MADISON'S TIMBER PREVIEW

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The recent trend of hedge funds and investments firms buying up significant assets in beleaguered North American forest products companies has taken Ainsworth Lumber Inc. by storm. Officially acquired by bondholders on July 29, 2008, Ainsworth embarked on a major restructuring plan in February 2008 by issuing an offer to exchange most of its $823.5 million unsecured debt for secured notes paying 14 per cent. (Refer to your July 24, 2008 issue of *Madison's Timber Preview* for background information on Ainsworth). In exchange, investors received warrants to purchase up to 35 per cent of the company's stock at one cent a share.

Tricap Partners Ltd., having already acquired Ainsworth debt which it converted to 24 per cent ownership in 2006, swooped in to protect its investment. On June 17, 2008 Tricap was one of three main noteholders to backstop the debt restructuring. The other two were HBK Master Fund, and Barclays Bank. Together the three companies owned 96 per cent of company stock. Determining further need to protect its investment, Tricap went on to purchase almost 30 million Common Shares, representing approximately 30 per cent of Ainsworth, at a price of $1.75 per share on November 06, 2008.

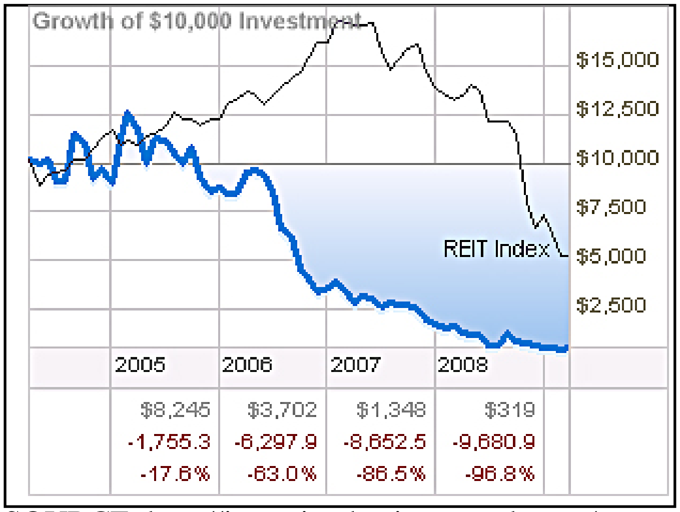
As puzzling as such a move might be to some analysts, to others it just means that Tricap recognizes a company in trouble, and with undervalued assets. In addition, Tricap is no stranger to making such moves in the lumber industry, having, in 2004, acquired a 20 per cent ownership interest through its debt position in Doman Industries, later to become Western Forest Products. Tricap now owns 70 per cent of Western. Both family built and owned companies, neither Ainsworth nor Western have any family members represented on the board of directors at present. Some of Tricap's activities in the past after acquiring debt-laden companies hit by a market downturn are enough to send a chilly message.

A division of Toronto's Brookfield Asset Management Inc., Tricap's $1.4 billion in assets under management represents a small fraction of Brookfield's total of $90 billion. Tricap profits by charging extremely high interest on debt relief to companies in need of major restructuring. If the company is unable to pay back their debt, Tricap sponsors a recapitalization plan to convert the debt to ownership stakes (equity) - literally purchasing companies at bargain basement prices. Either way Tricap wins, it either earns the high interest in the agreed-upon time frame, or it owns the company and has only to maintain minimal operations while waiting for market conditions to improve.
When Tricap took over Western, company shares were trading at $10 per share but are now down to a dismal 51¢. Western continues to bleed money, in 3Q 2008 losing $19.3 million. In early November, the company's chief executive and president Reynold Hert stepped down from his post. Also in November, Birch Mountain Resources Ltd., a limestone and gravel company that services the oilsands in Alberta, saw its stock plunge 73 per cent and became unable to repay a major loan to its senior lender. After lending Birch Mountain $31.5 million in December 2007, Tricap ran out of patience. Birch Mountain had been in default since July, and despite some loan extensions company management failed in its goal of finding a suitable buyer. The company is now likely to be liquidated and its shareholders' stakes obliterated. The only winner is Tricap, which in addition to its lending fees, hopes to recoup its initial investment, and more, by selling the company or its assets.

Will Tricap pull the same stunt with Ainsworth, or Western? If they can not repay debt in a reasonable time period then the answer appears to be yes. There is hope yet for Ainsworth, which on March 3, 2009 announced a net loss in 4Q 2008 of $80 million on sales of $90.4 million compared to net loss of $80.5 million on sales of $88.6 million for the same period in 2007. 2008 year end losses were $234 million, a $202 million increase in losses from 2007. Company shares were trading at 75¢ at the time of the financial results announcement, about the same as one year earlier.

Ainsworth's main product, oriented strand board, enjoyed a bit of a run of stable prices towards the end of 2008. After a terrible year seeing a low of C$145 per thousand square feet in February 2008, OSB 7/16" Ontario was selling for C$220 per msf from the beginning of November through mid-February 2009. With a slight waver of C$15 per msf in recent weeks, it would seem that some vestige of stability has been found in the balance of supply and demand

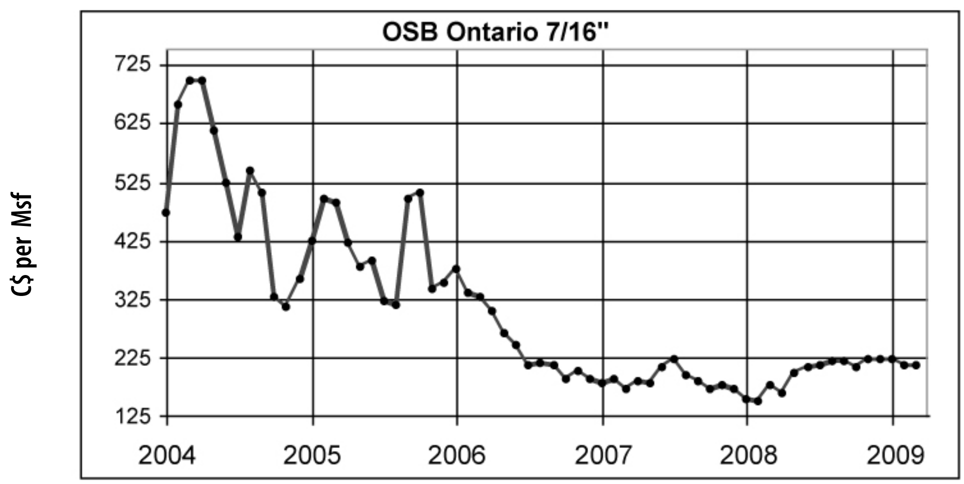
Ainsworth Stock vs. REIT Index



SOURCE: http://investing.businessweek.com/

for OSB. Unlike dimension lumber, with too many producers to count, OSB is a bit of a specialty product with fewer producers who are better able to establish a price floor. Levelling off at C$220 per msf is not exactly encouraging, considering that is very close to cost of production. OSB mills built and acquired in the past 15 years have been geared to high volume production; at this point most of them are heavily curtailed or closed indefinitely.

According to Ainsworth's 2008 annual report, OSB shipments of 378, 000 msf in the fourth quarter of 2008 were not significantly different than in the same period of 2007. For the year, OSB shipments were 17 per cent lower in 2008 compared to 2007. Until North American market conditions improve, the company has frozen all discretionary capital expenditures. It appears that Ainsworth will run "on hold" until demand for wood products from the US shows signs of returning. Even the company annual report states that is not expected to happen in 2009.



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The next move for Tricap in terms of the panel producing sector will likely be a merger between Norbord Inc. and Ainsworth. Brookfield holds approximately 325 million, or 75 per cent, of the total number of Norbord's common shares issued and outstanding after investing $144 million on January 6, 2009. The purchase effectively doubled Brookfield's previous stake in Norbord. The asset management company will probably have to consolidate operations between the two companies in order to keep costs down during this extended downturn in the US home building market.

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