



MADISON'S TIMBER PREVIEW

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As 2Q 2011 financial results for North America's forest industry pour in, lumber, panel, pulp, and paper producers report spotty earnings. Most companies recognize that the first half of this year was much improved over last year and certainly over 2009, but most operators also agree that expectations for the remaining two quarters of this year are not great. This week's issue of your *Madison's Timber Preview* is dedicated to the latest movements and developments in the financial structure of North American's forest products companies, and also takes a look at company executive's moods and predictions.

On the side of good news, Ainsworth Engineered in 2Q financial results released late last week, proclaimed its OSB mill in Barwick, ON, has recorded the highest volumes of production since its purchase from Boise Cascade in 2004.

Norbord announced at the end of July that the company's European panel operations, which contributed nearly half its total revenue, rose 27 per cent to US\$117 million in 2Q. Norbord's North American operations, meanwhile, generated a breakeven performance, compared to earning US\$64 million a year ago.

Tembec's CEO James Lopez called for Canada's lumber producing companies to consolidate. He said July 26 in an analyst conference call that industry leaders have been burned in the past in predicting a recovery in the US housing market coming into 2011. Low lumber prices have been prevented from falling even more dramatically only due to increased Chinese demand.

"We had one good month [this year] but that was one good month in a number of bad months and we're not optimistic for the balance of the calendar year," said Lopez.

In British Columbia, Western Forest Products reported, also last week, a sizable improvement in 2Q earnings, of \$12.1 million, compared to 1Q 2011, at which time the company posted a loss of \$1 million. Western's lumber shipments increased by 11 per cent, to 210 million board feet, in 2Q. It is important to note that 34 per cent of Western's lumber products headed to destinations within Canada, 24 per cent to Japan, 23 per cent to China, and only 14 per cent to the US.

Due to continued instability in US and EU economies, North American lumber producers and wholesalers remain cautious in the short term.

On August 2, Interfor announced that its proposal under BC Hydro's Phase 2 Power Call to construct a 20 MW power plant at Grand Forks, BC, failed. The company will not be proceeding with its plan to develop a co-generation plant at that site but would continue to look at capital projects for Grand Forks, indicated Andrew Horahan, Interfor's regional manager for the Kootenays, to local media.

On the paper side, Domtar has announced that, due to a completion of FSC Certification for its specialty paper mills, the company's Espanola Mill in Ontario can expect to see more production over the next year. Domtar mills in Port Huron, MI, and Rothschild and Nekoosa, WI, are also now certified to

FSC standards by the Rainforest Alliance. The company expects to sell more than 150,000 additional tons of paper annually.

In a surprise announcement last week, AbitibiBowater has sold its former newsprint mill in Monroe County, AL, for US\$7 million. The Montreal, QC, company stopped making newsprint at the Perdue Hill mill in December 2008. The company laid off 167 workers in early 2009, as it filed for bankruptcy. New owner MLR Ventures, out of Oregon, plans to sell the plant for scrap. Locals are amazed, considering the mill, which opened in 1990, is one of the newest paper mills in North America. The buyer has mortgaged the former Alabama River Newsprint property for US\$6.62 million to two lenders, including an arm of Portland scrap metal firm Schnitzer Steel Industries.

As explanation for the unusual move, AbitibiBowater spokespeople blamed high power costs at the time of the shutdown. Unlike many paper mills, the facility can't generate power by burning pulp by-products, as the pulp mill next door is owned by Georgia-Pacific.

AbitibiBowater also said, Wednesday, that the average selling price for coated papers rose US\$28 per short ton in 2Q, while prices for specialty papers increased US\$26 per short ton, according to Reuters Canada. More price increases would be implemented in 3Q, which will likely reflect in some of the company's contracts. Cascades and other North American paper producers are expected to follow suit with their own announcements of price hikes shortly.

While some companies are boldly embarking on capital investment, usually with the help of one government grant or another, others are divesting seemingly marginal assets. All are looking to nurture new markets but all agree that only healthy demand out of the US will bring true improvement to business. Tembec CEO James Lopez makes a valid point, but perhaps he forgets what happened after forest companies went through a great round of consolidation in the early 2000s. Canfor and West Fraser chose to build incredibly high-tech "super mills" which were completed just in time to see the US home building market crash abysmally. Not one of those super mills has run full-bore, a good ten years on. The Abitibi Consolidated merger with Bowater turned out to be a disaster, particularly for Bowater's formerly well-earning solid wood assets.

Companies that merged and grew, that broadcast themselves as "vertically-integrated" forest products companies, have now divested and refocused back on core products. Domtar is back to making paper, AbitibiBowater has no more sawmills, and even Weyerhaeuser has rebranded itself as a REIT. There may be no easy solution to the slow recovery of the North American forest industry, and rushing into another round of consolidations may well cause more harm than good. If companies are looking for a single way to solve current revenue problems, one solution lies before them: biomass fuels. Reducing forest waste and making use of the full fibre from each tree is the answer to fluctuating wood demand and completes the supply chain from stump to customer.

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