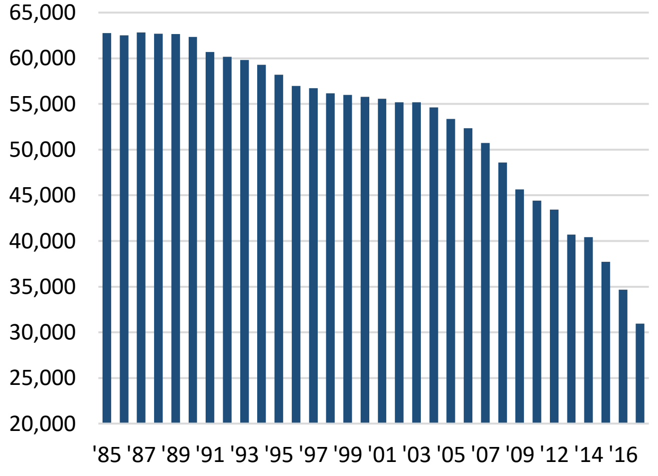
LOOKING BACK: Mondi Ltd.

Much is said of mergers and acquisitions. Common motives could include: expansion into new markets, acquiring a competitor to form a stronger player, or enjoying economies of scale. Bigger is generally thought to be better. These strategies have a compelling narrative for shareholders, and therefore often gain approval. However, much less is said of unbundling.
Unbundling tends to involve a large company spinning out a business unit not considered “core” to its current operations. This provides shareholders with the choice to either own that unit as a stand-alone stock, or not. This is what happened with Mondi Ltd.

Mondi was spun out of Anglo American in 2007, and since then, the return attributable to Mondi shareholders has been exceptional – returning just short of 21% annualised over the 11-year period (outperforming the All share’s return of 9.2%). These returns may paint a rosy picture, but the paper sector has not been a kind place to be in the last two decades.
Mondi’s history starts in 1967, in Merebank just outside of Durban. It was housed within the Anglo American stable, where in addition to their mining assets, the conglomerate held a host of companies in unrelated industries; from paper production, to merchant banking.
In the years leading up to 2007, the paper markets were going through a difficult period. Globally, the industry was slowing. Paper firms had become debt-heavy, over-investing in capacity which applied further pressure to their markets. It was with this global backdrop that Anglo’s decided Mondi was no longer a core asset, and as they had been doing since the mid-1990s, decided to unbundle the business.

Chart 1: Paid Circulation of Daily Newspapers (USA thousands)



The timing for the unbundling was unfortunate. The global financial crisis a year later, saw demand growth collapse. Combined with the overhang of supply that had been built up over the years, the paper markets bottomed. Further structural changes were also in play, such as the gradual but steady decline in demand for the paper products used in newspaper and magazines publications. Chart 1 illustrates this downward trend.

Amidst this challenging environment, Mondi successfully transformed itself. The largest contributor to its transformation was the purchase of assets in Central and Eastern Europe. These emerging economies offered access to cheaper labour, but more importantly timber, their key input to making the intermediate commodity of paper pulp. Proximity to the source of this allowed Mondi to remain a low-cost producer.

Mondi has expanded steadily across products and geographies and this has been pivotal to its success. However, perhaps the most under-appreciated part of Mondi’s actions has been their methodical closure of under-performing assets. These assets can be disadvantaged by outdated technology, located too far from key suppliers or markets, or no longer see enough demand for what they produce.

Whatever the case has been, Mondi has closed plants not meeting their cost of capital, as they detract from group returns. These assets begin to take up more resources to keep them open than good assets do. While it is expected for demand to contract for some periods, as is the nature of cyclical industries, there is always a point at which it no longer makes sense to stick it out – Mondi’s discipline in closing these under-performing assets has served them well, by ensuring their remaining assets create value for the group.

Looking back to the humble beginnings at the Merebank Mill, it is difficult to imagine that the firm’s evolution would have followed the same path had they still been a business unit held within a mining house. Capital intensive industries, especially those threatened by structural change, require management’s dedicated attention to continue to deliver strong returns. In Mondi’s case, its unbundling allowed the focus required to grow the business effectively and trim under-performing aspects.