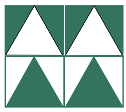

MADISON'S TIMBER PREVIEW

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February 13, 2009

The current financial difficulties of forestry companies are now well known, even outside the industry itself. Historically closely tied to the US housing market, forestry company stocks are generally valued by investors as reasonably stable with predictable returns as they follow US home building cycles. In Canada it is the cash price of whatever wood, pulp or paper products the company produces that determines its level of fiscal success, while in the US real estate values of timberlands add juicy heft to company valuations.

This has been true until recently, when so many external factors have come to play, from global financial markets to local sales volumes and everything in between, that even the most experienced stock market analyst is having difficulty making predictions. Everyone is watching the main players for an indication of future market directions.

One of these players is BC's Jim Pattison, a major stock holder in Canfor Corp. and Canfor Income Pulp Trust. Brookfield Asset Management, out of Toronto, have also made major moves in lumber industry investment in the past few years, buying into Western Forest Products and Ainsworth Lumber. Another major player is Prem Watsa, head of Toronto's Fairfax Financial Holdings Ltd. In fact, Fairfax's having added another $80 million to the coffers of troubled AbitibiBowater this week has speculators and professionals alike rushing to find out what genius, or lunacy, might be the reason for this seemingly risky venture. (Please refer to your Dec. 12, 2008 issue of *Madison's Timber Preview* for a company history of AbitibiBowater).

After decades of growth as the individual Abitibi-Consolidated and Bowater Inc., the 2007 merger to create the giant AbitibiBowater has since been widely cited as "too big, too late", with credit problems surfacing almost immediately. The first was a US$1.4-billion debt refinancing package that was finalized just before the repayment deadline of April 1, 2008. This debt was lingering from a $5.8-billion deal for Montreal's Donohue Inc. completed in 2000 by Abitibi-Consolidated. That buy out had lowered the company's stock value significantly, and it did not then begin to recover until the 2007 merger with Bowater Inc.

At the end of March 2008, Fairfax bought $350-million in a convertible debenture from AbitibiBowater. That made it possible for the company to redeem a $196-million note due on April 2, 2008 and another $150-million in debt due in June. It was likely the terms of the initial debt refinancing package that lead Fairfax to invest further in AbitibiBowater this week; the unregistered convertible debenture, at an 8 per cent interest rate, could be converted to common shares at $10 per share.

Despite steadily falling newsprint demand, the move seemed to make sense in the face of newsprint prices that were up US$25 per metric ton in 2007, due mostly to global production curtailments. After the March 2008 cash infusion, company stock prices rebounded by almost $5.50 (an over 30 per cent gain) in the two weeks following Fairfax's involvement, but by October 10, 2008 gains were trimmed down to US$1.50. With the benefit of hindsight we now know that newsprint prices continued to rise through much of 2008 as production was curtailed further, but the scale of the global economic downturn has been too great to sustain the rise. Newsprint demand is not expected to return to former levels into the end of 2010 at the soonest.

However an indication that perhaps Prem Watsa and Fairfax do indeed know something that the rest of us are missing came on Monday, with the announcement that Seattle-based Steelhead Partners LLC now holds 14.8 per cent of Abitibi's shares. Steelhead acquired its first 5 per cent of Abitibi's shares in July, 2008, then another 5 per cent in early January. In an echo of the Fairfax deal, AbitibiBowater has been scrambling to refinance or repay more than US$700 million in interest due this year.

The total debt being carried by AbitibiBowater currently stands at over $6 billion. The company has not paid the interest owed from the March 2008 deal in cash, but by issuing additional debt to Fairfax, with an effective interest rate of 18.5 per cent. At best it seems that Fairfax, and now Steelhead, are hedg-

ing bets that newsprint market conditions will improve sooner rather than later and that AbitibiBowater will restructure to become increasingly competitive. At worst it seems that the punishing interest rates will yield generous revenue to the lenders.

With $1.8 billion of debt maturing soon, the company is indeed planning to restructure, swapping $555 million in unsecured debt on the balance sheet of the Bowater operating unit - a part of the company that actually makes a profit - for new secured debt paying higher interest. What is puzzling is that AbitibiBowater is still facing a March deadline to repay a $347 million loan at its Abitibi-Consolidated unit. Add to that $272 million maturing in July, about $248 million of debentures due on August 1, and another $234 million of securities that mature in March 2010.

For each $1,000 principal amount of Existing Notes validly tendered (and not validly withdrawn) and accepted for exchange and for which the holder elects to subscribe for First Lien Notes in the Concurrent Notes Offering (a "Subscribing Tender"), such holder will receive the principal amount and form of Exchange Notes shown in the table below:

SUBSCRIBING TENDERS

EXISTING NOTES TENDERED	PRINCIPAL AMOUNT OF EXCHANGE NOTES	FORM OF EXCHANGE NOTES(1)
[illegible] NOTES	[illegible]	SECOND LIEN NOTES
[illegible] NOTES	[illegible]	THIRD LIEN NOTES
2011 NOTES	[illegible]	THIRD LIEN NOTES
2012 NOTES	[illegible]	THIRD LIEN NOTES
2013 NOTES	[illegible]	THIRD LIEN NOTES
2021 NOTES	[illegible]	THIRD LIEN NOTES

(1) Not including First Lien Notes subscribed for in Concurrent Notes Offering.

SOURCE: Canada News Wire www.madisonsreport.com

New subsidiary Bowater Finance II LLC, is offering to swap securities maturing from 2009 to 2021, at a discount, for new 10 per cent second-lien notes and 10.5 per cent third-lien notes due in 2012. The company is also trying to raise $211 million through a sale of new 15.5 per cent first-lien notes due in 2011.
In addition to merely fighting to reduce its debt payments, AbitibiBowater is negotiating the controversial sale of its hydro assets. The asset sale could contribute an estimated $200 million to the company's bottom line at a crucial time.

Meanwhile in a frightening parallel to US bank executive bonuses, former Abitibi Bowater CEO John Weaver's base salary for 2007 was $1.3 million plus incentives and bonuses for a total of $3.6 million. His pension was valued at $6.8 million, and his severance was pegged at just over $8 million. Weaver announced his retirement in June 2008, but remains as a board member until the end of the fiscal year this March. As senior vice president, Thor Thorsteinson's total compensation for 2007 was about $1.2 million, including base pay and incentives. His pension funds were worth about $3.4 million, while his severance package was estimated to be worth $2.3 million.

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