

Mondi: thinking out of the box

Mondi is a leading global packaging and paper group. It was unbundled by Anglo America in 2007 into a dual-listed structure with its primary listing on the London Stock Exchange and a secondary listing on the JSE. The company employs 26,000 people with 100 production sites across 30 countries situated mainly in Europe, Russia, North America and South Africa. Mondi specialises in providing innovative, sustainable packaging and paper solutions, across multiple industries, for both local and global customers. Mondi is very well-positioned to benefit from megatrends such as the rapid rise in e-commerce and the focus on the environment.



**Nick
Rogers**

Mondi has a resilient and defensive business model which fits perfectly into our long-term investment philosophy. Its Rand hedge qualities, diversified earnings, vertical integration and management's ability to adapt and grow via strategic acquisitions will continue to drive earnings. Let us now look at its product mix followed by the main components of Mondi's robust business model.

Mondi's products can be broken down into 4 main divisions. 1) Flexible Packaging (39% of Revenue). Mondi is the largest kraft (German word for 'strength') paper producer globally and the number one paper bag producer in Europe. 2) Corrugated Packaging (27% of Revenue). Mondi is the leading producer of containerboard (cardboard) in Europe. It is the most frequently used packaging material because it is versatile, lightweight and strong. 3) Uncoated Fine-Paper (22% of Revenue). Demand has been hit hard by COVID-19 as this relates to "A4" office paper & newsprint. Despite Mondi being the largest supplier of UFP in Europe, volumes across the industry are in a structural decline of 5% p.a. as internet use reduces the demand for paper. That said, as vaccines are rolled out, mobility will increase globally and workers will return to offices, temporarily boosting demand. 4) Engineered Materials (12% of Revenue). Products include innovative personal care components for use in nappies, feminine hygiene products and release liners (for example, pressure-sensitive adhesives.) Lockdown measures in key markets drove increased home consumption and demand for related cleaning and hygiene products whilst the investment into 100% bio-degradable wet wipes offers exciting earnings potential. What is extremely encouraging is that Mondi was able to increase the price of containerboard during Q1 2021, with a further increase scheduled for next month.

Firstly, Mondi's geographical diversification plays an important role by avoiding reliance on one specific region's GDP growth,

SPEED READ

- Innovative packaging can increase output and reduce labour and storage costs by a total of up to 40%.
- European e-Commerce packaging is set to grow at an 8% compound annual growth rate (CAGR) over the next 3 years.
- Mondi's new Štefí paper mill has the capacity to replace up to 2 billion plastic bags annually.

currency, production capacity and consumer demand. Mondi splits revenue reporting by location of production & customers. This is led by Western Europe (38% of production and 38% of customers), Emerging Europe (35% & 23%) Russia (12% & 9%), North America (7% & 11%), SA (7% & 8%) and finally Asia/Australia (1% & 9%). Overall, there is a healthy mix between both developed and emerging economies, which makes it competitive relative to its peers.

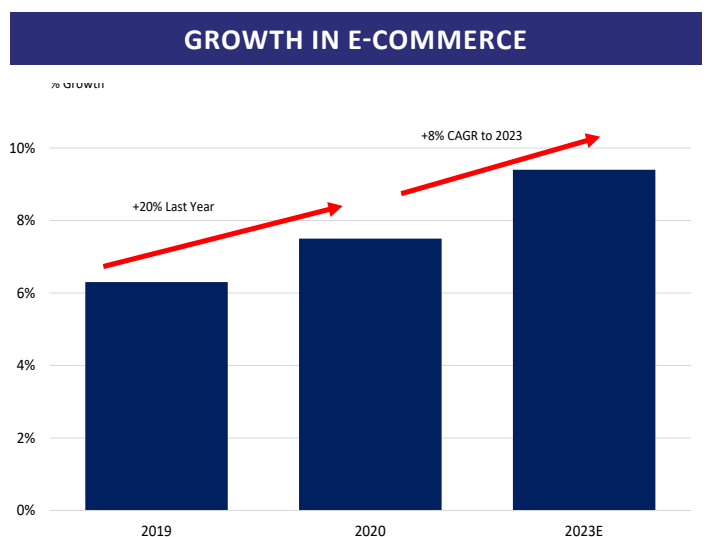
Secondly, Mondi's vertical integration across the value chain is a key defensive characteristic as it reduces the Group's exposure to price volatility by providing control over supply and production. Wood, pulp and recycled paper comprise one-third of Mondi's total input costs. Mondi manages around 2.3 million hectares of natural forest in Russia and 254,000 hectares of plantation forestry in South Africa. These cheap assets provide low input costs which in turn lead to higher margins. Corrugated Packaging is the highest margin business (25%), followed by the Uncoated Fine Paper (20%), Flexible Packaging (18%) and Engineered Materials (11%). Mondi also produces pulp, paper and plastic films and is consequently able to develop and manufacture effective and innovative industrial and consumer packaging solutions – critical given the structural changes underway presently – which offer enormous benefit to its clients.

Mondi has a very strong track record of delivery on major

projects, having invested over €1.4 billion since 2014, with an average return on capital above 20%. Last year, Mondi announced that former CFO, Andrew King, would replace David Hathorn as the new CEO. He is considered by analysts as a “very safe pair of hands.” Mr King has been extremely successful in making astute capital expenditure and strategic decisions. For example, he was instrumental in the latest expansion projects at Ruzomberok (corrugated) and Steti (flexible). Both play into the two megatrends of the rapid growth in e-Commerce and ESG.

- Ruzomberok is capable of producing 300,000 tons p.a. of kraft-top white cardboard which increases packaging appeal (beyond the typical brown box) especially as more retailers transition to e-commerce and packaging differentiation becomes crucial to maintain brand loyalty.
- Steti’s production capacity of 130,000 tons p.a. of specialty kraft paper can displace 2 billion plastic shopping bags.

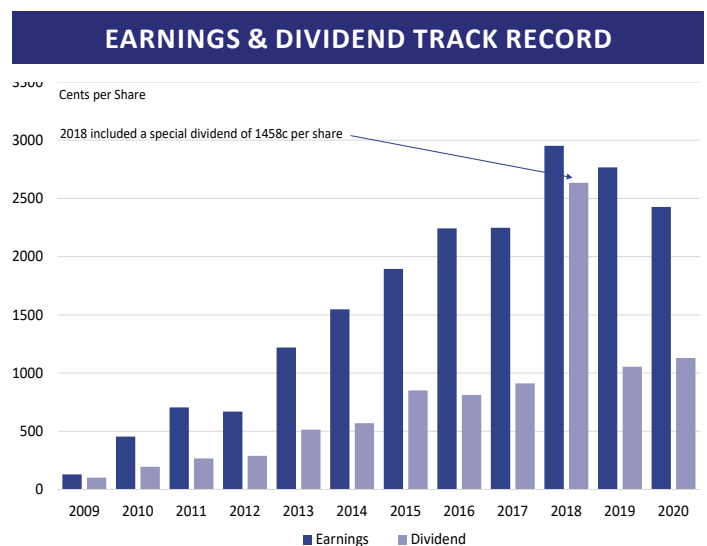
With global e-Commerce having surged from \$1.9 trillion in 2019 to US\$2.4 trillion in 2020, retailers like Amazon are looking for e-Commerce solutions that are not only “frustration-free” for the customer to open (and if necessary, return goods) but that are also recyclable or bio-degradable due to the rise in stringent ESG regulations and eco-friendly consumer demands. Mondi fully understands that the right e-Commerce packaging solution can turn a box into a real asset. For example, just by adjusting the packaging design and quality, you can increase your output and reduce labour and storage costs by a total of up to 40% - significant for any business, but especially so in e-Commerce where margins are razor-thin and volumes drive profits. A recent survey highlighted that 56% of online shoppers have received at least one damaged package from their online shopping. This can make or break repeat business and brand loyalty. Furthermore, 41% of respondents bought multiple sizes



E-commerce grew strongly last year in reaction to Covid, but despite the higher base, growth is expected to accelerate even further over the next 3 years.

or colours of certain items with the intent of returning those that were not suitable. Here Mondi prides itself in providing packaging which is easy to reuse and reseal without extra adhesives, tape or glue if returning goods. Mondi has made great strides in driving its EcoSolutions approach, partnering with customers to achieve their design and sustainability goals. This culminated in Mondi winning 8 awards in 3 categories at this year’s WorldStar Packaging Awards. Interestingly, 62% of consumers surveyed prefer paper-based packaging over plastic and Mondi is best positioned as the sole European supplier, offering a full portfolio of products. Sustainability is part of Mondi’s DNA. In fact, 76% of revenue comes from products that are either reusable, recyclable or compostable. This in itself illustrates how intuitive management’s strategy has been in preparing for the future.

COVID-19 wreaked havoc across most industries and yet Mondi finished 2020 with strengthened order books, benefiting directly from the strong growth in e-commerce and the continued drive from their customers for more sustainable packaging. As a result of its management track record, low-cost assets, attractive margins, and robust free cash flow yield which supports its strong balance sheet, Mondi has been able to successfully allocate capital towards both organic and acquisitive growth initiatives. Importantly, Mondi has paid a regular dividend since listing, cumulatively worth \$4.5 billion to investors whilst local competitor Sappi has paid just \$340 million over the same period. At its current price Mondi is, admittedly, relatively highly rated. However, on a medium-term view, we are happy to hold Mondi across growth and balanced portfolios and accumulate for new clients especially with the Rand at multi-year highs.



Mondi has a consistent track record of growing both earnings and dividends. Recent weakness in earnings was due to a combination of Covid and rand strength, but this trend should reverse looking forward.



We are excited to have resumed our seminar program in April / May. Our next seminar is scheduled for June / July. The topic will be announced in due course.

Please save the date below. Please note that due to Covid protocols, numbers are strictly limited to 100 per session, and only drinks (no food) will be served. Booking is therefore essential.



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Topic: To be announced

Natal Midlands

Date:	24th June 2021
Venue:	Fernhill Hotel Midmar / Tweedie Road Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	08 July 2021
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

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