Mark Sutton describes the 10 years of cooperation between International Paper and Ilim, explains how he manages to divide the markets in this partnership, and reveals business strategy in Russia.

International Paper is a leading global forestry company with assets in 24 countries. Since 1998, the company has worked in Russia. Its pulp and paper mill is situated in Svetogorsk in the Leningrad Region. For 10 years now the company has partnered with the Russian businessmen Zakhar Smushkin and Boris Zingarevich in Ilim Group, the largest forestry company in Russia. Mark Sutton had worked at International Paper for 33 years when he became its CEO in November 2014, and he then chaired the company's Board of Directors at the start of 2015.

In recent years, the US Department of State did not recommend for American businesses to take part in the St Petersburg Economic Forum. This year Sutton came over with his entire family and took part in the forum for the first time ever. With a smile on his face he assures that the Department of State are not against it. In his interview with ‘Vedomosti’, Sutton emphasized that Russia is an important part of the International Paper's business. Sutton, who also chairs US-Russian Business Council, says that business “can play a role in helping the countries to understand the value of cooperation”. International Paper itself has successfully worked with Russian business partners, Smushkin, who also took part in the conversation, happily agrees. “We believe that working collaboratively is better than individually,” he said with reference to the relationships with the American partners.
Is it possible to do business as usual with Russia even though the sanctions have not yet been taken away?

Mark Sutton: For us, business is the manufacturing of forest products, Russia is very competitive in this market and it is a fundamental part of the market for us. Our joint venture with Ilim is focused on the Chinese market, and the last two years have been very favorable for us. Another part of our business in Russia [The Svetogorsk PPM] is focused on the Russian market, and here we saw some setbacks, but recently there have been noticeable improvements. We are competitive on the domestic market and exceptionally competitive as exporters.

Are there any specific questions that you would want to discuss with Vladimir Putin during a US-Russia Business Council meeting? (the interview was held before the meeting at the forum. “Vedomosti”)

Mark Sutton: The council’s task is to get Russian and American businessmen to work together with the governments to create a positive environment for business with a long-term perspective. We do this every day and we work with both countries’ governments.

Would you call it business diplomacy?

Mark Sutton: You could call it business diplomacy, but everything is very pragmatic: we make decisions to help our companies, although helping our governments and countries is also good. But it is a wonderful opportunity for the employees and the companies that are located in Russia and the US to improve our business.

Do you expect the relationship between Russia and the US to improve?

Mark Sutton: I really hope that the US and Russia will continue improving their relations. Time horizons and prospects are important. Since we arrived in Russia in 1998, there have been three changes of American administration, and we make the long-term business decisions. I think that business can play its part in the countries understanding the value of cooperation.

Two important markets

Are you happy with International Paper’s business in Russia and its mill in Svetogorsk?
Are there any plans to further develop the company’s presence in Russia?

Mark Sutton: International Paper’s wholly-owned Russian business is in great shape; we have sufficient manufacturing capacity, and every year we invest in projects to improve the cost of energy, quality of products, environmental indicators among other areas. And we will continue investing in Russia. We talk with Zakhar about Ilim in the context of investments; here there are also a lot of interesting opportunities for the growth and development of our business.

In which areas do you plan to develop Ilim? New investments? Acquisitions, maybe?

Zakhar Smushkin: We are considering all options that would allow us to improve our profitability. Our company works in two main markets. Our production in Siberia is focused on exports, as the local market there is poorly developed. Thus, 98% of our production there goes to the Chinese market.

Our share of the softwood pulp market in China is around 15%-18%. There is huge competition in China for hardwood pulp, which is imported from South America. Our market is the northern and central parts of China, but we also deliver to the southern part of China via the sea. It is
true that the hardwood pulp market isn't as lucrative for us- it makes up at maximum 5% of our total profit, or even less. International Paper also works in the Chinese market and last year bought a mill in the US (Mark can also talk about this). But almost everything that we do in Siberia goes to China.

And up till now, the Chinese market has continued to grow, although the rate of growth has dropped a little, but the procurements are still quite high, enough for us. A different part of our joint business is situated in the European part and is focused on Europe and the domestic market. Here our mills mainly produce packaging materials.

In this way, we have three areas for development. First of all, the increase of the productivity of our mills by 500,000 tonnes per year in total thanks to debottlenecking. Another idea that we will discuss with the Ministry of Industry and Trade is that we will start to think further about one green-field project in Siberia, if we can find a place on the Chinese market for us. Thirdly, packaging, namely the development of the finished packaging sector (and its production with high added cost).

One of the tasks is the inner restructuring of the company because we examine the synergetic effect from, for example, between the Svetogorsk PPM and Ilim. It is still a little early to be talking about the internal calculations, but we are thinking about it. At the end of this year or the beginning of the next, we will take up a new strategy for the next 5-7 years and we will be able to sleep peacefully. (They laugh).

Mark Sutton: Zakhar alluded to the pulp and paper businesses that International Paper bought in the US. It is a mill of fluff pulp, which is used for diapers and other products. We sell it all over the world, including China. The Ilim business in Siberia, which is focused on China, and the International Paper business in the US, which is also making products for China and other countries, are producing different products. But it is softwood pulp. And these are two of the most competitive regions in the world for producing such a product. In Russia it’s Siberia, and in the US it’s the South-East part of the country.

They built a bridge.

Do you have an agreement about making sure you aren’t competing against each other?

Zakhar Smushkin: There is an agreement about there being no competition, of course- it is written in a corporative agreement. In Russia, for example, Ilim plays the main role, but globally International Paper does. But in many cases, when we do something separately, we come into contact, discuss, decide together, and we reach a mutual agreement.

Of course, all companies are looking for leadership, to be number 1.

Mark Sutton That's how it is.

How did you organize this? Is it a division based on products?

Zakhar Smushkin: We check all of the restrictions that apply to the place where we are preparing to sell, then we discuss profitability and risks. And if both sides agree, then we will do it.
Are you thinking about some other acquisitions in Russia?

**Mark Sutton:** We don't have any plans to acquire something separately. If Zakhar tells me about an opportunity, then we will discuss it together. For example, we could be interested in the packaging segment in Russia.

Are you considering the possibility of conducting an IPO for Ilim?

**Mark Sutton:** No, we're not considering that.

**Zakhar Smushkin:** First of all, the stock market in Russia right now is practically non-existent... (laughs). There isn't enough long-term money in it. It's a joke. But what's the point in carrying out an IPO? We have equal shares, and if there were some third party, we would have to divide our power.

**Mark Sutton:** We at International Paper are very pleased with our partnership with Mr Smushkin and other investors. We are very happy to celebrate 10 years of cooperation this year and we believe this is a great partnership.

**Zakhar Smushkin:** The main purpose of an IPO is to invest additional capital. But the cost of capital on the market is much higher than the cost of loans. Currently, rates on loans are close to 3%. Unfortunately, LIBOR is increasing. But either way, we see no reason to conduct an IPO.

**Mark Sutton:** And the company’s balance sheet is very strong.

You became a CEO of International Paper not so long ago. At the time of your appointment, the company had already owned a stake in Ilim for seven years. How long did it take to build such a strong relationship?

**Mark Sutton:** This is not so my merit, as it is the merit of my predecessors. We have invested a lot of time and effort into building close a business relationship. We have shared technology. International Paper staff worked in Ilim, and employees of Ilim - in International Paper. What is more, some of the top managers at International Paper are members of the Ilim's Board of Directors, and Zakhar regularly interacts with the Board of Directors of International Paper. We have put a lot of effort over time to build good, sustainable relations - business as well as personal ones. Those relations are very important and productive to us. We like doing business together. Our employees like to work with us and with our partners in this joint venture.

**Zakhar Smushkin:** It seems that our employees are even more satisfied than us (laugh). I find this quite remarkable. Typically, joint ventures are created for a fixed period of time, but ours has existed for 10 years already. So, I can only confirm what Mark said earlier. In October, we will commemorate our 10th anniversary, probably in New York. And in June we will celebrate 25 years of Ilim. And we believe that we have built a bridge. We have very similar mindsets. The key to success is discussion, it must be open. We try to create an inner culture, if you like. It is very important to anticipate conflict situations. We love conflicts, we see them as a key to growth. We see that collaboration gives us more than what we could achieve individually. And I hope that we can continue this in the future. The world is in depression. We have a large production, but customers are being cautious. The secret to success lies in sustained pursuit and efficiency. And one of the ways to achieve this is through a joint venture. I understand Mark’s point of view, and the position of the Board of Directors and top management of International Paper. It may have been otherwise at first, but now we have a good relationship and a good atmosphere.
How much would Ilim be worth?

**Zakhar Smushkin:** This is a matter of estimation, you know. Approximately $4bn. Maybe even more – about $4-4.5 bn. We use the average EV / EBITDA multiple of 6. But we are talking about market capitalization after deduction of debt and dividends.

*International Paper bought a stake for $600 million...*

**Mark Sutton:** Yes, somewhere around $600 million.

**Zakhar Smushkin:** $600-620 million or so. The average TSR is about 17% per year, if we consider the last 10 years. On average. This is a great success. We did not even know these figures ourselves. We specifically calculated it before Mark’s arrival (laughs).

**Mark Sutton:** Yes, this is a good return.

*You mentioned that you are discussing the possibility of merging Ilim and the International Paper mill in Svetogorsk. What form would this take? Purchase? Merger?*

**Zakhar Smushkin:** The discussion is ongoing. But you know, getting a share in the Svetogorsk mill is not only a matter of efficiency. The proportions and share of market presence would change, the government would also have to be consulted. There are many aspects. But overall, maybe, it will happen, if it contributes effectively and brings us additional profit. Svetogorsk is a good pulp and paper mill.

**Mark Sutton:** This is one of the strategic regions, which, as Zakhar said, is regularly the focus of our attention. International Paper has operation, for instance, in both Western and Eastern Europe, and we consider the whole business in terms of an overall strategic plan. We discuss this on a regular basis.

**Zakhar Smushkin:** I, personally believe that some Eastern European assets of International Paper are far more efficient than Svetogorsk. Mark, for example, can offer me Svetogorsk, but I can say that I would like something else (laugh). We need to discuss this. We can buy something else. Business is always an opportunity that is difficult to predict.

*Speaking of opportunities, will your new project in Siberia be based within your established production or will it be a project from scratch?*

**Zakhar Smushkin:** We discuss both possibilities at the Ilim Board of Directors meetings. If we talk about the first option, we are talking about overcoming current supply-side constraints and debottlenecking - the brown-field project will increase the capacity of the two mills in Siberia by 400,000 tons. In fact, this would be [like building] a medium-sized pulp and paper mill. We are going to discuss it with Russian government officials. And maybe, if government provides support, for example, by covering some social obligations or by offering additional funding or investment, we can consider the second option - building a new production line from scratch, since consumption in China is huge. So, we can discuss the possibility of construction with the Irkutsk Region or Krasnoyarsk Krai authorities. We need to be sure that in 20-30 years the mill will work, because depreciation takes time, and the pulp and paper industry is hampered by very high capital expenditures.

**Mark Sutton:** We work guided by the principles of sustainable forest management, in order to be certain that forest productivity will be maintained for a long time. As Zakhar already said, when we make a capital investment, we need 40-50 years of certainty that we will get renewable wood fiber and establish timber supplies.
The practices of sustainable forest management help us with this aim. International Paper and Ilim use good forest management practices.

Russia and the governors

What is your opinion on the preference that government gives to investors from the Far East?

Zakhar Smushkin: We have not considered this specifically. The government would like to encourage production in the Far East. But unfortunately, there is not enough forest there. Or rather, there is another type of forest, not the one that we use. Therefore, our main regions remain the Irkutsk Region and the Krasnoyarsk Krai. But we regularly discuss this.

On our initiative, for the first time, McKinsey took part in putting together the Strategy for the Development of the Forest Sector of Russia. We participated as sponsors. And, as far as I know, this is the first real strategy which utilizes a marketing, rather than a resource-based view. Usually officials think: we have a forest, what should we do with it? It is time to explain to them: there is no market for this forest, so it is better to leave it alone to avoid losses. We need to start from the market – if there is place on it for goods, then maybe we can do something with this forest.

There are two possible approaches. Usually, this is done by International Paper when preparing for mergers and acquisitions. We do not have enough capacity for this. Of course, brownfield is a bit cheaper. We have some place in Ust-Ilim, for instance. Greenfield is a riskier project, because Siberia is a large and very complex region. But we have experience. The first attempt required from us a little more time than we initially planned, and a little more resources (the Big Bratsk project, increasing in the capacity of the Bratsk Pulp-and-Paper Mill, Vedomosti), but overall the result was acceptable.

Mark Sutton: Yes.

Zakhar Smushkin: We do not look at this issue as a separate company Ilim, but together with International Paper. We consider ourselves leaders in producing pulp and packaging. Together with International Paper, which is eight times larger than Ilim. Of course, we will discuss with our partners what they think about it, how it relates to the strategy of International Paper. We need to arrive at a unanimous decision at the Board of Directors meeting.

It is difficult, but this is the key to success.

Mark Sutton: When we are on the same page, we make better decisions. We considered some very serious issues, and we are happy with the decisions we made. Our decisions were often preceded by lively discussions, sometimes we had disagreements, but we always managed to reach a common decision and stick to it.

How are your relations with regional governments?

Zakhar Smushkin: Ilim is large enough to avoid problems with governors. Usually, we sustain a very good relationship. Regional governments are friendly to us, they support us, since we pay a lot of tax, create jobs, fulfill social obligations, and often engage in in charitable projects.

Do you have to invest a lot in infrastructure compared to other countries where International Paper operates?

Mark Sutton: In Siberia, yes. In the European part of the country - it seems to me that it matches the experience that International Paper has in other countries. But Siberia is
completely different, everything has to be done there. We have good relations with the local authorities, there are always issues for discussion. We make a great contribution to the economy, and to social programs.

**Zakhar Smushkin:** Mark, you remember how two years ago International Paper’s entire Board of Directors came to Irkutsk and had a meeting there, where the governor took part. This was not Ilim, but International Paper. This was unexpected, even for me. There was a rather difficult conversation with the governor – what do we think about these things or those questions. But we try to communicate with local governments.

"Recently, Vedomosti asked the director of one international company, ‘what did you learn in Russia?’ He answered that he learned to debate and value trust. So what have you learned in Russia?"

**Mark Sutton:** You need the same things to do business in Russia as you do in other countries. The first thing is trust. Mutual respect. And we’ve been convinced that the level of education in Russia is very high, both among management teams and ordinary employees.

There’s an American saying: do business with those you trust. And this is the basis of everything. You need time, need to survive and overcome problems and challenges together, in order to build this trust. But when it’s there, you can achieve practically anything.

**America and Trump**

*International Paper has mills beyond US borders. What is your view of President Trump’s initiative to return production to the US? Could this affect your company? Of course, International Paper isn’t Ford, which had to abandon its Mexican mill, and it isn’t United Technologies. What do you think will happen?*

**Mark Sutton:** Timber enterprises must be built where there is plenty of wood. This is demand number one. We make the bulk of our products near markets which will consume them. For example, we export 25% of our products made in the US and import practically nothing. We don’t have factories which could be re-located. We make products in Latin America for Latin America and Asia. Ilim makes products in Siberia for China. Siberia is the best place for making these kinds of products thanks to its good softwood and logistics.

That is, our industry is a little different to other types which transfer production based on cost of labor and other factors. This isn’t how we operate. We make our products from renewable natural resources – wood fiber and recovered fiber.

We receive about 75% of the energy for our production from carbon-neutral energy sources. For us there won’t be any changes, because we already make products in the US, which must be produced in the US for the US.

In other industries, for example the automobile industry, it’s possible to have different reasons for transferring production. But we don’t.

"And, generally-speaking, how could these initiatives affect the American economy?"

**Mark Sutton:** Initiatives by themselves can’t change anything. I think the US economy will recover, if tax reform is introduced and the regulations seriously change, and if businesses see these decisions as favorable. If the decision is made that factories must be located in the US, and not in other countries, this will happen. But the president’s idea was centered around whether it’s possible to transfer those factories which are turning out products for the US consumers, to the US. And that’s where the issue lies.
The US government would want to see economic growth of no less than 3% a year, but at the moment it’s at 1.5-1.8%, so there is a lot of work. But it seems to me that the potential for the US economy is bigger than it’s shown in the last two years.

*Trump has announced that the US will withdraw from the Paris climate agreements. What do you think about this?*

**Mark Sutton:** It is unlikely that this will affect our business. Our decision on reducing emissions of harmful substances is a part of our company. If you look at the annual report then you’ll see that in 2010 the company voluntarily committed itself to reducing greenhouse gas emissions by 20% by 2020. In 2015, we’d already reduced them by 16%, that is, we are ahead of schedule.

Changing the US’ participation in the Paris agreements won’t affect International Paper’s operations. Reducing harm to the environment is also a good business. We have always wanted to reduce the cost of energy and emissions. This is good for the environment, our employees, and our consumers. The majority of our investments are long-term, based on good business objectives.

*How big a share does raw materials have in your recycled products?*

**Mark Sutton:** It depends on the business. The best example is the production of corrugated packaging, about 35% of which comes from recovered fiber. But recovered fiber only exist if you start with a tree grown in accordance with the principles of sustainable forest management. In return for each tree used in production, we plant 3-4 new ones, which become a source of recycled fiber.

**More packaging**

*In December, International Paper bought the Weyerhaeuser mill for $2bn. Why did you pay so much? Pulp accounts for 5% of the company’s turnover – do you plan to increase this segment of your business?*

**Mark Sutton:** The price was very good. From the point of view of profit multipliers and tax adjustments. We paid $2bn for a business with EBITDA of almost $400mn. For International Paper this is a small segment, but it is growing by 5% each year. And the most famous products in which the final product – absorbent – is used, are babies’ diapers. These are sold all over the world and the US’ softwood is the best raw material for them. This is an important business for International Paper, because it’s growing faster than our other businesses.

**Zakhar Smushkin:** The market supported the deal. The share price rose afterwards.

*Income from selling paper fell in the last quarter, and this is a consistent trend. What could counterbalance this fall?*

**Mark Sutton:** In the US and Europe demand for printing paper has decreased. We see growth in Asia, Latin America (apart from Brazil, where there’s a recession), Eastern Europe and Russia. There’s a balance. But this product makes up only a small share, while packaging and pulp are, by contrast, growing.

In a situation where the demand for paper has fallen, we switch assets over to other products. Still wood, but a different final product. We can cope with a situation where demand has fallen. The reason for this fall is new technology. We use this (points at a mobile phone) and this (points at a tablet).
Zakhar Smushkin: It’s impossible to call this a trend in the pulp and paper industry alone. Unfortunately, it’s like this everywhere, just look at metal or oil. It’s everywhere, the world has simply been in an economic depression. Metal prices have fallen several times, in our industry there’s a slight decrease.

Mark Sutton: Yes.

Zakhar Smushkin: But I still don’t think we’re in a bad position.

Your forecast for printing paper: will demand decrease further or will something change?

Mark Sutton: We produce paper in all major markets, and the trend is consistent. In Asia, the market has grown a little, in Western Europe and the US, it’s fallen rather. If we put these trends together, demand hasn’t changed.

How do you see the future of the traditional timber industry in the era of processing (recycling) in the face of increased interest over environmental issues? And what role will you play in the timber industry?

Mark Sutton: From International Paper’s perspective, the most important thing we can do is be sure that we are utilizing forests in accordance with the principles of sustainability: that they are used sustainably, taking environmental issues into account, and that more is planted, than is used. For us, this is a sustainable natural resource, which we need to manage correctly in order to protect.

We understand forest management in line with the principles of sustainability and taking into account environmental regulations, as management for the sake of forests, wild nature and water quality.

But forest industry products play a huge role. In different parts of the world, for example in the US, land is mostly privately owned, and forests are protected on private land if people grow trees, sell them and then again grow them and sell them. If this doesn’t happen, they may not be able to pay taxes on the land. A working forest is a healthy forest. It’s like this all over the world.

Mark Sutton

Chairman of the Board of Directors, International Paper

Born in 1961. Graduated from Louisiana State University (Bachelor of Science degree in electrical engineering)

1984: began his career at International Paper as an engineer

2002: vice-president and general manager, responsible for all corrugated packaging operations across seven countries in the EMEA region (Europe, the Middle East and Africa)

2005: vice-president of corporate strategic planning, from 2007, senior vice-president responsible for the work of various units

2014: appointed CEO, from 2015 appointed Chairman of the Board of Directors
International Paper Company

Timber industry company

Shareholders (data from Bloomberg): almost all shares are free float, largest investors – Blackrock (9.03%), Wellington Management Group (8.8%), Vanguard Group (6.99%), State Street Corp. (6.36%).

Market capitalization - $24bn.

Financial indicators (2016):

Revenue - $21.1bn.

Net profit - $904mn.

Founded in 1898 in the US, the company produces industrial and consumer packaging, paper, pulp. International Paper has worked in Russia since 1998, and owns Svetogorsk PPM, Tikhvinsky Integrated Forestry Enterprise, and 50% of Ilim Group.