

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

Madison's Timber Preview

This week's issue of Madison's Timber Preview examines recent activity in the lumber futures market, leading real estate activity and economic indicators out of the US, and a positive relationship between the latest Institute of Supply Management's monthly manufacturing supply index and corrugated box shipments.

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British Columbia Forest Minister's Trade Mission to China

Pat Bell, BC's Minister of Forest and Range, is departing on a trade mission Friday to China in a bid to boost exports to what is now the province's second-largest lumber market.

"I'll be joined by the Canada Wood Group and senior executives from BC's largest forest companies to promote wood-frame construction and create new demand for our forest products," said Bell in a Ministry of Forests statement.

The delegates will visit the Shanghai metro area, Sichuan province, and Beijing-Tianjin corridor – the three regions of China where BC and Canada have focused most of their marketing activities.

Bell described the delegation as the largest-ever mission by both the provincial government and the forest industry to build a BC presence in China. He said the Chinese market is "unique," needing close co-operation between both government and industry to succeed.

Bell, along with industry representatives, hope to make a case for the use of wood in federal government-sponsored affordable housing during a meeting with the China Ministry of Housing and Urban Development.

The trade mission will also be stopping in Japan.

US Leading Real Estate and Economic Indicators

The US homebuyers' tax credit has been extended to April 30, 2010. President Barack Obama approved the extension as part of a US\$24 billion economic stimulus bill signed Friday.

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North American Wood Fibre Costs

Wood costs have remained unchanged for Canadian pulp mills in 2009 despite tighter wood chip supply, reports the North American Wood Fiber Review.

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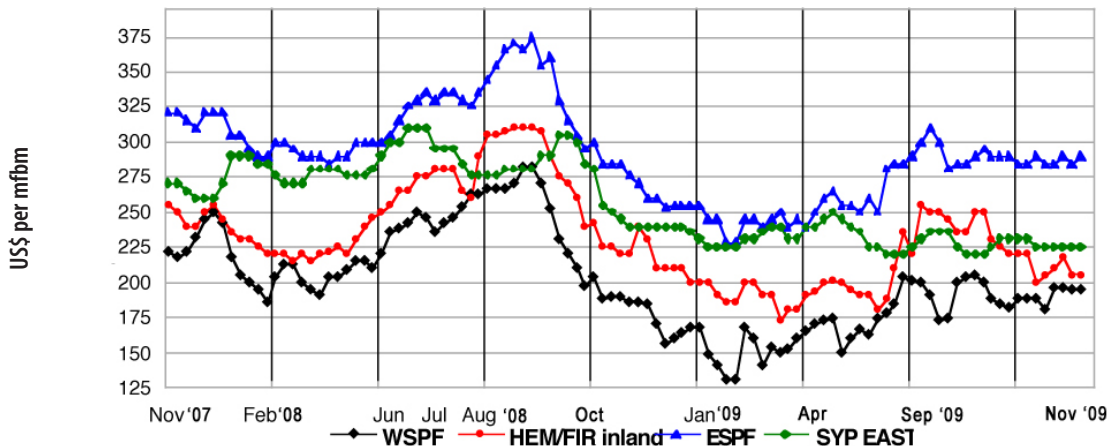
Timber Resource Perspectives

At the 6th Timberland Investment World Summit in New York city last week *Madison's* learned about all kinds of exciting developments, discoveries and updates for the forest products sector.

Speakers from Credit Suisse, Potlatch, and Timberland Investment Resources gave presentations about the relationship between lumber prices and timberland values, the future of housing construction in the US and developing regions, and expected demand for wood products globally into 2015.

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KEY 2x4 PRICES November 2007 - November 2009



Prices are in U.S. dollars per 1,000 fbm.

Key Prices

| | This Week | Last Week | Change | Month Ago | Change | Year Ago | Change |
|----------------------------|-----------|-----------|--------|-----------|--------|----------|--------|
| WSPF KD R/L 2x4 | 194 | 195 | -1 | 180 | +14 | 189 | +5 |
| WSPF KD R/L 2x6 | 194 | 193 | +1 | 190 | +4 | 180 | +14 |
| WSPF KD R/L 2x8 | 219 | 210 | +9 | 215 | +4 | 207 | +12 |
| WSPF KD R/L 2x10 | 310 | 300 | +10 | 315 | -5 | 216 | +94 |
| WSPF KD PET 2x4 Stud | 195 | 190 | +5 | 190 | +5 | 180 | +15 |
| Douglas Fir Green R/L 2x4 | 170 | 163 | +7 | 155 | +15 | 172 | -2 |
| Douglas Fir Green R/L 2x10 | 245 | 240 | +5 | 210 | +35 | 230 | +15 |
| ESPF KD 2x4 8ft Stud | 285 | 285 | 0 | 275 | +10 | 255 | +30 |
| OSB Ontario 7/16" (CDN\$) | 185 | 185 | 0 | 185 | 0 | 220 | -35 |

Madison's Lumber RETROspective
60 years of lumber history over 60 issues! Check out additional pages in your Reporter

Weekly News

US Economy

CONTINUED A trio of economic reports this week showed the US economy continues to rebuild itself. The US manufacturing sector has now grown for three consecutive months, according to the Institute for Supply Management.

The US manufacturing sector grew in October at a faster rate than was expected, with a reading of 55.7, the highest since 56.0 in April 2006.

US construction spending made its largest gain in a year in September, with the biggest increase in private residential building in more than six years.

The US National Association of Realtors said Monday the number of contracts to buy previously owned homes in the US rose in September for an eighth straight month as home buyers worried that the home buyer tax credit would not be renewed.

The index of signed purchase agreements, or pending home sales, rose 6.1 per cent after a 6.4 per cent gain in August.

Wood Chip Supply

CONTINUED Wood fibre supply to Canadian pulp mills has shifted from lower-cost residual chips from local sawmills to higher-cost wood chips manufactured from roundwood, according to the North American Wood Fiber Review. The low operating rates for many sawmills has decreased the availability of relatively inexpensive residual chips.

With the US lumber market predicted to improve in the latter half of 2010, Canadian sawmills are likely to be running

at higher operating rates a year from now.

Because lumber production has declined by about 50 per cent over the past three years but pulp production has only fallen by 25 per cent, many pulp mills throughout the country have increasingly had to rely on more expensive chips manufactured from roundwood.

Many Canadian paper companies sell their products into the US market, therefore are competing with the US domestic pulp and paper manufacturers. Pulp mills in Eastern Canada have been at a big disadvantage the past few years, partly due to substantially higher wood fibre costs. In 3Q 2009, pulp mills in Eastern Canada had approximately 70 per cent higher conifer fibre costs than the US South. As a result, many pulp and paper mills in Ontario, Quebec and the Maritime Provinces have been forced to reduce production more than other regions of North America the past 12 months.

Mackenzie Pulp Mill Offer

The Mackenzie Pulp Mill Development Corp, a newly-formed company which includes local investors, announced Tuesday it has reached a six-month agreement with Worthington Mackenzie Ltd. that allows it to take possession of the Mackenzie pulp mill. The company also has an exclusive option to purchase, but stresses it will not be operating the mill. The development corporation says its key focus is to protect the pulp mill's assets and infrastructure during the winter by keeping critical equipment warm.

The four investors are: Fort St. James-based K&D Logging, the McLeod Lake Indian Band-owned Duz Cho Logging, Vancouver Island-based Interior Fibre Management, and Tanner Elton & Associates (Elton is former Director of the BC Forest Safety Council).

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Timberland and Wood Products Perspectives and Expectations

At the 6th Timberland Investment Conference in New York City, several presenters spoke about the relationship between timberland value and lumber prices. In the same way that the lumber market can impact prices further down the value chain for such products as market pulp, and to a lesser extent paper, solid wood prices have an effect on timber value, and thus on timberland as an investment.

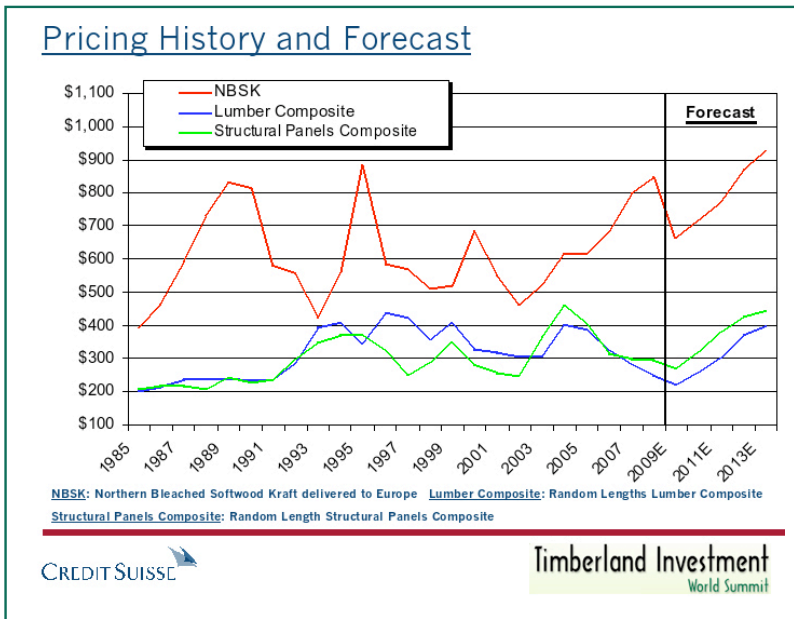
by Kéta Kosman

Chip Dillon, Managing Director of Credit Suisse, explained the discrepancy between lumber prices and timberland value. Tom Temple, VP of Wood Products at Potlach, and Chung Hong Fu, Economic Research Analyst with Timberland Investment Resources, discussed perspectives on the changing global market for wood products.

Focussing mostly on US timberland, Credit Suisse's Dillon noted that of the 2.3 million acres (1 million hectares) total US land mass, 29 per cent (or 651 million acres) is comprised of forests. In addition, 26 per cent is pasture or range land, 20 per cent is crop land, and 13 per cent is wildlife or parkland. In terms of ownership, 37 per cent of US timberland is federally owned, and 55 per cent owned by private investors, with the rest held by state governments. Of the private timberland, the vast majority, 99.8 per cent, of owners hold less than 1,000 acres. A closer examination shows that just over 23,000 owners hold timberlands larger than 1,000 acres. This group would include Real Estate Investment Trusts and other investment vehicles such as the Harvard Endowment Fund.

Dillon's research found that, while timber values have been dropping in recent years due to reduced sawlog costs, the land values have remained the same. A big question mark for the future, said Dillon, is a projected reduction in North American timber supply once British Columbia's beetle kill salvage has run its course. Based on hard data and this type of analysis, Dillon expects the composite lumber price to approach US\$300 mfbm by the end of 2010. See graph on this page.

Potlach's Temple started his talk with a look at US home building. Due to demographics, specifically the children of baby boomers who are approaching their mid-20's and will soon be forming households



of their own, and an upside from increasing immigration numbers, Temple sees a reversal to the past few years of dropping US housing starts coming. He estimates between 1.5 to 1.8 million annualized monthly starts in the near future. However he pointed out, as other home building watchers have been saying, that the size of these new homes will likely be smaller, by an average of 100 square feet, than the luxury homes of the early 2000's.

When this happens, said Temple, demand will stress the mills due to low inventories. The industry has been operating at below cash costs, therefore needs to equalize before there will be any significant increase in production.

Madison's posed the question of less expensive finishing materials, such as plastic windows, which many analysts have been mentioning in addition to smaller home sizes. Temple side-stepped this question by saying he is "not in the window business." Regardless of who makes the alternative products, there is agreement within much of the industry that such cost-cutting measures in US home building will occur, at least at the outset.

In terms of the market for forest products in China, Temple maintained that, based on current demand, that market is mostly for makers in Western Canada. So far Chinese buyers have been looking for low grades almost exclusively, orders that BC's beetle kill is perfectly suited to serve. Temple quoted a statement by BC's Minister of Forests that to 2Q 2009 BC shipped 1.5 billion board feet to China, and that number for 2010 is expected to be 4 billion.

The obvious question is what will happen to Chinese demand when North American lumber prices firm next spring? Expectations are that Chinese demand for pulp would drop off when the price of that commodity rose, however such a drop has not yet happened.

Chung Hong Fu of Timberland approached the question of solid wood products market from a global perspective, with a look strictly at the financial situation. In the short term, said Fu, lumber is experiencing a market cycle, however some structural changes are coming. In the long term Fu predicts a homogenization of wood products. Consumer demands are already changing, and there will be less differentiation on how a product is made, regardless of end use. Fu used the example of US furniture makers. Both domestic sales and exports have dropped because consumers are no longer willing to pay a premium for domestic products. Fu sees an increase in demand for composite and engineered products, particularly in the panel market, and an increase in glulam use in North America.

In the end, said Fu, solid wood products in the developed world are on a very different market path from that of the emerging world.

It is clear from these conference presentations that, while all agree that the worst is over and recovery is on the way, there is also consensus that the lumber and panel market will be different than what the industry had become used to. Adjustments will have to be made, to production, to products, and to the varying demands of different markets.