Robert Dunn **Michael Wolleben**

Hidden Opportunities

Valuing possible breakups by providing sum-of-the-parts analysis.

- ✓ Domtar Corporation (NYSE: UFS), a forest & consumer products company, operates two distinct segments: (1) Pulp & Paper (77% of consolidated sales and 67.5% of adj. EBITDA in 2020E); and (2) Personal Care (23% of sales and 32.5% of adj. EBITDA in 2020E).

- ✓ For background, UFS was previously covered by *The Hidden Opportunities Report* from March 2017 until its achievement of our fair value estimate in January 2018 (a period in which the stock returned ~39.5% compared with 16% and 17% gains in the S&P 500 and Russell 2000, respectively). Notably, since January 2018 UFS's share price has declined ~49% (compared with a 18% gain in the S&P and a ~7.0% decline in the Russell) albeit with the bulk of the decline occurring amid the pandemic in 2020. Within this context, in August 2020, UFS disclosed a review of potential strategic alternatives for its Personal Care (PC) division, which, as noted in our original report, has a markedly divergent product set and growth profile (as well as requires different manufacturing, technology and marketing strategies) when compared with the company's core-Pulp & Paper (P&P) division. Moreover, we continue think the PC segment could garner a premium valuation from a range of strategic partners (while also attracting interest from private equity suitors) and that as a standalone the P&P segment, which is in the process of repurposing a portion of its production assets toward the attractive packaging sector, could itself become an takeover/go-private target.

- ✓ As such, with shares trading at less than 5.0x 2022E EV/EBITDA and a discount to tangible book value we estimate the stock is undervalued, particularly relative to the potential value creation from the separation/monetization of its PC unit and the potential attractiveness of a standalone P&P business to strategic acquirers.

- ✓ Considering management commentary, peer, and M&A valuations as well as discounted cash flows, value of $38 per share and $19 per share can be assigned to UFS's Pulp & Paper and Personal Care businesses. Accounting for corporate costs and projected net debt of ~$20 per share yields a base case sum-of-the-parts value of roughly $37 per share (with bull/bear cases of ~$31-$42 per share).

Domtar Corporation

(NYSE: UFS)

Date (9/23/20)

Price $26.03/share

Market capitalization ~$1.45B

Pulp & Paper: $38 per share

Personal Care: $19 per share

Corporate/Net Debt: ($20 per share)

SOTP: $37 per share*

***SOTP may not add due to rounding**

NOTE: This publication could be considered as advocating for corporate restructurings. Authors select companies for this report based on the potential for a future value-unlocking transaction. In many cases, these companies have or could come under activist investor pressure, media scrutiny, or general market speculation that a spin-off or asset sale is possible.

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The Background

Domtar Corporation (NYSE: UFS), based in Fort Mill, SC, has origins dating back to the founding of Burt, Boulton Holdings Ltd., a lumber treating operation, in the U.K. in 1848 and the subsequent founding, in 1903, of Dominion Tar and Chemical Co., which operated a Canadian-based coal tar distillation plant. Over the decades, the company diversified into myriad businesses, including paper, newsprint, containerboard, and packaging, before changing its name to Domtar Ltd. in 1965. In 2007, Domtar merged with Weyerhaeuser's (NYSE: WY) paper business to form Domtar Corporation. In 2008-2012, the company divested non-core assets, including a lumber business, a hardwood pulp mill and a coated groundwood mill, as well as entered the personal care arena. Today, UFS operates two distinct business segments (see Background #1): (1) Pulp & Paper (77% of consolidated sales and 67.5% of adjusted EBITDA in 2020E), which produces pulp and manufactures uncoated free sheet paper; and (2) Personal Care (23% of sales and 32.5% of adj. EBITDA in 2020E), which makes absorbent hygiene products, such as adult & infant diapers.

Background #1 Domtar Corporation: Consolidated Selected Financial Items, 2015–2022E
($ in millions)

	2015	2016	2017	2018	2019	2020E	2021E	2022E
Revenue:								
Pulp & paper	$4,458	$4,239	$4,216	$4,523	$4,332	$3,504	$3,659	$3,697
Personal care	$869	$909	$996	$1,000	$953	$1,005	$1,015	$1,036
Intersegment sales	($63)	($58)	($64)	($68)	($65)	($70)	($70)	($70)
Total	**$5,264**	**$5,090**	**$5,148**	**$5,455**	**$5,220**	**$4,439**	**$4,605**	**$4,663**
Adjusted operating income:								
Pulp & paper	$336	$277	$246	$453	$289	$54	$128	$222
Personal care	$62	$59	$53	$10	$31	$70	$71	$73
Corporate	($44)	($49)	($51)	($46)	($50)	($30)	($40)	($40)
Total	**$354**	**$287**	**$248**	**$417**	**$270**	**$94**	**$159**	**$254**
Adjusted EBITDA:								
Pulp & paper	$633	$561	$500	$691	$517	$269	$338	$425
Personal care	$124	$123	$120	$80	$96	$129	$129	$132
Corporate	($44)	($49)	($51)	($46)	($50)	($30)	($40)	($40)
Total	**$713**	**$635**	**$569**	**$725**	**$563**	**$368**	**$428**	**$517**
Capital expenditures:								
Pulp & paper	$221	$287	$128	$164	$220	$128	$265	$275
Personal care	$57	$55	$48	$37	$41	$35	$41	$47
Corporate	$6	$4	$4	$2	$3	$2	$3	$3
Total	**$284**	**$346**	**$180**	**$203**	**$264**	**$165**	**$309**	**$324**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

For context on the following discussion, UFS management has provided some anecdotal 2020 guidance as well as articulated some longer-term financial commentary and targets. Notably, the company withdrew its explicit financial guidance (as well as suspended its dividend and share repurchase programs) in May 2020 with the exception of a capital spending target, which currently stands at $160-$170 million (compared with the initial range of $230-$260 million; see Background #2). At least initially, the company's anecdotal commentary suggested that its paper business would be more balanced (given recent capacity closures) in 2020 with modestly lower maintenance expenses (see Background #2) and that following a challenging year in 2019 pulp prices had likely reached a cyclical bottom (with the medium to long-term fundamentals of the softwood and fluff pulp markets continuing to trend positively amid rising demand and limited capacity expansion). On the personal care side, the 2020 focus was to remain on improving profitability, following the consolidation of its U.S. facility footprint and product/customer portfolio in 2019, amid solid demand in the adult incontinence market and the ramp of a new infant diaper customer. That said, as the COVID-19 pandemic began to unfold UFS implemented a range of cost reductions measures, which in aggregate target ~$200 million of run-rate savings by the end of 2021, as well as acted to reduce inventory, defer a portion of previously planned capital investments and suspend its capital return program (i.e. share repurchases and dividends). As well, in response to the markedly lower demand for paper (amid global office closures and disruptions in commercial printing) the company idled its paper operations at the Ashdown, AR, Kingsport, TN and Hawesville, KY mills as well as took extended downtime at its Johnsonburg, PA and Rothschild, WI facilities, which, in total, effectively represent almost 300,000 tons of annual paper production capacity. Conversely, on the personal care side of the business, the company experienced record demand in 1Q 2020 (amid so-called "pantry loading" for household items, such as diapers) as well as accelerated margin improvement. In terms of its most recent anecdotal commentary on 2H 2020, UFS expects the paper market to remain weak albeit with a degree of incremental recovery in 3Q 2020 and toward year-end. (In that context, demand improved sequentially in both June and July.) Relatedly, management expects the near-term pulp market will be impacted by seasonal softness as well as elevated global inventories and weak demand trends from the paper market. The Personal Care business is expected to continue benefiting from new customer wins and productivity gains (amid relative stability in raw material costs) in 2H 2020.

Background #2 Domtar Corporation: 2020E Financial Guidance, Selected Items

	2019 Actual	2020E Initial	2020E Previous	**2020E Current**
Maintenance costs	$508 million	$485 - $495 million	$445 - $455 million	-
Capital expenditures	$255 million	$230 - $260 million	$140 - $150 million	$160 - $170 million
Depreciation & amortization	$293 million	$290 - $300 million	-	-
Interest expense	$52 million	$57 - $60 million	$60 - $62 million	-
Income tax rate	2%	20% - 22%	17% - 19%	-

Source: Company reports.

Longer term, UFS has provided estimates for the long-term growth rates of its four primary end-markets (see Background #3). Within Pulp & Paper, UFS projects a steady decline of 3%-5% in Communication Paper, partially offset by growth in Specialty Paper, which is expected to roughly track GDP. Market Pulp is projected to experience a 1%-2% annual advance. Within this market context, particularly in regard to communication paper's secular decline, UFS has articulated a long-term roadmap that could result in ~50% of its paper production capacity ultimately being converted to produce high-quality containerboard and/or softwood/fluff pulp. (To that end, as will be described in more detail later in this report, the company recently announced that the idled paper operations at its Ashdown, AR facility would be converted to softwood and fluff pulp production and that its Kingsport, TN facility would be repurposed to produce high-quality recycled containerboard.) The company's Personal Care (PC) markets are projected to have a long-term growth rate of 2%-4% annually. (More broadly, the company has articulated the expectation that its PC business has a runway to sales of $1.3-$1.5 billion and a "mid-teens" margin profile.)

Background #3 Domtar Corporation: Long-Term Growth Rate Projections, by End-Market

	Long-term growth rate	% of sales (2016)	% of sales (2018)	% of sales (2020E)
Pulp & Paper:				
Communication Paper	(3%) - (5%)	51%	48%	43%
Specialty Paper	GDP	12%	11%	12%
Market Pulp	1% - 2%	19%	23%	21%
Personal Care:				
Personal Care	2% - 4%	18%	18%	23%

Source: Company reports.

Pulp & Paper (P&P)

The Pulp & Paper segment, which is projected to account for 77% of consolidated revenue and 67.5% of adjusted EBITDA in 2020E, produces pulp, including softwood, fluff, and hardwood, as well as manufactures (and markets) uncoated free sheet paper, via a network of 13 pulp and paper mills in the U.S. and Canada. (For reference, fiber-based pulp is the primary raw material used in the production of many kinds of paper.) The division, which is run by Michael Garcia, is headquartered in Fort Mill, SC.

Background #4 Domtar Corporation: Pulp & Paper Segment, Selected Items (2016-2022E)
($ in millions)

	2016	2017	2018	2019	6 mos. 2019	6 mos. 2020	2020E	2021E	2022E
Revenue	**$4,239**	**$4,216**	**$4,523**	**$4,332**	**$2,263**	**$1,833**	**$3,504**	**$3,659**	**$3,697**
Paper	$3,251	$3,033	$3,258	$3,208	$1,659	$1,285	$2,481	$2,579	$2,581
Market pulp	$930	$1,119	$1,197	$1,059	$550	$492	$953	$1,011	$1,046
Operating income (as reported)	**$217**	**$250**	**$457**	**$225**	**$212**	**$17**	**$53**	**$128**	**$222**
Impairments	*$29*	-	-	*$32*	-	-	-	-	-
Restructuring	*$31*	-	-	*$22*	-	*$1*	*$1*	-	-
Gain on disposal of equipment	-	($4.0)	($4.0)	-	-	-	-	-	-
Pension settlement	-	-	-	*$10*	-	-	-	-	-
Adjusted operating income	**$277**	**$246**	**$453**	**$289**	**$212**	**$18**	**$54**	**$128**	**$222**
Depreciation & amortization	$284	$254	$238	$228	$117	$114	$215	$210	$203
Adjusted EBITDA	**$561**	**$500**	**$691**	**$517**	**$329**	**$132**	**$269**	**$338**	**$425**
Adjusted operating margin	6.5%	5.8%	10.0%	6.7%	9.4%	1.0%	1.5%	3.5%	6.0%
Adjusted EBITDA margin	**13.2%**	**11.9%**	**15.3%**	**11.9%**	**14.5%**	**7.2%**	**7.7%**	**9.3%**	**11.5%**
Capital expenditures	**$287**	**$128**	**$164**	**$220**	-	-	**$128**	**$265**	**$275**
Shipments:									
Paper - total (in thousands of ST)	**3,144**	**3,000**	**3,080**	**2,838**	**1,461**	**1,172**	**2,274**	**2,329**	**2,296**
Communications paper	2,522	2,401	2,446	2,299	1,182	935	1,816	1,862	1,824
Specialty and Packaging	499	490	525	446	235	203	386	394	397
Paper sourced from 3rd parties	123	109	109	93	44	34	72	74	75
Pulp (in thousands of ADMT)	**1,513**	**1,722**	**1,536**	**1,539**	**719**	**816**	**1,731**	**1,749**	**1,766**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

On the Pulp front, UFS currently has more than 4 million tons of pulp production capacity, of which more than 50% is used internally (to make paper). Excess production of ~2 million tons is sold to third parties on the open market and is expected to generate ~27% of P&P segment sales in 2020E. (Note: roughly $0.5 billion and $0.2 million of pulp sales are exports to China and Europe, respectively.) For some market context, following the combination of International Paper (NYSE: IP) with Weyerhaeuser's (NYSE: WY) pulp operations in December 2016, UFS is the third largest producer of fluff pulp. Other players include, Georgia Pacific (a subsidiary of privately held Koch Industries), Arauco (private), the Metsa Group (METSA FH) and the Paper Excellence Group (private). All told, UFS projects Market Pulp to post long-term growth of 1%-2% (see Background #3 and/or Background #6)

Given the long-term growth outlook for pulp, particularly against the backdrop of on-going/secular headwinds in the paper market, UFS spent ~$160 million in 2015-2016 to convert paper-making assets/capacity at its Ashdown, AR mill to produce high-quality "fluff pulp", which is used in absorbent personal care products, such as diapers, as well as "softwood pulp", which is used, in among other things, containerboard. More recently, in August 2020, the company announced that it would spend an incremental $15-$20 million over the next 12-14 months to complete the conversion of its Ashdown facility to 100% softwood and fluff pulp production with potential annual capacity of ~775,000 air-dried metric tons (ADMT).

On the Paper front, with almost 3 million tons of production capacity, which represents more than 30% of total North American capacity, UFS is the largest manufacturer of uncoated free sheet paper followed by International Paper (NYSE: IP) with more than 20% share and Packaging Corp. of America (NYSE: PK), which has an additional ~10% share. Other players, including Georgia Pacific and Lindsay Goldberg, a private-equity firm that controls paper-brands, such as Pixelle Specialty Solutions and Crown Paper Group, as well as packaging-players, such as Paccor, Golden West and Schur Flexibles, collectively control an additional ~15% share of the market. UFS's brands include Cougar, Husky, Lynx, EarthChoice and First Choice. Its top ten customers, which are primarily domestic retailers, merchants, and office equipment manufacturers (see Background #5), accounted for ~37% of consolidated sales in 2019, and the company's largest customer, Staples (NASDAQ: SPLS), represented about 11% of total UFS sales.

Background #5 Domtar Corporation: Pulp & Paper Segment, Product Applications & Distribution

Type	**Uncoated Free Sheet**			
	Communication Papers			**Specialty & Packaging Papers**
Category	Business Papers	Commercial Printing	Publishing Paper	
Application	Photocopies	Commercial Printing	Stationery	Food & candy packaging
	Office documents	Direct mail	Brochures	Fast foot takeout bags
	Presentations	Pamphlets	Annual reports	Check & security papers
	Reports	Brochures	Books	Surgical gowns
		Cards	Catalogs	
		Posters	Forms & Envelopes	
Domtar sells to:	Retailers, Merchants, Office Equipment manufacturers, Stationers	Merchants, Converters, End-Users		Converters
Customer sells to:	Printers, Retailers, Stationers, End-users	Printers, Converters, Merchants, Retailers, End-users		End-users

Source: Company reports.

Uncoated free sheet paper, for which UFS's ticker is an acronym, is among the most common grades of paper and is typically categorized as either communication paper, which is used for both business and publishing purposes, or as specialty/packaging paper (see Background #5). The use of communication paper, which includes copy paper as well as book/magazine paper and comprise about 43% of total sales (and ~80% of segment paper shipments) in 2020E, remains in secular decline. In fact, UFS estimates the market has contracted more than 50%

since 2007 and could be expected to continue shrinking at a rate of 3%-5% annually over the long term (see Background #6). In contrast, the market for specialty paper, which includes packaging (for food and medicine) as well as medical gowns/drapes, sandpaper backing, and other specialized uses and which should comprise 12% of total sales (and the roughly 17% of paper shipments) in 2020E, is projected to have a long-term growth rate roughly in-line with gross domestic product (GDP). (See Background #6.) Given the dour long-term outlook for communication paper (and management's nearer-term belief that while customer demand will rebound as the global economy reopens it is not likely to reach pre-pandemic levels), UFS recently announced that it would permanently close its manufacturing facility in Port Huron, MI during 1Q 2021 and that it would begin to convert its Kingsport, TN facility toward the production of recycled containerboard, which along with the aforementioned conversion at the Ashdown, AR facility will reduce the company's annual uncoated free sheet paper capacity by ~720,000 tons (and its overall workforce by ~800 employees). In terms of the Kingsport-conversion, management expects to spend $300-$350 million over the next 28-31 months and targets a completion of the project by 1Q 2023. Once fully operational, Kingsport is projected to produce ~600,000 tons of high-quality/strength recycled linerboard (and medium) for use in corrugated packaging. Per management, the containerboard market is a roughly 40 million ton opportunity that is growing at ~2% (or ~800,000 tons) annually; moreover, UFS's Kingsport facility is within "a day's drive" of over 60 independent corrugated customers (serving the food & beverage and e-commerce markets) representing more than 4 million tons of annual containerboard demand.

Background #6 Domtar Corporation: Pulp & Paper Segment, Long-Term Growth Projections

	Long-term growth rate	% of sales (2016)	% of sales (2018)	% of sales (2020E)
Pulp & Paper:				
Communication Paper	(3%) - (5%)	51%	48%	43%
Specialty Paper	GDP	12%	11%	12%
Market Pulp	1% - 2%	19%	23%	21%

Source: Company reports.

On a consolidated basis, following a solid year in 2018 when sales increased ~7.5% to $4.5 billion, in part due to capacity reductions at a competitor, 2019 P&P segment sales declined ~4% to $4.3 billion. Adjusted operating income fell 36% to $289 million as increased maintenance, freight, raw material, and SG&A expenses drove a 330-basis-point deterioration in the operating margin to 6.7%, while adjusted EBITDA declined about 25% to $517 million. (See Background #4.) In 1H 2020, P&P segment sales declined 19% to $1.83 billion, driven by a 22.5% decline in paper and a 10.5% decline in pulp, while adj. EBITDA more than halved to $132 million, in part, reflecting an almost $30 million loss at the Pulp business. As mentioned earlier, UFS anecdotally expects the paper market to remain weak in 2H 2020 albeit with incremental improvements in 3Q 2020 and toward year-end. As well, management expects the near-term pulp market will be impacted by seasonal softness along with elevated global inventories and weak demand trends from the paper market. For full-year 2020, we project P&P segment sales will decline roughly 19% to $3.5 billion while adjusted EBITDA roughly halves to $269 million (see Background #4).

For 2021-2020, we project a modest rebound in sales to ~$3.7 billion with adjusted EBITDA of $425 million, which, for context, both reflect levels that are well below 2019 results (see Background #4).

Personal Care (PC)

The Personal Care segment, which accounted for 23% of consolidated sales and 32.5% of adjusted EBITDA in 2020E, is headquartered in Raleigh, NC. The segment was established in 2011 via the acquisition of Attends Healthcare, a manufacturer of primarily Attends branded adult incontinence supplies. Attends was helmed by Michael Fagan, who now runs the PC segment. In subsequent years, UFS focused on building out its personal care business, in large part through a series of acquisitions, including deals to purchase Attends Europe, which is owned and operated separately from the domestic business, and EAM Corp., a non-wovens manufacturer with proprietary technology, in 2012. In 2013, UFS purchased Associated Hygienic Products (AHP), one of the largest domestic suppliers of private label/store brand infant diapers as well as of the Fisher-Price, Fitti, and SleepWell brands. In 2014, the company purchased Laboratorios Indas, Spain's largest provider of branded adult incontinence and infant diaper products, including the Indasec, Bambino, Coral, Addermis Biactiv, and Cicactiv brands. In 2016, UFS acquired Home Delivery Incontinent Supplies Co., a national direct-to-consumer provider of Reassure brand adult incontinence products. (See Background #7.) Currently, following the consolidation of its facility in Waco, TX during 2Q 2019, UFS operates a network of five production and distribution facilities in the U.S. and Europe. (In terms of its European footprint, UFS's operations are in Aneby, Sweden and Toledo, Spain.)

Background #7 Domtar Corporation: Acquisitions in the Personal Care Segment
(currency in millions)

Announced	Target	Seller	Purchase Price	EV/EBITDA	EV/Sales
Aug-11	Attends Healthcare (U.S./Can.)	KPS Capital Partners	$315	8.1x	1.6x
Jan-12	Attends Healthcare (Europe)	Rutland Partners	€ 180	7.8x	1.3x
May-12	EAM Corporation	Kinderhook Industries	$61	-	1.4x
May-13	Associated Hygienic Products	DSG International	$272	8.8x	0.9x
Nov-13	Laboratorios Indas	Privately-owned	€ 400	8.7x	2.1x
Aug-16	Home Delivery Incontinent Supplies	Privately-owned	$55	-	0.8x
Average				**8.3x**	**1.3x**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Management's decision to aggressively enter the personal care market over the last decade was informed by solid underlying demographic trends, in terms of the overall growth and aging of the population, both in the U.S. and globally. On the aging front, it is estimated by the U.S. Census Bureau that by 2035, roughly 77 million Americans will be 65 or older, representing ~20% of the U.S. population, and some studies have suggested that nearly one in three people in that population suffer from incontinence. On the infant front, global population growth and rising standards of living provide a favorable backdrop for increasing use of disposable diapers. All told, UFS expects market demand for its personal care products will grow at a compound annual rate of 2%-4% (comprising roughly 4%-5% growth in the adult incontinence market and 1%-2% growth in the infant diapers market) and that its current asset base provides a clear runway to $1.3-$1.5 billion of annual sales. On the margin front, management indicates that the integration of its six previous acquisitions has weighed on profitability in recent years but that EBITDA margins in excess of 15% (i.e., "mid-to-high teens") are very reasonable for the PC business, particularly as the business continues to scale.

Background #8 Domtar Corporation: Personal Care Segment, Selected Items (2016-2022E)
($ in millions)

	2016	2017	2018	2019	6 mos. 2019	6 mos. 2020	2020E	2021E	2022E
Revenue	**$909**	**$996**	**$1,000**	**$953**	**$467**	**$495**	**$1,005**	**$1,015**	**$1,036**
Operating income (as reported)	**$57**	**($527)**	**($5)**	**($15)**	**($26)**	**$38**	**$70**	**$71**	**$73**
Impairments	-	*$578*	*$7*	*$26*	*$25*	-	-	-	-
Restructuring	*$1*	*$2*	*$8*	*$20*	*$12*	-	-	-	-
Purchase accounting	*$1*	-	-	-	-	-	-	-	-
Adjusted operating income	**$59**	**$53**	**$10**	**$31**	**$11**	**$38**	**$70**	**$71**	**$73**
Depreciation & amortization	$64	$67	$70	$65	$30	$29	$59	$58	$60
Adjusted EBITDA	**$123**	**$120**	**$80**	**$96**	**$41**	**$67**	**$129**	**$129**	**$132**
Operating margin	6.3%	-52.9%	-0.5%	-1.6%	-5.6%	7.7%	7.0%	7.0%	7.0%
Adjusted operating margin	6.5%	5.3%	1.0%	3.3%	2.4%	7.7%	7.0%	7.0%	7.0%
Adjusted EBITDA margin	**13.5%**	**12.0%**	**8.0%**	**10.1%**	**8.8%**	**13.5%**	**12.9%**	**12.8%**	**12.8%**
Capital expenditures	**$55**	**$48**	**$37**	**$41**	-	-	**$35**	**$41**	**$47**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

In 2019, PC segment sales declined almost 5% to $953 million, driven by a ~3% decline in volume, which was in part due to UFS's internal customer/product rationalization efforts, as well as a 2% drag from currency, while adjusted EBITDA improved 20% to $96 million as the company's restructuring (e.g. closure of the Waco, TX facility) and simplification (e.g. concentrating on only the most strategic customers and SKUs) efforts began to gain traction. In 1H 2020, PC segment sales increased 6% to $495 million, primarily driven by increased demand for household products, primarily in 1Q 2020, amid the COVID-19 pandemic, while adj. EBITDA increased almost 65% to $67 million as the company's margin momentum continued to build. As mentioned earlier, UFS expects the PC segment will continue to benefit from new business wins, most notably in the infant diaper segment, and productivity gains (amid relative stability in raw material costs) in 2H 2020. For our part, we expect full-year 2020 PC segment sales will increase 5.5% to roughly $1 billion with adjusted EBITDA up almost 35% to $129 million.

For 2021-2020, we project a conservative top-line CAGR of ~1.5% to $1.036 billion with relative margin stability, implying 2021E adjusted EBITDA of $132 million (see Background #8). (For context, UFS has indicated the longer-term expectation that the PC business could generate $1.3-$1.5 billion of sales with a mid-to-high teens EBITDA margin profile.)

Balance Sheet and Cash Flow

At the end of 2Q 2020, UFS had net debt of roughly $978 million, including $124 million of cash and ~$1.1 billion of debt. The company had an adjusted net leverage ratio of ~2.4x, which was within its 3.75x covenant and total liquidity of ~$906 million. (See Background #9.) In May 2020, the company entered into a $300 million term loan agreement that matures in May 2025 and its closest maturity is $300 million of 4.4% notes due April 2022.

Background #9 Domtar Corporation: Balance Sheet Snapshot

($ in millions, except per share amounts)

	2016	2017	2018	2019	2Q 2020
Cash	**$125**	**$139**	**$111**	**$61**	**$124**
Debt:					
Bank indebtedness	$12	-	-	$9	-
Current debt	$63	$1	$1	$1	$13
Long-term debt	$1,218	$1,129	$853	$938	$1,089
Total	**$1,293**	**$1,130**	**$854**	**$948**	**$1,102**
Net debt	**$1,168**	**$991**	**$743**	**$887**	**$978**
TTM Leverage ratio	2.0x	2.0x	1.2x	1.7x	2.7x
TTM Leverage ratio, net	**1.8x**	**1.7x**	**1.0x**	**1.6x**	**2.4x**
Debt to equity	48.3%	44.7%	33.6%	39.9%	48.4%
Net debt to equity	**43.6%**	**39.2%**	**29.3%**	**37.3%**	**43.0%**
Shareholders equity	$2,676	$2,529	$2,538	$2,376	$2,277
Book value/share	$42.68	$40.33	$40.22	$38.70	$40.88
Tangible book value	$1,518	$1,896	$1,941	$1,777	$1,713
TBV/share	**$24.21**	**$30.24**	**$30.76**	**$28.94**	**$30.75**

Source: Company reports.

In 2019, UFS generated $442 million in cash from operations and free cash flow of $188 million based on net capital spending of $254 million (see Background #11). Looking into 2020, in response to underlying industry conditions amid the COVID-19 pandemic, UFS tempered its capital spending expectations to $160-$170 million (from its initial budget of $230-$260 million); as well, the company suspended its quarterly dividend (formerly $0.455 per share, which would have implied a ~6% yield) as well as its share repurchase program (see Background #11). Longer term, management has indicated that maintenance capex in Paper & Pulp is likely to be in the $120-$150 range million annually and that at Personal Care, capital spending is likely to be in the range of 3%-5% of segment sales. That said, as noted earlier, the company expects to spend $300-$350 million, primarily in 2021-2022, to re-purpose its Kingsport, TN facility toward containerboard production (away from uncoated free sheet paper).

Background #10 Domtar Corporation: Sources and Uses of Cash Flow

($ in millions; shares in millions)

	2016	2017	2018	2019	6 mos. 2019	6 mos. 2020	2020E	2021E	2022E
Net income	$128	($258)	$283	$84	$98	$24	$31	$79	$155
Depreciation & amortization	$348	$321	$308	$293	$147	$143	$274	$269	$263
Other	($11)	$386	($37)	$65	($71)	($12)	($25)	($20)	($20)
Cash flow from operations	**$465**	**$449**	**$554**	**$442**	**$174**	**$155**	**$280**	**$328**	**$398**
Additions of property, plant & equip.	($347)	($182)	($195)	($255)	($101)	($102)	($165)	($309)	($324)
Proceeds from sale of PP&E	$1	$19	$5	$1	$1	$0	$0	$0	$0
Capital expenditures, net	**($346)**	**($163)**	**($190)**	**($254)**	**($100)**	**($102)**	**($165)**	**($309)**	**($324)**
Free cash flow	**$119**	**$286**	**$364**	**$188**	**$74**	**$53**	**$115**	**$19**	**$74**
FCF/share	$1.90	$4.56	$5.77	$3.06	$1.17	$0.95	$2.06	$0.34	$1.33
Acquisitions	($46)	($8)	-	-	-	($30)	($30)	$0	$0
Dividends	($102)	($104)	($108)	($110)	($55)	($51)	($51)	$0	$0
Repurchases	($10)	$0	$0	($219)	($8)	($59)	($59)	$0	$0
Diluted shares	**62.7**	**62.7**	**63.1**	**61.4**	**63.3**	**55.7**	**55.7**	**55.7**	**55.7**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Additionally, despite the recent steps UFS has taken to preserve liquidity during the current period of uncertainty management remains broadly committed to returning ~50% of free cash flow to shareholders in the form of dividends and share repurchases over the long-term.

Background #11 Domtar Corporation: Share Repurchase History, 2012-1H 2020

(shares in millions; $ in millions, except prices)

	# of shares	Avg. price	Total cost
1H 2020	1.8	$33.05	$59.4
2019	6.2	$35.29	$219.5
2018	-	-	-
2017	-	-	-
2016	0.3	$32.21	$9.8
2015	1.2	$41.40	$50.1
2014	1.0	$38.59	$38.5
2013	5.0	$36.55	$183.5
2012	4.0	$39.16	$156.7

Source: Company reports.

The Breakdown

Based on the guidance, commentary, and forecasts discussed throughout this report, it can be reasonably projected that UFS could generate 2022E sales and adjusted EBITDA of ~$4.66 billion and $517 million, respectively (see Breakdown #1). For context, the current consensus forecast, per Bloomberg, for 2022E EBITDA is ~$589 million.

Breakdown #1 Domtar Corporation: Adjusted 2015-2019 Results and 2020-2022E Forecasts
($ in millions)

	2015	2016	2017	2018	2019	2020E	2021E	2022E
Revenue:								
Pulp & paper	$4,458	$4,239	$4,216	$4,523	$4,332	$3,504	$3,659	$3,697
Personal care	$869	$909	$996	$1,000	$953	$1,005	$1,015	$1,036
Intersegment sales	($63)	($58)	($64)	($68)	($65)	($70)	($70)	($70)
Total	**$5,264**	**$5,090**	**$5,148**	**$5,455**	**$5,220**	**$4,439**	**$4,605**	**$4,663**
Adjusted operating income:								
Pulp & paper	$336	$277	$246	$453	$289	$54	$128	$222
Personal care	$62	$59	$53	$10	$31	$70	$71	$73
Corporate	($44)	($49)	($51)	($46)	($50)	($30)	($40)	($40)
Total	**$354**	**$287**	**$248**	**$417**	**$270**	**$94**	**$159**	**$254**
Depreciation & amortization:								
Pulp & paper	$297	$284	$254	$238	$228	$215	$210	$203
Personal care	$62	$64	$67	$70	$65	$59	$58	$60
Total	**$359**	**$348**	**$321**	**$308**	**$293**	**$274**	**$269**	**$263**
Adjusted EBITDA:								
Pulp & paper	$633	$561	$500	$691	$517	$269	$338	$425
Personal care	$124	$123	$120	$80	$96	$129	$129	$132
Corporate	($44)	($49)	($51)	($46)	($50)	($30)	($40)	($40)
Total	**$713**	**$635**	**$569**	**$725**	**$563**	**$368**	**$428**	**$517**
Capital expenditures:								
Pulp & paper	$221	$287	$128	$164	$220	$128	$265	$275
Personal care	$57	$55	$48	$37	$41	$35	$41	$47
Corporate	$6	$4	$4	$2	$3	$2	$3	$3
Total	**$284**	**$346**	**$180**	**$203**	**$264**	**$165**	**$309**	**$324**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Breakdown #2 Domtar Corporation: Public Comparables

(currency in millions, except per share amounts; shares in millions)

	Domtar Corp	Cascades Inc	P H Glatfelter Co	International Paper Co	Neenah Inc	Packaging Corp of America	Resolute Forest Products Inc	Stora Enso Oyj	UPM-Kymmene Oyj
Ticker	UFS	CAS CN	GLT	IP	NP	PKG	RFP	STERV FH	UPM FH
Price (as of 9/23/20 close)	**$26.03**	**14.15**	**13.00**	**39.27**	**36.89**	**104.15**	**4.41**	**13.64**	**26.42**
Market Capitalization	1,436.7	1,344.5	576.8	15,436.8	619.8	9,877.1	379.6	10,846.7	14,101.3
EV	**2,504.7**	**3,664.5**	**847.7**	**24,485.8**	**997.1**	**11,634.0**	**1,044.6**	**14,186.7**	**14,732.3**
Revenue 2019A	5,220.0	4,994.6	912.5	22,431.8	948.0	6,946.3	2,967.8	10,076.8	10,302.7
Revenue 2020E	4,439.1	5,105.2	901.5	20,289.1	773.0	6,508.6	2,777.8	8,714.6	8,727.9
Revenue 2021E	4,604.8	5,178.6	937.0	20,392.9	842.7	6,586.6	2,985.0	9,042.2	8,959.3
Revenue 2022E	4,662.9	-	-	20,150.0	-	6,617.5	-	9,228.0	9,210.2
EV/Sales 2019A	0.5x	0.7x	0.9x	1.1x	1.1x	1.7x	0.4x	1.4x	1.4x
EV/Sales 2020E	0.6x	0.7x	0.9x	1.2x	1.3x	1.8x	0.4x	1.6x	1.7x
EV/Sales 2021E	0.5x	0.7x	0.9x	1.2x	1.2x	1.8x	0.3x	1.6x	1.6x
EV/Sales 2022E	0.5x	-	-	1.2x	-	1.8x	-	1.5x	1.6x
2019A EBITDA	563.0	592.3	111.5	3,786.7	123.0	1,447.2	205.8	1,562.1	1,817.4
2020E EBITDA	368.2	653.5	117.0	2,883.7	87.9	1,154.8	249.0	1,287.6	1,336.9
2021E EBITDA	428.0	611.0	121.0	2,817.3	109.5	1,175.6	287.7	1,520.6	1,544.0
2022E EBITDA	517.2	636.0	-	2,864.5	-	1,101.5	-	1,668.9	1,657.5
2019A EBITDA Margin	10.8%	11.9%	12.2%	16.9%	13.0%	20.8%	6.9%	15.5%	17.6%
2020E EBITDA Margin	8.3%	12.8%	13.0%	14.2%	11.4%	17.7%	9.0%	14.8%	15.3%
2021E EBITDA Margin	9.3%	11.8%	12.9%	13.8%	13.0%	17.8%	9.6%	16.8%	17.2%
2022E EBITDA Margin	11.1%	-	-	14.2%	-	16.6%	-	18.1%	18.0%
2019A EV/EBITDA	4.4x	6.2x	7.6x	6.5x	8.1x	8.0x	5.1x	9.1x	8.1x
2020E EV/EBITDA	6.8x	5.6x	7.2x	8.5x	11.3x	10.1x	4.2x	11.0x	11.0x
2021E EV/EBITDA	5.9x	6.0x	7.0x	8.7x	9.1x	9.9x	3.6x	9.3x	9.5x
2022E EV/EBITDA	4.8x	5.8x	-	8.5x	-	10.6x	-	8.5x	8.9x
Average, ex. UFS		***7.8x***							
2019A EPS	$1.78	$0.94	$0.73	$4.37	$3.41	$7.64	($0.19)	$0.78	$2.02
2020E EPS	$0.55	$1.64	$0.78	$2.55	$1.62	$5.36	$0.38	$0.49	$1.29
2021E EPS	$1.42	$1.54	$0.84	$2.53	$2.75	$5.48	$0.78	$0.77	$1.56
2022E EPS	$2.79	$1.44	-	$2.64	-	$5.33	-	$0.94	$1.68
P/E 2019A	14.7x	15.1x	17.8x	9.0x	10.8x	13.6x	-	17.5x	13.1x
P/E 2020E	47.3x	8.6x	16.8x	15.4x	22.7x	19.4x	11.7x	28.1x	20.5x
P/E 2021E	18.3x	9.2x	15.5x	15.5x	13.4x	19.0x	5.6x	17.6x	17.0x
P/E 2022E	9.3x	9.8x	-	14.9x	-	19.5x	-	14.6x	15.8x
2021E FCF Yield	1.3%	8.6%	8.7%	9.6%	-	5.6%	3.9%	5.3%	-
2022E FCF Yield	5.1%	-	-	-	-	-	-	6.3%	1.0%
2022E Free Cash Flow	74.2	-	-	-	-	-	-	676.8	140.0
2022E FCF Per Share	$1.33	-	-	-	-	-	-	$0.86	$0.26
2022E P/FCF	19.5x	-	-	-	-	-	-	15.9x	100.6x
P/B	0.6x	0.9x	1.1x	2.2x	1.7x	3.2x	0.3x	1.5x	1.5x
Leverage ratio, net	2.4x	3.6x	-	3.2x	-	1.6x	-	2.0x	0.4x

	Canfor Pulp Products Inc	Metsa Board Oyj	Mercer International Inc	Suzano SA	Asaleo Care Ltd	Essity AB	Hengan International Group Co Ltd	Kimberly-Clark Corp	Ontex Group NV	Procter & Gamble Co/The	Svenska Cellulosa AB SCA	Unicharm Corp
Ticker	CFX CN	METSA FH	MERC	SUZB3 BZ	AHY AU	ESSITYB SS	1044 HK	KMB	ONTEX BB	PG	SCAB SS	8113 JP
Price (as of 9/23/20 close)	**4.56**	**6.94**	**6.51**	**46.63**	**1.03**	**306.00**	**56.55**	**144.82**	**11.88**	**136.31**	**121.35**	**4,677.00**
Market Capitalization	297.5	2,480.2	428.8	63,475.7	559.4	214,916.8	67,276.8	49,390.4	978.3	339,360.3	85,723.4	2,903,642.1
EV	**294.2**	**2,785.0**	**1,288.2**	**136,894.0**	**704.0**	**267,146.8**	**60,848.7**	**56,271.4**	**1,831.6**	**360,044.3**	**95,042.4**	**2,833,811.1**
Revenue 2019A	1,097.7	1,922.3	1,606.7	25,476.3	415.5	128,514.7	21,870.5	18,426.6	2,286.3	67,424.0	20,076.2	722,432.9
Revenue 2020E	1,015.3	1,856.0	1,397.7	29,446.8	429.5	125,819.9	23,756.2	18,755.6	2,146.3	70,150.3	18,764.5	751,283.4
Revenue 2021E	1,188.3	1,903.4	1,555.3	33,153.3	437.0	129,853.9	25,477.3	18,936.0	2,164.7	72,804.1	19,119.5	787,228.9
Revenue 2022E	-	1,948.1	1,781.0	34,409.2	444.0	134,378.7	26,982.6	19,381.4	2,210.3	75,398.0	19,684.9	827,274.0
EV/Sales 2019A	0.3x	1.4x	0.8x	5.4x	1.7x	2.1x	2.8x	3.1x	0.8x	5.3x	4.7x	3.9x
EV/Sales 2020E	0.3x	1.5x	0.9x	4.6x	1.6x	2.1x	2.6x	3.0x	0.9x	5.1x	5.1x	3.8x
EV/Sales 2021E	0.2x	1.5x	0.8x	4.1x	1.6x	2.1x	2.4x	3.0x	0.8x	4.9x	5.0x	3.6x
EV/Sales 2022E	-	1.4x	0.7x	4.0x	1.6x	2.0x	2.3x	2.9x	0.8x	4.8x	4.8x	3.4x
2019A EBITDA	70.2	284.0	237.2	10,849.0	80.1	22,070.6	5,907.5	4,221.7	241.2	17,011.8	5,267.2	128,792.8
2020E EBITDA	48.5	281.9	169.2	13,833.3	89.3	25,054.3	6,859.3	4,447.2	249.8	18,569.9	3,900.4	148,510.1
2021E EBITDA	112.0	301.4	211.6	17,581.4	90.8	25,831.7	7,248.3	4,527.6	266.4	20,267.3	5,004.9	156,461.5
2022E EBITDA	-	304.2	409.0	17,797.8	92.2	26,760.5	7,632.6	4,662.0	279.5	21,390.0	5,635.5	165,305.3
2019A EBITDA Margin	6.4%	14.8%	14.8%	42.6%	19.3%	17.2%	27.0%	22.9%	10.5%	25.2%	26.2%	17.8%
2020E EBITDA Margin	4.8%	15.2%	12.1%	47.0%	20.8%	19.9%	28.9%	23.7%	11.6%	26.5%	20.8%	19.8%
2021E EBITDA Margin	9.4%	15.8%	13.6%	53.0%	20.8%	19.9%	28.4%	23.9%	12.3%	27.8%	26.2%	19.9%
2022E EBITDA Margin	-	15.6%	23.0%	51.7%	20.8%	19.9%	28.3%	24.1%	12.6%	28.4%	28.6%	20.0%
2019A EV/EBITDA	4.2x	9.8x	5.4x	12.6x	8.8x	12.1x	10.3x	13.3x	7.6x	21.2x	18.0x	22.0x
2020E EV/EBITDA	6.1x	9.9x	7.6x	9.9x	7.9x	10.7x	8.9x	12.7x	7.3x	19.4x	24.4x	19.1x
2021E EV/EBITDA	2.6x	9.2x	6.1x	7.8x	7.8x	10.3x	8.4x	12.4x	6.9x	17.8x	19.0x	18.1x
2022E EV/EBITDA	-	9.2x	3.1x	7.7x	7.6x	10.0x	8.0x	12.1x	6.6x	16.8x	16.9x	17.1x
Average, ex. UFS					***11.9x***							
2019A EPS	($0.43)	$0.41	$0.31	($2.29)	$0.06	$14.84	$3.26	$6.88	$1.13	$4.48	$4.07	$99.26
2020E EPS	($0.26)	$0.38	($0.36)	($10.81)	$0.07	$16.42	$3.90	$7.69	$1.21	$4.97	$2.39	$115.82
2021E EPS	$0.26	$0.44	$0.38	$5.23	$0.07	$17.48	$4.14	$7.89	$1.36	$5.39	$3.74	$128.64
2022E EPS	-	$0.45	$2.46	$3.75	$0.08	$18.44	$4.41	$8.31	$1.43	$5.76	$4.32	$138.38
P/E 2019A	-	16.9x	21.1x	-	18.7x	20.6x	17.4x	21.0x	10.6x	30.5x	29.8x	47.1x
P/E 2020E	-	18.5x	-18.1x	-	14.7x	18.6x	14.5x	18.8x	9.8x	27.4x	50.7x	40.4x
P/E 2021E	17.5x	15.9x	17.1x	8.9x	14.1x	17.5x	13.6x	18.4x	8.7x	25.3x	32.4x	36.4x
P/E 2022E	-	15.4x	2.6x	12.5x	12.9x	16.6x	12.8x	17.4x	8.3x	23.6x	28.1x	33.8x
2021E FCF Yield	5.6%	2.4%	-	11.2%	-	6.4%	-	5.2%	-	4.1%	0.5%	2.8%
2022E FCF Yield	-	5.1%	47.2%	15.4%	-	6.8%	-	5.4%	-	4.4%	1.1%	3.2%
2022E Free Cash Flow	-	126.2	202.2	9,674.1	49.2	14,613.5	3,958.1	2,650.7	103.3	14,710.3	931.8	88,343.5
2022E FCF Per Share	-	$0.35	$3.07	$7.17	-	$20.81	-	$7.77	-	$5.93	$1.33	$148.00
2022E P/FCF	-	19.6x	2.1x	6.5x	-	14.7x	-	18.6x	-	23.0x	-	31.6x
P/B	0.5x	1.9x	0.9x	25.3x	3.0x	3.9x	3.2x	-	0.9x	7.4x	1.2x	5.9x
Leverage ratio, net	-	1.0x	2.1x	4.1x	1.6x	2.0x	-	1.5x	3.1x	1.0x	1.7x	-

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Industry M&A Activity

In terms of M&A activity, recent transactions in the broad Pulp, Paper & Packaging sector have averaged ~8.0x trailing 12-month EV/EBITDA, ~7.5x forward 12-month EV/EBITDA and 1.3x EV/sales (see Breakdown #3). [Note: the following exhibit excludes Cascades' September 2019 purchase of Orchard Paper, which was in bankruptcy, for $207 million (or ~4.6x the $45 million of adjusted EBITDA that is expected to be generated, on a run-rate basis, in 2021).] Additionally, we would note that UFS's recent transactions in the Personal Care space averaged 8.3x (see Background #7 in the "Background" section of this report).

Breakdown #3 Selected Pulp, Paper & Packaging Sector Transaction Multiples

($ in millions)

Announced	Target	Buyer	TTM EV/EBITDA	FTM EV/EBITDA	EV/Sales
Nov-05	Georgia Pacific	Koch Industries	7.7x	7.3x	1.1x
Sep-10	Cellu Tissue	Clearwater Paper	6.0x	-	1.0x
Apr-13	Buckeye Technologies	Georgia Pacific	7.6x	-	1.9x
Sep-13	Boise Inc.	Packaging Corp. of Amer.	6.7x	6.4x	0.8x
Jan-14	New Page Holdings	Verso Corp.	5.8x	-	-
Dec-14	Dunn Paper, Inc.	Clearwater Paper	6.2x	-	-
Oct-15	Wausau Paper	SCA Americas	12.4x	8.7x	1.8x
May-16	Weyerhaeuser (fluff Pulp unit)	International Paper	6.3x	-	1.5x
May-17	US Corrugated Inc. (certain assets)	WestRock Co.	5.0x	-	-
May-17	Tembec Inc.	Rayonier Advanced Materials	5.5x	-	-
Dec-17	Cham Paper (specialty paper unit)	Sappi Limited	5.9x	-	-
Mar-18	Suzano SA	Fibria Celulose	10.8x	-	-
Apr-18	Caieiras Specialty (paper mill)	Ahlstrom Brasil	8.2x	-	-
Jul-18	Expera Specialty Solutions	Ahlstrom Munksjo Oyj	8.5x	-	-
Aug-18	P.H. Glatfelter (specialty paper unt)	Pixelle Specialty Solutions	11.9x	-	-
Oct-18	Resolute Forest Prod. (S.C. paper mill)	New-Indy Containerboard	12.9x	-	-
Oct-19	Orora Ltd. (Australasian Fibre unit)	Nippon Paper	11.5x	-	-
Nov-19	Verso (specialty paper unit)	Pixelle Specialty Solutions	7.7x	-	-
Nov-19	TC Transcontinental (paper & packaging)	Hood Packaging Corp.	-	-	0.8x
Average			**8.2x**	**7.5x**	**1.3x**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Pulp & Paper Segment

Public comparables to UFS's Pulp & Paper segment could include Cascades Inc. (CAS CN), PH Glatfelter (NYSE: GLT), International Paper (NYSE: IP), Neenah Paper (NYSE: NP), Packaging Corp. of America (NYSE: PKG), Resolute Forest Products (NYSE: RFP), Stora Enso (STERV FH), UPM Kymmene (UPM FH) as well as pulp players, such as Canfor Pulp Products (TSE: CFX), Metsa (METSA FH), Mercer International (NASDAQ: MERC) and Suzano SA (SUZB3

BZ), who purchased Fibria Celulose (formerly FIBR3 BZ) in 2019, which trade, on average, at ~8.0x 2022E EBITDA, albeit in a wide range of roughly 3.0x-11x. (See Breakdown #2.)

Applying a discounted/low-end multiple of 5.0x to 2022E segment EBITDA of $425 million yields a segment value of roughly $2.12 billion, or ~$38 per share (see Breakdown #4). For additional context, this segment valuation implies EV/Sales and EV/Asset multiples of 0.6x, respectively.

Breakdown #4 Domtar Corporation: Estimated Value of Pulp & Paper Based on 2022E EBITDA
($ in millions, except per share amounts; shares in millions)

		Pulp & Paper	
2021E Revenue		$3,659.4	
Revenue growth est.		1.0%	
2022E Revenue		**$3,697.1**	
Operating margin		6.0%	
Operating income		**$221.8**	
EBITDA margin		11.5%	
2022E EBITDA		**$425.2**	
Applied multiple	4.5x	**5.0x**	5.5x
Enterprise value	$1,913.2	**$2,125.8**	$2,338.4
Diluted shares	55.7	55.7	55.7
Per share basis	$34.35	**$38.17**	$41.98

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

As well, a discounted cash flow (DCF) analysis based on our forecasts, a weighted average cost of capital of 6%-8%, and a terminal EBITDA multiple of 4.5x-5.5x, yields an enterprise value, at the mid-point, of ~$2.12 billion (see Breakdown #5).

Breakdown #5 Domtar Corporation: Discounted Cash Flow Analysis of Pulp & Paper Segment

($ in millions)

	2020E	2021E	2022E	2023E	2024E	2025E	CAGR 21-'25
Revenue	$3,503.7	$3,659.4	$3,697.1	$3,604.7	$3,514.5	$3,426.7	(0.4%)
EBITDA	269.0	338.5	425.2	432.6	421.7	394.1	7.9%
Less: Depreciation & Amortization	(215.5)	(210.4)	(203.3)	(198.3)	(193.3)	(188.5)	
EBIT	**$53.6**	**$128.1**	**$221.8**	**$234.3**	**$228.4**	**$205.6**	
Less: Taxes @ 20.0%	(10.7)	(25.6)	(44.4)	(46.9)	(45.7)	(41.1)	
Tax-affected EBIT	**$42.8**	**$102.5**	**$177.5**	**$187.4**	**$182.8**	**$164.5**	
Plus: Depreciation & Amortization	$215.5	$210.4	$203.3	$198.3	$193.3	$188.5	
Less: Capital Expenditures	($127.9)	($265.3)	($274.5)	($126.2)	($123.0)	($119.9)	
Less: Changes in Working Capital	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	
Unlevered Free Cash Flow	**$130.4**	**$47.6**	**$106.3**	**$259.5**	**$253.0**	**$233.0**	

	A	+	B			=	C		
Discount Rate	Discounted Cash Flows 2017E - 2025E		PV of Terminal Value as a Multiple of 2025E EBITDA 4.5x	5.0x	5.5x		Firm Value 4.5x	5.0x	5.5x
6.0%	$733		$1,328	$1,476	$1,623		$2,061	$2,209	$2,357
7.0%	**$709**		$1,267	**$1,408**	$1,549		$1,977	**$2,118**	$2,258
8.0%	$687		$1,210	$1,344	$1,478		$1,897	$2,031	$2,165

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Personal Care Segment

The Personal Care segment could be compared to publicly traded peers such as Asaleo Care (AHY AU), Essity AB (ESSITYB SS), Hengan International (1044 HK), Kimberly-Clark (NYSE: KMB), Ontex Group (ONTEX BB), Procter & Gamble (NYSE: PG), Svenska Cellulosa (SCAB SS), and Unicharm Corp. (8113 JP), which trade, on average, at 12x 2022E EBITDA albeit, again, in a wide range of 6.5x-17x (see Breakdown #2). Additionally, we would note that UFS's transactions in the Personal Care space averaged 8.3x (again, see Background #7 in the "Background" section of this report).

Applying an 8.0x multiple to 2022E EBITDA of $132 million yields a segment value of roughly $1.05 billion, or nearly $19 per share (see Breakdown #6). Again, for additional context, this segment valuation implies EV/Sales and EV/Asset multiple of ~1.0x and 0.85x, respectively.

Breakdown #6 Domtar Corporation: Estimated Value of Personal Care Based on 2022E EBITDA
($ in millions, except per share amounts; shares in millions)

		Personal Care	
2021E Revenue		$1,015.5	
Revenue growth est.		2.0%	
2022E Revenue		**$1,035.8**	
Operating margin		7.0%	
Operating income		**$72.5**	
EBITDA margin		12.8%	
2022E EBITDA		**$132.1**	
Applied multiple	7.5x	**8.0x**	8.5x
Enterprise value	$990.5	**$1,056.5**	$1,122.5
Diluted shares	55.7	55.7	55.7
Per share basis	$17.78	**$18.97**	$20.15

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

A discounted cash flow analysis assuming compound annual top-line growth of about 1.5%, and relatively steady operating and EBITDA margins, a weighted average cost of capital of 6%-8%, and a terminal EBITDA multiple of 7.5x-8.5x, results in an enterprise value, at the mid-point, of $1.085 billion (see Breakdown #7).

Breakdown #7 Domtar Corporation: Discounted Cash Flow Analysis of Personal Care Segment
($ in millions)

	2020E	2021E	2022E	2023E	2024E	2025E	CAGR 21-'25
Revenue	$1,005.4	$1,015.5	$1,035.8	$1,051.3	$1,061.8	$1,072.4	1.3%
EBITDA	129.2	129.5	132.1	136.7	138.0	139.4	1.5%
Less: Depreciation & Amortization	(58.8)	(58.4)	(59.6)	(57.8)	(58.4)	(59.0)	
EBIT	**$70.4**	**$71.1**	**$72.5**	**$78.8**	**$79.6**	**$80.4**	
Less: Taxes @ 20.0%	(14.1)	(14.2)	(14.5)	(15.8)	(15.9)	(16.1)	
Tax-affected EBIT	**$56.3**	**$56.9**	**$58.0**	**$63.1**	**$63.7**	**$64.3**	
Plus: Depreciation & Amortization	$58.8	$58.4	$59.6	$57.8	$58.4	$59.0	
Less: Capital Expenditures	($35.2)	($40.6)	($46.6)	($52.6)	($53.1)	($53.6)	
Less: Changes in Working Capital	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	
Unlevered Free Cash Flow	**$79.9**	**$74.6**	**$71.0**	**$68.3**	**$69.0**	**$69.7**	

	A	+	B			=	C		
Discount Rate	Discounted Cash Flows 2017E - 2025E		PV of Terminal Value as a Multiple of 2025E EBITDA				Firm Value		
			7.5x	8.0x	8.5x		7.5x	8.0x	8.5x
6.0%	$298		$781	$833	$886		$1,079	$1,131	$1,183
7.0%	**$290**		$746	**$795**	$845		$1,035	**$1,085**	$1,135
8.0%	$282		$712	$759	$807		$994	$1,041	$1,089

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Accounting for corporate costs of capitalized at less than 6.0x, or the weighted average segment multiple, as well as projected net debt of roughly $910 million, yields a sum-of-the-parts valuation of roughly $2.0 billion, or about $37 per share (Breakdown #8).

Breakdown #8 Domtar Corporation: Sum-of-the-Parts Fair Value Estimate

($ in millions, except per share amounts; shares in millions)

	Pulp & Paper	Personal Care	Corporate	Enterprise Value	Net Debt	Market Cap
2022E Revenue	**$3,697.1**	**$1,035.8**				
Operating margin	6.0%	7.0%				
Operating income	**$221.8**	**$72.5**				
EBITDA margin	11.5%	12.8%				
2022E EBITDA	**$425.2**	**$132.1**	**($40.0)**		**($909.7)**	
Applied multiple	**5.0x**	**8.0x**	**5.7x**		**1.0x**	
Enterprise value	**$2,125.8**	**$1,056.5**	**($228.4)**	**$2,953.9**	**($909.7)**	**$2,044.2**
Diluted shares	55.7	55.7	55.7		55.7	55.7
Per share basis	**$38.17**	**$18.97**	**($4.10)**		**($16.33)**	**$36.70**
Bull	$41.98	$20.15	($3.74)		($16.33)	$42.06
Base	$38.17	$18.97	($4.10)		($16.33)	$36.70
Bear	$34.35	$17.78	($4.46)		($16.33)	$31.34

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

The Wrap-Up

For background, UFS was previously covered by the *Hidden Opportunities Report* from March 2017 until its achievement of our fair value estimate in January 2018 (a period in which the stock returned ~39.5% compared with 16% and 17% gains in the S&P 500 and Russell 2000, respectively). Notably, since that time UFS's share price has declined ~49% (compared with a 18% gain in the S&P and a ~7.0% decline in the Russell) albeit with the bulk of the decline occurring amid the pandemic in 2020. Within this context, in August 2020, UFS disclosed a review of potential strategic alternatives for its Personal Care (PC) division, which, as noted in our original report, has a markedly divergent product set and growth profile (as well as requires different manufacturing, technology and marketing strategies) when compared with the company's core-Pulp & Paper (P&P) division. Moreover, we continue think the PC segment could garner a premium valuation from a range of strategic partners (while also attracting interest from private equity suitors) and that as a standalone the P&P segment, which is in the process of repurposing a portion of its production assets toward the attractive packaging sector, could itself become an takeover/go-private target.

As such, with shares trading at less than 5.0x 2022E EV/EBITDA and a discount to tangible book value we estimate the stock is undervalued, particularly relative to the potential value creation from the separation/monetization of its PC unit and the potential attractiveness of a standalone P&P business to strategic acquirers.

Considering management commentary, peer, and M&A valuations as well as discounted cash flows, value of $38 per share and $19 per share can be assigned to UFS's Pulp & Paper and Personal Care businesses. Accounting for corporate costs and projected net debt of ~$20 per share yields a base case sum-of-the-parts value of roughly $37 per share (with bull/bear cases of ~$31-$42 per share).

Risks include a lack of management execution, labor disputes, competition, raw material/currency fluctuations, and/or weakening end-market demand due to an economic recession/pandemic or technological disruption.