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INDUSTRY ALERT

Industry Update

Paper & Forest Products | Are Uncoated Free Sheet Prices Heading North?

Focus stocks

Domtar (UFS.N), USD53.76 Hold,
Price Target USD45.00

International Paper (IP.N), USD26.62
Buy, Price Target USD32.00

Glatfelter (GLT.N), USD14.19 Buy,
Price Target USD18.00

Wausau Paper Corp
(WPP.N), USD10.54 Buy, Price Target
USD13.00

Could we see price increase announcements in the North American uncoated free sheet sector? We think announcements over the next few weeks are extremely probable. Initiatives in the \$60/ton range on a variety of UFS grades seem likely. Depending on the size and speed of implementation, a successful hike could lead to upward revisions in 2010 earnings estimates. DB's current estimates project UFS prices rising \$10/ton in Q1, \$20/ton in Q2 and \$30 in Q3.

Here's the case. Yr/yr volume comparisons have been improving in recent months and preliminary December shipment figures showed a 1.2% y/y gain - the first positive comp since April 2007. Some of this improvement is simply the result of lapping very weak yr-earlier figures. However, our discussions with merchants, importers and other players in the trade suggest a healthier tone to the business. At the same time, global pulp prices continue to surge - pushing up UFS production costs on a global basis. Since most North American UFS producers are backward integrated to pulp, rising pulp doesn't have a big impact on most domestic producers. But, it does have a big impact in Asia and Europe, where a much larger portion of the industry is non-integrated. Inventories appear lean. Mill inventories are down 20% from yr-earlier levels. Merchant inventories are reportedly down in the same range.

Who would higher prices matter for? With some 4MM tons of capacity, Domtar is North America's largest uncoated free sheet producer and almost a "pure play" on UFS and market pulp. IP is the #2 producer and Boise (not covered, NYSE: BZ.N, \$5.77) is the #3 player. Among our coverage names, Glatfelter and Wausau also have significant exposure to UFS pricing.

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