By **MONICA SHAW,** Editor

Boxing it up the right way

Smurfit-Stone Container's CEO Patrick Moore talks with *Pulp & Paper* about a new strategy that boxes the company into a more manageable structure that can focus on a profitable containerboard effort

Since the formation of Smurfit-Stone in 1998 with the merger of Jefferson Smurfit Corp. and Stone Container Corp., a series of factors have come together to alter the paperboard and packaging landscape, according to Patrick J. Moore, and these led to Smurfit-Stone's strategic repositioning that was announced last November. Moore, Smurfit-Stone's chairman and CEO, recently spoke with *Pulp & Paper* regarding the restructuring plan, the sale of Smurfit-Stone's Consumer Packaging division, safety, and other industry topics.

Moore joined Jefferson Smurfit in 1987 as assistant treasurer after 12 years in the banking industry. He has held various positions within the company, including treasurer, vice president of the Industrial Packaging division, and CFO. In January 2002, Moore was named president and CEO of Smurfit-Stone Container Corp. He was elected to the additional post of chairman in May 2003.

STRATEGIC RESTRUCTURING PLAN

Smurfit-Stone announced its restructuring plan in November 2005. Can you comment on the plan and its progress since that time?

Overall, ours is a four-pronged strategic plan targeting the removal of $600 million in costs over a three-year period ending in 2008, generating $650 million in additional revenue, greater financial flexibility through the help of debt reduction, and changes to our organizational structure. I believe that organizational change is especially critical, because without that it's hard to achieve the other three. [Note: Smurfit-Stone has recalculated its cost-reduction target to $525 million by 2008 to reflect the sale of its Consumer Packaging business.]

Smurfit-Stone was organized along fairly traditional lines for our industry in that we had a number of plants run by general managers with full authority, creating too many independent decision makers. Now, we are organized along more functional lines, especially in the operations area. With the new strategic plan, we've moved away from the complex regional manager structure with area general managers and plant general managers. We now have regional sales vice presidents and regional manufacturing vice presidents, with manufacturing and sales at each plant reporting to them.

Moore says the new strategic plan allows Smurfit-Stone "to drive scale and efficiency."

Prior to the restructuring, our sales organization would sell for one or maybe a complex of plants — probably no more than four within a general geographic region. Now, they sell for the whole system. For example, if a sales rep in Chicago finds business that is most efficiently run in Florida, we do so if it makes sense operationally. Before, plant geography constrained us because we were afraid to ship products too far. The real issue is driving business to the lowest cost manufacturing facility as opposed to just minimizing freight. This also allows us to drive a standardization of operating practices within the organization, which is critical.

In addition, it allows us to drive scale and efficiency, which has suffered with the series of acquisitions that provided too many smaller, inefficient plants. We are now driving toward larger, more efficient plants, committing up to $400 million to do so. Our new president and COO, Steve Klinger, is driving toward a higher margin business and he really adds to the organizational integrity we're trying to build.

We have a few pieces missing with regard to our strategic plan, but for the most part the structure is in place and functioning as we had hoped. In the second quarter of this year, favorable market conditions, increased containerboard production and higher average prices drove the improvement in our results from the first quarter. Also, our mills ran at full capacity during the second quarter. Average per-day box shipments were up from the same period last year, despite the closure of seven box plants since the second quarter of 2005. In addition, the sale of our Consumer Packaging segment for $1.04 billion at the end of the second quarter will allow us to focus on our core businesses. We are encouraged by the initial progress on our strategic initiatives, and I look forward to a return to profitability in the third quarter 2006 as solid demand combined with low containerboard inventories continue.

Some analysts were doubtful about Smurfit-Stone's ability to find a buyer for its Consumer Packaging operations as advertised in the restructuring announcement, since some of the more obvious choices carried lots of financial leverage. Still others were surprised at the amount paid for the assets by the private Texas Pacific Group. Why was this business unit targeted? How do you view the transaction?

As Smurfit-Stone grew, it became more of a containerboard company, which represented more than 75% of our revenue stream. It is important to note that our former Consumer Packaging division was very diverse, with four coated recycled boxboard mills and 40 converting plants involved in flexible packaging, contract packaging, laminations, and multiwall specialty bag businesses in addition to folding cartons. We felt we did not have a big enough market share to influence what happened in those businesses going forward and that we didn't have the resources available to drive further consolidation there.

Through the whole process of selling the Consumer Packaging business, I said it wasn't going to be a fire sale. We drove towards a fair value, and we achieved our goals. We found a very strong buyer in Texas Pacific Group. We received what we believe to be a fair price for the business, and it's a fully financed transaction.

As Smurfit-Stone seeks $650 million in additional revenue growth, what sort of value-added strategy are you pursuing to improve margins?

Smurfit-Stone has definite competitive advantages on this front. First, we have the largest integrated system in the industry, which gives us unparalleled geographic reach. In addition, we have an array of innovating products such as our META and VPS packaging systems, as well as our EnviroShell and RecyclaCorr products, among many others. We are improving our manufacturing product mix with more higher growth categories. And, as we lower our cost profile, many product categories that previously were unattractive to us will present growth opportunities.

Moore says value-added products like RecyclaCorr, a wax replacement medium that is safe for direct and indirect food contact and is recyclable, will help Smurfit-Stone reach revenue targets.

We are also growing our Asian business, allowing us to provide products and services along the supply chain. Rather than investing in additional assets there, we basically act as our supply chain into Asia for packaging, managing vendor processes over there. If there's a non-corrugated part of the package, we'll source it. We do all the design, graphics, and photography. We're the full-service agency for our Asian customers.

COST CONTROL AT BOX PLANTS AND MILLS

You have called the effort to rationalize the box plant system and lower corrugated converting costs the "lynchpin" in Smurfit-Stone's strategic plan. How many more plants will be closed and what is the significance of the $250 million set aside for new 2 billion ft²/yr high-speed corrugators?

Prior to implementing the restructuring plan, Smurfit-Stone closed 35 corrugated plants since its 1998 formation. I don't think people realize the extent of what we've done to drive out our lower margin business. We've announced the closing of another 12 box plants since our restructuring began in 2005, with a target of 25-30 plants by year-end 2008. We're pretty comfortable with what business is left, and our strategy is to retain a significant portion of it.

We have a lot of corrugating plants that are very efficient, very low cost. It's just that they're balanced on the wrong side by some of the less efficient, higher cost facilities, so we could still close as many as another 15 plants or so, and remove corrugators from another half dozen, which will become sheet plants. Corrugating capacity will be replaced with the new high-speed corrugators, four or five of which will probably end up in large metropolitan areas, saving up to $290 million per year by the end of 2008.

Naturally, there will be an installation sequence due to cash flow and resources to manage the projects, but we have them prioritized. Milton, Ontario, is already on line, with scaling efforts underway in metropolitan areas such as Dallas, Los Angeles, and Atlanta. Our mill system can support these new corrugators, and integration levels won't change dramatically.

I think the part of our strategy distinguishing us from others is the fact that we have the largest market share. We operate in almost every major region in North America, so we can shut down less efficient facilities and move that production into a larger, efficient plant without losing much market share. We are able to scale up, and that's a very important part of our strategy. We're not going to do this by giving up market share.

However, Smurfit-Stone's three-year plan isn't focused only on closures or on building new large-scale facilities. It's also centered around consolidation in urban areas that capitalizes on opportunities within existing plants. We have an incremental $330 million set aside for investment in the corrugators and new converting equipment, as well as capital for a new management information system to support our efforts.

What is Smurfit-Stone's strategy for driving out costs at the mill level?

We kicked off the strategic restructuring process last year with the closure of two Canadian facilities in August, providing substantial margin improvement for our organization. Obviously, Canada is a very difficult place to do business from a competitive standpoint today. The currency disadvantage is huge, and fiber availability is a big issue.

But we've also been investing in our mills over a number of years. Today, we're more focused on energy related projects. Our forward view is that energy will continue to be a persistent issue, and so we're focused on lowering energy used at mills, whatever the form. We hedge. We enter longer-term contracts. But energy reduction is the real focus, so we're putting capital there.

As an industry, the bulk of required environmental spending should be behind us by mid-2007. Barring any new regulations from Washington, this should free up capital for further energy reductions and other projects.

While we have a very large mill system with 19 mills and 32 machines, we're a very competitive mill system. In its totality, it's probably mid-second quartile from a cost standpoint, and we're pleased with that progress.

How are you optimizing the integrated mill and box plant system to reduce costs?

Part of our initiative is to just do a better job of running this big, big system we have. When you look at our competitors, especially as it relates to containerboard, nobody has a system as large as or as diverse as ours, so challenges associated with optimization are pretty enormous.

We have a good deal of visibility into our supply chain. We invested early on after the merger of the companies in 1998 to create a sophisticated supply chain, so we move product from Point A to Point B very well. But optimizing the grades within a 32-machine system is tough, as is balancing that with the needs of the market today.

We've made a lot of progress in adding to the efficiency of our mill system, both on trim optimization where we've reduced the number of sizes by 90%, as well as the number of grades we're making by more than 50%. We're beginning to see some of the benefits in box plant inventories and mill trim efficiency, which we are measuring through our strategic plan.

Workers at the Fernandina Beach, Fla., box plant monitor product quality.

INDUSTRY TRENDS

Smurfit-Stone has experienced the influx of outside money into the industry with the Texas Pacific deal. How do you feel about the general trend of private companies buying into the industry? What advantages do these companies have?

Right now, there is a good match between the pulp and paper industry, which is restructuring and has assets available for sale, with a financial market that has been very robust from an equity standpoint. It hasn't always been that way in private equity, which is a very cyclical business as well, but today it happens to be very liquid. There's just a lot of opportunity out there on both sides, but I do think it's a good thing longer term for our industry. It should be important to people that we're attracting new capital into the business, and it will be good for the competitive juices within the industry.

Private companies are able to look beyond the next quarter, which is very difficult for public ones. In today's public company environment, it is difficult to restructure as an industry and restructure as a company, as we are doing. If you have some slippage in a quarter, you tend to pay a pretty severe price for that.

Although Smurfit-Stone has a three-year strategic plan, I do expect quarter-to-quarter execution of it, and our management team will tell you that I'm very stringent about that. But again, I look at it as the benefit over three years.

Is there any way that the North American industry can keep its large multinational customers from sourcing boxes in China?

I think if they're manufacturing in China, they're going to source boxes in China, so Smurfit-Stone wants to be the one sourcing the packaging for them through our joint venture there, eliminating the need for them to have separate procurement offices in China. We simply act as their supply chain for packaging. We also have such joint ventures in Thailand and India, and we're currently looking elsewhere in Asia.

As far as the containerboard industry in specific, I think it's difficult for us to compete in the industry there. You're not going to build a mill in China, as the quality of product there is very good today. Now, it is recycled base, so it doesn't fit all applications but it's still a very high quality product. We can buy from Nine Dragons just as easily as build a mill over there.

Do you foresee that RFID costs will have to be absorbed by box makers? What are some of your efforts in the area and what does the future hold?

Our view at Smurfit-Stone is that RFID technology will be part of the total cost of a package for our customers. We will price accordingly. We must come to an agreement on how this whole process will work, but if we add value to our customers, allowing them to sell more product as a result of what we're doing, then we would expect to get paid for it.

We're working with all of our major customers who are impacted by RFID, and we do a lot of business with large consumer products companies, all of whom are in one form or another going through RFID testing. What will drive the adoption of RFID is whether the chips and the tags can be manufactured in a cost efficient manner, and we think those costs are prohibitive at this time.

Still, at our Carol Stream, Ill., R&D Center we are aggressively approaching the issue, testing prototypes of the readers and packaging lines. I would say we are as far out as or ahead of anyone else on the RFID issue, but no one's got a solution today.

If you looked back to three or four years ago, you might have thought the industry would be a bit further along with RFID, but in another three or four years, who knows? It might become far more economic to produce the tags and find ways to apply them in, again, a cost efficient manner that drives value for our customers.

Smurfit-Stone's Stevenson, Ala., mill was one of the first mills of its size to achieve one million hours worked and one full year worked without a recordable incident when it accomplished the feat in 2003. The mill is an OSHA VPP Star facility.

Moore (third from right) celebrates 1 million hours without a recordable incident with employees at Smurfit-Stone's West Point, Va., mill.

You received the Pulp & Paper Safety Assn.'s Executive Eagle Award for safety excellence this year, and three Smurfit-Stone mills were given awards for the monumental achievement of more than 1 million hours worked without a lost time incident. To what do you attribute Smurfit-Stone's safety record?

It's just a culture within Smurfit-Stone. It's that difficult, but it's that simple. We just live it day in and day out, and it impacts everything we do in our organization. We don't do business any other way.

Safety is our No. 1 operating priority, and we will shut a facility down to correct it. We view it as a process that can be managed, and maybe that's how we're different. Others sometimes seem to accept that it's a difficult industry and people are going to get hurt. We don't believe that.

It's not just Smurfit-Stone, obviously, that deals with safety extremely well. But maybe we just have that little extra focus on it that separates us a bit from the rest of the pack.

I'm not just proud of our people, but the industry as a whole for being as focused on safety as it is. I believe that says a great deal about the value we place on our employees within this industry. **P&P**