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2005 PIMA Leadership Conference
 State of the Industry
 Peter Ruschmeier, Senior VP
 June 28, 2005

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 PLEASE SEE ANALYST CERTIFICATION AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 43

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Outline

- ◆ Economy
- ◆ Key Themes
 - Supply/Demand
 - China
 - Costs
 - Financial Returns
- ◆ Summary

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Economy

- ◆ Global economic growth is moderating.
- ◆ Oil prices continue to rally.
- ◆ The yield curve is flattening.
- ◆ The “twin deficits” could continue to put upward pressure on interest rates.
- ◆ Low mortgage rates have fueled housing bubbles in some regions, but home price appreciation appears to be slowing.
- ◆ Steady employment growth should support increased demand for paper.

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Economy

Global economic growth is moderating...

Composition of Global GDP and GDP Growth

Trillions of US \$ (2005) (left scale) and GDP Growth (right scale)

Source: DRIMcGrawHill, International Monetary Fund, Lehman Brothers

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Economy

The Baltic Freight Index (heavily influenced by China) may be flagging a slowdown in China.

Baltic Freight Index - Global Ocean Shipping Rates

Current Level

China joins WTO in December 2001

Source: Lehman Brothers and Bloomberg

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Economy

As oil prices continue to rally...

U.S. West Texas Intermediate Crude Oil

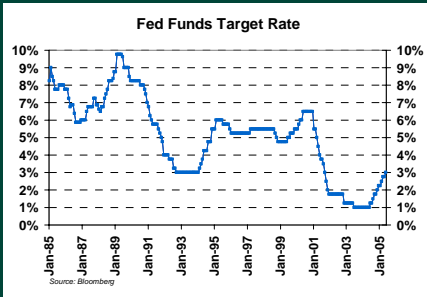
\$ per 42 gallon barrel

Source: Lehman Brothers and Bloomberg

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Economy

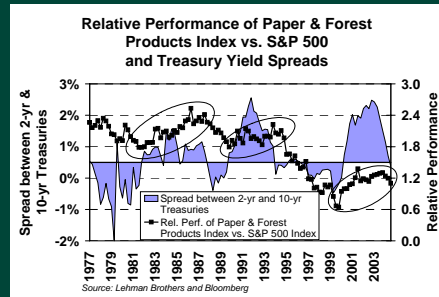
And the Fed raises short-term rates...



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Economy

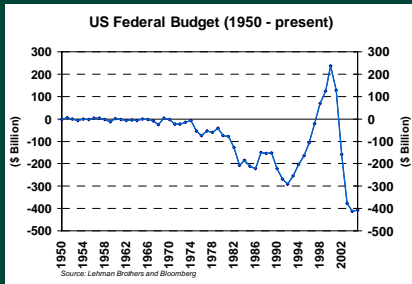
Leading to a rapidly flattening yield curve...



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Economy

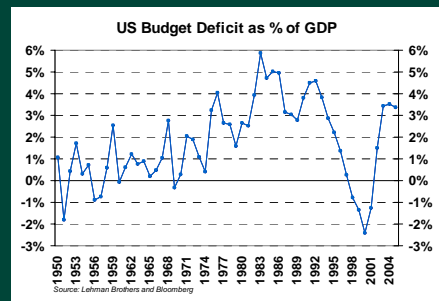
At a time when the "Twin deficits" (budget and trade) could further pressure interest rates upward...



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Economy

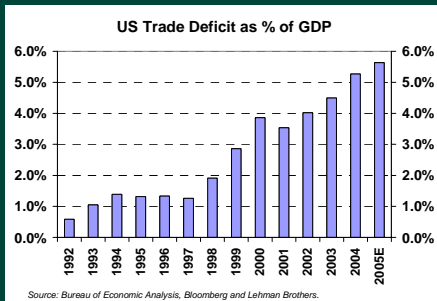
The budget deficit is more than 3% of GDP...



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Economy

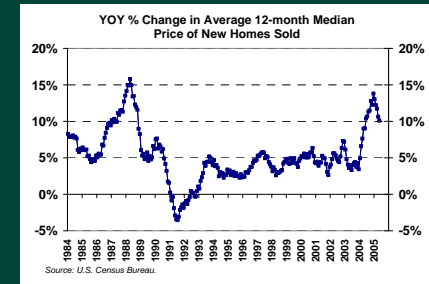
And the trade deficit is approaching 6% of GDP...



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Economy

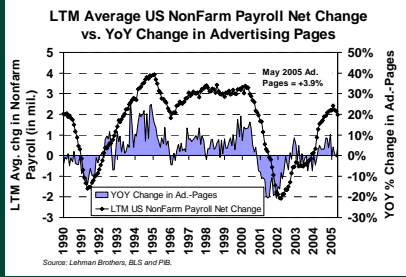
Low mortgage rates have led to "regional bubbles" in housing, but home price appreciation appears to be slowing...



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Economy

Growth in Non-Farm Payrolls typically supports magazine ad pages...



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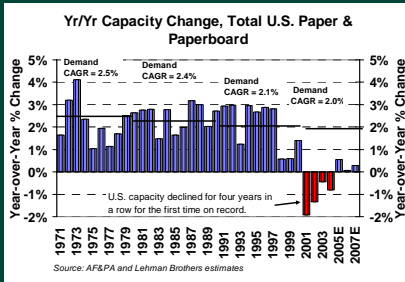
Supply/Demand

- ◆ U.S. trend demand growth exceeds supply growth by a wide margin, with imports accounting for the difference.
- ◆ We believe trend global demand growth also exceeds supply growth.
- ◆ It appears that moderating economic growth is causing demand in the U.S. and globally to fall below trend levels.
- ◆ We believe an inventory de-stocking cycle is amplifying weak demand trends and may be close to a reversal.

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Supply/Demand

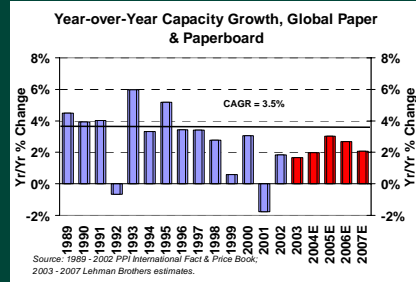
Trend demand growth for the U.S. easily outpaces supply growth, but to a lesser degree. The gap is satisfied by imports.



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Supply/Demand

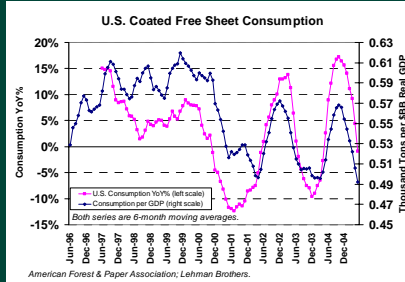
Globally, we believe trend demand growth also outpaces supply growth, but to a lesser degree...



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Supply/Demand

Inventory stocking/de-stocking cycles create a smoke screen for underlying supply/demand trends...



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China

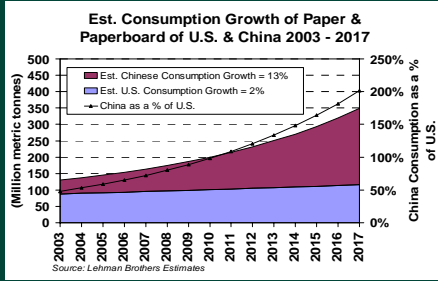
Top Reasons to Watch China Closely

1. World's largest consumer of steel by a 2-1 factor.
2. Second largest consumer of paper and paperboard in the world (for now) behind the US.
3. Large labor cost advantage (per capita income is 1/40th US).
4. Lower energy costs, coal vs. natural gas.
5. Willingness to tolerate lower returns.
6. Ambitious plans for capacity growth.

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China

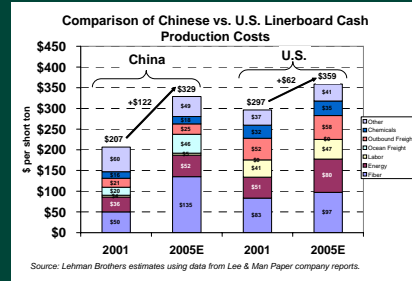
As China industrializes, consumption growth of 13% is possible, leading to an industry 2X the size of the U.S. by 2017.



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China

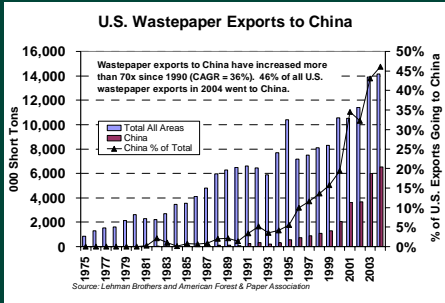
China's cash costs for linerboard are below the U.S. for now, but their advantage is eroding...



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China

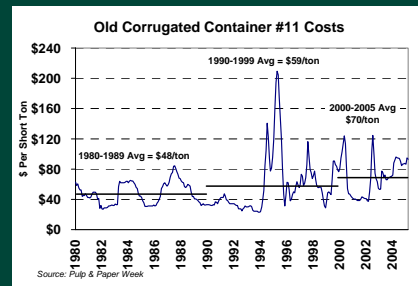
With 46% of U.S. wastepaper exports now going to China...



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China

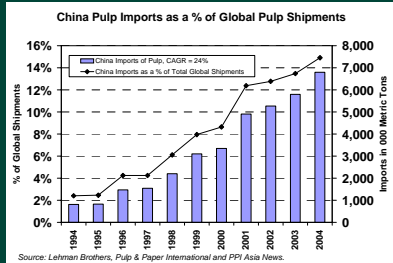
We continue to believe in an eventual "boom" in fiber costs...



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China

China's booming demand growth for pulp is supported by rapidly rising consumption growth for grades that consume pulp, AND an upgrade in the quality of pulping fibers used.



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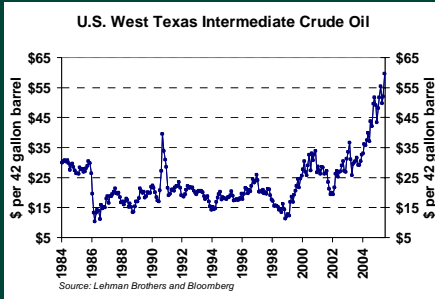
Costs

- ◆ Input costs are likely to remain at chronically high levels.
 - Energy - oil prices are up 6X in 6 years.
 - Chemicals - caustic soda is up 3X in 18 months.
 - Transportation - costs are also rising.
 - Fiber - we expect fiber costs to rise further.

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Costs

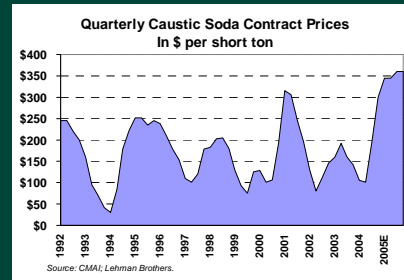
China's strong demand is a key driver of high oil prices



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Costs

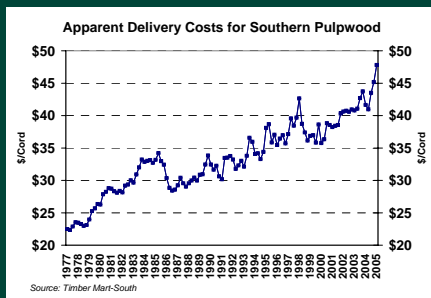
Rising chemical prices...



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Costs

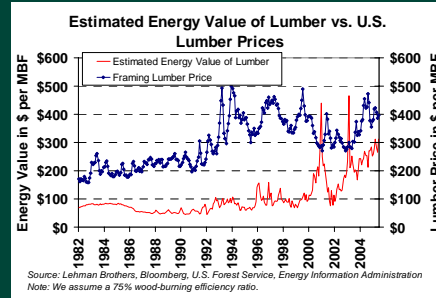
Rising transportation costs...



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Costs

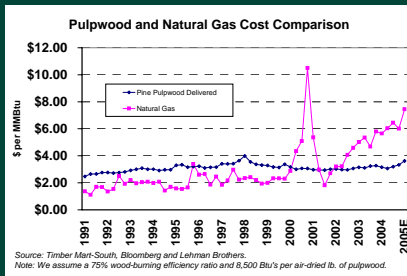
Energy value of lumber...



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Costs

At less than \$70/cord, pulpwood is priced to yield energy at an estimated cost of less than \$4 per MM BTU.



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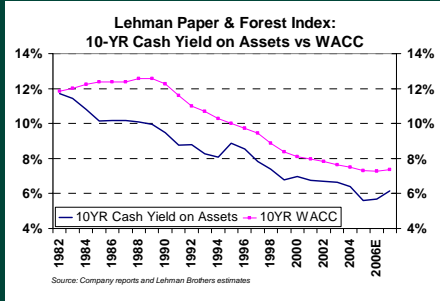
Financial Returns

- On average, returns on assets fail to meet/exceed cost of capital.
- Investors are fairly efficient at pricing the enterprise value such that the cash yields on the enterprise value approximate the WACC.
- At less than 8%, the industry's WACC is fairly low.
- HOWEVER, WACC is not being minimized because cost of equity is historically expensive vs. cost of debt and net debt to assets are near a 16 year low.
- Capital discipline has improved significantly, and free cash flow has improved, but some commodities like OSB continue to exhibit boom/bust behavior.
- Private investors are showing an increased interest in the industry, including increased awareness of unrealized timberland value.

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Financial Returns

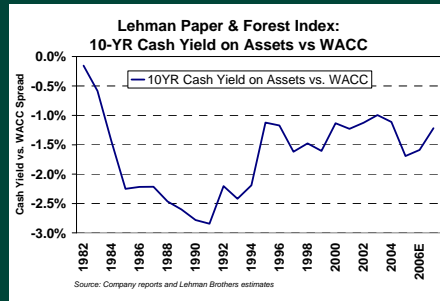
Return on assets does not meet cost of capital...



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Financial Returns

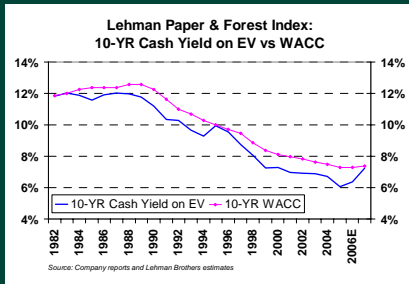
But the magnitude of value destruction is moderating...



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Financial Returns

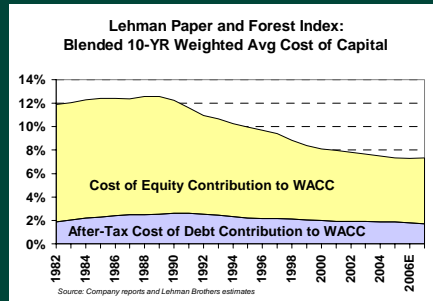
While cash yields on enterprise values are much closer to WACC...



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Financial Returns

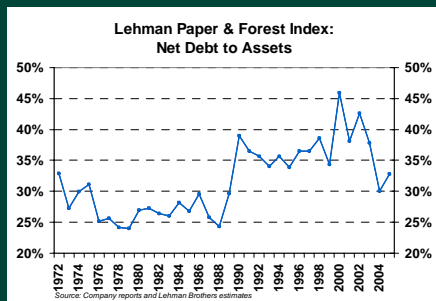
At less than 8%, WACC is fairly low for the industry...



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Financial Returns

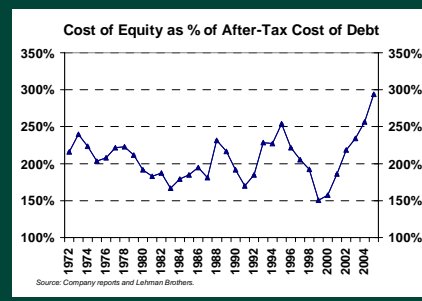
But net debt to assets are near a 16 year low...



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Financial Returns

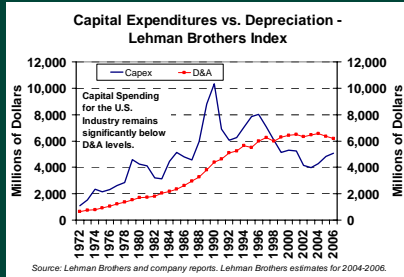
At a time when cost of equity relative to debt is at all-time high...



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Financial Returns

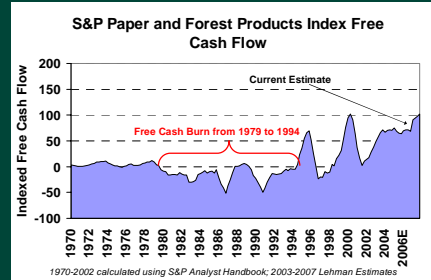
Our coverage universe of U.S. paper companies is spending less than their depreciation rates (since 1998).



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Financial Returns

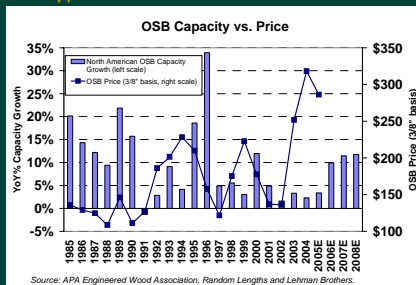
Free cash flow generation improving...



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Financial Returns

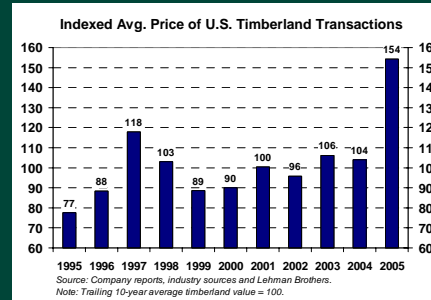
Spikes in OSB capacity growth have followed pricing peaks... 2006-2008 appears no different.



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Financial Returns

Private buyers are seeing value in timberlands...



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Financial Returns

Interest from private equity and activist investors is up sharply...

- ◆ Madison Dearborn Partners acquired Boise Cascade's forest products business.
- ◆ Cerberus Capital acquired GP's building products distribution business and MeadWestvaco's coated paper business.
- ◆ Kohlberg & Co. acquired IP's specialty papers business.
- ◆ Carl Icahn announced plans to take an active roll in shares of Temple-Inland before selling shares.
- ◆ Franklin Mutual Advisers took a 17 MM share activist position in shares of Weyerhaeuser.
- ◆ TPG-Axon announced a 6.1% stake in shares of LPX.

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Summary

- ◆ Economy: brace for a slower growth.
- ◆ Supply/Demand: Underlying trends are positive but hurt by a slowing economy and de-stocking.
- ◆ China: a low cost competitor for now, but not for long.
- ◆ Costs: no relief is sight from higher costs, so companies must pass along costs to customers, or suffer margin erosion.
- ◆ Financial returns: returns are still not acceptable, but financial discipline is improving (with some exceptions) and financial buyers/activist investors are showing interest in the industry.

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