



MADISON'S TIMBER PREVIEW

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Fourth quarter and year-end 2011 financial results are starting to come in for coastal North American timber holders and lumber producers. Some companies made out well compared to the previous year, while others had a much better showing in 2010 than they did last year.

Pope Resources, based in Poulsbo, WA, on February 8 reported net income of US\$2.3 million on revenue of US\$17.8 million for 4Q 2011, compared to US\$1.7 million on revenue of US\$8.5 million for the comparable period in 2010.

"The big story for 2011 was strong demand from China for logs and lumber," said David Nunes, President and CEO, in a company statement. "We were well positioned to capitalize on this surge in demand since all of our tree farms are tributary to export log ports. Based on both new properties acquired by our second timber fund in 2010 and significant amounts of deferred harvest volume from 2008-2010, we had a record harvest year in 2011 at 90 million board feet (MMBF). In addition, we enjoyed an increase in both export demand and greater competition in domestic markets where many of the mills benefitted by the exporting of lumber to China."

Pope's Fee Timber operating income for 4Q was US\$5.5 million compared to US\$1.7 million for 4Q 2010. This tripling of operating income was due to the combined impact of a 164 per cent increase in timber harvest volume, which increased from 11 MMBF in 2010 to 29 MMBF in 2011, and a 17 per cent boost in average realized log price, which increased from US\$481 per MBF in 2010 to US\$565 per MBF in 2011.

Elsewhere, Spokane, WA's, Potlatch Corp January 31 reported a 4Q 2011 loss from continuing operations of US\$1.5 million compared to US\$8.9 million for the same time period in 2010.

Potlatch's operating income for the Resource segment was US\$59.8 million in 2011 compared to US\$62.1 million in 2010. Operating income for the Real Estate segment totalled US\$31.4 million in 2011 compared to US\$30.4 million in 2010. The Wood Products segment had operating income of US\$7.3 million in 2011 compared to US\$7.1 million in 2010.

Meanwhile, Weyerhaeuser -- which can hardly be called a lumber producer anymore with only two mills running part time -- reported on February 3 net earnings of US\$65 million for 4Q 2011 on net sales from continuing operations of US\$1.6 billion. This compares with net earnings of US\$171 million on net sales from continuing operations of US\$1.5 billion for the same period last year.

Strength in log exports to China during 4Q proved to be an advantage, said a company statement, while the Real Estate segment proved less successful. However, a solid asset base and the conversion into a REIT are proving beneficial for the company. Pretax earnings from Weyerhaeuser's real estate division increased to US\$41 million, buoyed by sales of land and residential lots. Profit compares with US\$13 million a year earlier.

The pretax loss at its wood products unit in the quarter was US\$80 million, the company statement said. A year earlier that loss was a US\$188 million.

As has been often repeated by *Madison's* for the better part of the past two years, this reliance on log exports by coastal US lumber producers will likely pose a problem in the future. While it is important to remember that some volume of log exports plays an important role for North American forest companies

when lumber demand and prices are down, that volume must be kept at reasonable levels. It is the manufacturing of lumber, after all, that provides the greatest profit margins. Overshipping of raw logs creates hungry customers overseas who only want more, and if sustained at unhealthy levels for too many years result in the closure of sawmills.

British Columbia went through exactly that problem in the 1980s, except the logs were going into Japan rather than China and other emerging Asian markets.

Alarmed by the log export activity of the past two years, Oregon Governor John Kitzhaber met with the OR Forest Industries Council in December to address various forest business policy issues of the day, according to the *Oregon Report*. Expanding on his November Forestry Board speech, the Governor said real change is needed in Oregon's federal forest management.

"Due to the imminent fiscal disaster facing federal timber counties in the state," the Governor said "congressional inaction is not an option."

He promised to support legislative proposals now being drafted in Congress, which could increase federal timber sale revenues for the counties.

The Associated Oregon Loggers published a rebuttal, also on the *Oregon Report*, stating, "The rise in log exports to China has left coastal sawmills facing new price competition for timber. Oregon Governor Kitzhaber unfairly criticized log exports in his November 3 testimony before the state Board of Forestry. 'We are at risk of becoming a timber colony for Asia,' Kitzhaber had said. 'While (log exports are) undermining our mill infrastructure and surrounding communities...' The Governor's deceptive remarks—repeated by the media—slanders those Oregon forest sector businesses and jobs that grow, harvest and deliver timber," maintained the Associated Oregon Loggers.

Bill Sauer, Executive Director of the Northwest Loggers Association in Terrace, BC, explained in a piece to the *Terrace Standard* Wednesday that here in British Columbia, there is about 65 to 70 million cubic metres of timber harvested in most years.

"In the last few years about 2.5 million cubic metres, or 3.6 per cent of the total harvest, has been exported as raw logs from public forest lands, primarily to Asia. It is a well known fact that without the Asian market, specifically China, very limited harvesting activity would be happening in our region. No activity translates to no jobs," claimed Sauer.

The fine balance between increasing log exports, and providing harvesting jobs in the bush, and fostering a lumber producing industry, which provides four to six times as many jobs per volume, is extremely delicate when economic times are tough.

The difficult lesson learned by BC in the 1980s can be easily translated south of the border to Washington State and Oregon. Customers who had become accustomed to an abundant log supply are not so easily weaned when lumber production ramps up and volumes of logs going offshore show declines. In addition, the sawmilling infrastructure damaged by low volumes of lumber production and subsequent low mill operating rates are not so easily brought back up to former manufacturing levels.

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