

Report on Operations by the Board of Directors

Markets and Deliveries

Market uncertainty continued for a second year as a result of the faltering global economy with a consequent fall-off in demand for advertising-driven paper grades. Average European paper prices deteriorated due to excess capacity in certain grades, whilst in North America demand for printing and writing paper improved towards the end of the year resulting in price increases in local currencies in newsprint and fine paper.

Paper and board deliveries totalled 13 149 000 tonnes, which is 291 000 tonnes more than in 2001. Deliveries of wood products totalled 5 112 000 cubic metres, compared with the previous year's 4 860 000 cubic metres.

Paper production was curtailed by 1 257 000 tonnes to adjust for market demand (220 000 tonnes in North America), compared with 1 540 000 tonnes (395 000 tonnes in North America) in 2001.

Financial Results (compared with the previous year)

Earnings per share were EUR 0.57 (EUR 0.94) and cash earnings per share EUR 1.97 (EUR 2.34), both excluding non-recurring items. Earnings per share (basic) were EUR -0.25 (EUR 1.03) and cash earnings per share EUR 2.49 (EUR 2.43). The share write-down related to impairment was tax-deductible, resulting in a basic earnings per share increase of EUR 0.34.

Sales totalled EUR 12 782.6 (EUR 13 508.8) million, a decrease of EUR 726.2 million or 5.4% on the previous year. Average prices decreased in all product areas in 2002. Sales volumes increased in Magazine Paper, Packaging Boards and Timber Products but decreased in Newsprint and to some extent in Fine Paper.

The operating profit excluding non-recurring items was EUR 926.5 million, or 7.2% of sales (EUR 1 495.2 million, or 11.1%), a decrease of 38.0% on the previous year. Magazine Paper, Newsprint and Fine Paper reported lower operating profits than in 2001, mainly due to lower sales prices, while Packaging Boards and Timber Products increased profits. The weakening of the US dollar decreased the operating profit by EUR 28 million, which was offset by hedges. The operating profit for the year totalled EUR -151.6 (EUR 1 486.9) million after non-recurring items of EUR -1 078.1 million.

Non-recurring items comprised a EUR -25.1 million provision for closing down the UK merchant Papyrus

GB Limited, a EUR 76.7 million capital gain on the sale of Billerud AB shares in Sweden, EUR -54.0 (USD -50.0) million from the North American Profit Enhancement Plan and EUR -1 166.7 (USD -1 081) million of US impairment charge, offset by EUR 24.4 million from a change in the average exchange rate. Other non-recurring items were the EUR 8.8 million closure costs at Summa in Finland and a EUR 75.4 million capital gain on the sale of forest assets in Finland and USA.

The share of results of associated companies amounted to EUR 14.6 (EUR 79.6) million, a loss of EUR 5.5 million from Tornator Timberland Oy being offset by a profit of EUR 5.4 million from Billerud AB and positive results in other associated companies.

Net interest costs for the year totalled EUR 229.5 million, which is 4.6% of interest-bearing net liabilities and EUR 103.6 million less than for the previous year, mainly due to lower interest rates and a positive cash flow. Foreign exchange gains in financial items were EUR 44.9 million and dividend income was EUR 9.2 million. The valuation of financial instruments and derivatives resulted in a net loss of EUR 50.4 million; these items are valued at market value, thus causing volatility in net financial items, although of a non-cash nature.

Profit before taxes and minority interests, excluding non-recurring items, amounted to EUR 734.9 (EUR 1 231.3) million.

Net taxes were a positive EUR 120.9 (EUR -299.6) million, thus increasing EPS by EUR 0.14, though aggregate tax excluding non-recurring items represented an underlying rate of 31.4% (31.6%). The write-down of the shares in the parent company, relating to the impairment depreciation in Stora Enso North America Corp., is tax deductible according to a recently received advanced tax ruling. At the current tax rate of 29%, the value of this tax deduction, which is considered a non-recurring item, is EUR 298.4 million to be utilised against 2002 results.

Minority interests were EUR 0.1 (EUR 2.9) million, leaving a net loss for the period of EUR 222.2 (profit of EUR 926.3) million.

The return on capital employed was 7.1% (10.8%) before non-recurring items. Capital employed was EUR 11 242.4 million at the end of the period, a net decrease of EUR 2 616.7 million since the beginning of the year, reflecting the impairment charges in North America and the weakening US dollar.

Financing

Cash flow from operations totalled EUR 2 083.8 (EUR 2 757.5) million, with cash flow after investing activities amounting to EUR 1 247.7 (EUR 1 849.9) million. The cash earnings per share excluding non-recurring items were EUR 1.97 (EUR 2.34).

At the end of the period, interest-bearing net liabilities were EUR 3 055.1 million, down EUR 1 764.8 million on the previous year. Unutilised credit facilities, and cash and cash-equivalent reserves totalled EUR 1.8 billion.

The debt/equity ratio at 31 December was 0.37 (0.53) and equity per share EUR 9.36 (EUR 10.03).

Capital Expenditure and Asset Restructuring

Capital expenditure for the year totalled EUR 877.6 million, which is 70.5% of depreciation; this is lower than planned as some expenditure ran over to 2003. The main investments were the new PM4 (EUR 254.1 million) and rebuild of PM3 (EUR 28.6 million) at Langerbrugge in Belgium, the rebuilding of Oulu PM6 in Finland (EUR 16.5 million), folding boxboard improvements at Baienfurt in Germany (EUR 10.2 million) and finishing department investment at Fors in Sweden (EUR 10.6 million).

In October Stora Enso's Board of Directors approved a comprehensive Asset Restructuring Programme to improve Group asset quality in the Magazine and Fine Paper segments. This plan is part of an ongoing programme to increase the overall competitiveness of assets, which include about a hundred production units, whilst meeting the growing quality and volume demands of customers. The plan includes targeted investments, machine specialisation measures and elimination of less-competitive production assets. The Asset Restructuring Programme is in line with the Group's capital expenditure policy.

Stora Enso North America

Stora Enso's results in North America improved during the second half of the year though they continue to be unsatisfactory. The operating loss for the first half of 2002 was USD 105 million and for the second half, USD 50 million, giving a loss for the year of USD 155 (EUR 164) million, before goodwill amortisation and impairment and other non-recurring items, compared with a USD 26 (EUR 29) million loss in 2001.

Cash flow after investing activities for the first half of 2002 was USD 25 million and USD 113 million for the second half, making USD 138 (EUR 146) million for the year before non-recurring items, compared with USD 239 (EUR 267) million in 2001.

Market-related downtime totalled 220 000 tonnes, a reduction of 175 000 tonnes on 2001. Synergies, which

were mainly derived from transfer of best practices, totalled USD 91 (EUR 96) million.

Research and Development

In 2002 Stora Enso spent EUR 91.6 million on research and development, which is 0.7% of net sales, the emphasis being on consumer board and product development for digital and other document printing. The product portfolio for different printing technologies has also been further enhanced.

Changes in Group Composition

In March Stora Enso announced the sale of Mölndal Mill in Sweden to KLIPPAN AB, a Swedish listed speciality paper company. This divestment is part of the Fine Paper Division's Asset Restructuring Programme to concentrate investment in large, cost-efficient mills.

In May plans to restructure ownership of Group forestlands in Finland and the USA were announced, the transactions actually taking place in December. Stora Enso sold 59% of its shares in its Tornator forest company to a new company established by Finnish institutional investors, leaving it with a 41% share, now accounted for as an associate; the aggregate market value of the forest assets sold was EUR 502 million. At the same time Stora Enso North America Corp. sold some 300 000 acres (125 000 hectares) of forestland to Plum Creek Timber Company, Inc. for USD 141 (EUR 142) million.

In June Stora Enso sold most of its shareholding in Billerud AB in a secondary market transaction resulting in a capital gain of EUR 76.7 million; following the sale Stora Enso now owns only 300 000 shares, being 0.5% of the share capital and votes.

Personnel

Staff numbers were reduced by 472 during the year to 42 461 at 31 December, mainly due to the divestment of Finnish forest assets, the closure of PM1 at Summa Mill in Finland and reductions in North America.

The average number of employees was 43 853, down 422 on the previous year.

Changes in the Management Group

In March Keith B Russell joined the Group as Senior Vice President of Investor Relations, reporting to the CEO.

Also in March Petri Wager was appointed Senior Vice President, Corporate Marketing and Sales, and joined the Management Group, replacing Sven von Holst.

In June, John F Bergin, Senior Vice President, Speciality Papers Business Group (Packaging Boards Division), joined the Management Group, replacing Ronald E. Swanson.

Issues with Competition Authorities

In August the European Commission informed Stora Enso that it had terminated its investigation in the competition case related to newsprint producer operations instituted in 1999, when the European Union Statement of Objection alleged that there had been a newsprint price cartel in the period 1989 to 1995; the case is now closed.

Changes in Share Capital

During 2002 a total of 99 200 A shares and 25 672 634 R shares were repurchased by the Company, representing 2.9% of the shares and 1.0% of the voting rights, and with a nominal value of EUR 43.8 million. The average price paid for A shares was EUR 12.28 and for R shares EUR 11.14. The Annual General Meeting ("AGM") on 19 March 2002 decided to lower the Company's share capital by EUR 13.8 million through the cancellation of 813 200 A shares and 7 319 800 R shares. These shares had been repurchased under the authorisation of the AGM in 2001. The AGM on 19 March 2002 further authorised the Board to repurchase and dispose of not more than 9 100 000 A shares and not more than 35 500 000 R shares in the Company. Repurchases started on 24 May 2002 and by 31 December 2002 the Group had repurchased 85 400 A shares and 25 326 834 R shares, 0.9% and 71.3% of the authorised amounts respectively. By 31 December 2002 the Company had allocated 69 303 of the repurchased R shares under the terms of the Stora Enso North America Option Plan, leaving the Company holding 85 400 A shares and 28 257 531 R shares.

During the annual conversion period of 16 to 27 September 2002, a total of 1 143 700 A shares were converted into R shares. A total of 1 161 000 new R shares were issued under the terms of the 1997 warrants, of which 3 000 were registered in the Finnish Trade Register on 9 January 2003.

A total of 864 000 new R shares are subscribable against outstanding warrants.

Share Capital

At the year end Stora Enso Oyj had 182 316 685 A shares and 717 461 614 R shares in issue, of which the Company held 85 400 A shares and 28 257 531 R shares with a nominal value of EUR 48.2 million; this holding represents 3.1% of the Company's share capital and 1.1% of the voting rights. Shareholders' equity amounted to EUR 8 156.9 million as against a market capitalisation on the Helsinki Exchanges on 31 December of EUR 9.1 billion. The nominal value of the issued share capital was EUR 1 529.6 million.

Significant Changes in Ownership

In 2002 the Finnish State reported sales of Stora Enso Oyj shares on 4 April and 14 June, following which the Finnish State holds 55 595 937 A shares and 41 483 501 R shares, representing 10.8% of the share capital and 23.5% of the voting rights.

Events after the Period

On 16 January Stora Enso Oyj signed a new EUR 2.5 billion revolving credit facility agreement with a group of 21 banks. The facility, which has a maturity of five years and a margin of 0.425% p.a. over Euribor, is for general corporate purposes including refinancing current syndicated facilities of EUR 1.6 billion.

Outlook

In Europe demand for advertising-driven paper is stable at low levels, but prices are under pressure mainly due to oversupply. Office paper demand has weakened seasonally, but it is expected to recover slightly during the first quarter of 2003. Demand and prices for packaging boards and wood products are expected to remain stable in the near term.

In North America demand improved from low levels in advertising-driven paper grades towards the end of 2002 and has continued thus far in 2003. Demand for wood products is stable and prices will be dependent on the supply and demand balance in the near future.

The further continuation of the positive trend in North America, and indeed the outlook for global paper markets, depends largely on the outcome of the current geopolitical situation.

Distribution of Dividend

The Board of Directors will propose to the forthcoming Annual General Meeting of Shareholders that a dividend of EUR 0.45 per share be paid for the financial year ending 31 December 2002. If the proposal is approved, the dividend will be paid on 4 April to shareholders entered on the dividend record date of 25 March in the register of shareholders maintained by the Finnish Central Securities Depository, Swedish VPC and US Citibank, N.A.

Annual General Meeting

The Annual General Meeting will be held at Finlandia Hall, Helsinki, Finland on Thursday 20 March 2003, beginning at 4.00 p.m. (Finnish time). The Board of Directors will also propose to redeem the shares in treasury as well as a new repurchase programme.