



MADISON'S TIMBER PREVIEW

PO Box 2486, Vancouver, BC V6B 3W7 ✦ Tel: 604-984-6838 ✦ Email: madrep@shawcable.com ✦ Web: www.madisonsreport.com

September 09, 2011

Conifex Timber arrived on the Canadian forestry scene to little fanfare in August 2008 with the purchase of the bankrupt Pope & Talbot's Fort St. James, BC, sawmill. The company paid \$12.8 million for the 250 mfbm annual capacity mill which had employed 238 workers, and assumed \$3 million in mostly reforestation liabilities. Conifex then spent another \$12 million upgrading mill equipment, and was able to restart operations on a one shift-basis in March 2009. In June 2010 the company completed purchase of AbitibiBowater's idled Mackenzie, BC, sawmill complex, starting up that location also on one shift in November 2010. By late March 2011 both facilities increased production to two shifts.

Between the two sites, Conifex currently has an annual lumber production capacity of approximately 745 mmfbm on a two-shift basis, supported by renewable forestry licences with an allowable annual cut of approximately 1.6 million cubic metres. The timber supply is located in the northern Interior of British Columbia, so those operations are not as impacted by beetle-kill harvest as BC mills farther south.

Conifex reported 2Q results August 18, showing a net loss of \$3.6 million on sales of \$26.9 million. 2Q lumber revenue increased by 105 per cent compared to one year ago, with most of this increase attributable to revenue from lumber shipments increasing by 18 per cent compared to 1Q. The results also reflected a 30 per cent increase in shipment volumes which were offset by a 12 per cent decline in average unit sales prices.

This week Conifex announced its intent to purchase two long-time partners, both privately-owned; global lumber distributor and marketer Welco Lumber, and the lumber transportation and logistics business Navcor Transportation Services. The transaction close date is December 31, 2011.

Conifex will issue an aggregate of 11,281 common shares at \$8.50 per share, "pursuant to retirement arrangements with a current employee", according to a company press release.

"The deal has merit for Conifex to cut out the middle-man," CEO Ken Shields told *Madison's* in a phone interview Thursday. "We plan to ramp up production to 150 mmfbm every quarter in 2012 at each plant, and it just makes good sense right now to internalize our marketing.

"Conifex is essentially buying the business of Welco that covers wholesale lumber distribution in Japan, China, and North America. Other parts of Welco made sense to remain independent of Conifex, so that company will retain its specialty business, its other lumber clients, and will carry on other operations as before."

Shields explained that the transition of relevant Welco operations is already happening, and he hopes to have the details complete by the end of 2011. Conifex's sales contract with Welco would have expired in mid-November, so the two companies would have had to "work on transition at some point" regardless, said Shields.

Several Welco owners already held Conifex shares and liked the company.

"We're working collaboratively, building on our previously existing very good relationship," explained Shields. "Conifex will pay cash for Welco.

"Navcor's transportation services range from ocean to train and to truck."

It makes sense for Conifex to consolidate these operations under its own management, rather than to continue paying others for logistics and lumber export sales now that the company has proven itself a successful player in the North American lumber industry.

Such efforts to move the scope of operations under one roof reminds Madison's of a rumour, heard about a year ago, that Rick Doman was considering purchasing a ship for Eacom to send lumber over to Europe, rather than relying on buying container space at regular intervals. The cost savings, efficiency improvement of consolidating operations to one office, as well as greater ability to control logistics, is a benefit for any company expecting to increase shipments from either the east or the west coast.

June 08, 2010 Conifex went public on the TSX Venture exchange valued at \$8.35 per share. A somewhat bumpy ride followed, with the company reaching its to-date, all-time high share price of \$11.75 on April 1, 2011. Share prices closed September 07 at \$8.70.

The lateral trend of share prices is difficult to understand given that the company made shrewd purchases of idled assets, garnered the second-best deal in recent Canadian history for its timber supply (after only Eacom Timber), increased production in keeping with lumber demand, and nurtured new customers in China at an excellent pace. It seems that the mood of investors about the North American lumber industry in general is tainted by continued low housing starts and a struggling economy. Forest industry investors are placing less emphasis on the fundamentals of a business than on general economic indicators. Making negative investment decisions out of fear is not usually an effective way to move forward.

However the Conifex business model and philosophy differs quite a bit from more established lumber producers.

"20 per cent of our market is Canadian, always," Conifex CEO Ken Shields stated. "In 3Q 2011 the US is still showing the weakest demand, at 40 per cent of our production. China has been a steady customer at 60 per cent. A one-third split between the three regions would be optimal. For Conifex to be successful we need to service all three areas.

"Our log pile is uniquely suited to serve the US, Japan, and China," Shields explained further. "Both Conifex mills are located quite far north, only in the southern parts of our timber supply is there a significant amount of dead Pine. Most of our logs are green Spruce.

"The lower grade, usually beetle-kill, goes to China, while the premium wood is sent to Japan." Setting up a three-pronged customer base across regions will do Conifex well to weather future economic fluctuations, and also position the company to take advantage of the next surge of demand.

Keta Kosman
Publisher
Madison's Lumber Reporter
Madison's Timber Preview
Madison's Investment Rx
www.madisonsreport.com
604 984-6838