

Right location but close to the tipping point?

Survey confirms upward trend continues but skepticism has increased ♦ North and South America considered most competitive locations for forest based industries ♦ Innovation and talent focus is back

StepChange Consulting conducted a survey among the participants of the 29th Annual RISI North American Forest Products Conference in October 2014 in Boston, the results of which have been compared to the last three years' surveys to enable a historical comparison and analysis of 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. Further results of the survey provide a viewpoint of participants about the competitiveness of North America as a location for forest based industries.

Key highlights of the survey results

- Positive expectations: 68% of respondents believe that their area of the industry is on a peak or upward trend. This view is less optimistic than in 2013 (83%) and at the same level as 2012
- Increasing costs: More than 75% of respondents expect higher transportation costs, 63% expect higher raw material costs and feel as well the pressure of increasing levels of customer service
- About 50% of participants expect to offset the higher costs through higher selling prices and an increased customer demand while 20% see lower selling prices and 24% see lower demand
- Industry consolidation through M&A activity is expected to be one of the most important focuses with 79% of the respondents foreseeing it as an increasing market trend
- Measures to address developments are focused mostly internally. Areas of focus being pricing & margin management, product development & innovation and talent acquisition & development – all of which increased in share of respondents seeing these as priorities
- Cost reduction initiatives still remain relevant as a priority for over a third of respondents
- Restructuring and consolidation, mergers & acquisitions as well as supply chain initiatives are areas that gained considerably in importance compared to previous years as priorities
- Cash flow management and working capital focus are areas that significantly lost importance amongst participants as compared to 2013
- Compared to the small number of respondents (7%) who stated that workforce reduction is a focus in 2011, in 2014 almost 23% of the respondents say that workforce reduction is among their current priorities

North American forest based industry survey results

- Respondents consider domestic demand and export opportunities as two of the most important factors impacting positive growth of the forest based industry in North America
- Labor laws and regulations as well as innovation and R&D environment are considered by all respondents as major barriers to growth for the forest based industry
- With regard to the US, the participants' views on government support are polarized. For the US, 39% of the respondents believe that government actions are required to improve competitiveness of the forest based industries while 39% do not
- Compared to US and Canada, Mexico is the country where participants believe the least that government support is required for improving competitiveness of the forest based industries
- 78% participants believe that North America is more attractive (46%) or at least as attractive (32%) as an industry location as the rest of the world
- On the global scale, North America is ranked second after South America as the most competitive region for the forest based industries. East/Southeast Asia is ranked third.
- Brazil was mentioned most often as the most competitive country for forest based industries followed by the US and China

Survey demographics

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

Demographic of respondents

Participants by industry [%]

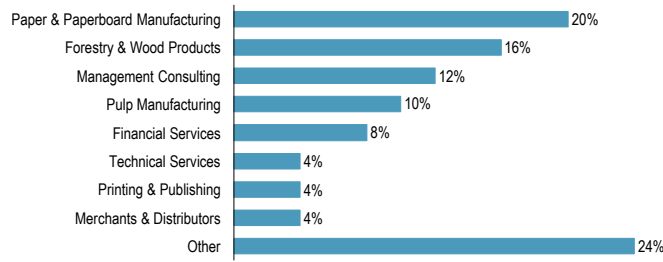


Figure 1 – Demographics of respondents

More than half of the survey respondents work directly within the paper & paperboard manufacturing, forestry & wood products, pulp manufacturing, printing & publishing and merchants & distributors (54%).

20% of respondents work in paper & paperboard manufacturing. Within this group 40% of the respondents work for graphic paper producers and 40% for the segment of packaging – paper & board. Seven percent work in the tissue business.

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

Upward trend continues but with increased pessimism

Two thirds of all respondents believe their sector is on an upward trend (62%) or at a peak (6%). One third of respondents have a rather negative outlook and believe that their segment of the industry is in a trough (4%) or on a downward trend (28%).

Reflecting a slightly more pessimistic mood in the industry, compared to 2013, the percentage of respondents who see the economy on a downward trend has more than doubled, while the number of respondents who see the industry being in a trough has decreased slightly.

Industry development

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

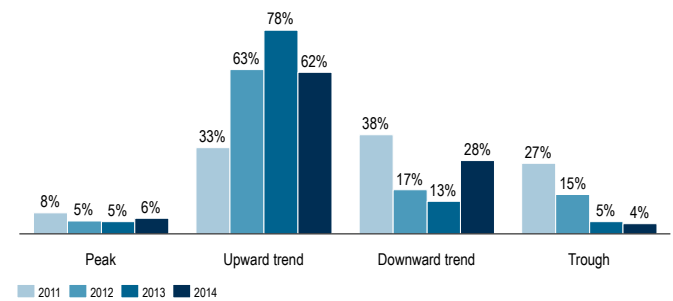


Figure 2 – Pulp and paper economic cycle position

Following the same trend as in 2013, all respondents (100%) of the forest and wood sector see their area moving upward. On the contrary, the pulp manufacturing sector sees their area on a downward trend or in a trough (60%). The Paper and Paperboard manufacturers have a polarized view with 60% of graphic paper respondents seeing a downward trend while 80% of packaging respondents see an upward trend.

Industry development

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

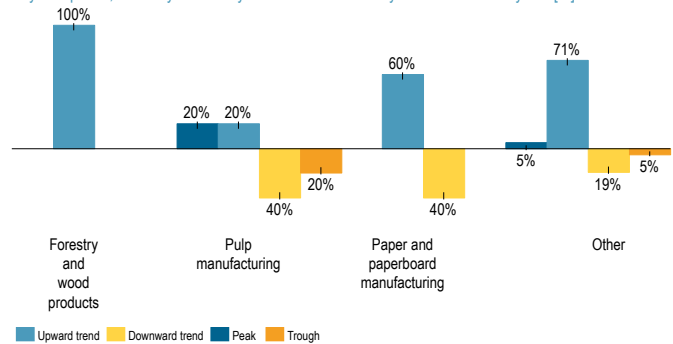


Figure 3 – Pulp and paper economic cycle position

Margins expected to continue to be under pressure

As in previous years, participants are continuing to signal an expected increase of costs. Over 75% of respondents state that transport costs are increasing while only 5% said they are decreasing. Even though the share of respondents seeing increased raw material costs has decreased compared to last year, 63% of participants still foresee costs to increase while 13% see decreased raw material costs. The participants view on availability of financing remains relatively unchanged year over year.

Industry development

Cost side: What trends are you seeing in the market for the coming year? [%]

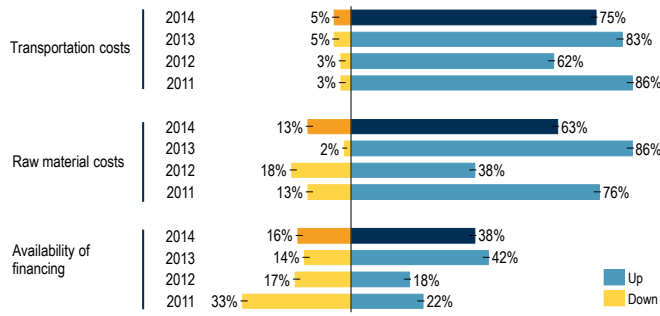


Figure 4 – Historical comparison of cost related trends

Reflecting a less optimistic view on the sales side than last year, only about half of participants (about two thirds last year) see higher selling prices and an increase in customer demand to offset the expected higher costs. For the first time in four years, the share of participants seeing increases in selling prices and improved customer demand is less than in the previous year.

The share of participants seeing decreases in customer demand remained the same as last year at 20% while the share experiencing decreasing customer demand has doubled to 24%. In these trend areas, graphic papers' participants were pessimistic as compared to packaging respondents. 40% of graphic paper respondents see a downward trend on selling price and 60% see customer demand decreasing. Packaging respondents on the other hand only see increasing or no change trends in selling price and customer demand.

To counter the less optimistic views on price and demand, 79% of participants foresee continued M&A and industry consolidation.

As in previous years, participants see customer service levels increasing. Over the past four years, an increasing share of participants experience increased required levels of customer service to the present value of 65% of participants. Over the past four years, no participants have seen a decreasing level of customer service.

As in previous years, the majority of participants still do not see changes in customer complaints levels while the remaining participants are somewhat polarized with 23% seeing increases in complaints and 18% seeing decreases in complaints.

Similar to previous years, the majority of participants see no change in payment behavior with perception remaining mostly similar to 2013. The remaining one third of participants have a polarized view with 16% seeing an increase on late payments

and bad debts while the same share of respondents see the opposite.

Industry development

Sales side: What trends are you seeing in the market for the coming year? [%]

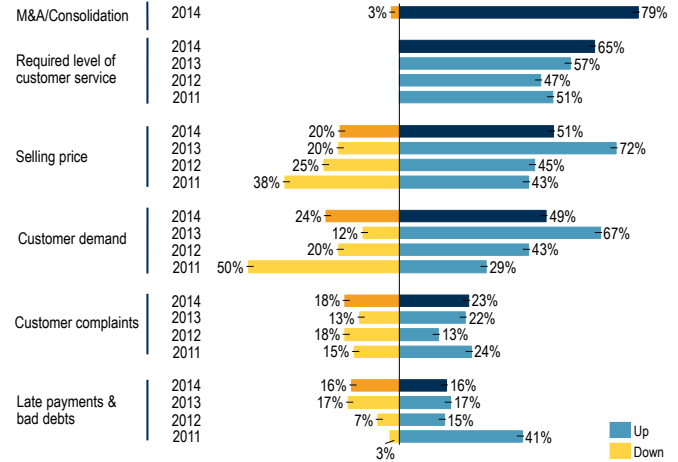


Figure 5 – Historical development of sales related trends

Current company priorities

Answers from non-pulp and paper related respondents were excluded from the evaluation of "current company priorities" to get a more industry-specific view.

Companies take both internal and external measures in managing profitability. The top three focus areas are internal initiatives directly focusing price and margin management, product development & innovation as well as talent acquisition & development. 2014 results show that the top three priorities have gained even more significance compared to 2013 and for two of them (product development & innovation and talent acquisition & development) the share of respondents declaring them as a company priority is the highest recorded in the past 4 years. While the economy has recovered and unemployment rates have dropped, initiatives to manage talent acquisition and development of human resources gained in relevance, up from 32% in 2013 to 42% in 2014.

Mergers & acquisitions improved as a priority to fourth position on the list with 38% of survey respondents naming this a priority. Cost reduction initiatives, while still remaining relevant as a priority for over a third of respondents, have lost some relevance vs. previous years.

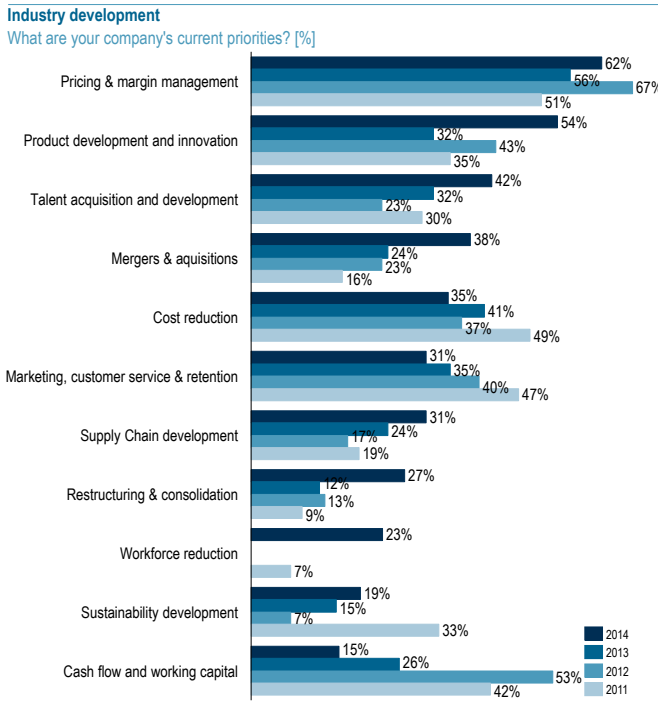


Figure 6 – Historical comparison of current priorities

While an increasing share of participants continues to see increased levels of required customer service, a decreasing number of participants see marketing, customer service and retention as business priority year over year for the past four years.

Initiatives in the supply chain area continued to increase in relevance for the third year in a row achieving 31% in 2014.

Cash flow and working capital initiatives have moved down the priority list with only 15% of participants seeing them as a priority.

Compared to the small number of respondents (7%) who stated that workforce reduction is in focus in 2011, in 2014 almost 23% of the respondents say that workforce reduction is one of their current priorities.

Sustainability development initiatives, which ranked as the sixth highest priority in 2011 by one third of respondents, dropped to tenth place in 2014 with only 19% of respondents indicating sustainability as a priority in their company. Nevertheless it needs to be noted that in 2014, despite the decrease of expectations on higher prices and higher customer demand, sustainability development measures re-gained importance for the third year in a row (starting from 2012).

In 2014, the major operating sectors had slightly differing views on priorities. Paper & paperboard manufacturers indicated three main priorities: 70% state pricing and margin management as a top priority, directly followed by 60% indicating product development and innovation and by 50% indicating mergers & acquisitions.

For the respondents of the forestry & wood products sector, the most important priorities are mergers & acquisitions as well as pricing and margin development both with 38% share of responses while product development and innovation, talent acquisition and development and supply chain development were all third (25%). Cost reduction and restructuring initiatives were not mentioned by any of these respondents.

Respondents from non-pulp and paper related industry sectors (e.g. management consulting and financial services) have very broad and diverse perspectives on priority areas.

Industry drivers of growth for North America

Participants see domestic demand as having a positive influence on growth of the industry (50%). However, this view is somewhat polarized taking into consideration that 29% of the participants foresee domestic demand as a potential negative influence.

Export opportunities are regarded as the second most positive driver on the industry by 45% of the respondents. Energy prices (32%) and taxes & fees (32%) were seen as next drivers of growth. Although energy prices were also seen as a negative influence by 21% of respondents.

Industry drivers

Please select the FIVE MOST IMPORTANT factors impacting growth of the forest based industry in North America positively or negatively? [%]

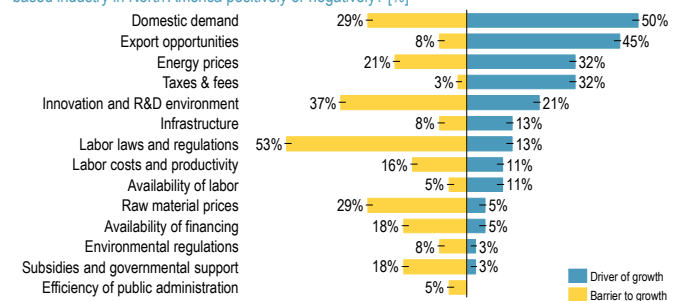


Figure 7 – Growth factors of forest based industry in NA

Labor laws and regulations (53%), innovation and R&D environment (37%), and raw material prices (29%) are perceived to be major barriers to growth. Although innovation and R&D environment was also seen as a positive influence by 21% of respondents.

Participants most believe that government support is needed in Canada with 45% believing it is required while 32% are not seeing support as being required. With regard to the US, the participants' views on government support are polarized. For the US 39% of the respondents believe that government actions are required to improve competitiveness of the forest based industries. Nevertheless, 39% believe that government action is not required.

Industry drivers

Do you believe supportive government action is required in the following countries to improve competitiveness of the forest based industries over the next 5 years? [%]

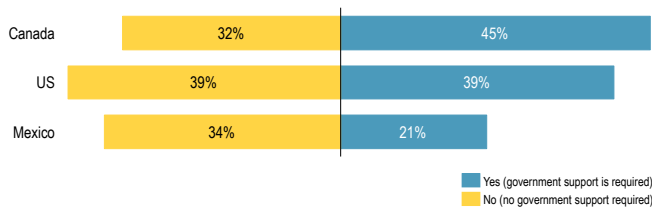


Figure 8 – Government support as factor of improved competitiveness

Mexico is the country for which the respondents believe the least that government support is required to improve competitiveness of the forest based industries.

North America viewed as attractive for Pulp and Paper industry

46% of participants believe that North America is more attractive for forest based industries compared to the rest of the world. Another 32% believe that North America is as attractive as many other regions of the world.

NA attractiveness

How attractive is North America as an industry location for forest based industries compared to the rest of the world? [%]

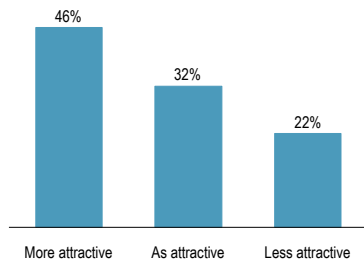


Figure 9 – Perspective on NA as an industry location

Non-pulp and paper related respondents had a bit more pessimistic view towards North America's attractiveness with only 23% of them considering North America to be more attractive

than the rest of the world. While 31% of those respondents consider North America to be less attractive than the rest of the world.

On the global scale, as can be seen in figure 10, South America is considered by participants to be the most competitive region for the forest based industry with North America in the second place and East/Southeast Asia in third place.

Global competitiveness

Please rank the following regions according to their global competitiveness in the forest based industries (1 = most competitive)

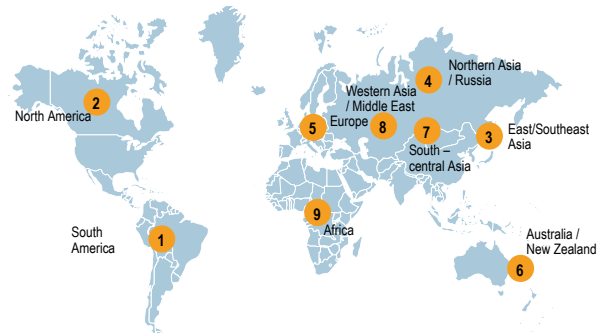


Figure 10 – Perspective on global competitiveness

South America in the number 1 spot was ranked first by 35% of participants and second by 30% of participants as the most competitive region. North America was ranked first by 24% of participants and second by 22% of participants. Although East/Southeast Asia was ranked first by 32% of respondents, it was not ranked by as many respondents as South America and North America for second and third positions. Europe ranks in 5th place.

Global competitiveness

Which country/countries do you globally consider to be most competitive as a base for the forest based industries?

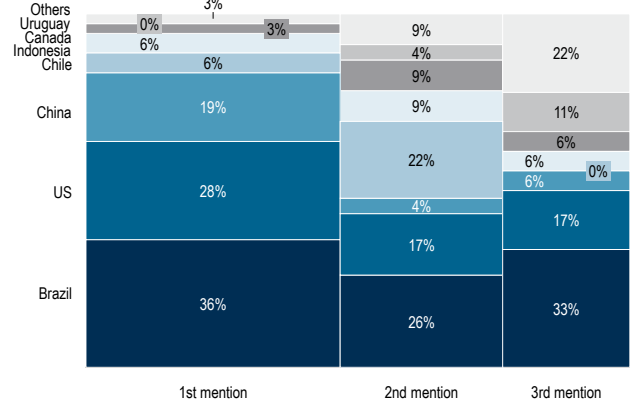


Figure 11 – Perspective on global competitiveness

Brazil (36%) was identified most often by respondents as the most competitive country for forest based industries followed by the US (28%) and China (19%). Other countries mentioned were Chile and Uruguay in South America, Canada in North America, Indonesia, Russia and Korea in Asia, Australia and New Zealand in Oceania and South Africa in Africa. An interesting note is that no European country was mentioned considering the significant capacity existing in Europe today.

talent management this is a very positive sentiment for the future development of the industry in North America.

Summary

In summary, the industry seems to go forward with slightly lower expectations than in 2013 and closer to 2012 but with far more positive expectations than in 2011.

Industry consolidation through M&A activity is expected to be one of the most important focus areas.

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 product development and - on an especially positive note - innovation initiatives.

Reflecting the lower unemployment data and the increasing war for human resources, talent acquisition and development is the number three priority.

Cash flow and working capital management has lost its importance in terms of priorities that it had in the prior years during and after the financial crisis.

The survey further reflects that the main drivers of industry growth in North America are domestic demand and export opportunities while the major barriers to growth are labor laws & regulations and innovation and R&D environment. While regulations are externally driven and can only be influenced through concerted industry action, any barrier that exists with respect to innovation can be addressed by companies themselves.

Respondents did not uniformly agree that government support is necessary to improve global competitiveness. A clear majority of respondents perceives North America to be more attractive, or at least as attractive, as an industry location for forest based industries as the rest of the world. And in the end, North America and the US were ranked number two among respondents as the most competitive regions and countries globally for forest based industries. Combined with the increased focus on innovation and



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.



**DRIVING CHANGE
TO DELIVER RESULTS**

