



MADISON'S TIMBER PREVIEW

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Many people are noticing, in the mysterious workings of the stock market, that there seems to be a rebound in investment in some of the North American lumber companies. A few weeks ago both Canfor and West Fraser experienced surprising increases in stock prices, even more puzzling given that both companies had just, or were just about to, release rather dismal quarterly results. Canfor's share prices have risen from a quarterly low of \$4.58 on July 15, 2009 to \$6.05 currently. This despite the company's July 30 announcement showing lower profit in 2Q 2009. In fact profits were down a full \$0.38 per share, to \$0.07 per share. The 2Q results were, however, a marked improvement over 1Q 2009. Similarly, West Fraser shares have gone from a quarterly low of \$20.26 on July 13, 2009 to \$29.48 currently. That company's 2Q results, released July 21, showed a large jump in losses compared to one year earlier. West Fraser quickly responded to the losses by announcing another round of mill curtailments.

The jump in share prices was such a surprise to everyone that Reuters did a story on it. (link <http://ca.reuters.com/article/businessNews/idCATRE56J4DM20090720>)

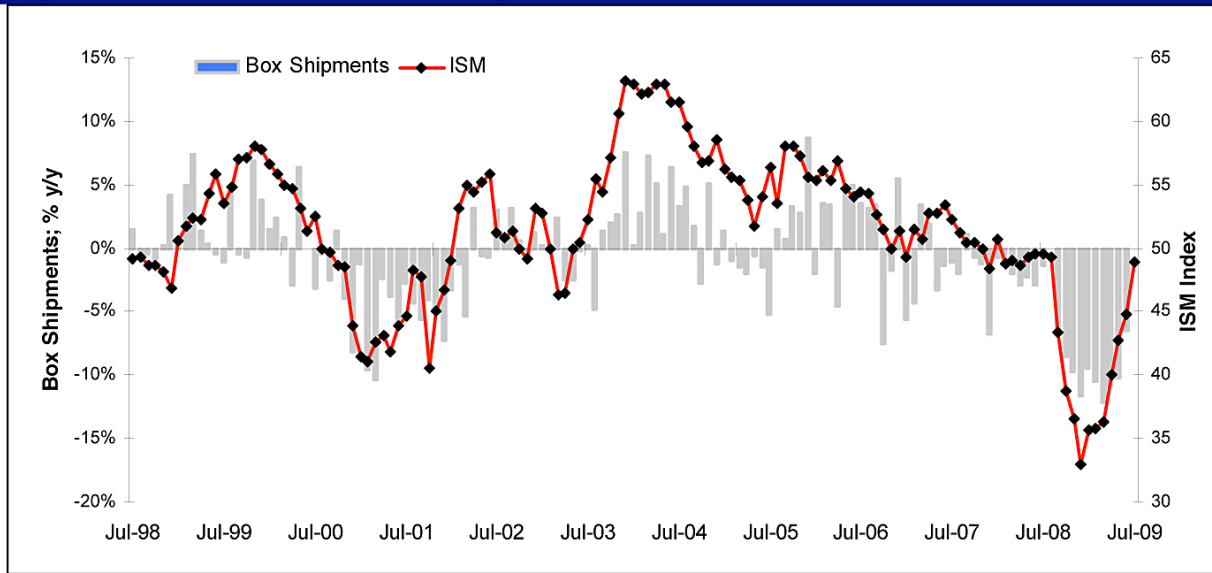
Could investors be realizing that lumber, panel and pulp company share prices have been severely discounted, and - seeing glimmers of hope of economic recovery in general and US housing starts specifically - want to get in on bargain basement shares? Analysts point to mill curtailments across North America, by the major lumber companies, as a reason investors are becoming less concerned. Some American lumber manufacturers were able to offset losses by selling off timberland, however with land value also depressed these one-time gains are viewed as temporary measures. Rayonier was given a 'buy' rating by Deutsche Bank on July 30, 2009 based mostly on "black liquor" tax credit revenue.

Weyerhaeuser, with very public financial struggles, increased revenue from timberland sales by US\$39 million over 1Q 2009, and US\$24 million over the same time period one year earlier. However with log prices at deep cyclical lows, it is generally acknowledged that the land was sold at a discount.

Louisiana Pacific is being watched closely, due mainly to a 46 per cent increase in OSB sales over 1Q 2009. However with a 36 per cent decrease in sales over the same time period one year earlier, many analysts are still wary of LP's financial position in the near future. Of concern is a sharp rise in LP's interest expenses, from US\$12 million in 1Q 2009 to US\$21 million in 2Q 2009, due to refinancing. Domtar is being lauded by almost every analyst involved in the wood products industry, mostly due to revised valuation and declining financial risk. On March 31, 2010, Domtar will close sale on 400 thousand acres of CN timberlands, old mill sites and hydro assets for C\$150 million. Also the company strategically reopened its Woodland, ME, pulp mill in order to take advantage of "black liquor" tax credits in the US, estimated to be over US\$450 million for 2009 to the company.

Historically there has been a strong relationship between the Institute of Supply Management's monthly manufacturing index and corrugated box shipments, thus expectations are that corrugated box shipments are due to increase. Analysts at Duetche Bank predict the overall Index is poised to break above 50 during 3Q 2009, with box shipments to follow suit shortly.

Figure 1: ISM Index vs. Box Shipments



Source: Deutsche Bank, Industry Data and AF&PA

In terms of solid wood products, market recovery is not likely before the end of 1Q 2010 but when demand does return it will be huge. Currently panel companies are suffering less than those focussed on dimension, due mostly to fewer producers involved therefore more ease in setting floor levels on prices.

Continued downtime at mills, both globally and in North America, has served to drive pulp prices up, in large part due to lowered inventories and high wood chip prices. North American NBSK pulp list prices rose for two months in a row, up US\$40/metric ton to US\$700/metric ton. Brokers are also reporting that North American spot price levels are expected to increase August 15 from the US\$560-590/metric ton net delivered reported in mid-July.

Newsprint will be the last of the forest industry to recover. That sector does not yet seem to have hit bottom. Total North American newsprint demand fell 25 per cent in June 2009 compared to one year earlier, and down 31 per cent compared to the first half of 2008. Consumption at US daily newspapers fell 25 per cent compared to June 2008, and 20 per cent compared to the first half of 2008. Producers continue to take extensive downtime, mill operating rates dropped to 64 per cent in June 2009 compared to June 2008, with US mills in particular operating at just 56 per cent. In June 2008 North American newsprint mills were operating at 94 per cent capacity. Despite these low operating rates, North American mill inventories at the end of June 2009 were up 41 per cent compared to one year earlier.

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