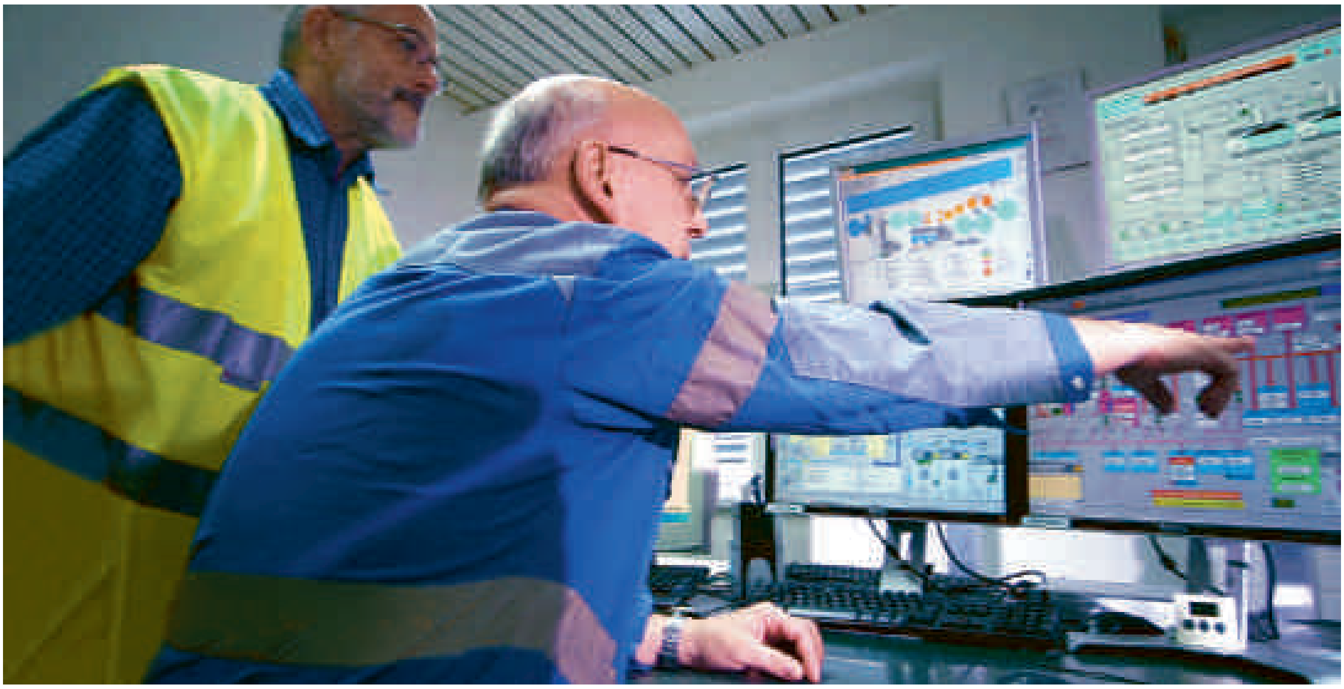
Operational progress nullified by consequences of fire and price declines



Despite an increase in the volumes of product sold, the Paper Division saw its net sales decline 2.8% to CHF 305.7 million. Falling prices, a fire in the winder of the PM 4 paper machine and an impairment to the division's tangible fixed assets all had their adverse impact on EBIT for the year, which stood at CHF –264.7 million.

Market environment

The demand in Western Europe for newsprint and magazine paper suffered a further decline in 2013, albeit a slighter one than the previous year. European demand for newsprint was down 6%, while magazine paper saw an 8% decline. By comparison, demand for newsprint in Switzerland fell 9% year-on-year, while Swiss demand for magazine paper was down 8%. The declines in the demand for magazine paper are due partly to a trend among customers to opt for lower paper qualities to reduce their costs.

On the supply side, the mothballing of newsprint facilities by several manufacturers had a positive effect. About a million tonnes of Western European newsprint production capacity was taken out of the market in 2013. As a result, and for the first time in years, supply and demand approached broadly equal levels, and prices could be raised in the second half of the year. The increases were modest, though, and were insufficient to fully offset first-half price declines.

On the magazine paper front, Western Europe still has about a million tonnes of overcapacity. Machine utilizations here remained poor, and prices showed sideways and slightly downward trends.

Europe's paper manufacturers are experiencing bleak times in earnings terms, and most of them posted red-ink operating results for the year. CPH's Paper Division faces further adversity through the continuing overvaluation of the Swiss franc: Perlen Papier manufactures all its products in Switzerland, but exported 81% in 2013 (compared to 79% the year before). The markets are also taking longer to recover than had been hoped, and the predatory competition remains fierce. In view of all these factors, the CPH Board of Directors and Group Executive Management resolved to effect a CHF 235.0 million impairment to the division's tangible fixed assets.

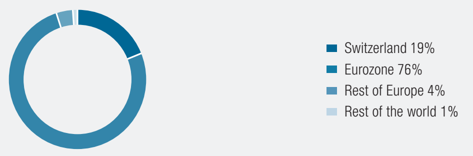
Business development

The Paper Division sold 373 008 tonnes of newsprint in 2013, an 8.9% increase on the previous year. The PM 7 paper machine is still ramping up on schedule to its full annual capacity, which should ultimately reach 360 000 tonnes. Last year – its third full year of operation – already brought the milestone of the first million tonnes.

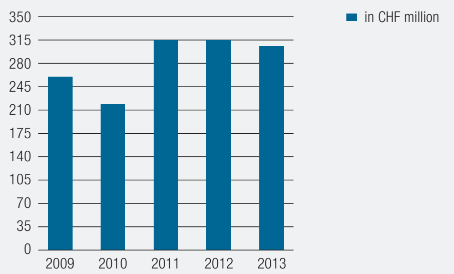
The 141 390 tonnes of magazine paper produced, by contrast, represented a 15.0% decline. The fire in the winder of the PM 4 paper machine at the end of October resulted in a 32 300-tonne loss of production in November and December. The damage caused by the fire and the resulting production loss were largely covered by insurance policies held.

Despite strong volume placements, the division's CHF 305.7 million net sales for the year fell short of the CHF 314.3 million generated in 2012.

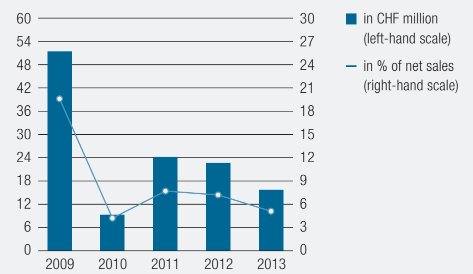
Paper net sales by region



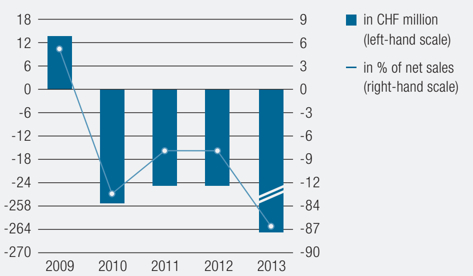
Paper net sales trends



Paper EBITDA trends



Paper EBIT trends



The reasons for this can be found primarily in the further paper price declines, which again nullified all the progress made on the cost front. Perlen Papier's share of the Swiss newsprint market was increased to 34%, while its share of the Swiss magazine paper market remained unchanged at 32%.

Perlen Papier has made great efforts to improve its performance and has achieved further efficiency gains. The increased volumes recorded over the past few years have been produced with a slightly smaller workforce, which numbered 365 personnel at the end of 2013. Savings have also been achieved on the energy cost front; and the drive to obtain more recovered paper from Swiss sources also showed further success.

The division reported an EBITDA for 2013 of CHF 15.6 million, down from the CHF 22.6 million of the previous year. Capital spending increased from the CHF 3.5 million of 2012 to CHF 9.8 million. Up until the PM 4 winder fire, year-to-date EBIT had been broadly at its 2012 levels. But the exceptional expense incurred through the fire and its impact on production removed CHF 4.5 million from the EBIT result. The impairment to the division's tangible fixed assets depressed the operating result by a further CHF 235.0 million, producing an EBIT for the year that, at CHF –264.7 million, was a decline on 2012.

Strategy

Perlen Papier aims to achieve cost leadership in its prime sales market for paper production activities. To this end, the division will continue to pursue its efficiency-enhancement and profitability-raising programme, with a particular emphasis on promoting the procurement of the recovered paper used in its production from Swiss sources.

In view of the energy-intensive nature of its manufacturing activities, the division is putting a further focus on enhancing energy costs. With this aim in mind, the Perlen site resolved to switch to the free electricity market for its energy needs from 2014 onwards. The move is expected to deliver savings of over CHF 10 million in 2014 alone. The entry into operation of the nearby Renergia waste incinerator facility will further improve Perlen Papier's energy and carbon emission credentials. The Renergia project is well on track, and the facility will open as planned in 2015.

Outlook

Given the present broad balance between supply and demand in the newsprint segment, the pressure on paper prices may ease in the shorter term. But Western European demand for this paper product is expected to decline a further 6% in 2014. On the magazine paper front, the overcapacities remain and the resulting predatory competition is likely to further increase. With its advanced manufacturing facilities, though, Perlen Papier is well equipped to meet and master these challenges; and its continued endeavours to raise the efficiency of its production and business activities should have a positive impact on its operating results.