CAC XI : RIO DE JANEIRO

Item 'J' : Introduction to Paper/Pulp Session

1. The first slide shows the contributions to the Group's 1988 Turnover and Trading Profits from the different Paper and Pulp activities.

   It also shows the forecasts for 1993 taken from the Operating Group plans.

   Once again, there are slight differences from the figures shown by David Allvey but none of these is significant.

2. Key features of the table are:-

   (a) The importance of Carbonless (which includes Thermal Papers), accounting for 64% of profits in 1988 and 68% in 1993.

   (b) The significance of the £39 million contribution from pulp in 1988, which only rises to £45 million by 1993 because of an expected squeeze on prices and margins.

3. Taking Appleton and Wiggins Teape first, the returns on net assets in both companies are around 22% or 23% and assuming that these returns can be sustained, the businesses should be capable of meeting the Group's requirement for self-funded growth.

4. Assessments of the market prospects for the main sectors in which the two companies operate suggest that although the demand for Paper overall is expected to grow at 3% p.a., Printings and Writings will grow at around 4% p.a, with Carbonless growing somewhat faster at 4-5%. This, however, is significantly slower than the growth rates of over 10% experienced in the early 1980's and also represents a decrease from the 7-8% rates of growth in 1987 and 1988.

5. The existing activity with the best prospects for growth is Thermal Papers, used in fax machines (50%), sensitised labels (20%) and other applications such as recorders for charts (30%). Although the current size of the market is small in relation to Carbonless (40,000 tonnes in the US compared with 900,000 tonnes for Carbonless), demand is growing at over 20% p.a. and by 1993 is expected to reach over 100,000 tonnes p.a. The market in Europe has similar characteristics.

   Longer term, further technical developments are expected to lead to fax machines capable of using plain paper but even when this development occurs, the growth rates for Thermal papers are still expected to remain high.

6. The demand for pulp is forecast to grow at around 2.8% with market pulp (i.e. pulp sold on the open market rather than being used in integrated manufacture) growing somewhat faster at around 4% p.a. in line with the growth in output of Printings and Writings. Substantial increased capacity for pulp manufacture is due to come on stream in the early 1990's just when demand is expected to slacken in line with the forecast reduction in the rate of overall economic growth. As a result, prices are expected to be under pressure at about this time. However, because of its better economics, the margins on Eucalyptus pulp should hold up rather better than those for the higher cost pulps based on Northern softwoods. Longer term, prices are expected to fall gradually in real terms as further sources of low cost wood are opened up.

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7. Because of the balance between pulp and paper capacity, the Group will be somewhat insulated from the effects of the drop in pulp prices since the lower profits from pulp will be offset, at least initially, by improved paper margins. However, the longer term prospects must be for lower growth and increased pressure on margins due to the pressure on the Carbonless market.

8. The forecasts for Wiggins Teape show sales increasing faster than the market due to an assumed 0.5% p.a. improvement in market share. Profits are shown as increasing by 15.7% p.a. due to improved margins.

9. Appleton is forecasting lower growth as market shares are assumed to fall gradually from 45% to 43%. However, even this represents an improvement in trend compared with the last two years during which the market share fell from 50% in 1986 to 45% in 1988. Trading Profits are forecast to increase by 11.4% p.a. over the next five years which is significantly faster than sales.

10. The sensitivity of these forecasts for the existing businesses is an obvious issue. However, as indicated in the Chairman's analysis of the strategic issues for the Group, it is suggested that the main discussion today ought to centre on the renewal options for the business.

11. The subjects for discussion are summarised on the next slide:-

    (a) The first requirement is to identify possible renewal options meeting the Group's criteria for returns and growth potential and also being large enough to be significant in relation to Carbonless. A sub-issue here will be the potential size of Thermals and the extent to which this product group has the potential to boost the growth of Carbonless to acceptable rates overall.

    (b) The second issue is the level of investment that would be required to establish the Group in a leadership position in whichever market segment is identified for the renewal option.

    (c) Assuming that the renewal option involves an entry into a substantial new market, the investment required to establish a leadership position would be significantly large and the Group may not want to commit this scale of further resource to Paper. It has therefore been suggested that alternative strategies might be considered for a genuine merger through an exchange of shares rather than through an outright acquisition.

    (d) The final two issues are concerned with the options for Brazil and for BATCo. However, the most important issue is the renewal options.

[The Chairman to invite Mr. Frigon or Mr. Broughton to open the discussion].

RS/DJA
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