Pöyry Capital's Quarterly European Pulp, Paper and Packaging Update

AFRY
ÅF PÖYRY

Welcome to the latest edition of the Pöyry Capital Newsletter. In this edition we focus on the potential medium-term impact of the COVID-19 pandemic on the forestry, pulp, paper and packaging industry and potential impact on Mergers and Acquisitions in the next few months. (At this difficult time saying anything sensible about the short term is almost impossible.)

In many countries the paper and packaging industry has been classed as "essential" or of "national security interest" and has therefore been encouraged to continue operations while ensuring the safety of its people. Of course, in some cases the products being made are of acute importance today.

FOREST PRODUCTS

Panels, construction materials, furniture

The outlook appears difficult. Construction projects currently in progress may continue (although this is a topic of some debate as we write). However, new large-scale construction projects are likely to be put on hold due to social distancing, other mobility restrictions, and lack of people (through illness, self-isolation or because some foreign workers have returned to their home country). Meanwhile the housing market is effectively suspended in many countries and disposable income is uncertain if not falling. In anticipation of this slowdown, some panel mills across continental Europe are being temporarily shut.

Attempting to find something positive, it has been suggested that home DIY activity may pick up, but the impact of this will depend on DIY products being available online or shops being open.

Summary: Until social distancing measures are lifted such that construction projects can kick off, DIY stores reopen and economic activity increases, this industry segment looks to be challenged for some time.

Pulp and Dissolving Wood Pulp

After a sharp decline in prices from around the end of 2018, things started to stabilise in Q4 2019. At the start of 2020, the mood was positive and there was even some hope that prices might increase. The mood was lifted further by the Phase 1 trade deal signed by China and the US in mid-January (feels like an age ago, doesn't it?). So what can we say now?

Pulp

Although we may not see that anticipated recovery in pulp prices, recent industry consolidation should underpin the market provided pulp producers are disciplined. As we will note below, demand for tissue and hygiene/sanitary products is strong, providing further support.

Meanwhile it will be interesting to see how China reacts to the COVID-19 experience. We are already seeing a return to pre-crisis production at many sites. Will we see any more policy action? For example, further restrictions on the import of "dirty" recycled fibres may encourage manufacturers to import more virgin pulp while improving recycling within the country. China is now a much larger consumer of virgin pulp when compared to the last recession in 2009 / 2010.

Dissolving Wood Pulp

Here, the picture is mixed. First, the bad news:

- Mitigated partly by online sales, clothing demand has fallen – do we need new clothes while we are cooped up at home? Textile demand in Europe and North America will likely be muted for some time with a consequential impact on DWP prices. China is a possible beacon of hope if the economy is able to recover quickly to pre-crisis levels.
- The pressure on DWP prices may be exacerbated by the low oil price which should cause polyester prices to fall.

With our glass half full, however:

- Some specialty DWP producers with a high-value and less cyclical niche may prosper even in this challenging market – rayon for tyre reinforcement being one example.
- With India and Pakistan in lockdown we may see a dislocation in the global cotton market. The last time this happened in 2010 cotton and DWP prices shot up. However, this depends on textile demand and as noted above this may not happen for some time.
- The Chinese government has reduced the tariff for the import of DWP into China and the Americans have recently eliminated tariffs in the imports of textile products from China.

Summary: Conventional pulp prices should remain stable (driven by tissue and hygiene product and Chinese demand), but there is downside risk for commodity DWP prices. However, the lockdown in India and Pakistan might change things in the DWP world.

Tissue

The panic-buying of any form of tissue paper (toilet, kitchen rolls, handkerchiefs) has aroused much comment. We have received many memes on the toilet paper side, but due to copyright issues we cannot use them, although we are happy to send them via email.

Many earnest psychology experts have put forward all sorts of reasons for this behaviour. We would make the following observations:

- During this crisis, many customers have had to try, or settle for, private label tissue products. When the supermarkets are full again will their behaviour change? If these private label products worked well, will they again pay a premium for a particular brand? The same thought might apply to kitchen roll paper.
- Despite the COVID-19 spike in demand, we do not expect much new capacity to be added in Europe. More likely, a few opportunistic converters will be established and start to import and convert jumbo tissue rolls from overseas.
- Meanwhile those manufacturers supplying the away from home segment will be suffering for some time.

Summary: Everyone is a winner now (except away from home focused tissue manufacturers), but we may see an acceleration of private label adoption once the crisis is over.

Publication papers

This segment is highly geared to economic activity and so will be one of the most impacted sectors in the short and medium term. During the Global Financial Crisis publication paper manufacturers were hit hard. This crisis may see further weeding out of those manufacturers that are not cost competitive.

For some publication paper waste paper is the principal raw material. Here we are seeing some restrictions in the collection and transportation of waste paper creating delays and extra logistics costs. We have started already to see disruption in the logistics chain of recycling companies.

Summary: What looked like a great 2020 in the publication paper industry now looks like a thing of the past. We now expect a decline in demand and some closures of the least cost competitive mills.

Office papers

In recent years this segment has seen market declines of 2 to 4% per annum and the trend appears likely to continue. While office paper demand will clearly be impacted by the Work-From-Home phenomenon, there are reports of substantial increases in demand for paper for those home schooling and working at home. It's early days, but we will be watching this space closely. What we can say is that those who have focused their service offering on supplying offices and professions will be looking for new customers.

Summary: Companies that are not vertically integrated and supply commodity papers to the office market and distributors will suffer a period of material weakness.

Specialty paper products

Again, the picture is mixed. Specialty paper manufacturers focused on the manufacturing of food-on-the-go papers or papers for consumer durables and those operating in cyclical markets (such as construction, furniture, cars) are clearly vulnerable today while demand for other specialty papers may be more robust, notably medical crepe paper and air filtration products.

Summary: It depends on the specialty paper type manufactured.

PACKAGING

Containerboard, Corrugated Packaging and Solid board

As we all wait at home for next delivery, we may speculate that the containerboard and corrugated packaging industry will come out well from this crisis. But like most things in life, things are more complex.

This crisis has created many challenges for the containerboard industry, notably:

Disruption in inbound (as noted above, for recycled material) and outbound logistics could create additional costs, with a potential lack of raw material and a potential spike in raw material prices.

Containerboard and corrugated packaging companies that are highly exposed to industrial demand (consumer durables, cars, etc) are seeing a strong fall in demand. Some of the outstanding debt of regional players in Germany and Italy are now trading at deep discounts.

One positive note is that some of the conversions from other paper grades that were anticipated to start later this year in 2021 might now be delayed or even cancelled.

For Solid board packaging and graphic board, we see luxury packaging board suffering and stationery market demand also falling (with the caveat noted above regarding the impact of home schooling and working from home). Meanwhile the Solid board packaging companies focused on food packaging should be doing well.

Summary: As industrial production contracts in Q2 2020, we will see slowing demand for containerboard manufacturers. Recent attempts to increase containerboard prices in Europe might prove quite a challenge during this crisis.

Cartonboard and Cartonboard Packaging

Again, a mixed picture with many of the trends already noted apparent here such as logistics issues (especially for recycled material).

Many food-on-the-go carton manufacturers (burger boxes, french fries containers, sandwich boxes, etc) may see a material drop in demand - some of the largest manufacturers in this particular sub-segment have already announced a change in their 2020 earnings outlook and we should expect this trend to continue until economies begin to recover.

One mitigation has been an increase in the demand to eat at home as well as for products that appear on our supermarket shelves such as cereals, while new hygiene measures (re-usable cups not being especially hygienic) may create additional requirements for sustainable carton cups.

Summary: Food on the shelf carton board packaging to benefit temporarily from the disruption while food-on-the go will be severely impacted for a few quarters.

Source: Mergermarket, Capital IQ, Company Information, Pöyry Capital

Rigid Plastics

Winners and losers, here too.

Those who service low growth, low differentiated markets of food, beverage and household products (previously perceived as rather dull) are the winners while the previously glamorous segments such as cosmetics and premium personal care are struggling.

These days containers which prolong shelf–life and enable distribution through supermarkets to consumers and which serve food, beverage and household needs are critical and in strong demand. Commodity, low-growth, uninteresting packaging products, which have been at best "resilient" in the good times, are now flying off supermarket shelves as consumers resort to panic buying and stockpiling.

PET and HDPE containers for food and beverage and household products have been in exceptionally high demand. From speaking to one private label manufacturer, we understand that the empty shelves in supermarkets and chemists for anti-bac soap and hand gel are not due to a scarcity of packaging or indeed manufacturing capacity in Europe. The problem is more often related to the disruption in supply chains of essential chemicals from China and Asia. Thankfully these are now coming back on line.

After one of the strongest years of growth in 2019 in cosmetics and premium personal care, 2020 will be a stark and depressing contrast. Cosmetics companies traditionally have relied heavily on travel retail channels in airports and large department stores. These are now almost completely out of bounds.

By contrast, companies exposed to pharma end markets, devices and dispensing will of course be supported by increased demand for their products. We have witnessed stockpiling of inhalers while those making dispensing pumps and closures for liquid soap and hand sanitisers are adding capacity to meet the surge in demand.

Looking further ahead, rigid plastic packaging producers are developing technologies that allow the packaging of products to be stored at room temperatures for a long period. With the decline in the oil price, most important resins for the manufacturing of plastic packaging are also falling – they had already declined by 15 to 25% in the last twelve months. Meanwhile producers are also working to meet the need to use recycled resins.

Summary: Companies exposed to the food, beverage and household markets will be experiencing strong demand; a diversified end market exposure is helpful. Food to Go trays will be slightly soft, food trays for home cooking will benefit. Strong growth expected in pharma and dispensing whilst discretionary personal care and beauty will be challenging for some time.

GLASS

Glass Packaging – North America

Glass packaging for the food and beverage markets has seen substantial consolidation over the last decade. However, this consolidation, together with improved market discipline and few capacity additions and even some furnace closures, has not been enough to compensate for the continued decline in US consumption of "mega" beer and substitution into beverage cans. Meanwhile import tariffs that were expected to curb the flow of cheaper imports of bottles appear to have made little impact.

There is quite a bit of good news, however. Low gas prices are making a big difference, especially now for those glass manufacturers that have not hedged gas prices. And while "on trade" beer (some 35% of total beer sales in the US – mostly sold in kegs or barrels) declines sharply due to the closure of restaurants, bars and hotels, this beer is now being packed in retail formats such as cans - and glass.

Glass Packaging - Europe

Here we have a more fragmented and balanced market than in North America. Recently there has been a slight growth in consumption of glass bottles. Southern European producers have benefitted from a client base which is more regional (and less powerful), but recent capacity additions in Spain and France may threaten this balance.

The impact of COVID-19 on European glass manufacturers is currently unclear. Wine and beer remain freely available and the shops are open. While on trade sales will naturally collapse, this may be offset by increased consumption at home.

Niche Glass (Spirits)

Manufacturers of short run bespoke bottles for the premium spirits market (mostly Scotch whisky, gin and cognac) tend to be located close to the European distillers and bottles are filled in Europe prior to export. During the clamp down on corruption in China four years ago, we could see that sales of super–premium spirits are highly exposed to demand in China and elsewhere in Asia.

And as with cosmetics above, a large proportion of sales of premium spirits (and therefore bottles) depends on duty free channels in airports.

The lockdown in China and the fall in air traffic will therefore have had a material impact on sales. It will be interesting to see how quickly Chinese demand picks up.

One manufacturer of niche glass has recently reported that production has been suspended at two of its plants for two weeks. While Asia may see a small rise in demand as the economies recover, those supplying this specialist segment may have to wait much longer before this market recovers.

Summary: Glass packaging which serves the food, wine and beer markets should be relatively stable – it will be very tough for those supplying premium or discretionary products (such as spirits or luxury cosmetics).

METALS

Beverage Cans

Following extensive consolidation in this industry, which few imagined could ever have been permitted, and with greater market discipline, beverage can manufacturers have had a good run, with demand picking up due to environmental concerns around the world over plastic and switching from PET to beverage cans. Manufacturers have been adapting to this demand with innovations in can design – we now have "specialty cans" as we have Specialty everything else.

However, while we may see some mitigation from at home consumption (see Glass above) it looks like being a very gloomy summer for breweries and soft drinks manufacturers in the Northern Hemisphere with all outdoor events and mass gatherings and parties cancelled.

Source: Mergermarket, Capital IQ, Company Information, Pöyry Capital

Food Cans

If you have not been able to get your hands on a tin of tomatoes or beans, you might think that the food can industry is going to have blockbuster year. However, the beauty of the tin is the longevity that it gives you on the shelf. Although food can manufacturers might be enjoying a short-term surge in demand, their product remains fundamentally "unsexy". As much as they try to tell you that plastic is dead and long live the food can, the fact is that brand owners prefer the look, feel and malleability of plastic.

Cans will continue to be used for low-value, undifferentiated products (pulses, tomatoes, pet food) but recent strategic disposals in this space provide evidence that this market lacks long term growth. When the crisis is over, let's look out for further disposals (or perhaps JVs) in this market.

So while can manufacturers may have a strong first half year, the picture for the full year may not be so glorious. How many of the tins we have bought recently will still be in our cupboard in a year's time?

Summary: Strong first quarter and generally stable thereafter although with a softer seasonal summer uptick than is usually the case. Medium term, the challenges in this market will remain the same.

M&A OUTLOOK

A market dislocation like the one that we are currently experiencing creates different challenges for buyers and sellers. How manage this will depend on how quickly things can return to anything like normal - will this downturn have a "V" shape recovery or will it be more like a "U" or "L" recovery?

Early indications from China suggest that there has been a significant upturn in March following the strong shock to the economy in January and February. However, the Chinese government has utilised tools in its arsenal that we might not be willing to accept in the Western world. So maybe we will be more U than V. If that is the case, the feedback loop mechanism would imply that the recovery in China would not be as strong because of the big demand drop in the Western World for 2020 and so we may see a longer period of the global economy not operating to its full potential.

So how might M&A be affected in our sectors?

Valuation

This is the obviously tricky one. How can buyer and seller agree on a price at these times? Sellers may find it hard to shake off the expectation of multiples that have been paid in recent years while buyers may not only query these multiples, they may also query the underlying sustainability of the earnings.

Buyers in private transactions may be able to point to signals coming from public markets where in many cases we have seen a substantial rebasing of company values. However, with the markets so volatile some sellers (especially in previously well-rated or "sexy" sector segments) may be reluctant to accept these valuations. For the sector segments which have been in negative growth for some time, perhaps there will be less to disagree about.

This all suggests that we may see a period of reflection with buyers and sellers agreeing to disagree for a while, but in some sector segments we may see continuing activity. As noted above, many of the industries that we cover have been classified as of "national interest" or "essential" – in these businesses we are seeing much less disruption and we should not experience a complete disappearance of cash flows in Q2. Here it may be possible to agree that the current dislocation is a minor blip that can be "normalised".

Timing and Timetables

Most sale processes that had already launched are likely to continue, albeit with some delays depending on the sector segment (for example because company approvals take longer, physical due diligence is impossible, lenders are sitting on their hands – see below – and so on). Many deals that are ready to launch now are being paused for a month or two "until the dust settles". So while we may not see many new deals launched in Q2 2020, if things do look more benign in June be ready for a flood of opportunities in early Q3 and forget about the conventional summer break this year in Europe – we expect a strong push to work through the summer to get things done.

Debt distress

In most of our sector segments this is not a good time to have too much leverage on the balance sheet. There will be difficult conversations being had with lenders and out of these discussions we may see transactions soon – either outright sales or recapitalisations through convertibles or equity like instruments. There are opportunists around, corporate and private equity, keen to take advantage.

Sources of financing

Who will lend today on new deals? With banks under pressure in Europe to support companies and the general public, there might be not much willingness to finance new transactions. We may therefore see growth in non-bank lending, albeit at a higher price and with stricter covenants than we are used to.

In North America the non-bank lending market has played a major role in PE-funded transactions. It will be interesting to see how these institutions deal with the first big crisis they have faced.

CONCLUSION

After a relatively quiet Q1, we will probably see a at least as quiet Q2. However, this dislocation will pass and risk appetite will return. Exactly when we cannot know but we see enough indications – from the pick-up in China to the determination of governments and central banks to protect the economy – to be hopeful that the bounce will come soon.

What we have learned from past experience (notably in many transactions done in 2011 - 12) is that companies and sponsors with ample liquidity and the right level of preparedness can be in a position to buy high quality companies that might have seemed too expensive or unreachable a few months ago.

So – let's be prepared and act decisively when the market turns. We at Pöyry Capital - along with our colleagues in AFRY - are here to work with you on this analysis and help at every step of the way.

Cele Moncayo

Managing Director
+ 44 7946 521880
celedonio.moncayo@afry.com

Sandra Bowhay

Managing Director
+ 44 7920 254258
sandra.bowhay@afry.com

Sandra Bowhay

Managing Director

Sandra Bowhay has joined Pöyry Capital as Managing Director and Co-Head of Forest Industry & Packaging. She joins from HSBC where she was responsible for the bank's paper and packaging sector coverage worldwide. Sandra is working alongside Cele Moncayo, Head of Forest Industry & Packaging at Pöyry Capital.

Sandra writes:
The last time I changed employer was almost 13 years ago. That was back in August 2007 and it was the same week as BNP announced that they had been forced to freeze $2.2bn in three investment funds due to liquidity issues relating to their sub-prime exposure.

I joined Poyry Capital on the 20th January; the same week that the China State Council announced that the Lunar New Year holidays would be extended in an effort to contain the Coronavirus.

I clearly have a very bad sense of timing

Despite this, I am thrilled to have joined Pöyry Capital. I have on occasions sat on the opposite side of the negotiating table to Cele and his colleagues. This was always an unnerving experience, as the team here has a reputation for knowing the Paper and Packaging Sector inside and out. It was this deep sector knowledge that attracted me to the firm.

Now that I am on the same side of the negotiating table, I can confirm first hand that my previous impressions of the firm were based on reality. I have found the breadth and depth of knowledge here to be extensive. I have also been delighted to discover that in addition to the impressive knowledge base of our 19 sector-focused investment bankers, we can also draw on the seemingly limitless energy and knowledge of our consulting, engineering and forestry colleagues in AFRY.

More personally it has been a revelation to witness team spirit and collaboration within the firm – and within AFRY as a whole. Knowledge and expertise are openly and proactively shared every day.

During these challenging times, where we are working in enforced isolation, we continue to apply the same team ethic. Our daily call and our regular interactions with clients seem to be keeping us all sane. We are managing to maintain the momentum on existing projects while creating a significant pipeline of new opportunities.

TRANSACTION UPDATE –1Q 2020

Specialty Paper
- Not available

Tissue
- Not available

Printing and Writing Paper
- Not available

Containerboard / Solid board / Corrugated board
- Not available

Carton Board
- 04 February 2020: a group of private investors announced the acquisition of Akomex
- 05 February 2020: CDL announced the acquisition of Moulded Fibre Products
- 23 January 2020: A&R Carton announced the acquisition of BSC Drukarnia Opakowan (39.18%)

Rigid Plastics
- 25 March 2020: Nefab Packaging announced the acquisition of Szkaliczki & Partners Plastic Processing
- 18 March 2020: Bormioli Pharma announced the acquisition of GCL Pharma
- 17 March 2020: Groupe Guillin announced the acquisition of Thermoflex
- 05 March 2020: Envases Soplados announced the acquisition of Espacoplas - Industria e Comercializacao de Plasti
- 05 February 2020: PSB Industries announced the acquisition of Qualipac
- 27 January 2020: Silgan Holdings announced the acquisition of Albea Dispensing Systems

Flexibles and Labels
- 19 March 2020: Cheyne Capital Management (UK) announced the acquisition of Irplast
- 16 March 2020: It was announced that an undisclosed bidder will acquire Schades (50% Stake); R+S Group (83.33% Stake)
- 05 March 2020: Pregis announced the acquisition of SO.Pr.Ad
- 03 March 2020: Coveris Holdings announced the acquisition of Plasztik-Tranzit Csomagoloanyag-Gyarto
- 31 January 2020: CCL Industries announced the acquisition of Ibertex Etiquetaje Industrial
- 17 January 2020: CCL Industries announced the acquisition of I.D.&C. World Holdco and Identilam
- 03 January 2020: CCL Industries announced the acquisition of Flexpol

There has been a rerating for the sector and most of the sectors covered are trading at a material discount to the average valuation of the last 7 years

Printing and writing paper valuations have reached almost an all time low (driven by a strongly decelerating economy) to some extend exhibiting a similar trend for valuations for rigid plastic packaging companies (driven by environmental concerns)

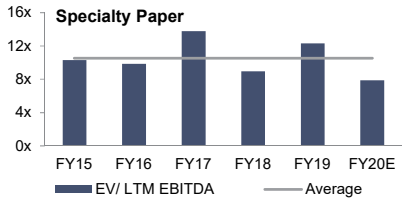
Pulp
- Not available

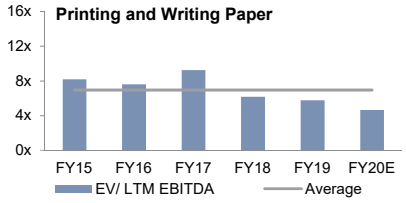
Metal Packaging
- 06 February 2020: Management and Connection Capital announced the acquisition of Cargostore Worldwide Trading
- 31 January 2020: Enodev announced the acquisition of Sparflex France
- 03 January 2020: Guala Closures announced the acquisition of Closurelogic

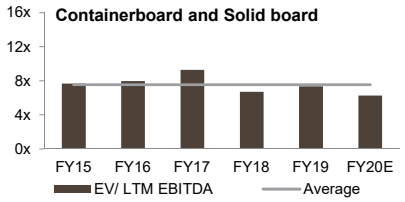
Glass Packaging
- Not available

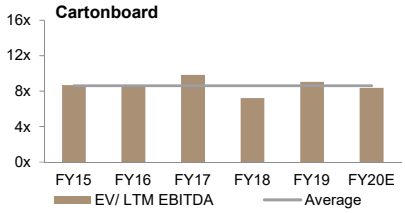
Distributors
- 13 January 2020: Freytag & Petersen announced the acquisition of Wagener Verpackung
- 09 January 2020: Macfarlane Group announced the acquisition of Armagrip
- 06 January 2020: IGEPA announced the acquisition of ZING

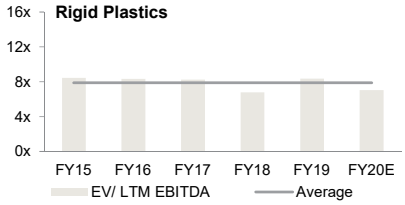
Paper and Packaging Machine Manufacturers
- No selected transactions in the analysed quarter

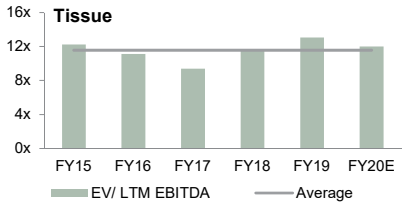


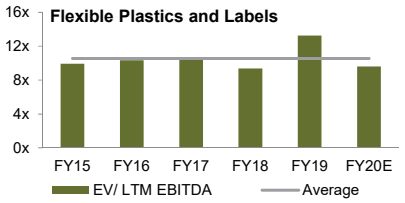


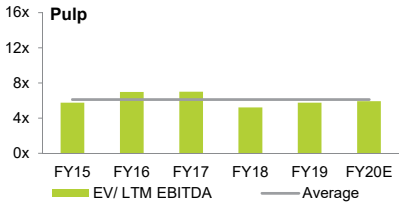


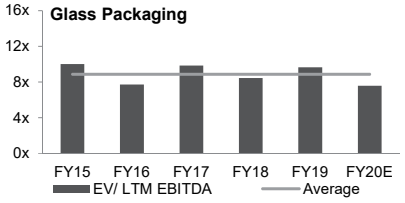


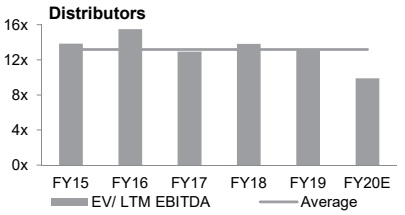


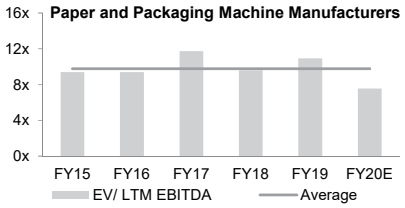


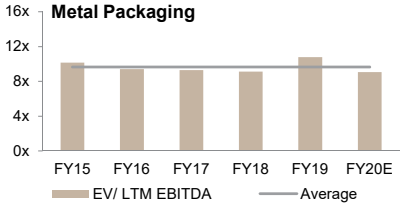












Source: Mergermarket, Capital IQ, Company Information, Pöyry Capital | Source: Capital IQ, Company Information

Pöyry Capital's Quarterly European Paper and Packaging Update

SELECTED TRANSACTIONS

Jass
has agreed to acquire
CONVERT PAPER
Exclusive Financial Adviser to Papierfabrik Adolf Jass
December, 2019

Global paper and packaging company
Has sold its JV equity stake in a Asian paper mill to its joint venture partner
Financial advisor to Global paper and packaging company
September, 2019

vpk packaging group
has agreed to acquire the European and Chinese businesses of
CORENSO
from
MDP NPAC Holdings
Exclusive Financial Advisor to VPK
May 2019

PEMCO
has sold 100% of
RANHEIM PAPER & BOARD
to
FUNDERMAX
Exclusive Financial Advisor to PEMCO AS
January 2019

Sale of forestland assets in New Zealand, Brazil & Uruguay
Phaunos TIMBER FUND
Financial Adviser to Phaunos Timber Fund
November 2018

RGE
has agreed to acquire
LWARCEL CELULOSE
From the Lwart Group
Joint Financial Advisors to RGE Inc.
September 2018

Quantum CAPITAL PARTNERS
has agreed to divest
barcelonacarton
to
RdM
Exclusive Financial Adviser to Quantum Capital Partners
June 2018

OPENGATE CAPITAL
has divested
NORPAPER
Gemayel Freres & Chaoui Industrial Group
Exclusive Financial Adviser to OpenGate Capital
June 2018

BainCapital
has agreed to acquire a majority stake in
FEDRIGONI
Financial Adviser to Bain Capital, LP
March 2018

DeLaRue
has agreed to carve out a majority stake in its paper business to
epiris
Exclusive Financial Adviser to De La Rue, Plc
March 2018

sappi
has agreed to acquire the speciality paper business of
Cham Paper Group
Exclusive Financial Adviser to Sappi Limited
February 2018

PHI INDUSTRIAL ACQUISITIONS
has agreed to divest the Spanish and French operations of
Abelan Board & Packaging Solutions
to
AURELIUS
Exclusive Financial Adviser to PHI Industrial Acquisitions
November 2017

MM KARTON AG
has agreed to acquire
ASG
(Polish Personal Care Operations)
Exclusive Financial Adviser to Mayr-Melnhof
October 2017

GRAPHIC PACKAGING INTERNATIONAL, INC.
has agreed to acquire
NORGRAFT PACKAGING S.A.
Exclusive Financial Advisor to Graphic Packaging
October 2017

RIVERROCK ES PLASTIC
has divested 100% of the share capital in ES-Plastic to
Proplast PACKAGING GROUP
Exclusive Financial Adviser to RiverRock European Opportunities Fund Ltd.
October 2017

山鹰纸业 SHANYING PAPER
Has agreed to buy
NORDICPAPER
Exclusive Financial Advisor to Anhui Shanying Paper
October 2017

Founded 21 years ago, Pöyry Capital is a sector-focused M&A advisory business, the investment banking arm of AFRY (previously ÅF Pöyry). Pöyry Capital has the largest dedicated forest products investment banking advisory team in London, managing transactions across the value chain including timberland, wood products, biomaterials, pulp, paper and packaging. It also offer M&A advice in energy & infrastructure and in industrials. Over the past three years the firm has advised on 18 completed transactions in five continents for clients from Europe and beyond.

Contact

Cele Moncayo
Managing Director
+ 44 7946 521880
celedonio.moncayo@afry.com

Sandra Bowhay
Managing Director
+ 44 7920 254258
sandra.bowhay@afry.com

www.poyrycapital.com

AFRY
ÅF PÖYRY