Eastern Canada Pulp and Paper
...industrial transition during uncertain times

Unifor Wage Policy Conference
Montreal, February 14-16, 2018
Bill Murnighan
Director, Research Department
Outline

1. Global Context
2. Canadian Industry
3. Major Product Lines
4. Corporate Finances
5. Bargaining Outcomes
6. Comments
The crisis and transition
...taking stock

• A decade out from the collapse of Wall Street, Canadian workers have been through several crises.
• All of Canadian manufacturing hit: 400,000 jobs lost in the decade. Pulp and paper among hardest hit sectors.
• The 2014 Wage Policy Conference took place in a steady, but weak, economic recovery. The question then: Is the crisis over?
• Yes, but long-term structural shifts still at work, leading to ongoing transition in industry, combined with new uncertainties around trade and market access.
1. Global Context
Global industry still restructuring …contrasting forces deliver varied results

• Digital media overtakes printed media, newspapers in crisis, driving down all graphic paper.
• But surging growth in developing countries counter-acts to a degree, and shifts demand.
• Explosion of on-line retail driving strength in packaging.
• Variable results:
  – mature vs. developing markets
  – graphic vs. packaging and tissue
Deep shift of capacity...

..moderate overall growth

- Global demand up 3% since 2013.
- Up 1% last year, modest growth ahead.
- But packaging up 10%, while papers decline.

Source: RISI
2. Canadian Industry
Where were we?
...hit before and during global financial crisis

✗ Already dramatic structural decline in demand across all graphic papers before 2008-09.
✗ Canada’s focus on newsprint, world’s leading supplier, particularly in Eastern Canada.
✗ Dramatic rise in dollar: + 30% from 2004-2008.
✗ Financial crisis: global paper demand fall hard, mature markets hit, developing markets slow.

= Crisis: dramatic cuts to output, employment and several bankruptcies.
Now? Positive momentum  
...better economic conditions

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<thead>
<tr>
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<th>Then (February 2014)</th>
<th>Now (February 2018)</th>
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<tbody>
<tr>
<td>U.S. Economic Growth</td>
<td>1.9%</td>
<td>2.3%</td>
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<tr>
<td>U.S. Unemployment</td>
<td>6.7%</td>
<td>4.1%</td>
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<tr>
<td>Canada Economic Growth</td>
<td>2.5%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Canada Unemployment</td>
<td>7.0%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Canadian Dollar</td>
<td>91¢</td>
<td>81¢</td>
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</table>

Canadian output
...relative stability over last four years

- Newsprint saw hard slide in decade prior to 2013: lost half.
- More stability since then.

Source: Natural Resources Canada
Pulp and paper value largely recovered …increase over last four years

- Grew by $4 billion since 2013.
- Better and stable prices, combined with lower dollar.

Source: Statistics Canada, CANSIM Table 204-0014
Transitioning to stronger markets …two-thirds not graphic papers

Value of Shipments, 2017

- Pulp, 28%
- Converted, 36%
- Paper, 12%
- Paperboard, 7%
- Newsprint, 17%

Source: Statistics Canada, CANSIM Table 204-0014
Four of five segments increase in value
...newsprint decline no surprise

Value of Shipments, by Segment, 2007-2017

Source: Statistics Canada, CANSIM Table 204-0014
Employment stabilizes
...half decade of relative overall stability

• Just 5% decline in overall employment since 2014.
• Compared to half lost in decade prior.
• Tiny uptick last year.

Source: Statistics Canada, CANSIM Table 281-0024
Industry-wide earnings fall then recover …another sign of returning stability

• Average for whole industry.
• The year 2009 unmeasurable
• Real incomes mostly flat.
• Increases last few years a positive sign.

Source: Statistics Canada, CANSIM Table 281-0029
Exports remain strong ...healthy trade balance

- Rare trade surplus in manufacturing.
- $1.4 billion increase in exports since 2014.
- Lower dollar helps.

Source: Industry Canada, Trade Data Online, January 2018
U.S. still dominant trading partner
..some growth in overseas markets

- China has offset some of slide in exports to U.S.
- Exports to China tripled in decade, but slowing ahead.

Source: Industry Canada, Trade Data Online, January 2018
Forestry investment turnaround …across all sectors

- Investment crashed through 2009.
- $3.5 billion in pulp and paper last four years.
- Positive sign for future.

Source: Statistics Canada, CANSIM Table 029-0045
Trade uncertainties grow  
...aggressive US actions

• **Softwood:**  
  – April-June 2017: average 26.8% preliminary countervailing and anti-dumping.  
  – November 2017: lowered average: 20.8% combined, Canada going to World Trade Organization.

• **Supercalendered:**  
  – November 2015: 18-20% on 3 companies, reduced January 2018 to 2%-16%.

• **Newsprint:**  
  – January 2018: preliminary 6.5% countervailing.
Unifor mobilization ...broad support and results

- Community rallies June 2017.
- Pushing governments to support sector, ongoing.
Advancing our views on forestry …Unifor’s new forestry policy

• Adopted August 2017 in Winnipeg.
• Includes economic analysis and policy views.
• Well-received by industry, stakeholders and governments.
3. Major Product Lines
Newsprint
Slide in newsprint demand continues …Eastern Canada at heart of the transition

- Another 25% decline since 2014.
- Newspapers closing and scaling back as digital media shift accelerates.

Source: RISI
Pricing low and flat
...reflecting weak and declining market

- Price stability better than freefall.
- Lower Canadian dollar has been essential.
- Forecasts for stable and low prices ahead.

Source: RISI, BMO Capital Markets
Market Pulp
Market pulp demand more stable …and pricing strong

• Canada provides a quarter of world supply of NBSK
• Stable production last four years.
• Strong pricing combined with lower dollar make lucrative.

Source: RISI, BMO Capital Markets
Printing and Writing Papers
Demand down
...lower ahead

• Slide in demand across all graphic papers. Global peak around 2007, then slide 20%.
• North American demand down 5.7% in 2017 for both coated and uncoated grades to 15.3 million tonnes.
• Some stabilization, but further declines ahead resulting in capacity cuts and conversions.
Packaging
Packaging sees strong performance ...attracting conversions and capacity

- Flip-side of digital revolution: on-line shopping. Other graphic papers hit as media shift, but packaging is strong and growing.
- North American containerboard consumption (all grades) up 2.6% last year, forecast 2.9% in 2018.
- $1.5 billion spent on five mill conversions last four years, more ahead.
- North American capacity expected to grow 8% from 2015 to planned expansions by 2019.
Tissue
Tissue remains recession-proof...
...global demand means strong growth

• In mature markets, sanitary product demand largely immune from fluctuation. Rapid growth in developing nations, China and Latin America lead growth.

• Global demand up 3.4% per year last decade, forecast to climb 3.5% per year to 2025.

• Strong conditions enticing investment: North American capacity up 2.7% by end of 2018 to 10.3 m tonnes. Four US start ups in less than 10 months.

• Global overcapacity concerns, but growth segment remains attractive. More conversions ahead.
4. Corporate Finances
Global forestry recovery
...profitability returns

• Global forestry industry was hit hard by financial crisis and recession.
• World’s 100 largest firms lost combined $6.5 billion in 2008. As a group, earned just 1.6% net profits in 2009.
• Almost a decade later much stronger results. Wood sector leading profitability, but paper also stronger.
• PwC 2016 review of Top Global 100 forestry firms saw combined $12.1 billion profits, and highest operating margins in five years (2017 report forthcoming).
• Canadian firms weaker than other regions, notably the EU and US, but positive and strengthening.
Canadian firms best performance in decade ....majority but not all firms

• 11 of Global Top 100 have HQ in Canada:
  – Net profits of $1.5 billion in first 9 months of 2017.
• Several sources show improved financial performance:
  – Federal NRCAN review of corporate filings
  – RISI earnings survey
  – PwC earnings survey
  – Results of publicly traded firms in Eastern Canada
Federal government forestry report
...$4 billion operating profits and R.O.C. growing

Source: Natural Resources Canada
Canadian profitability returns
...forestry margins strengthening: now above 5%

Source: RISI
Eastern Canada 2014-2017
...PwC net profit quarterly summary

• **Combined:**
  – Cascades
  – Tembec
  – Norbord
  – Resolute

• **Losses through 2015, much stronger last year.**

Source: PwC
Western Canada 2014-2017

...PwC net profit quarterly summary

• Combined:
  – West Fraser
  – Canfor
  – Mercer
  – Interfor
  – Western
  – Conifex
  – Fortress

• More heavily wood than paper.

Source: PwC
Private Companies = Private Finances

- Irving
- Kruger
- Aditya Birla
- Atlantic
- Georgia-Pacific
- White Birch Paper
- Port Hawkesbury
- Twin Rivers
- Strathcona
Publicly-Traded Companies = Public Financial Reporting
**Solid profitability, strong first nine months of 2017**

### Financial Performance 2013-2017 to-date

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<thead>
<tr>
<th></th>
<th>2013</th>
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<th>2015</th>
<th>2016</th>
<th>2017-9 mo</th>
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<tbody>
<tr>
<td><strong>Revenue</strong> ($ billions)</td>
<td>5.39</td>
<td>5.56</td>
<td>5.26</td>
<td>5.10</td>
<td>3.82</td>
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<tr>
<td><strong>Op. Profit</strong> ($ millions)</td>
<td>161</td>
<td>364</td>
<td>288</td>
<td>223</td>
<td>195</td>
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<tr>
<td><strong>Net Profit</strong> ($ millions)</td>
<td>91</td>
<td>431</td>
<td>142</td>
<td>128</td>
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Source: Market Watch: FactSet Research Systems Inc
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<td><strong>Op. Profit</strong> ($ millions)</td>
<td>176</td>
<td>93</td>
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<td><strong>Net Profit</strong> ($ millions)</td>
<td>11</td>
<td>-147</td>
<td>-65</td>
<td>135</td>
<td>450</td>
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Source: Market Watch: FactSet Research Systems Inc
Stable revenues last three years, smaller losses

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Source: Market Watch: FactSet Research Systems Inc
Stable revenue, improved profits in 2017

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Source: Globe and Mail: Morningstar
Bought Tembec, strong record of profitability

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Source: Morningstar Research Inc
Steady revenues, but net losses in recent years

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<td>208</td>
<td>276</td>
<td>308</td>
<td>331</td>
<td>244</td>
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<tr>
<td>Net Profit ($ millions)</td>
<td>55</td>
<td>-64</td>
<td>-34</td>
<td>7</td>
<td>-19</td>
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Source: Globe and Mail: Morningstar
Growing revenues and solid profitability

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<tr>
<td>Revenue ($ billions)</td>
<td>9.55</td>
<td>9.90</td>
<td>11.38</td>
<td>14.17</td>
<td>14.86</td>
</tr>
<tr>
<td>EBIT ($ millions)</td>
<td>814</td>
<td>854</td>
<td>878</td>
<td>447</td>
<td>836</td>
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<tr>
<td>Net Profit ($ millions)</td>
<td>727</td>
<td>450</td>
<td>507</td>
<td>153</td>
<td>708</td>
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Source: Market Watch: FactSet Research Systems Inc
All signs point to solid performance
….majority but not all firms

• Operating margins and return on capital (NRCAN)
• Net profit margins (RISI)
• Net profit volumes (PwC)
• 5 of 7 publicly-traded firms show solid profits
• Private firms investing, expanding or purchased
5. Bargaining Context
Negotiated wage settlements
...average annual percent wage increase

- Range of ~1.5% - 2% last four years.
- Unifor Constitution provides Officers’ wage increase set at weighted average of Unifor members:
  - 2015: 1.5%
  - 2016: 1.4%

Source: Employment and Social Development Canada
All Canadian hourly-paid workers
...average increase in earnings and inflation

- Earnings of most Canadians keeping pace with inflation.
- Some strength noted last year, making stronger gains.

Source: Statistics Canada, CANSIM Tables 281-0029, 326-0021
Western Pattern Unifor and PPWC
…solid improvements

• Four year agreement
• 2% wage increase each year
• Trades adjustment: $1.00 1st year, and $0.50 4th year
• Benefit increases, including:
  • life insurance
  • weekly indemnity
  • vision
  • hearing aids
  • orthotics
• Paid education leave (Unifor)
6. Comments
Successful transition underway
...positive momentum ahead

• Global industry showing continued growth and successful transition to growing markets and segments.

• Canadian industry has had among most difficult challenges in global industry: newsprint dominance and weak policy (high dollar, lack of industry support, failure to negotiate new softwood deal).

• Despite challenges Canadian industry succeeding in transitions, experiencing better conditions, stronger performance, largely profitable.

• Bargaining outcomes across economy are reflecting recovery and positive momentum.