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**Winter
2009**

Pulp and paper sector in crisis conditions

The results are frightening.

The biggest pulp and paper companies has been striking the balance for the 2008 during the last few weeks. The results are frightening. In general, according to the RISI, global production of pulp was reduced by 2 million tons since September and up till December 2008 (and the whole global market produces 40 million tons per year). Pulp producers faced the problem of low demand and overproduction. They had to decrease production volumes and close down some enterprises.

Low demand led to quick decline of prices on market pulp. Although, the prices have not reached their critical point yet. "Should the price fall to 400 USD per ton and stay at this level for at least a year, the bigger part of the European companies would be in serious trouble. Such conditions will hardly be bearable for Russian companies," the marketing director of Arkhangelsk Pulp and Paper Mill said.

Russia possesses one-fourth of forests of the world. The effective output is rather poor, however. Part of the Russian production at the global market equals to only 2-3%. Even such countries like Japan, Germany and Italy are ahead.

Another point is that redistribution of facilities is taking place in the world currently. Large companies construct their mills in those countries where the cost of raw materials is minimal. As a matter of fact, it takes Russian broadleaf forest from 50 to 100 years to reach the maturity which is required for processing. For eucalyptus – the major type of commercial timber in South America (Brazil, Uruguay) - this period makes up only 5-7 years. Thus, competition is getting stronger and it will have a negative influence on the development of the Russian pulp and paper sector.

Facing bankruptcy

Most weak pulp and paper mills of Russia may already be called bankrupts. It is since September 2008 that the influence of the global financial crisis on the pulp and paper industry became noticeable. Many companies faced low demand for their production (export of pulp to China decreased by 30-40%, of cardboard – by 25%), 30-40 % decline in prices and credit funds shortage and appreciation. As a result, the branch cut down on the production by over 7% (in rubles) in the last quarter of 2008 as compared to the same quarter a year ago.

For some Russian pulp and paper mills one day to go or get close to go bankrupt was more than enough. Neman pulp and paper mill as well as Kamenogorsk offset paper mill belonging to North-West Timber Company are nearly bankrupts. Its investors have recently suggested repaying with creditor banks by office paper, planners, folders and envelopes. The total debt amounts to about 6 billion rubles (3 of them being the debt under credit and 1 billion – a funded loan debt).

The situation at Sokol Pulp and Paper Mill in the Vologda region is also difficult. Several hundred workers have been fired and one of the two papermaking machines has been stopped. The situation is so difficult that even the issue concerning mill's payments of for natural gas has already been discussed by the government of the region.

Segezha Pulp and Paper Mill in Karelia is also cutting down its production. According to company representatives, it is going to stop the production of noncompetitive products about 20% of the total production output.

Holdings are to survive

In 2008 RAO Bumprom (Russian Association of Pulp and Paper Industry Organizations and Enterprises) predicted an insignificant growth in production; in 2009 experts expect it to fall by over 12%. Such a result is quite predictable taking into consideration that in Russia there are just a few large producers. Their capacities exceed 200 thousand tons and make up over 80% of all pulp and paper products. All the others, especially "independent dwarfs" are likely to disappear.

Finally Russia will share the common trend to enlarge facilities in timber industry complex. There are about 200 functioning pulp and paper mills in the country now. To compare: in Finland their number is four times less but they produce two times as much pulp and paper products.

General increase in costs of raw materials, electricity and transportation makes investors search for ways of costs reduction and capacities optimization. If 10-15 years ago annual production output of a pulp and paper mill was about 450-500 thousand tons, today it has reached 700-1000 tons. Similar is the situation for paper and cardboard production facilities with their production volume making up 350-500 thousand tons per year.

It should be mentioned that the majority of these economical problems are experienced by paper "dwarfs". Against such a background production output of Syktyvkar LPK plant (Mondi Group) in 2008 look like a challenge. In 2008 it produced 812.8 thousand tons of paper and cardboard, which is 1% more than the expected volume. However, the output figures in 2007 were less by 1% as well. The representatives of the mill say that "insignificant decrease in the output had been forecasted for 2008 because of STEP project and the necessity to stop the equipment for its modernization. Particularly, in October and November 2008 such operations were successfully carried out on papermaking machine No. 14, which is used for production of Snegurochka office paper - the major brand of the mill.

Pulp and paper sector in crisis conditions

Moreover, by the end of the year managers of the project in Syktyvkar signed contracts for the total amount of 400 million EUR, the main equipment has been purchased".

Other large Russian pulp and paper mills continue to operate normally. Particularly, the largest company in the branch - Ilim Pulp - continues to increase production, incl. corrugated cardboard production. It also plans to modernize facilities and increase pulp cooking at Bratsk Forest Complex.

Exhausted potential

Nevertheless, it's not a secret for many specialists that Russian pulp and paper mills have nearly exhausted their potentials. Output shown in prior years was mostly due to loading of existing facilities – up to 90%. For further development complete equipment modernization and new pulp and paper mills construction are required, which implies large investments.

Foreign investments help to achieve this, but rather slowly and not that radically as desired. Despite great potential of the Russian timber industry, Russian companies haven't become global players in any of the branch sectors (pulp, paper and cardboard production). Russian influence in the world market is insignificant - Russian timber industry products making up just 3% of the world production volume. In terms of export profits the country falls behind the majority of foreign producers, e.g. at least six times behind Canada.

Besides, the demand and prices for different types of paper on the domestic market decreased with product cost and prices on energy resources increasing.

In addition to this, domestic pulp and paper mills do not manufacture many kinds of products at all, i.e. some office paper types, art printing paper, food packaging paper, etc. Domestic production is also inferior to the foreign analogues in terms of quality: this is true for office paper and paper for copy making machines, coated paper, magazine paper, cardboard for bottom and top liners with white coating.

Despite the unstable growth of the production volumes during the last decade, Russian pulp and paper industry failed to reach the maximum rate achieved in 1989.

There are about 165 pulp and paper mills, constructed in 1970s, either currently operating or in stand-by regime at the moment. Only ten of them are producing about 70% of Russian pulp and 80% of paper. Bratsk and Ust Ilimsk timber industry complexes in Irkutsk region, Kotlas Pulp and Paper Mill (Ilim Pulp), Arkhangelsk Pulp and Paper Mill, Segezha Pulp and Paper Mill together with Kodopoga in Karelia, Solikamskumprom in the Perm region, Volga, Mondi Syktyvkar LPK and Svetogorsk in the Nizhny Novgorod region.

Forecasts

We still have a number of strategic advantages to fight for leading positions in some segments of the world market. On the one hand, we have a big sales market. On the other hand, European and Chinese markets are near. A serious fight for European market is likely to start in the nearest future. In other words, the idea to considerably raise export duties on round timber is wise enough. It should merely be strengthened by certain investments in woodworking. Otherwise, western enterprises deprived of Russian pulp will purchase raw materials from South America.

The global crisis will put an end to small and a number of medium enterprises of Russian pulp and paper industry. As the global market is becoming more and more competitive, the long-term perspective is not that optimistic. In order to survive, enterprises would need to invest into new large projects. Production increase in many branches of economy is considered to be a good sign, but as far as this sector is concerned, the trend to export materials has become extremely problematic (84% of pulp and 50% of cardboard and paper).

Paper industry may become unprofitable already this year. According to Russian Governmental Business Trends Centre it has been more than a year since the decline in timber, woodworking, pulp and paper industries had began. In December 2008 pulp and paper production decreased by 20.9% as compared to the production peak.

According to Russian association of pulp and paper industry organizations and enterprises (RAO Bumprom), in 2009 production reduction will make up 12%, which would make it unprofitable. The chairman of the board, Vladimir Chuyko believes that such a result may take place due to decline in demand and price as well as price rate growth for the natural monopoly services and credit interest rate increase. "There is a slumping demand for the pulp and paper products in particular, and this holds for both, domestic and foreign markets. For instance, Pulp and Paper Mills selling their production on export markets only were badly affected.

The crisis will not last forever and experts are expecting urgent demand for the production when it is gone. According to Mr. Chuyko, it can grow as much as 1.5 times by 2015. As to Bumprom association experts, the production volume of the market pulp will increase 1.68 times, production of paper – as much as 1.7, of cardboard – as much as 2.2, but these changes require investments.

Stagnation in Russian pulp and paper sector

Pulp and paper industry of the North-West Russia has been at the stage of stagnation for three years already.

Pulp and paper industry of the North-West Russia has been at the stage of stagnation for three years already. It can be explained by the following factors: out-of-date machinery, low prices on pulp and economical crisis.

In 2008 total pulp cooking volume in the North-West Russia increased only by 0.2% as compared to 3.733 mln tons in 2007. Stagnation started 3 years ago with the first decline in production fixed in 2006. In 2007 production output continued decreasing making up 1.5%. Deterioration rate of main pulp and paper mills to reach 70%

Forest machinery manufacture does not meet the main tasks of timber industry development. Currently most plants for forest machinery manufacture stopped their activity. Most research and design bases for forest machinery manufacture have been lost.

As stated in the Development Strategy of the Ural Federal District up to 2030, there is no basis for domestic forest machinery service and maintenance. Pulp and paper mills in the Ural federal district (Sverdlovsk and Tumen regions) use technologies developed in 1940s. Deterioration rate of main pulp and paper mills makes up 70%, that of main technological equipment reaching 80% at a number of mills.

Total production decrease in QIV 2008 reached 20% with November and December being the most unprofitable. Thus, pulp cooking volume decreased by 26.3% compared to December 2007, market pulp – by 25.9%, paper – by 15%, cardboard – by 14.1% and paper bags – by 45.8%.

January 2009 also watched decrease in production. According to Russian State Statistics Service, market pulp production output fell by 32.5% as compared to December 2008, paper production – by 18.9%, that of cardboard and paper bags – by 38.9% and 73.4% respectively.

Today all enterprises are trying to survive by cutting down their costs and adapting their production to the demand on the domestic market. Large investment projects are postponed. According to Russian Association of Pulp and Paper Industry Organizations and Enterprises, in 2009 there will be seen negative dynamics in production output, export and import – import being mostly affected.

However, experts find out other reasons of existing stagnation. Production output started declining in 2005 when there appeared producers of cheap raw materials from South America and China on the world market. Some experts consider that stagnation started even earlier in 2003 due to machinery depreciation at the Russian pulp and paper mills.

Russian President Mr. Medvedev suggested closing down the Baikal Pulp and Paper Mill during his visit to Irkutsk. He claimed that the mill should be closed regardless of its water rotation type and suggested location of other enterprises on the territory of the mill. Regional government demand 49% of shares of the company, owned by the federal centre.

The President supported the position of the Irkutsk mayor who believes that the work resumption of the Baikal Pulp and Paper mill, whether with closed water rotation system or not, is unlikely to be approved by the Federal Government. The President knows the situation at an advanced level, and is aware of all the details. The pulp type, required by our industry may easily be produced by other Russian mills.

Currently Angara region Government is planning to get the situation under control. For this reason, mayor of Irkutsk issued a letter to the Federal Property Management Agency. He suggested handing over the federal holding of shares (49%) to the Irkutsk government.

"Personnel dismissal has already been announced. We do realize all the possible social consequences of closing the mill down and offer alternatives for Baikalsk development, e.g. we could launch some safe production and tourism business," the official claimed. Earlier, the Angara region government put forward the suggestion to locate a woodworking plant on the territory of the mill, which would produce not less than 1 million tons of timber per year. Besides, the Slyudyansk region territory, where the mill is situated, may be included into the touristic SEZ Baikal Gates."

However, Dmitry Medvedev said the government would support construction of pulp and paper mills close to the country's borders to increase export of more value-added products. «Construction of new pulp and paper mills remains a pressing issue for our country,» Medvedev said during a government meeting in Chita.

Last November, Russia delayed an increase in timber-export duties that were scheduled to come into force January 01, 2009. According to the Ministry for Economic Development, Russia, the world's biggest timber producer, imports a third of all the timber-derived products it consumes.

For example, within the framework of anti-crisis measures Investment Council under the Government of the Krasnoyarsk area decided to provide Enisey PPM with over 850 thousand EUR. The money is to compensate part of costs on product manufacturing and export. The mill is obliged to keep over 1400 workplaces and take measures in order to reduce production costs.

At the top level

Russian President Mr. Medvedev suggested closing down the Baikal Pulp and Paper Mill.

Arkhangelsk region

Solombala pulp and paper mill is getting ready to start pulp production.

January 26, 2009 Solombala pulp and paper mill (Solombalales) started preparing machinery to start pulp and paper production. Technological workers set already to work.

Machinery of the main shops – cooking, drying etc – will be put into operation February 04, 2009. According to the schedule, the first products will be produced February 06, 2009.

At the same time the company continued works on reconstruction of water treatment systems. In December 2008 the second Bellmer press filter for sewage sludge dewatering was delivered at Solombala pulp and paper mill.

At the same time the largest in last years project – construction of a timber preparation plant – is being realized at Solombala pulp and paper mill (Solombalales Group of Companies).

Project documentation is to be prepared by the middle of March with the project to be submitted for board approval by the end of March.

Currently the customer and project designer are discussing the details with all the notes being sent to St. Petersburg where specialists from CJSC Giprobum-Poyry are to consider the notes and make all the required corrections.

New facilities are to include timber preparation plant (capacity reaching 1 million of chips per year), bark processing machinery, conveyor system, and yard for timber and bark-and-wood fuel, as well as shipping site. Expected investment volume amounts to 13 million EUR.

Ilim Group to continue mill construction in Arkhangelsk region.

Ilim Group continues construction of a new mill for neutral sulfite semichemical production in the Arkhangelsk region.

Ilim Group won't stop realization of the project worth 72 mln USD even in current financial situation. The facility is to be launched in July 2009. Production facility is to make up 900 ton of semichemical per day and will allow increasing production volume and developing infrastructure.

Arkhangelsk PPM to reduce its investment programme

JSC Arkhangelsk pulp and paper mill reduced its investment programme as much as 5.3 times as it had been expected. Currently it makes up 7.5 mln EUR.

The company also postponed the construction of new flow for neutral sulfite semichemical cooking which will allow increasing cooking capacity up to 308 thousand tons.

Reference:

Arkhangelsk pulp and paper mill was founded in 1940. In 1992 it was turned into a Joint-Stock Company. The main shareholder is Pulp Mill Holding GmbH (Austria) – over 65% of shares. Basic products include cardboard, packaging and market pulp.

Stora Enso at the crossroads

Stora Enso is to reschedule project in Nizhny Novgorod region.

Stora Enso Oyj (Finland) is to choose a site for pulp-and-paper mill construction in the Nizhny Novgorod region with investment volume amounting to 1.6 billion EUR. Currently the Ministry for Industry and Trade is considering the project for it to be included in the list of priority projects in the field of forest exploitation.

Earlier the company intended to construct a mill for clay-coated paper production – annual capacity making up 500 thousand ton. At the same time Stora Enso considered a possibility of a mill construction for annual production of 1 million ton of pulp.

The corresponding agreement between the Administration of the Novgorod region and Stora Enso was signed December 20, 2007. The project includes development of forest infrastructure and construction of a mill at the area of 300 ha.

Later Stora Enso has decided to defer its final decision regarding the proposed pulp and paper mill project at Nizhny Novgorod in Russia to a later stage due to the weak global financial situation and near-term outlook for the forest products industry. The project is not cancelled by this decision, and various actions will be taken to facilitate possible implementation of the project in the future.

Stora Enso will hold negotiations with the Nizhny Novgorod regional administration in the near future to establish a new timetable for the proposed project.

Reference:

Stora Enso started pre-feasibility study for a world-class pulp and paper mill in Russia July 17, 2007. December 20, 2007 Stora Enso signed letter of intent concerning possible pulp and paper mill in Russia. Stora Enso started feasibility study for a world-class pulp and paper mill in Nizhny Novgorod region May 23, 2008.

More investments in construction and...

Manturovo project was included in the list of priority projects.

Investment project on pulp and paper mill construction in Manturovo (Kostroma region) was included in the list of priority projects in the field of forest exploitation. The mill is to be launched in 2011.

Ministry for Industry and trade signed the appropriate document January 28, 2009. The project is to be invested by LLC ASPEK Management Company and CJSC ASPEK-Lesprom with investment volume amounting to 1.6 billion EUR.

Manturovo pulp and paper mill is to produce 800 thousand ton of market pulp that will be used for paper production. As raw material the mill will mostly use broadleaf timber up to 4 million cubic meters from annual allowed cutting volume rate.

Production development

Mondi Group invites more specialists for STEP project realization.

Mondi Group invites more specialists for STEP project realization. Management of the company invited specialists from SAPP Group. They are Wolfgang Schubert, Christian Sommerer, Johannes Galos that have been involved in project realization in the field of pulp-and-paper industry for over 20 years. New specialists are to deal with technical issues and cooperate with subcontractors.

The invited specialists are familiar with the project as they made assessment of the invest project at Syktyvkar woodworking plant in 2008.

Volga PPM is to invest 100 mln EUR into production development in 2009-2011.

Volga Pulp and Paper Mill, JSC is planning to invest over 100 million EUR into production development in 2009-2011. With the existing problems of the global newsprint market the main task for the Volga enterprise is to strengthen its marketability on the priority export markets. In the next three years the administration of the company will invest over 100 million EUR into production development.

The money will be used for the increase of the main newsprint production volume by almost 25% by 2011. Besides, the mill is planning to modernize two papermaking machines (№6, №7) (20 million EUR for each machine) during the next 1.5 years, which will allow increasing mill production by 10-15%.

At present, the modernization projects are at the R&D stage and are to be approved by the Board of Directors, meanwhile, the negotiations with the machinery suppliers, incl. Metso, Voit, GLW, JonsonFoil, are being held.

The next investment project includes paper machine №8 modernization. It is one of the most powerful machines in Russia today. The investments will amount to approximately 20 mln EUR. The machine capacity will increase by 290 thousand tons against current 270 thousand tons. The mill is planning to begin the reconstruction works of the paper machine №5 in 2011.

Another decision is to replace the papermaking machine No 4 in 2009-2010. This papermaking machine is used for fluting and test liner production. Equipment being replaced, the today's machine capacity of 15 thousand tons will increase up to 80-100 thousand tons, and the produced paper will be of much higher quality.

The investment project is to be financed by means of own capital and loans. The main task for the Volga Pulp and Paper Mill is increase production volume and improve paper quality as well as save sale, production costs and provide production of 800 thousand tons of newsprint per year.

Packaging equipment

Vyborgskaya Cellulose is to reconstruct packaging line.

JSC Vyborgskaya Cellulose completed works on reconstruction of packaging line for paper-base production. There was assembled a new line for paper rolls and cardboard transportation from paper mill to warehouse with the help of FISS lifting-tilting device (Italy) designed for heavy cardboard rolls up to 2.8 m and 4 tons.

Packaging machine was also reconstructed, which allows producing white cardboard for corrugated containers (white top liner) manufacture as well as increasing capacity of transport system. As a result, Vyborgskaya Cellulose increased deliveries to European and large Russian customers. Investment volume amounted to 440 thousand EUR. Delivery of tilting device was financed by JSC VTB within the framework of Vyborgskaya Cellulose reconstruction programme.

New line for corrugated packaging production is to be launched at Seleginsk PCM.

New line for corrugated packaging production was launched at Seleginsk Pulp and Cardboard Mill March 17, 2009. The delivery included two high speed lines for corrugated boxes production - 8PA (2600x1600 mm) and 5PA-FG (2500x1000 mm) – manufactured by Tien Chin Yu Machinery Manufacturing Co. (Taiwan). Auxiliary equipment was also installed at the mill.

New equipment will allow expanding product assortment, manufacturing corrugated products with larger size range, including 5-layered corrugated cardboard. This investment project worth over 2 million EUR started in the end of 2007 and was completed in January 2009. Currently the mill can achieve project capacity. The plant for corrugated packaging production being modernized, the mill is to improve product quality, increase production output by 40% and decrease variable costs regarding corrugated production.