

MADISON'S LUMBER REPORTER



Publisher
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Editor
Kéta Kosman

Market Analyst
Zara Heartwood



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www.madisonsreport.com
madrep@shawcable.com
604 984-6838

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News & Updates

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In this time of flux for the forest industry, don't miss out on any of the critical changes occurring with Canadian lumber producers. Sign up for *Madison's* online database of lumber producers! Viewed conveniently through your web browser, a one-year subscription gives you access to up-to-the minute information on the status of operations for primary mills, remanufacturers, panel mills, pulp and paper mills, wood preservers, shake and shingle mills and wholesalers.

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Canadian Housing Starts

Construction of new homes in Canada surged by 8 per cent in June. The annual pace of housing starts rose to 140,700 units in June from 130,300 in May, with the increase in activity spread across single and multiunit buildings, said Canada Mortgage and Housing Corp.

It was the first back-to-back gain since August-September figures in 2008, and about 20 percent higher than the low hit in April. The May figure was upwardly revised to 130,300 units from 128,400 previously, well ahead of April's 117,600 starts.

The seasonally adjusted annual rate of urban starts increased 9.5 per cent to 120,100 units in June, while rural starts were estimated at 20,600 units.

The surge was particularly strong in Western Canadian cities, with urban housing starts leaping almost 60 per cent in the Prairie provinces and 25 per cent in British Columbia.

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BC Labour Issues

Next week the United Steelworkers Union, representing BC's forest industry workers, will begin negotiations with the first of four industry bargaining groups. *Madison's* has learned that the union is likely to begin with the Conifer group, representing BC's independent lumber producers. The union's position and industry proposals already submitted are so far apart that next week's discussions could set the stage for a protracted labour disruption in the near future.

The companies are faced with the combined challenges of record low lumber prices, a stronger Canadian dollar and pine beetle log issues. Indeed, the Coalition for Fair Lumber Imports has for several months been investigating stumpage rates and log grading in BC, going so far as to issue a press release in March detailing its concerns on this subject.

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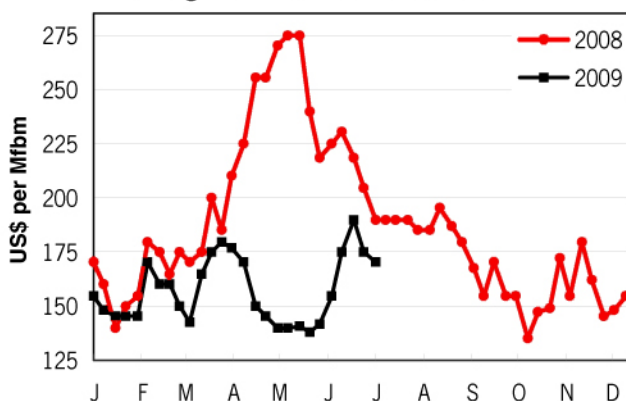
Global Forestry Survey 2009

In late June PricewaterhouseCoopers released its annual survey of the global forest industry. *Madison's* examines the results against PwC's 2008 report and draws conclusions about the state of the industry for the near future.

When put together with Export Development Canada's revised global economic figures released this week, and news about the US housing industry, PwC's report helps demonstrate where the forest industry is going in 2010 and beyond.

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Douglas Fir Green #2&Btr 2x4



CANADIAN HOUSING STARTS

Actual and Seasonally Adjusted Annual Rates

	June 2009		May 2009	
	Actual	SAAR	Actual	SAAR
Canada, all areas	13,743	140,700	12,604	130,300
urban ctrs with >10,000	11,686	120,100	10,368	109,700
singles, urban centres	5,716	53,100	4,939	49,500
multiples, urban centres	5,970	67,000	5,429	60,200
rural areas	2,057	20,600	2,236	20,600
Atlantic urban centres	904	7,400	760	7,700
Quebec urban centres	2,990	32,600	3,594	34,800
Ontario urban centres	4,440	43,400	3,665	42,100
Prairie urban centres	2,290	24,700	1,540	15,500
B.C. urban centres	1,062	12,000	809	9,600

Source: Canada Mortgage and Housing Corporation

Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	190	200	-10	184	+6	262	-72
WSPF KD R/L 2x6	208	208	0	178	+30	248	-40
WSPF KD R/L 2x8	230	225	+5	190	+40	248	-18
WSPF KD R/L 2x10	322	322	0	212	+110	267	+55
WSPF KD PET 2x4 Stud	200	210	-10	187	+13	235	-35
Douglas Fir Green R/L 2x4	170	175	-5	155	+15	190	-20
Douglas Fir Green R/L 2x10	245	240	+5	200	+45	205	+40
ESPF KD 2x4 8ft Stud	285	285	0	270	+15	300	-15
OSB Ontario 7/16" (CDN\$)	220	209	+11	195	+25	215	+5

Weekly News

Home Building in Canada

CONTINUED Canadian residential building permits have increased in three consecutive months and are now 26 per cent above February's low, while starts (which naturally follow) are nearly 20 per cent above their April low.

Both single and multi-unit starts rose in June, aided by the remarkably strong spring selling season—note that they're still 28 per cent and 41 per cent below year-ago levels, respectively. Higher affordability and improved confidence brought buyers off the sidelines this spring.

Home sales nation-wide jumped more than 40 per cent in seasonally adjusted terms between January and May, with preliminary readings from the big cities pointing to further strength in June. Given that starts follow both sales and permits, there could be some further modest upside in the coming months, according to Sherry Cooper, Chief Economist at BMO Capital Markets.

While the housing starts number have improved sharply, they are still well

below year-ago levels. June starts were 34 per cent lower than in the same month of 2008, and 48 per cent below the peak reached in September, 2007.

Government incentives included in fiscal stimulus packages may have helped to prop up the numbers, said Millan Mulrairie, an economics strategist at TD Securities.

"There's evidence of some stabilization in the sector itself, not only this report but other reports have also shown some buoyancy - particularly existing home sales," said Mulrairie.

CMHC said it expects housing starts to improve throughout the rest of the year and the years to come, until the pace of activity edges back up to meet demographic demand for about 175,000 new homes a year.

Earlier this week, Statistics Canada released some other positive construction numbers, showing that building permits issued in May surpassed the \$5-billion mark for the first time since October, 2008, led by construction plans for schools and hospitals.

Labour Issues in BC

CONTINUED Of note, Canfor and West Fraser each have significant capacity in the US south, and could increase Southern Yellow Pine production in the event of a labour disruption. However, SYP is not always interchangeable with Western S-P-F. Many of the other operators in BC have no alternatives for production elsewhere, so would be more affected by a full labour stoppage than the big two.

Wage reductions in the 10 to 20 per cent range, or perhaps more, have been offered by the employer groups, and lengthy contracts of up to six years, which would not be in the union's best interest.

This is the first bargaining process since the IWA merged with the Steelworkers. The IWA was perceived as a weaker union, while the Steelworkers are a much stronger bargaining unit, and have built up reserves during the previous commodity boom. The Steelworkers collective is larger than the IWA was. In addition the bargaining committee has changed, adding to the unpredictability of future direction.

It would be unwise for the Steelworkers to take a significant roll-back because that would set a poor precedent for other industries the union represents, as well as for the forest industry nationally in future labour negotiations.

Madison's will be keeping a close watch on any developments in order to best inform the industry about future labour and employer movements.

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The State of Forestry

PwC 2009 Survey Report

On June 24, 2009 PwC released its annual forest industry survey for 2008. *Madison's* examined the findings closely, against the same report for 2007, to find where the industry has been and to determine where it is going. According to the most recent report, "the top 100 forest, paper and packaging companies from around the world saw net income tumble from positive \$14 billion in 2007 to record losses of \$8 billion in 2008 [. . .].

by Kéta Kosman

This year's survey shows that:

- Total sales were \$357 billion in 2008, up from \$333 billion in 2007,
- Cash flow from operations totaled \$26 billion in 2008, down from \$31 billion in 2007,
- Operating income of \$21 billion represented a decrease of 19 per cent compared to 2007, and
- Average ROCE (return on capital employed) dropped from 5 per cent in 2007 to 2.4 per cent in 2008. Only six companies earned a return of 10 per cent or more in 2008, compared to 14 in 2007."

The increase in total sales was mostly due to the strengthening Euro against the US dollar.

The sharp decline of net income is "a result of goodwill and fixed asset impairments, restructuring, severance and high operating costs." However, cash flow only dropped 16 per cent, due mostly to companies' focus on conserving cash. Much of the impact on the bottom lines was a result of non-cash or long-term items, according to the PwC report.

In contrast to the first half 2007, which showed strong global economic growth lead by emerging markets, the second half of 2007 was marked by a global economic slowdown mostly due to the credit crisis in the US. In 2008, global growth predictions were revised downward. Moving into the second half of 2009, there are indications that the US economy, as well as major economies globally, have stopped shrinking. The question that remains is when will actual growth begin once more, and by what scale?

Even those not involved in the forest industry realize by now that the complete stall of home building in the US in the middle of 2006 is a core cause of the current troubles for the forestry sector. Today there remains a sizable glut of unsold

new homes in key markets like Phoenix, AR and Las Vegas, NV. There have been indications of late that even in these hard-hit areas new home sales are improving, although at great discounts and usually at auction. In other regions of the US, home building has restarted, although full recovery is still a way off. In fact, 73 per cent of all existing houses and condos sold in the Las Vegas area in June were foreclosures, up from 56 per cent a year earlier, according to MDA DataQuick. Foreclosures accounted for 51 per cent all existing-home transactions in California. Meanwhile, the median price for an existing, single-family detached house in California plummeted 30 per cent to US\$267,570. Many analysts agree that until US home prices stabilize it will be very difficult to make accurate predictions about new home building.

About 20 million of the 93 million houses, condos and co-ops in the US were worth less than their loans as of March 31, 2009, according to Seattle-based real estate data service Zillow.com. The decline in the housing market has slashed more than 55 per cent of total homeowner equity since 2005, diminishing the 'wealth factor' for many homeowners, and forcing them to curtail spending.

As for Canada, most analysts have been predicting since early 2009 that Canadian home building, and indeed a strengthening of the Canadian economy, would come sooner than in the US. Thursday's release of Canadian housing starts seems to confirm this prediction. Canadian housing starts rose in June for a second consecutive month, adding further proof that the sector was on the mend after building activity fell to a nine-year low earlier this year. New home construction rose 8 per cent last month to a seasonally adjusted rate of 140,700 units, encompassing both single and multiple segments, Canada Mortgage and Housing Corp said.

Of interest is a separate report from Scotia Capital, which said new immigrants were driving housing demand and narrowing the home ownership gap with their Canadian-born counterparts. *Madison's* was told earlier this year by seasoned analysts that this same situation would unfold in the US,

that the steady influx of immigrants would bring a unexpected rise in US home building. While employment, interest rates and GDP are closely watched by financial analysts, immigration figures are often ignored. New home building has stalled for three years, but the number of new citizens naturalized in the United States increased 58 per cent from 660,477 in 2007 to an all-time record of 1,046,539 in 2008, according to the US Office of Immigration Statistics "Annual Flow Report".

New immigrants tend to rent upon arriving in Canada or the US, but eventually make the move to home ownership. There is a reversal looming, where suddenly there will be a lack of homes, and building will start up at a frenzied pace.

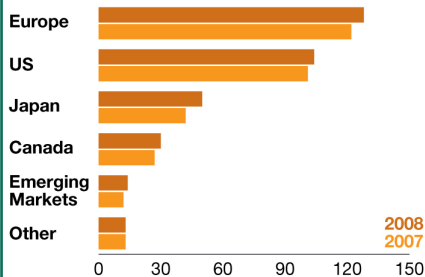
A report released Thursday by Export Development Canada contains revised figures for Canadian exports. The global economy is now forecast to contract by 1.7 per cent in 2009, followed by modest 2.7 per cent growth in 2010. Driving the contraction in exports are plummeting export prices and sharply weaker physical shipments. Commodities will see the biggest drop in export sales, with energy, fertilizers and base metals sustaining an average decline of 38 per cent.

Global recovery is not likely to begin until the latter part of 2010, according to EDC. Growth will return next year, and at first blush, the 2.7 per cent increase looks respectable. However, it is barely above a recessionary pace, and given this year's tumble, it amounts to baby steps out of a deep valley. Moreover, it comes with heavy public assistance. Based on OECD estimates, public stimulus packages are contributing about 1 per cent to 2010 growth, without which we would still be in a protracted recession. Policy measures are already kicking in, and their effects will be more obvious this fall. But true recovery will be a 2011 thing.

For the past month, the World Bank has been calling for all nations not to embark on any new stimulus packages, in particular due to an aging population which alone will bring a sharp rise to pension and health care costs in the near future.

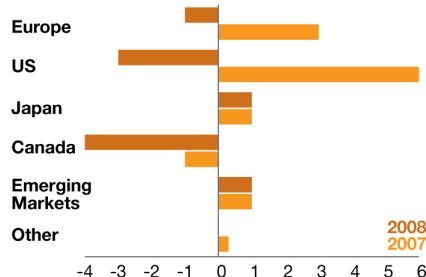
The Japanese economy has yet to recover in any meaningful way, June US housing starts will come out next week but are not expected to show a radical change over the previous month, and, while the emerging markets of China and some south Asian countries are the only regions showing an increase in imports of Canadian wood products, the figures themselves are so small compared to the US or even Japan that few industry observers are paying attention.

Figure 9: Sales
(US \$ billions)



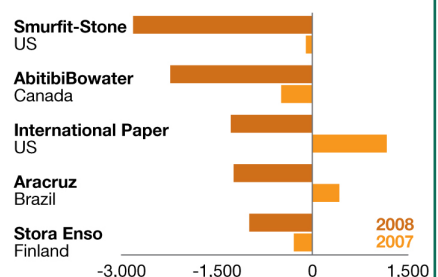
Source: PricewaterhouseCoopers LLP

Figure 10: Net Income (Loss)
(US \$ billions)



Source: PricewaterhouseCoopers LLP

Figure 11: Largest Losses
(US \$ millions)



Source: PricewaterhouseCoopers LLP