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CASE STUDY: MONDI

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Boxing clever

Mondi is a vast global paper and packaging company. Having demerged from its South African parent in 2007 it needed to establish a treasury operation almost from scratch, and quickly. With so many possibilities, and a business to run, how did it cope?

When a member of a successful group goes it alone, one of the first requirements is to build a whole new support structure from scratch. It represents an exciting, if rather daunting opportunity to create afresh and lose all those old and perhaps inefficient ways.

When Mondi demerged from its former parent company, the South Africa-based mining giant, Anglo American, in June 2007, its group treasurer, James Paterson, knew exactly what he wanted to build, and then he built it.

Having joined the company the previous year, Paterson, with the help of his newly formed but dedicated team of seven treasury staff and hand-picked technology vendors, set about bringing the plans to fruition.

Mondi has gone from next to nothing to a whole new centralised treasury operation in a remarkably short time. The work is ongoing, but for now its new technology is providing centralised funding, cash pooling, hedging, netting and advisory services to what is a fairly substantial business group.

Mondi now employs around 35,000 people, across 127 different sites in 35 countries. With global facilities and a strong manufacturing base being supported it comes as no surprise that Mondi is a



Source: Mondi

capital intensive operation. It is currently investing €525 million in a new paper manufacturing machine for its Russian operations, and around €325 million is being ploughed into its Polish subsidiary's paper recycling equipment.

Group sales stood at €6.3 billion in 2007, with EBITDA hitting €870 million. The company still had net debt of €1.6 billion as of June 2008.

In product terms, the company has a focused offering, concentrating mainly on packaging paper and office supplies. The former covers manufacture of corrugated sheet and boxes, and the latter gives Mondi its status as the largest producer of A4 paper stock in Europe. The company also has a sideline in newsprint and paper recycling and is moving progressively into speciality products such as flexible and non-paper based packaging. Mondi also has its own forestry assets part of which stem from its prior ownership by Anglo American. This ownership explains its exist-

tence. As a mining company, Anglo American required vast quantities of timber. To supply this need it established its own forests; the paper business naturally developed off the back of this.

Apart from its historical connection with South Africa, Mondi's business geography is centred around western and emerging European countries, with a substantial operation in Russia.

The story here starts in May 1999 when Anglo American moved its stock listing and headquarters to London. With the paper side of the business enjoying a boom-time in the early 2000s, it became a very profitable part of the group. Anglo was happy to feed it cash to grow the business and it duly exploited the opening up of eastern Europe, acquiring a number of the old state-run paper businesses on the strength of Anglo's balance sheet.

Around 2004/2005 Anglo's share price started going through the roof. This created the impression that, although successful in its own right, the paper business was a drag on earnings: the market, it seemed, wanted a pure mining company. The decision was made in 2006 to demerge Mondi from Anglo American.

When the demerger took place in June 2007, the new business was hoping to set up as a UK-headquartered, UK-listed company. But the South African authorities saw Mondi as a South African company, given that this was where the capital for the original group came from. 'It put a real spanner in the works of the demerger negotiations, delaying the process quite substantially,' notes Paterson.

In order to gain approval for the listing in the UK, Mondi was obliged to be headquartered and also listed in South Africa. It duly established its global headquarters in Johannesburg, whilst its principal European

operations (which now account for about 80 per cent of the business) took root in Vienna.

To keep all parties happy, a dual-listed structure was established, with the company's shares being traded on both London and Johannesburg exchanges. Although Mondi is keeping good company by being split into two major legal entities in this way, with Shell and Unilever having similarly taken this path, the structure has its issues. It does not directly change the way the company is run, but Paterson comments that when banks looked at the business and saw two separate legal companies they started worrying about guarantees and security. 'It just made the whole explanation of the new group to potential bankers even more complicated.'

Through its various acquisitions, Anglo's paper business, and thus Mondi, had become a rather fragmented affair made up from both large and small operations. 'From a treasury centralisation approach, it was quite a difficult beast to work within,' admits Paterson. 'There were so many different parts to it and no real central co-ordination.' But before he'd even got to this stage, the demerger itself presented 'major implications for the treasury department'.

Paterson, who had just joined Anglo's treasury when the decision was taken to split the business, explains that Mondi had been established as a subsidiary of Anglo, with Anglo having a central treasury providing all the core treasury functions to the rest of the group.

As an independent company, Mondi was going to have to create a new group treasury – Paterson at the helm – with all the people, processes and systems to establish, manage and optimise. Indeed, from a treasury point of view, 'there was a com-

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Mondi factory

Source: Mondi

plete new set of requirements for Mondi to operate as a standalone business’.

One of the most pressing issues concerned the new company’s approach to funding. This started with a discussion on what Mondi’s capital structure should look like, away from Anglo, and what its approach to shareholders might be.

Anglo had a policy of not hedging, considering itself ‘big enough and ugly enough’ not to need it for any of its exposures. Mondi, as a smaller and far more risk-averse business, would most likely need a hedging strategy for its exposures. But then it also needed to put in place the systems to be able to work out exactly what its exposures were. ‘There were lots of questions being asked at an early phase of design,’ recalls Paterson.

As Mondi moved through the processes, it gradually started to clarify its treasury position. On the capital structure side, it came up with the view that Mondi ‘was very much a growth story’, with a solid asset base in Europe and opportunity to grow from the strong investment base it had. But to have access to the finance required to grow the business it needed to develop sufficient debt capacity.

This was all going on in early 2007, just before the credit-crunch really hit. There was no thought at this point of liquidity constraints or pricing issues. ‘It was the top of the market from a treasurers perspective,’ says Paterson.

Having decided it wanted to be an investment grade company, Mondi agreed what a sensible debt level would be for the group. Naturally there was some disagreement between the management of Anglo

and Mondi as to what level of debt would go with the new company.

Eventually it was calculated that Mondi would take a €1.5 billion five-year multi-currency debt facility with its eleven ‘hand-picked’ banks, and a separate ZAR2 billion (€0.15 billion) three-year single bank funding in South Africa, providing it with sufficient headroom and flexibility (the paper industry is rather volatile and these figures represent 100 per cent more than required, says Paterson).

Once word had got out that Mondi was seeking this facility, Paterson says he had numerous calls from other banks looking to be in on the deal; oh, how things have changed, he says!

On the hedging side of things, as a new company, Mondi opted for conservatism, building an overview of risk around the group. Given the nature of its business, Paterson says there are some ‘fairly substantial’ risks to be managed, and these were communicated to shareholders, securing their buy-in to the hedging policy.

Mondi also needed to lay solid treasury foundations with the right people, policies and systems to be able to consistently provide services to the whole group.

Four treasury personnel were already located in Vienna, but additional staff were required for the new London operation, one of which was Paterson.

As the primary borrower under the funding facility, Mondi created a new legal entity – Mondi Treasury Ltd – which would act as the treasury vehicle for the whole group. South Africa was a far smaller operation and so no staff were directly employed. Instead, Mondi opted for an

outsource provider (one of its banks) for basic treasury dealing and accounting capabilities.

Within the group, a clear standard treasury policy was established to define the risk and operational controls, and ensure that everyone – from the board right down the operating level – would know the responsibilities and procedures of this function.

This policy also set up a system for the delegation of powers and limits within the treasury function and established a means of ‘communicating and educating’ across the group exactly what would be required when dealing with the treasury operation.

With all funding having previously come via Anglo, Mondi had to have its debt facility in place at the point of demerger. It would then have to draw down on this facility, repay all the inter-company loans to Anglo, manage all the FX exposures off the back of that, and change the functional currency of the group from USD to euros. ‘A lot of the focus up to the point of demerger was on the demerger itself,’ notes Paterson. ‘Once we became free of Anglo, it was then very much about building on the foundations we already had.’

Technology was considered a key driver in this new treasury. ‘We’re a pretty lean treasury function,’ explains Paterson, ‘so we needed to make sure we could optimise our technology and minimise the number of people we have in treasury.’

Straight through processing was the overarching theme, with adoption of new technologies wherever possible as the means to an end. This would cover the TMS, accounting, banking and netting systems.

Some of these tools were already in place in Mondi’s Vienna office. Sungard’s Quantum, for example, had been ‘imposed’ on it as part of Anglo American’s policy of using that vendor wherever possible. This solution was ‘not ideally suited to Mondi’s particular operation’, but Anglo obviously had the bigger picture in mind.

There was no existing netting system, but a cash pooling structure, using ABN Amro across most of Mondi’s European network, was in operation. Prior to demerger, this cash management structure was in the process of being changed across the Anglo group to use Deutsche Bank, and this plan continued for Mondi.

Building a treasury infrastructure, from

Mondi's perspective, was not simply a case of stripping out the legacy technology and starting again. It was more a matter of 'challenging those systems, questioning whether they were the right things for us as a standalone company, and whether it was worth the effort and the cost of changing them'.

From an organisational point of view there was a clear division of responsibilities. Mondi's UK office was responsible for all the trading activity and Vienna assumed control of all pooling and netting operations.

Policy dictated that all FX exposures would now be hedged out to six months. This required explanation to those involved, to enable them to manage it and handle the accounting implications across the group.

Interest rates were hedged to a maximum of five years, requiring a range of interest rate swaps to be installed.

Mondi has massive exposure to costs related to energy, pulp and carbon credits, so a policy was devised to hedge elements of these. And of course all of the above had to be carried out within certain limits for trading and counterparty exposure.

Having emerged from Anglo, it soon became apparent that Mondi's version of Quantum really was not the right system. 'We found it cumbersome, expensive to operate and difficult to change,' Paterson comments.

In November 2007, it started a search of the TMS market. RFPs were sent to most of the major suppliers, including SAP. Within two months a choice had been made in favour of an ASP-delivered version of City Financial's eTC. This, says Paterson, 'is something quite different in the market place'. It certainly 'seemed to tick all the boxes' anyway.

The Mondi team spent a lot of time talking to existing users to pin down its strengths and weaknesses. Having implemented many systems over the years, Paterson reports that he has 'never been to so many positive reference sites'. 'We didn't quite believe them to start with, we thought they'd been handpicked by the supplier,' he states, adding that if he'd believed what he was being told Mondi could 'probably have shaved a month or two off the implementation process'.

The idea from the start was to steer

clear of consultants – 'I'm not a great lover of consultants', states Paterson – and have a well-supported user-friendly system with a reporting tool simple enough that Mondi's treasury staff could extract the information it requires without relying on other people.

Whilst City Financials supplied one consultant as part of the main contract (even then, not all of his allotted hours were used), no more were used in the entire project.

Mondi also wanted a multi-bank dealing platform for its London office, choosing 360T. This system now handles the group's entire FX trading, although Russian rouble trades are semi-manual, requiring a call to the bank to warn them they are about to be hit with a request prior to capturing the winning deal in the system. However, Mondi's commodity hedging is kept entirely separate because it is a rather customised function.

Non-inclusions aside, 360T produces 'some very powerful information', including comparative trading reports that can be used to drive better deals, says Paterson.

The system is now fully integrated with eTC, with confirmations flowing through Misys' CMM for confirmations and matching on one side, and Deutsche Bank's DBI payments system on the other, following approval in eTC. 'It all works very efficiently, with no re-keying of deals or transactions.'

eTC acts as Mondi's main accounting system so it is used for end-of-month statementing, automatically emailing inter-company statements to every subsidiary.

With bank statements coming through to eTC from Deutsche Bank on a daily basis, these can be confirmed, matched, and reconciled before being processed at month-end through the Hyperion reporting and analysis tool.

The whole in-house project was delivered in six months, on budget and on time, and with not a consultant in sight. ASP, notes Paterson, ensured that the implementation process was 'a lot easier and quicker' than if the system had been installed in-house.

Once the bulk of the TMS project had been completed eTC ran in parallel

with Quantum for a further six months before going live in August 2008. 'We've never looked back,' says Paterson.

On the cash pooling side, Paterson says the fragmentation of the company had led to over 175 bank accounts being set up, requiring daily cash pooling sweeps. Following the switch from ABN to Deutsche Bank at Anglo, the latter was retained by Mondi and is now used for operational primary banking purposes; it is not used as an overlay structure. In fact, one of the reasons Deutsche Bank was chosen was because it had the reach and the local tools for each of Mondi's far flung operating units. This enables each subsidiary to use it as its main bank for collections and payments.

The policy itself is to minimise any trapped cash across the group, feeding on a daily basis the local currency pools which are then sent onwards to the master account in London. Although this is operated from Vienna, it is funded from the main treasury company in London on the same daily basis.

At the moment, pools are run in the main currencies of euros, sterling and dollars. Separate pools are run for Swedish krona and Czech krona which are not operated by Deutsche Bank, but all MT940s feed through this institution so it is still effectively Mondi's only banking platform for access to information on pools. Poland too has a local pool because local regulations make it awkward to integrate into the main European cash pool. 'One of the rea-



sons for keeping the pool master account separate from the treasury account is that it gives us a means of measuring performance of each treasury team,' says Paterson. These teams are targeted on hitting a certain pool balance every day.

With all statements being loaded into eTC daily, Mondi treasury can manage all the interest allocations and send out month-end statements to every subsidiary. 'It really minimises the administration of running the pool.'

Without a netting system in place, all of these subsidiaries were paying each other in all sorts of currencies, via a range of routes and using third-party banks to make those payments, says Paterson. 'By putting in a netting system we effectively centralised one payment with each of those subs in their functional currency.'

The requirement for netting was not, as you might expect, driven by a treasury need, he says. It had been pencilled in for some time later, but the operations units were in dire need of a system to reconcile their inter-company balances so they could once and for all agree what the outstanding invoices were between companies every month.

System providers were called upon once again, and a small firm in Austria, Bellin, won the day. Its solution can be loaded with invoices from both the payables and receivables side, providing a communication tool between both parties to enable resolution of any inter-company conflict. 'At a point every month you just close it, run the netting and all those invoices that have been confirmed and agreed on both sides get settled.'

With most of the subsidiaries being part of the cash pooling system there is no movement of money per se; funds are just offset against the inter-company balance. With Mondi Finance as the central company, it acts as the in-house bank on all these transactions.

'We've put in place some very good systems now,' says Paterson, reviewing his work. 'But we need to optimise that further, and what I'd really like to do is take it to the next level by taking away a lot of the basic cash management operations from the subs; they really should not be dealing in cash now.'

There are some countries – Poland, Russia, Turkey and South Africa – where the centralised plan has proven to be more


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James Paterson, Mondi

difficult, primarily because of local regulations. 'We need to spend more time looking at our options, seeing if there are any clever ways to incorporate those into the process without deviating from the local rules and regulations.'

With the bulk of the structure in place it will leave Paterson and his team more time to delve into the 'nitty-gritty of cash management', where value can hopefully be

added.

Even with more work on the horizon, it is quite clear that Mondi has completed a lot over the past 18 months or so. Part of the secret of its success is that it used only a small team to make the key decisions, says Paterson. But you also get the impression that everyone involved was keen to prove that it could go it alone. And that is exactly what Mondi has done. 

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