



February 27, 2009

In this climate of financial crisis for North American forestry companies, abysmal 4Q results released by both West Fraser and Canfor - Canada's largest and second largest lumber producers respectively - sent out alarm signals. The lumber industry and investment groups are all taking notice of the bad news, particularly since both companies financial statements declared that 1Q 2009 was going to show even more losses.

Major closures and curtailments at both sawmill and pulp mill operations were immediately announced by both companies, along with an explanation that yet more closures could come depending on market conditions. Given that the main customer for Canadian dimension lumber, US home builders, have reduced building activity to record low numbers - a situation which will continue through this next building season - it is curious that lumber producers waiting so long to curtail.

West Fraser lost \$69.5 million or \$1.63 per share in 4Q 2008, compared with a loss of \$2.9 million or seven cents per share a year ago. Sales in the quarter totalled \$745.6 million, down from \$782.2 million. Meanwhile, Canfor Corp. reported a loss of \$229.8 million or \$1.61 per share in 4Q 2008, compared with a loss of \$237 million or \$1.66 per share a year ago. Sales in the quarter totalled \$588.7 million, down from \$711 million. Both took millions in charges related to the economic downturn.

Canfor's lumber segment lost \$50.8 million on 791.6 mfbm SPF production in 4Q 2008, while West Fraser lost \$86 million on 794 mfbm SPF production for the same period. Currently lumber prices are as much as \$50 lower than the average recorded for each respective dimension in 2008. It seems obvious that production levels needed to be drastically cut by mills sooner. For how long can a sawmill lose \$3 million a month? It's not a matter of having the benefit of hindsight; the evidence was readily available in 2Q 2007 that US home building was in trouble and lumber demand would drop off dramatically.

So why didn't the sawmills curtail sooner? Because they each wanted to outlast their competition; they wanted to keep running longer and grab all the customers once their competition had to close. Not only that but they wanted to buy out their competition. Lumber company management, both on the coast and in the BC interior, were operating with this mentality but they all got caught in the same net in the end. These closures are coming much later than they should have, because now the market is stuck with an untenably low lumber price, of approximately \$70 below production for benchmark WSPF 2x4s.

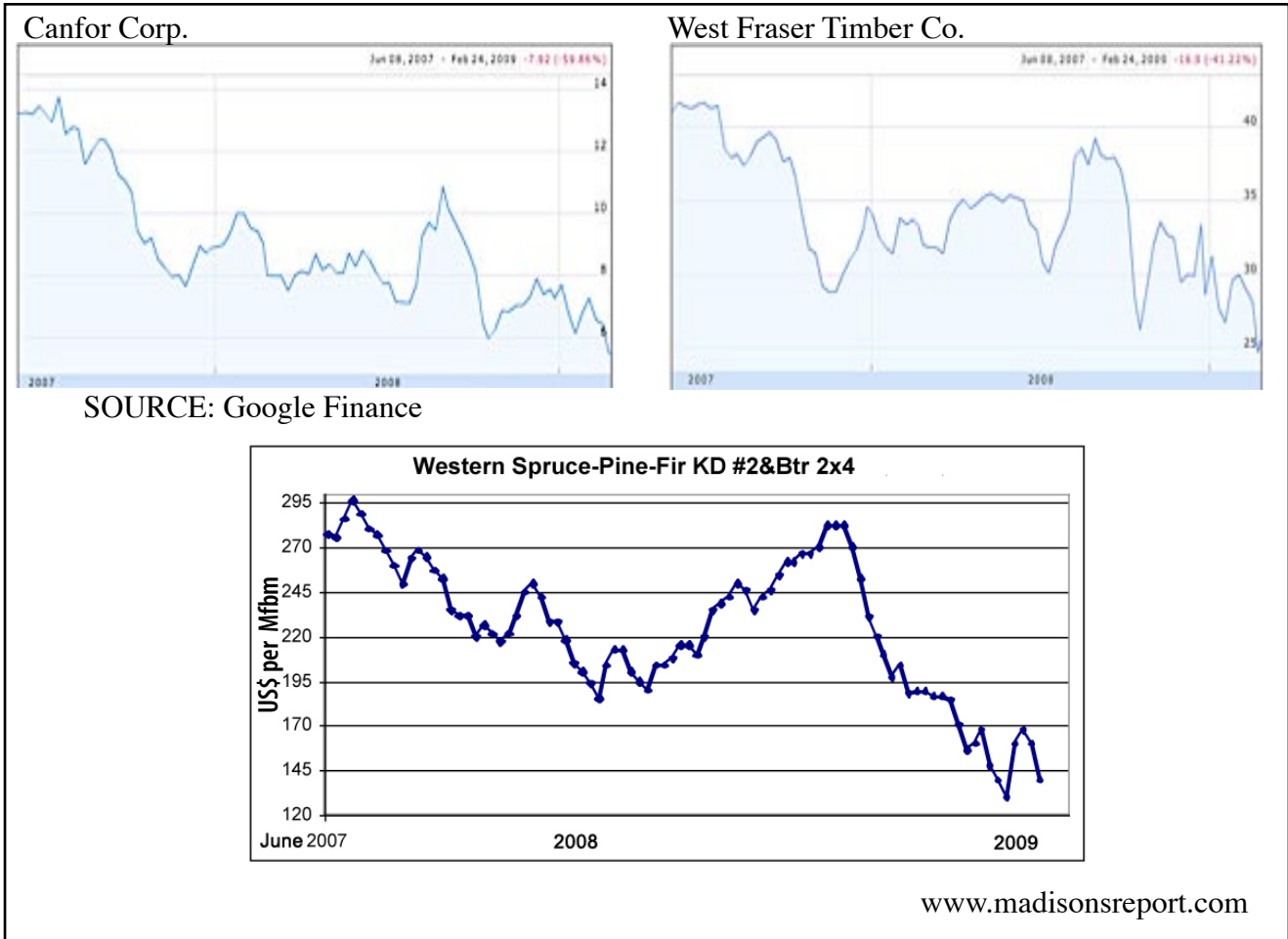
So far, the companies say, lumber prices keep falling along with demand and the trend is expected to continue for the foreseeable future. Canfor president and chief executive Jim Shepard told a conference call. "The truth is that the US housing market drives our business and as long as housing starts remain at record lows in the United states the forest industry will struggle."

"Lumber prices are at unsustainable levels and we believe that, in the absence of demand improvement, more production must come out before prices will stabilize at more normalized levels," West Fraser's chairman, president and CEO Hank Ketcham said on a conference call. Ketcham said West Fraser suffered its "worst financial loss in its history" in 2008 as a result of the US housing collapse and a drop later in the year of global pulp markets. "We don't see any meaningful recovery over the next few months," he added.

Over the past 18 months, Canfor has reduced its logging and hauling costs, increased productivity despite curtailments, disposed of non-core assets and enacted salary rollbacks and staff reductions. In addition, Canfor cut production by about 258 million board feet at sawmills in BC and Alberta, and a third shift has been removed at its Quesnel operation. Shifts also will be reduced at New South's Camden sawmill in South Carolina, the company said. West Fraser cut production at five BC sawmills by about 446 million board feet this year. In all, the company has curtailed about 30 per cent of its annual production capacity of 6 billion board feet.

In terms of pulp the situation is similar, except the drop in price lagged behind that of lumber. Pulp mills did not see the distressing need to close immediately until after December 2008 inventory numbers came in. Like the overall economic downturn trailed an oversupply of housing, the eventual upswing in pulp prices will lag behind the recovery of lumber, indeed will likely take somewhat longer due to reduced revenues for publishers of all kinds. Until paper demand picks up, pulp mills will remain on indefinite closures. Longer in fact, because global pulp inventories currently stand at record high levels.

The pending BC government reduction of the Annual Allowable Cut is going to impact these large lumber producers severely. When stumpage in the BC interior was reduced to \$0.25 for salvage quality logs, companies cut down



healthy trees along with the beetle infested to take advantage of the reduced stumpage rate on the whole lot. Had forest operators taken the time and effort to let the good trees stand, they would have harvested more of the dead beetle wood as well and slowed their lumber production somewhat. The pockets of trees that escaped the infestation would have been left to grow and only increase in value. However companies that raced out to the forest to cash in on the reduced stumpage fees are now left in the position of having the government dictate reduced harvesting when the Chief Forester's report is released in spring 2009.

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