

July 22, 2011

## Forest Products

Industry Comment - Changes

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## Pulp &amp; Paper

## Pulp &amp; Paper: June Pulp Stats Indicate Further Seasonal Softening; FX Headwinds Add to Risk

World pulp industry statistics were released by the Pulp and Paper Products council for the month of June yesterday morning, revealing operating rates of 91% for NBSK producers, down from 94% in May-11, and softwood pulp shipments of 1,773K mt, down 3% from 1,824K mt in May-11 but up 3% y/y. Shipments to key region China fell slightly to 393K mt from 406K mt in May but were up 45% from Jun-10, and are up 59% YTD compared to the first 6 months of 2010. Shipments to North America and Western Europe came in at 356K mt and 552K mt, respectively, compared to 348K mt and 601K mt in May. Importantly, global softwood pulp inventories hit 28 days on a seasonally adjusted basis compared to 26 days in April and May, and are now approaching what is considered to be a balanced 30 days of inventory.

While pulp industry fundamentals are still relatively firm they do reflect a seasonal softening, in our view, which is being reflected by major producers reducing list prices in North America and China. Specifically, several major NBSK producers recently announced US\$30/mt reductions effective August 1 in North America, bringing list prices to US\$990/mt from highs of US\$1,040 in June. In addition, Canfor Pulp announced a reduction to August list prices in China by US\$30/mt bringing prices to US\$830/mt from US\$920-930/mt in June. Similar to 2010, when North American prices fell from US\$1,020/mt to US\$960/mt during the late summer/early fall, we do not believe NBSK pulp prices will fall significantly from August levels; however, we note continued robust demand from China is a risk key to this outlook. In addition, we highlight the increased risk to pulp producers posed with the depreciating USD which is hovering near USD/CAD1.06 and USD/EUR 1.44.

In light of falling spot pulp pricing and FX headwinds we are reducing our target multiples for Canfor Pulp, Mercer International and Fibrek, resulting in correspondingly lower target share prices. For Outperform rated Canfor Pulp we are reducing our target share price to \$18.50 (from \$21) representing a 4.8x 2011E EV/EBITDA multiple - a premium to the peer group average of pulp producers in our coverage universe at 4.6x due to the stock's attractive 9% dividend yield. For Outperform rated Mercer, we are reducing our target share price to US\$14/share from US\$17, representing a 4.6x 2011E E/EBITDA multiple, in line with the peer group average. Lastly, we are reducing our target price for Fibrek to \$1.40 from \$1.60, reflecting a 4.4x 2011E EV/EBITDA multiple, a discount to the peer group average due to Fibrek's structural disadvantages in terms of fibre cost and product mix. Lastly, we are maintaining our Strong Buy rating on Fortress Paper and Domtar along with our \$60 and US\$125 target prices (respectively).

We also note a slowdown in global textile markets and a significant drop in cotton prices is currently pressuring dissolving pulp ("DP") prices with recent quotes for the commodity at US\$1,580/mt in China, down from highs of US\$2,600/mt in the spring. While we acknowledge the significant drop in prices is a negative for Strong Buy rated prospective DP producer Fortress Paper (FTP-T), we believe this price level is healthier for the industry overall and regard it as more sustainable going forward. We note our 2011 and 2012 estimates assume a US\$1,500/mt DP price, therefore we are leaving our estimates, target price and rating unchanged.

Company	Ticker Primary	Ticker Secondary	Current Price	Target Price (6-12mo) Old	Target Price (6-12mo) New	Div. Yield	Tot. Return To Target	Rating Old	Rating New
<b>Pulp &amp; Paper</b>									
Canfor Pulp Products Inc.	CFX-TSX		C\$17.97	C\$21.00	C\$18.50	9%	12%	Outperform 2	Outperform 2
Domtar	UFS-NYSE	UFS.T-TSX	US\$94.47	US\$125.00	US\$125.00	1%	33%	Strong Buy 1	Strong Buy 1
Fibrek Inc.	FBK-TSX		C\$1.19	C\$1.60	C\$1.40		18%	Market Perform 3	Market Perform 3
Fortress Paper	FTP-TSX		C\$34.20	C\$60.00	C\$60.00		75%	Strong Buy 1	Strong Buy 1
Mercer International Inc.	MERC-NASDAQ	MRI.U-TSX	US\$9.80	US\$17.00	US\$14.00		43%	Outperform 2	Outperform 2

Raymond James Ltd.

## Pulp &amp; Paper

## Canfor Pulp Products Inc. CFX-TSX

Rating: Outperform

Current Price(Jul-20-11)	C\$17.97	Target Price (6-12 mos)	Old: C\$21.00 New: C\$18.50
52-Week Range	C\$19.52 - C\$12.18	Total Return to Target	12%
Market Capitalization (mln)	C\$1,281	Dividend/Yield	C\$1.60/8.9%
Shares Outstanding (mln, f.d.)	71.3	Current Net Debt (mln)	C\$80
Average Daily Volume (000s)	87	Enterprise Value (mln)	C\$1,148

EPS	1Q	2Q	3Q	4Q	Full	Revenue	EBITDA	P/E	EV/EBITDA
	Mar	Jun	Sep	Dec	Year	(mln)	(mln)		
2010A	C\$0.57	C\$0.88	C\$0.78	C\$0.68	C\$2.91	C\$1,001	C\$230	6.2x	5.0x
Old 2011E	0.71A	0.66	0.49	0.57	2.44	921	243		
<b>New 2011E</b>	<b>0.71A</b>	<b>0.68A</b>	<b>0.49</b>	<b>0.57</b>	<b>2.45</b>	<b>927</b>	<b>249</b>	<b>7.3x</b>	<b>4.6x</b>
Old 2012E	NA	NA	NA	NA	1.81	956	220		
<b>New 2012E</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>1.81</b>	<b>956</b>	<b>220</b>	<b>9.9x</b>	<b>5.2x</b>

Pulp (US\$/mt)	
2010A	C\$960
Old 2011E	1,000
<b>New 2011E</b>	<b>1,000</b>
Old 2012E	925
<b>New 2012E</b>	<b>925</b>

Source: Raymond James Ltd., Thomson One

## Domtar UFS-NYSE

Rating: Strong Buy

Current Price(Jul-20-11)	US\$94.47	Target Price (6-12 m)	US\$125.00
52-Week Range	US\$105.82 - US\$48.44	Total Return to Target	33%
Market Capitalization (mln)	US\$4,006	Dividend/Yield	US\$1.00/1.0%
Shares Outstanding (mln, f.d.)	42.4	Current Net Debt (mln)	US\$248
Average Daily Volume (000s)	725	Enterprise Value (mln)	US\$3,511

EPS	1Q	2Q	3Q	4Q	Full	Revenue	EBITDA	P/E	EV/EBITDA
	Mar	Jun	Sep	Dec	Year	(mln)	(mln)		
2010A	US\$1.59	US\$2.67	US\$4.26	US\$2.41	US\$10.93	US\$5,866	US\$1,087	8.6x	3.2x
Old 2011E	3.25A	2.90	2.50	2.48	11.78	5,592	1,189		
<b>New 2011E</b>	<b>3.25A</b>	<b>2.90</b>	<b>2.50</b>	<b>2.48</b>	<b>11.78</b>	<b>5,592</b>	<b>1,189</b>	<b>8.0x</b>	<b>3.0x</b>
Old 2012E	NA	NA	NA	NA	9.58	5,400	994		
<b>New 2012E</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>9.58</b>	<b>5,400</b>	<b>994</b>	<b>9.9x</b>	<b>3.5x</b>

Pulp (US\$/mt)		UFS (US\$/st)	
2010A	US\$960	US\$916	
Old 2011E	1,000	955	
<b>New 2011E</b>	<b>1,000</b>	<b>955</b>	
Old 2012E	925	920	
<b>New 2012E</b>	<b>925</b>	<b>920</b>	

Source: Raymond James Ltd., Thomson One

## Pulp & Paper

### Fibrex Inc. FBK-TSX

**Rating: Market Perform**

Current Price(Jul-20-11)	C\$1.19	Target Price (6-12 mos)	Old: C\$1.60 New: C\$1.40
52-Week Range	C\$1.70 - C\$0.88	Total Return to Target	18%
Market Capitalization (mln)	C\$155	Dividend/Yield	C\$0.00/0.0%
Units Outstanding (mln, f.d.)	130.1	Current Net Debt (mln)	C\$113
Average Daily Volume (000s)	66	Enterprise Value (mln)	C\$232

EPS	1Q	2Q	3Q	4Q	Full	Revenue	EBITDA	P/E	EV/EBITDA
	Mar	Jun	Sep	Dec	Year	(mln)	(mln)		
2010A	C\$(0.01)	C\$0.11	C\$0.09	C\$(0.05)	C\$0.14	C\$557	C\$62	17.3x	3.7x
Old 2011E	0.03A	0.04	0.05	0.06	0.16	569	76		
<b>New 2011E</b>	<b>0.03A</b>	<b>0.03</b>	<b>(0.01)</b>	<b>0.00</b>	<b>0.05</b>	<b>527</b>	<b>60</b>	<b>NA</b>	<b>3.9x</b>
Old 2012E	NA	NA	NA	NA	0.08	518	62		
<b>New 2012E</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>0.08</b>	<b>518</b>	<b>62</b>	<b>14.7x</b>	<b>3.7x</b>

Pulp (US\$/mt)	
2010A	US\$960
Old 2011E	1,000
<b>New 2011E</b>	<b>1,000</b>
Old 2012E	925
<b>New 2012E</b>	<b>925</b>

Source: Raymond James Ltd., Thomson One

### Fortress Paper FTP-TSX

**Rating: Strong Buy**

Current Price(Jul-20-11)	C\$34.20	Target Price (6-12 mos)	C\$60.00
52-Week Range	C\$63.15 - C\$22.96	Total Return to Target	75%
Market Capitalization (mln)	C\$525	Dividend/Yield	C\$0.00/0.0%
Shares Outstanding (mln, f.d.)	15.0	Current Net Debt (mln)	C\$55
Average Daily Volume (000s)	59	Enterprise Value (mln)	C\$584

EPS	1Q	2Q	3Q	4Q	Full	Revenue	EBITDA	P/E	EV/EBITDA
	Mar	Jun	Sep	Dec	Year	(mln)	(mln)		
2010A	C\$0.30	C\$0.37	C\$0.29	C\$(0.06)	C\$0.90	C\$281	C\$26	NA	NA
Old 2011E	(0.42)A	(0.08)	0.42	1.99	1.91	324	55		
<b>New 2011E</b>	<b>(0.42)</b>	<b>(0.08)</b>	<b>0.42</b>	<b>1.99</b>	<b>1.91</b>	<b>326</b>	<b>55</b>	<b>17.9x</b>	<b>10.7x</b>
Old 2012E	NA	NA	NA	NA	8.64	476	191		
<b>New 2012E</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>8.64</b>	<b>489</b>	<b>191</b>	<b>4.0x</b>	<b>3.1x</b>

Source: Raymond James Ltd., Thomson One

## Pulp & Paper

### Mercer International Inc. MERC-NASDAQ

Rating: **Outperform**

Current Price(Jul-20-11)	US\$9.80	Target Price (6-12 mos)	Old: US\$17.00	New: US\$14.00
52-Week Range	US\$15.27 - US\$4.25	Total Return to Target	43%	
Market Capitalization (mln)	US\$558	Dividend/Yield	US\$0.00/0.0%	
Shares Outstanding (mln, f.d.)	57.0	Current Net Debt (mln)	US\$870	
Average Daily Volume (000s)	400	Enterprise Value (mln)	US\$1,228	

EPS	1Q	2Q	3Q	4Q	Full	Revenue	EBITDA	P/E	EV/EBITDA
	Mar	Jun	Sep	Dec	Year	(mln)	(mln)		
2010A	€(0.21)	€0.23	€0.82	€0.63	€1.47	€901	€224	4.7x	3.9x
Old 2011E	0.52A	0.38	0.48	0.42	1.70	891	215		
<b>New 2011E</b>	<b>0.52A</b>	<b>0.38</b>	<b>0.48</b>	<b>0.42</b>	<b>1.70</b>	<b>891</b>	<b>215</b>	<b>4.0x</b>	<b>4.0x</b>
Old 2012E	NA	NA	NA	NA	1.59	897	254		
<b>New 2012E</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>1.59</b>	<b>897</b>	<b>254</b>	<b>4.3x</b>	<b>3.4x</b>

	Pulp (US\$/mt)	Pulp (Eur.Del) US\$/mt
2010A	US\$960	939
Old 2011E	1,000	995
<b>New 2011E</b>	<b>1,000</b>	<b>995</b>
Old 2012E	925	915
<b>New 2012E</b>	<b>925</b>	<b>915</b>

Source: Raymond James Ltd., Thomson One

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**Growth (G)** Low to average risk equities with sound financials, more consistent earnings growth, possibly a small dividend, and the potential for long-term price appreciation.

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**Venture Risk (VR)** Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

## Rating Distributions

	Coverage Universe Rating Distribution		Investment Banking Distribution	
	RJL	RJA	RJL	RJA
<b>Strong Buy and Outperform (Buy)</b>	76%	55%	61%	15%
<b>Market Perform (Hold)</b>	22%	40%	41%	5%
<b>Underperform (Sell)</b>	2%	5%	0%	0%

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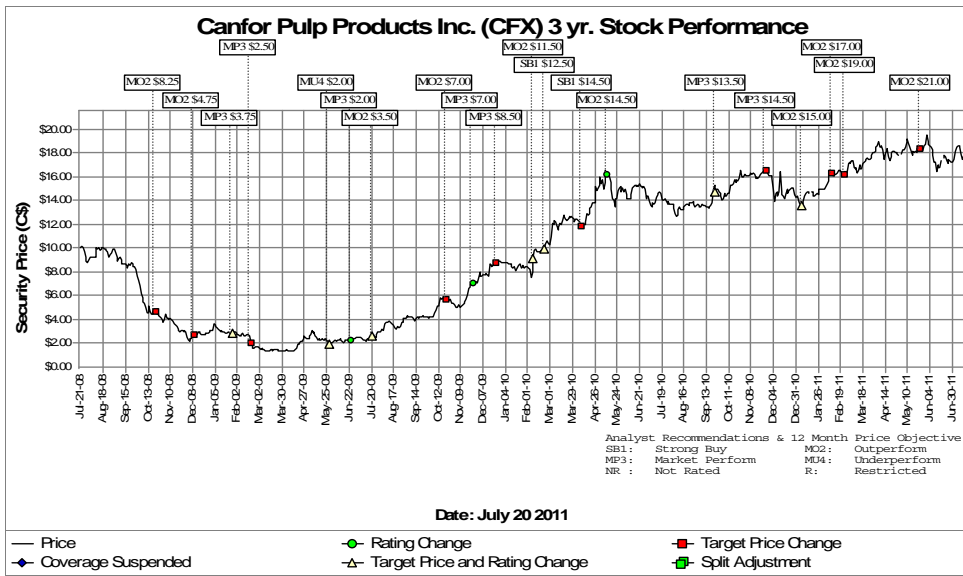
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## Stock Charts, Target Prices, and Valuation Methodologies

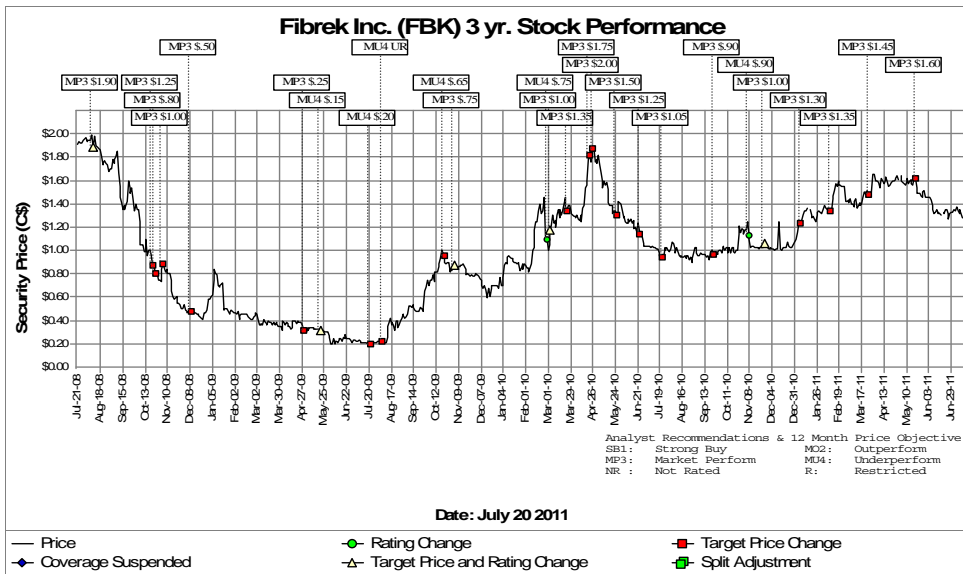
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**Target Prices:** The information below indicates target price and rating changes for the subject companies included in this research.



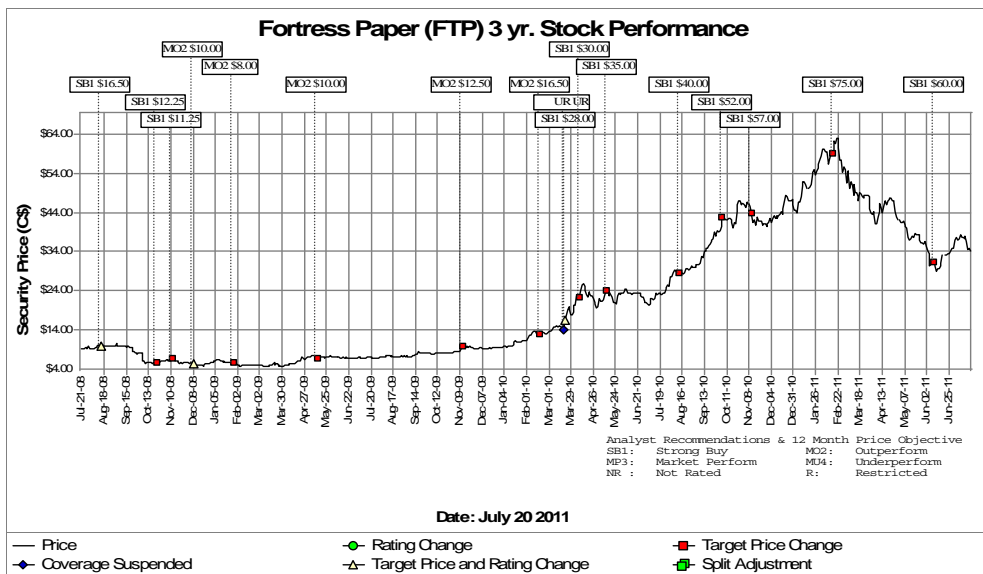
Update Date	Closing Price	Target Price	Rating
May-24-11	18.38	21.00	2
Feb-24-11	16.17	19.00	2
Feb-09-11	16.35	17.00	2
Jan-07-11	13.61	15.00	2
Nov-24-10	16.54	14.50	3
Sep-23-10	14.68	13.50	3
May-11-10	16.20	14.50	2
Apr-08-10	11.90	14.50	1
Feb-22-10	9.90	12.50	1
Feb-08-10	9.10	11.50	2
Dec-23-09	8.81	8.50	3
Nov-24-09	7.10	7.00	3
Oct-21-09	5.69	7.00	2
Jul-21-09	2.66	3.50	2
Jun-24-09	2.26	2.00	3
May-27-09	1.90	2.00	4
Feb-18-09	2.00	2.50	3
Jan-27-09	2.86	3.75	3

**Valuation Methodology:** Our valuation methodology for Canfor Pulp includes a comparison of EV/EBITDA multiple relative to appropriate industry competitors.



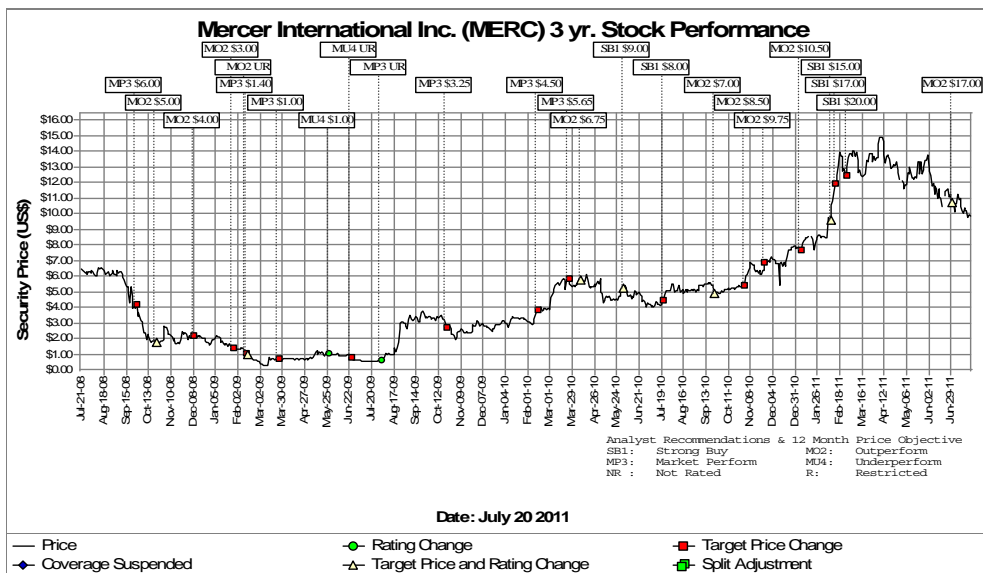
Update Date	Closing Price	Target Price	Rating
May-19-11	1.62	1.60	3
Mar-25-11	1.48	1.45	3
Feb-09-11	1.34	1.35	3
Jan-07-11	1.23	1.30	3
Nov-24-10	1.06	1.00	3
Nov-05-10	1.13	0.90	4
Sep-23-10	0.97	0.90	3
Jul-21-10	0.94	1.05	3
Jun-23-10	1.14	1.25	3
May-25-10	1.30	1.50	3
Apr-26-10	1.87	2.00	3
Apr-21-10	1.82	1.75	3
Mar-24-10	1.34	1.35	3
Mar-03-10	1.18	1.00	3
Feb-26-10	1.10	0.75	4
Nov-03-09	0.87	0.75	3
Oct-21-09	0.95	0.65	4
Aug-05-09	0.22	UR	4

**Valuation Methodology:** Our valuation methodology for Fibrek includes a comparison of EV/EBITDA multiple relative to appropriate industry competitors.



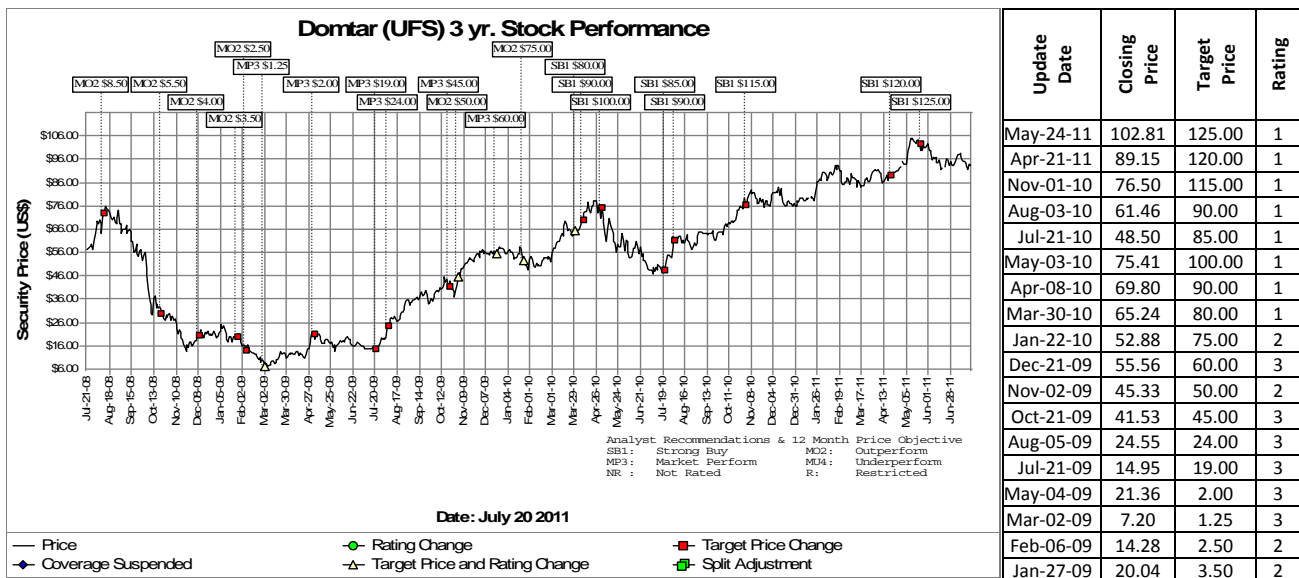
Update Date	Closing Price	Target Price	Rating
Jun-09-11	31.24	60.00	1
Feb-15-11	59.26	75.00	1
Nov-10-10	43.75	57.00	1
Oct-05-10	42.70	52.00	1
Aug-11-10	28.60	40.00	1
May-12-10	24.00	35.00	1
Apr-08-10	22.44	30.00	1
Mar-22-10	16.55	28.00	1
Mar-19-10	14.10	UR	UR
Feb-17-10	12.91	16.50	2
Nov-11-09	10.00	12.50	2
May-13-09	6.90	10.00	2
Jan-27-09	5.60	8.00	2
Dec-09-08	5.45	10.00	2
Nov-11-08	6.65	11.25	1
Oct-22-08	5.75	12.25	1
Aug-13-08	9.80	16.50	1

**Valuation Methodology:** We value Fortress Paper by Discounted Cash Flow Valuation (DCF) taking into account the company's growth potential and key commodity price assumptions.



Update Date	Closing Price	Target Price	Rating
Jun-29-11	10.68	17.00	2
Feb-24-11	12.48	20.00	1
Feb-15-11	11.95	17.00	1
Feb-09-11	9.61	15.00	1
Jan-07-11	7.66	10.50	2
Nov-24-10	6.87	9.75	2
Nov-01-10	5.41	8.50	2
Sep-23-10	4.89	7.00	2
Jul-21-10	4.45	8.00	1
Jun-01-10	5.25	9.00	1
Apr-08-10	5.76	6.75	2
Mar-24-10	5.87	5.65	3
Feb-12-10	3.83	4.50	3
Oct-21-09	2.73	3.25	3
Jul-31-09	0.57	UR	3
Jun-24-09	0.78	UR	4
May-27-09	1.05	1.00	4
Mar-25-09	0.69	1.00	3

**Valuation Methodology:** Our valuation methodology for Mercer International includes a comparison of EV/EBITDA multiple relative to appropriate industry competitors.



**Valuation Methodology:** We value Domtar on a comparative basis to historical multiples.

**Risk Factors**

**General Risk Factors:** Following are some general risk factors that pertain to the projected target prices included on Raymond James research: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation; or (4) External factors that affect the U.S. economy, interest rates, the U.S. dollar or major segments of the economy could alter investor confidence and investment prospects. International investments involve additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability.

**Risks - Canfor Pulp Products Inc.**

i) Slower than expected economic growth could reduce our commodity price forecasts. ii) A strengthening of the Canadian dollar could negatively affect earnings. Downward pressure could be placed on pulp price forecasts if the Euro depreciates relative to the US\$. iii) CFX has a fibre agreement with Canfor Corporation, a shortage of fibre supply or higher chip prices could negatively affect earnings. iv) A rise in interest rates would place downward pressure on CFX's high-yielding units.

**Risks - Fibrek Inc.**

i) Slower than expected economic growth could reduce our commodity price forecasts. ii) A strengthening of the Canadian dollar could negatively affect earnings. Downward pressure could be placed on pulp price forecasts if the euro depreciates relative to the US\$. iii) A shortage of fibre supply or higher chip prices could negatively affect earnings. iv) A rise in interest rates would place downward pressure on Fibrek's units. v) Fibrek earnings could be negatively affected by unexpected curtailments.

**Risks - Fortress Paper**

i) cost overruns, delays and implementation issues relating to Fortress' capital expansion program, ii) pulp, cotton, energy, chemicals, synthetic fibre and other input cost inflation, iii) their ability to secure initial contracts for new products as customers are cautious on being "first adopters", iv) increasing usage of debit, credit and electronic point of sale transactions as substitutes for physical cash usage, v) the risk of new entrants in the non-woven wallpaper or dissolving pulp markets and possible erosion of Fortress' market share, vi) potential negative impact of EUR/C\$ and CHF/C\$ fluctuations given Fortress' exposure to both operational and translational foreign exchange risk, vii) dependence on a few key, large customer contracts, viii) the ever-evolving highly technical and innovative nature of products within the security industry - potential loss of market share and key contracts if Fortress cannot keep abreast of the competition. ix) Slower than expected economic growth could reduce our commodity price forecasts. x) A strengthening of the Canadian dollar could negatively affect earnings. Downward pressure could be placed on dissolving pulp price forecasts if the CAD depreciates relative to the US\$.

**Risks - Mercer International**

i) Forest product commodities are cyclical, slower than expected economic growth could reduce our commodity price forecasts. ii) As pulp prices are denominated in U.S. dollars, an appreciation of the Euro (and to a certain extent, the Canadian dollar) could negatively affect earnings. iii) A reduction in the availability or an increase in price of raw materials (e.g., related to market conditions or weather) could negatively affect operating margins iv) Forest product markets are global in nature, trade issues affecting market access could impact earnings. v) Successful appeals from competitors regarding government grants could delay and/or reduce the amount of grants Mercer is entitled to.

**Risks - Domtar**

i) Forest product commodities are cyclical, slower than expected economic growth could reduce our price forecasts. ii) As sales are denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) An increase in energy prices could negatively impact earnings iv) A reduction in the availability or an increase in price of raw materials could negatively affect operating margins v) Forest product markets are global in nature, trade issues affecting market access could impact earnings.

Additional Risk and Disclosure information, as well as more information on the Raymond James rating system and suitability categories, is available at [www.raymondjames.ca/researchdisclosures](http://www.raymondjames.ca/researchdisclosures). Copies of research or Raymond James' summary policies relating to research analyst independence can be obtained by contacting any Raymond James & Associates or Raymond James Financial Services office (please see [raymondjames.com](http://raymondjames.com) for office locations) or by calling 727-567-1000, toll free 800-237-5643 or sending a written request to the Equity Research Library, Raymond James & Associates, Inc., Tower 3, 6<sup>th</sup> Floor, 880 Carillon Parkway, St. Petersburg, FL 33716.

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