



**Sector:**  
Paper & Forest Products

**Sector Weighting:**  
Underweight

# **CIBC World Markets Inc. Institutional Client Presentation**

**PricewaterhouseCoopers 22nd Annual Global Forest &  
Paper Industry Conference 2009:  
ReEnergising The Forest & Paper Industry**

## **The Global Economic Crisis And Other Shocks To The Forest Sector: So What?**

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# Outline

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- **The Current Chaos**
- **Solid Wood/Housing**
- **Pulp**
  
- **So What? - Looking Out From The Chaos**



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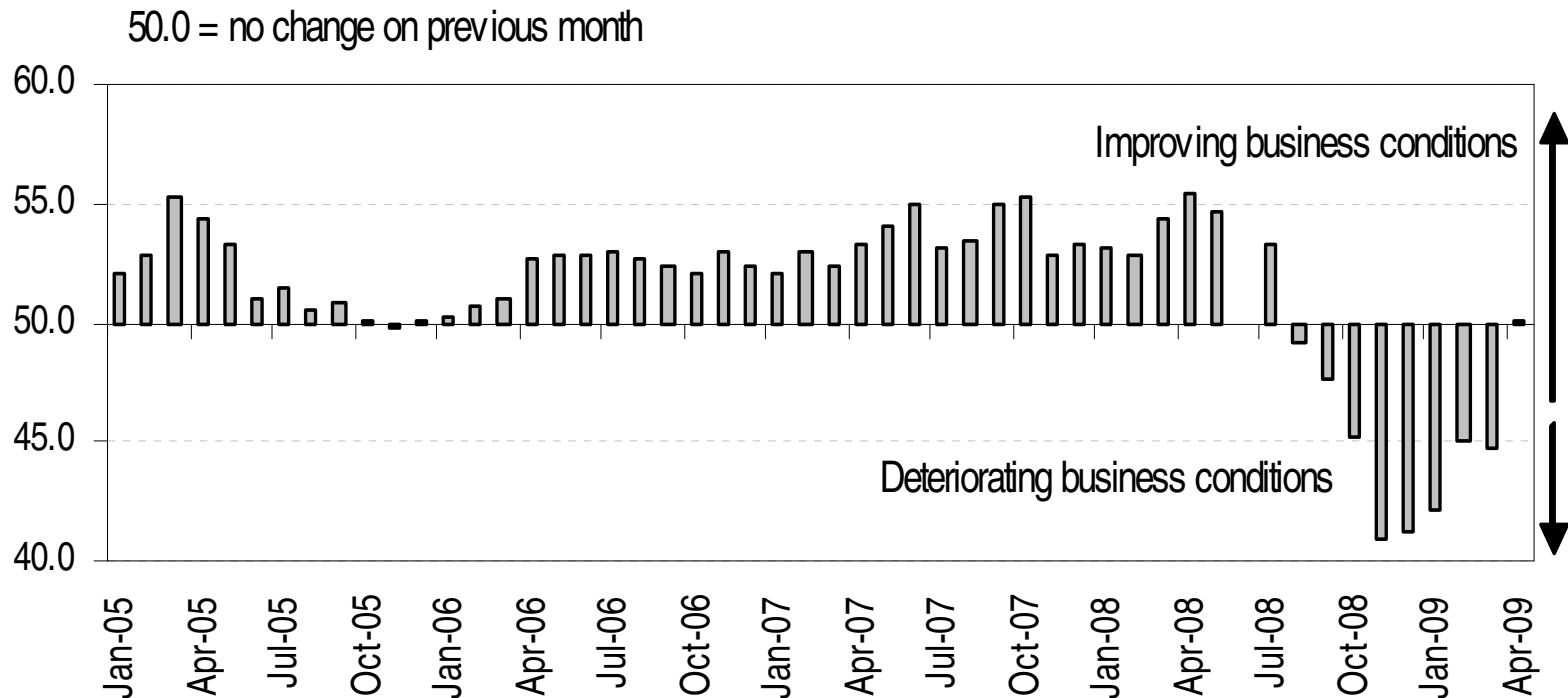
# The Current Chaos

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- *Significant credit crunch*
  - Difficult for even companies with strong balance sheets to operate due to capital rationing
- Many of the offshore economies are *now in worse shape than the U.S.*
- Initial signs the financial system is starting to function again
  - Global bond issues up ~ 10% year over year in Q1
  - Interbank lending rates have plummeted from their peaks
- Still lots of macro-economic unknowns
  - *Could we be facing a "lost decade" of growth like Japan experienced?*
  - Historically, peak-to-trough changes in employment & house prices take ~5 years after a severe financial crisis (2012?)



# China Purchasing Managers' Index



Source: CLSA and CIBC World Markets Inc.

- However, there are some bright spots on the horizon.
- China is implementing a \$725 billion stimulus package. This is equivalent to 16% of GDP (vs. 6% in the U.S. and 2.5% in the EU).
- The impact is already showing up, with a clear turnaround in the perceived business conditions in China. But is this enough?



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# The Current Chaos

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A number of pressing issues are at play in the current chaotic economic and business climate.

Some are a result of the dramatic decline in global demand, and others are independent:

- Significant shift in cost structures – Driven by changing currencies, prices and volumes
- Changing trade & transportation patterns
- Evolution in public policies with regard to energy pricing and carbon
- Evolving role of government in general, including a re-assessment by some governments of the forest industry's "social contract"....tenure reform is on the horizon

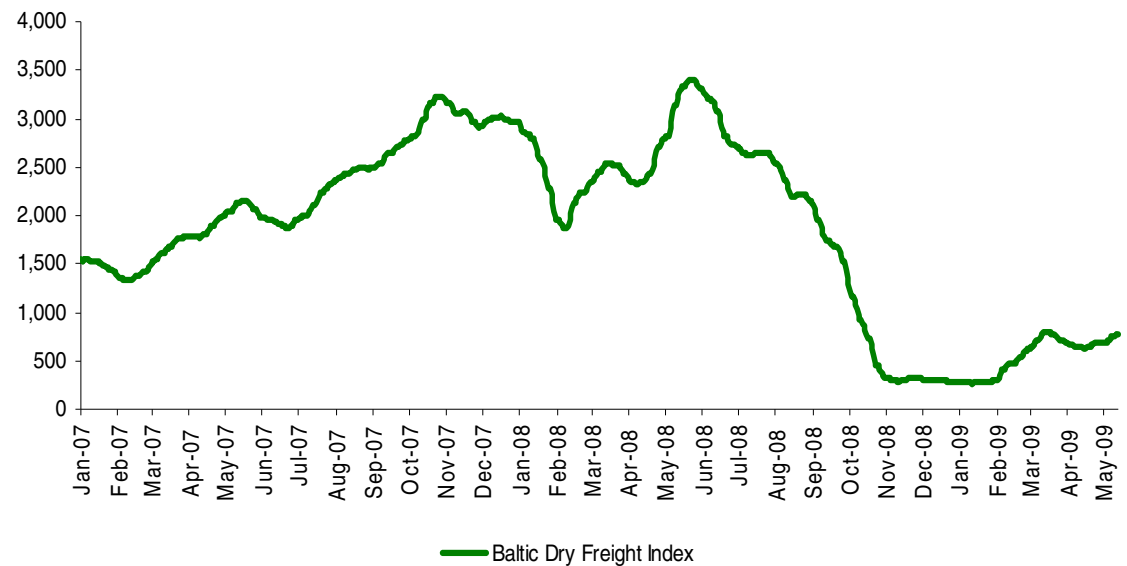


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- ❑ **Transport costs are typically 20%-30% of the total delivered cost of forest products**
- ❑ **Cost of ocean freight transport has fallen through the floor. Index down from ~3500 in May 2008 to ~250 in January 2009, and back up to ~750 in May**
- ❑ **The world *has become smaller* – despite the rhetoric that globalization is reversing**
- ❑ **International trade will play a *bigger role* – but offshore demand has to pick up first**

**Baltic Handy-Size Freight Index**



Source: Baltic Dry Index and CIBC World Markets Inc.

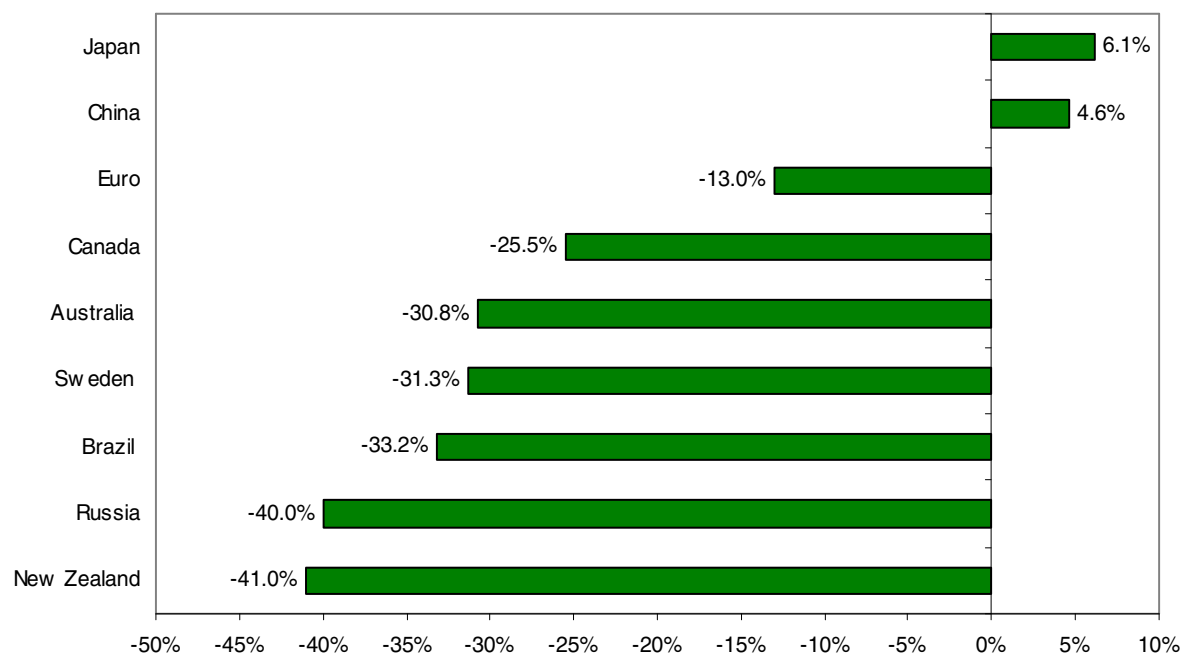


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- ❑ **Due simply to changes in exchange rates, the cost competitiveness of the Canadian industry has improved relative to that in the U.S., Euroland, Japan and China**
- ❑ ***... but Canada has lost competitiveness compared to key offshore competitors in Sweden, Brazil, Russia and New Zealand***
- ❑ ***Downward pressure is being exerted on prices denominated in US\$ – benefits of weaker currencies passed on to the consumer***

**World Currency Movements (Against The US\$):  
Average Q1/2008 Vs. March 31, 2009**



Source: Bloomberg and CIBC World Markets Inc.

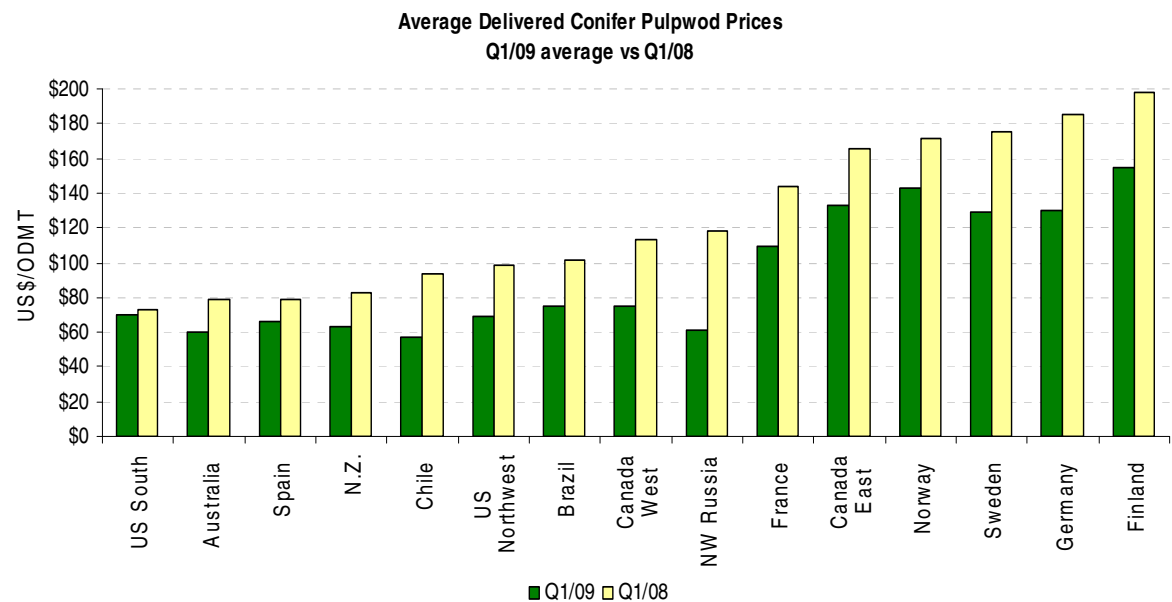


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- ❑ **Changes in currencies and demand have caused a downward shift in the global cost curve for pulp fiber – the biggest drop in US\$-denominated pulpwood costs in over 20 years. The curve is now much flatter, and in two segments**
- ❑ **The largest declines have been experienced in *NW Russia* ~50% and *Chile* ~40%**
- ❑ **Changes within N. America are very uneven: *W. Can & PNW* ~30%, *E. Can* ~20%, and *U.S. South* ~5%**
- ❑ **Europe is down 15%-30%, depending on the country**

## Average Delivered Conifer Pulpwood Prices Q1/09 Average Vs. Q1/08



Source: Wood Resources International and CIBC World Markets Inc.



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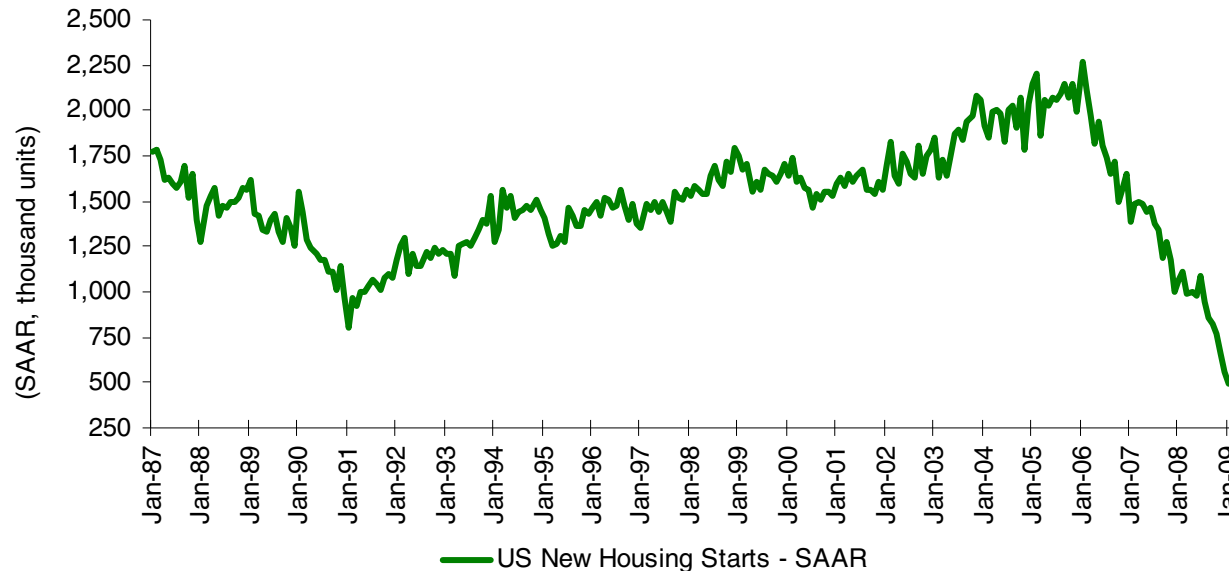
# Selected Thoughts On Housing



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# U.S. Housing Starts



Source: U.S. Census Bureau and CIBC World Markets Inc.

**The U.S. housing start chart speaks for itself. Single-family starts fell to 356,000 (SAAR) in March ..... <1/4 of the peak.**

**We have a cyclical problem in housing demand – 0.5MM in 2009E and 0.7MM in 2010E?**

**However, we don't have a secular problem. Normalized starts of 1.5MM in the U.S. is reasonable.... but when?**

**In the meantime, expect more sawmill closures. We are now into the third year of a bad lumber market, and folks are running out of cash. 15 sawmills estimated to close in Southern U.S. in 2009 (~750 MMbf)? – 7% capacity drop.**

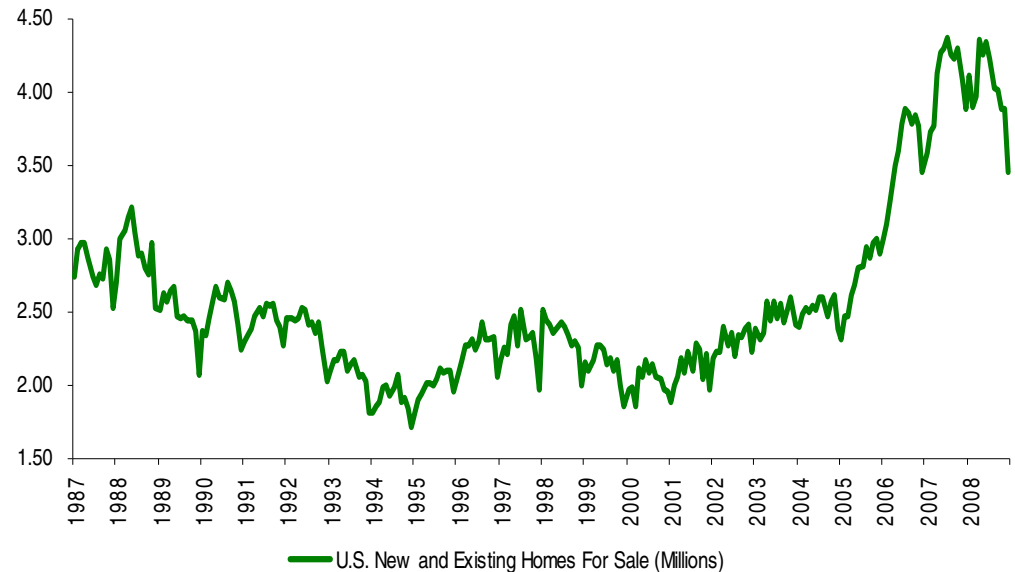


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- ❑ **The housing market drives the demand for solid wood products, and a good part of the U.S. economy**
- ❑ **The “months supply of homes for sale” is still more than double the historical level**
- ❑ **But the *absolute inventory* has actually been coming down since November**
- ❑ **If this trend continues (and mortgages begin to flow, and more foreclosures are avoided), the “*months of supply*” could drop dramatically in late 2009**

## U.S. Housing Inventory For Sale



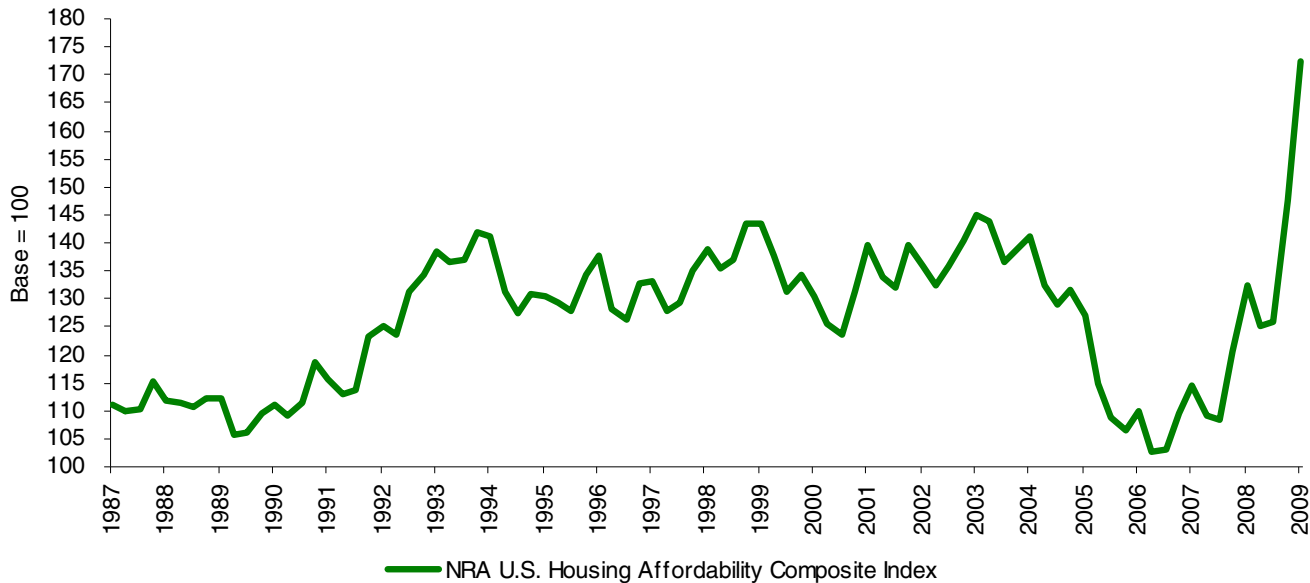
Source: NAR and CIBC World Markets Inc.



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# U.S. Housing Affordability Index



Source: National Association of Realtors

Home prices have already come down substantially, and interest rates are low. As a result, affordability of housing is now at its highest since at least the mid-1980s.

However, many are still reluctant to enter the housing market since they are not confident they will have a job.



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- On the supply side, the key problem facing the housing markets *is foreclosures*, and they could delay the U.S. housing recovery until 2012.
  - The ~\$1 trillion in sub-prime mortgages has been the problem over the past two years.
  - Over the next two years we still have to be concerned with the ~1 trillion in ALTA A and ~\$0.6 trillion in Option ARMS that are up for renewal.
  - Will the Obama administration's efforts (e.g., Homeowner Affordability and Stability Plan) really solve the problem? No one knows.



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# Selected Thoughts On Pulp



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# Rationalization Of The Pulp Sector

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- The pain has accelerated in the form of capacity closures, but it is also being more widely shared
- Gross closures of global wood pulp capacity (mkt + integrated)
  - 2000-2007: ~29 million Tpy, of which ~65% in N. America
  - 2008: ~10 million Tpy, of which ~50% in N. America
- But this misses the closures of non-wood pulp capacity in China
  - 2005-2008: ~5.4 million Tpy closed
  - NDRC has targeted another 2 million tonnes by end of 2011



# U.S. Black Liquor Subsidy

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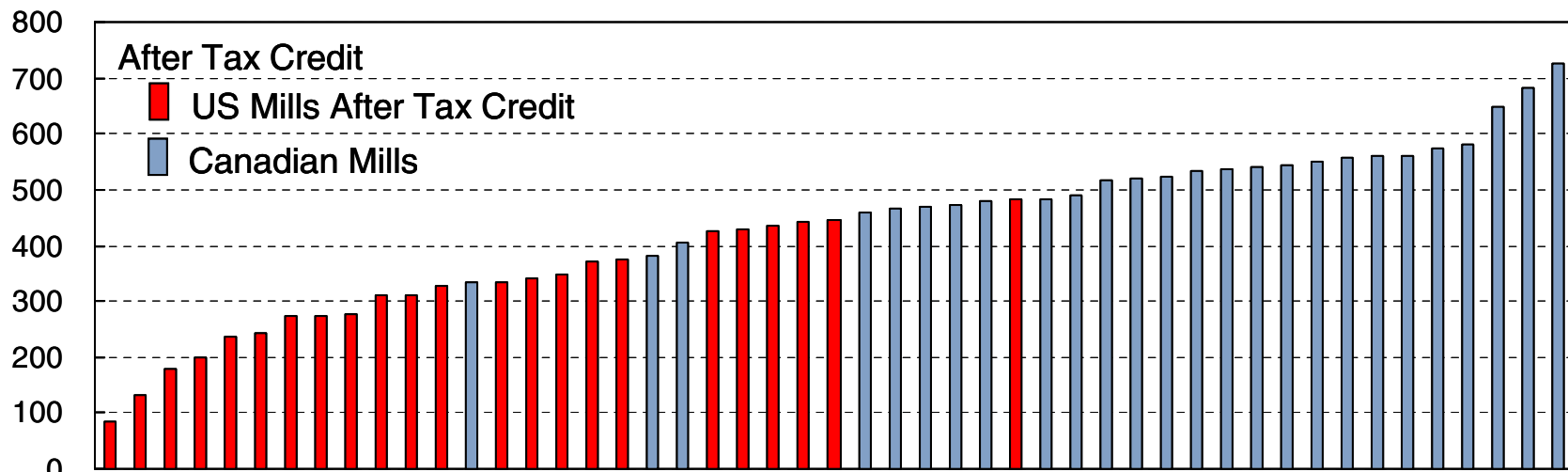
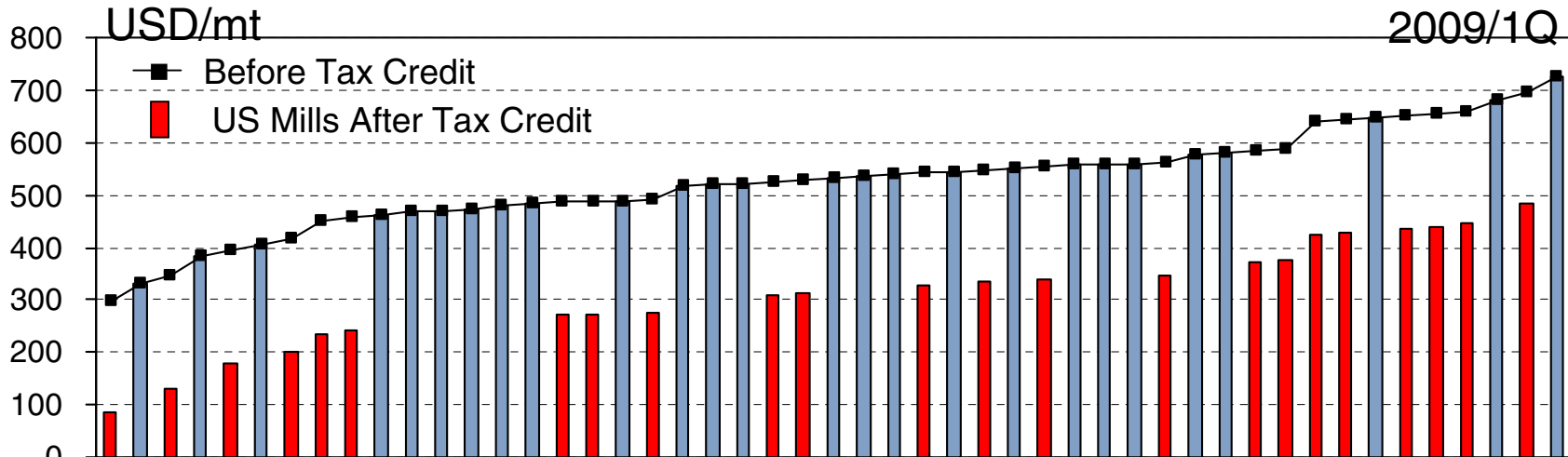
- Alternative Fuel Mixture Tax Credit confers a significant subsidy to kraft pulp mills in the U.S. ... \$6 billion-\$8 billion range in aggregate.
- Equivalent to roughly \$220/tonne of pulp.
  - Major impact on relative cost positions – U.S. mills now dominate the lower end of the N. American cost curve.
  - Difference between generating negative EBITDA and a decent return.
  - Offsets being lobbied for in Canada. So far, “heat, but no light.”
- Status remains uncertain:
  - Administration is recommending it be eliminated in October.
  - Will likely expire at the end of the year.
  - Even though transitory, it provides a significant boost to the balance sheets of selected players.
  - Replaced by something else related to renewable energy?



# U.S. KRAFT PULP MILLS BECOME LOW-COST PRODUCERS

## NA Market & Integrated NBSKP Producers – Manufacturing Cost

Before the tax credit\*, Canadian and U.S. producers were distributed throughout all cost levels. After the potential tax credit is applied, U.S. producers dominate the top 50% of lower-cost pulp producers.



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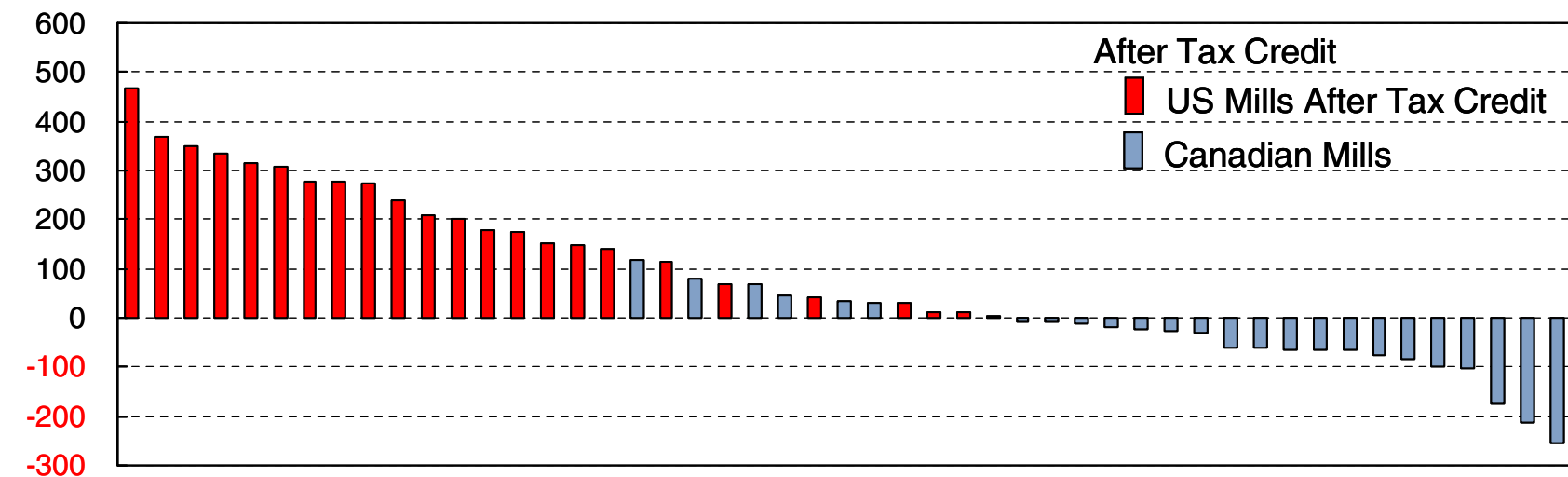
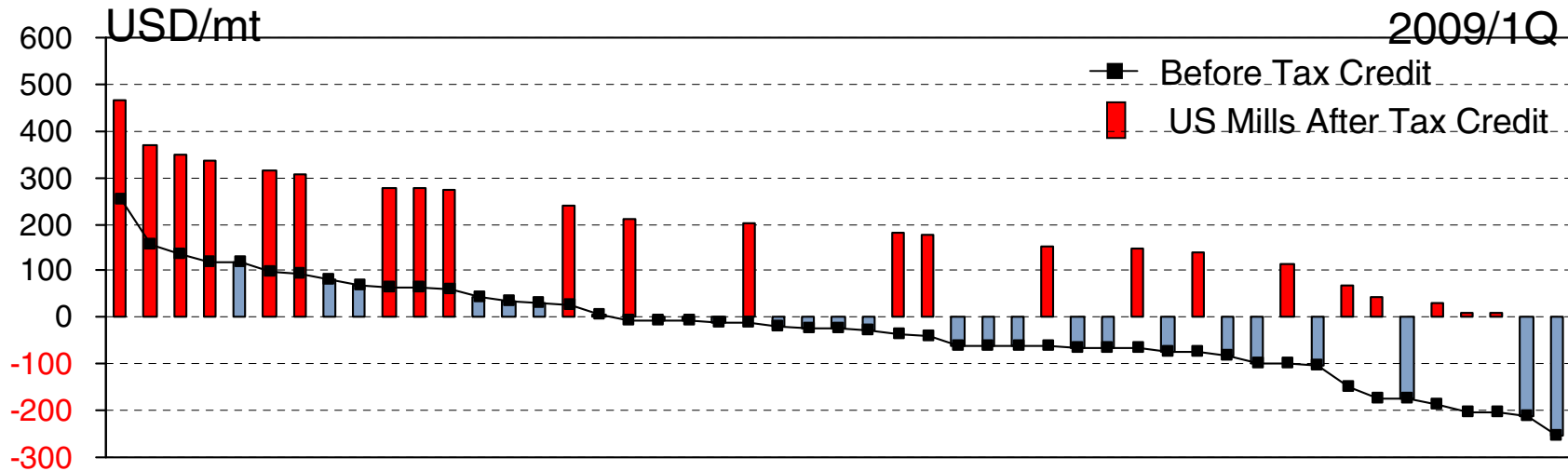
Source: Pöyry Consulting



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# DRAMATIC SHIFT IN ECONOMIC ADVANTAGE

## NA Market & Integrated NBSKP Producers – EBITDA



\*\*EBITDA=Pulp Price(550 USD/mt) - Manufacturing Cost - Delivery Charges to Natural Market

Source: Pöyry Consulting



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# *Looking Out From The Chaos*



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# Silver Lining?

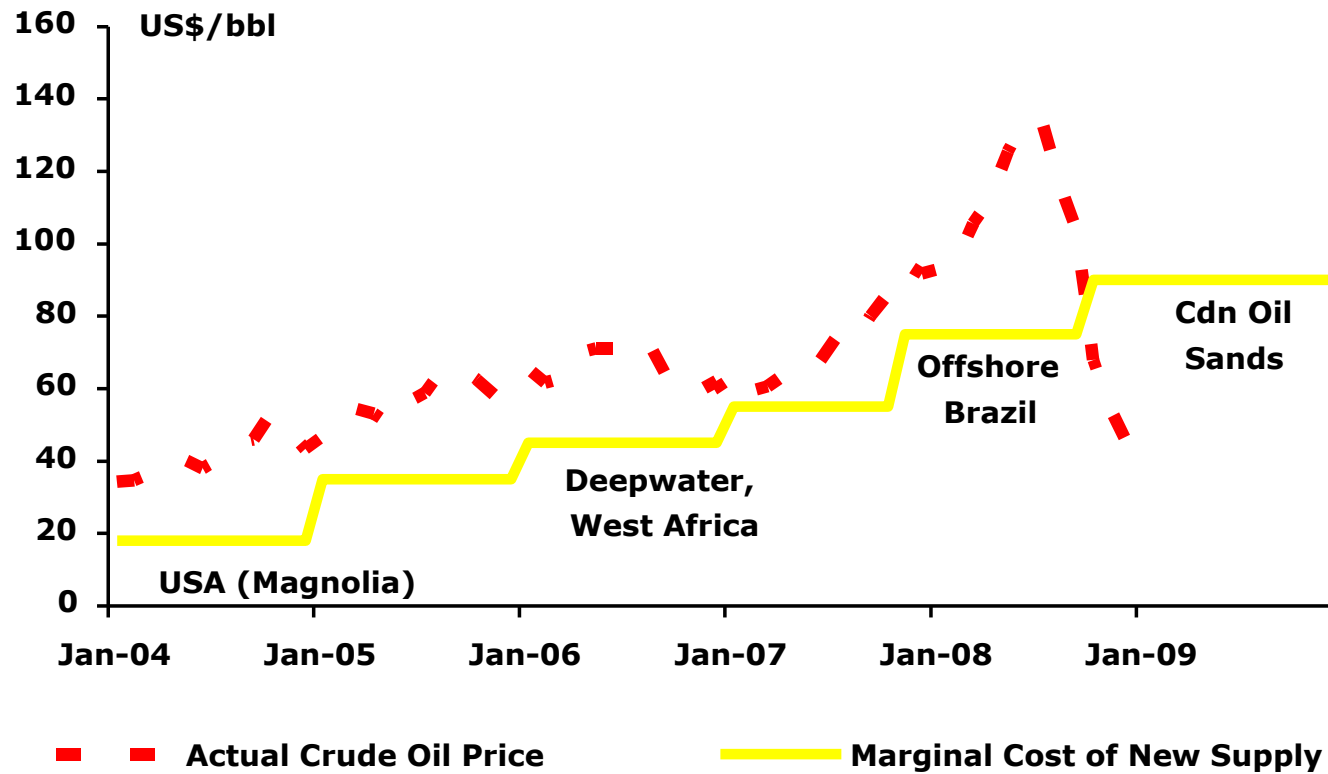
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- The financial crisis is causing mayhem throughout the global industry... but it also may have a “silver lining” for N. American producers:
  - Caused capacity expansions in S. America to slow down
  - Added fury to the “*Perfect Storm*” that has moved onto Europe after hitting Canada
  - Revealed that the Chinese industry is much more dependent on direct (& indirect) export markets than thought
  - Exposed the “weak underbelly” of the Russian oligarchs
- **Implication? Future offshore competition may be less than we had thought – at least for a while. *Markets will be tighter when the recovery does eventually come due to reduced capacity.***



# Don't Confuse The Cyclical With The Secular Move In Oil Prices

**Given the shape of the global cost curve for oil ~ a "normalized" oil price in the US\$60/Bbl-US\$80/Bbl range seems reasonable**



Source: CIBC World Markets Inc. Economics



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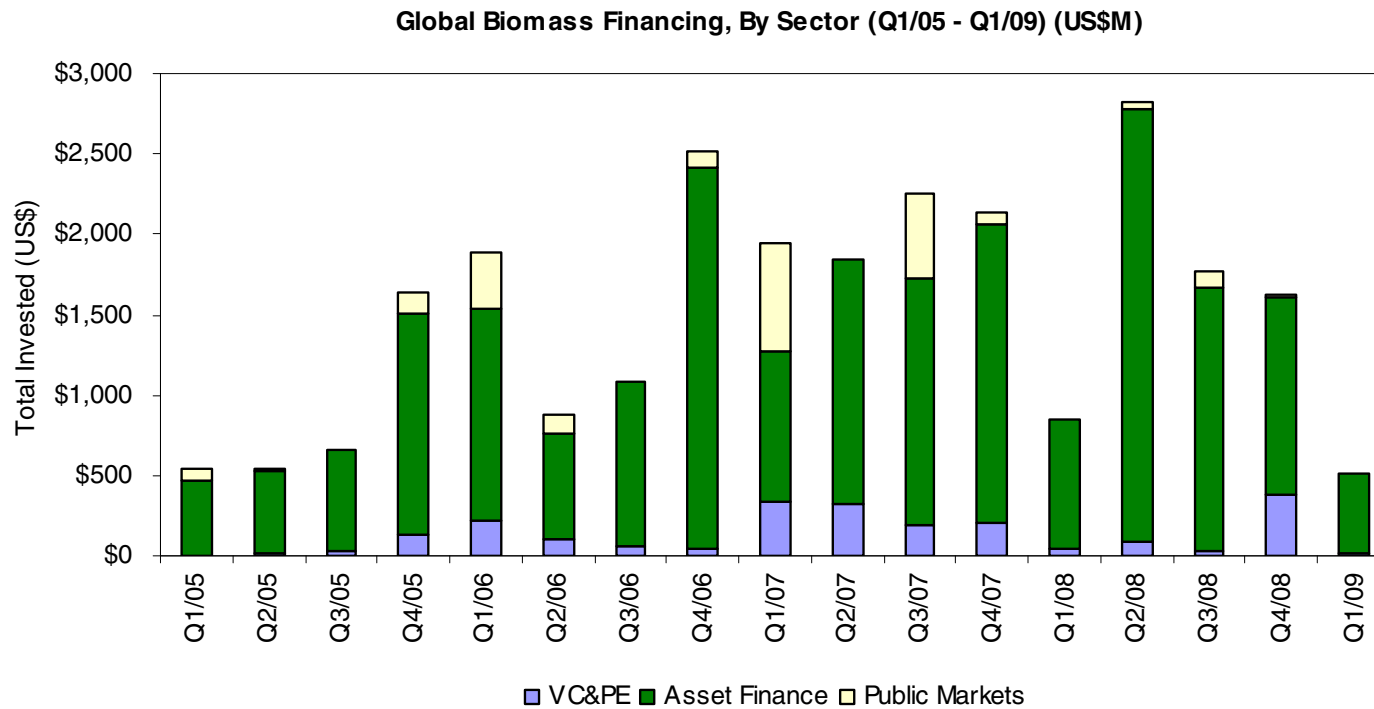
# Carbon

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- There will be a price on carbon
  - Cap-and-trade system for NA by 2012?
  - Support for international measures at Copenhagen meetings in December 2009
- The value of carbon offsets will likely be dwarfed by the value associated with changes in relative product prices
  - *Lumber vs. cement and steel*
  - *Virgin fiber vs. recycled*



# Global Biomass Financing



Source: New Energy Finance, CIBC World Markets Inc.

The crisis has caused financing in the emerging biomass-based energy segment to plummet – down from almost \$3 bln. in Q2/08 to \$0.5 bln. in Q1/09.

However, this will rebound over time in response to higher energy and carbon prices. Are we ready for the implications?



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# How Can We Create Value?

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- Recognize we are dealing with a very heterogeneous resource.
- Match the specific quality of fiber to a specific application in a specific market.
- Numerous impediments to doing this:
  - Technological barriers?
  - Market knowledge and/or access?
  - Availability of capital?
  - Existing tenure systems?

...The industry's transformation is just starting.  
Will we proceed in a thoughtful fashion?



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Sector Underperformer (Sell)	2	12.5%	Sector Underperformer (Sell)	2	100.0%
Restricted	1	6.3%	Restricted	1	100.0%

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