

# Challenges for Mature Industry

## FBA Annual meeting

### May 25, 2011

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# Agenda for today's discussion

- A brief overview of North America Situation
- Prospects for N.A. economy
- Industry base case outlook
- Scenarios and other industries



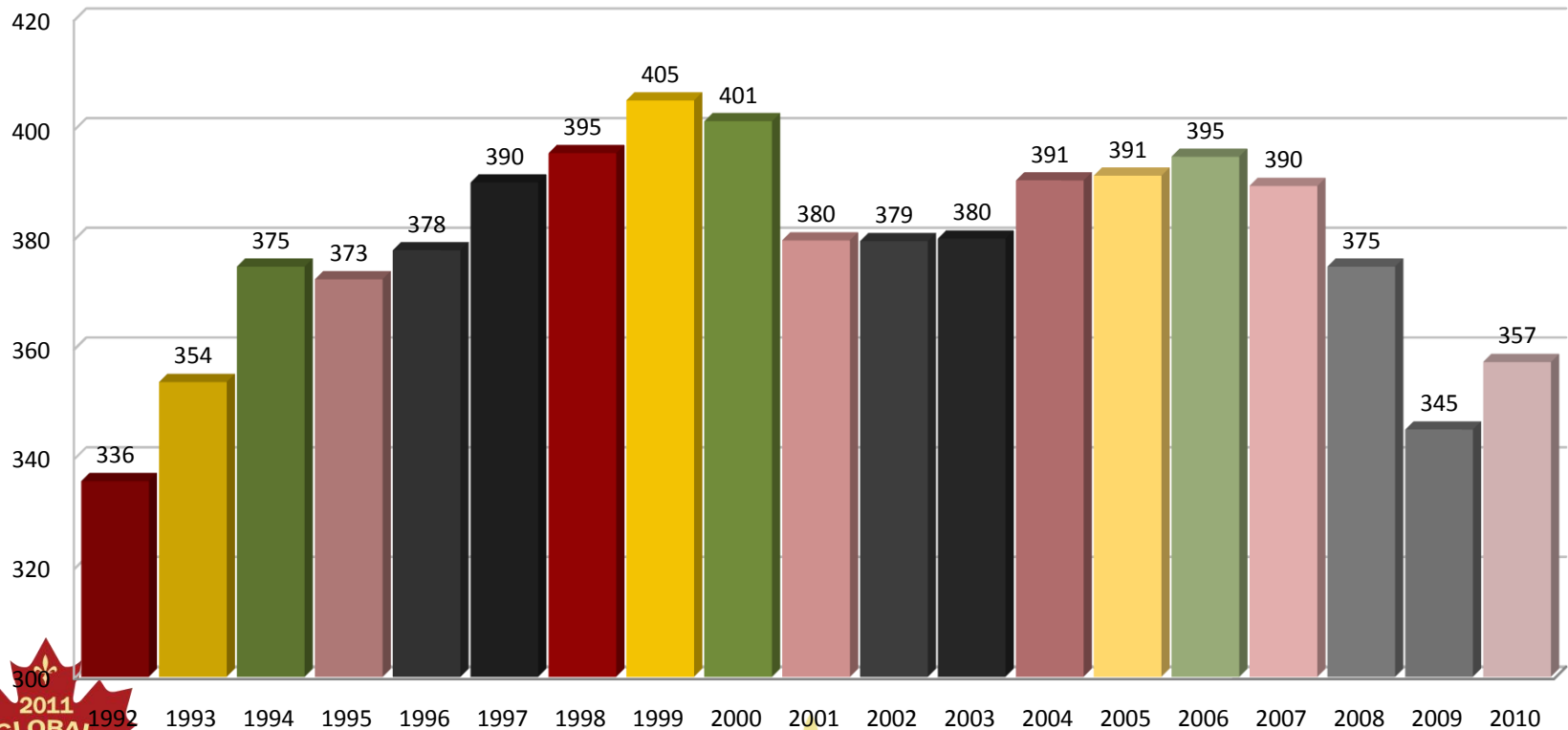
# Challenges of a Mature Market

- In mature industry, demand growth slows or begins to contract
- In economic terms, there is no longer the incentive to invest in new capacity to meet growing demand
- Focus has to shift:
  - Niche or segments with unique requirements
  - Cost and asset management
  - “New” products or distribution channel changes

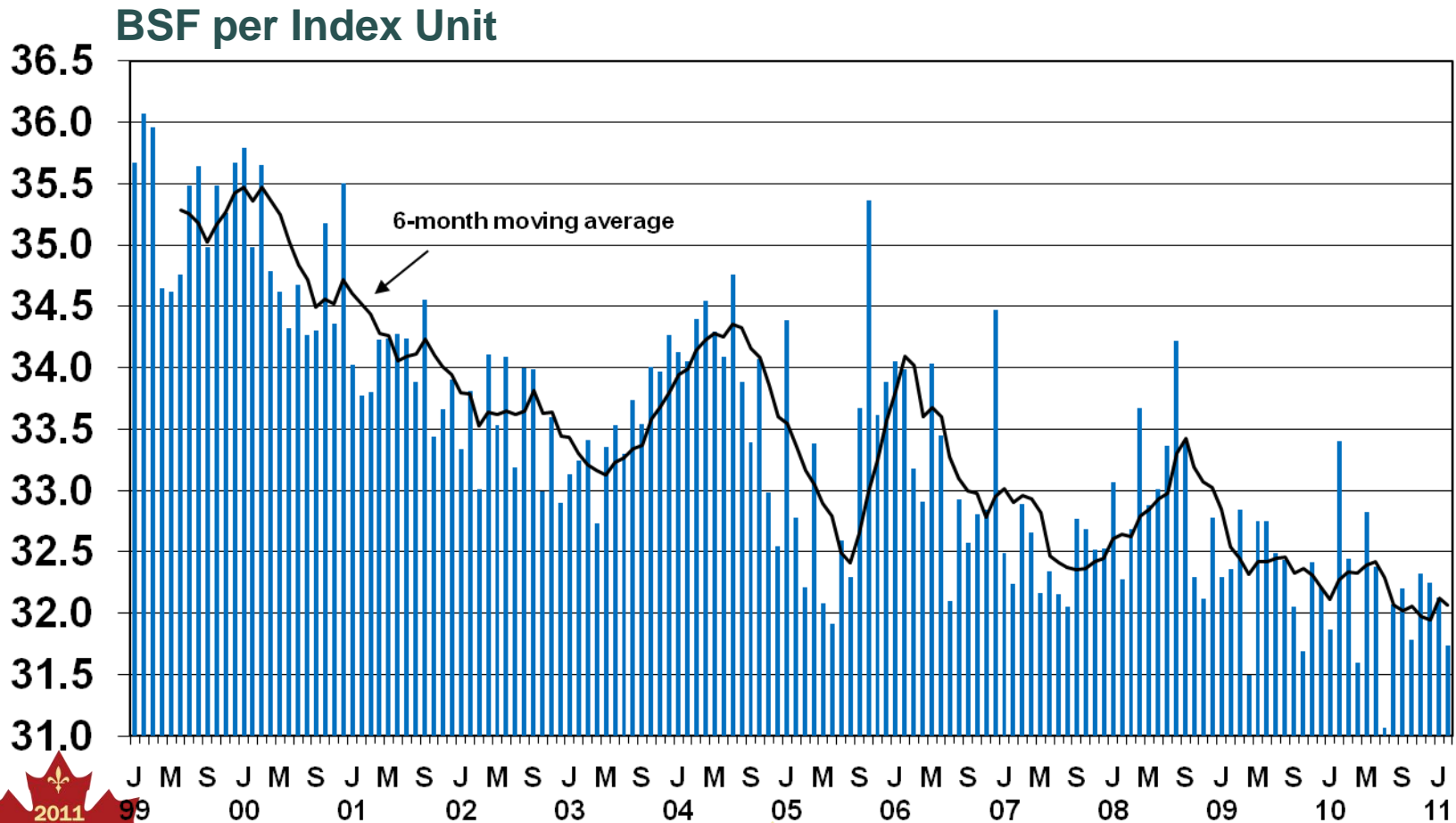


# Structural shift after 2000: Mfg. loss and usage decline

**Total Volume**  
(Billions of Square Feet)



# US Box Shipments: Growth about 1% below non-durables since 2000



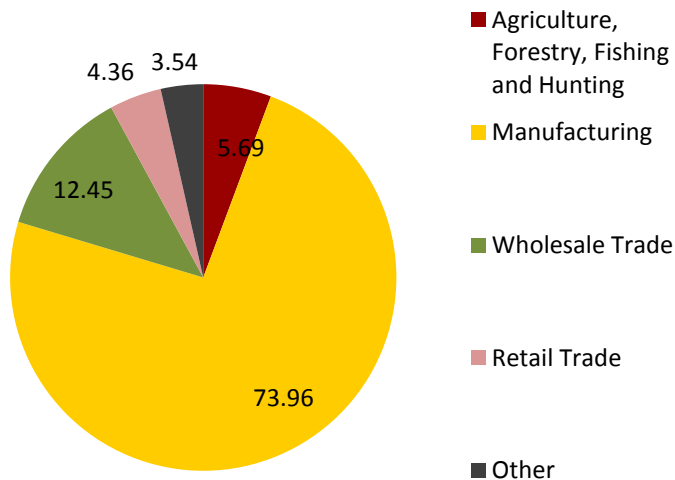
Source: RISI



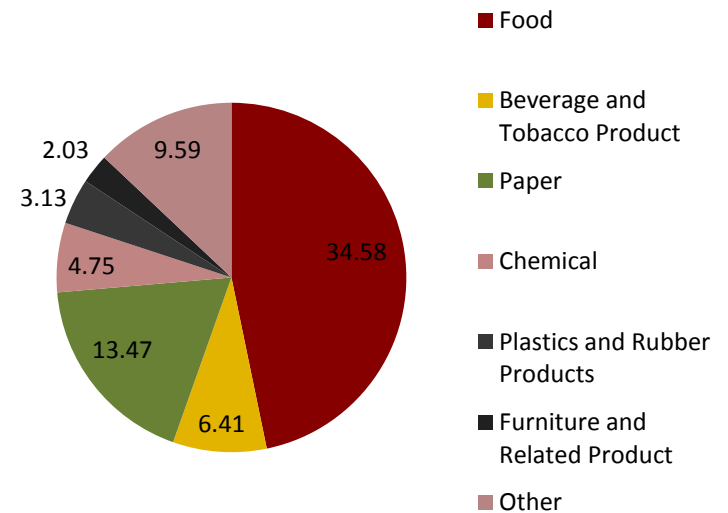
# One factor discuss later: what is left!

## Niche market and possible growth segments

### Categories



### Manufacturing



Source: FBA

# Variety of factors at work: some may be reversing course

- Strong dollar and loss of competitive position
- Competitive advantage in segments lost forever: furniture, toys, etc.
- Pressure to reduce usage for environmental reasons
- Substitution issues: such as shrink wrap, plastic containers
- Good news: some reversal likely on mfg base and environmental story



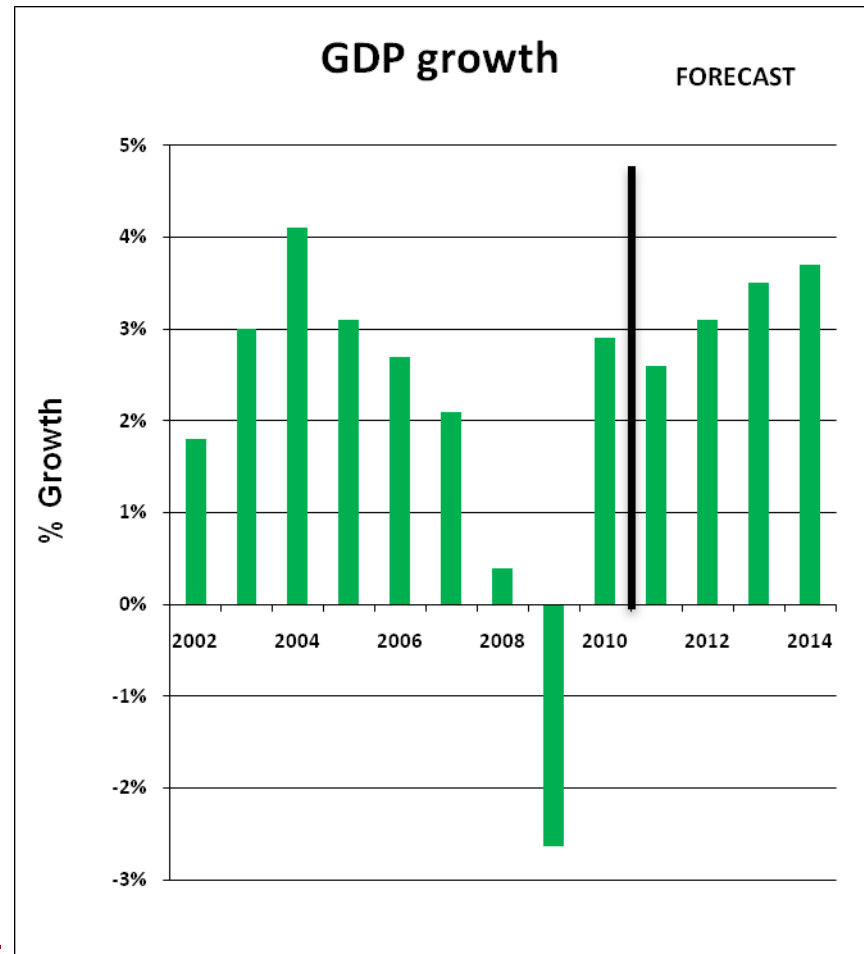
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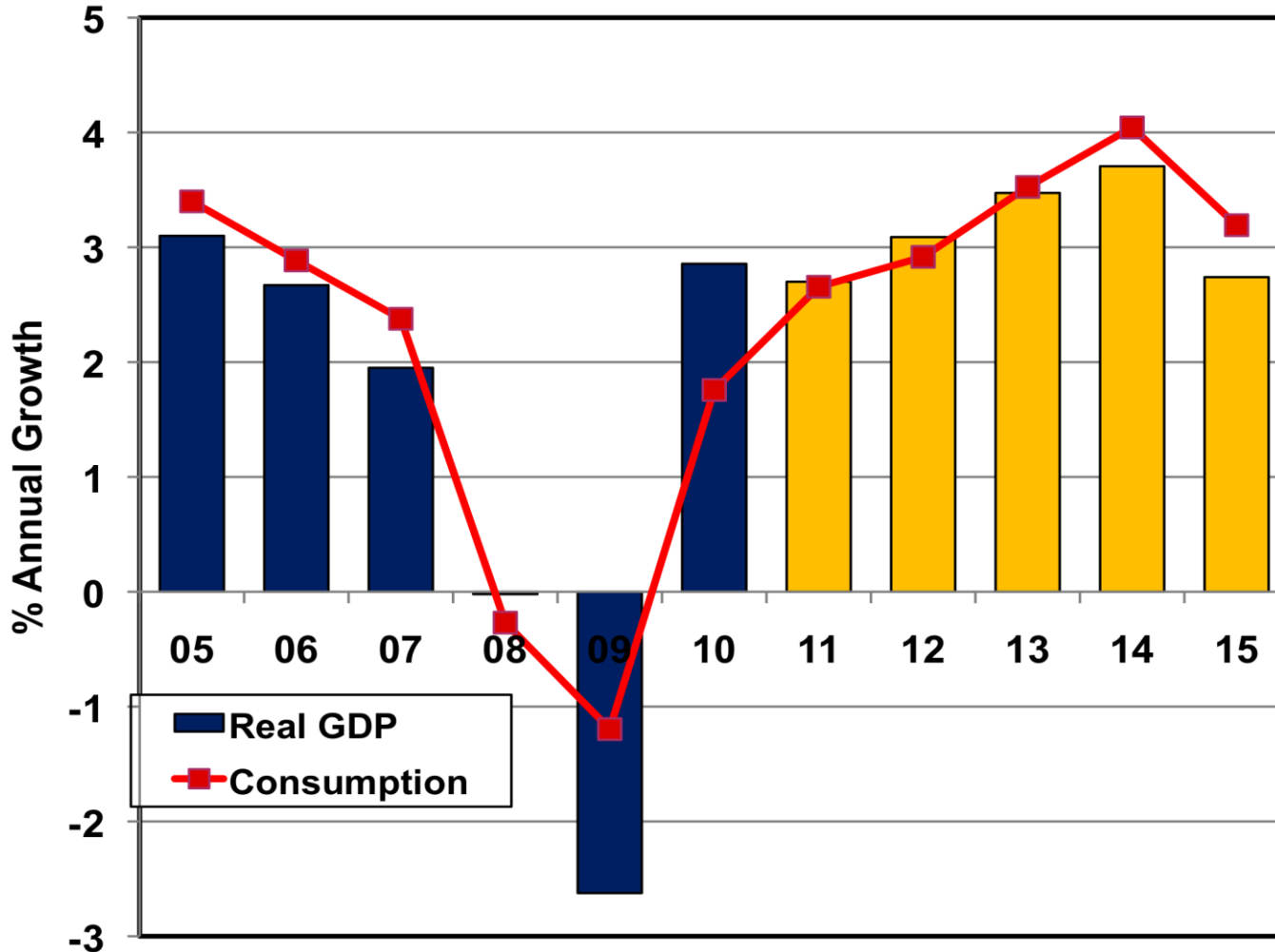


# U.S. Growth : 3% give or take

- Key driver will be consumer spending
  - Employment numbers positive
- Some help: net exports
- Industrial production recovery stronger: inventory cycle and net exports
- Head winds:
  - Oil prices
  - Housing
  - Government—State/Federal?

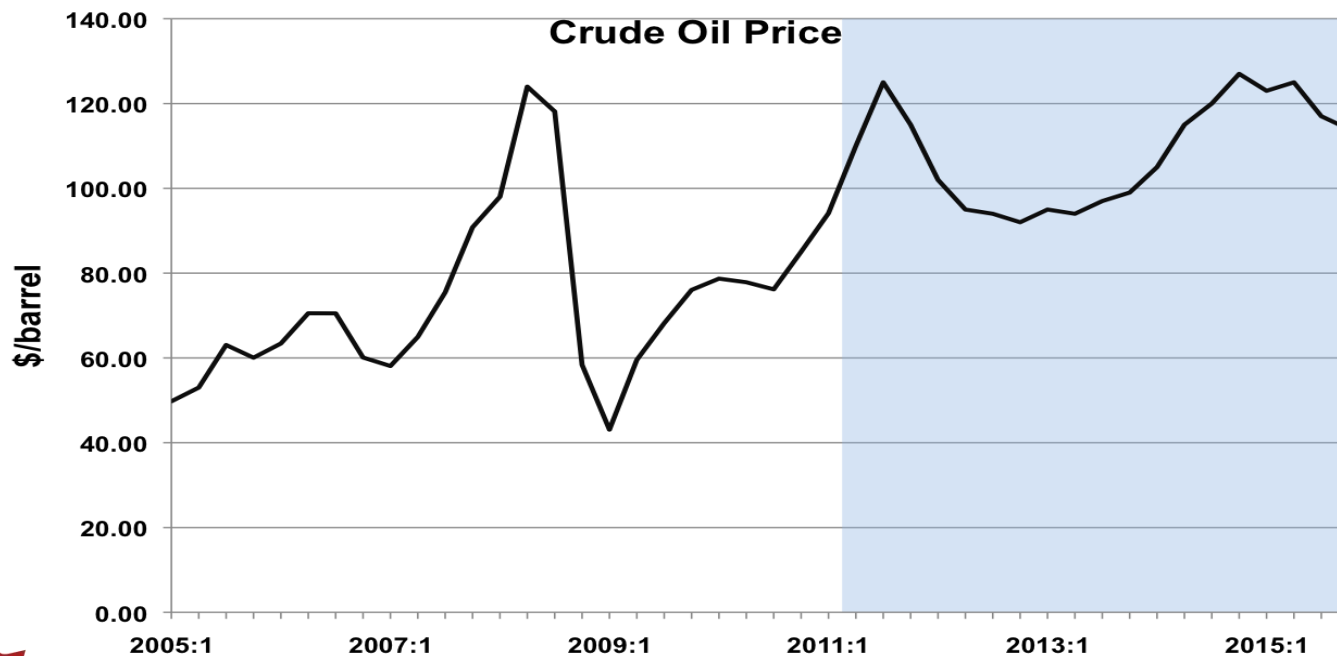


# Consumer spending growth expected to be crucial to outlook



# A major uncertainty: Oil prices

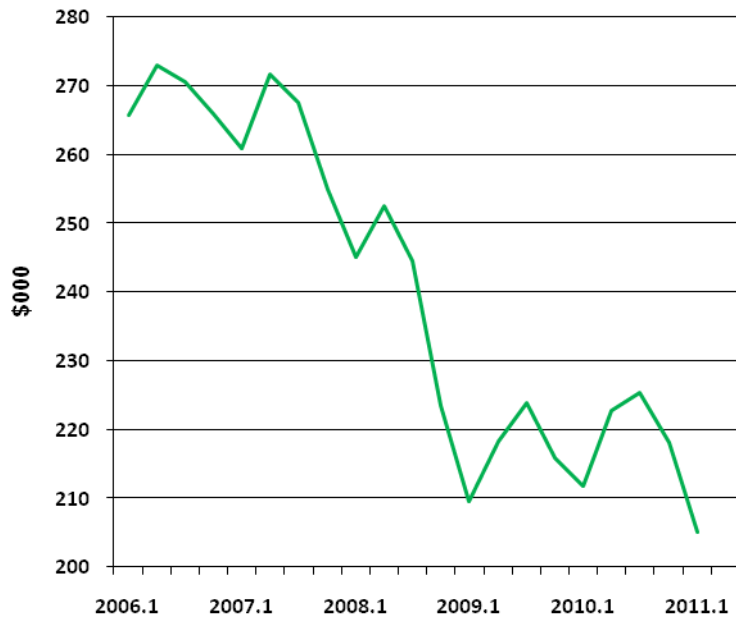
## Different picture for Natural Gas in U.S.



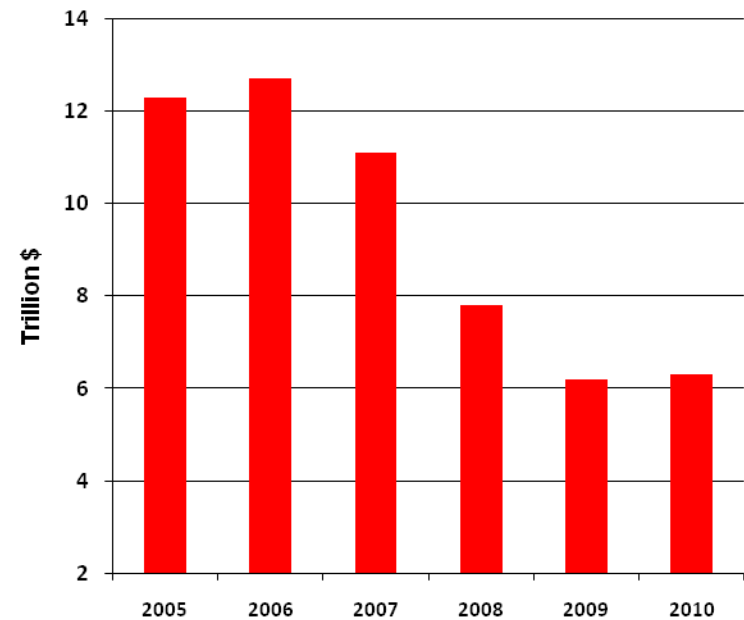
Source: RISI outlook

# Falling home prices: important for several reasons

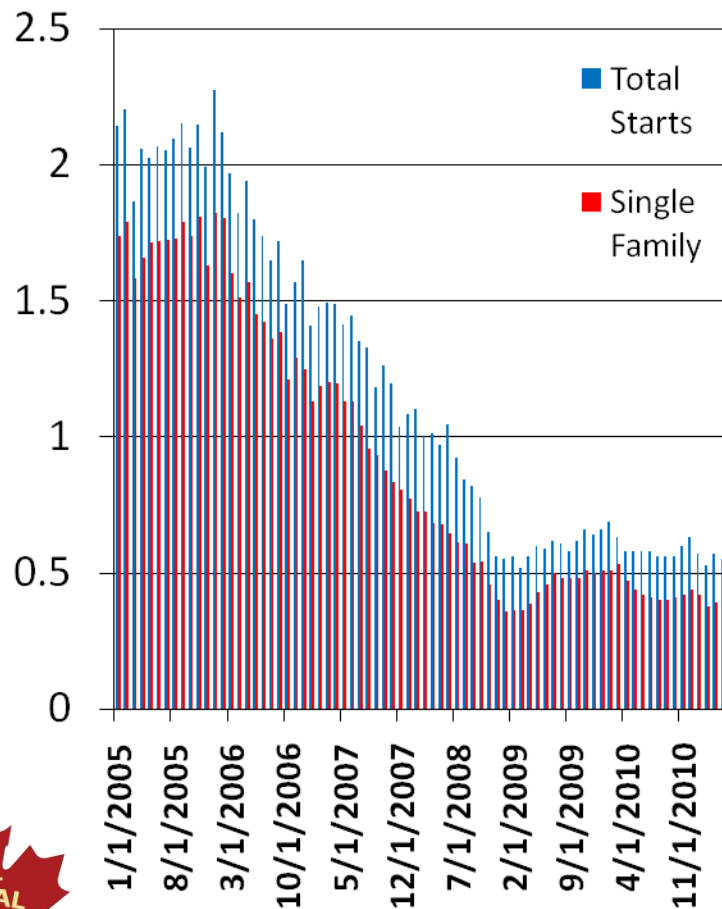
Median Existing Home Price



Home Equity



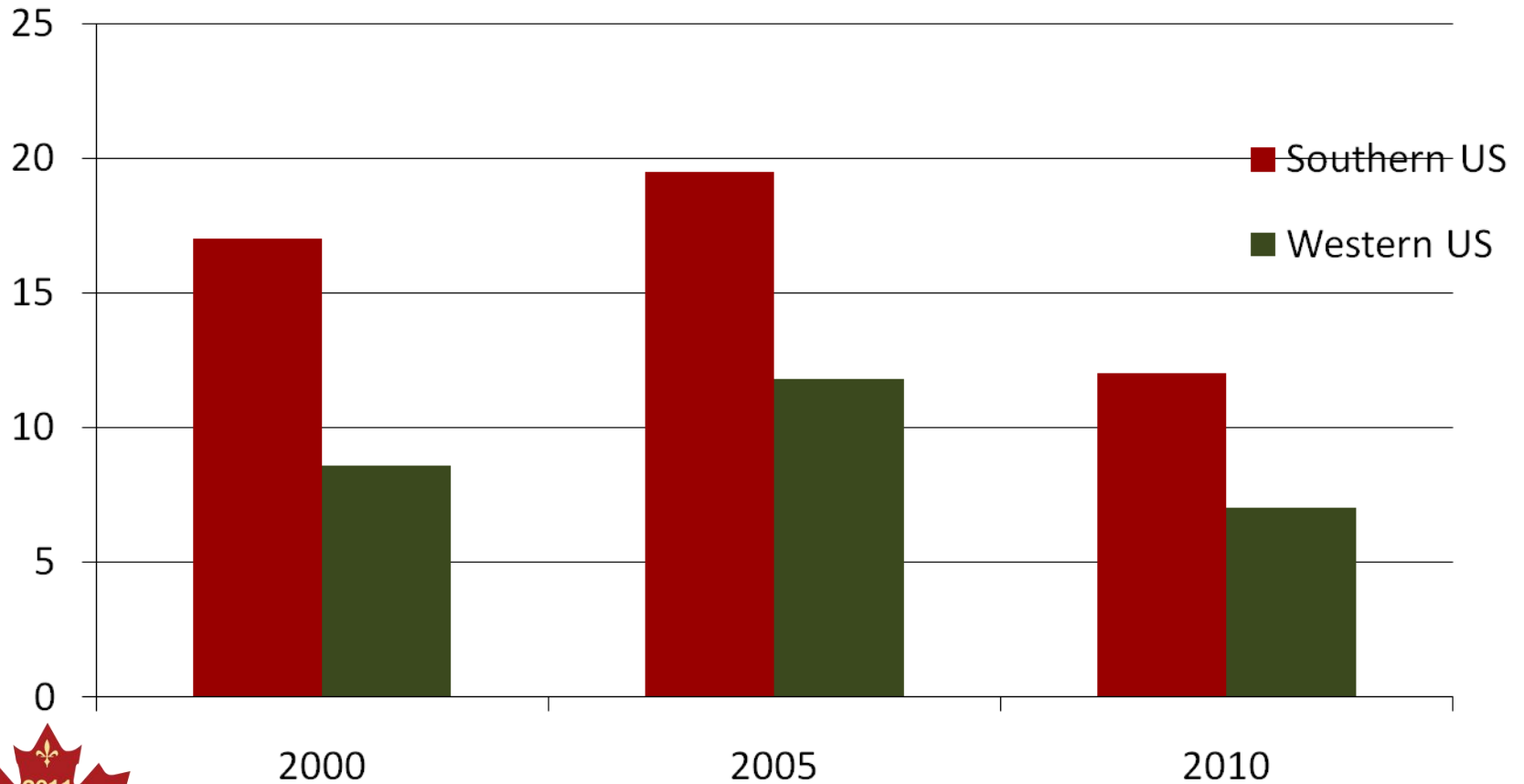
# Housing starts: Not responding to low rates



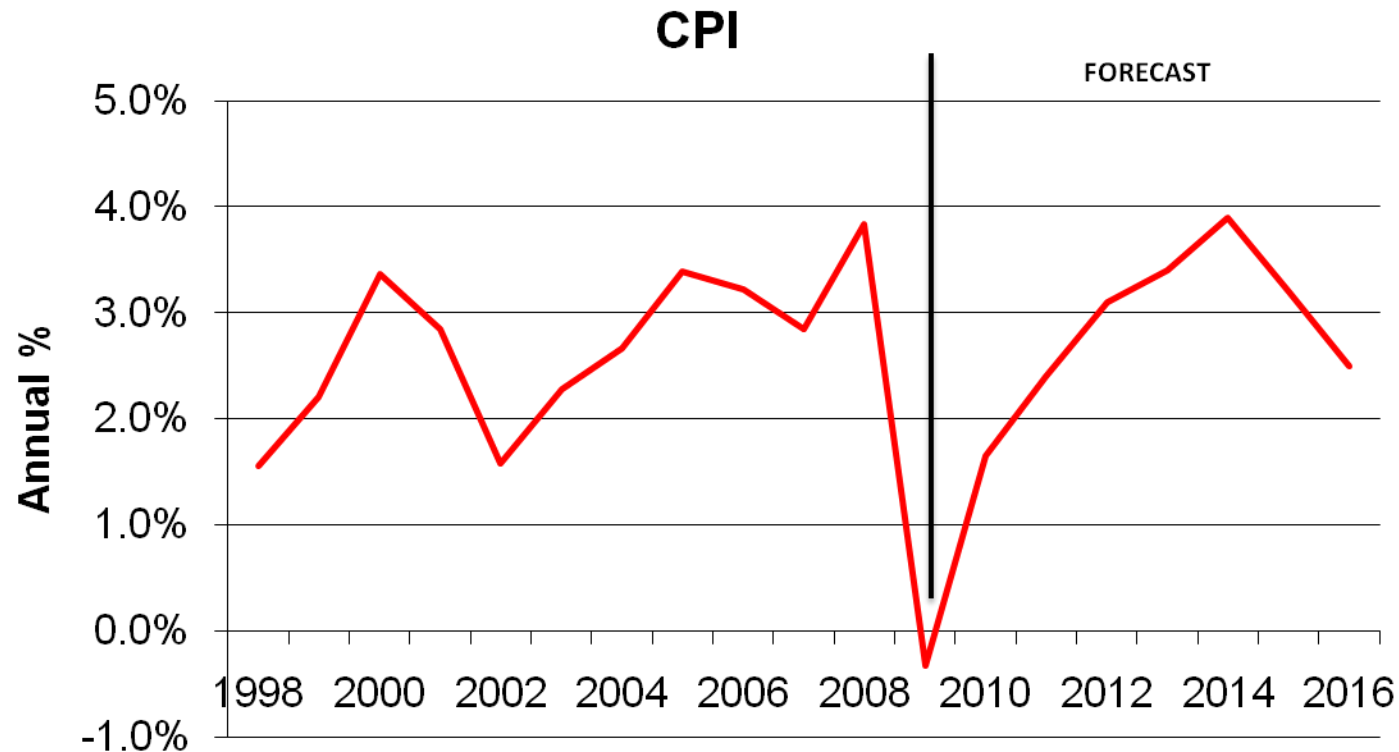
- Inventory correction
- During tax break, small recovery in SF starts
- Flat line since
- Unlikely to improve this year
- Some positives for MF



# An issue for major fiber source: lumber production and chip prices



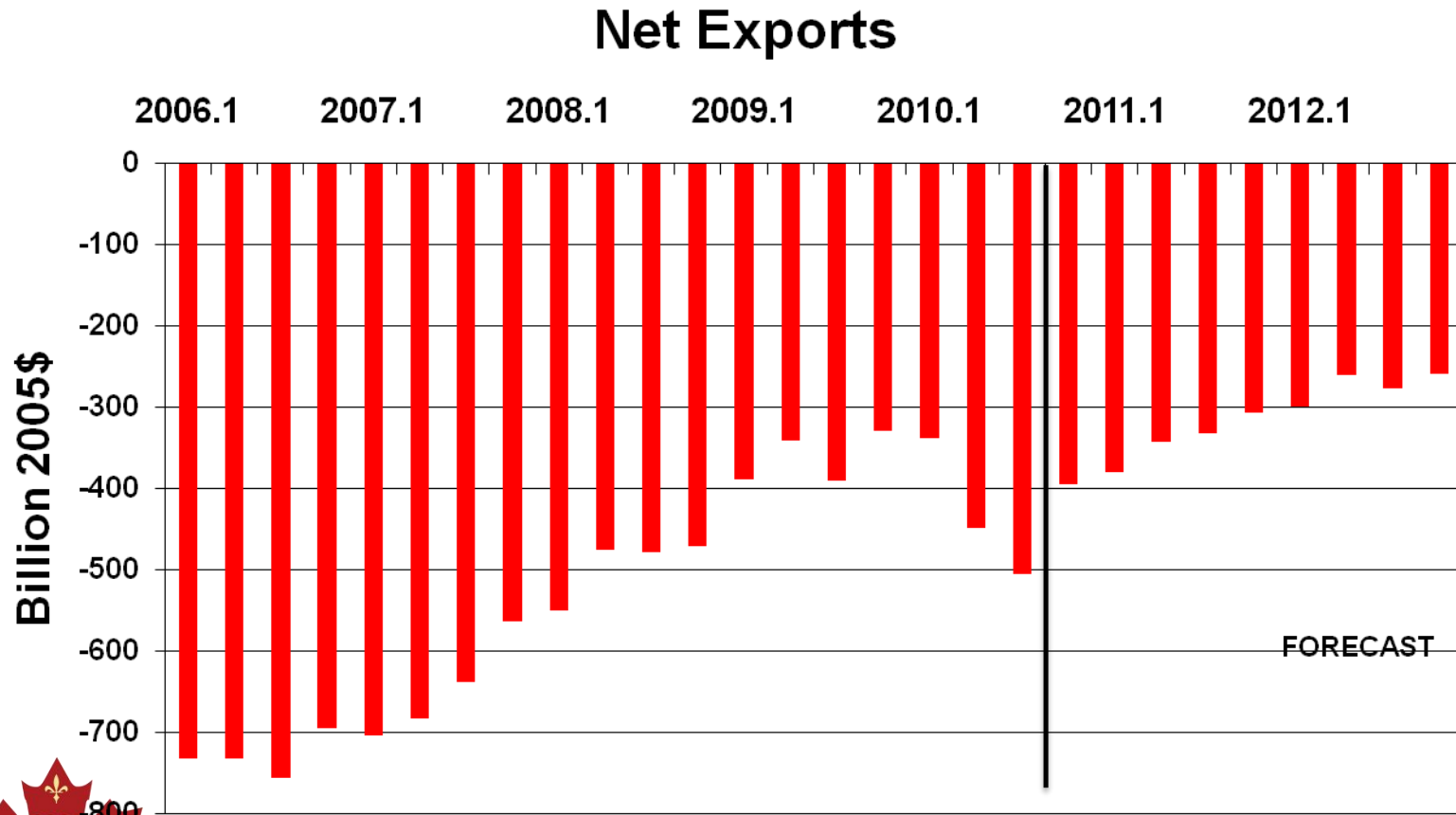
# Inflation moves higher—but core remains tame



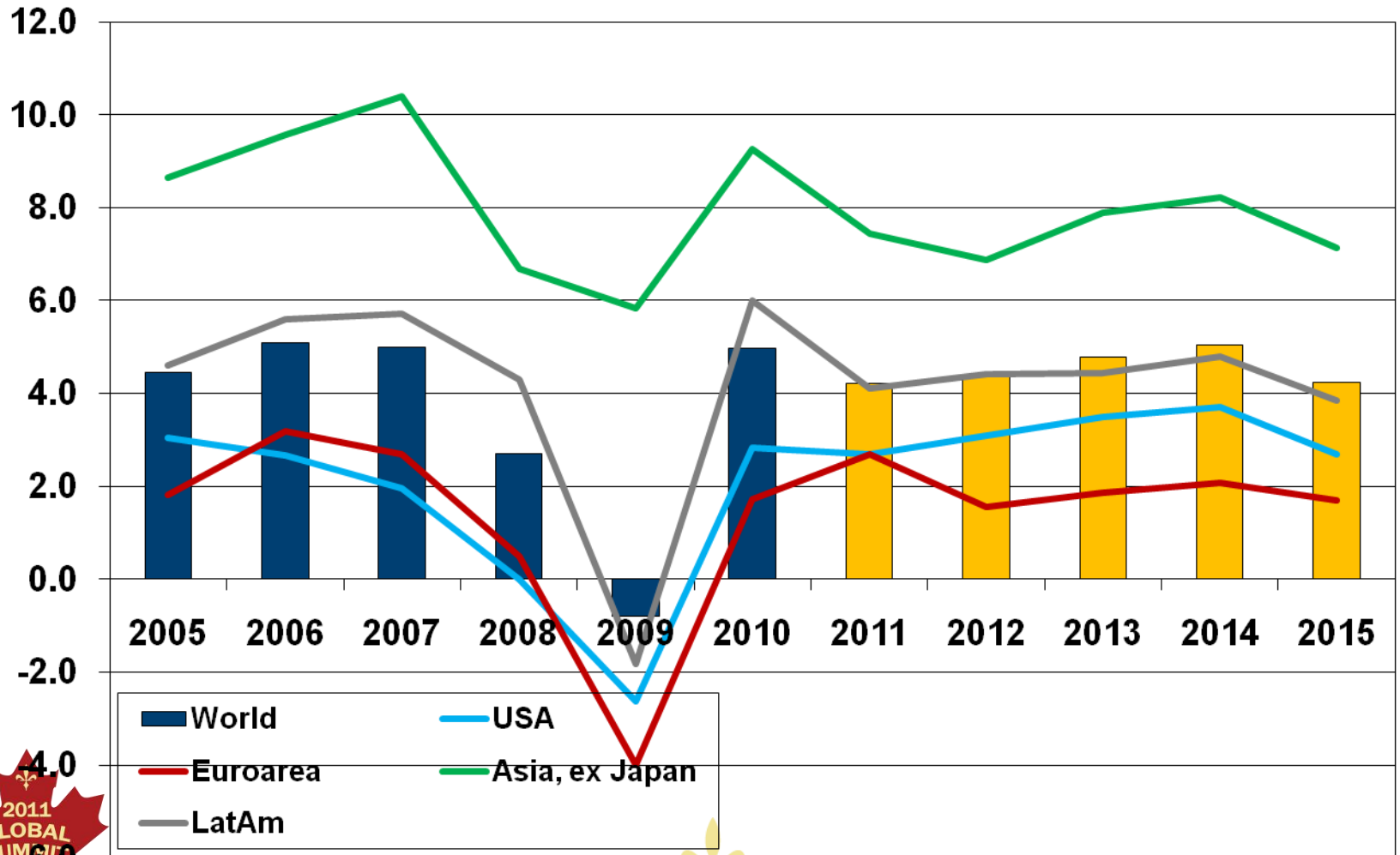
Source: BLS, RISI



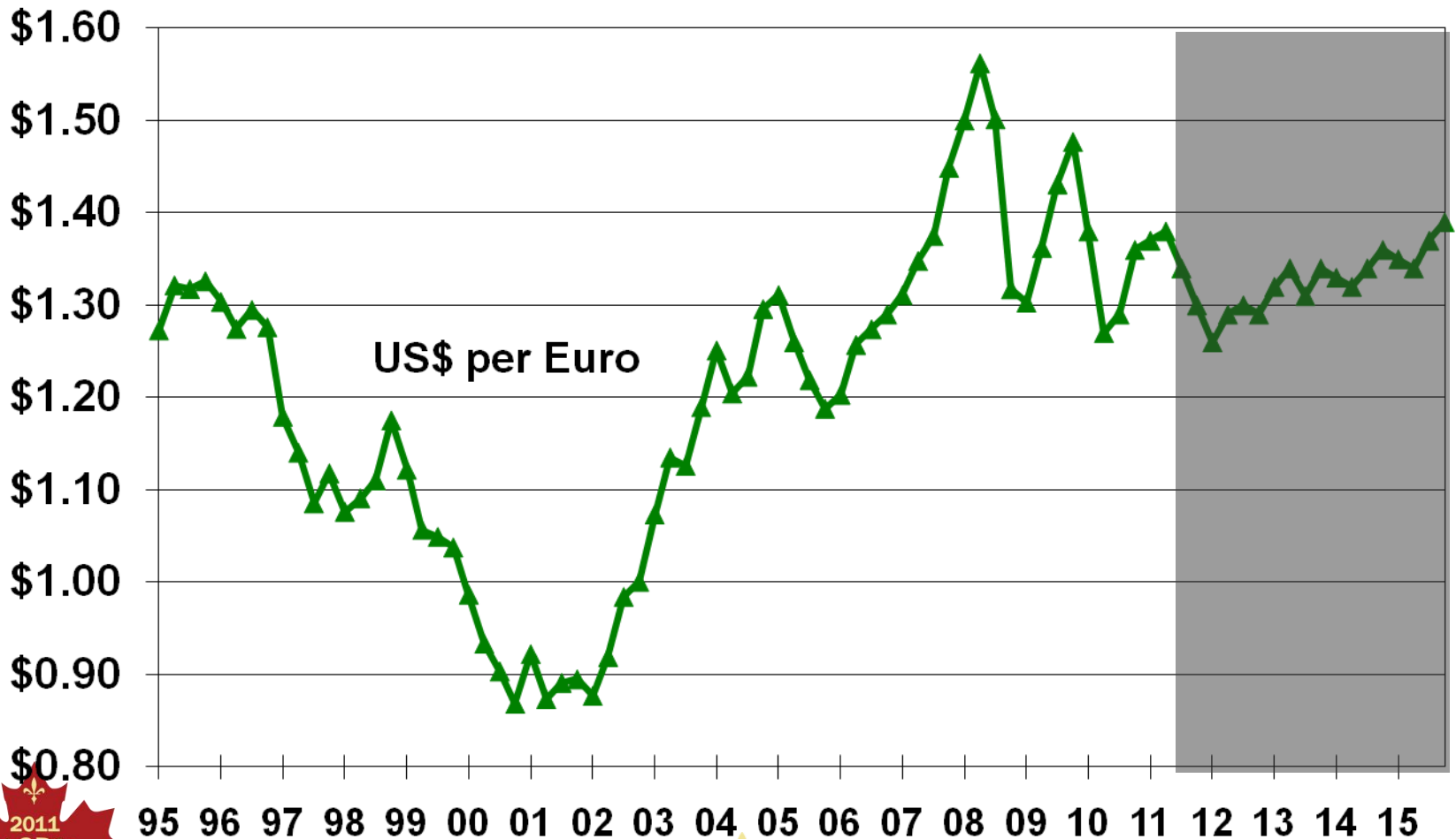
# Net exports trend: particularly helpful for mfg. sector



# Reason #1: world growth continues near 4%

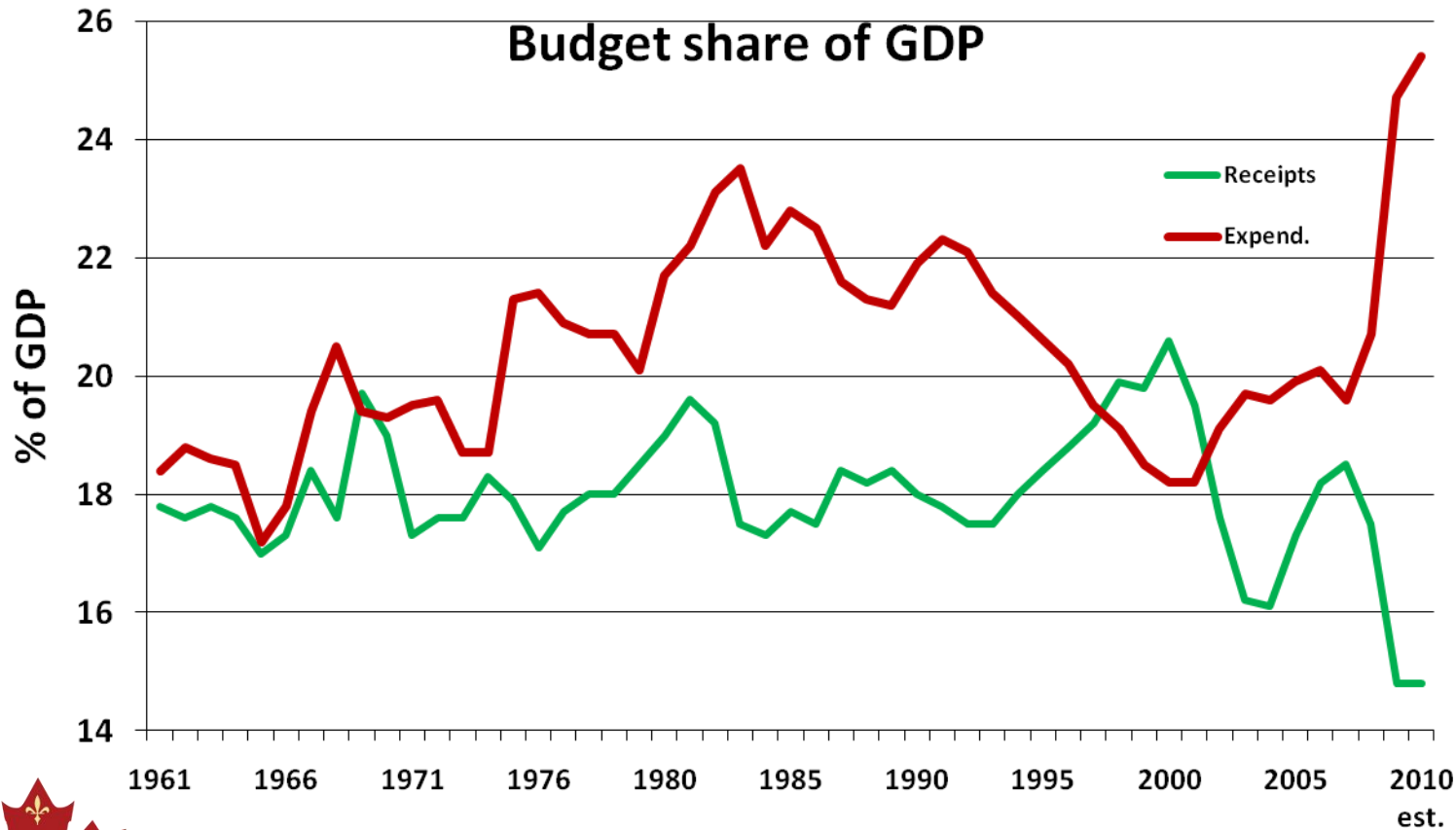


## Reason #2: Dollar remains relatively weak

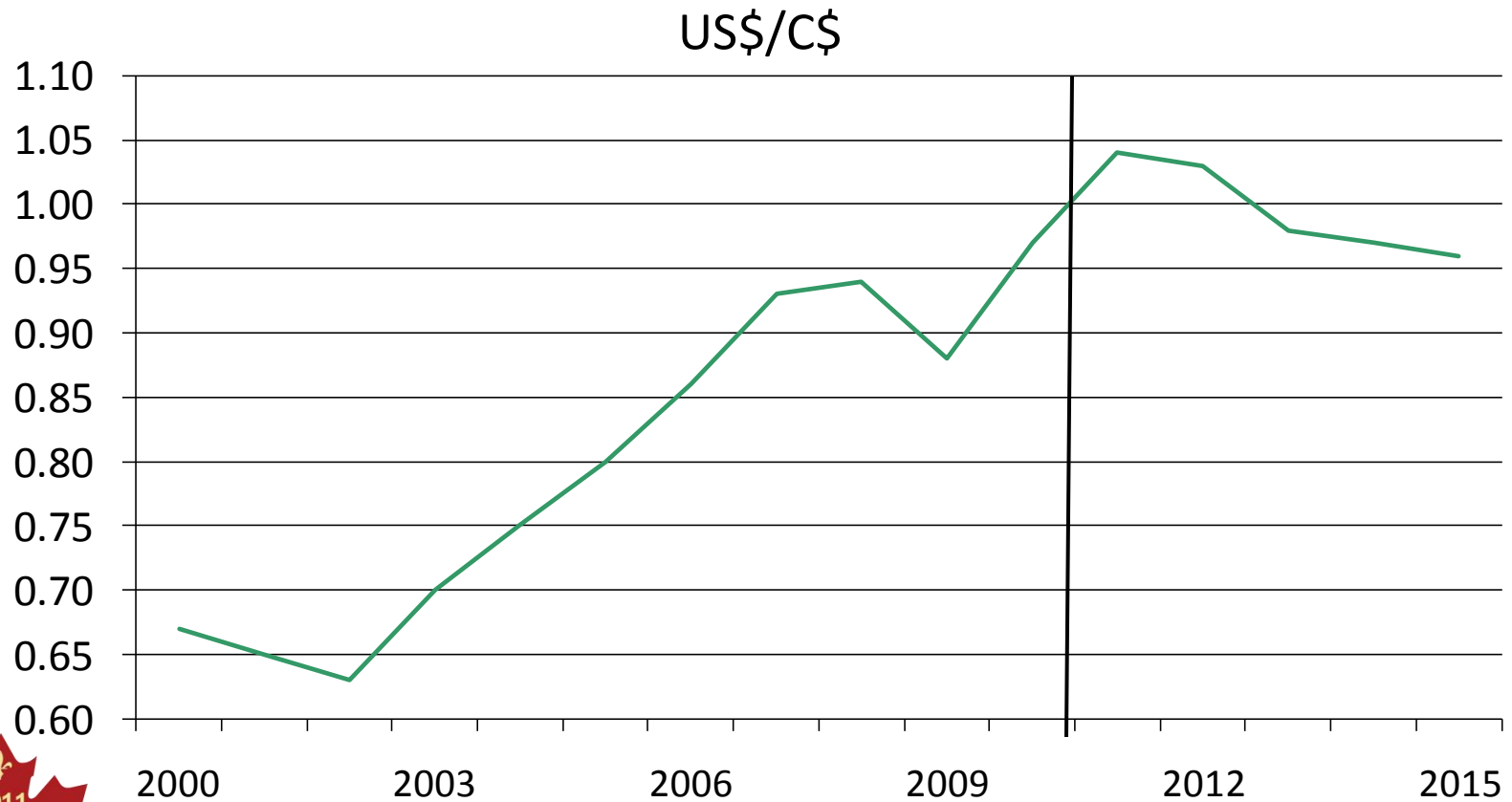


Source: Fed, RISI

# The other challenge for US: tackling massive budget deficit



# Expect C\$ to remain above parity GIVEN OIL PRICE OUTLOOK

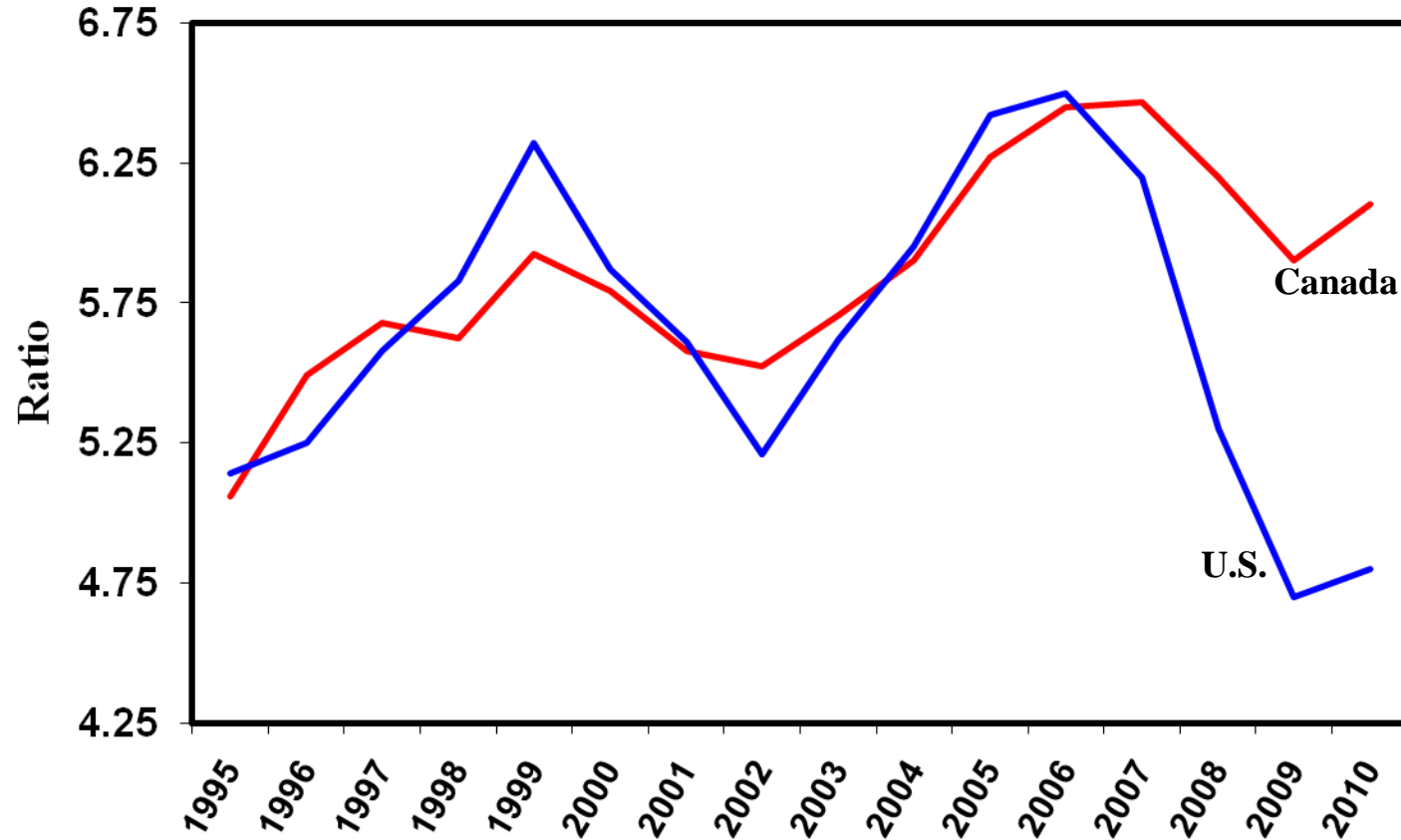


Source: FRB, RISI



# Canadian economy in much better shape

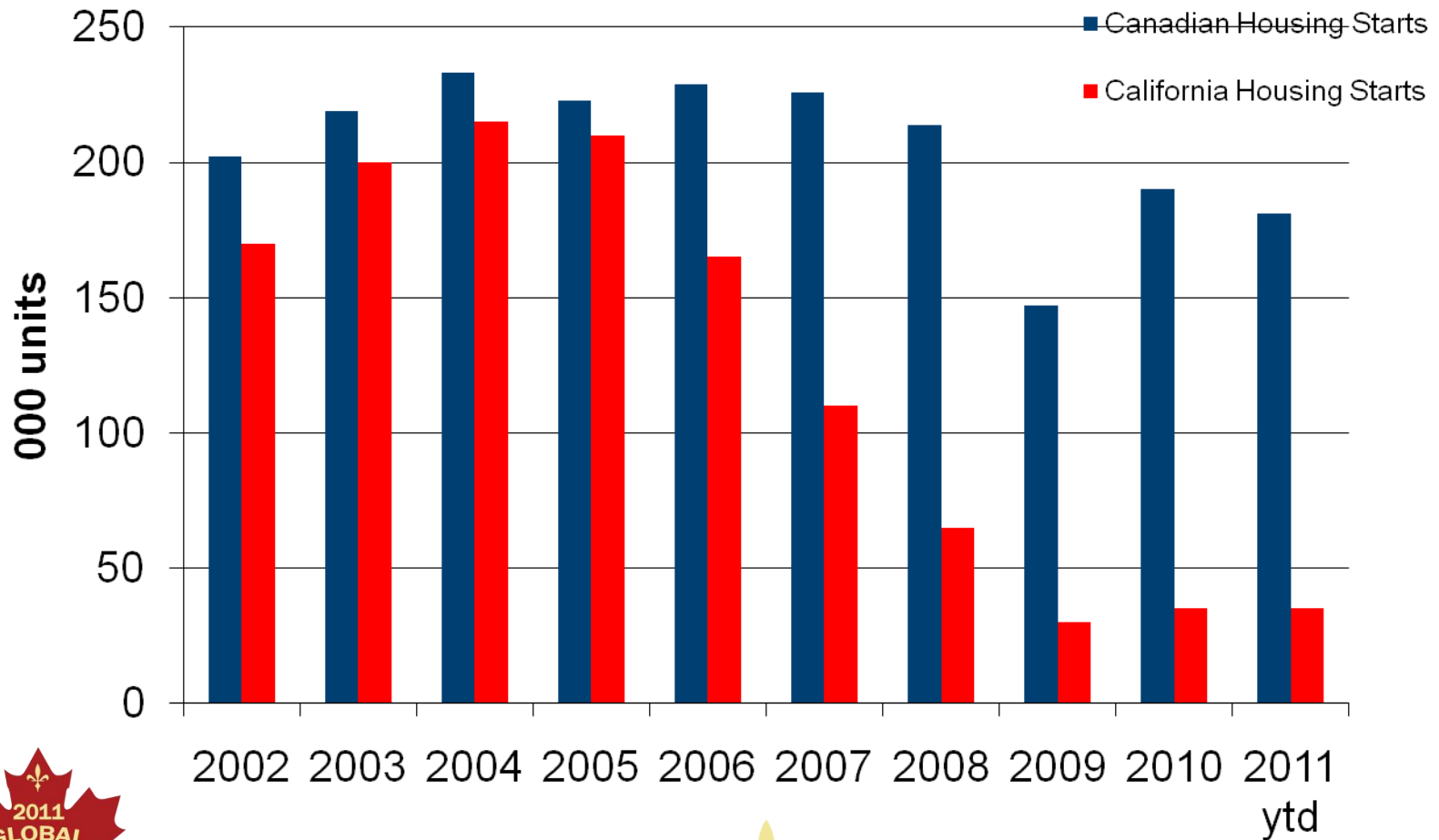
## Ratio of Net Worth to Disp. Income



Last Plot: Q4, 2010  
Source: Statistics Canada, FRB



# As seen in Canadian housing market



# Agenda for today's discussion

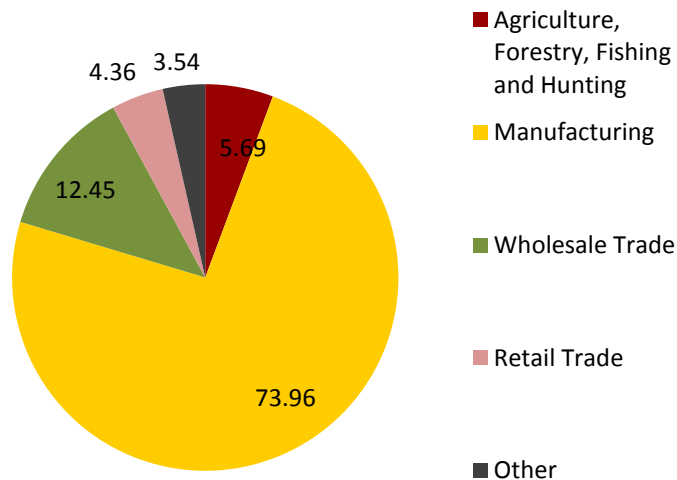
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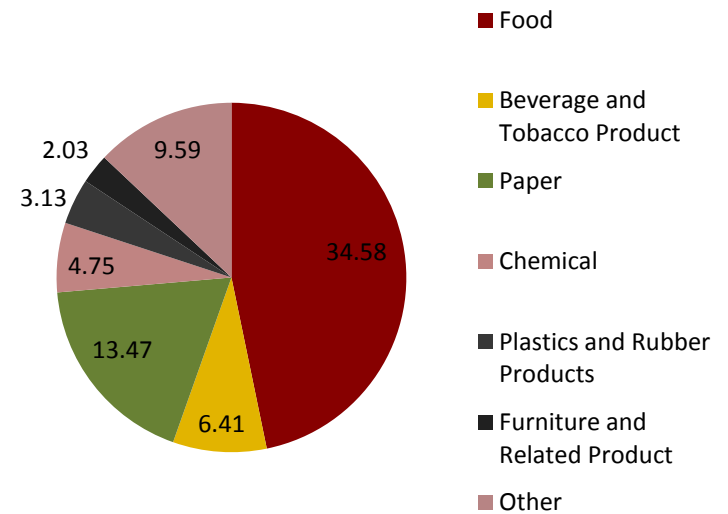
# Focus on what is left!

## Niche market and possible growth segments

### Categories

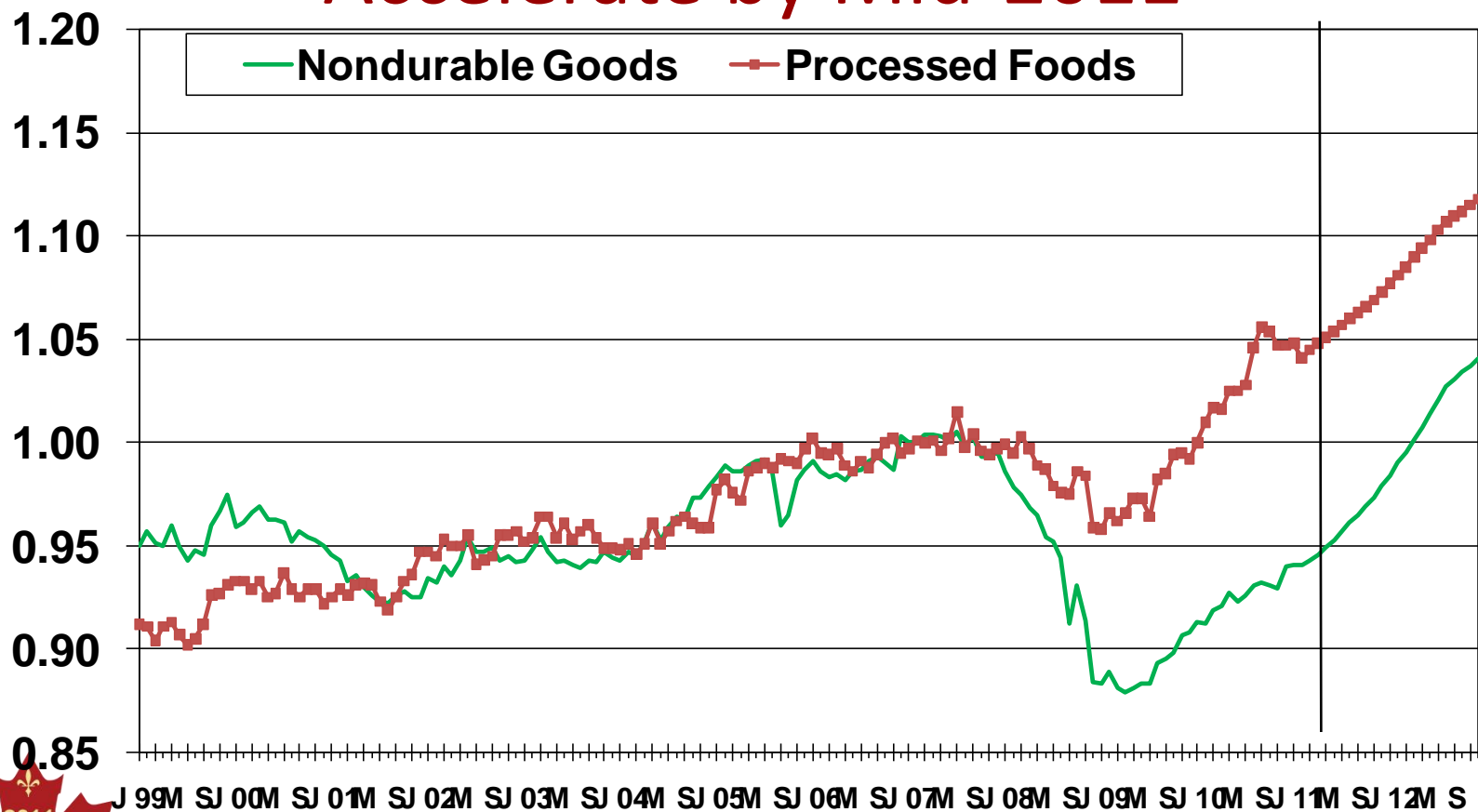


### Manufacturing

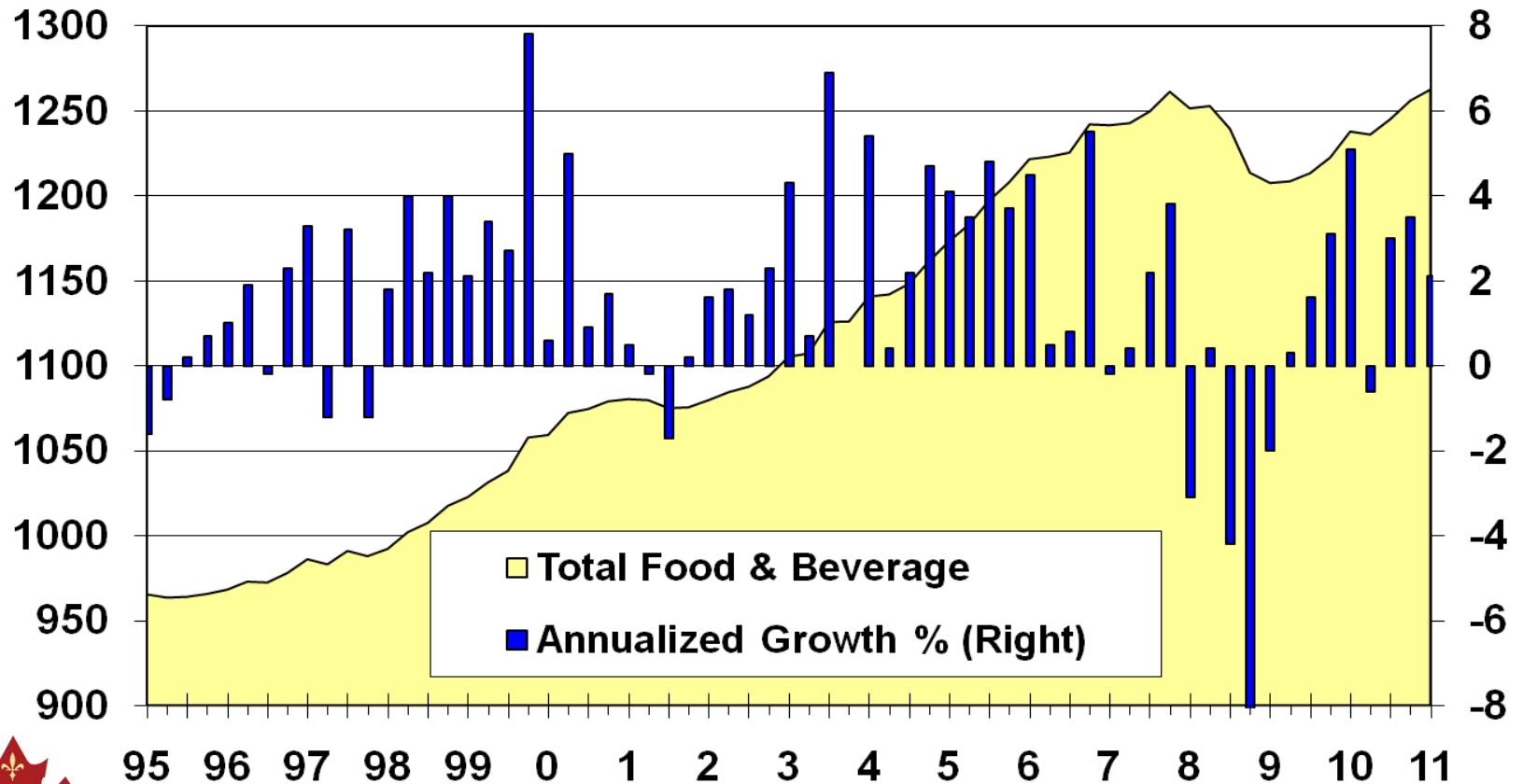


Source: FBA

# Industrial Production of Nondurable Goods and Foods Is Expected to Accelerate by Mid-2011



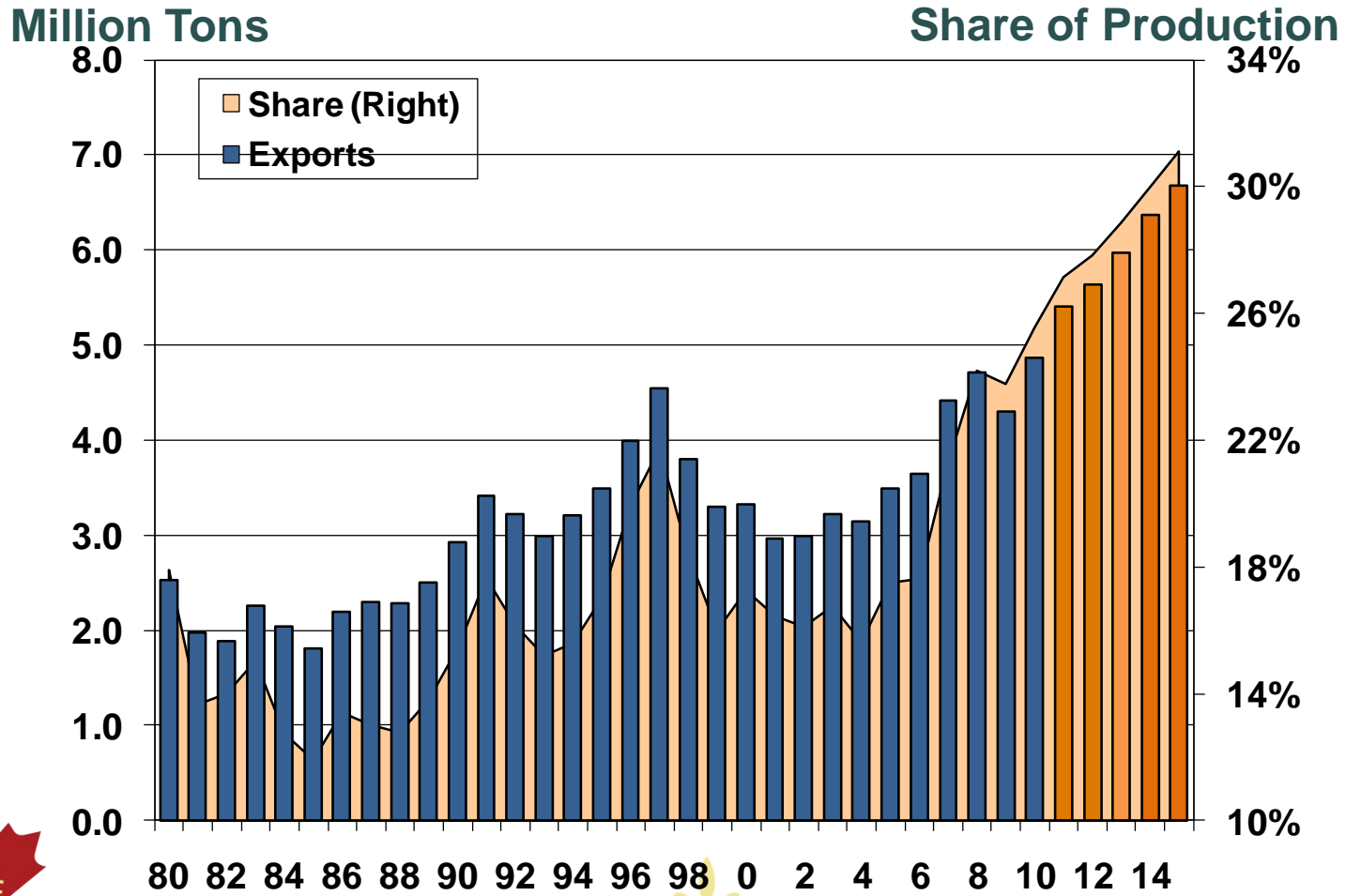
# Food/Beverage has recovered: key segment to focus on for market opportunities



Source: RISI



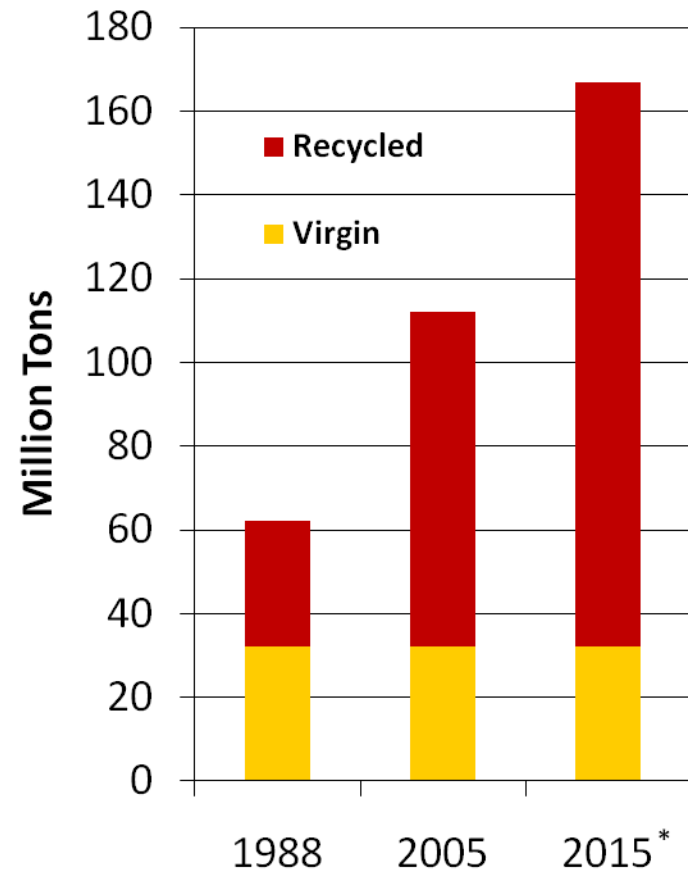
# Global demand for Kraftliner will remain intense



Source: RISI

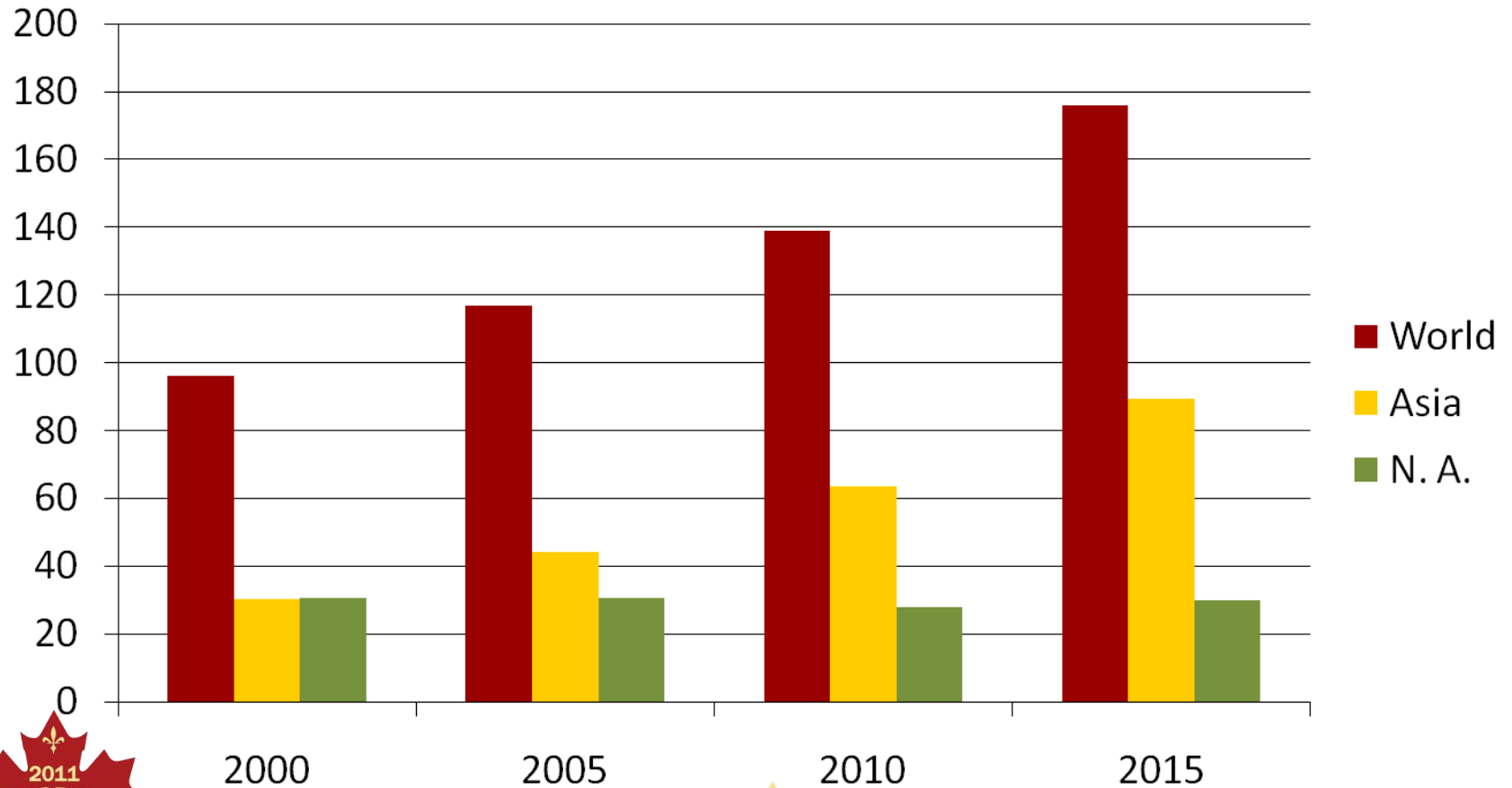
# Scenario project in 2004: Impending global shortage of OCC and Weyerhaeuser exposure

- Work done 7 years ago, concerned about global containerboard growth vs. fiber supply
- Missed severity of 2008 recession
  - Even so, Asia, particularly China, exceeded forecast
- Key message intact: OCC prices rise above chip equivalent
  - What if?—OCC goes above \$150/ton?



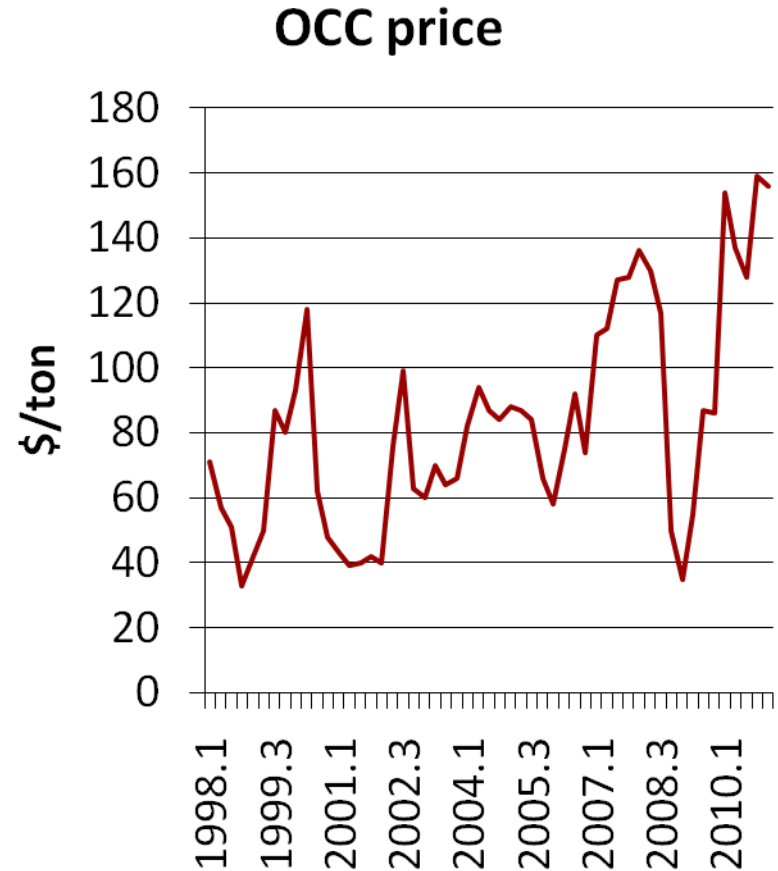
\*Weyerhaeuser scenario work;  
2004

# Another Challenge: Global growth and Limited Raw Material



# The what if was deferred, but..

- Prices were approaching the number in 2007
- Recession led to decline in global demand
- Now pushing the limits again
- Today: What will industry do???



# North American Packaging Summary

- Market did recover in 2010 from deep whole
  - Growth expected to moderate in 2011-12
- There Are Some Downside Risks
  - Will external shocks derail the fragile economic recovery?
  - Is the weakness in the box market in early 2011 really due to weather?
- But Upside Potential more likely
  - Will the recovery in manufacturing exceed our expectations?
  - Will the corrugated boxes start to benefit from the sustainability issue?



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# Discussion of structural change in other industries

- Wood products segments have been mature for 100 years
  - After WW II, raw material scarcity became big issue
  - Drove industry to keep looking for alternative options
- Paper/Newsprint sustained rapid growth, until electronics substitution—initially positive
- Composite products had to meet challenge of losing traditional furniture markets
- OTHERS: steel, railroads, etc.

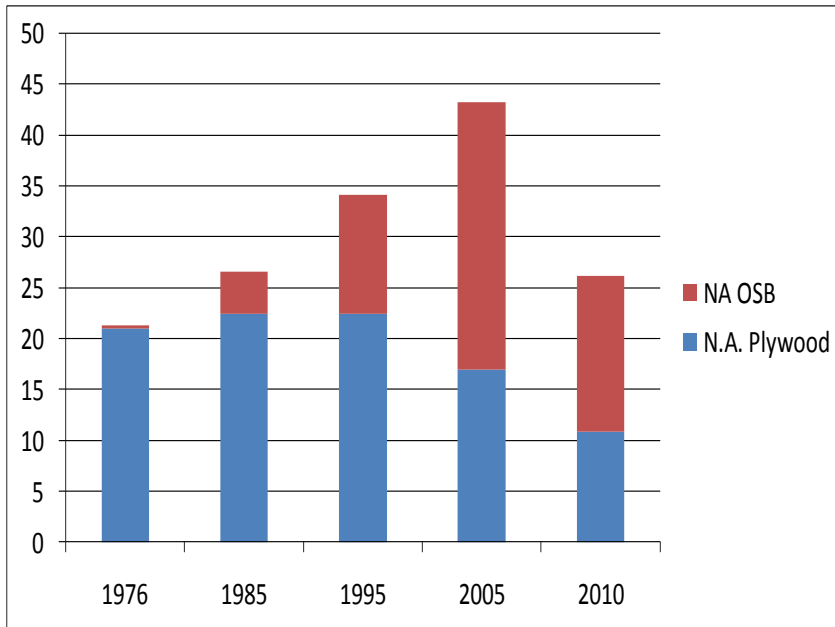


# Lessons of raw material shortages and market changes in Wood Products

- Challenge of scarce raw material in softwood wood products:  
SOFTWOOD SAWLOGS
- In softwood wood products: constant technology/market change due to raw material scarcity
  - Size and quality of average logs decline
- Technology to improve recovery of the scarce raw material
  - Small log handling, sawing and peeling
  - Need to use different type of raw material:  
hardwoods



# Consider fundamental change for structural panels market



- Plywood displaced lumber sheathing
- Then rising timber prices hit plywood
- Oriented Strandboard (OSB) used different raw material
- Hard for plywood guys to see “opportunity”
- Plywood forced to special applications—where OSB could not go



# Other wood product market examples

- Mill focus on Home Depot: Successful in getting consistent quality to California and improved margins for the mill— R&R/consumer vs. homebuilder
- MDF looked for alternatives to declining furniture industry:
  - shifted to flooring substrate
  - moldings as alternative to clear lumber
- Hardwood lumber: packaged product to specific markets to get significantly better margins



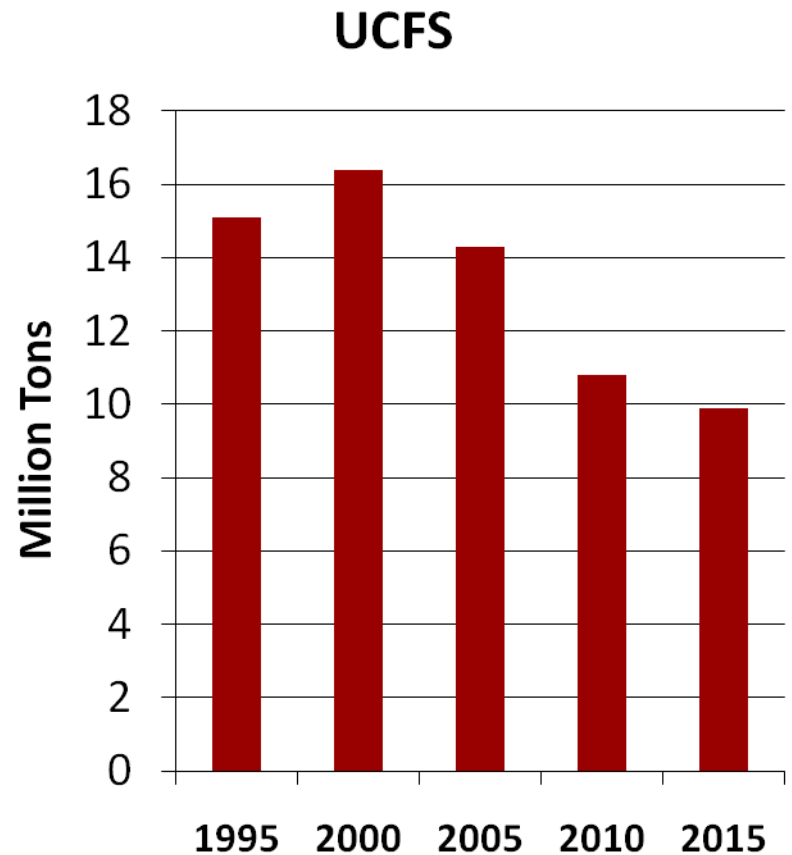
# Another Scenario effort focused on Electronics and P/W papers

- Around 2000 became concerned about electronics substitution issue and maturing paper markets
- Most in business did not see a threat: technology had been a friend
- Scenario team included Microsoft and some R&D/IT experts
  - Built several scenarios for UCFS and Newsprint
  - Resulted in recommendations on grade options and changing investment priorities



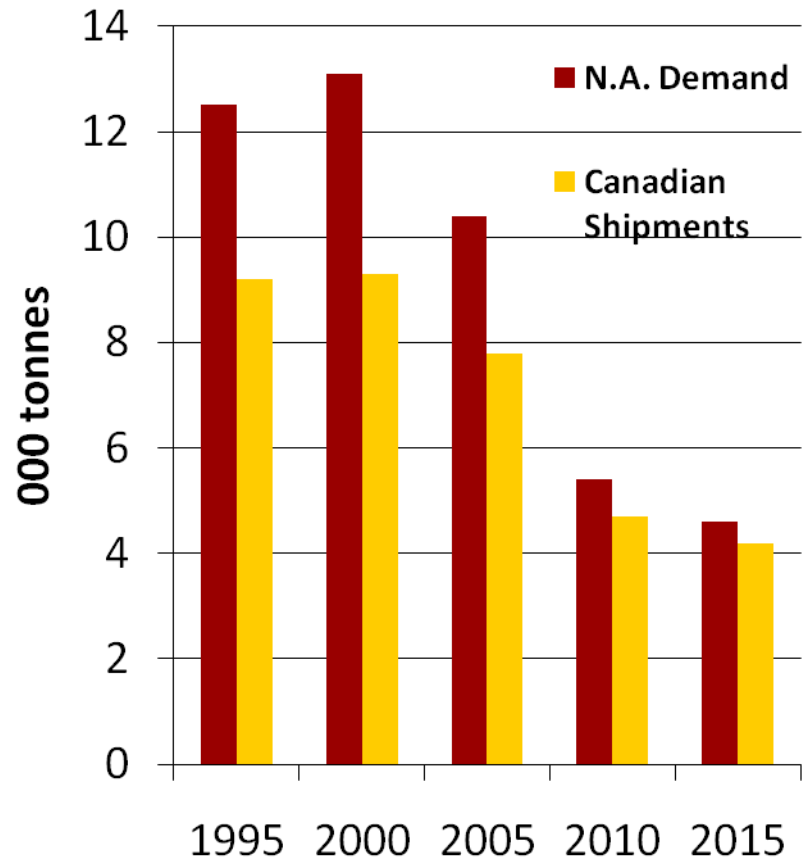
# Decline in UCFS even faster than expected

- Hard for business manager's to believe threat was real
- Suggested focus on specialty papers and market segments—away from commodity grades
- Home office potential and shift in packaging for display
- Reconfigure mills to these grades: bigger scale mills



# Even bigger hit to newsprint

- Massive decline in demand
- Scenario effort suggested quality focus and alternative grades, such as LWC substitute
- Export opportunities, but had to look at paper properties
- Big issue for Canada



# Recent Example in our industry

- Large dairy producer asked suppliers to provide ideas on how to:
  - Reduce carbon foot print
  - Reduce packaging weight
- Initially, of 12 supplier's, only one even listened to the problem
- Another supplier offered a broader solution, by looking at all in cost and environmental issues—got the business
- **MESSAGE: Listen to what customer needs and offer unique solutions**



# Concluding and Some implications from Other Industries

- Some segments will continue to grow and survive in U.S.
  - Food and beverages
  - Export oriented products improving—some reversal?
- Keep open mind to new product options/threats
- Use technology to design boxes to specific end-use requirements and optimize raw material usage
  - Service and technology support
  - Specialized/differentiated paper grades for different end-uses given global shortage of raw material
- **Capitalize on our environmental message—strong one!**

