

## Up, up, up – the only way is up?

Outlook study reveals expectations of a further strengthening of the economy in 2018: ♦ Growing demand and price increases expected for the coming year ♦ Company priorities on pricing, margin management and cost reduction ♦ talent acquisition and retention with stronger importance ♦ Europe attractive industry location due to infrastructure, qualified labor and domestic demand

### Results from the 2018 pulp and paper outlook and European competitiveness survey

Similar to previous years StepChange Consulting conducted a survey among participants of the 20<sup>th</sup> Annual RISI European Conference as well as other industry experts. The results of this survey were compared to results of the previous three years.

The outcome of the survey provides an indication about the perception of current market and economic developments in the industry, and highlights what the priorities in the industry currently are.

#### Highlights of the survey

- 62,5% of participants expect the economy in their region to strengthen within the next 12 months. 32% expect the economy to stagnate (move sideways) while 5,5% expect the economy to decline – most positive sentiment within the last four years.
- With regards to the expected development in the pulp & paper segments for 2018, participants have similar positive views: 92% of respondents from packaging-paper & board, 94% from uncoated and coated woodfree paper and all respondents from pulp manufacturing expect a positive or peaking economic development for their segment. A slightly more negative outlook can only be observed in the converting, printing & merchenting segment and in newsprint & uncoated / coated mechanical papers.
- On the cost side, the vast majority of participants foresees a cost increase in raw material and transportation.
- On the sales side, an increase in selling prices is expected by more than two thirds of respondents. Customer demand is foreseen to go up, as well as the required levels of customer service.

- Top company priorities mentioned to be pricing and margin management followed by cost reduction.
- An area that gained significant importance in the priority list vs. 2017 is sustainability development and talent acquisition and retention
- Industry 4.0 not yet taking off and remains low on priority list
- The single most important driver perceived to change the industry in the next five years are environmental and sustainability requirements, change in demand / consumer behavior and capacity development / consolidation
- Europe is seen as an attractive business location for the forest-based industry due to its infrastructure, availability of qualified labor and domestic demand

#### Survey Demographics

Over 110 respondents participated in the survey representing a wide spectrum of the industry including suppliers, manufacturers, converters, distributors and printers & publishers as well as financial services. 50% of the survey respondents are from the paper or paperboard manufacturing sector, 9% from financial and technical services and consulting, 6% from pulp manufacturing, 4% from merchenting and distribution, 7% from converting and 3% are from printing and publishing as visible in Figure 1. In the survey analysis that is to follow, it will be distinguished whether the results originate from the view pulp, paper and packaging industry only (aggregation of the responses from the categories within the orange box in Figure 1 – paper & paperboard manufacturing, converting, pulp manufacturing, forestry and wood products and printing and publishing), or all respondents.

#### Demographics

What is your specific industry segment? [%]

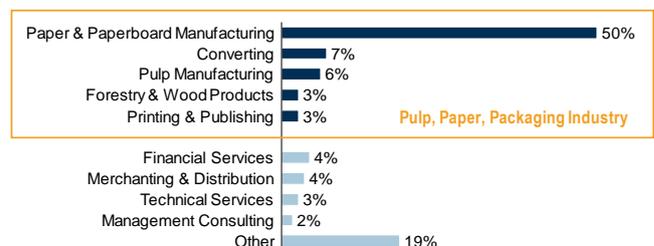


Figure 1: Demographics of respondents

Within the group of participants from paper & paperboard manufacturing (multiple answers were allowed), 48% are from the packaging sector, 22% from coated and uncoated woodfree, 15% from newsprint and uncoated/coated mechanical papers and 8% from specialty and engineered papers.

Overall, respondents from the pulp paper and packaging industry only, have a predominantly and continuously positive outlook on the economic development in Europe. Like last year, 57% of participants foresee an upward trend in the economy as visible in Figure 2. The positive expectation for the next 12 months represents a massive change of the negative trend since 2014.

#### Historical macroeconomic development

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

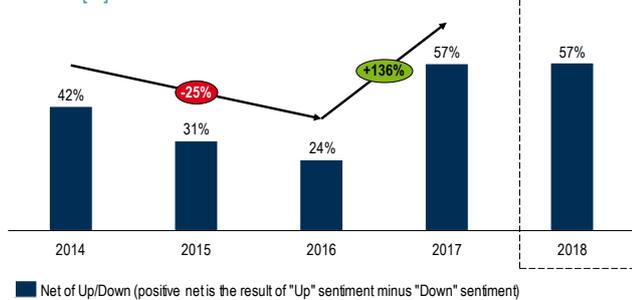


Figure 2: Historical development of macroeconomic sentiment

Taking a closer look by sub regions, a question for which all respondents to the survey were included, most optimism comes from Western and Southern Europe. 73% of the respondents from Western and Southern Europe expect the economy to increase (compared to 36% last year). 18% await a sideways development. 9% of the respondents think a negative economy development will happen. North European participants also have a positive view on the economic development in the next year, similarly to the previous year. For Eastern & South East Europe and Central Europe the outlook is equally positive as seen in Figure 3.

#### Macroeconomic development

Where do you see the economy in your region heading in the next 12 months? [%]

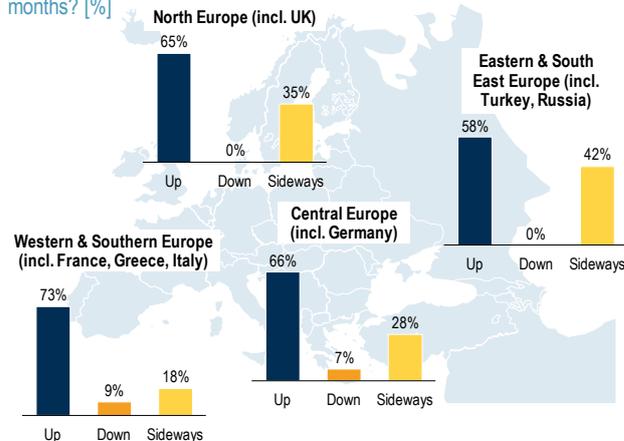


Figure 3: Economy development expectations by European region

Consequently, comparing the results from the pulp, paper and packaging industry to the results of all respondents to the survey, it becomes clear that the industry has a slightly more pessimistic economic outlook with 57% expecting an upwards development, whereas 61,5 % of all respondents foresee a positive development.

Nevertheless, the overall sentiment regarding economic development has predominantly stayed positive in all regions compared to last year.

#### Constant continuity: Positive industry development expected to continue

The specific view on the development of the paper industry in 2018 is expected to remain equally positive compared to last year. 81% of respondents believe their segment of the industry will increase or reach a peak (compared to 64% last year). This is based on industry responses alone. Only 10% of respondents perceive their respective business segment to be declining or reaching a trough compared to over 26% of respondents in 2017.

### Industry development

How will your sector of the pulp and paper industry develop in 2018? [%]

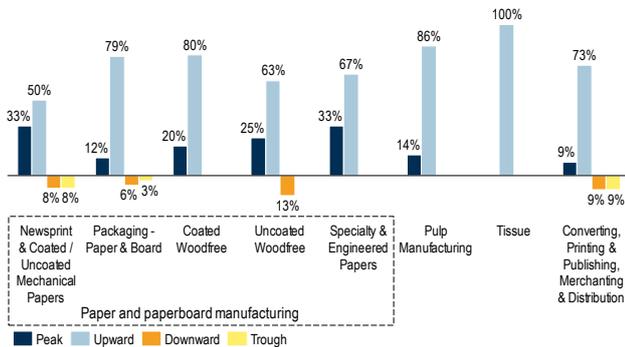


Figure 4: Pulp & paper 2017 development by industry segment

By sector and looking at responses from the industry only, packaging- paper & board, coated woodfree and pulp manufacturing and tissue have the most optimistic views in the industry, with between 90-100% in each segment expecting a positive segment development in 2018. Compared to the previous year, more respondents believe that their sector of the economy has reached a peak (packaging: 2018 – 12%, 2017 - 0%, coated woodfree: 2018 - 20%, 2017 - 0%, uncoated woodfree: 2018 - 25%, 2017 - 0%; speciality: 2018 – 33%, 2017 - 0%). A predominantly negative outlook cannot be observed in any of the segments, also newsprint(!) & uncoated / coated mechanical papers has a largely positive outlook with 83% of respondents. Only in the converting, printing & merchandising segment and uncoated woodfree segments, some negative views occurred as seen in Figure 4.

### Price expected up, and so are costs

The survey covered questions inquiring how respondents see the development of market parameters and which priorities have been defined to deal with business challenges.

On the sales side, respondents from the pulp, paper and packaging industry only were asked which trends are expected in 2018 vs. 2017 (Figure 5). First, for customer demand, a more optimistic picture occurs than in the previous year: 69% of respondents foresee a demand growth and only 13% a decline, compared to 53% and 22% in 2017. This is a more certain view on a positive demand development within the industry than in the previous year. Investigating in detail where this demand increase is originating from, 79% of respondents from packaging, 67% from specialty and engineered papers and all respondents from converting, printing and publishing, merchandising and distribution expect demand to increase. For newsprint & uncoated / coated mechanical papers (36% up), coated woodfree (25% up) and uncoated woodfree (33% up), expectations are less positive.

Looking at the selling prices, an increase is particularly expected: 74% of respondents believe that prices will increase in 2018. That is an increase of 32 percentage points compared to the previous year. Only 9% of respondents foreseeing a drop. Also investigating in detail where this expected increase in pricing is coming from, it is driven by newsprint 6 uncoated/coated mechanical papers, coated woodfree, uncoated woodfree and speciality and engineered papers. Pulp manufacturing and tissue have more moderate views (50% up each).

59% of participants responded that customer service level requirements are expected to increase further (compared to 62% in 2017).

Views on increasing late payments and bad debts have remained stable compared to the previous year, with a slight increase. Only 19% of respondents believe that it will influence the market compared to 15% in 2017.

Customer complaints are predicted to remain relatively stable with 16% expecting an increase compared to 11% in 2017.

### Industry development

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

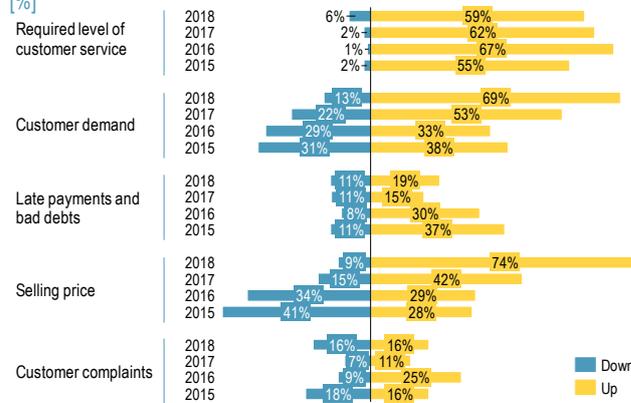


Figure 5: Historical comparison of sales related trends

### Cost trends

On the cost side, mixed trends can be observed from respondents from the pulp, paper and packaging industry only, with predicted increases and decreases in 2018 compared to 2017 as seen in Figure 6. As for raw material costs, 70% of respondents expect further increases in 2018, that is an increase of 6 percentage points compared to 2017. Also, transportation cost is predicted to increase by 66% in 2018 (49% in 2017). On the contrary, there are more ambivalent views on energy cost in 2018. 44% believe that increases will occur in 2018, that is 11

percentage points less than in 2017. Also the availability of financing is expected to go down in 2018 (14% up, 9% down).

### Industry development

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

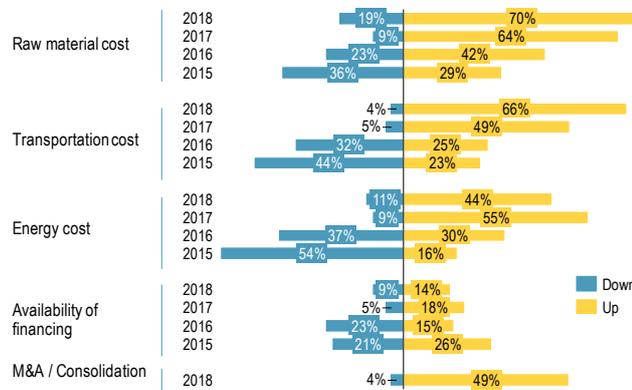


Figure 6: Historical comparison of cost related trends

### Company priorities largely focusing on price and margin management and cost reduction

Companies take both internal and external measures in order to manage profitability. For 2018, the key measures to achieve this are expected to be pricing and margin management and cost reduction by 61% and 59% of respondents respectively as seen in Figure 7. These priority listings come from respondents from the pulp, paper and packaging industry only. Product development and innovation, the key priority of companies in 2017, has been pushed to the third place in 2018, however, 44% of participants continue to see it as priority. Supply chain development reaches 4<sup>th</sup> place in 2018 with 40% of respondents naming it a priority for their company, compared to only 22% in 2017. Talent acquisition comes in in 5<sup>th</sup> place in 2018 with 34% of responses, compared to the 7<sup>th</sup> place in 2017 with only 22%. This is a significant improvement with a 50% increase in responses compared to the previous year, bringing talent acquisition and retention back to the priority list of companies. Sustainability development made the biggest relative improvement as for priorities: In 2018, 31% of participants named it as a key priority for the coming year, compared to only 16% in 2017. This is a ranking improvement from 11<sup>th</sup> to 6<sup>th</sup> place in 2018. The biggest relative drop occurred for diversification and business development. It dropped in the priority listing from 5<sup>th</sup> place in 2017 (33%) to the second last place in 2018 (16%), indicating its receding importance. Work force reduction remains unchanged on the last place on the priority list for this year. As for Industry 4.0, it is not a key priority of companies with only 17% seeing it as such.

### Industry priorities

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

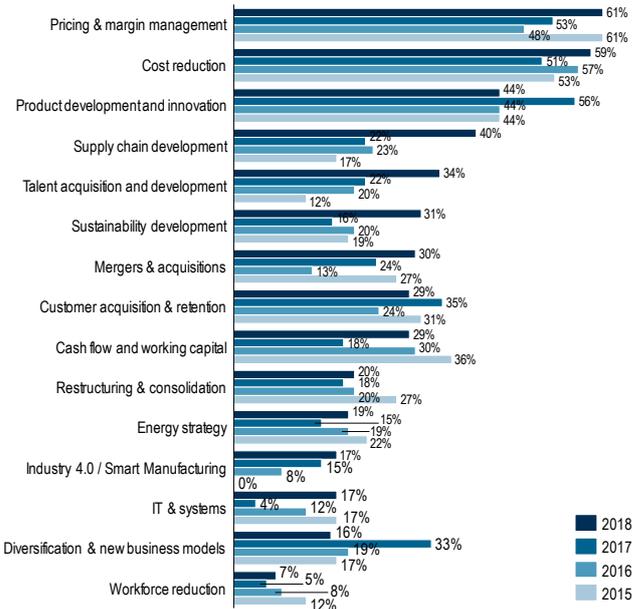


Figure 7: Historical comparison of current priorities

### Industry drivers - Outlook for the next five years

The top 3 positive industry drivers as expected through the lens of the pulp, paper and packaging industry, have not changed dramatically from the previous year. One difference is that environmental and sustainability requirements has taken over the first place in 2018 with 61% of respondents (56% in 2017) expecting it to have a positive influence on the industry over the next 5 years. Changing customer behavior and requirements follows closely in second place with 59% of respondents foreseeing its positive influence. The majority of the industry continues to expect a positive influence of capacity consolidation in the industry (54% in 2018, 52% in 2017) in the next 5 years. As for negative influences to the industry, price and margins, rising fiber costs and energy and legislation were named by the majority of the participants. Compared to last year, competition for talent and workforce qualification is increasingly seen as a challenge by the industry as seen in Figure 8.

### Industry drivers

What influence do you expect the following drivers to have on the industry in the next 5 years? [%]

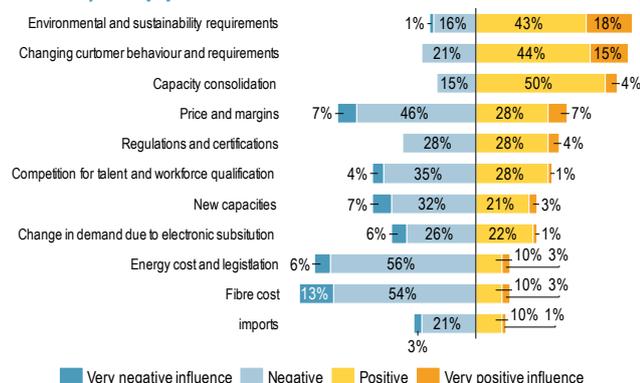


Figure 8: Expected influence by external drivers

Asked for the single most important driver that will affect or change the industry in 2018, 18% participants name the availability / cost of input materials to impact their segment in the next 5 years (Figure 9). 16% of participants noted changes in customer demand as the main driver, followed by regulations and the environment (15%). Interestingly, environment and sustainability requirements are seen as predominantly positive industry influencers in the next 5 years by the majority of respondents, however, when asked about the single most important driver, sustainability only reached the bottom of the priority list (3%).

### Industry drivers

What is the single most important driver for change that will impact your area over the next 5 years? (open question) [%]

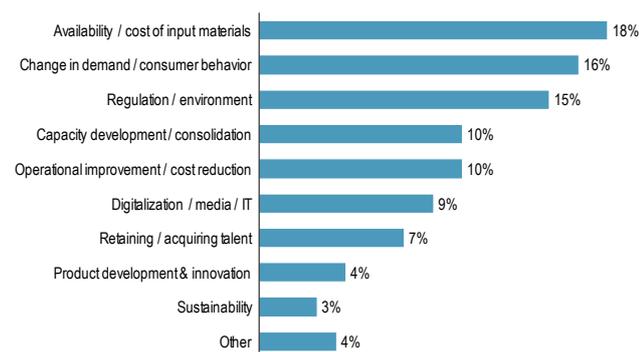


Figure 9: Single most important driver of business in next 5 years

### Competitive Europe?!

The second part of the survey addressed Europe as an industry location for the forest-based industries, its attractiveness and competitiveness on a global scale. Overall, 57% of all survey respondents see Europe as attractive as other regions, and 22% see it as more attractive. On the contrary 21% see it

as less attractive. The same question asked in our 2017 North American survey, portrayed a more confident perception of the North American Audience about their region: 41% see North America as a more attractive industry location and 43% say it is as attractive, only 16% consider North America as less attractive as seen in Figure 10.

How attractive is Europe / North America as an industry location for forest based industries, compared to the rest of the world?

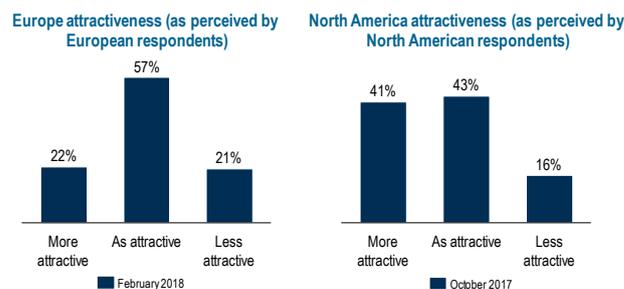


Figure 8: Europe and North America as industry locations

### European attractiveness

Please indicate Europe's attractiveness for the forest based industry in each category

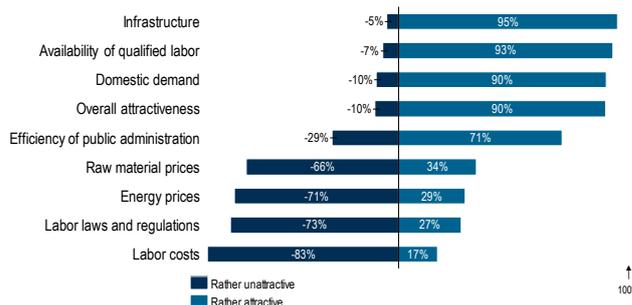


Figure 9: Europe's attractiveness as industry location - detailed

As for the specific nature of Europe's attractiveness to the forest-based industries, respondents name infrastructure (95%), availability of qualified labor (93%), domestic demand (90%), overall attractiveness (90%) and the efficiency of public administration (71%) as rather attractive features in Europe. On the downside, labor costs, labor laws and regulations as well as energy prices and raw material prices were seen as rather unattractive in Europe as can be seen in Figure 11.

Looking on a global scale, it becomes visible that neither of the two locations are considered as most competitive. Respondents agree that South America is the most competitive region for the forest-based industries globally. South America is followed by East / Southeast Asia in second place. Thereafter Europe only comes in as third competitive location in the world. Africa comes in last after Australia / New Zealand as seen in Figure 12.

#### European competitiveness

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



Figure 10: Global competitiveness of regions

### Summary and Conclusions

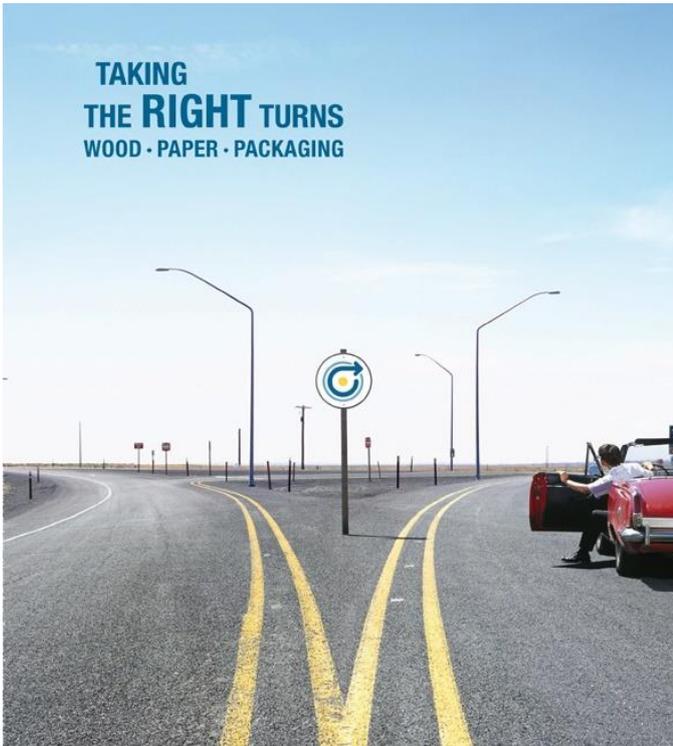
The pulp and paper survey revealed a very positive view about macroeconomic developments in 2018. In particular, Western and Southern Europe and Northern Europe as regions are most optimistic about the economic developments. The sentiments have further improved compared to the previous year.

The survey shows some interesting continuations of various trends from the previous year. As in the previous year, the increasing cost trend is expected to continue during 2018. The picture is clearest in raw material where the vast majority of respondents anticipate a further cost increase in 2018. A growing share of participants also expect transportation costs to increase further.

The top industry priorities have remained the same compared to previous years, only the order at the top has slightly changed. In 2018, pricing and margin management and cost reduction are again on place 1 and 2 on the priority list. This also goes hand in hand with the expected selling price increases and the rising raw material costs.

The rising priority of Supply Chain Management and talent acquisition probably indicates the reaction of the industry on increased transport costs in 2017 and a fiercer competition in attracting and developing talent.

All in all, the outlook survey shows a rosy outlook as for economic development for the current year. However, cost management may represent a thorn in the picture of economic growth.



### 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](mailto:leapfrog@stepchange.com).



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