cmpc PULP

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July 2009

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Opinion: Roger Wright, Consultant

"In 2011 the pulp industry will be very different"

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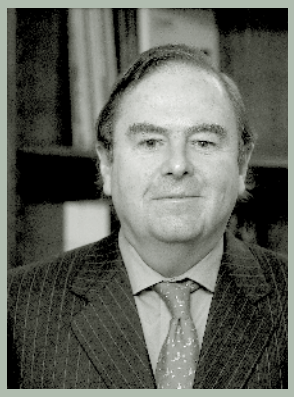


welcome

Dear Friends,

The last few months have been very difficult for everybody, markets have continued very weak and recovery is still not here. There are some encouraging signs in Asia where demand has been very strong, especially in China. There, a combination of strong domestic demand with low production of Chinese non-wood pulp has boosted demand compensating for the low European orders. This is indeed a small sign that we hope will be followed by others throughout the summer hopefully bringing better news to our beleaguered industry.

What has not been good news has been the unfair and uncompetitive black liquor subsidy that the US has been giving their pulp producers as a result of a very twisted interpretation of a law that encouraged substitution of fossil fuels in transportation. The end result has been that several pulp producers have been receiving subsidies of up to US$300 per ton of pulp as a result of adding some diesel oil to their black liquor, quite the opposite of what is the spirit of the law. Now there is more disturbing news that the Canadian government has started a new scheme that would give Canadian producers a similar subsidy to help the industry. We all hope that both countries end as soon as possible these subsidies as they are only hurting the taxpayer in trying to keep alive an industry that cannot and will not survive in the long term.

Back to the newsletter, this issue has a very interesting article by Roger Wright in which he looks to the future of pulp production and how the consolidation will play an important factor in the companies that will be the leaders in the next few years, all of them from the Southern Hemisphere.

Also we look at how the technology has played a vital part in the plantations wood yield, which in turn has been one of the main reasons of the growth of the pulp production in South America and has also contributed to the competiveness of this sector. Also you will find information about the increase of production at Santa Fe and other CMPC news.

I hope you enjoy this newsletter, please write and tell us if you have found our articles interesting or if there are other subjects you would like to see covered in future issues.

Best regards,

Guillermo Mullins
Commercial Director of CMPC Pulp

CMPC Pulp will invest

US$26 million

in a new project

to optimise operations.

At Santa Fe Mill

New capacity expansion

CMPC Pulp will increase production capacity of Line 2 at Santa Fe Mill by 20% (from 780,000 tonnes per annum to 940,000 t/a). Adjustments to the production process in a number of areas as part of a US$26 million project will start next September and will be fully operative by mid 2010.

An important part of this investment (US$20 million) corresponds to new environmental improvements: reduction of odour emissions at Line N°1 and decreases in water use. The former will be achieved by improving gas retrieval and expanding incineration capacity.

These measures form part of an Environmental Cooperation Agreement recently signed by the company, the community and the authorities.

Roger Wright:

"In 2011 the pulp industry will be very different"

"All market BHKP will be produced by no more than 10 producers in Chile, Brazil, Uruguay and South East Asia".

"The changes which started to become evident a couple of years ago are the most fundamental and far-reaching of any that I have seen in the last forty years", says Roger Wright, the founder and Managing Director of Hawkins Wright Ltd. a leading independent research company which specialises in international pulp and paper markets.

For 25 years, Roger Wright has undertaken over 500 research and consultancy assignments in over 50 countries. He has made many contributions to industry publications and frequently addresses audiences at international conferences on trade matters.

In this interview he gives us his personal view of the pulp industry, a business which attracted him from a young age. "Like every young boy, I dreamed of a life in the pulp industry!" he comments. He started working in a small paper mill in Scotland in 1964 with no clear career path in mind. After two years learning the basics of papermaking he joined a small consultancy established to specialise in market research in paper, print and packaging markets. He started Hawkins Wright in 1983 and he has grown the business to the extent that he now employs three people.

"My greatest influence has been the pleasure of working with friends all over the world and in trying to make sense of the many changes which are always taking place in pulp and paper industries. I have yet to succeed", says Roger Wright.

What differences do you see between pulp and other commodity markets?

Pulp, like most other commodities, is traded globally and mainly sold in dollars. As with all commodities, prices are strongly influenced by wider macroeconomic conditions. However, the pulp business has several characteristics that set it apart. In spite of the consolidation within the industry over the past ten years, the pulp business remains fragmented. The dependence on forests also sets pulp apart from other commodities derived from mining or shorter rotation agricultural commodities. Forests are highly diverse in terms of their species, ownership, and management. They are also renewable.

Although pulp is a commodity, it has not been possible to create a properly functioning futures exchange which other commodity markets depend on for price transparency. This may be partly due to the diversity of pulp grades which are not readily substituted. As a result the pulp business is characterised by complex contractual agreements, which depend very much on personal relationships.

However, the main differences probably lie in the end-uses. Despite the current economic turmoil, there remains a strong case for rising commodity prices in the longer term, due to a rising global population and limited resources. However, pulp may not benefit to the same degree as extractive commodities, partly because it is renewable, but also because demand for the end product – paper -is flat or even declining in some areas.

Over 55% of bleached chemical pulp is used in printing and writing papers, demand for which is contracting. New media are replacing graphic papers and this substitution trend is accelerating because of the global recession. Capacity for graphic paper production has been cut by over 15 million annual tonnes in North America and Europe in the last three years and there is more to come. When economies do recover, other commodities will benefit but I think it is highly probable that 2007 will prove to be the all-time peak for pulp and white paper demand. In volume terms, In five years the pulp market is likely to be about the same as in 2001 but BHKP will account for some 75% of total bleached chemical pulp.

How do you see the industry in ten years time?

We will not have to wait for ten years to see a very different industry; even in 2011 it will be very different.

Demand for communication papers is declining rapidly as the adoption of new technologies gathers pace. There are now 1.6 billon internet users, 575 million households have broadband connections and 4.1 billion subscribe to mobile phone providers. Advertising expenditure on the internet has reached $52 billion. Newspaper circulations are falling rapidly and, in the USA, newsprint consumption is 48% lower than it was in 2003. Other potential threats to printing papers include e-paper, a thin portable piece of plastic which can be read anywhere.

For pulp suppliers, the decline in communication papers will be partly compensated for by continued growth in tissue consumption, particularly in developing countries. The proportion of wood pulp in these papers will increase even more rapidly as higher quality tissues become more popular.

Who will be the major players then?

Supply patterns will also be very different. Over 40% of the recovery boilers in North America are over 35 years old. Many of these will close in the next few years as profitability has never been sufficient to justify investment in replacement.

In Finland and Sweden, the last new pulp mill started up about 20 years ago and it is now closed, probably permanently. Japanese, Korean, Taiwanese and some European BHKP producers are uncompetitive and are unlikely to survive for the next ten years.

In contrast, about 17 million t/y of eucalyptus and acacia pulp capacity has started up in the last decade in South America and SEA.

I believe that all market BHKP will be produced by no more than 10 producers in Chile, Brazil, Uruguay, Iberia and South East Asia.

In Europe, competition for energy fibre will make softwood pulp manufacturing uncompetitive except in new facilities which combine pulp and energy production.

It is likely that in 2020, most BSKP market pulp will be a by-product of bio-refineries made by producers close to the big energy consumers in USA and Europe.

How will developments in bio-energy based on woodchips and pellets affect our business?

The contraction of paper production in Japan will obviate any growth in woodchip demand for pulp production, In ten years time, it is likely that the use of wood and biomass for energy will exceed the volumes currently used by the traditional forest products industries.

The major economies have ambitious plans for renewable energy and, after spending billions of dollars on wind, solar and tidal solutions, they will increasingly focus on woody biomass as a feedstock for bio-energy, bio-fuels and bio-chemicals.

Already, some 12 million t/y of wood pellets are used for domestic and commercial heating and for power generation. Of this, 8 million tonnes is in the EU. The potential for pellets and biomass is huge. In the UK alone, existing plans for future power generation imply a need for about 16 million tonnes of woody biomass, the equivalent to four Santa Fe's! Even more will be needed for domestic heat.

What do you think of the US alternative fuel tax credit? Will it continue?

Again I must stress that these are my personal opinions, I think that this tax credit will sound the death knell for many US paper producers. In an oversupplied market, an effective reduction of $100-200 in production costs will inevitably affect paper prices. After the credit is rescinded, you can imagine the difficulties in recovering paper prices by 20% in the depths of a recession. "Short-term gain, long-term pain".

Tree cloning at CMPC

In 2010 the company hopes to begin the mass production of the first clones of radiata pine developed by its Biotechnology Centre.

CMPC has carried out research since 2001 using somatic embryogenesis of plants, an In Vitro micropropagation technique that enables embryos to be produced from somatic cells.

The contribution of cloned plants to the company's plantations will be significant, states Adelaida Poblete, Head of the Department of Biotechnology of Plant Production Management at Mininco Forestry.

In initial analyses it has been found that the development of some clones, measured in volume, is greater than the average of the family from which they originate.

From 2012, an increasing proportion of CMPC's new radiata pine plantations will correspond to clones selected by its Genetic Improvement Programme and produced by its Biotechnology Centre in accordance with the most desired industry qualities. The company's forests will be renewed with mother plants that will produce trees with advantages such as longer fibre length, higher density or low lignin content. Thus, the company's wood supply will increase without having to expand its forestry estates.

Convinced that this is the way to sustainable growth, CMPC has carried out research since 2001 using somatic embryogenesis of plants, an In Vitro micropropagation technique that enables embryos to be produced from somatic cells; that is to say, from cells which are different from the sexes (gametes). "In the case of radiata pine, these embryos are produced from an immature seed and it is interesting that all the embryos obtained in this way are identical, that is to say, a clone", explains Adelaida Poblete, Head of the Department of Biotechnology of Plant Production Management at Mininco Forestry, a subsidiary of the CMPC Group.

During the initial development of this technique, which up until then had not been available in Chile and was subject to patents, the company worked together with the Pontificia Universidad Católica de Chile Subsequently, the methodology that had been developed was revised and validated as original by Doctor Jenny Aitken from New Zealand, who periodically advises on the checks, updates and optimisation of the use of this technique.

In initial analyses it has been discovered that the development of some clones, measured in volume, is higher than the average of the family from which they originate, "which is very encouraging," states Adelaida Poblete, "as it shows potential for the technology which until recently was just theory".

The scientist points out that these cloning trials are still very recent (with the oldest being four years old), therefore it is necessary to wait a couple of years to validate the results before starting the mass commercial production of the plant material. The company hopes to transform the first select 15 clones of radiata pine in 150,000 mother plants in 2010, becoming established as a plantation from 2012.

Department of Biotechnology of Plant Production Management at Mininco Forestry, a subsidiary of the CMPC Group.

One of the main benefits of this type of technique is that these characteristics can be consistent and can be replicated from tree to tree in the same way.

By the end of their production period, the first 150,000 cloned mother plants will produce between 5-6 million final plants, which represents between 13-16% of CMPC's total production of pine plants in a three year period. This production will continue to increase, potentially able to reach 80% of the total plantation of radiata pine. "Their ultimate contribution to the company's plantation will be significant", states Adelaida Poblete, "as it represents the best genetic material available at CMPC and one of the ways to increase the volume and quality of the wood from our forests".

Up until now, the qualities assessed in radiata pine have been volume, straightness and density, but the technique also enables individual qualities to be identified under other selection criteria, such as the pulp quality of the wood, resistance to disease, efficiency in terms of water or nutrient use.

The company estimates that the cost of the production of the cloning plants will be slightly higher than currents costs of controlled cross pollination of plant material (used most at the plantations), which, at the same time, is practically double the cost of plants produced from seeds. However, the selection of the type of plant to be used does not depend solely on cost, but also on the benefits, in terms of the volume of wood per type of product per hectare, or more specifically, in dollars/hectare at harvest, explains Adelaida Poblete. This means that the cloning material will most likely be used in a large percentage of CMPC's estates, despite its higher initial cost.

In addition to the advantages in terms of quality of the raw material, which will enable the selection of clones with the desired qualities, one of the main benefits of this type of technique is that these characteristics can be consistent and can be replicated from tree to tree in the same way. "The homogeneity which tree cloning enables must mean the finer tuning of a more predictable raw material for the pulp mills", concludes the Head of the Department of Biotechnology at CMPC.

CMPC PULP: Facts & Figures 1H2009 (e)

Preliminary results for the second quarter of 2009 suggest that the worst part of the crisis may be over, thanks largely to strong sales in China and other South East Asian markets.

FOEX pulp price indicators are improving marginally in Europe and China and with our production costs under control, EBIDTA is slowly recovering from the record lows reached in the first quarter of 2009.

Nevertheless, still there are dark clouds on the economic horizon that make us cautious about the near future. Paper production and pulp consumption statistics from Europe and America show the effects of a deep industrial recession in both regions. Unemployment keeps rising in many countries and the consensus forecasts for 2009 growth in each major economy have been adjusted down every month this year. The question is whether burgeoning pulp prices are sustainable or a temporary blip as consumers' pulp inventories are replenished from their record lows. Without a solid recovery in these markets, "green shoots" must be viewed with caution until the large fiscal stimulus packages begin to show a clearly sustainable economic recovery.

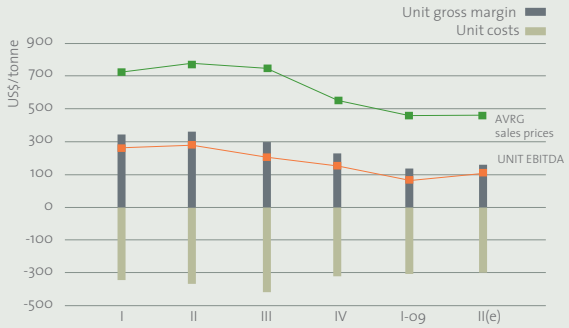
Our sales data through May 2009 reveals how Asian markets are recovering faster than other regions and the serious damage this crisis has inflicted on the European paper sector.

Lower pulp prices also led our sales income to fall 37% y/y.

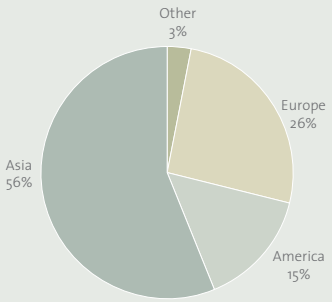
Operating Results
(Thousand US$)

	1Q2008	2Q2008	3Q2008	4Q2008	1Q2009	2Q2009 (e)
Sales	345	377	282	273	220	236
Cost of Sales	169	188	164	165	153	148
Gross Margin	176	189	118	108	67	88
Administrative & Selling Expenses	38	41	43	35	26	27
EBITDA	138	148	118	108	67	88
EBITDA/Sales	40%	39%	27%	27%	19%	26%
Shareholders Equity	1.179	1.075	1.100	931	1.523	1.504
Total Assets	2.510	2.184	2.099	1.912	2.703	2.645
Sales (thousand tonnes)	481	504	387	499	486	511

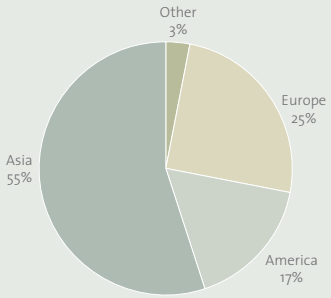
Results by Quarter



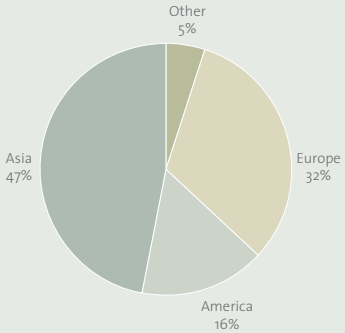
Pulp Exports @ May 2009
(720 thousand tonnes)



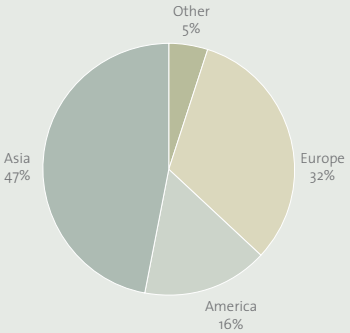
Pulp Exports @ May 2009
(US$ 316 thousand C&F)



Pulp Exports @ May 2008
(691 thousand tonnes)



Pulp Exports @ May 2008
(US$ 502 thousand C&F)



news

CMPC TISSUE BOUGHT COMPANY IN BRAZIL

The CMPC Group expanded its operations in the tissue business to Brazil with the purchase of Melhoramentos Papeis, a company with two production plants for toilet paper, paper towels and serviettes in Sao Paulo State and a total production capacity of 75,000 tonnes/annum. It has approximately 10% of the Brazilian market, with total sales of US$190 million.

CMPC Tissue already had subsidiaries in Argentina, Colombia, Mexico, Peru and Uruguay, in addition to Chilean operations, totalling a capacity of 340,000 tonnes/annum. In 2008, total sales reached US$ 870 million.

The acquisition of Melhoramentos Papeis, for US$55 million, entails assets of US$162 million, as detailed by the company in April 2009.

OLGA MORENO RETIRES AFTER 44 YEARS AT THE COMPANY

On 30 April 2009, our dear Olga Moreno Escobar took a well deserved break after 44 years of work for CMPC in the pulp business.

During her long service, Olga undertook a wide variety of roles, with recent responsibility for controlling export services payments, in addition to statistics exchange administration in Chile. In all her positions, Olga gained the respect, admiration and affection of those who worked with her for her professional and interpersonal qualities.

In her place, David Vásquez, trained in international trade, has taken on the role of Logistics Management Support.

Chairman of the local association of Mapuche communities at Collipulli, Dionisio Prado.

CMPC CONSOLIDATES ITS RELATIONSHIPS WITH NEIGHBOURING COMMUNITIES

Workers and executives at CMPC Pulp, other subsidiaries of CMPC and neighbouring companies, have had the opportunity to discover more about Mapuche culture during talks given at Pacífico and Santa Fe Mills by the Chairman of the local association of Mapuche communities at Collipulli, Dionisio Prado.

These meetings are in addition to other promotional activities recovering the identity of the native people of the area in which the company's mills are located (Araucanía and BioBio), such as weaving, Mapuche language courses and traditional music concerts, carried out with the collaboration of Pacífico Mill.

CMPC PULP DOCKS AT ONSAN PORT IN KOREA

In order to offer a logistic alternative to its customers, CMPC Pulp is docking at a second port in Korea, Onsan, from this April. Situated on the east coast of the peninsula, this is now a destination for the company's shipments, in addition to Inchon Port.

Operations at Onsan are run by Horizon Taeyoung Korea Terminals, which has a pulp terminal at the port.

Easter Island

Currently 550 figures between 4 and 20 meters high, are to be found the length and breadth of the island.

Easter Island is considered to be the largest open-air museum in the world. Its monumental stone statues, probably constructed between 1110 and 1300, are the most characteristic expression of its culture heritage, Rapa Nui; however, what is most surprising is that this culture has been able to develop in such isolation from the rest of the world. The nearest location to this island is the southern point of Chile, at a distance of 3,500 km, followed by Tahiti at 4,600 km and New Zealand at 7,000 km.

It was given the name 'Easter Island' by the Dutch explorer Jakob Roggeveen, who discovered it on 5 April 1722, the day of the Resurrection. It was annexed by Chile 121 years ago and is currently under the jurisdiction of one of its regions, but there exists a bill to give it greater autonomy as a special region.

The flight from Santiago to Easter Island takes approximately 6 hours.

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CMPC PULP

Production and distribution of pulp based on Radiata Pine and Eucalyptus. The mills are Pacifico (500,000 tons Radiata Pine), Laja (360,000 tons Radiata Pine) and Santa Fe (1.2 million tons Eucalyptus). This pulp is exported to countries in Asia, Europe, Oceania and the Americas.

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