

Global Pulp & Paper: a financial perspective

UBS Investment Research
Global Paper & Forest Products
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Gail Glazerman, Analyst
+1-212-713-3486

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Analyst Certification and Required Disclosures Begin on Page 22

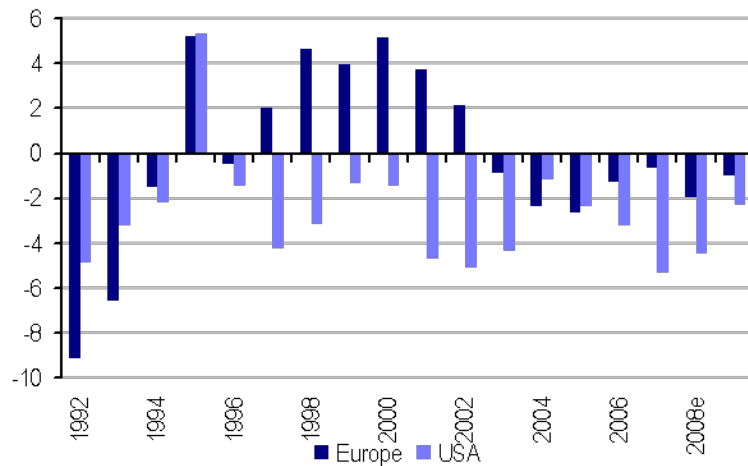
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History of Poor Returns

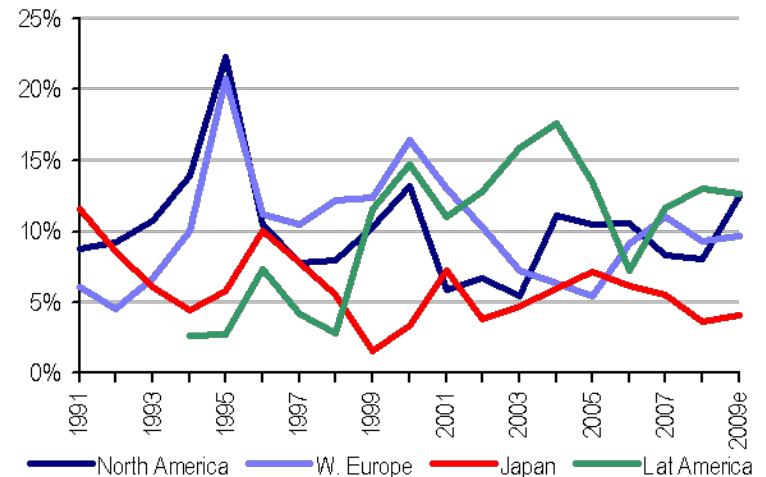
- ◆ The paper industry has long-frustrated investors with their inability to generate consistent above cost of capital returns
 - US industry has not exceeded cost of capital since 1995
 - European sector has fared better but in hindsight it was driven by F/X
 - Latin America has shown somewhat better results.

Return on Capital less Cost of Capital (%): US and Europe



Source: Company reports, Bloomberg, Thomson DataStream

Return on Invested Capital UBS Global Paper Universe



Source: Company reports and UBS estimates

Reflected in weak share performance

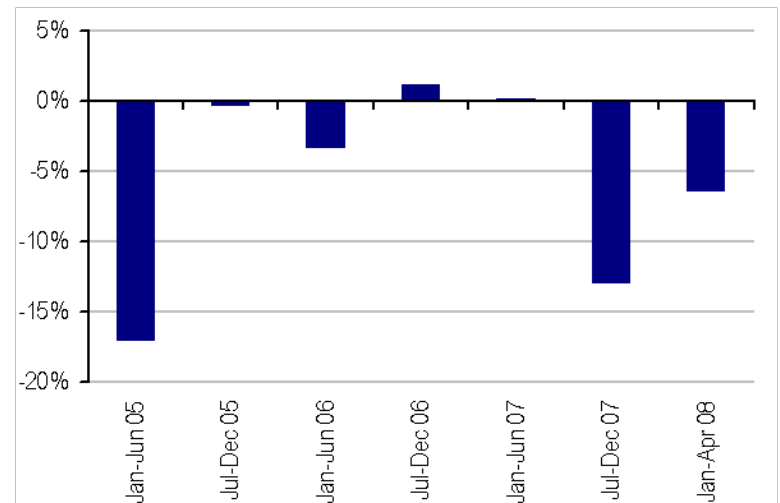
- ◆ Reflecting poor returns/profitability the MSCI paper index has been weak

MSCI Global Paper Index Relative to Market



Source: MSCI and UBS

MSCI Global Paper Index Performance (%)

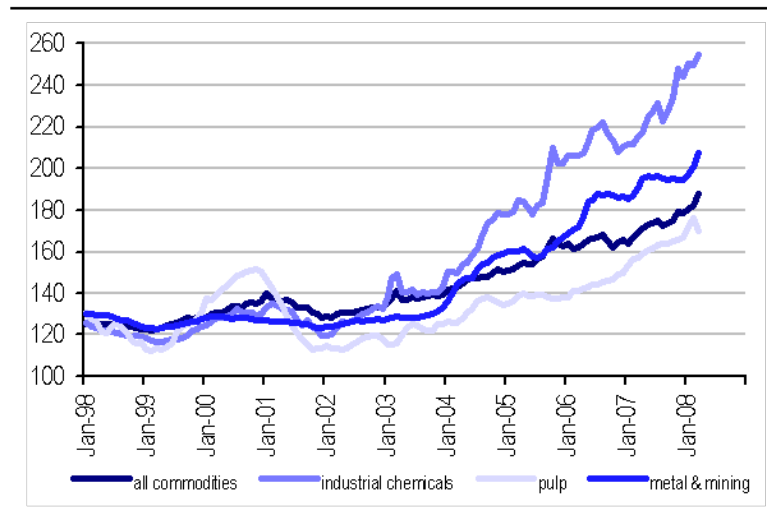


Source: MSCI and UBS

Weak paper performance in contrast to strong global materials

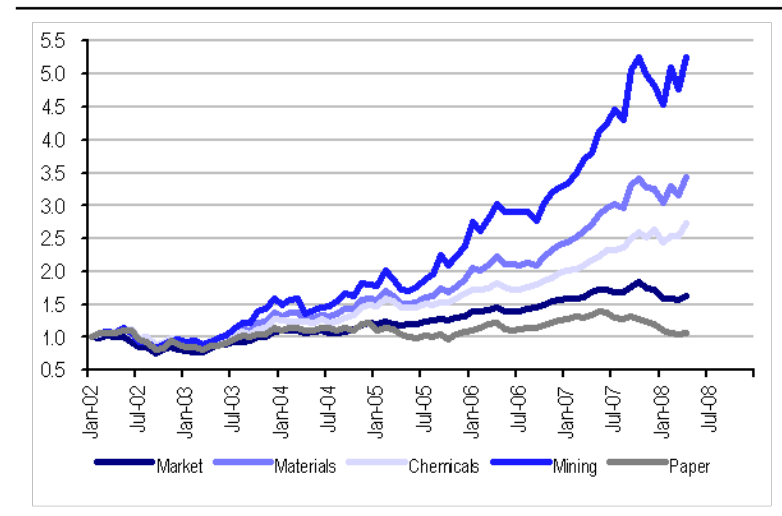
- ◆ Paper has underperformed the broad market in a time when other materials have outperformed

US Producer Price Index – Select Basic Materials (index)



Source: US Department of Commerce

MSCI Global Basic Materials Performance (Jan 02=1)

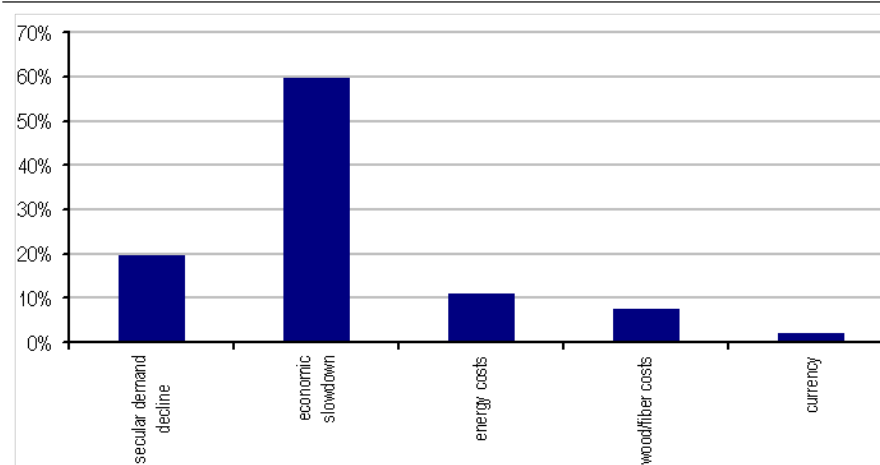


Source: MSCI and UBS

Investor sentiment

- ◆ We conducted a survey of US paper investors in Jan-2008
 - Threat of macro slowdown was key focus
 - Less concern about inflation, but this is a big driver so far

The biggest threat to the paper industry in 2008 is:



Source: UBS US paper investor survey Jan-08

Challenges: inflation

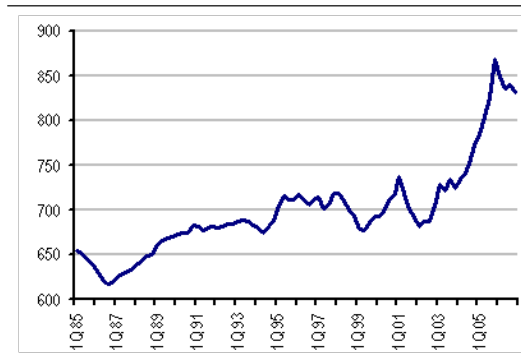
- ◆ The industry has suffered from significant inflationary pressures in the past 5 years
 - RISI data suggests that US average cost/ton is up about 25% since 2002
 - Europe has been more insulated, but is starting to feel the pinch
 - Asia seeing pressure, especially in the form of fiber

US Kraftliner Average Cost per ton, US\$



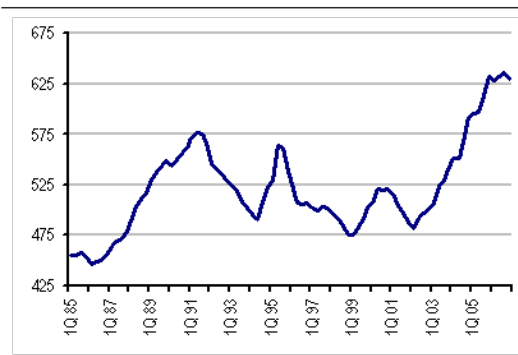
Source: RISI

US Uncoated Free Sheet Average Cost/ton (US\$) Cut Size



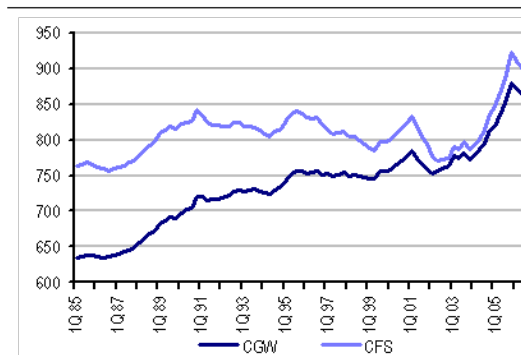
Source: RISI

North American Newsprint, Average Cost/Tonne (US\$)



Source: RISI

US Coated Paper Average Cost/ton (US\$)

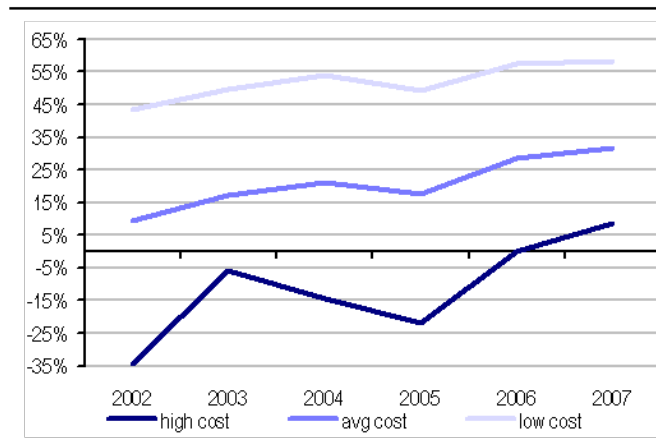


Source: RISI

Inflation example: pulp

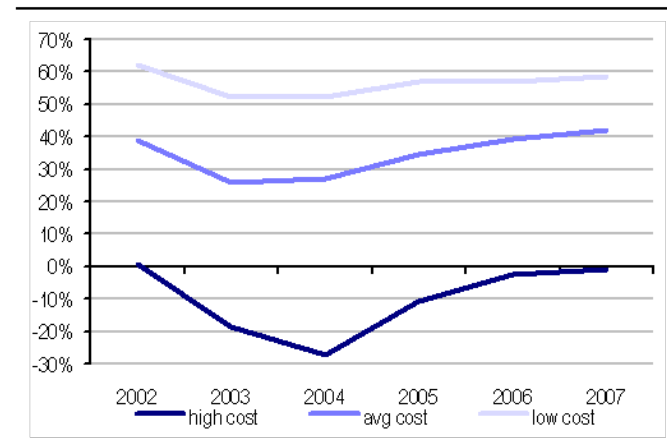
- ◆ Since 2002 trough pulp prices have recovered about 90%
- ◆ Margin of low cost producer
 - up 10% (NBSK)
 - Flat (hardwood)

Global Softwood Kraft Margins – Delivered Frankfurt



Source: RISI and UBS est

Global Hardwood Kraft Margins – Delivered Frankfurt



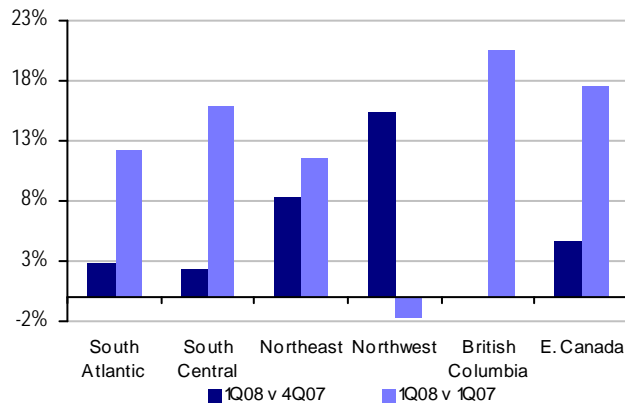
Source: RISI and UBS est

Sources of inflation: wood fiber

- ◆ U.S. wood costs are rising
 - This is largely due to low availability of residual wood chips from saw mills
 - High diesel costs associated with harvesting activity

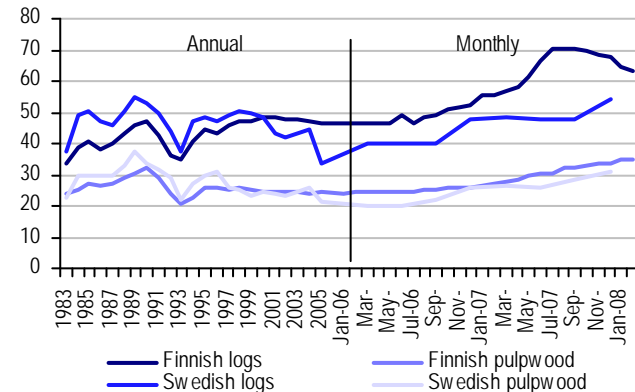
- ◆ Europe wood costs biggest factor (so far) harvests, not Russia
 - Poor winter harvests (2 years)
 - Rising demand for alternative uses (energy)
 - Rising export duties from Russia

North American Woodchip Prices, y/y % change



Source: International Woodfiber Report

Wood costs in Finland

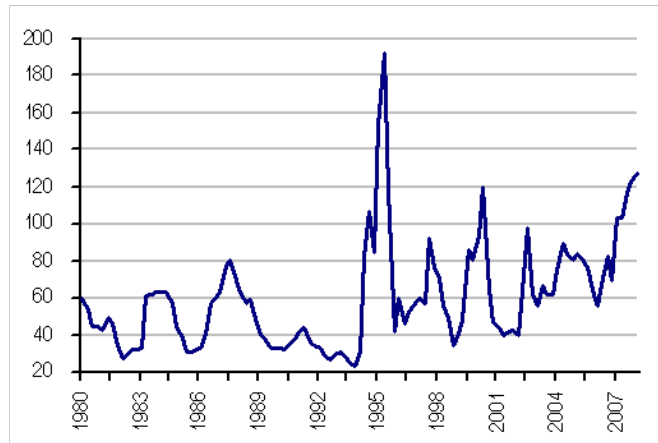


Source: Metla, UBS

Sources of inflation: wastepaper

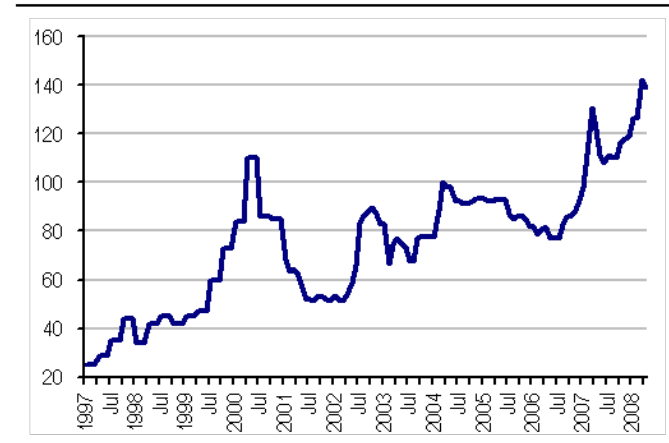
- ◆ Strong demand, especially in Asia, has driven up global wastepaper costs
 - This is particularly painful in Asia where wastepaper can account for over 50% of costs
 - High wastepaper costs/low availability one factor cited in sharp rise in Asian newsprint prices

U.S. Old Corrugated Container Price (US\$/ton)



Source: Official Board Market

U.S. Old Newspaper Price (US\$/tonne)

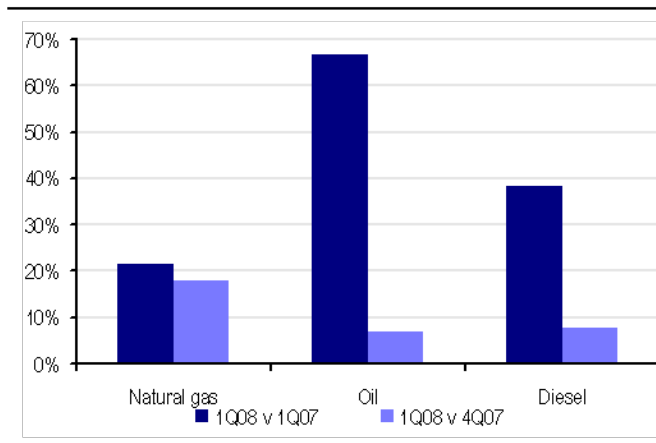


Source: Official Board Market

Inflation: energy

- ◆ Energy cost inflation flows through the industry in several ways
 - Direct consumption of fuel (natural gas, oil, electricity)
 - Transportation (diesel fuel surcharges)
 - Chemicals
 - Pulp production can be energy enhancing. This gives integrated paper makers an energy advantage over non-integrated players

Energy cost inflation (US-%)



Source: Bloomberg, US Department of Energy

Caustic Soda Prices (US\$/ton)

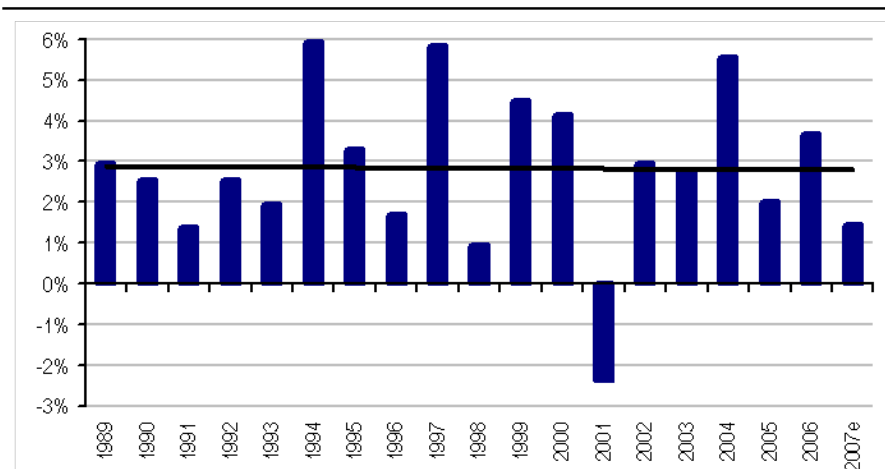


Source: UBS Chemicals Research

Challenges: demand growth

- ◆ Paper demand growth has slowed as some developed markets have experienced secular declines, only partially offset by growth in emerging markets
- ◆ While there is significant potential in emerging markets, to date the paper industry has not seen the demand pull from emerging markets as other basic materials (yet).

World Paper & Board Demand Growth



Source: RISI, PPPC, AF&PA, CEPI, industry sources and UBS estimates

Challenges: demand growth

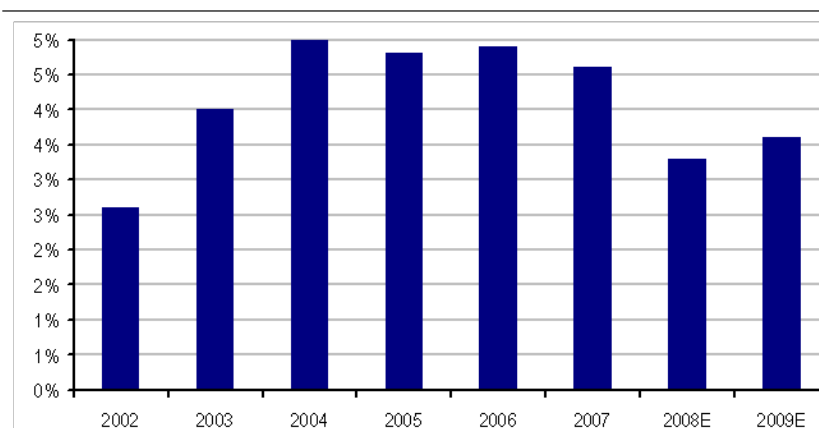
- ◆ UBS economics forecast assumes weaker macro backdrop – but start of recovery in the U.S. economy by year end 2008

UBS Global GDP Growth Forecasts

	2002	2003	2004	2005	2006	2007	2008E	2009E
USA	2.2%	2.7%	3.9%	3.2%	3.3%	2.2%	0.8%	2.6%
Canada	3.4%	2.0%	3.3%	3.1%	2.8%	2.7%	1.2%	2.5%
Japan	-0.3%	1.4%	2.3%	1.9%	2.4%	2.1%	1.0%	1.6%
W. Europe	1.0%	1.0%	2.1%	1.7%	2.9%	2.7%	1.6%	1.5%
Latin America	-0.5%	2.0%	5.7%	4.4%	5.2%	5.1%	4.1%	3.8%
Asia			8.8%	8.6%	8.4%	8.5%	7.4%	7.6%
China	10.0%	12.0%	11.7%	10.9%	10.7%	10.9%	9.9%	9.5%
World	2.6%	4.0%	5.0%	4.8%	4.9%	4.6%	3.3%	3.6%

Source: UBS calculations and estimates

Global GDP Growth (%)



Source: UBS calculations and estimates

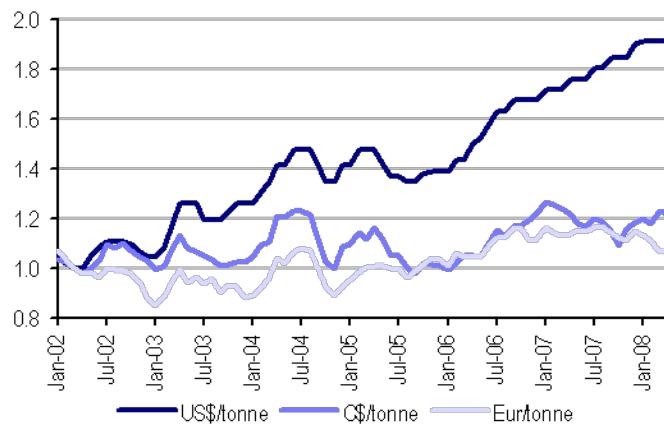
Challenges: demand growth

- ◆ Given this macro backdrop – demand has been a modest positive surprise in early 2008
 - US paper/board shipments up 1.3% year to date in the first quarter.
 - European demand is up 1-2% ytd
 - Global newsprint demand is up 2% ytd
 - Reports of strong demand in Asia, particularly in China. Apparently driven by buying ahead of the Olympics
 - Global market pulp shipments rose 6% in the first quarter (y/y)

Weak U.S. dollar

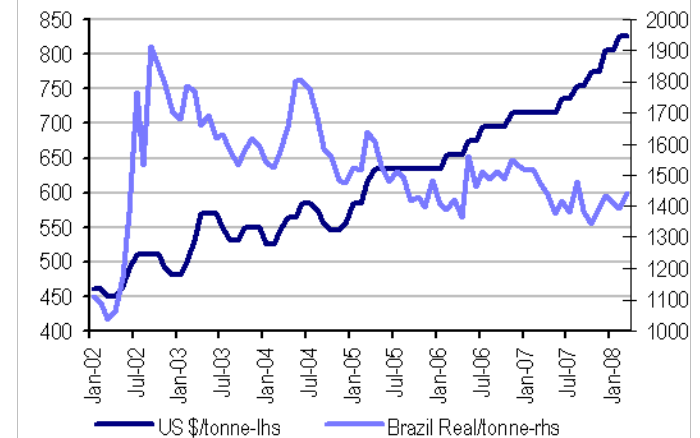
- ◆ Currency trends, especially the weak U.S. dollar, have significant implications for the global paper industry
- ◆ Pulp as an example:
 - U.S. price is up >90% from 2002 trough
 - Euro price (€) is up c10%
 - Canadian (C\$) price up c20%
 - Brazilian real price is 25% below 2002 peak

NBSK Pulp Price in Local Currency –indexed to 2002



Source: RISI and Thomson DataStream

Eucalyptus Pulp Price in US\$/tonne and Brazilian Real/tonne

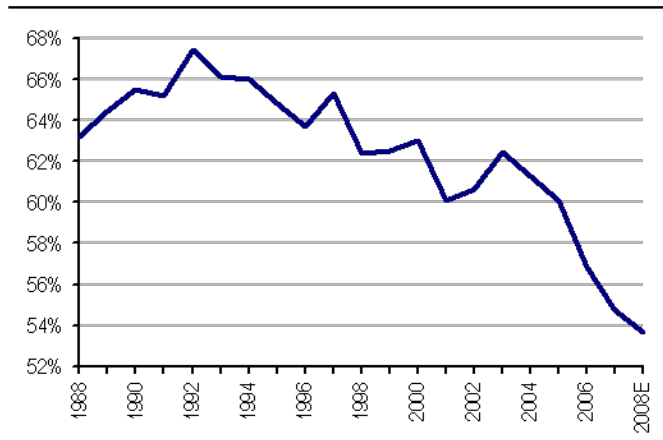


Source: RISI and Thomson DataStream

Weak U.S. dollar - consequences

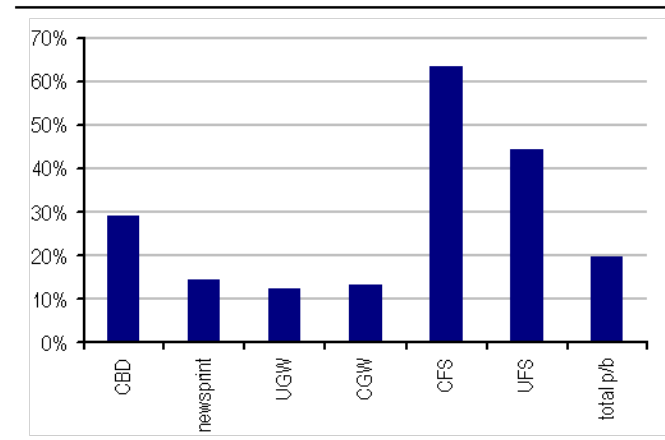
- ◆ Canadian industry responding with capacity closures
 - Announced paper/board closures since mid-2005 represent 20% Canadian capacity
 - Net exports down to 54% from peak over 67% of production

Canadian Paper & Board Net Exports as % Production



Source: PPPC, RISI and UBS est

Canadian Paper & Board Closures since mid-05 % market

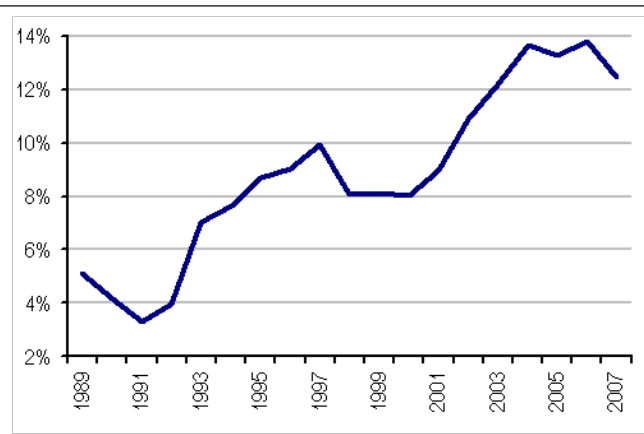


Source: Company reports, industry source and UBS est

Weak U.S. dollar - consequences

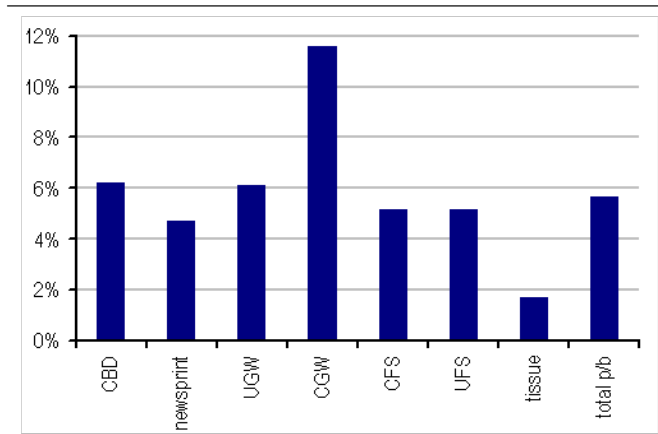
- ◆ European industry increased reliance on exports despite the currency moves
 - Pickup in exports in 2002, just as the F/X troughed against the US\$
 - Sharp rise in the € is hurting Europe's global cost position
 - In late 2005 the industry started to respond. About 6% total gross capacity has shut
 - Imports becoming an issue in newsprint and kraftliner

W. European Paper & Board Net Exports as % Production



Source: PPPC, RISI and UBS est

W. Europe Paper & Board Closures since mid-05 % market

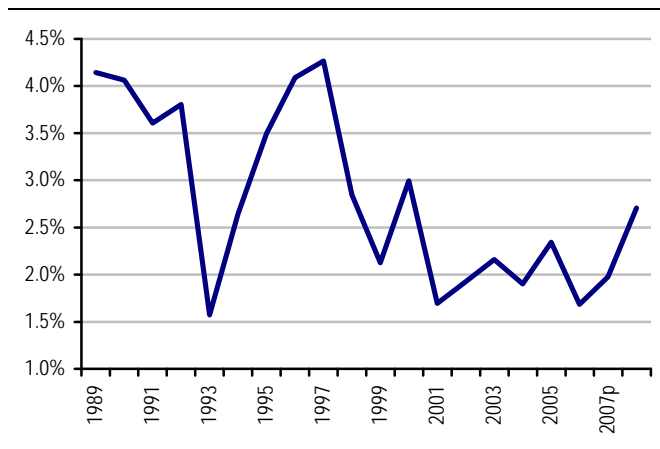


Source: Company reports, industry source and UBS est

Industry response: Cap ex

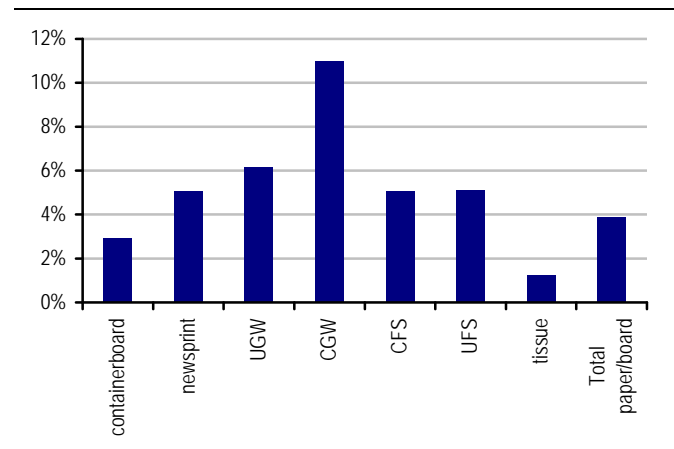
- ◆ In developed markets the industry has become more rational when considering capacity expansions
 - U.S. paper/board industry cap ex/depreciation <100% since 1998 and U.S. capacity at the lowest level since 1995
 - Global capacity growth slowed to 2% since 2005 vs long term average of 3%
 - World paper/board capacity closures 15.6 million tonnes since mid 2005

World Paper & Board Capacity Growth y/y % change



Source: RISI, AF&PA, PPPC, Cepi, industry sources and UBS estimates

World Paper & Board Closures since mid, % market

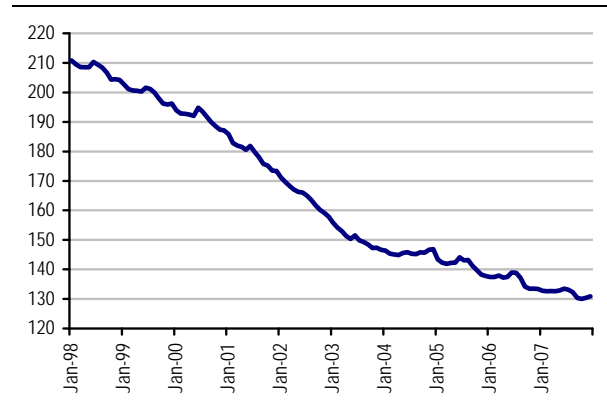


Source: Company reports, industry source and UBS est

Industry response: Cost cutting

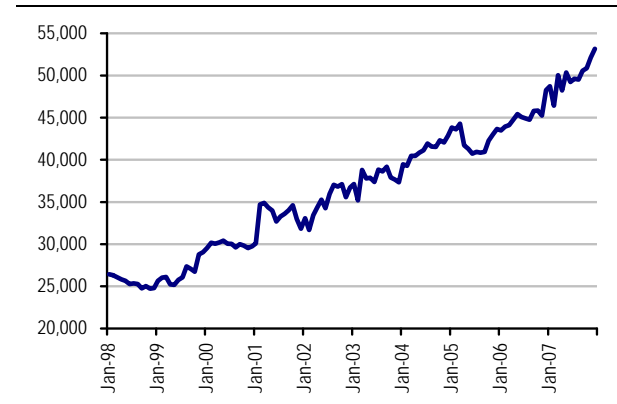
- ◆ While the benefits are obscured by inflation, the industry has worked to aggressively reduce costs.
 - European industry employment in 2006 was 33% below 1991 levels while the number of mills fell 22% but industry production rose 51%
 - In the past 10 years US industry employment is off 38% while revenue per employee has essentially doubled.
 - Many companies report 20% or greater reductions in purchased energy per unit of output. Though this has been offset by higher unit costs for energy

US Paper/Pulp/Board Mill Employment (000)



Source: US BLS

US Pulp/Paper/Board Mill Revenue per Employee (\$)



Source: US BLS, AF&PA

Industry response: management change

- ◆ Over the past several years there has been a impressive change in management throughout the industry
 - Many new managers come from outside the industry
 - In Europe, Stora Enso, UPM, SCA, Norske Skog, M-real all have new senior management in the past few years
 - In the U.S.: International Paper, Weyerhaeuser, Smurfit-Stone, Potlatch, Temple-Inland, Abitibi-Bowater are just a few of the companies to see new senior managers in the past few years

Industry response: M&A

- ◆ In the past 10 years there have been two waves of M&A
- ◆ In the late 1990s transactions were driven by scale
 - Stora/Enso; IP/Champion/Union Camp; Weyerhaeuser/Willamette/McBlo; Smurfit/Stone/St Laurent; Abitibi/Donohue; Norske Skog/Fletcher Paper...
- ◆ Through the more recent round of M&A companies are specializing by
 - Selling non core assets: International Paper, MeadWestvaco, Weyerhaeuser, Stora Enso, Smurfit-Stone, Temple-Inland
 - Acquisitions focused on select product areas: New Page/Stora NA; Abitibi/Bowater; Domtar/Weyerhaeuser uncoated; Graphic Packaging/Altivity
- ◆ In North America most paper/board markets have consolidated with an industry leader with 30-40% market share and two players holding a combined share >50%

Conclusion

◆ Difficult road ahead

- Managing to a high cost/lower demand environment likely to result in closure of further high cost capacity
- We expect further M&A to help manage through this difficult period, especially in Europe
- F/X developments going to be a key determinant. Though would take time to rebalance even if the U.S. dollar starts to strengthen
- Emerging market demand and availability of fiber to service capacity in those markets will be key to the future of the industry

Risk Statement

The global paper and forest product industry is highly sensitive to shifts in supply and demand. Consequently, the key risks are weak demand, as evidenced by general economic conditions, or increases in supply, in the form of capacity additions. These could cause market imbalances.

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	59%	38%
Neutral	Hold/Neutral	34%	35%
Sell	Sell	7%	26%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	67%
Sell	Sell	less than 1%	25%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2008.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

Required Disclosures (Continued)

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Company disclosures

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Aracruz Celulose ^{16, 20}	ARCZ6.SA	Sell (CBE)	N/A	R\$13.30	02 May 2008
MeadWestvaco ^{4b, 6b, 6c, 7, 16}	MWV.N	Buy	N/A	US\$26.03	02 May 2008
M-real	MRLBV.HE	Neutral	N/A	€1.90	02 May 2008
Stora Enso ^{4a, 6a, 16}	STERV.HE	Neutral	N/A	€8.30	02 May 2008
Suzano Papel e Celulose ^{2a, 20}	SUZB5.SA	Buy (CBE)	N/A	R\$28.10	02 May 2008
Temple-Inland ^{2b, 4b, 13, 16}	TIN.N	Buy	N/A	US\$12.12	02 May 2008
UPM ^{4a, 6a, 16}	UPM1V.HE	Neutral	N/A	€12.76	02 May 2008
Votorantim Celulose e Papel ^{16, 20}	VCPA4.SA	Buy (CBE)	N/A	R\$51.05	02 May 2008
Weyerhaeuser ^{3, 4b, 6b, 7, 16}	WY.N	Buy	N/A	US\$63.68	02 May 2008

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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