**Stora Enso Oyj - Q2 Earnings Presentation 2023 | GCS | July 21, 2023**

**Annica Bresky**

Welcome, everyone, and thank you for joining us today for our Second Quarter Results Presentation. I'm here today with our CFO, Seppo Parvi.

I will take you through the highlights and financial performance and then go through our key priorities and how we are accelerating, restructuring in the current challenging market conditions. Seppo will then take you through the financial performance in more detail. At the end, I'll give you an outlook of the coming quarter before we get into the Q&A session.

But before that, let's briefly take a look at our purpose. As you're aware, sustainability is deeply embedded in our strategy and corporate culture. Our purpose, to do good for people and the planet is more important and relevant now than ever. Replacing fossil-based materials with our renewable products is what drives our underlying performance and our opportunities for growth and innovation.

At the same time, we positively contribute to mitigate climate change, future-proofing our own company and our societies. And I would like now to show you a very exciting example of that. The image on the right shows a project called the Wisdome Stockholm, part of Sweden's National Museum of Science and Technology. It's built with our material and will be a landmark for sustainable and climate smart construction in wood. Beyond the reduction of carbon dioxide, in the actual construction phase, the building alone will be storing almost 700 tonnes of carbon dioxide. The project is now completed with doors opening in December. And if you have a chance, go and see for yourself how the boundaries have been pushed of what is possible to build with wood. I believe it's truly amazing.

Now let's take a look at the market dynamics and the recent development. The long-term structural tailwinds such as sustainability megatrends, also the climate change the world faces are still robust and direct our strategic choices. And there are several regulatory initiatives and directive supporting our strategic roadmap. Some of these are the, for instance, the nature restoration regulation, which intends to set targets to restore nature, important to create biodiverse and resilient ecosystems and already an integral part of our forest management.

The Packaging and Packaging Waste Regulation supports our renewable and circular packaging. And another strong driver for our product comes directly from the brand owners, who are responding to the increasing consumer demand for eco-friendly products. Lastly, the EU battery regulation supports our development of Lignode, with the introduction of the battery passport requiring battery producers to specify the amounts of renewable content in a battery.

Now if we then take a look at the current situation, the market has so far this year been hit with strong headwinds. The macroeconomic uncertainties still persist and the continued high inflation is challenging for consumers. It's causing a cost of living crisis. They reduce their consumption of different packaged goods and driving our customers to reduce orders to manage increasing inventories.

More specifically, in the second quarter, we experienced low demand and the fastest ever decline in global pulp prices. At the same time, global pulp inventories are at very high levels and the large amount of new pulp capacity is entering the market. The China market is also weak. We also saw reduced demand and continued customer destocking in our packaging business. The high interest rate environment has also severely reduced the activity in the construction market and, unfortunately, we can see no improvement in site in terms of building starts or housing permits.

In the forest, the tight wood market continued. This was due to increasing energy wood consumption and also the lack of wood imports from Russia. In general, our costs in many of our input materials and services are elevated compared to historical levels. And as a result, the second quarter was disappointingly weak, but we are committed to deliver on our strategic roadmap.

So now, let's take a look at some of our key events for this quarter. Naturally, in this turbulent market, we must adapt and continue to focus on what we can impact and control. Therefore, we have accelerated our restructuring plans, actions that will improve our long-term competitiveness and profitability by EUR 110 million annually. And I will give you some more details on this later.

On a positive note, I'm excited to see that the acquisition of the De Jong Packaging at the end of this year -- last year positively contributed to our results. And as we speak, we are building market share in Western Europe by ramping up Europe's largest and most modern corrugated packaging unit.

Another part of our roadmap is to sustainably secure our funding and liquidity. We have just launched a combined green and sustainability-linked financing framework for issuing these types of financing instruments. And during the quarter, we issued EUR 1 billion of green bonds and raised EUR 550 million in bilateral loans.

Now, let's take a look at our financial performance. As mentioned, our profitability for this quarter was significantly impacted by higher input costs and lower volumes and prices, leading to squeezed margins. Our group sales decreased by 22% to EUR 2.4 billion, and this was mainly due to lower demand and customer destocking, decreasing deliveries in all our divisions.

We've also prioritised profitability over volumes, taking production curtailments where needed. Lower sales prices, especially in wood products, biomaterials and packaging materials, together with increased variable costs, mainly due to higher wood costs, had a negative effect on our profit.

Structural changes also had an adverse impact on sales, mainly related to the paper site divestments at Nymölla and Hylte in Sweden, Maxau in Germany, as well as the exit from our Russian operations. Our Forest division, however, delivered record Q2 results and as said before, our Packaging Solutions business performed well.

In summary, our group operational EBIT decreased by 93% to EUR 37 million and the operational EBIT margin decreased to 1.6% from 16.5%. The operational return on capital employed for the last 12 months, excluding forest was 10.7%, which is below the long-term target of more than 13%.

Despite all, I'm pleased to say that we are continuing to grow in our selective strategic areas of packaging, building solutions and biomaterials innovations. These have, in Q2, increased their share of group sales to 57% from 53% in the previous quarter. In the last few years, we have accelerated our actions to fulfil our strategic roadmap, and we have successfully accomplished a significant transformation of our product portfolio towards growth areas.

You can see on the left that in 2006, 70% of our sales were generated by the previous paper business. Today, we have no longer a Paper division. We project that in 2025, 60% of our sales will be derived from our growth areas, rising to 80% in 2030. With this objective, we can profitably grow share with our existing and new customers, both in current and new markets with new products and solutions.

The allocation of our capital, I believe, is key to achieve this objective. The choices we make on how we use and develop our assets, enables our long-term growth and our profitability. And I will now try to cover some of these recent initiatives. I mentioned the acquisition of De Jong earlier. It is a major strategic investment, now moving ahead with integration. The expansion of the new high-tech packaging unit has been designed with a strong focus on cost efficient and sustainable operations.

The divestment of our consumer board production site in Beihai in China is progressing, and this will enable us to focus capital allocation on our most competitive assets. We have now also started the construction of our new high volume and cost efficient consumer board line at our Oulu site in Finland. And this will significantly advance our growth in renewable packaging, and we will be stronger when the cycle turns.

As you are also aware, biomaterials innovation is a key area for us that we continue developing. The largest potential is in Lignode. This is our anode material for hard carbon based on lignin. The pilot plant for Lignode continues its operation at the Sunila site in Finland, and we are currently investigating for more competitive locations for commercial scale-up and production. Recognising the potential for lignin-based products, we're also exploring external sourcing for lignin. I promised earlier to give you some further details on our restructuring plans.

So, let's go through that now. We have a short to long-term action plan for value creation. And of course, with the current challenging market environment, we are accelerating restructuring to improve future competitiveness and profitability and also to build market share where we already have leading positions. These are my key priorities.

As announced during the quarter, we are planning to permanently close down and divest non-competitive assets. The pulp production site at Sunila, Finland, the De Hoop containerboard site in Netherlands, one containerboard line at the Ostroleka site in Poland and the Näpi sawmill in Estonia. We also intend to divest the wood products Do It Yourself unit in Netherlands, and the divestment process is ongoing for Beihai Mill and forest operations in China.

We're also continuing to decentralise, creating leaner and more efficient group functions to simplify our organisation and reduce overhead costs. This will further empower the divisions to independently drive customer intimacy, increase business focus and implement cost reductions. The restructuring actions across the group would result in a total headcount reduction of approximately 1,150 employees and it will improve profitability by an estimated increase in operational EBIT of around EUR 110 million per year. Such actions are, however, never easy, especially since it impacts our people but unfortunately, necessary to strengthen Stora Enso now and for the future.

If we look long term, as mentioned earlier, we are building on strong market positions, driving innovation and focusing capital allocation into strategic growth markets. We are strengthening the whole business into a more resilient and cost-efficient platform, with cost-competitive assets and cutting-edge products to support the long-term growing demand for Stora Enso's renewable products.

With that, let's now take a look at the development of our long-term group financial targets. The weak second quarter is, of course, also reflected in how we deliver against our group targets, remembering, of course, that we are comparing ourselves with a very strong quarter last year. Our sales decreased by 22%, impacted by the, as I said, the lower demand and structural changes, mainly related to the previous mentioned paper site divestments, as well as the exit from the Russian operations. And although the net debt related targets were achieved in the second quarter, the operational return on capital employed targets were not met. For the divisions, Biomaterials and Forest division are ahead of their ROOC targets while the other divisions clearly underperformed.

And now, I hand over to you, Seppo, to give us some more light and insights on the financials.

**Seppo Parvi**
Thank you, Annica. Lower sales prices and volumes, together with high input costs significantly reduced our profitability. As mentioned earlier, the market demand was clearly weak compared to the previous year, driving both sales prices and volumes down. Fiber costs were significantly higher due to the increase in wood costs. Especially in Finland and Sweden, market is tight due to the increase in demand of energy wood and lack of volumes from Russia.

Energy, logistics and fixed costs were lower year-on-year, but chemical costs were still increased slightly. The negative impact from other variable costs and change of inventory is mainly coming from Packaging Materials division. In Packaging Materials, destocking in the supply chain continues. Sales decreased by 19%, or EUR 269 million to below EUR 1.2 billion due to lower containerboard prices and lower volumes for consumer board. They were partly offset by higher consumer board prices. The consumer board market softened further with lower demand.

The containerboard market stabilised at the low level, but inventories were still at the high level. Price erosion continued, and we have taken production curtailments to adjust lower demand. Operational EBIT decreased by EUR 222 million to negative EUR 22 million. Higher consumer board prices were offset by mainly lower containerboard prices and also lower volumes and higher wood costs. Total variable costs increased due to wood prices, but other variable costs decreased from peak levels. Operational return on capital was 7.3%, below the long-term target of over 20%.

Here you can see market prices for the Packaging Materials division. In the second quarter, containerboard prices continued to decrease due to weak demand and continued high inventories in the supply chain. The demand was weak due to slow economic growth and low private consumption but is expected to stabilise at low levels. Destocking continues, as mentioned earlier. Folding boxboard prices have decreased from the peak levels of summer '22 as a result of softening demand and destocking. Price pressure has been mounting due to low demand.

In Packaging Solutions, there was solid result development despite a weak market. Market has now stabilised at the low level. Sales decreased by 55%, or EUR 102 million to EUR 288 million and acquired De Jong Packaging Group, more than offset the impact of the divestment of the Russian operations in Q2 a year ago.

Sales from Northern and Central-Eastern European businesses decreased slightly due to the soft market. Sales prices in corrugated packaging were lower as a consequence of lower containerboard prices, and we continue to focus on defending our selling prices. Operational EBIT increased by EUR 13 million to EUR 15 million. The acquired De Jong Packaging Group as well as actions to reduce costs and improve business performance, mitigated the impact of the soft market and the divestment of the Russian operations a year ago. Operational return on capital was 5.9%, below the long-term target of over 15%.

In biomaterials, very challenging market conditions continued. Decline of the market started late first quarter this year. Sales decreased by 27%, or EUR 143 million to EUR 379 million. Market has softened further with low demand and increased global pulp inventory levels. This has led to a record decline in market pulp prices and lower deliveries impacting sales negatively. Also, curtailments and production losses due to maintenance impacted sales volumes negatively. Operational EBIT decreased to a negative EUR 13 million due to lower sales prices and volumes, as well as higher maintenance and wood costs.

Market-related curtailments, annual maintenance shutdowns and higher wood costs significantly impacted the result for the quarter. The Montes del Plata site in Uruguay and the Skutskär site in Sweden had planned major annual maintenance shutdowns, followed by challenging start, increasing the maintenance impact in the quarter. Operational return on capital was 19.1%, above the long-term target of over 15%.

The record speed of decline in market pulp prices and lower deliveries pressured sales and margins. Our Biomaterials division especially faced the fastest ever decline in global market pulp prices, as is visible in the graph on the right-hand side here. Significant amount of new capacity is entering the market at the time when demand continues to be low and global market pulp inventories are on very high levels. We also expect inventories to remain on a higher level going forward. Global pulp inventories continued at the level above the 5-year average, as you can see on the other graph on the left-hand side here.

In Wood Products, demand has significantly weakened as construction activity was on hold. Sales decreased by 31%, or EUR 195 million to EUR 436 million, mainly impacted by lower sales prices and volumes, especially for sawn wood. After last year's record strong market, demand for sawn wood has significantly become big. Construction activity in the division's main markets remain low and is negatively impacted by fewer building permits and projects, is due to the high interest rate environment and cost of living crisis.

Operational EBIT decreased by EUR 140 million to negative EUR 6 million, affected by lower prices and volumes. Results were impacted by lower sawn wood prices, lower volumes and continued high raw material costs. Operational return on capital was below the long-term target of over 20% at 5.6%.

In the forest, stable and strong performance continues. Sales decreased by 4%, or EUR 29 million to EUR 620 million, caused by lower demand. Wood prices remained high due to tight wood markets. The wood market in the Baltics and Nordics remained especially tight due to the increase in energy wood demand and lack of Russian wood imports. We have managed to secure wood availability through flexible use of our own forests and efficient good sourcing, both from Nordics and Baltics. Record-high second quarter operational EBIT of EUR 62 million was driven by a stable and a strong operational performance in our own forests and in the wood supply operations. Operational return on capital at 4.1% was above the 3.5% long-term target.

Forest valuation continues to show strong resilience in a high interest rate environment. On this graph, you can see the stable development of our forest assets fair value by quarter. The total value of our forest assets, including leased land and our share of Tornator forest assets in Finland, remained stable at EUR 8.1 billion, is equivalent to EUR 10.23 per share. There was a EUR 266 million decrease versus previous quarter in the value, mainly due to weaker Swedish krona. Market transaction-based forest property prices are updated in Finland and Sweden in connection with Q2 and Q4 reporting. So, this is based on the latest market data available.

Now handing back to you, Annica.

**Annica Bresky**
Thanks, Seppo. And I will now go through the market demand outlook per division for quarter three compared to Q2 this year. And it's fair to say that Q3 will be another challenging quarter due to sequentially deteriorating market conditions. In Packaging Materials, the demand for consumer board is expected to be weaker and destocking at customers continue, but the demand for containerboard is expected to stabilise at low levels.

In Packaging Solutions, demand for corrugated packaging is expected to be stronger, but it is lower than the normal seasonal peak. In Biomaterials, the pulp demand is expected to be weaker, as high inventory levels are expected to continue, as Seppo showed, together with a larger amount of new capacity entering the market. For Wood Products, the market demand for both sawn wood and building solutions is weaker, as the building activity in construction industry continues to be slow. For the Forest division, sawlog demand is expected to remain stable due to tight wood market. And the pulpwood demand is expected to decline due to weak pulp market. The demand for pulpwood for energy, however, will remain strong.

And I will now summarise our key takeaways before we move into the Q&A session. So, all in all, we continue to adapt and navigate the challenging market environment. Our financial performance for the second quarter was disappointingly weak and was caused by market-related lower demand in combination with high input costs for most of our businesses. Therefore, we are accelerating our restructuring plans to improve our long-term competitiveness and profitability. These initiatives are expected to improve our operational EBIT by EUR 110 million annually. We reiterate that we expect the full year of 2023 operational EBIT to be significantly lower than the EUR 1.9 billion achieved in the full year of 2022.

On our strategic initiatives, we are focusing capital allocation on long-term value creation in key growth areas. And to further accelerate our sustainability commitments and strategy, we launched a new framework for green and sustainability-linked financing, raising EUR 1 billion from the bond markets. And in addition, we have raised EUR 550 million in bilateral loans to secure our liquidity and financing in the current business environment. We are positioning ourselves for profitable growth in our key segments and to be stronger when the cycle turns.

And with that, we are ready to take all your questions and moving into the Q&A session.

**Question and Answer**

**Operator**
[Operator Instructions] Our first question comes from Lars Kjellberg at Credit Suisse.

**Lars F. Kjellberg**
Yes. A couple of questions relating to the structure of your business now. Clearly, wood costs have been moving up quite materially and you're obviously highlighting energy use as an issue when it comes to demand, but even so we have a weak demand in your industrial products. So, the question is really, how should we think about this structural tightness of the Nordic/Baltic wood market and in that context, your ability to drive profitable growth through the organic investment, for example, in Oulu? That's one of my questions.

**Annica Bresky**
Thank you for your question. And of course, right now, the Finnish sites are challenged by high wood costs, as we have said in the Nordics and the Baltics. However, the investments that we are doing in consumer board, they are driven by long-term growth, and we have seen our consumer board business to be resilient, even though right now the market is weaker. And the site in Oulu is going to be Europe's most cost-efficient folding boxboard and CUK or brown qualities production site, which is, of course, long term, how we are repositioning our assets. So, I have no doubt that we will be able to deliver very strong results going forward from that business when the cycle turns.

And also, if we look at kind of the wood market, yes, it is true that we miss the Russian wood imports. We are now taking decisions to close down, for instance, our pulp mill in Sunila, that releases wood volumes for our other sites, taking off some pressure on the Finnish wood market. So, thinking about it little bit long term, we will see, of course, as the demand goes down for sawn logs and also for pulpwood that there will be an adjustment also on the wood prices, but there is a lag effect of approximately 6 months to 9 months before that happens. Structurally though, there is a lower volume of wood available in that region.

**Seppo Parvi**
And we also believe that over time, energy wood consumption would go down when electrification of the boilers moves forward. Obviously, it doesn't happen overnight. It takes time as an investment cycle. And that would also ease the situation in the market.

**Operator**
Our next question comes from Charlie Muir-Sands at BNP.

**Charlie Muir-Sands**
Yes. Sorry. I'll limit myself to 2 questions, if that's okay. The first one is on the forest valuation. I think you attribute them to being mainly related to the movement in the krona. But I just wondered, can you clarify, are you seeing any signs of negative revisions to forest valuations on a local currency basis?

And then the second question relates to your working capital and CapEx. I just wondered if you could update us on what you think you can achieve in working capital this year? And what you're thinking about CapEx for this year, where I assume the guidance is unchanged and perhaps even for next year?

**Annica Bresky**
So, if I start with the forest valuation, the answer is no. We cannot see any other effects impacting beyond the currency effect.

**Seppo Parvi**
Yes. Then on your question of working capital and capital expenditure. So, we believe -- and what we are working on is to reduce working capital by EUR 250 million to EUR 300 million. And when it comes to capital expenditures, we have actually lowered the range by EUR 100 million, reflecting the reprioritisation of the projects and focus on the cash flow in short term.

**Charlie Muir-Sands**
Any view on next year?

**Seppo Parvi**
No, we don't comment next year's CapEx yet. But obviously, under the current business environment and assuming that it's not changing, we will keep focus on cash flow and cash flow generation and look at the priorities on capital expenditure size and investment and potential postponements.

**Annica Bresky**
And as we have communicated before, we will deliver on the strategic projects that we have in pipeline and we have kind of the Oulu investment there, raising kind of the general CapEx levels,

but we will not take any more decisions on new investments until we see the market cycle turning.

**Operator**
Our next question comes from Henri Parkkinen at OP.

**Henri Parkkinen**
Yes. I have 2 questions. First, regarding the consumer board business. In your comments, you say that you expect the demand to decline when going to the third quarter of this year. Could you please remind about the contract structure when you talk about the liquid packaging board and folding boxboard or therefore, how much of your, let's say, contracts will be renewed during next 12 months or something like that?

And the second question is related to Packaging Solutions. In your report, you mentioned that the IFRS net profit impact from De Jong was something like EUR 73 million negative during the first half of this year. But if we go to the comparable operating profit level, what was the impact, for example, during the second quarter of this year?

**Annica Bresky**
So, if I start with consumer board, we constantly renegotiate contracts. Folding boxboard, as you know, are mainly 1-year contracts, and we have them, of course, spread around the year. So not everything takes place at the same quarter. But generally, most contracts are renegotiated during quarter 3, quarter 4. If we look at liquid contracts, they are longer kind of contracts between 3- to 5-year contracts. We have seen, if we analyse kind of consumer board business as such, that the liquid business is resilient and stays more stable. Folding boxboard has been going down demand-wise. And that is what we expect for coming quarter.

The inventories on folding boxboard, however, have remained stable. So, this is, kind of, they are not increasing. And as I said, we are taking curtailment and production curtailments in order to make sure that when we enter price negotiations, we keep the inventories on those as low levels as possible. So that's why we are working with that. And if we look at kind of the liquid business, there, we expect it to be more or less kind of stable. And even though it's kind of weakening a little bit, it's resilient under these circumstances. For containerboard, however, you didn't ask that question, but in relation, that is where we see that it will stabilise at low levels. And of course, that improves the situation for pricing. And there, we have more kind of contracts being renegotiated all the time and have also bigger opportunities to adjust for changes in input costs and so on.

**Seppo Parvi**
Then on your question on this IFRS result and comment relating to De Jong, that is relating to write-off of the whole potential closure that we announced a month ago. And it is treated as item affecting comparability, IAC, and that's why it is not visible in operational EBIT. So operationally, no issues. It's the restructuring-related charge.

**Henri Parkkinen**

But you do not want to comment that the profit impact on the comparable operating profit level from De Jong during the second quarter of this year? So how much additional comparable operating profit you would…? Okay. I understood. Thank you very much.

**Seppo Parvi**
We don't comment separate individual business units for any of the divisions.

**Annica Bresky**
No, and we have to remember also that last year, we had the Russian operations in our results. But De Jong is delivering – it's strong and delivering good results for us.

**Seppo Parvi**
And integration is moving forward as planned with the expected benefits.

**Operator**
Our next question comes from Linus Larsson at SEB.

**Linus Larsson**
Thank you very much. And my 2 questions are relating to your near-term outlook. And you're saying that in the third quarter, you're expecting sequentially deteriorating market conditions. What do you see regarding variable costs? How do you expect variable costs to change in the third compared to the second quarter, please?

**Seppo Parvi**
When it comes to variable costs in Q3 versus Q2, obviously, year-on-year, we continue to see pressure and an increase in inflation. But quarter-on-quarter, variable costs are starting to flatten up. So, we don't expect such a big pressure, but they aren't really coming down either.

And on the market conditions between Q3 and Q2, do you want to comment that, Annica?

**Annica Bresky**
On the market conditions, well, the biggest kind of, we are long in pulp, as you know, 2.1 million tonnes. And with the closure, of course, of Sunila, if that is progressing after the negotiations, we will reduce that long position. It is the market pulp pricing levels, that is the uncertainty of -- and the weakening that we see on that market that drives mainly that comment that we are making. And as you saw, we are on high inventory levels there. So, that is kind of what's driving our outlook.

**Linus Larsson**
And relating to that in -- not only in biomaterials but on a group total, do you expect -- what is your production planning currently? Do you expect to take more or less market related to downtime in the third compared to the second quarter?

**Seppo Parvi**
We don't, Linus, comment in detail our plans when it comes to downtime market-related or otherwise. But it's clear that the severe market conditions don't improve as we expect, it doesn't. So, we continue to take downtime where needed to adjust our production volumes to the demand to avoid inventory build-up.

**Operator**
Our next question comes from Cole Hathorn at Jefferies.

**Cole Hathorn**
Two quick questions to start. On the disposal of the China business, can I just confirm you're looking to try and sell your forest holdings as well as that mill collectively all into one package, so the EUR 340 million forest value on the balance sheet, plus whatever you can get for that Beihai Mill is the first one?

The second question. You mentioned that there was some inventory write-down effect in the second quarter, mostly in packaging materials. Could you quantify that? And will there be a sequential improvement effectively next quarter because I imagine there wouldn't be further write-down to that inventory? Just to start and then I've got one follow-up.

**Annica Bresky**
So, on Beihai, yes, we are selling both the mill and the forest operations. And as I said that divestment process is proceeding well, and we have interest in our assets. We will decide if we sell them in a bundle or separate to maximise the value of our assets.

**Seppo Parvi**
And when it comes to inventory in Packaging Materials, it's not really directly Packaging Materials inventory valuation or revaluation. It is relating to volumes in inventory. In the Q2 a year ago, inventory volumes went up. They have been going down this year. That is where the effect is coming from. And then, obviously, going further, it depends how the inventory levels move sequentially. But obviously, like I said, normally, these kind of big changes between the sequential quarters don't happen. This was year-on-year and different business environment.

**Cole Hathorn**
And then maybe looking into '24 and '25, I mean, Packaging Materials now at negative EBIT. That's just -- it's not a sustainable level for this business or a medium-term level for the business. What are the big buckets or big roadmap items that need to change to get profitability to improve in the business? Is it a case of, if wood costs stay higher for longer, you need to step up the liquid packaging board contract prices? What are the key buckets that you need to turn around the profitability? And I realise it will be '24/'25. I'm just trying to understand how we should expect the sequential improvement in profitability in those outer years?

**Annica Bresky**
So first of all, just a reminder in Packaging Materials, we have the asset of De Hoop there, which we are restructuring and closing, which is contributing, of course, to the negative results that we have on that division. And then if we look at going forward, of course, now we have the perfect storm situation where input costs are still high. They haven't come down due to inflation and then the prices come down faster. Moving forward, of course, I mean, we expect in the slowdown of the economy, inflation will gradually kind of reduce.

We will be able to renegotiate sourcing contracts on logistics, on other input costs such as chemicals and so on. And also, through restructuring, find ways of redirecting our wood opportunities to where we have most profitable kind of products. And in our contracting with customers, of course, we cannot have a kind of non-profitable products. So, what I see in Packaging Materials, if we look at underlying demand, if it has come down, it is still resilient and it is on good levels. Once destocking is done for the customers and the brand owners, which is what we are trying to achieve by taking curtailments now, we also have a better negotiating position to kind of deliver on the underlying demand. And long term, we need to remember that renewable packaging is growing and expected to grow for the years when the cycle turns. Pulp price is also declining for Packaging Materials, will eventually also be visible in reduced kind of pressure from input costs.

**Operator**
Our next question comes from Harri Taittonen at Nordea.

**Harri Taittonen**
Sure. Maybe on the pulp market, just if you can give colour because you have quite a diverse portfolio and it seems that the short fiber prices have declined much more steeply, and the long fiber prices have been holding up a little bit better than the price difference that is quite wide. So, what are you seeing there going into the second half of the year, I mean, in terms of your product mix by grade, if you can elaborate a little bit on that?

**Annica Bresky**
So, for Europe, on softwood and also hardwood, we expect continued kind of demand decline by 7% approximately for both these type of grades. Fluff is holding on better. So there, we expect the demand increase to 2.9% or almost 3%. Then in China, we also -- we had the kind of demand and the bottom kind of it. It's for softwood and hardwood, around 3% decline for the coming quarter year-on-year. If we look at it sequentially, if you're interested in that. we would see in Europe, softwood and hardwood at approximately and also fluff at the same levels of demand. That's also true for China. But the challenging situation is that there is new capacity coming on stream. It's quite sizable when demand is not really strong.

We see weakening of the packaging end uses of the paper -- graphical paper end-users on the demand side. So, there is going to be continued price pressure on the pulp side. And as I said, the inventories are high. If you look back historically to come down from the levels that we are now on inventory levels, it takes 1 year before they get in balance. So that's why I'm not very optimistic that we would see a quick turnaround on the pulp market.

**Harri Taittonen**
Yes. Understand. Yes. Surely, we are interested in sequential development. And maybe the second question on the Packaging Materials. I mean, what is the best sort of estimate on the underlying demand growth sort of versus destocking? And then, obviously, during the pandemic years, there was not that much supply coming from Asia. But how much is that kind of affecting the supply-demand balance at the moment? Is it sort of a new feature, which is also -- which also needs to be taken into account and thinking about the sort of the timing of the potential kind of end of the destocking period, I mean?

**Annica Bresky**
Did I hear your last question? You asked about Asian imports, or did I miss that?

**Harri Taittonen**
Yes. I was just thinking that the markets are completely right that, that sort of there's two elements. One is destocking and the other one is underlying demand, which are both kind of affecting supply and demand. But then the third issue is that if there's sort of an increase in supply affecting the market in a different way compared to the pandemic years?

**Annica Bresky**
No, I don't see. Your last question about the Asian supply, I don't see that impacting our European market at all actually. The board production that's set up in China is used for domestic production and consumption in the Asian kind of region. So, that is not impacting our business where we have a majority of our sales in Europe. So, it's more kind of a European demand driven. I would say that, that destocking is going to continue to take place Q3, Q4 for consumer board. But I expect that to be kind of then reaching more balanced levels where the true underlying demand will kind of -- is resilient. Even though it's weaker than the record year last year, it's not weak. So, it's a matter of now making sure that inventory levels do not increase and that they are kind of balanced by the end of this year. And we are taking the actions necessary to make sure that from our side, we do our best to get there.

**Seppo Parvi**
And looking over the cycle, economy in general and this destocking, we foresee that the growth is still there. I look at the replacement of plastic by fiber packaging and these trends. They have not disappeared anywhere. But we need to look over the cycle and this destocking has been unusual this cycle.

**Annica Bresky**
Yes. I think it is a residue from the pandemic years where there were lot of supply chain challenges and kind of our customers wanted to be sure that they had materials. So, the stocks were higher. And now we are normalising that, and that takes a couple of quarters to get there.

**Operator**
Our next question comes from Brian Morgan at Morgan Stanley.

**Brian Morgan**
Hi there. Thanks very much for the time. Two questions from my side. Could you break down the operational EBIT improvement that you see, the EUR 110 million annual number into a bit more detail? How much of it is related to mill closures? How much is variable cost savings or fixed cost savings, et cetera?

And then the other question is just on pulp and just perhaps from a high-level perspective, do you think the industry is doing enough to rebalance the pulp market? Do we need some tough decisions made by the industry in general to rebalance this market?

**Annica Bresky**
If I say about restructuring, of course, majority of the fixed costs and also the FTE impact is on the assets that we are planning to close. And that also, of course, takes down maintenance costs. It takes down headcount and other services that are needed to service these units. Also, as I said,

for Finland, where the wood market is tight, it releases wood volumes that can be used for other sites, taking off some of the pressure. We do not comment more in detail kind of specific items on that. On the headcount for the lean group functions, that is a 20% reduction on headcount, which is included in these numbers and brings efficiencies also as we right-size or kind of group function operations.

If we look then at the pulp, if you could remind me again, the question on that? You asked the question about the pulp market.

**Brian Morgan**
Pulp market structure.

**Seppo Parvi**
It was if enough is done by industry to rebalance the market.

**Annica Bresky**
Thank you. I believe that it's going to take a while until this new capacity is absorbed by the market. It's quite sizable. It's 4.5 million tonnes coming out, coming this year and the next year. So, there is long-term growth in the pulp business of about 2% per year. But naturally, when this big capacity comes out, when market demand generally is slow and macroeconomics are slow, it's going to take a while before that is absorbed. If inflationary pressures stay on high levels, I expect that kind of uncompetitive smaller units will suffer. And of course, then if the situation does not improve since the cash cost is now on such levels that it is not profitable to run some of these pulp units. And we have seen that in China. There are smaller pulp mills there temporarily closing down and so on. There will need to be restructuring to stabilise this market. And we have taken the step with our unit in Sunila. I expect more to come if the situation becomes a longer issue.

**Operator**
[Operator Instructions] Our next question comes from Ephrem Ravi at Citi Research.

**Ephrem Ravi**
Just a hypothetical question, just to think about how you're looking at the business. So in the scenario where that your net debt-to-EBITDA reaches 2x by the end of the year, would you -- can you give us a priority of how you would stagger out your strategic growth projects in terms of which would take priority between Oulu conversion, Langerbrugge and Lignode, just to know that which is more critical, which is probably less critical for you from the way of you thinking about your long-term strategy?

And secondly, again, at least in the last 10 years, you haven't had a negative free cash flow year. How should we think about your capital returns in terms of your dividend payout, which is 50% across the cycle. So theoretically, it can go down to 0 in a year where -- because you haven't had this before. If your free cash goes negative, would you still think about paying a dividend?

**Seppo Parvi**
Well, first of all, on your question on net debt to EBITDA ratios and movement there, as we have said, we have already started actions to work, to improve our cash flow, working on working capital reductions. We are working to look at the priorities when it comes to CapEx, how to

improve cash flow by postponing some of the projects or cancelling, mainly postponing those to future. And we are also doing restructuring when it comes to bleeding units and unprofitable businesses to improve our profitability. So, with those actions, we are obviously managing our balance sheet.

When it comes to dividend and dividend policy, obviously, that is something that is tied to the result and result development, targeting to pay half of the earnings per share over the cycle. And as in the past, given the policy has followed the dividend -- sorry, the dividend policy has followed the profitability development of the company. But of course, it is over the cycle. So, we take a bit longer-term view on the dividend payments. But that is obviously something that Board will address then towards the end of the year, early next year before AGM.

**Annica Bresky**
And if I say a few words about prioritisation of CapEx initiatives, we have already decided on the Oulu conversion and that is ongoing. Actually, it's a good time to do investments during a downcycle and then ramp up the unit, which is expected to ramp up in 2025 once the cycle turns. And if we look at Langerbrugge, we have done the feasibility study that shows that, that unit can be converted profitably into a containerboard unit. But we will, of course, not do that until we see that the market kind of improves. In terms of Lignode, we are continuing to focus on the development there, looking for the most cost competitive asset to do such a scale up. But of course, also there, we need to be sensitive of how the market is generally kind of directing and our opportunities to free up capital for such investments.

**Operator**
Thank you very much. That concludes today's session. So, I'll hand back to our speakers for any closing remarks.

**Annica Bresky**
Thank you very much. A lot of interesting and good questions for you, and thanks for participating actively today. Looking forward to talking to you again in quarter three and wish everyone a great summer. Thank you very much.

**Seppo Parvi**
Thank you.