

Paper & Forest Products

Few Surprises in January P&W Data; Volume Trends Remain Weak

Final January printing and writing statistics were just released, and the data were expectedly weak and largely consistent with the preliminary data published earlier this month. Total printing and writing paper shipments declined 24.5% y/y in January off of a tough year-ago comp and hit the lowest absolute level in over 15 years. However, despite the sharp falloff in shipments volumes, producers (especially uncoated freesheet producers) did a good job managing inventories, which we believe has gone a long way toward limiting price erosion. Nevertheless, 2009 got off to a very weak start from a volume perspective and without a partial recovery in demand in the coming months, we think our 1Q09 volume assumptions could be at risk to the downside.

- **Total shipments of printing and writing papers declined 24.5% y/y in January** and were 23.6% below five-year historical average levels. Combined coated and uncoated paper inventories increased 39,000 tons month on month in January, which compared favorably to the historical average increase of 50,000 tons. At the end of January, total printing and writing inventories stood at 1.97mm tons, or 6.3% below historical average levels.
- Please see the attached tables for a more detailed look at the data and note the January highlights below:
 - ▶ **UCFS shipments declined 19.4% y/y** and were 21.0% below five-year average levels. Shipments of cutsize paper (45% of the UCFS market) were down 16.5% y/y, reflecting in large part the drag from deteriorating employment trends. Offset shipments (23% of the UCFS market) tumbled 23.6% compared to the prior year, while envelope grades were off 22.6%. Inventories declined 38,000 tons month on month versus the typical 3,000-ton *increase*, and stood 14.1% below average levels at the end of January.
 - ▶ **CFS shipments declined 27.1% y/y, which was consistent with preliminary data.** The catalog channel was notably weak, with shipments into this end market down 40.1% year on year, while coated freesheet shipments for commercial print applications declined 26.8%. Relative to five-year average levels, coated freesheet shipments declined 27.2%. Inventories of coated freesheet increased 44,000 tons versus the prior month in January, which was in line with the historical average inventory increase.
 - ▶ **Shipments of CGW were off 30.1% y/y in January** and were down 27.2% compared to five-year historical levels. Inventories increased 25,000 tons versus December levels, which compared to the historical average decline of 1,000 tons. Inventories remain well above year-ago and historical average levels, as stepped-up downtime has yet to bring mill inventories down to more manageable levels.

Key producers include UFS and IP in uncoated freesheet; SPP, VRS, UPM, and SEO in coated freesheet; VRS, UPM, ABH, SPP, and SEO in coated groundwood; and ABH and UPM in uncoated groundwood.

See page 3 for analyst certification and important disclosures.

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Table 1: Shipment Statistics

000 tons

	Jan-09	Jan-08	% change 08 vs '07	5-yr avg	% change vs. 5-yr
Uncoated Freesheet	817	1,014	(19.4%)	1,035	(21.0%)
Coated Freesheet	283	387	(27.1%)	388	(27.2%)
Coated Groundwood	282	403	(30.1%)	387	(27.2%)
Uncoated Groundwood	116	180	(35.2%)	151	(22.9%)
Total	1,498	1,984	(24.5%)	1,961	(23.6%)

Source: American Forest & Paper Association and J.P. Morgan calculations.

Table 2: Inventory Statistics

000 tons

	Jan-09	Dec-08	% change Jan vs Dec	5-yr avg	% change vs. 5-yr
Uncoated Freesheet	1,032	1,070	(3.6%)	1,201	(14.1%)
Coated Freesheet	601	557	7.8%	667	(9.9%)
Coated Groundwood	247	222	11.2%	161	53.2%
Uncoated Groundwood	91	82	10.9%	74	23.6%
Total	1,970	1,931	2.0%	2,102	(6.3%)

Source: American Forest & Paper Association and J.P. Morgan calculations.

Table 3: Key Paper Producers

Grade	Key producers
Uncoated Freesheet	Domtar and International Paper
Coated Freesheet	Sappi, Verso Paper, UPM, and Stora Enso
Coated Groundwood	Verso Paper, UPM, AbitibiBowater, Sappi, and Stora Enso
Uncoated Groundwood	AbitibiBowater and UPM

Source: Company reports and J.P. Morgan.

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