



MADISON'S TIMBER PREVIEW

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Now that the dreaded 1Q and 2Q of 2009 have passed, the questions everyone is asking are, "What is happening with the stock market?" and "What is happening with the economy?" Just as various analysts and industry watchers were incorrectly bullish in mid-2008, those same people now tend to veer in the direction of overly bearish. The economic situation in the US is somewhat more dire than in Canada, thus predictions of recovery there are more difficult to make. However, as a few seasoned analysts correctly pointed out at the beginning of this year, the Canadian economy would improve more quickly than in the US. Of course, for the wood products industry so reliant on the US for customers, the Canadian economy alone is not the issue.

With this difficult year half over, analysts are more accurately able to predict what is to come for the forest, paper and packaging industries in North America. As of Thursday, July 16, 2009 the S&P/TSX Composite gained for a third day, the longest winning streak in two weeks, as energy and gold producer stocks climbed with commodity prices. Crude oil for August delivery surged after a US government report showed a bigger-than-forecast decline in crude inventories as refineries increased operating rates. As commodity prices tend to be a leading indicator for the health of the stock market, this fresh sign of good news is welcome. The item to watch next is copper, which took a hit late last year but has been slowly climbing in price, both spot and futures. A spike in copper prices will point directly to a resurgence in US home building, as that commodity must be sourced at least three months in advance of actual construction.

The pains of the lumber market are no mystery to Madison's subscribers, indeed lumber futures have been trading at a big discount to cash only to fall even more for the July 15, 2009 session close. This caused further weakening to cash prices. All eyes are on the labour situation in BC, which is beginning to look more precipitous with each passing day.

North American NBSK pulp prices rose in July for the first time in 11 months, up US\$25/metric ton to US\$660/metric ton, driven by reduced supply from extensive downtime and closures, a weaker US dollar, decline in world pulp inventories by one day to 34 days of supply in May, and continued strong demand from China. 2Q North American reductions in pulp capacity are estimated at 1.2 million metric tons.

Spot US NBSK prices rose US\$15/metric ton to US\$510-530/metric ton. Prices continue to rise in China. Mercer Intl., West Fraser, Canfor, and Tembec have announced a US\$30/metric ton price hike on NBSK pulp for July shipments. In North America, Canfor, West Fraser, Tembec, and SFK Pulp have set July NBSK price at US\$700/metric ton, up US\$40/metric ton from the June price. In Europe, Billerud, Botnia, Mercer, Rottneros, and Sodra have set NBSK price at US\$660/metric ton, while Domtar has set a price of US\$680/metric ton.

Paper prices held firm for almost two years after lumber prices started to fall, and it is now expected a similar lag will occur once lumber prices start on their inevitable rise. List prices on coated paper fell US\$15/ton in June after falling US\$15/ton in May for No. 5, 40-lb offset rolls. PPW also revised April list prices by -US\$30/ton to reflect weakness in prices in the later half of April. Price erosion has been more dramatic in low-weight coated paper than in any other printing and writing paper grades.

Volumes appear very weak. May 2009 shipment data shows volumes were down 26 per cent compared to the same time last year, with year-to-date volumes down 36 per cent compared to 2008. Kruger recently announced indefinite closure of its Trois-Rivieres, QC, low-weight coated paper operations. Industry data is showing sharply lower printer inventories of -3.8 per cent in May 2009 compared to one month earlier, and -40 per cent in May 2009 compared to May 2008.

Newsprint prices may have reached bottom, but have shown no rebound yet. In the last three months, prices have fallen around US\$195/metric ton, or 28 per cent. Kruger, Catalyst, Tembec, and White Birch, four of the top five producers, pulled an August 1, 2009 US\$50/metric ton proposed price hike. AbitibiBowater, the No. 1 producer, failed to follow suit. Demand remains very weak.

Total North American newsprint demand fell 29 per cent in May 2009 compared to the previous month, and fell 32 per cent year-to-date compared to one year ago. Mills operated at just 67 per cent capacity in May 2009, but were at 94 per cent in May 2008 which suggests a late reaction to falling demand. At current levels, prices are well below the full cost for most mills. While producers are taking extensive downtime, the reality is that more permanent closures are inevitable. 693,000 metric tons, or 27 per cent of North American quarterly capacity, was taken offline during 2Q 2009.

In terms of containerboard, prices remained flat in June at US\$540/ton, after falling US\$70/ton since its peak last fall. Producers are showing discipline by keeping inventories increasingly lean and operating rates at historical lows, despite black liquor incentives. Export prices declined slightly (US\$0-15/ton) in June. With weak domestic volumes and a big year-to-date drop in exports, permanent mill closures appear inevitable. Box shipments in May 2009 fell a disappointing 10 per cent compared to May 2008 on a "blended" basis, in line with the year-to-date "blended" decline of 11 per cent compared to the same time period in 2008. Despite weak shipments, inventories declined dramatically in May, down 96K tons compared to April.

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