



PAPER & CONVERTING MACHINERY

CURRENT TRENDS

- Paper industry revenue has been adversely affected by digital media and is expected to decline at an annualized rate of 2.3% through 2025.
- Average paper industry capacity utilization has dipped in 2020 compared to 2019, with the October 2020 Federal Reserve Board capacity utilization for U.S.-based paper mills running at 83.5% of capacity.
- Paper machines are very difficult to sell for removal under duress and appraised values tend to represent a small percentage of depreciated book value.
- While paper machines are increasingly difficult to sell in their entirety, mill support equipment continues to be frequently sold on a removal basis.

PROJECTED VALUES (12-MONTH OUTLOOK)



GORDON BROTHERS BY THE NUMBERS

\$4B+

assets appraised and disposed

800+

engagements

3

worked with three of the largest printing companies

CAPACITY UTILIZATION MANUFACTURING NON-DURABLE GOODS: PAPER



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DECLINING INDUSTRY: Pulp and paper mills have experienced mixed results in recent years, as the global increase in digital media and internet usage have reduced the demand for various traditional paper products such as newsprint; however, the decline is offset slightly by growth in the personal care product segment, including items like diapers, feminine care and tissue products, and cardboard box and container manufacturing. Although up from lows seen from May through July, average paper industry capacity utilization has dipped in 2020 compared to 2019 with the October Federal Reserve Board capacity utilization for U.S.-based paper mills running at 83.5 percent of capacity versus 85.3 percent in October 2019. By comparison, current capacity is running lower than the average trailing 10-year utilization rate of 84.5 percent.

Through 2025, the industry is projected to contend with challenges, particularly as paper purchases by print publishing industries slow. Demand for industrial machinery and equipment typically corresponds to manufacturing activity. Despite changing demand in printing and papermaking, market share for new equipment has not changed since 2018 and has remained at approximately 18 percent of U.S. machinery manufacturing, which includes printing, paper, food, textile and various other operators in the machinery manufacturing space.

Demand for paper products may not change significantly but increasing levels of e-commerce shopping and deliveries to homebound consumers during the pandemic have increased demand for packaging products in 2020. On an adjusted basis, U.S. e-commerce sales as reported by the Census Bureau increased 31.8 percent for the second quarter of 2020 over the first quarter and increased 44.5 percent over the same period in 2019. E-commerce sales accounted for 15.1 percent of total sales for the second quarter, with expectations that they may comprise as much as 20 percent by the end of the year. Despite the uncertainty that comes with the ongoing pandemic-fueled recession, these figures bode well for packaging sales for the remainder of 2020 and into 2021.

On a global scale, the market for industry exports will decrease as developing economies advance their own paper production capabilities. As a result of this competitive pressure, research firm IBISWorld expects industry revenue to decline at an annualized rate of 2.4 percent to \$30.4 billion through 2025.

HIGH INSTALLATION COSTS, LOWER REMOVAL VALUES: While paper machines are typically the biggest cost in a mill, they are very difficult to sell for removal under duress. Appraised values tend to represent a small percentage of depreciated book value because a significant portion of the original cost is for special improvements including installation pits, poured concrete foundations, floor drains, erected steel infrastructure, extensive networks of process piping (i.e. steam, water, air), heavy electrical distribution systems and air handling ductwork. While certain components of these systems such as the head box, Fourdrinier section, press sections, dryer can sections, size press, coaters, scanners, calendar, reel and winder can be removed and sold piecemeal, the majority of the installation improvements either cannot be removed or are not economically feasible to remove. The cost of those improvements is lost when the equipment is sold for removal. Knowledgeable buyers typically disregard any value associated

with them and, in some cases, may even discount offers when significant de-installation and re-installation costs are present.

There could be some scrap value for the wiring, piping, vats and structural supports; however, it should not be assumed that these components have worth. Values for aluminum, stainless steel and copper have plummeted in recent years, and remnants once were viewed as "boot collateral" have become a burden. This potential liability should be discussed with an experienced appraiser.

DEMAND FOR SUPPORT EQUIPMENT AND SPARES REMAINS STEADY:

While paper machines are difficult to sell in their entirety, mill support equipment continues to be frequently sold on a removal basis. Stock prep equipment, pumps, screens, agitators, lab equipment, rolling stock, rewinders and roll wrap machines are examples of equipment that can add value. All paper manufacturers have this equipment in mills, regardless of the product being made, widening its marketability. These components are more readily dismantled and can be moved at a reasonable cost.

Beyond that, most mills have a significant inventory of spare motors and parts to ensure paper machines can continue running around the clock. Many of the transactions involving spare parts inventory are conducted in the secondary market because most mills operate older machines. While these items are not typically included in an appraisal, they could have noteworthy value in the event of liquidation.

OVER SIX MONTHS NEEDED TO SELL MOST MACHINES: Adequate time is needed to market paper machines internationally. Buyers will need more time to conduct required due diligence and line up financing for a purchasing decision of this magnitude. Considering less than a six-month disposition period in appraisal scenarios, it is likely that paper machines would sell only for the value of their better components, such as desirable press sections, some of the machine rolls, scanners, pressure-rated dryer cans, selected calendars and reels.

CONSIDER A DIFFERENT APPROACH: It often surprises lenders and companies that most machines valued for removal are worth a fraction of their original value and Gordon Brothers recommends an in-place appraisal with a business valuation overlay, in which machinery is valued to remain in place and in operation. This approach allows appraisers to consider income generating and cash flow aspects of the business that are not considered when estimating liquidation values for removal. This detailed business analysis attributes some portion of the overall enterprise value to the machinery. The valuation principles applied combine the knowledge of the productive capacity of the plants with the knowledge of the demand for and profitability of the products it produces in the current competitive environment.

By performing a business valuation simultaneous with the process of valuing the machinery and equipment, it is possible to determine the amount of value within the framework of the entire enterprise, as returns or deductions are taken for other contributory asset categories like working capital, real estate and identifiable intangibles. This value conclusion is representative of all physical depreciation and functional and economic obsolescence affecting the value of the equipment, quantified through the valuation of the business enterprise. While many lenders are wary of incurring the additional expense of a business valuation overlay, it can be a more accurate way of determining the true value of paper machines.

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The Expert: Scott Breier



With more than 20 years of experience in the industry, Scott Breier is an expert in the field of machinery and equipment valuation. He is an Accredited Senior Appraiser (ASA) with the American Society of Appraisers in the Machinery & Technical Specialties discipline. During his career, he has managed hundreds of appraisal projects across a wide array of industries. Read his full bio [here](#).



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