

## Stable outlook for pulp and paper industry

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PEFINDO views the outlook of Indonesia's pulp and paper industry as stable in the near to medium term. The industry is expected to grow driven by higher demand for tissue and paper-based packaging from domestic and international markets. The demand growth was mostly triggered by the increasing use of paper-based packaging due to many countries being more concerned for the environment issues such as global warming, biodegradability, and health problems caused by plastic packaging. Meanwhile we expect that the demand of paper for newsprint, printing, and writing, which is one of pulp's main derivatives, will continue to slowly reduce due to digitalization. Despite the global recession threat, the market value of pulp and paper sector is predicted to continue growing to USD380.12 billion in 2030 with a compound annual growth rate (CAGR) of 4% for the period 2022 to 2030.

Indonesia is one of the biggest pulp and paper producers in the world. Pulp and paper industry has an important role in Indonesian economic growth, with a contribution to gross domestic product (GDP) of 0.67% and generating state foreign exchange of USD7.5 billion in 2022, consisting of pulp exports of USD3.28 billion and paper of USD4.22 billion to several countries, such as China, Korea, India, Bangladesh, and Vietnam.

Indonesia presents a large business potential for pulp and paper products equipped with sufficient availability of raw materials. Indonesian pulp production capacity is around 12.13 million tons per year, while the paper production capacity is around 18.26 million tons per year as of 2022. The industry is providing employment to more than 161 thousand people directly and 1.2 million people indirectly. The Indonesian pulp and paper industry has greater potential by diversifying its products to increase added value, such as processing dissolving pulp to become viscose rayon as a raw material for textiles.

### **Potential demand from packaging and tissue**

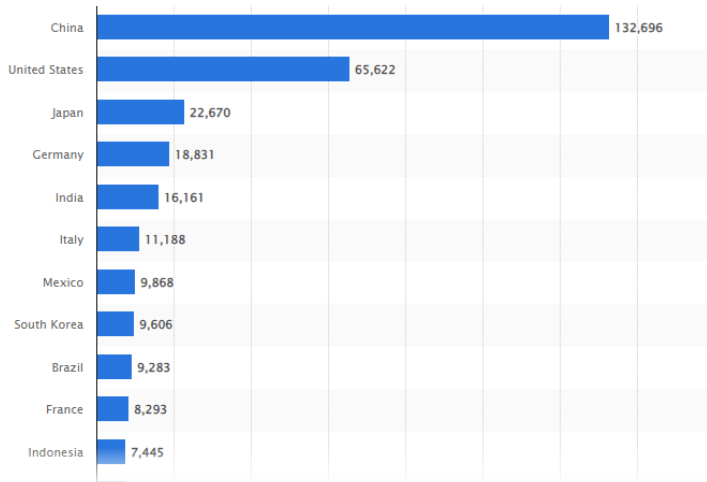
We expect demand of paper packaging and tissue will increase in the long term. Plastic packaging has been gradually substituted by paper packaging in consumer market and the Ministry of Industry in Indonesia plans to strengthen the downstream of pulp and paper industry by dissolving pulp products as the raw material of textile Industry with raising concern to use recyclable products. Paper packaging is less sensitive to economic cycles because it is not easily replaceable by a substitute product, as it is low priced, easy to use, hygienic, and environmentally friendly. Furthermore, increment of tissue demand is expected in line with increment public activities and more hygienic lifestyle trend after pandemic. This trend should compensate for lower demand for paper for media or office usage amid the digitalization trend.

Although the looming recession fear may adversely affect the demand for pulp and paper in the near term, the risk may be offset by condition in China which has already reopened economy activities after Covid-19 since China is the world's largest consumer of paper and paperboard. China was consuming 132.7 million metric tons in 2021, followed by United States, Japan, Germany, India and Italy which consumed 65.6 million, 22.7 million, 18.8 million, 16.2 million and 11.2 million tons paper and paperboard, respectively.

### China's environmental regulation

China government has concerned to environmental regulation which consist of: Environmental protection tax, Emission trading, Unsorted wastepaper import ban, Suspension of inappropriate mills, and reduced Old Corrugated Containers import quota. The China's regulation towards to cleaner and recyclable or environment friendly products as substitution of plastic may positively affect global demand and prices of pulp and paper. China is also expected to be the driving force behind the growth in pulp consumption in the medium term since China is the largest paper and paperboard consumer and importer in the world.

Figure 1. Consumption of paper and paperboard in selected countries worldwide in 2021  
(In 1,000 metric tons)



Source: [www.statista.com](http://www.statista.com)

### **Exposure to price volatility**

All pulp and paper producers will be exposed to the volatility of product prices and raw material costs, which are highly related to global commodity prices. Although most raw material needs can be sourced domestically at low cost, there are risks that the supply may not be sustainable due to factors such as unfavorable weather conditions and environmental issues. Any increase in reliance on costlier external sources for raw material needs may diminish pulp and paper production cost competitiveness and put pressure on the profit margins. This happened in 2021-2022 when there was logistic bottleneck issue resulting in imported material shortage of long fiber and lower export sales. Therefore, players incurred higher operating costs and generated lower profit in 2022. However, we view that the logistic bottleneck issue started to ease in the fourth quarter of 2022.

The players are also challenged to maintain good profitability and cash flow to service debt repayments, especially during the periods of unfavorable external factors such as sudden raw material shortages especially long fiber, increase in operating costs, lengthening receivables collection, fluctuation of pulp price, and others. The industry is also faced with critical questions about climate risk, the effect of forest usage and spur regulations.

During 2021 – 2022, the global industry suffered from increasing raw material prices, lack global supply of pulp due to unexpected stoppages at producers around the globe, strikes and problems in the supply chain, global inventories reaching critical levels that have not yet been fully normalized, particularly in China. In addition, the sector faced global inflation and higher wood costs or shortages in Europe, after embargoes on Russia for the invasion of Ukraine which impacted to increment prices due to high costs. We view majority players in Indonesia are benefiting this situation since they have vertical-integrated production from forestry products (short fiber) as its materials to pulp or its end-products such as paper and tissue. However, those Indonesian players experienced lack of long fiber as its imported raw material and made new formulas to produce products with lower content of long fiber.

Figure 2. Kraft pulp in CNY per ton



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)

In the fourth quarter of 2022, the raw material price started to normalize, close to its historical levels. As of June 26, 2023, kraft pulp price was around CNY5,050/ton, which is stable compared to around CNY4,500-8,000/ton in 2021-2022. The correction in pulp price in 2023 is mainly due to higher global pulp supplies as a result of easing global logistic, additional capacity from three new large pulp and paperboard mills scheduled to operate in 2023 and slower demand due to weakened global economic condition with potential higher inflation rate. The supply chain of pulp has been tight for 2021-2022 and is compressing, leading to an increase in pulp supply. However, we expect the kraft pulp price to remain stable in the near term, driven by China reopening its economy, conversion trend from plastic packaging to paper packaging, Green Procurement Guide policy in Tokyo, and the closure of some pulp and paper players in North America and Australia.

### High barrier to entry

We consider the pulp and paper industry has high barrier to entry Industry, given the large capital expenditure needs for machinery, factory equipment and forestry, which are majorly debt-funded, resulting in high financial leverage for most of Indonesian pulp and paper producers. Furthermore, the players must have high experience for managing forestry since well-integrated business led to lower cost and raw material certainty.

In addition, there are three large pulp capacity projects planned to start production in 2023, such as Arauco MAPA project with estimated pulp annual production capacity of 2.1 million tons in Chile, UPM's BEK greenfield plant with estimated pulp annual production capacity of 2.1 million tons in Uruguay, and Metsa Paperboard Kemi plant with estimated paperboard annual production capacity of 3.6 million tons in Finland. This huge new production capacity may weaken the price of global pulp due to higher supply in the near term. However, this may be compensated by increased demand in the medium term. We expect this industry's competitive landscape will focus on a few prominent players that aggressively expand its business by capturing new pulp forest areas, increase its production capacity and down streaming paper products to be viscose rayon as a raw material for textiles.

### Rated pulp and paper companies

As of June 30, 2023, PEFINDO has rated and published the ratings of four pulp and paper players, namely PT Indah Kiat Pulp and Paper Tbk (INKP, *idA+/Stable*), PT Oki Pulp and Paper Mills (OPPM, *idA+/Stable*), PT. Pindo Deli Pulp & Paper Mills (PIDL, *idA/Stable*), and PT Lontar Papyrus Pulp and Paper Industry (LPPI, *idA/Positive*). We also view that the rated entities are having moderate financial flexibility to raise external funding, either from issuing debt instruments, or incurring loans from banks considering their strong business position and stable industry outlook.

Table 1. Financial highlight as of 31 December 2022

As of/for the year ended	IN KP	LPPI	PIDL	OPPM
Consolidated Figure	Dec-2022	Dec-2022	Dec-2022	Dec-2022
	(Audited)	(Audited)	(Audited)	(Audited)
Total Adjusted Assets [USD Mn]	9,640.7	2,262.9	6,965.9	6,497.4
Total Adjusted Debt [USD Mn]	3,356.4	756.7	2,419.5	2,649.9
Total Adjusted Equity [USD Mn]	5,605.2	1,342.9	3,843.6	3,623.7
Total Sales [USD Mn]	4,002.6	656.0	2,314.4	1,815.3
EBITDA [USD Mn]	1,395.4	327.5	567.4	992.5
Net Income after MI [USD Mn]	857.5	228.2	765.7	789.6
EBITDA Margin [%]	34.9	49.9	24.5	54.7
Adjusted Debt/EBITDA [X]	2.4	2.3	4.3	2.7
Adjusted Debt/Adjusted Equity [X]	0.6	0.6	0.6	0.7
FFO/Adjusted Debt [%]	28.4	29.5	16.3	30.2
EBITDA/IFCCI [X]	5.5	6.6	4.8	5.1
Rating	idA+/stable	idA/positive	idA/stable	idA+/stable

Source: Financial statement, processed by PEFINDO

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