



MADISON'S TIMBER PREVIEW

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3Q 2009 results are out for many North American solid wood, pulp, and paper companies, with most reporting continued losses as expected. Severe curtailments, cost cutting measures and production adjustments to match low market demand have helped keep the losses above the level of tragedy that occurred one year ago.

Yet another increase in North American NBSK (northern bleached softwood kraft) pulp prices announced a month ago by several large producers in Canada and the US have been accepted by customers. List prices on domestic NBSK rose for the fifth straight month, up US\$30/metric ton to US\$800/metric ton. Low mill inventories, continued strong Chinese demand, and better than expected domestic demand drove the price rally. A weaker US dollar is contributing to the rise in export prices.

Similar efforts by newsprint producers to raise prices have not met the same success. List price for US newsprint is essentially flat this week, at US\$468 per ton, but down US\$280 per ton from January 1, 2009, according to FOEX.fi. European newsprint is doing much better than North American, up €17 per ton from January 1, 2009 to €511, possibly signalling economic recovery in Europe. However European producers indicate that a lot of the demand they see is from the export market, according to FOEX.

Containerboard prices, an important indicator of future product shipments, are up slightly but not as strong as late 2Q expectations. US containerboard export prices are up US\$15/ton to US\$335/ton FAS levels, driven by an uptick in demand. An announced large price increase for September/October in European containerboard was met with limited success, according to FOEX.

The global pulp and paper industry is in a panic over a potential biofuel subsidy in the US originally intended for farmers. Some analysts are calculating a credit of US\$1.01 per gallon of so-called "black liquor", a by-product from making pulp out of wood chips which is used in power cogeneration. In assessing the previous subsidy, part of the US Highway Act, many economists declared that the tax rebate, valued at US\$8 billion for US pulp mills, was never meant to be used for that purpose and was, therefore, not budgeted for by Congress. The reason for alarm globally is that curtailed US pulp mills came back online this year in order to take advantage of the Highway Act, which is set to expire at the end of this year. Overproduction, both of solid wood products and pulp and paper, in 2007 and especially 2008, is what drove those commodity prices down in the first place.

Wood chip scarcity due to rampant sawmill curtailments have helped keep market pulp prices high. This year, only an estimated 25 million tons of wood chips will be shipped worldwide, the lowest volume since 2002 according to Wood Resources Quarterly. Global trade of wood chips has increased on average four per cent per year from 2004 to 2008, reaching a record 32 million tons in 2008. This upward trend was broken in 2009 with trade being down 26 per cent during the first half of the year as compared to 2008. The drop in shipments was the direct result of the global financial crises and the reduced demand for paper products worldwide, according to the Quarterly.

In an effort to specialize, away from the competitive world of market pulp, Montreal forestry firm Domtar Corp. said Tuesday it will convert its Plymouth, NC, mill to a fluff pulp production facility, reducing its annual uncoated freesheet production capacity by about 200,000 tons. Domtar said the conversion will require a US\$73.5 million investment, and would boost its annual fluff pulp making capacity by

almost threefold to 444,000 metric tons. The mill reconfiguration will help preserve about 360 positions, Domtar said.

Responding to continued weak market conditions, Memphis, TN-based, International Paper Co, the world's largest containerboard and coated paperboard producer and second-largest North American player in uncoated paper, said Thursday it is cutting 1,600 positions — nearly 3 per cent of the current payroll — as it brings capacity into line with sharply diminished demand. The move, to be implemented from mid-December through Spring 2010, will cut IP's capacity, which has been about 16 million tons, by about 2.1 million tons or 13 per cent. Two-thirds of the capacity closures are in containerboard, IP's single largest business. Following these permanent shutdowns, IP will have about 10 million tons of North American containerboard capacity, 2.6 million tons of North American uncoated freesheet production capacity and 1.7 million tons of North American coated paperboard capacity.

Deutsche Bank Equity analysts promptly issued a note maintaining a "Buy" rating and a US\$28 price target for IP shares.

Meanwhile eyes turn to Smurfit-Stone, currently in bankruptcy, for a closure announcement of a similar magnitude.

On October 16, 2009, Nordic papermaker Stora Enso and Chilean partner Arauco completed a \$344 million acquisition of an Uruguayan pulp mill project from Spain's Ence. The deal, which included 136,000 hectares of land, was announced in May and the transaction was expected to be completed by year-end. "Cost-competitive plantation-based pulp is an essential part of Stora Enso's strategy and in one step, this transaction has secured the strategic raw material supply for a world class pulp mill in Uruguay that we are planning jointly with Arauco," said Stora CEO Jouko Karvinen. In a separate announcement, Karvinen explained that Stora's cost-cutting measures of earlier this year represent only one-third of the company's planned total cuts into early 2010.

Due to cost-cutting measures and a sharp rise in demand for face masks to protect against airborne viruses, Kimberley-Clark announced late Thursday that 3Q 2009 earnings were up 40 per cent compared to one year ago. The company earned US\$582 million, or \$1.40 per share, in 3Q 2009, up sharply from US\$413 million, or 99 cents per share, in 3Q 2008.

The other big shakeup in the North American forest products industry this week is rumours of a takeover of bankrupt Grant Forest Products, out of Ontario, by Atlanta's Georgia-Pacific. A panel producer, Grant's OSB capacity share is about 10 per cent of the North American market. G-P operates about 300 locations worldwide manufacturing tissue, pulp and paper, packaging, and building products. Despite local opposition to foreign take-over of the family-owned Grant FP, some analysts predict the acquisition would represent a large step in restructuring the OSB sector and putting the industry back into balance. A court-appointed monitor is reviewing the bids and will make a recommendation to the courts by December 1, 2009.

At the moment some indicators are moving upward, while others continue to lag, and yet others move sideways. Reactions by large companies in the solid wood, pulp, and paper industry are helping to stabilize supply and demand. While 4Q 2009 is not expected to see much improvement over 3Q, there are expectations that 1Q 2010 could see greater improvement in both demand and commodity prices.

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