



## Mercer International (NASDAQ: MERC)

February 9<sup>th</sup>, 2022

**Lauren Montgomery**  
Sr. Portfolio Manager

**Lucas Gordon**  
Portfolio Manager

**Quinton Watt**  
Analyst

**Ryan Doray**  
Analyst

**Alejandro Chavez**  
Junior Analyst

# Agenda

---



**1** Company Overview

**2** Industry Outlook

**3** Investment Thesis

**4** Valuation

**5** Catalysts and Risks

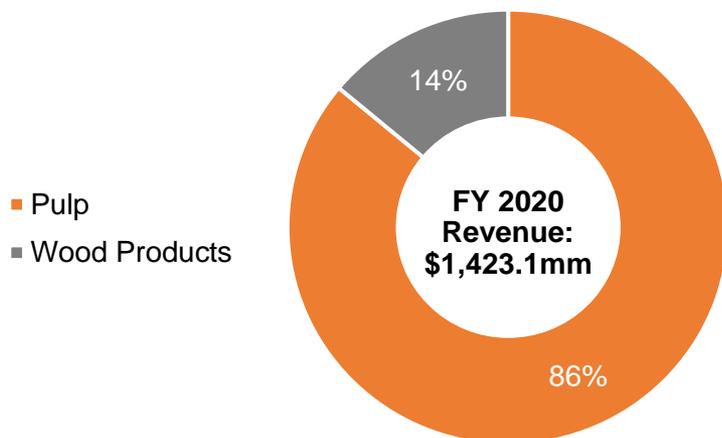
**6** Recommendation

# Mercer International (NASDAQ: MERC)

## Business Description

- Mercer International manufactures and sells northern bleached softwood kraft (“NBSK”) pulp internationally
- It operates two segments: pulp and wood products
- Mercer also generates and sells green energy produced from biomass cogeneration power plants to third party utilities
- End markets include specialty paper, printing & writing paper, construction firms, and home centers

## Segmented Revenue

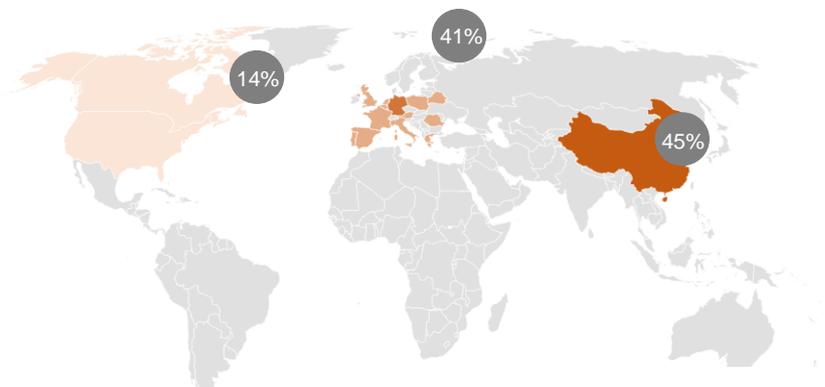


## Management Team



Name	David Gandossi	David Ure	Adolf Koppensteiner	Wolfram Ridder
Position	President & CEO	CFO	COO	VP Business Development
Years Exp.	20+	15+	30+	30+
Experience	Previously CFO at Pacifica Papers	Previously CFO at Finlay Forest Industries	Previously MD at Kvaerner Central Europe	Scientist for pulping technology development

## Sales by Geography



# Overview of Segments

## Pulp

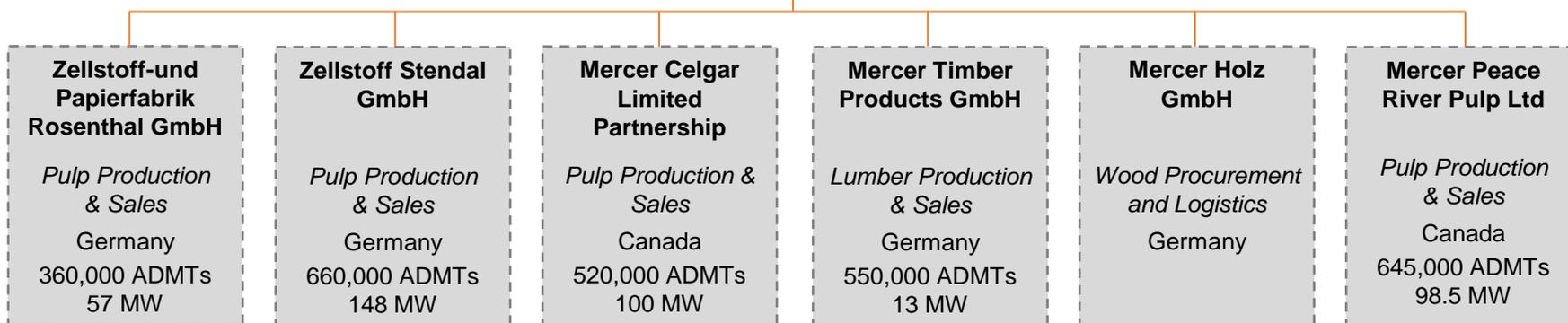
- Mercer is one of the world’s largest producers of market NBSK pulp, which allows Mercer to foster close relationships with large pulp consumers and gain access to superior industry information
- Mercer operates in this segment via two NBSK mills in Germany and two in British Columbia
- Significant investments made in cogeneration equipment allow Mercer to generate and sell a significant amount of surplus green energy
- In 2020, Mercer sold US\$90.3 million worth of surplus electricity and chemicals

## Wood Products

- Mercer manufactures, sells, and distributes lumber, electricity and other wood residuals to the United States, Europe, and other markets
- Annual production capacity of approximately 550 MMfbm of lumber and 13 MW of electrical generation
- Mercer generated:
  - US\$181 million of lumber-related revenues in 2020
  - US\$10.6 million worth of surplus electricity in 2020

## Subsidiaries

### Mercer International

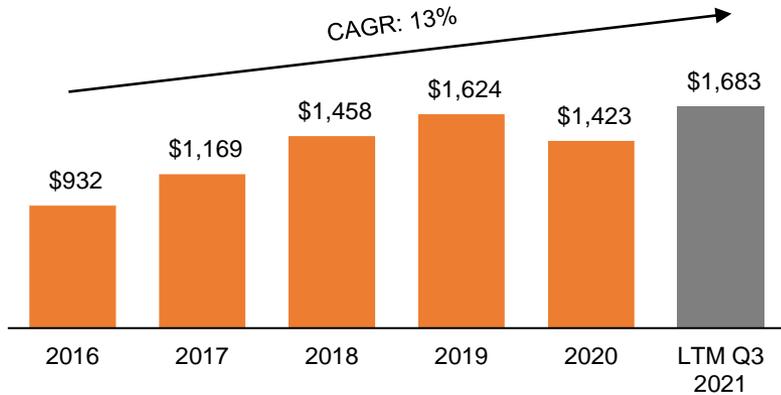


Source(s): Company filings

# Company Metrics

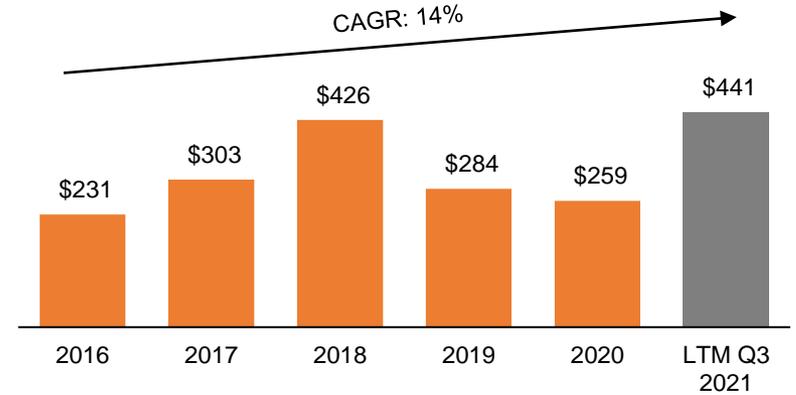
## Revenue

USD mm



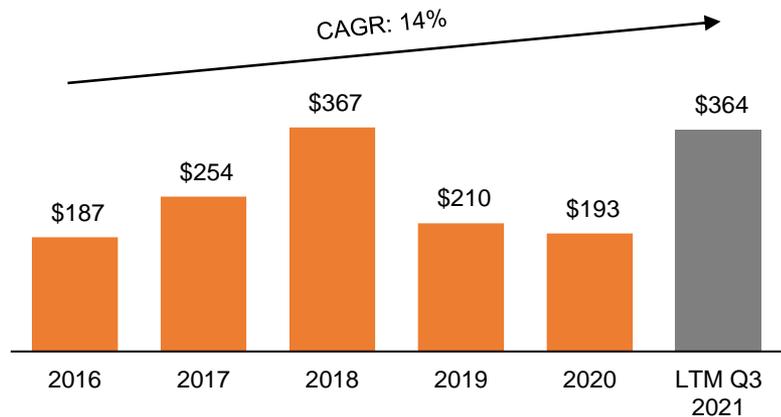
## Gross Profit

USD mm



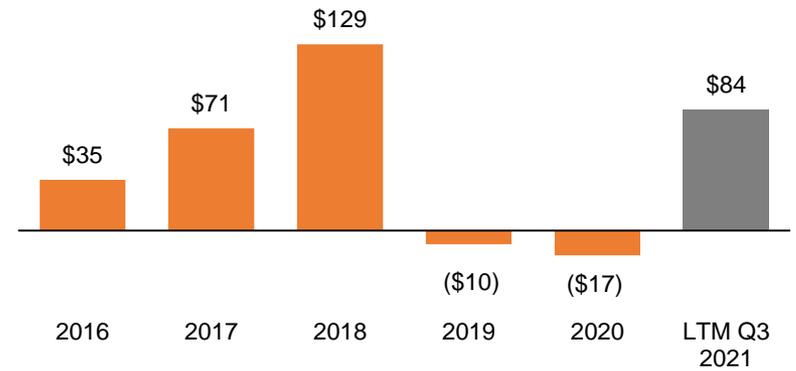
## EBITDA

USD mm



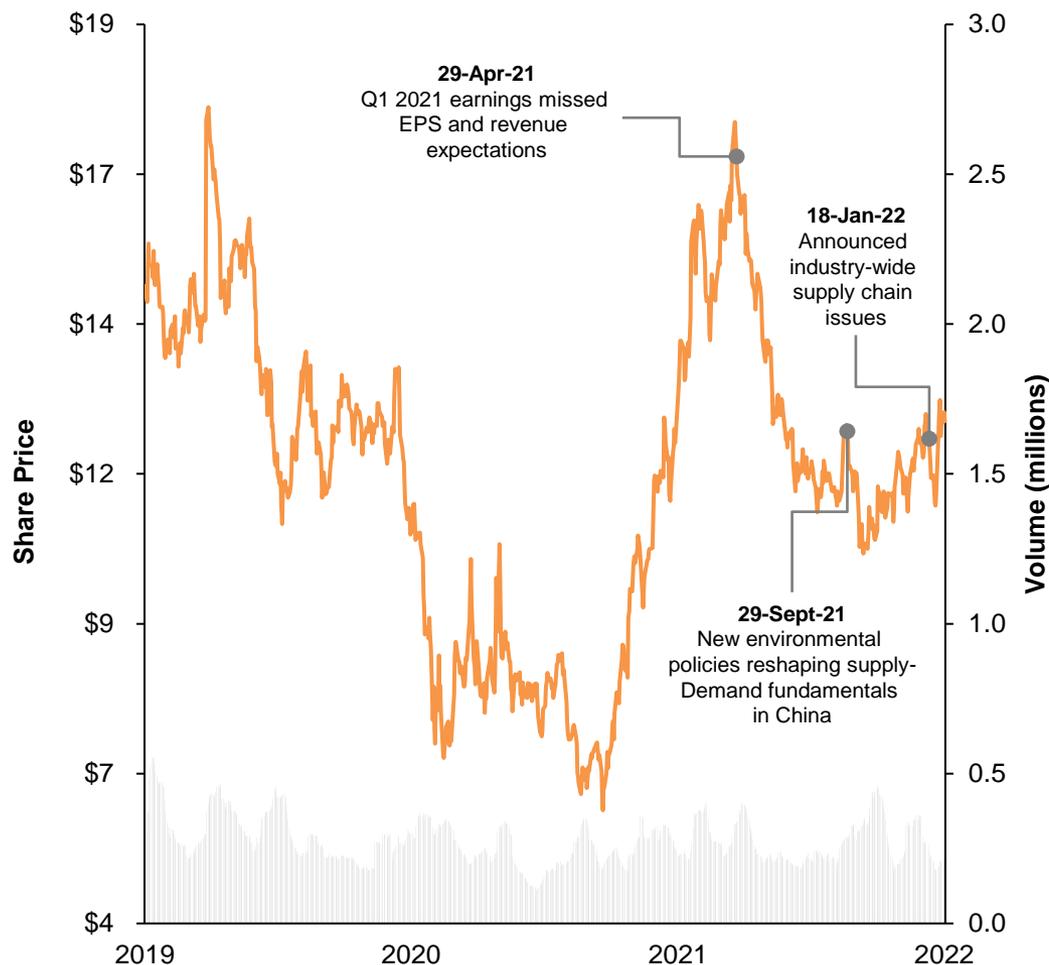
## Net Income

USD mm



# PV Chart and Capitalization Table

## Price-Volume Analysis



## Market Data

### Capitalization

Share Price (09-Feb-2022)	(US\$)	\$12.38
Basic Shares Outstanding	(mm)	66.0
Diluted Securities	(mm)	0.3
<b>Market Capitalization</b>	<b>(US\$ mm)</b>	<b>839</b>
(-) Cash & Equivalents	(US\$ mm)	(339)
(-) Investments in associate	(US\$ mm)	43
(+) Short-Term Debt	(US\$ mm)	55
(+) Long-Term Debt	(US\$ mm)	1,162
(+) Minority Interest	(US\$ mm)	-
<b>Enterprise Value</b>	<b>(US\$ mm)</b>	<b>1,749</b>

### Trading Multiples

EV / 2020A EBITDA	-	3.6x
EV / 2021E EBITDA	-	4.1x
EV / 2022E EBITDA	-	4.7x
P / 2020A EPS	-	4.9x
P / 2021E EPS	-	5.4x
P / 2022E EPS	-	7.1x

### Market Data

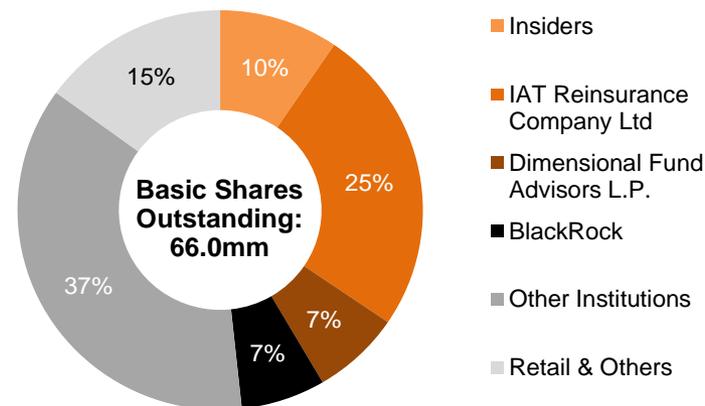
52-Week High	(US\$)	\$18.14
% of 52-Week High	(%)	68.2%
52-Week Low	(US\$)	\$9.51
Beta	-	1.70

# Shareholder Overview

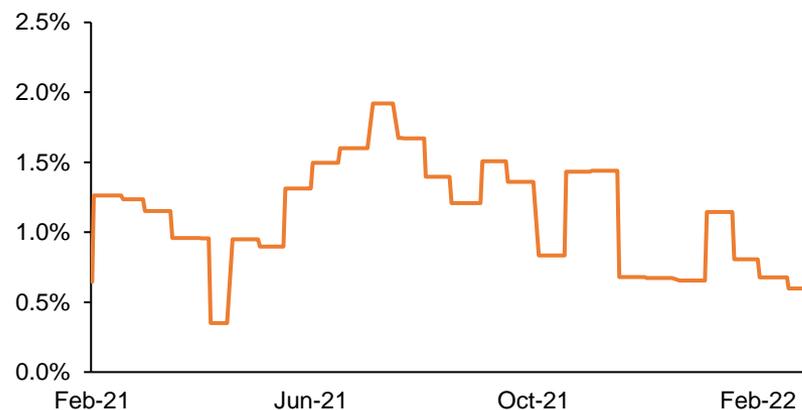
## Shareholder Summary

	<u># of Shares Held</u>	<u>% of Shares Outstanding</u>
<b>Insiders</b>		
Kellog, Peter Rittenhouse	3.5	5.3%
Lee, Jimmy S. H.	1.9	2.9%
Gandossi, David M.	0.2	0.3%
McCartney, William David	0.1	0.1%
Other Insiders	0.6	1.0%
<b>Total Insiders</b>	<b>6.3</b>	<b>9.5%</b>
<b>Institutions</b>		
IAT Reinsurance Company Ltd	16.5	25.0%
Dimensional Fund Advisors L.P.	4.7	7.1%
BlackRock	4.4	6.7%
Gates Capital Management, Inc.	3.8	5.8%
Redwood Capital Management, LLC	2.1	3.2%
The Vanguard Group, Inc.	1.4	2.2%
Boundary Creek Advisors LP	1.3	2.0%
Wells Fargo & Company	1.3	1.9%
Peter & Cynthia Kellogg Foundation	1.0	1.6%
K2 & Associates Investment Mgmt. Inc.	0.8	1.2%
State Street Global Advisors, Inc.	0.8	1.2%
Renaissance Technologies Corp.	0.7	1.0%
Other Institutions	11.0	16.7%
<b>Total Institutions</b>	<b>49.8</b>	<b>75.5%</b>
Retail & Other Investors	9.9	15.0%
<b>Total Basic Shares Outstanding</b>	<b>66.0</b>	<b>100.0%</b>

## Ownership Structure



## Short Interest



# Agenda

---



**1** Company Overview

**2** Industry Outlook

**3** Investment Thesis

**4** Valuation

**5** Catalysts and Risks

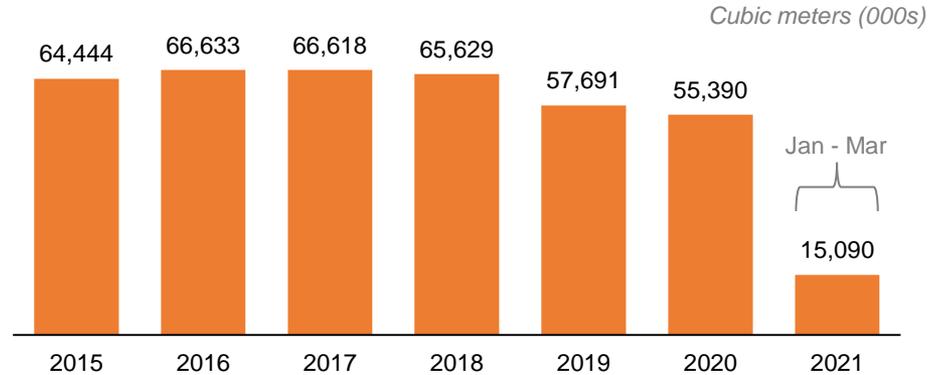
**6** Recommendation

# Lumbering on Into 2022

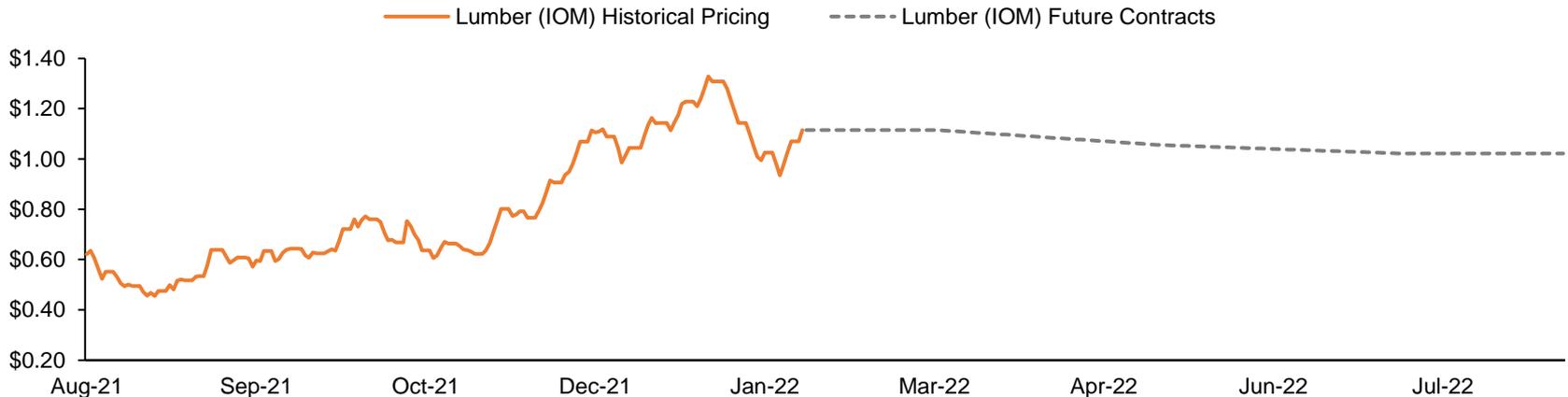
## Current Market Conditions

- U.S. lumber demand has been supported by rising housing starts, which will avg. ~1.6mm annually through 2024
- Rising home equity and a lack of new entry and first-move-up homes will force homeowners to 'fix up' rather than 'move up'
- Recovering Eurozone economies support modest demand growth
- Limited chance of unexpected supply additions given lengthy equipment vendor lead times, labor constraints in the southern United States, and old-growth forest protection initiatives

## Lumber Production in Canada, 2015-2021



## Lumber Price Forecasts (\$ per bd. ft)



Source(s): Capital IQ, IBIS World, Statista, CIBC Capital Markets

# Changes to the Pulp Market Landscape

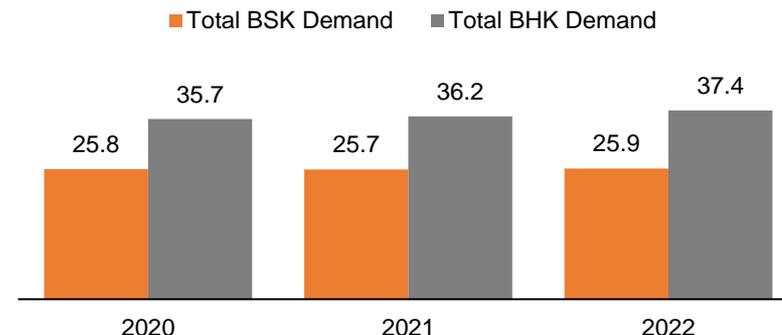
## Understanding the Pulp Industry

- Pulp is used in the production of paper, tissues, and other paper-related products
  - Classified according to fibre type, the process used in its production and the degree of bleach
- Kraft pulp (chemical type) allows for wood’s fibre to retain its length and flexibility, creating durable pulp products
  - Mercer produces and sells NBSK (Northern Bleached Softwood Kraft) and NBHK (Northern Bleached Hardwood Kraft)
- In 2020, market kraft pulp consumption was approx. 57% hardwood bleached and 37% softwood bleached

## Hot Pulp Markets

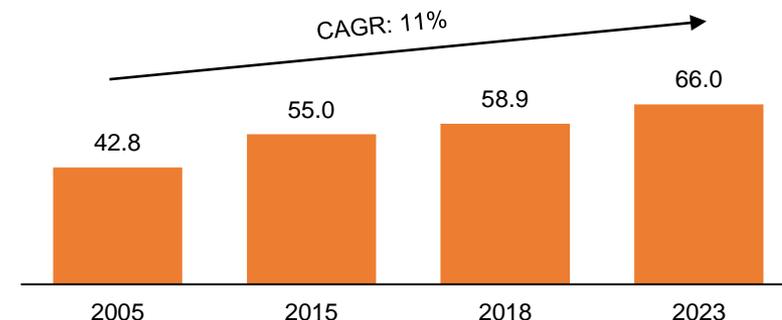
- Pulp markets are highly competitive and sensitive to cyclical changes in the global economy, industry capacity, and foreign exchange rates
  - Commodity material competing in the market based on price and quality
  - NBSK sells at a premium due to its lightweight and durable qualities
- Demand for NBSK from emerging markets has grown significantly, particularly in China and Eastern Europe
- Emerging markets account for 58% of global demand for bleached softwood kraft (China accounts for 34% alone)

## Global Pulp Consumption (millions of tons)



BHK has higher demand globally and secures high prices due to its superior quality in specific geographies

## Global Pulp Demand (millions of tons)



Emerging economies and growing disposable income are driving global pulp demand at an 11% CAGR through 2023

# Agenda

---



**1** Company Overview

**2** Industry Outlook

**3** Investment Thesis

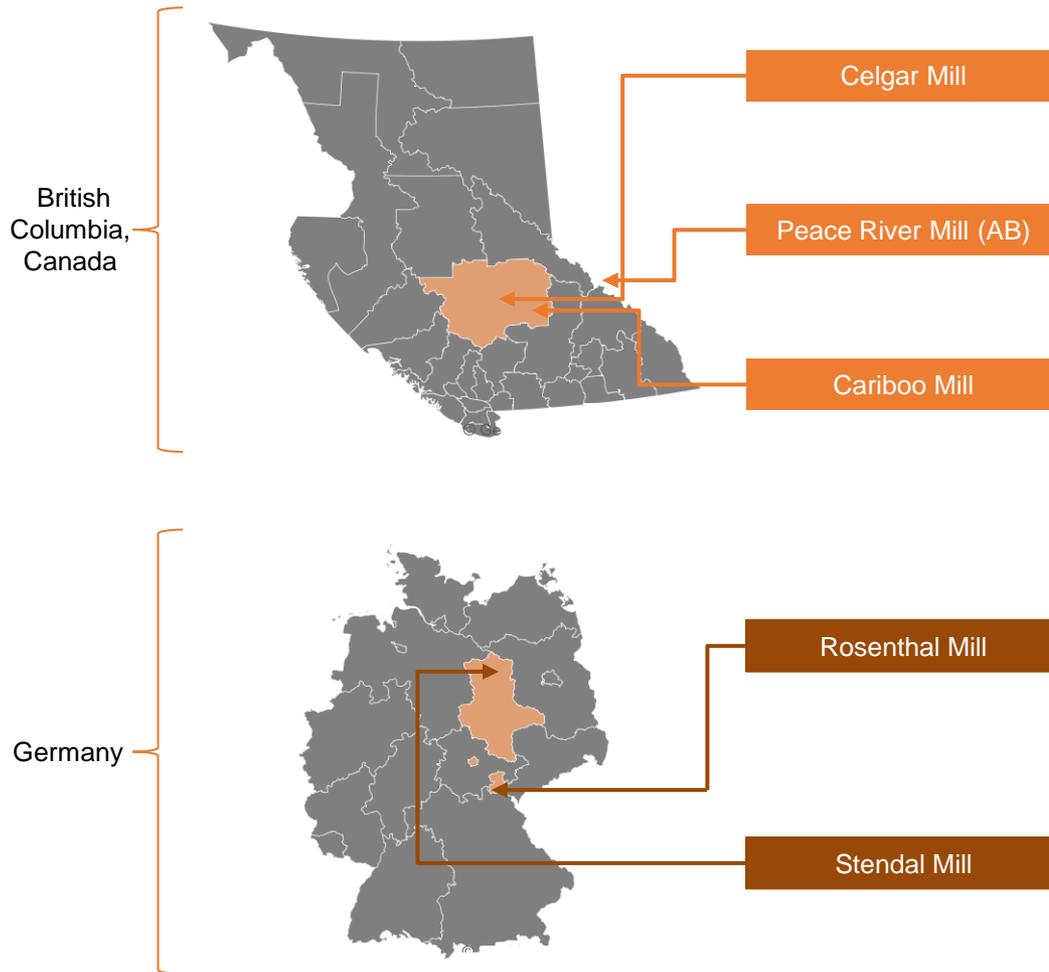
**4** Valuation

**5** Catalysts and Risks

**6** Recommendation

# Tree-mendous Geographical Positioning

## Strategically Located Asset Base Delivers High Quality Pulp

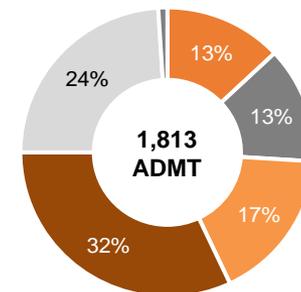


## The Power of Geography

- Northern Bleached Softwood Kraft is the benchmark grade of pulp worldwide
  - NBSK comes from Northern coniferous trees species
  - Mercer has strategic positions in Canada and Germany
- Mercer now maintains a market leading position despite its smaller size
  - Close to key global end-user markets (China and the U.S.)
- Mercer Stendal (Germany) is one of the newest and largest pulp mills in the world which further expanded in 2021

### Mercer Segmented Pulp Sales

- U.S.
- China
- Other Asia
- Germany
- Other Europe
- Other

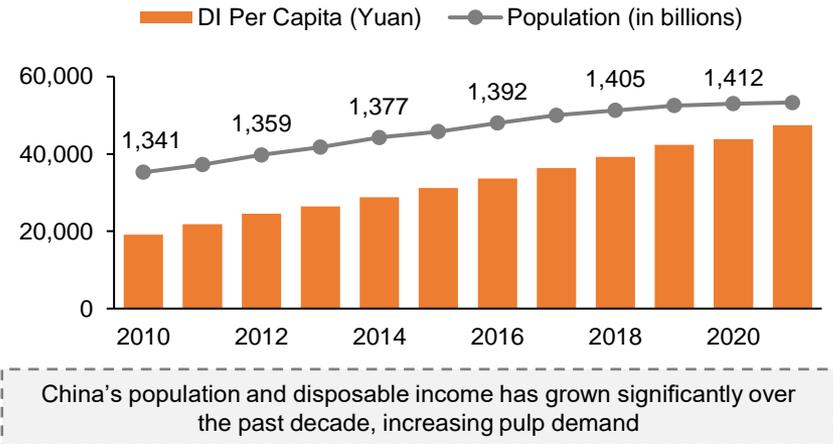


# Capturing the Demand of China

## Growing Pulp Demand in China

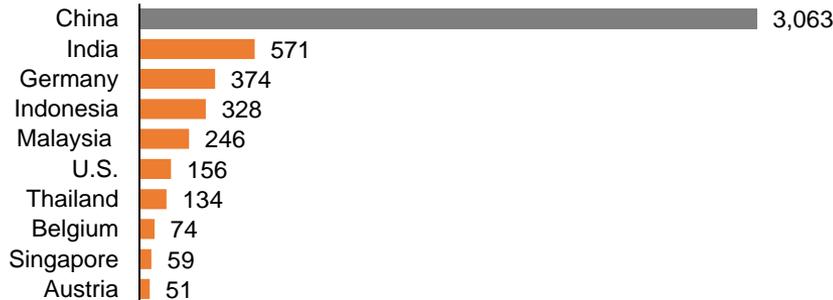
- Demand for NBSK and other pulp products has grown in emerging markets, particularly in China, which accounts for 34% of global demand
  - China’s demand is driven by their growing population and rising disposable income
  - Middle-class population in the middle-class has grown from 3% in 2000 to roughly 50% of the country in 2018
- China must import NBSK and NBHK pulp as their climate is not suitable for the specific trees used in production
  - Germany and Canada host a perfect climate, where Mercer strategically operates their mills

## The Driving Forces



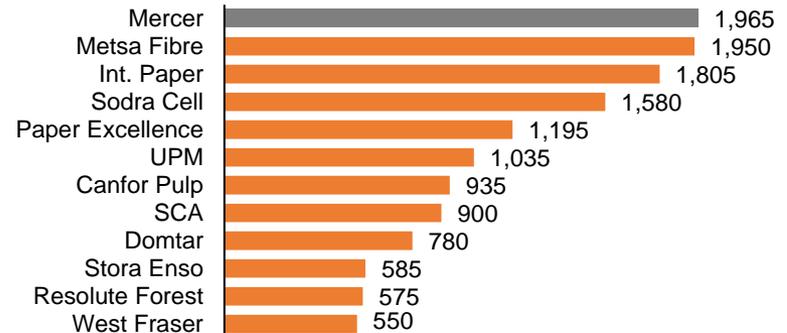
## Flush with Capacity, Mercer is Well Positioned to Capitalize on Chinese Growth

### Lead Importers of Chemical Pulp<sup>1</sup>



China is increasingly dependent on importing chemical pulp to support nation demand for tissue, paper, and feminine products

### Top NBSK Pulp Producers<sup>2</sup>



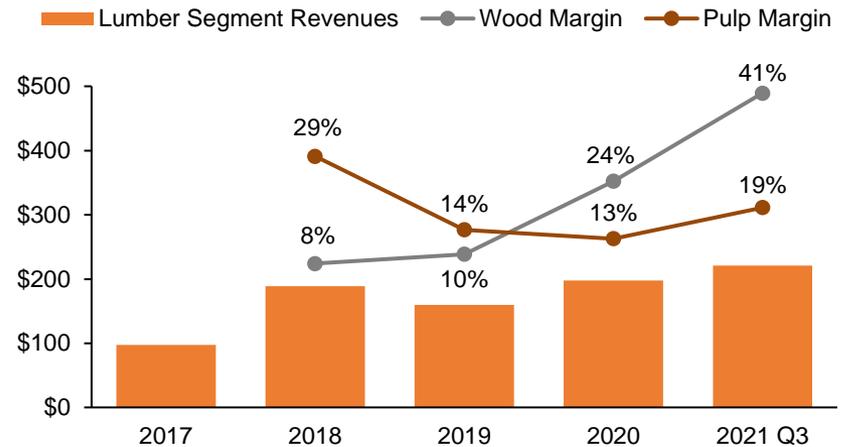
Mercer dominates global NBSK production

# Diversification into Core Competencies

## Expansion into the Lumber Industry

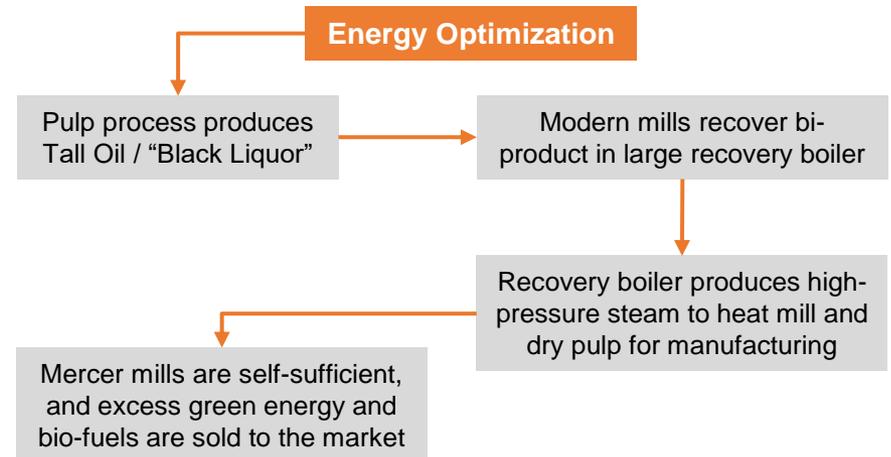
- Mercer acquired one of the largest softwood sawmills in the world in 2017, located in Friesau, Germany
  - Sawmill has a total capacity of 550 MMfbm per year, making it the 5<sup>th</sup> largest in the world
- Friesau sawmill was one of Rosenthal mill’s largest suppliers – the acquisition created synergies through the integration of fibre supplies
  - We expect Mercer will look to repeat this exercise at its other pulp mills to achieve synergies
  - Management noted the possibility of constructing a sawmill near the Stendal pulp mill

## Lumber Segment has Diversified EBITDA Margins



## Green Energy and Bio-Extractives Provide New Opportunities

- **Green Energy:** Mercer’s highly efficient and modern mills produce green energy – net exporters in electricity, sold to regional utilities and markets
- **Bio-Extractives:** Full value of lumber production is extracted, elements traditionally burned are manufactured into “Tall Oil” used in bio-fuels
- Green energy and bio-extractives provide Mercer with another opportunity to diversify its revenue streams
  - Mercer Stendal mill sold \$51.3mm of green-energy and \$6.8mm of bio-fuel in 2020
  - Mills are self-sufficient as a result of green energy



# Agenda

---



**1** Company Overview

**2** Industry Outlook

**3** Investment Thesis

**4** Valuation

**5** Catalysts and Risks

**6** Recommendation

# Discounted Cash Flows

## DCF Valuation Assumptions

- Revenue growth estimates are largely based on production forecasts (ADMT and MMfbm), segment growth rates, and commodity price estimates along with geography and product mixes which are key drivers for MERC
- Uptick in revenue in 2021E expected as a result of COVID-19 recovery and strong commodity prices
- Depreciation and amortization, capital expenditures, changes in net working capital and EBITDA margin are projected based on historical trends

WACC: **8.1%**Perp. Growth Rate: **1.7%**FDSO: **66.3 million**Tax Rate: **31.0%**

## DCF Unlevered Cash Flow Summary

(USD Millions)	Forecast Period													Terminal
	2018A	2019A	2020A	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	
<b>Revenue</b>	1,458	1,624	1,423	1,712	1,846	1,979	2,087	2,155	2,232	2,310	2,377	2,443	2,510	2,552
% Growth	-	11.4%	(12.4%)	20.3%	7.8%	7.2%	5.5%	3.2%	3.6%	3.5%	2.9%	2.8%	2.7%	1.7%
<b>Adjusted EBITDA</b>	365	210	193	317	330	341	347	345	343	341	336	330	339	345
% Margin	25.0%	13.0%	13.5%	18.5%	17.9%	17.3%	16.6%	16.0%	15.4%	14.8%	14.1%	13.5%	13.5%	13.5%
(-) Depreciation & Amortization	(97)	(126)	(129)	(159)	(160)	(159)	(156)	(149)	(142)	(135)	(127)	(119)	(111)	(113)
% of CapEx	111.3%	96.1%	166.3%	124.6%	121.6%	118.7%	115.7%	112.8%	109.8%	106.9%	103.9%	101.0%	98.0%	98.0%
<b>Adjusted EBIT</b>	268	84	64	158	170	182	191	196	201	206	209	211	228	232
% Margin	18.4%	5.2%	4.5%	9.2%	9.2%	9.2%	9.2%	9.1%	9.0%	8.9%	8.8%	8.6%	9.1%	9.1%
% Growth		(68.6%)	(24.1%)	148.3%	7.7%	6.9%	4.9%	2.5%	2.6%	2.3%	1.4%	1.1%	8.2%	1.7%
(-) Cash Taxes	(16)	(53)	(19)	(49)	(53)	(56)	(59)	(61)	(62)	(64)	(65)	(65)	(71)	(72)
Tax rate (%)	6.0%	62.9%	30.3%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%
<b>NOPAT</b>	252	31	44	109	118	126	132	135	139	142	144	145	157	160
(+) Depreciation & Amortization	97	126	129	159	160	159	156	149	142	135	127	119	111	113
(-) CapEx	(87)	(131)	(78)	(127)	(131)	(134)	(135)	(132)	(130)	(127)	(122)	(118)	(113)	(115)
% of Revenue	6.0%	8.1%	5.4%	7.4%	7.1%	6.8%	6.5%	6.1%	5.8%	5.5%	5.2%	4.8%	4.5%	4.5%
(-) Change in Net Working Capital	-	27	(75)	(58)	(24)	(21)	(15)	(8)	(7)	(5)	(3)	(2)	(0)	(13)
% of Change in Revenue		(16.2%)	(37.1%)	(20.0%)	(17.8%)	(15.7%)	(13.5%)	(11.3%)	(9.2%)	(7.0%)	(4.8%)	(2.7%)	(0.5%)	(0.5%)
<b>Unlevered Free Cash Flows</b>	262	53	21	83	122	130	138	144	144	145	145	145	155	145

Source(s): Capital IQ, Company filings, Equity research

# Discounted Cash Flows

## Valuation Summary

<b>Cumulative PV of Free Cash Flow</b>	<b>929</b>
<i>% of Enterprise Value</i>	44.1%
<b>Terminal Value</b>	
Terminal Year EBITDA	345
Terminal Year UFCF	145
Perpetuity Growth Rate	1.7%
<b>Terminal Value</b>	<b>2,255</b>
Terminal Value for EBITDA Multiple	2,345
Implied EV / EBITDA Multiple	6.8x
Implied EV / UFCF Multiple	16.2x
<b>PV of Terminal Value</b>	<b>1,178</b>
<i>% of Enterprise Value</i>	55.9%
<b>Enterprise Value</b>	<b>2,106</b>
(-) Short Term Debt	(55)
(-) Long Term Debt	(1,162)
(-) Minority Interest	-
(+) Cash	339
(+) Investments in Associates	(43)
<b>Equity Value</b>	<b>1,184</b>
Basic Shares	66
(+) Diluted Securities	0
<b>Fully Diluted Shares Outstanding</b>	<b>66.3</b>
<b>Implied Share Price</b>	<b>\$17.85</b>
Current Share Price	\$12.38
<b>Premium to Current Share Price</b>	<b>44.2%</b>

## Discount Rate Analysis

WACC		
10-Year US Treasury		2.0%
Market Risk Premium		5.0%
Beta		1.7
<b>Cost of Equity</b>		<b>10.6%</b>
Cost of Debt		5.2%
Tax Rate		31.0%
<b>After-Tax Cost of Debt</b>		<b>3.6%</b>
Target Debt/Capitalization		35.0%
<b>WACC</b>		<b>8.1%</b>
Debt Tranches		
	Face	Effective
(USD millions)	Value	Interest Rate
2026 Senior Notes	300.0	5.5%
2029 Senior Notes	875.0	5.1%
<b>Weighted Average</b>		<b>5.2%</b>

## Valuation Takeaways

- The DCF yields an implied price of \$17.85 (+44.2%), with a range of \$13.76 (+11.2%) to \$22.94 (+85.3%)
- The base case uses a 8.1% WACC with a 1.7% perpetuity growth rate

# Discounted Cash Flows

## Comparable Companies

USD mm	Equity Value	Enterprise Value	P/E			EV/EBITDA			EV/Revenue			Revenue Growth		EBITDA Margin	
			2020A	2021E	2022E	2020A	2021E	2022E	2020A	2021E	2022E	2021E	2022E	2021E	2022E
<b>Lumber</b>															
West Fraser Timber Co. Ltd.	\$9,776	\$8,961	4.4x	5.1x	8.7x	2.5x	2.9x	4.3x	1.1x	0.9x	1.1x	14.6%	(12.7%)	32.4%	25.5%
Louisiana-Pacific Corporation	\$5,508	\$5,551	4.5x	5.5x	9.6x	2.8x	3.7x	6.2x	1.2x	1.3x	1.5x	(6.1%)	(13.4%)	35.3%	24.3%
Western Forest Products Inc.	\$543	\$459	3.8x	5.6x	7.5x	2.0x	2.8x	3.3x	0.4x	0.4x	0.5x	(7.2%)	(11.9%)	15.8%	15.5%
Median			4.4x	5.5x	8.7x	2.5x	2.9x	4.3x	1.1x	0.9x	1.1x	(6.1%)	(12.7%)	32.4%	24.3%
<b>Pulp Producers</b>															
Stella-Jones Inc.	\$1,886	\$2,417	11.0x	11.1x	10.6x	7.7x	7.8x	7.7x	1.1x	1.2x	1.1x	(1.9%)	1.8%	14.9%	14.9%
Rayonier Advanced Materials Inc.	\$394	\$1,049	nmf	nmf	nmf	7.9x	7.2x	6.4x	0.7x	0.7x	0.7x	8.1%	0.1%	9.6%	10.8%
Clearwater Paper Corporation	\$474	\$1,147	nmf	9.2x	11.3x	10.0x	5.6x	5.9x	0.6x	0.6x	0.6x	9.6%	1.8%	10.6%	9.8%
Median			11.0x	10.2x	11.0x	7.9x	7.2x	6.4x	0.7x	0.7x	0.7x	8.1%	1.8%	10.6%	10.8%
Overall Median			7.7x	7.8x	9.8x	5.2x	5.1x	5.4x	0.9x	0.8x	0.9x	1.0%	(5.5%)	21.5%	17.6%
Mercer International Inc.	\$839	\$1,749	4.9x	5.4x	7.1x	3.6x	4.1x	4.7x	1.0x	0.9x	0.9x	9.2%	(2.3%)	21.4%	19.2%

MERC trades at a discount to competitors on a P/E and EV/EBITDA basis and is on par with competitors on an EV/Revenue basis

## Comparable Output Table

Metic	Multiple			Implied Share Price			Implied Return		
	Lower Limit	Median	Upper Limit	Lower Limit	Median	Upper Limit	Lower Limit	Median	Upper Limit
P / 2020A EPS	6.2x	7.7x	9.2x	\$16.09	\$19.89	\$23.69	29.9%	60.6%	91.3%
P / 2021E EPS	6.6x	7.8x	9.0x	\$15.46	\$18.27	\$21.08	24.8%	47.6%	70.3%
P / 2022E EPS	9.2x	9.8x	10.5x	\$16.24	\$17.44	\$18.64	31.2%	40.9%	50.6%
EV / 2020A EBITDA	3.6x	5.2x	6.8x	\$12.75	\$24.09	\$35.43	3.0%	94.6%	186.2%
EV / 2021E EBITDA	4.1x	5.1x	6.0x	\$12.17	\$18.56	\$24.95	(1.7%)	49.9%	101.5%
EV / 2022E EBITDA	4.6x	5.4x	6.1x	\$11.89	\$15.93	\$19.97	(4.0%)	28.7%	61.3%

MERC's implied share price and return are heavily skewed by its peers' high P/E multiples and negative revenue projections

# Agenda

---



**1** Company Overview

**2** Industry Outlook

**3** Investment Thesis

**4** Valuation

**5** Catalysts and Risks

**6** Recommendation

# Short-Term Tailwinds With Limited Downside

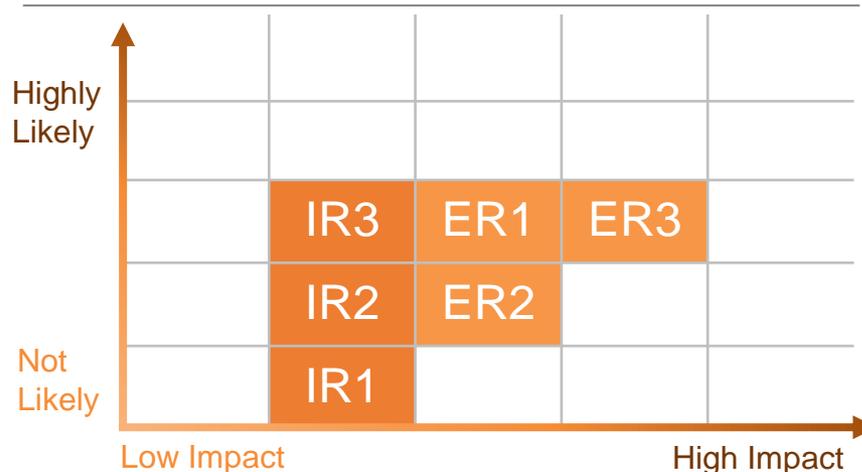
## Near-Term Catalysts

- **Positive Earnings Release** – February 17th earnings release could drive Mercer’s share price higher
- **Covid-19 Economic Recovery** – Recovering Eurozone economies will support modest demand growth and driving improvements
- **Competitive Housing Market** – Rising housing starts, low interest rates and low housing stock will keep US lumber prices elevated over the next year

## Long-Term Catalysts

- **Automation** – State-of-the-art technology in pulp mills will reduce costs and improve plant efficiency
- **Export Growth** – The ability for MERC to aid companies in meeting their renewable fuel targets will fuel exports
- **Rising price of wood pulp** – Anticipated to rise at an annualized 0.2% rate through 2026
- **Rising downstream demand** – Specifically for sanitary paper product manufacturers

## Risks



### External Risks

- Cyclical fluctuations in raw material prices and supply (ER1)
- New competitors entering or expanding in the market (ER2)
- Climate change decimating Mercer pulp production (ER3)

### Internal Risks

- Disappointing earnings release plummets stock (IR1)
- Legal and regulatory risk (IR2)
- Unplanned maintenance required on old, high-cost NBSK mills (IR3)

# Agenda

---



**1** Company Overview

**2** Industry Outlook

**3** Investment Thesis

**4** Valuation

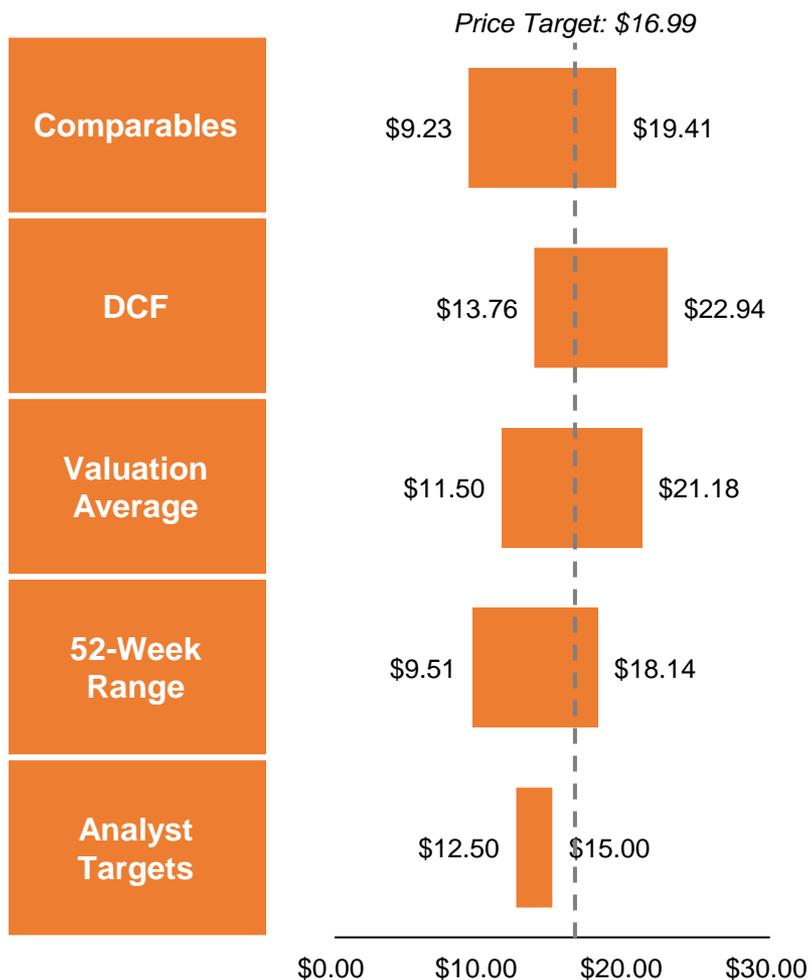
**5** Catalysts and Risks

**6** Recommendation

## RECOMMENDATION

# Buy Recommendation with a Price Target of ~\$16.99 (+37%)

### Indicative Valuation Range



### Price Target

Valuation Summary		
Analysis	Price	Weight
Comparables	\$17.82	10%
Discounted CF	\$17.85	60%
Street Consensus	\$15.00	30%
<b>Average</b>	<b>\$16.99</b>	<b>100%</b>



### Selected Broker Summary

