MADISON'S TIMBER PREVIEW

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Given the steady, albeit slow, stream of improving economic indicators for the North American forest products industry of late, it is not surprising that assets are once again beginning to change hands. This week came announcements of Canfor's purchase of two Tembec sawmills in British Columbia, and of AbibitiBowater, now known as Resolute Forest Products, initiating an unsolicited takeover of pulp manufacturer Fibrek.

Please refer to the December 12, 2008 issue of your *Madison's Timber Preview* for background on the ongoing financial saga that is AbitibiBowater. Also please refer to the June 4, 2010 issue for details on Fibrek, formerly known as SFK Pulp.

Cash-poor Tembec may have had little choice but to take Canfor's $60 million offer, which includes working capital, for the Canal Flats, and Elko, BC, sawmills. As the only remaining North American forest company with operations in both eastern and western Canada, Tembec was well-positioned to take advantage of the looming recovery in lumber prices. The company had the option both of further nurturing the growing Asian market for west coast lumber products, and of taking advantage of the close proximity to customers in the most densely populated areas of the US. Tembec could have quickly responded to changing market conditions by adjusting operations to serve whichever customer had the most hunger for wood at any given time. Now that the transportation pipeline for solid wood from BC to China is well established, Tembec could have played customers from the respective regions against each other.

A philosophy of strict fiscal discipline at Tembec for the past couple of years has lead it to divest itself of these two BC plants. In all likelihood the required $50 million in upgrade costs between them is what prompted Tembec to accept Canfor's purchase offer, which is expected to close near the end of the first quarter of 2012. Neither mill has been running for the past several years so they have not demonstrated benefits for Tembec's balance sheet.

Canfor, on the other hand, is likely just as interested in the timber supply of 1.1 million cubic metres attached to those mills as it is in the operations themselves.

Tembec's VP of Communications and Public Affairs, Linda Coates, explained to *Madison's* in a phone interview that Tembec is "concentrating its focus on eastern Canada for lumber assets. The company saw an opportunity in the Canfor offer to explore different options in reshaping its portfolio."

When asked about the recently announced sale of hardwood flooring assets in Ontario, Coates said, "Those were small operations relative the the full company portfolio, and have been acquired by a [private] company that is really involved full time in that business segment."

In terms of sawmill capacity and whether current Tembec curtailments will be extended, Coates said only, "Housing in the US is not doing very well, is not recovering as quickly as people had anticipated."

Meanwhile, continuing to pursue its record of absorbing stable, financially sound companies into its gargantuan, inefficient operations, Resolute has made an almost irrefutable play for Fibrek.

Resolute is offering 97 cents per share, saying it has commitments from current Fibrek shareholders to buy 49 per cent of the stock, which is estimated be worth $57.8 million.

That a full 46 per cent of those shares are coming from Fairfax Financial Holdings really makes one wonder what Prem Watsa is thinking. Or what Resolute's proposal to Fairfax comprised.

Recent quarterly numbers show that Fibrek's consolidated sales reached $138.3 million, an increase of $6.1 million over last year's third quarter. Higher sales volumes and higher recycled pulp prices contributed to the increase. The company has an annual softwood and recycled pulp capacity of 760,000 tonnes.

Headquartered in Montreal,QC, Fibrek has three modern pulp mill operations; one in Canada and two in the US. Its Marion County, WV, and Menominee, MI, mills make recycled, bleached, Kraft pulp (RBK) from urban waste paper, while the mill in St. Félicien, QC, manufactures virgin fiber from black spruce. Fairmont and Menominee are the only RBK mills in the Western Hemisphere that make dry pulp, which does not grow microorganisms. In addition, Fibrek has 100 per cent guaranteed fibre supply at all its mills. The company sells 84 per cent of its product in the United States.

The Resolute offer to current Fibrek shareholders is for either $0.55 in cash and 0.0284 of a Resolute share, $1 in cash only, or 0.0632 of a Resolute share only, subject to pro-ratio based on a maximum cash consideration of approximately $71.5 million and maximum number of shares of 3.7 million. Resolute would assume almost $100 million of Fibrek debt.

It is not surprising that AbitibiBowater is undergoing a brand change to become Resolute, clearly an attempt to distance itself not only from the absolute devastation of the formerly fiscally solid Bowater immediately following that merger, but also from the terrible public relations AbitibiBowater has undergone in the past two years. Everything from extended bankruptcy proceedings to court battles with governments both federal and in Quebec, ongoing environmental cleanup cost disputes with Newfoundland/Labrador, not to mention a nasty conflict with public utility Hydro Quebec. Apart from the attractions listed above, its possible that Resolute hopes some of Fibrek's deep commitment to sustainability, integrity, and social responsibility will become part of the overall new company identity.

All this effort may well be too little too late, as it comes fast on the heels of two top executives at Resolute receiving $4 million between them in severance packages while the company closes mills, cuts staff, and imposes wage rollbacks.

Former President and CEO, David Paterson took a severance of $1.338 million as well as an award of $765,000, a $430,000 bonus and $150,000 a month to consult for the company for six months, according to an SEC filing made November 15 because the Washington Post newspaper owns 49 per cent of the Bowater Mersey mill. Former CFO William Harvey received a lump sum severance payment of $1,346,181 in July and continues to work as a consultant for the company at $40,000 a month.

Company employees, however, are not faring nearly as well. Bowater Mersey will offer 80 severance packages to employees at the Liverpool, NS, mill in an effort to cut costs. The company is giving one and a half weeks' pay for each year of service. The company wants to lower the cost of labour from $97 a tonne of paper to $80. By the beginning of November, 175 workers had already taken a 22 per cent wage cut in the last two years to help the mill stay competitive, according to a union spokesperson. And on Wednesday, workers at the company's nearby Brooklyn Energy Power Plant narrowly voted to accept a wage freeze, the elimination of 80 positions, and cuts to their benefits plan in an effort to try to keep that mill open.

Elsewhere, Resolute announced November 17 it will be investing between $12 and $17 million over the next 12 months in its thermomechanical pulp mill in Iroquois Falls, ON, according to Northern Ontario Business.

Fibrek's Board of Directors responded to Resolute's action with a statement released Wednesday. The Board fears that Resolute's unsolicited offer undervalues the company and its future prospects, and is in the process of reviewing and evaluating the deal and will communicate a formal recommendation to their shareholders soon. To Fibrek's Board of Directors, Resolute's unsolicited offer appears opportunistic, according to a company statement.

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