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There is much disagreement and discussion across Canada about how to restart the faltering forest products industry. Some want an outright bailout, while most prefer a combination of funding for research and development, tax credits, and an extension of employment benefits for workers. Others, however, have already embarked on a journey of discovery, making new products to fit a growing market niche, and finding customers in emerging markets internationally. This last group is made up mostly of smaller, independent mills - although some of the big lumber companies have implemented innovative changes at particular mill sites - which are better able to maneuver quickly in response to changes to the market environment.

One company that has seen significant changes in the past five years, for better or for worse, is Western Forest Products. (Refer to the August 07, 2008 issue of Madison's Timber Preview for an examination of the coastal forest products industry.) One short decade ago Doman Industries Inc. was the largest forestry employer on Vancouver Island, with nine mills on the British Columbia coast. In early January 2009 Western Forest Products announced an extended closure of all but its two Port Alberni sawmills, including logging in the Queen Charlottes and the Lower Mainland, adding 720 to the 2,000 workers already laid off by mid-2008. In addition 1,320 logging and sawmilling staff are curtailed indefinitely.

**Western Forest Products Stock Prices 2004 - 2008**

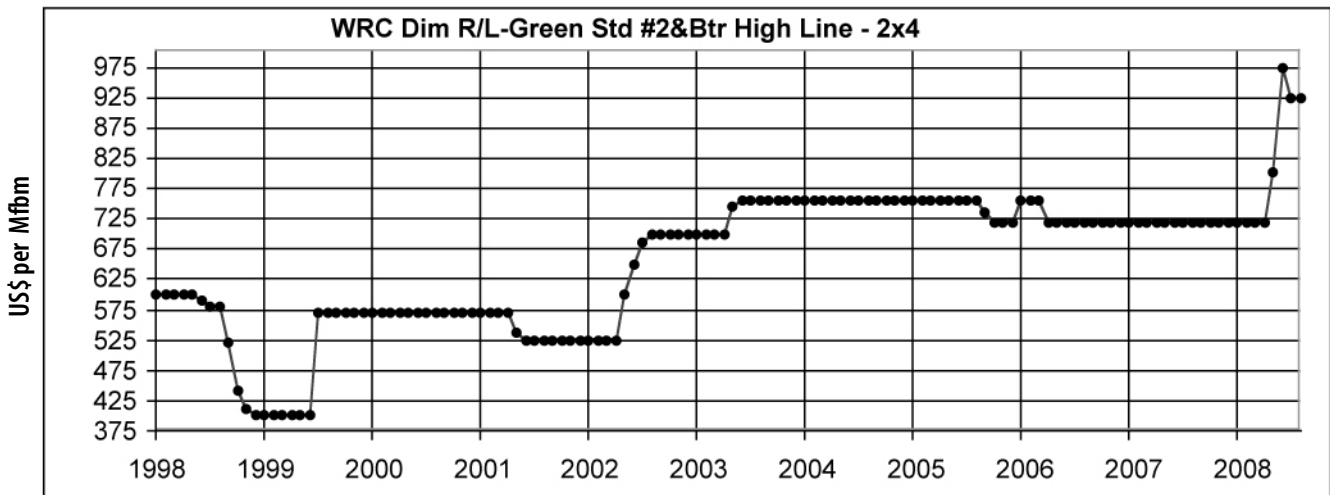


SOURCE: Google Finance

The company's gloomy financial picture started long before the bankruptcy of Doman Industries Inc. in 2004 that created the Western Forest Products we know today. Founder Herb Doman's ongoing policy of expansion finally came to a halt when he could no longer secure increased financing to maintain operations. Aging mills, a degradation of quality for Doman's integral green Douglas Fir product, and a slowdown for the coastal forest products industry in general all served to continue losses for the company. Bondholders took matters into their own hands, removed the Doman family and other Directors from the Board, and eventually centered company control in the Toronto offices of Brookfield Asset Management.

Forest industry veterans generally hold the opinion that it takes a lumberman to run a lumber company. Being a financial whiz in some office downtown in a major city does not afford much insight into the complex and difficult work of making money from processing timber. Evidence of the truth of this saying is only made clearer by the mounting losses posted by Western Forest Products since the bondholder takeover. Another Canadian family-built and owned wood products company to be recently taken over by bondholders, Ainsworth Lumber Co., a major panel producer, has also shown shocking losses since family members were removed from the Board of Directors. Tricap Partners Ltd. took control of Ainsworth in mid-2008, only to watch company share values decrease markedly since.

## Benchmark green Western Red Cedar 2x4 #2&Btr Price 1998 - 2008



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These examples beg the question: is a good understanding of business generally transferrable to the lumber industry in particular? There are more than a few lumber producers in the United States as well that have suffered a similar fate; family run companies that are now in the hands of asset management companies and are faring no better than they did before. Often they are doing worse, with mill and operations closures coming almost faster than the media can keep up with.

The game of Cedar production, for example, has changed dramatically in the past 15 years. Where there used to be a significant number of small and medium sized producers, there are now only two or three major players who hold market share to the degree that they alone set the commodity price. Cedar prices generally have traditionally been quite stable, with a certain level of seasonal shift during peak harvest and sale time (spring and early summer). As can be seen by the graph above, there has been a stable increase in benchmark green 2x4 cedar prices. Normally this would be very good news, except that sales volumes have declined markedly in the past five years. As a specialty product, cedar is most in demand when home building and renovating activity is at its highest.

Western Forest Products is now caught in a terrible position, some of its own creation but much simply due to drastic changes in the lumber industry over a very short time. Many market analysts, including we at Madison's, see a difficult long term future for the company. Expectations are that, unless there is a dramatic upturn in forestry over the next two or three quarters, Western Forest Products will need to completely reorganize or fold completely. Like the bankrupt Pope & Talbot before it, company operations will be sold off individually at greatly discounted prices. Since predictions for the wood products industry this year do not indicate a revival, in fact point to continued hardship, it seems likely Western Forest Products will not be with us much longer.

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