



July 2008 Focus Topic

An update of the Petroleum market



What is driving the price of Oil and Petroleum Products up so dramatically?

Rapidly escalating oil and fuel prices are having a dramatic negative impact on our economy which is translating to decline in demand for most goods and services in the US (catalogs and magazines included).

Rapidly escalating fuel and diesel prices are having a significant impact on freight and manufacturing costs of almost all paper products.

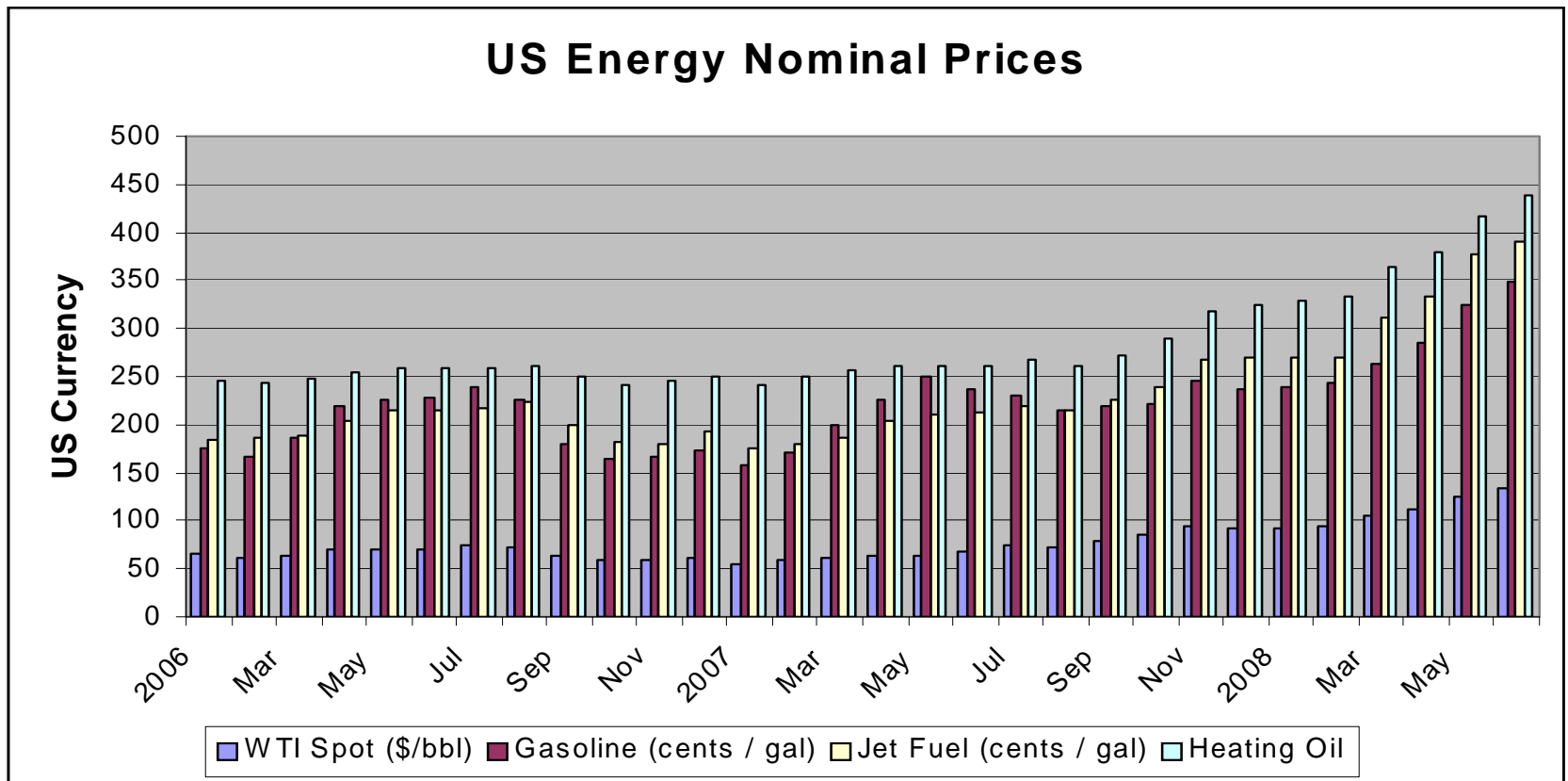
Several of the raw materials used in the paper making process are petroleum based (coating binders) or are relatively energy intensive to produce (coating / filler pigments).

The following slides explore the supply and demand of crude oil and a few other fuels in order to get a sense of what the key drivers are in the rapid ascent of prices of these products.



Question: Why have fuel prices risen so sharply?

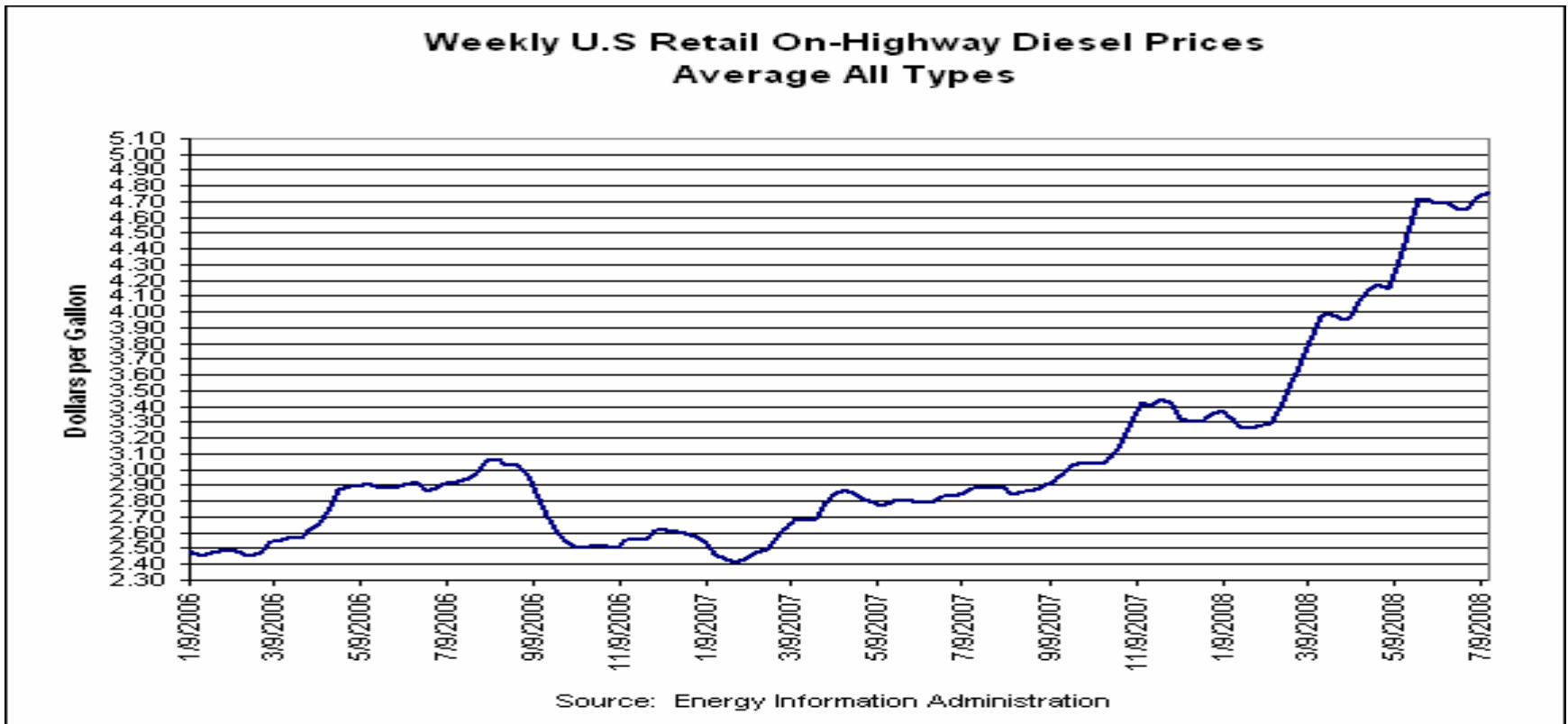
The graph below shows a small sampling of the price of common fuels that are up dramatically YOY in the US (60-100%). Consumers are reportedly becoming cash strapped as they are spending a larger percentage of their income on transportation and their household energy needs.





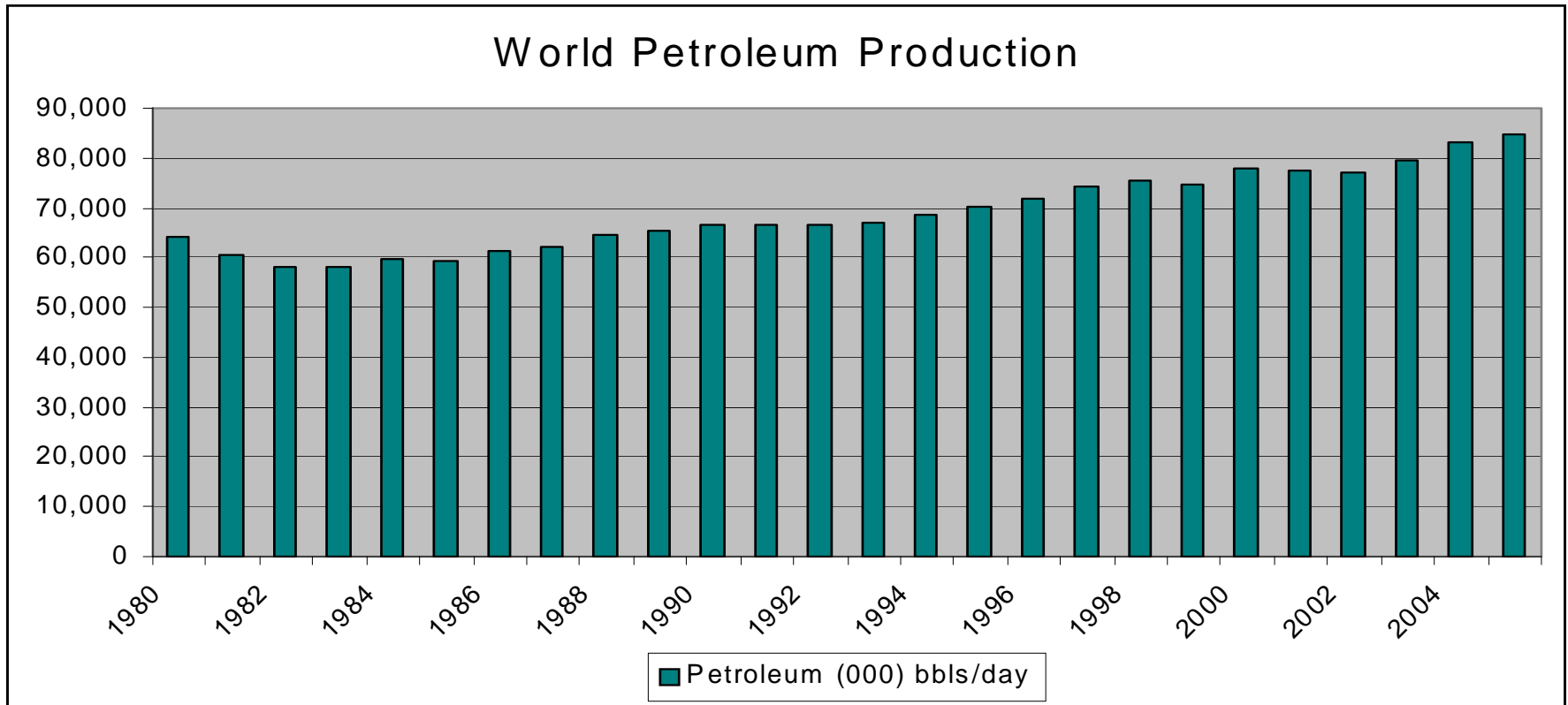
Diesel prices increase 70% YOY

Diesel fuel is obviously very important to the cost of freight for most goods shipped. This includes raw materials delivered to the paper mills (many of which are found in remote locations) and finished paper shipped from the mill to the printer.





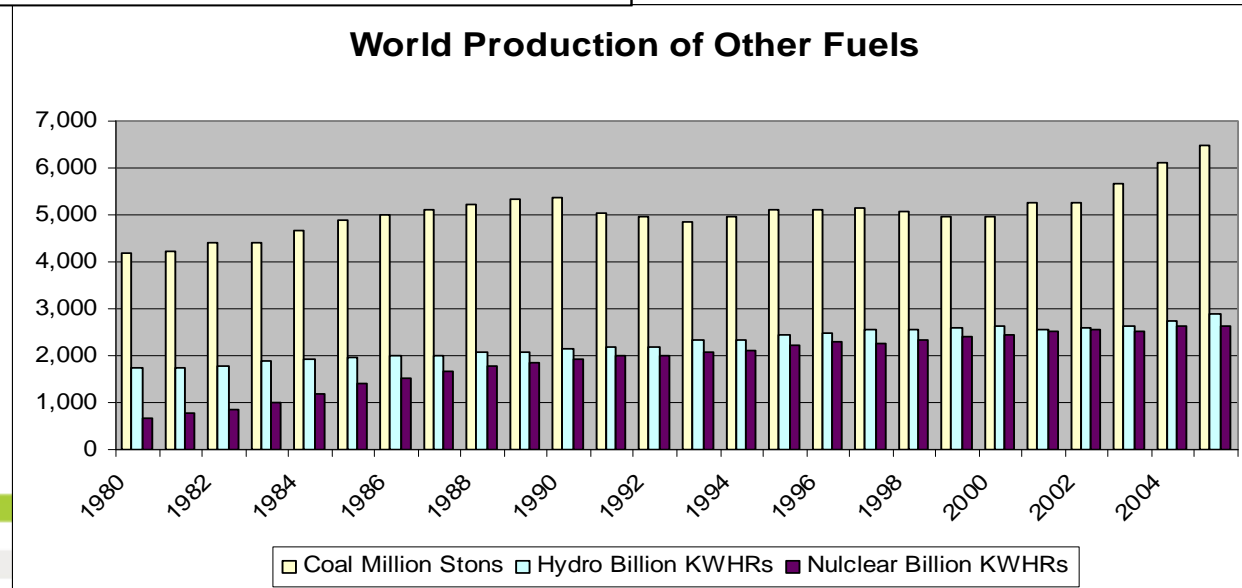
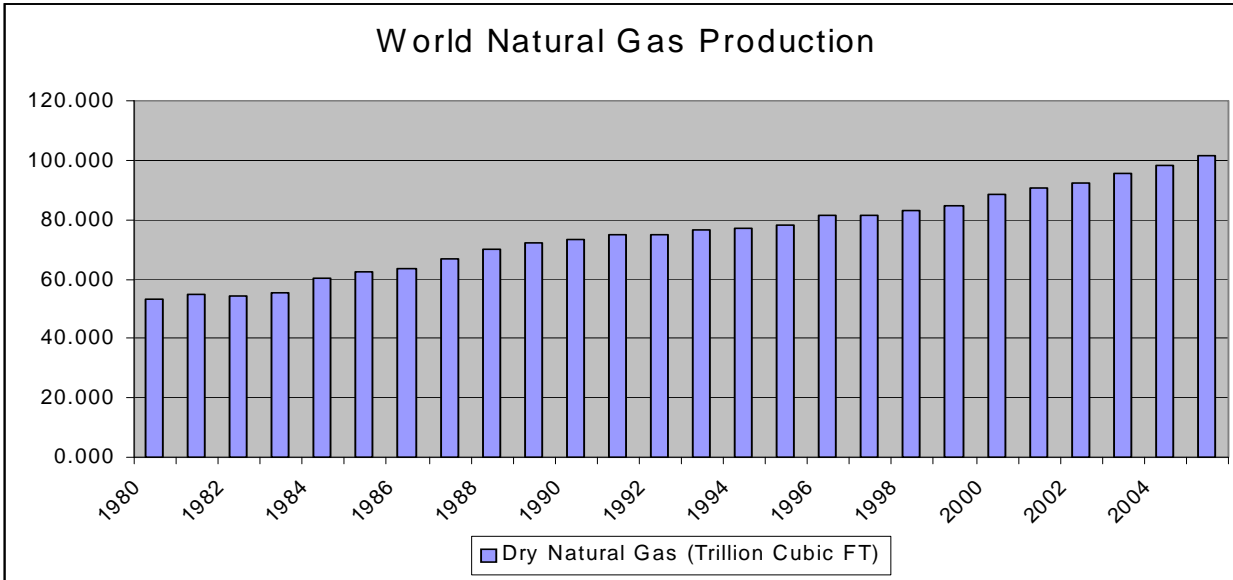
Historical trends show steady increase in petroleum production



A review of the historical trends of Petroleum Supply (Production) shows a steady increase that is required to meet the growing demand. The growth in demand has been most dramatic in China over the last decade.



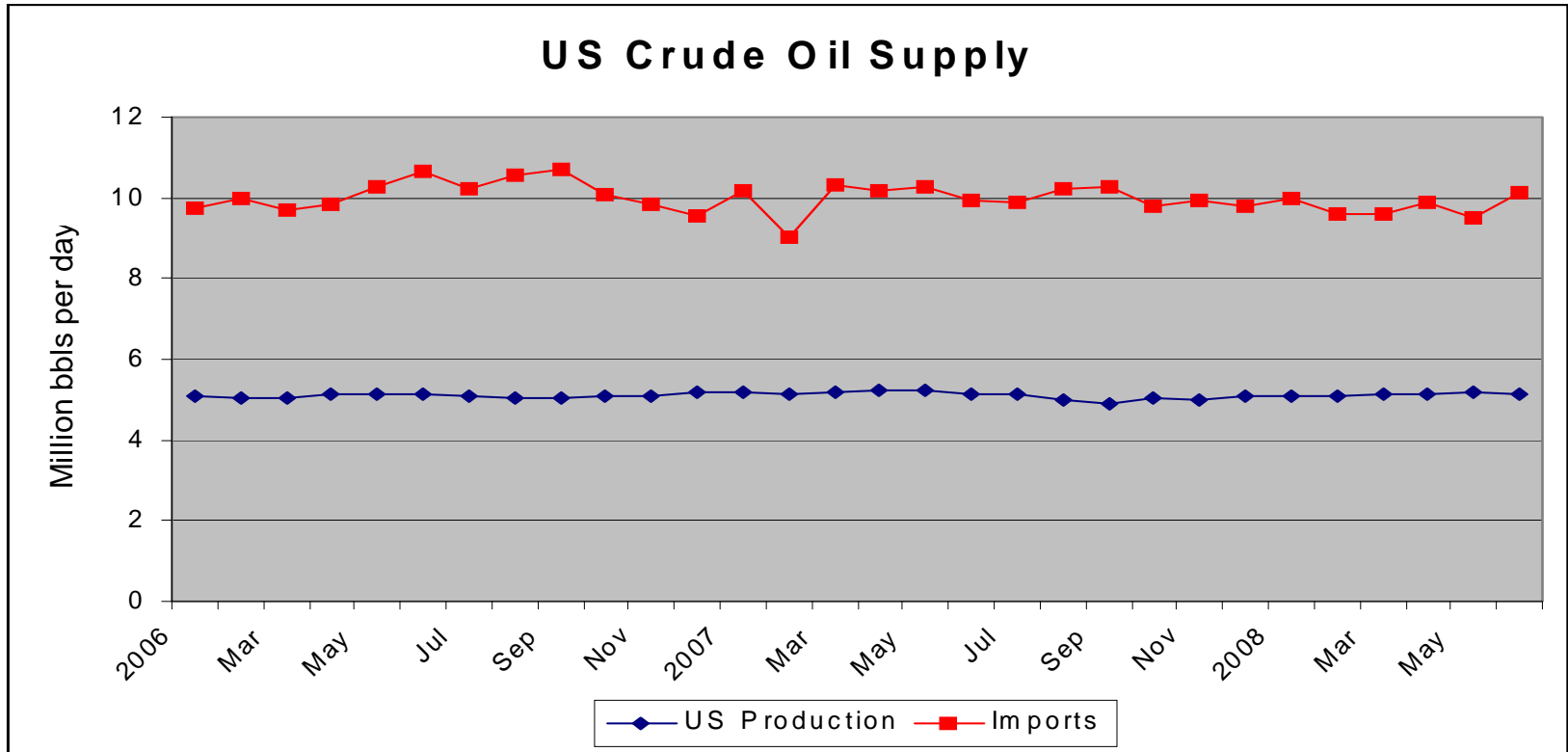
Worldwide production of other major fuel sources is increasing too



Source: DOE



Conclusion: US Oil Supply is stable

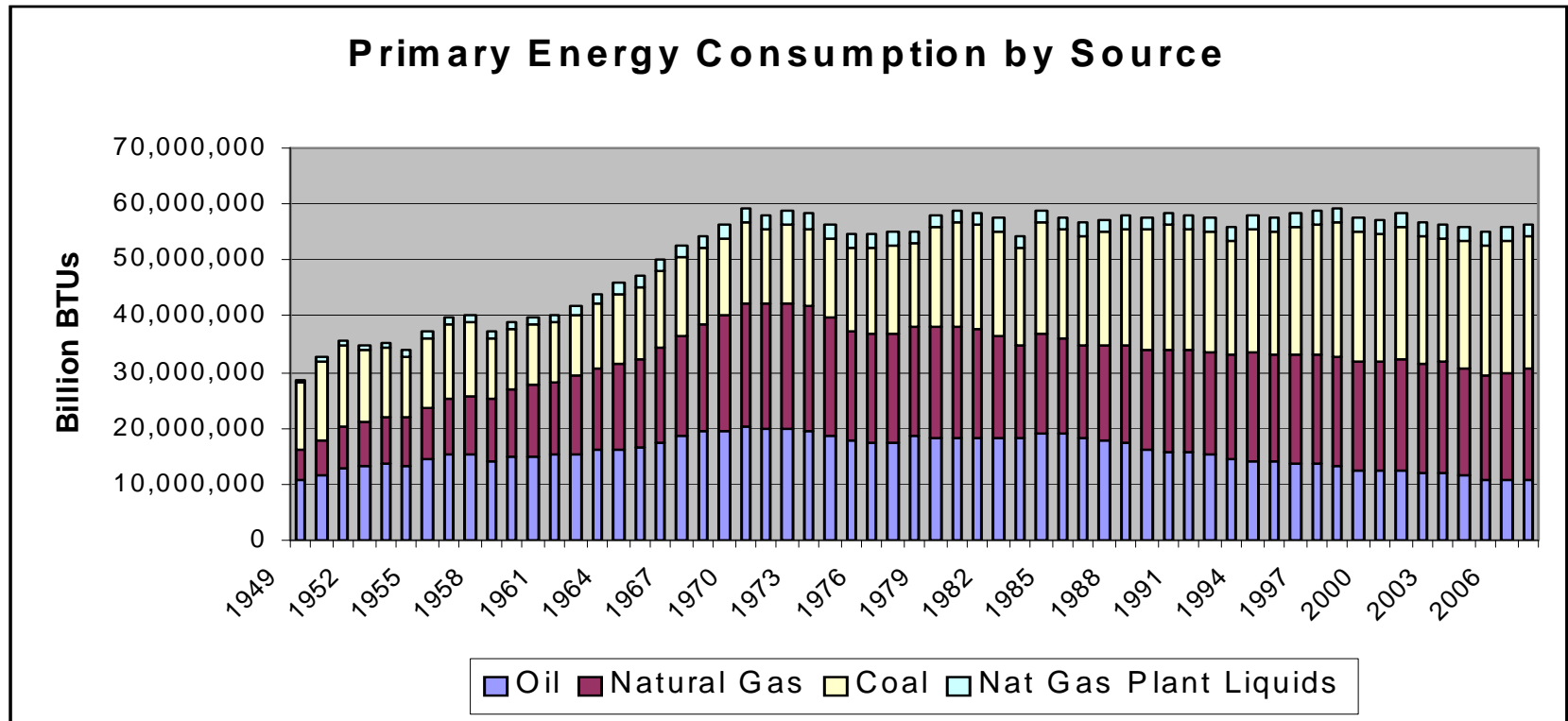


Over the last 10 quarters there does not appear from this data to be any decline in the supply of crude oil that could lead to a supply/demand imbalance.



Historical trends of US Energy consumption have been stable

The graph below shows that total US energy consumption has been relatively flat since the early 1970s. The oil portion of the consumption has decreased significantly and in 2006 was approximately half of what it was in the early 1970s.

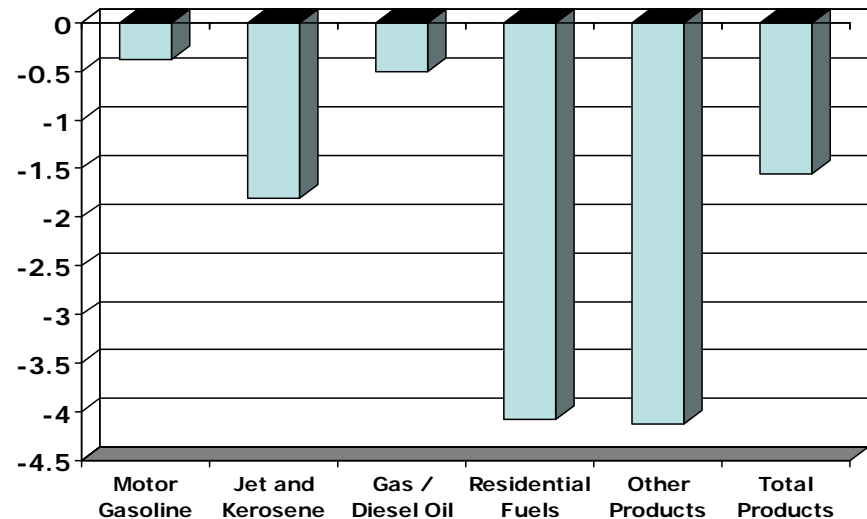




Conclusion: US Demand has actually declined in 2008 YOY

- On a quarterly basis, US Petroleum demand growth was 2.3% lower than last year during the 2Q; this follows on an even weaker 4.4% decline rate during the 1Q
- Petroleum demand growth was last this weak in 2001, when the GDP growth rate slipped to -1.4%, much lower than the 1.0% recorded in the 1Q of 2008. Though not surprising, this indicates that high retail fuel prices are cutting into petroleum consumption, beyond what weak economic growth alone would imply.
- All major fuel categories have posted YOY declines but the largest have occurred in fuels used for industrial purposes.

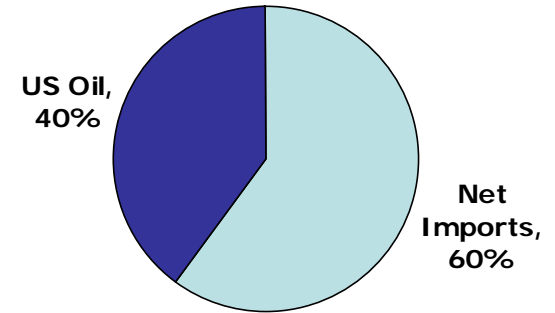
US Demand by Product, YOY Change



Dependency on Foreign Oil

- Although the US is the third largest oil producer, most of the oil we use is imported. The US is the world's largest oil consumer at 20.7M bbls per day. In order to satisfy that demand, the US imports 12.4MM bbls per day. (2006 data)

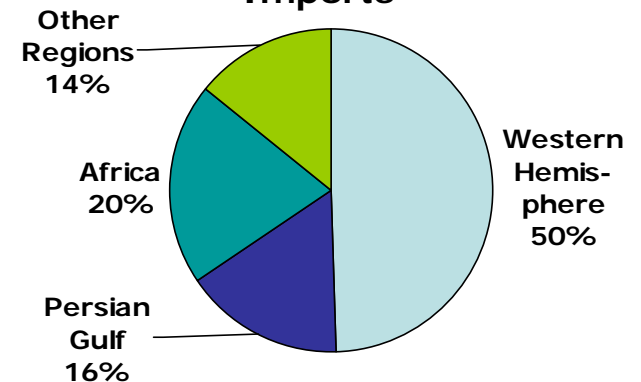
Net imports as shares of US demand



- Western Hemisphere nations provide about half of the US imported petroleum. The top five countries the US imports from are as follows (2006 data):

1. Canada	(17.2%)
2. Mexico	(12.4%)
3. Saudi Arabia	(10.7%)
4. Venezuela	(10.4%)
5. Nigeria	(8.1%)

Sources of US Petroleum Imports





Conclusion: Speculation appears to be playing a key role in price inflation

Is speculation a key to the increase the US has seen in market pricing?
According to Michael Masters (Masters Capital Management, LLC) in testimony before the Congressional committee, the answer is, Yes.

In this testimony:

- The number of Index Speculators – who distribute their allocation of dollars across the 25 key commodities futures according to the popular indices – has seen huge growth.
- Assets allocated to commodity index trading strategies have risen from \$13B (2003) to \$260B (Mar 2008) and the average price of the commodities that compose this index has risen 183% in those 5 years.
- The popular press explanation given for rising oil prices is the increased demand from China. Over the last five years the annual Chinese demand has increased 920M barrels, while the increase in demand from Index Speculators is 848M barrels over the same time period.
- Index Speculators have now stockpiled via futures market 1.1B barrels of petroleum, which is 8 times more oil as the US has added to the Strategic Petroleum Reserve over the last five years.