



THE RECOVERED PAPER MARKET

QUARTERLY REPORT

July 2012



GENERAL MARKET ANALYSIS *by Andy Hudson*

The second quarter of 2012, April to June, did not bring a recovery in prices as hoped by many merchants and suppliers of old corrugated containerboard (OCC). The fears in Europe continue to cast a shadow on U.S. markets despite tailwinds from low interest rates and healthy earnings reported by companies. China as the major buyer of UK cardboard is still experiencing a slowdown in exports. This reduction in Chinese demand has coincided with a drop in domestic demand caused by downtimes at DS Smith and Smurfit Kappa combined with production problems at Saica. Some surplus material has found markets in Europe which has sustained merchants. All of which has combined to put a downward pressure on price.

This drop in demand has coincided with a drop in supply as collection rates have been falling since January 2012 potentially caused by the recession and partially the price drop making smaller collections less desirable.

t2e MARKET ANALYSIS

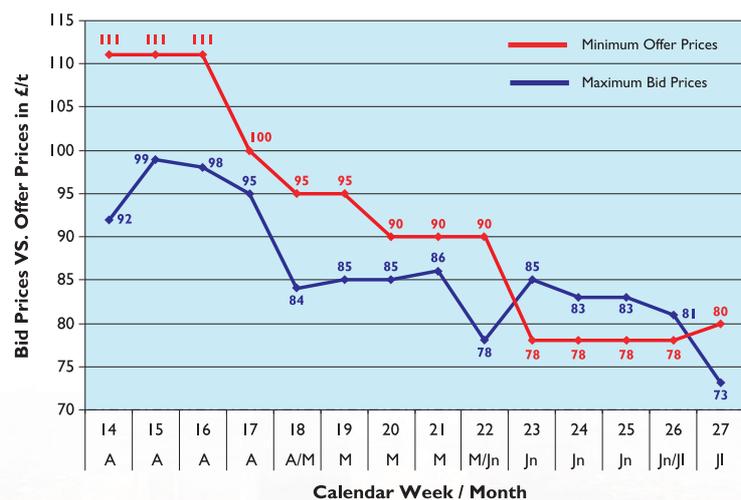
The second quarter of 2012 saw a continuation of the downward trend that started in mid-February. In the last week of April the best offer prices, which had been relatively stable at £111/t for the previous three weeks, started to follow the downward trend seen in the best bid prices. Throughout the whole period offer prices fell from £111/t to £78/t and bid prices from £99/t to £73/t. Falling bid prices were attributed to higher freight rates, reduced availability of containers and full stocks at domestic mills (reflected by export prices only £4 - 6 higher than domestic prices). Even though container availability improved by the end of May, by the beginning of June freight rates had increased further.

The graph opposite shows the best bid greater than best offer prices for weeks 23-25. This reflects the geographical diversity of price with the highest bid price in London while the lowest offer prices were in Northern Ireland.

The total bid volume for the period fell by 67% from 94,452 tonnes of OCC to 30,560 tonnes, of which 18,960 tonnes were Container HC (790 loads) and 11,600 tonnes (580 loads) were Container HC light.

The total offer volume for the period was 1,955 tonnes of OCC of which 1,173 tonnes were Container HC (51 loads), 460 tonnes Container Standard (20 loads), 230 tonnes Curtain Sided Trailer (10 loads) and 92 tonnes Walking Floor Trailer (4 loads).

Combined Bid and Offer Prices for OCC on t2e's Marketplace Weeks 14 to 27



Although the price drop would indicate that the market in the UK is oversupplied, the t2e marketplace has experienced a different situation. At these prices t2e has seen more demand than supply with buyers wishing to buy more tonnage in one order than sellers are offering. The offer volume was only 6.5% of the bid volume. This is partially attributed to sellers holding onto tonnage in anticipation of higher prices, which is unsustainable over longer periods. There is a great opportunity for sellers in the market to meet this demand which will otherwise be fulfilled outside of the UK. We have seen more activity in our Forward Markets and encourage participants to use this powerful tool for buyers to secure tonnage in advance and for sellers to secure prices and improve their stock management.

MANAGING DIRECTORS COMMENTS

How can the marketplace work for you?

This has been a busy quarter globally, for RP, and the development of the RP market. Recovery seems to slip between three steps forward and either two or four steps back. Growth in the UK in the first quarter has evaporated and slipped into contraction in the second. The Euro lurches from one disaster to another and as yet no discernible impact can be seen from either Germany's change of heart or France's change of political direction. America is gearing up for a presidential election but with the economy still floundering in the doldrums the outcome is very uncertain. Against this backdrop it is hardly surprising that markets for China, who are also in a period of political transition, have receded and with it their demand for raw material.

From a RP perspective ONP usage in Europe remains substantial but declining (it is declining significantly faster in the US). This has partially been compensated by growth in the Far East but as yet we are not seeing the same level of aggressive buying for export markets in the UK as there has been in OCC. In the OCC market a number of factors are coming into play with the movement of exchange rates and the global recession, Chinese paper mills are finding their markets increasingly competitive and their profitability declining (see box). As a result they are applying downward price pressure onto their supply chain. This they have achieved successfully in their domestic market and to a certain extent onto the global export market.

They have taken advantage of this lull in demand to increase their concentration on quality issues.

Angus Macpherson
Managing Director of
The Environment Exchange



Although some have suggested that Customs' issues are more a consequence of the transition of power in China than any particular quality issues, import difficulties have arisen. Where the UK used to exercise a clear advantage over other European nations in quality, it is now beginning to lose ground. As a result, there is no means of discriminating between materials and an increased number of disputes and prices have dwindled down to the lowest common denominator. The mills are also seeking alternative raw materials.

This drop in price is making other overseas destinations such as India, Vietnam, Korea and Malaysia look more attractive to traders. As yet these destinations lack the volume requirements or the relative stability of the Chinese markets but this could change. Additionally traders are not overlooking the more traditional domestic and European markets which continue to draw down substantial volumes. But without global price transparency and ease of access to new participants, traders are on many occasions missing out on these opportunities.

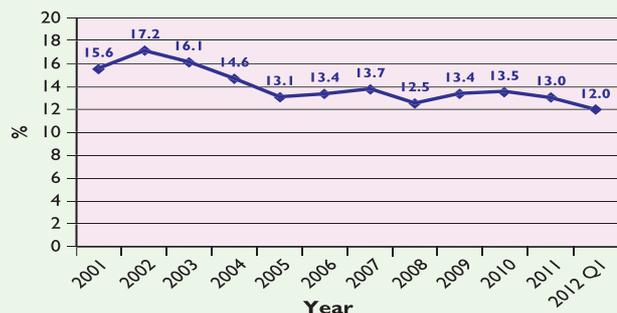
Now that the collected marketplace in the UK has been successfully developed with the transition to the second generation of IT for the website, t2e is concentrating on the development of its delivered marketplace which we intend to launch before the end of year initially starting with delivery to 12 Chinese ports.

Thank you to all who have helped with the development to date. There is a long way to go!

DECREASING PROFITABILITY

A factor affecting Chinese buying patterns is the decreasing profitability in the paper making industry, the result of increased costs in labour, raw materials, machinery and environmental compliance, as well as increasing internal competition created by over capacity. Bizarrely despite these increased costs, there are incentives for mills to increase capacity to avoid enforced closure by the Government as a result the problem of over-capacity is being exacerbated.

2001 – 2012 Changes in Gross Profit in
Chinese Paper Making Industry



Source: (National Bureau of Statistics of China, Research In China, 2012)



CHINA DIRECT: Yaya reports on t2e's recent visit to China's Paper Mills

t2e's will provide free communication between the UK and China

RECENT MARKET SITUATION IN CHINA

The period (April – June) saw reports of falling demand from UK exporters and Chinese paper mills coupled with falling prices. In China prices for European OCC decreased from \$190 to \$183/tonne, while prices for US OCC fell from \$217 to \$210/tonne. Compared to previous years, traded volumes are below expectation; typically busy periods are quiet and typically quiet periods are even quieter! Table 1 below shows the annual pattern in liner board sales for paper mills in China, which drives the production of finish product in paper mills and ultimately demand for waste paper.

According to the annual pattern shown below (Table 1), the industry should be expecting an increase in activity of liner board production in September; which in turn should stimulate an increase in buying demand for recovered paper during August. However, t2e heard from a number of paper mills that yards are already fully stocked with both finished products and secondary raw material, casting doubt over this typical annual pattern. Combine this with the current gloomy situation in Europe and it seems the next few months cannot be easily predicted. Despite this, there were some glimmers of hope from the industry that demand may pick up in September.

Table 1: Annual Pattern for Liner Board Consumption in China

Month	Jan	Feb	Mar	April	May	June	July	August	Sep	Oct	Nov	Dec
Production Activity	Quiet	Quiet	Moderate	Moderate	Quiet	Quiet	Quiet	Quiet	Increasingly busy	Busy	Busy	Busy
Reason	Quiet season for exports out of China. Salaries paid out before year end, Business are sitting on low cash flow. Restricted ability to pay for material		Export is higher than in January and February. Cash flow improves after Chinese New Year. Mills increase stock levels		Steady export sales of liner board	Quiet for export, peak season for electricity consumption due to air conditioning during summer, which has an impact on electricity supply for paper mills encouraging production downtime and reducing demand for raw materials			Build up stock levels in preparation for export and domestic use	From September, increase sales of liner board by paper mills to meet peak American and European demand over Christmas Season and prepare for Chinese New Year		

Source: (Qilu Stock Research Centre, 2010)

ISSUES OF QUALITY AND CHANGING PREFERENCES

There is a growing push from policy makers that China should increase its domestic recycling rate to reduce reliance on imports, but many argue that in fact the Chinese recycling structure – although different from European systems – does in fact already deliver high recycling rates and that the reason for a reliance on imports is that domestic supply is neither sufficient to meet demand nor at the margins desirable in its composition. Imports meet a demand for longer fibre in the recovered paper, which – due to the quality of packaging in the domestic market system that uses shorter (post recycled) fibre material – cannot be sourced internally.

In reaction to this situation as well as reinforcing their preference for US material, a number of paper mills are further diversifying their supply chain to incorporate materials such as eucalyptus pulp, dissolved pulp and straw pulp. However, feedback from t2e's recent visit to China revealed that although European material has longer fibres, the inconsistent quality of the material supplied from Europe, and the UK in particular; longer shipping periods from Europe; fluctuating costs for both material and shipping, and an unsettled Euro; the preference of Chinese paper mills is increasingly swaying towards domestic material. Cost also contributes to this with domestic prices some \$50 to \$60 a tonne lower than imported material. The message from China to European suppliers is that if they wish to secure China as an end market for their material, they must maintain high quality and there needs to be a robust dispute resolution service to arbitrate an increasing number of quality disputes.

NEWS

t2e's SECOND GENERATION RP TRADING PLATFORM

In preparation for the launch of the delivered contract to China, t2e has introduced a second generation of its trading platform. To the viewer the visual appearance has not only had a facelift but also the pages are faster, more flexible and easier to use than before. Using the latest web standards supported by new internal and external software, it provides the participant with an improved experience. Additional features include giving those entering on-line bids and offers greater control of their selection of loading and packing options at different nominate locations.

Using the page view below as an example, participants can now:

- View live tradable prices for the UK collected contract;
- See aggregated UK supply and demand segregated by area on a single screen;
- Personalise their view by making their own market by location, market type (Spot or Forward), load type, packing method and payment terms;
- Compare prices in their personalised market.

As well as accessing a wealth of other data.

For more information on the features of our Recovered Paper market call us on 0131 473 2337 or visit our demo site at <http://www.t2e.co.uk/about-t2e/interactive-trading>

The screenshot shows the t2e trading platform interface. At the top, there's a banner for 'THE ENVIRONMENT EXCHANGE' with the slogan 'Use the power of the marketplace'. Below the banner, there's a navigation bar with 'Home Page', 'Trading Line: 0131 473 2337', and 'Contact'. The main content area is titled 'Trading OCC' and 'Prices by Region'. It shows a dropdown menu for 'Market: Spot 2012' and 'Region: All'. Below this, there's a table of prices for various regions: E. Midlands, Gtr London, N.Ireland, North East, North West, Scotland, South West, and W. Midlands. Each region has a table with columns for Buy Size, Buy Price, Sell Price, and Sell Size.

E. Midlands				Gtr London				N.Ireland			
Buy Size	Buy Price	Sell Price	Sell Size	Buy Size	Buy Price	Sell Price	Sell Size	Buy Size	Buy Price	Sell Price	Sell Size
33	£93.00	£94.00	15	2	£99.00	£100.00	12	15	£80.00	£82.00	25
10	£93.00	£95.00	10	10	£96.00	£100.00	20	20	£76.00	£83.00	23
5	£92.00	£96.00	20	22	£86.00	£101.00	15	30	£74.00	£83.00	3
22	£91.00	£99.00	13	26	£85.00	£103.00	23			£85.00	35
24	£90.00			30	£85.00	£103.00	5				
15	£90.00					£105.00	20				

North East				North West				Scotland			
Buy Size	Buy Price	Sell Price	Sell Size	Buy Size	Buy Price	Sell Price	Sell Size	Buy Size	Buy Price	Sell Price	Sell Size
23	£93.00	£91.00	25	23	£95.00	£96.00	40	13	£85.00	£86.00	5
15	£90.00	£92.00	13	45	£92.00	£97.00	10	22	£84.00	£86.00	10
15	£86.00	£92.00	5	15	£90.00	£97.00	3			£87.00	23
		£93.00	25			£99.00	25			£89.00	18
		£94.00	45			£101.00	23				
		£99.00	33								

South West				W. Midlands			
Buy Size	Buy Price	Sell Price	Sell Size	Buy Size	Buy Price	Sell Price	Sell Size

WHERE TO SEE US NEXT



t2e will be exhibiting on Stand 19T49 on 11th – 13th September 2012

Please come by the stand during the exhibition, or contact us in advance to arrange a meeting. We will be using the show to demonstrate the trading site for the new second generation Recovered Paper Market, as well as to continue to promote our existing services. So please get in touch with the Recovered Paper trading team (RP@t2e.co.uk) on 0131 473 2337, or press@t2e.co.uk for more information.

t2e - smart, simple, safe trading

The Marketplace for Recovered Paper

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