

Equities

14 August 2011 | 20 pages

Paper Clips

How Slow Can It Go? Positioning for Weaker Economic Growth

■ Industry Overview

- **What if the Economy Slows? Pulp and OCC Prices Should React First** — Recent macro concerns have placed a negative bias on GDP forecasts, potentially impacting pulp & paper demand and prices. An analysis of the last three recessions suggests that if weakness occurs it will first arise in global pulp and OCC markets, which are marked by volatility and active short-term trading.
- **Investment Strategy – Be Selective; Buy Klabin, PKG** — In a weakening macro environment we would not expect significant outperformance from the pulp & paper sector, given its correlation to the global economy and its high beta. However, **packaging producers in increasingly consolidated markets may be able to “ride out” the turbulence**. While we are not calling for a recession, we believe Packaging names are better positioned in a slowing economy given recent sector consolidation, improved balance sheets, and less pricing volatility. We prefer exposure to Klabin and Packaging Corp.
- **Containerboard and Freesheet Prices Have Become Less Cyclical** — In periods of economic slowdown pulp and OCC (old corrugated container) prices are likely to see the quickest deterioration as consumers begin to adapt to weaker demand and work down raw material inventories. Over the last three recessions (1991, 2001, 2008), Pulp and OCC prices fell the steepest (down 27%-34%), while Containerboard and Uncoated Freesheet prices held up relatively better (down 6%-9%).
- **Even if Markets Recover, Don't Expect a Quick Snapback for Pulp** — With N. American & LatAm pulp producer shares down 22% over the past month, investors have been increasingly focused on value opportunities. Yet the fundamental headwinds that were present prior to the most recent market turmoil are likely to limit any potential rebound, in our view. We are cautious on pulp in 2H11 given the risk of further pricing pressure, a softer rebound in Chinese demand, and 2013+ overcapacity.
- **Earnings Sensitivity: Fibria the Most Exposed to Pricing Volatility** — Assuming a weaker economic outlook Fibria's earnings would be the most negatively impacted as pulp is highly macro driven (for every \$10/mt move in pulp, our EBITDA forecast falls ~3%). In containerboard TIN has the largest earnings sensitivity to price changes in our coverage universe, but TIN's shares are likely to be driven by IP's hostile bid rather than near-term price fundamentals.
- **Watch Containerboard Shipment Data August 16, Pulp Data in late August** — For Pulp, we will be carefully watching upcoming global shipment and producer inventory data for signs of demand weakness – we expect a rise in inventories (+1 day) linked to seasonally slower summer activity. In US containerboard, we expect a mild seasonal rise in inventories (~0.2 weeks) from current relatively tight levels (3.6 weeks in June).

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What's Inside: In this monthly thought piece we provide analysis related to our theme of the month as well as several tables and graphs of monthly sector data

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Slower Growth Ahead

Recent economic turmoil has created downside risk to GDP forecasts. Last week Citi economists lowered their US GDP growth estimate for 2H11 (to 2.2% from 3.1%) due in part to the US debt crisis, and risks to growth next year are significant. We have gauged the potential risk to our price assumptions for the pulp & paper sector by analyzing the last three recessions. While we are not calling for a recession, our analysis suggests that if weakness occurs it will first happen in global pulp and OCC markets, which are marked by volatility and active short-term trading. In contrast, packaging producers may be better-positioned than in previous periods of economic weakness.

Recent selloff opens up value – yet potential outperformance in pulp remains limited. According to our valuations the sector offers attractive long-term value, yet the risk of continued fundamental headwinds through year-end (weak prices, slower China demand, rising inventories) limit the potential near-term investment opportunities in pulp. We think Packaging producers will be able to better ride out economic stress given recent sector consolidation, improved balance sheets post the 2008 crisis, and less pricing volatility.

Earnings Sensitivity Analysis: Pulp producers the most sensitive to a weaker outlook. In an environment of slower economic growth, pulp producer earnings would be the most negatively impacted. If pulp prices were to fall US\$100/tonne below our forecast in 2012, EBITDA generation for the LatAm pulp producers would fall 15-28% below our forecasts (Fibria is the most exposed to pulp price volatility). In containerboard, TIN has the largest earnings sensitivity to price changes in our coverage universe (\$10/ton change could impact EPS by ~\$0.22); however in our view TIN's shares are likely to be driven more by IP's hostile bid rather than price fundamentals in the near term. *See Figures 10-11 for more details.*

Analyzing Global Demand Trends

Adjusting for secular decline in some grades of paper, real demand for paper and paperboard products generally moves in-line with global GDP. As shown in figure 1, in years of economic slowdown pulp shipments tend to see the initial contraction in activity as consumers adapt to weaker demand and begin to work down inventory levels. However slower demand generally causes inventories to rise, causing operating rates to contract and pricing pressure to emerge (see Figure 2).

Figure 1. Global GDP vs. Paper Demand & Pulp Shipment Growth

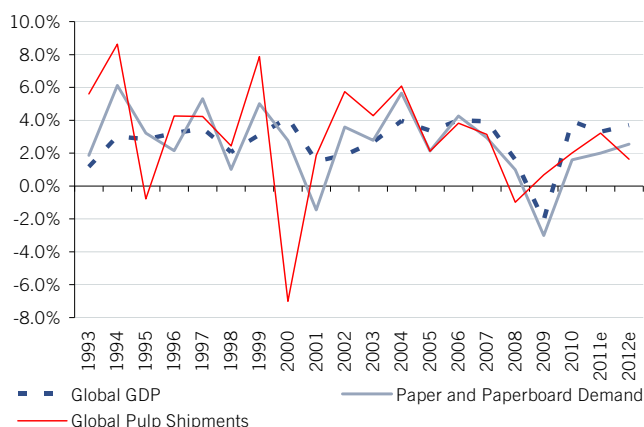
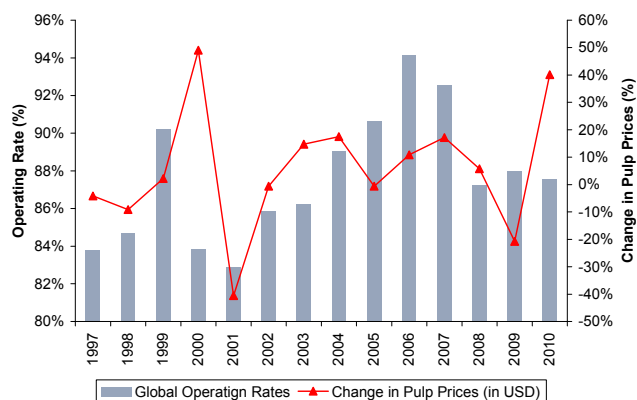


Figure 2. Operating Rates vs. Pulp Prices Change



Source: Citi Investment Research and Analysis, PPPC

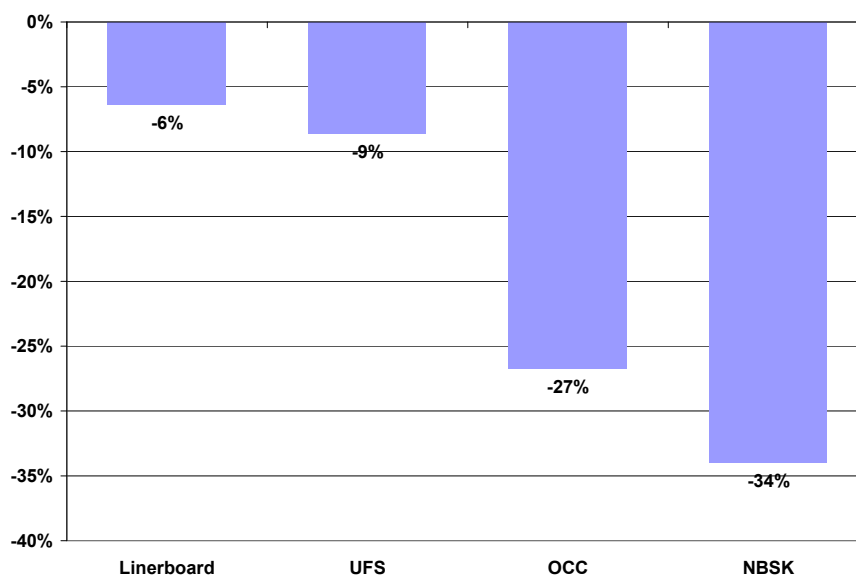
Source: Citi Investment Research and Analysis, PPPC

Figure 3 traces the average decline in product price through the first year of a recession.

Looking at the last three recessions (1991, 2001, 2008), NBSK and OCC prices fell the steepest, while Containerboard and Uncoated Freesheet prices held up relatively better.

In periods of economic slowdown pulp and OCC prices are likely to see the quickest deterioration.

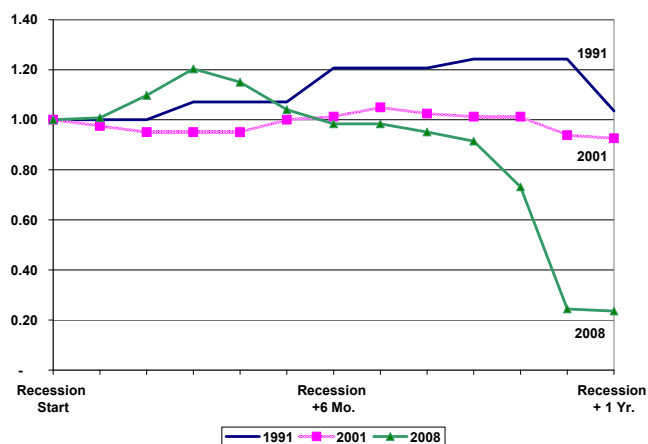
Figure 3. Product Prices Changes One Year into a Recession, Avg. Last Three Recessions



Source: Citi Investment Research and Analysis, Pulp & Paper Week

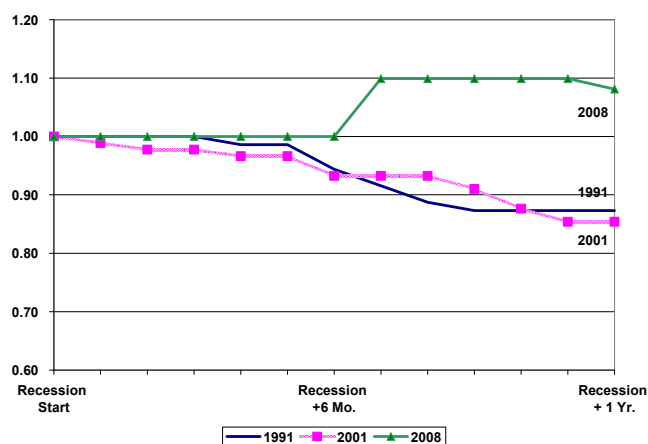
While investors might expect OCC prices to be more volatile than finished paper & packaging prices, this volatility has increased over time. Indeed, OCC prices were relatively stable in the first year of the 1991 and 2001 recessions, but plunged steeply in 2008 (-76%). We attribute this change to the growing role of China in the global market. China has become the largest market for recovered paper (63mmt, or 30% of global demand). The country imports 39% of the recovered paper it uses, and demand is expected to grow ~9% CAGR between 2010-2014. Chinese traders have been more likely to employ a “spigot on, spigot off” approach, entering and exiting the market due to short term price signals.

Figure 4. OCC Prices Have Become More Volatile in Downturns



Source: Citi Investment Research and Analysis, Pulp & Paper Week

Figure 5. While Containerboard Prices Have Become Less Volatile

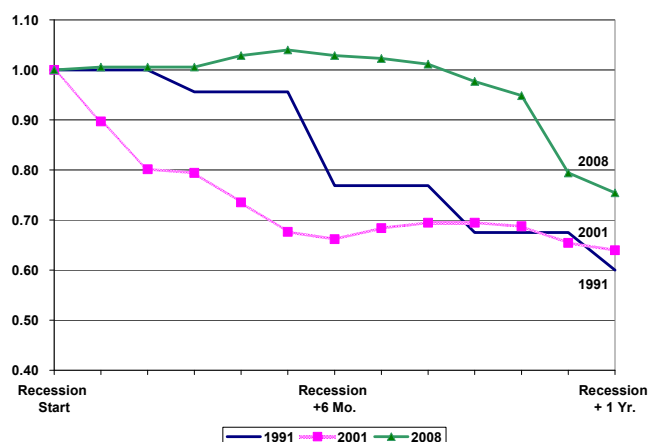


Source: Citi Investment Research and Analysis, Pulp & Paper Week

In stark contrast to the more volatile OCC market, product prices for containerboard held up significantly better in the last recession than they did in 2001 and 1991. Why? We view consolidation as a key driver of this dynamic, as the top 4 North American players now hold 68% of the market, as opposed to 35% a decade ago.

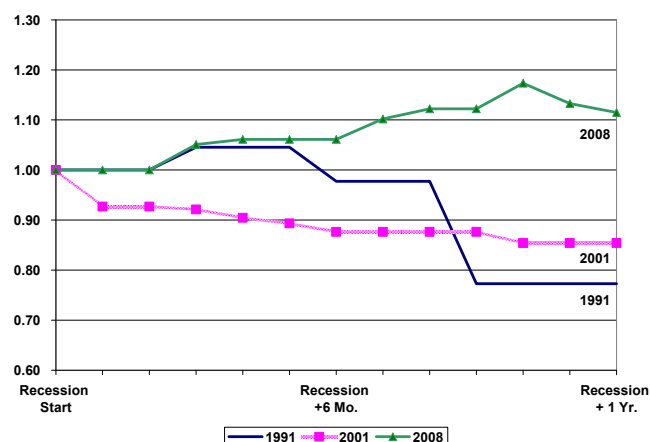
A similar dynamic can be seen with pulp and uncoated freesheet prices. Looking at the past three recessions, NBSK prices fell an average of 34% in the first year. While uncoated freesheet prices were also weak in the 1991 and 2001 recessions, in 2008 product prices actually rose.

Figure 6. NBSK Prices Remain Highly Sensitive to Slowing Growth



Source: Citi Investment Research and Analysis, Pulp & Paper Week, PPPC

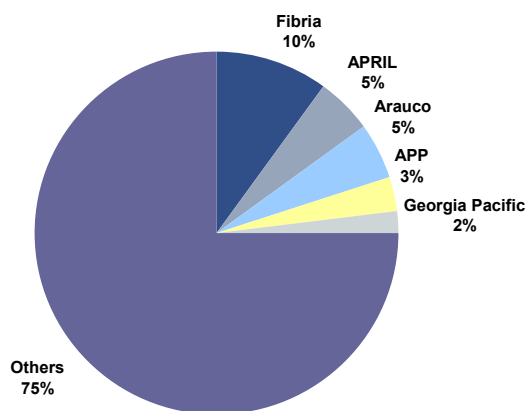
Figure 7. Uncoated Freesheet Prices Held Up Better in 2008



Source: Citi Investment Research and Analysis, Pulp & Paper Week

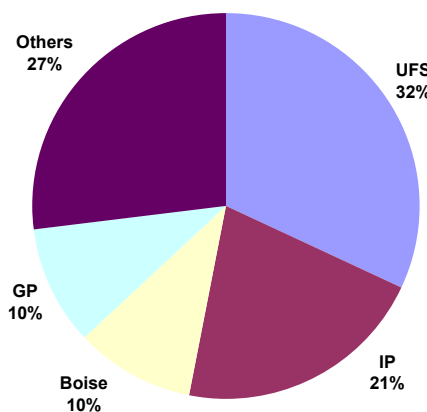
Again, the consolidation story has been key, with the top 4 North American players holding 73% of the market, as opposed to 48% a decade ago. In addition, North American producers are increasingly backwards-integrated into pulp, and more likely to capture the finished paper margins that accompany declining pulp prices.

Figure 8. Global Pulp Market Share, 2010



Source: Citi Investment Research and Analysis, Fibria, Hawkins Wright

Figure 9. North American Uncoated Freesheet Market Share, 2010



Source: Citi Investment Research and Analysis, Company Reports

This contrasts sharply to the highly fragmented global pulp market, where the top 4 producers hold only 23% of the market.

Bottom line – We prefer packaging-exposed names such as Klabin and PKG in a slower-growth environment. If economic growth improves, we don't expect pulp prices to meaningfully rebound as we head toward a 2013 supply-driven downcycle.

Earnings Sensitivity

Figures 10 & 11 show the pro forma EPS sensitivity to changes in containerboard and pulp prices for some of our largest names.

Figure 10. LatAm Pulp: Estimated Sensitivity to \$10/ton Pulp Price Change

	Fibria	Suzano	CMPC	Copec
Market Pulp Capacity (mm tonnes)	5.3	2.0	2.8	3.0
Pulp Price change (US\$/tonne)	10	10	10	10
Revenue impact (mm)	R\$ 83	R\$ 32	US\$ 28	US\$ 30
EBITDA impact (mm)	R\$ 76	R\$ 30	US\$ 27	US\$ 25
% of total	3%	1.8%	2%	1.3%
Est. tax rate	35%	35%	20%	20%
Earnings impact (mm)	R\$ 49	R\$19.7	US\$ 21.3	US\$ 22.8
Share count (mm)	468	409	110.0	1,300
EPS impact	R\$ 0.10	R\$ 0.05	US\$ 0.10	US\$ 0.02
% of Total	12%	6%	3%	2%
Official Forecasts				
2012 Pulp Price (BEKP) – US\$/mt	935	935	935	935
2012 Pulp Price (NBSK) – US\$/mt	815	815	815	815
2012 EBITDA (Citi Forecast) mm	R\$ 2,284	R\$ 1,669	US\$ 1,285	US\$ 2,324
2012 EPS (Citi Forecast)	R\$ 0.82	R\$ 0.81	US\$ 3.09	US\$ 0.98

Source: Citi Investment Research and Analysis, Company Filings, FactSet

Figure 11. US Containerboard: Estimated Sensitivity to \$10/ton Containerboard Price Change

	International Paper		Temple-Inland		Packaging Corp	
	IP		TIN		PKG	
Capacity (mm tons)	10.0		4.1		2.5	
Price change (\$/ton)	10		10		10	
Revenue impact (\$mm)	100		41		25	
Est. tax rate	33%		40%		35%	
Earnings impact (\$mm)	67.0		24.6		16.3	
Share count (mm)	430.5		110.8		101.5	
EPS impact	\$	0.16	\$	0.22	\$	0.16
% of Total	5%		12%		6%	
Citi Forecasts						
2012 Linerboard (\$/t)	\$685		\$685		\$685	
2012 EPS	\$	3.32	\$	1.82	\$	2.58
Source: Citi Investment Research and Analysis, Company Filings, FactSet						

We would stress that these sensitivities are rough estimates that reflect a pure change in price – in a real slow growth scenario the negative impact of falling prices would likely be partially offset by falling raw material costs for fiber, chemicals, freight, and other inputs.

Figure 12. Global Pulp & Paper Valuation Table

13-Aug-11	Main Product	Reuters ticker	Rec	Currency	Current Price	Target Price	ETR	Mkt Cap (US\$m)	P/E(x)				EV/EBITDA (x)				Net Debt/EBITDA		P/BV	Div Yield	FCF Yield	ROIC
									2009a	2010a	2011e	2012e	2009a	2010a	2011e	2012e	2010a	2011e	2010a	2011e	2011e	2011e
Latin America ¹																						
Empresas CMPC	Pulp/Tissue	CAR.SN	2M	CLP	21,101	26,500	28%	9,859	39.9	14.5	16.5	14.5	nm	11.8	10.5	9.9	2.5	2.3	1.3	1.9%	2.7%	6%
Empresas Copec	Diversified	COP.SN	2M	CLP	7,660	9,200	22%	21,147	36.8	20.9	18.3	16.6	nm	14.4	11.8	11.2	1.7	1.5	2.0	1.9%	2.6%	11%
Fibria	Mkt Pulp	FBR.N	2M	USD	8.98	13.80	56%	4,203	NA	11.5	21.0	17.6	10.3	6.1	6.4	5.7	3.6	3.3	0.4	3.9%	9.2%	1%
Klabin SA	Pkg	KLB.N4.SA	1H	BRL	4.82	7.10	52%	2,749	NA	19.4	31.4	14.9	9.4	7.0	6.8	5.4	2.2	2.0	0.9	4.3%	9.9%	1%
Suzano Papel	Pulp/Paper	SUZB5.SA	2H	BRL	8.46	12.00	48%	2,147	9.2	4.6	8.5	10.4	7.6	4.6	7.0	6.2	2.3	4.6	0.4	6.2%	-77.2%	5%
Masisa ¹⁰	Wood Prd	MSS.SN	2H	CLP	54.30	97.00	79%	803	18.9	11.1	10.5	5.9	6.2	4.7	3.6	2.7	3.1	2.2	0.6	2.7%	10.1%	4%
Duratex ¹⁰	Wood Prd	DTEX3.SA	2H	BRL	9.60	17.00	80%	3,278	29.2	12.0	10.2	8.4	16.0	6.9	5.5	4.6	1.1	0.9	1.5	2.5%	0.8%	13%
Sum/Average								44,186	26.8	13.4	16.6	12.6	9.9	7.9	7.4	6.5	2.4	2.4	1.0	3.3%	-6.0%	6%
North America ²																						
Buckeye Technologies	Mkt Pulp	BKI.n	NR	USD	26.19	NR	NM	1,045	45.2	29.8	11.7	9.1	12.1	10.4	na	4.4	1.8	na	na	n/a	n/a	n/a
International Paper ⁶	Diversified	IP.n	1H	USD	25.55	38.00	53%	11,038	28.8	12.4	8.7	7.7	6.2	5.1	4.3	3.7	2.0	1.5	1.6	3.8%	13.7%	8%
Kimberly-Clark	Tissue	KMB.n	1L	USD	65.14	71.00	13%	24,780	14.4	13.9	13.3	12.3	7.4	7.6	7.4	7.5	1.2	1.5	3.8	4.3%	4.0%	17%
Louisiana-Pacific	Wood Prd	LPX.n	NR	USD	6.61	NR	53%	874	na	na	na	na	nm	15.6	nm	9.5	4.2	5.4	na	n/a	n/a	n/a
MeadWestvaco	Pkg	MWV.n	NR	USD	26.94	NR	53%	4,598	34.5	17.5	13.6	11.8	8.6	6.5	5.8	5.5	1.4	1.5	na	n/a	n/a	n/a
Packaging Corp ⁶	Pkg	PKG.n	1M	USD	23.26	33.00	45%	2,352	25.0	14.4	13.6	9.0	8.0	6.3	6.3	4.4	1.1	1.2	2.3	3.2%	3.6%	11%
Plum Creek Timber	Wood	PCL.n	NR	USD	35.95	NR	45%	5,823	24.8	27.2	30.2	24.2	nm	nm	19.3	16.2	6.2	4.9	na	n/a	n/a	n/a
Rayonier	Mkt Pulp	RYN.n	NR	USD	58.46	NR	45%	4,748	39.0	26.1	na	na	14.8	12.3	10.3	9.8	0.8	0.6	na	n/a	n/a	n/a
Temple-Inland ⁶	Pkg	TIN.n	2H	USD	27.82	32.00	17%	3,005	39.2	30.8	25.9	15.2	2.8	2.9	2.4	1.6	1.6	1.2	2.9	1.9%	5.0%	6%
Weyerhaeuser	Wood Prd	WY.n	NR	USD	16.83	NR	17%	9,066	na	35.1	53.8	23.0	nm	12.2	11.4	9.5	3.5	3.2	na	n/a	n/a	n/a
Domtar Corp ⁶	Pulp&Paper	UFS.n	2H	USD	70.38	95.00	36%	2,949	66.1	6.4	6.5	7.5	6.8	3.0	2.6	2.8	0.3	nm	0.9	1.4%	24.7%	12%
Sum/Average								67,610	23.4	19.8	19.1	13.2	8.4	8.0	7.5	6.6	2.2	2.3	2.3	3%	10.2%	11%
Europe ³																						
Billerud	Pkg	BILL.ST	NR	SEK	49.10	na	na	789	24.2	7.2	6.6	7.6	7.3	3.2	2.9	3.0	nm	nm	na	n/a	n/a	n/a
Holmen	Paper	HOLMB.ST	NR	SEK	171.10	na	na	1,630	14.5	20.4	10.6	10.2	5.6	5.8	4.8	4.6	2.0	1.7	na	n/a	n/a	n/a
M-Real	Paper	MRLBV.HE	NR	EUR	1.60	na	na	665	na	7.0	11.9	6.0	nm	4.2	5.1	4.0	2.7	3.3	na	n/a	n/a	n/a
Smurfit Kappa	Pkg	SKG.I	1M	EUR	5.40	13.00	141%	1,707	NA	12.6	4.4	3.4	5.7	4.8	3.9	3.2	3.4	2.7	na	0.0%	4.4%	9%
Stora Enso	Paper	STERV.HE	1M	EUR	5.24	13.00	1.41	4,573	27.6	6.6	6.3	5.9	7.6	5.0	3.8	3.4	2.4	1.6	na	n/a	n/a	n/a
Svenska Cellulosa	Tis/Pkg	SCAB.ST	1M	SEK	85.80	13.00	1.41	7,998	10.2	9.7	10.0	8.5	5.6	5.4	5.5	4.7	2.1	2.2	na	n/a	n/a	n/a
UPM-Kymmene	Paper	UPM1V.HE	1M	EUR	9.39	13.00	1.41	7,021	85	9.5	8.3	7.3	8.2	6.1	5.3	4.4	2.4	2.3	na	n/a	n/a	n/a
Mondi Plc	Pkg/Paper	MNDI.L	1M	GBP	5.36	7.70	48%	2,578	33.5	13.2	9.4	7.7	7.2	5.1	4.2	3.6	1.5	1.1	1.0	4.6%	12.4%	-1%
Sum/Average								27,138	34.5	10.1	8.5	7.3	6.7	5.3	4.8	4.1	2.4	2.6	1.0	2%	8%	4%
Asia																						
Nine Dragons Paper ⁷	Pkg	2689.HK	1M	HKD	5.32	10.50	100%	3,183	17.8	9.2	9.8	7.3	14.5	9.5	11.2	9.0	3.6	5.3	1.0	1.0%	-31.3%	7%
Lee & Man Paper ⁷	Pkg	2314.HK	3M	HKD	3.65	4.70	32%	2,197	55.1	9.3	9.3	8.8	nm	8.4	8.5	8.1	2.3	2.5	1.6	3.6%	-3.0%	12%
Hengan	Tissue	1044.HK	2L	HKD	67.30	77.00	17%	10,614	NA	33.9	28.9	22.5	nm	nm	nm	15.8	nm	nm	na	2.3%	3.1%	n/a
Shandong Chenming	Paper	1812.HK	NR	HKD	3.88	NR	na	195	9.2	6.7	5.5	4.2	3.3	5.0	4.2	3.6	4.5	3.9	na	n/a	n/a	n/a
Vinda	Tissue	3331.HK	1L	HKD	8.61	10.50	23%	1,036	19.7	21.6	17.5	12.2	13.4	14.8	11.9	8.9	1.2	1.5	na	1.4%	-3.3%	18%
China Sunshine	Pkg/Paper	2002.HK	NR	HKD	2	NR	na	154	27.3	7.1	4.8	3.7	14.4	11.1	6.0	4.4	8.0	3.7	na	n/a	n/a	n/a
Sum/Average								26,844	25.8	14.6	12.6	9.8	na	8.9	8.4	8.3	4.2	3.9	1.3	2.1%	-8.6%	12%
Other Regions																						
Mondi Pkg Paper Swiecie ³	NA	CELA.WA	3M	PLN	71.70	71.00	9%	1,228	50.2	14.4	9.4	11.0	19.6	8.4	6.4	7.3	1.0	0.1	2.5	0.0%	12.2%	21%
Sappi ⁵	Fine Paper	SAPJ.J	2M	USD	25.70	38.00	48%	1,922	na	35.8	35.5	8.1	9.6	5.1	3.9	3.3	3.0	2.2	1.0	0.0%	11.3%	-10%
Sum/Average								3,150	50.2	25.1	22.4	9.5 #	14.6	6.7	5.2	5.3	2.0	1.1	1.7	0.0%	11.7%	5%
Total Average								168,927	27.0	15.9	15.8	11.5	7.3	7.5	7.0	6.3	2.5	2.6	1.6	2.7%	2.7%	9%

¹ Companies Covered by CIR Analyst Juan Tavarez. ² Company figures are derived from IBES. ³ Mondi Pkg Paper Swiecie is covered by CIR analyst Rafal Wiatr. ⁴ Covered by CIR analyst Julian Bu. ⁵ Covered by CIR analyst Tassin Meyer.

⁶ Covered by CIR analyst Anthony Pettinari. ⁷ Covered by CIR analyst Eric Lau. ⁸ Consensus sourced from IBES. ⁹ Europe Companies are consensus figures sourced from IBES. ¹⁰ Covered by CIR analyst Luis Vallarino. KMB is covered by CIR analyst Wendy Nicholson.

Source: Citi Investment Research and Analysis

Figure 13. Investment Thesis

Company	Ticker	Product(s)	Country	Rating	Investment Thesis
Suzano	SUZB5.SA	Pulp/Paper	Brazil	2H	Overlooked value; yet leverage concerns creates an overhang in the stock
Fibria	FBR	Pulp/Paper	Brazil	2M	Attractive valuation, yet exposure to pulp cycle and global growth outlook
Klabin	KLBN4.SA	Packaging	Brazil	1H	Support from strong GDP expectations, indirect play on Brazilian consumer
Empresas CMPC	CAR.SN	Pulp/Paper	Chile	2M	Fair valuation; Strong earnings growth, Positive growth initiatives priced in
Empresas Copec	COP.SN	Mkt Pulp	Chile	2M	Fair valuation; Growth prospects are priced in

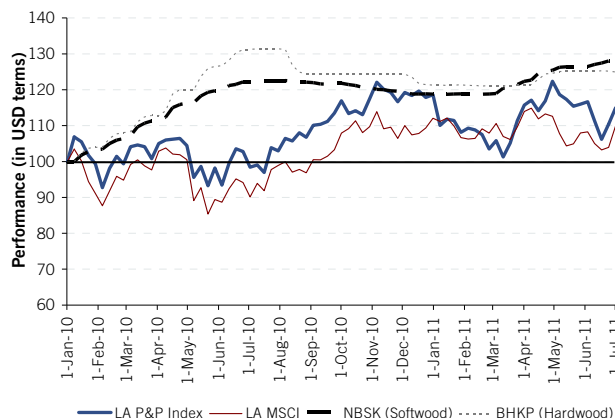
Source: Citi Investment Research and Analysis

Figure 14. LatAm Pulp & Paper Share Price Performance

Company	Rating	Price 13-Aug-11	Target Price	Expected Total Return	Market Cap (US\$ mln)	Performance (in USD)			Perf. (USD) YTD	Daily Liq. (US\$ mln)
						1 month	6 months	1 year		
Fibria	2M	US\$9.0	US\$13.8	56.1%	4,203	-26%	-41%	-44%	-44%	23.2
Suzano Papel	2H	R\$ 8.46	R\$ 12.0	48.0%	2,147	-23%	-37%	-43%	-41%	8.9
Klabin	1H	R\$ 4.82	R\$ 7.1	51.7%	2,749	-12%	-9%	10%	-15%	8.8
Empresas CMPC	2M	CLP 21,101	CLP 26,500	28.4%	9,859	-15%	-9%	-2%	-16%	4.2
Empresas Copec	2M	CLP 7,660	CLP 9,200	22.0%	21,147	-13%	-7%	-6%	-16%	8.8

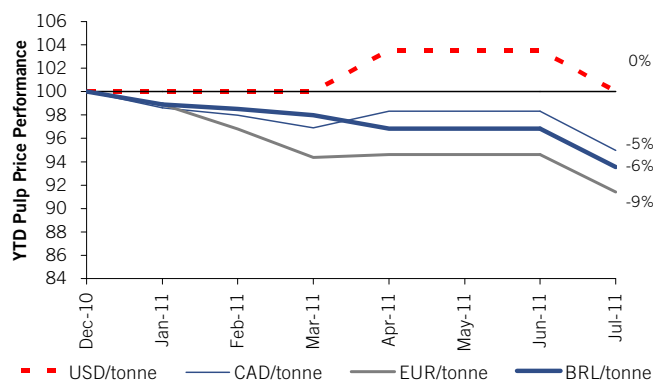
Source: Citi Investment Research and Analysis

Figure 15. Performance (since Jan/10) LA P&P Index, LA MSCI, Pulp Prices



Source: Citi Investment Research and Analysis

Figure 16. Hardwood Pulp Prices (in various currencies) , since Dec/10



Source: Citi Investment Research and Analysis

Figure 17. Pulp Price Forecasts (in US\$ per tonne)

AVERAGE PULP PRICES	2005A	2006A	2007A	2008A	2009A	2010E	2011E	2012E	2013E	2014E	Normalized
Eucalyptus Pulp (US\$/tonne)*	578	640	703	785	565	848	846	815	700	655	680
y-o-y growth	9%	11%	10%	12%	-28%	50%	0%	-4%	-14%	-6%	4%
Softwood Pulp - NBSK (US\$/ tonne)*	614	681	798	843	668	937	986	935	790	725	750
y-o-y growth	-1%	11%	17%	6%	-21%	40%	5%	-5%	-16%	-8%	3%
Hardwood/Softwood Spread	(36)	(41)	(95)	(58)	(103)	(88)	(140)	(120)	(90)	(70)	(70)
YEAR-END PRICES	DEC/05	DEC/06	DEC/07	DEC/08	DEC/09	DEC/10	DEC/11	DEC/12	DEC/13	DEC/14	
Eucalyptus Pulp (US\$/tonne)*	590	680	780	600	700	850	810	760	630	655	
Softwood Pulp - NBSK (US\$/ tonne)*	610	730	875	660	800	950	950	880	720	725	

*delivered to Europe / Normalized Prices are based on 10-year average

Source: Citi Investment Research and Analysis

P&P Sector Performance

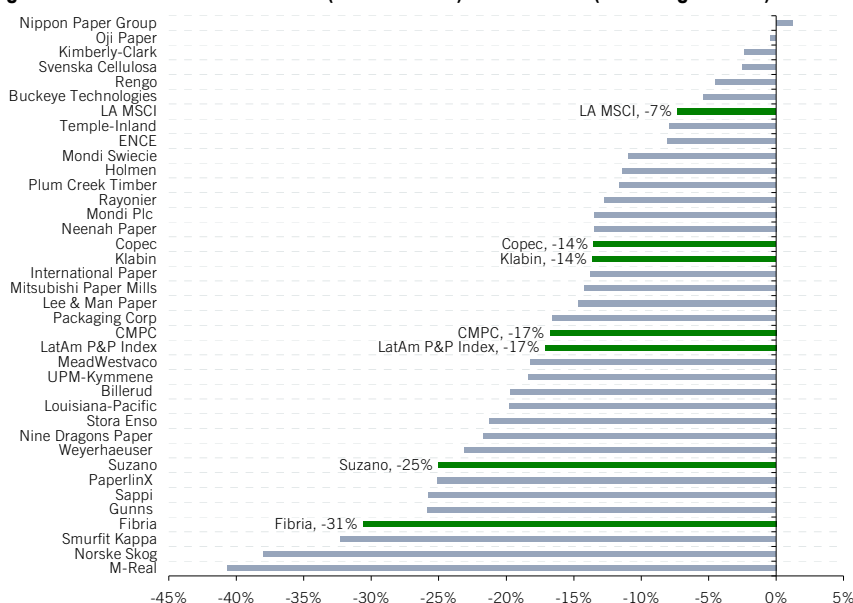
Performance Review: While the Latam P&P stocks were in negative territory, the stocks less exposure to pulp outperformed its local P&P peers. Copec was down up 14% and Klabin was down 14%. YTD the highlight go the underperformance of Suzano down 19% and Fibria down 18%.

Catalysts for Aug/11: We expect continuous negative momentum for the pulp stocks as recently we confirmed a price cut of \$30/ton in hardwood pulp for Europe.

One-Month Performance

Within the Global Sector, Nippon Paper was the winner (up 1%) and M-Real underperformed (down 41%).

Figure 18. Share Price Performance (in USD terms) – One Month (as of Aug 12 2011)

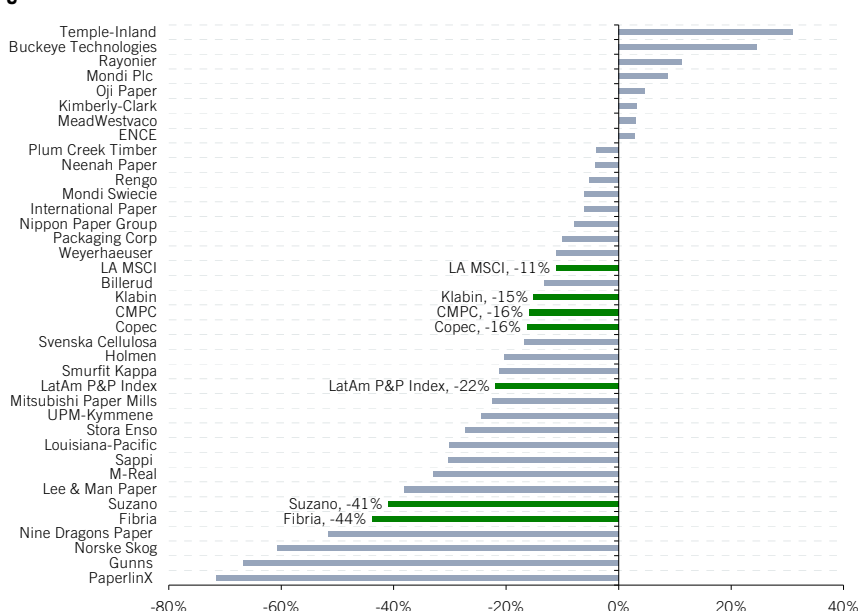


Source: Citi Investment Research and Analysis

Year-to-Date

Regardless of the negative performance in our Latam coverage the winner was Klabin (down 15%), while the Brazilian Pulp stocks Suzano (down 41%) and Fibria (down 44%) underperformed.

Figure 19. Share Price Performance – Year-to-Date



Source: Citi Investment Research and Analysis

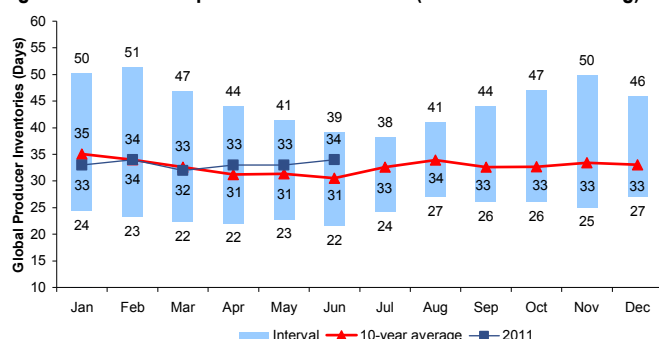
Industry Fundamentals

Producer Inventories – June pulp producer inventories increased to 34 days of supply vs. 33 days in May and 25 days last year. Hardwood inventories remained flat at 42 days (above its 37 day historical average), while Softwood increased by 2 days to 28 days (nearing its 29 day historical average).

A Look Ahead – Our recent conversations with industry sources suggest that July buying activity will follow a typical seasonal slowdown; historically July pulp producer inventories have increased by 3 days.

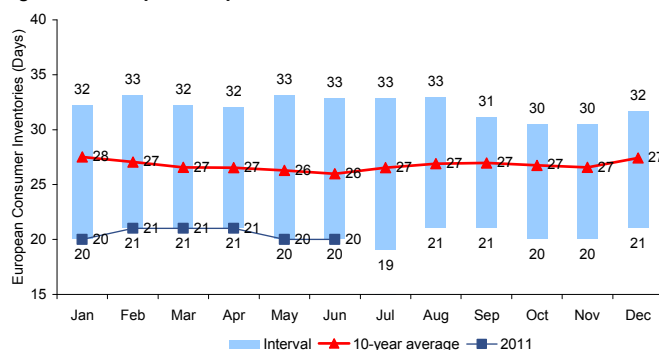
Operating Rates – World-20 shipment data increased to 3.6 million tonnes (+4.8% M/M, and +3% Y/Y), reflecting improved activity in North American and China. Among the pulp grades, hardwood pulp shipments (+13% M/M) led the rise in global shipment activity as operating rates among producers rebounded to 91%, with Eucalyptus at 100%.

Figure 20. Global Pulp Producer Inventories (2011 vs. Historical Avg)



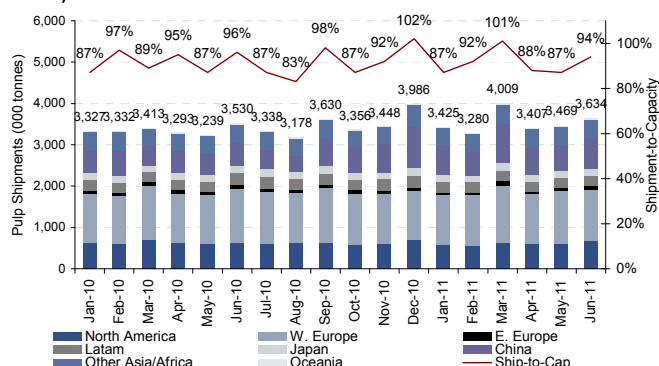
Source: PPPC and Citi Investment Research and Analysis

Figure 22. European Pulp Consumer Inventories



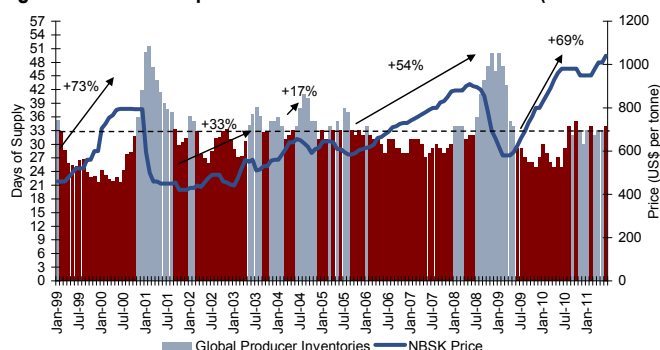
Source: Utipulp and Citi Investment Research and Analysis

Figure 24. World-20 Pulp Shipments vs. Shipment/Capacity (Since Jan/10)



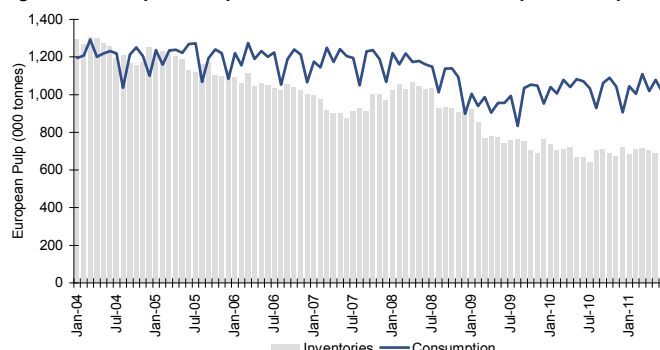
Source: PPPC and Citi Investment Research and Analysis

Figure 21. Global Pulp Producer Inventories vs. NBSK Px (Since Jan/99)



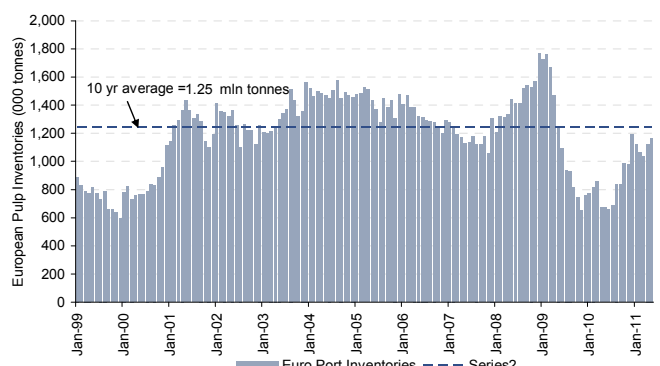
Source: PPPC and Citi Investment Research and Analysis

Figure 23. European Pulp Consumer Inventories vs. Pulp Consumption



Source: Utipulp and Citi Investment Research and Analysis

Figure 25. European Pulp Port Inventories (Since Jan/99)



Source: Europulp and Citi Investment Research and Analysis

Pulp Prices

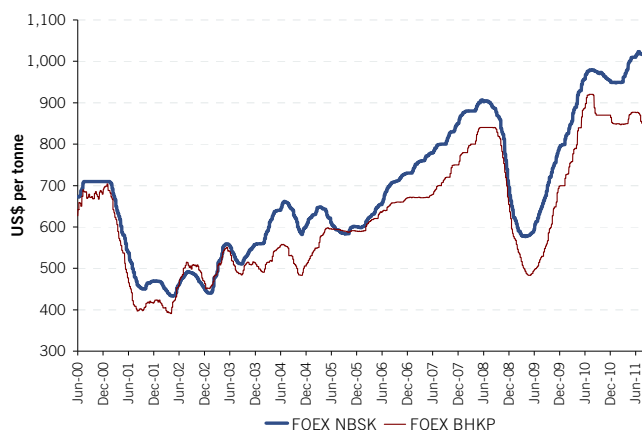
- **Pulp Price down** – Pulp price decreased to Europe. NSBK was down 2% m-o-m at US\$1,004/tonne and BHKP was down 3.8% m-o-m at US\$ 841/tonne. Recently pulp producers announced price decrease in Aug, US\$30/tonne in BHKP to Europe and a decrease of \$30/tonne in NSBK to US.

Figure 26. FOEX Pulp Price Index Performance

Pulp Price - FOEX PIX Indices	Bloomberg Index Code	Units	Price 4-Aug-11	1 month	6 months	YTD	1 year
NBSK (Softwood) - to Europe		FOEXNBSK					
in USD		USD/tonne	1,004	-1.9%	5.7%	5.8%	2.6%
in Euro		EUR/tonne	712	1.1%	1.8%	0.3%	-4.3%
In BRL		BRL/tonne	1,593	0.3%	0.3%	1.2%	-7.1%
BHKP (Hardwood) - to Europe		FOEXBHKP					
in USD		USD/tonne	841	-3.8%	-0.9%	-1.0%	-8.5%
in Euro		EUR/tonne	596	-0.9%	-4.6%	-6.1%	-14.6%
In BRL		BRL/tonne	1,335	-1.7%	-6.0%	-5.3%	-17.0%
Hardwood/Softwood Spread		USD/tonne	(163)	(161)	(132)	(102)	(113)

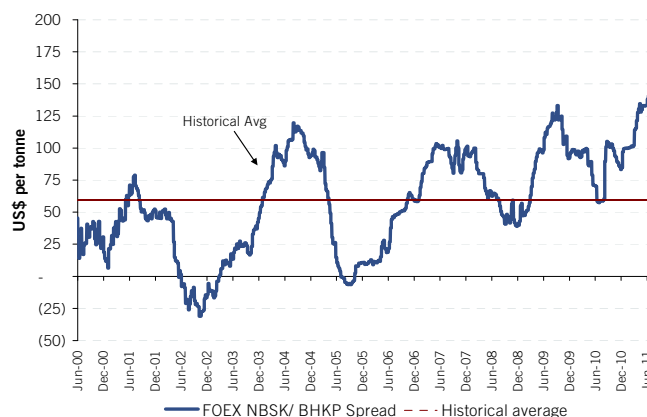
Source: FOEX and Citi Investment Research and Analysis

Figure 27. Pulp Prices (FOEX NBSK vs. FOEX BHKP)



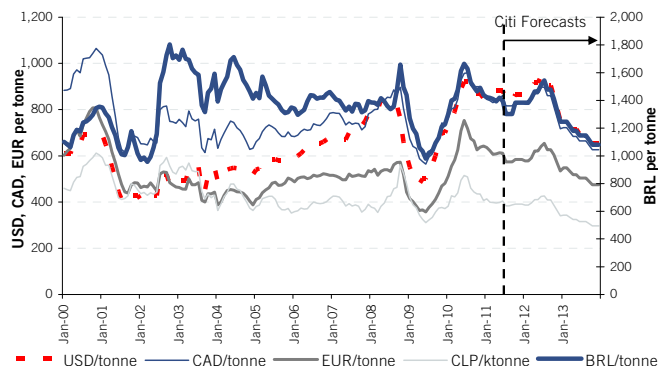
Source: FOEX and Citi Investment Research and Analysis

Figure 28. Spread - NBSK vs. BHKP



Source: FOEX and Citi Investment Research and Analysis

Figure 29. Hardwood Pulp (BEKP) in various currencies



Source: FOEX and Citi Investment Research and Analysis

Figure 30. Pulp List Prices

BEKP Pulp List Prices								
Region	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Announcement (Aug/11)
North America	900	900	900	930	930	930	900	\$0/tn
Europe	850	850	850	880	880	880	850	-\$30/tn
China	750	750	750	780	780	780	730	\$0/tn
NBSK Pulp List Prices								
Region	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Announcement (Aug/11)
North America	960	960	990	990	1,020	1,040	1,020	-\$30/tn
Europe	950	950	980	980	1,010	1,040	1,020	\$0/tn
China	850	860	890	890	920	920	850	\$0/tn

Source: Citi Investment Research and Analysis

Paper Prices

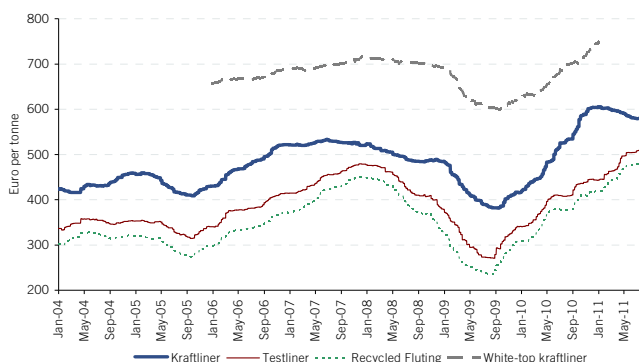
- **Paper Price:** Highlight to OCC prices decreasing by 1.5% m-o-m, but not enough to offset the price pressure seen since last year (up 24% YTD and up 34% y-o-y). Packaging paper looks the most favorable paper for 2011 as demand keep healthy and raw material cost remains at high levels.

Figure 31. FOEX Paper & Packaging Index Performance

Paper & Packaging Prices	Bloomberg Index Code	Units	Price 4-Aug-11	1 month	Performance 6 months	YTD	1 year
Paper Prices - FOEX PIX Indices							
Lightweight Coated (LWC) - Europe	FOEXLWC	EUR/tonne	691	0.6%	2.9%	5.8%	7.8%
Coated Woodfree - Europe	FOEXCTD	EUR/tonne	714	-0.6%	-0.8%	-0.5%	1.6%
A4 B-grade Copy paper - Europe	FOEXA4BC	EUR/tonne	870	-0.5%	0.2%	0.6%	5.4%
Newsprint - Europe	FOEXSTD	EUR/long ton	502	0.4%	13.7%	19.4%	22.1%
Newsprint - US	FOEXUSNP	USD/tonne	624	0.0%	-0.3%	-0.3%	3.8%
Packaging Paper Prices - FOEX PIX Indices							
Kraftliner - Europe	FOEXKFT	EUR/tonne	580	-0.2%	-3.7%	-4.1%	10.2%
White-top Kraftliner - Europe	FOEXWKFT	EUR/tonne	786	0.6%	5.3%	5.4%	13.1%
Testliner - Europe	FOEXTST	EUR/tonne	511	1.2%	14.8%	15.2%	25.4%
Testliner 3 - Europe	FOEXTST3	EUR/long ton	489	-0.4%	13.4%	13.3%	24.8%
Recycled Fluting - Europe	FOEXRBF	EUR/tonne	478	-0.3%	14.0%	14.1%	26.2%
Recovered Paper: OCC - Europe	FOEXOCC	EUR/tonne	154	-1.5%	18.9%	24.1%	33.6%

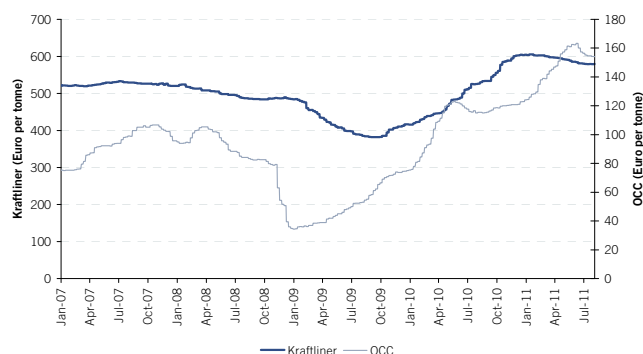
Source: FOEX and Citi Investment Research and Analysis

Figure 32. Paper Prices (Since Jan '03) – FOEX Index



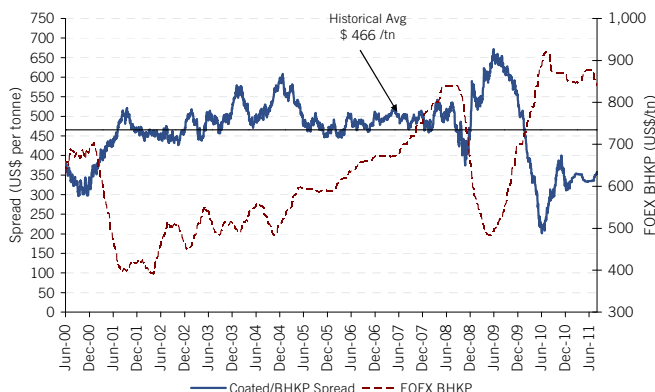
Source: FOEX and Citi Investment Research and Analysis

Figure 33. Packaging Paper Prices (since Jan '04)



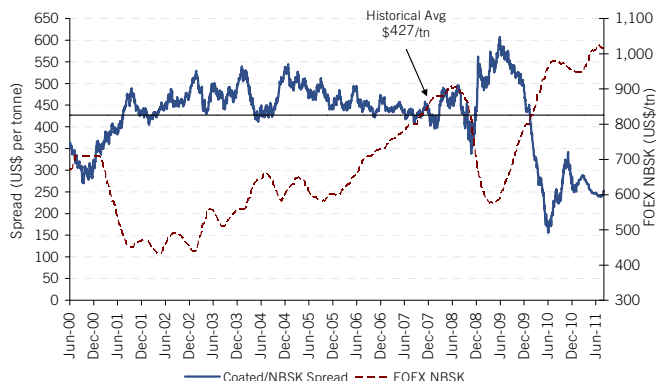
Source: FOEX and Citi Investment Research and Analysis

Figure 34. Coated Paper/BHKP Spread vs. BHKP Price (Since Jun '00)



Source: FOEX and Citi Investment Research and Analysis

Figure 35. Coated Paper/NBSK Spread vs. NBSK Price (since Jun '00)

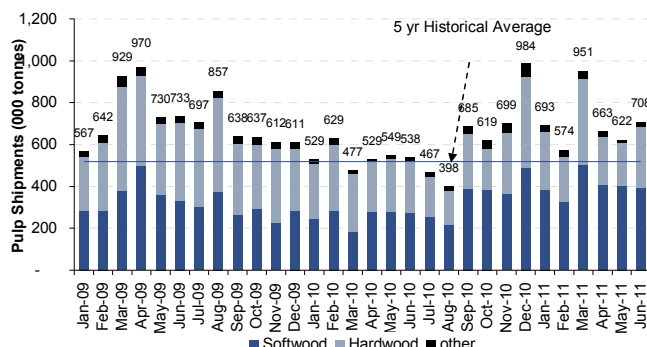


Source: FOEX and Citi Investment Research and Analysis

China Activity

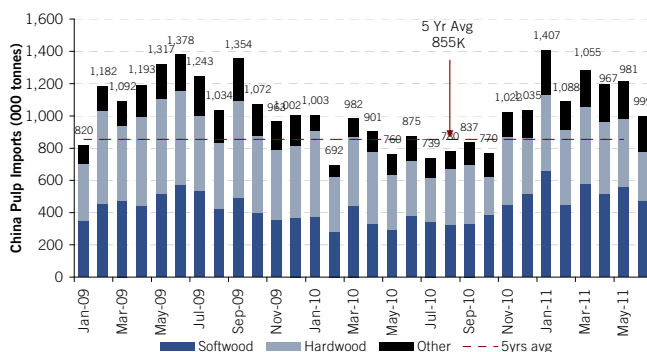
- **Pulp Shipments to China (PPPC data):** China shipments increased 14% m-o-m to 708k mt. While Brazilian export data indicated a 9% drop m-o-m in pulp, the difference in PPPC data as it accounts for “invoiced” shipments, which indicates to us that if Brazil “port” exports were down in June, producers sold inventories located abroad. Hence a rise I inventories at “home” were offset by a reduction of inventories located overseas.
- **BR Pulp Export to China:** Soft Brazilian exports to China of 85,000 tonnes (-9% m-o-m, -35% y-o-y). Despite the price cut by \$50/ton in BHKP effectively in July, we expect pulp exports to remain soft also in August.

Figure 36. Pulp Shipments to China (Since Jan/09)



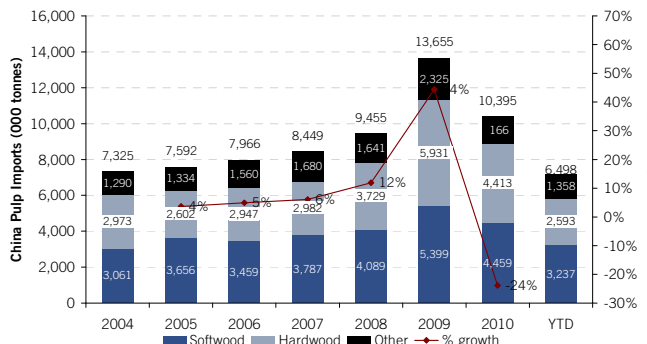
Source: PPPC, Citi Investment Research and Analysis

Figure 38. China Pulp Imports (Since Jan/09)



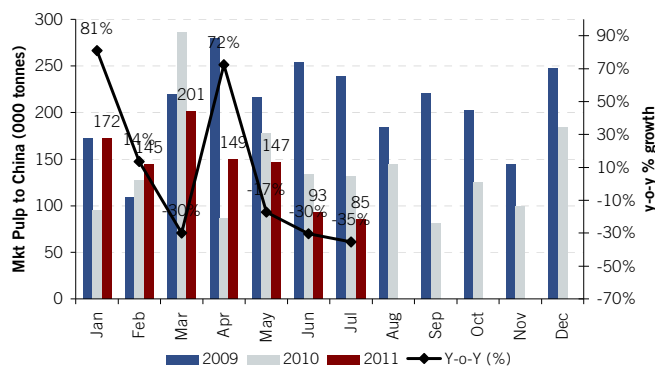
Source: RISI, Citi Investment Research and Analysis

Figure 40. China Pulp Imports (2004-YTD)



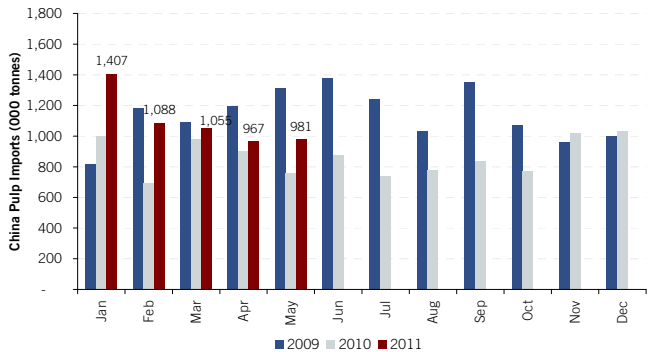
Source: RISI, Citi Investment Research and Analysis

Figure 37. Brazil Pulp Exports to China – (Since Jan/09)



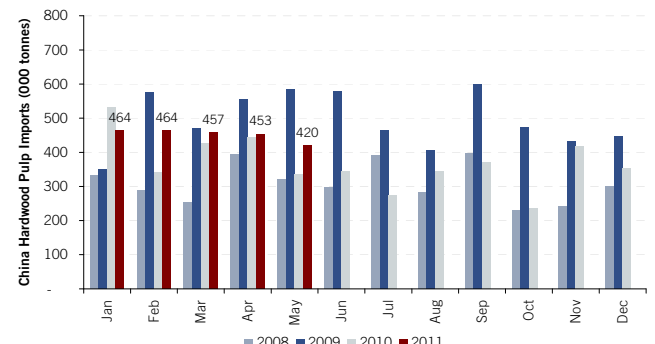
Source: MDIC/ SECEX, Citi Investment Research and Analysis

Figure 39. China Pulp Imports (Since Jan/09)



Source: RISI, Citi Investment Research and Analysis, Bloomberg

Figure 41. China Hardwood Pulp Imports (Since Jan/08)



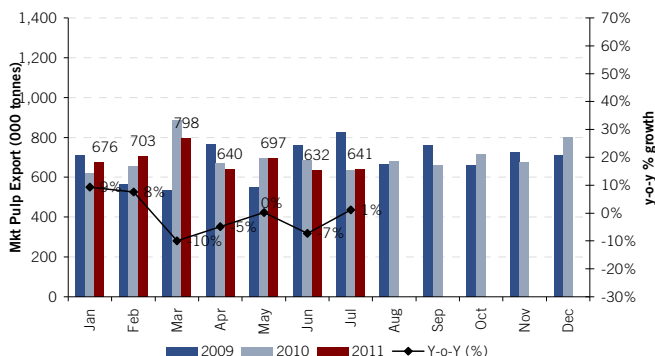
Source: RISI, Citi Investment Research and Analysis

Brazil Trade Activity

■ **July Brazil Pulp Activity:** Brazilian pulp exports increased to 641,000 tonnes, up 1% m-o-m and 1% y-o-y. YTD pulp exports are flat as stronger pulp activity in Europe has offset the weakness in the US and Asia (ex China).

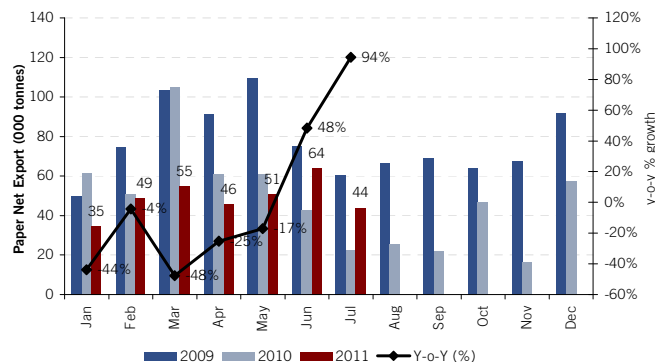
■ **July Brazil Paper Activity:** Paper imports eased across all grades, down 7% m-o-m to 113k tonnes, while weakness in kraftliner exports of 17k tonnes drove a 30% m-o-m drop in paper exports.

Figure 42. Brazilian Pulp Exports- Monthly (2009-11)



Source: SECEX/MDIC and Citi Investment Research and Analysis

Figure 43. Brazilian Paper Net Exports- Monthly (2009-11)



Source: SECEX/MDIC and Citi Investment Research and Analysis

Figure 44. Brazilian Pulp & Paper Trade – Monthly

BRAZIL PULP EXPORTS		Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11
Total Exports (000 tonnes)		633	677	661	716	674	800	676	703	798	640	697	632	641
Y-o-Y Growth		-23%	1.8%	-13.3%	8.2%	-6.9%	12.8%	9.3%	7.5%	-9.9%	-4.9%	0.2%	-7.3%	1.1%
Europe		315	325	367	411	343	411	289	342	331	340	419	284	387
US		134	135	151	124	174	108	111	149	153	124	103	182	110
China		131	144	81	125	100	184	172	145	201	149	147	93	85
Asia (ex China)		49	69	60	51	51	93	90	60	109	23	23	59	50
to Other Regions		5	4	2	4	6	3	14	6	4	3	6	14	8
Export Mix														
Europe		50%	48%	56%	57%	51%	51%	43%	49%	41%	53%	60%	45%	60%
US		21%	20%	23%	17%	26%	14%	16%	21%	19%	19%	15%	29%	17%
China		21%	21%	12%	18%	15%	23%	25%	21%	25%	23%	21%	15%	13%
Asia (ex China)		8%	10%	9%	7%	8%	12%	13%	9%	14%	4%	3%	9%	8%
to Other Regions		1%	1%	0%	0%	1%	0%	2%	1%	1%	1%	1%	2%	1%
Exports/Capacity		76%	82%	80%	86%	81%	96%	82%	85%	96%	77%	84%	76%	77%
PAPER/ PAPERBOARD NET EXPORTS		Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11
Total Net Exports (000 tonnes)		23	25	22	47	17	57	35	49	55	46	51	64	44
Y-o-Y Growth		-63%	-62%	-68%	-27%	-75%	-38%	-44%	-4%	-48%	-25%	-17%	48%	94%
Coated		-31	-36	-30	-30	-32	-30	-32	-30	-39	-29	-22	-24	-21
Uncoated		69	52	63	62	69	74	57	52	74	67	73	82	63
Kraftliner		14	17	18	20	20	23	30	25	25	27	20	23	16
Other		-29	-8	-29	-5	-40	-11	-21	0	-5	-19	-21	-17	-14
Imports		138	133	137	111	150	120	138	120	135	138	122	122	113
Coated		34	39	32	33	36	34	36	33	43	32	24	28	25
Uncoated		17	24	22	19	20	18	17	20	17	21	17	15	18
Kraftliner		0	0	0	0	0	0	0	0	0	0	0	1	0
Other		87	70	82	60	94	68	85	67	74	85	81	78	69
Exports		161	158	159	158	167	178	172	168	190	183	173	186	157
Coated		3	3	2	3	3	5	4	3	4	3	2	4	4
Uncoated		86	76	85	81	88	92	74	72	91	87	90	97	81
Kraftliner		14	17	18	20	20	23	30	26	25	28	20	24	17
Other		57	62	53	54	54	57	64	67	69	66	60	61	55

Source: SECEX/MDIC and Citi Investment Research and Analysis

Below we provide links to recent research reports written by CIRA analysts over the past month.

Pulp & Paper Estimate Update - Adjusting Estimates Based on Softer China Pulp Buying, Lowered GDP Assumptions;

June Containerboard Data - Soft Shipments but Inventories Remain Balanced;

Paper Bulletin - Superior returns in developing market packaging;

South African Paper - Earnings improving but headwinds gaining momentum;

Packaging Corp of America (PKG) - Strong 2Q, but Rising Costs Keep 3Q Outlook Muted;

Packaging Corp of America (PKG) - Energy Project Risks Receding, Rewards in Plain Sight; Reiterate Buy;

Global Market Pulp - The Peak has Passed; Correction but No Collapse as China Takes a Breather;

LatAm Pulp & Paper - Getting Worse Before it Gets Better; Moving to the Sidelines;

Market Pulp Activity – June '11 - A Rebound in Shipments Helps Balance Producer Inventories;

Temple-Inland Inc (TIN) - After Solid 2Q, Negotiated Transaction Remains Most Likely Outcome for IP Bid;

LatAm Pulp & Paper - Cost Pressures Win Round Two; 2Q11 Previews;

Fibria Celulose SA (FBR) - As Expected, Cost Pressures Dominate 2Q11 Results;

International Paper Co (IP) - Solid 2Q Beat Driven by Ilim JV, Cost Management;

International Paper Co (IP) - The Best of Both Worlds: Long-Term Strategy and Day-to-Day Execution;

Domtar Corp (UFS) - Softening Pulp Cycle Keeps Us on the Sidelines; Hold;

Fibria Celulose SA (FBR) - The Battle to Protect Returns; Quantifying Mgm't Initiatives;

Klabin SA (KLB4.SA) - In-line 2Q11; Extended Downtime Pressures Margins;

Sappi Ltd (SAPJ.J) - Q3 — All About Costs; Disappointing Outlook;

Pulp Price Radar - The Summer Cool Down Continues in August: BEK down \$30/t in Europe, NBSK down \$30/t in the US;

Mondi Swiecie S.A. (CELA.WA) - 2Q11 Results Above Expectations Supported by One-Off Item;

Fook Woo Group Holdings (0923.HK) - Better Clarity on Shareholding Structure; Buy;

International Paper Co (IP) - Extended Tender Offer for TIN a Vote of Confidence in Turbulent Times;

Smurfit Kappa Group (SKG.I) - Solid Q2 and Latam Upside; Reiterate Buy;

Suzano Papel e Celulose SA (SUZB5.SA) - Weak 2Q11 Results: Bigger Costs = Bigger Miss.;

Empresas CMPC SA (CAR.SN) - 2Q11: Volume Recovery Continues, Yet Below Expectations;

Fibria Celulose SA (FBR) - Oji Paper Makes a US\$313m Offer for Piracicaba Paper Asset...At Low End of Our Range, But We'll Take It;

July Paper Volumes - Uncoated Freesheet In-line as Exports Help Balance Market

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Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30 June 2011 is as follows: Buy (1) representing 30% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 36% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 34% of the DMBH coverage 0% of which are IB clients.

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of International Paper Co, Louisiana-Pacific Corp, Smurfit Kappa Group, Temple-Inland Inc, Weyerhaeuser Co. This position reflects information available as of the prior business day.

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