

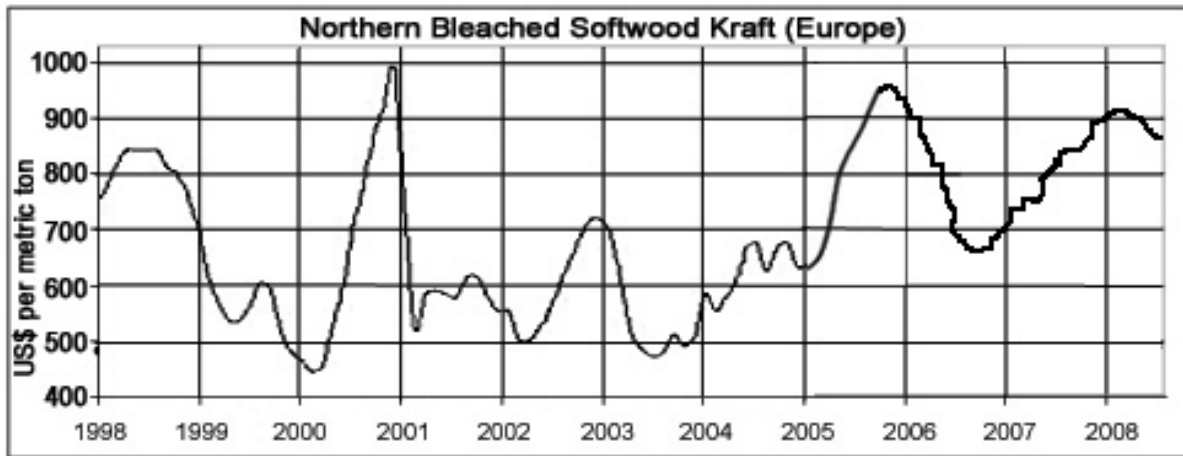


August 21, 2008

Market pulp (NBSK, Northern Bleached Softwood Kraft) has become a global product in recent years. Formerly ruled by North American producers, the pulp market has expanded to include rapidly emerging countries like Brazil and Indonesia. In addition, improvements to production technology have made the previously highly-regarded North American long fibre softwood no longer necessary to produce good quality pulp. Energy rebates, low wage rates and the ability to grow fibre quickly (for example, a eucalyptus tree can grow to full size in seven years) have given these new players in the pulp market a competitive advantage.

Generally speaking pulp is made from wood chips (sawmill residue) although it is also possible to chip whole logs, particularly small roundwood which is not especially useful or valuable for making lumber. When sawmill production is down, as it currently is, chips are difficult to source and become expensive. The irony of this situation was not lost on North American pulp producers in the 1Q 2008, when pulp prices were nearing record highs but pulp mills had to close because they could not get chips. Into spring, demand for wood chips from the agricultural sector for bedding and mulch rises sharply, causing even more limited supply. In September 2007 wood pulp futures started being traded on the Chicago Mercantile Exchange.

**Benchmark Market Pulp Prices 1998-2008**



17% 22% 7% -10% -11% -3% -4% -2% -5% -14%

Catalyst Paper Corp. Earnings Yield www.madisonsreport.com

Pulp prices are directly driven by demand for paper, notably newsprint. Newsprint demand is extremely dependent on economic strength; when times are tough and money is tight, the first thing to get cut from any budget is advertising. Less advertising means smaller newspapers. In the past pulp prices were very volatile, causing great problems to company bottom lines around the world. A decision was made within the industry to heavily hedge pulp in order to create a more stable price cycle. The plan

has worked remarkably well, with major issues like forest fires, a nationwide strike in Finland and sawmill closures causing a chip shortage having negligible effects on the price of pulp. At most the impact could be seen three to four months after the fact.

Wood products companies often build pulp mills adjacent to sawmills in order to best capitalize on the wood residue (sawdust and chips). In a perfect world, both plants chug along at full capacity with the pulp mill sometimes trucking in chips from another location as well. In recent years advancements in cogeneration have allowed pulp and paper mills to significantly reduce high energy costs by powering operations from waste products, often by as much as 60 per cent. Even these advancements, however, have not been enough to offset the lower production costs of newly emerging producer countries.

The company at the leading edge of such creative uses of waste for energy is Catalyst Paper Corp. In mid 2006 the company was already using biofuels to provide 75 per cent of the energy needed for heating its plants. In 2007 BC Hydro awarded the company a Power Smart Excellence Award as an Energy Champion for saving 148 gigawatt hours of energy per year, equivalent to \$8,143,000 annual cost savings. As BC Hydro's largest customer, that is a significant achievement for Catalyst Paper.

In October 2000 NorskeCanada was created from a buyout of Fletcher Challenge by Norway's Norske Skog. In October 2005 shareholders agreed to change the name to Catalyst Paper Corp. Global economies were doing well, demand for paper was high and pulp prices would reach near record highs before the year was over. In that year Canada was the world's largest market pulp supplier, with 11.4 million tonnes of capacity accounting for 21 per cent of global capacity. Also in 2005 Catalyst signed a Climate Savers agreement with the World Wildlife Fund, pledging to achieve a sustained 70 per cent reduction in greenhouse gas emissions by 2010. Pulp mills use significant amounts of chemicals, particularly for bleaching, making them targets for environmentalists as major polluters.

In 2007 Catalyst launched a new product, named Catalyst Cooled Paper, whose manufacture adds no net carbon emissions to the atmosphere. A partnership with Rolling Stone Magazine for paper supply was quickly struck. The company plans to continue with such developments into the future.

It is extremely unlikely that market pulp production in North America will ever return to its former high levels, thus advancements in the use of fibre for other purposes is essential for the survival of the pulp mills that do continue operating. Cellulostic fibre for textiles, to be used for making clothes, is another example of unique production techniques on this continent. The distinct advantage for the North American pulp and paper industry is the proven practice of sustainable harvesting and immediate replanting of fibre. The government of Indonesia has already laid charges against one of its new paper producers for illegal logging and harvesting. In today's world of consumer awareness, such activities may prove lethal if they are to continue.

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