MADISON'S TIMBER PREVIEW

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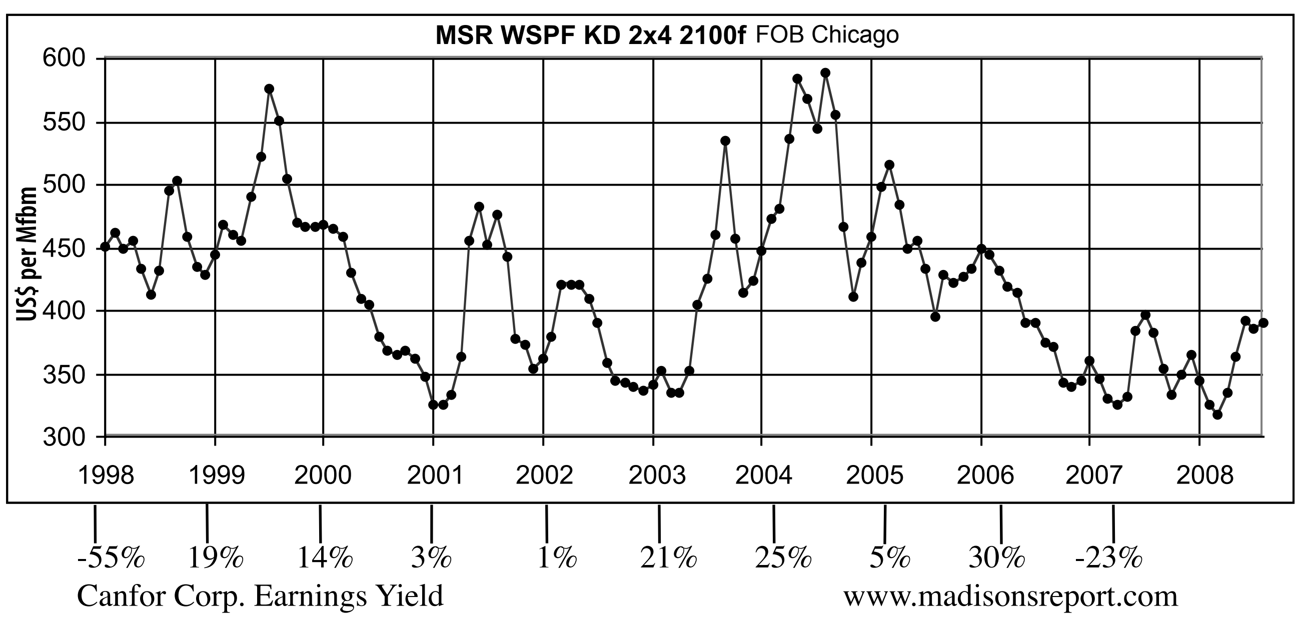
September 04, 2008

A very important component of the secondary, or value-added, wood products industry is lumber remanufacturing. Producing specialty and commodity products, remanufacturers source fibre from primary mill outputs, such as lumber or cut blocks. Remanufacturers provide a wide variety of services, from finishing primary mill products to trimming and grooving, as well as making use of mill residuals to produce, for example, fingerjoint studs and lumber. Beams, moulding, decking, flooring, panelling, trim, furring strips and fascia are just a few of the commodity items produced at remanufacturing plants. Specialty items, including stress grade, select, shop and timbers make up a smaller portion of the lumber remanufacturing industry.

While lagging behind Ontario and Quebec in secondary manufacturing, British Columbia is by far the largest forestry region in Canada, with 40 per cent of Canada's total harvest and 44 per cent of solid wood exports. The province's lumber remanufacturing sector is divided into three regions: the Northern Interior, with a stable fibre base closely linked to primary mills; the Coast, with high-value fibre and close proximity to US customers; and the Southern Interior, with a mix of northern and coastal elements. The main types of fibre consumed by secondary manufacturers in BC is divided almost equally, with 45 per cent coming from lumber and timbers, 32 per cent from raw logs and 23 per cent from trim blocks.

Benchmark Machine Stress Rated WSPF 2x4 2100f 1998-2008



Canadian secondary wood products manufacturers were thrown into a state of confusion after the signing of the Softwood Lumber Agreement of 2006. Prior to that, remanufacturers selling into the US were exempt from the softwood lumber duty; but after the 2006 Agreement was signed a complicated process of calculating duty rates was initiated. Two options were available, with almost all secondary exporters avoiding "Option B" (export quota with lower tax rate) in favour of the "First Mill" provision (export tax with surge penalty). Significant restructuring, and changes to company business models ensued after the 2006 Agreement took effect, with lumber remanufacturing CEO's almost unanimously calling for significant changes to the Agreement terms.

One of the major complications of the 2006 Agreement to doing business as a Canadian lumber remanufacturer was the method of calculating the "First Mill" provision (the choice preferred by 70 per cent of secondary manufacturers, according to the BC Ministry of Forests). In order to take advantage of no export charge on value-added components, producers must not own tenures nor even be associated with tenure holders. There is a cap of $500/mfbm on the export price for secondary manufacturers that meet the criteria. This change to the previous business model created a situation in which 71 per cent of fibre was sourced from primary mills at full market value, which made it economically difficult to recover costs related to 'fall down' (wood waste, or by-products).

By annual production amounts, the single largest secondary wood products manufacturer in western Canada is Canadian Forest Products. Canfor has two reman plants in BC and one in Washington state. Its BC mills together exported an estimated 415 million board feet of various remanufactured wood products in 2006. Started in 1938 as Pacific Veneer, a furniture panelling and veneer producer, the company changed its name after acquiring Canadian Forest Products Limited in 1947. In 1951 Canfor first delved into the pulp industry, followed by a long string of purchases and buy-outs. The company became public in June 1983. Canfor's 1999 purchase of Northwood Inc. made it Canada's largest producer of softwood lumber and kraft market pulp.

The biggest acquisition yet came in 2004 with the purchase of Slocan Forest Products for $450 million (including $175 million of Slocan's debts). Canfor had tried but failed to take over Slocan in 1995. Slocan finished 2003 with net earnings of $27.1 million, and $0.73 earnings per share. The purchase boosted Canfor's annual production capacity to 5.2 billion board feet and annual sales to $3 billion.

In 2006 Canfor, in partnership with other players, embarked on a pellet production facility adjacent to it's Houston, BC 'super mill'. In that same year the company launched the Canfor Pulp Income Trust, transferring its pulp and paper interests to the indirectly owned limited partnership and separating its wood products business from its pulp business. Share prices were strong as the new company was bullishly traded on the stock market, becoming one of the very few forestry interests in Canada to pay a dividend in the past two years.

In that same year Canfor made the ill-fated decision to take advantage of the weak lumber market and buy three sawmills, two treating plants, and a finger joint plant from New South Companies Inc. out of South Carolina for US$205 million (including about US$55 million in working capital). Mid-2007 brought a very dramatic and high profile battle for control over the Board of Directors which ended with some resignations, a new CEO and Jimmy Pattison increasing his ownership to 30 per cent by the end of the year. Pattison's Great Pacific Industries Inc. had owned 21 per cent of Slocan.

At the beginning of 2008 the continued depressed lumber market forced Canfor to close several mills, including New Westminster, Fort Nelson (two panel mills) and Chetwynd, all in BC, and to curtail many other operations. Canfor decided not to rebuild its North Central Plywood plant in Prince George, BC, destroyed by a major fire during the summer of 2008, due to a continued weak panel market. The facility had been breaking even before the fire.

The closure and curtailment decisions together cut company losses in half in the 2Q 2008, to $20 million.

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