Monthly Issue

FEBRUARY 2015

REEL TIME

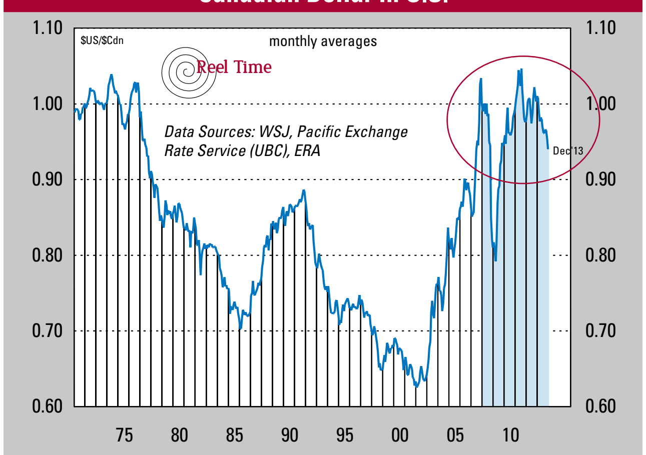
THE REEL TIME REPORT

Presented by Verle Sutton

CURRENCY: A Transformational Variable

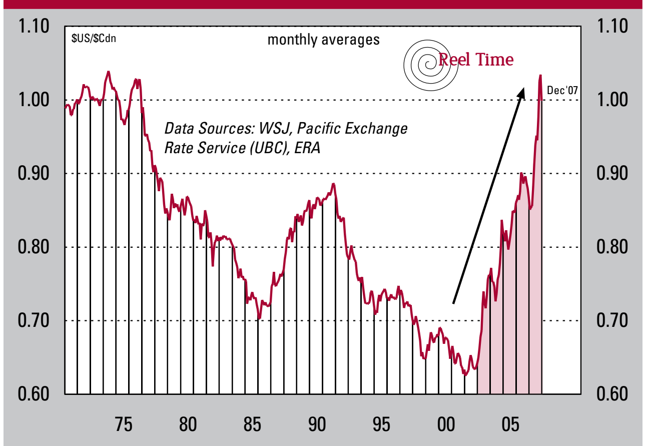
When currency values move up and down in a trading range, the positive or negative impacts on manufacturers in different countries can be important, but not transformational. The graph below highlights the trading range of the Canadian dollar (versus the U.S. dollar) between 2008 and 2013.

Canadian Dollar in U.S.



The variance in the graph above was certainly significant, especially to Canadian exporters, but even the most dramatic swing in the Canadian dollar during this six-year period had a minimal impact compared to the transformational change in the Canadian dollar that occurred between 2003 and 2007 (see the next graph). This five-year surge in the value of the Canadian dollar versus the U.S. dollar did great damage to Canadian manufacturing, including those companies in the paper business: proportionally, many more paper-mill closures occurred in Canada than in the U.S.

Canadian Dollar in U.S.



Short-term currency moves are impossible to forecast accurately, but long-term trends can be identified — both while they are occurring and sometimes before they begin. In the first decade of this century, everyone knew why the Canadian dollar was growing stronger and the U.S. dollar was growing weaker: it was the massive demand surge for energy and mining commodities, fueled by dramatic growth in China. This boom greatly benefited the overall Canadian economy (even though manufacturing suffered). Conversely, the energy/materials boom greatly damaged the U.S. economy. The U.S. was forced to pay higher and higher prices for vast and growing quantities of imported oil.

In the first quarter of 2014, a client requested that we produce a comprehensive five-year forecast for the primary publication and communication grades. With relative currency values being a key factor in such a forecast, a chapter was devoted to this subject.

(continued)

IN THIS ISSUE

The currency analysis we undertook in Q1/14 led us to confidently conclude that we were on the cusp of another transformational change in currency values. At the time this report was written, the Canadian dollar had begun to fall, but neither oil prices nor the euro had shown any weakness. We forecasted that a new cycle was about to get underway: the U.S. dollar would be surging in value versus both the Canadian dollar and the euro.

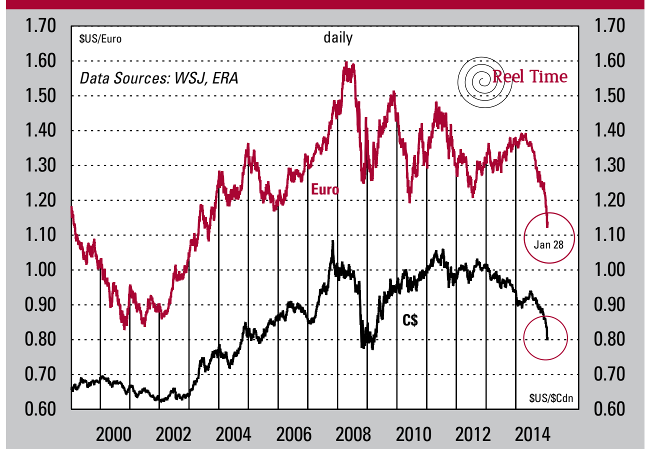
A copy of the currency chapter we produced last spring for that consulting project follows in the next four pages. In a sense, it is outdated, as the Canadian dollar and the euro have already plunged. However, I believe there is value in the analysis itself. **It provides the "why" behind recent currency trends, and offers evidence that this is not a short-term currency swing, but a long-term transformational development.**

Nevertheless, the transformational economic activity taking place at the present time will not go on forever. Eventually, U.S. manufacturing will be damaged sufficiently (as imports increase and exports decrease) to halt the strengthening of the U. S. dollar. In fact, the incredible steepness of the decline in the Canadian dollar and the euro (versus the U.S. dollar) in recent months will likely shorten the cycle. Perhaps the current cycle will last nearer to five years than ten.

The currency report attached is not updated, although some private material designed for our client has been edited out. Providing an unrevised version seemed to be the most effective way to illustrate the principles in play.

In our Market Review section, we will stay on the currency discussion for a while; January has been quite an eventful month (see the updated currency graph below).

The Euro and C$ in New York



CURRENCY VALUES: THE MOST CRUCIAL VARIABLE

April 14, 2014

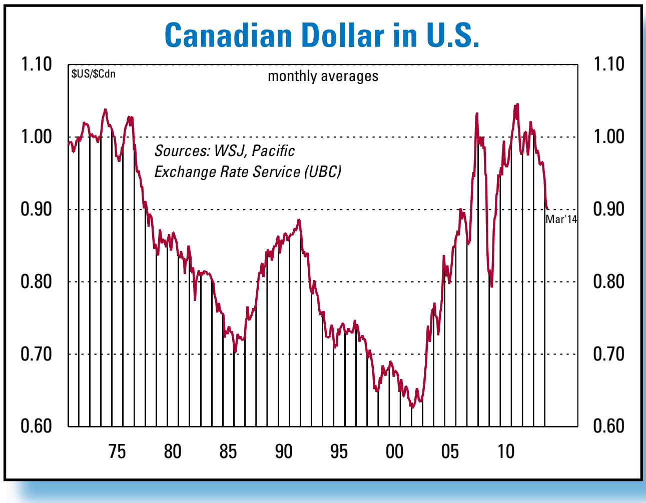
The Canadian Side

Canadian Dollar Versus the U.S. Dollar: The swings in Canadian currency (versus the U.S. dollar) in the last 40 years have been quite dramatic.

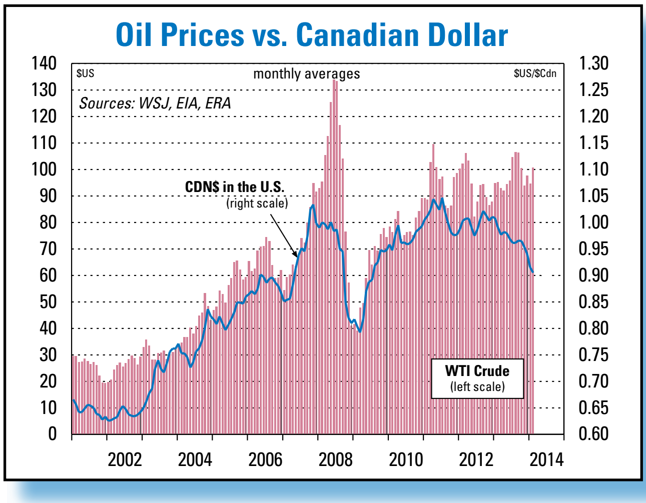
There was a ten-year period of weakness ending in 1985, and a six-year period of strength ending in 1991 (see the next graph). The reversal to weakness in 1991 lasted 12 years and protected the Canadian paper industry during those early years of deteriorating publication paper markets. That protection ended in 2003, though, when the Canadian dollar began to surge — practically straight up — until 2008. But 2008 did not signal the end of the strength. There was a flash plunge in the value of the Canadian dollar versus the U.S. dollar in late 2008 and into 2009 (due to the financial crisis in the U.S.), but that was a short-term phenomenon. The Canadian dollar remained strong, in a trading range, until late in 2013.

It seems that the Canadian dollar has been strong forever, but as mentioned in the previous paragraph, that strength began only in 2003. It was, however, a long 10 years for the Canadian paper industry: the secular decline in paper demand has been catastrophic for the paper industry around the world, but Canada felt it more than most other nations. Coated free sheet is no longer produced in Canada, and only two coated groundwood machines remain in operation. Most SC and newsprint capacity has been eliminated.

There is finally some good news for Canadian manufacturers, however. With the reversal of the loonie in 2013, this latest currency up-cycle appears to be over.



The Petrol Dollar: The graph below shows a strong relationship between oil prices and the Canadian dollar over the last decade. This correlation earned the loonie the nickname of the "petrol dollar." **Actually, a close look at the graph shows that the Canadian dollar generally moved a little in advance of oil prices, and that could be happening again. The next substantial move of oil prices is likely to be lower.**



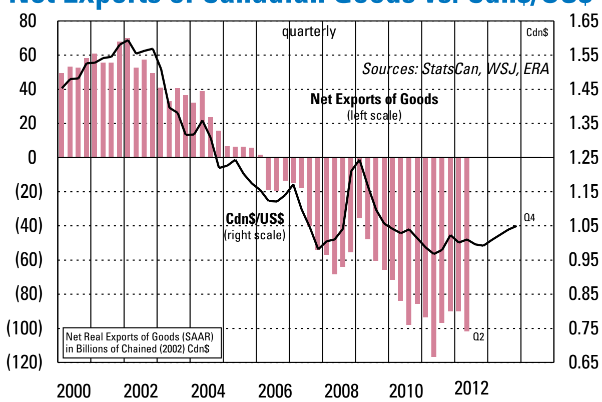
As we discussed in a previous chapter, mining commodities boomed right along with oil during that 10-year period. This, too, was a great stimulus for the Canadian economy, and was perhaps equally responsible for the strong loonie.

The previous strong mining boom was also a decade-long affair that occurred in the 1970s; it is no coincidence that this is the last time the Canadian dollar was at parity with the U.S. dollar. The Canadian currency was actually stronger than the U.S. for most of the time from 1970 to 1976 (see currency graph, previous page).

Obviously, those of us in the paper business — particularly in Canada — are keenly aware that this boom in oil and mining commodities had very negative consequences for Canadian manufacturers selling into the United States. The stronger Canadian currency that came with the oil/mining wealth effect made it very difficult for manufacturers to compete in the United States. Many Canadian manufacturers did not survive, and those that did were damaged.

The following graph was used in the 2010 report. It demonstrates how the stronger loonie correlated with (and in this case actually caused) a decline in Canadian exports of manufactured products to the United States. Thus, to a large degree, the growth in national wealth associated with the oil and mining boom was balanced by a dramatic weakening of the Canadian manufacturing base.

Net Exports of Canadian Goods vs. Cdn$/US$



(Part of this graph could not be undated past 2012, but the point is still made clearly.)

In effect, the Canadian currency, and to some degree all currencies, are self-correcting. It is easier to see the phenomenon in Canada, however, because such a high percentage of manufactured goods are exported to the United States. At present, mining activities are declining, and the Canadian manufacturing base is also weak. This should result in a weaker currency and a recovery in Canadian manufacturing, a process that appears to have begun already.

Factors Related to Currency Values: Countries with high and rising short-term interest rates, growing economies, and perceived economic stability should have strong currencies. There are numerous exceptions to this three-headed generalization, but it helps us to organize the way we think about currency projections.

It is also clear that currency cycles tend to be long-term in nature.

Therefore, just a superficial review of the factors influencing the Canadian dollar would lead one to project a weaker outlook for the Canadian currency:

- Mining commodities will remain weak.
- Oil prices will be trending lower in the years to come (and Canadian oil companies tend to receive somewhat less for their oil).
- The Canadian dollar had a good 10-year run, but, with 2013 so weak, that run appears to be over. Canadian versus U.S. currency cycles normally last 5–10 years.
- Canadian economic growth has been even weaker than that of the United States over the last two years, and that trend will likely persist in 2014.

In addition, over the long-term, exchange rates typically gravitate toward their purchasing power parity (PPP) level. PPP is calculated by comparing the costs of two identical baskets of goods in two countries. According to the IMF, the PPP exchange rate for the Canadian dollar is US$0.81. This means that the loonie is currently overvalued by 12% on a fair-value basis.

Recent Revisions in Forecasts of the EIA and Forest Economic Advisors: Many analysts, even the EIA (U.S. Energy Information Agency), have not been able to catch up with the magnitude of the energy revolution. Remarkably, many analysts are still forecasting higher oil prices in the coming 5 years and even 25 years out. The latest ERA revision projects that oil prices (in 2012 dollars) will fall from $98/barrel in 2013 to $89/barrel in 2015, before beginning to trend upward again to reach $118/barrel by 2030.

How any professional could predict steadily higher oil prices in the 2015–2030 period is puzzling. It will not happen — not in fixed dollars.

A March 12, 2014 Industry Intelligence post contained a currency forecast made by Forest Economic Advisors, which had just lowered its forecast of the Canadian dollar by 8% (versus the U.S. dollar). It was noted that the reduced EIA oil price projection was the primary reason for that revision. The new Forest Economic Advisors currency forecast shows the trough at $0.84 in 2017, prior to the beginning of an up-cycle that would put the value of the loonie at an average of $0.97 in the 2019–2028 period.

There are other currency forecasts to which I could refer, but this Forest Economic Advisors report contains helpful and relevant data. In addition, its currency forecast is interesting because the analysts tended to disregard much of the important evidentiary data they present.

For example, Forest Economic Advisors suggests that Canada "needs a weaker currency to erase its persistent current account deficit," which has risen 22% since 2002 (when the value of the Canadian dollar was below $0.65). However, the Forest Economic Advisors forecast — calling for an $0.84 bottom in 2017 — would not wipe away this surplus; it would dent it a bit, but the surplus would still be 15% or so higher than in 2002.

Then, relative to purchasing power parity (PPP), the Forest Economic Advisors wrote the following:

> *…we were reluctant to show our USD per CAD forecast gravitating back to its PPP level over the long term because the US Energy Information Agency showed real oil prices trending up over the next two decades, and we generally try to keep our oil price projections reasonably close to theirs. Thus, our long-term loonie forecast struck a balance between an appreciating trend driven by rising real oil prices and a depreciating trend driven by the historic tendency of exchange rates to trend toward their PPP level over the long term.*
>
> — Forest Economic Advisors, March 19, 2014

So, in other words, the high EIA oil price forecast is keeping the Canadian dollar forecast higher than would otherwise be the case, at least over the long-term.

This analysis is weak. The oil-price question is hardly a question anymore: **there will be a decades-long surplus of oil/other petroleum products and natural gas in both Canada and the United States.**

Currency values are much more complex. However, currency discussions should not be made even more complicated by baseless confusion over future energy prices.

The Unites States Side

The Other Side of the Equation: An important part of the relative strength of the Canadian dollar versus the U.S. dollar has been the weakness in the U.S. dollar.

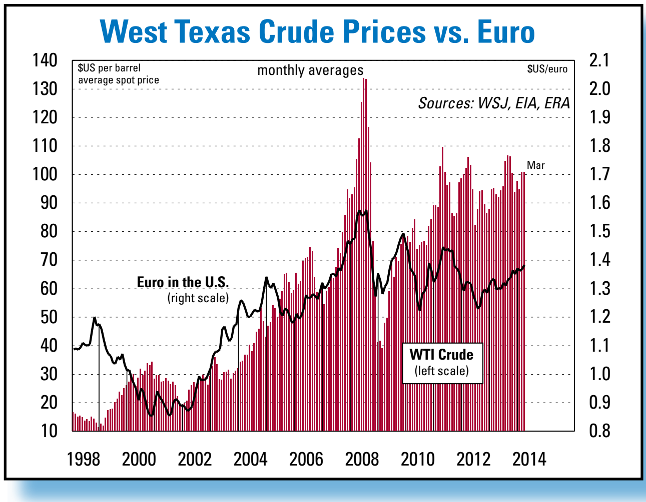
The U.S. Currency Cycle: First, there are underlying reasons why currencies tend to move in long-term cycles. Thus, if we know nothing more than how long a currency has been weak or strong, we know a lot — not everything that's helpful, but a lot.

Deutsche Bank offered some interesting comments in a recent report, suggesting that the average U.S. currency cycle (in one direction — up or down) is seven years; at the present time, the U.S. currency has been weak for nine years.

Several key paragraphs from the Deutsche Bank report are included below. Their analysis seems to be logical, but I am going to stay away from a technical discussion. I have added the boldface:

> *Since the end of Bretton Woods in the early 1970s, the dollar has followed a long-term cycle with up- and downtrends lasting on average 7 years … So this would mark the downtrend as lasting nine years, longer than the 1970s downtrend, but shorter than the 1990s one.* ***On that basis, we are currently in the midst of the big dollar turn higher.***
>
> *A combination of the long-term dollar cycle, a turn in the Fed cycle and US capital flows, and corrections in overvalued currencies should all support the dollar in 2014.*
>
> *The euro has been one of the stars of 2013, but we expect the trend lower to re-assert itself over 2014.* ***We forecast EUR/USD to reach 1.25 by end-14 and 1.10 by end-15.*** *A broadly stronger US dollar is the first ingredient to euro weakness….*
>
> — Deutsche Bank, April 7, 2014

Oil Prices and the Euro: Since 2002, the euro (in U.S. dollars) has correlated with oil prices almost as closely as the Canadian currency, and not because oil production in the European Union has been impressive (see the following graph).



What is actually being measured in this graph is the weakness in the U.S. dollar (versus the euro) that was caused by massive imports of more and more expensive oil. But, of course, that is changing rapidly.

During the last eight years, the global **increases** in the production of oil/other petroleum products and natural gas have occurred primarily in North America, and are now particularly centered in the United States (this is not because Canada is poor in oil and gas reserves compared to the U.S., but simply because of proximity to market, population, etc.). **It has not shown up yet, but the U.S. currency could be the new petrol dollar** (except that the correlation would be between oil production and currency rather than oil pricing and currency). **The great weakness in the U.S. economy over the last three decades is quickly becoming its greatest strength, and currency will follow.**

Currency Forecast

The Canadian dollar hit a six-week high this week at $0.91, but that is not unexpected. Even in a downtrend, there is variability.

It appears the stars are aligned for the U.S. dollar to strengthen and the Canadian dollar to weaken, so there is potential for an additive impact.

The Forest Economic Advisors forecast is for the Canadian dollar to fall to $0.84 by 2017.

Deutsche Bank expects the U.S. dollar to enter a "strong phase" soon, with the euro falling to $1.25 by the end of 2014 and $1.10 by the end of 2015.

It seems to me that Forest Economic Advisors is too slow and too cautious with its forecast of the drop in Canadian currency, and that Deutsche Bank is too aggressive with its forecast of a stronger U.S. dollar.

The following two tables show our forecast of the Canadian dollar versus the U.S. dollar and the euro versus the U.S. dollar.

Canadian Dollar vs. the U.S. Dollar 2014–2018 Forecast

Year (Average)	Loonie (in USD)	Year	Loonie (in USD)
2014	**0.90**	2017	**0.78**
2015	**0.86**	2018	**0.78**
2016	**0.82**		

Euro vs. the U.S. Dollar 2014–2018 Forecast

Year (Average)	Euro (in USD)	Year	Euro (in USD)
2014	**1.35**	2017	**1.15**
2015	**1.28**	2018	**1.10**
2016	**1.20**		

To the degree that this forecast is accurate, the Canadian dollar versus the euro would actually strengthen modestly during the forecast period (from the current ratio of C$1.51). However, with the euro currently so historically strong versus the Canadian dollar, this would be only a modest inconvenience to Canadian exporters.

U.S. paper companies, however, would be strongly disadvantaged against both Canadian and European producers. This could lead to higher U.S. imports of European coated paper, and then more U.S. machine closures than would have otherwise occurred. ●

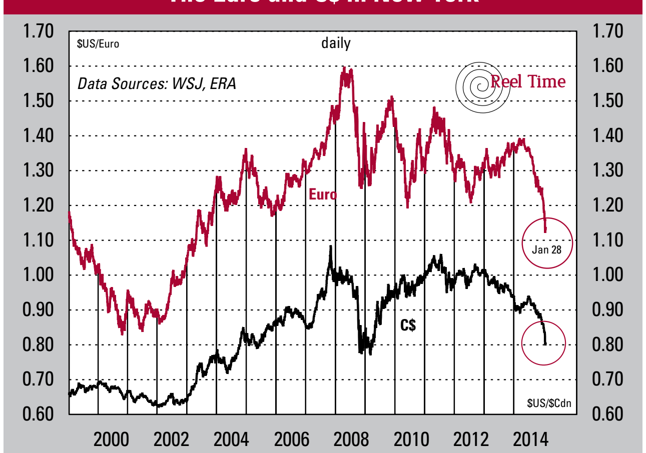
MARKET REVIEW

CURRENCY UPDATE

As mentioned in the introduction, the primary purpose of including the four-page April currency report in this issue is to provide evidence that the current strength of the U.S. dollar is not a short-term event. Readers should plan accordingly.

How far the euro and Canadian dollar ultimately fall is not knowable, although, in most currency cycles, levels tend to overshoot what seems logical (according to measures like the PPP). The speed of the declines in the euro and the Canadian dollar were much more rapid than we had forecasted, and it appears right now that the bottoms of our April 14, 2014 forecast will not be nearly low enough; the euro will likely fall through $1.10, and the Canadian dollar will likely not stop at $0.78.

The Euro and C$ in New York



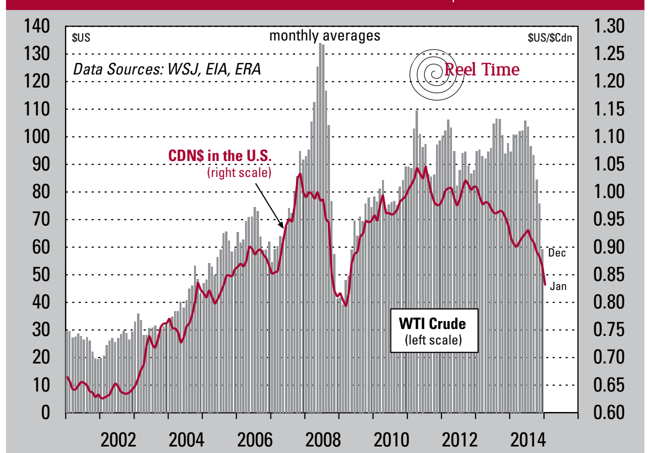
In our April 2014 issue of *Reel Time*, published even before the April 14 currency report, we suggested that a new (stronger dollar) currency trend was underway. In subsequent months, we regularly expressed concern about the repercussions a lower euro and Canadian dollar would have on the U.S. paper industry.

The stronger dollar has already brought great pressure to bear on the U.S. newsprint industry, but the worst is yet to come. The coated grades have not yet been affected very much, but that will change. As we review each of the grades in the next few pages, the currency influence will be discussed in more detail.

The graph in column one (also shown on page 2) shows that January has been an amazingly strong month for the U.S. dollar. The Canadian dollar fell from $0.86 on January 1, 2015 to less than $0.79 on January 30. The euro has performed similarly, down from $1.21 on January 1 to under $1.13 on January 30.

Just as an aside, the famous "Oil Price vs. Canadian $" graph is updated below. It has certainly held true to form.

Oil Prices vs. Canadian $



NEWSPRINT

Overview: It is not hyperbole to state that the North American newsprint industry has faced catastrophic conditions since 2000. North American newsprint shipments have plunged from 16 million tonnes to fewer than 6 million tonnes, a drop of 63%. North American demand has fallen from more than 13 million tonnes in 2000 to just over 4 million tonnes, a decline of nearly 70% (see graphs, pages 15, 16 and 17).

The steep losses in newsprint demand began in the U.S., but the technology virus that destroys paper demand has caught up with the rest of the globe, including the developing world. The steepest newsprint demand declines in 2014 were in China. Also note that the newsprint demand pattern in Europe is now similar to North American (see graphs, page 15). However, the process started later in Europe, so there were more than 8.5 million tonnes of newsprint demand still in place in 2014.

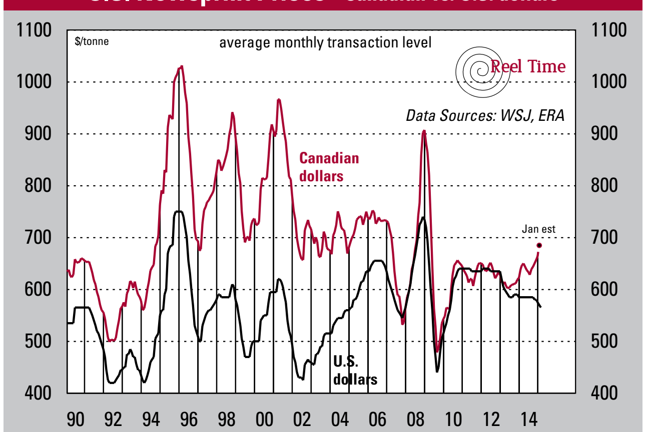
There has always been hope that a bottom in newsprint demand would eventually be reached, or at least a time when declines would be minimal. That point is not visible from here.

The U.S. Versus Canada: Conditions are currently as bleak as they have ever been for U.S. newsprint companies. It is even possible that newsprint production could cease entirely in the U.S. before the currency cycle runs its course.

Western U.S. newsprint producers are more in jeopardy since they are more dependent on exports, and because their transportation costs to North American customers are relatively high. The very low freight costs that U.S. eastern newsprint mills enjoy (versus Canadian competitors) are central to their hope of surviving for five years or so.

Note in the next graph that U.S. prices in Canadian dollars are now up to about $680/tonne — more than $100 above the U.S. price. This spread (or a wider one) will likely exist for at least three more years, and perhaps up to six or seven years.

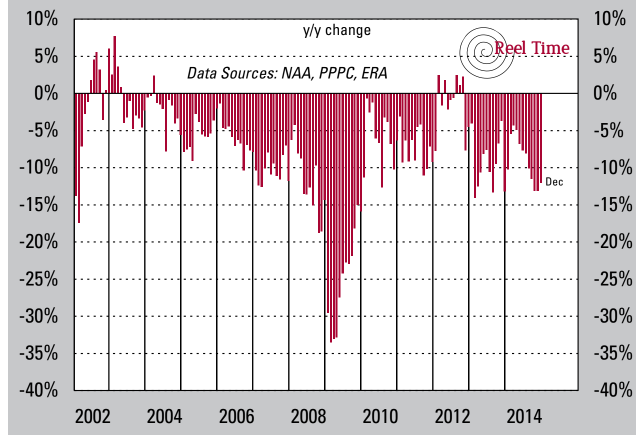
U.S. Newsprint Prices • Canadian vs. U.S. dollars



North American Newsprint Demand: Shipments to publishers were down by 15.2% (y/y) in December. This is the fourth consecutive month in which losses were greater were than 15%. Shipments to commercial printers remained relatively strong, up (y/y) by 0.4%. These two end uses combined in December to take North American newsprint demand down by 11.9% (see next graph).

For 2014, shipments to publishers fell by 12.2%, but newsprint shipments to commercial printers saw an increase of 2.5% (a rare positive number). This took total North American newsprint demand down 9.0% (403,000 tonnes) in 2014.

North American Newsprint Demand



Newsprint Exports and Imports: Offshore exports were down 4.7% (y/y) in December, and finished 2014 down by 6.8% (135,000 tonnes; see graphs and tables on page 16).

The bad news on offshore exports started to be seen in the data during the last half of 2014, but the export market is actually in much more serious trauma than the data indicates. We expect much worse in 2015 — even more so with the sharp decline in the euro in January.

We have added a mention of imports to the discussion this month. Offshore newsprint imports were nearly zero in 2014 (3,000 tonnes). However, at least one European newsprint producer is kicking the tires in the United States, as the strong dollar gives Europeans a chance to get back into the U.S. market. It is too soon to form any conclusions, but this could turn out to be a serious problem, especially if we see the euro and U.S. dollar at parity sometime in 2015 or 2016.

North American Newsprint Shipments: Combining North American demand with offshore exports, we find that North American newsprint shipments dropped by 8.3% (533,000 tonnes) in 2014.

All of the loss in North American shipments in 2014 occurred in the United States. Canadian newsprint producers increased their newsprint shipments by 0.8%, but the shipments of their U.S. counterparts fell by 22.7%.

Capacity and the Supply/Demand Balance: Capacity eliminations were covered in detail last month. With 1,135,000 million tonnes of North American newsprint capacity being removed in the 13-month period from January 1, 2014 through

January 31, 2015 (in addition to 300,000 tonnes or so of value-added groundwood capacity shutting down), it would seem that the newsprint market in the east should be strong. However, that does not appear to be the case. There are reports of modest weakness.

That surprising softness in the eastern newsprint market is likely due to 1) a continuation of substantial weakness in North American demand; 2) "imports" from the U.S. west as these newsprint companies try to find replacement destinations for offshore exports that are being stymied by the dockworkers' slowdown; and 3) most important, what we expect will be a severe drop in 2015 offshore newsprint exports; some Canadian producers are already trying to replace offshore-export losses by growing market share in the U.S. — a market declining recently at a 17% rate.

As an aside, Resolute has shut down so much newsprint production that the company should not have any trouble filling up remaining capacity. However, if White Birch and/or Kruger reduce prices for major buyers to get additional tonnes, then I am guessing that even Resolute will have to make some price adjustments to stay in touch with the market. (This is another reason, by the way, for Resolute to allow prices to fall until its competitors are forced out of the market.)

We have revised our *Reel Time* newsprint prices down by $5/tonne in both December and January. The total decline since September is $15/tonne and is influenced by the weak U.S. west (which is about 20% of the U.S. market).

It still seems logical that the newsprint market in the east will firm up soon, and pricing will stop falling, but that does not appear to be the case yet. At the present time, it looks as if there could be another $5/tonne newsprint decline, on average, in February.

In the west, the situation is much worse, with prices down roughly $30/tonne in 2014 — to $535/tonne or even lower. Prices cannot fall much more.

The dockworkers' slowdown in the west is a big deal; one contact in that area believes that only about 15% of normal shipments are going out. This must be creating a lot of downtime in western newsprint, but the good news is that it comes at a time when orders are very hard to come by anyway, both in North America and offshore.

We hope for the best for our friends in the western U.S., but it seems likely these producers (even though every mill is owned by a different company) will have to begin shutting down before very long; a string of consecutive closures over the next several years is likely.

SC AND COATED GRADES

SC and Coated Pricing

We have changed the format this month: the discussion of pricing and market conditions comes first.

Verso announced price increases to take effect with all orders entered today (January 30), and with all orders already entered that ship on or after March 2. The increases are for $40/ton on SCA, $30/ton on No. 5 coated groundwood, $20/ton on No. 4 coated groundwood, and $40/ton on No. 3 coated free sheet.

These increases are a catch-up for the increases that Verso and NewPage did not announce when others did in Q4/14. Since customers buying paper out of the two mills that Catalyst purchased from NewPage did not have to deal with an increase either, Catalyst will probably announce similar price hikes.

Other companies will not likely announce additional increases, but the Verso announcement will give them the support needed to more fully implement increases already announced.

SCA: The UPM Madison mill is taking downtime from January 24 to about February 9. The company cited market conditions, high energy costs, and competition from a highly subsidized Port Hawkesbury.

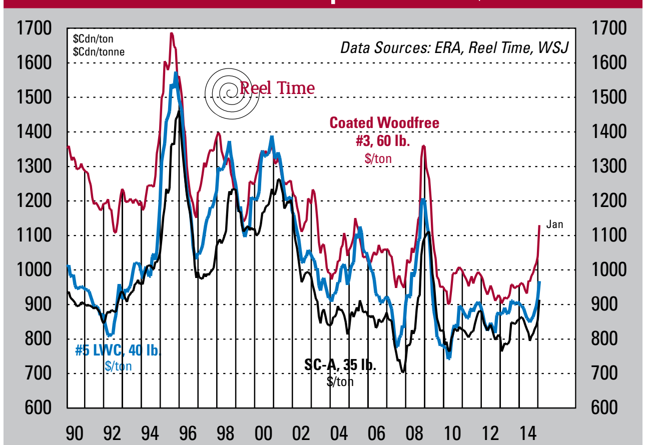
Citing market conditions, in terms of volume, is not a legitimate explanation: Madison could easily fill up with SCA and some SCB (which is undersupplied right now). However, market conditions, as related to pricing, could be a very legitimate reason for taking some downtime, especially during the high-cost energy time of the year.

This outage will remove only about 10,000 tons of SC supply, but even that small reduction is helpful to Madison's competitors.

At the present time, the SCA market is more firm than it would typically be at this time of the year. In addition, in the months ahead, SCA order entry will also benefit from the currently undersupplied SCB and coated groundwood markets. Nevertheless, producers have been very tentative about raising prices. This is due in part to the fact that even though the market is firmer than usual, backlogs have not been extended out very far. In addition, the lack of pricing support from NewPage–Duluth undermined the market. (Verso raised prices for that important mill today.) Last, the Canadian producers (that control most of the SC capacity) don't need any increases; they are already doing very well.

The next graph shows U.S. prices, in Canadian dollars, for the two coated grades and SCA. Our focus here is on SCA pricing (the bottom black line). Note that U.S. SCA prices in Canadian dollars have jumped from less C$800/ton to over C$900/ton since the middle of 2014, with more than half of that improvement occurring in the last two months. With the exception of parts of 2008 and 2009, this is the highest level these prices have seen since 2003.

U.S. Publication-Paper Prices in $Cdn



Coated Groundwood: It is believed that Coated Groundwood No. 5 backlogs are extended out at least 45 days for all producers, and even longer for most, so the market is very healthy. Another indication of market strength is the very low coated groundwood mill inventories (see the graph in the right column).

We have *Reel Time* coated groundwood prices up by $20/ton since the announcement in the fall. This sort of ignores the fact that Verso and NewPage did not go up much, if at all. And, even ignoring these companies, $20/ton is probably too much. However, all companies should be receiving the $30/ton increase by March (or April if there is quarterly price protection). Then, if import growth in 2015 is slow to develop, another price increase of perhaps $40/ton will be announced for July.

By the way, note in the previous graph that the two coated groundwood machines left in Canada have very good pricing at the moment.

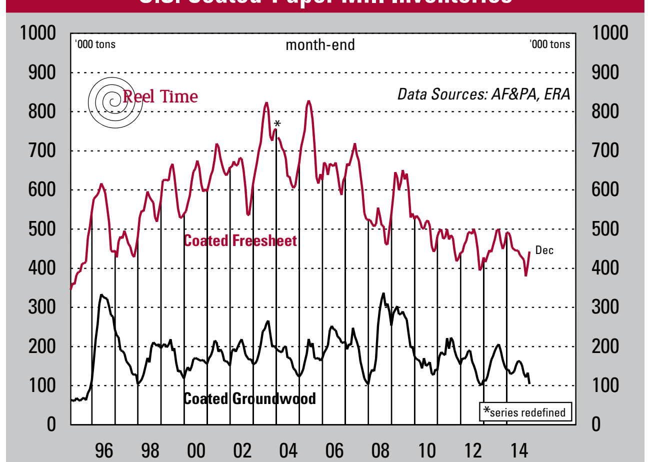
We don't talk much about coated groundwood No. 4 grades; perhaps that will change in the coming months. Verso has told some customers that it does not plan on producing No. 5 grades. The company hopes to be able to sell all of its coated groundwood in the No. 4 market. I doubt this will occur, but it will apparently be the company's objective. The No. 4 market is not as firm as the No. 5 market: paper is readily available.

Coated Free Sheet: It seems that, except for Verso and NewPage, coated free sheet suppliers were generally able to implement the $40/ton increase. As with coated groundwood, we ignored Verso and NewPage and raised our *Reel Time* prices by the full $40/ton. Obviously, with Verso controlling half the market, the average price did not really go up $40/ton. Nevertheless, in order not to undermine the price-increase attempt, that is how we handled it.

Reel Time pricing will not move higher as the Verso price increase is implemented.

Backlogs in coated free sheet are short right now, and order entry has not kept up the last two months. Note in the next graph how quickly coated free sheet mill inventories have jumped up. Mill inventories of coated free sheet tend to grow from November through the first five months of the next year,

U.S. Coated-Paper Mill Inventories



but the spike upward in November/December 2014 has already used up nearly half of the potential inventory build.

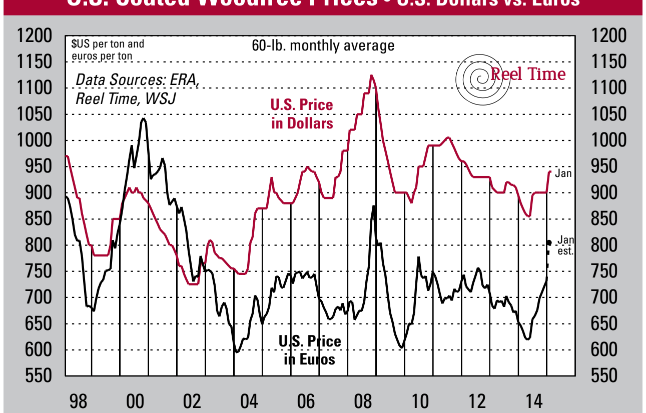
This weakness is troubling, and interesting. There is a good chance the problem is not primarily related to coated free sheet. My guess is that the soft uncoated free sheet market has resulted in the coated free sheet manufacturers losing out on some of their uncoated free sheet "fill" business. It will be interesting to see how this plays out, but the first six months of 2015 will not be easy for coated free sheet companies.

SCA and Coated Imports

The big brokers in the U.S. are all being contacted by European publication paper companies. There is no question that higher imports are on the way. With any luck these imports will not be extensive, but they certainly could be. This is a great and growing concern.

We publish the following graph now and then. It provides U.S. coated free sheet pricing in euros. (We also have versions for SCA and coated groundwood, and they appear similar at present.) U.S. coated free sheet pricing in euros has skyrocketed by nearly €200/ton in the last nine months. Only for one brief period during the last 12 years (late in 2008) was the U.S. coated free sheet price in euros higher than it is right now. This euro price realization is very tempting for European producers of all the publication-paper grades, and it could be better for them in the months ahead.

U.S. Coated Woodfree Prices • U.S. Dollars vs. Euros



Through the end of 2014, however, U.S. offshore imports of SCA and coated had not been strong. SCA imports were up by a modest 4,400 tons in December, but finished the year down 18.6% (68,300 tons).

We usually review AF&PA import/export data for the coated grades, but the PPPC data is finalized for 2014 so we will reference the PPPC for this report. The PPPC shows North American imports of coated groundwood dropping by 23.7% in December and off by 28.8% (127,900 tons) for the full year of 2014.

For coated free sheet, the PPPC has North American offshore imports down by 2.5% in December and 2.3% for 2014 (see graph, page 15).

We expect offshore SCA and coated imports to come roaring back in 2015, but it may take three to six months for the flow to gain momentum.

SC and Coated Shipments, Demand and Production

SCA: North American shipments of SCA to North America were up 8.8% in December, and that brought full-year 2014 shipments up to almost flat, down 0.5% (5,500 tons).

As mentioned earlier, North American SCA imports were down by 18.6% (68,300 tons) for 2014.

Therefore, total North American SCA demand in 2014 dropped by 5.2% (35,300 tons).

SCB demand in 2014 was up 3.5% (24,300 tons). In combination, SCA and SCB demand in 2014 was nearly flat, down by just 12,000 tons.

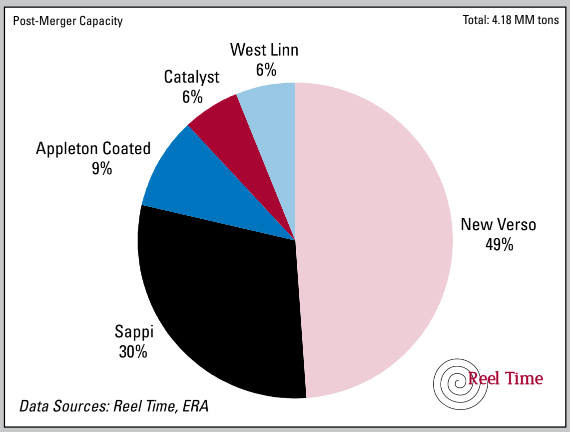
Coated Groundwood: U.S. coated groundwood shipments were strong in December, up 4.4% to 251,200 tons. Inventories were reduced by a very large 29,300 tons. Even factoring in the large decrease in inventory, coated groundwood production was 221,900 tons. (Production is equal to shipments plus or minus the monthly inventory change.) With the Verso–Bucksport mill closed, our new estimate of average maximum coated groundwood production is 225,000 tons, so mills ran full in December (see the production table on page 13).

For the full year of 2014, U.S. coated groundwood shipments saw a decline of 3.6% (106,500 tons). You are probably tired of hearing that coated groundwood demand was worse than coated groundwood shipments in 2014, but, for maybe the last time, demand was down by 7.8% (275,000 tons).

We don't know exactly what coated groundwood consumption was in 2014 because we don't have a good measure of the changes in consumer inventories, but consumption was probably similar to demand, i.e., down about 7.8%.

Following the Bucksport closure and the ownership changes of earlier this month, ERA Forest Products Research developed new graphs of company-by-company capacity for coated groundwood and coated free sheet. Nice graphs, eh?

North American Coated Woodfree Capacity



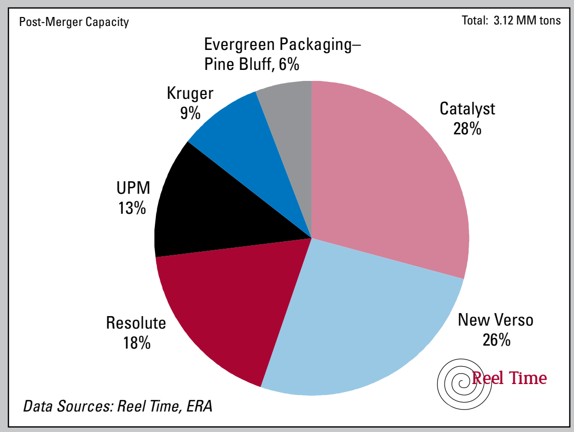
Coated Free Sheet: Before we start the review of the data this month, I need to go back to last month for a minute. At that time, I questioned the coated free sheet production data because it didn't seem consistent with previous months; I thought perhaps there was a reporting problem with the AF&PA getting incorrect information from one of the mills. Well, I was right that the data was wrong, but I was wrong about why it was wrong. The reason the production data did not look right is that I used a wrong figure: *purchases* data instead of *shipments*. Anyway, the production table on page 14 is corrected for November, and December has been added to it.

U.S. coated free sheet shipments in December were up by a slight 0.5% (y/y), and for the full year of 2014 were off by 2.4% (92,000 tons). Demand for 2014 held up a little better than shipments, down just 0.9% (35,000 tons).

As mentioned earlier, coated free sheet inventories were up substantially in the last two months — by 30,000 tons in November and 32,900 tons in December.

Coated free sheet production was 321,600 tons in December, near our current estimate of average maximum monthly production for coated free sheet, so no downtime was taken. However, in order to keep full, producers had to add that 32,900 tons to their inventories. ●

North American Coated Mechanical Capacity



— *Verle Sutton*

U.S. Coated Groundwood Production • 000 short tons

Data Source: AF&PA

Month	Shipments	+/- Inventory Changes	= Prod'n	Prod'n Adj. to 31 Days	NOTES: Capacity changes for high-bright, SC, and CGW
Jan/12	281,800	600	282,400	282,400	
Feb	273,400	-1,500	271,900	290,700	
Mar	273,600	+5,500	279,100	279,100	
Apr	246,700	+11,600	258,300	266,910	
May	276,200	-200	276,000	276,000	Verso (Sartell, MN) PM#3 shut down — 180,000 tons **(CGW/SCA)**
Jun	301,400	-32,300	269,100	278,100	Resolute (Catawba, SC) PM#1 shut down — 150,000 tons **(CGW)**. Indef.
Jul	272,300	-12,600	259,700	259,700	Great Northern restarted 2nd machine (125,000 tonnes **newsprint**
Aug	274,000	-15,300	258,700	258,700	and **high-bright**)
Sep	282,200	+11,000	293,200	303,000	Resolute (Dolbeau, QC) — restarted 165,000 tons in October **(SCB)** Average maximum produc-
Oct	279,400	-11,000	268,400	268,400	Port Hawkesbury Paper — restarted 415,000 tons **(SCA)** tion is about 270,000 tons
Nov	264,500	-3,400	261,100	269,800	Resolute (Fort Frances, ON) — closed 110,000 tons **(high-bright)**
Dec	247,800	+13,600	261,400	261,400	Resolute (Grand-Mère, QC) — closed 135,000 tons in November **(SCB)**
Jan/13	255,900	-3,300	252,600	252,600	
Feb	218,900	+12,300	231,200	256,000	
Mar	247,800	+21,300	269,100	269,100	
Apr	228,100	+21,000	249,100	257,400	
May	237,900	+9,500	247,400	247,400	
Jun	251,500	+13,700	265,200	274,000	
Jul	255,800	+11,600	267,400	267,400	
Aug	255,900	+5,200	261,100	261,100	
Sep	269,600	-16,500	253,100	261,500	
Oct	261,000	-23,000	238,000	238,000	
Nov	234,700	-16,300	218,400	225,680	
Dec	240,700	-9,500	231,200	231,200	
Jan/14	231,400	+800	231,200	231,200	Resolute (Fort Frances, ON) — closed another 100,000 tons **(high-bright)** ;
Feb	206,400	-11,100	195,300	216,200	Great Northern shut down 50,000 tons **(uncoated groundwood)**
Mar	237,000	+1,800	238,800	238,800	
Apr	230,600	+4,400	235,000	242,800	
May	221,300	+15,800	237,100	237,100	
Jun	232,100	+11,000	243,100	251,200	
Jul	227,800	-1,800	226,000	226,000	
Aug	256,200	-8,900	247,300	247,300	
Sep	267,800	-22,300	245,500	253,700	FutureMark (Alsip, IL) — shut down 160,000 tons **(CGW)** Average maximum monthly CGW
Oct	260,500	-9,200	251,300	251,300	Resolute (Laurentide, QC) — shut down 210,000 tons **(SCB)** production is about 255,000 tons
Nov	226,100	+12,400	238,500	246,450	Verso–Bucksport, ME 350,000 tons **(CGW)**
Dec	**251,200**	**-29,300**	**221,900**	**221,900**	Average maximum monthly CGW
Jan	—	—	—	—	production is about 225,000 tons

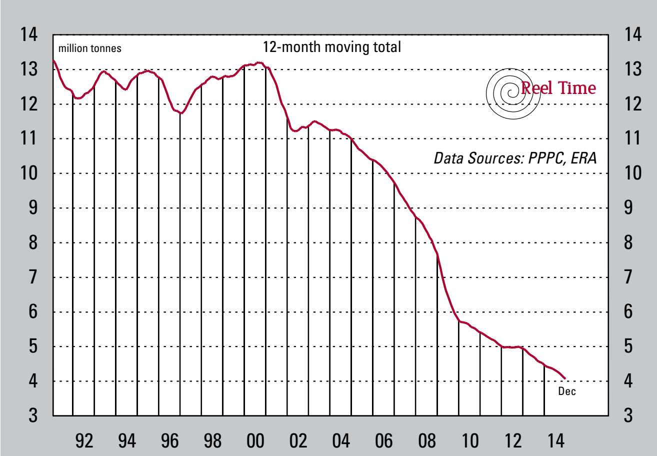
U.S. Coated Free Sheet Production • 000 short tons

Data Source: AF&PA Reel Time

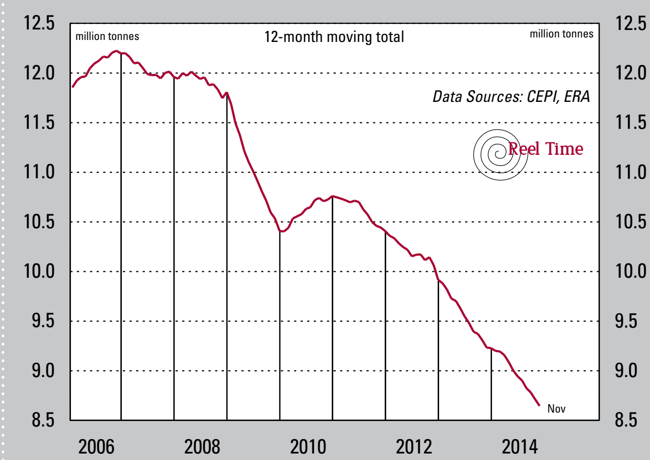
Month	Shipments	+/- Inventory Changes	= Prod'n	Prod'n Adj. to 31 Days	NOTES
Jan/12	312,600	+8,400	321,000	321,000	
Feb	303,300	+18,300	321,600	356,100	Smart Papers (OH) — 45,000 tons **CFS** closed
Mar	316,500	+17,900	334,400	334,400	
Apr	298,100	+20,400	318,500	329,100	
May	314,900	+6,800	321,700	321,700	
Jun	316,200	-1,500	314,700	325,200	
Jul	322,100	+13,900	336,000	336,000	
Aug	257,800	-15,200	242,600	242,600	
Sep	352,800	-66,300	286,500	296,100	Average maximum monthly production is about 345,000 tons
Oct	380,000	-55,400	324,600	324,600	
Nov	331,900	+3,200	335,100	346,300	
Dec	299,000	+24,900	323,900	323,900	
Jan/13	336,100	-6,000	330,100	330,100	
Feb	287,200	+9,500	296,700	328,500	
Mar	314,900	+14,900	329,800	329,800	
Apr	311,300	-2,600	308,700	319,000	
May	310,000	+13,000	323,000	323,000	
Jun	309,500	+16,900	326,400	337,300	
Jul	326,600	+22,200	348,800	348,800	
Aug	339,300	+800	340,100	340,100	
Sep	349,100	-29,400	319,700	330,400	
Oct	364,500	-23,700	340,800	340,800	
Nov	294,100	+15,100	309,200	319,500	IP (Courtland, AL) — 100,000 tons **CFS** closed
Dec	287,200	+27,500	314,700	314,700	
Jan/14	323,000	-4,500	318,500	318,500	
Feb	284,900	-10,400	274,500	303,900	NewPage (Rumford, ME PM12) — 100,000 tons **CFS** closed
Mar	327,500	-28,300	299,200	299,200	
Apr	312,200	-4,800	307,400	317,600	
May	292,800	-3,200	289,600	289,600	
Jun	307,800	+800	308,600	318,900	**Restart** of NewPage (Rumford, ME PM12) — 100,000 tons **CFS**
Jul	330,700	-11,700	319,000	319,000	Average maximum monthly production is about 330,000 tons
Aug	314,800	-5,600	309,200	309,200	
Sep	331,100	-5,600	325,500	336,350	
Oct	343,000	-42,100	300,900	300,900	
Nov	285,300	+30,000	315,300	325,800	
Dec	**288,700**	**+32,900**	**321,600**	**321,600**	

DATA PAGE: SHIPMENTS/PURCHASES TABLE AND VARIOUS GRAPHS

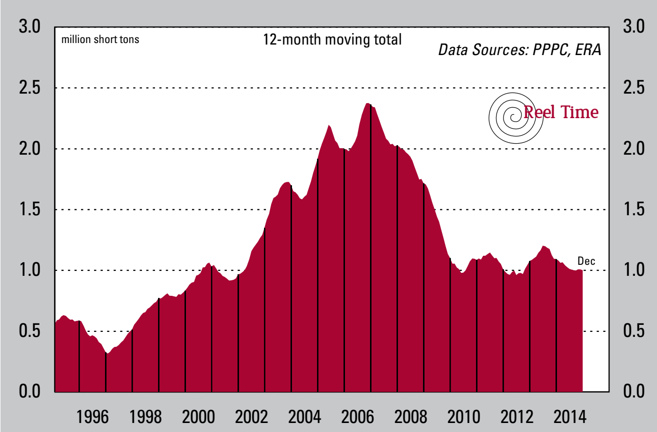
Total North American Newsprint Demand



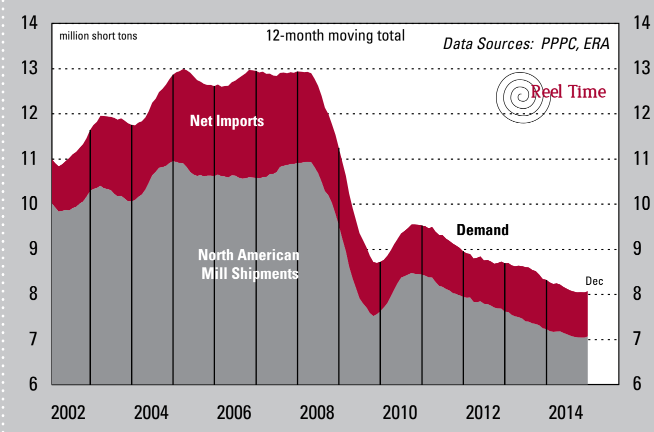
European Newsprint Shipments



North American Coated Papers Net Imports



Coated Papers North American Demand vs. Shipments



SHIPMENTS AND PURCHASES

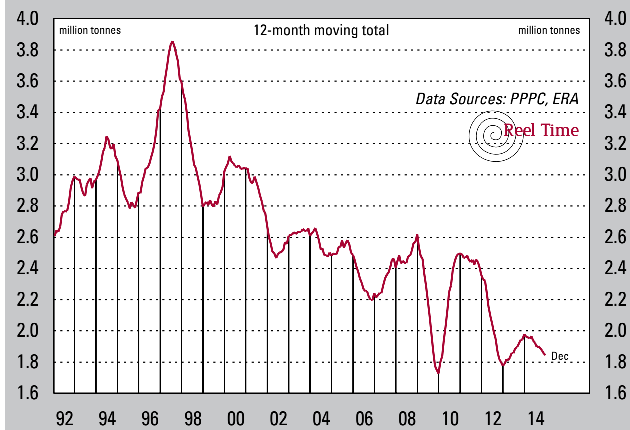
	Newsprint: 000 tonnes / Other grades: 000 tons	02	03	04	05	06	07	08	09	10	11	12	13	YEAR-TO-DATE Dec/13	Dec/14	% Chg
Newsprint	Shipments from NA to NA	11150	11005	10763	10194	9605	8664	7702	5681	5346	4989	4924	4468	**4463**	**4064**	**-8.9%**
	Offshore Shipments from NA	2615	2607	2481	2487	2242	2403	2548	1725	2495	2354	1773	1976	**1977**	**1842**	**-6.8%**
	Total Shipments from NA	13765	13613	13244	12681	11847	11067	10250	7406	7841	7343	6697	6444	**6440**	**5907**	**-8.3%**
	% Offshore Shipments to Total	19.0%	19.2%	18.7%	19.6%	18.9%	21.7%	24.9%	23.3%	31.8%	32.1%	26.5%	30.7%	**30.7%**	**31.2%**	
	Imports	199	212	223	190	142	79	64	85	65	17	17	6	**6**	**3**	**negl.**
	NA Shipments to Newspapers*	8129	8123	7998	7563	7027	6265	5245	3997	n/a	4124	3950	3538	**3489**	**3062**	**-12.2%**
SCA	Shipments to NA from NA**	1505	1503	1559	1742	1457	1685	1613	1324	1205	1074	854	1065	THIS PPPC DATA CAN NO LONGER BE PUBLISHED		
	Shipments to NA from Europe	483	553	489	411	591	528	476	305	419	424	333	370			
	Total Shipments to NA	1988	2056	2048	2153	2048	2213	2088	1629	1624	1498	1188	1435			
	% European Shipments to Total	24.3%	26.9%	23.9%	19.1%	28.8%	23.9%	22.7%	18.7%	25.8%	28.3%	28.0%	25.8%			
CGW	U.S. Shipments	4476	4517	4737	4704	4517	4663	4151	3370	3765	3455	3273	2975	**2954**	**2848**	**-3.6%**
	U.S. Purchases	5302	5740	6155	6117	6046	5965	5147	4003	4145	3816	3845	3574	**3546**	**3270**	**-7.8%**
	% Shipments to Tot. Purchases	84.4%	78.7%	76.9%	76.9%	74.7%	78.2%	80.6%	84.2%	90.8%	90.5%	85.1%	83.2%	**83.3%**	**87.1%**	
CFS	U.S. Shipments	4463	4191	4652	4626	4968	4997	4439	3638	4146	3988	3911	3821	**3829**	**3737**	**-2.4%**
	U.S. Purchases	5287	5088	5714	5584	6148	5600	4699	3608	4275	4168	4012	3935	**3956**	**3921**	**-0.9%**
	% Shipments to Tot. Purchases	84.4%	82.4%	81.4%	82.8%	80.8%	89.2%	94.5%	100.1%	97.0%	95.7%	97.5%	97.1%	**96.8%**	**95.3%**	

This line represents U.S. Dailies' Consumption through 2009. **As of 2006, SCA data is from the PPPC.*

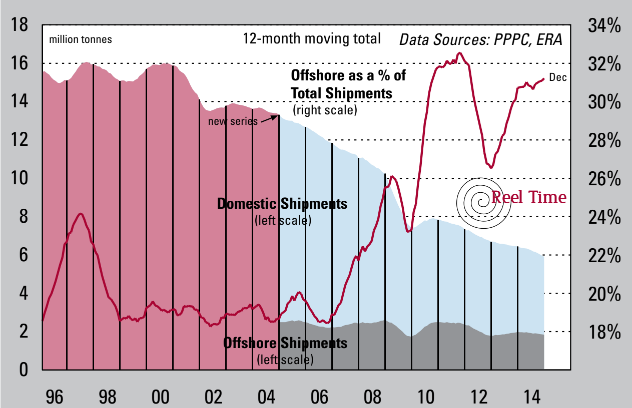
DATA PAGE: NEWSPRINT IMPORTS/EXPORTS

Euro and Canadian Dollar in New York

North American Newsprint Exports



North American Newsprint Shipments



IMPORTANT POINTS

- In the table at the bottom left, note the difference between U.S. and Canadian newsprint shipments to the United States.
- In the table below, note the dramatic year-to-year variation in North American exports to "other Asia."

Note: Import/export data on this page will rotate monthly among coated groundwood, coated free sheet and newsprint.

Newsprint Shipments to the U.S. • 000 tonnes

Year	From U.S.	From Canada	From Offshore	Total
2006	4,243	4,289	142	8,674
2007	3,910	3,725	79	7,714
2008	3,531	3,217	62	6,810
2009	2,632	2,230	85	4,947
2010	2,390	2,135	66	4,591
2011	2,228	2,002	25	4,256
2012	2,294	1,863	17	4,173
2013	1,882	1,847	6	3,735
Year-to-Date Dec/13 vs. Dec/14				
2013 (Dec)	1,882	1,847	6	3,735
2014 (Dec)	1,465	1,897	3	3,365
% Change	-22%	+3%	negl.	-10%

Source: PPPC

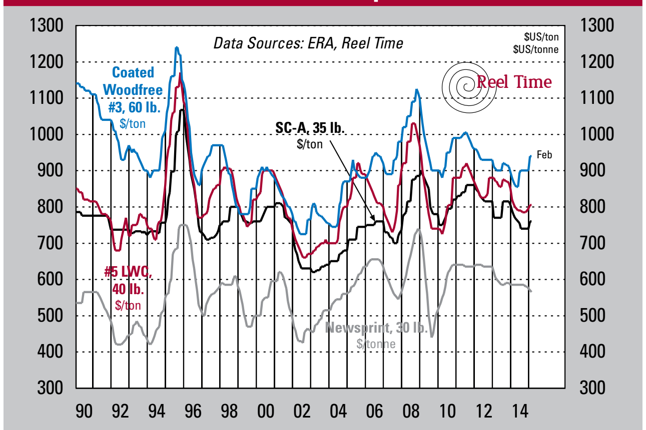
North American Offshore Newsprint Exports, by destination • 000 tonnes

Year	Western Europe	Latin America	Japan	Other Asia	Total Asia	Other	Total Offshore
2006	406	845	197	692	889	102	2,242
2007	643	889	160	588	748	123	2,403
2008	529	1,051	125	724	849	119	2,548
2009	433	771	48	402	450	71	1,725
2010	329	975	87	988	1,075	112	2,492
2011	284	873	97	1,010	1,107	92	2,355
2012	196	821	51	690	741	15	1,773
2013	151	836	58	909	967	23	1,977
Year-to-Date Dec/13 vs. Dec/14							
2013 (Dec)	151	836	58	909	967	23	1,977
2014 (Dec)	205	802	103	698	801	34	1,842
% Change	+36%	-4%	+77%	-23%	-17%	negl.	-7%

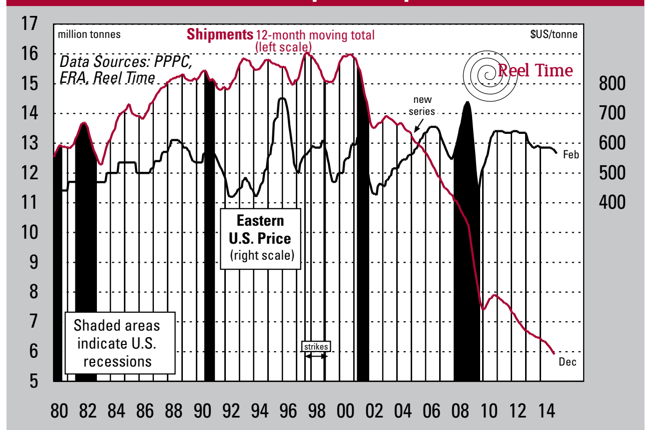
Source: PPPC

PRICING DATA

U.S. Publication-Paper Prices



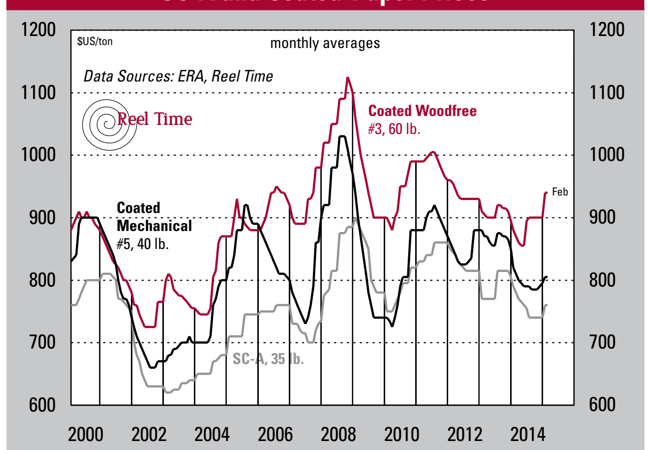
North American Newsprint Shipments vs. Price



Pricing Over Latest Five Months	Sep	Oct	Nov	Dec	Jan
PUBLICATION GRADES					
27.6# Newsprint (24" x 36")	$620	$615	$615	$610	**$605**
30# Newsprint (24" x 36")	585	580	580	575	**570**
35# High-Bright (65-bright)	640	640	640	640	**635**
33# SCB	720	720	725	730	**750**
35# SCA	740	740	740	740	**760**
34# Coated Groundwood (No. 5)	895	895	900	905	**915**
40# Coated Groundwood (No. 5)	785	785	790	795	**805**
60# Coated Free Sheet (No. 3)	900	900	900	900	**940**
COMMUNICATION GRADES					
50# Offset Rolls	885	885	880	875	**865**
20# Cut-Size (17" x 22")	1,130	1,130	1,125	1,120	**1,110**
PULP					
NBSK (U.S.)	1,025	1,025	1,025	1,020	**1,010**

Notes: Newsprint and pulp prices are in metric tonnes, all other grades per short ton; all basis weights refer to 25" x 38" ream, except newsprint and cut size.

SC-A and Coated-Paper Prices



Quarterly Price Forecast vs. Actual

Reel Time — *Note: 2015 forecast was made on Nov. 10, 2014*	Q1/15 Forecast	Q1/15 Actual (Jan)	Q2/15 Forecast	Q2/15 Actual	Q3/15 Forecast	Q3/15 Actual	Q4/15 Forecast	Q4/15 Actual
30# Newsprint	$575	$570	$565		$540		$560	
35# SCA	775	760	775		815		815	
40# Ctd. Groundwood (No. 5)	815	805	845		875		870	
60# Ctd. Free Sheet (No. 3)	940	940	940		980		980	

Annual Average Prices • Current Annual Forecast • Long-Term Price Forecast

Reel Time	Actual Annual Prices 2008	2009	2010	2011	2012	2013	2014	Current Forecast 2015	Annual Fcst Made Nov/14 2015
30# Newsprint	$674	$550	$596	$640	$637	$594	$584	$560	$560
35# SCA	839	830	784	848	825	792	755	780	795
40# Ctd. Groundwood (No. 5)	990	800	798	895	846	866	795	840	851
60# Ctd. Free Sheet (No. 3)	1,058	949	939	989	936	908	885	960	960

NOTE:

- Revised prices are shown in red.

Prices are average market prices of spot and contract, direct sales and merchant sales. Prices are not reduced by standard payment terms or merchant/broker commissions.

PROGNOSTICATIONS

Prog•nos•ti•cate [Webster] *v.* to foretell or predict, especially from signs or indications.

Pulp: Pulp prices are collapsing in U.S.-dollar terms for softwood in most major markets, but hardwood is holding fairly firm for now; hardwood prices will start to move lower in the coming months. The strong U.S. dollar will benefit non-U.S. producers, as we don't expect they will "give away" all of their currency advantage, even as U.S.-dollar pricing weakens. *(Source: ERA)*

Newsprint: Prices are slipping modestly in the east, but closures should bring the market into balance by late in Q1.

SCB: Prices have not gone up by the full $40/ton yet, but that should occur by the end of Q1. *Reel Time* shows $20/ton currently in place.

SCA: *Reel Time* shows $20/ton currently in effect, but the other $20 should be implemented by April (except for large buyers with six-month agreements).

Coated Groundwood: In spite of the firm market, the full $30/ton will not be implemented until March (or April for those that have quarterly price protection).

Coated Free Sheet: With Verso joining in, the full $40/ton should be fully implemented by early March.

Please note: Each month, we will present very specific projections. Our hope is to accurately forecast market direction and identify transitions. We don't expect to be correct very often with exact amounts and timing of price increases.

PLEASE NOTE: Verle Sutton has been writing *Reel Time* and consulting under that name for the last fourteen years. He has created a new company that will be solely focused on consulting. **Sutton Paper Strategies** is the name of that new entity. Please visit **www.suttonpaperstrategies.com**.

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