



CIBC  
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**Sector: Paper & Forest Products**

**Sector Weighting: Underweight**

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# World Newsprint Market: Winners And Losers

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See "Important Disclosures" section at the end of this report for important required disclosures, including potential conflicts of interest.

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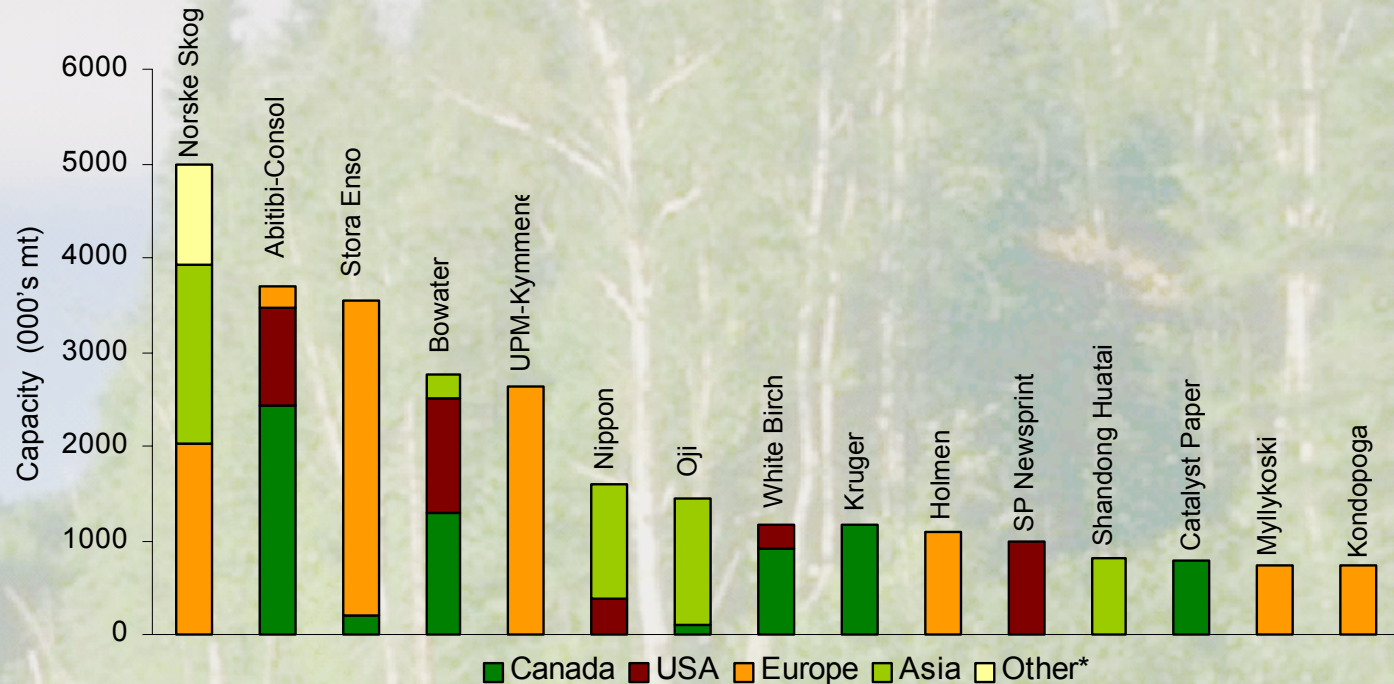
See "Price Target Calculation" and "Key Risks to Price Target" sections at the end of this report, or at the end of each section thereof, where applicable.

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# Who Are The Players?

## 15 Largest Global Newsprint Producers (2006)



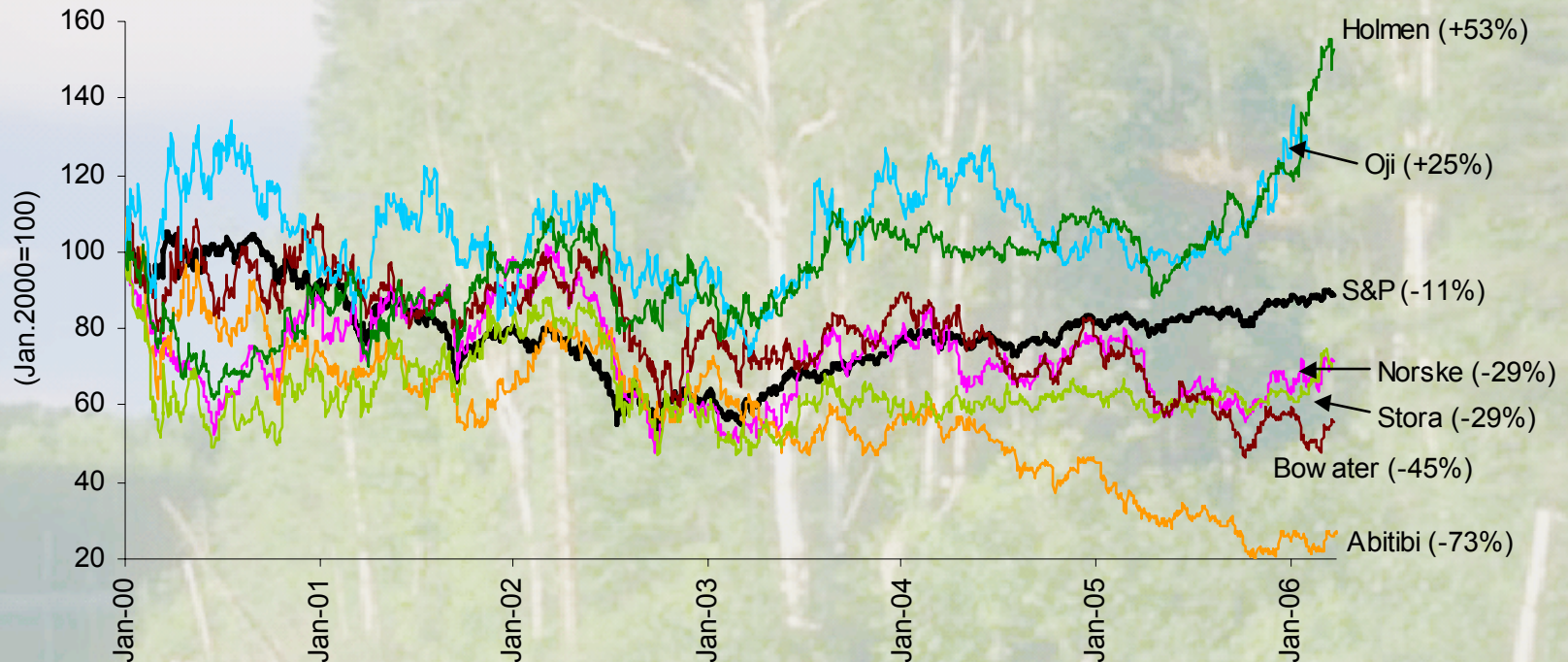
\* Other: Primarily Latin America & Australasia.

Source: Canadian Paper Analyst, CIBC World Markets.

- **Norske Skog is the biggest, and most international.....big changes in 2005/6.**
  - **Increased presence in Asia with 100% stake in PanAsia, and exited North America with sale of stake in Catalyst.**
- **Abitibi has fallen to second with sale of PanAsia stake. Still has large UGW capacity in North America.**
- **Shandong Huatai will jump from 12<sup>th</sup> to 8<sup>th</sup> in late 2007 – 1/3 increase.**

# 1. Financial Performance

## Share Prices Of Major Newsprint Producers (January 2000-March 2006)

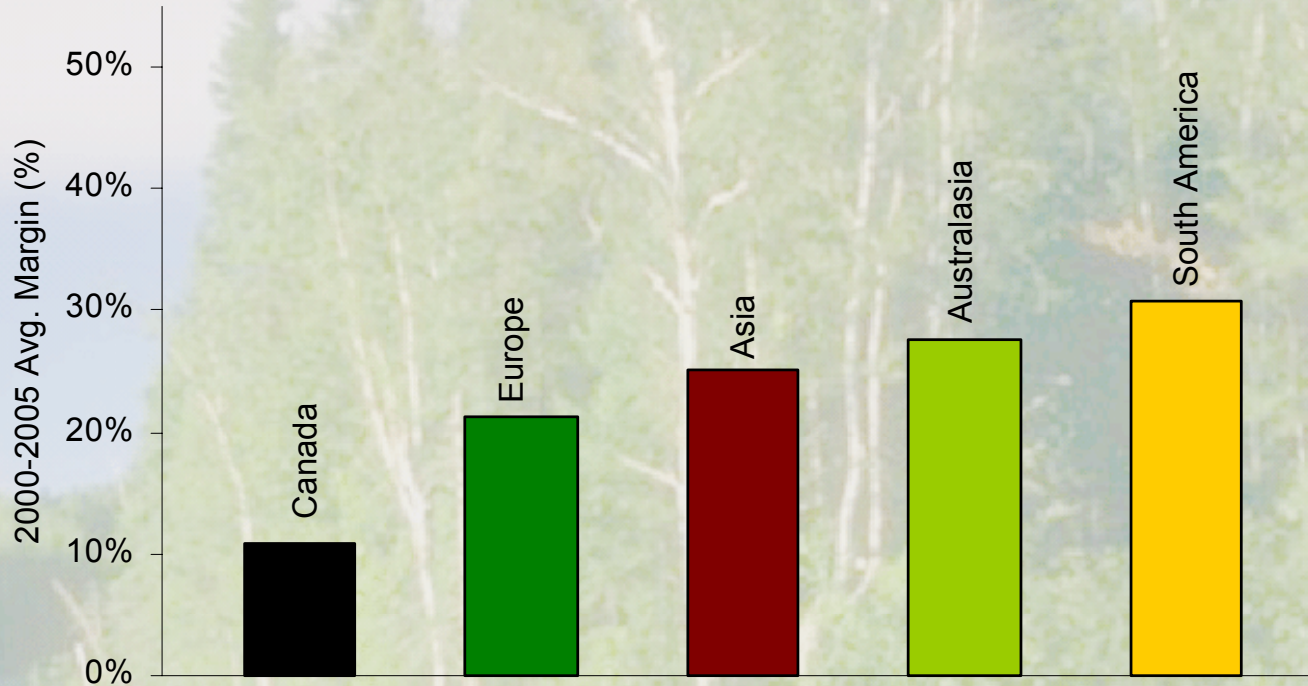


Source: Bloomberg, CIBC World Markets. Performance results shown should not and cannot be viewed as an indicator of future performance.

- **Big moves up by Holmen and Oji since beginning of 2005 – outperformed the S&P.**
- **Abitibi and Bowater down the most – largely due to rising Canadian dollar.**

# 1. Financial Performance

## Regional Profit Margins For Norske Skog 2000-2005 Average

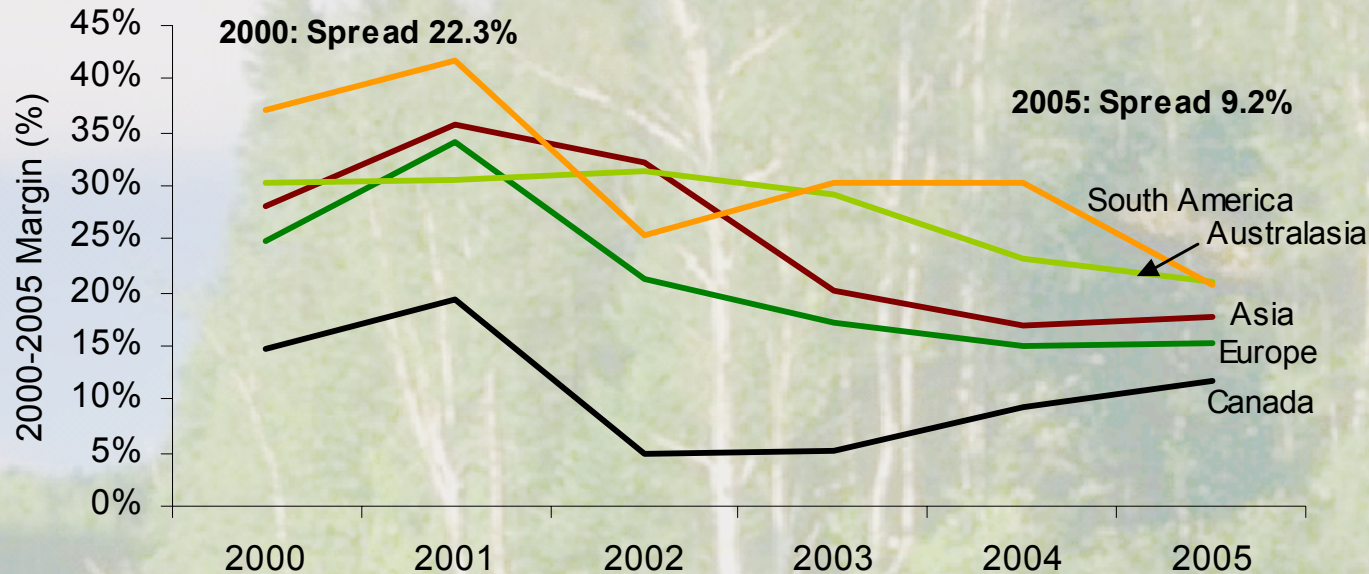


Source: Company reports,, CIBC World Markets.

- **Range from 10% to 30%, with Europe and Asia in the middle.**
- **Brazilian operations now up to 20% more expensive than in parts of Europe, and 50% more than in Chile – skyrocketing electricity, strong currency and high taxes.**
- **Canada was the worst, and partly due to strong C\$ - sold in Q1/06.**

# 1. Financial Performance

## Norske Skog's Regional "Newsprint" Profit Margins 2000-2005

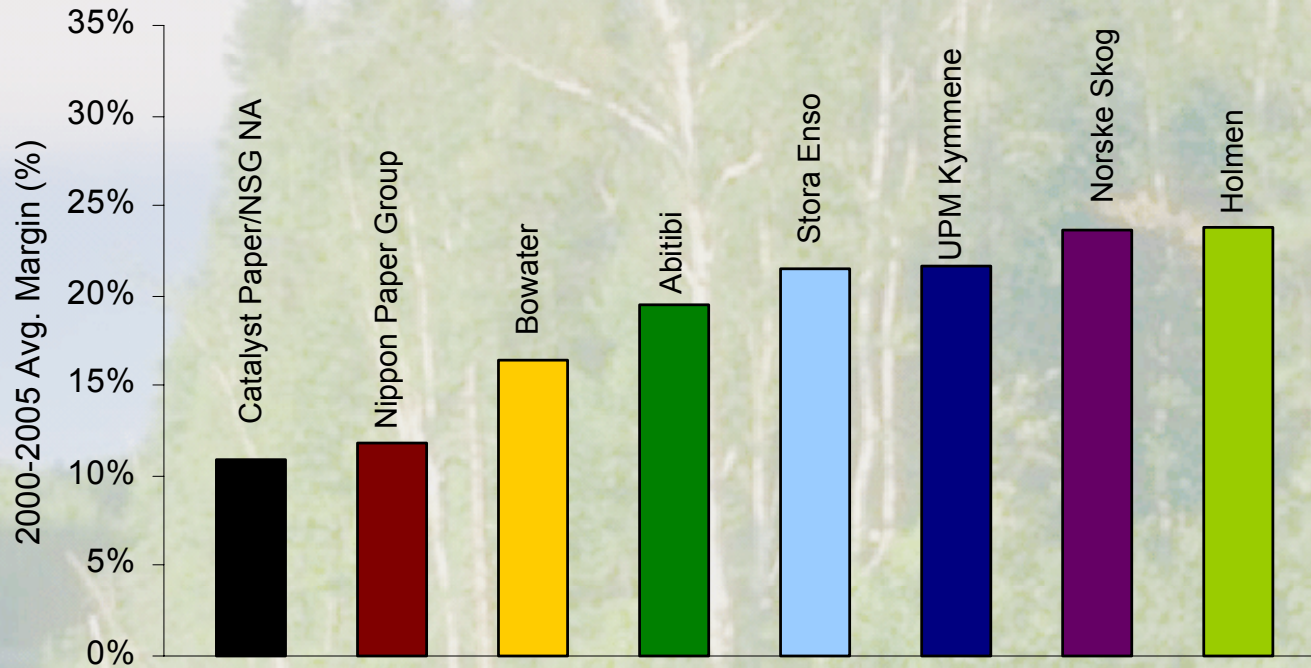


Source: Company reports,, CIBC World Markets.

- **The trend has been down in all of the regions, except North America – the latter reflects management improvements at Catalyst and falling fiber costs.**
- **The spread between the highest and lowest margins has narrowed from 22% to 9% - reversion to the mean.**

# 1. Financial Performance

## “Newsprint” Profit Margins By Company 2000-2005 Average

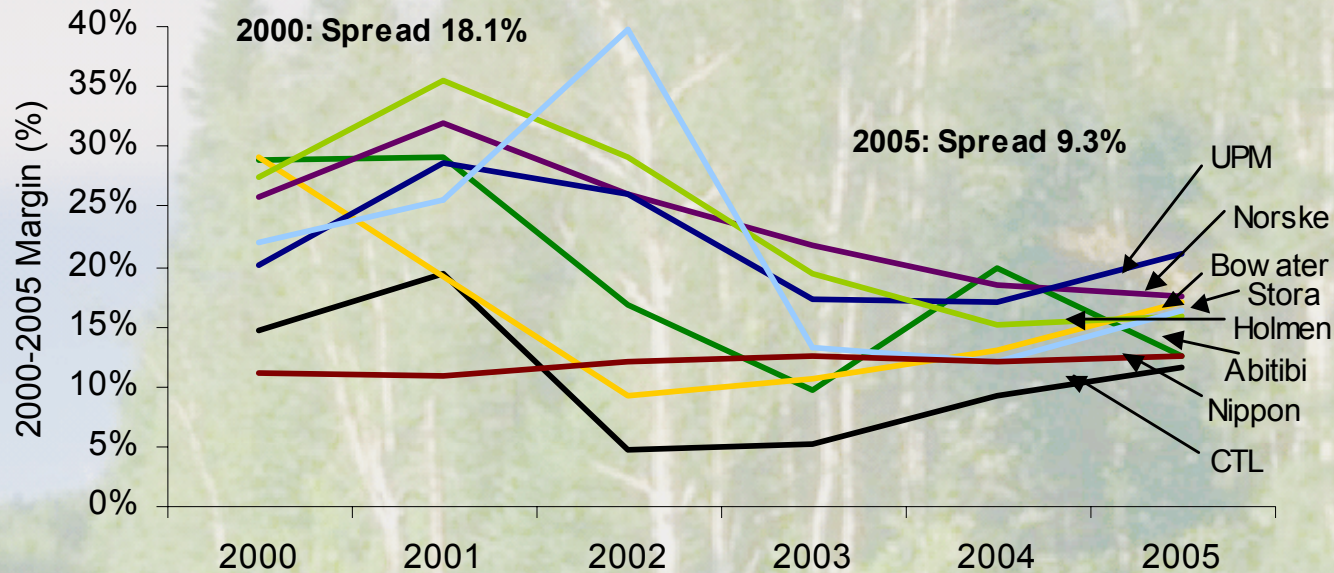


Source: Company reports,, CIBC World Markets.

- **Range from 10% to 25% - Catalyst at the bottom, Norske Skog/Holmen at the top.**
- **European's stronger – due to better equipment and weaker currency over this period?**

# 1. Financial Performance

## “Newsprint” Profit Margins By Company 2000-2005



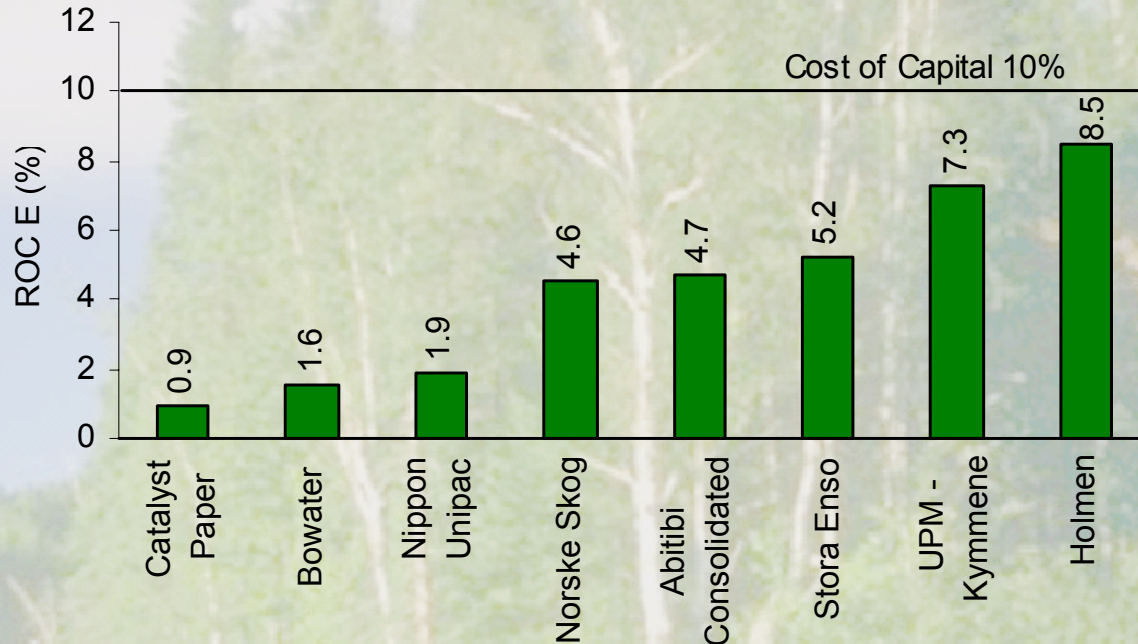
Source: Company reports,, CIBC World Markets.

- Downward trend for most, but partial recovery for most since 2003 (but not Norske).
- Spread between “best” and “worst” cut in half – from 18% to 9%. European advantage narrowing.
- Margins in Japan are very stable, and also among the lowest.



# 1. Financial Performance

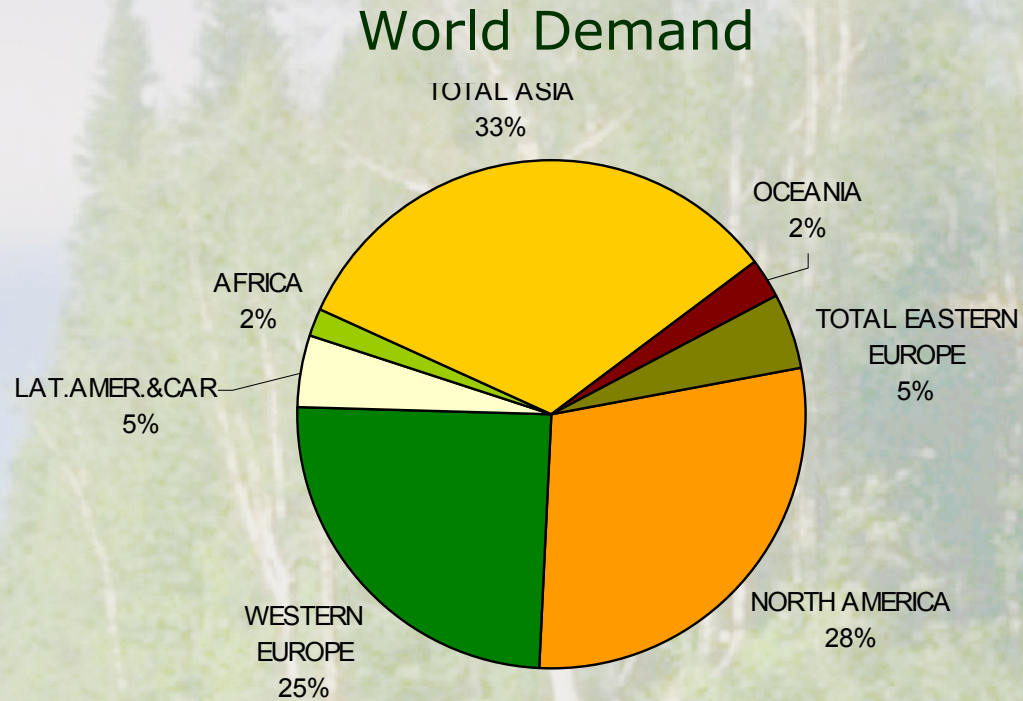
## Return On Capital Employed Five-year Average (2000-2004)



Source: PricewaterhouseCoopers, CIBC World Markets.

- The “purest” newsprint companies are Norske Skog, Abitibi, Bowater and Holmen.
- Holmen and Norske Skog have generated roughly the same margins, but Holmen’s ROCE is almost double....too much capital employed with Norske?
- Regardless of which paper grade they are focused on, none of the major paper companies have been able to earn their cost of capital over time.
- Why? No barriers to entry, but meaningful barriers to exit?

# 2. Regional Demand

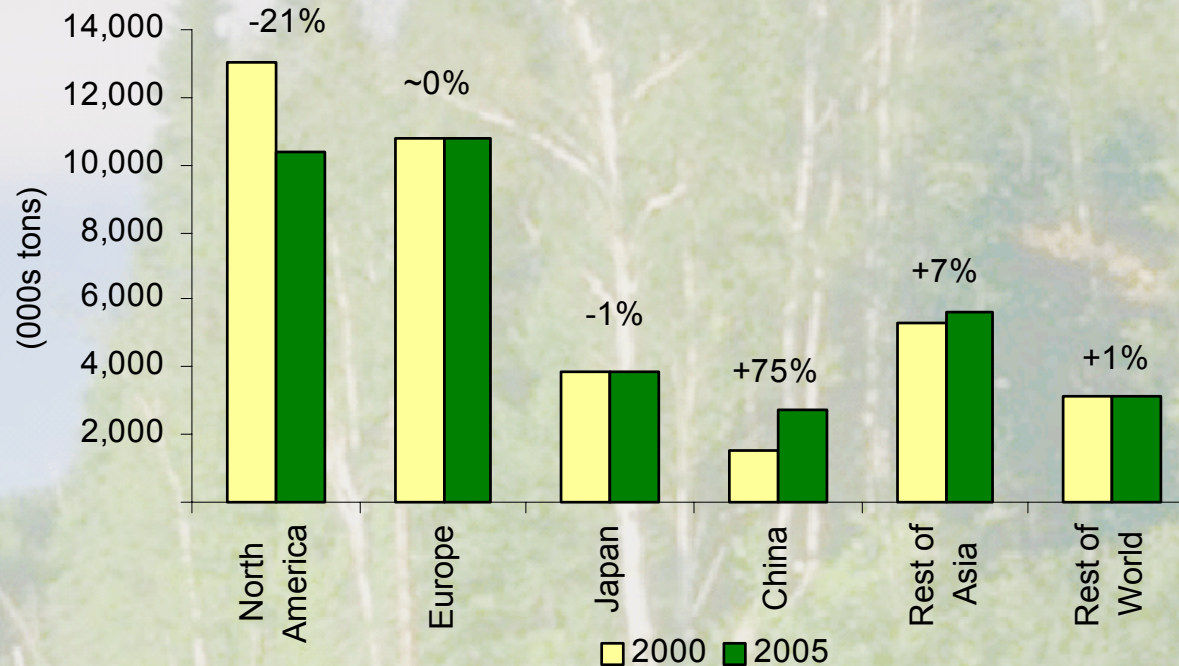


Source: PPC, CIBC World Markets.

- **Global demand totaled 36.598 million tpy in 2005.**
- **Asia is now the single biggest continental market, followed by Europe and North America.**

# 2. Regional Demand

## Growth In Global Newsprint Demand: 2000 Vs. 2005

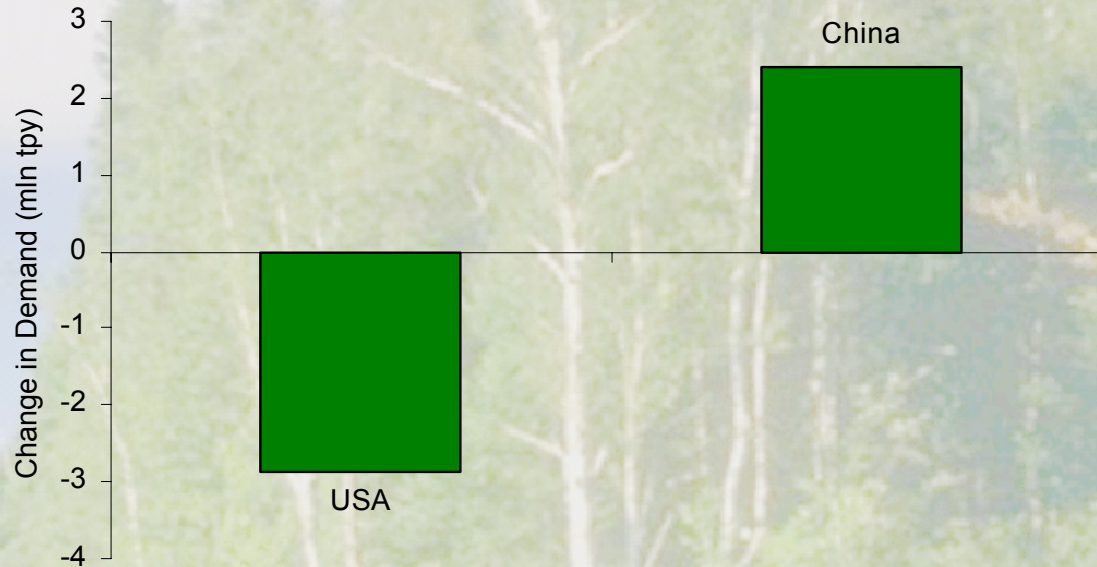


Source: PPPC.

- **Global demand has been essentially flat since 2000 (North America down, and Asia up).**
- **Rise in China has been dramatic – up 75% in five years.**
- **India has accounted for most of the rise in “Rest of Asia” – up 44%.**
- **Europe in aggregate has been flat, with West down and East up – both around 300,000 tonnes.**

# 2. Regional Demand

## Changes In Demand: China Vs. United States (1990-2005)



Source: PPPC, CIBC World Markets.

- **Over the longer term, the declining demand in the U.S. has been largely offset by increasing demand within China (-2.9 million versus + 2.4 million).**
- **Chinese demand driven by dramatic growth in advertising and new publications, improved access to better quality paper.**

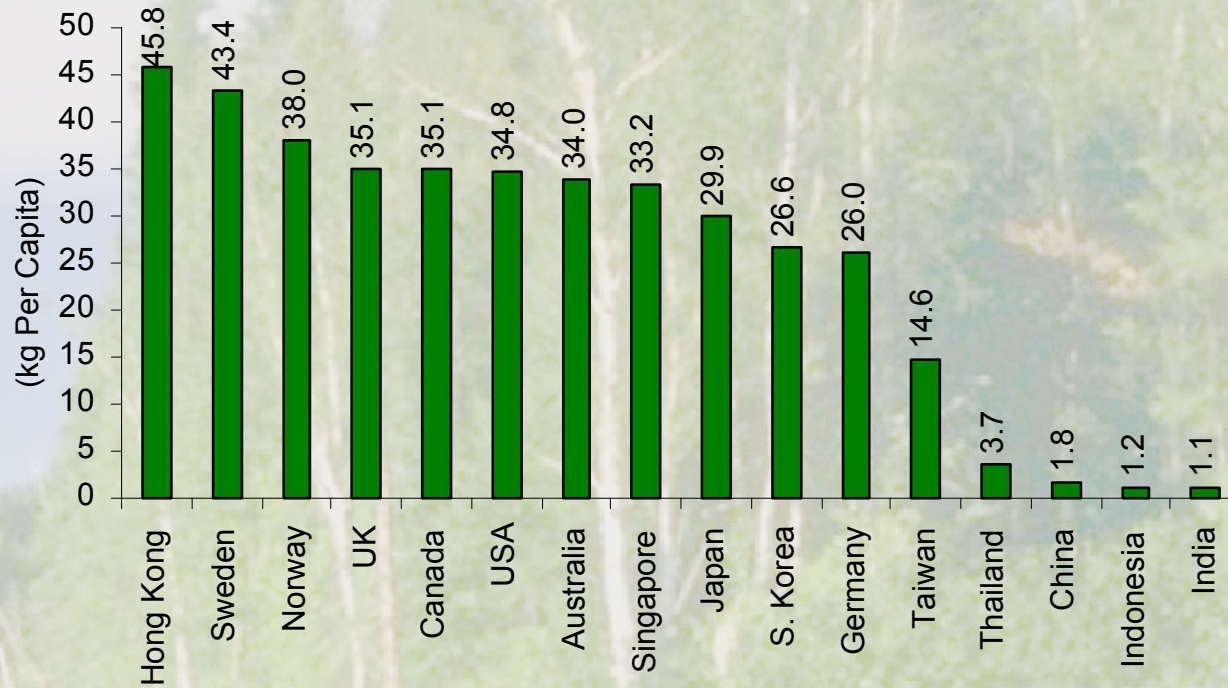
# 2. Regional Demand

## Secular Annual Growth In Demand Going Forward

- Global: 1.0%
- North America: -0.5%
- Rest Of World: 2.0%
  - Emerging Markets: 3.5%
  - China And India: 5%-6%
- Key drivers outside North America are increasing:
  - Population
  - Literacy
  - Urbanization
  - Democratization

# 2. Regional Demand

## Newsprint Consumption Per Capita (2004)

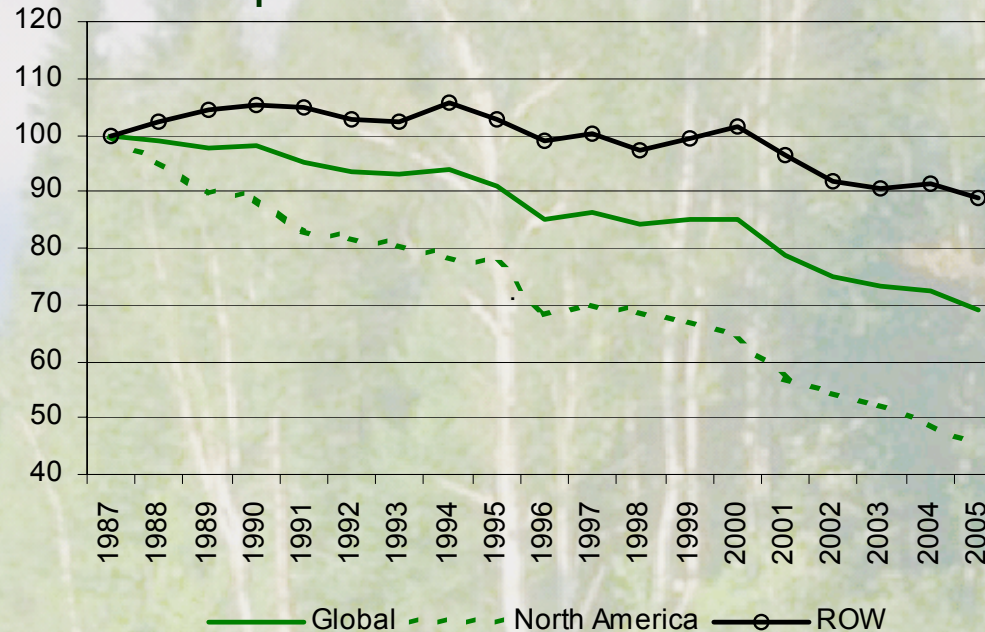


Source: PPPC.

- **If Hong Kong is any indication, the potential for the rest of China (and India) is exciting – 45.8 versus 1.8. Kg/capita.**
- **China's per capita consumption has risen by more than 350% since 1990.**

# 2. Regional Demand

## Consumption Per Unit Of Real GDP

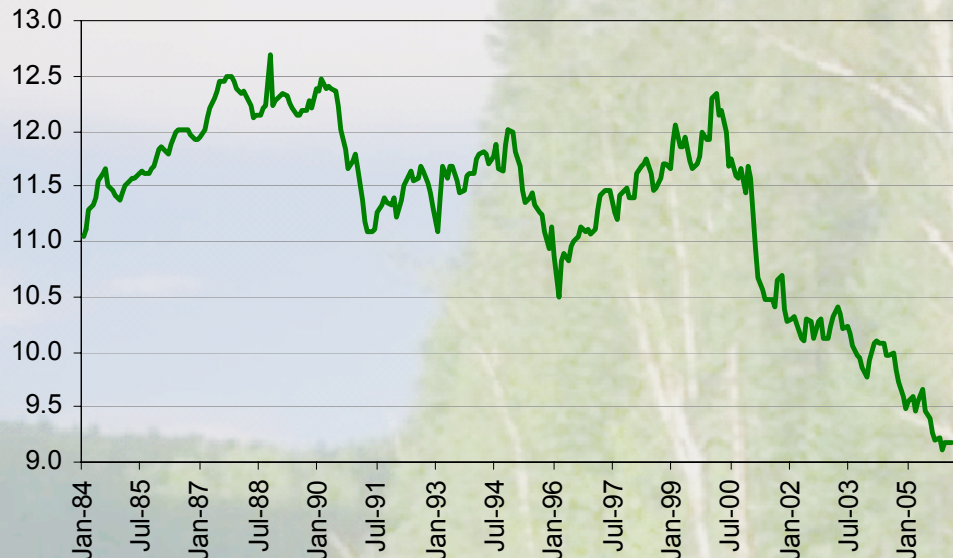


Source: RISI.

- The “intensity of consumption” has been declining for newsprint in both North America and the rest of the world.
- Newsprint is not alone - the same is occurring for UFS paper – the dominant grade of printing & writing paper – since the early 1990s.
- The North American experience with newsprint is worth studying...it may be the future for the rest of the global industry.

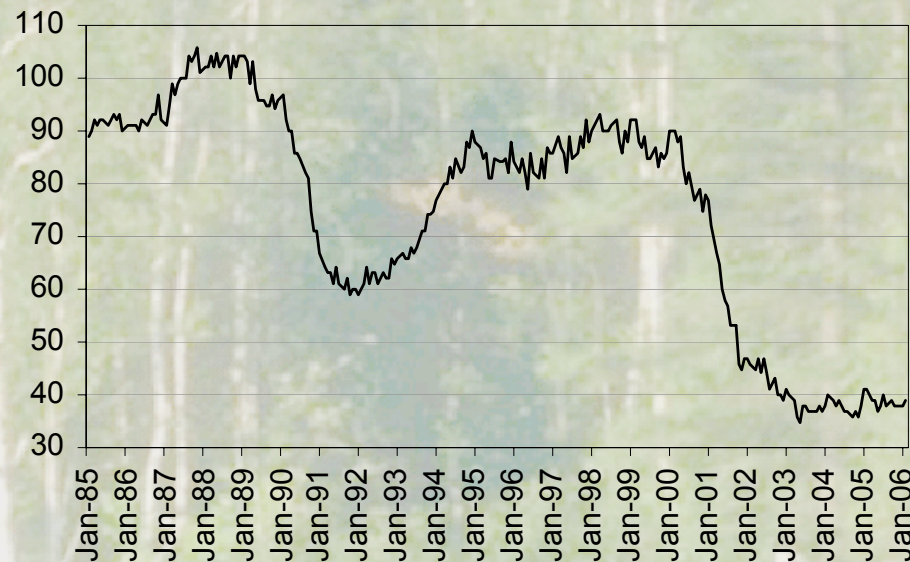
# 2. Regional Demand

## SAAR Total U.S. Newsprint Consumption



Source: PPPC.

## Help-Wanted Index



Source: The Conference Board.

- **The consumption of newsprint in North America is on a secular decline - down for the 33<sup>rd</sup> straight month in February 2006.**
- **From 2000 to 2003, the Help-Wanted Index fell 60%, and U.S. newsprint consumption fell 20%...Index has bottomed, but consumption still falling.**
- **We expect 3% annual drop in 2006/7.**



# 2. Regional Demand

U.S. newsprint consumption declined 5.5% in 2005.

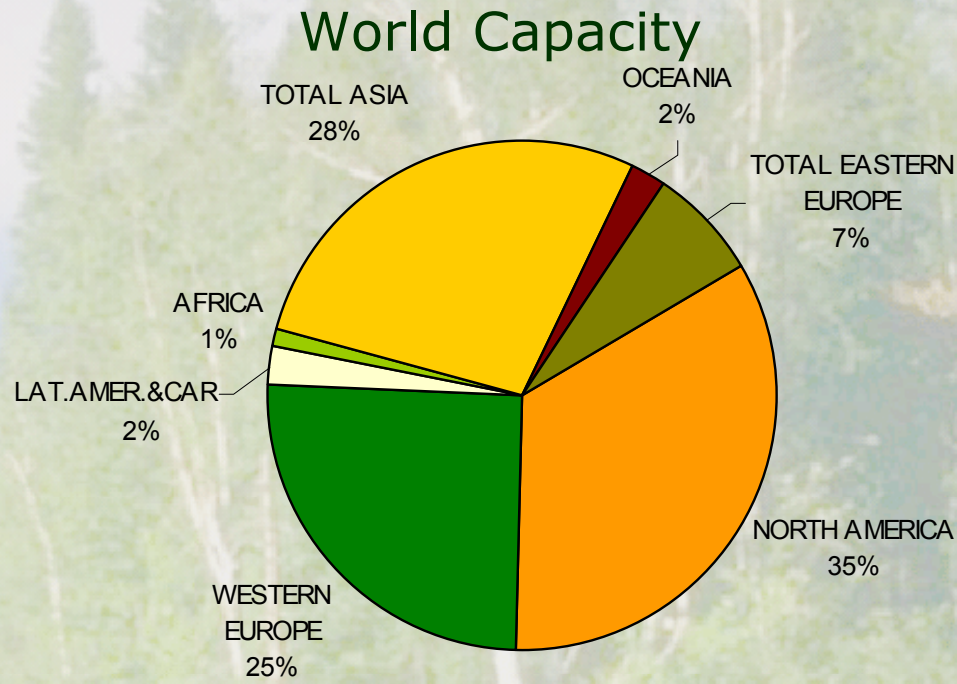
Why?

- **1%-2% due to declines in grammage – (toward 48.8)**
- **0.5%-1.0% due to other conservation measures (tabloid format, fewer financial quotes)**
- **2%-3% due to reduction in circulation**
- **1% due to lower advertising lineage (competition from other media)**

**First two causes have likely run their course.**

**Last two causes likely remain an ongoing threat.**

# 3. Regional Industries

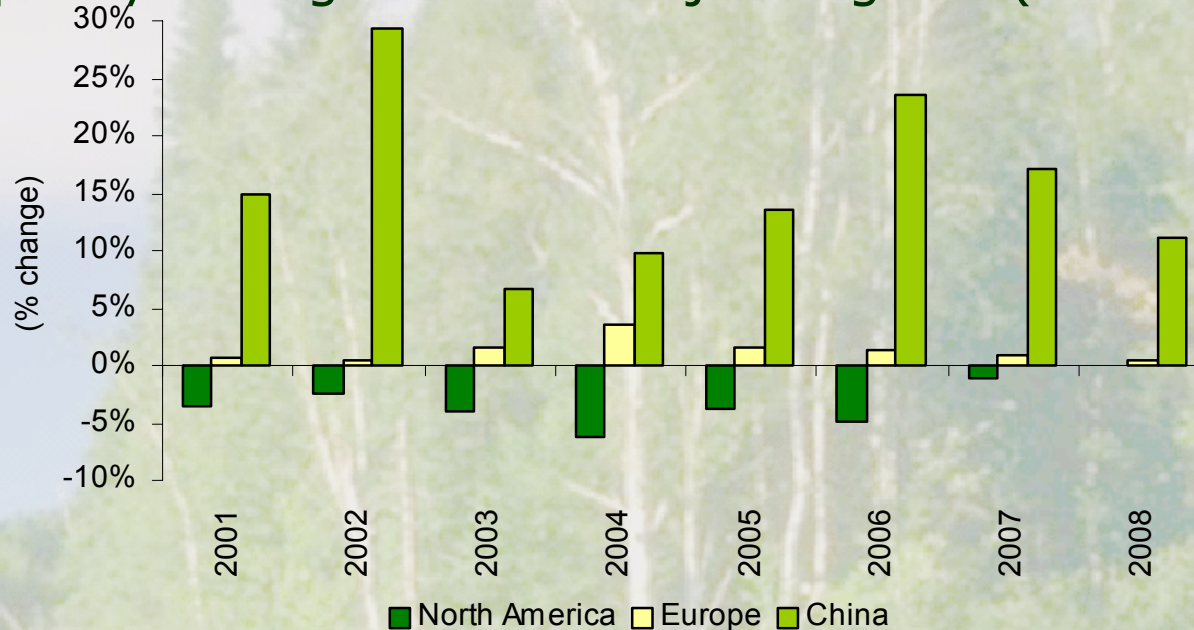


Source: PPPC, CIBC World Markets.

- **Global capacity is 39.645 million tonnes in 2006**
- **North America remains the largest producing region (for now).**

# 3. Regional Industries

## Capacity Changes In The Major Regions (2000-2008)

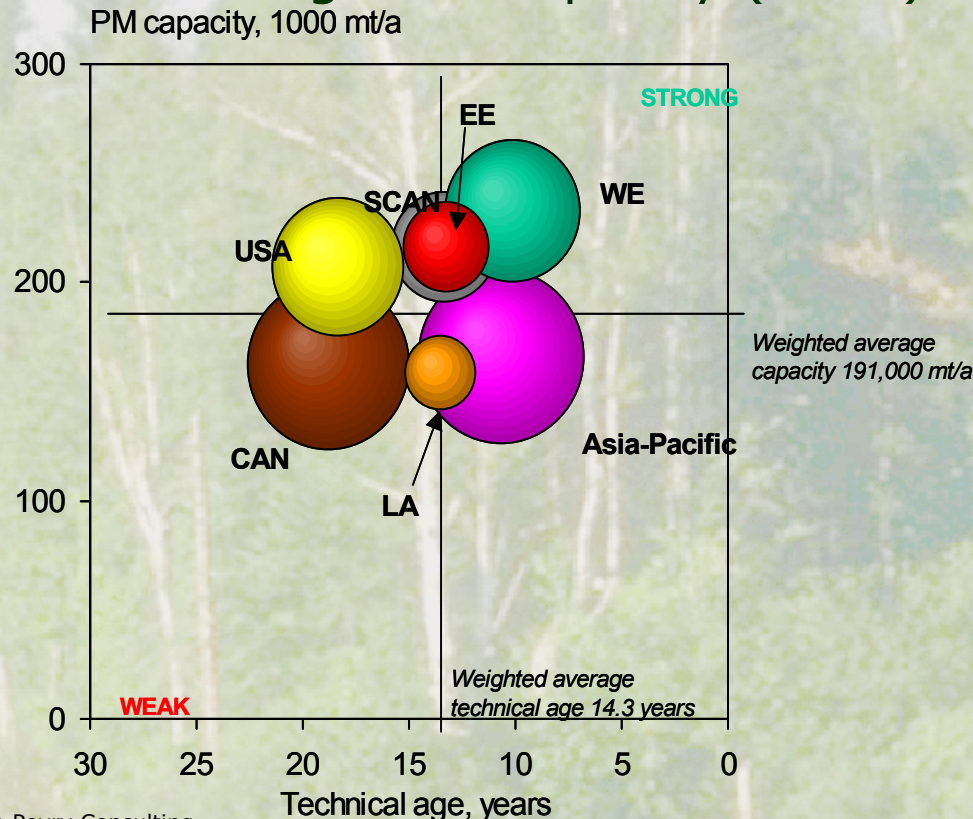


Source: PPC, CIBC World Markets.

- **Global newsprint capacity remained essentially flat from 2000 to 2005. The PPC expects its to rise by 0.6% in 2006, 1.4% in 2007 and 1.3% in 2008.**
- **The global numbers mask major changes at the regional level.**
  - **Significant declines in North America**
  - **Modest increases in Europe (mostly in the East)**
  - **Dramatic increases in China – roughly 15% annual growth in 2000-2005. Up 23% in 2006 and 17% in 2007.**
  - **Rest of Asia essentially flat (although RAMA is building in India in 2008).**
  - **Brazil now unattractive due to energy, and tax regime.**

# 3. Regional Industries

## Technical Age Vs. Capacity (2003)

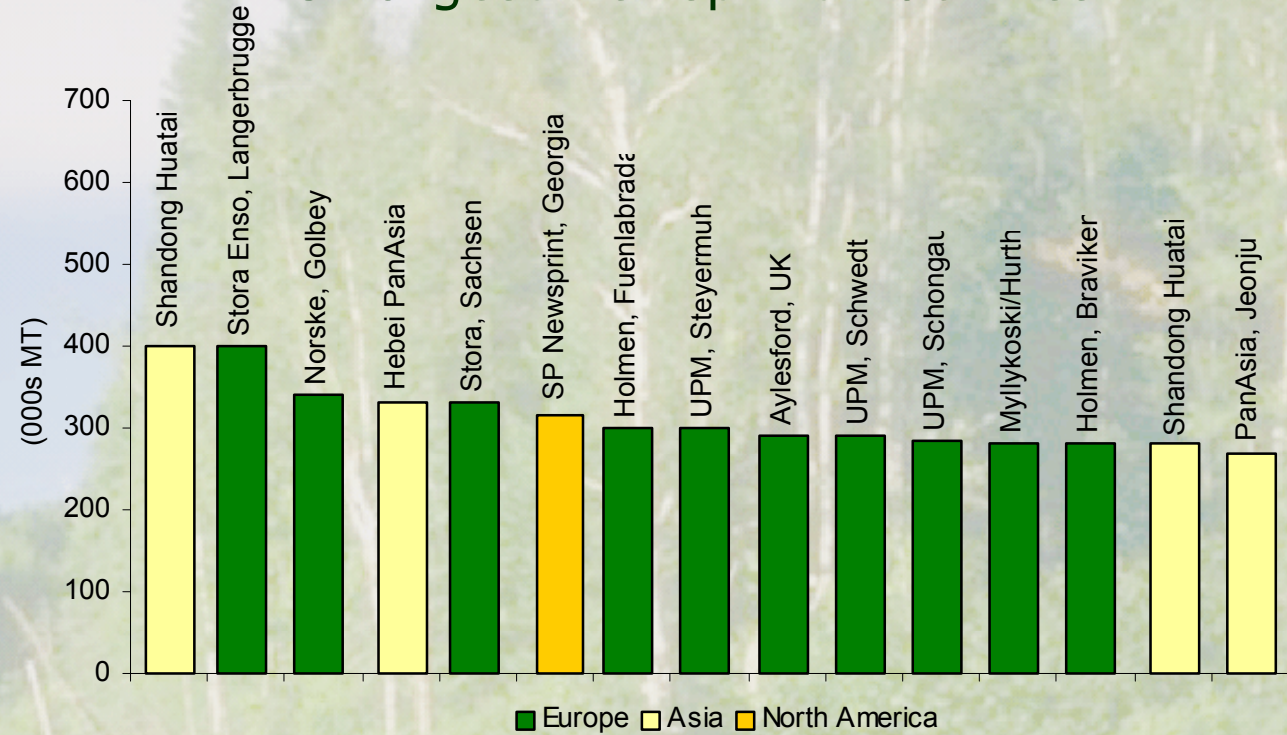


Source: Jaakko Poyry Consulting.

- Mills in Western Europe are on average the most “technically competitive”, while those in Canada are the least.
- Canada’s average has improved since 2003 – 8 machines closed or converted.
- Weighted average capacity in 2003 of roughly 190,000 tpy. (versus new world class machine of 400,000 tpy)

# 3. Regional Industries

## 15 Largest Newsprint Machines

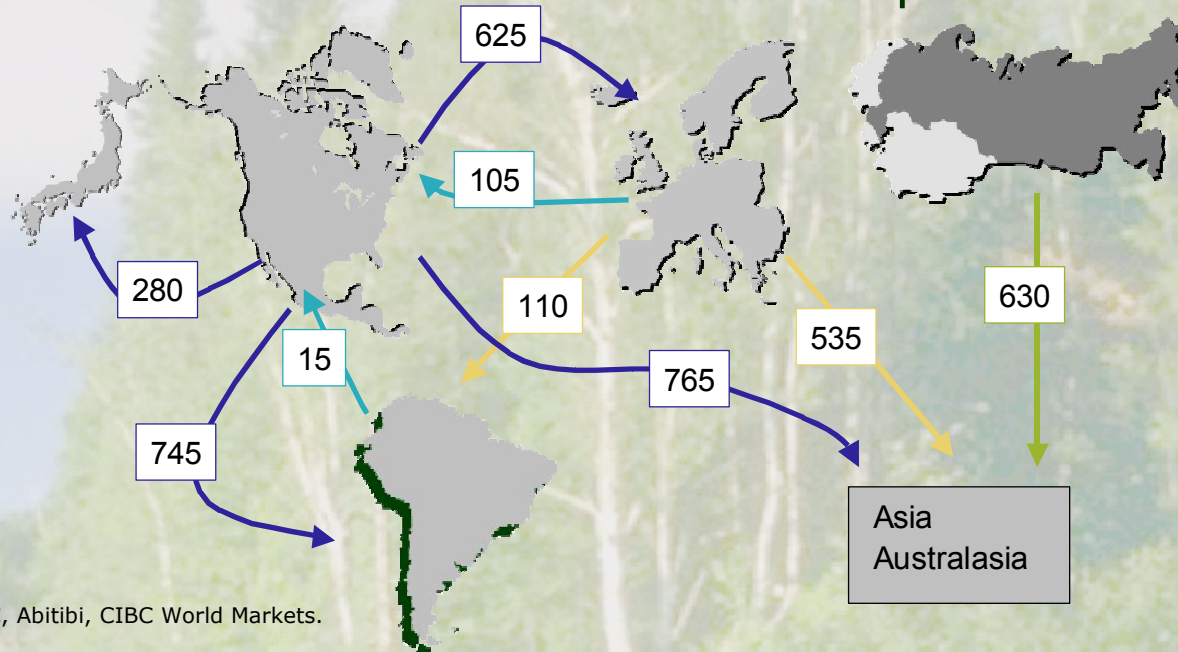


Source: Canadian Paper Analyst, CIBC World Markets.

- **Size does matter when it comes to efficiency of newsprint machines**
- **Europe has most of the biggest machines (10) – versus only one in North America**
- **Two more 400,000 tpy machines will be started in Shandong province in late 2006/early 2007. China will have five of the top 15 by mid-2007.**

# 4. Benefit From Trade

## Global Trade Flows Map

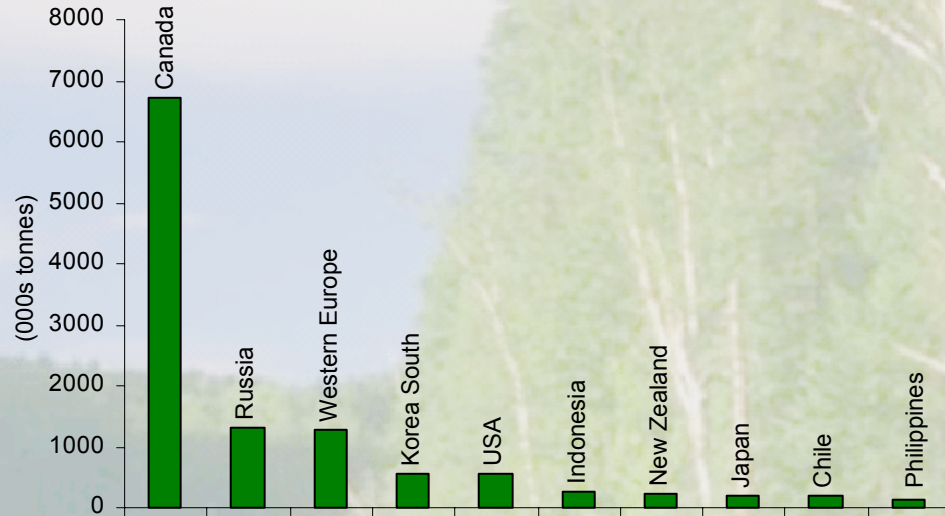


Source: PPPC, Abitibi, CIBC World Markets.

- **North America ships significant volumes to all the major continental markets (except China)**
- **North America's absolute exports to Asia fell sharply in 1996-8 in response to the Asian financial crisis, increases in Asian newsprint capacity and Chinese anti-dumping duties on newsprint.**
- **Asia's imports are now sourced relatively evenly among North America, Western Europe and Russia.**
- **Inter-regional trade fell roughly 15% last year:**
  - **Western Europe to Asia down 40%**
  - **Russia to Asia down 30%**
  - **North America to Japan down 30%**

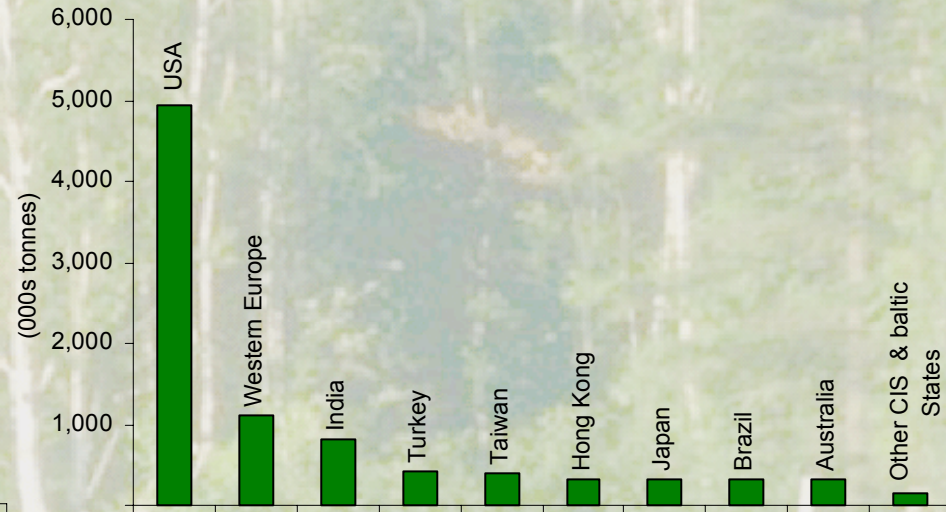
# 4. Benefits From Trade

## Top 10 Exporters 2005



Source: PPPC, CIBC World Markets.

## Top 10 Importers 2005



Source: PPPC, CIBC World Markets.

- **Canada remains the dominant exporter, but over 70% is to the U.S.**
- **Russia is getting bigger, but less is going to Asia**
- **India is now the second biggest importing country (not in Top 10 in 2003)**
- **Chinese market is "an island". Tariffs sliding down from 7.5% in 2005 to 5% in 2006**

# 4. Benefits From Trade

## Chinese Anti-Dumping Duties

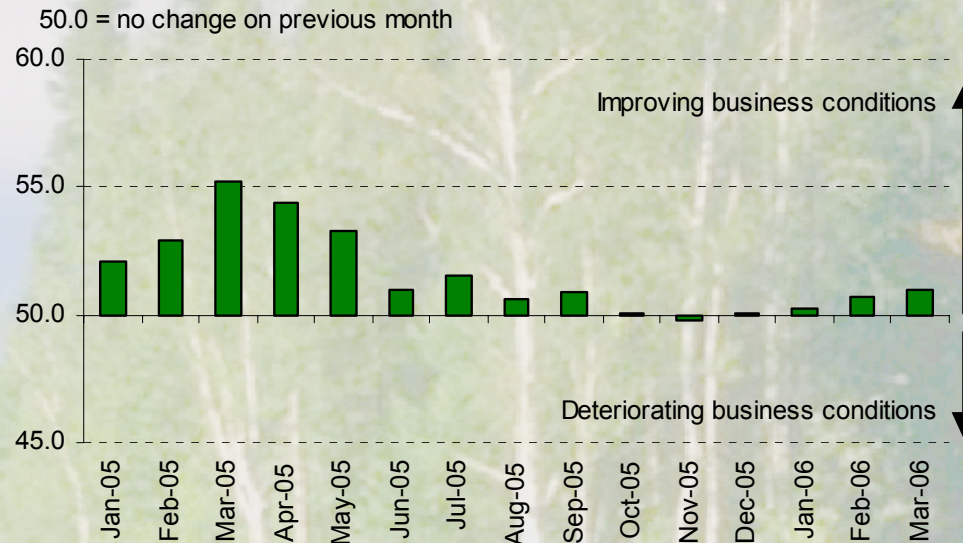
Canada	57%-78%
United States	78%
South Korea	9%-55%

- **In 1999, China imposed stiff anti-dumping duties on key exporters – they were maintained after a sunset review in 2004.**
- **“Infant Industry” strategy? Korea is the only major Asian exporter.**
- **Protection will become “academic” with the installation of new Chinese capacity.**
- **Will China become a net exporter of newsprint? Depends critically on level of domestic demand.**



# 4. Benefits From Trade

## CLSA China Purchasing Managers' Index



Source: CLSA, CIBC World Markets.

- **The above is the one of the few macro-indicators from an independent source.**
- **Despite marginal improvements in recent months, the PMI only at 51.0 in March (<50.0 signals a contraction in manufacturing).**
- **Growth in output and new orders remains subdued. Industrial profits are being squeezed, and evidence that growth is slowing:**
  - **Soft imports**
  - **Contracting industrial lending**
  - **Fewer mainland tourists visiting Hong Kong**

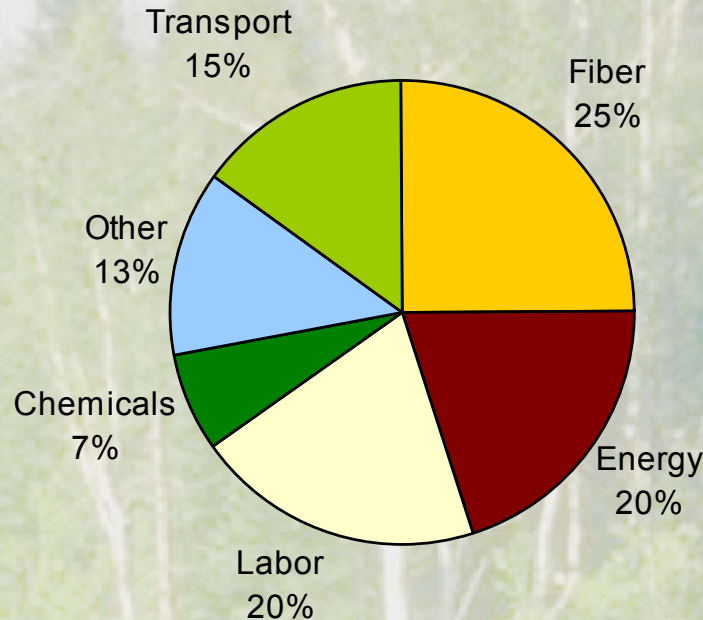
# 4. Benefits From Trade

## Will China become a net exporter of newsprint?

- After growing 9.9% in 2005, consensus estimates for Chinese GDP growth at 9.0% for 2006 and 8.5% for 2007...still quite strong demand.
- But some pundits are less optimistic. CLSA is forecasting Chinese growth of 5%-7% for 2006 and 3%-5% in 2007.
- Given the rapid expansion in Chinese capacity (23% in 2006, 17% in 2007), newsprint prices in China are expected to drop sharply if domestic demand falters.
- In such a scenario, China would likely become a net exporter to Asia (and possibly the West Coast of the U.S. ). Would severely hurt the older mills in Asia and cause a negative “ripple effect” through the global newsprint market.
- Does it make sense for China to export energy in the form of newsprint? Interesting policy question for the National Development and Reform Commission.

# 5. Relative Costs

## Typical Cost Structure For Newsprint, 2005

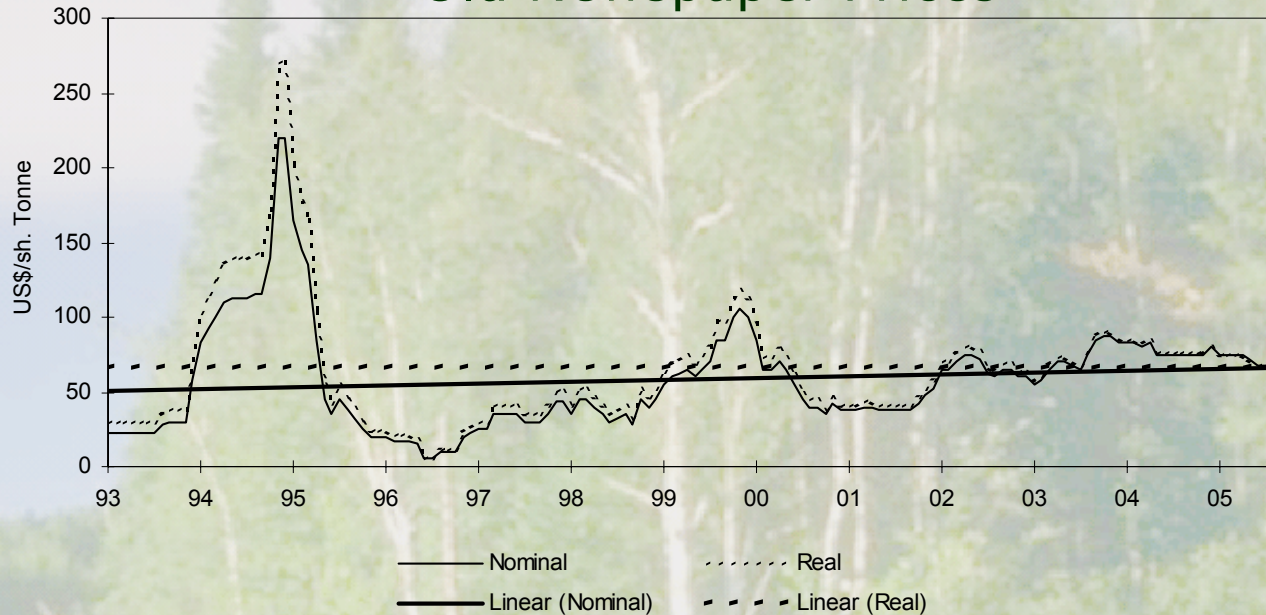


Source: CIBC World Markets.

- **Fiber**: U.S., Western Canada and Southern Hemisphere have an advantage in virgin fiber (and relative prices of virgin/recovered fiber will likely decline).
- **Energy**: Russia, parts of Canada and recovered-based producers have an advantage.
- **Labor**: Asia and Southern Hemisphere have an advantage.
- **Transportation**: North America has an advantage (back-haul rates)

# 5. Relative Costs

## Old Newspaper Prices

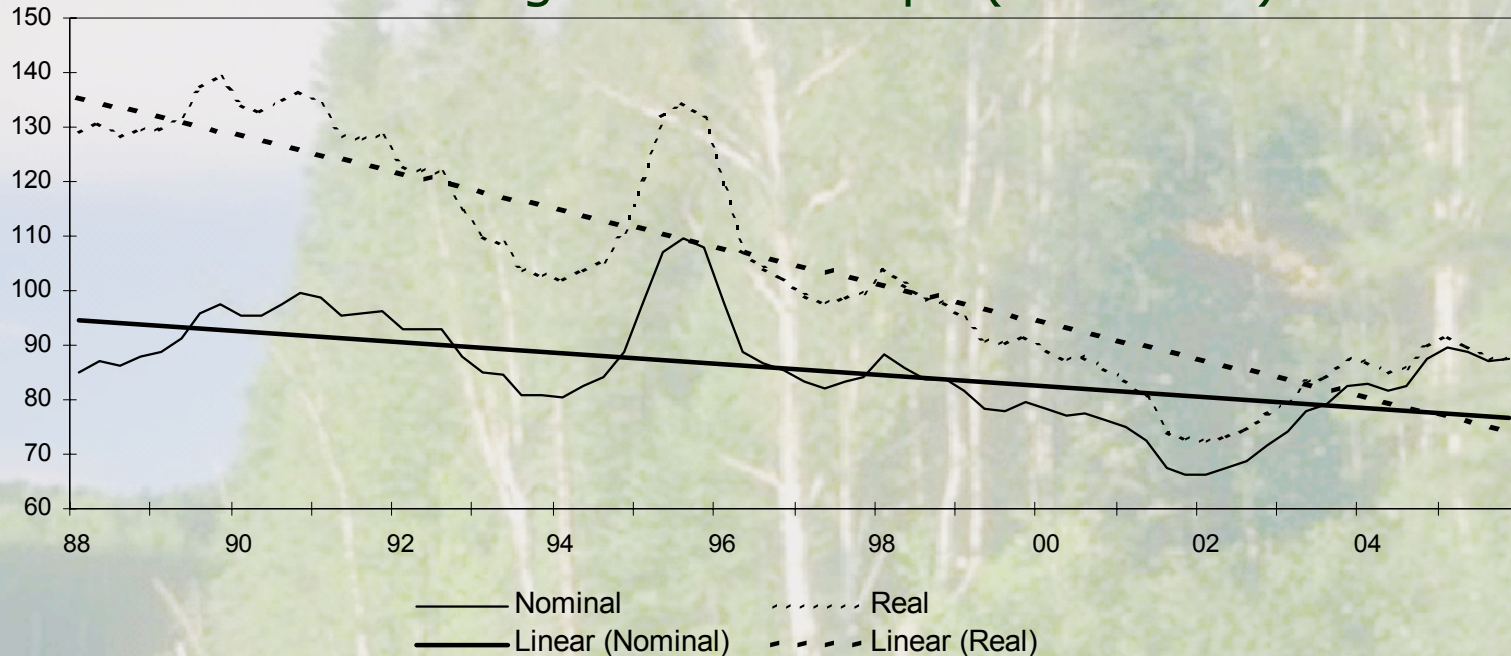


Source: Pulp & Paper Week, CIBC World Markets.

- **The impact of increasing Asian demand on recovered paper prices has been masked since 2000 by lower demand in North America and Japan.**
- **Recovery rate of ONP in U.S. roughly 75%... would need to grow to 87% to satisfy new Asian demand – almost impossible.**
- **Europe increasingly needs its own ONP, and Japanese economic recovery may curb exports. Increased recovery of ONP in Asia will be required (but enough??)**
- **Expect a secular (and cyclical) increase in ONP prices.**

# 5. Relative Costs

## Global Average Conifer Chips (Softwood)

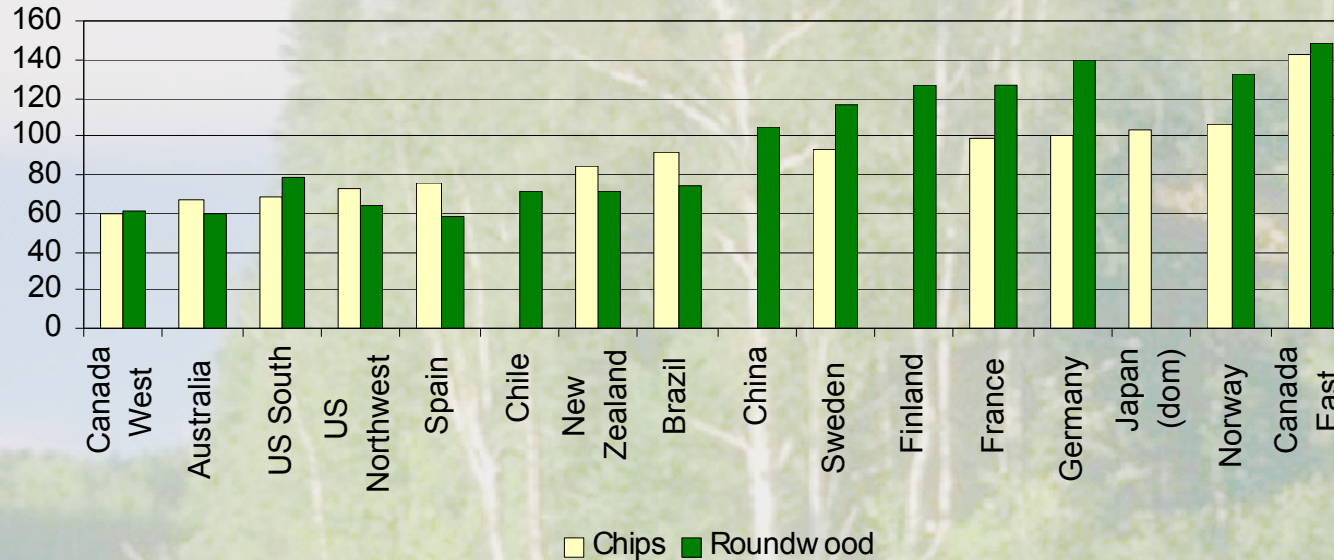


Source: Wood Resources, CIBC World Markets.

- **Real wood prices are on a secular decline. This suggests that virgin wood fiber has become less economically scarce over time.**
- **Will the downward trend continue? We think so. Asia is short of wood fiber, but the world is not.**
- **Virgin-based mills will benefit relative to recycled based mills.**

# 5. Relative Costs

## Average Delivered Softwood Pulp-fiber Prices For Q4/05 (US\$/ODMT)

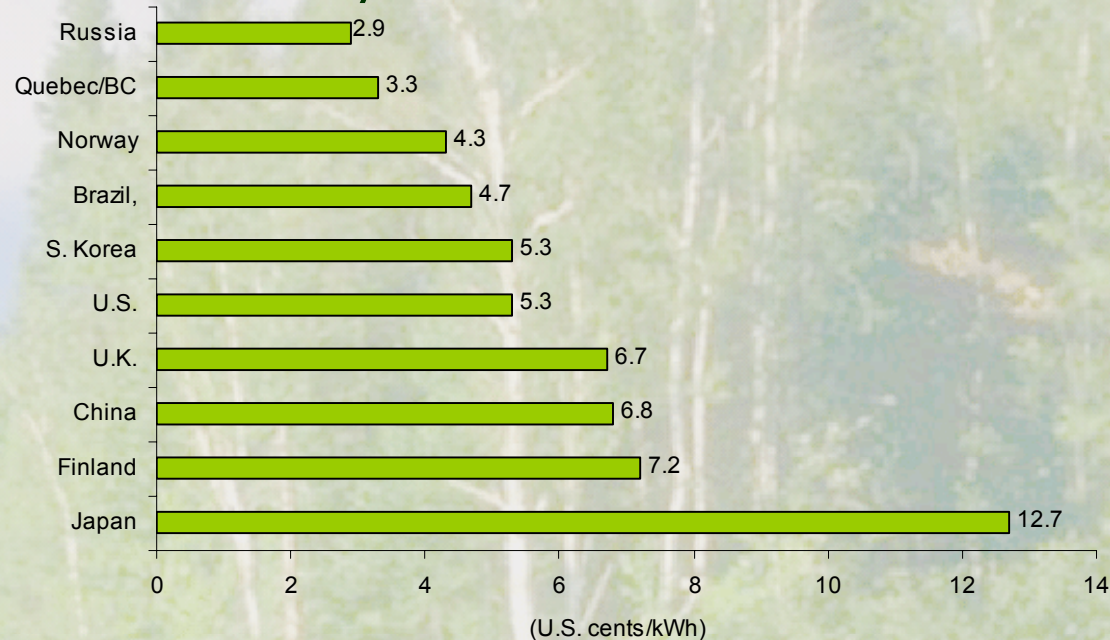


Source: Wood Resources International, CIBC World Markets.

- **Canada is at both ends of the curve when it comes to fiber costs for the pulp & paper producers – highest in Eastern Canada and lowest in Western Canada**
- **Prices in Europe have been rising and are now much higher than in the U.S.**
- **Virgin fiber prices in China and Japan are consistently among the highest due to their deficit in wood fiber. A price premium is expected to continue, but it will likely decline over time due to inter-regional trade.**

# 5. Relative Costs

## International Electricity Prices For Industrial Users (2004)



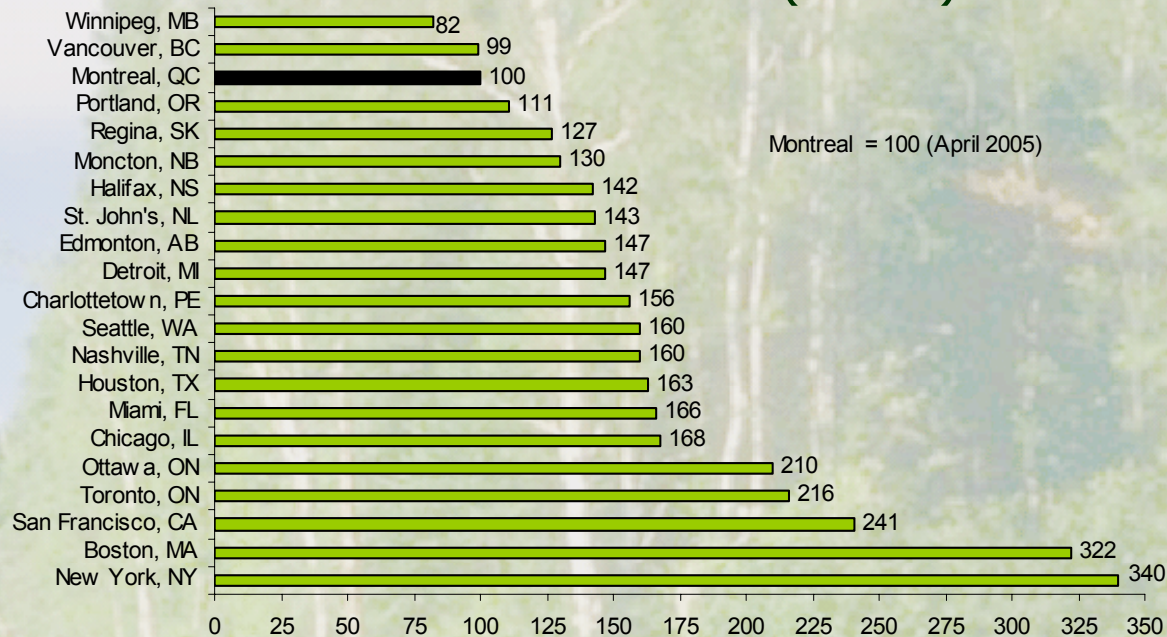
Source: International Energy Agency, U.S. Dept. of Energy, Hydro Quebec.

- **Newsprint is one of the most energy-intensive paper grades due to mechanical pulping process.**
- **Difficult to find comparable and current data.**
- **Russian mills have the biggest electricity advantage....Japanese mills the biggest handicap.**
- **China is a "moving target" – appears to be site-specific, with access an issue for some.**
- **Regional prices dependent on coal and gas are much more volatile than those dependent on hydro and nuclear – latter have high fixed costs, but low variable costs.**

**For example: Electricity prices in Brazil up from 2.5 cents in 2002 to 6.0 cents in Q1/06  
...new investment in newsprint industry no longer attractive.**

# 5. Relative Costs

## Comparative Index Of Electricity Prices In North America For Large Power Customers (2005)



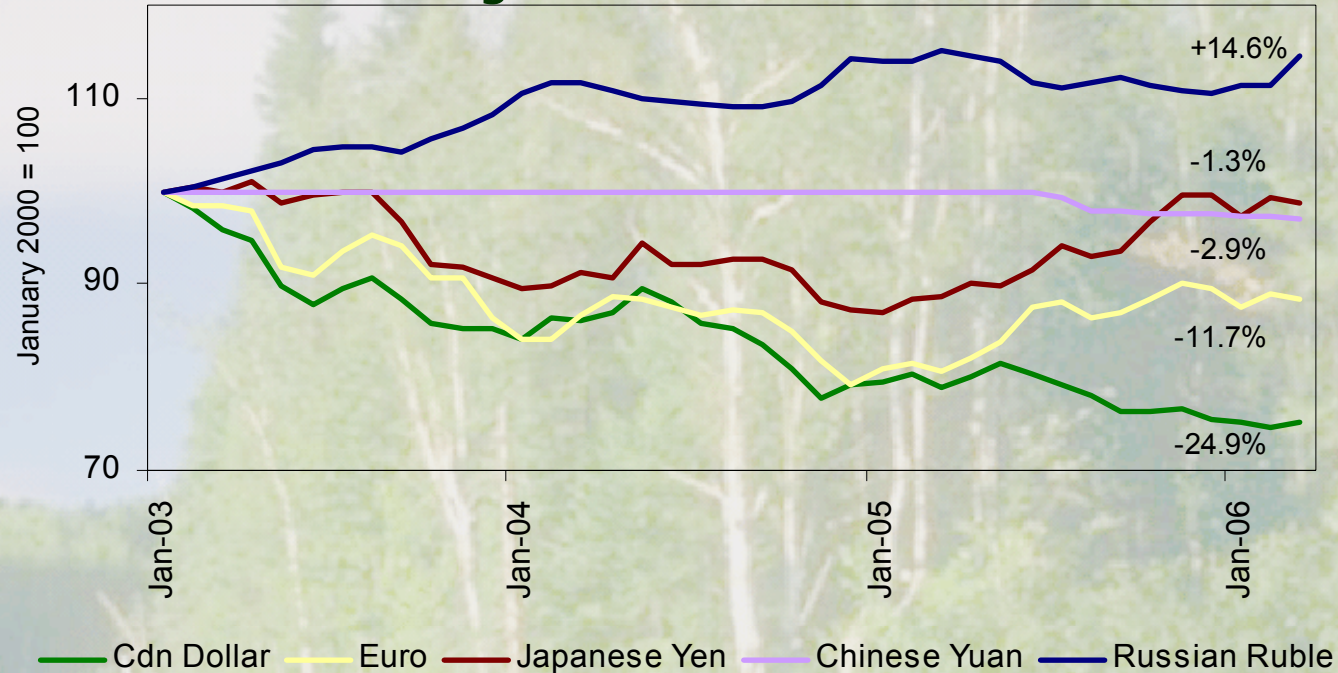
Source: Hydro Quebec, CIBC World Markets.

- **Within North America, British Columbia and Quebec have the advantage – Northeast U.S. worst**
- **In Ontario, 60% increase since 2001, with 15% in 2005.**
- **Further increases coming in Canada in 2006**
  - **8%-15% in Maritime provinces. Catalyst for potential closures by Bowater and Stora?**
  - **5% in Quebec**



# 5. Relative Costs

## Exchange Rates To The U.S. Dollar

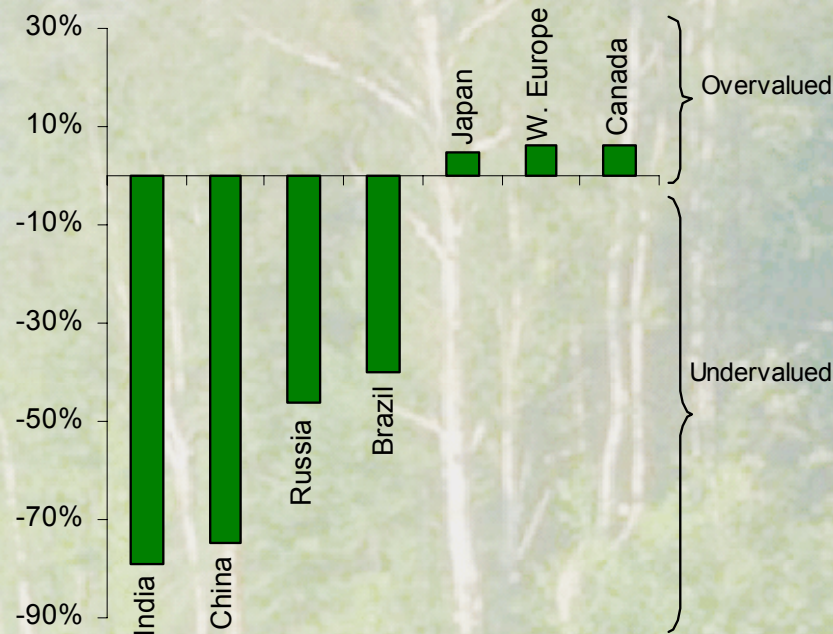


Source: Bloomberg, CIBC World Markets.

- **Due to its "twin" current account and budgetary deficits, the US\$ is expected to depreciate over time. This will help the U.S. industry's competitiveness.**
- **Since 2003, the Canadian industry has been hurt the worst by an appreciating currency.**
- **A weak currency benefited Russia in 2003, and Europe and Japan in 2005.**
- **What will happen in the future? Important, but difficult to predict.**

# 5. Relative Costs

## Percent Change From The Current To The PPP Implied Exchange Rate (2006)

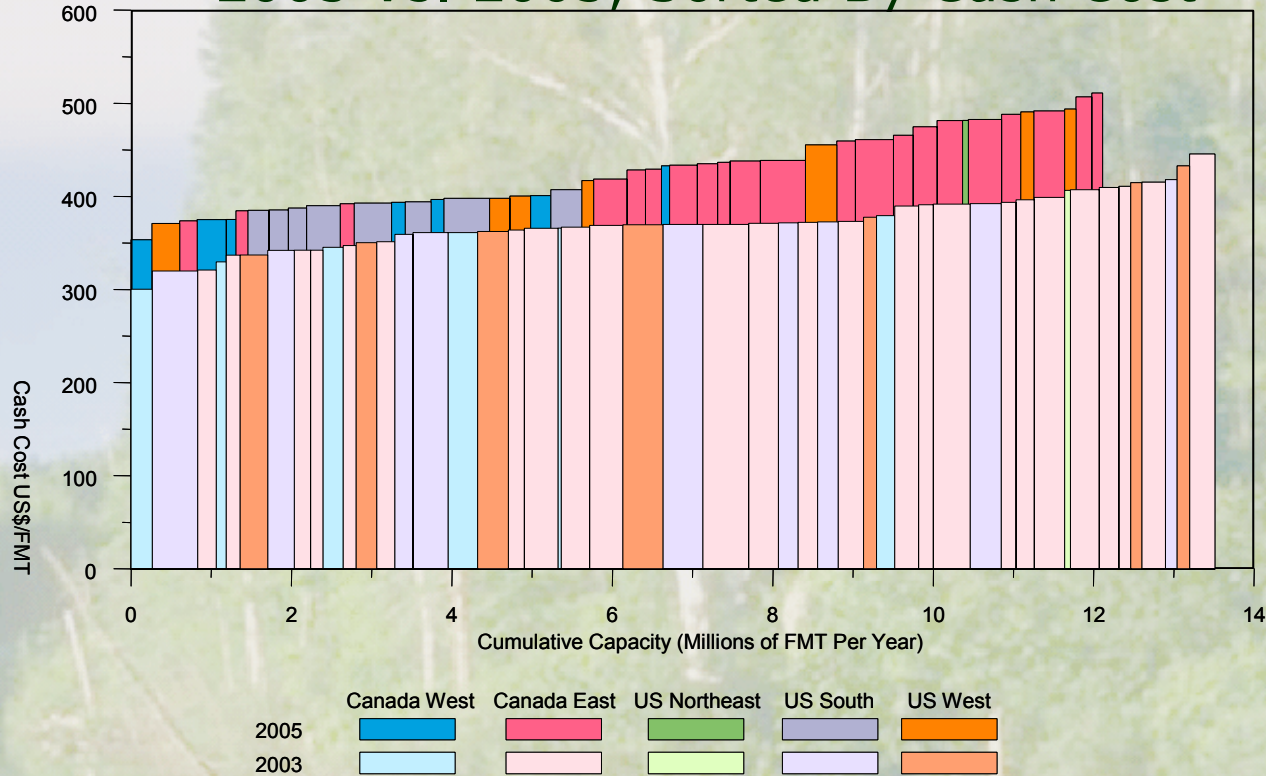


Source: International Monetary Fund.

- **The Purchasing Power Parity concept is one approach to estimating the long-run exchange rate.**
- **Over the intermediate term, the Chinese and Indian currencies are likely to appreciate the most. The Russian and Brazilian currencies also have upward pressure...ability to export newsprint may be undermined.**
- **The Canadian, European and Japanese currencies may be slightly overvalued.**

# 5. Relative Costs

## North American Newsprint Comparison Cost Curve 2005 Vs. 2003, Sorted By Cash Cost

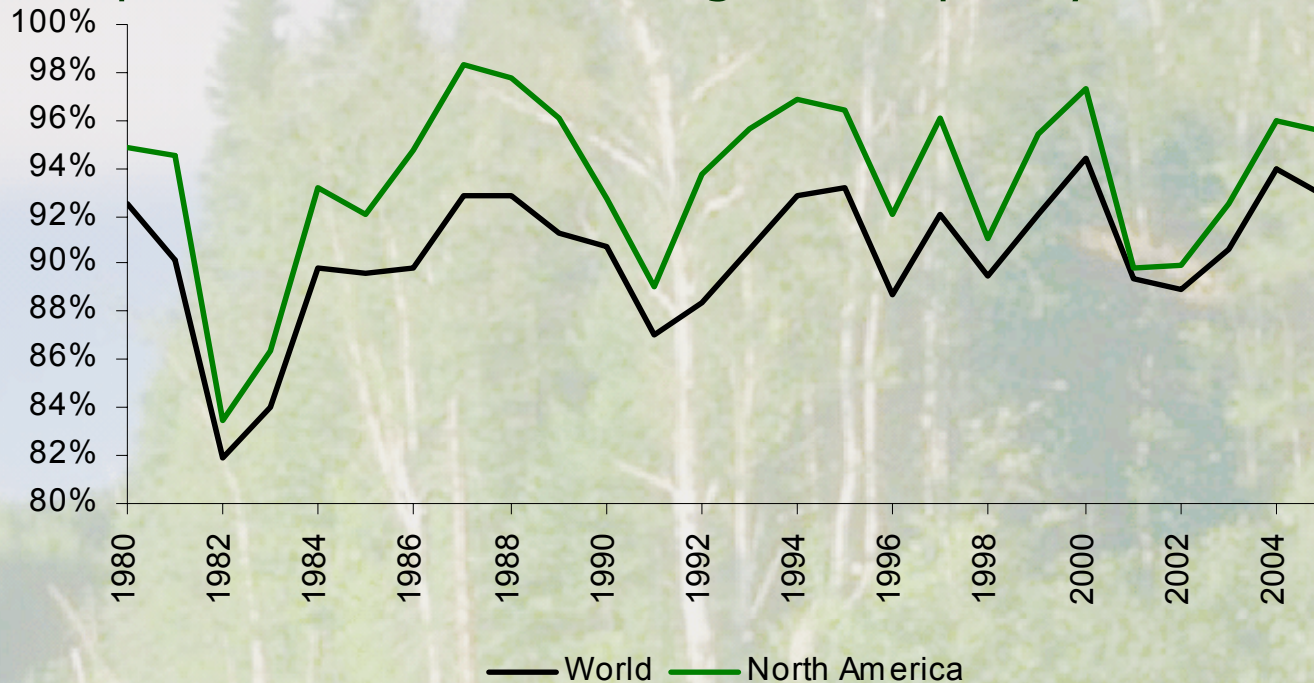


Source: Paperloop Benchmarking Service.

- **Due largely to the strong C\$, the Canadian mills dominate the top end of the cost curve.**
- **15% appreciation of the C\$ made the cost curve steeper – up another 5% since then.**
- **More eastern Canadian mills are threatened, representing 4%-5% of North American capacity.**

# 6. Broader Industry

## Shipments As A Percentage Of Capacity: 1980-2005

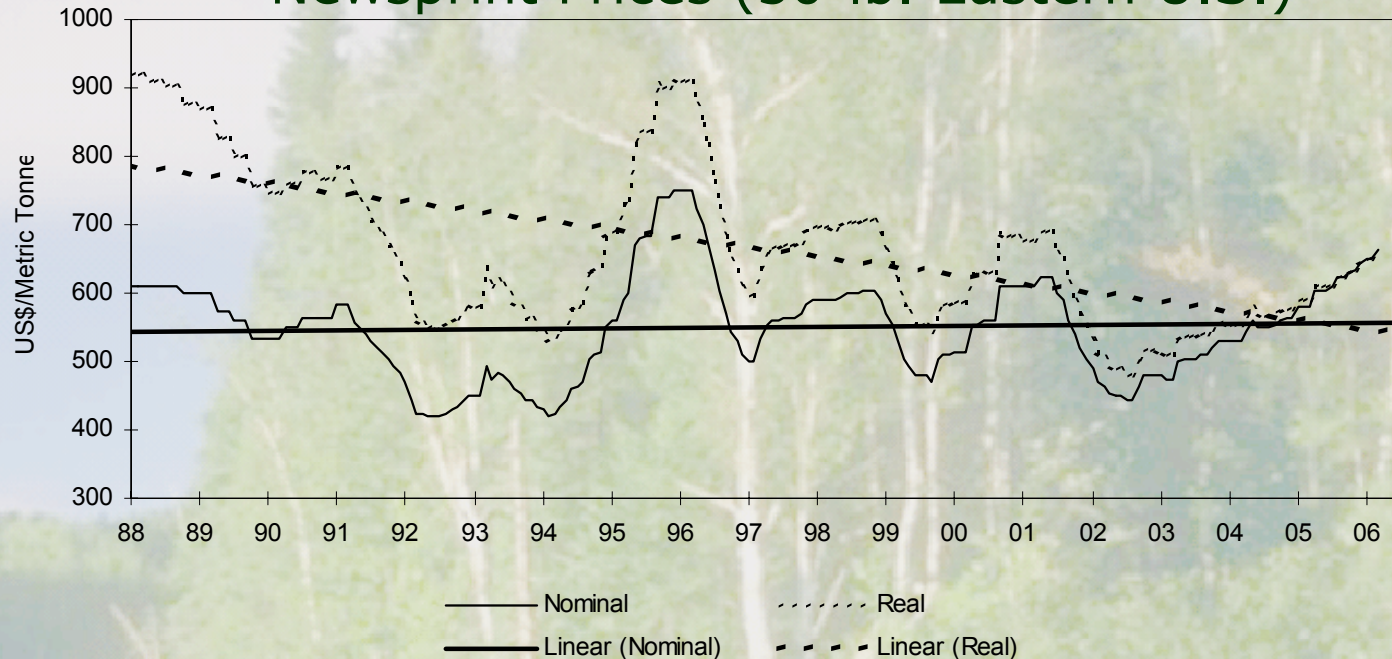


Source: PPPC.

- **Publishers are focused on the price of newsprint, and the price is driven by the industry operating rate.**
- **Operating rates approached a cyclical peak in 2004 – global rates always lower due to uneconomic capacity in developing countries.**
- **For 2006, we expect the global rate to decline to 91%, but the North American rate to increase to 98% - the practical maximum.**

# 6. Broader Industry

## Newsprint Prices (30-lb. Eastern U.S.)



Source: Pulp & Paper Week, CIBC World Markets.

- **Prices are near cyclical peaks. Highest in U.S. since 1996, Europe since 1998, and Hong Kong since 2000.**
- **Publishers are not big winners now, but they do benefit from the downward secular trend in real newsprint prices.**
- **Producers not winners due to higher costs...U.S. prices driven higher by the “cost-push” affect of higher input prices and the strong C\$.**

# 6. Broader Industry

## Winners:

- Consumers (in the longer term)
- Owners of recovered paper
- Owners of virgin fiber in Asia
- Chinese producers (with modern mills)?
- U.S. producers (with modern mills)
- B.C. producers (if not for the strong C\$)

# 6. Broader Industry

## Losers:

- Recovered-paper consumers
- Old newsprint industry (especially in Asia)
- Eastern Canadian producers
- Western European producers
- Labor – everywhere in the global industry (except in the new mills being constructed).
- Shareholders (everywhere?) –  $ROCE < \text{cost of capital}$

# Strategic Case Study: PanAsia

- PanAsia - the largest newsprint producer in Asia (excluding Japan).
- In September 2005, Abitibi sold its 50% stake in PanAsia to its partner, Norske Skog.
- Norske expanded its position in the fastest growing market in the world; and Abitibi retreated to the slowest growing market.
- Norske paid US\$600 million (plus a cash purchase price of up to US\$30 million depending on 2006 results).
- Based on an enterprise value/2005 EBITDA multiple:
  - Norske Skog paid 14.5x\*, and at the time,
  - Norske Skog was trading at 7.9x, while
  - Abitibi was trading at 11.4x.

Who got the best deal?

What is an acceptable price for “growth”?



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Note: RISI is paying the analyst's hotel and airfare expenses. CIBC World Markets is assuming all other costs associated with this trip.

# Companies Mentioned

## **Important Disclosure Footnotes for Companies Mentioned in this Report that Are Covered by CIBC World Markets:**

### **Stock Prices as of 04/11/2006:**

Abitibi-Consolidated Inc. (2a, 2d, 2e, 2f, 2g, 6a) (A-TSX, C\$4.84, Sector Outperformer)

Bowater Inc. (2g, 9) (BOW-NYSE, US\$28.13, Sector Performer)

Catalyst Paper Corporation (2a, 2e) (CTL-TSX, C\$3.29, Sector Underperformer)

## **Companies Mentioned in this Report that Are Not Covered by CIBC World Markets:**

### **Stock Prices as of 04/11/2006:**

Anglo American (AAUK-NASDAQ, US\$21.23, Not Rated)

Holmen AB (HOLMBQ-L, p1869.00, Not Rated)

Huatai Paper (600308-CH, £10.30, Not Rated)

Nippon Paper Group (3893-T, ¥428000.00, Not Rated)

Norske Skogindustrier ASA (NSG-OL, [NOK]109.25, Not Rated)

Oji (3861-T, ¥713.00, Not Rated)

Stora Enso Oyj (SEO-NYSE, US\$14.70, Not Rated)

UPM-Kymmene Corp. (UPM-NYSE, US\$23.15, Not Rated)

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# Key To Important Disclosure Footnotes

## Key to Important Disclosure Footnotes:

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- 12 The equity securities of this company are subordinate voting shares.
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## CIBC World Markets Price Chart

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<b>Stock Ratings</b>		
SO	Sector Outperformer	Stock is expected to outperform the sector during the next 12-18 months.
SP	Sector Performer	Stock is expected to perform in line with the sector during the next 12-18 months.
SU	Sector Underperformer	Stock is expected to underperform the sector during the next 12-18 months.
NR	Not Rated	CIBC does not maintain an investment recommendation on the stock.
R	Restricted	CIBC World Markets is restricted*** from rating the stock.
<b>Sector Weightings**</b>		
O	Overweight	Sector is expected to outperform the broader market averages.
M	Market Weight	Sector is expected to equal the performance of the broader market averages.
U	Underweight	Sector is expected to underperform the broader market averages.
NA	None	Sector rating is not applicable.

\*\*Broader market averages refer to the S&P 500 in the U.S. and the S&P/TSX Composite in Canada.

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## Ratings Distribution\*: CIBC World Markets' Coverage Universe

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Sector Outperformer (Buy)	305	36.7%	Sector Outperformer (Buy)	160	52.5%
Sector Performer (Hold/Neutral)	401	48.3%	Sector Performer (Hold/Neutral)	187	46.6%
Sector Underperformer (Sell)	98	11.8%	Sector Underperformer (Sell)	49	50.0%
Restricted	16	1.9%	Restricted	16	100.0%

## Ratings Distribution: Paper & Forest Products Coverage Universe

(as of 11 Apr 2006)	Count	Percent	Inv. Banking Relationships	Count	Percent
Sector Outperformer (Buy)	4	28.6%	Sector Outperformer (Buy)	3	75.0%
Sector Performer (Hold/Neutral)	7	50.0%	Sector Performer (Hold/Neutral)	5	71.4%
Sector Underperformer (Sell)	3	21.4%	Sector Underperformer (Sell)	2	66.7%
Restricted	0	0.0%	Restricted	0	0.0%

Paper & Forest Products Sector includes the following tickers: A, BOW, CAS, CFP, CTL, DTC, FPS, IFP.SV.A, IP, LPX, NBD, TBC, WFT, WY.

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