸

The weakening of the dollar helped make American production more competitive, and improved SENA's relative competitiveness with respect to importers. As the dollar weakened further, however, there was a negative effect as well. Firstly, Stora Enso's ability to profitably import paper from Europe was severely hampered. This in turn cancelled many of the global synergies envisaged, because production optimization was made more difficult. Secondly, Stora Enso was a euro-denominated company, meaning that the euro value of the dollar denominated cash flows brought by Consolidated Papers declined. Stora Enso's currency hedging policy covered all dollar-denominated fixed assets, so this partly mitigated the effect of the weakening dollar. All future revenue streams, however, were not hedged at the time of acquisition. Therefore, the dollar's weakness caused some of the benefits sought after with the acquisition to be missed, and caused a major part of the losses when the company was divested as the euro value of the company's future cash flows had weakened. This issue, however, divided Stora Enso management interviewees.

Some interviewees strongly supported the position that since the Consolidated deal acted as a natural hedge, the weakening of the US dollar was indifferent for Stora Enso, because it made local US production more competitive. This view is justified if one only thinks about the company's value in US dollars. Thinking about the company as a whole, however, one may conclude that the US dollar weakened too much.¹⁷⁹

In the 2008 annual general meeting, when SENA had been divested, the chairman of the board Claes Dahlbäck said:

*“A weakening US dollar pushed our revenue down, and the dollar has continued falling this year. Our North American business was becoming a heavy burden.”*¹⁸⁰

In other words, the weakness of the dollar was a problem for Stora Enso as a whole, although it helped the competitiveness of SENA's US-based production. Upon divestment, SENA was no longer regarded as just a hedge with which to ensure access to US markets despite the weak US dollar. Rather, the revenue it brought was being thought of in euro terms. The weakening of the dollar caused SENA's revenues in euros to tumble, and hence decreased the Euro-value of SENA. It also hampered the sale of products from other Stora Enso's production facilities to North America, causing harm to the performance of the company as a whole.

A relevant question is whether there was something in SENA's operations that led to poor performance from 2004 onwards, despite the protection provided by the weakening dollar against imported products from Europe. One major problem was spiraling costs of employment. This development is further discussed in chapter 5.3.7.

5.2.11. The United States government will continue to set up trade barriers against European paper importers if the dollar strengthens.

Dimension: Government officials

Result: Yes, strong euro caused no need for barriers against European producers, but antidumping suits against Asians have been seen

Stora Enso management interviewees cited previous experiences with the United States pulp and paper industry, which called for trade barriers in the form of anti-dumping regulation every time the United States dollar was trading at a rate favorable to European producers. Management thought that by becoming a United States-based player in the market, these actions could be either prevented or Stora Enso would be protected from their effect. Stora Enso could be able to sell to the market at favorable terms whatever the United States dollar – euro exchange rate is.¹⁸¹

A Stora Enso management interviewee speculated that if Stora Enso and some other European companies had not had such a strong presence in the North American market, competitors would have tried to push for trade barriers against Europeans as well. Now, local producers focused their efforts on hampering Asian imports instead.¹⁸² Despite taking a lot of market share, the Chinese fine paper producers avoided major trade barriers of this kind between 2000 and 2007, making it easier for them to access the US market. Some minor trade barriers, however, have been set but these have only dealt with a limited range of products

and arrived only late in the inspection period. These actions have probably in part caused the stagnation of Chinese and other Asian imports, presented in figures 24-26:

- 2007 Coated Free Sheet Paper – Import tariffs set against certain companies in China, South Korea and Indonesia on grounds of dumping and government subsidized production. This action was initiated by NewPage corp.
- 2006 Liner paper - Import tariffs set against certain companies in China, India and Indonesia on grounds of dumping and government subsidized production.
- 2005 Tissue paper – China on grounds of dumping and government subsidized production.
- 2004 Crepe paper – China on grounds of dumping and government subsidized production.¹⁸³

Furthermore, on 25 September 2009, NewPage, SENA's acquirer, filed an anti-dumping complaint against Chinese and Indonesian producers of coated paper. At the time of writing, the complaint is still pending.¹⁸⁴

5.2.12. By obtaining a local manufacturing footprint in the United States, Stora Enso is better able to optimize its production and exports from Europe to the United States

Dimension: Company business structure

Result: No, Customers were used to receiving Consolidated's paper, and did not equally value European paper

Stora Enso already had significant exports to the United States before acquiring Consolidated Papers. By obtaining local production, management assumed that Stora Enso could better take advantage of changes in foreign exchange rates and produce always in an area which is advantageous in terms of cost. Before the acquisition, Stora Enso was vulnerable to fluctuations in the US dollar / euro exchange rate as well as local government trade barriers.¹⁸⁵

The logic of the synergies between local and imported products is well depicted in a management presentation to investors from the time:

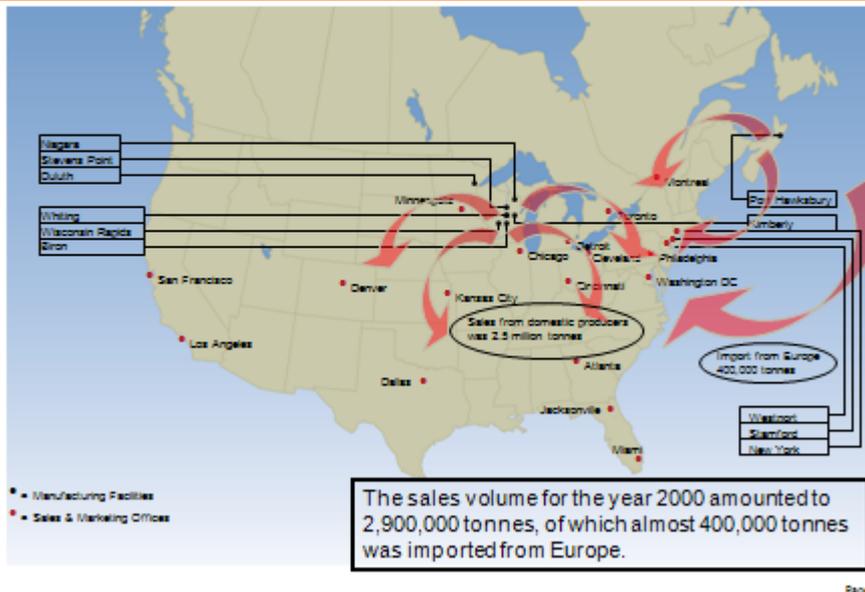


Figure 32 Stora Enso management presentation describing logic behind the Consolidated Papers acquisition from 16 May 2001¹⁸⁶

This assumption turned out to have been rather optimistic. By acquiring Consolidated Papers, Stora Enso increased its presence in its major customers’ home market. It could offer both paper produced in the US and in Europe. Customers, however, were unwilling to accept European paper delivered as an alternative to the Consolidated “quality” paper they were used to.¹⁸⁷ In this sense, there were not so many transatlantic capacity management synergies, because Stora Enso’s products were not completely interchangeable in the eyes of customers.

5.2.13. Stora Enso could not continue expanding through M&A in its home market, Europe, due to governmental anti-trust action

Dimension: Government officials

Result: Correct, the EU commission has since limited M&A action in the industry

In 2000, Stora Enso was Europe’s largest pulp and paper company, and in many products and in many markets such as Finland and Sweden, it was a dominant player.¹⁸⁸ The management of the company thought that buying any larger European companies was out of the question, as market share in certain products and certain markets would have become so large that anti-trust officials would have interfered.¹⁸⁹

Overall, this assumption is difficult to verify, as Stora Enso has not attempted to carry out any major M&A transaction in Europe since the Consolidated merger. UPM-Kymmene, a

company of similar size, however, acquired German paper manufacturer Haindl.¹⁹⁰ The EU commission studied the deal thoroughly and as a condition to approval, UPM had to sell two of Haindl’s six mills to Norske Skog.¹⁹¹ Stora Enso had also been interested in Haindl, but according to management interviewees, they would have faced similar, if not worse, difficulties in carrying out the acquisition.

*”We no longer had the possibility to buy Haindl because we were too large a player, especially in the Central European magazine paper market.”*¹⁹²

M-Real (previously Metsä-Serla) was allowed to purchase Modö paper in August 2000 and several other companies¹⁹³. The EU competition agency cannot be said to have had a generally negative attitude towards pulp and paper industry consolidation. On the other hand, Stora Enso was one of Europe’s largest pulp and paper companies at the time, and had had to fulfill several terms and conditions in conjunction with the Stora – Enso merger two years earlier. These included divestments of some business units.¹⁹⁴

5.3. Assumptions made when choosing Consolidated Papers as the merger target

Assumptions made about Consolidated Papers as an acquisition target

Assumption	Dimension	Outcome
The target must be a good location and it must be an established brand	Demand	SENA held its positions rather well, and managed to exert some control over prices
The main owner is selling because he sees CPI is too small and due to lack of successor	Company competencies	Yes, but also due to declining performance and a lack of belief in the market
The capacity of CPI is the best in its industry and runs efficiently	Company competencies	Performance gap between CPI and new Asian players grew large, causing need for significant investments
There are other buyers interested in buying the company as well	Supply	Yes, There were 6 interested companies, two of whom presented final bids
STE can segment its customers according to location and deliver products from different regions optimally	Demand	Customer synergies were not realized to their full potential
STE can sell its premium quality products to its customers at a premium price	Prices	Premiums were not obtained to a significant extent even though European paper was of better quality
Unlike in the Eurocan project, employee relations are not likely to pose a problem	Employees	Employees accepted the new owner, but trade unions managed to obtain significant additional benefits

Figure 33 The assumptions about the target company made by Stora Enso management. While stating whether an assumption proved correct or not is not always clear-cut, the color coding depicts their general correctness – If the assumption proved correct, it is marked green, if it failed, it is colored in red.

5.3.1. The target must be at a good location and it must be an established brand

Dimension: Demand

Result: Correct, SENA held its positions rather well, and managed to exert some control over prices

Enso's previous experiences with the North American market signified to Stora Enso management that being at a good location in relation to both customers and raw material is very important. Location was also important in recruiting good personnel. In the Eurocan project (talked about in further detail in chapter 5.2.1), this had clearly been a problem:

*"And then we also noticed that getting staff to that area (Kitimati, British Columbia, Canada) was a central problem as it is located 1000km north of Vancouver ... Getting families to move there is just impossible."*¹⁹⁵

As previously mentioned, the choice for Stora Enso was either to build the foothold in the United States by buying one mill at a time or to buy a large company with an established operation. By buying an established operation, it could use the existing operation's management in continuing the expansion further. Furthermore, individual mills for sale were often of poor quality. Therefore, it was felt that Stora Enso needed to buy a company that would act as a solid base.¹⁹⁶

In executing its strategy and building a North American foothold, however, Stora Enso succeeded well and in this respect, the assumption can be said to have proved correct. The assumption is rather difficult to assess, because the alternative scenario, buying individual mills in poor locations did not realize, neither are there good comparable cases. In a declining market, however, maintaining such an operation viable would probably have been even more difficult. The problem with Consolidated Papers was not its operations as such, at least in comparison to its American competitors, but rather the unfortunate fact that its price was too high in comparison to its performance in the years following the acquisition.

5.3.2. The main owner is selling because he sees that Consolidated is too small on its own, because of his will to retire and no successor to continue leading the family business

Dimension: Company competencies

Result: Yes, but also due to declining performance and a lack of belief in the market

According to Stora Enso management interviewees, when buying Consolidated Papers they had the impression that the main owner, the Mead-Witter family was selling the company mostly because there were no successors in the family to follow George W. Mead, then aged 72, in the paper business. In addition, Stora Enso management assumed that Consolidated Papers and its chairman George W. Mead *"had come to the conclusion that they would not succeed on their own, but that they would have to join something"*.¹⁹⁷

According to the owner, these were indeed the reasons. There were no successors within the family to succeed George W. Mead in managing the company. In addition, Consolidated Papers had experience declining profitability already for several years. A couple of years earlier, it had acquired a couple of old paper mills from the troubled Repap USA. These, according to George W. Mead, had not cost much but were not profitable either. Hence, in 1999, the company had hired Goldman Sachs to investigate options to stop the decline of the company - whether to grow organically, acquire other companies or put the company up for sale. The result of this analysis had been that because there were so many larger paper companies interested in growing through M&A, selling the company would be the best option for shareholders. According to George W. Mead, it was not only the company's business model that was declining, there were problems in the market as well. In an interview with the author, to the question whether he felt at the time of the acquisition that the American market would still stay strong, George W. Mead replied: *"It wasn't, you know, if it was as strong as it had been, then we wouldn't have been looking around for a buyer."*¹⁹⁸

At the same time Stora Enso management still thought that the North American market had room to grow: *"When it comes to growth, we believed that there would still be growth there (In the USA)"*¹⁹⁹ The buyers obviously thought that their competence in reading the market was better than the seller's. Furthermore, they and the local seller viewed the future of the local market in clearly different ways.

An interesting question is why buyers were willing to pay such a high price for Consolidated Papers even though its operations were clearly in decline. In the Q3/1999 earnings report Consolidated Papers reported smaller profit margins which it attributed to:

*"Reduced selling prices, less-than-optimal product mix and periodic downtime partially offset by improved cost of sales. The periodic downtime was caused by global over-capacity and a continued high level of imports."*²⁰⁰

Consolidated therefore acknowledged that the markets were global, and that imports were hurting its margins already in 1999. The company's sales were also down, and profits had been in steady decline since 1995.

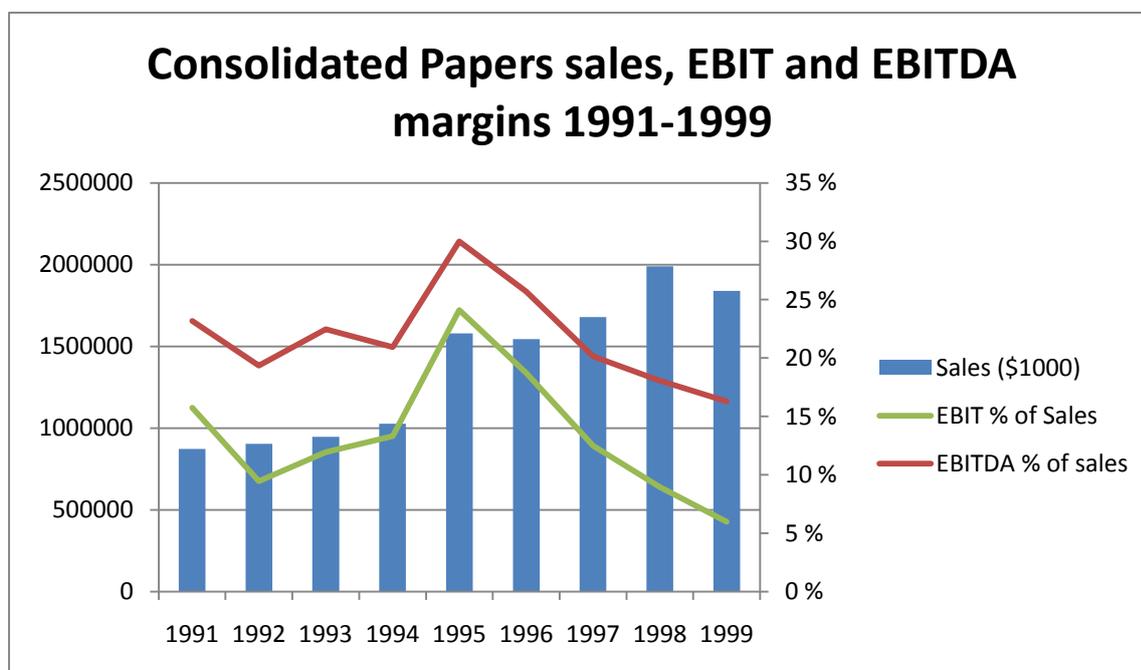


Figure 34 Consolidated Papers sales EBIT and EBITDA margins 1991-1999²⁰¹

There also seems to have been a difference in the cash flow forecasts that the buyer and seller had made. At the time of the deal, Goldman Sachs projected Consolidated's cash flows including merger synergies so that its value would vary between \$3,34 billion to \$5,47 billion depending on the cost of capital used. The corresponding range used in the calculation was 8,0% to 12,0%.²⁰²

Although the relationship between the cost of capital and the value of the company is not linear, an inverse linear approximation may be used, at which the \$4,8 billion acquisition would be value neutral for Stora Enso if its cost of capital were about 8,4%. This is significantly lower than Stora Enso's weighted average cost of capital of 9,3%. There is differing information available on what cost of capital Stora Enso used to evaluate the company. A Stora Enso management interviewee stated that the deal was value neutral, suggesting that cash flows would have been evaluated at a cost of capital of 9,3%. An adviser involved in the deal was of the opinion that the deal did meet a hurdle rate cost of capital defined for acquisitions, which was higher than the cost of capital. Stora Enso's

investor presentation following the announcement of the acquisition declared that the deal exceeded the cost of capital of 9%, taking into account synergies and performance improvements that had already been decided upon.

While the 0,9% difference between the buyer's and the seller's estimations for the estimated return on investment is small as a figure, the corresponding difference in Consolidated Papers' value is over \$400 million. This analysis is "quick and dirty", but it shows that Stora Enso and Consolidated Papers' assumptions on the future of the business differed somewhat already at the time of acquisition.

5.3.3. The capacity of Consolidated Papers is the best in the industry and runs efficiently. Stora Enso, however, has the needed know-how to make Consolidated Paper's operations more efficient and more profitable.

Dimension: Company competencies

Result: Despite efforts to improve performance, the performance gap between Consolidated Papers and new Asian players grew large, causing need for significant investments.

According to an interviewed consultant involved in the deal, Stora Enso aimed to find an acquisition target whose capacity would be in good and competitive condition - It should not require major further investments in the years following the acquisition.²⁰³ In 2002, two years after it acquired Consolidated Papers, however, Stora Enso announced major restructurings in its North American division. These included mill closures which caused one-time expenses, as well as investments in more productive mills.²⁰⁴ All in all, Stora Enso managed to bring down employee headcount by about 35% while keeping production stable. This was stated by several interviewees, both among management and implementers. According to a management interviewee involved in the acquisition, it was known that improvements could be done already at the time of the acquisition. It was part of the value-add that Stora Enso could bring, and most of the calculated cost reduction synergies were based on implementing best practices. The same interviewee also said, however, that the extent of the work needed to put the company in order came as a surprise.²⁰⁵ Another interviewee claimed even that:

"The plants weren't at all as good (as the board had been told)... they were older and didn't work as well and were not of the quality (Stora Enso had been told)"²⁰⁶

Stora Enso representatives did not get to do a proper due diligence on the company at the time of acquisition because it was a public company. They did get to see the mills, but only

briefly. This, according to an interviewee, was not enough to get a feeling of how efficiently operations were running. On the other hand, according to a consultant involved in the deal, it does not take long for an expert in the paper industry to see how efficiently operations are being run, if one has access to certain performance metrics.²⁰⁷

According to another interviewee, the question of asset quality has more to do with the condition of the markets:

*“In a very good market you can look upon this as a very good quality asset because you can earn a lot of money on these machines ... But they became very quickly obsolete when the market came down ... They were kept in as good shape as they could be given their age and size, but ... many of them were too old and too small for a market where costs became everything.”*²⁰⁸

The fact that the paper market collapsed hastened and magnified the need for restructuring investments. As prices came down, previously profitable mills went below the profitability threshold, and increased efficiency was needed to operate profitably. A competitor interviewee explained that the major investments done on paper capacity in Asia increased the performance gap between these new state of the art mills and American ageing capacity. This gap led to the need for significant investments in order to keep mills competitive. Stora Enso management had not foreseen the steep rise in Asian capacity, the aggressive competition of which facilitated price erosion. This is one of the reasons management may have underestimated the need for investments in their newly acquired capacity.²⁰⁹

The main cause of the surprise probably didn't arise from ignorance concerning what Stora Enso had bought, but rather from a change in the company's external environment. There was also over-confidence in how well Stora Enso management could turn Consolidated Papers' declining performance around.

5.3.4. *There were other potential buyers interested in buying the company as well*

Dimension: Supply

Result: Yes, There were 6 interested companies, two of whom presented final bids

Stora Enso management was aware of the fact that there were not the only ones bidding for Consolidated Papers. Signals of this came from many directions. The investment bank hired to advise Stora Enso had been approached by another company interested in giving a mandate

to handle acquiring Consolidated Papers. Stora Enso management had heard market rumors of the existence of competition and ranges of the competitors' offers.²¹⁰

In the SEC filing following the publication of the deal, Consolidated Papers claimed to have interested over ten players, of which six had presented indicative offers. In the final stage, two binding offers had been submitted, one from Stora Enso and the other from a major US pulp and paper company.²¹¹ According to a consultant involved in the deal, the other offer had been very close to that of Stora Enso. Market rumors following the acquisition suggested that there were two other companies that had been significantly interested in Consolidated Papers, one of which was one of the largest US pulp and paper companies, and the other was another major Nordic player. UPM-Kymmene was not, however, interested in Consolidated Papers as it was tied up with trying to merge with Champion International.

In other words, had Stora Enso offered less than it did, it most likely would not have succeeded in buying the company. Stora Enso management interviewees had mixed sentiments about whether they had felt certain haste about realizing the deal. While some said that they had not felt hurried in the deal, others thought that because Stora Enso had previously lost many bids, management felt urged to make sure that this time would succeed. According to one management interview, the price offered was not changed during the process, as they did not want to start haggling over the price. Instead, Stora Enso "*crafted the highest possible justifiable offer*"²¹². This leaves room to ask, how much of the value creation potential of the deal was ever possible to be retained by Stora Enso's shareholders. For further discussion on shareholder value, please refer to chapter 6.5.

5.3.5. Stora Enso can segment its customers according to location, and deliver products from different regions optimally

Dimension: Demand

Result: Partly correct, but customer-related synergies were not realized to their full potential

The United States paper market is rather segmented, and operates locally. Due to large inland freight costs, operating close to the customer brings significant benefits. At the time of the acquisition, Stora Enso already imported a lot of paper to the East Coast of the United States by sea, both from Europe and its Canadian mill in Nova Scotia. The amounts of paper brought from Europe, however, were rather insignificant compared to the production capacity acquired in the Consolidated Papers deal.

The rationale behind buying a significant player from the Midwest was that Stora Enso could optimize its delivery costs by segmenting customers according to location – East Coast customers would receive more paper from Europe, whereas Midwest customers would receive paper produced in Wisconsin.²¹³ This would also enable optimizing production and sales to clients in all market conditions. Gaining access to Consolidated Papers' client base would also enable selling them more paper produced in Europe.

The problem with this thinking, according to a management interviewee, was that clients were more country loyal than Stora Enso management had expected. Consolidated's American major customers located on the East Coast were used to receiving paper from the Midwest, and did not want to buy paper from Europe. Stora Enso was unable to transfer the good reputation of Consolidated Papers to cover its imported papers, and hence the anticipated sales synergies largely failed to realize.²¹⁴

5.3.6. Stora Enso can sell its premium quality products to its customers at a premium price.

Dimension: Prices

Result: Premiums were not obtained to a significant extent even though European paper was of better quality

European fine paper was, according to one interviewee, slightly different than American paper and was considered a premium product. In the American market, Stora Enso management assumed that Stora Enso could sell European style paper to Consolidated's customers in the US and receive a premium compared to competing paper grades.

This assumption, however, did not prove correct. According to a management interviewee, American customers were willing to accept European style paper, but were not willing to pay extra for it. Furthermore, the quality premium Consolidated Papers had previously managed to charge its customers for magazine and fine paper became smaller, because new market entrants from China proved capable of producing good quality paper. They could deliver reliably, offer good customer service and sell with cheaper prices. For Consolidated Papers and SENA, quality and reliability were therefore no longer sources of competitive advantage to the same extent they had been previously.²¹⁵

5.3.7. Unlike in the Eurocan project, employee relations are not likely to pose a problem

Dimension: Employees

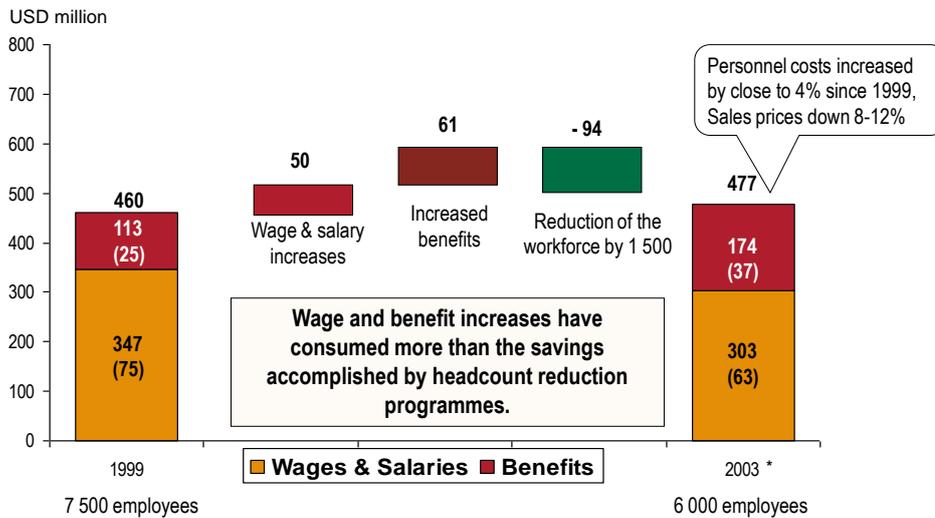
Result: Employees accepted the new owner, but trade unions managed to obtain significant additional benefits

A typical problem in post-merger integration is relations with the target company's employees. In this case, however, the need for drastic employee reductions was not at first seen, because Consolidated's old headquarter functions were going to be kept to a large extent, as Stora Enso lacked these functions in the United States. Scandinavian management style was also not deemed to differ too much from the American style, and management assumed that cultural clashes could be avoided. According to a Stora Enso management interviewee, Scandinavians and Americans shared the same Christian cultural heritage, making integration a lot easier than for example if the counterpart had been Asian.²¹⁶

In practice, integration between the two companies went well. When profitability started to decline shortly after the acquisition, mill closures and employee reductions were announced.²¹⁷ According to the former owner, however, the sentiment among employees did not put the blame for the drastic measures on the new owners.²¹⁸

An adviser involved in the deal and familiar with US pulp and paper industry mentioned that spiraling healthcare costs were a major problem in the United States for all industries throughout the 2000s. In his opinion, the paper union was strong enough to hold on to these benefits, despite the weak performance of the companies. The cost of employment in the pulp and paper industry rose strongly between 2000 and 2004, an effect felt also by Stora Enso North America. According to management interviewees, this was because Consolidated Papers had agreed to a long-term employment contract with very favorable terms towards employees in 1999, which Stora Enso had to abide by until 2006-2007.²¹⁹ The results of personnel reduction were therefore meager due to the simultaneously rising costs of employment. It is likely that this trend has continued, although it is still unclear how the Obama administration's attempts to reform health care insurance will affect the situation.²²⁰ This development was mostly unforeseen by Stora Enso management at the time of the acquisition. The situation is well depicted in a Stora Enso investor presentation slide shown below:

Personnel Cost Development SENA 1999-2003



19

* excludes one time job reduction costs

Figure 35 Stora Enso investor presentation 3 March 2004²²¹

5.4. Where did the assumptions come from?

The interviews with Stora Enso management and advisers show that the assumptions, made before the transaction was carried out, were formed through a number of influences.

Six primary sources have been identified, including external advice, informal advice and rumors, Stora Enso sales force contacts, previous experiences, bias due to cultural differences and the effect of the media. In the following sections, the effect of each area is explained more thoroughly.

5.4.1. External advice

Stora Enso used a lot of external advisers during the acquisition process. According to interviewees, the idea of expanding to the United States came from management itself, but after that, both investment bankers and consultants were frequently asked to present their ideas. Stora Enso management met with representatives of several investment banks. They pitched their ideas on which US market players would be suitable and available acquisition targets. Then, Stora Enso management had two separate formal studies done. One, done in collaboration with the Citibank investment banking division, analyzed all potential acquisition targets in Northern America. The second one was done by Pöyry and it analyzed

the physical condition of North American pulp and paper capacity.²²² According to the CEO of Stora Enso of the time, he also had private discussions with a pulp and paper industry analyst. A short while before deciding whether to make a final offer or not, he presented the situation and the terms of the deal to the analyst, who looked at them.

*“I asked what he would do in the situation, he said that the idea was correct, but the price was rather high. Overall, however, he would take the risk.”*²²³

This said, the extent of the drop in Stora Enso’s share price came as a surprise to the CEO.²²⁴

Some Stora Enso management and implementer interviewees brought up the role of the external advisers in the stirring up the deal. They questioned whose interests investment bankers actually look after, as their compensation is often purely based on whether the deal goes through or not.²²⁵ The seller also brought up the role of investment banks in managing to stir up a lot of M&A transactions in the 1990s by pitching their ideas to growth-hungry corporate managers.²²⁶ On the other hand, Stora Enso can be considered to have been an enlightened buyer of professional services. The company’s CEO was a former banker himself, the chairman was an adviser to investment bank Goldman Sachs and the director in charge of this particular M&A deal had had a long career in management consulting before joining Stora Enso.

5.4.2. Informal advice and rumors

Management team members also had private discussions with their more informal contacts about the acquisition case in addition to the ones on the board and executive management teams. Management heard rumors about the existence of a competitive bidder. These signals together with signals coming from Stora Enso’s investment banking adviser, Citibank, indicated to management a certain price level under which the deal would not go through.

5.4.3. Stora Enso sales force contacts and discussions with customers

As mentioned in chapter 5.2.9, Stora Enso managers heard their customers express their wish that Stora Enso could deliver locally produced products in the United States. Customers expressed their wish to Stora Enso management, which in part made them feel that local presence would be important to harness good relations with important customers. This influence on managerial cognition might have been an intentional effort by big customers to try and further squeeze their paper suppliers.

5.4.4. Previous experiences

Stora Enso's management team was a group of senior executives who had taken part in Enso's previous acquisitions in the 1990s as well as the Stora – Enso merger in 1998. As mentioned in chapter 5.1.5, this previous experience gave them confidence in the company's ability to successfully carry out large acquisitions and integrate the targets to the group. For example, the merger between Stora and Enso was described as very challenging due to large perceived differences in company cultures. International mergers in general were found more difficult than domestic ones.²²⁷ Enso had a lot of experience in both, however, and most of the recent transactions had been carried out by the same top management team that was to handle the Consolidated Papers deal. This prior experience and success was mentioned as a primary reason for choosing M&A as the method for growth by the interviewees. Management did not feel that failure in integrating the two companies would pose a major risk to the success of the Consolidated Papers acquisition.²²⁸

5.4.5. Bias due to different corporate culture backgrounds

The Stora Enso management team, which consisted mainly of Finns, was very much in favor of continuing acquisitions and growing aggressively. After the Stora - Enso merger, Stora Enso had two very different alternatives in America: to divest or to expand. The lone factory in the North America built by Stora, Port Hawkesbury, was unprofitable. The choice was either to divest it, or expand business on the continent and in doing so, also try to enhance the profitability of the Port Hawkesbury mill. The mill at Port Hawkesbury had just undergone major investment prior to the Stora – Enso merger in 1998. Therefore, according to the management team member, it would have been difficult to persuade the board, dominated mostly by Swedes, to divest it, especially when the opening of the mill had just been celebrated. It was therefore easy to persuade the board to a policy of expansion in the United States.²²⁹

5.4.6. The effect of the media

According to a competitor interviewee, the media has played a significant role in determining the direction of the Finnish pulp and paper industry. As a reflector of public opinion, the media has looked at different companies and management groups in a different light depending on their current strategy, or the success of their past actions. The interviewee called for stronger boards of directors and CEOs that could better withstand pressure from the public.²³⁰

Although one cannot draw the conclusion based on one interview that the media has been able to influence the industry, it is still a good idea to look at the attitudes of the media from different periods. This might help to assess what the general feeling surrounding the industry at the time was. This may have influenced the managements of paper industry companies as well.

At the time of the acquisition of Consolidated Papers, Stora Enso along with the whole industry was doing well. There was a general “feel good” atmosphere both in the media and the industry.

The results of a news search done on the Stora Enso – Consolidated Papers acquisition, development and divestment shows that the media was positive or somewhat positive towards the deal in the beginning. Later on, however, the deal has been criticized, showing a late comprehension or an inconsistency in its treatment.

Around the time of the announcement, many Finnish journalists had a favorable attitude towards M&A transactions in the pulp and paper industry, especially ones where Finnish companies were the buyers. In the Stora Enso – Consolidated Papers case, most articles written at the time in Finnish newspapers²³¹ commended the deal, although concerns were raised about the price. There were even elements of a “Finnish invasion”, with text that portrayed a nationalistic or patriotic tone. A good example is Taloussanomats article which looks at the acquisitions of US companies made by Stora Enso and UPM-Kymmene:

“The position of Finnish companies has changed dramatically within a week. Only a few weeks ago they had a rather modest foothold in the world’s largest paper market. After the megamergers, Finns have risen to become the dominators of the American market in their strong paper grades.”²³²

Helsingin Sanomat wrote:

“Who would have thought a week ago that among the world’s three largest pulp and paper companies, two would be Finnish ... At last we can harvest Finnish attempts to increase value-add and to build wider machines. The road to M&A is quickly open because the companies’ return on shares has evened out on different sides of the Atlantic, and stock is accepted as a method of payment.”²³³

In another article, a Helsingin Sanomat journalist wrote:

*“Champion and Stora Enso’s new, larger size guarantees that Mr. Härmälä and Mr. Niemelä (CEO of UPM-Kymmene) will expand the picture of Finland as a modern country of know-how and a dynamic population. Nowadays Finland has a broad sphere of internationally renowned names. The country is known for other things than reindeer milk”.*²³⁴

The price paid for Consolidated Papers included a much higher premium than for Champion international. This is one of the reasons why many journalists looked at UPM-Kymmene’s deal under its original terms more favorably. When UPM-Kymmene withdrew from the deal, the media treated the decision in different ways. Suomen Kuvalehti, for example, wrote:

*“The world is treating Finnish pulp and paper companies in very different ways. UPM-Kymmene is suffering a major blow and will most probably have to withdraw from the USA. In front of UPM lies thinking about new acquisition targets, as International Paper probably will take over Champion International. Stora Enso’s American conquest is, on the other hand, going according to plan”.*²³⁵

Helsingin Sanomat wrote:

*“Although UPM-Kymmene has failed in its efforts to expand in recent years, Niemelä is not feeling sorry for himself, pointing out that he is the head of the best company in the field., He does concede, however, that losing Champion was a disappointment, as it involved a good deal of work, travel and long discussions.”*²³⁶

Kauppalehti wrote during the bidding war for Champion: *“The dismantling of the offer (UPM’s offer for Champion) can’t be seen as a personal loss in prestige for CEO Juha Niemelä. There is a lot to acquire also outside of Champion, and only a few companies have as easily managed to make 1,3 billion Markkas which UPM is getting as compensation. In addition, UPM would surely be left undisturbed for a long time by competitors such as IP.”*²³⁷

Despite criticism of the high price, Stora Enso’s deal was treated rather positively. After SENA’s first impairment charge in 2002, and especially after the divestment, however, Stora Enso’s management and board received heavy criticism from the media. In 2002, Helsingin Sanomat wrote:

*“The acquisition was not a strategic mistake if a global pulp and paper company is considered a sensible target. But the timing of the deal was a failure, and it cost too much ... At least for now there has been no evidence to support the benefits from global operations.”*²³⁸

In 2007, the same journalist Jyrki Iivonen wrote:

*“The main ones responsible for the North American catastrophe are Jukka Härmälä who planned and executed the Consolidated Papers acquisition in the spring of 2000. Härmälä is not the only guilty one...(The article also mentions) Claes Dahlbäck, Marcus Wallenberg and Jan Sjöqvist.”*²³⁹

Taloussanomat wrote *“The great American erroneous acquisition, Consolidated Papers, caused a multi-billion euro loss for Stora Enso. In recent years, the closest competitors have not made equally large mistakes, as they have only succeeded in executing mid-sized erroneous investments.”*²⁴⁰

Although these articles were just a sample, it is clear that the media was quick to criticize and find culprits for both the unsuccessful merger and the direction in which the pulp and paper industry was going. It is likely that journalists felt free to criticize Stora Enso because a large part of it was controlled by the Finnish government. It is difficult to show whether or not these changing opinions have had an effect on corporate decision making.

As an adviser to the deal said, however, M&A is a “*confidence game*”, meaning that corporate management needs to feel confident in the future in order to want to carry out M&A transactions.²⁴¹ Public opinion surely has its effect on how confident boards and CEOs feel about deals they are about to undertake. In this case, public opinion was in favor of making large deals, and there was public support for them. Once problems emerged, this public support faded and turned into strong criticism. In such a climate, further expansion to the United States could have been more difficult.

The agency theory in M&A also supports the effect of public opinion on corporate decisions, because a part of the self-interest managers have in M&As is increasing personal prestige. Making deals which are not unpopular are not a good way to doing so. Management was blamed for wasting taxpayer’s money in their “*American conquest*”.²⁴² The media, however, have not presented proper analysis of how much Stora Enso actually lost as a result of the deal.²⁴³

6. Discussion: What actually caused Stora Enso's losses?

In this section, the results obtained are analyzed further. This includes looking at the interdependence of the assumptions and the link between the assumptions and the valuation of the target company. The most critical assumptions in terms of the final losses for Stora Enso are identified. Furthermore, the potential for shareholder value creation foreseen at the time of the acquisition, Stora Enso's alternative investment prospects at the time as well as the final cost of the transaction for Stora Enso are assessed..

6.1. Interdependence of assumptions

It is clear that the assumptions made by Stora Enso management in conjunction with the Consolidated Papers acquisition are not independent. Rather, the assumptions and their correctness are closely linked to one another. In this section, their interdependence is assessed, with the aim of building a model that depicts the sensitivity of the acquisition to changes in its environment.

The interdependence of assumptions is assessed by combining them into chains. Assumptions belonging to the same "chain" are interrelated. In addition, the correctness or incorrectness of some assumptions is also linked to other chains. Hence we have a model that describes factors affecting the correctness of the assumptions and depicts the causality of these factors. By interdependence, we mean, for example:

- The assumption "M&A are preferential to greenfield investments because the risk is smaller" is linked to the assumption "Stora Enso had vast competency within the organization in pulling mergers through" because they both have to do with management's attitude towards different strategic options.
- On the other, these two assumptions are not linked to the assumption "The capacity of CPI is the best in its industry and runs efficiently, because the latter has to do with Consolidated Papers operations on their own, while the former ones have to do with Stora Enso's management attitudes towards strategic actions.

The interdependencies of each factor are described in more detail in section 7.3, the assumption chains.

6.2. The link between the assumptions and the value of the target company

In an M&A transaction, the value of a company is typically calculated using several different methods. These include comparing the company to its peers by looking at valuation multiples to see how attractive the company's valuation is compared to its peers. When calculating the value of a company to an acquirer, however, the most typical valuation method is the discounted cash flow method (DCF), which is the sum of all future cash flows brought by the target to its parent discounted with the parent's demanded rate of return for the investment.

The formula for DCF is as follows:

$$\text{Present value of future cash flows} = \sum_{n=0}^{\infty} \frac{FCF_n}{(1+r)^n} = \frac{FCF_1}{(r-g)}$$

The present value of future cash flows is the sum of all future cash flows, but this can be simplified so that the free cash flow of the first year is used as the base assumption, after which the following cash flows are estimated using a constant growth term (g). R signifies the rate of return demanded for the investment, and in the simplified case, it is assumed to be constant to perpetuity.

The formula for free cash flow calculation can be further separated. By definition, free cash flow is defined as follows:

- $FCF = \text{Net income} + \text{Depreciation/Amortization} - \text{changes in working capital} - \text{Capital expenditure}$

In other words, the free cash flow term is roughly equal to:

- $\text{Revenues} - \text{Costs} - \text{Investments}$.

In the paper industry, revenues can be approximated by multiplying the volume of paper sold by its average price, i.e. $\text{Revenues} = \text{Volume} * \text{Price}$

- Costs, on the other hand, can be divided into variable and fixed costs, i.e. $\text{Costs} = \text{Volume} * \text{Variable cost} + \text{Fixed costs}$

Therefore, our approximation for free cash flow in a given year is:

- $FCF = \text{Volume} * \text{Price} - (\text{Volume} * \text{variable cost} + \text{Fixed costs}) - \text{Investments}$

The growth term can also be broken down further in a similar manner.

- $\text{Growth} = \text{Growth in price} * \text{Volumes} + \text{Growth in volumes} * \text{Price}$

For the purpose of the model, we may therefore divide the assumptions made into six categories:

- Volume and growth in volume
- Price and Growth in price
- Variable costs
- Fixed costs
- Investments
- Weighted average cost of capital

These are further interlinked so that investments may affect growth in volume, growth in price (in case of R&D investments where products are improved), variable and fixed costs.

For each of the six factors, we may now identify assumptions and outcomes of events that correspond. By doing so, we may link the acquisition assumption model to the DCF valuation model.

6.3. The assumption chains explained

In this section, the rationale for each assumption chain as well as the links to the valuation model are presented and elaborated.

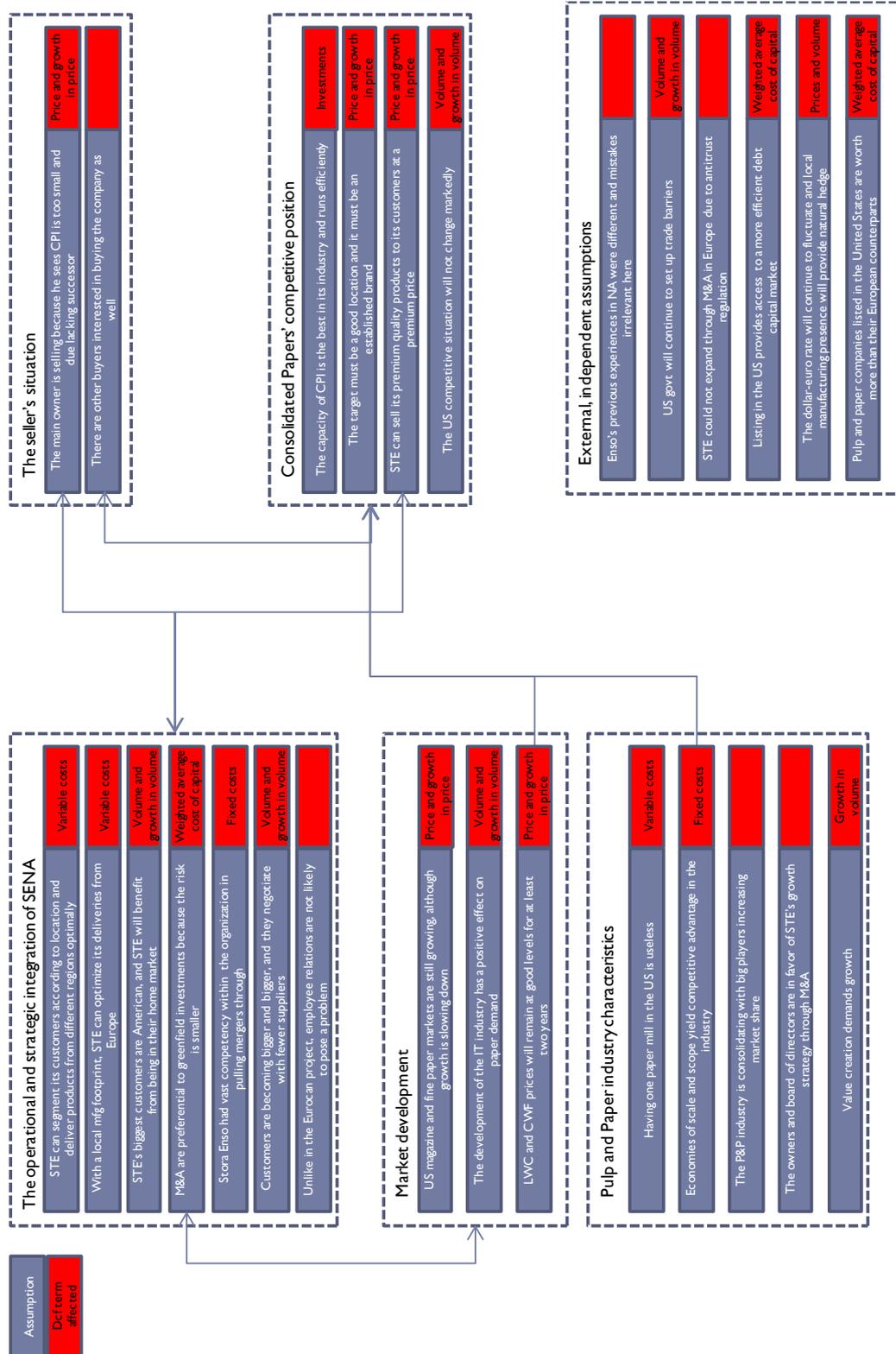


Figure 36 Assumption interdependencies and their link to the discounted cash flow valuation model

Chain 1 – The seller’s situation

Assumption	Outcome	Grouping	Link to	DCF term affected
The main owner is selling because he sees CPI is too small and due lacking successor	Yes, to some extent but also because the market outlook was seen increasingly grim	1	3	Price and Growth in price
There are other buyers interested in buying the company as well	Yes, There were 6 interested companies, two of whom presented final bids	1	2	

The assumption that the seller was selling due to his own personal circumstances rather than a desire to exit the market because of foreseen poorer market conditions is closely related to there having been competition over Consolidated Papers. It seems that most bidders for the company must have had a more positive outlook on the market than the seller did. The six bidders were interested in the company because of the condition of its capacity, its reputation in the market as well as the desire to increase market power by consolidating the industry. This links this chain to the chain “2 – Consolidated Papers’ competitive position”. Furthermore, the deal was carried out with buyer assuming healthy future market development, while the seller saw it increasingly grim. This links the chain mostly to price and growth in price in the DCF formula. It also links this chain to chain 3 – The operative and strategic integration of SENA.

Chain 2 – Consolidated Papers’ competitive position

Assumption	Outcome	Grouping	Link to	DCF term affected
The capacity of CPI is the best in its industry and runs efficiently	Performance gap between CPI and new Asian players grew large, causing need for significant investments	2		Investments
The target must be a good location and it must be an established brand	SENA held its positions rather well, and managed to exert some control over prices	2		Price and Growth in price
STE can sell its premium quality products to its customers at a premium price	Premiums were not obtained to a significant extent even though European paper was of better quality	2	3	Price and Growth in price
The competitive situation in the United States will not change markedly	Asian players entered the market, disrupting the balances between demand and supply	2		Volume and growth in volume

Consolidated Paper’s competitiveness and the competitive environment form the second chain of assumptions. The assumption of Stora Enso management was that CPI’s operative efficiency was at a good level and that its capacity was competitive in comparison to other US paper producers. This assumption was supported by the premium prices Consolidated Papers was able to receive due to its good quality and good customer service. It was not, however, supported by Consolidated’s financial performance which showed strong deterioration between 1995 and 1999.

When the market declined, this efficiency helped SENA, formed by combining Consolidated Papers to Stora Enso’s existing Port Hawkesbury mill, to protect and even gain in market

share. The prices overall as well as the price premiums obtained by SENA, however, diminished due to increasing competition from Asian players that also caused significant price erosion.

The increasing presence of Asian players to the US market caused the assumption of the competitive field remaining unchanged to be incorrect. The Asian player's state of the art production capacity also helped prove wrong the assumption of the efficiency of Consolidated Papers' production capacity. According to a competitor interviewee, an increasing performance gap was formed between Asian players and US paper producers, causing part of the poor profitability of the Americans. Asian players not only produced good quality paper, but their customer service was also at a high level, eroding price premiums obtained previously by leading American producers. In addition to the entrance of Asian players, supply and demand has also been affected by American producers' attempts to close down production. A good example of this is SENA's major restructuring attempts. According to a competitor interviewee, however, these measures have not been successful, because capacity has been closed at the poorer end, while good quality capacity continues to increase its efficiency. In effect, the reduction in supply is hence less substantial, lessening its effect on the imbalance of demand and supply.

This chain of events also destroyed Stora Enso's assumption that it could sell its European "premium products" at a premium prices. American customers did appreciate the good quality, but were not willing to pay for it as Stora Enso's management had assumed. American customers were used to American paper, and preferred that even after the acquisition, when Stora Enso attempted to optimize its deliveries from its production facilities in the United States, Canada and Europe. This chain of assumptions is significant to the valuation of SENA, because it has a strong effect on the price factor, which in turn plays a key part in determining revenues.

The assumption behind Stora Enso's customer management links this chain of assumptions to the chain "3 – The operational and strategic integration of SENA"

Chain 3 – The operational and strategic integration of SENA

Assumption	Outcome	Grouping	Link to	DCF term affected
STE can segment its customers according to location and deliver products from different regions optimally	Customer synergies were not realised to their full potential	3		Variable costs
With a local mfg footprint, STE can optimize its deliveries from Europe	Customers were used to receiving CPI paper, and did not want European paper	3		Variable costs
STE's biggest customers are American, and STE will benefit from being in their homemarket	Benefit difficult to quantify, but market share did grow in the beginning	3		Volume and growth in volume
M&A are preferential to greenfield investments because the risk is smaller	With declining prices and falling US dollar, greenfield would only have made markets worse	3	5	Weighted average cost of capital
Stora Enso had vast competency within the organisation in pulling mergers through	Operational intergration of CPI went well	3		Fixed costs
Customers are becoming bigger and bigger, and they negotiate with fewer suppliers	Customers became larger, but still kept many suppliers onboard	3		Volume and growth in volume
Unlike in the Kitimati project, employee relations are not likely to pose a problem	Employees accepted the new owner, but trade unions managed to obtain significant additional benefits	3		

This chain of assumptions has to do with how well Stora Enso managed to integrate its North American operations. The basic assumption of Stora Enso management was that there was a vast competency within the company to pull through large mergers. This assumption was based on Stora Enso's previous experiences which were perceived successful by management. While overall Stora Enso management still feels that the operational integration of Consolidated Papers went well, the scene on the customer side was different. Competence in this field affects the amount of fixed costs the company is able to eliminate.

According to Stora Enso management and implementer interviewees, the sales culture between Consolidated Papers and Stora Enso was different, causing some challenges in the sales front. Customers took advantage of these difficulties. This limited Stora Enso's ability to exploit its increased market power. Furthermore, customers were unwilling to accept Stora Enso's attempts to optimize its deliveries from its different locations. This affected the variable costs factor. The assumption that Stora Enso would be able to exploit local presence also in relation to European production did not prove correct in this market. Some benefits were attained, however, because Stora Enso was able to serve its American customers' European operations due to its local presence in the US. On the other hand, according to a competitor interviewee, size can also be a negative characteristic if customers have purchasing policies that restrict the amount bought from one supplier. This aspect of customer management affects the volume term of the valuation model.

Related to this issue is the alternative course of events that could have taken place if Stora Enso had instead decided to invest in greenfield projects instead of buying an established player. In declining markets, this would have been a very risky project, as a newcomer would

have had to fight for market share with price in the absence of a good reputation. A more risky project would have required a higher cost of capital attached to it. This assumption also links the chain of assumptions to the chain “5- Pulp and paper industry characteristics”.

Chain 4 – Market development

Assumption	Outcome	Grouping	Link to	DCF term affected
US magazine and fine paper markets are still growing, although growth is slowing down	Growth stopped to a large extent when the IT bubble burst	4		Price and Growth in price
The development of the IT industry has a positive effect on paper demand	Technological development has started to reduce paper consumption	4		Volume and growth in volume
LWC and CWF prices will remain at good levels for at least two years	Prices fell strongly beginning in 2001	4	2	Price and Growth in price

In a growing market, making greenfield investments is more lucrative because of the possibility to obtain state of the art capacity. In 2000, Stora Enso management did not deem this option to be viable, however, because only limited growth was foreseen. Nevertheless, the good prospects of the printed and fine paper markets caused inflated asset prices, linking this chain to chain 1 “the seller’s circumstances”.

The growth of the paper market was expected due to the assumption of continued strong economic growth, which the United States has seen during the 1990s. The growth was largely attributed to the growing IT industry, which was causing a decline in newsprint, but a surge in printed paper demand in the form of increased advertising. The IT bubble burst in 2000, which was a partial reason for an economic downturn, reflected strongly also in the paper market. Prices were down both because of declining demand, but also due to the entry of Asian players, linking this chain also to chain 2. In 2000, the fundamental correlation between economic growth and paper consumption was broken. This can be partially attributable to the gradual shift in advertising away from printed media to the internet as well as trends to reduce paper consumption in offices as a means to help the environment. This chain can be considered significant in determining the value of SENA, because it effects both growth and volume figures.

Chain 5 Pulp and Paper industry characteristics

Assumption	Outcome	Grouping	Link to	DCF term affected
Having one paper mill in the US is useless	Yes, the Port Hawkesbury mill would not have succeeded on its own due to poor location	5		Variable costs
Economies of scale and scope yield competitive advantage in the P&P industry	Examples of both large and small successful companies exist	5	2	Fixed costs
The P&P industry is consolidated with big players increasing market share	2001 marked the end of the consolidation trend for now	5		
The owners and board of directors are in favour of STE's growth strategy through M&A	Yes, to begin with but later board rejected global strategy and divested SENA	5		
Value creation demands growth	M&As in the industry have generally not proven to be very successful	5		Growth in Volume

This chain of assumptions looks at assumptions that have to do with industry fundamentals. A key fundamental that was believed is that economies of scale and scope bring significant benefit in the pulp and paper industry. This in turn led to the idea that having only one paper mill, Port Hawkesbury, is useless because there are few synergies obtainable. Furthermore, it was believed that the industry was strongly consolidating, with larger players becoming larger, and smaller players disappearing from the market. Stora Enso wanted to be a consolidator and therefore actively sought M&A opportunities. This was part of their official and public strategy, endorsed by the board. It was also assumed that growth is a key value driver. As one management interviewee said “*basic valuation models require a growth term*”²⁴⁴ as has been shown in the beginning of this section. Several of these assumptions have failed to realize during the last decade. First of all, there are both small and large pulp and paper industry companies that have managed to be successful. The consolidation trend of the industry has practically stopped, because the benefits of consolidation have been difficult to realize in a declining market. According to a competitor interviewee, size, which traditionally has brought benefit in the form of better market power towards customers and suppliers, as well as increased internal efficiency, has not brought these benefits during the last decade as expected. Companies involved in mega-mergers, such as Stora Enso with Consolidated Papers, and International Paper with Champion have seen their acquisitions form a considerable drain rather than a profit driver. On the other hand, smaller players such as Hollmen in Sweden or Myllykoski in Finland have managed to stay viable, and have at times seen even better profit margins than their larger competitors.²⁴⁵ In other words, value creation has not demanded growth, but rather growth at high asset prices has destroyed value. While it is true that Stora Enso's lone paper mill in Canada was an unprofitable concept, the reason was probably not the size of the unit alone.

The board of directors, which in 2007 still had the same chairman and one other member, as at the time of the acquisition, has since lost its belief in the need to operate globally. To

succeed Jukka Härmälä, they chose Jouko Karvinen, who has made it clear that profitability is his key priority, even if it means downsizing the company significantly. The board is therefore currently endorsing an opposite trend in order to maximize profitability. The reversal in this trend is significant, and could be one of the reasons why Stora Enso lost faith in its North American division and sold it. Originally, the time horizon for the Consolidated Papers acquisition was much longer than the seven years the company was owned by Stora Enso.

According to an adviser involved in the deal, the halting of the consolidation trend was to be expected after market prices for paper fell. For smaller players willing to divest mills or to merge with larger players, it was impossible to get the prices for assets that were hoped for. The larger players, on the other hand, seem to be waiting for smaller players to go out of business.²⁴⁶ In a declining market, capacity closures would be needed to improve price levels and see to it that operative capacity attains sufficient usage. The so called free rider problem has caused even large players to have severe difficulties in getting price increases through. A good example of this is NewPage, the company that bought SENA, which has a leading market share in many of its products²⁴⁷, but, according to an adviser interviewee, still hasn't managed to affect prices positively due to smaller players who keep in hampering the market.²⁴⁸

This chain of assumptions links to several parts of the DCF model, the growth in volume term, the variable and fixed cost terms, and can be considered a significant chain for the value creation resulting from the acquisition.

External, independent assumptions

This group of assumptions is by nature independent and affects the picture in different ways.

Assumption	Outcome	Grouping	Link to	DCF term affected
Enso's previous experiences in NA were different and mistakes irrelevant here	Yes, problems with SENA did not have to do with location nor trade unions	6		
US govt will continue to set up trade barriers	Yes, strong Euro caused no need against Europe, but antidumping suits against Asians have been seen	6		Volume and growth in volume
STE could not expand through M&A in Europe due to antitrust regulation	Yes, it seems likely	6		
Listing in the US provides access to a more efficient debt capital market	Yes, Stora Enso was readily offered credit	6		Weighted average cost of capital
The dollar-Euro rate will continue to fluctuate and local manufacturing presence will provide natural hedge	Yes, Dollar-Euro fluctuated, and strong Euro made American production competitive from 2005 onwards	6		Prices and volume
Pulp and paper companies listed in the United States are worth more than their European counterparts	The valuation gap diminished during the 2000s	6		Weighted average cost of capital

The listing of Stora Enso in the NYSE was part of the deal structure, but it also meant that Stora Enso could have better access to debt capital markets and perhaps obtain cheaper credit. This assumption can be considered to have held during the time Stora Enso was listed there (until 2008) this has affected the valuation of SENA positively, as it has lowered the company's cost of capital.

The assumption that the US government would set up trade barriers for trade in case of a strong US dollar is one which increased the value of the target company, because setting up trade barriers helps secure more revenues for domestic manufacturers. Although the weakness of the US dollar against the euro led to no need for such barriers against European companies, Asian manufacturers have been targets for such government action during 2000 - 2007 several times, as seen in previous sections.

The fluctuation of the US-dollar euro exchange rate was a factor which was deemed completely unpredictable by Stora Enso management. With a weak US dollar, local US based capacity was more competitive than European imports, so in this sense, the weakening of the US dollar helped SENA's local operations somewhat. The general poor price development, however, mitigated the positive effects of this. Only 2006 onwards, the general good price development has helped secure positive operating margins in dollar terms for US paper manufacturers.

6.4. Identification of the most critical assumptions

Looking at the list of over 20 assumptions gathered and analyzed, it is clear that they have not all been equally important in determining the value of the target company for Stora Enso. To answer the primary research questions of this report, why Stora Enso bought Consolidated, and which factors hindered attaining the preconceived benefits of the acquisition, the most critical assumptions must be identified. This leads us to a list of four key lessons that show what developments Stora Enso management failed to foresee when acquiring Consolidated Papers.

Out of the five assumption chains and the group of independent assumptions, three seem to be most critical. They are market development, Consolidated Papers' competitive position and the US dollar / euro exchange rate.

Market development

By buying Consolidated, Stora Enso management bought a front row seat in a market perceived to be growing. The investment calculation was based on hope that demand was to remain strong and prices steady. Instead, the bursting of the IT bubble led to a recession in the United States, and demand for paper fell. The paper industry did not manage to control supply sufficiently, which led to a long lasting slump in paper prices. Stora Enso management had failed to foresee correctly this development. What was also crucial was that paper consumption trends were changing, and the relation between GDP growth and growth in the consumption of many paper grades was broken. The change in demand is probably the factor that most harshly affected the value of Consolidated Papers for Stora Enso, leading us to the first lesson:

- 1) Stora Enso management failed to foresee that the economic cycle would turn so suddenly and that the structure of demand for paper was fundamentally changing.

Consolidated Papers' competitive position

Stora Enso bought Consolidated Papers because it was supposed to have the best capacity in the industry. Its machines wouldn't require heavy investment. While demand for paper in the United States started to fall, the American paper industry was facing issues with its own competitiveness against increasing Asian and especially Chinese competition. These players were able to produce good quality paper inexpensively and presented a challenge to US paper manufacturers who operated with older capacity and had higher labor costs. The increasing presence of Asian players had already been noticed by Consolidated Papers, whose profitability had weakened dramatically between 1995 and 1999.²⁴⁹ This development was probably one of the reasons why Consolidated Papers main owners were willing to exit the paper industry. Lesson number two is therefore:

- 2) Stora Enso management failed to see the increasing presence of Asian paper manufacturers as a market disrupting threat

One key rationale behind the deal for Stora Enso was that they thought they would be able to further improve the operational efficiency of Consolidated Papers. As mentioned, Consolidated Papers' profitability had constantly weakened since 1995, and Stora Enso

management assumed they could stop and even reverse this trend.²⁵⁰ Yet, the value of these synergies was modest compared to the premium paid to Consolidated Papers' shareholders, and furthermore, the level of operational synergies targeted was not attained. In fact, Consolidated Papers' employee costs spiraled despite heavy layoffs.²⁵¹ The premium, on the other hand, would have been justified only if Consolidated Papers' profits and cash flows would have significantly improved. This leads us to the conclusion that:

- 3) Stora Enso management was overconfident in its ability to turn Consolidated Papers weakening profitability trend around.

The US dollar / euro exchange rate

A further reason for the acquisition was that Stora Enso could gain a stronger foothold in the North American market, also for its products produced in Europe. To begin with, the strong US dollar made exporting paper to the US from Europe very profitable, and Stora Enso could inherit North American customer relationships from Consolidated Papers to its benefit. In the years that followed, however, the US dollar weakened significantly, making selling European paper in the United States a lot less profitable. Stora Enso management had assumed that the dollar / euro exchange rate could fluctuate, but did not expect such a radical weakening of the US dollar. The weakening did make SENA's own production more competitive, but on the other hand hampered production optimization. It was an important reason why Stora Enso's euro denominated losses as a result of the acquisition and divestment of Consolidated Papers were so large, as euro-denominated cash flows were coming down. Stora Enso had hedged its physical assets against currency risk, but not its future cash flows. The adverse development of the US dollar was one of the reasons why SENA was divested – chairman Dahlbäck called it “*a burden*”²⁵² because euro-denominated revenues, and hence the euro value of North American business were falling so much. This leads us to our fourth lesson:

- 4) Stora Enso management showed insight in creating a natural currency hedge but did not expect the US dollar to weaken as much as it did

All of the lessons boil down to how difficult it is to predict the future accurately. In this case, Stora Enso management had a seemingly overoptimistic view on the development of their environment. All but one of these factors were beyond the control of Stora Enso – The only way management could influence the outcome was to control the acquisition price. With a

lower price, on the other hand, Consolidated Papers would have been sold to someone else. In other words, in order to want to make the acquisition, one had to have a rather rosy picture of the future. The heavy bidding for Consolidated Papers, furthermore, suggests that this view of the future was shared by many throughout the industry – with the support of boards of directors and the financial markets.

6.5. The question of shareholder value

Acquisitions generally aim at increasing the short term or long term value of the acquiring company. In many cases, however, the key benefactors are the target's shareholders. (see, for example Bruner, 2002) In this section, the acquisition's prospects of increasing shareholder value to Stora Enso's pre-deal shareholders are discussed.

There is no doubt that the management of Stora Enso thought that the Consolidated Papers acquisition would bring benefit to the company. The strategic rationale in light of the information available was clear, although there was some overconfidence in how much Stora Enso could improve Consolidated Papers' performance. Yet the same rationale was seen by many other competing companies too. This caused the price of obtaining the strategic benefits to rise dramatically – It was a seller's market. Given the high price, how was the Consolidated Papers acquisition meant to benefit Stora Enso shareholders? Answering this question requires assessing Stora Enso management views on what shareholder value actually is.

At the time of the acquisition, Stora Enso had a publicly communicated target for return on capital employed of 13%. Historically, this was a high figure for a pulp and paper company, but in 1999-2000, the market was very favorable for the industry and these figures were being met both by Stora Enso and many of its competitors including UPM-Kymmene.²⁵³

Return on capital employed (ROCE)²⁵⁴ was a measure being followed widely in the industry.²⁵⁵ The significance of the 13% ROCE target in day-to-day management, however, is questionable. A Stora Enso management interviewee said:

“I never really understood where that target rate came from ... If you own forest or hydroelectric dams, attaining 13% is very difficult because they usually yield a return of around 5%. The return is stable but rather moderate.”²⁵⁶

In Stora Enso's calculations, the price offered for Consolidated Papers was deemed high. Yet, according to projected price calculations, the forecast rate of return for the acquisition met a hurdle rate set for acquisitions. According to an adviser involved in the deal, the rate of return forecast was higher than the company's cost of capital. According to a management interviewee, the deal was "value neutral", in other words, it was not supposed to neither create nor destroy shareholder value significantly for Stora Enso.²⁵⁷

The synergies anticipated between Stora Enso and Consolidated Papers were supposed to amount to approximately \$110 million a year. Using Stora Enso's weighted average cost of capital of 9,3%,²⁵⁸ the synergies were valued to be at around \$1,2 billion. When the equity price offered for Consolidated Papers was \$3,6 billion, representing a 69% or approximately \$1,5 billion dollar control premium compared to the share price right before the acquisition was publicized, it is clear that the Consolidated Papers shareholders received more than 100% of the theoretical value created in the deal. Stora Enso's cash flow projections therefore assumed that the market was undervaluing the standalone company before the acquisition. Since Stora Enso's and the equity market's perception of the standalone value of Consolidated Papers differed significantly, it is hardly surprising that Stora Enso's share price reacted negatively when the deal was made public, dropping around 15%.

According to an investment banker, a drop of around 10% was expected, due to the dilution of shareholding in the company and the high price. For Stora Enso management, the extent of the drop was more of a surprise. Generally, however, they knew that markets usually react to acquisitions negatively, as it takes time for the market to understand the value creation logic of such a large transaction.²⁵⁹

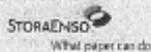
Given that the value created from synergies was transferred to the target company shareholders and that there were several uncertainties involved including the creation of synergies, the taking through of a savings program at Consolidated Papers, and the success of post merger integration, it is fair to ask whether the deal ever had any chances of creating shareholder value all other factors remaining equal. According to a consultant involved in the valuation process, the price paid significantly exceeded their valuation of the company, but said that the valuation and the price paid can differ significantly when dealing with an auction. As mentioned, Stora Enso had "*crafted the highest possible justifiable offer*"²⁶⁰ for Consolidated to tackle competing bidders. It was therefore a well known fact by all relevant parties that the price paid was high.

Stora Enso's rationale, however, was that the acquisition was the first step in their North American strategy.

*"We saw that this (Consolidated) on its own, its ROCE would stay somewhere around 8%, clearly less than what it in principle should have been. But then our thought was that, to lift the ROCE, we'd use our foothold and then we could by single pieces which would then start improving the whole. We didn't intend to stay at that return level or that entity."*²⁶¹

While this deal was "value neutral", its price could be compensated for by buying smaller units in North America and integrating them to SENA, which, according to Stora Enso management, had a strong management team in place. These additional units could even have been individual mills without management teams in place. Using the North American platform in such a way would have enabled creating value by enabling the combination of local synergies between North American mills to the global customer and production optimization synergies attained from combining North American and European operations. This rhetoric was repeated often in Stora Enso's publications, a good example of which is an R&D conference where CEO Jukka Härmälä presented the following slide. An adviser involved in the deal, however, stated clearly that any continuation plans and gains thereof were not factored into the valuation.²⁶²

Basic Assumptions about Future Business Environment



- Forest industry structure is still fragmented. Consolidation will continue in the years to come
- Consolidation will take place both through mergers as well as acquisitions
- Main transaction instrument in mega M&A's will be stock or a combination of stock and cash
- Hostile takeover bids and bidding wars will not be unusual
- Building new capacity is viewed with suspicion by investors
- E-commerce will reshape our business

Conclusions



- Successful integration of Consolidated Papers is our main task
- Still some room for M&A's in Europe although high market share is limiting factor
- Second step in North America – could be a single mill as well
- Consolidation and strengthening of assets in Asia
- New capacity requires divestment of assets considered non-core and to close obsolete facilities
- Langerbrugge PM4 is Stora Enso's main capex 2001 and 2002. This decision restricts capex elsewhere
- Use of eCommerce to create value
- Critical re-thinking of core competencies and their impact on corporate structure

Table 6 Two slides from a Stora Enso hosted R&D conference in February 2001²⁶³

An adviser to Stora Enso said that the board had discussed the price for a long time. They were aware that it was a very high price to pay. In the end, it boiled down to a bet concerning market prices for the paper products involved. In hindsight, one can say that since the prices declined so heavily, the bet failed. A key question that had been particularly addressed by Stora Enso management, stated both by the adviser and a management interviewee, was whether the company can survive having done the deal. The adviser involved said that Stora Enso management was well aware of the fact that many acquisitions done when the economy is “hot” and when asset prices are high can lead to serious trouble, especially when financed with debt. Stora Enso also had the possibility to finance the whole deal with debt and was prepared to pay the price fully in cash in case they wouldn't have managed to list their ADR in the NYSE by a given time.²⁶⁴ Instead, however, Stora Enso took a more conservative approach and financed the deal with equity. This significantly lowered the risk of the acquisition, and has probably helped the company keep afloat even as its markets deteriorated both in the United States and Europe. This, according to the adviser, was a sign of management insight from Stora Enso's top management team and board.²⁶⁵

In addition to the above mentioned continuation plans, an issue discussed by management at the time was the so-called valuation gap between US and European stock prices. Stora Enso management was aware of the fact that foreign companies that list in the United States tended rise in value following the listing, due to a broader access to potential investors and better availability of financing. This was mentioned as a key value creation driver by some management interviewees, although others said that while they were aware of this, it was not a reason for the acquisition.²⁶⁶

Other reasons stated were that, given that the industry was consolidating, this acquisition meant that Stora Enso would become a global leader in its industry. An adviser close to the deal said the acquisition made Stora Enso a “*consolidator rather than a consolidatee*”²⁶⁷. “*International Paper could no longer be mentioned without also noting Stora Enso*”²⁶⁸, which had previously suffered in the eyes of investors from its large government and family ownership. His personal view was that, had Stora Enso not carried out the deal, it probably would have been acquired itself at some point. Other, non-quantifiable benefits are the customer synergies Stora Enso allegedly received from the deal. A management interviewee claimed several times that the deal gave access to the European operations of such customers as Time Inc, which previously had not bought from Stora Enso.²⁶⁹ The additional revenues and profits resulting from this are not publicly available, making this statement difficult to verify.

On the whole, however, it is a fair question to ask whether the main benefactor from the acquisition was meant to be Stora Enso as a company or its shareholders. In the Finnish pulp and paper industry, there has been a long history of prioritizing growth before profitability. (Lamberg, 2007) This has been shown several times in the history of the Finnish pulp and paper industry, and was mentioned as a key trait of the industry by a competitor interviewee. For Enso, this has been a particular issue, because of its government ownership. The Finnish government had used its companies for other means than shareholder value maximization as well, including supporting its regional employment politics.²⁷⁰ Large scale investments had been made with very low returns on investment. (Lamberg, 2007) The CEO Jukka Härmälä was not a pulp and paper industry veteran when he joined the company in 1993. Instead, his background was in banking. The interviewees mentioned that in the 1990s, shareholder value and the pricing mechanisms of shares were on the table frequently, and were an important issue. Yet, with such a legacy, and many management team members that had managed the company also in times when shareholder value was not that important, was the Consolidated

Papers acquisition really meant to maximize shareholder value? From a strategic perspective it seemed like the right thing to do at the time for the company, but the benefits were given mostly to Consolidated Papers shareholders already beforehand, in the form of cash and a significant portion, 18%, of Stora Enso stock. Stora Enso shareholders were left with a risky, but yet “value neutral deal.”

On the other hand, one may ask who would have benefited if Stora Enso itself had been acquired. Statistically, the largest gain would most likely have come to Stora Enso’s shareholders as is the case with most M&A transactions. (See for example, Bruner, 2002) Another question is whether the new owner would have regarded keeping production in Finland and Sweden as being that important.

The question of shareholder value can be summed up rather well in the words of an adviser interviewee who said: *“Does Stora Enso management regret doing the deal – Probably yes, but did the company survive? Yes, and did it make it a significant global player in the market? - yes”*²⁷¹

6.6. The effects of the deal on Stora Enso’s other operations – What else could Stora Enso have done?

When a company with sales of 10,6 billion euros in sales (1999)²⁷² invests 3 billion euros in cash, and 5 billion counting equity, such an investment is bound to have an effect on the company’s other prospective investments.

When SENA was divested in 2007, Stora Enso was simultaneously dealing with the issue of closing its Kemijärvi pulp mill. This became a heated political debate in Finland, with many demanding that the government, the major stockholder in the company, take action to prevent this and other closures. There was also speculation in the press that the failed investment in the United States was a reason behind closing the Kemijärvi mill. At the time, Helsingin Sanomat, a leading Finnish newspaper wrote *“According to Stora Enso country manager Aulis Ansaharju, the reason for the closure of the mill is not bad profitability, but the rising price of raw material. The workers at the factory, on the other hand, think they have to pay for, for example, the unprofitable America-venture Stora Enso had taken part in”*.²⁷³ At the same time, a left wing Member of Parliament was quoted saying *“The American adventure is now being charged from other units”* while referring to the closure of Kemijärvi.²⁷⁴

Stora Enso, however, had acquired Consolidated Papers with rather conservative deal terms. While it could have financed the whole purchase with cash and debt, it chose to pay 50% of the equity price by issuing new stock. This considerably decreased the risks involved with the deal, even though the market turned down. This is well depicted by looking at Stora Enso's debt / equity ratio in the following chart, which remained at sustainable levels throughout the holding period 2000-2007. In fact, according to the former CFO, owners demanded additional payouts, after which the company acquired and cancellation a substantial amount of its own shares. This was meant to prevent the company's balance sheet from becoming sub-optimal.²⁷⁵ These additional payouts were carried out even when SENA was still very unprofitable. It is therefore not fair to say that the SENA "venture" would have been the reason for other closures.

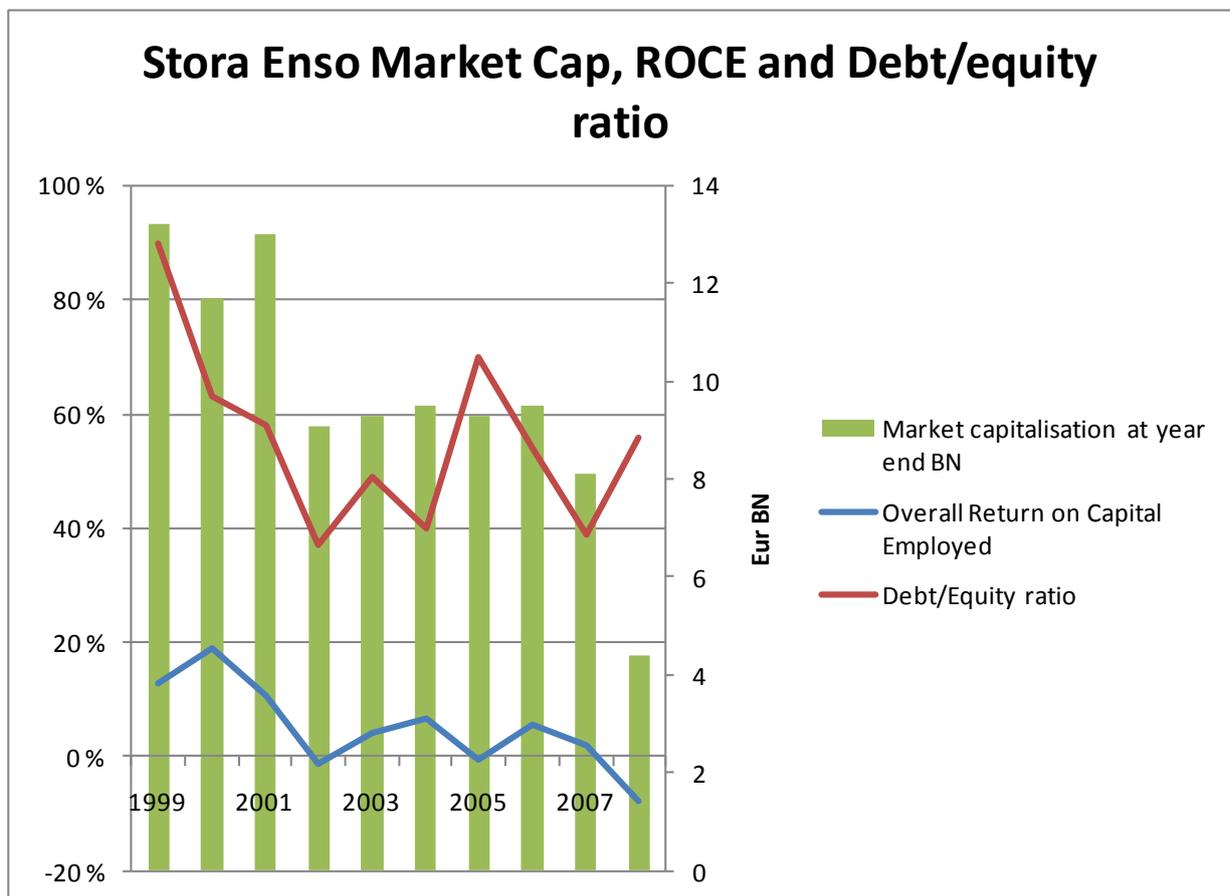


Figure 37 Stora Enso market capitalization, return on capital employed and debt/equity ratio 2000-2008²⁷⁶

When asked the question, what alternative scenarios Stora Enso had at the time, Stora Enso management interviewees gave differing answers. These included buying something else in the United States or investing in a joint venture in Asia. Investing heavily in China, however, was not considered a viable option at the time.

*“I’ve sometimes thought that if we had proposed giving up the US deal and hence not going to the World’s largest paper market, and instead we had suggested putting a billion into China, it would never have been accepted. I’m positive about that.”*²⁷⁷

South America and China had been identified as strong areas in the future, but first the company had felt the need to secure its home market position in the United States. In doing so, Stora Enso would have two solid home markets. It could then use cash flow from both markets to fund its more risky investments in emerging markets.²⁷⁸

*“We would anyway have had to use the money (from hydro electric power plants) on something”*²⁷⁹, stated one interviewee. Therefore a large scale payout of dividends would have been unlikely. As can be seen from Stora Enso’s overall profitability during this time, the money invested would not very likely have obtained a satisfactory rate of return even if it had been invested somewhere else. In general, investing in the pulp and paper industry in 2000 has been a poor investment. It is also possible that Stora Enso might not have sold its power plants. In this case, Stora Enso would have been a lot more profitable, as owning the power plants has since been very profitable for the buyer Fortum.²⁸⁰ A comparable example is UPM-Kymmene, which failed in its attempt to take over Champion International. As a result, it paid an extraordinary dividend, and acquired a smaller Canadian operation, Repap Canada. It has later regretted the acquisition in Canada and closed down the mills it bought. UPM-Kymmene has also been an active player in both South America and Asia. UPM did not sell its power plants, and in recent years, a large part of its profits have in fact come from electricity sales.²⁸¹

In retrospect, one could think that investing in new efficient mills in China would have been a sensible course of action since it has later on proven to be one of the best places to make paper profitably. China and South America were in Stora Enso’s plans, but first the idea was to build a strong home market in North America.²⁸² It is unfair to say, however, that the Consolidated Papers acquisition and the fact that its cash flows were weaker than expected would have severely hampered Stora Enso’s ability to invest in interesting ventures. This claim is supported by the fact that Stora Enso began acquiring its own shares to optimize its capital structure.²⁸³ In other words, it was seen wiser by the board to pay out a significant part of the balance sheet than to invest it.

6.7. What was the extent of Stora Enso's losses as a result of the acquisition and subsequent divestment of Consolidated Papers and Stora Enso North America?

In the media, Stora Enso has been heavily criticized for the losses it incurred by first buying Consolidated Papers in 2000 for a high price and then selling it in 2007 for a considerably lower price. The deal has, for example, been chosen in a newspaper poll as the worst deal in Finnish corporate history.²⁸⁴

Estimates of the final cost of the whole North American excursion vary between one and six billion euros. The calculations have been done with variable rigor.

The aim of this section is to give a fair representation of the cost of the transaction, and to identify factors that have to be assessed. The section consists of four parts. In the first part, we look at estimates presented by others, and assess their reliability. In the second section, we calculate losses by comparing cash flows in the acquisition and divestment processes as well as during ownership. In the third section, we provide another calculation by assessing accounting profits, while in the fourth section, we look at the effects of the acquisition on Stora Enso as a company, and consider how to treat the equitized deal structure so that pre-deal shareholders are adequately compensated for their diluted stockholding.

Previously presented analyses of the cost of the Consolidated acquisition

The primary analysis to be considered is the one presented by Stora Enso's current CEO Jouko Karvinen at the 2008 annual general meeting, right after closing the divestment of SENA.

He presented his calculation while saying that it is meant to be as simple as possible. It should therefore be treated as Stora Enso's view on the order of magnitude of the cost.

North America 2000 through 2007 

CASH FLOW	EUR million	No Sale - Impairment	EUR million
Initial Investment	-4 974	Impairment of Goodwill	-201
Cumulative Cash Flow	814	Impairment of Fixed Assets	-528
Total Prior Divestment	-4 160	Total Impairment in Q3/2007	-729
Divestment	2 162		
Total	-1 998		

Cumulative Cash Flow: EBITDA – CAPEX for the period 8/2000-12/2007, excluding Port Hawkesbury

Divestment: Total Enterprise Value disposed including assumed liabilities of EUR 314 million (USD 450 million) and USD/EUR hedge gains of EUR 408 million.

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Figure 38 Slide from Jouko Karvinen's presentation at 2008 Stora Enso AGM that estimates losses from SENA between 2000 and 2007²⁸⁵

According to the calculation, the total loss that occurred to Stora Enso was around 2,0 billion euros. There are, however, some problems in the calculation:

- Cash flow has been calculated by subtracting capital expenditures from earnings before interest, taxes, depreciation and amortization. EBITDA – CAPEX, however, is not the same figure as operating cash flow less investments. There are major differences in the two figures that owe to, for example, taxation of operational profits and changes in net working capital. Without further calculation, the effect of this difference is difficult to quantify.
- The treatment of Port Hawkesbury is problematic. Port Hawkesbury's cash flows have been left out of the operational cash flows. Port Hawkesbury is not part of the initial investment either, because it had already been built by Stora earlier. Yet, in the sale price, Port Hawkesbury was included. According to Stora Enso management team interviewees, Port Hawkesbury's operational cash flows were negative throughout the period and its value was negative at the time of divestment, because it was expected to be closed, which would have incurred costs. If this was the case, then the loss calculated is in fact too large.

- The positive taxation effects of making a loss have not been included
- The calculation does not take into account the time value of money.

Shortly after Karvinen presented his calculation, Taloussanomati, one of the leading economic dailies in Finland, criticized Karvinen's calculation for giving an over-optimistic picture of the true losses.

Taloussanomati's calculation was based on Karvinen's but it added a significant cost of capital of 6,4% to the investment. The journal itself admits its calculation to be imprecise as it assumes that all annual cash flows to be of equal size. Nevertheless, the adding of the cost of capital naturally increases the magnitude of the losses, to about 4,5 billion euros.²⁸⁶ This calculation could be criticized for adding a cost of capital that is too large. There is no risk involved in historical cash flows, so why discount them at a rate that assumes uncertainty? This calculation does not address problems with the treatment of Port Hawkesbury, nor does it take into account the positive taxation effects of making a loss.

In other calculations, the extent of the losses vary between 0,9 billion euros and 6 billion euros, depending on what rate of return one uses, and especially which currency one does the calculations in.²⁸⁷ It can therefore be assumed that making a calculation is not straightforward. They may be biased and make different assumptions.

A calculation of the extent of the losses carried by Stora Enso – Cash Flow method

In this section, a calculation is presented in a step by step manner. As many factors as possible have been taken into account. Naturally, some assumptions also have to be made. The aim of this is to provide a transparent and understandable calculation. This calculation has been shown to various parties, including former Stora Enso management team members and a consultant close to the paper industry, who was an adviser both in the acquisition and divestment processes. They have provided suggestions on how to correct the calculation, but care has been taken not to include any biased views on the matter. The steps of the analysis are:

- Establishing the final acquisition and divestment prices in dollars
- Calculation of the operational cash flows in dollars during ownership
- Assessing the correct cost of capital

- Calculation of the losses in US dollars
- Using appropriate adjustments, calculation of the losses in euros
- Calculation of losses to pre-acquisition Stora Enso shareholders

Establishing the final acquisition and divestment prices in dollars

When the deal was announced, the price per Consolidated Papers share of \$44 was based on Stora Enso’s share price at the time of announcement, in February 2000. This gave Consolidated Papers a total price of about \$4,0 billion in addition to about \$ 0,9 billion in assumed debt. Since part of the deal was financed, however, using Stora Enso equity, the acquisition price was also subject to variation. When the deal was closed on September 1, 2000, Stora Enso’s share price had fallen so that in total, equity value was \$3,564 billion and assumed debts had fallen to about \$800 million due to Consolidated Paper’s good profitability between February and September 2000.

Acquisition	\$ MM
Cash	2034
Stora Enso ADRs	1530
Assumed debt	800
Total EV	4364

Table 7 Final terms of the acquisition²⁸⁸

The company was sold, in term, in a deal that included cash, a vendor note given by Stora Enso to the buyer, NewPage, as well as a 20% holding in NewPage corp. At the time of making the deal public, these were valued as follows:

Sale	\$ MM
Cash	1526
Stock	370
Vendor note	171
Assumed debts	450
Total EV	2517

Table 8 Terms of the Divestment²⁸⁹

The vendor note had a face value of \$200 million, and in fact both the value of the vendor note and the ownership in NewPage have since been valued at zero due to NewPage’s financial difficulties.²⁹⁰ For the sake of the calculation, however, the values estimated at the time of the transaction are used because what happened after that was a separate decision and no longer had to do with the original acquisition.

In conjunction with the divestment, the value of Port Hawkesbury is problematic. Some Stora Enso management interviewees claimed that the value of the mill was negative at the time of divestment, because of the constant negative cash flows it produced. On the other hand, Swedish journal Affarsvärlden estimated that the value of Port Hawkesbury was significant, because it was in fact SENA's newest mill.²⁹¹ In the Finnish economic journal Kauppalehti, Port Hawkesbury was recognized as a liability after the divestment. "Port Hawkesbury's closure will cost NewPage \$500-600 MM".²⁹² To this day, however, Port Hawkesbury has not been closed, however. It is therefore probably a fair assumption that a mill constantly on the border line of positive cash flows is worth zero, because while it earns some cash flow now, its future closure will come at a cost.

Calculation of the operational cash flows in dollars during ownership

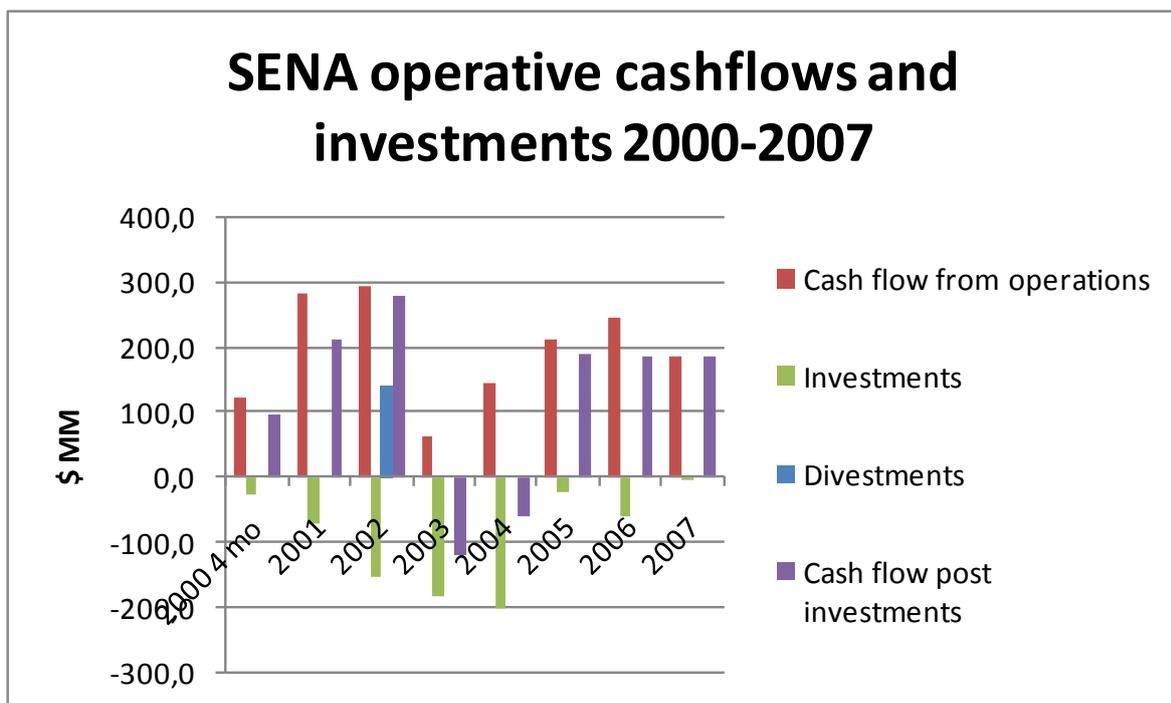


Figure 39 SENA operative cash flows and investments 2000-2007. Note 2005-7 figures calculated based on euro cash flows converted using yearly average exchange rates²⁹³

As can be seen in the above picture, Stora Enso North American managed to obtain positive cash flows from operations throughout the period. In 2003 and 2004 total cash flows were negative due to heavy investments. These values do not take into account any financing costs,

or gains from currency hedges. In total, the cumulative operative cash flows during this period were \$1543 million, investments \$724 million, the divestment of forest assets in 2002 for \$142 million, giving a total of \$961 million.²⁹⁴

One can also see that in terms of cash flow, 2006 and 2007 were rather good years. Operationally, 2002 was in fact the best year, although heavy investments brought total cash flows down significantly.

In order to keep calculations simple, we have assumed that cash flows from Port Hawkesbury were zero throughout the period. The reason for this is that according to Stora Enso management interviewees, Port Hawkesbury's cash flows were negative throughout the period. This is supported by the fact that, for example, during 2005-2006, the mill was closed due to profitability challenges, signaling negative cash flows.²⁹⁵ This was at a time when prices had already picked up. Yet in 2002, in conjunction with the SENA profit enhancement plan, the mill underwent expansion investments, signaling that there was still faith in its machines.

Assessing the correct cost of capital

The question of which rate of return would be appropriate for adjusting cash flows is difficult. On one hand, there is no uncertainty associated with historic cash flows. This would mean that the correct rate of return to be calculated would be a risk-free rate in US dollars, such as a treasury bill rate. Yet on the other hand, Stora Enso has had to pay interest on its debts and its shareholders have had a certain return on equity they would have expected to gain. This thinking, in turn leads to what many analysts and journalists have used, the WACC, or weighted average cost of capital.

Yet, one could think of the matter in terms of how much shareholders have lost if the money invested had been spent on something else. In such a case, Stora Enso could have paid off its debts, given the money out as dividends or invested it in its other activities. In this case, one could use the interest paid by Stora Enso in its debt, again the risk free rate, or Stora Enso's ROCE during 2000-2007.

The ambiguity of this matter is probably one of the reasons for the large spread in estimates of the total losses.

In this calculation, however, the risk free rate has been used. In this way, the losses can be calculated from a shareholders perspective.

The discount rate has been searched in such a way that for cash flows of a given year, the time left to the end of 2007 is calculated, and then the appropriate rate is looked up from the yield curve valid at the end of the given year. Note that cash flows of a given year have been set to occur at the end of each year.

Cash Flow Year	Point in Yield Curve	Yield curve rate in given year	Discount factor
2000	7	5,16 %	1,42
2001	6	4,61 %	1,31
2002	5	2,78 %	1,15
2003	4	1,84 %	1,08
2004	3	2,75 %	1,08
2005	2	4,37 %	1,09
2006	1	5,02 %	1,05
2007	0	0,00 %	1,00

Table 9 US treasury bond rates in different years and at different points in the yield curve²⁹⁶

Calculation of the losses in US dollars

\$ MM	2000 4 mo	2001	2002	2003	2004	2005	2006	2007	Total
Cash flow from operations	122,0	282,0	293,0	61,0	143,0	212,0	244,9	185,9	1543,8
Investments	-4391,0	-71,0	-155,0	-182,0	-204,0	-22,8	-59,9	-2,3	-5088,0
Divestments	0,0	0,0	142,0	0,0	0,0	0,0	0,0	2517,0	2659,0
Cash flow post investments	-4269,0	211,0	280,0	-121,0	-61,0	189,2	184,9	2700,6	-885,3
Value end of 2007	-6071,3	276,5	321,1	-130,2	-66,2	206,1	194,2	2700,6	-2569,0

Table 10 Table of cash flows²⁹⁷

In the table above, the investment and divestment prices and cash flows have been discounted using the method previously explained to present value at the end of 2007. This gives a total cost in US dollars to the venture about \$2,6 Billion. Without any time value of money taken into account, the extent of the losses is \$885 million.

Using appropriate adjustments, calculation of the losses in euros

Next, the losses in US dollars are converted into euros, as Stora Enso is a euro based company. In some previous calculations, yearly cash flows have been converted into euros using exchange rates for each year. This method, however, does not take into account any currency hedges or dollar based debt that has been raised to fund the investment. According to Stora Enso's CFO at the time, the acquisition was in fact fully hedged against changes in

the USD-euro exchange rate. This data can be verified by looking at Stora Enso's annual reports. In 2004, the annual report of Stora Enso states that *“Group policy for translation risk exposure is to minimize this by funding assets, whenever possible and economically viable, in the same currency, but if matching of the assets and liabilities in the same currency is not possible, hedging of the remaining translation risk may take place.”*²⁹⁸

The amount of losses accumulated from depreciation of dollar based assets and the gains from the hedging thereof can be found in Stora Enso's annual reports under the section “CTA and hedging thereof”. CTA stands for cumulative translation adjustment, and is a technical term used in the IFRS accounting system for valuing foreign currency based assets to their true value. The CTA comes from changes in value arising from changes in the foreign currency, not from other factors that affect an asset's value. Stora Enso's currency hedge policy stated that all foreign currency-based assets must be hedged either by matching them with liabilities in the same currency, with any remaining mismatches to be hedged with other hedging instruments.

As stated in the annual report of 2007, *“Exchange differences, arising from the translation of equity, results and dividends for foreign subsidiary and associate undertakings, are aggregated with the financial instruments hedging these investments and the net is recorded directly in shareholders' equity as CTA; this is expensed through the Income statement on the divestment of a foreign entity.”*²⁹⁹ In other words, it is enough for us to look at the CTA and the hedging thereof at the end of the ownership period, when these differences are realized.

*“At the time of the SENA disposal, CTA losses and hedging gains for the divested operations amounted to EUR -509.7 million and EUR 640.3 million respectively. The Canadian currency movements and hedging gains came to EUR 33.9 million and EUR 65.4 million respectively, and for the USA, EUR -543.6 million and EUR 574.9 million. The net currency gain of EUR 130.6 million mainly represented currency gains in the earlier years of the SENA operations before the Group implemented a comprehensive equity hedging regime in North America. In the period 2002 to 2007, when full hedging was in place, CTA losses amounted to EUR 590.3 million against which equity hedges generated gains of EUR 600.4 million, an overall gain of EUR 10.1 million, being +1.7% of the exposure”*³⁰⁰. However, the hedge gain was taxable where as the CTA losses being hedge were not tax deductible. This led to a net tax cost of 189,3 million euros, of which the pro rata USA share is 170,0 million euros.

Therefore, the overall gain from currency hedging of US based assets was 404,9 million euros.

Total euro losses

Now that the currency hedges have been taken properly into account, we may now convert all cash flows into euros using either the year end or the year average rate. This gives the total loss in euros to which we add the gain from currency hedges.

EUR MM (year average rate)	2000 4 mo	2001	2002	2003	2004	2005	2006	2007	Total
Cash flow from operations	132,1	315,0	309,9	53,9	115,0	170,3	194,9	135,6	1426,7
Investments	-4756,3	-79,3	-164,0	-160,8	-164,0	-18,3	-47,7	-1,7	-5392,0
Divestments	0,0	0,0	150,2	0,0	0,0	0,0	0,0	1835,8	1986,0
Realised equity hedging gains								404,9	404,9
Cash flow post investments	-4624,1	235,7	296,2	-106,9	-49,0	152,0	147,2	2374,6	-1574,4
Value end of 2007	-6576,3	308,9	349,1	-117,1	-54,7	172,8	162,3	2374,6	-3380,4
Tax benefit multiple assuming 28% marginal income tax									0,72
Consolidated's Shareholders' share of loss (18%)									0,82
After tax losses for pre-deal shareholders									-1995,8

Table 11 Stora Enso's total after tax losses for existing shareholders

Calculation of total losses in euros

As we can see, the pre-tax total losses now lie at around 3,4 billion euros, which is more than the loss in dollars using the 2000 year end rate (approximately 2,75 billion euros).

We may therefore conclude that while the losses in dollars constitute only about 2,0 billion euros at 2007 end exchange rates, an additional 0,7 billion euros comes purely from the depreciation of the divestment value during the ownership period, despite the hedging of the assets.

We also notice that the time value of money constitutes a considerable sum in this calculation. Without taking that into account, the pre-tax euro losses are around 1,5-1,6 billion euros, while the time value adds an additional 1,8 billion euros.

Correction for taxes and shareholding dilution as a result of the acquisition

When calculating the losses from a pre-acquisition Stora Enso shareholder point of view, the dilution of shareholdings that occurred in conjunction with the deal must be taken into account. The merger resulted in the creation of 167 million new shares, on top of an existing stock base of 760 million shares. This means that pre-acquisition shareholders received 82% of the merged company, meaning that 18% of the losses were incurred in theory by Consolidated Papers' shareholders.

In addition, to look at the deal from a shareholder perspective, we must take into account taxes. An estimated 28% tax rate is used, which is based on Stora Enso's tax rate from on continuing operations, which has varied between 25-33% during 2000-2007.

This leaves the total loss in cash to about 0,9 billion euros without the time value of money, and to about **2,0 billion euros** adjusted with the risk free rate."

Isolation of the effect of the weakening US dollar

During the ownership period, the US dollar weakened dramatically. It is therefore an interesting question how much of the losses were caused purely by changing currency rates. The sales price, \$2517 million, equaled approximately 1712 million euros using the end of 2007 exchange rate, whereas it would have equaled about 2735 million euros using the average exchange rate of 2000, \$0,92 / euro. The difference is therefore approximately one billion euros, from which we must deduct the positive hedging gains of 405 million, as well as the taxation and ownership dilution effects. The total effect of the exchange rates was approximately 365 million euros, a significant part of the losses. In addition one may argue, however, that the weakening US dollar made North American production more competitive, reducing losses. On the other hand, one should also take into account the loss of synergies caused by Stora Enso not being able to sell its European paper to the same extent. Both of these effects are difficult to quantify.

A calculation of the extent of the losses carried by Stora Enso – accounting profit method

In order to validate the results of the cash flow method, an alternative method can be used. The accounting loss is calculated by looking at SENA's earnings before interest and taxes during the ownership period. These figures must include all depreciation, amortizations, impairment charges as well as goodwill amortization. This method has the additional benefit of being able to more accurately assess the after tax losses incurred by Stora Enso.

Based on information available in annual reports and investor presentations, EBITDA and EBITA figures have been gathered in euros wherever possible. In a couple of cases, figures have only been available in US dollars. There, the figures have been converted into euros using year-end rates. The figures include CTA adjustments, hedges thereof, and the extra tax cost mentioned. These add up to a total loss of about 140 million euros market for 2007. In

addition to this, information on goodwill impairments and amortizations has been searched.

These are listed in the following table:

EUR	2000	2001	2002	2003	2004	2005	2006	2007	Total
EBITA	79,20	-23,28	-164,00	-163,00	-103,41	-180,20	-5,70	162,60	-397,79
Non recurring items	-36,00		-238,70	-24,60	-74,10				-373,40
Total	43,20	-23,28	-402,70	-187,60	-177,51	-180,20	-5,70	162,60	-771,19
Goodwill amortization/impairment	0,00	-33,00	-992,80	-33,10	-29,70	-8,00	0,00	-158,90	-1255,50
Total	43,20	-56,28	-1395,50	-220,70	-207,21	-188,20	-5,70	3,70	-2026,69
Other items									
Cumulative translation adjustment (USA)								-543,60	-543,60
Hedging thereof								574,90	574,90
Extra tax cost								-170,00	-170,00
Total loss without time value of money	43,20	-56,28	-1395,50	-220,70	-207,21	-188,20	-5,70	-539,90	-2165,39
total loss w/o PH (assuming PH EBITDA on ave. 0)									-1800,99
Capital employed in the USA	2000	2001	2002	2003	2004	2005	2006	2007	
Usa	4781,20	4741,30	2654,00	2143,00	2079,00	2085,00	1729,00	422,00	
Difference y/y	4781,20	-39,90	-2087,30	-511,00	-64,00	6,00	-356,00	-1307,00	
Years to divestment		1	2	3	4	5	6	7	
Change in assets in the USA	4781,20	-39,90	-2087,30	-511,00	-64,00	6,00	-356,00	-1307,00	
Actualization factor - 1	0,50	0,37	0,19	0,11	0,11	0,11	0,06	0,00	
Interest gathered assuming debt	2388,99	-14,83	-401,35	-56,14	-7,06	0,64	-20,72	0,00	1889,52
Total loss for company pre tax									-3690,51
Tax benefit multiple assuming 28% marginal income tax									0,72
Consolidated's Shareholders' share of loss (18%)									0,82
Total loss for pre deal shareholders after tax									-2178,88

Table 12 Accounting profit calculation of the Consolidated Papers acquisition and divestment³⁰¹

As we can see from the table, the accounting loss arising from the ownership period of Consolidated Papers amounts to about 1,8 billion euros. Port Hawkesbury has been treated here so that the depreciation on Port Hawkesbury assets of 364 million euros during 2000-2007 has been subtracted from the loss. In addition, it has been assumed that Port Hawkesbury has not provided any EBITDA during this time. This can be assumed because it was reportedly suffering from profitability problems during the whole time, and was even closed for a long period. Then, on the other hand, it can be assumed to have made somewhat positive EBITDA margins at least when prices were at higher levels, because otherwise it would most likely have been closed.

The question of time value of the assets invested is approached differently in this method. The idea is to gather data on how much capital employed there has been in the United States in each year. As the figure is the highest in 2000, when no amortizations had yet been made, this value carries interest throughout seven years. Any capital freed during this time receives interest on up until the end of 2007. This interest is subtracted from the one on the original sum. The interest rate used is again the US risk free rate at the appropriate point on the yield curve in each given year. However, in order to calculate how much maintaining this capital has cost the company, a margin on 0,8% is added on top of the interest rate, to make it correspond to the interest paid on debt. In this sense, we get a sense of how much accounting loss has been caused by maintaining the additional capital on the balance sheet.

The total cost of capital during the ownership period is about 1,9 billion euros, making the total accounting loss add up to about 3,7 billion euros. This figure is well in line with the figure obtained using the cash flow method, which was around 3,4 billion euros.

Again, we may subtract from this figure 18%, which have theoretically been carried by new shareholders. In addition, we may subtract an estimated 28% in taxes, because interest on debt amortizations and impairments are tax deductible. In this way, the loss carried by Stora Enso pre-acquisition shareholders adds up to about **2,2 billion euros**.

The treatment of the equitized deal structure

As a third method to calculate the total losses incurred by Stora Enso management, a method is used that separates cash flows to and from Stora Enso plc. and those between Stora Enso plc. and its shareholders. This is done in order to explicitly account for the fact that 50% of equity sale price was paid in Stora Enso stock. This, according to some interviewees, was a result of Stora Enso management insight and conservative approach to taking risks. The calculation also serves as a good verification for the two calculations shown previously.

The method of calculation is otherwise the same, except that in the initial investment, only the assumed debt of Consolidated Papers, and the cash part of the sale price are taken into consideration. This considerably reduces the negative cash flow incurred as a result of the deal. Pre-deal shareholders of Stora Enso are compensated for the stock issued the company by taking the portion of the new shareholders into account when calculating payouts and the company's end value after the SENA divestment. Hence, 18% of dividends and share repurchasing proceedings paid out between 2000 and end of 2007 are calculated as a loss for Stora Enso shareholders. In addition, 18% of the company's equity value on the approximate time of closing the SENA divestment, 31 December 2007 is calculated as a loss for Stora Enso shareholders. This is because without the deal, this 18% would be under their ownership, all other factors remaining equal, which they could have theoretically bought back.

EUR MM (year average rate)	2000 4 mo	2001	2002	2003	2004	2005	2006	2007	Total
Cash flow from operations	132,1	315,0	309,9	53,9	115,0	170,3	194,9	135,6	1426,7
Investments	-3099,0	-79,3	-164,0	-160,8	-164,0	-18,3	-47,7	-1,7	-3734,7
Divestments	0,0	0,0	150,2	0,0	0,0	0,0	0,0	1835,8	1986,0
Realised equity hedging gains - extra tax								404,9	404,9
Cash flow post investments	-2966,9	235,7	296,2	-106,9	-49,0	152,0	147,2	2374,6	82,8
Value end of 2007	-4219,4	308,9	349,1	-117,1	-54,7	172,8	162,3	2374,6	-1023,4
18% of dividends paid out + share repurch.	0,0	-109,4	-124,3	-127,2	-103,4	-127,8	-65,8	-63,9	-721,8
Value end of 2007	0,0	-143,3	-146,5	-139,4	-115,2	-145,3	-72,6	-63,9	-826,2
18% of equity value 31 Dec 2007								-1278,0	-1278,0
Total loss to shareholders (pre tax)									-3766,6
Assumed corporate, dividend + capital gain tax 28%									1054,6
Total loss to shareholders (after tax)									-2711,9

Table 13 Cash flow to shareholders calculation of the Consolidated Papers acquisition and divestment

This method gives slight higher loss figures as a result. The approximate loss to pre-deal Stora Enso shareholders after loss-related tax benefits calculated with an assumed corporate, dividend and capital gain tax rate of 28% is around **2,7 billion euros**. This difference arises from other factors, namely the difference in valuation of Stora Enso's other assets between 2000 and 2007. Between 2000 and 2007, the optimism of the European paper industry was turning into an increasingly grim outlook. Nevertheless, this method yields a loss figure that is around 500 million euros higher than the calculated after tax share of accounting losses of pre-deal shareholders, which was 2,2 billion euros. This method can naturally be contested due to the rather harsh assumption of when the 18% stock should theoretically be bought back. This is due to the rather large fluctuation in value of Stora Enso stock during the closing of the divestment. We may hence conclude, that without the acquisition, all other factors remaining equal, and with the assumption of the alternative cost of capital used, Stora Enso's pre-deal shareholders would have been about **2,0 – 2,7 billion euros** better off without the buying and selling of Consolidated Papers.

Other factors that affect the calculation

The figure stated above is an estimate of the extent of the losses to Stora Enso's shareholders based on all publicly available quantified data. There are, however, other factors which are difficult to quantify based on data available. These may have a minor effect on the total losses, and hence act as limitations to the calculations presented.

Stora Enso still retains some minor holdings in the United States. When Stora Enso sold SENA, it retained its holdings operated by Corenso, its packaging business. Corenso still owns a core board machine in Wisconsin Rapids, Wisconsin which used to be part of Consolidated Papers. According to the former CFO of Stora Enso, the factory's book value is around 20-30 million euros.

SENA data did not include sales in the USA that originated from the company's European operations. While Stora Enso already had sales to the USA before the Consolidated Papers acquisition, the increased presence on the continent also allowed for additional sales from the company's European mills to the USA. This data is difficult to quantify based on publicly available data.

There is contradiction over whether Stora Enso's increased presence in the USA also allowed for increased sales to US companies' European operations. According to the CEO, major customers such as Time Inc. did not previously order from Stora Enso in Europe, whereas this benefit from global operations was not seen by other Stora Enso management interviewees.

By listing in the United States and by having a large proportion of ownership there, Stora Enso gained access to more capital, perhaps at cheaper interest rates. This effect is also very difficult to quantify, but might have had a positive effect on the company's results

On the other hand, there were significant costs related to the listing in the United States, arising from complex accounting policies. The United States was increasingly viewed as a difficult place to list shares due to the tightening regulation that followed the Enron scandal in 2001, such as the introduction of the Sarbanes – Oxley act in 2002.

Overall, the non-quantifiable side effects of the increased presence in the United States can be estimated to have had a somewhat positive effect on results. With an estimated 100 million euros (after tax) coming from these side effects, the total loss to Stora Enso shareholders is approximately 1,9 billion euros in cash, and 2,6 billion euros, assuming pre-deal shareholders would have bought back the new shares issued at the end of 2007. It is interesting to note, that purely from the company's point of view, the venture was in fact one which generated positive cash flows.

6.8. The Stora Enso – Consolidated Papers acquisition in the M&A literature context

Overall, it seems like the acquisition of Consolidated Papers was a rather typical acquisition, at least when compared to the findings from M&A literature in chapter 4.

The decision making process of the deal seems to have gone in the order predicted by the assumption framework. First, the company management had thought about its next step in general, deciding that M&A is the preferable course of action in the industry which already had enough capacity. Secondly, it was decided that the US market was the primary target, because the Chinese and South American markets did not seem like viable options quite yet for major expansion. Thirdly, the target was sought with Consolidated Papers coming on the top of the list of good candidates to buy.

In terms of deriving the assumptions, the deal process has followed many elements found in literature. Imitation of other companies was present as a factor. This can be seen in the large number of deals involving US pulp and paper companies and the high level of interest shown towards acquiring them. It seems also that management's past experience in M&A played a significant part in coming to the idea that M&A would be the preferable course of action. This is, however, slightly contradictory to the board's position, many of whose members had warned about poor results with M&A, especially in the United States.³⁰²

Most of the rationales for the deal were synergistic. These included financial synergies, such as the possibility to take advantage of differences in cycle in different parts of the world. (Seth, Song and Pettit, 2000) The deal was also supposed to yield economies of scope by enabling the optimization of production between the US and Stora Enso's European paper mills. Economies of scale were supposed to be attained by buying additional production units in the US later on. Market developments, however, prevented this from taking place. (Walter and Barney, 1990)

In terms of cross border synergies, "exploitation of cross border synergies quicker than through organic investment" was clearly a factor. Stora Enso wanted to start to sell more of its products in the US, but needed Consolidated's competencies in sales and marketing to do so. Using its excess resources (i.e. overcapacity in Stora Enso's European mills) was also one of the key rationales. Furthermore, value was supposed to be created through the transfer of know-how – i.e. Stora Enso's best practices in producing magazine paper to Consolidated Papers to increase efficiency. (Seth, Song and Pettit, 2000) In terms of Trautwein's (1990) valuation theory, Stora Enso tried to take more advantage of imperfections in the currency markets. The strong dollar attracted many European producers to find better prices for their products in North American market.

In addition to the synergistic benefits, elements of agency-related motives were also present. By buying Consolidated Papers, Stora Enso bought a “ticket” to the US paper market, and knowingly overpaid for it. The rationale behind was to buy Stora Enso a chance to be among the leading shapers of the industry globally. To get the first proper foothold in North America, Stora Enso had to overpay, raising concerns whether shareholder value was ever the primary goal. There are elements of both Mueller's (1969) growth (as opposed to value) maximization subject to profitability boundaries. An implicit part of the deal may also have been a defense against takeovers, a motive suggested by Gorton, Kahl, Rosen (2005). By becoming one of the shapers, Stora Enso avoided being the target of other “consolidators” in the market.

Knowingly overpaying for Consolidated Papers gives rise to the idea that there might have been “CEO hubris” involved too. Stora Enso management was overconfident in its ability to turn around the declining performance of Consolidated Papers, and also misjudged its ability to continue consolidation activity in the North American paper industry. A key argument behind the high price was that by offering less, the deal would never have happened. This, again, is in line with Roll's 1986 hubris theory, where managers are equally likely to under and over-estimate synergies, but only succeed in takeovers when they over-estimate them.

The case provides evidence for many of the other M&A related factors presented in literature. Öberg and Holtström's (2006) theory that mergers are a response to similar action among customers is supported by this case. Serving global customers, which had themselves consolidated significantly was one of the rationales. The Consolidated Papers exhibited Stora Enso's repetitive momentum in mergers and acquisitions. Previous experiences had proved positive, and hence supported continuing growth through further mergers and acquisitions.

Many of the merger success factors also found support in the case. It seems that the presence of competing bidders caused a “winner's curse” for Stora Enso, as suggested by Varaiya and Ferris (1987). The winner of the auction ended up losing the most.

7. Conclusion: What can we learn from this acquisition?

The reason why Stora Enso bought Consolidated Papers is well in line with previous literature on merger motives. These included market power, synergies, and empire building to some extent, as well as “CEO Hubris”. Stora Enso management wanted to create a company with a global reach. Growth and size were thought to be beneficial *per se*, but as Stora Enso’s growth options in Europe were limited, its acquisition target had to be abroad. Stora Enso therefore chose the United States, the world’s largest paper market, as an area where it also wanted to become dominant. Having a global reach was to enable profiting from global synergies, including the ability to offer a “one stop shop” to major customers, as well as protection from economic cycles. The reason why Stora Enso chose Consolidated Papers was that it had a product portfolio that was well in line with that of Stora Enso’s. Consolidated had a reputation for good quality products that enabled charging a price premium. This made it a good base on which to add other companies, and hence partake in the consolidation of the US pulp and paper industry. Acquiring a major US player such as Consolidated could also protect Stora Enso itself from being acquired.

In addition to identifying the strategic benefits of acquiring Consolidated Papers, Stora Enso management made well over 20 different implicit assumptions about the future development of various factors. Out of these, we have identified four critical factors, the development of which Stora Enso management failed to foresee correctly. These are the main causes why the strategic benefits of the acquisition failed to realize.

The paper market is cyclical and management surely knew that it would continue to be so in the future as well. The sudden turn of the cycle, however, surprised management. Furthermore, management was overconfident in its ability to turn around Consolidated’s weakening performance. Efforts to improve Consolidated’s operational efficiency were hampered by the increasing entry to the market of Asian players with a better cost structure. This development could be seen already in 1999, but it was mostly left unnoticed by Stora Enso. The US dollar weakened significantly, cancelling part of the deal’s strategic rationale of geographic cross-selling. These developments severely hampered cash flows generated by the newly formed Stora Enso North America and brought down its value, causing the major losses incurred by Stora Enso. The case is a prime example of how difficult it is to predict the future.

For the paper industry, the slump in demand and prices that began in 2001 was no ordinary slump. In 2001, significant changes in the dynamics of the whole industry started to evolve. Firstly, the overall fundamental demand in Northern America for paper started to stagnate and drop; The negative effect of computers and electronic data handling on paper consumption that had been talked about for 30 years started to take effect. Stora Enso had therefore bought a foothold in a market that was fundamentally declining. In addition, the focus of the pulp and paper industry started to strongly shift away from its traditional markets in the western world. North America and Europe were ridden with slowing demand and structural overcapacity. Earlier overflow production could be sold to emerging markets. In the early 2000s, however, increased investment in emerging countries such as a China started to show so that first, the export market dried up, but then trade flows were also reversed so that Chinese and other Asian producers started to export their high quality products to the United States and now even Europe.

Consolidated Papers was not as highly profitable in 1999 as it had been. Its profitability was in fact declining severely despite overall growth in the market. Yet, the premium paid for the company was very high, and by far exceeded the value of the synergies calculated. The price was based on future growth expectations that didn't realize and the possibility for Stora Enso to act as a shaper of the industry in the future. There was also over-confidence in Stora Enso's ability to further improve Consolidated Papers' performance.

The strong weakening of the US dollar between 2003 and 2007 made it difficult for Stora Enso to sell its European products profitably to its new customers in United States, cancelling part of the strategic rationale of the deal. While it did help improve the competitiveness of US production, it brought down the euro denominated value of SENA, forming a significant reason why Stora Enso's losses when divesting SENA were so high.

Overall, Stora Enso undertook the deal using market forecasts that were largely based on the assumption of the fundamentals of the industry staying the same. Given the information at hand, the acquisition of Consolidated Papers looked like it had the potential of making Stora Enso one of the dominant global pulp and paper companies. The risks and price, however, were high because Stora Enso was not alone in its aspirations to take a leading position in controlling the huge but slowing North American paper market. This is illustrated by the large number of other deals that took place in North America at the time. Most of them,

however, failed to yield the results that had been anticipated, which is why the strong consolidation trend going on at the time largely slowed down after 2000-2001.

The Stora Enso – Consolidated, as well as the International Paper – Champion acquisitions occurred very late in the cycle, at the peak, at a time when mergers and acquisitions are usually the most common but also usually the most unprofitable. Only half a year later, such asset prices would have been impossible, because already between announcing and closing the Consolidated Papers acquisition, pulp and paper industry stock prices had started to fall strongly. In this sense the timing of the deal was unfortunate. For Stora Enso, the timing was due to mainly the fact that only in 1999-2000 was the company ready to take on such a large step in further growth, as the company was still in the process of integrating Stora and Enso, following the merger in 1998. Secondly, and in part due to the high asset prices, there were also a lot companies for sale in late 1999 / early 2000.

The price paid for Consolidated was already seen as a problem by many at the time of the acquisition. It was thought that a larger unit size was needed to stay competitive in the industry and in that sense price premiums were justifiable. Stora Enso, however, was primarily not after synergies, but was rather looking to keep Consolidated Papers running mostly as it was. On the other hand, the chairman of Consolidated Papers saw that the company's current business concept was not going to work very well in the long-term. Stora Enso grew larger on a global scale, but on a North American scale the Consolidated Papers production system only grew by one unit. For the other bidder that was a large North American paper producer, the value of the synergies obtainable was surely higher. In the final stage of the deal, the options for Stora Enso were to a) admit that Consolidated Papers provides a good position to take part in future industry restructuring but that its price is unjustifiable. In this case it would have been sold to a competitor and the possibility to gain a leading position in the US reorganization of the industry would probably have been lost, or b) take the risk and pay a bit too much, but trust that future actions enabled by a front seat in the consolidation trend would make up for the value possibly lost in acquiring Consolidated Papers.

Stora Enso chose the latter. The risks, however, realized and in this light, buying Consolidated Papers at that price was a mistake. Instead of making North America a steady cash flow generator with which Stora Enso could manage its currency and economic cycle exposure and fund its growing investments in emerging regions, Stora Enso had to put a lot

of effort and investment into upgrading its North American operations to make them competitive once again. By 2005-2006, the effects of this work were already starting to show, and the cash flows generated improved significantly. They were not enough to bring the acquisition as a whole “to the black” because the cash flows of the first two-three years are so crucial, but overall, the business was running with rather good margins again. This did not show in accounting profit due to heavy asset depreciation and impairments, but cash flows in dollars were almost as strong as at the time of acquiring the company. In September 2007, however, the company was sold to NewPage after Jouko Karvinen had taken over as CEO following Jukka Härmälä’s retirement. Without interest taken into account, pre tax positive cash flow arising from the acquisition and divestment of Consolidated and SENA totals about \$640 million dollars or 177 million euros including gains from equity hedges for the company³⁰³. For the company’s shareholders, however, when the loss in shareholding and an alternative cost of capital is taken into account, losses account to about 2-2,7 billion euros, depending on one’s calculation method. Due to the financing of the deal in part with equity, the acquisition did not endanger the survival of the company, despite the large losses incurred.

From an M&A literature point of view, the study has argued that it is not enough to look purely at the explicitly anticipated benefits of M&A when assessing the success of deals. M&A motives portray assumptions that are directly linked to the fit between the target and the acquirer. As has been seen, corporate management that performs M&A transactions also makes dozens of assumptions that may not directly be related to the target company. Rather, they have to do with the external environment, and indirectly affect the outcome of the deal.

Predicting the future is always difficult. When attempting to do so, however, it makes sense to explicitly list the assumptions one makes. The M&A assumption framework created works as a good decision making tool for managers, who should discuss these assumptions widely among themselves and assess the future prospects of the assumptions rigorously. The assumptions made are most often not independent of one another, but rather the proving of one assumption to be correct or incorrect may also affect that of another one. Therefore the assumptions listed should be put into “chains” such as the ones that have been modeled in this study. This will yield a model with which management can build various scenarios and therefore assess different outcomes of the M&A transaction in question. This might help improve decision making quality, as assumptions are explicitly shared and discussed, and the

connections of seemingly irrelevant factors to the outcome of an M&A transaction may be found.

The assumption framework and the modeling that has been done in this study is the first attempt of such a method. Future studies can surely develop this idea further. Ideas for future studies include, for example, looking at a sample of M&A deals and assessing which assumptions made by management have been the most critical in determining the success of the deal. Such analysis could show whether there are some assumptions that management should be particularly wary about making.

Another further avenue of study specific to the case study would be to study the sensibility of divesting SENA. On one hand, the company was joined together with another large local manufacturing system in the hope of creating value through synergies. Stora Enso still holds a 20% stake of the newly formed company. On the other hand, according to many former Stora Enso management interviewees, SENA's capacity was of much better quality than that of its main competitors, including the acquirer NewPage. Currently, NewPage together with SENA as a whole claims to be the cost leader in the industry.³⁰⁴ According to interviewees in this study, SENA could have well competed in the market and continued to generate good cash flows. Local manufacturing capacity could service customers with rather good margins in dollar terms. On the other hand, 2008 and 2009 were recession years in the United States, seeing asset values generally coming down strongly and paper demand further decreasing.³⁰⁵ This again makes the decision to divest SENA look like a good one in the short term, as the price obtainable for it later on would have likely been lower.

In a couple of years, it will be interesting to see how SENA's acquirer NewPage will do, facing continuous pressure from Asia, whether the US paper demand will start to recover and how the US dollar / euro exchange rate will develop. These factors will shed new light on whether the decision to divest was the right one. The years to come will also show which of the world's paper manufacturers will survive, and in which form. Are they the ones with global reach and the ability to service global customers, or is it purely regional cost leadership that matters?

8. References

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- ⁴ Discussion with a source close to the board of directors
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- ¹⁷ Discussion with a competitor interviewee
- ¹⁸ Statement by a source close to the board of directors
- ¹⁹ Discussions with Stora Enso management and competitor interviewees
- ²⁰ Press releases by UPM-Kymmene: “UPM-KYMMENE AND CHAMPION INTERNATIONAL AGREE TO EUR 20 BILLION (\$20 BILLION) MERGER CREATING A PREMIER GLOVAL FOREST PRODUCTS COMPANY” published 17 February 2000, and “UPM-KYMMENE WITHDRAWS FROM CHAMPION DEAL” published 12 May 2000, available online 6 February 2010 at <http://w3.upm-kymmene.com/upm/internet/cms/upmcms.nsf/pr2?OpenView&select=2000>
- ²¹ Discussions with an implementer interviewee
- ²² Discussion with Stora Enso management interviewee
- ²³ Discussion with a source close to the board of directors
- ²⁴ Discussion with a management interviewee
- ²⁵ Discussion with adviser interviewee
- ²⁶ SEC filing by Consolidated Papers dated 28 July 2000, pp. 24, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>
- ²⁷ Discussion with adviser interviewee
- ²⁸ Discussion with a management interviewee (the CEO)
- ²⁹ Discussion with a management interviewee
- ³⁰ Helsingin Sanomat article “Puheenjohtajalla aihetta itsekritiikkiin” – The chairman of the board has reason for self-criticism, published 22 September 2007, available online http://www.myphotos.eu/uploads/HS20070922SI3TA01_kopio.pdf
- ³¹ The chairman of the board, Claes Dahlbäck, in an interview with Swedish newspaper E24, , published 4 February 2010, available online 2 March 2010 at http://www.e24.se/business/ravaror/dahlback-visst-gramer-jag-mig-over-usa-affaren_1840883.e24
- ³² See quote in chapter 5.4.1
- ³³ SEC filing by Consolidated Papers dated 28 July 2000, pp. 24, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>
- ³⁴ SEC filing by Consolidated Papers dated 28 July 2000, pp. 24, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>
- ³⁵ Stora Enso Investor presentation “Road show Stora Enso today”, published 13 September 2000, available online at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ³⁶ SEC filing by Consolidated Papers dated 28 July 2000, pp. 24, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>

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- ³⁷ News article in Talouselämä “Mr. Aulis karsi turhan hierarkian” – Mr-Aulis got rid of excess hierarchy, published 26 March 2003, available online 6 February 2010 at <http://www.talouselama.fi/tyoelama/article162828.ece>
- ³⁸ Discussions with Stora Enso management interviewees
- ³⁹ Article in Turun Sanomat on 28 August 2002 ” Stora Enson Yhdysvaltain poistot painavat vuoden tuloksen tappiolle” – Stora Enso’s writeoffs in the United States cause a loss for the year, available online 10 January 2010 at <http://www.ts.fi/arkisto/haku.aspx?ts=1,0,0,0:119617,0>
- ⁴⁰ Discussions with management interviewees
- ⁴¹ Discussion with an implementer interviewee
- ⁴² Discussions with management interviewees
- ⁴³ Ibid + Discussion with a source close to the board of directors
- ⁴⁴ Stora Enso investor presentation “Stora Enso North America profit enhancement plan”, published 27 Aug 2002, available online 6 February 2010 at <http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>
- ⁴⁵ Ibid. and Stora Enso full year results presentation 2003, available online 6 February 2010 at <http://www.storaenso.com/investors/presentations/2004/Pages/presentations-2004.aspx>
- ⁴⁶ Discussions with Stora Enso management and implementer interviewees
- ⁴⁷ Stora Enso investor presentation “Divestment of North American Paper Operations” published 21 September 2007, available online 6 Feb 2010 at <http://www.storaenso.com/investors/presentations/2007/Pages/presentations-in-2007.aspx>
- ⁴⁸ For a broader review on M&A literature as a whole, see, for example, Parvinen (2003)
- ⁴⁹ Statement by Stora Enso management interviewee
- ⁵⁰ Ibid.
- ⁵¹ Statement by a source close to the board of directors
- ⁵² Interview with Stora Enso management interviewee
- ⁵³ Interview with Stora Enso management interviewee
- ⁵⁴ Ibid.
- ⁵⁵ Stora Enso investor presentation “Roadshow in London and in New York” on 14-17 March 2000, available online 28 January 2010 at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ⁵⁶ Several management and implementer interviewees mentioned further M&A plans, and they can also be seen in contemporary publications such as an investor presentation held on 16 May 2001 “Capital Markets Day in Chicago, Kai Korhonen, President and Ron Swanson, Deputy & Senior Vice President of Stora Enso North America. available online 28 January 2010 at <http://www.storaenso.com/investors/presentations/2001/Pages/presentations-2001.aspx>
- ⁵⁷ Stora Enso investor presentation: 12 March 2004, available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2004/Pages/presentations-2004.aspx>
- ⁵⁸ The aforementioned companies have seen weakened results, but their balance sheets are strong
- ⁵⁹ M-Real’s bonds were selling at very low values compared to the par value, suggesting that the investor community thought it possible that the company might go bankrupt. Abitibi is in debt restructuring at the time of writing.
- ⁶⁰ Interview with an adviser
- ⁶¹ Several cross-border mergers took place in 2000, including Stora Enso – Consolidated, M-Real – Modo paper, as well as several others where the principle buyers were International Paper, Abitibi, Weyerhaeuser. See for example article in Taloussanommat: “Metsäyhtiöiden arvonnousu tekee yritysostot edullisiksi” – The rise in the valuation of forest companies makes acquisitions cheaper, available online 28 January 2010 at <http://www.taloussanommat.fi/arkisto/2000/02/23/metsayhtioiden-arvonnousu-tekee-yritysostot-edullisiksi/200031352/12>
- ⁶² Stora Enso investor presentation “Roadshow in London and in New York” on 14-17 March 2000, available online 28 January 2010 at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ⁶³ Slide from internal Stora Enso management presentation in 2001, provided by an interviewee to the author in conjunction with an interview in September 2009
- ⁶⁴ View of several Stora Enso management interviewees who claimed that Stora Enso could not have carried out large acquisitions in Europe without the interference of EU commission anti-trust officials
- ⁶⁵ UPM press release, “The European commission accepts the UPM-Kymmene-Haindl deal, available online 28 January 2010 at <http://w3.upm->

kymmene.com/upm/internet/cms/upmcomfi.nsf/prv/Euroopan_unionin_komissio_hyv%C3%A4ksyi_UPM-Kymmenen_Haindl-kaupan?OpenDocument

⁶⁶ Opinion of an adviser interviewee

⁶⁷ View shared by several competitor and adviser interviewees

⁶⁸ Jouko Karvinen's statement, cited in Talouselämä article "Stora'n suuri puhdistus" – Stora's great cleanup, available online 28 January 2010 at <http://www.talouselama.fi/uutiset/article170273.ece>

⁶⁹ Ibid.

⁷⁰ Interview with Stora Enso management interviewee

⁷¹ Interview with Stora Enso management interviewee

⁷² See financial results from 2008 of UPM-Kymmene, M-Real, Myllykoski, Stora Enso, International Paper, Holmen

⁷³ Stora Enso management interviewees. Mergers and acquisitions also listed as part of Stora Enso's strategy, see for example Stora Enso's 1999 annual report, available online 28 January 2010 at

⁷⁴ Interview with competitor representative

⁷⁵ Stora Enso management interview

⁷⁶ Interview with seller, as well as statement by Magnus Diesen in an article in Talouselämä "Paperitehtaita on rutosti liikaa" – There are far too many paper mills, published 17 March 2006, available online 29 January 2010 at <http://www.talouselama.fi/uutiset/article163353.ece>

⁷⁷ Statement by Stora Enso management interviewee

⁷⁸ Statement by Stora Enso management interviewee

⁷⁹ Stora Enso management interviews

⁸⁰ Statement by a Stora Enso management interviewee

⁸¹ Statement by competitor interviewee

⁸² Statement by a source close to the board of directors

⁸³ Stora Enso management interviewees

⁸⁴ Article in Time Magazine, "Sweden: The Oldest Corporation In the World", Published 15 March 1993, available online 29 January 2010 at <http://www.time.com/time/magazine/article/0,9171,870230,00.html>

⁸⁵ Stora Enso annual report 2008, pp. 65, available online 29 January 2010 at http://www.storaenso.com/media-centre/publications/annual-report/Documents/SE_Annual_Report_08_en.pdf

⁸⁶ See Investor presentation slide presented on page 58

⁸⁷ Kemijärvi was originally an independent company, but highly unprofitable and was therefore shortly after founding joined together with another government owned company, Veitsiluoto

⁸⁸ Article in YLE – Elävä arkisto, "Kemijärven sellutehdas" – The Kemijärvi pulp mill, available online 29 January at <http://yle.fi/elavaarkisto/?s=s&g=1&ag=86&t=686&a=5861>

⁸⁹ Discussion with a Stora Enso management interviewee

⁹⁰ Statement by a source close to the board of directors

⁹¹ Slide from internal Stora Enso management presentation in 2001, provided by an interviewee to the author in conjunction with an interview in September 2009

⁹² Stora Enso management interviewees. Exceeding calculated synergies is also evident in Stora Enso's 1999 results presentation, published 10 February 2000, available online 29 January 2010 at:

<http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>

⁹³ Discussions with Stora Enso management and implementer interviewees

⁹⁴ Statement by Stora Enso management interviewee

⁹⁵ Stora Enso 2001 Financial results presentation, available online 29 January 2010 at

<http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>

⁹⁶ Ibid.

⁹⁷ Discussion with implementer interviewee

⁹⁸ Discussion with an implementer interviewee

⁹⁹ Stora Enso annual report 1999, pp. 6-8 (Letter from the chairman, the CEO, and excerpts from Stora Enso's strategy) available online 29 January 2010 at http://www.storaenso.com/media-centre/publications/older-annual-reports/Documents/storaenso_annualreport1999pdf.pdf

¹⁰⁰ Ibid. pp.87

¹⁰¹ Statement by Stora Enso management interviewee, who also served on the board

¹⁰² Statement by Stora Enso management interviewee, who also served on the board

¹⁰³ Helsingin Sanomat article "Puheenjohtajalla aihetta itsekritiikkiin" – The chairman of the board has reason for self-criticism, published 22 September 2007, available online

http://www.mvphotos.eu/uploads/HS20070922SI3TA01_kopio.pdf

¹⁰⁴ Discussion with a source close to the board of directors

¹⁰⁵ Ibid.

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- ¹⁰⁶ SEC filing by Consolidated Papers dated 28 July 2000, pp. 24, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>
- ¹⁰⁷ The chairman of the board, Claes Dahlbäck, in an interview with Swedish newspaper E24, , published 4 February 2010, available online 2 March 2010 at http://www.e24.se/business/ravaror/dahlback-visst-gramer-jag-mig-over-usa-affaren_1840883.e24
- ¹⁰⁸ Discussions with a source close to the board of directors
- ¹⁰⁹ Ibid.
- ¹¹⁰ Discussion with a source close to the board of directors
- ¹¹¹ Claes Dahlbäck's speech the 2008 Stora Enso annual general meeting, video available online 10 January 2010 at http://www.goodmood.tv/vod/storaenso/agm_08_eng/index_wmv.htm
- ¹¹² The chairman of the board, Claes Dahlbäck, in an interview with Swedish newspaper E24, published 4 February 2010, available online 2 March 2010 at http://www.e24.se/business/ravaror/dahlback-visst-gramer-jag-mig-over-usa-affaren_1840883.e24
- ¹¹³ Port Hawkesbury history, available online 29 January 2010 at <http://www.townofporthawkesbury.ca/town-history.html>
- ¹¹⁴ Discussion with a Stora Enso management interviewee
- ¹¹⁵ Statement by Stora Enso management interviewee
- ¹¹⁶ Quote from a Stora Enso management interviewee who also served on the board
- ¹¹⁷ Claim difficult to verify using public data because Stora Enso did not publish separate figures by mill, but this claim was supported by several management and adviser interviewees
- ¹¹⁸ Article in Market Wire, "Stora Enso's Port Hawkesbury Mill to Restart" Published in September 2006, available online 29 January 2010 at http://findarticles.com/p/articles/mi_pwwi/is_200609/ai_n16754882/
- ¹¹⁹ Claim difficult to verify using public data because Stora Enso did not publish separate figures by mill, but this claim was supported by several management and adviser interviewees
- ¹²⁰ Discussions with Stora Enso management interviewees
- ¹²¹ Claes Dahlbäck's speech the 2008 Stora Enso annual general meeting, video available online 10 January 2010 at http://www.goodmood.tv/vod/storaenso/agm_08_eng/index_wmv.htm
- ¹²² Statement by Stora Enso management interviewee
- ¹²³ Statement by Stora Enso management interviewee
- ¹²⁴ Discussions with Stora Enso management interviewees
- ¹²⁵ See for example financial results of International Paper
- ¹²⁶ Opinion of several Stora Enso management interviewees
- ¹²⁷ Stora Enso investor presentation: Roadshow in London and in New York 14-17 March 2000, available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ¹²⁸ According to Stora Enso management interviewees
- ¹²⁹ See, for example, the financial results of Stora Enso and UPM Kymmene between 1995-2000
- ¹³⁰ See, for example, the development of the Nasdaq Index between 1995- 2000
- ¹³¹ When calculating the value of a company, its cash flows during the first years are proportionally more important due to the effect of the increasing discounting factor
- ¹³² Stora Enso investor presentation 2 August, cited in SEC filing, available online 10 January at <http://www.sec.gov/Archives/edgar/data/23752/000090342300000352/0000903423-00-000352.txt>
- ¹³³ US Census Bureau statistics, available online 29 January 2010 at <http://www.census.gov/hhes/www/poverty/histpov/recessn.html>
- ¹³⁴ See FAO statistics graph presented in Figure 23
- ¹³⁵ Stora Enso investor presentation "Stora Enso North America profit enhancement plan" available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>
- ¹³⁶ Stora Enso investor presentation from 27 August 2002, "Stora Enso North America profit enhancement plan", available online 29 January at <http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>
- ¹³⁷ Source: Yahoo Finance
- ¹³⁸ Source: US Bureau of Economic Analysis statistics, available online 10 January 2010 at <http://www.bea.gov/national/index.htm#gdp>
- ¹³⁹ Alfred Berg Paper & Forest Seminar. Presentation by CEO Jukka Härmälä. Available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2004/Pages/presentations-2004.aspx>
- ¹⁴⁰ Article by Juho Loirinsuo and Lauri Hetemäki "Magazine paper consumption has started to decline in the US", available online 29 January 2010 at <http://www.metla.fi/pp/LHet/soirinsuo-hetemaki-magazine-pt-2008.pdf>
- ¹⁴¹ E-mail from George W. Mead to the author, sent 13 November 2009

¹⁴² Source: A NewPage investor presentation, “Goldman Sachs Montreal Paper and Forest Products Investor Conference Presentation”, 19 March 2009, available online 3 February 2010 at http://library.corporate-ir.net/library/19/193/193188/items/329175/9BF17741-86A4-46F9-AB51-41FA4A0266AD_GoldmanSachs031809.pdf (Indicative trend line drawn by author)

¹⁴³ Ibid.

¹⁴⁴ Uncoated Free sheet paper was not produced by Consolidated Papers, and the situation with Consolidated’s paper grades i.e. Coated wood free and supercalendered papers was not quite as bad. However, according to Stora Enso management interviewees, this picture still serves well in describing how the link between GDP growth and paper consumption was broken.

¹⁴⁵ Source: an International Paper investor presentation from June 9, 2009, available online 10 January 2010 at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9ODE2OHxDaGlzZEIEPS0xfFR5cGU9Mw==&t=1>

¹⁴⁶ Source: FAO statistics, accessed in November 2009 at FAOSTAT forestry, available online 10 January 2010 at <http://faostat.fao.org/site/626/default.aspx#ancor>

¹⁴⁷ See chapter 5.2.11 for more details

¹⁴⁸ Discussions with Stora Enso management interviewees

¹⁴⁹ See George W. Mead’s speech on the following page

¹⁵⁰ FAO statistics, depicted on the previous page

¹⁵¹ Discussion with a Stora Enso management interviewee, also George W. Mead’s speech on the following page supports this

¹⁵² Source: Stora Enso investor Presentation on 13 September 2000 “road show Stora Enso today”, available online 10 January at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>

¹⁵³ Article China on a hot streak with larger scale, new mills, Solutions for People Processes and Paper magazine, available online 10 January at:

<http://www.thefreelibrary.com/China+on+a+hot+streak+with+larger+scale,+new+mills.-a0114704164>

¹⁵⁴ Discussion with an implementer interviewee. Note, that according to George W Mead’s speech in 2000, Asian players already had an 85% market share on the West Coast in 1999

¹⁵⁵ George W Mead at the Consolidated Papers 2000 AGM, available through an SEC filing, available online at <http://www.sec.gov/Archives/edgar/data/23752/00009147600000158/0000914760-00-000158.txt>

¹⁵⁶ Source: US International Trade Commission – Trade Stats Express, accessed November 2009 at <http://tse.export.gov/>

¹⁵⁷ Source: US International Trade Commission – Trade Stats Express, accessed November 2009 at <http://tse.export.gov/>

¹⁵⁸ Source: US International Trade Commission – Trade Stats Express, accessed November 2009 at <http://tse.export.gov/>

¹⁵⁹ Statement by Magnus Diesen in an article in Talouselämä “Paperitehtaita on rutosti liikaa” – There are far too many paper mills, published 17 March 2006, available online 29 January 2010 at

<http://www.talouselama.fi/uutiset/article163353.ece>

¹⁶⁰ The gap between prices of different papers in the USA and Europe was, according to an implementer interviewee, mostly due to the strong demand of the IT sector, which was a large advertiser

¹⁶¹ Stora Enso investor presentation ” Stora Enso North America profit enhancement plan” from 27 August 2002, available online 10 January 2010 at

<http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>

¹⁶² Stora Enso 2007 Capital Markets day presentation 5 November 2007, available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2007/Pages/presentations-in-2007.aspx>

¹⁶³ Discussion with management interviewee

¹⁶⁴ Discussion with adviser interviewee

¹⁶⁵ Discussions with Stora Enso management interviewees

¹⁶⁶ Discussion with a management interviewee (the CFO)

¹⁶⁷ Statement by Stora Enso management interviewee

¹⁶⁸ Stora Enso investor presentation: Roadshow in London and in New York 14-17 March 2000, available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>

¹⁶⁹ Discussions with management interviewees – Also see quote in chapter 5.1.4

¹⁷⁰ See quote by Stora Enso management interviewee in chapter 5.1.4

¹⁷¹ Article in Turun Sanomat on 28 August 2002 ” Stora Enson Yhdysvaltain poistot painavat vuoden tuloksen tappiolla” – Stora Enso’s write-offs in the United States cause a loss for the year, available online 10 January 2010 at <http://www.ts.fi/arkisto/haku.aspx?ts=1.0.0.0:119617.0>

¹⁷² On 1 March 2000, 1 Us Dollar was equivalent to 1.04 euros – on 1 September 2000 when the deal was closed, 1 US dollar was equivalent to 1.13 euros

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- ¹⁷³ Statement by Stora Enso management interviewee
- ¹⁷⁴ Scenarios depicted based on discussions with Stora Enso management interviewees
- ¹⁷⁵ Data source: www.oanda.com, accessed 30 January 2010
- ¹⁷⁶ Source: US International Trade Commission – Trade Stats Express, accessed November 2009 at <http://tse.export.gov/>
- ¹⁷⁷ Discussion with competitor interviewee and Stora Enso management interviewee
- ¹⁷⁸ Statement by a source close to the board of directors
- ¹⁷⁹ Discussions with interviewees
- ¹⁸⁰ Claes Dahlbäck’s speech the 2008 Stora Enso annual general meeting, video available online 10 January 2010 at http://www.goodmood.tv/vod/storaenso/agm_08_eng/index_wmv.htm
- ¹⁸¹ Discussions with Stora Enso management interviewees
- ¹⁸² Ibid.
- ¹⁸³ Anti-dumping suits are listed on the US Import Administration webpage under “news”, available online 30 January 2010 at <http://ia.ita.doc.gov/ia-news-2009.html>
- ¹⁸⁴ Risi-info: US coated papermakers file antidumping complaint seeking import duties on Chinese, Indonesian sheet market imports, published 25 September 2009, available online 30 January 2010 at <http://www.risiinfo.com/technology/pulping/US-coated-papermakers-file-antidumping-complaint-seeking-import-duties-on-Chinese-Indonesian-sheet-market-imports.html>
Also: US Import Administration News, available online 30 January 2010 at <http://ia.ita.doc.gov/ia-news-2009.html>
- ¹⁸⁵ Discussions with Stora Enso management interviewees
- ¹⁸⁶ Stora Enso investor presentation: Capital Markets Day in Chicago, Kai Korhonen, President and Ron Swanson, Deputy & Senior Vice President of Stora Enso North America. 16 May 2001, available online 10 January 2010 at <http://www.storaenso.com/investors/presentations/2001/Pages/presentations-2001.aspx>
- ¹⁸⁷ Discussions with implementer and management interviewees
- ¹⁸⁸ Source: Stora Enso investor Presentation on 13 September 2000 “road show Stora Enso today”, available online 10 January at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ¹⁸⁹ Discussions with Stora Enso management interviewees
- ¹⁹⁰ UPM press release, “The European commission accepts the UPM-Kymmene-Haindl deal, available online 28 January 2010 at http://w3.upm-kymmene.com/upm/internet/cms/upmcmsfi.nsf/prv/Euroopan_unionin_komissio_hyv%C3%A4ksyi_UPM-Kymmenen_Haindl-kaupan?OpenDocument
- ¹⁹¹ European Commission Press Release “Komissio hyväksyy UPM-Kymmenen ja Norske Skogin Haindl-kaupan” – The Commission accepts the acquisition of Haindl by UPM-Kymmene and NOrdke Skog, published 21 November 2001, available online 30 January at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/1629&format=HTML&aged=1&language=FI&guiLanguage=en>
- ¹⁹² Discussion with Stora Enso management interviewee
- ¹⁹³ European Commission Press Release “Komissio hyväksyy Modo Paperin siirtymisen Metsä-Serlan omistukseen” – The Commission accepts the acquisition of Modo Paper by Metsä Serla, published 7 August 2000, available online 30 January at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/00/913&format=HTML&aged=1&language=FI&guiLanguage=en>
- ¹⁹⁴ European Commission Press Release “Komissio hyväksyy Enson ja Storan fuusion” – The Commission accepts the merger between Enso and Stora, published 25 November 1998, available online 30 January at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/98/1022&format=HTML&aged=1&language=FI&guiLanguage=en>
- ¹⁹⁵ Statement by Stora Enso management interviewee when discussing Enso’s previous experiences with Kitimati
- ¹⁹⁶ Discussions with Stora Enso management interviews
- ¹⁹⁷ Statement by Stora Enso management interviewee
- ¹⁹⁸ Statement by the seller
- ¹⁹⁹ Statement by a Stora Enso management interviewee
- ²⁰⁰ Consolidated Papers Q3/1999 earnings statement. Available as an SEC filing online 1 February 2010 at <http://www.sec.gov/Archives/edgar/data/23752/0000023752-99-000029.txt>
- ²⁰¹ Source: Consolidated Papers annual reports 1996-1999, available at SEC Edgar archives using company name “Consolidated Papers” at address: <http://www.sec.gov/edgar/searchedgar/companysearch.html>
- ²⁰² SEC filing by Consolidated Papers dated 28 July 2000, pp. 29, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>

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- ²⁰³ Interview with adviser
- ²⁰⁴ Stora Enso investor presentation “Stora Enso North America profit enhancement plan” published 27 August 2002, available online 1 February 2010 at <http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>
- ²⁰⁵ Discussions with Stora Enso management and adviser interviewees
- ²⁰⁶ Statement by a source close to the board of directors
- ²⁰⁷ Discussions with Stora Enso management and adviser interviewees
- ²⁰⁸ Statement by Stora Enso management interviewee
- ²⁰⁹ Ibid.
- ²¹⁰ Discussions with Stora Enso management interviewees
- ²¹¹ SEC filing by Consolidated Papers dated 28 July 2000, pp. 23, available online 29 January 2010 at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>
- ²¹² Statement by Stora Enso management interviewee
- ²¹³ Ibid.
- ²¹⁴ Ibid.
- ²¹⁵ Discussions with Stora Enso management interviewees. The price premium charged by Consolidated Papers was also mentioned by the seller, George W. Mead, according to whom, the premium had started to diminish already before the acquisition due to pressure exerted by Asian market entrants.
- ²¹⁶ Discussion with management interviewees, and with the seller
- ²¹⁷ Stora Enso investor presentation “Stora Enso North America profit enhancement plan” published 27 August 2002, available online 1 February 2010 at <http://www.storaenso.com/investors/presentations/2002/Pages/presentations-2002.aspx>
- ²¹⁸ Discussion with management interviewees, and with the seller
- ²¹⁹ Discussion with management interviewees
- ²²⁰ Discussion with adviser interviewee
- ²²¹ Stora Enso investor presentation: Credit Suisse First Boston: Annual Global Basics Conference in New York. Presentation by Lars Bengtsson, SEVP Stora Enso North America. Available online 10 January 2004 at <http://www.storaenso.com/investors/presentations/2004/Pages/presentations-2004.aspx>
- ²²² Discussions with Stora Enso management and adviser interviewees
- ²²³ Discussion with a Stora Enso management interviewee
- ²²⁴ Discussion with a Stora Enso management interviewee (the CEO)
- ²²⁵ Discussion with a Stora Enso management interviewee
- ²²⁶ Discussions with the seller
- ²²⁷ Discussions with Stora Enso management interviewees
- ²²⁸ Ibid.
- ²²⁹ Discussions with a Stora Enso management interviewee
- ²³⁰ Discussions with a competitor interviewee
- ²³¹ The author has looked at articles from Helsingin Sanomat, Taloussanomat, Turun Sanomat, Kauppalehti, Talouselämä, Aamulehti
- ²³² Article in Taloussanomat from 23 February 2000, “Stora Enso maksaa ylihintaa USA:n ostoksesta enemmän kuin UPM-Kymmene” – Stora Enso pays higher premium for US acquisition than UPM-Kymmene, available online 10 January 2010 at <http://www.taloussanomat.fi/arkisto/2000/02/23/stora-enso-maksaa-ylihintaa-usan-ostoksesta-enemman-kuin-upm-kymmene/200024862/12>
- ²³³ Article in Helsingin Sanomat “Sama päämäärä, kaksi tietä” – The same goal, two different routes, published on 23 February 2000
- ²³⁴ Article in Helsingin Sanomat “Suomella on nyt leveä kärki” – Finland is now running with a broad profile, published on 28 February 2000
- ²³⁵ Article in Suomen kuvalehti “Viimeinen vaihtoehto” – The last alternative. Published in magazine 18/2000
- ²³⁶ Article in Helsingin Sanomat ”UPM-Kymmene outbid: gives up planned merger with Champion” dated 15 May 2000, available online 10 January 2010 at: <http://www2.hs.fi/english/archive/today/150500-01.html>
- ²³⁷ Article in Kauppalehti: “Champion tarjoukset jo riskirajoilla” Champion offers already at critical level, published 12 May 2000, available online 11 January at <http://www.kauppalehti.fi/5/i/talous/uutiset/arkisto/showArticle.do?db=KKL0001T&ris=16&rid=8695&qid=0&rsi=0&page=0&size=20&hits=65>
- ²³⁸ Article in Helsingin Sanomat “Jos Jukka Härmälä olisi uskonut itseään” If Jukka Härmälä had believed himself, published 28 August 2002

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- ²³⁹ Article in Helsingin Sanomat “Puheenjohtajalla aiheita itsekritiikkiin” The chairman of the board has reason for self-criticism, published 22 September 2007
- ²⁴⁰ Editorial in Taloussanomat, published on 25 September 2007
- ²⁴¹ Discussion with adviser interviewee
- ²⁴² Example: Helsingin Sanomat article from 22 September 2007 “Stora Enso vetäytyy jättitappion jälkeen Pohjois-Amerikasta” cited online 24 August 2009 at http://www.mvphotos.eu/uploads/HS20070922SI3TA01_kopio.pdf
- ²⁴³ Discussion with Jukka Härmälä, Magnus Diesen, Esko Mäkeläinen and Kimmo Kalela on May 25 2009
- ²⁴⁴ Statement by Stora Enso management interviewee
- ²⁴⁵ For example, Myllykoski’s operating profit in 2005 about 4% while for Stora Enso it was 2,7%. (excluding non-recurring items) Data available 3 February 2010 at Myllykoski’s investor website, <http://www.myllykoski.com/EN/Facts+and+Figures/Operating+Profit/frontpage.htm> and at Stora Enso’s investor website, <http://www.storaenso.com/investors/reports/full-year-results/Pages/full-year-financial-results.aspx>
- ²⁴⁶ Opinion of an adviser interviewee
- ²⁴⁷ NewPage is North America’s largest producer of coated papers according to an investor presentation “Goldman Sachs Montreal Paper and Forest Products Investor Conference Presentation”, 19 March 2009, available online 3 February 2010 at http://library.corporate-ir.net/library/19/193/193188/items/329175/9BF17741-86A4-46F9-AB51-41FA4A0266AD_GoldmanSachs031809.pdf
- ²⁴⁸ Opinion of an adviser interviewee,
- ²⁴⁹ See chapter 5.2.5
- ²⁵⁰ See chapter 5.3.2
- ²⁵¹ See chapter 5.3.7
- ²⁵² Claes Dahlbäck’s speech the 2008 Stora Enso annual general meeting, video available online 10 January 2010 at http://www.goodmood.tv/vod/storaenso/agm_08_eng/index_wmv.htm
- ²⁵³ See UPM-Kymmene’s and Stora Enso’s annual results 1990-2000
- ²⁵⁴ For a definition of ROCE, see for example <http://www.investopedia.com/terms/r/roce.asp>, available online 3 February 2010
- ²⁵⁵ ROCE was claimed to be an important measure both by Stora Enso management as well as competitor interviewees
- ²⁵⁶ Statement by Stora Enso management interviewee
- ²⁵⁷ Discussions with management and adviser interviewees
- ²⁵⁸ Stora Enso Annual Report 1999, pp. 12, available online 3 February 2010 at http://www.storaenso.com/media-centre/publications/older-annual-reports/Documents/storaenso_annualreport1999pdf.pdf
- ²⁵⁹ Discussions with Stora Enso management and adviser interviewees
- ²⁶⁰ Statement by Stora Enso management interviewee, see chapter 5.3.4
- ²⁶¹ Statement by Stora Enso management interviewee
- ²⁶² Discussion with adviser interviewee
- ²⁶³ Slide from an internal R&D conference supplied by a management interviewee during an interview in September 2009
- ²⁶⁴ Discussion with adviser interviewee. Deal terms can be found in the related SEC filing by Consolidated Papers, pp.24, dated 28 July 2000, available online 3 February 2010 Consolidated Papers at <http://www.sec.gov/Archives/edgar/data/23752/000094018000000882/0000940180-00-000882.txt>
- ²⁶⁵ Discussion with an adviser interviewee
- ²⁶⁶ See chapter 5.2.8
- ²⁶⁷ Statement by an adviser interviewee
- ²⁶⁸ Ibid.
- ²⁶⁹ Discussions with Stora Enso management interviewees
- ²⁷⁰ See, for example, Kemijärvi example in chapter 5.1.5
- ²⁷¹ Statement by adviser interviewee
- ²⁷² Stora Enso 1999 full year results presentation published 10 February 2000, available online 29 January 2010 at: <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ²⁷³ Helsingin Sanomat article: ”Stora Enso ei myy Kemijärven tehdasta vaikka ostaja löytyisi” – Stora Enso won’t sell its Kemijärvi mill even though a buyer could be found <http://www.hs.fi/talous/artikkeli/Stora+Enso+ei+myy+Kemij%C3%A4rven+tehdasta+vaikka+ostaja+l%C3%B6ytyisi/1135231314486>

- ²⁷⁴ Iltasanomat article "Stora Enso sulkee kaksi tehdasta Suomesta" – Stora Enso closes two mills in Finland, published 25 October 2007, available online 10 January 2010 at:
<http://www.iltasanomat.fi/utiset/kotimaa/utinen.asp?id=1448243>
- ²⁷⁵ Discussions with a Stora Enso management interviewee (the CFO)
- ²⁷⁶ Source: Stora Enso Annual Reports 2000- 2008, available online 10 January 2010 at
<http://www.storaenso.com/media-centre/publications/older-annual-reports/Pages/older-annual-reports.aspx>
- ²⁷⁷ Statement by Stora Enso management interviewee
- ²⁷⁸ Discussion with Stora Enso management interviewee
- ²⁷⁹ Statement by Stora Enso management interviewee
- ²⁸⁰ Helsingin Sanomat article "10 epäonnistunutta yrityskauppaa ja yksi jokeri" – 10 failed M&A transactions and one joker – published 14 June 2008, available online 8 February 2010 at
<http://www.hs.fi/tulosta/1135237190786>
- ²⁸¹ See, for example, UPM-Kymmene full year results for 2008 pp.6, available online 3 February 2010 at
http://files.shareholder.com/downloads/UPMKYM/840625870x0x270552/f098165d-19d7-460c-ac3b-b523a8735860/FinancialReview_08en.pdf
- ²⁸² Discussion with Stora Enso management interviewee
- ²⁸³ See, for example, Stora Enso full year results presentation 2003, published 4 February 2004, available online 3 February 2010 at <http://www.storaenso.com/investors/presentations/2004/Pages/presentations-2004.aspx>
- ²⁸⁴ Helsingin Sanomat poll, "Stora Enson Amerikan retki epäonnisin yrityskauppa" Stora Enso's American venture the most unsuccessful acquisition", published 18 June 2008, available online 10 January at
<http://www.hs.fi/talous/artikkeli/Kysely+Stora+Enson+Amerikan+retki+ep%C3%A4onnisin+yrityskauppa/1135237288847>
- ²⁸⁵ Stora Enso 2008 Annual General Meeting presentation by Jouko Karvinen, on 26 March 2008, available online 10 January 2010 at : <http://www.storaenso.com/investors/presentations/2008/Pages/default.aspx>
- ²⁸⁶ Article in Taloussanomat "Stora Enso ei vieläkään kerro koko totuutta" Stora Enso still not telling the whole truth, published 28 March 2008, available online 12 February 2010 at
<http://www.taloussanomat.fi/utiset/2008/03/28/stora-enso-ei-vielakaan-kerro-koko-totuutta/20088829/12>
- ²⁸⁷ Article in Kauppalehti cited in November 2009 at:
<http://www.finsve.com/fi/ajankohtaista/utiset.asp?type=kauppalehti&itemid=1105>
- ²⁸⁸ Stora Enso investor presentation "Stora Enso today" from 13 September 2000, available online 12 February 2010 at <http://www.storaenso.com/investors/presentations/2000/Pages/presentations-2000.aspx>
- ²⁸⁹ Stora Enso investor presentation: "Divestment of North American paper operations. Presentation by Jouko Karvinen, CEO, and Hannu Ryöppönen, Deputy CEO & CFO" from 21 September 2007, available online 12 February 2010 at <http://www.storaenso.com/investors/presentations/2007/Pages/presentations-in-2007.aspx>
- ²⁹⁰ Helsingin Sanomat article "Stora Enso kirjaa NewPage omistuksena nollan arvoiseksi" Stora Enso revalues to zero its holdings in NewPage, published 17 July 2009, available online 12 February 2010 at
<http://www.hs.fi/talous/artikkeli/Stora+Enso+kirjaa+NewPage-omistuksensa+nollan+arvoiseksi/1135247720992>
- ²⁹¹ Article in Affarsvärlden "Sorgebruket" - from 13 November 2007, available online 10 January 2010 at:
<http://www.affarsvarlden.se/hem/nyheter/article280589.ece>
- ²⁹² Article in Kauppalehti: "Amerikan-retken hinta 1,3–3,3 miljardia euroa" The price of the American venture: 1.3-3.3 billion euros, published 6 November 2007, pp 7
- ²⁹³ Currency exchange rates calculated using Federal Reserve calculated yearly average rates available at
<http://www.federalreserve.gov/releases/g5a/20080102/>
- ²⁹⁴ Figures have been gathered from Stora Enso investor presentations 2000-2007, available online 12 February 2010 at <http://www.storaenso.com/investors/presentations/2009/Pages/default.aspx>
- ²⁹⁵ Press release by Stora Enso, "Stora Enso's Port Hawkesbury mill to restart", published 29 September 2006, available online 12 February 2010 at <http://www.storaenso.com/media-centre/press-releases/2006/09/Pages/stora-ensos-port-hawkesbury-mill-to-restart.aspx>
- ²⁹⁶ Statistics from the US treasury, available online 10 January 2010 at :
http://www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield_historical_huge.shtml
- ²⁹⁷ Figures gathered from Stora Enso investor presentations 2000-2007
- ²⁹⁸ Stora Enso annual report 2004, pp. 56, available online 12 February 2010 at
<http://www.storaenso.com/media-centre/publications/older-annual-reports/Documents/financials-2004-english.pdf>
- ²⁹⁹ Stora Enso annual report 2007, pp.120, available online 12 February 2010 at
<http://www.storaenso.com/Documents/annual-report-2007-eng.pdf>
- ³⁰⁰ Ibid. Page 184
- ³⁰¹ Figures gathered from Stora Enso investor presentations 2000-2007

³⁰² The chairman of the board, Claes Dahlbäck, in an interview with Swedish newspaper E24, , published 4 February 2010, available online 2 March 2010 at http://www.e24.se/business/ravaror/dahlback-visst-gramer-jag-mig-over-usa-affaren_1840883.e24

³⁰³ The difference between the two figures owes to the fact that the US dollar sum does not include any hedging gains. The euro sum has been obtained by converting yearly cash flows at end of the year rates to euros, adding the gains from the company's Dollar hedges.

³⁰⁴ A NewPage investor presentation, "Goldman Sachs Montreal Paper and Forest Products Investor Conference Presentation", 19 March 2009, available online 3 February 2010 at http://library.corporate-ir.net/library/19/193/193188/items/329175/9BF17741-86A4-46F9-AB51-41FA4A0266AD_GoldmanSachs031809.pdf

³⁰⁵ Ibid.