

Climbing the mountain with enough fuel?

Industry survey confirms positive but slowing business environment ♦ Industry not convinced by the benefits of TPP/TTIP ♦ USA voted most attractive industry location in North America

StepChange Consulting conducted a survey among the participants of the 31st Annual RISI North American Forest Products Conference in October 2016 in San Diego, and compared the results with the last four 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 being taken to address the issues. Further results of the survey provide a viewpoint of participants about the impact of the Transpacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) on the North American forest-based industries and about the competitiveness of North America as a location for forest-based industries.

Key highlights of the survey results

- Ambiguous expectations: 56% of respondents believe that their area of the industry is on an upward trend. This view is less optimistic than in any of the last 4 years (2015: 66%, 2014: 62%, 2013: 78%, 2012: 63%)
- Increasing costs: 61% of respondents expect higher raw material costs, 64% expect higher transportation costs, and feel as well the pressure of providing increased levels of customer service
- Increasing prices, demand questionable: 58% of participants expect to offset the higher costs through higher selling prices and 50% expect an increased customer demand while 21% see lower selling prices and 34% see lower demand
- Industry consolidation through M&A activity is expected to remain in focus: 58% of the respondents foresee it as an increasing market trend

- Measures to address developments focus on marketing, customer service & retention, cost reduction and product development & innovation
- Pricing and margin management's priority dropped since last year. Mergers & acquisitions are losing importance on company level for the second consecutive year in spite of its high importance as an industry trend
- Benefits of trade partnerships (TPP, TTIP) are not obvious and questioned by the participants, less than one fourth expecting positive impact
- Respondents consider domestic demand and export opportunities as two of the most important factors impacting on positive growth in the forest-based industry in North America
- Raw material prices and availability of labor are considered as the major barriers to growth for the forest-based industry
- 74% of the participants believe that North America is a more attractive or as attractive industry location as the rest of the world

Survey demographics

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

Demographic of respondents

Participants by industry [%]

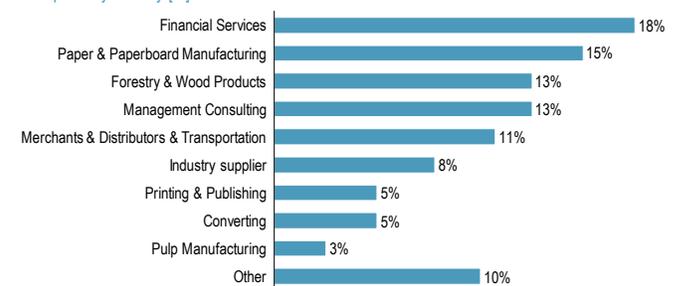


Figure 1 – Demographic of respondents

More than 40% of survey respondents have a direct industry affiliation either with paper & paperboard manufacturing, forestry & wood products, converting, merchandising or distribution.

15% of respondents work in paper & paperboard manufacturing. Within the paper & paperboard manufacturing group (multiple answers possible), 67% of the respondents work for graphic

paper producers, 50% work for the packaging paper and paperboard manufacturers and 17% work for specialty and engineered papers. 17% work in the tissue segment. Where appropriate, non-forest products or non-pulp and paper responses were evaluated separately.

Upward trend continues but with increased pessimism

More than half of all respondents have a positive outlook and believe their sector is on an upward trend (56%), although none of the participants evaluated their segment in peak. 43% of the respondents have a rather negative outlook and believe that their segment of the industry is in a trough (10%) or on a downward trend (33%).

Reflecting a slightly more pessimistic mood in the industry, compared to 2015, the percentage of respondents who see the industry being in a downward trend has more than doubled, while the percentage of respondents who see the economy in a trough has remained on the same level.

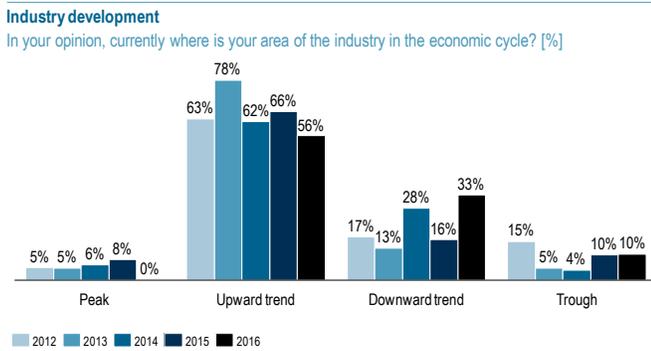


Figure 2 – Pulp and paper economic cycle position

The vast majority of the respondents (91%) from the forest and wood sector see their area moving upward. The paper and paperboard manufacturers are in a polarized equilibrium with 47% of the respondents experiencing an upward trend and the same number of participants observing a downward trend, while 7% seeing a trough in this segment.

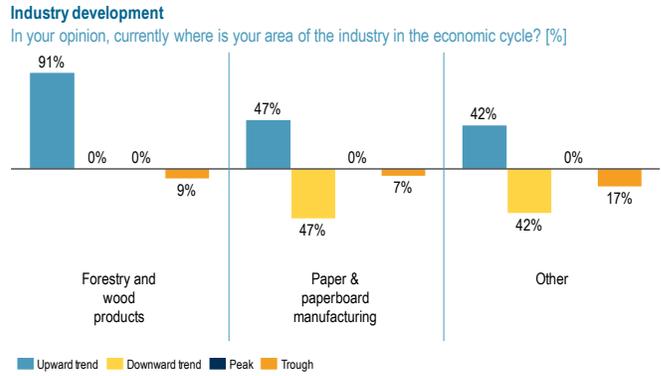


Figure 3 – Pulp and paper economic cycle position

Costs and prices expected to increase while demand expected to stagnate

As in previous years, participants are continuing to signal an expected increase in costs. 61% of participants still expect raw material costs to increase while 15% see decreasing costs. 64% of the respondents state that transport costs are increasing while 6% said they are decreasing. The participants view on the upward trend of financing availability is continuing on a pessimistic tendency since 2013, while the view on the downward trend is rather stable in the long term.

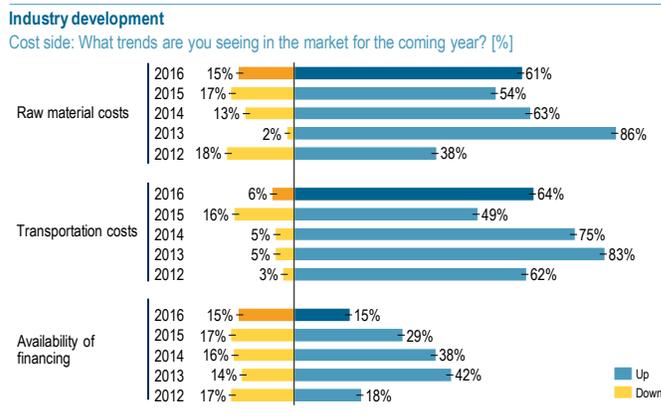


Figure 4 – Historical comparison of cost related trends

Reflecting a slightly more optimistic view on the sales side than in the last two years, 58% of participants see higher selling prices, while 21% expect lower prices. 50% of participants forecast increasing customer demand, however, 34% forecast decreasing demand. In these areas, paper and paperboard participants were more optimistic with about 67% seeing both prices and demand to increase.

The last two years witnessed high M&A activity and industry consolidation, and currently 58% of the participants expect it to continue.

As in previous years, participants see customer service levels increasing. With the highest share of the respondents in the last five years, 73% expect customer service levels to remain a priority. Over the past five years, virtually no participants have indicated a decreasing level of customer service.

Contrary to prior years, this year only 6% of respondents see an increasing level of customer complaints and 24% observe a decrease.

After a peak last year, late payment & bad debt is expected to increase by 18% of the participants and 12% await a decrease.

2015 (50%). Cost reduction kept its importance as second priority with a decreased value of 47% compared to last year. Product development & innovation gained more importance compared to other topics but remained nearly on last year's level with 47%.

Pricing and margin management's priority dropped from 72% to 40% compared to last year. Talent acquisition & development and cash flow & working capital decreased in importance as well and now both are current priorities for 30% of participants.

Initiatives in the supply chain development remain largely unchanged compared with previous years, with about one fourth of survey participants viewing this activity as important.

Finally, it is worth highlighting that mergers & acquisitions are losing priority for the second consecutive year, currently seen as important by only 23% of the respondents.

Industry development

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

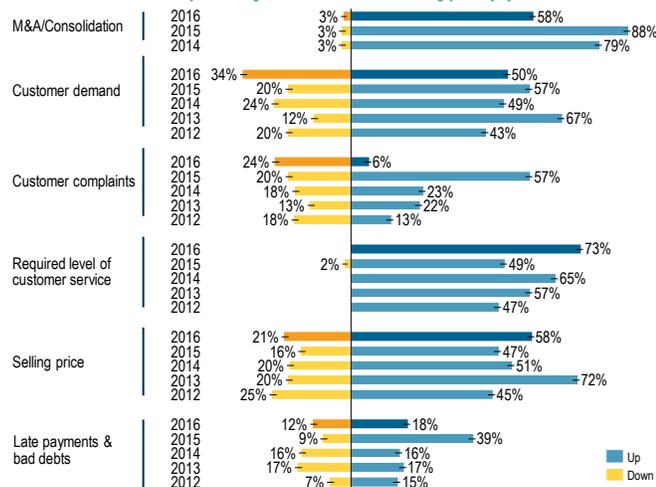


Figure 5 – Historical development of sales related trends

Current company priorities

Answers from other industry sectors (non-forest products or non-pulp and paper related respondents from consulting, technical and financial services) were excluded from the evaluation of “current company priorities” to get a more industry-specific view.

The top three priority areas are marketing, customer service & retention; cost reduction; and product development & innovation. The structure of the top priorities changed from last year: In 2015 five areas were prioritized by more than 50% of the participants, while in 2016 there is only one area over 50%.

Marketing, customer service & retention became a top priority with 53%, although it remained nearly on the same level as in

Industry priorities

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

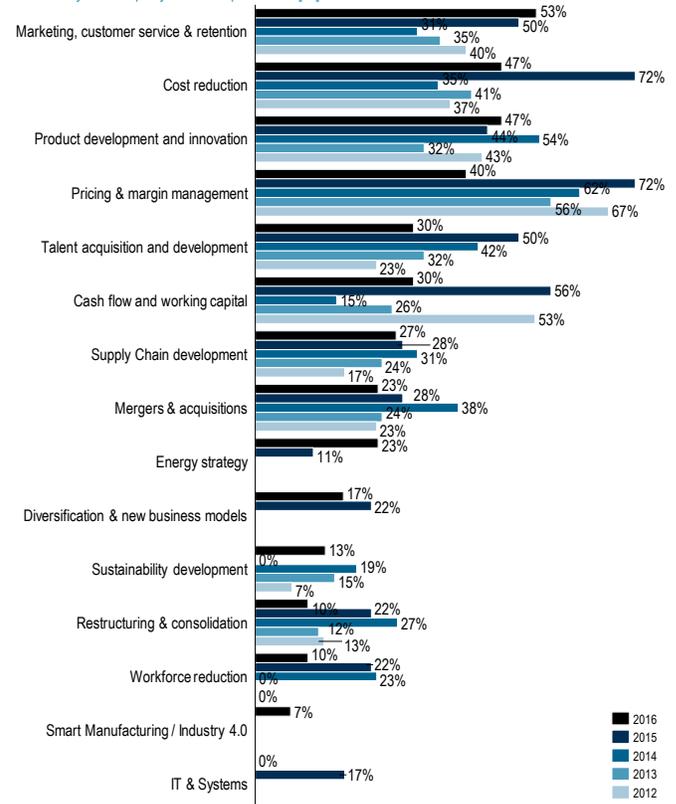


Figure 6 – Historical comparison of current priorities

Impact of trade partnerships questionable

The Transpacific Partnership (TPP) is a trade agreement (already signed but not ratified) between the USA and the twelve Pacific Rim countries. The Transatlantic Trade and Investment Partnership (TTIP) is a proposed trade agreement under ongoing negotiations between the USA and the European Union. The aim of these trade agreements is to boost trade between the parties by lowering both non-tariff and tariff trade barriers (e.g. standardizing industry-specific regulations).

Survey participants were asked about the expected impact of these trade agreements, respectively on North American forest-based industries. The results look very similar for TPP and TTIP, the majority of the respondents cannot decide on the effect of the trade partnerships. Among participants with expectations, the share of opinions with positive and negative impact are balanced.

Transpacific Partnership (TPP)

Will TPP impact the North American forest based industries? [%]

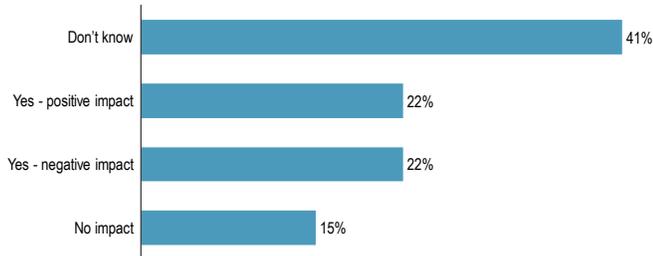


Figure 7 – Sentiment on TPP

For TPP, 22% expect positive and same number of respondents expect negative effects of the trade agreement.

Transatlantic Trade and Investment Partnership (TTIP)

Would you expect TTIP to impact the North American forest based industries? [%]

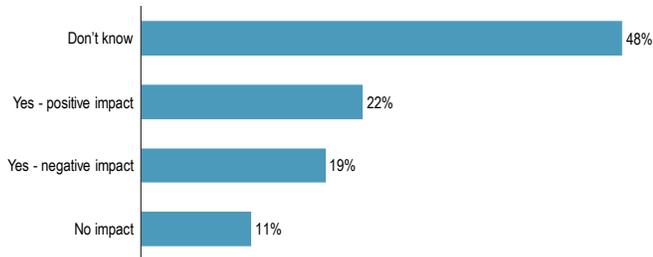


Figure 8 – Sentiments on TTIP

For TTIP 22% expect positive and 19% expect negative effects. Expectations about no impact are in the minority, 15% for TPP and 11% for TTIP, respectively.

These results show that the industry players are currently not convinced about the success of the TPP and TTIP trade agreements and only a small amount of the survey participants see possible benefits through these trade partnerships.

Industry drivers of growth for North America

Participants see domestic demand as having the biggest positive influence on the growth of the industry (61%), while only 6% of the participants foresee domestic demand as a potential barrier to growth.

Industry drivers

Please select the FIVE MOST IMPORTANT factors impacting growth of the forest based industry in North America positively or negatively.

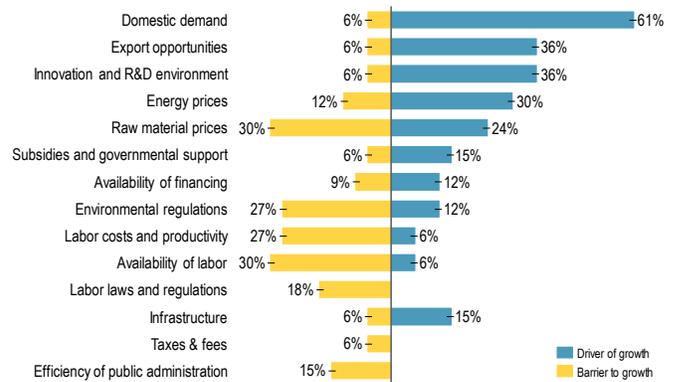


Figure 9 – Growth factors of forest-based industries in NA

Export opportunities and innovation & R&D environment are regarded as the second most important drivers of the industry by 36% of the respondents. Energy prices and raw materials prices were seen as next drivers of growth by 30% and 24% of survey participants, respectively. However, raw material prices, at the same time, were seen by 30% of respondents as the greatest barrier to growth. Further growth barriers are availability of labor (30%), environmental regulations (27%) and labor costs & productivity (27%).

North America viewed as attractive for Pulp and Paper industry

37% of participants believe that North America is more attractive for forest-based industries compared to the rest of the world. The same amount of respondents believe that North America is as attractive as 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?

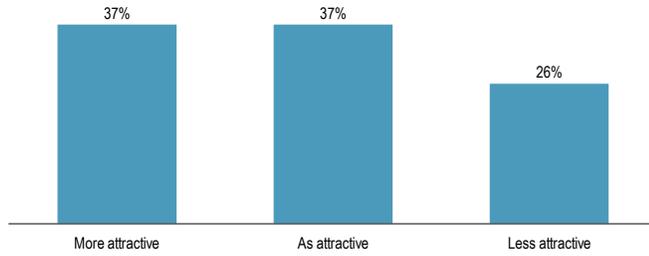


Figure 10 – Attractiveness of forest-based industry in NA

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

NA attractiveness

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



Figure 11 – Attractiveness of forest-based industry in NA

East / Southeast Asia was ranked first by 30% of participants and second by 37% of participants as the most competitive region. South America was ranked first by 26% of participants and second by 30% of participants. Although North America was ranked first by 37% of respondents, it was ranked second only by 11%. Europe ranks in 4th place, Northern Asia / Russia in 5th place.

NA attractiveness

Please indicate the most attractive country for the forest based industries for each category

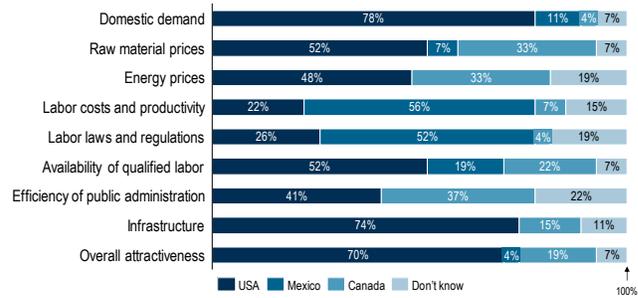


Figure 12 – Location attractiveness by topic

Within North America, the USA is, overall, the most attractive country for forest-based industries for 70% of the participants, followed by Canada (19%) and Mexico (4%). The main leading categories of attractiveness in the USA are domestic demand with 78% and infrastructure with 74%. Further categories regarding the USA's attractiveness are raw material prices (52%), availability of qualified labor (52%) and energy prices (48%). In the efficiency of public administration, the USA and Canada are nearly on the same level with 41% and 37%, respectively. In terms of labor costs & productivity, Mexico is the most attractive for 56% of the respondents. Labor laws & regulations is a further category where Mexico is considered as most attractive by 52% of the participants.

Summary

The industry is moving forward with similar if slightly more pessimistic expectations than in 2015. Nevertheless, North America remains an attractive industry location for forest-based industry players.

There are some thorns among the roses: costs are expected to increase which, in combination with higher selling prices slowing down demand in some industry sectors, will continue to put pressure on consolidation.

The positive sentiment regarding increasing selling prices is at odds with a slowing in the strength of customer demand. Companies respond to increasing customer service requirements by shifting their priorities accordingly. As in the previous year, industry consolidation through M&A activities is expected to remain one of the most important trends.

Marketing and customer service & retention and product development & innovation are the key priorities in the industry. With increasing raw material and transportation costs, cost reduction is still a priority of companies in the forest-based industry.

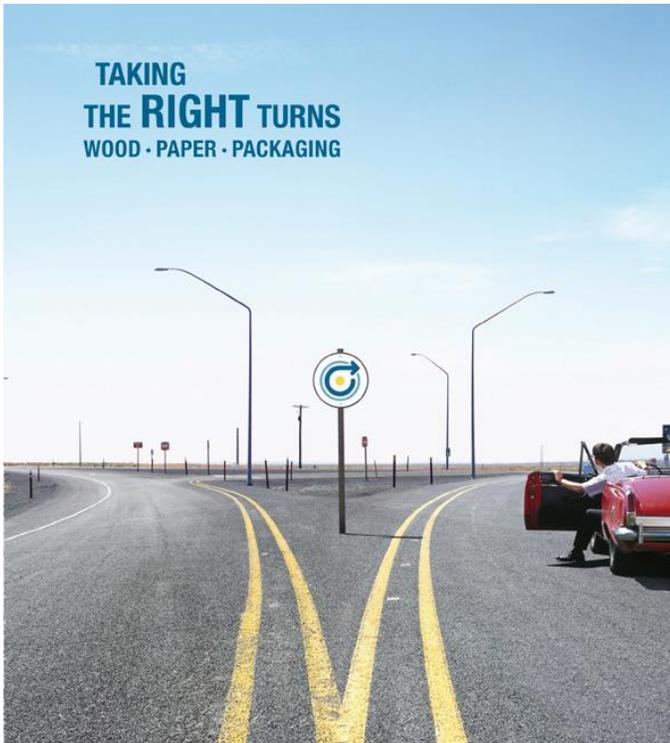
The negotiations around the finalizations of the trade agreements with the Pacific Rim countries (TPP) and with the European Union (TTIP) are currently extensively discussed topics in worldwide politics. Concerns are growing around the details of these trade partnerships both on governmental and civilian levels. In this survey, the responses of the industrial players reflect that they are not convinced by the benefits of the agreements. The majority of the participants doesn't know what will be the impact, with only few determined views on benefits or drawbacks of the agreements.

The survey further reflects that the main drivers of industry growth in North America are domestic demand and export opportunities with environmental regulations being perceived as a major threat to growth.

The clear majority of respondents perceives North America to be a more attractive or as attractive industry location compared to the rest of the world. North America was ranked number three among respondents as the most competitive regions globally for forest-based industries.

The leader role of the USA in North America appears unquestionable, with domestic demand, infrastructure, raw material prices and the availability of qualified labor the important factors where the country outperforms its neighbors.

In conclusion, the overall business outlook remains positive if fragile, with some signs of slowing industrial performance. Our survey has raised further questions as well as giving some answers: is the industry at a turning point? How will the forest-based industry look like with increasing costs, and what will happen to customer demand? Hold onto your seats ...



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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