MADISON'S TIMBER PREVIEW

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The world of softwood kraft pulp has changed dramatically in the past two years. Previously strictly regional, market pulp expanded to become a global product over a decade ago. New technologies, emerging markets and extremely competitive countries in the southern hemisphere with fast-growing trees have all served to squeeze out high cost, outdated North American pulp mills. The advantage of good quality long fibre softwood pulp has diminished with the development of technology that requires only a small percentage of northern bleached softwood kraft combined with recycled fibres and eucalyptus pulp to make acceptable strength paper products. In addition the customer base is changing drastically, with China looking to become a global leader in softwood pulp consumption.

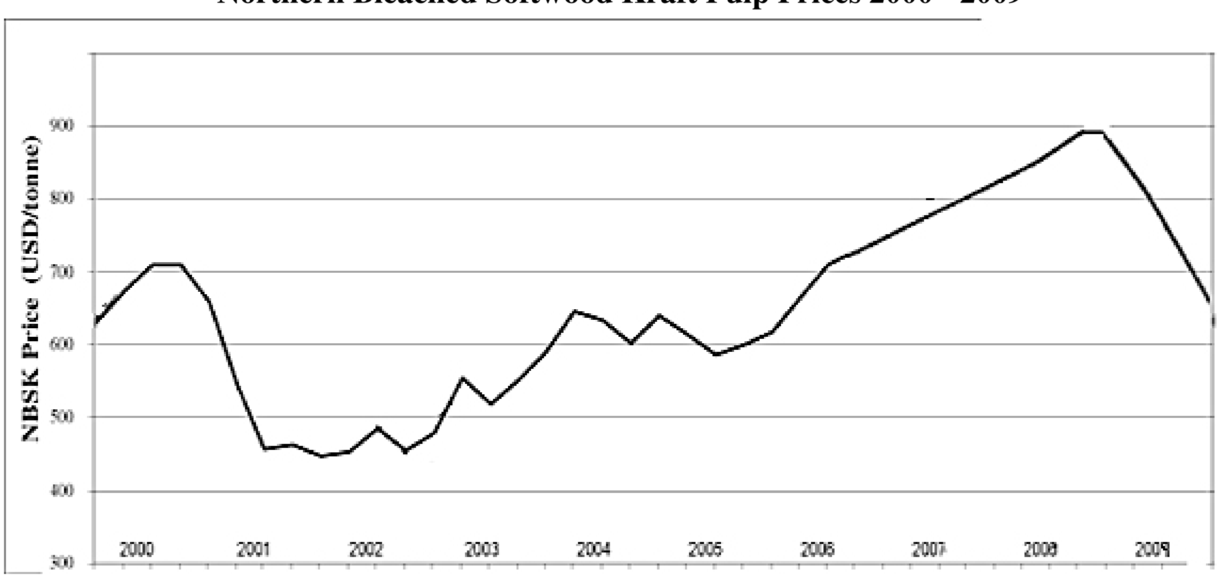
In 2005, 93 per cent of the world's market pulp deliveries consisted of chemical pulp, and the remaining 7 per cent was high yield, or semi-chemical, pulp. In 2005, world chemical market pulp capacity grew by over 1.8 million metric tonnes, or 3.7 per cent. Most of the growth was in bleached softwood due to definitional changes in North America, capacity ramping up in Germany, and grade switching at some US mills. Overall, bleached softwood capacity increased by close to 1.1 million metric tonnes or 5.0 per cent. On the demand side, after three consecutive years of growth above trend, 2005 world demand grew by only 1.2 per cent.

Canada was the world's largest market pulp supplier in 2005, with 11.4 million metric tonnes of capacity (9.3 million metric tonnes of chemical market pulp and 2 million metric tonnes of high yield market pulp) accounting for 21 per cent of global capacity. The US was the second largest market pulp supplier in 2005, with 16.4 per cent of global market pulp capacity (8.8 million metric tonnes of chemical market pulp).

According to Global-Production.com, between 2002 and 2006 world exports of wood, pulp & paper products grew at an average annual rate of 10.6 per cent. Exports from emerging economies grew by 15.4 per cent, thus these countries increased their share of world exports from 23.7 per cent in 2002 to 28.1 per cent in 2006. Since entering the global arena as an exporter of wood products, Brazil switched its focus to primarily pulp in 2002. This tactic served the country well in surpassing other emerging economies in the global pulp market. By 2007 Brazil's pulp capacity was steadily rising, by 17 per cent from 2007 to 2008, according to the UN Food and Agricultural Organization. That agency projects that Brazil's pulp production will rise by another 16 per cent in 2010, for a total 30 per cent increase in three years. For the same time period, capacity figures for Canada and the US do not change, however rampant pulp mill closures in North America point to marked decreases in production.

Clearly the real issue is market share. Even with these aggressive emerging markets globally and the financial failures of pulp companies in North America, there is room to be profitable in the pulp and paper industry in Canada

Northern Bleached Softwood Kraft Pulp Prices 2000 - 2009



and the US. A good example of a company that, despite taking a hit to the bottom line of late, will likely start doing quite well in the not-too-distant future, is SFK Pulp Fund.

A small company compared to the giants usually examined in this report, however no less relevant, SFK Pulp operates pulp mills in Saint-Felicien, QC, Fairmont, WV, and Menominee, MI, with a total annual production capacity of 735,000 metric tonnes, and employs approximately 550 people. The Saint-Felicien mill has an annual production capacity of 375,000 metric tonnes of NBSK pulp, while the Fairmont and the Menominee mills have a combined annual production capacity of 360,000 metric tonnes of air-dried market recycled bleached kraft. The Quebec mill sells within Canada as well as exporting to the US and Europe, while the US mills serve American customers.

Currently a leading producer and marketer of premium virgin and recycled kraft pulp, the company was formed in mid-2002 in Quebec. The company strategy to stay small, lean and build an accessible customer base has served it well. SFK Pulp Fund joined the Toronto Stock Exchange on August 08, 2002 at $10.60 per share. Apart from a brief rise on October 25, 2002 to $11.21, the company stock has generally declined to date. Trading for $0.40 on April 17, 2009, SFK Pulp has been just as badly hit by declining lumber and pulp demand as everyone else. However the company is not in trouble, not on the verge of bankruptcy like many others. What has SFK Pulp done differently to make it so well positioned for the eventual market upswing?

For one, modest-sized operations and diversity in the cyclical, capital-intensive, and competitive pulp industry have all been factors. In addition, a competitive cost position, modest product and operational diversity, relatively secure fibre supply, and less aggressive financial risk profile relative to its North American peers. After an initial public offering, the company generated $444 million as one of the largest open-ended income trust funds in Canada. On August 1, 2002 SFK Pulp acquired the Saint-Felicien mill from Abitibi-Consolidated. In 2003 the company saw net sales rise to $213 million, up 40 per cent from the previous year. 2004 brought record sales, which rose to $269 million, and record production. Earnings per share for SFK Pulp stock holders were at $0.43, up from $0.07 in 2003. A 20 per cent reduction in Quebec's annual allowable harvest in 2005 brought a net loss, of $5.2 million, to the company for the first time. The company subsequently decided not to publish annual reports, making a historical assessment difficult but not impossible.

For 2006 year end, SFK Pulp posted net sales of $313 million. On October 31 of that year the company successfully completed the acquisition of two mills for $156 million from AFR Holdco Inc. The acquisition was funded through a $90 million public offering of debentures, and $255 million in fully underwritten debt financing. SFK Pulp managed to squeak out of 2006 with net earnings of $1.3 million.

In February 2007 the company obtained $6 million in interest-free financial assistance from Investissement Québec for capital upgrades to its Saint Felicien mill as support for investment in the forest industry. In the spring of 2008 SFK Pulp had its second change of President and CEO. At the beginning of 2009 the company adopted "proactive measures to face volatile market conditions" by curtailing production at the Saint Felicien mill. On April 1, 2009 that curtailment was extended.

Wise choices, cautious movement, steady growth and sharp responses to difficult market conditions have left SFK Pulp Fund well positioned to continue strong earnings when pulp prices firm up.

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