



THE RECOVERED PAPER MARKET

QUARTERLY REPORT

February 2013



GENERAL MARKET ANALYSIS *by Andy Hudson*

The fourth quarter of 2012 marked the end of a difficult year for the paper industry. After a strong January, collection rates for Recovered Paper have been relatively stable during the year with the lowest rate in September. The subsequent shortage of raw material for export resulted in increased prices being paid by UK domestic mills and exporters (exporters normally £12 to £14 above domestic prices) which eased off during the December month.

Higher collection rates and exports in October and November became possible through material made available from retailers in anticipation of a better Christmas season than in 2011. On the other side of the world many Chinese paper mills were uncertain about the renewal of their import licenses and consequently the continuity of their linerboard production. Against this background it is hard to determine why exports have been higher in October of 2012 than in the last 3 years (only topped by February 2011 and January 2012).² By the end of 2012 demand for finished products appears to have increased as the global economy seems to be strengthening and China's economy has picked up. Prices for OCC came close to £100 again after a price correction during 2012.

What has clearly stood out in 2012 is the demand for an improvement of quality for raw materials and finished products. For example, Palm Paper has strengthened their product quality to make their newspaper products more compatible, whilst UPM has improved the output quality at their Shotton MRF. However, there is still no agreed mechanism for testing quality standards for the industry a subject that is being addressed in the MRF consultation.

t2e MARKET ANALYSIS

The fourth quarter of 2012 saw a slight peak in prices, with best buying prices of £93 in November and best offer prices as low as £72 in October for the tonne OCC. It is interesting to note that the lowest offer prices were flat during October and December, reflecting the utilisation of Forward Markets with the same price offered over a longer period. Sellers of the material have used this option in anticipation of falling prices - especially in areas where historically lower prices have been paid. An increase in buying prices during October and November can be explained by an increase in demand for "Christmas-Orders".

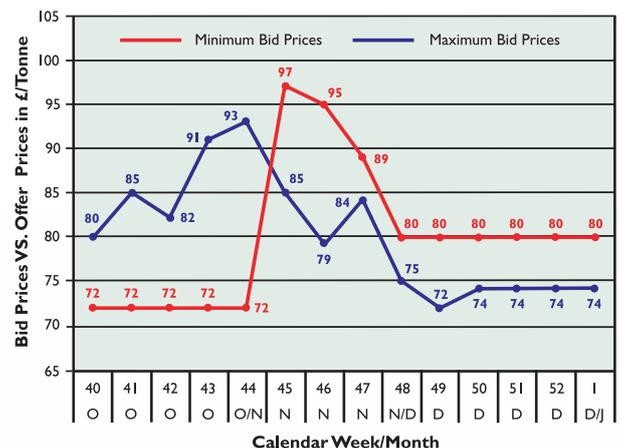
Buying prices in Greater London, the South East and the East Midlands in the fourth quarter were between £2 and £10 below the selling prices for these regions. The lowest selling price of £72 occurred in Northern Ireland (Belfast Port FAS).

The fourth quarter also saw a slight decrease in buying volume in comparison to the preceding quarter. Particularly during December, where buyers placed fewer orders - greatly influencing the overall tonnages in Q4.

Whenever prices reach a certain mark, sellers tend to hold material in anticipation of higher prices. We have seen the same phenomenon in December with a flat price of £74 placed in Forward markets and regions with historical lower prices. Spot market prices in higher priced regions have been between £80 and £97 during the same period.

The total bid volume for the period has decreased from 95,816 tonnes of OCC to 62,312, of which 45,552 tonnes were Container HC (1,898 loads) and 16,760 tonnes (838 loads) were Container HC light. The total offer volume for the period was 4,075 tonnes of OCC, of which 2,040 tonnes were Container HC (85 loads), 1,368 tonnes Container Standard (57 loads), 368 tonnes Curtain Sided Trailer (16 loads) and 299 tonnes Walking Floor Trailer (13 loads).

Combined Bid and Offer Prices for OCC on t2e's Marketplace Weeks 40 to 1



¹ t2e market price data 2012 and LetsRecycle Price Data, UK Domestic Mill prices and Export Prices for old KLS, <http://www.letsrecycle.com/prices/waste%20paper/paper-prices-archive>

² Based on CPI Key Indicator Data for Nov 2009 – Nov 2012

MANAGING DIRECTORS COMMENTS

A New Year, new challenges and new opportunities and yet the same issues remain. Most important of all the world still wants and needs recovered paper. If anything it needs it more than ever before. Not only is global demand for paper increasing but also with the expansion of the biomass markets in Europe there is increased demand for the primary raw material. So not only is the end market expanded but the alternative source a raw material is constricting. When the building market takes off once again the shortage is predicted to become acute. Combined with an energy shortage and emissions reduction targets, the future for recovered paper is secure.

However that sets the scene but does not provide all the answers. Which markets will grow which will contract? In the short term, China and Indonesia are the biggest inter-continental buyers. As a percentage of total recovered paper bought and sold in the world their volumes are small although increasing. However their buying activities have a disproportionate impact on global prices. Why? Because small supply shortages or excesses traded openly have a disproportionate impact on price.

So if the Chinese buyers leave the market, for example at Chinese New Year, recovered paper quickly builds up in merchants yards, cash gets short, sellers get distressed, prices are pushed down and traders push prices lower to preserve volumes and margins. Everyone is frightened of selling at the bottom of the market and yet at the same time terrified that the market might drop further. As soon as the Far Eastern buyers return to the market the situation is reversed supply shortages start to occur, yards are empty, domestic mills with 'just in time' stock levels of less than a week become concerned, prices start to rise rapidly, sellers start sitting on stock further restricting supply in the anticipation that prices will rise further although fully aware that at some time it must peak and concerned that buyers will not pay, further exacerbated by significant shipping times to the Far East.

The Chinese aspire for increased domestic collection rates which may change their reliance on imported recovered paper. Will that solve the problem? No.

India, Latin America and the Middle East are predicted to be new areas of growth but how long is

it before they become self-sufficient and those trends are reversed and if so who knows from where the next importer will come?



Equally no-one has any idea of what the true global market price either should be or is. Indices are all very well but they are always speculative, a wish list from buyers and sellers, speculative and never transaction based. While domestic mills try to resist the impact of this volatility by nurturing their local supply chains with opaque bi-lateral contracts in effect everyone is impacted and the greater the opaque market the more volatile becomes the spot one. Everyone says they wish prices were less volatile but little is done to solve the problem. Such are the realities of a spot market.

So what might be the solution? A facility which:

- allows you to buy and sell forward and trade out if there is a problem;
- reflects pricing by the majority at any time rather than the minority;
- finds a solution when you have a problem with out creating price disturbance;
- has a common set of trading rules;
- can resolve problems and assist in trade disputes;
- has secure payments.

That facility is called a marketplace.

The recovered paper market is the largest global commodity market without a marketplace. While a mature industry, it is now a fast changing global industry and will continue to be so. The marketplace provides a focus for continuity. It not only assists the market to secure margins in a world of changing shipping and exchange rates it also provides new opportunities for all involved. The marketplace will come. It is all a question of timing. It is far better to be there at the beginning and mould its development than arrive at the end and miss out. I look forward to your comments, your solutions and your commitment. Thank you to those that are already participants.

Angus Macpherson
Managing Director of
The Environment Exchange



CHALLENGES FACED BY THE CHINESE PAPER MAKING INDUSTRY

by Yaya Cao

Despite a challenging 2012, players in the Chinese paper making industry have high hopes for 2013. However, looking forward the industry continues to face challenges.

1. Capacity

An increase in investment between 2007-2008 led to an increase in Chinese capacity between 2010 and 2011. By 2012, there were 2,737 paper mills in China, with an estimated production capacity of 1.2 billion tonnes, a 9.5% increase from 2011. In the same period, total demand increased by only 6.4% to 1.05 billion tonnes, as a result there is overcapacity of 0.15 billion tonnes.

Industry experts suggest that the industry will be burdened with excess capacity for another three years. This is mainly attributed to the sluggish recovery of the world economy and the time it has taken for demand to catch up with the rapid increase in production capacity, as well as the impact of new technologies and packaging substitutes in the industry.

However as shown in the diagram it is predicted that global waste paper consumption will achieve steady growth over the next two years reaching approximately 260 million tonnes, a 58% recovery rate, by 2014. It is anticipated that increasing global demand for finished products will mean that Chinese paper mills will continue to increase their intake of recovered paper.

2. Quality

When China imports recovered paper the quality of paper is specified in great detail and classified accordingly. US waste paper is classified into 51 types; Japanese waste paper is divided into 27 kinds; European waste paper is categorised into 5 groups and 57 kinds. This level of classification is not available to determine the quality of local material. There are 6 to 7 different, very broad, categories of domestic recovered paper and quality varies according to region, mills or trading parties.

Promoting standard specifications has long been identified within China as the way forward for the recovered paper sector; however it will need to fit with the requirements of the local market. If quality specifications are too low, low quality material will be mingled with good quality resulting in a reduction in overall quality; if it is too high, it might be difficult to obtain enough quality recovered paper. Various industry associations such as the China Paper Making Association and China Resource Recycling Association are said to be working on the classification, standardisation and specification for recovered paper; however it is still unclear as to when these standards will be introduced and whether or not they will be used by industry players.

3. Product Innovation

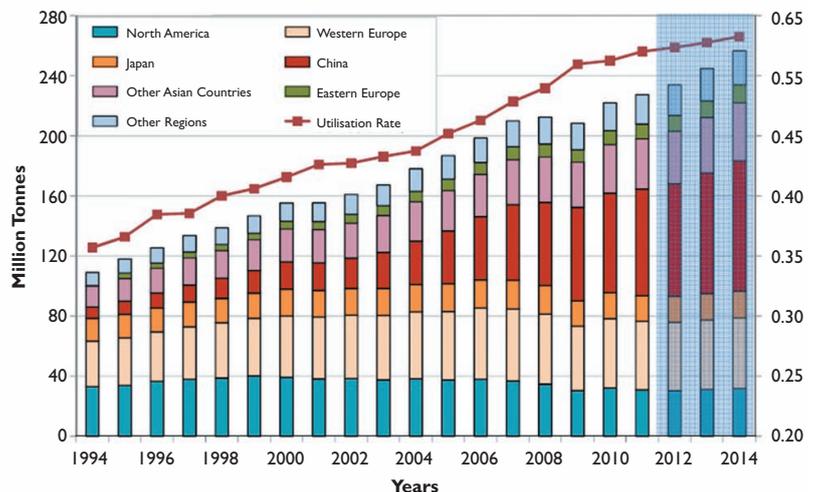
Like the Chinese economy, the paper making industry is in transition. Production capacity is highly concentrated in certain types of paper such as packaging paper and tissues. This results in an imbalance between supply and demand as well as low levels of innovation and differentiation between paper mills, which is crucial to increase global market share, particularly in times when the industry is going through periods of integration and restructuring. Thus, innovation is the key to stay competitive, allowing differentiation as well as insuring sustainability.

4. Environmental Regulations

Over the past decade, increasing attention has been paid to reducing the pollution caused by the paper industry.

Measures have been taken by the Chinese government to promote green low-carbon industry. Every year, paper mills below certain capacity levels that cause high levels of pollution have been shut down to accelerate the restructuring process. The "Paper Making Industry's twelve-five year plan", released in 2012, has further tightened regulations regarding environmental damage and pollution. As time goes by, paper mills are becoming more aware of emissions and having to comply with increasingly rigorous environmental compliance standards.

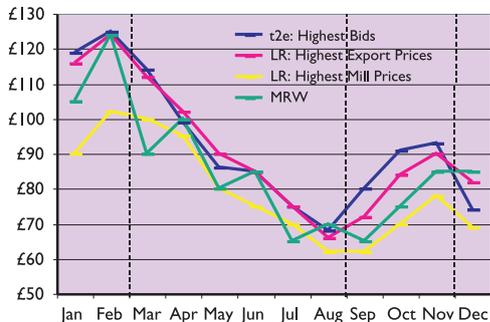
Global Waste Paper Consumption and Utilisation Rate



Source: Hannah Zhao, RISI First China International Recycled Fibre Conference, 2012

2012 DATA REVIEW

2012 - t2e, LetsRecycle, MRW



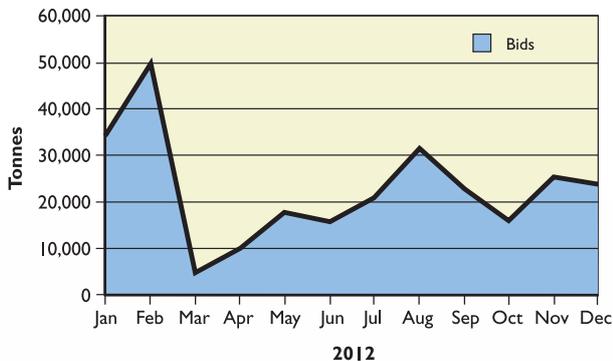
Source: Letsrecycle, Paper Prices, <http://www.letsrecycle.com/prices/waste%20paper>
MRW, <http://info.mrw.co.uk/>

To show the price spreads in the OCC spot market this is a comparison of the highest bid prices (best available buying price from a seller's prospective) with the lowest offer prices (best available selling price from a buyers prospective) on t2e. When aggregated these best prices are purely indicators for market trends as regional price differences makes it very difficult to present all the available data in a single graph. Historically prices bid in Greater London are higher than those in Scotland or Wales. If you are interested in a regional breakdown of t2e prices please contact our RP market team.

t2e Highest Bid and Lowest Offer Prices



Volume in Tonnes Bid on t2e in 2012



In 2012, 273,192 tonnes of OCC were entered as bids into t2e's Recovered Paper Market. Multiple factors caused the dramatic decrease of bids in March 2012. February and March are historically quiet months for collection and exports of the material. Additionally, heavily increased freight rates and a shortage of shipping space forced Exporters to limit their bid volumes on t2e. The second biggest volume demand on The Exchange was in August which led to increasing prices in subsequent month.

WHERE TO SEE US NEXT



t2e - smart, simple, safe trading
The Marketplace for Recovered Paper

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