

A new Dawn?

Economic survey reveals upward trend, sustainability a necessity for future competitiveness

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

StepChange Consulting conducted a survey among the participants of the 27th Annual RISI North American Forest Products Conference in October 2012 in Boston, the results of which have been compared to last year's survey in order to 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 being taken to address the issues.

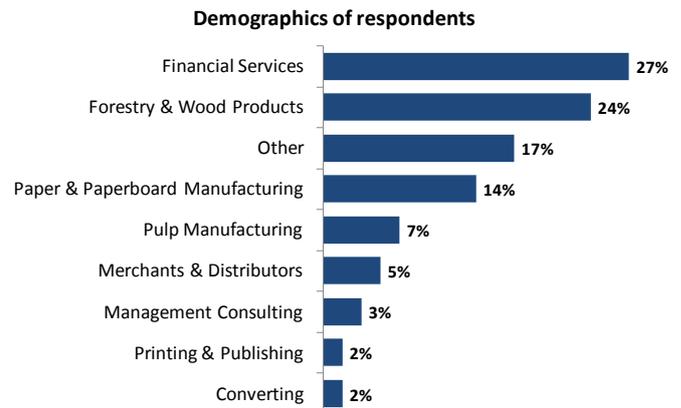
The headlines of the economic outlook survey results are:

- Improved expectations: Slightly more than two thirds 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. One third of respondents, however, believe that the economy is either in a downward trend or trough.
- 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.
- Slightly less than half of the respondents indicate that customer demand and selling price are up.
- Respondents see high raw material and transportation costs and as well feel the pressure of required levels of customer service increasing.
- Measures to address developments are focused externally and internally. Areas of focus being pricing & margin management, cash flow & working capital and product development & innovation which all have gained significantly more importance compared to 2011 results
- Cost reduction, talent management and sustainability are the areas of focus that have dropped considerably in importance of respondents compared to 2011.
- M&A activity, restructuring and consolidation have gained slightly more importance compared to 2011.
- Compared to the small number of respondents (7%) who stated that workforce reduction is in focus in 2011, no respondent believes that this is an area of focus for 2012.

Sustainability survey results:

- Almost half of the participants 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 half 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
- The same amount of respondents disagree with the statement that sustainability targets set by public discussion are realistic and achievable
- Slightly less than half of respondents share a neutral opinion to the question whether companies are 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.

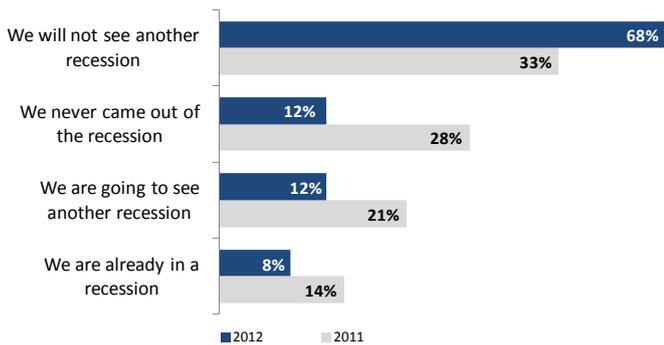


Half of the survey respondents either belong to the financial services sector (27%), or are working within the forestry & wood products sector (24%).

Almost one third of respondents in the "Other" category (17%) are working in the transportation business. 14% of respondents are working in paper & paperboard manufacturing. Within this group, more than half of the respondents work for graphic paper producers and one fifth each for packaging/board producers and specialty paper producers.

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?



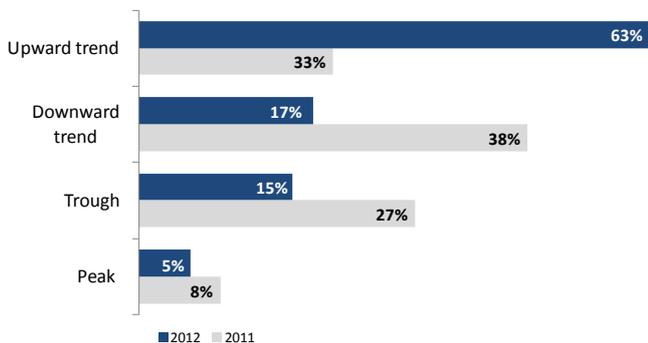
Slightly over two thirds (68%) of respondents believe that we will not see another recession within the next 12 months. However, one third of respondents believe that we never came out of the last recession (12%), we are going to see another recession (12%) or that we are already in a recession (8%).

Compared to 2011, the number of respondents who believe that we will not see another recession has increased by a remarkable 35%. Overall, 43% of the respondents who do not expect another recession work either in paper & paperboard manufacturing, pulp manufacturing or for the forestry & wood products sector. One fourth of respondents who indicate that we will not see another recession work in the financial services industry.

Taking a closer look at only the paper & paperboard manufacturers, 63% believe that we will not see another recession, 13% indicate that we will see another recession and 25% believe that we never came out of the last recession.

Overall the financial services sector is more positive than the rest of the respondents.

Question 2: In your opinion, currently where is your area of the industry in the economic cycle?



More than two thirds of respondents believe their sector is on an upward trend (63%) or at a peak (5%). One third of respondents have a rather negative outlook and believe their segment of the industry is in a trough (15%) or on a downward trend (17%).

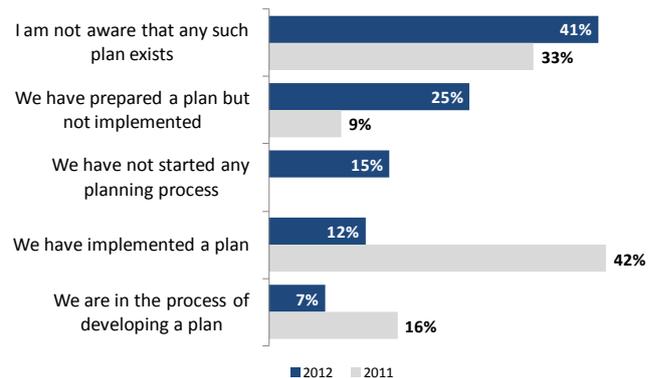
Compared to last year, the number of respondents who see the economy on an upward trend has nearly dou-

bled, even though slightly fewer respondents than in 2011 believe that the economy currently peaks.

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

From the paper & paperboard manufacturers, packaging - paper & board seems to be pleased with the current economy, whereas the graphic paper segment is rather negative about the current economic situation.

Question 3: Is your company planning for a recession?



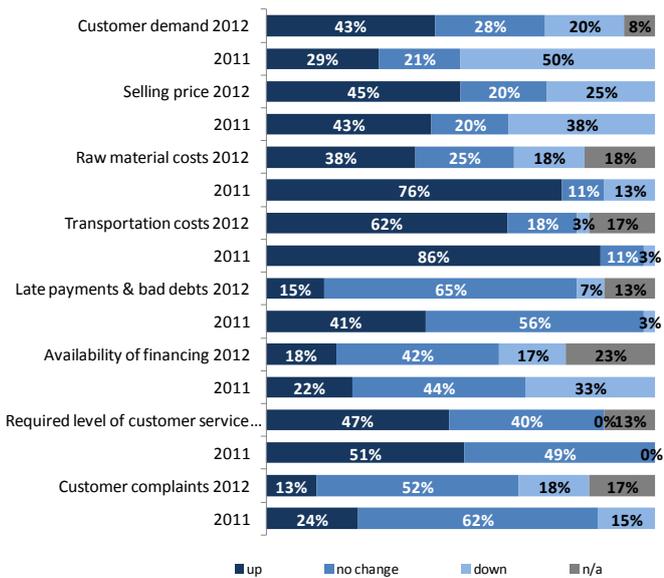
Results for the current year clearly demonstrate that the majority of industry sectors do not seem to be concerned about an upcoming recession. Only 12% of respondents indicate that their company has implemented a plan. 25% have prepared a plan but not implemented and 7% are in the process of developing a plan. However, more than 50% of respondents mention that they are not aware that any such plan exists (41%) or that they have not started any planning process yet (15%).

There seems to be a major change compared to 2011 in that almost four times less respondents in this year's survey stated that they have implemented a plan to deal with recessive markets.

Still preparing for an upcoming recession are mainly the respondents from the graphic paper sector. Taking a closer look at the participants who answered that they are not aware of any plan, more than one third 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 (17%), 30% answered that their company has not yet started any planning process, or they are not aware that any plans exist. 50% have prepared a plan, or are in the process of preparing a plan. The remaining 20% have already implemented a plan.

Question 4: What trends are you seeing in the market relative to last calendar year (Growth and Profit enablers)?

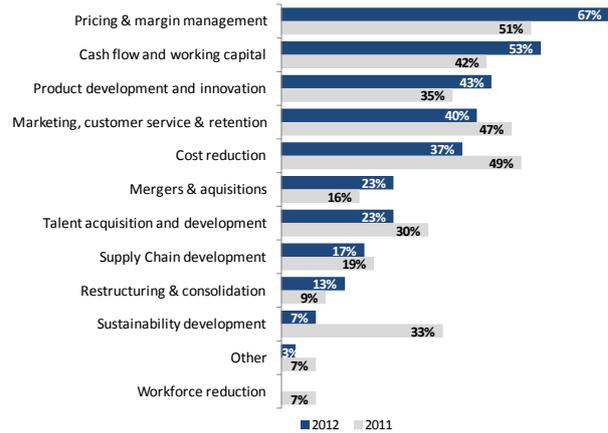


In all cost categories participants are signaling increasing costs, although with fewer respondents agree than in 2011. 62% of respondents say that transportation costs went up and 38% answer that raw material costs also increased. However, compared to 2011, both numbers decreased by 24% and 38% respectively.

Half of the respondents say customer service requirements have increased (similar to 2011). Another positive sign in 2012 is that 43% of respondents indicate that customer demand has increased, compared to 29% in 2011. Additionally, only 13% of the responses indicate that customer complaints have increased as well (down 11% from 2011). Regarding selling price, respondents are polarized. 45% of respondents indicate that the selling price is up compared to 25% who answer that it went down. In more detail, more than one third of respondents who see increasing selling prices are from the forestry & wood products sector or paper and paperboard manufacturers.

Similar to 2011, late payments and bad debts and the availability of financing seem to remain unchanged for the majority of respondents with a tendency towards improved payment behavior in 2012. Interestingly, availability of financing has not increased although general economic expectations are quite positive.

Question 5: What are your company's current priorities?



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. Top priority with even more significance remained pricing and margin management (67%). Cash flow and working capital management (53%) gained relevance which appears to be in line with previously stated availability of financing. Respondents further identified customer service and retention (50%) as a top priority for their company along with liquidity management (47%). In 2011, respondents indicated similar top priorities. With still increasing cost pressures (see question 4) it is surprising to see, that cost 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.

Surprisingly, sustainability development, 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.

Mergers & acquisitions improved in priority among survey respondents compared to 2011 and went from 16% up to 23%.

Only 23% of respondents seem to continue to focus on talent acquisition and development. In 2011 this was a priority for 30% of respondents. 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.

Supply chain development decreased slightly in 2012 to 17%, compared to 19% in 2011.

While industry sectors have differing priorities, all sectors share the view that pricing & margin management is a top priority, except for the printing & publishing sec-

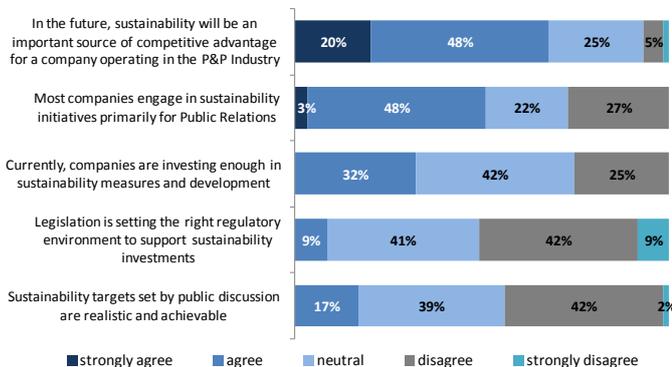
tor. Paper & paperboard manufacturers indicate two main priorities. 88% of the respondents state working capital management as a top priority, directly followed by 75% who indicate pricing & margin management as another top priority. For the respondents of the forestry & wood products sector, 57% indicate pricing & margin management is top priority. Half of the respondents from this sector stated as second highest priority customer service & retention, cash flow and working capital management as well as cost reduction.

Respondents from non pulp and paper related industry sectors (e.g. financial services) believe that customer service & retention (50%) and cash flow and working capital management (50%) are top priorities.

Survey results about sustainability in the forest products industry:

The two main topics of the Rio+20 Conference, held in Rio de Janeiro in June 2012, were the institutional framework for sustainable development and a green economy in the context of sustainable development & poverty eradication. Therefore, the goal of this survey section was to explore how companies in the paper and forestry industry currently engage in sustainability initiatives.

Question 6: Sustainability - How do you evaluate the following statements?



More than two thirds of respondents (68%) 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. 25% share a neutral opinion about this topic.

Slightly more than half of the respondents (51%) agree with the statement that most companies engage in sustainability initiatives primarily for public relations. Only one fourth (27%) does not agree with this statement.

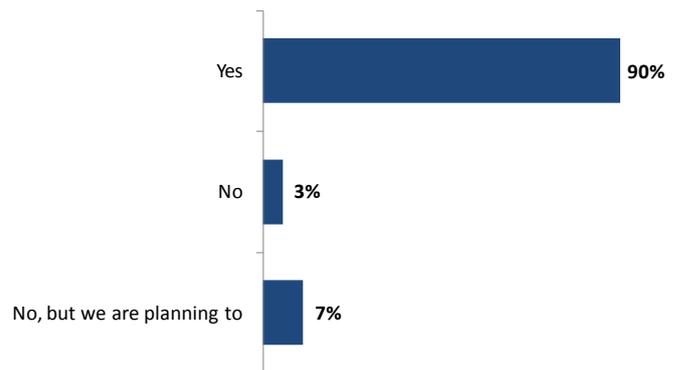
Respondents seem to be polarized concerning the question whether companies are currently investing enough in sustainability measures and development. While almost one third (32%) agree with this statement, one fourth (25%) do not agree and almost half of respondents (42%) have a neutral opinion.

Participants of the survey seem to agree that legislation is not setting the right regulatory environment to sup-

port sustainability investments. Only 9% agree that they are, in contrast to more than half of respondents (51%) who think they are not setting the right regulatory environment.

A similar picture can be observed for the last question, whether sustainability targets set by public discussion are realistic and achievable. Only 17% agree versus 44% who disagree or even strongly disagree.

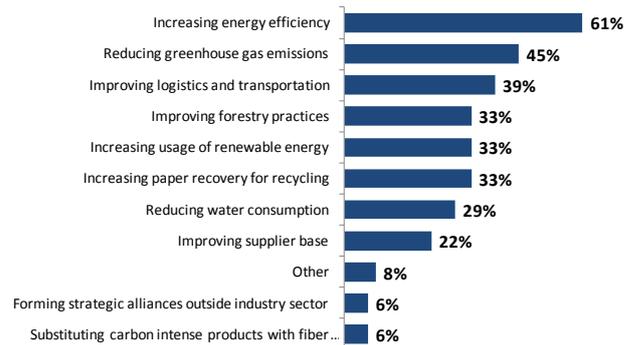
Question 7: Sustainability - Is your company currently participating in a sustainability initiative?



Although only 7% of respondents to question 5 see sustainability development as a priority within their company, 90% of survey participants indicate that their company is currently participating in a sustainability initiative. Only 10% of participants from 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: Sustainability - Please specify the focus areas of your company's sustainability initiatives



For respondents, the top three focus areas for sustainability initiatives are within the areas of energy efficiency (61%), reduction of greenhouse emissions (45%) and improving logistics and transportation (39%). For the paper industry being an energy intensive industry this is not a big surprise.

Improving forestry practices, increasing the usage of renewable energy and increasing paper recovery for

recycling are seen as focus areas by 33% of respondents.

The reduction of water consumption as well as improving the supplier base is important for 29% and 22% of respondents respectively.

Summary

In summary, the industry seems to go forward with far more positive expectations than in 2011. Most respondents do not see a recession in progress or on the horizon within the next year, which could have been expected given the US debts and uncertainties around the Euro Zone. For this seem reason, most companies probably do not see the necessity to get prepared or implement a plan for an upcoming recession.

The overall economy and pressures in the areas of increasing costs and increasing customer service requirements 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 working capital management and product development and innovation.

Cost reduction has lost the most importance in terms of priorities it had in the prior year along with sustainability development and talent management.

Mergers and acquisitions were mentioned as a priority more often than in 2011 but still by only a few respondents.

The last questions of the survey reflect that sustainability is of importance to the industry. Interestingly nine out of ten survey participants 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 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 leafrog@stepchange.com.