Recovery or Recession?
Tactics Dominate Strategy

With further uncertainty ahead companies focus on tactical measures
Results from Q4-2023 StepChange Economic Outlook Industry Study

StepChange CONSULTING

Uncertain outlook | Customer and demand management in focus | Raw material and energy costs expected to rise again | Companies prioritize tactical measures over strategic topics | Geopolitics continued topic of concern | Digitalization and Sustainability less of a priority than in previous years | Workforce reduction back in scope

The following publication is based on the global economic outlook study conducted in October 2023 amongst top managers and decision makers in the wider forest products industry (wood, pulp, paper, packaging, tissue), including participants of the International Containerboard Conference in Chicago. Over 95% of the respondents are top executives or in managerial roles (75% and 20% respectively).

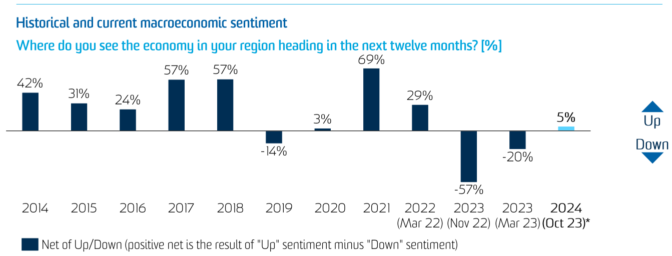
The aim of the survey is to gauge the sentiment regarding macroeconomic expectations for 2024 as well as corporate trends and priorities. The second part of the survey is dedicated to the subject of digitalization and sustainability.

Highlights of the study

- Macroeconomic outlook uncertain
- Main focus of companies on demand and margins
- Industry expectations slightly improved, although many believe that the trough lies ahead
- Energy, transportation, and raw material costs expected to rise once again
- Reduced availability of financing expected
- Industry consolidation considered a positive influencer to drive the industry in upcoming years
- Geopolitical tensions are a growing source of concern

Rock bottom or turnaround?

The general macroeconomic outlook has improved relative to the previous studies. Since the November 2022 survey, which showed the most negative all-time sentiment, the sentiment has continuously improved again, even from a low level. Most respondents expect the economy in their region to stagnate or grow slightly, but not deteriorate. [see Figure 1].



*Date in brackets signifies date of survey response collection – responses concern following year

Figure 1: Macroeconomic development

The industry outlook is mixed. Many respondents believe that pulp, paper, and packaging will either reach a trough in 2024 or experience a further decline, although almost the same number of respondents expect an increase. The paper & paperboard segment is the most optimistic, with nearly 60% of the respondents expecting to see an improvement. [see **Figure 2**: Outlook on industry segment development].

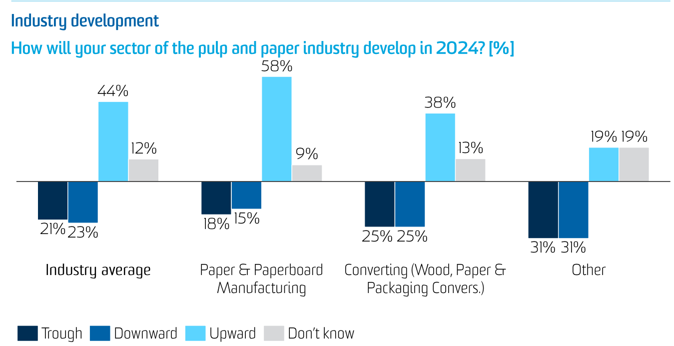


Figure 2: Outlook on industry segment development

In the three prior studies over the last two years the industry outlook has been far more pessimistic. A year ago, only ~14% of respondents expected to see an improvement for 2023 (12% for paper and paperboard manufacturing).

Market related trends show a varied picture- views on customer demand are divided, with a similar number of respondents expecting an increase and a drop. Many expect that costs will rise again after perceived drops in 2023 (especially energy and raw material costs). Availability of financing is further expected to drop as interest rates remain high and late payments/bad debts are expected to increase. [see **Figure 3**].

In general, the negative trends that were very prominent in 2023 responses to the study are no longer as negatively perceived, suggesting the outlook has slightly improved. While prices are mostly considered to drop further, the outlook on demand is slightly net positive. Strategic trends like sustainability, digitalization and diversity are expected to increase even if responses here do not fully align with company priorities [see Figure 5].

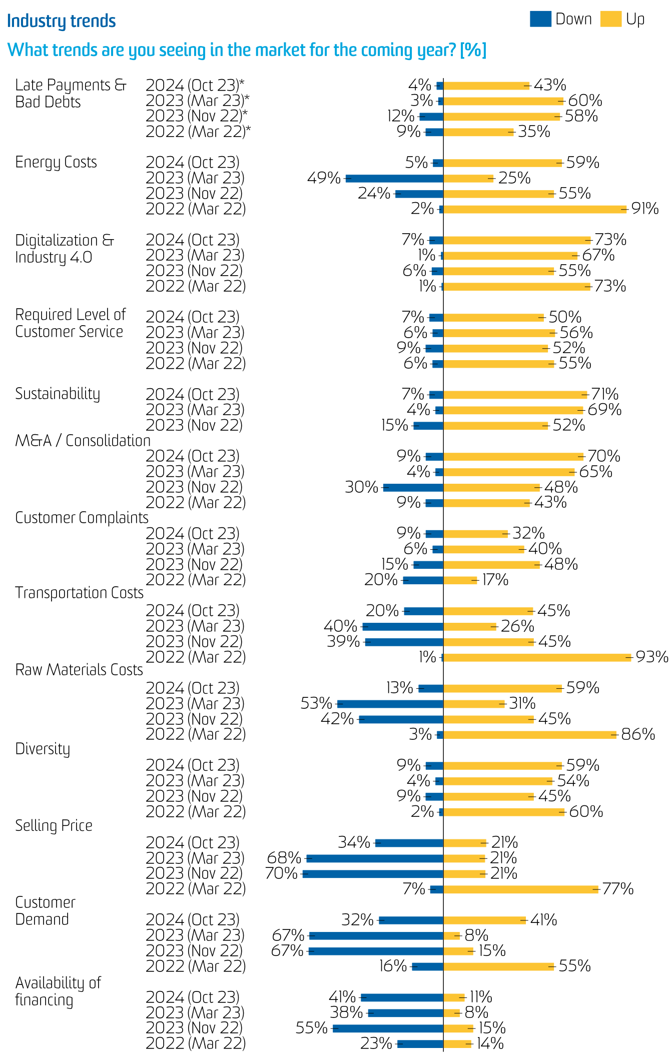


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Figure 3: Industry trends

2023 was a complicated year for many companies in the industry in a post-corona world, where the effects of the war in Ukraine and geopolitical tensions translated into sluggish global demand, which subsequently also impacted pulp, paper, and packaging. As seen in the latest B3NCH publication (a comparison of financial performance of 70+ stock listed companies in various segments), all peer groups experienced a drop in profitability relative to the previous year, except for flexible (plastic) packaging [see Figure 4]. However, in light of current global challenges, results have still remained on unexpectedly high levels considering 10+ years.

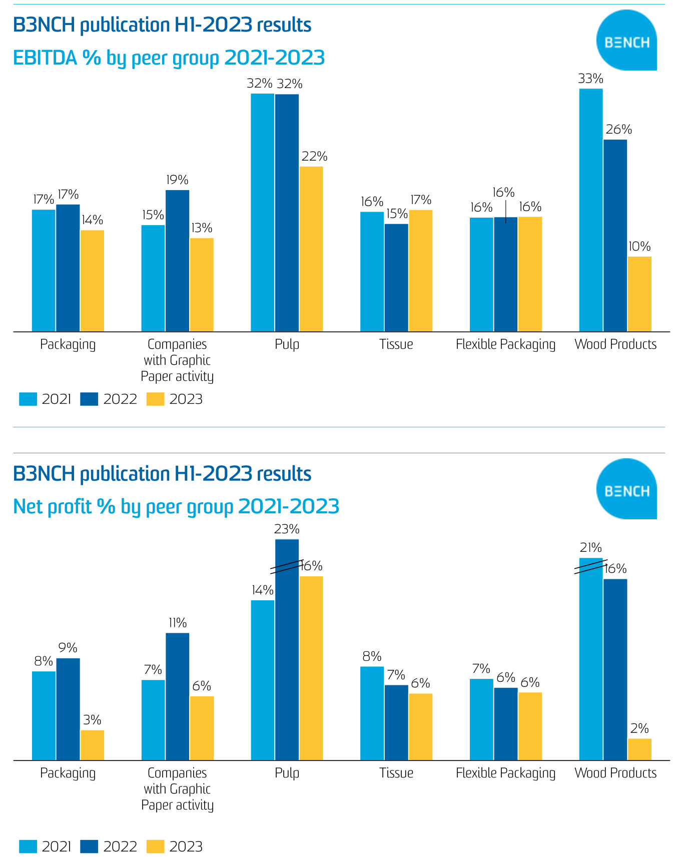

Figure 4: 2020-2022 EBITDA & Net profit % by B3NCH peer group

Wood products is a segment that struggled particularly in the first two quarters of 2023- net profit fell to a mere 2% in comparison to long-term (demand-, supply chain- and pandemic-driven) records of 21% and 16% in 2022 and 2021, respectively.

A shift in company priorities – Customer focus

Company priorities [see Figure 5] have also changed with the economy entering a period of weaker demand. Focus areas are customer related. Pricing and margin management is the top priority, customer acquisition and retention, and product development are in third place. While the focus has shifted away from cost reduction as a top priority, cost reduction still remains in second place. After years in a lower priority range Cash Flow and Working Capital have made a comeback. Strategic topics such as sustainability, digitalization and diversity show the biggest relative decline in priority (minus 18pp, -8pp, -12pp).

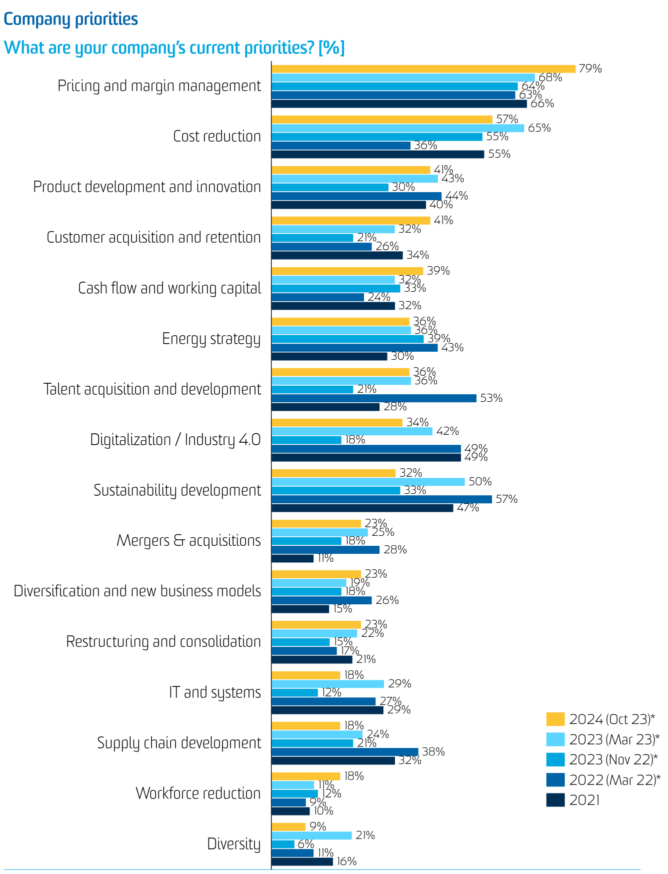

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Figure 5: Historical comparison of current priorities

As seen in previous publications, short-term priorities are not necessarily in line with long-term industry expectations. In a longer perspective, strategic topics such as digitalization and sustainability are expected to play a significant role in shaping the industry even if not a top priority at the moment. [see Figure 6].

However, the current most important factor expected to positively drive the industry in the upcoming years is capacity consolidation followed by digitalization, sustainability and changing customer requirements. In previous editions of the study, digitalization and sustainability were ranked higher. The recent Smurfit Kappa/Westrock merger may signal a trend towards further large and small-scale consolidation.

Among the key drivers that are expected to have the most negative impact on the industry are geopolitics and energy costs/legislation, fiber costs, new capacities, and eroding prices. Global geopolitical tensions and wars will impact supply chain and risk strategies of an industry that has been accustomed to global trade.

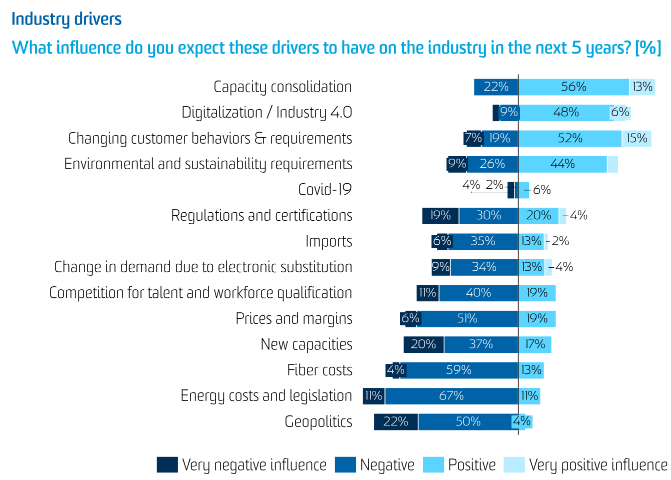

Figure 6: Main drivers and influence expectations

Digitalization focus shifts

Industry drivers presented show that respondents expect digitalization to remain an important aspect, driving change and development in the industry [see Figure 6] even if currently not a top company priority. With regards to specific questions on the status of digitalization, the focus is on administrative processes, predictive analytics, and production processes. Smart products and machinery remain at the bottom in terms of ongoing projects [see Figure 7].

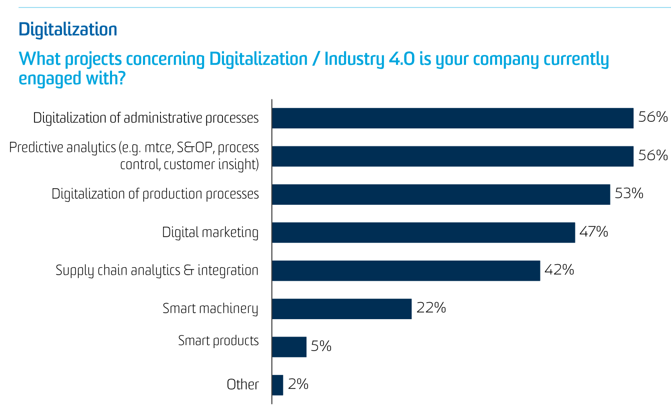

Figure 7: Digitalization projects

With regards to expected benefits from introducing digital solutions, cost reduction and productivity rank on top followed by sales growth, energy efficiency and sustainability [see Figure 8].

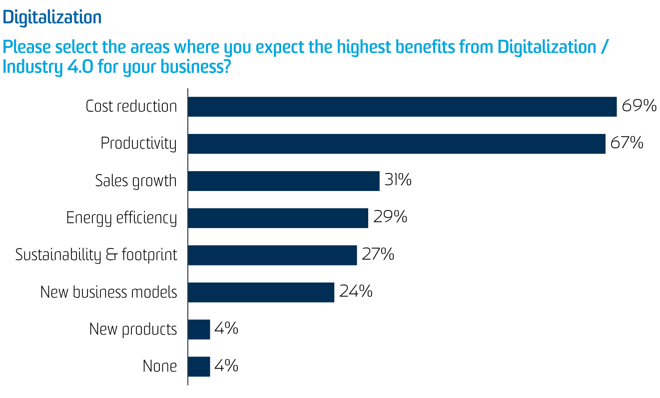

Figure 8: Expected benefits from digitalization

Sales growth has surpassed energy efficiency in terms of expected highest benefits. Cost reduction and productivity have remained at the top relative to previous versions of the study.

According to respondents, the top four main barriers to digitalization are changing existing processes, identifying digital opportunities, IT Systems & Infrastructure and Training. [see Figure 9].

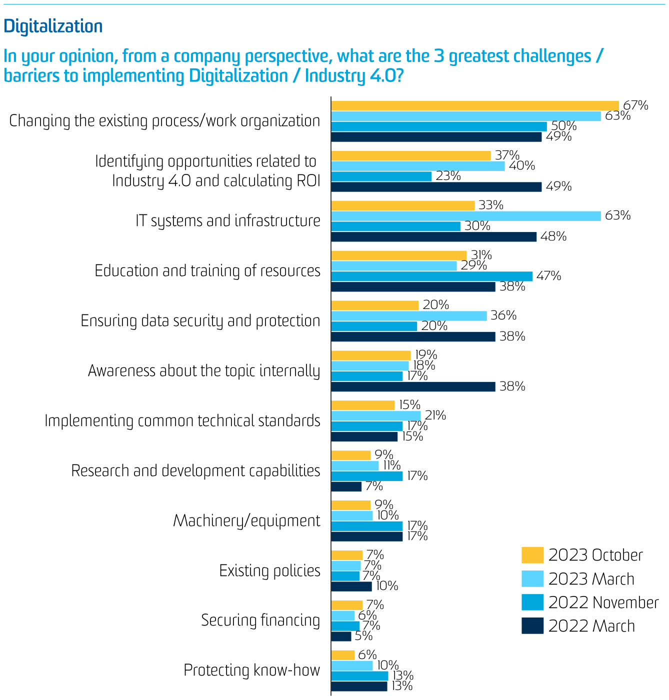

Figure 9:: Barriers to digitalization

Sustainability skepticism

While sustainability is considered the #4 trend [see Figure 6] to positively impact the industry it has currently dropped to the #9 spot in company priorities [see Figure 5].

Companies are progressing with their sustainability agendas. With each survey conducted, a larger and larger share of companies report having a clear sustainability strategy and tracking their footprint [see Figure 10].

Digitalization is a principal factor in improving and tracking sustainability, yet it remains an underdeveloped avenue – only around 56% of respondents state to have access to tools for integrated and automated measurement of sustainability performance.

Increasingly, we are seeing sustainability play a key role in supply chain management related topics; both in terms of customers evaluating the sustainability performance of the respondents as well as respondents surveying the sustainability performance of their suppliers.

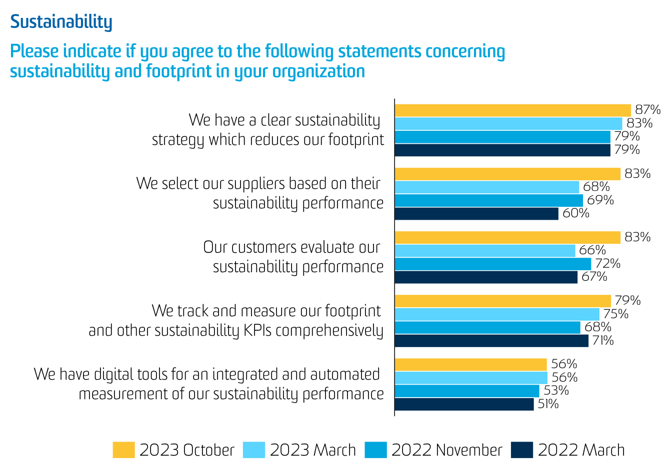

Figure 10: Sustainability strategy perception

Companies are also seeing a larger share of renewable energy in their overall energy consumption, although there remains room for improvement in reducing dependency on fossil fuels [see Figure 11].

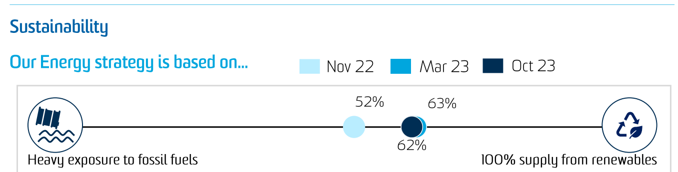

Figure 11: Energy strategy [% of Renewable energy planned to be used]

Despite a perceived increase in presence and importance, respondents are slightly more skeptical about the benefits of sustainability in comparison to previous periods. This is especially apparent when it comes to profitability improvements and appreciation by financial markets [see Figure 12]. Additionally, it is remarkable to see the declining approval on the statement that a sustainability strategy supports talent attraction.

The view that sustainability has the potential to improve the world for everyone is far less prevalent than in March of 2022.

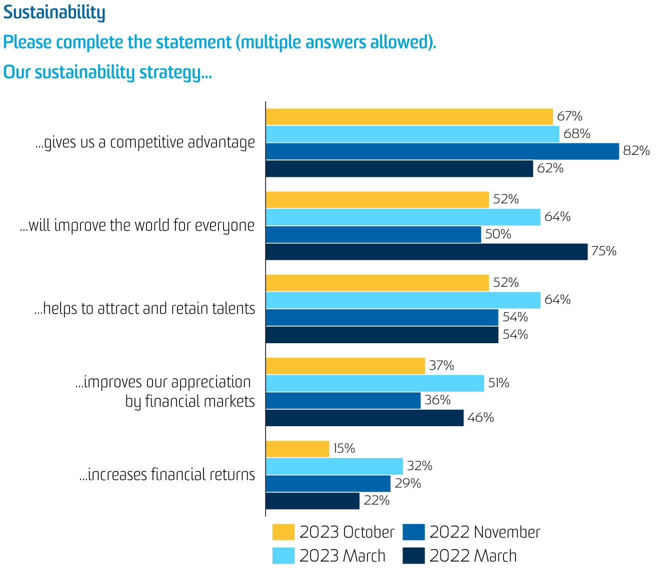

Figure 12: Benefits of increasing sustainability

Summary & outlook: Challenges & opportunities ahead

Companies are overall rather negative compared to the average sentiment from similar studies conducted over the last 10+ years. However, the outlook is more optimistic in direct comparison to the sentiment since November 2022. Companies seem to be aware of longer-term strategic trends but are currently focusing on tactical measures to secure results and manage immediate challenges.

- Mixed industry outlook– while some respondents expect that rock bottom is yet to come, others are optimistic for a turnaround in 2024
- Customer focus, pricing and margin management takes central focus as companies are subject to low demand
- Working Capital, Cash Management and availability of financing growing in importance again
- Costs are expected to increase again after declining in 2023 – cost management remains a top priority, including an increased focus on workforce reduction
- Capacity consolidation is expected to be a major positive driver for the industry
- Geopolitical tensions are expected to impact uncertainty
- Long-term strategic topics, such as sustainability and digitalization are less of a priority than in previous studies although they are amongst the top long-term trends
- Administrative processes remain at the top of the list of things companies are aiming to digitalize
- Although further advancements have been made, companies are less optimistic about the benefits of sustainability

Viewpoints are divided and few are confident as to what awaits the industry in 2024. Generally, the outlook is still rather pessimistic, but with an element of optimism. Low demand, high inflation and interest rates are underlined by further growing geopolitical tensions. While these drivers will continue to challenge the industry, the industry has become more resilient having gone through various ups and downs over the last 3 years. The new normal will remain unpredictability and volatility.

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.

StepChange is further an industry thought leader in digital strategy and on the forefront of bringing digital transformation to the fiber value chain.

With an international team of industry experts StepChange will 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 publication,
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