This Wood Fibre Giant Could Turn a Curve This Quarter: Time to Invest?

Description

Domtar Corporation's (TSX:UFS)(NYSE:UFS) recent corporate re-engineering efforts and some significant global tailwinds could boost its revenues and profits this quarter, even in the face of declining global paper demand. There could be hopes for a sustained future revenue growth, too.

Domtar is one of the largest paper and pulp producers in North America, supplying a wide variety of wood fibre-based products, including communication, specialty and packaging papers, market pulp, and absorbent hygiene products.

While communication papers constituted half of Domtar's 2016 annual sales, specialty paper sales contributed 12% to the top line, and the market pulp segment has grown from 14% of sales in 2008 to 20% of 2016 revenues. Thanks to the re-configuration of the company's Ashdown paper plant in 2015 to a fluff-pulp production facility, pulp revenues could grow significantly going forward.

However, the biggest change to Domtar's revenue composition, one that could become even more important in the near future, is the introduction of a personal care segment through acquisitions between 2011 and 2014 to contribute 18% of the company's US$5.1 billion sales last year.

Could Domtar turn a corner this quarter?

After reporting sequentially declining revenues year on year due to weakening paper demand as global communications become more digitized and move away from the print media, 2017 could become a pivotal year for Domtar's revenue line.

For a start, the new personal care segment is growing in importance, and it is expected to grow by between 2% and 4% in the long term.

Most importantly, general market pulp prices have been trending up globally in 2017. Domtar's pulp shipments increased by 25% in the first quarter of 2017 and they were 15% year to date by the second quarter; all this is happening when the company has successfully streamlined its cost structure and the pulp and paper cost per tonne has been recently trending down quarter on quarter.

Domtar could significantly benefit from a weakening U.S. dollar this quarter. About 56% of Domtar's 2016 market pulp was shipped to customers in China, Japan, Southeast Asia, Europe, the Middle East, and North Africa, while 48% of the company's personal care products have been traditionally sold to Europe, with 2% shipped to other foreign markets outside North America.

The recent weakness in the American dollar could boost Domtar's price competitiveness in foreign markets, boost demand for its products, and bring foreign currency translation gains to Domtar's financials.

Most noteworthy, there could be a sustained high demand in China as the country's environmental regulations are reported as likely to continue suppressing local pulp and paper production growth, while Domtar has significantly increased its market pulp production capacity. Coupled with rising inland China paper and pulp prices, exporting to China is an important growing business line for Domtar.

To add more, world packaging paper demand is seen higher due to increasing online commerce, especially in Asia, while global specialty paper use is expected to grow by 4.37% between 2017 and 2021, according to a report by Research and Markets called "Global Specialty Paper Market 2017-2021."

Domtar is one of the leading players and a key vendor in the global specialty paper market, and the company is expected to grow by 3% in the long term.

Investor takeaway

Domtar's boosted revenue quality due to fluff pulp investments and diversification into consumer personal care products have improved revenue quality, while a recently weakened U.S. dollar could boost the company's export revenues, presenting some significant reasons for an investment in the stock.

Investors could enjoy a 4.24% dividend yield while waiting for capital gains to accrue.

The company has streamlined its cost structure, and new growth opportunities are becoming more visible.

The company has also recently aggressively repurchased shares, and cash flow discount models point to a current deep discount from intrinsic value in the company's share price today, providing a significant margin of safety.

You could place Domtar on your watch list today, so you don't miss the turning curve when Domtar arrests the declining revenue pattern and grows the bottom line. And the company has a recent history of beating analyst earnings forecasts; it has done so in four of the last five quarters, and it could do so again.

Happy investing.

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Author
brianparadza