

## Full steam ahead or time to take a breath?

**Signs of slowing growth ♦ Pricing, product development, and M&A key priorities ♦ US confirmed as most attractive region ♦ North America ranked most competitive location globally ♦ Skepticism about benefit of Smart Manufacturing**

StepChange Consulting conducted a survey amongst industry managers, stakeholders and participants of the 33<sup>rd</sup> Annual RISI North American Forest Products Conference. Results were compared to surveys from prior years providing an analysis of long term trends.

The outcome of the survey provides an indication about the perception of current economic and market developments and provides insight about current company priorities. Additionally, the survey provides a viewpoint about the competitiveness of North America as a location for the forest-based industries.

### Key highlights of the survey results

- Expectations are more skeptical compared to last year: 49% of respondents believe that their area of the industry is on an upward trend compared to 60% in 2017. It is the lowest expectation since 2014. The number of respondents expecting a peak increased from 9% to 21%.
- 63% of respondents expect increasing customer demand for the upcoming year
- 54% of respondents expect selling prices to continue to go up
- Increasing costs continue to be the main concern: 73% of respondents expect higher raw material costs, and 78% expect higher transportation costs – nevertheless, cost reduction dropped further from 5<sup>th</sup> to 7<sup>th</sup> place when it comes to company priorities.
- Industry consolidation through M&A expected to be ongoing, with a slight increase from 55% to 57%. At the same time M&A is a key company priority for 42% of respondents (up 10pp).
- Company priorities are centered around “pricing & margin management”, “product development & innovation”, and “M&A”

- Respondents continue to consider domestic demand and export opportunities as two of the most important factors impacting industry growth in North America
- Raw material prices and availability of labor are considered to be the major barriers to growth. For labor costs, labor laws and productivity, Mexico is considered more attractive than the US or Canada. Despite ambivalent views on energy prices being a barrier to growth, US energy prices were considered the most favorable, compared to energy prices in Canada and Mexico.
- Respondents consider the Americas the most competitive region in the forest-based industry globally, with North America in first, and South America in second place
- 89% of participants believe that North America is more or equally attractive as an industry location compared to 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. 31% of respondents are from paper & paperboard manufacturing and converting, 21% from services, 18% from forestry & wood products. Where appropriate, responses from categories with a direct industry affiliation were evaluated separately.

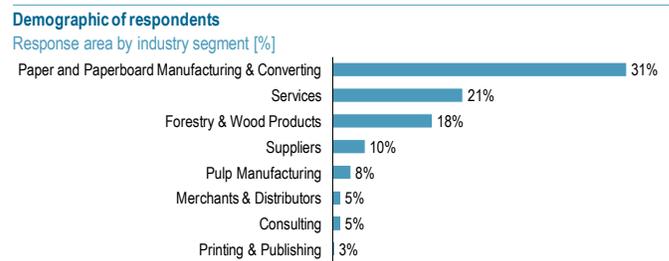


Figure 1 – Demographic of respondents

### Optimism on hold

Almost half of all respondents expect a positive outlook and believe their sector is in an upward trend (49%). However, 21% of participants considered their business area to be peaking. Less than one third of respondents expect a rather negative outlook and believe that their segment of the industry is on a downward trend (28%) or trough (3%).

Reflecting a more pessimistic perspective compared to 2017 and the previous years, the share of respondents who see the industry in an upward trend is now below 50% for the first time since 2014. This is in line with the increased share of respondents currently perceiving a peak, and those experiencing a downward trend.

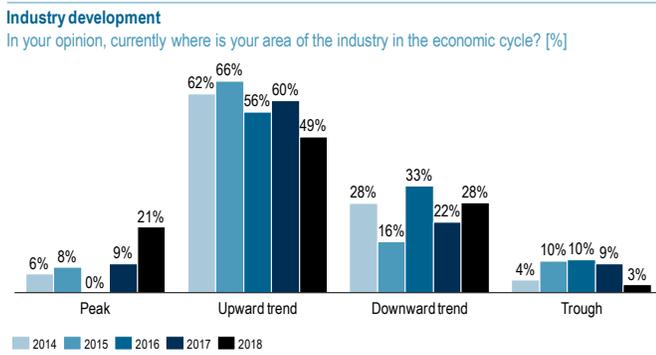


Figure 2 – Pulp and paper economic cycle position

Less than half of the respondents (46%) from the forest and wood sector see their area moving upwards, while 31% believe the industry has reached its peak. The respondents from the paper and paperboard sector have an ambivalent view: 54% believe that the industry is currently in an upward trend. On the other side 31% of respondents consider their industry to be in a downward trend, while 15% see that a peak has been reached.

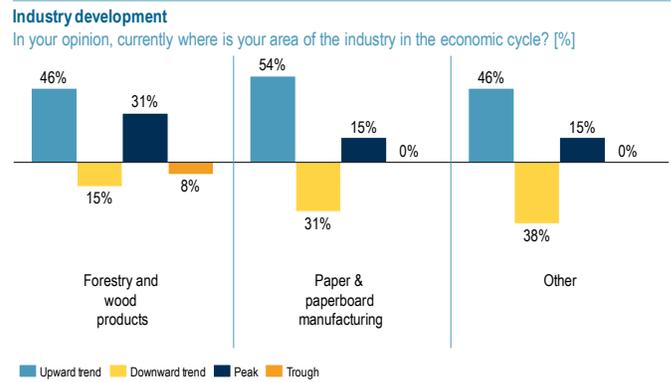


Figure 3 – Pulp and paper economic cycle position

### Demand and price are up - and so are costs

Like in previous years, participants see a continued increase in costs. 73% of participants expect raw material costs to increase (vs. 76% in 2017) while only 11% see decreasing costs. 78% of respondents state that transport costs are increasing, while 8% believe they are decreasing. Regarding availability of financing 35% see an upward trend with only 16% seeing a decreasing availability of financing.

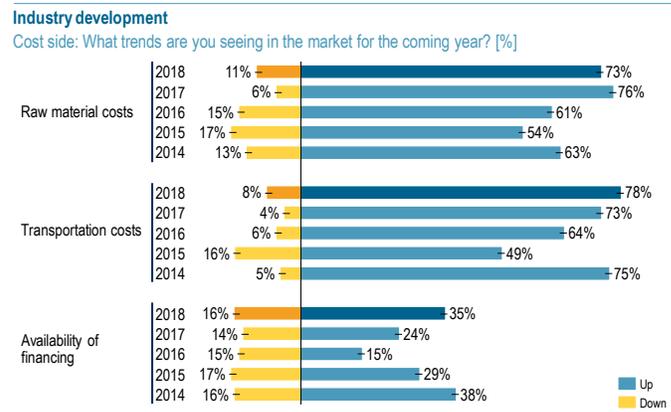


Figure 4 – Historical comparison of cost related trends

A notable outcome of this study is the continued positive view on demand. 63% (vs. 69% in 2017) of respondents expect an increase in demand with only 14% of participants expecting decreasing demand.

As in previous years, most participants still see increasing customer service levels. 68% expect customer service levels to remain a priority. Over the past five years, almost no participant has indicated a decreasing level of customer service.

Compared to 2017 year, a little more pessimistic view can be noticed on the sales side with 54% of participants expecting higher selling prices, while 24% expecting lower prices.

M&A activities and industry consolidation are expected to continue by 57% of respondents.

After a peak in 2015, late payment & bad debt is expected to slightly increase by 22% of participants with a highest share of participants (19%) since 2014 who see a decrease.

This year 16% of respondents expect an increasing level of customer complaints, while 22% expect a decrease, which is the second highest result since 2014.

### Industry development

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

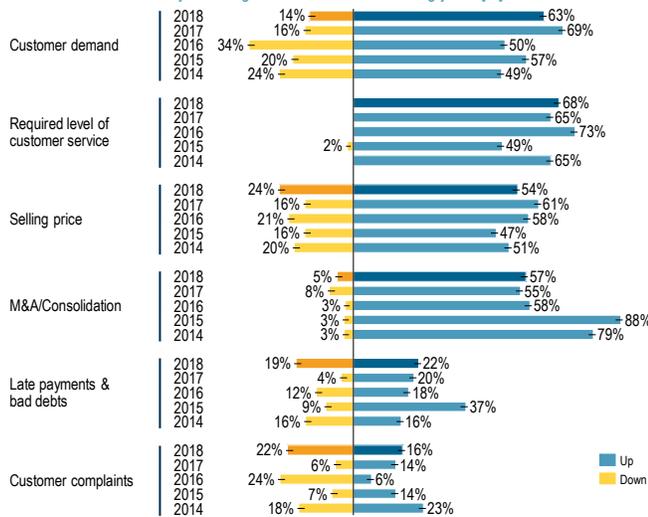


Figure 5 – Historical development of sales related trends

### 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 an industry-specific view.

The top three priority areas in 2018 are pricing & margin management (53% compared to 54% in 2017), product development and innovation (42% compared to 46% in 2017) and mergers & acquisitions (42% compared to 32% in 2017).

Cost reduction has lost its priority continuously since 2015, when it was ranked in first place (72%), and recently moved to seventh place in 2018 (25%). Mergers & acquisitions reached six years’ highest result in 2018. Talent acquisition and development is

considered within the company priorities by one third of the participants.

Digitalization / Smart Manufacturing only mentioned by 17% as a top priority, even with a slight decrease vs. 2017. The importance of work force reduction declined steeply in 2017 by 17 percentage points to 4% of respondents considering it a company priority and remained at 6% in 2018.

Restructuring and consolidation is gaining importance after a two-years trough at 7%, currently seen as important by 17% of respondents.

### Industry priorities

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

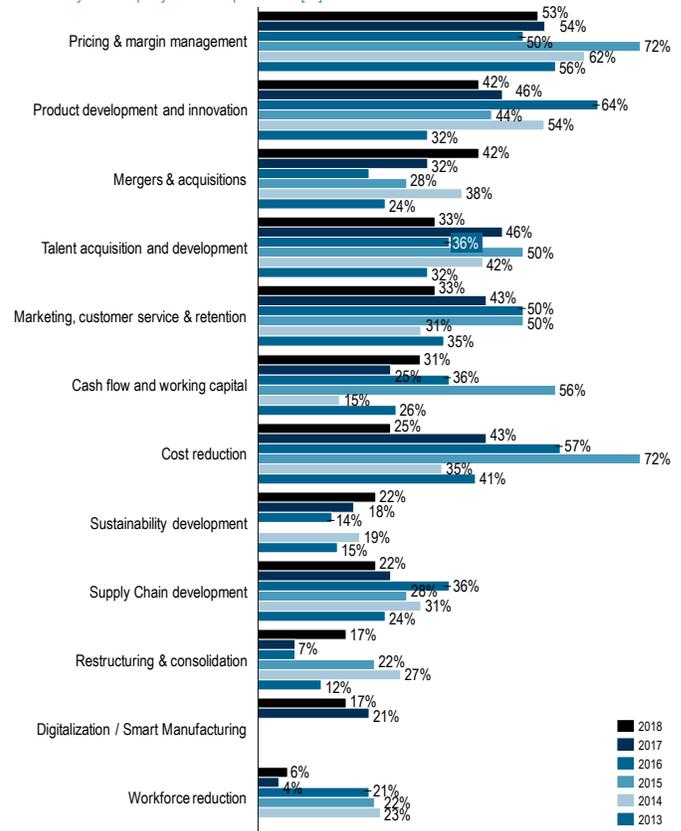


Figure 6 – Historical comparison of current priorities

### Drivers and barriers to growth in North America

Domestic demand is considered the biggest driver of growth (58%), while only 12% 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.

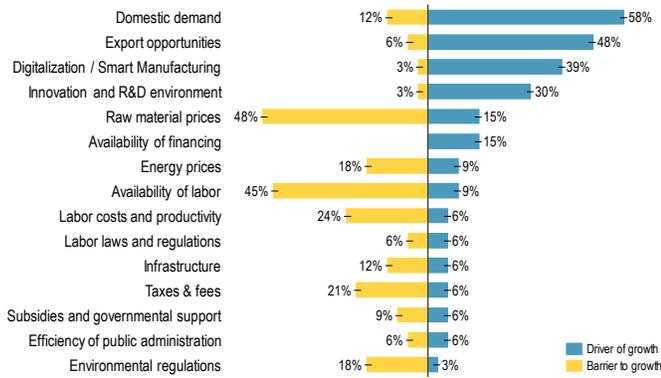


Figure 7 – Growth factors of forest-based industries in NA

Export opportunities and Digitalization / Smart Manufacturing are perceived as the second and third most important growth drivers by 48% and 39% of respondents, respectively.

The most significant growth barriers for the survey respondents are raw material prices (48%), followed by the availability of labor and labor costs (45%) and productivity (24%).

Looking at the most significant changes compared to 2017, raw material prices are considered as a barrier to growth, from 36% of respondents in 2017 to 48% in 2018. Also, the perception of taxes & fees as a barrier increased from 6% in 2017 to 21% in 2018.

### North America most attractive for Pulp and Paper industry

45% of participants rate North America as being more attractive for forest-based industries than all other global regions and further 34% of respondents state that North America is at least 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?

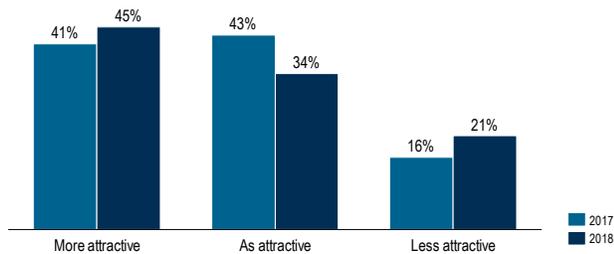


Figure 8 – Attractiveness of forest-based industry in NA

On global level, the attractiveness of regions remained almost unchanged: both in 2017 and 2018, the Americas were rated as the most competitive regions for the forest-based industry, with North America in first place, and South America in second place. On third and fourth ranks Europe and East / Southeast Asia switched places, the ranking of the remaining regions did not change compared to 2017. As in previous years, the region considered to be least competitive is Africa.

#### NA attractiveness

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



Figure 9 – Attractiveness of forest-based industry in NA

North America was ranked first by 59% of participants and second by 17% of participants as the most competitive region. South America was ranked first by 21% of participants and second by 17% of participants. Europe was ranked first by 3% of respondents.

#### NA attractiveness

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

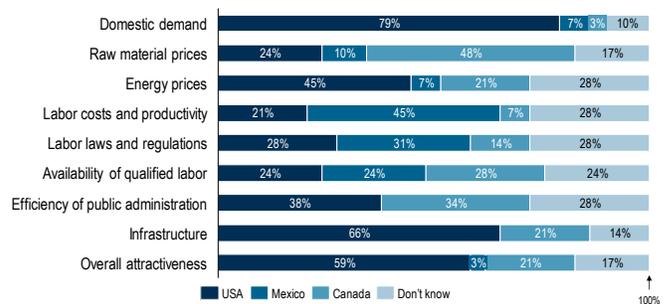


Figure 10 – Location attractiveness by topic

Within North America, the USA is rated the most attractive country for forest-based industries by 59% of the participants, followed by Canada (21%). The main leading categories of attractiveness in the USA are domestic demand with 79% and infrastructure with 66%. Further categories regarding the US attractiveness are energy prices (45%) and efficiency of public

administration (38%). Regarding raw material prices, Canada has been ranked as most attractive by 48% of respondents. Mexico is considered the most attractive region regarding labor costs and productivity, and labor laws and regulations by 45% and 31% of respondents, respectively.

### Digitalization / Smart Manufacturing

Respondents have a skeptical view on the current status and potential benefits of Digitalization / Smart Manufacturing. A little less than one third of the respondents have a clearly formulated strategy on digitalization. Simultaneously, almost half of the participants expect Digitalization / Smart Manufacturing to transform their supply-chain.

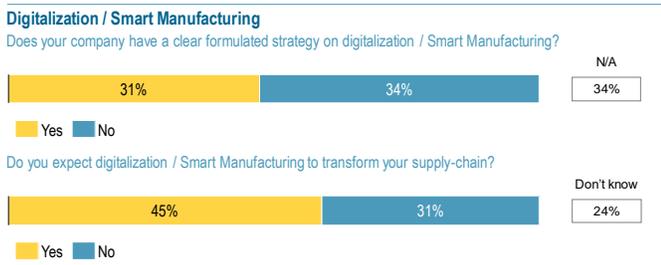


Figure 11 – Strategy on digitalization and its effect on supply-chain

There is a scattered picture among the respondents regarding the expected benefits from digitalization / Smart Manufacturing. A little more than half of the participants see a cost reduction benefit, while 24% don't see any benefit at all. Further expected benefits are sales growth, new products and energy efficiency.

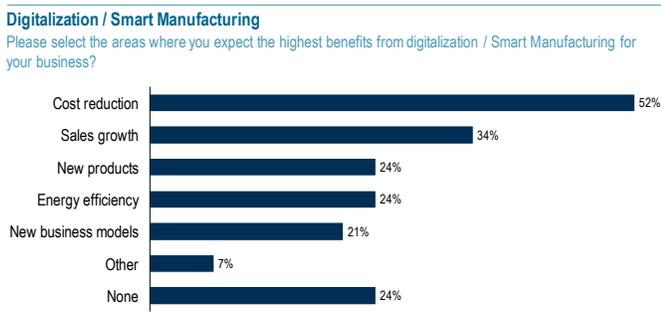


Figure 12: Expected benefits from digitalization / Smart Manufacturing

### Summary

The industry has slightly less optimistic expectations than in 2017. In 2018, North America was considered the most

competitive industry-location globally for the forest-based sector. The business development expectations are very optimistic: Survey respondents expect demand and prices to increase, however with a more moderate rate than in 2017.

Companies continue to focus on customer and marketing related priorities with an increasing priority on mergers & acquisitions. Main priorities are around pricing & margin management. Despite increasing costs, cost reduction has dropped dramatically as a company priority. Despite a further drop of product development and innovation as a company priority, it is still amongst top three priorities.

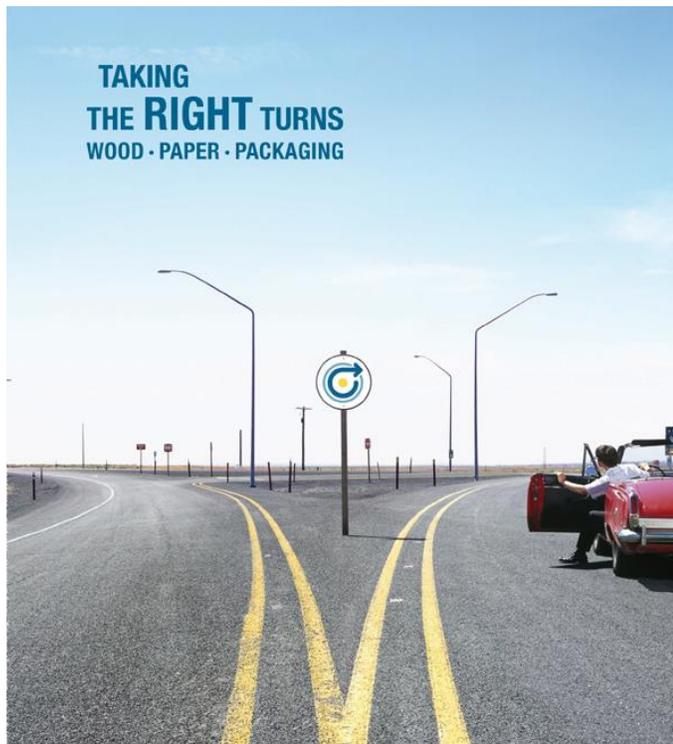
The survey further reflects that the main drivers of industry growth in North America are domestic demand and export opportunities. For most respondents, North America is more attractive as an industry location compared to the rest of the world. In addition, North America was ranked number one among respondents as the most competitive region globally for forest-based industries, with South America in second place.

The perception of the US as the leading region is stable compared to 2017. Domestic demand, infrastructure, and energy prices are considered the key drivers of competitiveness. The increased raw material prices make Canada the most attractive country in this perspective. However, the US are still the most attractive country overall in North America.

The benefits of Digitalization / Smart Manufacturing are not perceived equally among respondents. More than half of the respondents expect digitalization to support cost reduction initiatives, around one third expect it to support sales growth. At the same time around a quarter of the respondents don't expect any benefit from digitalization.

Cost reduction is seen as a benefit by the majority, however, almost a quarter of respondents do not see any benefits. On the other hand, it is considered as the third most important factor impacting growth in North America.

In conclusion, the overall business outlook is a little less positive compared to previous years but remains promising. However, some responses are showing signs of slowing growth and a peaking industry. The slowdown of growth seems to be somehow consequent after years of continuous growth. One of the probably most important questions that remain is, which scenario we need to expect – a long-lasting phase of stable success or even further growth, or a negative wave that might contain setbacks?



### About StepChange Consulting

StepChange is an industry focused and independent management consultancy specialized on pulp, paper and packaging with a proven track record to turn strategy into increased shareholder value.

StepChange provides support to leading organizations in the industry from strategy development to implementation of operational improvements. With an international team of industry experts StepChange will hit the ground running. StepChange develops 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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