



MADISON'S TIMBER PREVIEW

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A small international producer of security and other specialty papers out of North Vancouver, with two paper mills in Switzerland and Germany, is making waves all over the financial press this week. Fortress Paper Ltd. has negotiated a deal to buy Fraser Paper's Thurso, QC, pulp mill, idled in June 2009, for the sweet price of just \$3 million. While this sale price seems incredibly low it is not undervalued for an idled pulp mill due to liabilities, specifically environmental clean up costs. With a \$102.4 million loan from Investissement Quebec following approval by the Quebec government for a cogeneration power plant to be built on the mothballed NBHK pulp mill site, Fortress plans to begin production of dissolving grade cellulose for the textile industry by mid-2011. A 25-megawatt power plant fed by waste from its operations and from an extensive local network of chip and other biomass suppliers is expected to begin supplying electricity by late 2012. Fortress intends to invest \$153-million to convert the plant – \$91-million for the actual conversion and another \$62-million to build cogeneration facilities. Once up and running, the refurbished plant will, analysts figure, be a cash cow.

The specialty cellulose mill is planned to have an annual production capacity of more than 200,000 air dried tonnes. Fortress Specialty, its wholly-owned subsidiary, will focus on producing primarily viscose fibre (rayon) products. Fortress Paper has to renew collective agreements with three unions at the mill. The deal is expected to close by April 30, 2010.

Analysts love this deal because it moves the mill site away from market pulp production, an increasingly difficult business in the northern hemisphere now that southern pulp producers are producing good quality pulp out of Eucalyptus trees, and into rayon. Demand for rayon is climbing briskly as a substitute for cotton. According to the US Department of Agriculture, cotton production is dropping, down by about one-sixth in the past four years over historic levels. The economics don't make sense for farmers who can make more money by growing food or ethanol feed stocks. Demand for cotton, meanwhile, is growing. But there isn't enough of it, so demand for rayon is climbing at about 7 per cent a year, according to Fortress. (Refer to the November 14, 2008 issue of your Madison's Reporter for more information on the global shift away from cotton, to rayon, in textile production).

Even prior to the Thurso mill announcement, Fortress was showing glowing financial results. The company returned more than 100 per cent since it started trading less than three years ago and 300 per cent since it bottomed in the market crash a year ago.

Fortress Paper was incorporated on May 30, 2006 and completed its IPO on June 28, 2007, through the issuance of 5 million shares at \$8 per share for total proceeds of \$40 million. The company is a leading international developer, producer and marketer of security and other specialty paper. Fortress operates in niche markets with high entry barriers placing the company in an enviable position of controlling significant market share in growth industries. It is anticipated that the demand growth will remain driven by the innovation of the quality end product and the identification of new uses for non-woven wallpaper base. Fortress has generated significant earnings growth since boosting its production capacity in 3Q 2007.

For year-end 2008 Fortress reported a revenue increase of 30 per cent and earnings increase of 143 per cent compared to 2007. The company maintained its 37 per cent international market share of non-woven wallpaper base and had a strong balance sheet with positive working capital of \$19.9 million.

The company experienced a drop in sales in 1Q 2009. In May 2009, Fortress reported a 14 per cent drop in 1Q profit as its specialty paper segment faced a challenging quarter due to the global economic

Fortress Paper Share Prices vs. S&P 500, 2007 - 2009



SOURCE: Google Finance

slowdown. The company posted net income of \$3.6 million, down from \$4.2 million in 1Q 2008. Sales dropped 6 per cent to \$46.6 million, the company said.

By 4Q 2009 things were already improved, as both Fortress specialty paper mills experienced strong sales and earnings throughout the quarter. The increase relative to the prior year comparative period was partially due to the global financial and economic crisis which impacted sales late in 2008. Fortress Paper Ltd. reported net income of \$3.7 million for 4Q 2009 on sales of \$51.0 million, compared to 4Q 2008 when the company reported net income of \$2.8 million on sales of \$46.3 million. In 3Q 2009 the company reported net income of \$3.5 million on sales of \$51.0 million or basic and diluted earnings per share of \$0.34.

For the year ended December 31, 2009, Fortress Paper recorded net income of \$12.7 million on sales of \$198.3 million. For the year ended December 31, 2008, the company recorded net income of \$12.7 million on sales of \$189.0 million.

The market for security papers continues to show strength and the order book for wallpaper base has grown to its current level of eight weeks, according to a company press release. Additionally, global demand for security papers remains strong due to an industry focus on innovation to stay ahead of counterfeiters, quality of end products, and the confidence in and reputation of suppliers.

With only a handful of security paper producers around the world, and demand increasing due to new technologies like Durasafe technology, Biometric e-passport and the LQard Identification Card System, expectations of increasing profits for Fortress are justified.

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