04-Sep-2025

International Paper Co. (IP)

Jefferies Industrials Conference

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Philip Ng
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MANAGEMENT DISCUSSION SECTION

Philip Ng
Analyst, Jefferies LLC

All right, guys, I'm Phil Ng, Jefferies' Paper and Packaging Analyst. We got International Paper here. Representing the company, we got Andy Silvernail. Well, Andy, hopefully we keep this a tradition. This is year two.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

Yes. Absolutely. Yeah, we will.

Philip Ng
Analyst, Jefferies LLC

And you've been in your role for about year-and-a-half. You've been a very busy man, Andy.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

Yeah, a very busy man.

Philip Ng
Analyst, Jefferies LLC

So, maybe this is a good venue for you to kind of convey some of the puts and takes and how you kind of envision this transformation playing out.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

Yeah. Yeah. So where do you want to run to today, what direction? You just want to talk about where we are to-date or you want to talk – how do you want to handle it?

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Philip Ng

Analyst, Jefferies LLC

However you want. To kick things off, just kind of reflect.

Andrew K. Silvernail

Chairman & Chief Executive Officer, International Paper Co.

Okay. Great. Yeah. So look, after a year and a half, I would say that the base case is very, very much what I expected it to be, minus weaker markets just generally, if you look at the overall economic growth. Maybe I'll just touch on that first, Phil, and jump into it.

Philip Ng

Analyst, Jefferies LLC

Sure. Yeah.

Andrew K. Silvernail

Chairman & Chief Executive Officer, International Paper Co.

So, and I'll start with the US. The US, we had expected in this year to be up about plus 1. It's actually going to be – I think it's going to end up being down about 2. In the marketplace, that's about a 3 point swing for us in general. And the question that I think everybody has, we've talked up a lot about this at dinner last night, was around kind of, is there structurally something different in the market, kind of expectations, how do you think about that?

And we've dug a ton into the marketplace to ask that question and there's really no evidence at this stage. There are always puts and takes around medium – kind of thinking about the offsets of mediums and what are you using for materials, but there's really kind of nothing structurally. The thing that always sticks in people's minds is, well, I'm getting more things at my house that are arriving in bags, right?

So, is that bad for packaging? And a couple of things is that's something that happens all the time. If you look at the historical trends in packaging, those sorts of things are constantly moving and the relative volume in the marketplace is actually pretty small. And so you look at that structurally now, and if you actually kind of ask yourself the simple question, well, what's happening? It's just the velocity of good movement. I mean, it's really quite that simple.

And in the US, I would say there are really two factors that appear to be the biggest drags. One is around, I think we're all very aware around, kind of trade and tariffs and how those have played. And literally, you guys have heard me say this many times, but we saw when the first barrage of conversations happened kind of post-January, we saw a little bit of tick down in the market.

And then on so-called Liberation Day, we saw another tick down and that has stayed really consistently the same in both markets in the US and in Europe. And as I talk to my peers, as I talk to our customers, so much is just driven on the unpredictability of the marketplace and therefore the willingness to spend. And so, I think we're going to live with this a little bit until you get through some of that, until you annualize some of that or you get some stability. The second one in the US is really around housing.

And one of the conversations we had last night is if you just kind of think about the last time you moved and you think about the packaging intensity that happened in that move, and you think about where we are in terms of

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people actually buying and selling houses and in people and moving right now, we're at historically a pretty depressed level in that regard. And so those two factors have been hanging on the overall packaging market.

And the good news in both of those is it's hard to imagine those being systemically sticky, right? It's hard to see you go – as I look at some point in the future, it's hard to imagine that we're going to wake up five years from now and it's going to be the exact same story. And so I think that's actually a very good news story in the US. Europe is different to some degree, right?

One is, you have – certainly you have the challenges of trade and tariffs, but the overhang of the conflict on the eastern fronts in Ukraine, that's pretty substantial. And I spent about 10 weeks in Europe this year after we closed the DS Smith deal and just understanding that. And when you're physically there, you're actually talking to people day in and day out, you understand the weight of these two things pretty heavily in Europe.

Long term, there's really no reason to believe that structurally that something has changed in the markets in terms of volume growth over time. They're both kind of 1% to 2% volume growth markets over a cycle for different reasons, right? In Europe, there's more of a material change component to it. And the kind of drives that in the US, it's a combination of economic growth and a little bit better demographics than in Europe. So, that's kind of on the market side.

And what I would say is, what we're experiencing is that sluggishness, what we talked about in the second quarter, that has continued. There's no doubt about it that that sluggishness has continued. And at this stage, right, my plan is, how do you win in that sluggish environment and not bet on the comp, right? I am never a believer and I'm going to wait for something in a marketplace to bail us out or bail me out. I just simply don't believe in that.

When that does happen, what we want is we want a cost base and we want a resource centric focus around customers and around asset quality and around our people that allow us to be in the best possible competitive position. So, everything we're doing now, all the restructuring that we're doing is fundamentally about having the best competitive position in the marketplace. So, I can talk about that in more depth.

And so, what I would say is, if you categorize it very simply, if you took, if you said the markets were growing at the rates that kind of everybody in the industry had expected coming into it, it's actually more than $0.5 billion of profits for us. That's about the number that you would tie to it. It's actually a little bit north of that, frankly.

But in the US, it's really around the volume losses there. And in Europe, it's a combination of volume and price softness that we had versus the expectations. So, given that, right, and given where we are, I'm actually pretty happy with structurally what we've gotten after. And do you want me to just talk about that a little bit, the structural side?

Philip Ng

Analyst, Jefferies LLC

Sure.

Andrew K. Silvernail

Chairman & Chief Executive Officer, International Paper Co.

Yeah. So, in the US we really we launched the 80/20 methodology in the US in June of last year and we made a whole series – as you know, a whole series of announcements that have happened over the past year. And if you

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kind of look at the laundry list, it's actually kind of breathtaking that when you look at the number of actions that we have taken and the impact that we've had. And if you simplify, if you kind of break it down and say, well, what are we actually doing?

If you look at what we announced 10 days ago, if you look at that on the Thursday of – right, it's almost two weeks ago now, if you look at that, that's actually a great encapsulation of strategically what we are doing in the US and in Europe. So I'll take a second and use that example because I think it's actually really informative of what's happening. So, in the US we did – effectively did three things, right? We announced the sale of GCF, we announced the closure of Savannah and Riceboro and we announced the investment in Riverdale, right? So, those are the three big things that happened in that announcement.

And so, what does that tell you about us? Number one. We are a packaging company and only a packaging company. And that's really important, right? The history of International Paper has been as a broad-based fiber company, right, that has had up to, I think, eight or nine very large scale business units with a really large centralized structure. We blew up the centralized structure last year, we radically decentralized back into it, closer to the customers, closer into the field, and we're focusing on packaging.

And so, if it doesn't lead to packaging, we really don't have much interest in it. And that's fundamentally. And so, being an integrated packaging player is the right movement for us. We're further ahead in the US, Europe is going to have a little bit different flavor around integration, but we're going to be a packaging company.

Why? Structurally, it's just a better business, right? So, if you look at returns on invested capital of the industry, if you look at the marketplace and you take the paper based businesses and you actually look at returns on capital, those that are packaging centric versus everything else, it's not even close.

And so, being in that – and it's also a hell of a lot less volatile than people think, right? If you actually look at kind of a range of growth rates over time, there's about a 4-point range of outcomes in that packaging world through a cycle, except during a severe recession, right? And my point of that is, it's far less volatile than people kind of think of a paper based business being just in terms of volumes.

The volumes then drive the pricing volatility that's tied to that, right? So what you're seeing in Europe is that combination of a weak market and weak price coming with it, right? So, that double whammy is really tough. It's big time wind in your face. In the US, because structurally it's a better marketplace, we've had a weaker market, but price has held up better than it has in Europe. In this business structurally, if we get this right, when we get this right, structurally it's a much, much, much better business than I think people associate with a paper-based business generally. So, that's kind of – that's that part of it.

The restructuring of Riceboro and Savannah, if you think of it, there's really there's two components to it. One is, it's volume that's moving through aged or strategically inferior assets. And in our business, strategically inferior assets are simply a problem. Simply a problem. They drive all bad behavior, they drive terrible returns on capital. You have to be – well, you don't have to, but you want to be in what I call the good half of a normal distribution of the asset curve, so you think of all of the assets in the industry across a normal distribution, right?

Those who are on the right half versus the left half, the good versus the bad, the outcomes are dramatic, right? And I'll give you an example of this. So, let's – and I'll move to Riverdale in a second. But as you are moving out of strategically challenged assets and into good assets, which is the Riverdale move, we had a giant capital call in Savannah that was coming. We had to do some major repairs that basically drove no economic value.

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But you had to do if you were going to keep the site open. For even less money than that was going to cost, we were able to invest in Riverdale. So as we exited Savannah, we basically pushed off a $300 million capital call, plus or minus – excuse me, Savannah, into Savannah. And then we are investing $250 million in Riverdale.

The first one is a negative ROIC, right? I shouldn't say negative. It's below your cost of capital. You're going to destroy value in that first scenario. So you don't do that. You exit the export market that's associated with those assets, which is over through a cycle is pretty poor profitability. You now put that into lightweight paper, right, where the market has been moving and is moving and has a much better and very positive return on invested capital. That trade, that $300 million or $250 million trade, is a huge economic improvement. That is really what we're doing across the company.

So we've been doing that in the US for a year now. We've made some huge structural moves in the US. There's still more to do, but there's – right, we've done a lot already. We're just starting in Europe. And in that process in Europe, you've seen us announce consultations in the UK. Some of you may have seen the announcement of a consultation in Croatia around a paper mill from the other day. So that same process is now happening in Europe.

And so, structurally, we're going after that, and it's all about moving to better and more attractive profit pools, and then moving that quality of assets up that curve, and then moving financial resources and human resources to those to move to the right side of that curve. That's what this is all about, right? And ultimately what it does is it puts you in a position to have an advantaged cost position, number one.

Number two, to be a service leader, because you can invest those incremental resources back into service. And that's what we've been doing in the US and it's why you've seen a huge spike in our service levels in the US. And ultimately, that allows you to win market share in the markets, in the geographic markets and in the vertical markets that you find attractive. So in a nutshell, that's the game, right? And that's what we've been up to.

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QUESTION AND ANSWER SECTION

Philip Ng
Analyst, Jefferies LLC

Q

Great. So you've obviously done some capacity closure, and that was great color, Andy. I guess in the past, just having that excess 2 million tons of capacity would lead to bad decisions.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yes.

Philip Ng
Analyst, Jefferies LLC

Q

With that out of the way, what does that actually unlock in terms of behavior? How are you incentivizing your people on the sales side make the right decision? And trading that bad business in economic downtime, what does that unlock from a profitability standpoint?

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

It's a great question, Phil. And so, there's a lot of intricacy in that question. I'm going to simplify it some. I'll use an example because I think that might help.

Philip Ng
Analyst, Jefferies LLC

Q

Sure.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

So let's use the Savannah example, and then let's also talk about sales incentives, those two things combined, because I think that would be helpful. So, in the Savannah example, when you have 1 million tons of excess capacity, if you have 1 million tons of capacity that doesn't have a home in the box market, but it's sitting there and you're sitting on a fixed cost base of a few hundred million dollars a year. In this industry, what historically has happened is people have had assets that are on the bad side of the curve, right?

You will basically effectively price that to marginal cost, right, because to keep the availability of that asset, you'll price there. And then what happens is because you're now pricing at marginal cost, any capital that's going into that asset is coming in at a negative return, right? That's just fundamentally what you're doing. And so what you then do is you then bootstrap that, right? So you don't invest properly, you kind of slow bleed it because you're like, I'll wait till the upcycle. Well, guess what happens? The upcycle happens.

Now you've under invested in the assets, you're plowing money in a short window back into the asset for really, really, really crappy returns, right? You're just – you're chasing that. And so that just – so think of that, just that sine wave gets bigger and bigger and bigger over time and you're chasing that capital.

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And then you have a sale structure, and the sales folks are being told, don't lose market share, don't lose volume. So what are they doing? They have an incentive structure that's in place. Well, we didn't really have a very good incentive structure in the past, and so they're just kind of following marching orders, so to speak. And so, what you get in there is you get volume chasing price, chasing bad, bad assets. And that's just a terrible combination, and frankly, what we've been doing for decades.

And so, what we're doing now is eliminating that. So, you're eliminating the bad asset problem, you're eliminating the need to chase, to fix it or to win at marginal cost. And then, we've changed the incentive structure. So one of the things that – we're going through our strategic planning process right now and we did a review, Lance and I did on Tuesday, and we actually looked at a scatterplot of the US of pay and performance of our salespeople pre the changes that we made last year to today.

And so, think of that scatterplot. If I got performance on one side, I got pay on the other, you'd want everything to be around the [ph] 45 degrees (00:16:23), right? That's where you'd want to see it. Well, guess what? You go back and you look at previous years, it's this crazy scatterplot blob in the left hand corner with everything tightly around that. So basically, everyone being paid the same with kind of no correlation to performance. It's absolutely fascinating.

Now, you look at the changes that we made last year paying performance and it is literally hugging the [ph] 45 degrees (00:16:50). So we have every single salesperson plotted around that. That is an awesome thing to see. I don't know if that makes sense to everybody what we're talking about. That change is not small. That is an enormous change and you actually mix that with a quality asset set, right? We don't have to chase crappy business to keep an asset full in the short term from a cash standpoint. Those two changes are – and then you look at what we did, the example I just used from two weeks ago, that's a great example of the structural changes.

Philip Ng
Analyst, Jefferies LLC

Q

Super. Talk about how the game plan to win back business. What are you doing to provide value for your customers, how that progress is coming along?

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yeah. So, first of all, one of the great assets that I got to inherit when I joined International Paper in the US was far and away the best footprint in the industry. So if you actually just take the footprint, if you were to take a kind of chart out geography, so think of any major metro area, and you were thinking about profitability and growth and you were to take those and put kind of bubble charts, bubbles representing the size of a market and you would look at us versus the rest of the US marketplace, we, far and away, have an advantaged footprint.

And I would argue, we probably have an advantaged mill asset base once we're out of the low quality assets. So, as I look at that and I say, okay, how does that allow us to win over time? We have a terrific advantage. However, our business – what a lot of people don't understand is our business is actually hyperlocal, right?

People kind of think of a fiber based company and you think of a global commodity, whatever. Our business is done within 250 miles of any metropolitan area. And so, that's where competition happens, right? That's where I experience competition. And so, I have to win in that local marketplace which means I have got to have the cost position, the service and the competitive market share position to win in that local market.

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And so, what our focus is, let's drive the basics of service in those local markets. So quality, on-time delivery, speed of response. We have customers – I mean, our major customers, we're responding to them same day, right? That's the level of responsiveness to our major customers. And that is – in my view, that's the price of entry, is that level of intensity around service and support.

And the reason for that is that if you think about how packaging moves through our customers' facilities, the cost of that packaging relative to what they're doing is minuscule. Their cost of failure is extreme. And they know it and we know it. And so, as we drive those service levels up, they actually are now taking their people out of their distribution centers or manufacturing plants, and they're reallocating people to other jobs or they're eliminating them altogether. And so, as we embed inside our customers and we make their lives easier, right. They – actually, they gain and we gain. And a big piece of what we gain is stickiness and that stickiness is really important.

And don't get me wrong, I'm not going to over exaggerate the stickiness, but there is probably somewhere in the 10% plus range that customers – that's the cost of switching. If you just kind of look at what – as we look at our customers, when they are looking at a new contract or whatnot, the last thing they're going to do is switch for 1% or 2%. They are not going to go through that kind of disruption.

You're talking customers that we're doing changeovers with now. This is a six-month process because they need to prove – they're about to move all of their business from a competitor to you. And it's 40 of our plants doing business with 60 of their plants, right? That is not an easy switch. That's complex and they can't afford the failure. And so, we kind of think of this as – well, I'll trade for a few pennies of price. Well, you'll do that if your service stinks or if your quality is bad.

And if your service is really good and your quality is really good, it's not that that becomes a definitive barrier for all time, but what that does is it definitely raises the switching cost. There's no doubt about it, and it gives you entry into innovation. And that to me is where it gets exciting, because now if I'm partnering with that customer and we're working together on the entire value chain, we can take total cost out of the system, right, with us making money and them making money, right? We can both do that. And so that's where the service game really comes into play.

Philip Ng
Analyst, Jefferies LLC

Q

Super. It sounds like you have the foundation in place and the game plan in place for the US market.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yes.

Philip Ng
Analyst, Jefferies LLC

Q

Help us think through Europe. I think initially, at least part of the thesis in terms of synergies was the estimate was short on paper.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yes.

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Philip Ng
Analyst, Jefferies LLC

Q

You could kind of backwards integrate yourself, the paper you export.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yeah.

Philip Ng
Analyst, Jefferies LLC

Q

You've obviously taken a lot of capacity out, right?

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yes. Yeah.

Philip Ng
Analyst, Jefferies LLC

Q

So, how has that equation changed and what do you need to do to kind of get the estimate right in terms of that transformation. The playbook – just kind of expand on the playbook.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yes. So first, let me touch on the thesis here around one of the benefits. And when we looked at that, we thought there might be up to $100 million benefit in DS Smith procuring paper from International Paper. And what that's proven as we've dug into that, everything I talked about a moment ago, there's actually more economic value in choosing to not do that.

And actually, restructuring the US market, there's more economic value to capture than in shipping paper over the ocean. And a big piece of that is the amount of supply of paper in Europe, right? So the availability of high quality paper in Europe is a different scenario than in the US, right? There are more independent assets in Europe than there are in the US.

And so, just looking kind of which one do I want to choose? Well, I'd rather choose A, because it's going to drive more economic value. But I do give up B, there's no doubt about it. That being said, one of the best pieces of synergy that we have is our Madrid mill, so the Madrid mill that IP bought and then refurbed over the last half decade or so.

It's interesting because you hear some of the stories around that Madrid mill that are actually kind of funny about, we overspent on it. But when you actually look at it, I'd love to do ten more of them just like that, because it's a lowest cost, highest quality mill probably in Europe. Yeah. It's certainly in the top decile of mills. And so we've gotten a lot of benefit from that in the Iberian Peninsula because we can now feed 100% internally. So that's played out well.

The reality is that the European market, what I talked about before and that softness, that's just a big headwind, right? So in Europe alone, you're talking about almost $350 million of headwind in volume in price from our profit

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standpoint, from our expectation of where – just on those two alone is actually $375 million, if I remember, right. And so, we're battling that headwind. But the key to it is to not let go of that crisis and to allow that to drive the restructuring, right?

So, how do we actually move as fast as we can to restructure the business? In many ways, probably 80% of the game plan is very similar to the US, right, which is structurally move to the right profit pools, the right assets aligned, the right people aligned to that. So we're moving down that path very aggressively. The difference is, in the US, right, we're basically an integrated company, for the most part. In Europe, we're only about 50% integrated. So we're going to continue to move towards more integration there.

But to be clear, I'm not going to go out and buy a bunch of assets at this stage, right? There's enough high quality paper available that we don't need to go and put a bunch of money in the ground and buy assets. We need to optimize from here. So we need to exit those things that are non-strategic and unattractive, frankly, structurally. And we've announced the start of that. You're going to continue to see more of that, the kind of drumbeat that you've seen in the US, expect to see that in Europe. And we have to move aggressively to do that. The total bogey of just cost out structurally is $500 million to $600 million of just cost out that we're going to take in Europe.

And so, that's moving along. It's going to take longer than the US by the nature of the consultation process. So in the US, we basically say, we announce it and we do it, right? In Europe, you have to announce a consultation process. You have to go through that in good faith. And that's very important, right? It's not a paperwork exercise. You have to go through the processes in good faith and you have to look at alternatives, because alternatives do present themselves.

And so, you've got to go through that process. And so, we're doing that now. We're moving very quickly. We have announced a whole series of actions relative to consultation in the UK. You now heard me talk about Croatia. We've also talked about the country structure that were ongoing, and so that's just going to roll through the system here over the next couple of years.

Philip Ng
Analyst, Jefferies LLC

Q

Within that $500 million to $600 million bucket, would you be able to unpack what are some of the big cost out? Is it on the mill side, the box side? Do they have a bloated corporate cost structure like the IP US and things?

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yeah. So let me do – I want to take the last one first and then I'll walk the other ones. So, there was not a large central structure in London like we had in Memphis up until last year. There was not that. But what you found was, in Europe what was happening was instead of managing the complexity at a corporate center, they were managing it at regional centers.

And so you had a very small group of people in London. You only had 100, couple of hundred people in London, total. But what you had were these very large country structures, these very large, very complex country structures. And so what we're doing is we're simplifying that. So that, we're going I think it was from 13 structures down to seven, and taking out a whole bunch of the kind of mill stuff that's in there in terms of management. It really is about managing complexity, Phil, right? It's not a value added piece of it. It's just kind of managing the complexity. So you have to attack that.

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On the converting side, the game plan around major geographic centers, so the game plan in Barcelona is the same as the game plan in Atlanta, right? So you have multiple converting plants in and around the area and you're looking at matching market segmentation with volume and mix, right? So the ability to match that so you can specialize in certain areas around volume and mix, drive productivity, drive service levels up dramatically.

A bigger difference in Europe that you don't have is you have a lot more singular converting plants that are in a market, right? So in the US, we mostly have multi-plant markets, not completely, but mostly multi-plant markets. In Europe, you absolutely have multi-plant markets, but you also have a lot of these one-off things. And so, in that case, in the multi-plant markets, same game plan as the US, right. We'll restructure that and we'll optimize around those major geographies.

And then the singular plant markets, they have to stand on their own, right? They have to stand on their own, just like if any of us own them as entrepreneur, they have to stand on their own and they have to win on their own. And if they can't stand on their own, they can't win on their own, they don't have a history, right? Or they don't have a future. And that's just the reality of that. So we're going to go through that same process that we went in the US.

The paper side is very different in Europe than in the US. Yes, we are short paper, but if you actually look at the tons that we sell that move through converting and the tons that we manufacture that we produce through paper, you'd go – well, you're not short paper. You'd go, what is it? Well, because half of what we make goes into other markets. It does not go through our converting process into packaging, ultimately end up on shelves or at your door.

And just like I talked through a moment ago, with export in the US, we're doing that same analysis around all of the assets in Europe and asking a simple question which is, do they drive an attractive return or not? Do they have a strategic advantage or not? If they do, we want to keep those assets and we want to focus on packaging. If they don't, they have a different future, and probably not with us if you can't drive the economic value. So we're going through those analytics.

As I mentioned before, in an ideal world, you do exactly what you did in the US and you'd own high quality paper assets feeding the packaging system. That doesn't make sense right now in Europe, right? To go and to build something or to buy at a premium some kind of assets that damage the market in some way makes absolutely no sense. When you have availability, you don't have to put the capital in the ground. So that's a little bit different. We'll play that as it makes economic sense over time

Philip Ng
Analyst, Jefferies LLC

Q

Super. In the US, you've underinvested for many years, how is that situation in Europe? Is there a capital investment element? And then from a commercial element, were you guys – you have the right type of customer mix you want. I mean, sounds like it's a lot of cost with a lot of complexity, but just kind of tackle those two things.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yeah. So, Europe, what I would say – a couple of things that Europe has done different than the US that are good, because I talked about the things that are struggle, so the commercial organization in Europe has been historically better commercial organization than we had in the US. It was more service focused, much higher touch and touching more people in our customers' value chain.

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If IP legacy, IP had one or two relationships within a customer kind of thinking of their value chain, DS Smith has historically had six or eight touches in that chain and that matters. And the reason it matters is, if your relationship is with procurement, right, that is a structural disadvantage. If your relationship is with design, engineering, manufacturing engineering, that's a structural advantage. And that's really where you want that advantage to go.

And the reason being is that you're working early on in that relationship to drive value for both players versus it being a price discussion, right? And so, as you as you think about what we've done in Europe, we've built a lot of service intensity and a lot of sales intensity, but we spread it really, really wide across the customer base. And so, the customer base is more fragmented anyway.

And so we have a lot of resources that are being spread across markets that frankly the customer doesn't pay for. And so we need to focus that on a smaller subset of customers that really value and will pay for that level of service intensity. And so that's a difference that – so that's something that's changing ultimately in that marketplace.

And then, it's also a more innovative market. And the reason it's a more innovative market is there's a lot more CPG content, and there's a lot more CPG content by the nature of the markets themselves, right? There's a lot more packaging that happens on shelves in Europe. Phil, if you would spend much time in grocery stores in Europe, you'll notice that because of demographics, because of the cost of labor, etcetera, etcetera.

But also, you don't have the same industrial packaging infrastructure requirements that you have in the US. Just the distances to move things in Europe versus the US, it's a different marketplace than the US. So, there's more innovation, there's a higher service component content, and DS Smith has done that well. We need to focus those resources around that.

Philip Ng
Analyst, Jefferies LLC

Q

Okay. And just lastly, on the US market, we're in a pretty good spot, right? I mean, demand's been pretty muted and it sounds like you're pretty constructive in the medium, longer term. But a lot of capacity has come out, what's your view on the cycle next few years? I mean, I know your longer term targets were predicated on mid-cycle pricing. I mean, it's a conducive environment with operates in the mid-to-high 90s right now. So just kind of help us think through the cycle.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

Yeah. I think, so, number one, I would say that as I think of this, where we are relative to demand, to me it appears as though we are a lot closer to a negative that we're on the range of outcomes, we're much closer to a bottom or more difficult moment now than I can imagine in the future. I have a hard time imagining anywhere from two to five years from now, we're not in a very different place in terms of demand. It's hard to imagine that.

I talked about housing, I talked about some of the other structural issues out there. It feels to me as though we're poised for that market to improve. And from our own perspective, and I only talk about us, it's been all about that design of getting high quality assets, right, to get to the high quality side of the asset curve and to not have a bunch of latent capacity that doesn't make money through a cycle.

One of the long term excuses for not dealing with inferior assets was, well, I need that capacity for when the market comes back. Great. Market comes back, but when you actually map it over a cycle, it doesn't ever make money with those crappy assets, right, and less attractive business. And so, as we have structurally taken that

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out, our belief is that we would rather run tight than run loose through a cycle. It's a much better economic proposition to run tight than run loose through that cycle.

And so, if we face a much better economy, great. And we have to make choices. You're going to make choices around the right sets of customers and the right sets of assets to capture that economic value. So I would say the US is in a good position. I can't pick timing, right? Your economist gave a talk, I guess, yesterday, right?

Philip Ng
Analyst, Jefferies LLC

Q

Yes.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

A

And he's going to be a lot more right than I am because I'm not an economist, although I'm not sure economists are ever right. So, look, it's hard to predict the when of it, but I think structurally, the what of it and the value that gets created over time because of the restructuring of that market and what we have done, I think is very attractive.

Philip Ng
Analyst, Jefferies LLC

Okay. Well, Andy, thanks for all the great insight. Thanks so much.

Andrew K. Silvernail
Chairman & Chief Executive Officer, International Paper Co.

Thank you, guys. Take care.

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