



MADISON'S TIMBER PREVIEW

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Uncertainty among North American lumber producers remains in the aftermath of the 2006 US home building plummet, however there is clearly movement forward. Two Canadian-based forest companies have come to the forefront of investor attention lately, for very different reasons. Sino-Forest Products, with operations in China but based out of Mississauga, ON, found itself subject to a full-frontal assault by an upstart investment analyst openly involved in short-selling company shares. TimberWest Forest Corp, with assets on Vancouver Island but headed in Vancouver, BC, on June 15 completed its agreement for acquisition by two Canadian pension funds. Elsewhere, 2010 fiscal year-end figures have been released for several Japanese wood products companies showing improvements of between 7 and 800 per cent.

The business success of Sino-Forest has captured a lot of interest in the past two years, despite a minor lack of transparency into company operations. Quantities of plantations acquired and fibreboard produced have been released in its financial statements, as has company investment back into the land base. However the company has not yet paid a dividend. Confident investment continued regardless, driving share prices up 58 per cent in two short years. Sino shares went from \$10.12 in early January 2009 to \$24.28 in June 2011 just before the suspect report was released. A critical loss of valuation for the company ensued on June 16, in just two weeks, brought about by a staggering 80 per cent drop in share prices, which Thursday stood at \$3.32.

Credit Suisse issued a note Wednesday reviewing Sino earnings in which analysts expect a \$6 target price for Sino shares and maintain a neutral rating on the company. Analysts at Raymond James, meanwhile, valued shares at between \$13 and \$17 also on Wednesday.

Sino board members have not disclosed a significant amount of company information to quell investor concerns, at least not by North American standards. Considering that they are a Chinese operator they probably think they have been more than transparent enough in answering the accusations levelled by Muddy Waters. The negativity is now leaking into the holdings of major Sino shareholder Paulson & Co as the fund manager is down 20 per cent in 2011 on its US\$9 billion in financial assets. CITI Bank and Sino are largely responsible for the drop, with the latter accounting for 13 per cent of fund losses since the beginning of June.

Paulson is expected to make a statement Monday shedding some light on the murky situation.

When the \$1.03 billion TimberWest buyout was announced two months ago, the timberland owner and lumber producer put out a call for better offers. Last week it became obvious that no such offer was forthcoming. On Wednesday the initial takeover by two major Canadian pension funds went through. Existing TimberWest shareholders will earn \$6.16 per share, which were valued at \$6.06 on the TSX Thursday afternoon. TimberWest will henceforth operate as a private company. Existing operations are expected to go forward much as they have in the past, with a more conservative attitude likely. Pension funds traditionally have a very long-term outlook, thus a depressed lumber market over the course of a few years, as has been the case in North America, will be considered barely a blip. TimberWest had already embarked on a wise plan to parcel off its most valuable land for real estate sales over the next ten years, and this direction will likely continue under the new ownership.

Timber will be harvested at a rate most lucrative for the long term, and investment into silviculture will be significant. Suggestions that the pension funds will suddenly embark on wholesale clear-cutting makes no financial sense, that would be absolutely counter to the prevalent philosophy of these entities. If anything,

the pension funds will forestall logging until the US housing market returns to healthier levels. As a publicly-traded company TimberWest had to show at least some revenue each quarter thus was forced to sell logs offshore while its mill operations have been closed. The pension funds are able to suspend logging for a few years with the view of much higher yields come 2014.

Madison's finds renewed complaints by affected First Nations groups puzzling. The land in question was already understood to be owned by TimberWest, there have not been additional lands added to this sale. Existing claims by First Nations are being highlighted by the media when the company sale was going through, but no new information or complaints have been added. The Hul'qumi'num Treaty Group claims are the same as they always were, whether the land in dispute is held by TimberWest or by the pension funds.

Meanwhile, several lumber producers in Japan reported glowing 2010 financial results despite still stumbling Japanese home building for that year.

In its 2010 year end report, released in March, Sumitomo Forestry, mainly engaged in residential construction and forestry with operations in the Far East and Southeast Asia, posted a 10 per cent increase in sales over 2009, of ¥797,493 million. Total company net profit rose by 118 per cent, to ¥5,175 million. Sumitomo's home-building department posted a profit of ¥18,988 million, due mainly to the healthy remodelling business.

In its 2011 forecast, the company expects consolidated sales to improve another 2.2 per cent, to ¥815,000 million, and net income to increase another 93 per cent of ¥10,000 million.

Nice Holdings, out of Yokohama City, registered sales up 7.4 in 2010 compared to 2009, of ¥239,260 million, in its year-end report also in March. Net income, however, was down 38 per cent, to ¥318 million, due to an extraordinary loss of ¥964 million related to warehouses, offices, precut factories and stock inventory in Miyagi Prefecture, following the Great Eastern Japan Earthquake. Taken separately, the company's real estate division increased total sales by 7.4 per cent compared to 2009, and profit grew about 40 per cent, due mainly to new construction of condominiums in the Tokyo area.

In its own 2011 forecast, Nice expects sales to decrease by 4 per cent, to ¥230,000 million, while net income is expected to jump by 57 per cent, to ¥500 million.

Also in March, JK Holdings Co, of Tokyo, reported 2010 sales up 9.6 per cent compared to 2009, to ¥280,070 million. Company net income increased by 800 per cent, to ¥1,679 million, due to a greatly-improved profit-and-loss situation. JK Holdings' building material department improved sales by 10 per cent from the previous period due mainly to tight plywood supply.

For 2011 the company aims to further increase sales by 3.5 per cent, to ¥290,000 million, and improve net income by 34.5 per cent, to ¥1,100 million.

Tokyo's Jutec Holdings Corporation reported 2010 sales up 7 per cent compared to 2009, of ¥131,442 million and net income up 15 per cent, to ¥744 million.

The company expects 2011 sales to grow by 3 per cent, ¥135,000 million, and net income to fall by 26 per cent, to ¥550 million, mainly due to an extraordinary loss of ¥150 million.

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