THE RECOVERED PAPER MARKET

May 2012

GENERAL MARKET ANALYSIS *by Andy Hudson*

The first quarter of 2012 has been a difficult one for the Recovered Paper market, particularly brokers and exporters. A shortage in container availability developed as a result of ships on routes between Europe and China being cancelled which put pressure on the prices for Old Corrugated Cardboard (OCC). European order books from China have been weak which has cut demand and profits for major shipping lines, who in turn cut back resulting in a significant cargo backlog within Europe. Recently the situation appears to have eased and it is anticipated that this backlog will be cleared by late May or early June. But only after an increase in shipping prices by up to $600 per container, approximately $25 a tonne, which had a significant impact on the price of Recovered Paper that can be offered by export buyers.

Despite a rise in the last quarter of its Purchase Manager Index (PMI), China, the UK's biggest importer of recovered paper, is still suffering from squeezed order books and weak demand and as a consequence weakening linerboard prices and full stocks of raw material, another contributor to the current low in export prices. However, it is expected that orders will pick up as spring moves to summer.

With this weak export market the UK recovered paper mills are benefitting from lower recovered paper prices. The domestic demand for OCC was relatively consistent over the first quarter of 2012 although warehouses are apparently now almost full. Normally the summer is difficult and a worrying period for domestic mills in terms of availability but the low prices have allowed them to fill their stocks with low-cost material, which has further relieved price pressure in the market. As a result March and April saw low prices after a relatively strong February.

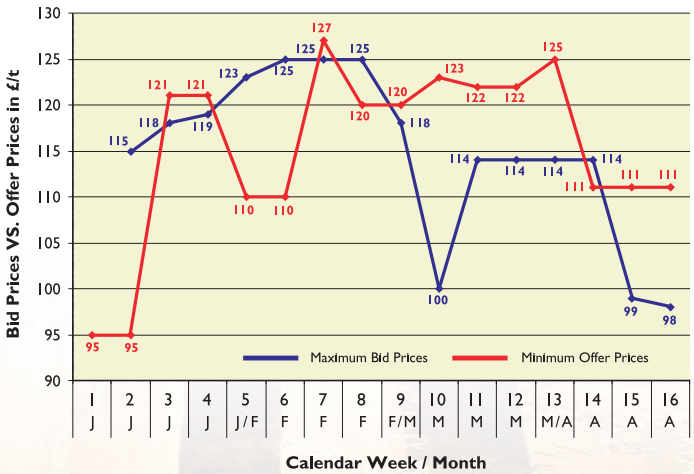
There is a lot of movement in the domestic market with Saica continuing to secure supply with contracts through their recent acquisition of Houghton's Waste Paper Ltd and Smurfit Kappa about to spend £98 million on replacing the two existing recycled container board machines in Kent with a new custom-made machine. Looking forward there is no doubt, that 2012 will be as challenging as 2011 with oil prices continuing to rise and the ongoing, and increasing, risks of a double dip recession and a global economic downturn.

t2e MARKET ANALYSIS

OCC offer prices increased in January, starting at £95 and climbing to £121/tonne, with record prices paid by exporters well above those of domestic buyers. February was quite stable until prices fell rapidly during the last week of the month. This fall continued into the first week of March. A key factor was the cancelation of ships to China which resulted in a lower demand from exporters. As the lack of availability of export containers extended into April, prices fell to a low of £98 a tonne, last seen in the last quarter of 2011.

The total bid volume for the period was 94,452 tonnes of OCC of which 76,752 tonnes were Container HC (3,198 loads) and 17,700 tonnes (885 loads) were Container HC light.

Combined Bid and Offer Prices for OCC on t2e's Marketplace Weeks 1 to 16



The total offer volume for the period was 2,623 tonnes of OCC of which 1,464 tonnes were Container HC (61 loads), 984 tonnes Container Standard (41 loads) and 175 tonnes Curtain Sided Trailer (7 loads).

MANAGING DIRECTORS COMMENTS

How can the marketplace work for you?

Angus Macpherson
Managing Director of
The Environment Exchange

Optimum supply chain management is a constant challenge for buyers. How is the supply chain incentivised to produce what is wanted, when it is wanted at the market price? Is vertical integration, outsourced or a combination the best approach? When is complacency setting in and when are price rises reasonable? What is the market price? How can a buyer know?

Perhaps going out to tender is the most effective approach? But this is time consuming and potentially complex – not something to be repeated frequently. Experienced buyers feel that they know every player in the market and their strategies and standards. But do they really know what their competitors are up to? The marketplace provides past, present and forward price and volume information that reduces the asymmetry of knowledge and assists investment decisions.

To diversify risk, buyers create a pyramid structure of multiple suppliers so that they are never over reliant on one source. This pattern is repeated by every other buyer in the market and frequently the building blocks of one buyer's pyramid overlap with the building blocks of another's. This gives comfort to the seller because they no more wish to be reliant on one buyer than a buyer wishes to be reliant on one seller, regardless of how seemingly benevolent each counter-party might appear. As a market moves from national to international, exporters get involved so there are even more buyers which in turn creates even more overlap.

THANK YOU TO JOHN HILL FOR HIS INSIGHTS ON SHIPPING, MORE TO FOLLOW ON THIS TOPIC IN THE NEXT QUARTERLY

TENDER TO THE MARKETPLACE

A marketplace brings simplicity to this complex web of relationships. It aggregates all the buyers and sellers in effect fusing all those pyramids into a single entity. Standardising procedures increases the tools that are available, such as forward contracts, and allows the maximum flexibility of choice with the minimum of effort. As a result all prices bid or offered on the marketplace are tendered to the whole market at any one time. So buyers get the lowest available offers while sellers receive the highest available bids. Hence it encourages the best aspects of the market to be maximised and deters those that are unwilling to strive for the best.

RAISING THE STANDARDS: HOW CAN THE MARKETPLACE WORK FOR THE MARKET?

Commitment to the marketplace

Using the marketplace as a tool, rather than a competitor, ensures it is there when you need it. A base transaction volume must be committed through the market which is not dwarfed by any potential surpluses or deficits. The smaller the volume; the greater the possibility of price volatility.

Collective power

Once committed, the collective power of the participants will deliver improvements in choice and standards (i.e. forward markets, quality specifications and price transparency). The wrong price will no more trade through the marketplace than it will on the open market.

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Standards

The introduction of a 'level playing field' through a code of conduct and penalties for non-compliance (both financial and reputational – is it really worth becoming a market pariah in the hope of scamming a few pounds more on a trade?) ensure a consistent standard is delivered to all participants, not just "favourites".

My bond is my word

. . . . Far more secure than "my word is my bond"! A marketplace is pragmatic rather than utopian. An independent dispute resolution mechanism is provided which both reflects the current standards being applied in the market and offers swift resolution. The financial bond provides both security and a mechanism for swift resolution of these disputes.

LET THE MARKETPLACE WORK FOR YOU

Some techniques to use the marketplace to your benefit include:

Spot markets: immediate transactions and availability

- *If you think that you are being underpaid* for your material you can place an anonymous offer on the marketplace at the price that you think is correct. If it trades then your price becomes the market price. If it does not then to trade you need to adjust your price to a level at which it trades. A similar technique can be adopted by a buyer that thinks they are overpaying for material.
- *If a supplier lets a buyer down* and so they are short of material and there is no time to seek the best available price you place a bid on the marketplace and allow it to do the work for you by anonymously relaying your needs across the whole market until a suitable seller comes forward. A similar technique can be followed by a seller that finds itself with a short-term surplus.

Forward Markets: secure price and volume today, for delivery at a known date in the future – a fortnight, a month, a quarter, or a year in advance.

- *Sell the load in advance*: As long as the load is available for collection at the location and date specified, the seller can be confident that they will receive the price transacted and consequently can rest assured that profit is secured.
- *Pre-sell or pre-buy*: a good option if you know that you will have a surplus or shortage of tonnage and don't want to disturb bi-lateral arrangements or market equilibrium.

So let the marketplace work for you, it:

- may not introduce you to new players or new tonnage or new players to the market, although it might do all three.
- does not impose new regulations; it codifies existing ones and in so doing facilitates the movement to improved standards.
- simplifies supply chain management, reduces the imbalance of information by aggregating supply and demand, increases security for both buyer and seller, raises standards and is a flexible tool available for market participants to exploit to their own advantage.
- will give back to market participants that are committed to it as good as it gets and potentially it will give significantly better through the multiplication effect of aggregating demand and supply.

Smart, simple, safe trading

For more information, or to join, contact:
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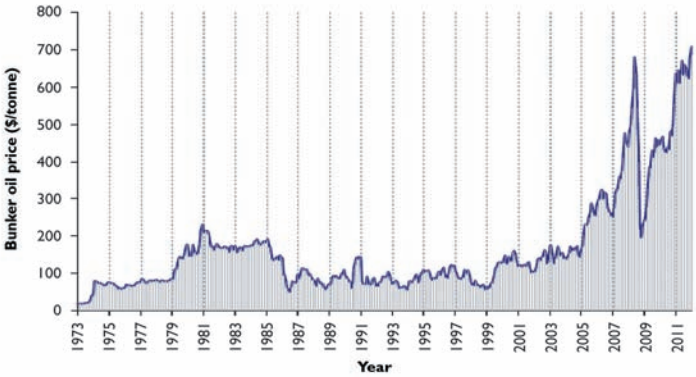
OIL PRICES AND OVERCAPACITY

by John Hill, Business Analyst, V. Ships

V.Ships

Over capacity has plagued the shipping industry. Inability to read the market in 2005-2006 led ship operators to believe that cargo volumes would continue to grow at exceptional rates. Thus, ship owners, operators and even charterers ordered new vessels, often bigger and faster than their predecessors. The result in 2012 is more vessels than previously seen. However, fallout from the 2006-2007 Credit Crisis culled demand and is still negatively affecting global markets. Consumer purchasing reduced, imports reduced and so too did freight rates. It turned from a seller's market to a buyer's market and recently in an attempt to keep market share (2009-2011), a number of larger container shippers started a price war. This resulted in the top 20 container carriers posting a combined loss of $20billlion in 2009, recovering in 2010, but falling back into losses of around $11billion in 2011.

This over capacity and falling demand has been compounded by the return of high oil prices. Bunker Oil, which fuels the majority of seaborne vessels, has seen vast increases in price over the past 48 months. Previously, ships were purchasing bunker oil at around $150 to $300 per tonne and represented around 15-20% of the vessel's operating costs. In today's market, ship operators are buying bunker oil at around $700 to $750 per tonne, and this now represents up to 50-75% of operating costs. At Full Steaming speed (typically 22-24Knots) the ship will burn around 200-250 tonnes of bunker oil per day - daily costs (only for fuel usage) have risen from anywhere as low as $40,000 to as high as $190,000.



It is simply not feasible to continue with this approach, and as the vast losses show, many shipping companies nearly went out of business. Consequently, they sought new strategies in order to maximise the potential return to profits.

The key strategic move that was enacted was Slow Steaming (also Extra Slow Steaming & Super Slow Steaming). This tactic involved cutting steaming speed from 22-24knots to as low as 15knots. The effect this has on fuel consumption is huge - ship engines will now be burning as little as 75 to 100 tonnes of bunker oil per day. Thus daily operating costs fall to between $50,000 and $75,000, against the previously mentioned figure which was closing in on $200,000 per day. This has reduced operating costs while allowing for a move closer towards to previous margin levels.

Slow Steaming also had an additional advantage. In slowing a vessel down you are going to increase the time it takes the vessel to transit its given route. For example, at Full Steaming speed, a round trip transit from Hamburg to Shanghai would take a single ship around 63 days. In order to offer a daily service on this route, the ship operator would be required to run 9 ships simultaneously. However, at the Slow Steaming speed the same transit could take a single ship 84 days and would require 12 ships to operate a daily service. Thus, Slow Steaming has inadvertently had a (slight) effect on reducing the effect of over capacity whilst increasing ship utilisation and pulling back some control (albeit very small amount) over freight pricing.

Another strategy by major shipping companies, for example Maersk, is to actually remove a number of vessels from the trade routes in which they have over capacity. They have removed as much as 9% of the vessel capacity on the Asia-Europe/ Europe-Asia trade route, reallocating some of the vessels to areas such as the West Mediterranean where they can be utilised in reducing the cost of operating in this market. Again they are attempting to reduce the effect of over capacity and market servicing costs, while increasing ship utilisation and clawing back some ability to control freight rates.

Over capacity is unlikely to go away, just look at the current vessel order book and new deliveries. Therefore, this type of behaviour and strategic change is likely to become commonplace. It may be uncomfortable for those using the containerships to move their goods more slowly, but without it, the operational cost of ships is just too high with current technology. Freight rates may be coming more in line with operating costs than we have seen previously, and future tactics such as preferential trade routes and cargos are likely to affect prices further.

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The Marketplace for Recovered Paper

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