

# **What A Difference 12 Months Makes: The Economy & Paper Markets**

**By Mark Wilde**

**January, 2009**



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**Deutsche Bank**



[Mark.Wilde@db.com](mailto:Mark.Wilde@db.com), Deutsche Bank Securities, January 2009

# Today's Agenda

- **Prospects for the Economy?**
- **Current State of the Paper Markets?**
- **Prospects for Paper Markets in 2009?**
- **What Will it Mean for Industry and Individual Players?**
- **Discussion**

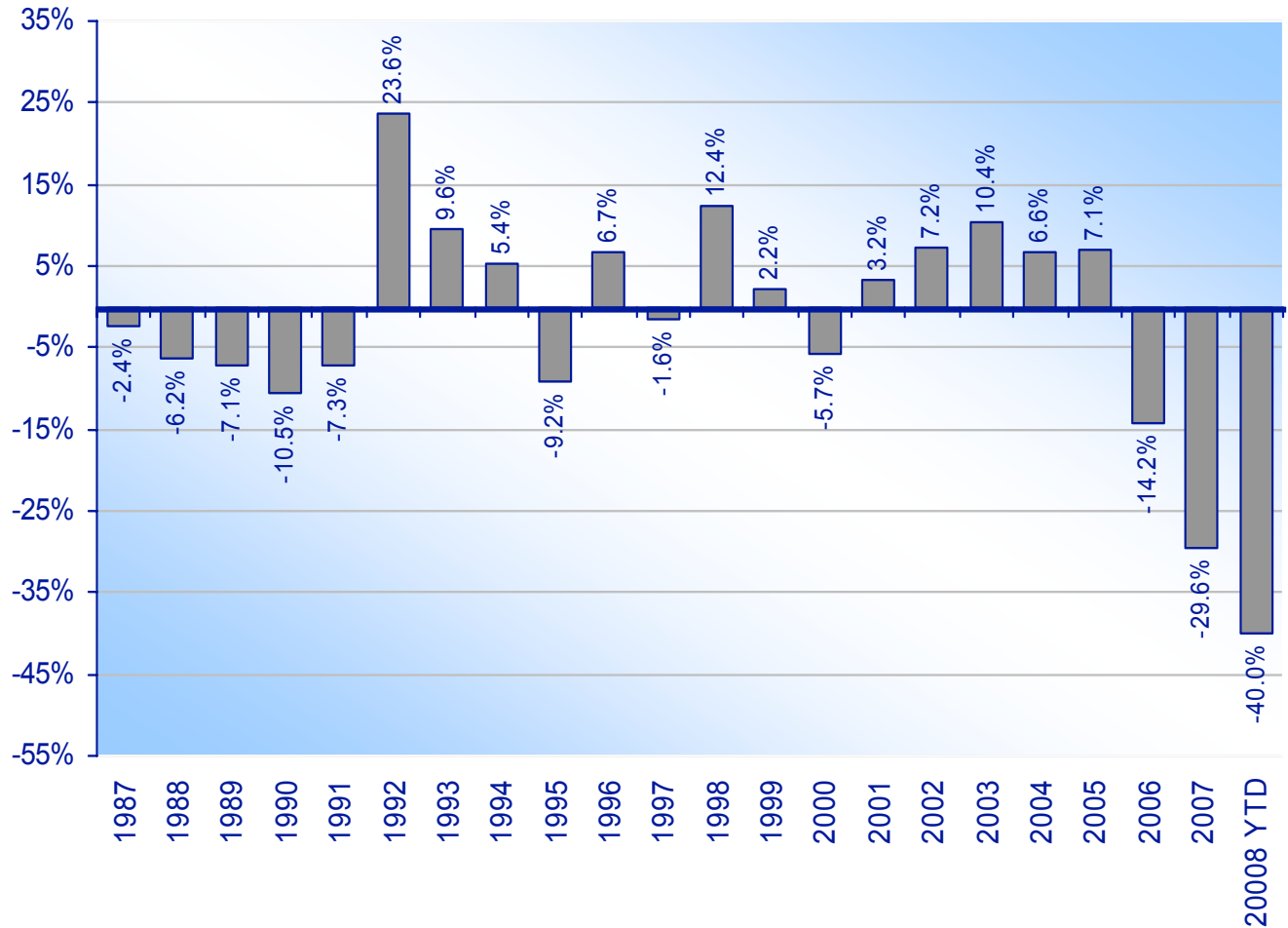


# Prospects for the Economy?

In 2008,  
housing starts  
have declined  
through November

**40%**

**Single Unit Housing Starts**  
(Y/Y % change - US)



Source: US Census Bureau, Factset



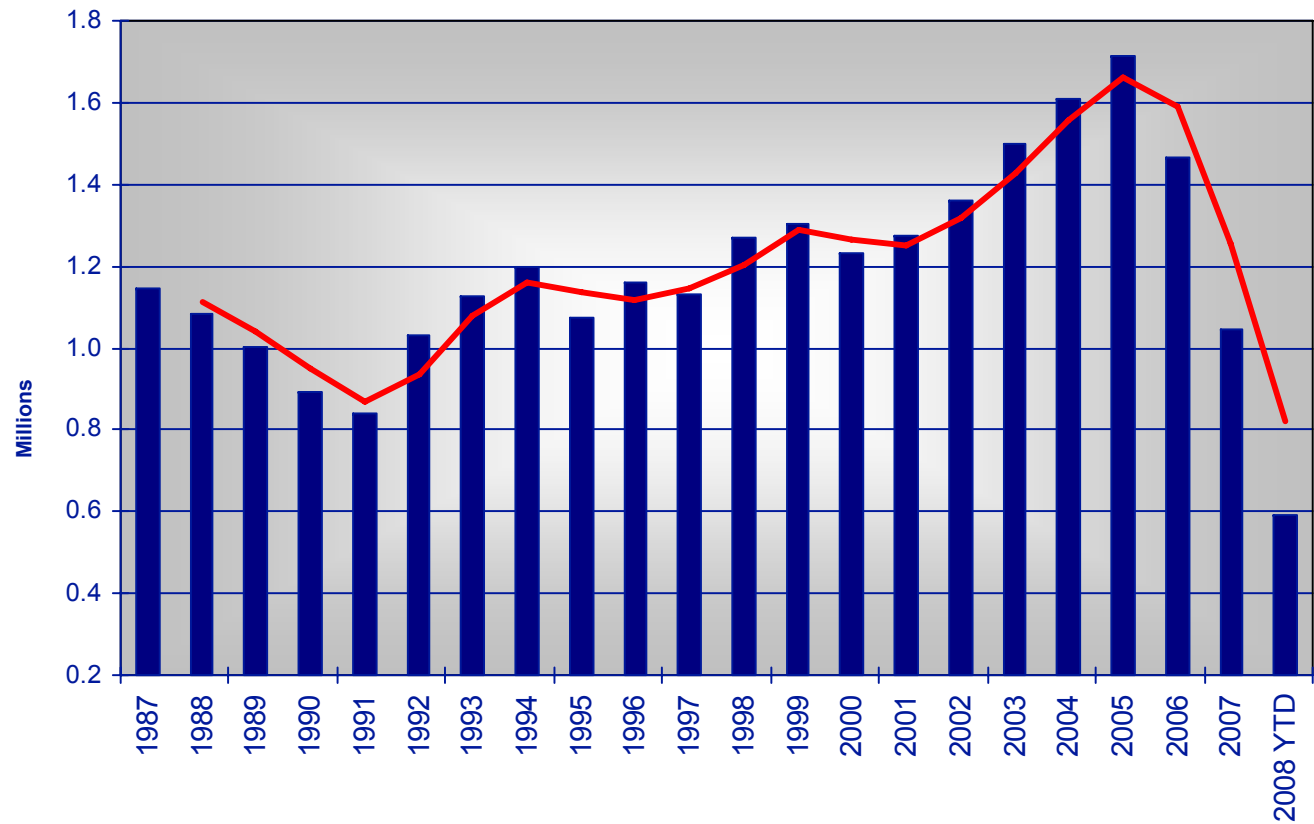
# Prospects for the Economy?

Housing Starts are  
**Down Significantly**  
Through Nov 2008

2008 YTD = 593K  
2007 YTD = 994K

## Total Single Unit Housing Starts

(Total Starts Per Year, Millions - US)



Source: US Census Bureau, Factset

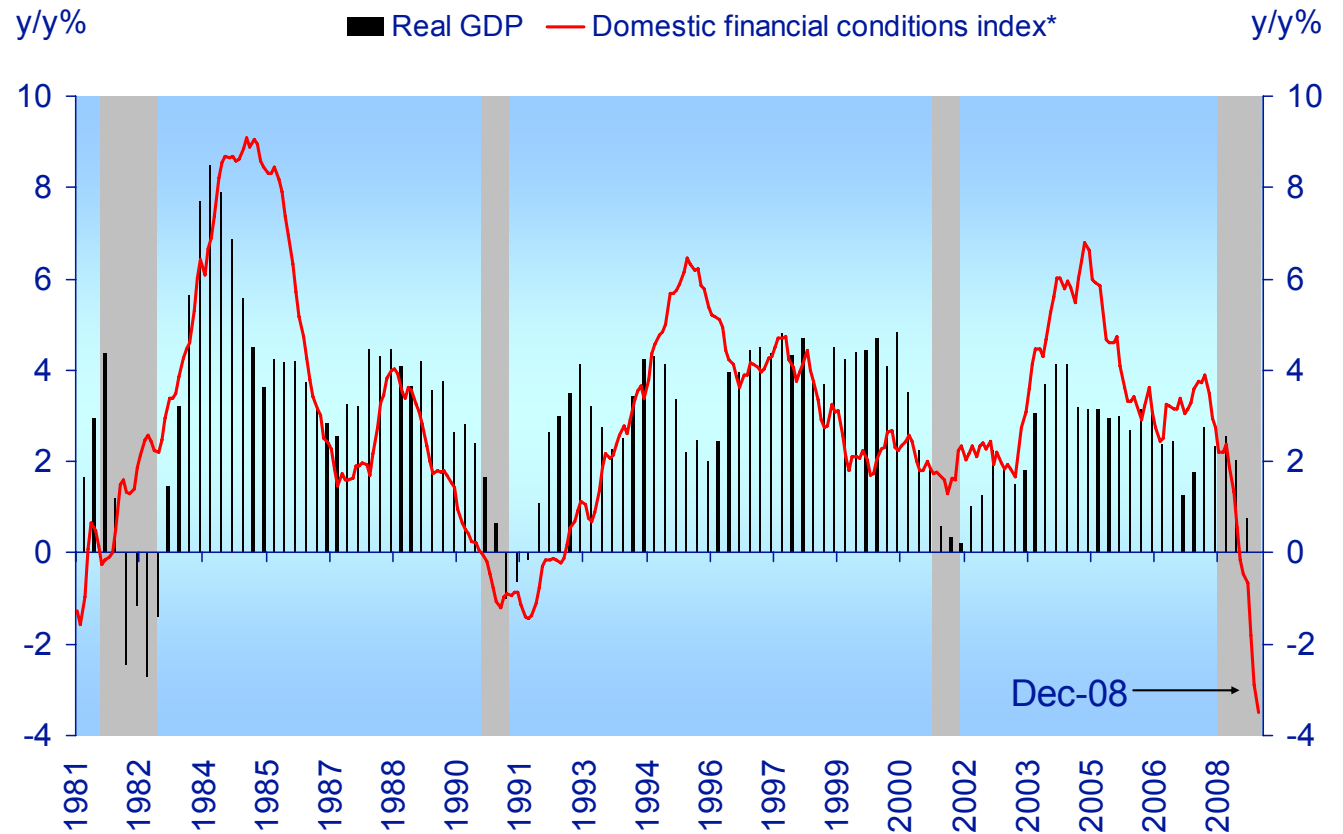


# Prospects for the Economy?

**Domestic Financial  
Conditions are  
Extremely Restrictive**

## Real GDP vs. Domestic Financial Conditions Index \*

*\* Includes M2, bank loans & leases, consumer credit, yield curve, credit spreads and cyclical stocks*



Source: BEA, DB US Economics Research



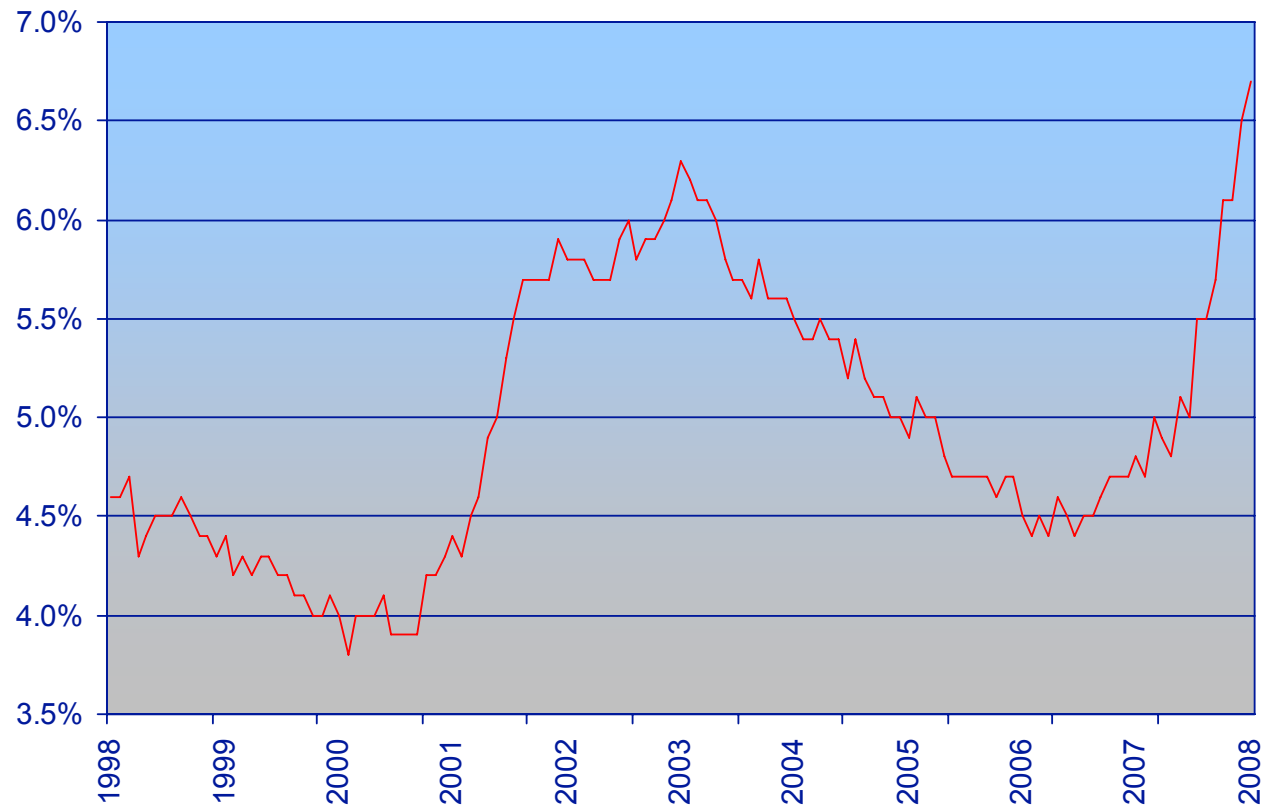
# Prospects for the Economy?

**Jobless claims  
are rising**

Unemployment Rate, % SA				
'08	'09	'09	'09	'09
Q4E	Q1E	Q2E	Q3E	Q4E
7.0%	7.4%	8.1%	8.4%	8.6%

Source: DB Economic Research Team

## Unemployment Rate, % SA



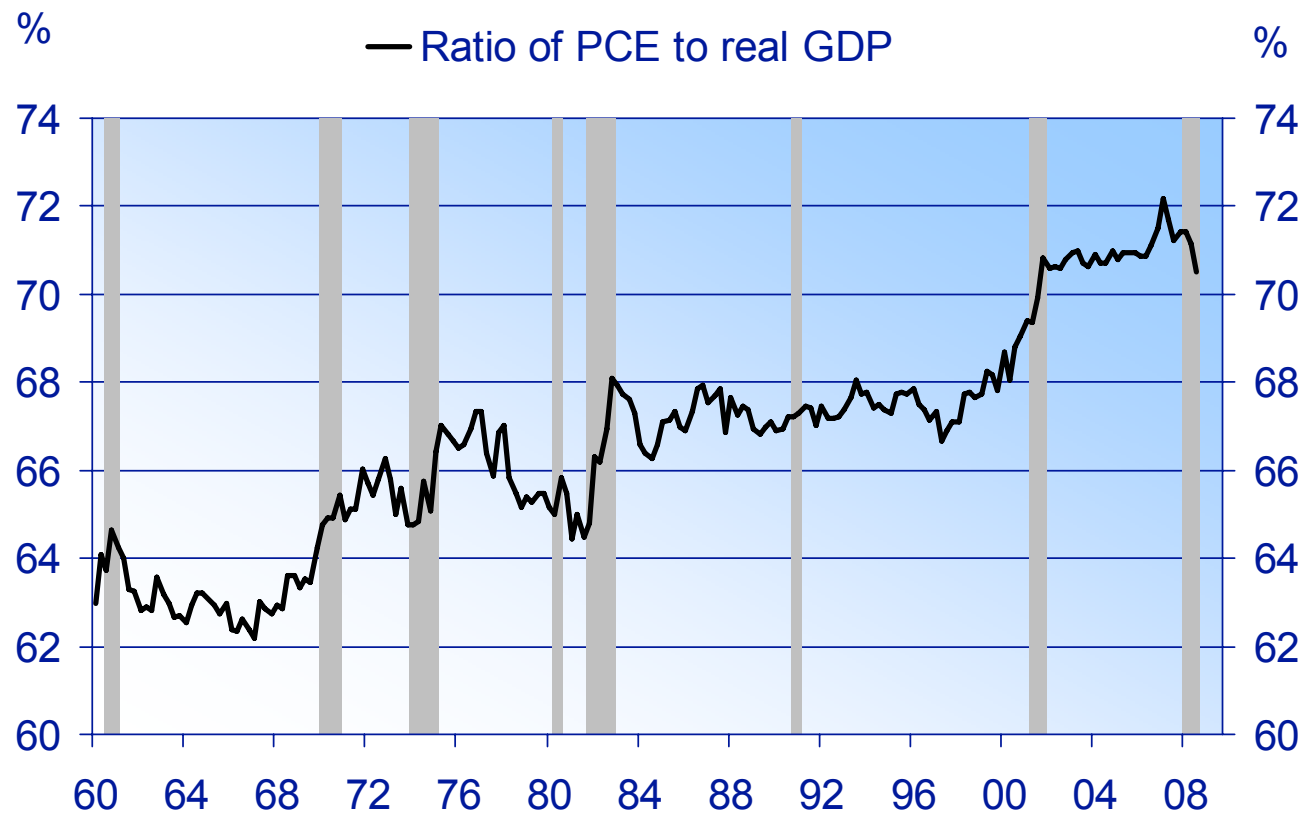
Source: DOL



# Prospects for the Economy?

Consumption is Bound to Slow from Excessive Levels

## Ratio of Personal Consumption Expenditures (PCE) to Real GDP

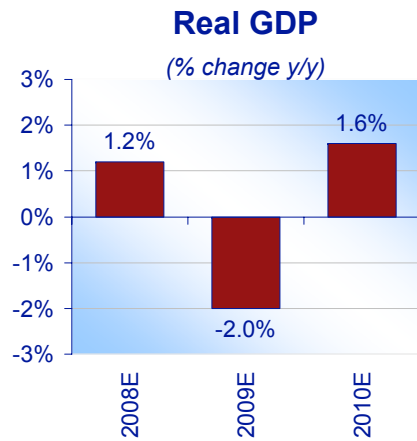


Source: FRB, DB US Economics Research



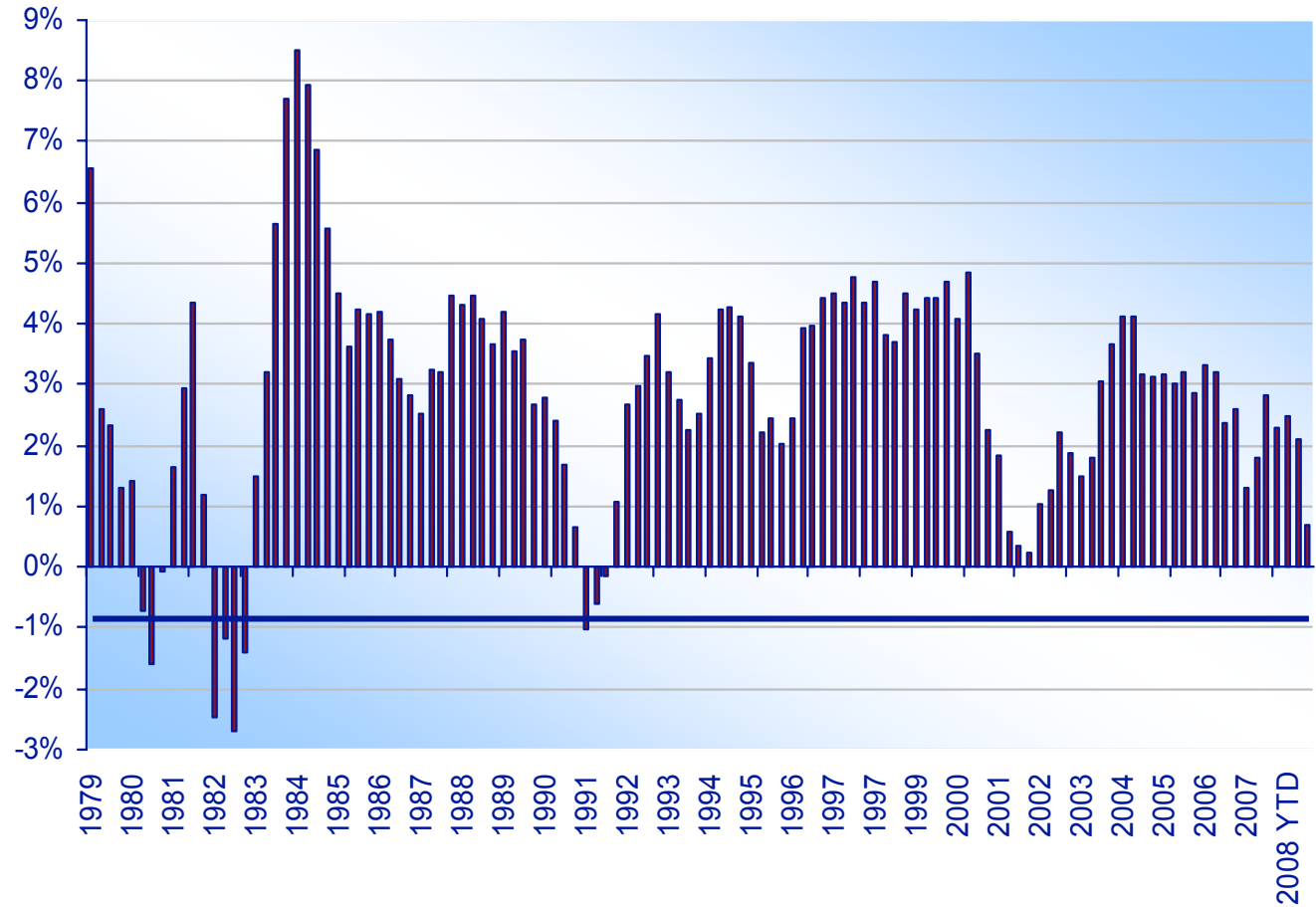
# Prospects for the Economy?

**With the Recession Beginning in December 2007, DB's Forecast is Consistent with an 18 Month Recession**



Source: DB Forecast

## Real GDP (% change y/y)



Source: Conference Board, BEA, DB US Economics Research





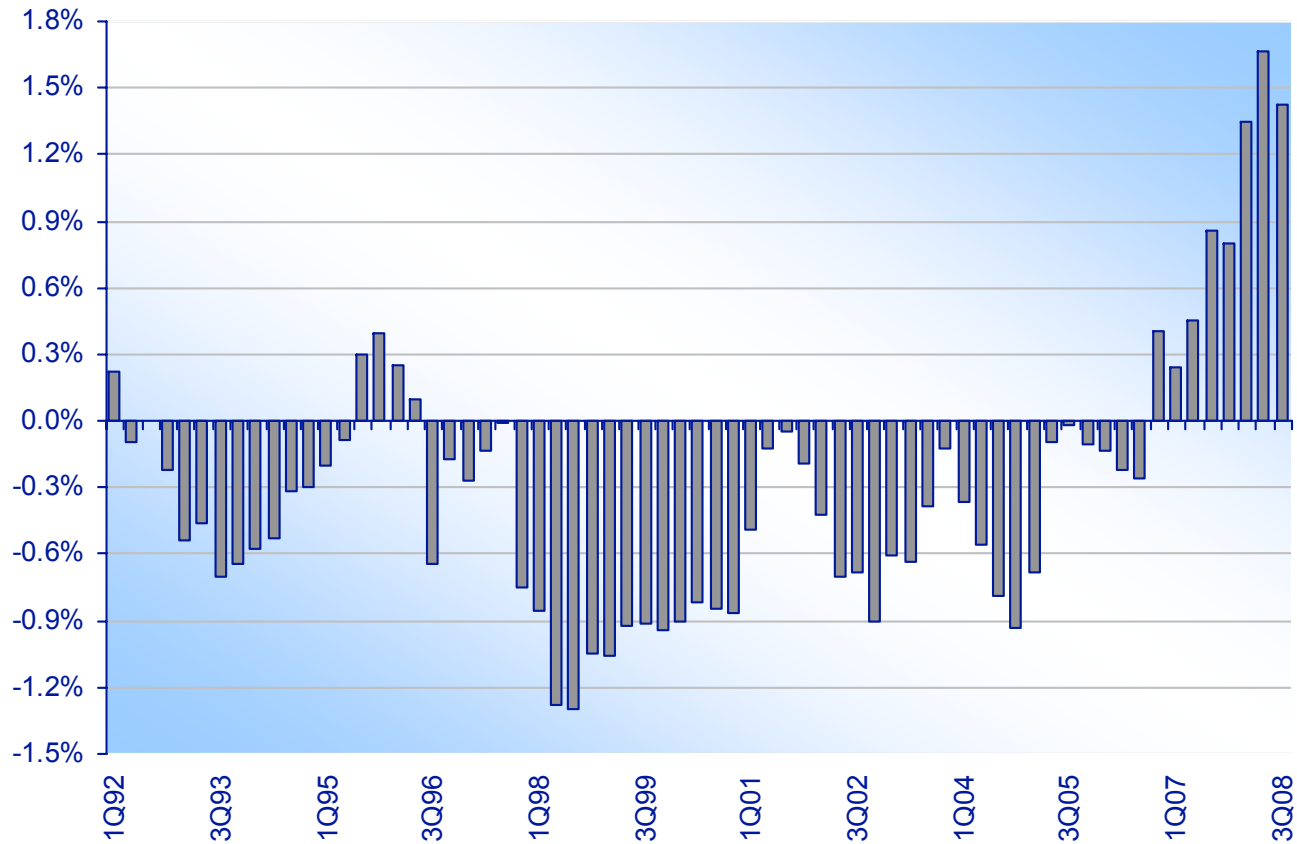
# Prospects for the Economy?

**Net Exports Have Been Contributing Strongly to Growth, However, Exports Appear to be Dragging in Recent Months**

**For Q4 2008, DB's Forecast for US Exports is a decline of 10% q/q, (SAAR)**

***We Are Beginning to See More Competitive Conditions in Many Paper Industry Markets***

**Real Net Exports Contribution to GDP Growth**  
(%, 4-Qtr. MA)



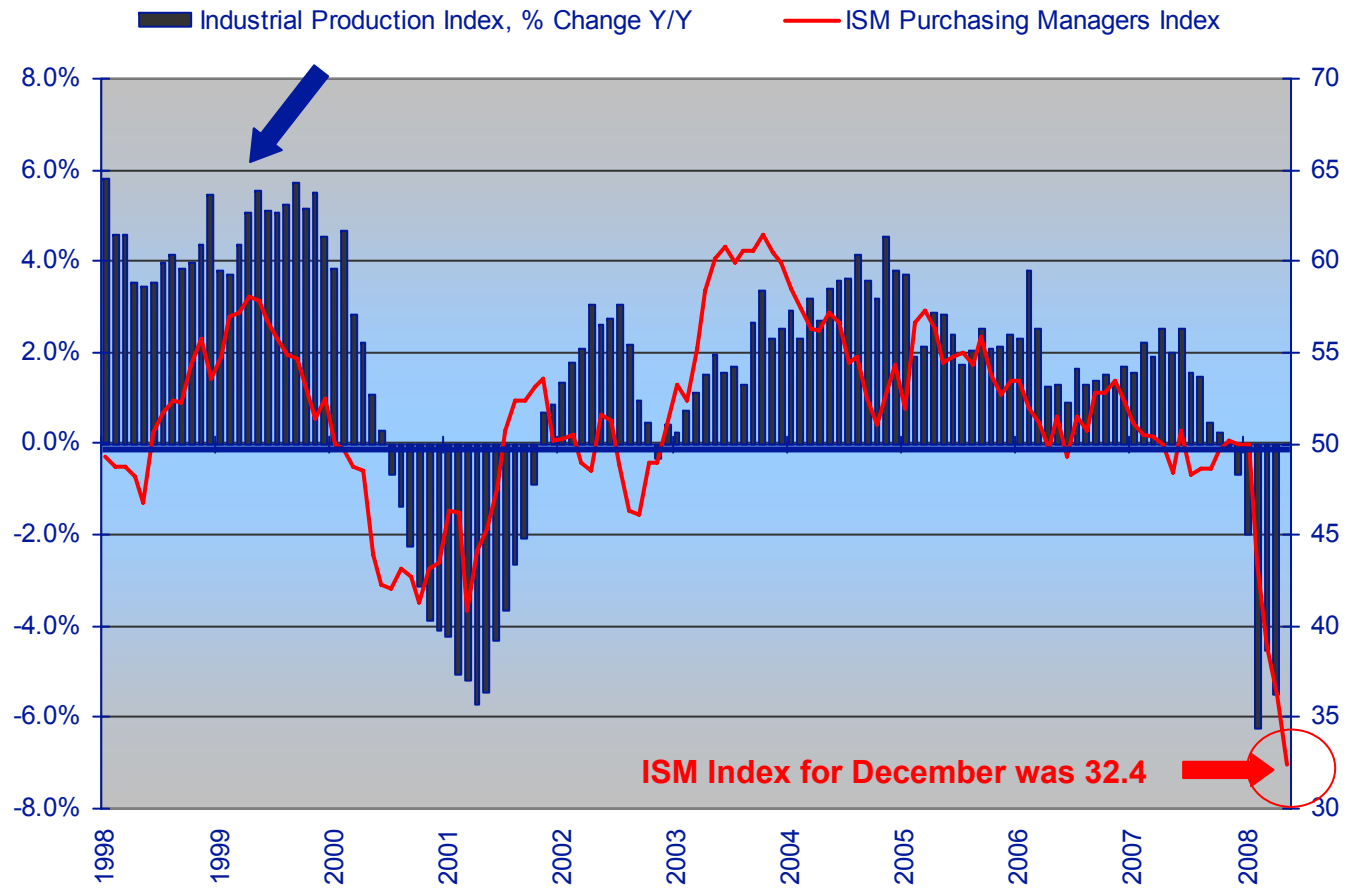
Source: BEA, DB US Economics Research



# Prospects for the Economy?

**ISM Purchasing Managers Index Reading Below 50 Indicates Sector is Contracting**

## ISM Purchasing Managers Index vs. Industrial Production Index



Source: Factset, ISM

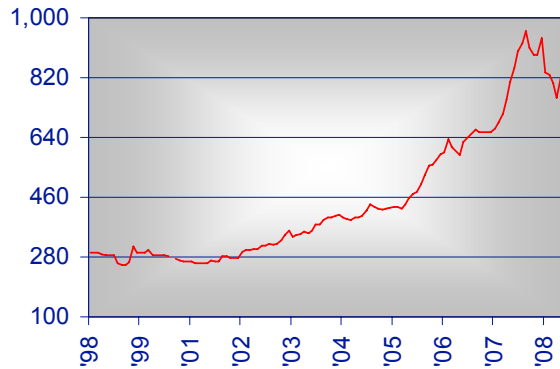


# Prospects for the Economy?

## Pressure on Global Commodity Markets

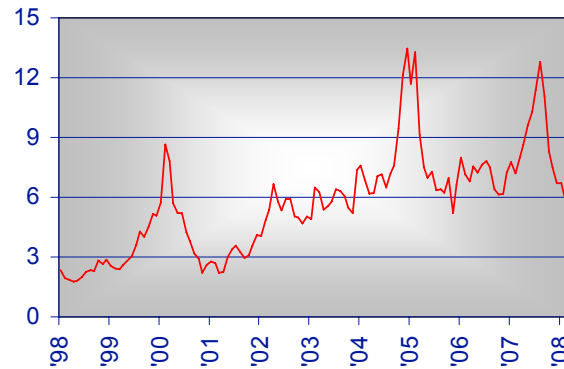
### Gold - \$USD

(Gold price against US\$)



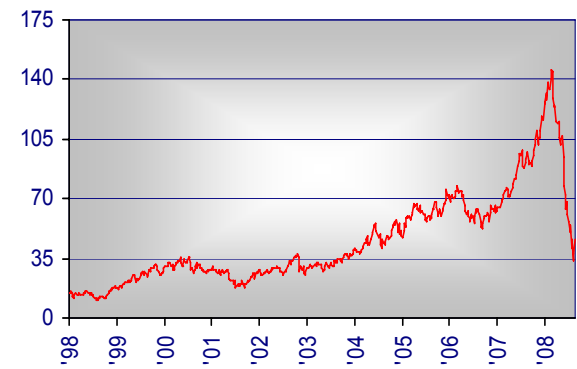
### Natural Gas

(US\$ - NYMEX Natural Gas Future)



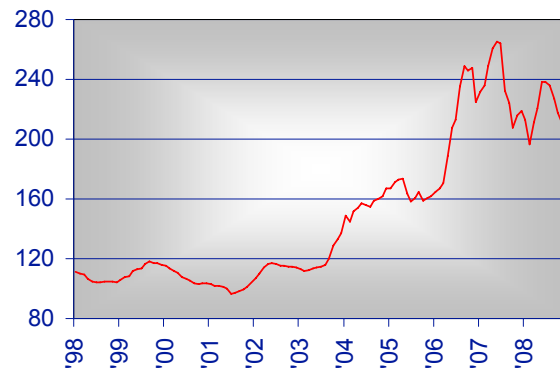
### Oil - \$USD

(US\$ per Barrel)



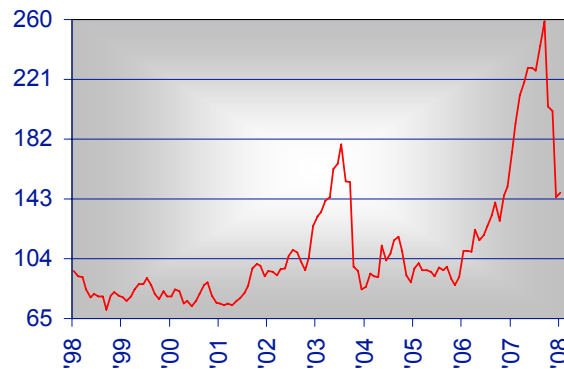
### Cold Rolled Steel

(PPI Cold Rolled Steel Sheet & Strips, '82=100 NSA, US)



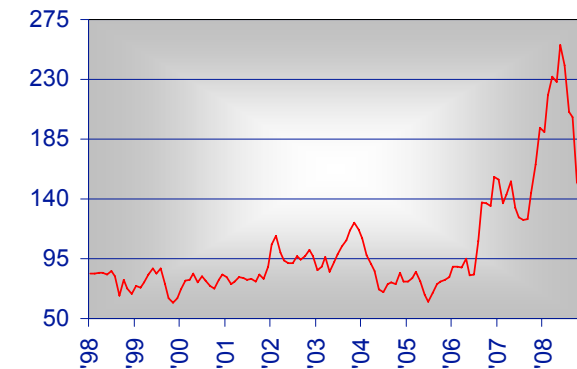
### Soybeans

(WPI Farm Products, Soybeans, '82=100 NSA, US)



### Corn

(WPI Farm Products, Corn '82=100 NSA, US)

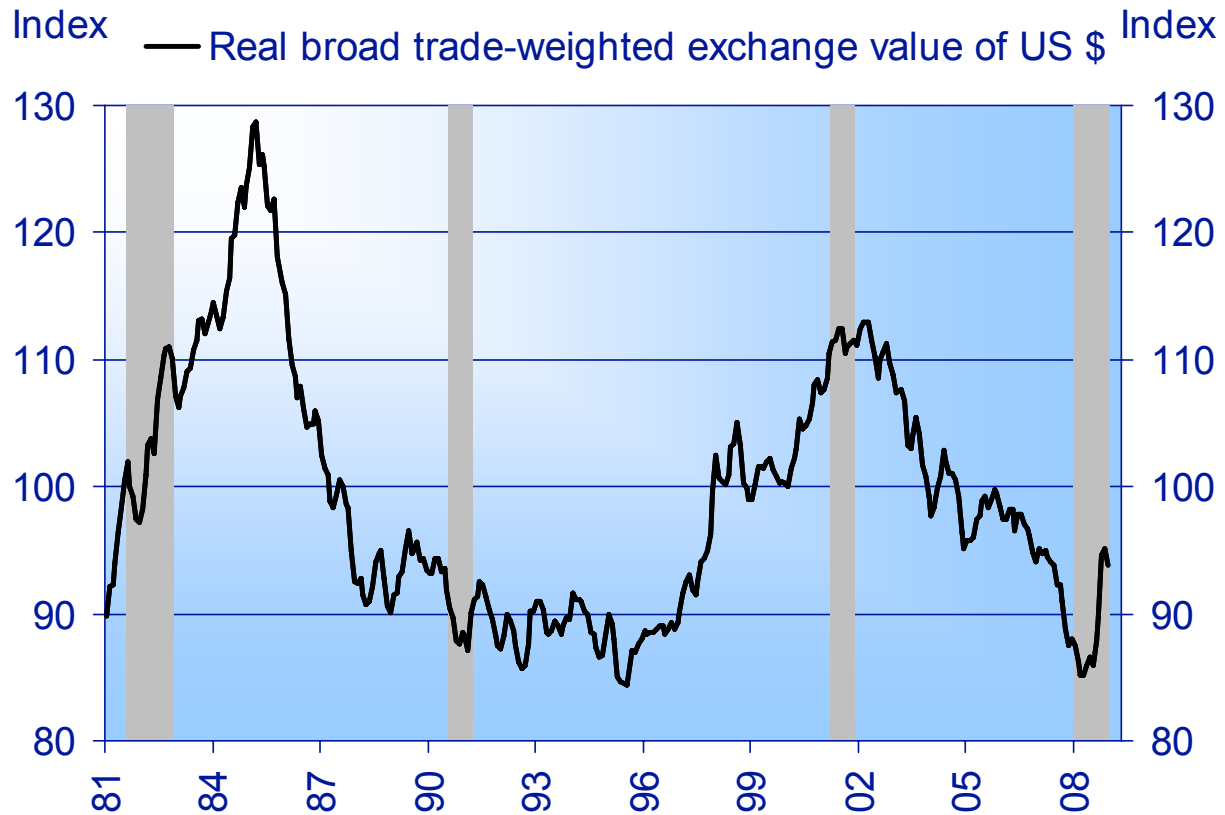


Source: Factset, Bloomberg, Deutsche Bank



# Prospects for the Economy?

## Real Broad Trade Weighted Exchange Value of US\$



Source: FRB, DB US Economics Research



## Current State of Affairs

What a Difference  
in 12 Months

January 2008

- Newsprint Consumption Quite Weak, but Prices Rallying
- Demand Was Improving in LWC
  - ⇒ *Inventories Had Fallen*
  - ⇒ *Prices Were Moving Up Rapidly*
- Uncoated Free Sheet Vol's Sluggish, but Prices Moving Up
- Falling US\$ Aiding Competitive Position of US Mills
- Intense Cost Pressure: Fiber, Chemical + Energy
- European Companies Were Restructuring Operations



# Current State of Affairs

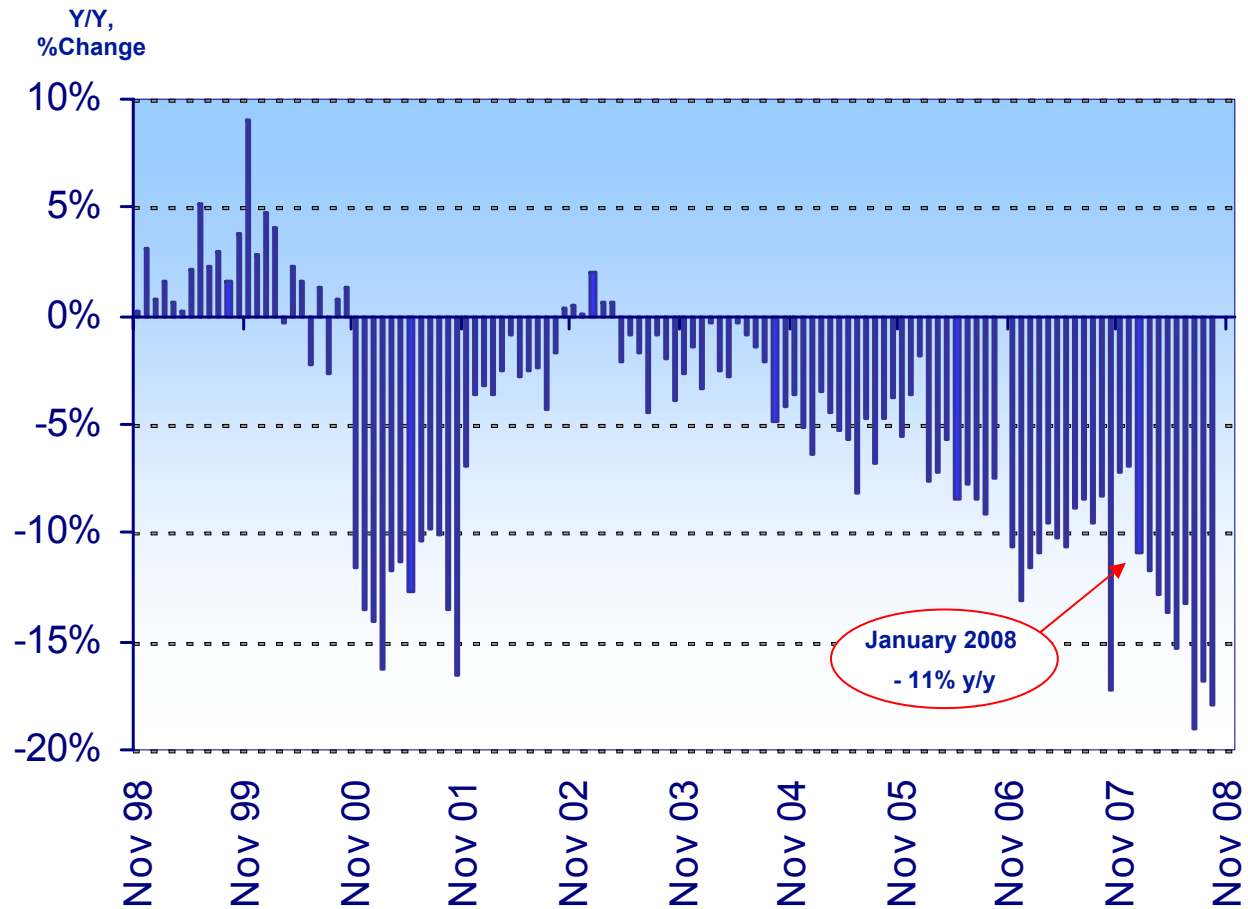
**What a Difference  
in 12 Months**

**Last January**

*Demand Was Weak  
Last Year - - - Even  
Weaker This Year*

## US Newsprint Consumption

(Y/Y % Change)



Source: RISI



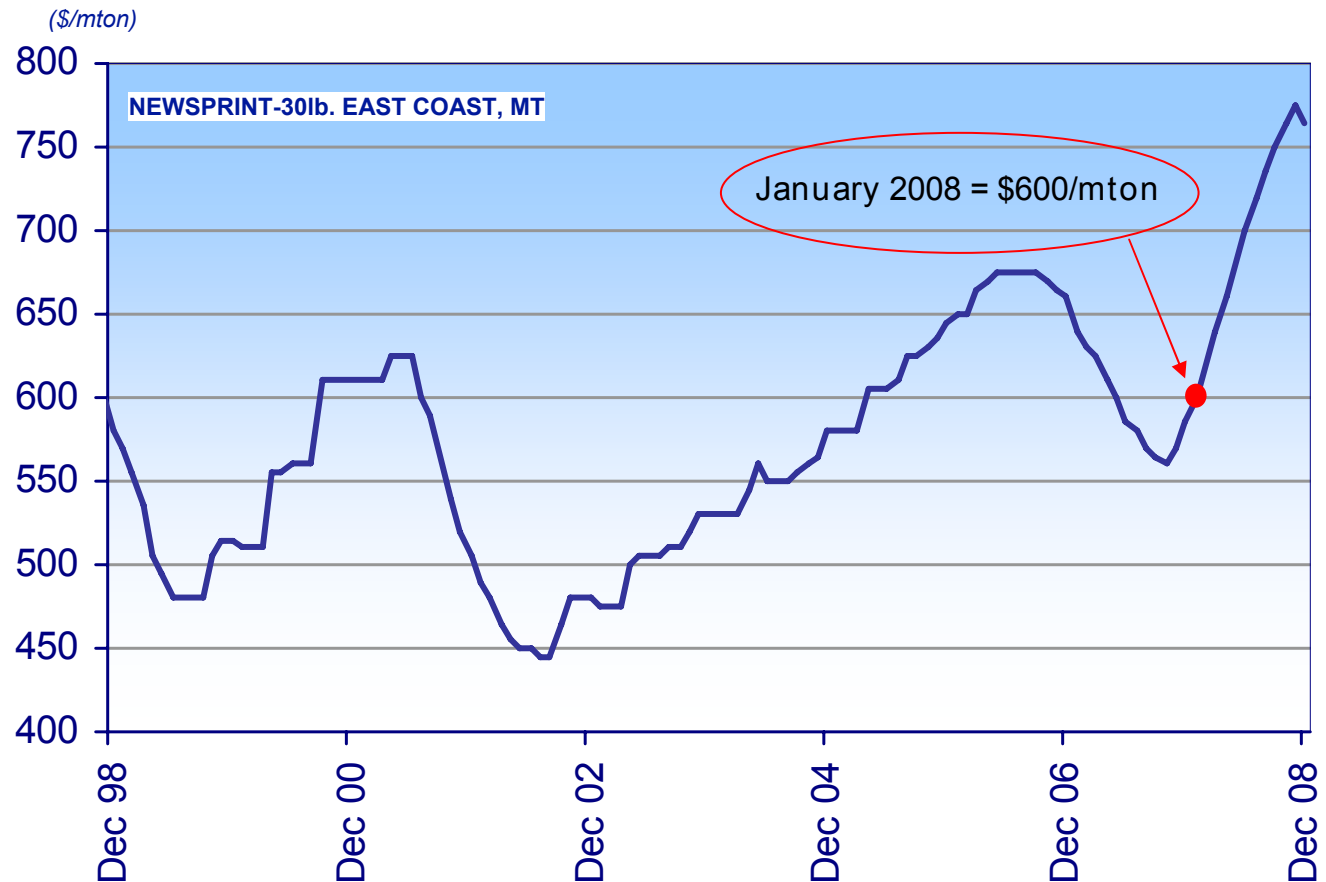
# Current State of Affairs

## What a Difference in 12 Months

*Prices Began to Rally After Abitibi/Bowater Merger*

### Newsprint Prices

(\$/mton)



Source: RISI

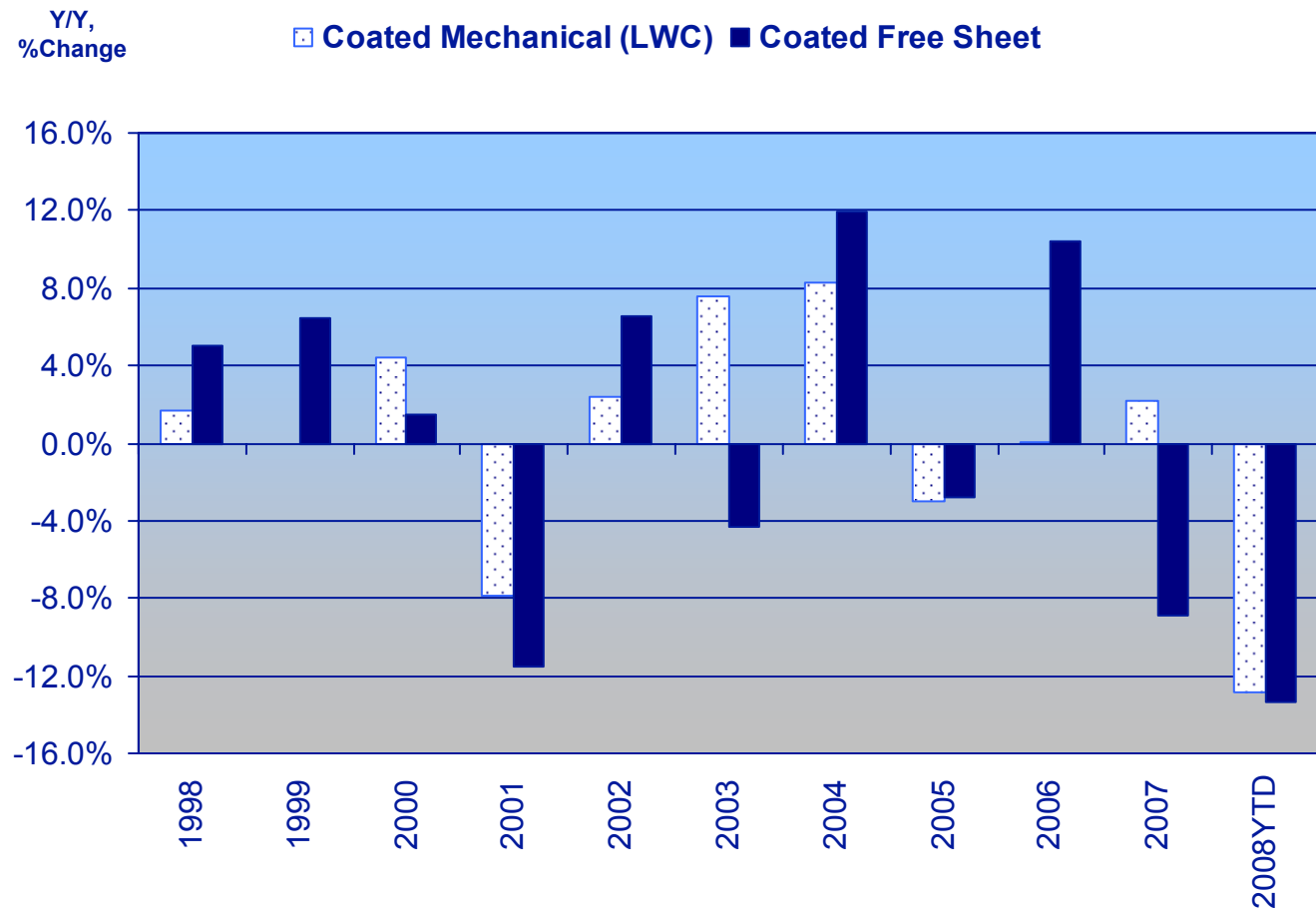


# Current State of Affairs

What a Difference  
in 12 Months

## Coated Paper – Apparent Consumption by Year

(Y/Y % Change)



Source: RISI



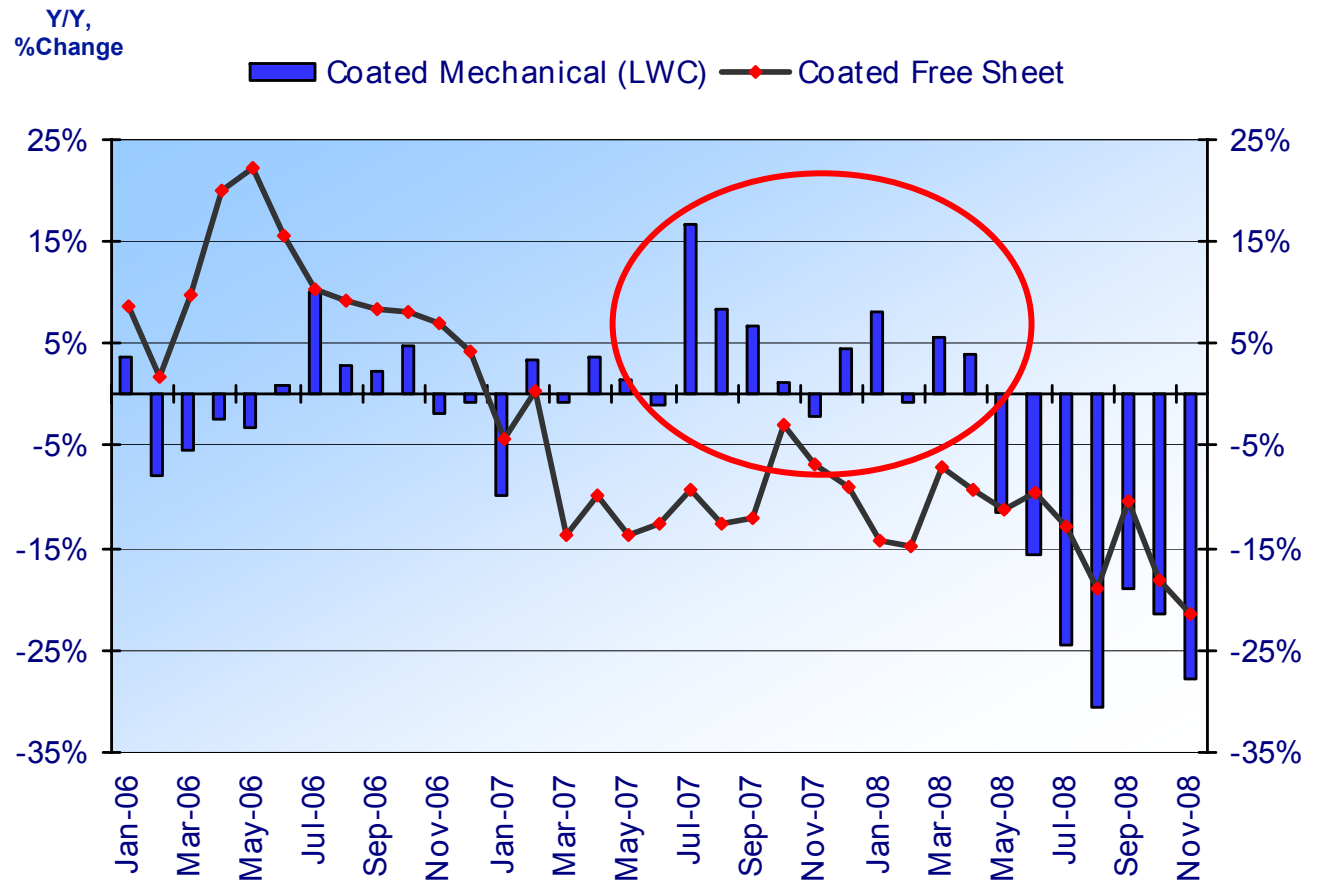


# Current State of Affairs

What a Difference  
in 12 Months

## Coated Paper – Apparent Consumption by Month

(Y/Y % Change)



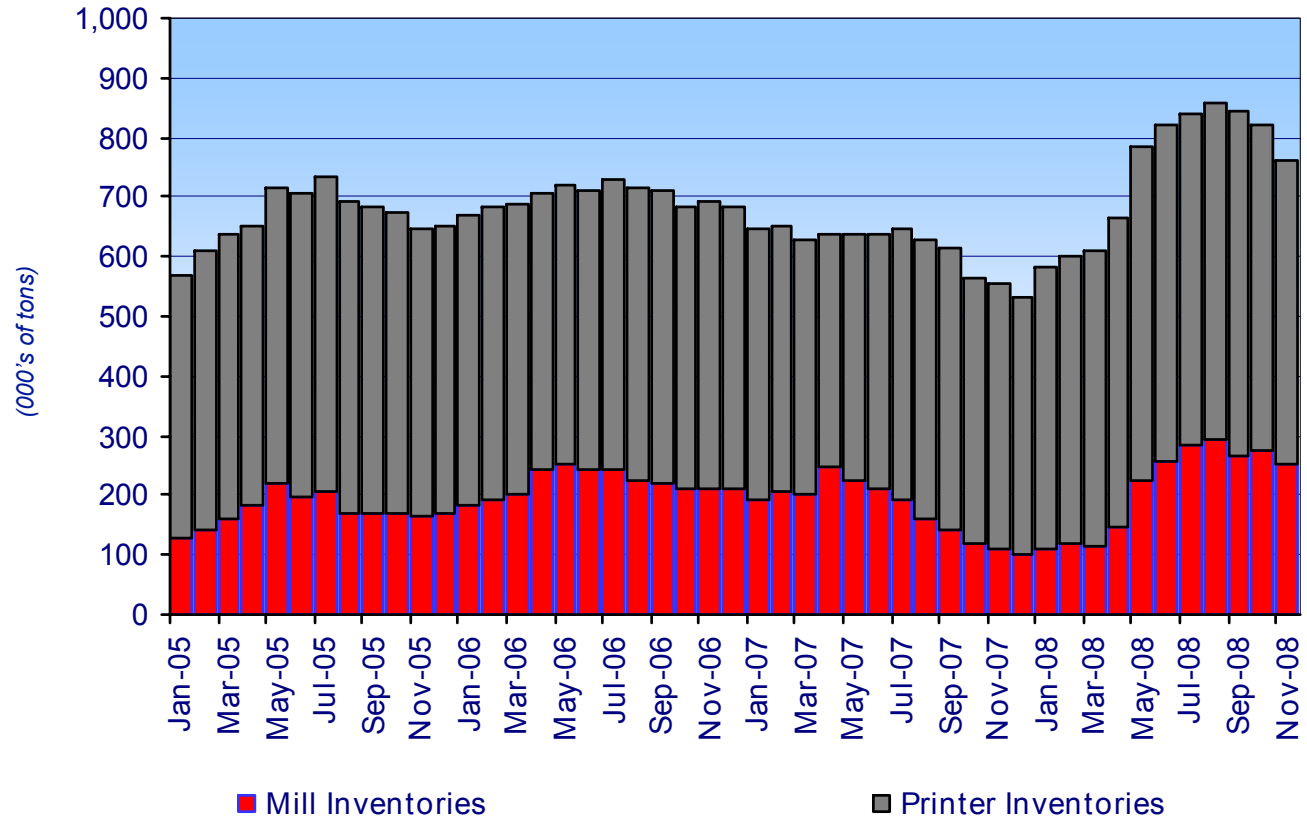
Source: RISI



# Current State of Affairs

**What a Difference  
in 12 Months**

**Coated Mechanical (LWC) – Inventories**  
(000's of tons)



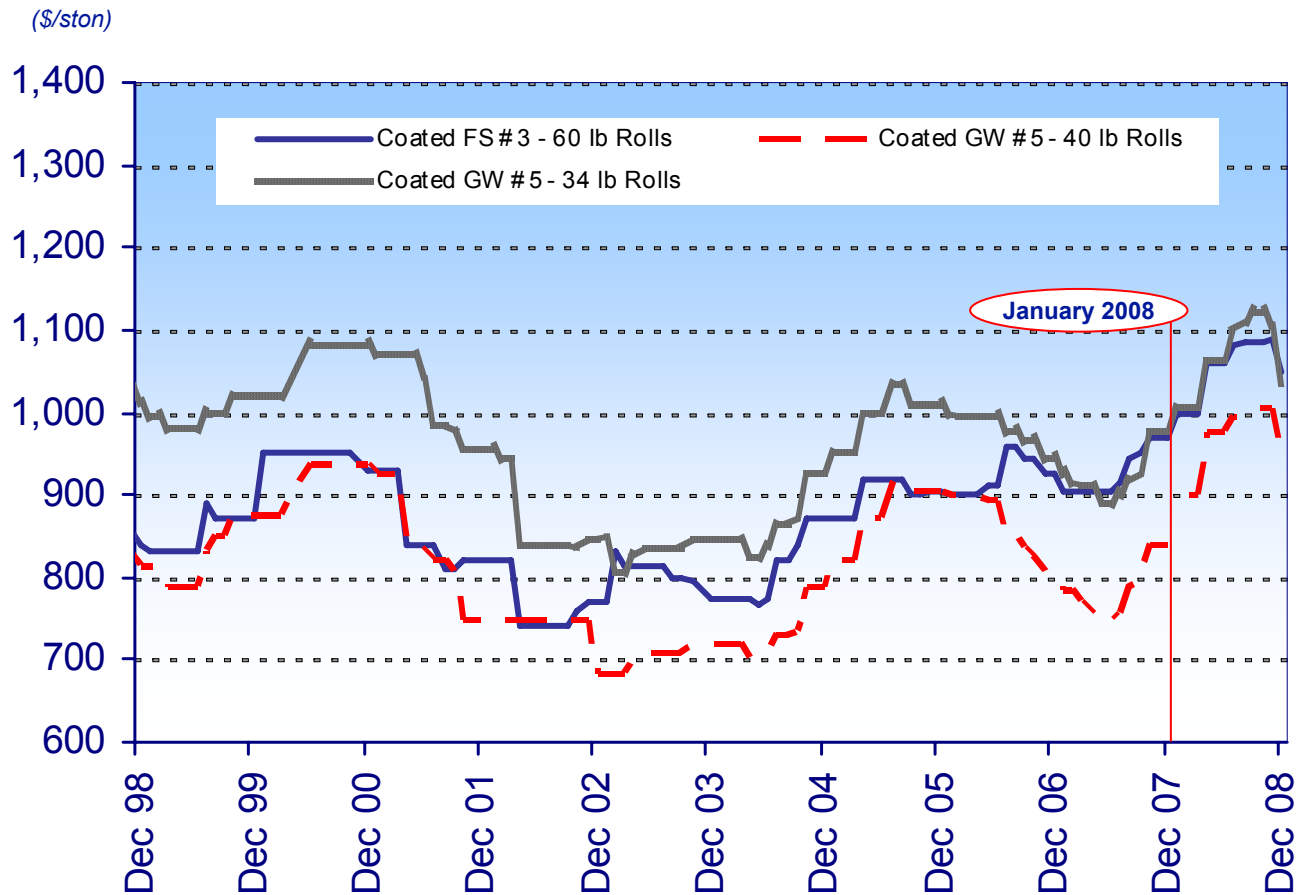
Source: RISI and Midland Paper



# Current State of Affairs

**What a Difference  
in 12 Months**

**Coated Paper Prices**  
(\$/ston)



Source: RISI



# Current State of Affairs

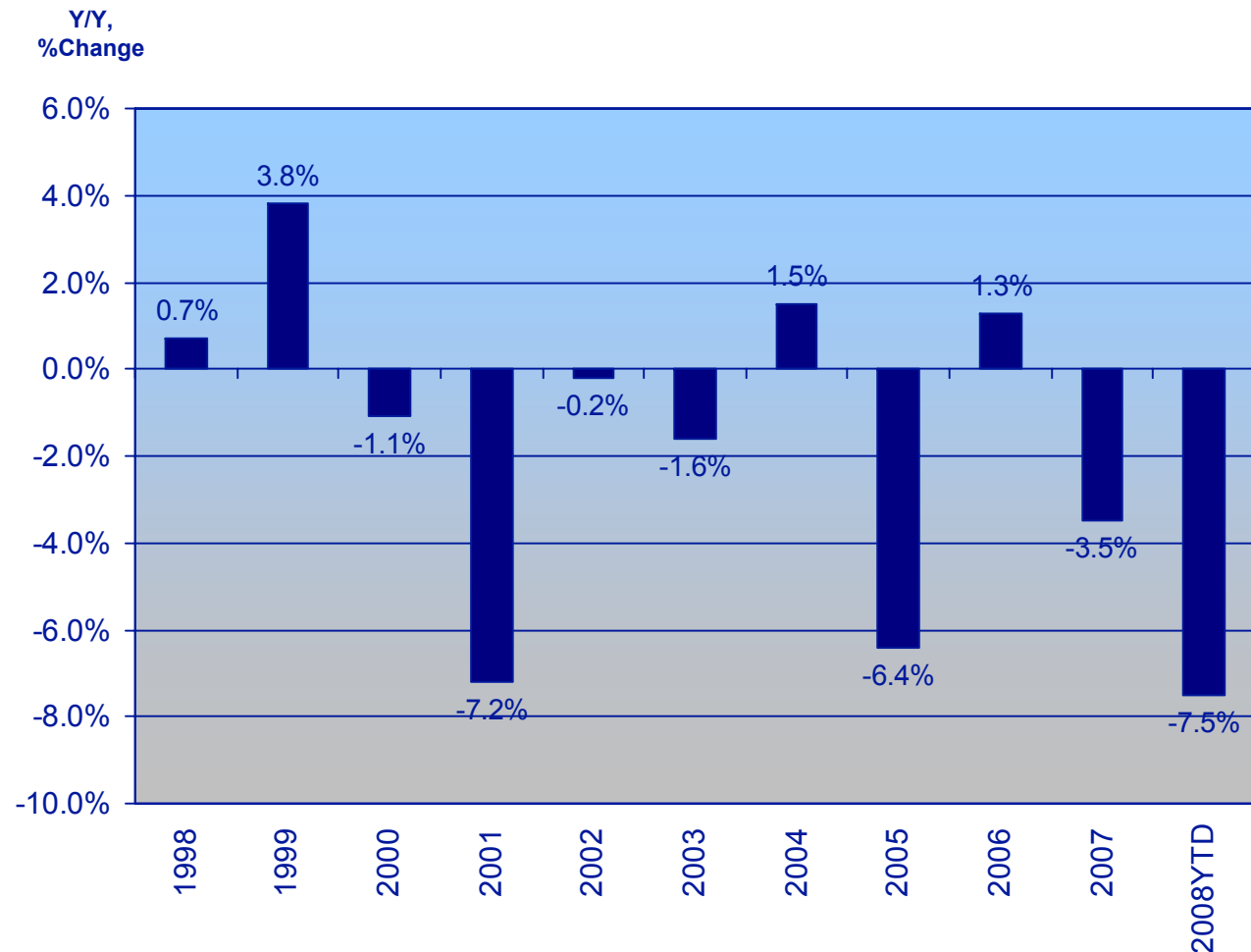
## What a Difference in 12 Months

Recent UFS Shipments <i>% Change y/y</i>		
Sept '08	Oct '08	Nov '08
- 5.4%	- 10.7%	- 17.3%

Source: AF&PA

## Uncoated Free Sheet – Apparent Consumption

(Y/Y % Change)



Source: RISI



# Current State of Affairs

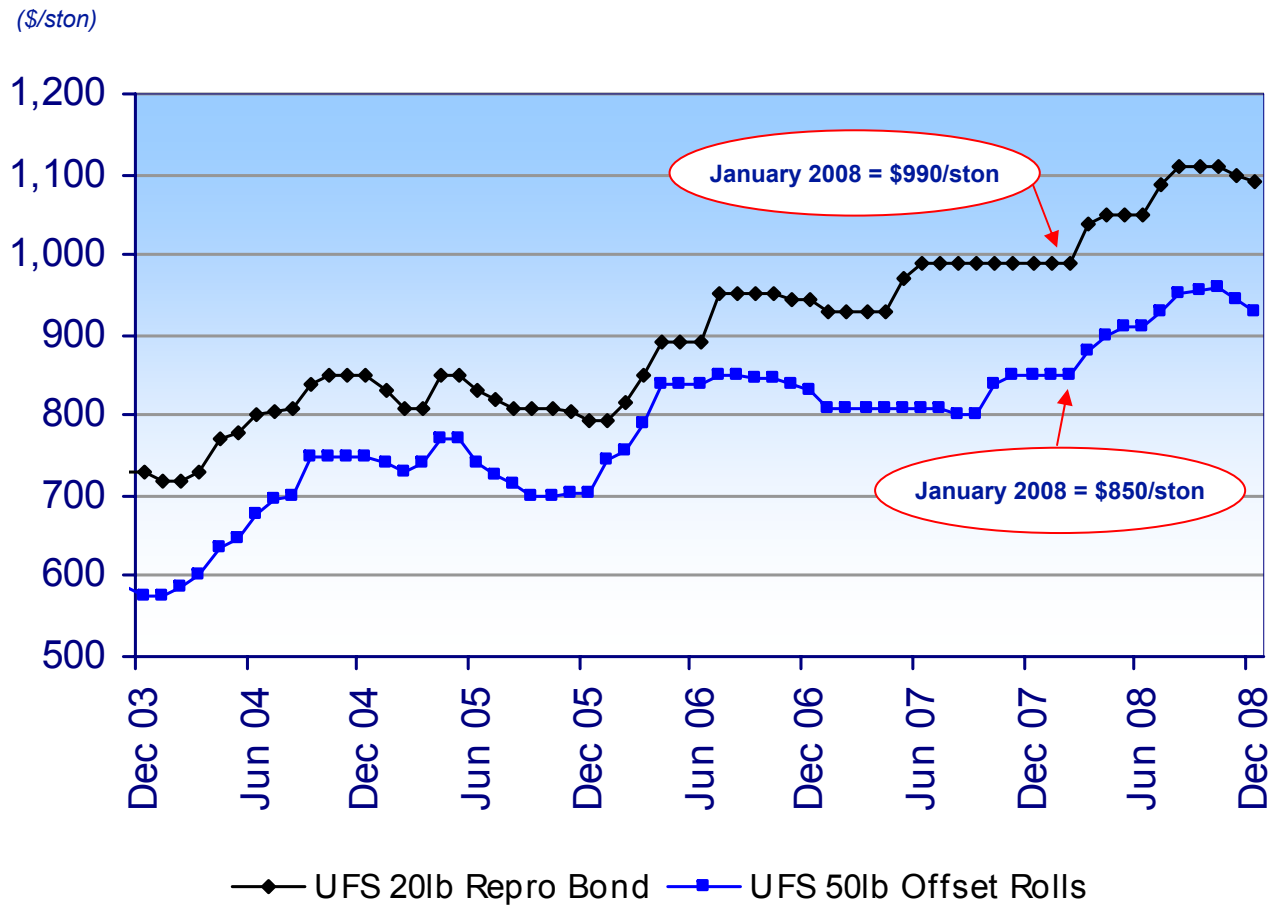
**What a Difference  
in 12 Months**

**Last January**

*Prices Were Rallying  
in Early 2008, They  
Have Started to Soften*

## Uncoated Free Sheet Prices

(\$/ston)



Source: RISI



## Current State of Affairs

### What a Difference in 12 Months

January 2009

- Consumption has Fallen off Dramatically in All Markets
  - ⇒ *Underlying Demand Has Eased*
  - ⇒ *Intense Inventory Pressure Across Economy*
- Inventories have Ballooned, Especially in LWC
  - ⇒ *Both at Mill & Printer Levels*
- Trade Picture Looks Riskier
- Producers are Taking Dramatic Amounts of Downtime
  - ⇒ *It Has Had Impact*
- European Companies (Still) Restructuring Operations
  - ⇒ *Stora Enso & UPM announcing big moves; M-Real sells coated paper to Sappi, International Paper closing Thomas Tait Mill (Scotland)*



# Current State of Affairs

**What a Difference  
in 12 Months**

**This January**

*Consumption Pattern  
Has Deteriorated in  
Recent Months*

## US Apparent Consumption – Key Paper Grades

	<i>% Change y/y</i>			
<b>Grade</b>	<b>2007</b>	<b>08 YTD</b>	<b>Q308</b>	<b>Nov 08E</b>
<b>CFS</b>	<b>- 8.9%</b>	<b>- 13.5%</b>	<b>- 14.1%</b>	<b>- 19.3%</b>
<b>LWC</b>	<b>2.2%</b>	<b>- 12.8%</b>	<b>- 25.0%</b>	<b>- 32.8%</b>
<b>UFS</b>	<b>- 3.5%</b>	<b>- 7.5%</b>	<b>- 7.0%</b>	<b>- 18.0%</b>

Source: RISI



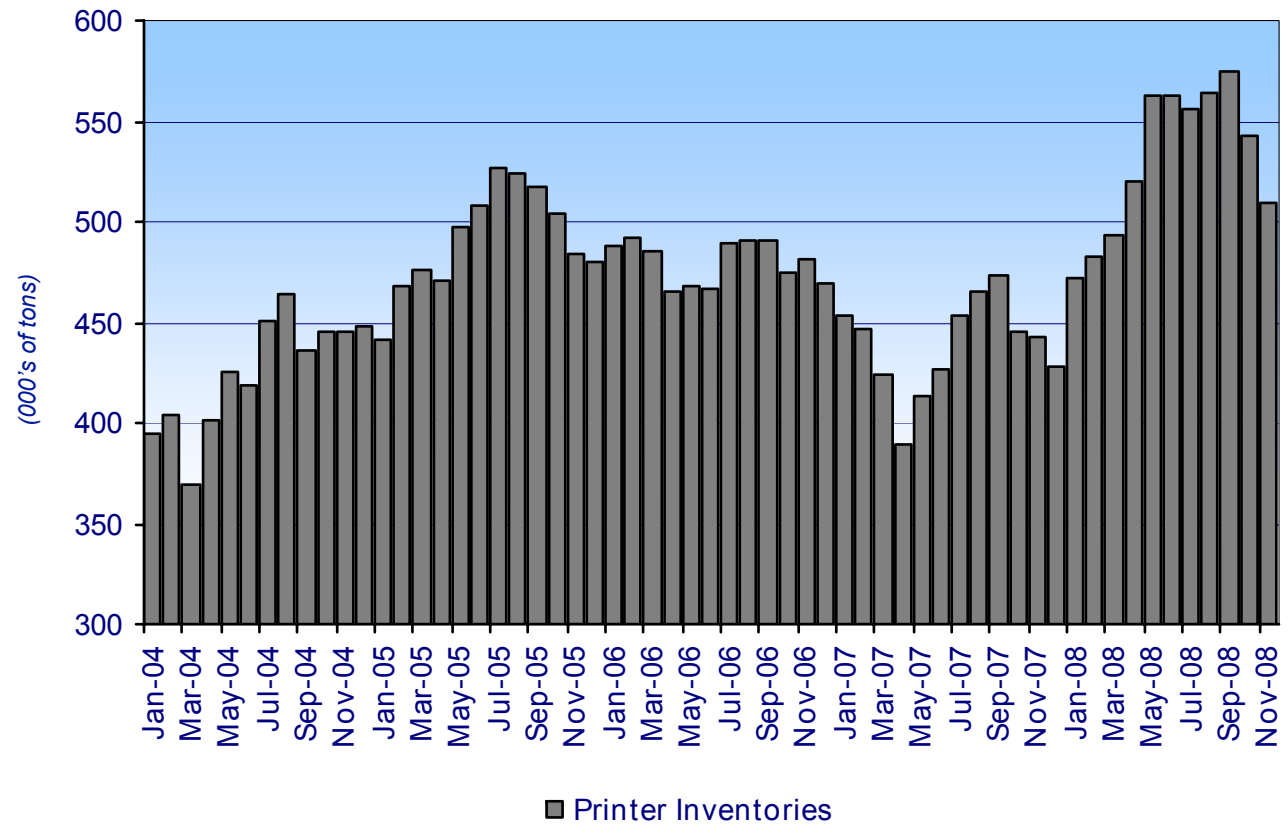
# Current State of Affairs

## What a Difference in 12 Months

*Inventories Have  
Ballooned, Especially  
in LWC @ Both the  
Mill & Printer Levels*

### Printer Inventories Of Coated Mechanical (LWC)

(2004 – Nov. 2008)



Source: Midland Paper Clips



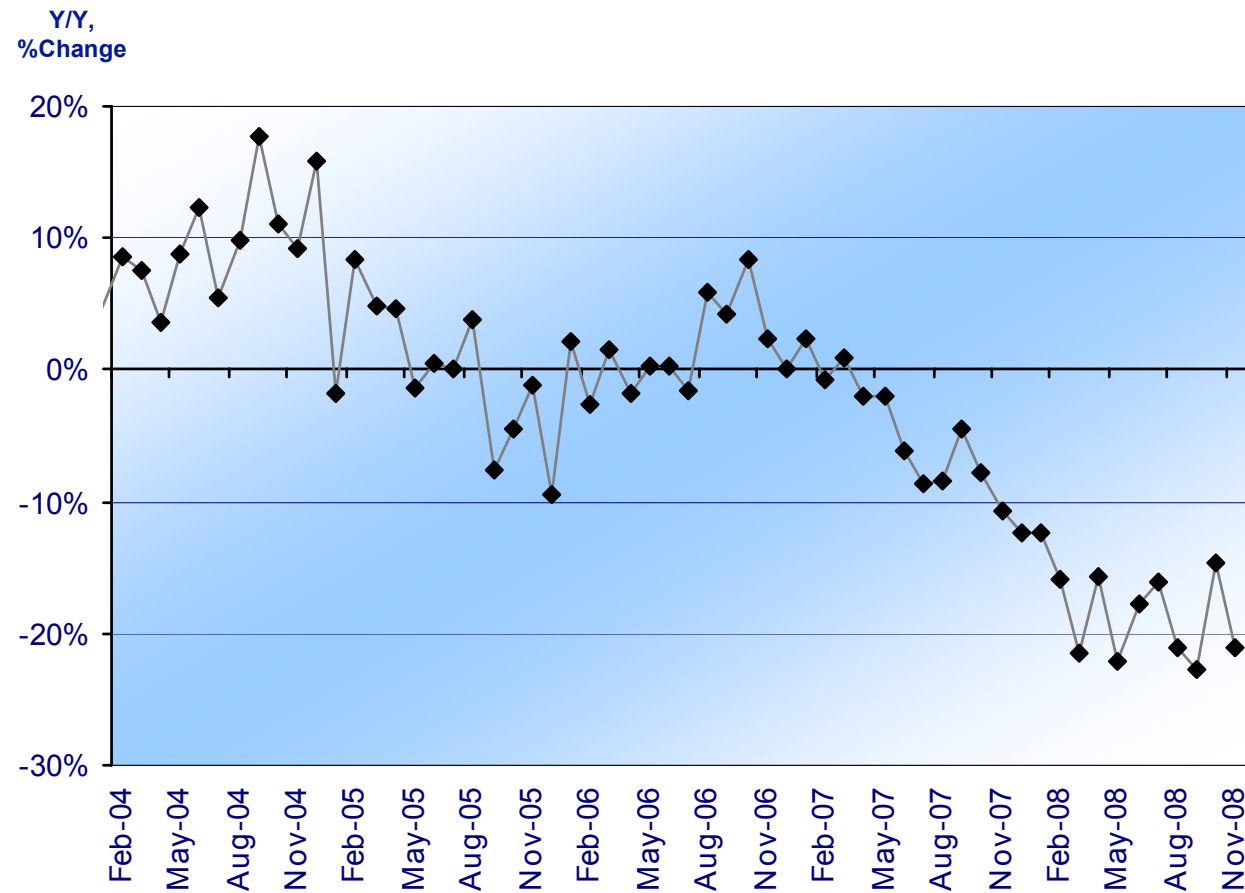


# Current State of Affairs

What a Difference  
in 12 Months

## Printer Consumption Of Coated Mechanical (LWC)

(%Change y/y)



Source: Midland Paper Clips



# Current State of Affairs

**What a Difference  
in 12 Months**

*Will This Trend  
Begin to Reverse?*

## Imports of Printing & Writing Paper

% Change y/y, ( <i>% of Total US Apparent Consumption</i> )				
Grade	2005	2006	2007	'08 YTD
CFS	-8.0% <i>(26.5%)</i>	15.4% <i>(27.7%)</i>	-28.7% <i>(21.7%)</i>	-24.6% <i>(19.1%)</i>
LWC	-9.4% <i>(27.0%)</i>	11.7% <i>(30.2%)</i>	4.8% <i>(30.9%)</i>	-22.8% <i>(28.0%)</i>
UFS	-6.9% <i>(12.4%)</i>	-9.2% <i>(11.1%)</i>	-12.3% <i>(10.1%)</i>	-1.2% <i>(10.8%)</i>

Source: RISI



# What's Ahead for the Paper Markets?

**Domestic Demand  
Outlook is Weak**

## Newsprint

- Cyclical Downturn Exacerbating Long-Term Structural Issues
- Advertising Downturn Being Compounded by Circulation Declines & Increased Financial Leverage
  - ⇒ *Tribune Has Filed for Bankruptcy*
  - ⇒ *Several Other Publishers are Struggling*
  - ⇒ *Papers Moving Away from 7 days*



# What's Ahead for the Paper Markets?

## Domestic Demand Outlook is Weak

*Pullback in Consumer Spending Hits Both Magazines & Catalogs*

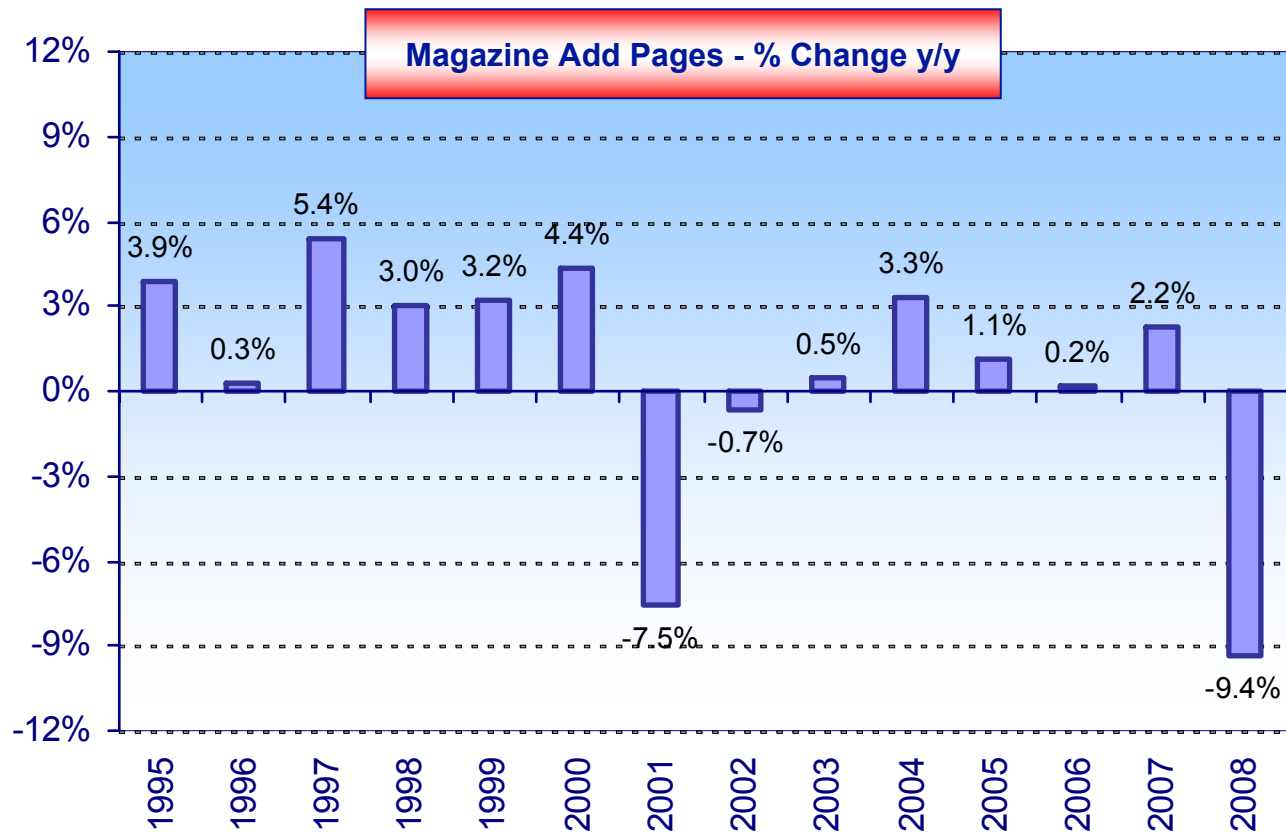
Catalogs Mailed, % Change y/y		
2006	2007	2008 YTD
2.2%	- 1.5%	- 5.4%

Source: RISI

**Other Issues:**  
*Retailers Struggling*

## Coated Paper

Y/Y,  
%Change



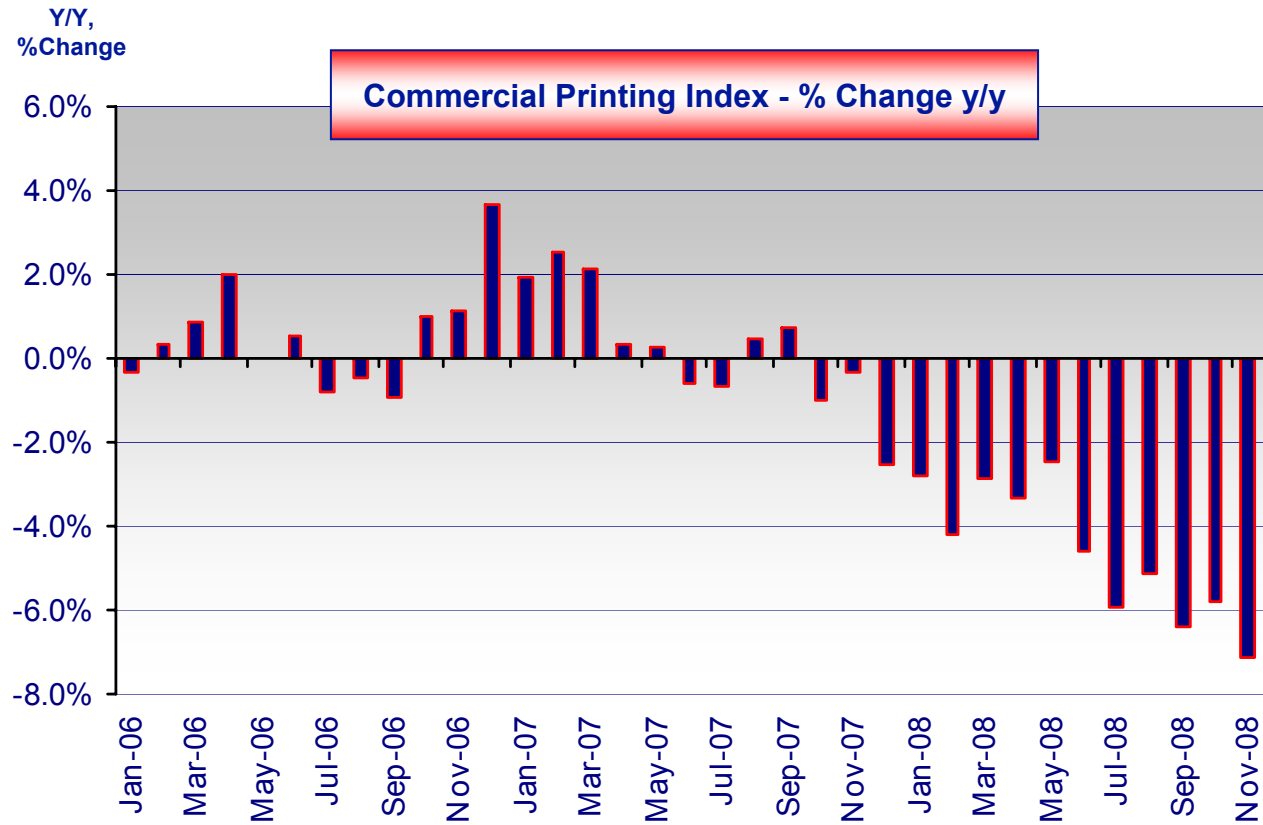
Source: Media Week Monitor (Includes 25 Major Magazines)



# What's Ahead for the Paper Markets?

**Domestic Demand Outlook is Weak**

## Coated Paper



Source: RISI



# What's Ahead for the Paper Markets?

**Domestic Demand  
Outlook is Weak**

## Uncoated Free Sheet

- **Issues for Uncoated Free Sheet**
  - ⇒ **Weakness in White Collar Employment**
  - ⇒ **Drop-off in Financial Services & Real Estate**
  - ⇒ **Potential for Increased Imports**
    - *Lower Pulp Costs*
    - *Lower Freight Rates*
    - *New Portucel Machine*

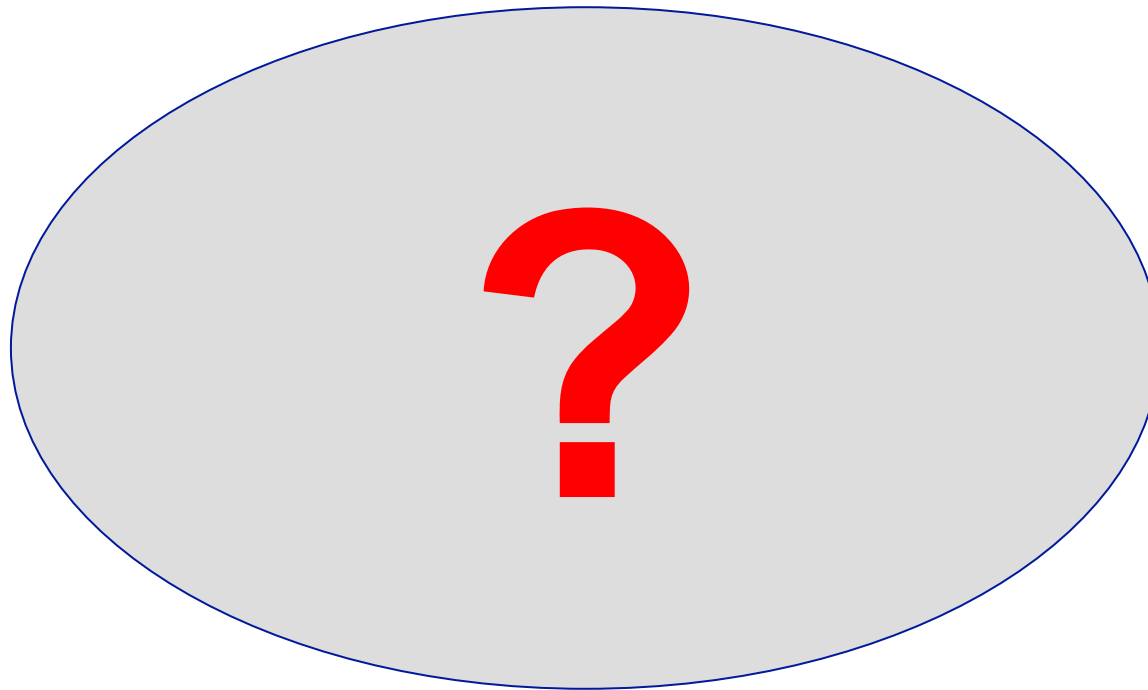


## What Does it Mean for Industry and Individual Players?

- Demand Is Apt to be Quite Weak in Most Markets
  - ⇒ *Slowdown is Global Phenomenon*
- Supply-Side Discipline Remains Critical, but Is it Enough?
  - ⇒ **More Downtime** – *Verso has announced 100K of LWC in '09H1; Sappi (Europe) Idling 25% of Capacity in January*
  - ⇒ *Additional Closures Appear Inevitable*
- Prices Remain Under Pressure
  - ⇒ *Downtime is Helping to Maintain Market Balance*
- Access to Credit Remains Central Issue
  - ⇒ *High Level of Financial Risk for Leveraged Players*
  - ⇒ *Further Restructuring in 2009 Appears Increasingly Probably*



# Your Questions





# Appendix 1

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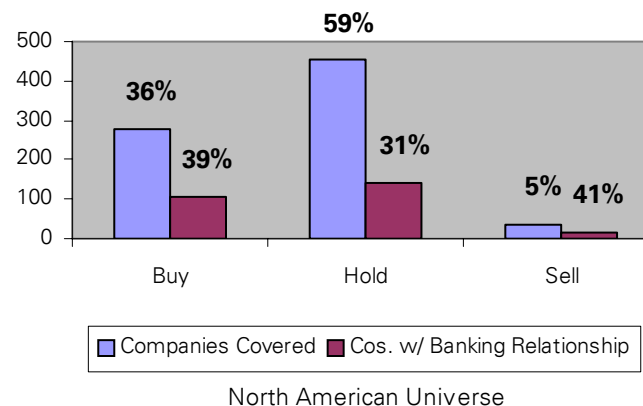
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