

December 13, 2011

Forest Products

Industry Comment - Changes

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Pulp & Paper

Pulp & Paper: Cutting NBSK Pulp Price Forecast; Valuations Approaching Trough Levels

Event

We are cutting our 2012 NBSK pulp price forecast to US\$900/mt from US\$915/mt with corresponding changes to our estimates and target prices. We are dropping our target price for Canfor Pulp to \$13.00/share from \$16.00 and for Mercer to \$8.00/share from \$10.00. As we expect Fibrek's share price will continue to trade in-line with the \$1.00/share offer from Resolute Forest Products (ABH-TSX) we are leaving our target unchanged.

Action

With materially less sensitivity, Strong Buy rated Domtar remains our top pick with NBSK exposure. Valuations for Canfor Pulp and Mercer International are near what we consider trough levels, however, we are maintaining our respective Market Perform ratings until such time as pricing stabilizes – something we do not expect until 1Q12. In addition, though up sharply today, we highlight that with a current yield of 17% the market appears to be signaling a cut to Canfor Pulp's \$0.40 per quarter dividend and we agree this is likely.

Analysis

At US\$890/mt as of Dec-11 US NBSK pulp prices are now down 14% from Jun-11 record highs of US\$1,040/mt and we believe a further US\$20/mt reduction in Jan-12 is possible before prices stabilize. As a result, we are reducing our 2012 NBSK pulp price forecast from US\$915/mt to US\$900/mt. In-line with this lower pulp price forecast and some adjustments to our unit cost estimates we are reducing our 2012 EBITDA estimates for Canfor Pulp by 21% (from \$217 mln to \$171 mln), Mercer by 11% (from €189 mln to €168 mln), and Fibrek by 12% (from \$46 mln to \$41 mln). As Domtar maintains significantly less exposure to NBSK pulp prices compared to these other producers this lower price assumption results in just a 2% reduction to our 2012 EBITDA estimate from \$986 mln to \$966 mln.

In the case of Canfor Pulp, we also believe a reduction in 2012 quarterly dividend payments is likely, particularly in light of what we now expect to be a lower pulp price environment in 2012 and the company's traditionally conservative dividend policy. We expect this will be announced early in the new year. While the significant drop in the company's share price reflects this expectation to a degree (shares of CFX are down 50% since early July as compared to TSX which is down 12% over this time period), we expect the stock's large retail shareholder base could see some additional turnover on this news. See details on page 2. Longer term, we believe the factors which pushed NBSK pulp prices to all-time highs in Jun-11 including growing demand in China (largely related to tissue industry expansion), permanent capacity shuts, and headroom in paper producer margins for sustainably high NBSK pricing provided by slumping NBHK prices, still exist and note our bullish long-term thesis remains intact.

Valuation

Our target prices of \$13.00/share for Canfor Pulp and \$8.00/share for Mercer represent 2012E EV/EBITDA multiples of 5.2x and 5.1x, respectively, as compared to the average of 5.1x for market pulp producers in our coverage universe. We also note, with CFX trading at \$9.20 and MERC at \$5.88 these stocks are trading at 2012E EV/EBITDA multiples of 3.6x and 4.6x, respectively – each approaching trough valuations and discounting average 2012 NBSK pulp prices in the US\$825/mt range.

Company	Ticker Primary	Ticker Secondary	Current Price	Target Price (6-12mo)		Div. Yield	Tot. Return To Target	Rating Old	Rating New
				Old	New				
Pulp & Paper									
Canfor Pulp Products Inc.	CFX-TSX		C\$9.20	C\$16.00	C\$13.00	17%	59%	Market Perform 3	Market Perform 3
Domtar	UFS-NYSE	UFS-TSX	US\$76.26	US\$125.00	US\$125.00	2%	66%	Strong Buy 1	Strong Buy 1
Fibrek Inc.	FBK-TSX		C\$1.01	C\$1.00	C\$1.00		-1%	Market Perform 3	Market Perform 3
Mercer International Inc.	MERC-NASDAQ	MRI.U-TSX	US\$5.88	US\$10.00	US\$8.00		36%	Market Perform 3	Market Perform 3

Raymond James Ltd.

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Market discounting Canfor Pulp dividend cut – As a reminder, Canfor Pulp’s dividends (or distributions prior to the conversion to a corporation) are traditionally set at the beginning of the year based on the company’s outlook with the payout ratio targeted at ~90% of distributable cash. We highlight that the cash payouts are not meant to represent a set yield the company will pay for the foreseeable future. Given the historical cyclicity in pulp and currency markets we regard this as a prudent strategy. Based on US\$900/mt average NBSK pulp prices and parity FX, we estimate CFX’s 2012 distributable cash (calculated as cash from ops before changes in working capital less capex, maintenance and interest) at \$1.34/share or ~\$0.30 per quarter assuming a 90% payout ratio (note: the distributable cash values in the table below differ from our published estimates which reflect adjusted EPS). This represents a 13% yield on the current share price, as compared to a 17% yield on the current \$0.40/share dividend. As mentioned above, although the steep 50% drop in the company’s share price likely reflects expectations of a reduced yield, we believe the shares may still experience a leg down should a dividend cut occur. We highlight, however, that longer term we remain bullish on NBSK pulp fundamentals and note that the conditions that led to record NBSK pulp prices in Jun-11 could begin to reassert themselves as early as this spring.

Exhibit 1: Canfor Pulp 2012E Distributable Cash Sensitivity to NBSK Pulp Prices and US\$/C\$ FX Rates

US\$/C\$	NBSK Pulp (del. US) (US\$/mt)															
	750	775	800	825	850	860	870	880	890	900	910	915	920	925	950	1,000
0.90	\$ 0.58	\$ 0.89	\$ 1.21	\$ 1.53	\$ 1.85	\$ 1.97	\$ 2.10	\$ 2.23	\$ 2.35	\$ 2.48	\$ 2.61	\$ 2.67	\$ 2.73	\$ 2.80	\$ 3.11	\$ 3.75
0.91	\$ 0.47	\$ 0.79	\$ 1.10	\$ 1.41	\$ 1.73	\$ 1.85	\$ 1.98	\$ 2.10	\$ 2.23	\$ 2.36	\$ 2.48	\$ 2.54	\$ 2.61	\$ 2.67	\$ 2.98	\$ 3.61
0.92	\$ 0.37	\$ 0.68	\$ 0.99	\$ 1.30	\$ 1.61	\$ 1.74	\$ 1.86	\$ 1.98	\$ 2.11	\$ 2.23	\$ 2.36	\$ 2.42	\$ 2.48	\$ 2.54	\$ 2.85	\$ 3.47
0.93	\$ 0.27	\$ 0.58	\$ 0.88	\$ 1.19	\$ 1.50	\$ 1.62	\$ 1.74	\$ 1.87	\$ 1.99	\$ 2.11	\$ 2.24	\$ 2.30	\$ 2.36	\$ 2.42	\$ 2.73	\$ 3.34
0.94	\$ 0.17	\$ 0.48	\$ 0.78	\$ 1.08	\$ 1.39	\$ 1.51	\$ 1.63	\$ 1.75	\$ 1.87	\$ 1.99	\$ 2.12	\$ 2.18	\$ 2.24	\$ 2.30	\$ 2.60	\$ 3.21
0.95	\$ 0.08	\$ 0.38	\$ 0.68	\$ 0.98	\$ 1.28	\$ 1.40	\$ 1.52	\$ 1.64	\$ 1.76	\$ 1.88	\$ 2.00	\$ 2.06	\$ 2.12	\$ 2.18	\$ 2.48	\$ 3.08
0.96	\$ (0.02)	\$ 0.28	\$ 0.58	\$ 0.87	\$ 1.17	\$ 1.29	\$ 1.41	\$ 1.53	\$ 1.65	\$ 1.77	\$ 1.89	\$ 1.95	\$ 2.00	\$ 2.06	\$ 2.36	\$ 2.96
0.97	\$ (0.11)	\$ 0.19	\$ 0.48	\$ 0.77	\$ 1.07	\$ 1.19	\$ 1.30	\$ 1.42	\$ 1.54	\$ 1.66	\$ 1.77	\$ 1.83	\$ 1.89	\$ 1.95	\$ 2.25	\$ 2.83
0.98	\$ (0.20)	\$ 0.09	\$ 0.38	\$ 0.67	\$ 0.97	\$ 1.08	\$ 1.20	\$ 1.32	\$ 1.43	\$ 1.55	\$ 1.67	\$ 1.72	\$ 1.78	\$ 1.84	\$ 2.13	\$ 2.71
0.99	\$ (0.29)	\$ 0.00	\$ 0.29	\$ 0.58	\$ 0.87	\$ 0.98	\$ 1.10	\$ 1.21	\$ 1.33	\$ 1.44	\$ 1.56	\$ 1.62	\$ 1.67	\$ 1.73	\$ 2.02	\$ 2.60
1.00	\$ (0.37)	\$ (0.09)	\$ 0.20	\$ 0.48	\$ 0.77	\$ 0.88	\$ 1.00	\$ 1.11	\$ 1.22	\$ 1.34	\$ 1.45	\$ 1.51	\$ 1.57	\$ 1.62	\$ 1.91	\$ 2.48
1.01	\$ (0.46)	\$ (0.18)	\$ 0.11	\$ 0.39	\$ 0.67	\$ 0.78	\$ 0.90	\$ 1.01	\$ 1.12	\$ 1.24	\$ 1.35	\$ 1.41	\$ 1.46	\$ 1.52	\$ 1.80	\$ 2.37
1.02	\$ (0.54)	\$ (0.26)	\$ 0.02	\$ 0.30	\$ 0.58	\$ 0.69	\$ 0.80	\$ 0.91	\$ 1.03	\$ 1.14	\$ 1.25	\$ 1.31	\$ 1.36	\$ 1.42	\$ 1.70	\$ 2.26
1.03	\$ (0.62)	\$ (0.35)	\$ (0.07)	\$ 0.21	\$ 0.49	\$ 0.60	\$ 0.71	\$ 0.82	\$ 0.93	\$ 1.04	\$ 1.15	\$ 1.21	\$ 1.26	\$ 1.32	\$ 1.59	\$ 2.15
1.04	\$ (0.70)	\$ (0.43)	\$ (0.15)	\$ 0.12	\$ 0.39	\$ 0.50	\$ 0.61	\$ 0.72	\$ 0.83	\$ 0.94	\$ 1.05	\$ 1.11	\$ 1.16	\$ 1.22	\$ 1.49	\$ 2.04
1.05	\$ (0.78)	\$ (0.51)	\$ (0.24)	\$ 0.03	\$ 0.31	\$ 0.41	\$ 0.52	\$ 0.63	\$ 0.74	\$ 0.85	\$ 0.96	\$ 1.01	\$ 1.07	\$ 1.12	\$ 1.39	\$ 1.94
1.06	\$ (0.86)	\$ (0.59)	\$ (0.32)	\$ (0.05)	\$ 0.22	\$ 0.33	\$ 0.43	\$ 0.54	\$ 0.65	\$ 0.76	\$ 0.86	\$ 0.92	\$ 0.97	\$ 1.03	\$ 1.30	\$ 1.83
1.07	\$ (0.93)	\$ (0.67)	\$ (0.40)	\$ (0.13)	\$ 0.13	\$ 0.24	\$ 0.35	\$ 0.45	\$ 0.56	\$ 0.67	\$ 0.77	\$ 0.83	\$ 0.88	\$ 0.93	\$ 1.20	\$ 1.73
1.08	\$ (1.01)	\$ (0.74)	\$ (0.48)	\$ (0.22)	\$ 0.05	\$ 0.15	\$ 0.26	\$ 0.37	\$ 0.47	\$ 0.58	\$ 0.68	\$ 0.74	\$ 0.79	\$ 0.84	\$ 1.11	\$ 1.63

At Dec-11 NBSK pulp prices and FX

RJ Current Estimates

Note: Distributable cash = Cash from operations before changes in working capital less capex, maintenance, and interest

Source: Raymond James Ltd.

Forest Products

Pulp & Paper

Canfor Pulp Products Inc. CFX-TSX

Rating: Market Perform

Current Price(Dec-12-11)	C\$9.20	Target Price (6-12 mos)	Old: C\$16.00	New: C\$13.00
52-Week Range	C\$19.52 - C\$8.75	Total Return to Target	59%	
Market Capitalization (mln)	C\$656	Dividend/Yield	C\$1.60/17.4%	
Shares Outstanding (mln, f.d.)	71.3	Current Net Debt (mln)	C\$82	
Average Daily Volume (000s)	115	Enterprise Value (mln)	C\$614	

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	3.2x	2.7x
Old 2011E	0.71A	0.68A	0.47A	0.38	2.24	901	224		
New 2011E	0.71A	0.68A	0.47A	0.38	2.24	901	224	4.1x	2.7x
Old 2012E	0.41	0.50	0.49	0.42	1.82	935	217		
New 2012E	0.23	0.35	0.34	0.29	1.22	863	171	7.5x	3.6x

Pulp (US\$/mt)	
2010A	C\$960
Old 2011E	978
New 2011E	978
Old 2012E	915
New 2012E	900

Source: Raymond James Ltd., Thomson One

Domtar UFS-NYSE

Rating: Strong Buy

Current Price(Dec-12-11)	US\$76.26	Target Price (6-12 m)	US\$125.00
52-Week Range	US\$105.82 - US\$62.28	Total Return to Target	66%
Market Capitalization (mln)	US\$2,906	Dividend/Yield	US\$1.40/2.0%
Shares Outstanding (mln, f.d.)	38.1	Current Net Debt (mln)	US\$248
Average Daily Volume (000s)	578	Enterprise Value (mln)	US\$2,498

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	7.0x	2.3x
Old 2011E	3.25A	2.37A	3.10A	2.47	11.19	5,570	1,119		
New 2011E	3.25A	2.37A	3.10A	2.47	11.19	5,570	1,119	6.8x	2.2x
Old 2012E	1.43	2.60	2.82	2.34	9.19	5,488	986		
New 2012E	1.31	2.51	2.72	2.25	8.79	5,468	966	8.7x	2.6x

Pulp (US\$/mt)		UFS (US\$/st)	
2010A	US\$960	US\$916	
Old 2011E	978	944	
New 2011E	978	944	
Old 2012E	915	940	
New 2012E	900	940	

Source: Raymond James Ltd., Thomson One

Fibrex Inc. FBK-TSX**Rating: Market Perform**

Current Price(Dec-12-11)	C\$1.01	Target Price (6-12 mos)	C\$1.00
52-Week Range	C\$1.70 - C\$0.63	Total Return to Target	-1%
Market Capitalization (mln)	C\$135	Dividend/Yield	C\$0.00/0.0%
Units Outstanding (mln, f.d.)	133.2	Current Net Debt (mln)	C\$96
Average Daily Volume (000s)	206	Enterprise Value (mln)	C\$205

EPS	1Q Mar	2Q Jun	3Q Sep	4Q Dec	Full Year	Revenue (mln)	EBITDA (mln)	P/E	EV/EBITDA
2010A	C\$(0.01)	C\$0.11	C\$0.09	C\$(0.05)	C\$0.14	C\$557	C\$62	14.1x	3.3x
Old 2011E	0.03A	0.04A	0.05A	(0.03)	0.09	539	53		
New 2011E	0.03A	0.04A	0.05A	(0.03)	0.09	539	53	NA	3.9x
Old 2012E	0.03	(0.01)	0.00	0.00	0.03	526	46		
New 2012E	(0.02)	(0.01)	0.02	(0.01)	(0.02)	520	41	NA	5.0x

**Pulp
(US\$/mt)**

2010A	US\$960
Old 2011E	978
New 2011E	978
Old 2012E	915
New 2012E	900

Source: Raymond James Ltd., Thomson One

Mercer International Inc. MERC-NASDAQ**Rating: Market Perform**

Current Price(Dec-12-11)	US\$5.88	Target Price (6-12 mos)	Old: US\$10.00	New: US\$8.00
52-Week Range	US\$15.27 - US\$5.30	Total Return to Target	36%	
Market Capitalization (mln)	US\$329	Dividend/Yield	US\$0.00/0.0%	
Shares Outstanding (mln, f.d.)	56.0	Current Net Debt (mln)	US\$793	
Average Daily Volume (000s)	253	Enterprise Value (mln)	US\$1,004	

EPS	1Q Mar	2Q Jun	3Q Sep	4Q Dec	Full Year	Revenue (mln)	EBITDA (mln)	P/E	EV/EBITDA
2010A	€(0.21)	€0.23	€0.82	€0.63	€1.47	€901	€224	3.0x	3.4x
Old 2011E	0.52A	0.26A	0.15A	0.13	1.06	906	188		
New 2011E	0.52A	0.26A	0.15A	0.13	1.06	860	188	4.2x	4.1x
Old 2012E	0.20	0.25	0.25	0.29	0.99	832	189		
New 2012E	0.03	0.22	0.25	0.22	0.72	807	168	6.2x	4.6x

**Pulp
(US\$/mt) Pulp
(Eur.Del)
US\$/mt**

2010A	US\$960	939
Old 2011E	978	968
New 2011E	978	968
Old 2012E	915	905
New 2012E	900	880

Source: Raymond James Ltd., Thomson One

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	Coverage Universe Rating Distribution			Investment Banking Distribution		
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Strong Buy and Outperform (Buy)	71%	59%	45%	49%	14%	23%
Market Perform (Hold)	28%	36%	48%	25%	5%	3%
Underperform (Sell)	1%	6%	7%	0%	6%	0%

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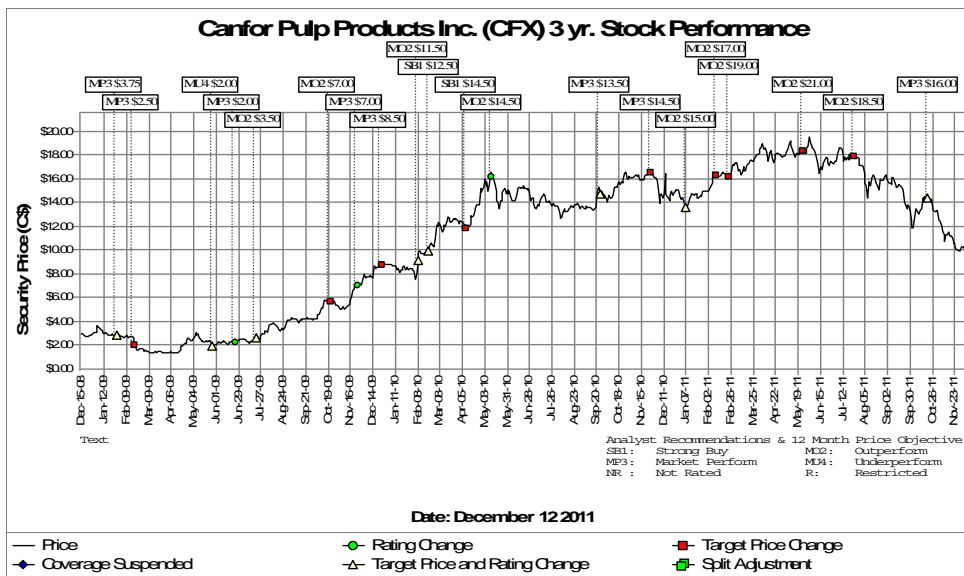
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Stock Charts, Target Prices, and Valuation Methodologies

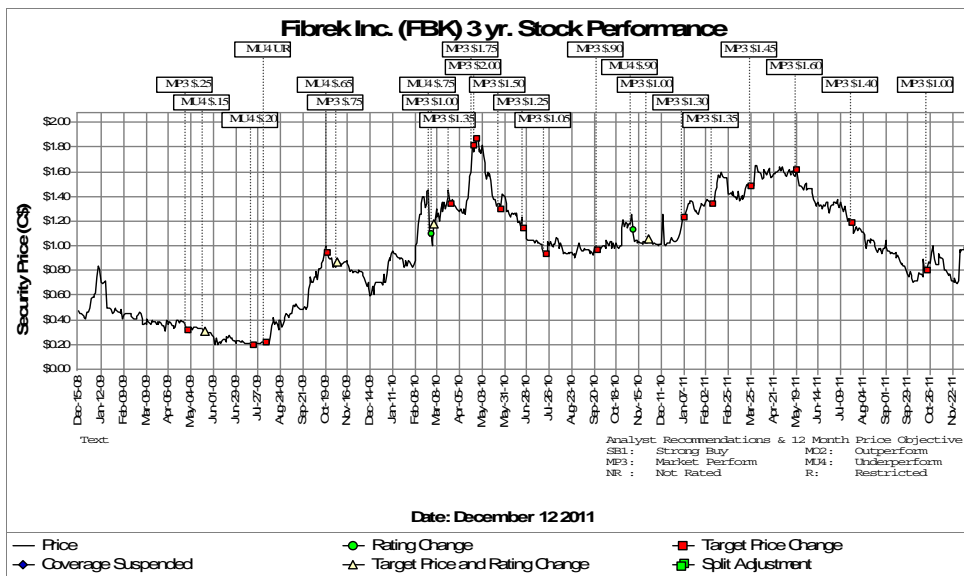
Valuation Methodology: The Raymond James methodology for assigning ratings and target prices includes a number of qualitative and quantitative factors including an assessment of industry size, structure, business trends and overall attractiveness; management effectiveness; competition; visibility; financial condition, and expected total return, among other factors. These factors are subject to change depending on overall economic conditions or industry- or company-specific occurrences.

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



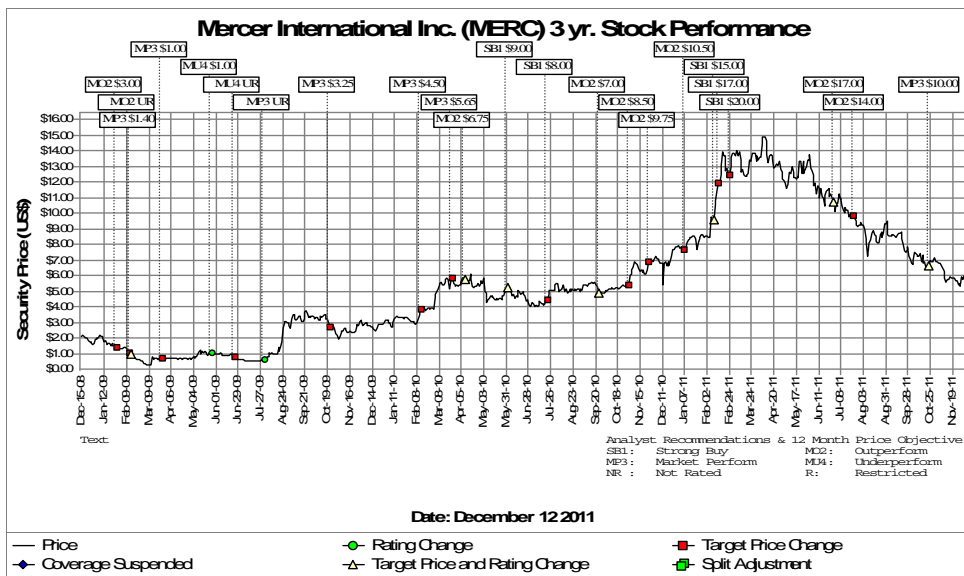
Update Date	Closing Price	Target Price	Rating
Oct-21-11	14.35	16.00	3
Jul-22-11	17.97	18.50	2
May-24-11	18.38	21.00	2
Feb-24-11	16.17	19.00	2
Feb-09-11	16.35	17.00	2
Jan-07-11	13.61	15.00	2
Nov-24-10	16.54	14.50	3
Sep-23-10	14.68	13.50	3
May-11-10	16.20	14.50	2
Apr-08-10	11.90	14.50	1
Feb-22-10	9.90	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

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



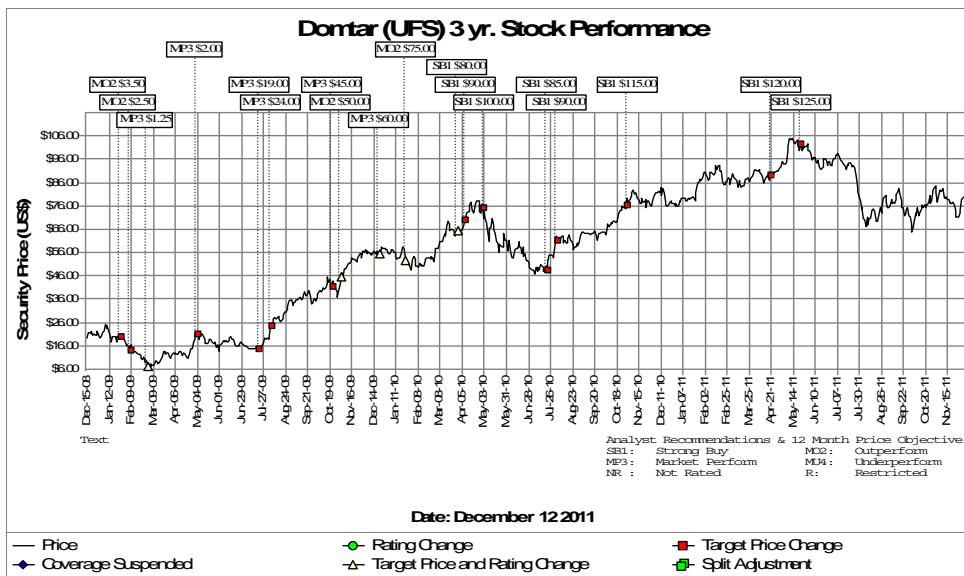
Update Date	Closing Price	Target Price	Rating
Oct-21-11	0.80	1.00	3
Jul-22-11	1.19	1.40	3
May-19-11	1.62	1.60	3
Mar-25-11	1.48	1.45	3
Feb-09-11	1.34	1.35	3
Jan-07-11	1.23	1.30	3
Nov-24-10	1.06	1.00	3
Nov-05-10	1.13	0.90	4
Sep-23-10	0.97	0.90	3
Jul-21-10	0.94	1.05	3
Jun-23-10	1.14	1.25	3
May-25-10	1.30	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

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



Update Date	Closing Price	Target Price	Rating
Oct-21-11	6.62	10.00	3
Jul-22-11	9.80	14.00	2
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

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



Update Date	Closing Price	Target Price	Rating
May-24-11	102.81	125.00	1
Apr-21-11	89.15	120.00	1
Nov-01-10	76.50	115.00	1
Aug-03-10	61.46	90.00	1
Jul-21-10	48.50	85.00	1
May-03-10	75.41	100.00	1
Apr-08-10	69.80	90.00	1
Mar-30-10	65.24	80.00	1
Jan-22-10	52.88	75.00	2
Dec-21-09	55.56	60.00	3
Nov-02-09	45.33	50.00	2
Oct-21-09	41.53	45.00	3
Aug-05-09	24.55	24.00	3
Jul-21-09	14.95	19.00	3
May-04-09	21.36	2.00	3
Mar-02-09	7.20	1.25	3
Feb-06-09	14.28	2.50	2
Jan-27-09	20.04	3.50	2

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.

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 - 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.

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