

## Equities

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# Printing & Writing Paper Update

## November Shipments Beat Expectations, but Prices Remain Seasonally Soft

### ■ Industry Overview

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- **Uncoated Freesheet Volumes Better Than Expected** – A preliminary report from the PPPC indicates North American uncoated freesheet shipments fell 1.3% Y/Y to 704k tonnes in November. The data is slightly better than expected, with buyers potentially taking advantage of recent price declines and seasonal discounting. Sequentially, November volumes fell 4% over October while operating rates stood at 84%, identical with November 2010. YTD shipments are down 3.1% Y/Y.
- **Prices Seasonally Soft, but Pace of Erosion Slowed in November** – Offset freesheet prices were flat at \$930/ton in November, stabilizing after three consecutive months of decline. Copy paper saw very minor erosion (\$5/ton or 0.5%) amid typical seasonal weakness. We forecast average 4Q prices for benchmark grades to fall 2% sequentially from 3Q. Looking to 2012, we expect prices to hold roughly flat Y/Y as North American producers match supply reductions to demand decline. Price upside seems limited given weak pulp markets (December US NBSK down 3% to \$890/mt).
- **European Demand Drop-off = More Competition in Export Markets** – European uncoated freesheet demand is expected to fall 5-6% Y/Y in 2011, steeper than the ~3% decline in North America. Weak European demand has pressured US exports and increased competition for LatAm and Asian business. European exports have risen ~9% YTD; we'll look for the timely completion of capacity closures in Europe (625k tonnes announced in 2011) to prevent oversupply in the global market in 2012.
- **Uncoated Freesheet Impact on Domtar, IP** – Domtar (UFS.N; US\$79.06; 2) has the highest exposure to North American uncoated freesheet in our coverage universe, with roughly 80% of 2010 op profit coming from this market and grade. International Paper (IP.N; US\$28.67; 1) has significant exposure to North American printing paper as well (17% of 2010 op profit), although volume declines in the US are partially offset by IP's presence in more attractive markets such as Brazil and Russia.
- **Coated & Mechanical Grades Hit Hard in 2011** – We expect November volume data for coated and mechanical paper to be released tomorrow by PPPC. Year-to-date these grades have been hit by significantly steeper volume declines (5-9%) than uncoated freesheet. This weakness is highlighted by NewPage's bankruptcy filing and recent capacity closures by Verso and White Birch. Producers in our coverage universe do not have meaningful exposure to these grades.

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

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## International Paper Co

### 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 \$33. 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

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.

Acquisition of TIN – IP has entered into an agreement to acquire Temple-Inland (TIN). If the deal is not approved by regulatory authorities or if IP has difficulty successfully realizing synergies from the 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 could be subject to government policies that could 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.

If the impact from the above risks turns out to be greater than we expect, the shares could fail to achieve our target price.

## Domtar Corp

### Valuation

We use EV/EBITDA as our primary valuation methodology, assigning a 4.0x target multiple to \$940mm estimated NTM EBITDA to derive a target price of \$83. Our target multiple of 4.0x reflects the view that while the Paper sector is in the middle stages of a recovery, Domtar's income and cash generation have peaked given secular decline for uncoated freesheet and declining pulp prices.

### Risks

Secular decline in uncoated freesheet – N. American demand for 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 UFS to miss estimates.

High cost position in volatile pulp market – UFS's pulp assets are relatively high cost, and significant quantities of low cost pulp are expected to come online from 2013 onward. Global pulp markets are volatile and a decline in pulp prices could negatively impact earnings.

Volatile tax rate – UFS's overall tax rate is more volatile than its peers. While UFS typically pays a normal tax rate for its US operations, due to accumulated tax losses it frequently pays no taxes on its Canadian operations. Lack of visibility into the tax rate makes UFS earnings more difficult to forecast.

Currency risk – ~50% of UFS pulp costs and 20% of paper costs are denominated in Canadian dollars. A strengthening of the Canadian dollar relative to the USD would negatively impact earnings, while a depreciation of the Canadian dollar would help UFS.

M&A Risk – UFS is in the midst of a strategic transformation, which may involve an acquisition in a new product line. The Paper industry has a long history of difficult acquisitions, and there is some risk UFS could overpay in a deal.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

## Appendix A-1

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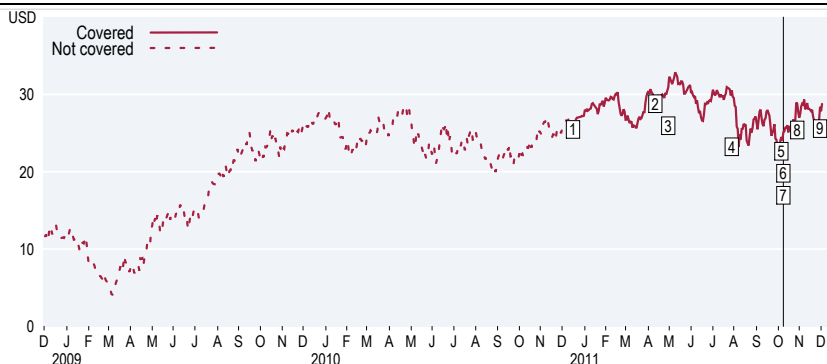
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#### International Paper Co (IP)

##### Ratings and Target Price History Fundamental Research

Analyst: Anthony Pettinari

Covered since December 16 2010



	Date	Rating	Target Price	Closing Price
1	16-Dec-10	1H	*33.00	25.47
2	12-Apr-11	1H	*34.00	28.80
3	29-Apr-11	1H	*36.00	30.88

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	28-Jul-11	1H	*38.00	30.53
5	6-Oct-11	1H	*29.00	24.49
6	8-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	8-Oct-11	*1	29.00	24.05
8	28-Oct-11	1	*36.00	28.81
9	30-Nov-11	1	*33.00	28.40

Rating/target price changes above reflect Eastern Standard Time

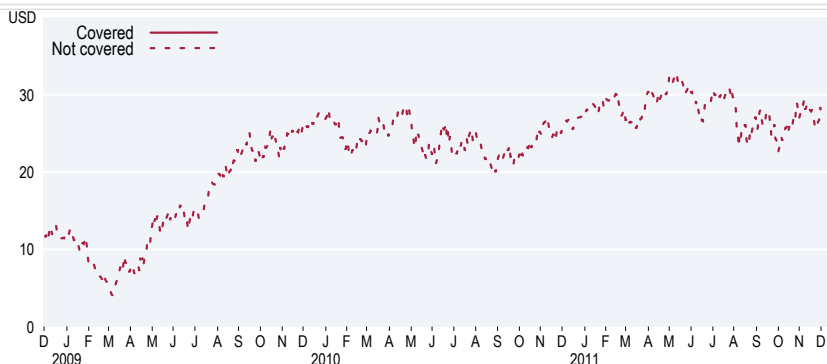
#### International Paper Co (IP)

##### Ratings and Target Price History Best Ideas Research

##### Relative Call (3 Month)

Analyst: Anthony Pettinari

Covered since December 16 2010



\* Indicates change

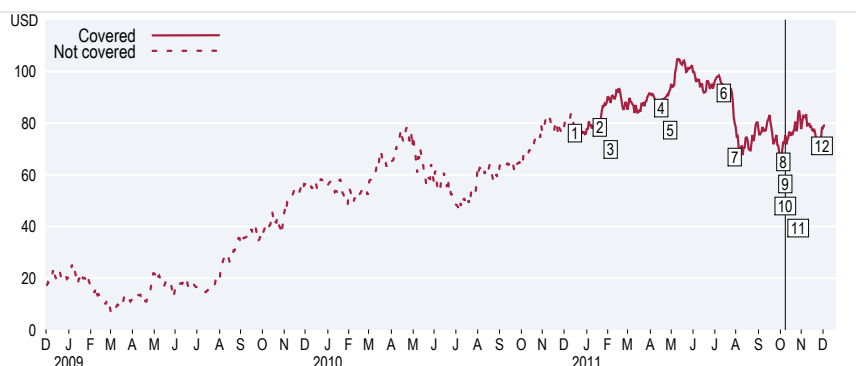
Rating/target price changes above reflect Eastern Standard Time

## Domtar Corp (UFS)

### Ratings and Target Price History

### Fundamental Research

Analyst: Anthony Pettinari  
Covered since December 16 2010



	Date	Rating	Target Price	Closing Price
1	16-Dec-10	*2H	*87.00	76.50
2	20-Jan-11	2H	*89.00	78.37
3	4-Feb-11	2H	*90.00	87.85
4	18-Apr-11	2H	*98.00	86.76

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	29-Apr-11	2H	*104.00	93.02
6	14-Jul-11	2H	*106.00	93.92
7	29-Jul-11	2H	*95.00	79.95
8	6-Oct-11	2H	*77.00	72.82

	Date	Rating	Target Price	Closing Price
9	8-Oct-11	Stock rating system changed		
10	8-Oct-11	*2	77.00	71.93
11	27-Oct-11	2	*90.00	83.98
12	30-Nov-11	2	*83.00	78.53

Rating/target price changes above reflect Eastern Standard Time

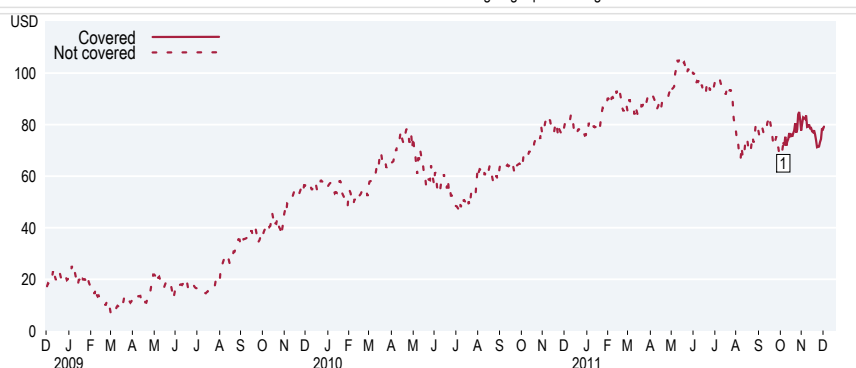
## Domtar Corp (UFS)

### Ratings and Target Price History

### Best Ideas Research

### Relative Call (3 Month)

Analyst: Anthony Pettinari  
Covered since December 16 2010



	Date	Rating	Target Price	Closing Price
1	6-Oct-11	*ADD LP	-	72.82

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 10 Oct 2011

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell

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