MADISON'S TIMBER PREVIEW

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As we approach end of one of the worst years in history for the forest industry, analysts and economists can now look at the financial situation more realistically. Sales, trade and production figures for the first half of 2009 have been released and are available for analysis.

Among the first to report on the forest sector is PricewaterhouseCoopers. Titled "Canada's forest and paper sector losses slowed in Q2 of 2009", the PwC report came out on Sept 1, 2009. Madison's must point out that the only reason losses seemed to slow is due to the large-volume, low-cost producers finally cutting production enough in 1Q 2009 to impact the cash price of lumber and panel commodities. Even in February of this year production levels were far too high compared to demand, which served to drive the benchmark 2x4 #2Btr price to a record low of US$135 mfbm. By July customers had noticed the decreased production levels and lumber traders were able to stick to floor pricing level. Currently, the high Canadian dollar is chipping away at some of these gains, causing lumber producers a different sort of consternation.

The PwC report maintains that firm pulp prices helped company bottom lines in 2Q 2009. However, as exports to China are cited as the reason for the increase in demand, it must be noted that this is possibly a temporary situation. Many industry insiders believe that Chinese demand for pulp may evaporate as the price of kraft pulp continues to firm, thus further price increases would not be supported. Conversely, a shortage of chips from sawmills is slowing pulp production in North America, which may cause a reduction in supply within six months.

A report out of Wood Resources Quarterly at the end of August shows that in April 2009 pulp production in Brazil increased 43 per cent over March, and 140 per cent over April 2008. The report goes on to state that in 2009 China increased imports from Brazil for two main reasons: many small domestic mills closed in China, and there were reduced imports from Indonesian pulp mills, which have had wood fibre supply problems. Perhaps the surge is Chinese demand in less temporary than some believe.

Adding more strength to the common understanding of the importance of the pulp market to the forest industry, the PwC report found that two Canadian companies benefitted from US$191 million of US alternative fuel tax credits, Domtar and AbitibiBowater. Unfortunately the tax credit; did little to help AbitibiBowater, which posted losses of $595 for the quarter, compared to losses of $254 for 2Q 2008. On Sept 04, 2009 AbitibiBowater received a court order to call for creditor claims, which must be received by Nov 13, 2009. The next day the company completed sale on 121,000 hectares of private timberlands in Quebec for $53 million in cash.

Meanwhile, six of the ten US forest products companies surveyed by PwC saw improved earnings in spite of lower reported net sales. 2Q 2009 earnings were clearly boosted by the alternative fuel tax credits being offered by the US government.

But what of these tax credits? We know that they are based on gallons, not on concentration of BTU content. It seems that the US Internal Revenue Service has been investigating some pulp producers, in an effort to determine water and inorganic solids content in the black liquor burned in recovery boilers at the kraft mills. The IRS may be examining whether companies have increased the water-content of their black liquor to increase the total gallons burned, thereby increasing the value of their credit. These discussions do not seem to constitute a formal IRS audit, however some "claw-backs" might be imposed if irregularities are found. In contrast, Canada's Pulp and Paper Green Transformation Program outlines strict requirements on reporting both percent solids concentration and recovery boiler process parameters. More information is available here http://cfs.nrcan.gc.ca/subsite/pulp-paper-green-transformation/quantification-black-liquor-production .

Solid wood products are at the beginning of their annual sluggish season. The still limping US housing market did not allow for a usual summer buy, which prevented lumber and panel prices from rebounding from abysmal price levels in 1Q 2009. Despite a late response, producers and wholesalers seem to have finally caught on by sticking to floor levels. As demand continues to soften into year end, we will see if lumber prices slide further or remain at the current lows.

In terms of the pulp and paper markets, major NBSK producers announced US$40 per metric ton price hikes for September. If successful, this will be the fourth consecutive price hike in North America, fifth in Europe, and sixth in Asia. Spot US NBSK prices rose to around US$600 per metric ton, driven by lean inventories and a slight uptick in US demand (shipments up 9.1 per cent in July compared to June). Catalyst Paper, Domtar, and Fraser Papers promptly announced mill restarts. Were these too soon ? That remains to be seen.

For newsprint, finding the balance in supply and demand is the name of the game. Recently the rate of decline in demand seems to be moderating. Total demand in July was down 23 per cent compared to July 2008, and total inventories fell to 11 thousand metric tons month-on-month against the 10 year trend of an average increase of 51 thousand metric tons month-on-month. However the list price in August fell by $20 per metric ton. At these levels, most producers are cash negative.

Containerboard, an important indicator of economic health as it demonstrates shipments of consumer goods, seems to continue struggling to find market balance. Linerboard list prices in August remained flat for the third consecutive month at US $540 per metric ton, however there may be discounting on the fringes. Spot prices are averaging US$445 per metric ton across the US. July box shipments regressed a bit after showing slight improvement in June, down 9.4 per cent in July compared to July 2008.

Across the board, prolonged curtailments and indefinite closures seem necessary to either allow for price increases or prevent further price erosion. As more positive economic news and projections emerge through the end of this year, expectations are that demand is going to come back much stronger than many have predicted. Should that happen, there will be a mad scramble across the industry to restart long-idled machines and mills back on line.

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