



REEL TIME

THE REEL TIME REPORT

Presented by Verle Sutton

FOR UFS... THE END IS NEAR!

Unfortunately, our title this month would be appropriate for many stories in our related industries, whether in regard to paper machines, paper consumers or paper companies.

And, from a scientific perspective, the end is also closer than previously thought. For thousands of years, until about 90 years ago, it was "known" that the Universe and the Earth were infinitely old. That's what Plato believed, and Darwin, and Einstein (until he wised up). It followed that the Earth, and humanity, would continue to go on for another infinite period. However, Einstein's Theory of Relativity (and more powerful telescopes) opened the door to numerous new discoveries, and that old theory was exposed. Now it is clear that there was a beginning to all matter, space and even time, and this "in the beginning" occurred only 13.7 billion years ago. Our third-generation sun is, at 4.5 billion years of age, about half-way through its life. But don't get too comfortable: the sun's luminosity is slowly heating up every year. The relatively stable current period of our sun (which has allowed human life to exist on Earth) has not been in place for very long, and will not last much longer (in cosmic terms). The unstable sun will kill off life on our planet long before it expands, consumes Mercury, Venus and Earth, and then burns out. Meanwhile, the expansion of the Universe is speeding up and spreading out. The process through which new stars are formed began

to shut down several billion years ago. At some point, the entire Universe will be devoid of all heat, and of all life, and will be completely and utterly dark.

The End is Near for Uncoated Free Sheet Price Control

Perhaps that introduction will put our business problems in perspective, i.e., things could be worse. And, in regard to the printing papers business, all grades have fared much worse than uncoated free sheet (UFS). So, even if the end is near for UFS (the end, that is, of consistently high prices), the last decade has been a quite remarkable and profitable run.

An extensive review of the substitution that occurs between UFS and other grades was provided in our June 2013 issue, and another smaller item appeared last November. Those might be a helpful in review, since little of that material will be duplicated here. However, it is necessary to review key developments again. Apologies to those of you for which the next few paragraphs are unneeded repetition.

Financial Benefits of Supply and Price Control:

Domtar and IP, with a little help from Weyerhaeuser (until Domtar purchased it in 2006), Boise and Georgia-Pacific, have been able to proactively take enough capacity out of the market to keep uncoated free sheet prices high since they began to move up in 2004.

There are high costs associated with supply control, but these costs were dwarfed by the impact of higher UFS prices. The uncoated free sheet business has been enormously profitable for North American UFS companies during the last decade.

To illustrate the revolutionary impact of supply and price control, we note that the price of 50-lb. UFS offset reached \$800/ton in only one year prior to 2006: during the super-commodity cycle of 1995. Since 2006, however, the price of 50-lb. offset has never fallen below \$800/ton!

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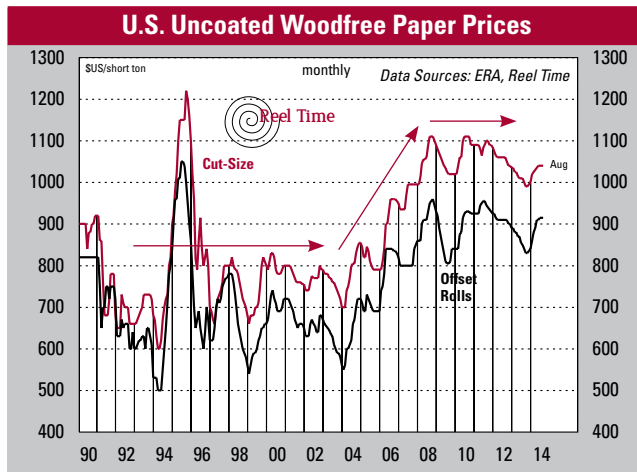
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Note: The pricing up-cycle in UFS got underway early in 2004 when offset prices began moving up from a low of \$550/ton. That \$800 mark was surpassed early in 2006.



The early years of supply control were easy, as there was still lots of inefficient capacity to be removed. In addition, uncoated free sheet pricing had not been high for a long enough period of time to encourage North American producers of coated free sheet, or international uncoated free sheet companies, to invest in sales organizations and the infrastructure needed to compete in the North America UFS segment.

Too Much of a Good Thing: However, by 2013, supply control was not easy anymore. UFS demand had declined by about 35% (nearly 5.0 million tons) from 2004. Domtar, and especially IP, had no inefficient capacity left.

Consistently high prices had stimulated steady growth in imports (primarily cut-size). What's more, high prices had opened the door for coated free sheet companies to become established in the uncoated free sheet market. Super-bright grades enticed some UFS business to switch to mechanical 80- or 90-bright grades. Last, high prices have encouraged marginal (high-cost) mills to remain in business, and others to start a new life. **Thus, in order for the market to remain balanced, Domtar and IP had to proactively take out enough capacity to make up for all of this new supply and the secular decline in demand.**

By the fall of 2013, prices of uncoated free sheet had been slowly eroding for over two years, even though IP and Domtar had continued to support the market with temporary downtime. It was decision time again. There were two options:

1) IP and Domtar could allow excess supply to push prices very low, i.e., close to cash-cost levels. The major producers could then rely on their superior, low-cost manufacturing operations and financial power to take back market share that had been given up. This decision would lead to short-term financial losses, but it would also result in dramatically increasing medium- and long-term profits. In effect, supply and price control would go into abeyance, but then come back and last much longer.

These lower prices would be very uncomfortable for IP and Domtar, and result in poor financial performance for several quarters. This, in turn, would result in a decline in company stock prices (more so for Domtar since the company's primary product is UFS. In fact, the stock symbol chosen by the company is "UFS").

However, these very low prices would be much more of a problem for importers, small producers of commodity UFS, and the coated producers making UFS on their coated machines. The financial problems for IP and Domtar would be temporary, but the problems created for some of the competition would be terminal. Some competitive UFS machines would be shut down, including some "coated" UFS capacity. With consistently high prices no longer guaranteed, exporters to the U.S. would alter strategic plans. A down-cycle in prices would also encourage large UFS cut-size buyers to remain primarily committed to the North American producers.

The fact is, IP and Domtar should never have waited until 2013 to allow prices to fall and purge the market of much of its competition. Nevertheless, in the fall of 2013, they had one last chance to do the right thing.

2) The second option was to select immediate gratification. One or both companies would take out even more capacity so that supply/demand could be balanced and prices increased...and, in the process, the competition would be subsidized.

The question became whether IP and Domtar would take their medicine in 2013 or take a more distasteful form of it later. If they delayed the hard decisions until later, high-level corporate executives would keep getting their large bonuses for a while longer, perhaps delaying the period of poor profits until the next group of executives were in place.



The Announcement of the Courtland Closure: It was immediately clear with the September 2013 closure announcement of Courtland (765,000 tons of uncoated free sheet and 185,000 tons of coated free sheet) that IP had chosen Door #2 — the selfish and short-sighted option by my way of thinking, and now being borne out as such in the market.

Additional UFS closures by Lincoln Paper and Tissue, GP and Boise in Q4/13 totaled 285,000 tons, so that by the time the second and final phase of the Courtland closure was completed in Q1/14, about 1,050,000 tons of official UFS capacity had been removed.

North American UFS demand in 2013 was only 9.54 million tons. Capacity that was closed was equal to 11.0% North American demand. Consider also that demand for UFS was falling by only around 3.5% per year. The idea at the time was that such a large decrease in capacity would allow North American UFS producers to rid the market of excess supply that had built up over time, reduce relatively unprofitable exports, and still enjoy a positive supply/demand balance for the full year of 2014 and probably longer.

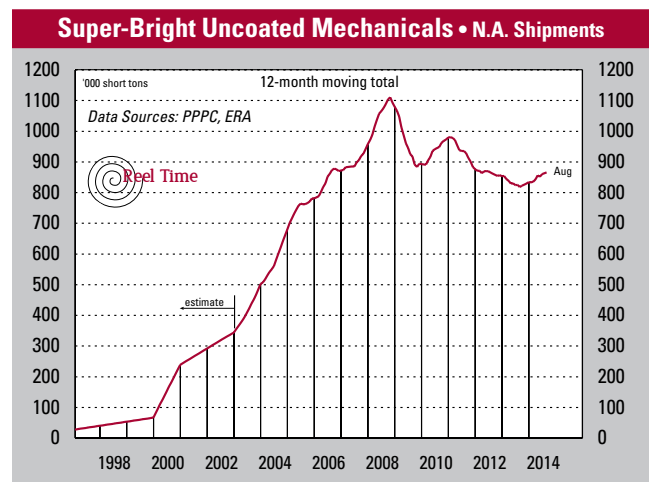
Way Too Much of a Good Thing: The two companies then compounded their error, and infuriated their customers by announcing a \$60/ton November 1, 2013 price increase even before the first phase of the Courtland closure was initiated, and then — before the ink was dry — another \$50–\$70/ton increase to be implemented on March 1, 2014. There was no pretense of partnership here. These were in-your-face “because we can” price increases. IP and Domtar just did not get it: it was not 2006. It is highly probable these decisions were not made by sales professionals but in the president’s office, far from the realities of the market.

These two price increases started a revolution. While the two majors were taking out supply, the competition was replacing it with new, lower-priced supply.

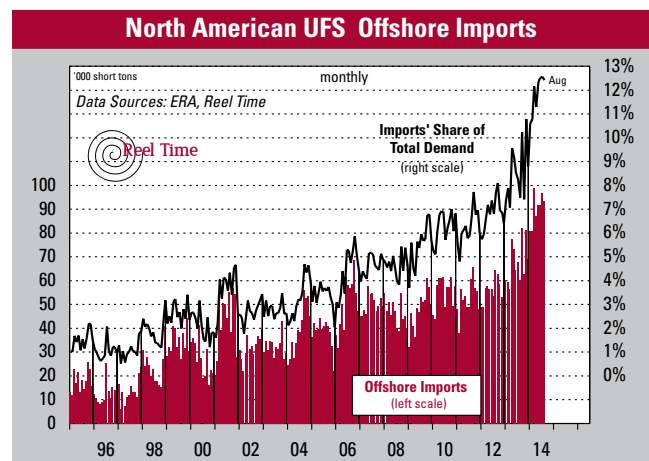
Additional Supply in 2014: The coated free sheet producers had available capacity that they allocated to UFS offset, forms and envelope grades. NewPage, Appleton Coated, and Verso are all substantial players in the UFS market. Our estimate is that about 240,000 tons of UFS was produced by coated companies in 2013, and the volume has increased considerably in 2014. How much volume is unknown, but, if forced to make a guess, we would say that shipments could

be growing at an annual rate of maybe **50,000 tons** — to nearly 300,000 tons in 2014.

The **super-bright manufacturers** have lots of 90-bright capacity available. For example, Norpac is now offering Norbrite (92 brightness), as a commodity offset alternative to UFS. High UFS prices gave these super-bright grades a boost in 2014 (+5.6%) through August. This rate of growth, annualized, would result in additional super-bright demand of **48,000 tons** in 2014 (see the next graph), and a loss in UFS demand of roughly the same amount.



Most important of all, offshore producers of UFS (mostly cut-size) had a great deal of excess supply they were happy to shift to North America. **Imports of UFS have exploded!** UFS offshore imports are up, through August, by 39.0%; at this rate, imports will grow by 303,000 tons in 2014. Actually, however, the growth trend is accelerating, with July and August being very strong months for UFS imports. When 2014 is complete,



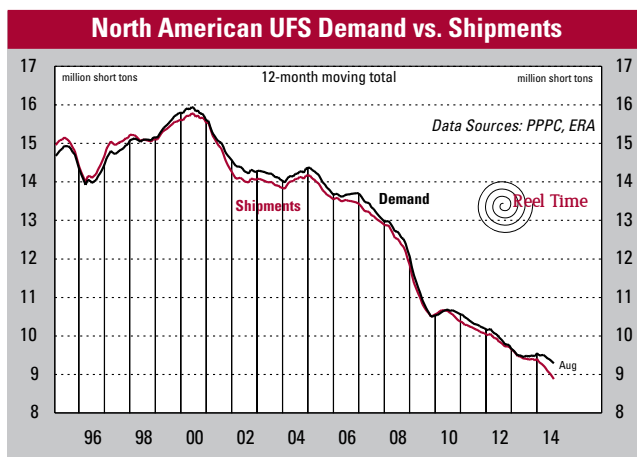
actual growth (y/y) in UFS offshore imports will probably be at least **325,000 tons**.

Offshore imports of UFS have escalated so much that they now account for 11.8% of North American demand (year-to-date). In absolute terms, North American imports of UFS surpassed 90,000 tons in both July and August. See bottom graph on page 3.

High prices of UFS also encouraged **Resolute to enter the UFS business at its Calhoun, Tennessee mill site**. The volumes expected are unknown and may or may not be substantial, but in any regard the policies of IP and Domtar have created another competitor.

The Resulting Supply/Demand Balance: The previous discussion suggests that “outside” competitors will increase UFS shipments to North America by roughly 425,000 tons in 2014.

This growth in outside supply is even more impressive when we consider that North American demand is declining simultaneously (4.1% to date). At that rate, North American demand will fall by 393,000 tons in 2014 at the same time new supply of 425,000 tons enters the market. That will be a negative variance for IP, Domtar and other “traditional” UFS producers of 818,000 tons in 2014.



Next, consider that offshore exports of UFS are down by 12.7% year-to-date. These exports are not, of course, part of North American demand, so this is an additional area of leakage. If that rate of decline is sustained, another 87,000 tons of offshore shipments will be lost by the end of 2014.

Last, at least for now, is to consider that there was excess supply in the UFS segment when entering Q4/13. How much is not known, but it was probably at least 250,000 tons. This estimate is based on the UFS operating rate of 91% in 2013, and the assumption that full capacity is a tad under 94%.

To summarize (based on annualized data, some of which is estimated), new outside supply (425,000 tons), reduced North American demand (393,000 tons), decreased exports (87,000 tons), and excess supply to start with (250,000 tons) combine for a total of 1,150,000 — exactly 100,000 tons more than the total UFS capacity removed in Q4/13 and Q1/14. But, of course, official capacity always overstates actual capacity, so the true reduction in shipments was a little under 1,000,000 tons. This means, in this analysis, that excess UFS supply once again exceeds demand by at least 150,000 tons, and excess supply will grow each month.

There are two ways to check our work. First, UFS operating rates according to the PPPC were 91% through August 2013, and, through August 2014, operating rates are again 91%. Therefore, UFS producers are right back where they were last year at this time. As mentioned previously, a 91% operating rate implies excess supply of at least 250,000 tons.

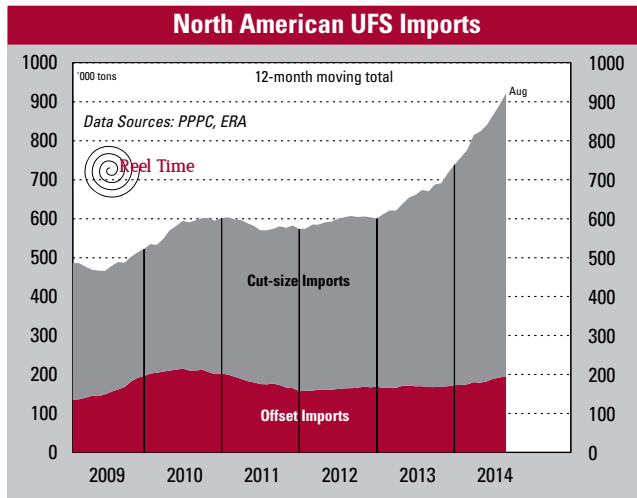
The second way to check on the supply/demand balance is to read quarterly reports. In regard to Q2/14, Domtar’s president, John Williams, tells us the following: “While paper productivity improved from the first quarter, we took fifty-one thousand tons of lack of order downtime...”

At first blush, 51,000 tons of market-related downtime in one quarter, seems much too high for one company. However, it is about what we should expect from Domtar, assuming that excess UFS supply is actually about 250,000 annual tons. By way of explanation, it is much easier to keep machines full when taking out capacity at the same time. Therefore, IP did not need to take much, if any, market-related downtime in the first half of 2014 because the company had just taken out more than 700,000 tons of capacity. Boise and GP also removed capacity in Q4/13. Therefore, most of the temporary downtime taken in Q2/14 was taken by Domtar. Now, switching to the big picture again, the fact that Domtar took 51,000 tons of market-related downtime in Q2/14 tends to support the theory that excess UFS supply currently totals roughly 250,000 tons.



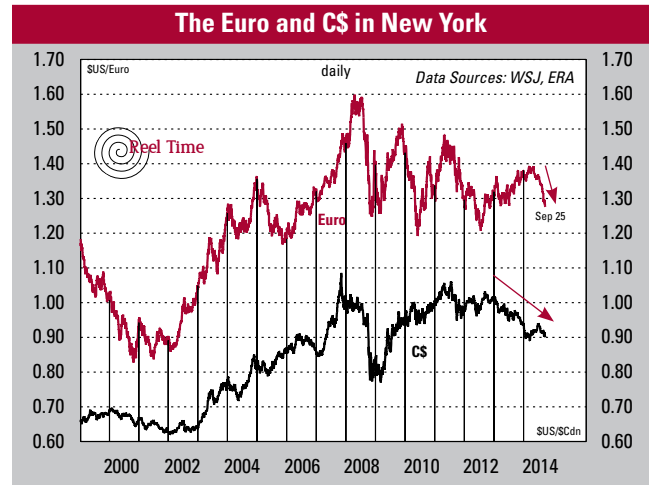
Crucial Implications of Cut-Size Imports: IP and Domtar have been playing with fire and will be badly burned. Of all the printing paper grades, cut-size is by far the easiest to export to the United States:

- There are no lead time issues, no changes in roll width, no problem with spoilage and resulting loss in value.
- Cut-size is also easy and cost-effective to ship across the ocean and within the country.
- There are a limited number of very large big-box and merchant customers that are responsible for the majority of cut-size business, making sales and service very simple.
- Crucially important is the fact that cut-size is the dominant UFS grade, making up 42.5% of North American demand in 2013.
- Finally, cut-size imports are coming from the entire world: China (see graph, page 14), Indonesia, South America, Australia and Europe. The groundwood grades, by comparison, cannot be efficiently produced in China, South America, or most of the rest of the world. However, it seems that UFS can be produced efficiently just about anywhere.



Imports of cut-size were up (y/y) 65% (29,700 tons) in August and are now up for the year by 45% (176,000 tons). Imports of cut-size had a 20% North American share in August and have a 19% share of demand year-to-date.

The stronger U.S. dollar of recent months was not a significant factor in the surge of UFS imports. On the other hand, the stronger dollar will be an added burden in the future. If,



in fact, the dollar gains as much as we expect it to, this will have a substantial impact on the volume of cut-size shipments to North America.

The Myth That Consolidation is Sufficient: Consolidation isn't enough. It is necessary, but not sufficient. That point has often been made in *Reel Time* over the years, and we have all seen consolidation fail in coated and newsprint grades.

It is true that IP and Domtar still operate about 55% of North American capacity, and it is also helpful for them that GP and Boise (Packaging Corp.) tend to be reasonable competitors. Nevertheless, it was never going to last forever: supply control eventually leads to extinction. In addition, if demand falls too fast, or if imports/other competitors have the ability to gain substantial market share, then it's game-over. And, due to the strategies the two majors have taken, the game is ending sooner than necessary.

North American UFS producers have already lost nearly 20% of the cut-size market. If they continue with strategies of the past, they will quickly lose another 20%. Control of the smaller offset/envelope/forms bond market is being lost as well. If any of the major coated free sheet companies decides to invest in the converting equipment needed to produce cut-size or folio sheets, further loss of control will occur.

Pricing Review: We understand that *Pulp and Paper Week* pricing for UFS offset is up \$80/ton, and cut-size \$30/ton from the low point in the fall of 2013. *Reel Time* pricing shows an \$80/ton increase in both grades. However, we attempt to track truckload volumes and do not factor in the large office



store prices. It makes sense, of course — based on the huge inroads made by cut-size imports recently — that large-buyer cut-size prices would have struggled to gain traction. That would explain some or even all of the difference between our pricing and that of *Pulp and Paper Week*.

On the other hand, in support of the *Reel Time* estimates, IP reported in its second-quarter financials, that average North American UFS prices were up (y/y) \$68/ton. Since there was some UFS price deterioration in the second half of 2013 in which IP probably participated, this would mean that IP's pricing of UFS is up (from the bottom) by more than \$68/ton. IP may not have achieved the full \$80/ton average increase that we have estimated for both offset and cut-size (and perhaps not the same level of increase for both grades), but it looks like the company's price realizations are close to our estimates. Of course, the multiple tiers of suppliers below IP and Domtar did not increase prices as substantially.

One last note on pricing: we see that Cenveo, the largest envelope converter in the U.S., reported that its prices have increased by a total of \$85/ton from the low last fall, also supporting our price-increase estimates.

There is a wide variation in cut-size pricing, with IP and Domtar at the top. Boise and GP are close behind, followed by smaller domestic producers. Imports come in at the bottom, but there is a wide range of import prices.

The variation in commodity offset prices is significant but not as dramatic as with cut-size. The ranking of traditional North American UFS producers would be the same for offset as for cut-size. However, the next tier of pricing is for the coated companies that have become established in the UFS arena. The objective of these companies is to price their UFS grades just barely low enough to win the business they need. Imports of commodity offset folio sheets and rolls are still not much of a factor, although prices would be lowest where they do exist.

In summary, we see that the two majors did not gain the full \$130 in price increases they announced. In fact, the second increase was extremely destructive in terms of long-term business relationships and long-term market share, and yet it gained them virtually nothing.

What's more, IP has picked up a huge tab for closing Courtland and, of course, the cash flow the company previously earned from Courtland has been eliminated.

Domtar, as it has tended to do successfully, waited for IP to make the first closure move, so it has not assumed any shut-down costs recently. However, Domtar's part of the unspoken agreement is to support prices by taking as much market-related downtime as needed to balance supply with demand.

I can't say exactly how the costs and price increases have balanced out in 2014 for the two majors, but it is safe to say that financial results in UFS have been disappointing. Domtar's stock has declined by nearly 40% from its March peak. (The Domtar stock price might actually have declined less if IP and Domtar had chosen Door #1.)

Think about the Domtar situation for a minute. The company was the beneficiary of IP's largesse — the expensive closure of Courtland — and yet the total closure of capacity equal to 11.0% of North American demand was not enough to tighten the market! Domtar has still not been able to keep its machines full or achieve the price increases expected.

So what do IP and Domtar do next? Do they take out another million tons this fall and try the process again? That is apparently what you do if you want to win CEO of the Year and reap huge bonuses.



Turn Out the Lights, the Party's Over

Those of you who...let's say, have considerable life experience, and are football fans, will remember Don Meredith singing, "Turn out the lights, the party's over, They say that all good things must end..." at the end of Monday Night Football games when it was clear which team would win.

If we are measuring the success of UFS supply and price control in 2014 compared to the 2004–2013 period, it is late in the fourth quarter and Dandy Don has already sung for us. If we measure the success of supply and price control based on absolute pricing levels, then it might be the middle of the fourth quarter, but the game has really already been decided. ●

— Verle Sutton



MARKET REVIEW

NEWSPRINT

North American Newsprint Demand: August's performance (y/y) was the worst in 2014, with North American newsprint demand dropping by 10.1%. The year-to-date loss is now 7.2% (214,000 tonnes). Both components of North American demand fared poorly in August.

Newsprint shipments to publishers fell (y/y) by 11.9%. August was the third very poor month in a row. Both June and July showed newsprint shipments to publishers down by 12.3%. The year-to-date decline is now 10.0%.

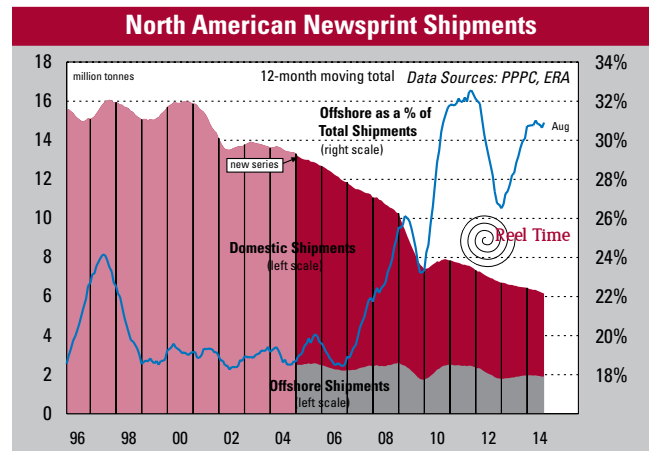
Newsprint shipments to the commercial side slipped (y/y) by 4.2%. (The Best Buy upgrade from newsprint to SCA was likely a factor here, and will be in the future.) However, on a year-to-date basis, newsprint shipments for commercial printing are still on the positive side (+2.7%).

Offshore Exports: In spite of all the bad news being associated with this source of demand, North American newsprint exports were up (y/y) 4.3% in August. The year-to-date decline is currently 5.8%. That does not seem too bad, but it does equate to a 78,000-tonne loss in just the first eight months of 2014.

The "bad news" mentioned in the previous paragraph will be discussed in more detail next month when we analyze the newsprint market and make our 2015 forecasts. Just as a preview, it is likely that offshore exports will be deteriorating late in 2014 and into 2015. The situation appears rather bleak.

Total North American Shipments: Combining North American demand and offshore exports, we find that total North American newsprint shipments were lower (y/y) by 5.8% in August. The year-to-date loss is now 6.7% (290,000 tonnes). Prorated, the 2014 decline in North American newsprint shipments is estimated at 435,000 tonnes.

Capacity: Kruger announced the closure of a 100,000-tonne newsprint machine in Brompton, Quebec, effective November 14. This mill is located close to the St. Lawrence Seaway, so it leads us to wonder whether or not the weakness in the newsprint export market is related to this decision. However,



that is only speculation; the mill is also close to Montreal and U.S. newsprint markets.

Although this is not a large closure, the 100,000 tonnes will naturally help in keeping supply and demand in balance. However, newsprint shipments are falling so fast that this closure will not even cover three months of losses. Kruger indicated that the shutdown will be of an indefinite duration, but, once operations halt, it is doubtful the machine will ever restart.

Pricing and Market Conditions: In the west, the situational weakness in newsprint pricing seems, at this point, to have infected most of the market in that region. The decline, however, is only a modest \$5 or \$10/tonne.

In the east, newsprint pricing is still holding. The DeRidder closure and the pending Kruger shutdown will likely allow pricing to remain firm until at least late in the year. Stability until year-end is not certain, however. It is a serious concern that mill inventories are still moving higher (see graph, page 13). In addition, how quickly newsprint exports decline from here is an important unknown.

Some analysts have been suggesting a newsprint price increase is likely in the near-term. That is certainly not the way we see it. It is true that a great deal of newsprint capacity has been removed this year, but it has not been enough. Growing mill inventories and weakness in the west are evidence that an increase is highly unlikely at this time. Higher prices will be reached only after enough newsprint capacity is eliminated to move the supply/demand balance in favor of producers, and when Resolute thinks it is a good idea. More on this in next month's issue.



Even though there has been a slight deterioration in newsprint prices in the west, the *Reel Time* average newsprint price will not be lowered at this time, since the west is only about 20% of the U.S. market.

SCA

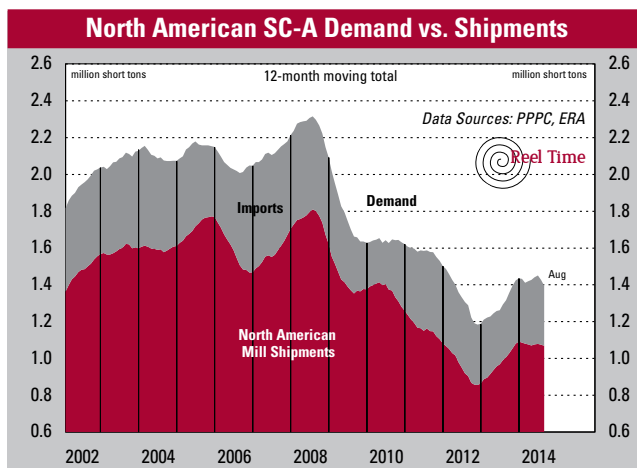
The Data: It is interesting that SCA shipments from North American producers have been the model of consistency in 2014, at the same time that offshore SCA imports have been more volatile than ever (on a month-to-month basis).

Just for this one paragraph, we will use the metric-tonne data we get from the PPPC. Monthly shipments of domestic manufacturers of SCA in 2014 (January through August) have been as follows: 79; 70 (adjusted for days of the month from 64); 79; 78; 78; 76; 80; and 79 in August. This is remarkable consistency. The only outlier was February.

Switching back to our normal use of short tons, North American SCA shipments in August were 86,000 tons, down (y/y) by 6.0% and off so far this year by 3.6% (24,300 tons).

Imports, on the other hand were steeply lower (y/y) early in the year, then were steeply higher for four months, and are now steeply lower again in July and August. Offshore SCA imports were down by 47% in July and 56% in August. On a year-to-date basis, offshore SCA imports have declined by 12% (25,400 tons).

The consistency of North American SCA shipments and the variation in imports is clearly discernible in the next graph.



Capacity: Shortly after last month's *Reel Time* was published, very important news came out of Resolute. The company announced that it would be closing its Laurentide mill, a 210,000-ton SCB operation in Quebec. This shutdown will take out a substantial chunk (about 23%–27%, depending on capacity estimates) of North American SCB capacity.

It might be better to compare the capacity to be removed with North American SCB demand that totaled nearly 700,000 tons in 2013 (PPPC data). The actual shipments of the Laurentide mill were running at an annual rate of approximately 195,000 tons. Therefore, the shipments being removed are equivalent to some 28% of 2013 SCB demand.

In addition, the PPPC data categorizes the Catalyst SCA-type grade as SCB, even though much (most?) of this capacity is purchased for SCA applications. Thus, the real loss of SCB capacity is even greater than the percentages provided in the two previous paragraphs. (The Catalyst grade has higher brightness and contrast than standard SCA, but a little less printed gloss. Due to the lower gloss level, it must be reported to the PPPC as SCB.)

The plan is to publish the annual *Reel Time* forecast of the value-added grades no later than November 14th. As is our practice, we will update capacity tables and discuss supply/demand in more detail at that time.

Pricing and Market Conditions: Resolute has apparently built up quite a bit of SCB inventory, so the effect of the Laurentide closure will not result in any short-term crisis. Nevertheless, the SCB market has tightened up substantially. In addition, SCB demand will exceed supply by year-end and into 2015. This excess demand for SCB will filter up to SCA and down to high-bright grades.

The SCA supply/demand balance has been a little weak in 2013, requiring most SCA mills to make some SCB. This availability of SCA supply enabled Best Buy to upgrade its insert business from newsprint to SCA this fall, and it also allowed coated groundwood buyers the option of moving down to SCA (if they were so inclined). Now, however, with a significant volume of SCB orders moving up to SCA, there will not be nearly as much open SCA supply in 2015 as most industry players believed a month ago — at least not in North America.

Pricing for SCB is flat to higher. SCA pricing has firmed up.



COATED GROUNDWOOD

Shipments and Demand: We have some fascinating coated groundwood data this month. Don't yawn; I am sure you will all find this as interesting as I do. On the one hand, U.S. coated groundwood shipments were actually up (y/y) in August, even if just barely (+0.1%). This is only the second month of 2014 in which coated groundwood shipments eked out a bit of an increase. Still, it was a relatively good month, eh? Well, maybe not. U.S. demand in August was down by 17.3%! How did this happen? Was it a good month or a horrible month?

U.S. shipments, at 256,200 tons, were actually very good for this day and age. This is the highest level of monthly coated groundwood shipments since October 2013, and the third-best month since November 2012. One of the reasons that shipments were so good, however, is that the latest month of (AF&PA) exports saw a (y/y) rise of 53.8% (15,600 tons).

The AF&PA definition of demand, i.e., purchases, is U.S. shipments minus exports and plus imports. So, North American demand data was not aided by the surge in exports. In addition, U.S. imports were much lower (y/y) in the latest month for which data is available. U.S. imports of coated groundwood were down (y/y) by 32.9% (23,400 tons). Obviously, U.S. shipments are not negatively impacted by lesser imports, but North American demand is.

Therefore, on a year-over-year basis, the combination of much higher exports and much lower imports combined to create a very wide, and probably historic, variance between shipments and demand of U.S. coated groundwood.

In regard to whether it was a particularly good month or bad month, it was more bad than good. The fact that shipments were higher due to exports is not a bad thing. However, it is doubtful the higher levels of exports with adequate margins are sustainable.

Meanwhile, it is very concerning that U.S. demand — that is, the volume of coated groundwood U.S. customers actually desire to purchase — is falling so significantly. There is, of course, a good deal of month-to-month variation in the demand data, so this month is certainly somewhat of an anomaly. Nevertheless, on a year-to-date basis, U.S. coated groundwood demand is down by 11.3%.

Note: Not to complicate things unnecessarily, but it should be mentioned that the AF&PA import and export data always differs from the PPPC because the two organizations get their data from different sources, and, of course, because the PPPC reports North American data while the AF&PA reports U.S. data.

In addition, the AF&PA is always a month behind with its import and export data (the latest month of data is currently July). Since the AF&PA import/export data is a month behind and yet the import data is needed to determine monthly demand, the AF&PA estimates demand by using the import data for the latest month it has. Then, in the following month, the demand data is finalized when the correct import data is available. In this case, August coated groundwood demand will be finalized next month when the actual import data for August is known by the AF&PA.

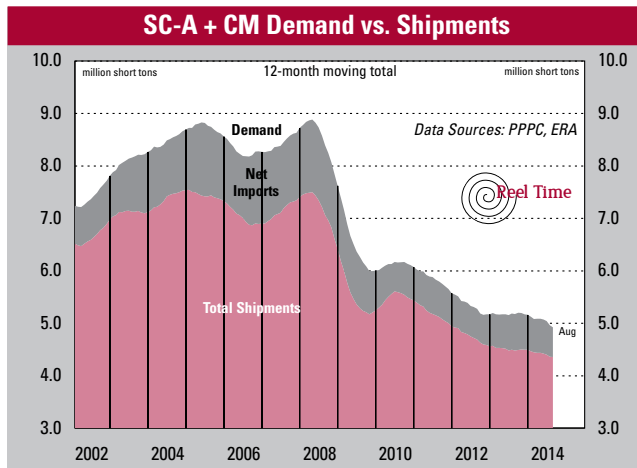
In August, there is currently a very wide variation in coated groundwood demand as measured by the PPPC (-3.5%) and the AF&PA (-17.3%). However, this variation may be less substantial next month after the AF&PA demand data is finalized for August. And, more importantly, the differences in reported levels of demand tend to be much less extreme when comparing data over a longer period of time. For example, on a year-to-date basis, coated groundwood demand is down by 11.3% (AF&PA) and 8.1% (PPPC). This kind variance in the data is not preferable, but it is workable.

Shipments and Production: The very good shipments in August were enough to eliminate most market-related downtime, but probably not all of it. Shipments (256,200 tons) minus the reduction in August inventories (8,900 tons) gives us coated groundwood production of 247,300 tons. Our current estimate of average maximum monthly production for U.S. coated groundwood producers is 255,000 tons (see production table, page 11).

Coated Groundwood Imports: As mentioned earlier, U.S. coated groundwood imports fell (y/y) by 32.9% (23,400 tons) to 56,400 tons. Imports from Canada (29,200 tons) made up 51.8% of the total. Through August, U.S. coated groundwood imports are off by 16.0%. About 85% of this reduction is from offshore.



Pricing and Market Conditions: The FutureMark closure and reduced availability of SCA, combined with a bit of seasonal demand strength, has extended backlogs. Pricing has firmed up for now, but weakness will creep back in by late November. It has to creep in; it can't charge in, because pricing is not that far above cash costs.



FutureMark Capacity Estimate Revised: We track the closures of value-added grades in our production tables. Just FYI, the estimate of the capacity reduction from the FutureMark shutdown has been revised up to 160,000 tons.

COATED FREE SHEET

Shipments and Production: It was not a very good month for coated free sheet either. U.S. coated free sheet shipments, at 314,800 tons, were down in August (y/y) by 7.2%. That put the year-to-date decline at 1.7%. Demand was better — off by only 1.3% in August — and is now about flat for the year.

Inventories were reduced by 5,600 tons — not terrible, but that decline is much less than is typical in August. On the other hand, mill inventories of coated free sheet are, in total, in much better condition than last year at this time (see coated mill inventory graph on page 13).

Production of U.S. coated free sheet was 309,200 tons in August, almost exactly equal to the average of the first seven months of the year. Coated free sheet picks up seasonal strength earlier than SCA and coated groundwood, and loses it earlier too, so that is not very good performance for the month of August. Our “full monthly production” estimate is 330,000 tons for U.S. coated free sheet, but so much uncoated free sheet is being produced on coated machines that market-related downtime in August was highly unlikely.

Coated Free Sheet Imports: After six months of 2014, U.S. coated free sheet imports were down by 1.7%; however, in July they were up by 25.9% (15,800 tons). Quite a change. Most of the strength came from South Korea and Germany. The year-to-date data is now on the positive side, with U.S. coated free sheet imports up by 2.0%. See the graphs and tables on page 14.

Pricing and Market Conditions: Backlogs are good at this time. The modest May price increase of \$40/ton is holding well.

CURRENCY

In some private consulting work this spring, we forecasted that the dollar would be strengthening dramatically in the years ahead. That long-term trend appears to be well underway. It does not bode well for U.S. paper producers. This subject will be covered in detail in one of our November forecast issues. ●

— Verle Sutton



U.S. Coated Groundwood Production • 000 short tons				
Month	Shipments +/- Inventory		Prod'n Adj. to 31 Days	NOTES: Capacity changes for high-bright, SC, and CGW
	Changes = Prod'n			
Jan/11	297,700	+35,000	332,700	332,700
Feb	262,700	+11,900	274,600	304,000
Mar	331,800	-5,000	326,800	326,800
Apr	257,400	+23,700	281,100	290,500
May	263,500	+41,100	304,600	304,600
Jun	309,200	-27,700	281,500	290,900
Jul	267,700	+30,800	298,500	298,500
Aug	301,500	-12,100	289,400	289,400
Sep	307,400	-25,400	282,000	291,400
Oct	300,800	-18,900	281,900	281,900
Nov	278,900	-11,500	267,400	276,300
Dec	274,600	-12,600	262,000	262,000
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
Jun	301,400	-32,300	269,100	278,100
Jul	272,300	-12,600	259,700	259,700
Aug	274,000	-15,300	258,700	258,700
Sep	282,200	+11,000	293,200	303,000
Oct	279,400	-11,000	268,400	268,400
Nov	264,500	-3,400	261,100	269,800
Dec	247,800	+13,600	261,400	261,400
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	271,900	-16,500	255,400	263,900
Oct	263,800	-23,000	240,800	240,800
Nov	238,000	-16,300	221,700	229,100
Dec	244,500	-9,500	235,000	235,000
Jan	231,400	+800	232,200	232,200
Feb	206,400	-11,100	195,300	216,200
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	—	—	—	—
Oct	—	—	—	—

Data Source: AF&PA

Average maximum production is about 270,000 tons

Average maximum monthly CGW production is about 255,000 tons



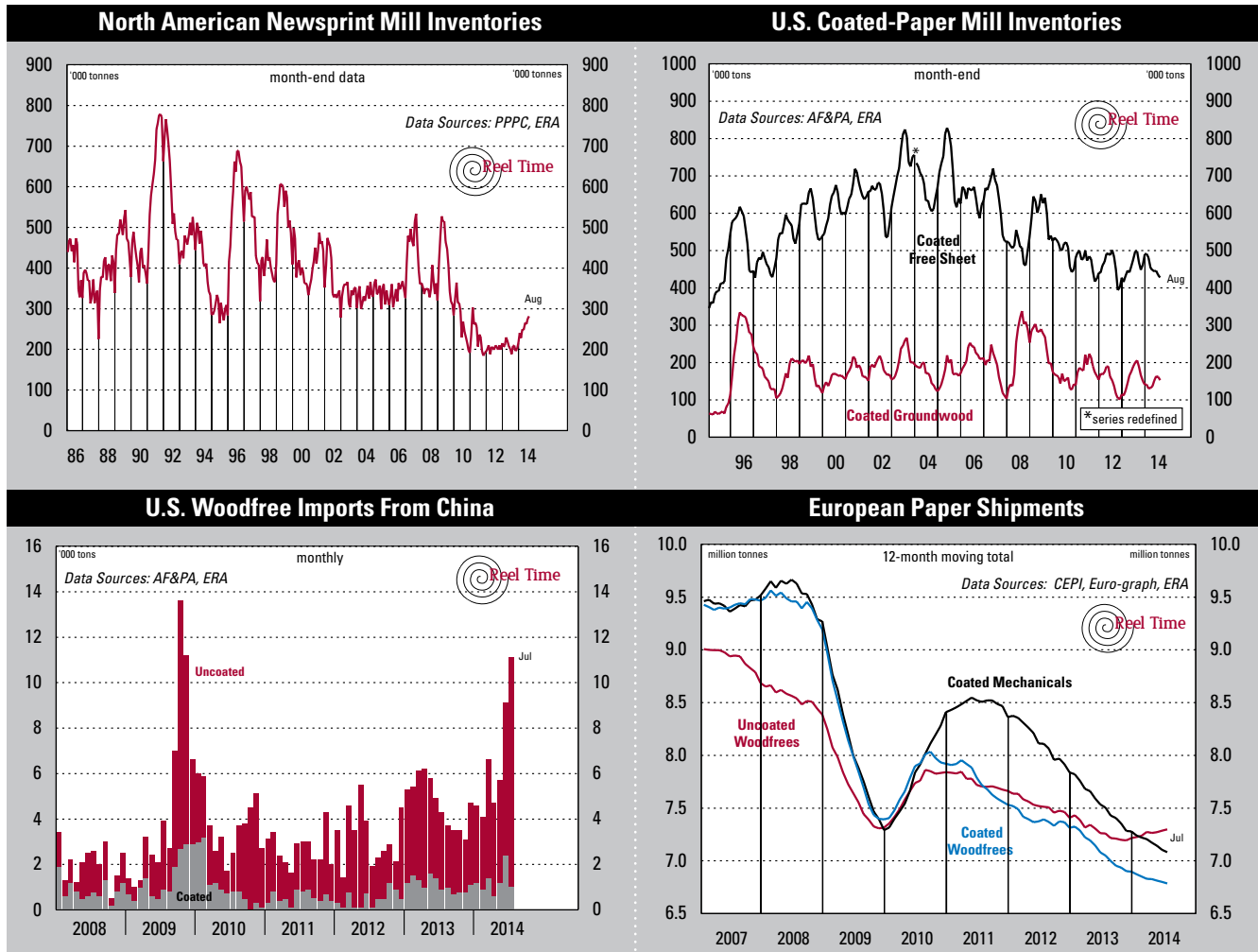
U.S. Coated Free Sheet Production • 000 short tons					
Month	Shipments +/- Inventory Changes = Prod'n		Prod'n Adj. to 31 Days	NOTES	<i>Data Source: AF&PA</i>
Jan/11	323,800	+13,500	337,300	337,300	
Feb	297,500	+5,500	303,000	335,500	
Mar	354,900	-24,300	330,600	330,660	
Apr	297,500	+21,500	319,000	329,600	
May	297,600	+18,700	316,300	316,300	
Jun	356,700	-26,500	330,200	341,200	
Jul	323,700	+22,300	346,000	346,000	
Aug	362,900	-22,500	340,400	340,400	
Sep	364,100	-17,300	346,800	358,360	
Oct	364,400	-30,400	334,000	334,000	
Nov	326,200	+13,300	339,500	350,800	
Dec	316,600	+29,300	345,900	345,900	
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	
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	352,300	-29,400	322,900	333,700	
Oct	364,000	-23,700	340,300	340,300	
Nov	289,800	+15,100	304,900	315,100	IP (Courtland, AL) — 100,000 tons CFS closed
Dec	287,900	+27,500	315,400	315,400	
Jan	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	
Aug	314,800	-5,600	309,200	309,200	

Average maximum monthly production is about 345,000 tons

Average maximum monthly production is about 330,000 tons



DATA PAGE: SHIPMENTS/PURCHASES TABLE AND VARIOUS GRAPHS

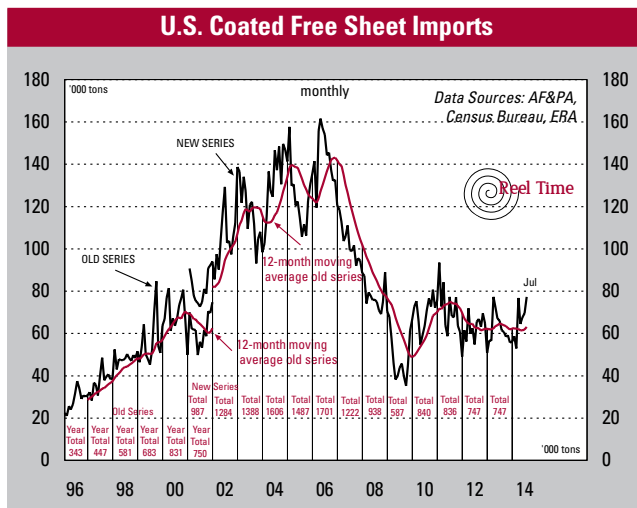
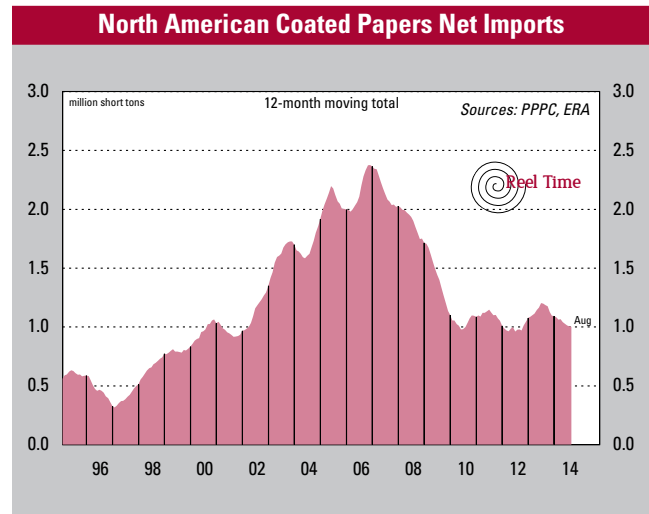
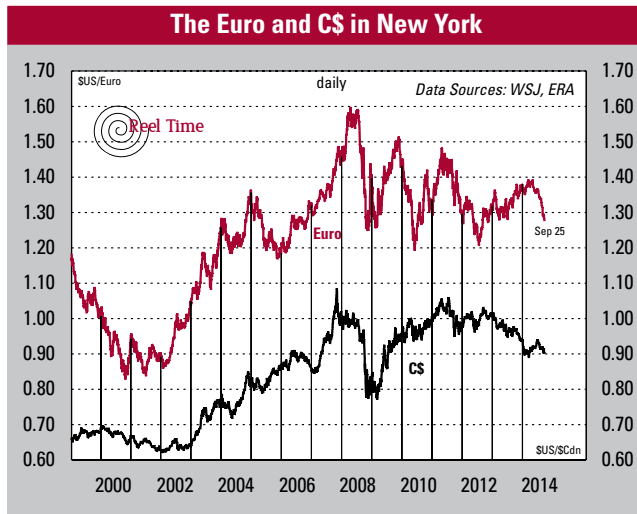


SHIPMENTS AND PURCHASES																
Newsprint: 000 tonnes Other grades: 000 tons		02	03	04	05	06	07	08	09	10	11	12	13	YEAR-TO-DATE		
														Aug/13	Aug/14	% Chg
Newsprint	Shipments from NA to NA	11150	11005	10763	10194	9605	8664	7702	5681	5346	4989	4924	4468	2954	2742	-7.2%
	Offshore Shipments from NA	2615	2607	2481	2487	2242	2403	2548	1725	2495	2354	1773	1976	1345	1267	-5.8%
	Total Shipments from NA	13765	13613	13244	12681	11847	11067	10250	7406	7841	7343	6697	6444	4300	4010	-6.7%
	% 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%	31.3%	31.6%	
	Imports	199	212	223	190	142	79	64	85	65	17	17	6	5	3	negl.
	NA Shipments to Newspapers*	8129	8123	7998	7563	7027	6265	5245	3997	n/a	4124	3950	3538	2320	2088	-10.0%
SCA	Shipments to NA from NA**	1505	1503	1559	1742	1457	1685	1613	1324	1205	1074	854	1065	THIS PPC 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	1948	1842	-5.4%
	U.S. Purchases	5302	5740	6155	6117	6046	5965	5147	4003	4145	3816	3845	3574	2355	2089	-11.3%
	% 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%	82.7%	88.2%	
CFS	U.S. Shipments	4463	4191	4652	4626	4968	4997	4439	3638	4146	3988	3911	3821	2534	2490	-1.7%
	U.S. Purchases	5287	5088	5714	5584	6148	5600	4699	3608	4275	4168	4012	3935	2627	2620	-0.3%
	% 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%	96.5%	95.0%	

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



DATA PAGE: COATED FREE SHEET IMPORTS/EXPORTS



IMPORTANT POINT

- The strength of the dollar and corresponding weakness in the Canadian dollar and euro will have tremendous negative implications for U.S. paper producers (see graph, upper left). At *Reel Time*, we expect these currency trends to continue.
- U.S. coated free sheet imports were flat in 2013 (y/y) and are little changed in 2014 (see table, bottom left).

U.S. Coated Free Sheet Imports, Country of Origin • 000 tons

Year	Scand.	Germany	Other Europe	Japan	China	South Korea	Other Asia	Total Asia	Other Countries	Total Offshore	Canada	Total
2006	244	136	276	87	292	462	61	902	2	1,560	141	1,701
2007	197	115	218	85	74	437	14	610	3	1,143	79	1,222
2008	139	85	188	91	19	375	11	496	1	909	11	920
NEW SERIES												
2009	68	48	132	76	207	35	17	1	3	587		
2010	72	166	163	73	333	14	13	1	5	840		
2011	65	196	152	56	350	6	7	4	n/a	836		
2012	86	194	115	54	267	22	6	3	n/a	747		
2013	82	190	109	51	283	15	13	4	n/a	747		
Year-to-date Jul/13 vs. Jul/14												
2013 (Jul)	46	105	69	36	181	9	9	2	n/a	457		
2014 (Jul)	37	114	69	36	194	5	9	3	n/a	467		
% Chg.	-19%	+9%	—	—	+7%	negl.	—	negl.	n/a	+2%		

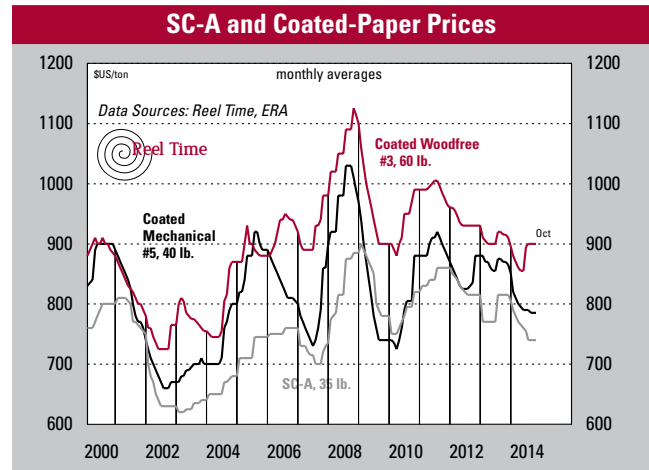
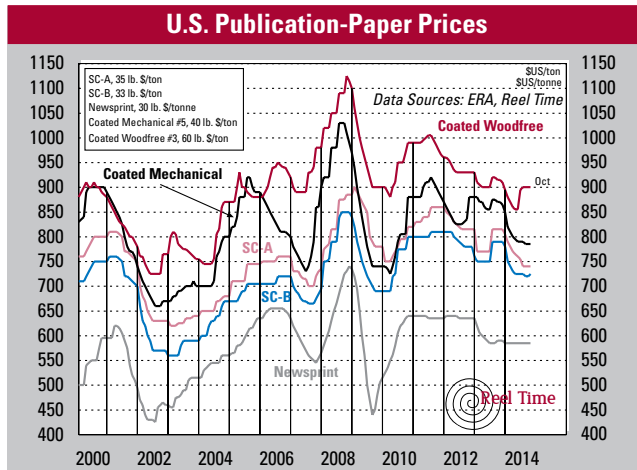
U.S. Coated Free Sheet Exports • 000 tons

Source: AF&PA

Year	Other Countries	Canada	Total		
2007	271	348	619		
2008	263	396	659		
Year					
Year	Mexico	Japan	Other	Canada	Total
2009	115	49	114	340	618
2010	103	37	173	398	711
2011	105	16	148	387	656
2012	99	19	186	342	646
2013	101	20	170	329	620
Year-to-date Jul/13 vs. Jul/14					
2013 (Jul)	57	12	112	189	370
2014 (Jul)	71	15	100	174	360
% Chg.	+25%	+25%	-11%	-8%	-3%

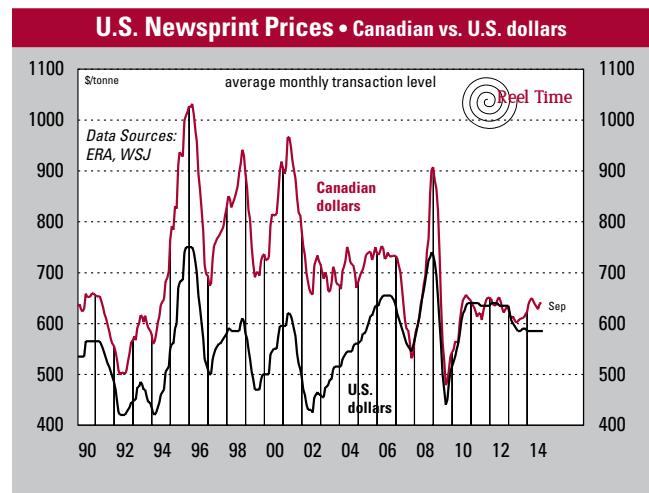


PRICING DATA



Pricing Over Latest Five Months	May	Jun	Jul	Aug	Sep
PUBLICATION GRADES					
27.6# Newsprint (24" x 36")	\$620	\$620	\$620	\$620	\$620
30# Newsprint (24" x 36")	585	585	585	585	585
35# High-Bright (65-bright)	640	640	640	640	640
33# SCB	725	725	725	720	720
35# SCA	760	755	740	740	740
34# Coated Groundwood (No. 5)	900	900	900	895	895
40# Coated Groundwood (No. 5)	790	790	790	785	785
60# Coated Free Sheet (No. 3)	855	895	900	900	900
COMMUNICATION GRADES					
50# Offset Rolls	880	885	885	885	885
20# Cut-Size (17" x 22")	1,125	1,130	1,130	1,130	1,130
PULP					
NBSK (U.S.)	1,030	1,030	1,030	1,025	1,025

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.



Quarterly Price Forecast vs. Actual								
Note: 2014 forecast was made on Nov. 13, 2013	Q1/14		Q2/14		Q3/14		Q4/14	
	Forecast	Actual	Forecast	Actual	Forecast	Actual	Forecast	Actual
	30# Newsprint	\$580	\$585	\$565	\$585	\$600	\$585	\$625
35# SCA	780	780	765	760	790	740	820	
40# Ctd. Groundwood (No. 5)	820	810	805	792	830	787	870	
60# Ctd. Free Sheet (No. 3)	885	870	875	868	900	900	930	

Annual Average Prices • Current Annual Forecast • Long-Term Price Forecast									
Actual Annual Prices								Current Forecast	Annual Fcst Made Nov/13
	2007	2008	2009	2010	2011	2012	2013	2014	2014
	30# Newsprint	\$575	\$674	\$550	\$596	\$640	\$637	\$594	\$585
35# SCA	719	839	830	784	848	825	792	760	789
40# Ctd. Groundwood (No. 5)	786	990	800	798	895	846	866	795	831
60# Ctd. Free Sheet (No. 3)	924	1,058	949	939	989	936	908	885	898

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 producers are attempting to push global prices higher for hardwood grades for October. Although the attempt seems somewhat premature, given some recent closures it appears that the market is bottoming. We suspect Q4 will be the low for both softwood and hardwood grades, with prices rising in the first half of 2015. (*Source: ERA*)

Newsprint: Newsprint prices should remain firm through the end of 2014.

SCB: Prices will be firm to perhaps a little higher through the end of the year.

SCA: Similar story: SCA prices will not go up but will remain stable until December or January.

Coated Groundwood: Coated groundwood prices will likely weaken by late November unless additional capacity is removed.

Coated Free Sheet: No change in coated free sheet prices will occur for the rest of this year.

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.

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THE REEL TIME REPORT



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