Company

Global Markets Research

Deutsche Bank

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INDUSTRY ALERT

Paper & Forest Products

Industry Update

Unprecedented Prelim November Printing & Writing #s

Focus stocks

AbitibiBowater Inc (ABH.N),USD0.42 Hold, Price Target USD2.00

Glatfelter (GLT.N),USD9.33 Sell, Price Target USD8.00

International Paper (IP.N),USD12.17 Hold, Price Target USD16.00

Domtar (UFS.N),USD1.75 Hold, Price Target USD4.00

We've come to expect weak P&W shipment numbers in recent months, but preliminary November numbers were much worse than we anticipated. Uncoated free sheet shipments were down 17.4% and coated paper volumes were off 22.8% (coated free sheet) to 36.1% (light-weight coated paper). Uncoated mechanical grades, the smallest category, were down a scant 8.7%. These are the poorest yr/yr comparisons we can recall and provide further evidence of just how intense the inventory de-stocking appears across the economy. While we think that final consumption is quite weak, we believe that a large portion of these declines represent inventory reductions all along the supply chain.

The near-term impact? First, lots more downtime through the balance of Q4 and into Q1. This will have an impact on near-term earnings for companies like Domtar, International Paper, and other big white paper producers. Second, these declines will keep the pressure on prices. To this point, the slippage in most white paper grades has been much smaller than we would have anticipated. While we think the "spot market" declines have been larger than the $10-20/ton dips shown in the trade papers, broader market prices have held reasonably well. This suggests that the industry's aggressive moves to cut supply have helped limit pricing erosion. However, with the industry now entering its slowest point in the year (December thru February), we do expect pricing pressure to intensify. The next 75 days will be an "acid test" for the sector. In the face of one of the sharpest cyclical drops ever in demand as well as seasonally slow demand, will the industry avoid a pricing collapse?

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