

Growth is back

Survey confirms upward trend, sustainability increasingly a necessity for future competitiveness

Results from 2013 economic outlook survey, including sustainability behavior of companies in the forest products industry.

StepChange Consulting conducted a survey among the participants of the 28th Annual RISI North American Forest Products Conference in October 2013 in San Diego, the results of which have been compared to the last two years' surveys to enable a historical comparison and analyze changes.

The outcome of the survey provides an indication about the perception of current economic and market developments in the industry, and which measures are currently being taken to address the issues.

Key highlights of the economic outlook survey results

- Improved expectations: Almost three quarters of respondents indicate that the industry will not see another recession within the next 12 months
- Likewise, a majority of respondents believe that the economy is on an upward trend. More optimistic than in the last few years as only less than one fifth of participants believe that the economy is either in a downward trend or trough phase
- Subsequently, more than half of the respondents indicate that they have not started any planning process, or are not aware of any plan, in order to deal with an upcoming recession
- More than 80% of respondents expect higher raw material and transportation costs and feel as well the pressure of required levels of customer service increasing
- More than two thirds of participants (72%) expect to offset the higher costs through higher selling prices and an increased customer demand (67%)
- Measures to address developments are focused mostly internally. Areas of focus being pricing & margin management, cost reduction and marketing, customer service and customer retention – while at the same time, they lost importance compared to 2011 and 2012 results
- Talent management and development as well as mergers & acquisitions and supply chain initiatives are the areas

that gained considerably in importance of respondents compared to previous years

- Cash flow management and working capital focus as well as product development and innovation are the two areas that significantly lost importance compared to 2012
- Compared to the small number of respondents (7%) who stated that workforce reduction is in focus in 2011, no respondent believed that this was an area of focus for 2012 and the same applies for 2013

Sustainability survey results

- More than two thirds of respondents agree that in the future, sustainability will be an important source of competitive advantage for a company operating in the pulp & paper industry – even though very few respondents see the topic as their top priority
- Almost 60% of the respondents believe that most companies engage in sustainability initiatives primarily for Public Relations
- Slightly less than half of the respondents disagree that legislation is setting the right regulatory environment to support sustainability investments
- Almost the same number of respondents disagree with the statement that sustainability targets set by public discussion are realistic and achievable
- Only one fifth of respondents state the opinion that companies are not investing enough in sustainability measures and development

Respondent demographics represent a wide spectrum of the industry including forestry & wood products, pulp manufacturing, paper & paperboard manufacturing, converting, merchants & distributors, financial services and management consulting.

Demographic of respondents

Participants by industry [%]

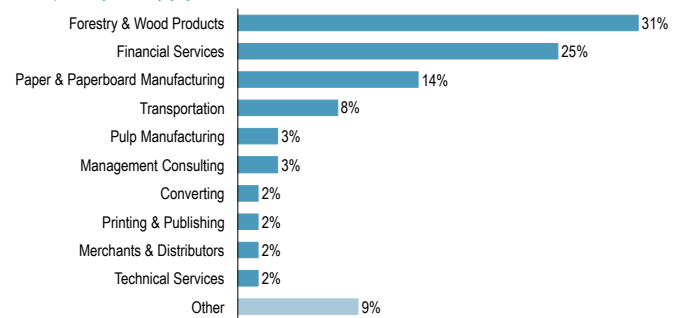


Figure 1

More than half of the survey respondents either work directly within the forestry & wood products sector (31%) or belong to the financial services sector (25%).

14% of respondents work in paper & paperboard manufacturing. Within this group, two thirds of the respondents work for graphic paper producers and almost half of paper & paperboard manufactures are in the segment of specialty and engineered papers. Eight percent work in the transportation and logistics business.

Where appropriate, non-forest products or non-pulp and paper responses were evaluated separately.

Question 1

Where do you see the economy heading in the next twelve months? [%]

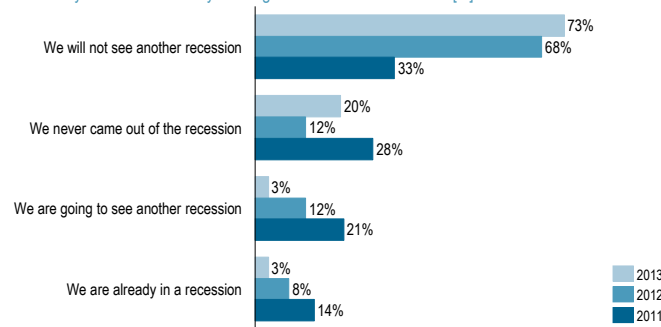


Figure 2

Almost three quarters (73%) of respondents believe that we will not see another recession within the next 12 months. However, one fifth of respondents believe that we have never come out of the last recession (20%)

Compared to 2011, the number of respondents who believe that we will not see another recession has increased by a remarkable 40% points from 33% to 73% and even compared to last year results the number increased by 5% points. Overall, 70% of the respondents who do not expect another recession work either in the forestry & wood products, financial services sector or for paper & paperboard manufacturing companies and 30% thereof alone in the forestry & wood products industry.

Taking a closer look by sector, the most optimistic sector is transport – where 100% of respondents indicate that we will not see another recession within the next 12 months.

According to paper & paperboard manufacturers, 78% believe that we will not see another recession, in contrast, 22% believe that we have never come out of the last recession.

70% of the forestry and wood products manufacturers do not expect another recession, while 5% believe we are going to see

another recession and 25% believe we never came out of the recession.

In the financial sector, traditionally an optimistic one, 75% do not expect another recession, while 13% indicate that we did not get out of the recession yet and 6% each believe we are either already in a recession or we are going to see one within the next 12 months.

More than three quarters of respondents believe their sector is on an upward trend (79%) or at a peak (5%). Less than one fifth of respondents have a rather negative outlook and believe their segment of the industry is in a trough (5%) or on a downward trend (13%).

Reflecting an optimistic mood in the industry, compared to the last two years, the number of respondents who see the economy on an upward trend has more than doubled, even though slightly fewer respondents than in 2011 and the same amount as 2012 believe that the economy currently peaks.

Question 2

In your opinion, currently where is your area of the industry in the economic cycle? [%]

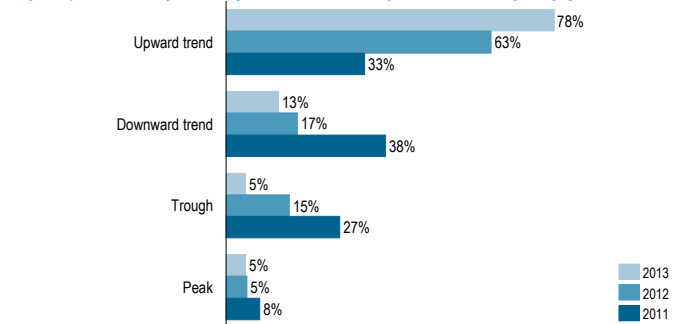


Figure 3

This year especially the forestry & wood products sector sees the economy on an upward trend or at a peak (95%), directly followed by the financial services sector (75%). However, some merchants & distributors, pulp manufacturers and logistic suppliers also see the economy on an upward trend.

From the paper & paperboard manufacturers, more than half are also optimistic (56%) and seem to be pleased with the current economy, whereas the graphic paper segment is polarized: while 50% see an upward or peak, the other half perceive the current economic situation as being in a downward trend.

Question 3

Is your company planning for a recession? [%]

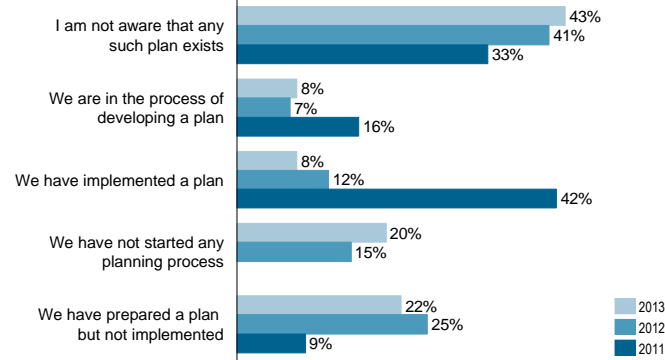


Figure 4

Results from 2013 clearly highlight that the majority of industry sectors do not seem to be concerned about an upcoming recession. Only 8% of respondents indicate that their company has implemented a plan. 22% have prepared a plan but not implemented and 8% are in the process of developing a plan. However, more than 50% of the participants mention that they are not aware that any such plan exists (43%) or that they have not started any planning process yet (20%).

There seems to be a major change compared to 2011 in that almost five times less respondents in this year's survey stated that they have implemented a plan to deal with recessive markets and the trend from last year continues although less accentuated.

Still preparing for an upcoming recession are mainly the respondents from the graphic paper sector – only 17% of them are not aware of any plan to tackle a potential recession. Taking a closer look at the participants who answered that they are not aware of any plan, half of the respondents are from the forestry & wood products sector. This is in line with the previous question where most of the respondents from this sector had a positive outlook.

From the respondents in question 2 who see the economy on a downward trend (13%), one third answered that their company has not yet started any planning process, or they are not aware that any plans exist. 67% have prepared a plan, or are in the process of preparing a plan. Interestingly, none of them have yet implemented a plan.

In all cost categories participants are signaling an expected increase of costs, even more than 2011. 86% expect further increases in raw material costs – this represents a more than doubling versus 2012. 83% believe that transportation cost did not

yet peak and will go up further – this is 21 percentage points more than last year.

Reflecting an optimistic view, most participants (72%) expect higher selling prices combined with an expected increase in customer demand to offset the expected higher costs. Both signs are very positive as they clearly indicate a trend. In terms of selling prices, the share of participants that perceive them to have increased went up from 45% last year. In terms of customer demand, 29% indicated a demand increase in 2011. In 2012 the share increased to 43% and for 2013 more than two thirds (67%) expect that customer demand will go up further. Only 20% perceive a deterioration of selling prices and only 12% perceive lower demand – this is a clear trend down from 50% in 2011 and 20% for 2012.

Question 4

What trends are you seeing in the market relative to last calendar year? [%]

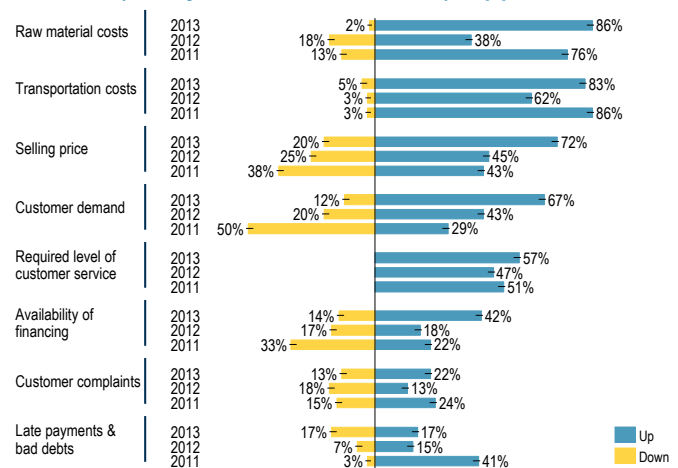


Figure 5

On the other hand, more than one fifth of responses indicate that they expect customer complaints to increase – this is an increase vs. last year but does not reach the level of 2011.

In more detail, 55% of respondents who see increasing selling prices are from the forestry & wood products sector or paper and paperboard manufacturers.

Fiscal stimulus seems to have finally arrived at the real economy as recognition that availability of financing went up as it more than doubled from 18% in 2012 to 42% in 2013. Those that judge availability of financing to have decreased went down from 33% in 2011 to 14% in 2013. Improved payment behavior deteriorated a bit in 2013 with polarized views – 17% each see an increase on late payments and bad debts as well as a decrease in the same category.

Question 5

What are your company's current priorities? [%]

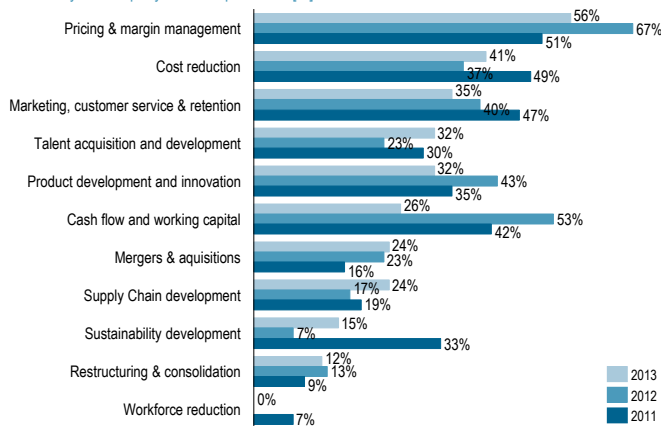


Figure 6

Answers from non-pulp and paper related respondents were excluded from the evaluation of question 5 to get a more industry specific view.

Companies take both internal and external measures in managing profitability. The top three areas are internal initiatives. Top priority with less significance than last year remained pricing and margin management (56%). Cost reduction initiatives gained relevance once again, although they continue to be lower than 2011.

Cash flow and working capital measures went down the priority list, which is in line with the previously stated availability of financing. Respondents further identified marketing, customer service and retention (35%) as a top priority for their company along with talent acquisition and development (32%).

With still increasing cost pressures (see question 4) it is surprising to see that cash flow and working capital reduction activities have lost significance versus 2011.

Product development and innovation (43%) and customer service and retention (40%) are seen as an enabling priority in difficult times and scored in the same region as previously in 2011 and 2012.

Sustainability development initiatives, which ranked as the sixth highest priority in 2011 by one third of respondents, dropped to tenth place in 2012 with only 7% of respondents indicating sustainability as a priority in their company. In 2013, with higher prices and increased customer demand, sustainability development measures are gaining importance once again (17%).

Mergers & acquisitions improved in priority among survey respondents compared to 2011 and 2012 and went from 16% in 2011 up to 24% in 2013.

While the economy recovers and unemployment rates drop, initiatives to manage talent acquisitions and development of human resources gained in relevance, up from 23% in 2012 to 32% in 2013. Workforce reduction is not seen as a priority as evidenced by that fact that in 2011 7% saw the reduction of staff as one measure and none of the participants indicate this as a possible option in 2012 or in 2013. Initiatives in the supply chain area increased in relevance in 2013 to 24%, compared to 17% in 2012.

In 2013 it is clearer than ever that industry sectors have differing priorities. Paper & paperboard manufacturers indicate three main priorities. 78% of the respondents state pricing and margin management as a top priority, directly followed by 67% who indicate cost reduction initiatives and next 56% cash flow and working capital as other top priorities.

For the respondents of the forestry & wood products sector, the single most important priority is talent acquisition and development (40%). The second priority for 35% of respondents are initiatives around mergers and acquisitions as well as management of pricing and margins. Cost reduction and restructuring initiatives are considered a top priority only for 10% of respondents.

Respondents from non-pulp and paper related industry sectors (e.g. financial services) have very broad and diverse perspectives on priority areas – talent and acquisition of human resources being considered the single most important focus area by 31% of respondents while 25% of respondents see on the other hand, reduction of workforce as a main priority.

Sustainability in the forest products industry survey results

The institutional framework for sustainable development and a green economy in the context of sustainable development & poverty eradication continues to be a focus area for the G20. Therefore, the goal of this survey section was to explore how companies in the paper and forestry industry currently engage in sustainability initiatives and how focus has developed since last year.

More than two thirds of respondents (72%) of this survey strongly agree or agree that sustainability will be an important source of competitive advantage for a company operating in the

pulp & paper industry. This is a slight increase over last year. 22% share a neutral opinion about this topic.

Question 6

Sustainability - How do you evaluate the following statements? [%]

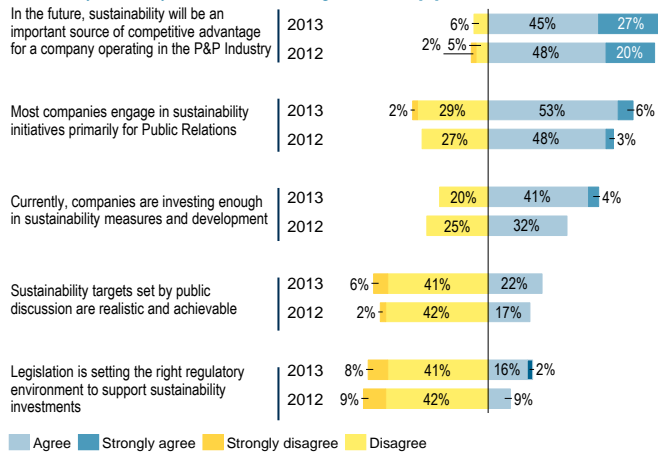


Figure 7

Almost 60% of the respondents agree with the statement that most companies engage in sustainability initiatives primarily for public relations – this has also increased versus 2012. On the other hand, almost one third does not agree with this statement. Respondents seem to be less polarized concerning the question whether companies are currently investing enough in sustainability measures and development. While 45% agree with this statement, only 20% do not agree and 35% have a neutral opinion.

Participants of the survey continue to agree that legislation is not setting the right regulatory environment to support sustainability investments. However, the perception has significantly improved as 18% agree legislation is setting the right regulatory frame conditions, in contrast to only 9% in 2012.

A similar picture can be observed for the question, whether sustainability targets set by public discussion are realistic and achievable as only 22% agree versus 47% who disagree or even strongly disagree.

Question 7

Is your company currently participating in a sustainability initiative? [%]

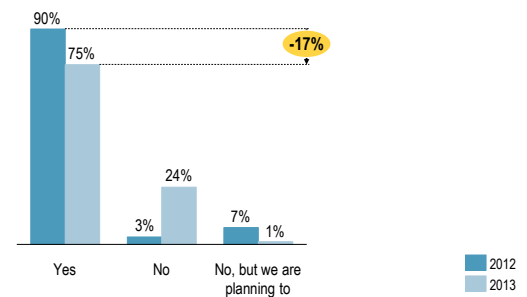


Figure 8

While 15% of respondents to question 5 indicate sustainability development to be a priority within their company, 75% of survey participants indicate that their company is currently participating in a sustainability initiative. Interestingly, in 2012 another 7% stated that they were planning to participate in such initiatives, but this didn't happen as the 75% represents 15 percentage points less than 2012, when 90% of participants indicated that their companies were participating in a sustainability initiative. None of participants from the forestry and paper related industries answer that it is currently not a priority.

Question 8 shows details from the viewpoint of the respondents who indicate that their company is currently participating in a sustainability initiative.

Question 8

Please specify the focus areas of your company's sustainability initiative [%]

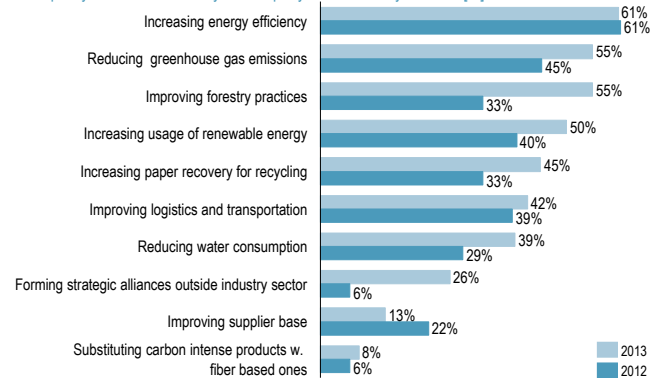


Figure 9

For respondents the top three focus areas for sustainability initiatives are within the areas of energy efficiency (61%), reduction of greenhouse emissions (56%) and improving forestry practices (55%) followed by increasing usage of renewable energy (50%). For the paper industry being an energy intensive industry this is not a big surprise. The fact that improving logistics and transportation is only a focus area for 42% of respondents is rather a

surprise, since 83% of respondents perceive higher transportation costs (see question 4, figure 5) as a major trend.

Increasing paper recovery for recycling is seen as a focus area by 45% of respondents up from only 33% in 2012. The number of initiatives for reducing water consumption also increased significantly from 20% to 39%. Although less companies indicate that they are currently participating in a sustainability initiative, the number of focus areas has increased further indicating that those companies currently involved in sustainability initiatives take the topic as a whole, and prefer holistic approaches rather than single initiatives.

Summary

In summary, the industry seems to go forward with far more positive expectations than in 2011 and even 2012. Most respondents do not see a recession in progress or on the horizon within the next year, which is supported by the latest economy results. It has been perceived, that the global economy gained momentum in the second quarter of 2013 after a relatively weak start of the year. The main impetus behind this pick-up in activity has come from the OECD economies, with a healthy performance in the US and the Euro-zone returning to growth after eighteen months of recession. For this reason, most companies probably do not see the necessity to get prepared or implement a plan for an upcoming recession. In the US especially, strong growth in the second quarter in combination with the expansion of its manufacturing sector has been supportive to the global economy.

The perceived pressures in the areas of increasing raw material and transportation costs appear to be offset by increasing demand and selling prices in most segments, except graphic paper.

Pricing and margin management is currently still the top priority for all sectors, followed by cost reduction initiatives.

Cash flow and working capital management has lost the most importance in terms of priorities that it had in the prior year along with product development and innovation.

Reflecting the lower unemployment data and the increasing war for human resources, talent acquisition and development is the priority area that most increased vs. last year.

Mergers and acquisitions were mentioned as a priority slightly more often than in 2012 by almost a quarter of participants.

The last questions of the survey reflect that sustainability continues to be of importance to the industry. Three quarter of the respondents indicate that their company is engaged in a sustainability initiative. However, only a few indicate that sustainability is seen as a priority. Obviously, when compared with other priorities, sustainability cannot compete with more important topics as listed in question 5 but nevertheless is seen as a necessity.

The paper and forestry industry, as a highly energy intensive industry, for the most part agrees that companies are still not investing enough in sustainability initiatives and that legislation needs to set the right regulatory environment to support sustainability measures. Respondents agree that increasing energy efficiency and reducing greenhouse gas emissions will be a step in the right direction concerning sustainability measures.



About StepChange Consulting

StepChange is an industry focused and independent management consulting company with a proven track record in supporting clients to achieve sustainable value. StepChange provides support to top tier organizations in the industry from strategy development to implementation of operational improvements. With an international team of industry experts StepChange can hit the ground running. StepChange provides innovative and yet pragmatic solutions, placing an emphasis on delivering measurable business results.

For further inquiries and comments regarding this Point of View please contact us at leapfrog@stepchange.com.



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