

STABILITY NOW

Weyerhaeuser closes Prince Albert. Domtar closes Cornwall. Cascades closes Thunder Bay. At the same time, new mills are being built in China.



Why is this happening? It's a good question, but basically it's a matter of price, cost and profitability. North American paper prices are about where they were in 1980, and are lower than they were ten years ago. During those ten years, despite consolidation and cost reduction programs, costs have risen, and North America's paper industry has not returned its cost of capital. Many mills barely cover their variable costs, and the strong Canadian dollar has made the problem even worse in Canada. Prices in

I discussed this with Paul Leclair, Chief Economist at the Pulp and Paper Products Council in Montreal, and he noted that while capacity closures are affecting supply in most grades, the impact on North American supply is particularly large in uncoated woodfree (also called uncoated freesheet).

Imports from offshore are a larger factor for coated grades than for uncoated freesheet, and while Domtar and Cascades do not have mills overseas, other large, global suppliers like Sappi, Stora Enso and UPM do. If coated mills

the Montreal office of Unisource Worldwide, Canada's leading paper merchant, explained that most uncoated mills had implemented allocations on roll offset, but not sheet fed offset.

This is not surprising. Web offset is at the bottom of the profitability scale for most mills, while sheet fed paper is a "value added" product. In addition, sheet fed orders are steadier, reflecting a large number of smaller jobs.

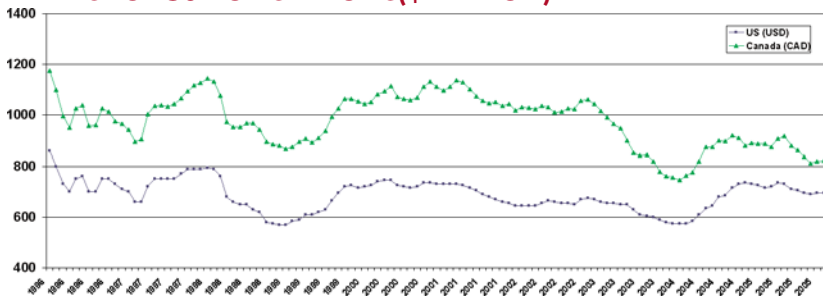
WHAT DOES ALL THIS MEAN FOR THE CANADIAN PRINTER?

First, it's important to understand how allocations work. Mills try to protect steady business and impose allocations in an attempt to manage the tonnage so that opportunistic buyers do not squeeze out the steady customers. In managing allocations, mills look at history, but it's not so simple. Who is growing? Who is declining? What new business have they just gained that is not fairly reflected in the history? And what about seasonality? One solution is to base allocation on something less than 100% of history, and use the balance to take care of these needs. That's pretty much what happens, but it's not an exact science. And usually, the printer is not part of the process.

Second, it's important to understand that the mills face a continual cost/price squeeze. We touched on this earlier. When the market permits mills to raise prices, they need to do so.

Third, it's important to understand the dynamics of supply and demand. The large mills run 24 hours a day, close to 365 days a year. Take out a little bit for maintenance and other downtime, and these mills are full at operating rates of about 93%. At 80%, prices fall. At 92%, prices fall. At 93% prices increase. The

PRICE OF 50# OFFSET ROLLS(\$ PER TON)



the US and Canada have been at parity since soon after NAFTA, and as the chart shows prices in the US are slightly below 1996 levels, while prices in Canada are sharply lower due to the strong Canadian dollar.

We might explore this more fully in another column, but here I want to address what is of greatest concern to printers, and so I asked a few of my printer friends what they were most concerned about. I think Don Gain, President of Harmony Printing in Toronto, captured it best with one word: "Stability."

Stability of price, of course, but even more important, stability of supply.

in North America close, printers can buy imports from known suppliers with established supply chains. For uncoated grades like Domtar's Windsor and Weyerhaeuser's Husky, however, new suppliers in Asia or elsewhere will need to enter the market if there are capacity shortfalls here.

I spoke to several paper merchants to find out what was happening in the marketplace. Are prices moving up? Are there capacity shortfalls? I learned that price increases have been announced on uncoated freesheet. There have also been some attempts to increase coated prices, but lower prices on imports are likely to limit coated increases. I also learned that allocations are in effect for some uncoated grades. Yvon Boyer, Vice President at

closures in uncoated freesheet have brought operating rates close to 93% (Risi projects 92% for 2006). Fundamentally, there should be no shortage but seasonality, inventory building, or even pre-price increase buying can be enough to move operating rates from 92% to over 93%. The market can go from loose to tight very quickly, but then it can loosen just as quickly.

BUT WHAT SHOULD PRINTERS DO?

Most important, stay close to your merchants, and also your mills. Make sure the mills know how important you are to them. If you buy sheet fed paper from the merchant warehouse, the mill often does not know who you are or how much you buy. Be sure your supply is protected. Remember, the market can go from loose to tight very suddenly.

Also, remember that the market can also loosen suddenly. Mills are trying to increase prices on uncoated freesheet and because of all the mill closures, there is an expectation that these price increases will hold. There may be a temptation to try to buy extra paper before the next price increase, but keep in mind that in a truly tight market it should be impossible to buy extra paper. We've seen that the mills impose allocations so that they can protect all customers. Yet, paradoxically, history shows that customer inventories tend to rise during "shortages." And more paradoxically, the lesson is that if you can buy that extra paper, you're probably better off not doing so. Unless your timing is perfect, if you are able to buy extra paper, the market is already loosening.

So stay close to your mills and merchants. And be careful with inventory.

CP

America, for Pira International, a supplier of strategic, marketing and technical consulting. Jack is also the founder of MarketIntell, a market intelligence consultancy focused on paper and print, and a veteran of 18 years in sales and marketing for printing papers with Domtar. Jack can be reached at jackm@pira-international.com