

Equities

28 July 2011 | 9 pages

International Paper Co (IP)

The Best of Both Worlds: Long-Term Strategy and Day-to-Day Execution

- Company Update
- Target Price Change
- Estimate Change

Buy/High Risk	1H
Price (28 Jul 11)	US\$30.53
Target price	US\$38.00
	from US\$36.00
Expected share price return	24.5%
Expected dividend yield	3.4%
Expected total return	27.9%
Market Cap	US\$13,348M

Price Performance (RIC: IP.N, BB: IP US)



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2010A
2011E
Previous
2012E
Previous
2013E
Previous

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2010A	0.04A	0.42A	0.91A	0.68A	2.05A	2.05A
2011E	0.74A	0.80A	0.78E	0.62E	2.94E	2.87E
Previous	0.74A	0.66E	0.78E	0.62E	2.80E	na
2012E	0.57E	0.83E	1.06E	0.86E	3.32E	3.18E
Previous	0.64E	0.93E	1.07E	0.91E	3.55E	na
2013E	na	na	na	na	2.90E	2.96E
Previous	na	na	na	na	3.00E	na

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	34.4	14.9	10.4	9.2	10.5
EV/EBITDA adjusted (x)	9.0	6.7	5.6	4.9	5.0
P/BV (x)	2.2	1.9	1.6	1.5	1.4
Dividend yield (%)	1.8	1.3	3.2	3.4	3.4
Per Share Data (US\$)					
EPS adjusted	0.89	2.05	2.94	3.32	2.90
EPS reported	0.89	2.05	2.93	3.30	2.89
BVPS	14.16	15.79	18.62	20.67	22.29
DPS	0.55	0.40	0.98	1.05	1.05
Profit & Loss (US\$M)					
Net sales	23,366	25,179	26,789	28,216	28,963
Operating expenses	-21,498	-23,749	-24,709	-25,687	-26,804
EBIT	1,868	1,430	2,080	2,530	2,158
Net interest expense	-669	-608	-532	-443	-325
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	1,199	822	1,548	2,087	1,833
Tax	-469	-221	-532	-668	-587
Extraord./Min.Int./Pref.div.	-352	289	255	13	5
Reported net income	378	890	1,271	1,432	1,252
Adjusted earnings	378	890	1,275	1,440	1,256
Adjusted EBITDA	2,776	3,275	3,736	4,056	3,656
Growth Rates (%)					
Sales	-5.9	7.8	6.4	5.3	2.6
EBIT adjusted	382.6	-23.4	45.5	21.6	-14.7
EBITDA adjusted	-6.9	18.0	14.1	8.6	-9.9
EPS adjusted	-56.1	131.3	43.3	12.9	-12.8
Cash Flow (US\$M)					
Operating cash flow	4,655	1,631	2,625	2,992	2,892
Depreciation/amortization	1,472	1,456	1,414	1,480	1,440
Net working capital	479	-458	-267	-120	0
Investing cash flow	-593	-834	-1,252	-1,100	-1,000
Capital expenditure	-534	-775	-1,110	-1,100	-1,000
Acquisitions/disposals	-17	-152	0	0	0
Financing cash flow	-3,376	-588	-1,124	-1,892	-1,892
Borrowings	-3,089	-383	-569	-1,336	-1,336
Dividends paid	-140	-175	-425	-456	-456
Change in cash	748	181	326	0	0
Balance Sheet (US\$M)					
Total assets	25,548	25,368	25,967	25,667	25,187
Cash & cash equivalent	1,892	2,073	2,399	2,399	2,399
Accounts receivable	2,695	3,039	3,901	3,781	3,581
Net fixed assets	12,688	12,002	11,784	11,404	10,964
Total liabilities	19,293	18,284	17,670	16,494	15,318
Accounts payable	3,708	4,190	4,291	4,451	4,611
Total Debt	9,033	8,671	8,000	6,664	5,328
Shareholders' funds	6,255	7,084	8,297	9,173	9,868
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	11.9	13.0	13.9	14.4	12.6
ROE adjusted	7.4	13.8	17.2	17.0	13.6
ROIC adjusted	7.1	6.6	8.5	10.1	8.8
Net debt to equity	114.2	93.1	67.5	46.5	29.7
Total debt to capital	59.1	55.0	49.1	42.1	35.1

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The Best of Both Worlds: Long-Term Strategy and Day-to-Day Execution

2Q recap – Buy-rated IP reported a strong 2Q with adjusted EPS of \$0.80, well above Citi estimates of \$0.66 and consensus at \$0.67. Adjusted EPS excludes \$0.28 of net charges, the largest being an asset impairment in Consumer Packaging (\$0.24). Topline was in-line with consensus expectations at \$6.64B, while op profit rose 29% Y/Y to \$603mm. IP's Ilim JV (earnings +30% sequentially) provided upside, while Containerboard was weaker than expected on the Vicksburg mill shutdown. The 2Q effective tax rate of 33% was roughly in-line with our estimates. 1H free cash flow (CFO – Capex) of \$752mm has exceeded our expectations. Year-end net debt declined sequentially to \$6.09B from \$6.48B in 1Q, highlighting IP's attractive deleveraging potential.

Stock Action – We are raising FY 2011 EPS estimates to account for IP's 2Q beat. Our FY 2012-13 estimates have been lowered slightly to reflect weaker pulp price assumptions. Rolling over to higher NTM EBITDA and adjusting for lower net debt (including pension underfunding), our TP goes to \$38. Reiterate Buy (1H).

International Paper Co

Company description

International Paper is the largest global producer of paper products, with 2010 sales of over \$25B. Containerboard (Industrial Packaging) and Printing & Writing Papers are the two most important businesses for IP, each contributing approximately 40% of earnings. Consumer Packaging (primarily Bleached Board) contributes ~10%, with Distribution contributing ~5%. The company is headquartered in Memphis, Tennessee, and had approximately 59,500 employees at year-end 2010.

Investment strategy

We are Buyers of IP with a target price of \$38. We are constructive given our view that: 1) the company's portfolio transformation puts it in a position to generate improved margin and ROC over the cycle; 2) IP is set to meaningfully improve free cash flow generation and cash conversion as a result of its more focused portfolio; 3) deleveraging and a disciplined attitude towards capital deployment will result in shareholder-friendly moves to return cash; and 4) IP's participation in BRIC markets is a way to offset the problems of mature, high cost developed markets.

Valuation

We use EV/EBITDA as our primary valuation methodology, assigning a 6.0x target multiple to \$3.6B estimated NTM EBITDA to derive a target price of \$38. Our price target further incorporates a \$2/share value for IP's 50% equity stake in the Ilim JV. Our target multiple reflects our view that 2011 is potentially a mid-cycle earnings year for the paper sector and IP. Over the past ten years, IP's trading EV/EBITDA multiple has been as low as 3.6x and at a ~60% discount to the S&P 500 and as high as 12.0x and at a 13% premium to the S&P 500.

Risks

We rate IP High Risk. Risks that may impact our target price include:

Demand decline in uncoated freesheet - North American demand for one of IP's key products, uncoated freesheet, has declined at a ~4% CAGR rate over the past 10 years. While the industry has matched supply to demand, an acceleration of this demand decline could cause IP to miss earnings estimates.

Hostile Takeover Bid for TIN – IP has entered into a \$3.4B hostile bid to acquire Temple-Inland (TIN). If IP were to overpay for TIN or have difficulty successfully realizing synergies from an acquisition it could negatively impact company earnings.

BRIC operational & political risk - IP generates roughly 27% of income from emerging markets, with significant JV investments in Russia, China and Brazil. These markets have historically seen unpredictable governmental policies, which could potentially impact IP's earnings negatively.

Containerboard capacity additions - North American containerboard supply/demand has been well-balanced in 2010-11, creating pricing power in IP's Industrial Packaging business. The addition of capacity in the Containerboard market could cause a loosening of this supply/demand balance, potentially impacting IP's earnings.

Currency risk - A strengthening of the US dollar relative to the other currencies would negatively impact IP's earnings, while a depreciation of the US dollar would positively impact IP.

Appendix A-1

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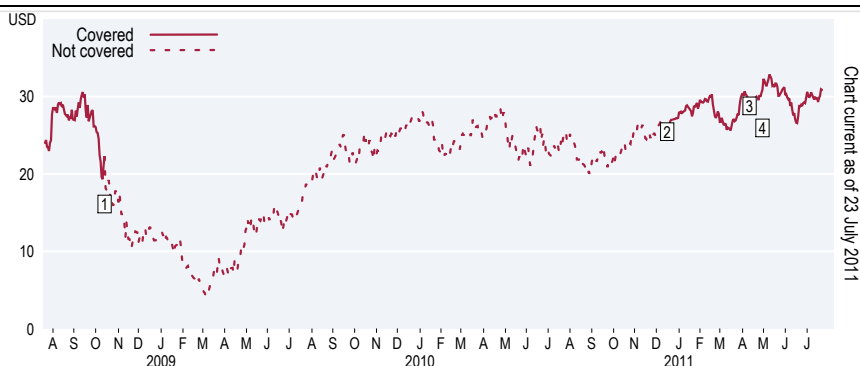
International Paper Co (IP)

Ratings and Target Price History

Fundamental Research

Analyst: Anthony Pettinari

Covered since December 16 2010



	Date	Rating	Target Price	Closing Price
1	14-Oct-08	Coverage terminated		
2	16-Dec-10	1H	*\$33.00	25.47

* Indicates change

	Date	Rating	Target Price	Closing Price
3	12-Apr-11	1H	*\$34.00	28.80
4	29-Apr-11	1H	*\$36.00	30.88

Rating/target price changes above reflect Eastern Standard Time

International Paper Co (IP)

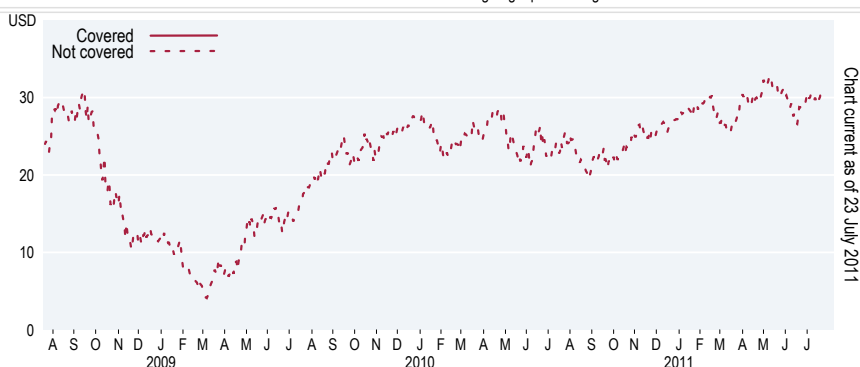
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Anthony Pettinari

Covered since December 16 2010



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Data current as of 30 Jun 2011	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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