

# Report on Operations by the Board of Directors

## Markets and Deliveries

Reduced demand and weakening prices characterised the paper and board markets in 2001. The uncertainty began in late 2000 and intensified during 2001 as a result of the deterioration in the global economy. Stora Enso continued to adjust production to market demand, curtailing paper and board output in line with the weak market by 1 540 000 tonnes, of which 396 000 tonnes took place in North America.

Paper and board deliveries totalled 12 858 000 (12 971 000) tonnes and sawn timber deliveries 4 860 000 (4 880 000) cubic metres.

## Sales and Financial Results

Earnings per share (basic) were EUR 0.94 (EUR 1.32) and cash earnings per share EUR 2.34 (EUR 2.61), excluding non-recurring items in both cases. Earnings per share (basic), including non-recurring items, amounted to EUR 1.03 (EUR 1.77), with comparable cash earnings per share being EUR 2.43 (EUR 3.16).

Sales for the year rose to EUR 13 508.8 (EUR 13 017.0) million, up EUR 491.8 million or 3.8% on the previous year. The figures for 2000 included EUR 317.2 million from the divested Gruvön Mill while the acquisition of Consolidated Papers, Inc. boosted the 2001 figures by net EUR 1 375.3 million. Lower volumes led to a decline of EUR 470 million in sales of magazine and fine papers.

Earnings before interest, tax, depreciation and goodwill amortisation (EBITDA), excluding non-recurring items, totalled EUR 2 762.8 million or 20.5% of sales (EUR 2 970.2 million or 22.8%), a decrease of 7.0% on the previous year.

Operating profit excluding non-recurring items was EUR 1 495.2 million or 11.1% of sales (EUR 1 925.6 million or 14.8%), a decrease of 22.4% due to lower sales volumes and prices as well as increased depreciation.

All other product areas, with the exception of newsprint, reported lower operating profits than in 2000.

Based on average rate for the year the strengthening of the US dollar was offset by a weaker UK pound and Swedish krona. Thus the net effect on sales was a negative EUR 15 million. The corresponding estimated

currency effect on operating profit was a positive EUR 60 million, mainly due to Swedish krona-based costs and depreciation.

Operating profit for the year totalled EUR 1 486.9 (EUR 2 371.3) million including net non-recurring items of EUR -8.3 million. These items comprised a gain of EUR 18.0 million from the sale of the Düsseldorf office in Germany and EUR 9.6 million in redundancy costs at the Nymölla Mill, Sweden. It also includes a EUR 16.7 million provision relating to the disposal price of Stora Carbonless Paper GmbH, a case which is still under negotiation.

Depreciation and goodwill amortisation totalled EUR 1 267.6 (EUR 1 129.4) million. The Consolidated Papers, Inc. acquisition increased goodwill amortisation by EUR 64.7 million (equal to USD 57.2 million) and depreciation by EUR 220.3 million. The increase was partly offset by the divestment of Gruvön Mill, totalling about EUR 25 million.

The share of results in associated companies was EUR 79.6 (EUR 20.6) million, of which Billerud AB accounted for EUR 56.9 million and the Sunila Oy pulp mill for EUR 15.2 million.

Net interest was EUR 333.1 million, 5.9% of interest-bearing net liabilities and up EUR 27.9 million on the previous year. Foreign exchange losses were EUR 58.5 million and dividend income was EUR 17.0 million.

Profit before taxes and minority interests amounted to EUR 1 223.0 (EUR 2 099.0) million, down EUR 876.0 million on the previous year. Profit excluding non-recurring items was EUR 1 231.3 (EUR 1 653.3) million, down 25.5%. Taxes amounted to EUR 299.6 (EUR 650.3) million and include a one-time adjustment of EUR 86.6 million resulting from the corporate restructuring in Germany. Excluding this item the effective tax rate was 31.6% (31.0%). Minority interest in profits was EUR 2.9 (EUR 13.7) million, leaving a net profit of EUR 926.3 (EUR 1 435.0) million.

Return on capital employed excluding non-recurring items was 10.8% (16.8%), which is higher than the average cost of capital (WACC). Thus Stora Enso is creating value. Capital employed at the year-end was EUR 13 859.1 (EUR 13 902.9) million, a net decrease of EUR 43.8 million.

## Financing

Cash flow from operations amounted to EUR 2 757.5 (EUR 2 818.0) million. Operating cash flow, being the cash flow from operations less investing activities, totalled EUR 1 849.9 (EUR -1 800.9) million.

At the year-end interest-bearing net liabilities were EUR 4 819.9 million, a decrease of EUR 362.8 million on the year 2000. Unutilised credit facilities totalled EUR 2.8 billion at the year-end.

The debt/equity ratio at 31 December was 0.53, compared with 0.59 at the end of 2000. Equity per share was EUR 10.0 against EUR 9.4 in the previous year.

## Stora Enso North America

Following the acquisition of Consolidated Papers, Inc. in September 2000, Stora Enso's integration process in North America is now successfully completed. The North American leadership team is in place and operations have been assessed and streamlined to enhance productivity, quality and efficiencies.

Financially, North American operations remained depressed during 2001 due to the recessionary US economy. Weak demand and low prices resulted in an operating loss for the year of USD 26 million (equal to EUR 29 million) before goodwill amortisation. Despite the weak market, the operating cash flow amounted to USD 210 million (equal to EUR 234 million). Curtailments amounted to 396 000 tonnes.

Synergy benefits from the acquisition for 2001 amounted to USD 66 million (equal to EUR 74 million), less than the initially calculated USD 90 million (equal to EUR 98 million). This may be considered a good achievement in difficult market conditions that severely limited productivity-related synergy gains. The main synergy sources were the transfer and implementation of best practice.

## Capital Expenditure

Capital expenditure totalled EUR 857.1 (EUR 769.3) million, well in line with the Group policy of not exceeding the annual level of depreciation. The main investments were the new pulping line no. 3 (EUR 134.5 million) and the rebuilding of board machine no. 5 (EUR 11.2 million) in Imatra, Finland, the rebuilding of fine paper machine no. 6 (EUR 56.7 million) in Oulu, Finland, fine paper machine no. 2 (EUR 22.1 million) in Uetersen, Germany, and newsprint paper machine no. 3 (EUR 14.5 million) in Summa, Finland.

An asset restructuring programme to increase competitiveness in the newsprint and magazine paper

businesses was initiated. The programme includes a newsprint production line, a biofuel power plant and the rebuilding of paper machine no. 3 in Langerbrugge, Belgium, as well as the shutting-down of paper machines no. 2 at Langerbrugge and no. 1 at Summa. The new newsprint line is expected to go on stream in June 2003.

In April ZAO Stora Enso Packaging announced the expansion of the production capacity of its plant in Balabanovo, Russia, with a total investment of EUR 14 million. The new capacity is expected to go on stream in March 2002.

## Changes in Group Structure

In March it was decided to dissolve the Pulp Division and reallocate non-integrated pulp mills to the Divisions to better reflect the balance in Group pulp sales and purchases as well as increase the captive use of pulp.

In August the Board approved the purchase of the outstanding 26.5% minority holding in Stora Enso Timber owned by SPB Beteiligungsverwaltung GmbH of Austria. Following the acquisition of the shares on 8 October, Timber Products became a core product area along with Publication Papers, Fine Paper and Packaging Boards.

In October Stora Enso agreed to sell 40% of its shareholding in Billerud AB (20% of the company) to AssiDomän AB pursuant to an option agreement made in autumn 2000. The disposal leaves the Group with a 30% holding, but the intention is to reduce the holding further. Billerud shares were listed on the Stockholm Stock Exchange on 20 November.

In October Stora Enso increased its holding in Stora Enso Suzhou Paper Co., China, by 20% to 80.87%.

In October the formation of a Specialty Papers Business Group within the Packaging Boards Division was announced. The new group comprises Stevens Point Mill, USA, Uetersen paper machine no. 1, Germany and Imatra paper machine no. 6, Finland.

During the year the streamlining of the Group structure continued with the merging of numerous separate legal entities within the Group.

## Research and Development

Research and development expenditure amounted to EUR 92.3 (EUR 94.5) million, which is 0.7% of sales. R&D focused on developing products for food and beverage packaging and services and on providing a comprehensive range of paper products for different printing and copying technologies.

## Personnel

The number of employees fell during the year by 1 692 to 42 932 at the 31 December mainly due to the divestment of Gruvön Mill and reductions in North America. The average number of employees was 44 275, up 2 490 on the previous year. The main reason for the increase was the full-year accounting of Consolidated Papers, Inc.

## Management Group Changes

Ingvar Petersson, Senior Executive Vice President, retired on 1 September 2001 and his responsibilities were divided as follows:

- Esko Mäkeläinen, Senior Executive Vice President, assumed responsibility for Stora Enso Financial Services in addition to his earlier responsibilities and was also appointed Chief Financial Officer, reporting to the CEO.
- Yngve Ståde, Senior Executive Vice President, Corporate Support, assumed responsibility for Northern European Forest Units, reporting to the Deputy CEO.

Kimmo Kalela, Senior Executive Vice President, Strategy and Business Development, retired at the end of 2001 and his responsibilities were divided as follows:

- Pekka Laaksonen, Senior Executive Vice President, Packaging Boards, assumed responsibility for Stora Enso's regional matters in Finland, retaining his previous responsibilities, reporting to the Deputy CEO.
- Magnus Diesen became Executive Vice President, Corporate Strategy, Investments and Business Planning, reporting to the CEO.
- Nils Grafström became Executive Vice President, Market Services and Information Technology, responsible for Corporate Marketing and Sales, retaining responsibility for South America, reporting to the CEO.

Jouko Taukojärvi, Senior Executive Vice President, Fine Paper, retired at the end of 2001 and was succeeded by Jussi Huttunen, who was appointed Senior Executive Vice President and a member of the Executive Management Group, reporting to the Deputy CEO.

Arno Pelkonen, was appointed Senior Executive Vice President, Timber, and a member of the Executive Management Group, reporting to the Deputy CEO.

## Issues with Competition Authorities

In December, the Supreme Administrative Court in Finland announced its decision on collaboration between Finnish forest companies in wood trade follow-up meetings. The Court imposed a final fine of FIM 3 million instead of the FIM 10 million earlier imposed by the Finnish Competition Council which Stora Enso had paid. The excess amount will be refunded.

The Company has replied to a Statement of Objection received from the European Commission in Autumn 1999 relating to newsprint producer operations in 1989-1995. The Company is still awaiting the Commission's decision and no provision has been made in this respect.

## Changes in Share Capital

During 2001 a total of 1 392 000 A shares and 15 932 800 R shares were repurchased by the Company. The average price paid for A shares was EUR 11.87 and for R shares EUR 11.52.

The Annual General Meeting (AGM) on 20 March 2001 decided to lower the Company's share capital by EUR 39.4 million through the cancellation of 910 600 A shares and 22 260 100 R shares. These shares had been repurchased under the authorisation of the AGM 2000.

The AGM on 20 March 2001 further authorised the Board to repurchase and dispose of not more than 9 679 000 A shares and not more than 35 586 000 R shares in the Company. Repurchases started on 28 March 2001 and by the year-end, 799 400 A shares and 9 974 000 R shares had been repurchased, representing 8.3% and 28.0% of the respective targets. By 31 December 2001 the Company had allocated 20 329 of the repurchased R shares under the terms of the Stora Enso North America Option Plan, leaving the Company holding 799 400 A shares and 9 953 671 R shares.

During the annual conversion period of 17-28 September 2001, a total of 4 524 requests were made for the conversion of A shares into R shares and accordingly 9 312 271 shares were converted.

A total of 2 001 733 new R shares were issued under the terms of the Stora Enso North America Option Plan and 1 857 000 new R shares were issued under the terms of the 1997 bonds with warrants. Of the latter 1 158 000 were registered in the Finnish Trade Register on 10 January 2002.

### **Share Capital**

At the year end Stora Enso had 184 273 585 A shares and 722 479 714 R shares in issue, of which the Company held 799 400 A shares and 9 953 671 R shares with a nominal value of EUR 18.3 million. The repurchased shares represent 1.2% of the Company's share capital and 0.7% of voting rights. Shareholders' equity amounted to EUR 8 989.0 million against a market capitalisation on the Helsinki Stock Exchange on 31 December of EUR 13.0 billion. The nominal value of the issued share capital was EUR 1 541.5 million.

### **Significant Changes in Ownership**

On 15 June 2001 Investor AB announced the sale of its entire shareholding in Stora Enso to the Knut and Alice Wallenberg and Marianne and Marcus Wallenberg Foundations.

### **The Board of Directors**

The Annual General Meeting on 20 March 2001 decided that, with the exception of Raimo Luoma, the previous Board should remain in office until the Annual General Meeting 2002. Ilkka Niemi was elected to the Board of Directors in place of Mr Luoma.

### **Outlook for 2002**

Weak demand and market uncertainty are expected to continue until the overall economy recovers. This means that 2002 will be a challenging year. Pulp prices are low with no sign as yet of any firm recovery. The weak demand for coated magazine papers and coated fine papers is expected to continue, although fine paper appears to have bottomed out during the fourth quarter. Demand for SC paper and uncoated fine paper should remain stable whereas demand for newsprint will be fairly weak in Europe and North America. Packaging board markets are likely to stay rather stable. Timber markets will continue weak, although a slight improvement in prices has recently been seen.

Market sensitivity generally has increased as production curtailments and de-stocking have emptied inventories. However, a pick-up in paper and board demand is conditional on a firm improvement in the global economy. Stora Enso will continue to adjust its production to market demand.

Once demand improves, Stora Enso will be in a good position to benefit from the full effects of synergies in North America, and the extensive restructuring and rebuild projects realised in recent years.