

29 Oct 2010 - 08:38:15 AM EDT

COMPANY ALERT

Domtar

First thoughts on Domtar's 3Q

Results

Hold

Reuters:UFS.N Exchange:NYS Ticker:UFS

Price (USD)	74.46
Price target	60.00
52-week range	78.39 - 39.54
Market cap (USDm)	3,201.8
Shares outstanding (m)	43.0
Free float (%)	100
Volume (28 Oct 2010)	214,153
TSE Composite	12,564.09

FYE 12/31	2009A	2010E	2011E
1Q EPS	-0.84	1.59A	-
2Q EPS	-0.76	2.67A	-
3Q EPS	1.32	3.55	-
4Q EPS	1.39	2.49	-
FY EPS (USD)	1.11	10.30	6.00
P/E (x)	24.3	7.2	12.4

* Includes the impact of FAS123R requiring the expensing of stock options.

Well ahead of expectations, partially driven by low tax rate. Pointing to \$4.26 in 3Q EPS, net of special items. DB was at \$3.55, and Consensus at \$3.29. Comps: 2Q10 = \$2.67, 3Q09 = \$1.32. Besides better operations (higher paper prices, slightly lower costs?) and a low tax rate, other big factors included reversal of significant 2Q maintenance downtime (\$30-40MM?) and Kamloops outage costs (\$14MM). Reduced depreciation (-\$4MM q/q) and interest expense (-\$6MM q/q) also helped the EPS comp.

Adjusted tax rate was apparently about 14%. 3Q adjusted EBITDA was \$334MM. Deduct \$97MM in D&A and \$24MM in interest expense, and we get to \$213MM (\$4.95/share) in pre-tax income. At our 3Q estimated tax rate of 20%, EPS would have been \$3.96. At a normalized rate of 32%, EPS would have been \$3.37.

Operating income before special items rose \$73MM q/q in Paper and \$1MM q/q in Merchants. Shipments-to-production ratio was 99%. During 3Q, paper inventories rose 10K tons, and pulp inventories rose 33K mtons.

Outlook Commentary: 4Q will be weaker sequentially for a number of reasons: (1) seasonally lower paper shipments, (2) lower pulp shipments due to Woodland sale, (3) lower pulp prices, and (4) seasonally higher input costs. For 4Q, DBe was at \$2.49, and consensus was at \$2.35.

Call at 10 am EDT N.A., 866-321-8231 and International, 416-642-5213.

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