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Industry Brief

## Forest Products

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### Building Materials

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#### Building Materials: Seasonal Lumber Trade Shaping Up

We are highlighting the seasonal lumber trade today with key components detailed below:

**Valuations close to cycle trough give rise to asymmetric risk/reward payoff** – Building materials producers are currently trading near cycle troughs and historically have only traded materially lower than current levels when lumber prices were in cash-flow negative territory – something we do not expect to occur in the near-term. Specifically Canfor (CFP-T, Outperform) and West Fraser (WFT-T, Outperform) are trading at 3.4x and 3.3x mid-cycle EV/EBITDA multiples respectively compared to cycle lows of 2.8x for each. Small cap producers such as Interfor (IFP.A-T, Outperform) and Conifex (CFF-V, Outperform) are also near trough valuations with mid-cycle EV/EBITDA multiples of 2.3x and 2.5x respectively compared to troughs of 2.2x and 2.4x respectively.

**Improvements in the US housing market are not required for the seasonal lumber rally to occur** – The past 2 seasonal rallies in lumber prices and building materials equities took place despite the US housing market remaining moribund (see Exhibit 1 below). We believe this will take place again this year with the absorption of excess inventories in China and thinning North American inventories help support benchmark WSPF 2X4 lumber prices.

**A pessimistic outlook on the part of lumber producers impacts logging plans and sets the stage for a price rally** – Our conversations with lumber producers lead us to believe they hold a relatively pessimistic near-term outlook which we expect to lead to reduced log inventory builds. This will hinder a supply response to even a modest uptick in spring demand as logging cannot recommence until the spring break-up is complete (April-May 2012) putting upward pressure on lumber prices, in our view.

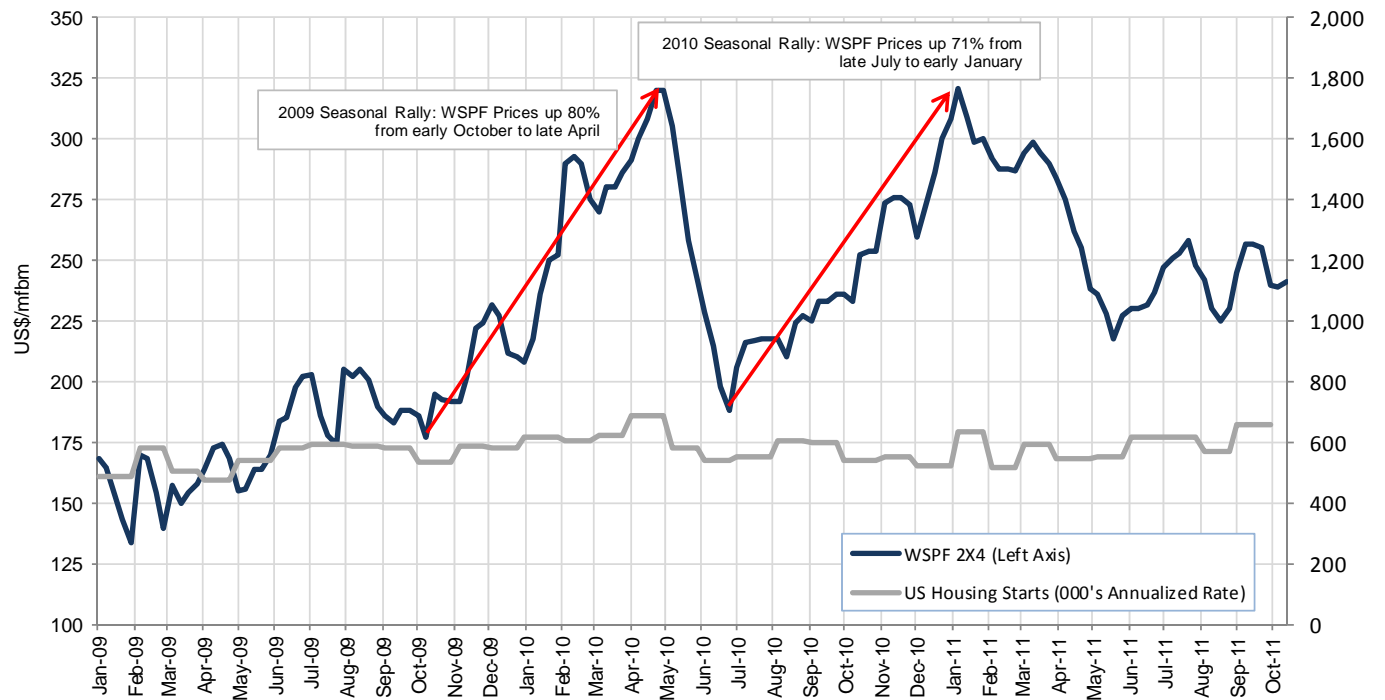
**US housing starts not as positive as they appear; overhangs remain** – US housing starts were released this morning coming in at 658k, up 15% from 572k starts in Aug-11 and above median consensus expectations of 590k. The bulk of the mth/mth increase was related to improved multi-family housing starts which rose to the highest level since Oct-08 at 233k reflecting increased demand for rental units while lumber-intensive single family housing starts of 425k were up just 2% mth/mth, roughly in line the YTD monthly average and yet to show a meaningful improvement from recessionary lows. Therefore, while mildly encouraging for the building materials sector, this data is not as positive as the overall starts figure suggests.

**Reducing building permit applications reflect broader issues** – Forward looking housing permits hit a 5-month low for Sep-11 likely reflecting a recent rise in foreclosure filings which is contributing to an increasing supply of unsold homes on the market negatively impacting development of new homes in near and mid-term, in our view. Excess housing supplies are currently estimated at 2.6 mln units by our RJA Real Estate Research Team, while a further 23% of households are in a negative equity position. We believe this trend of multi-family housing construction outpacing single family activity will persist until such time as mortgage availability in the US improves. We stress, however, that this cautious outlook on the US housing market does not preclude the potential for a seasonal rally, in our view.

Company	Ticker Primary	Ticker Secondary	Current Price	Rating
<b>Building Materials</b>				
Canfor Corp.	CFP-TSX		C\$9.84	Outperform 2
Conifex Timber Inc.	CFF-TSXV		C\$8.00	Outperform 2
Interfor	IFP.A-TSX		C\$4.11	Outperform 2
Norbord Inc.	NBD-TSX		C\$8.60	Market Perform 3
West Fraser Timber	WFT-TSX		C\$42.68	Outperform 2

Raymond James Ltd.

**Exhibit 1: Seasonal Lumber Price Rallies & US Housing Starts**



Source: Random Lengths, www.freelunch.com, Raymond James Ltd.

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<b>Market Perform (Hold)</b>	25%	37%	55%	31%	5%	3%
<b>Underperform (Sell)</b>		5%	8%		5%	0%

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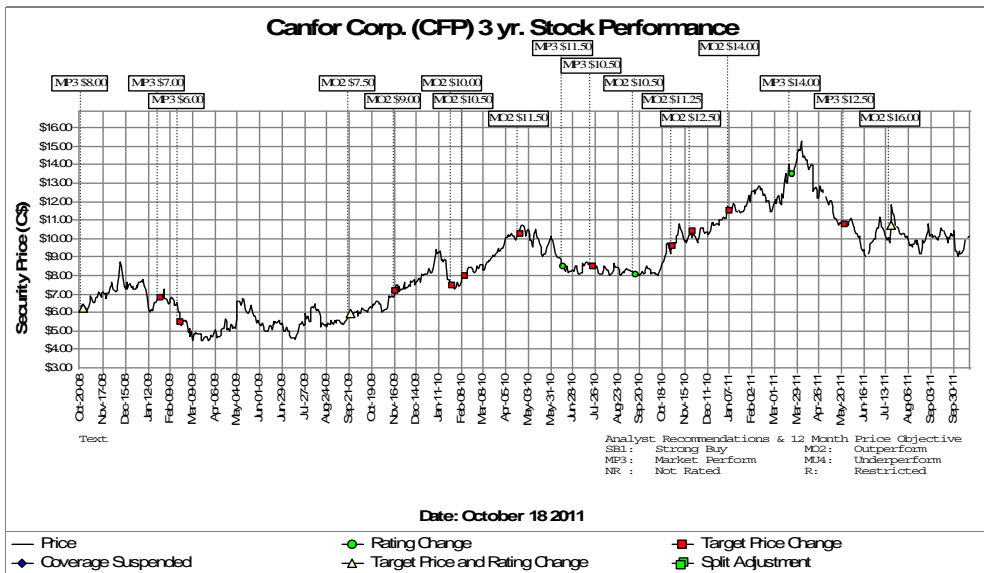
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**Target Prices:** The information below indicates target price and rating changes for the subject companies included in this research.



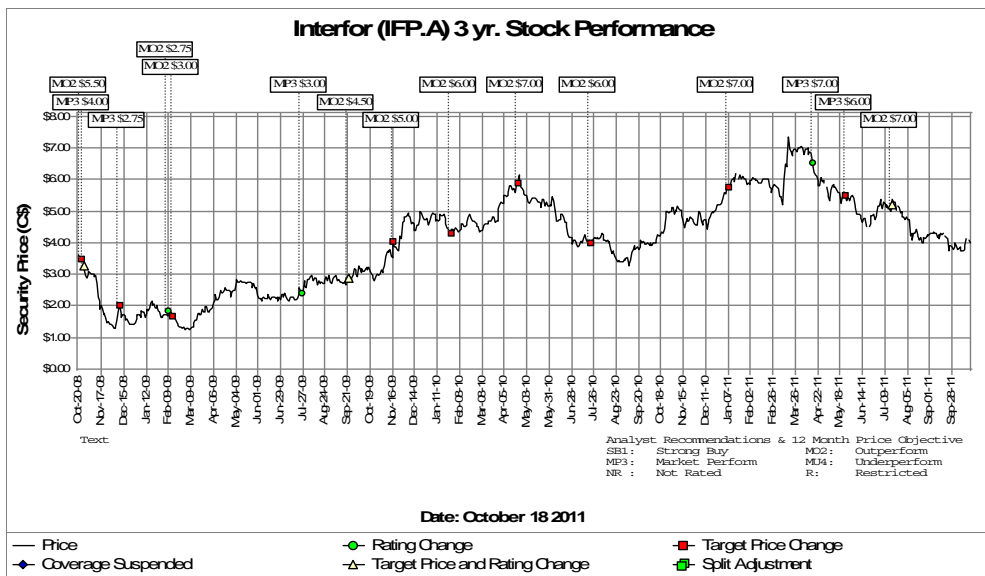
Update Date	Closing Price	Target Price	Rating
Sep-14-11	8.70	14.50	2

**Valuation Methodology:** We value Conifex on a comparative basis to peer group average multiples.



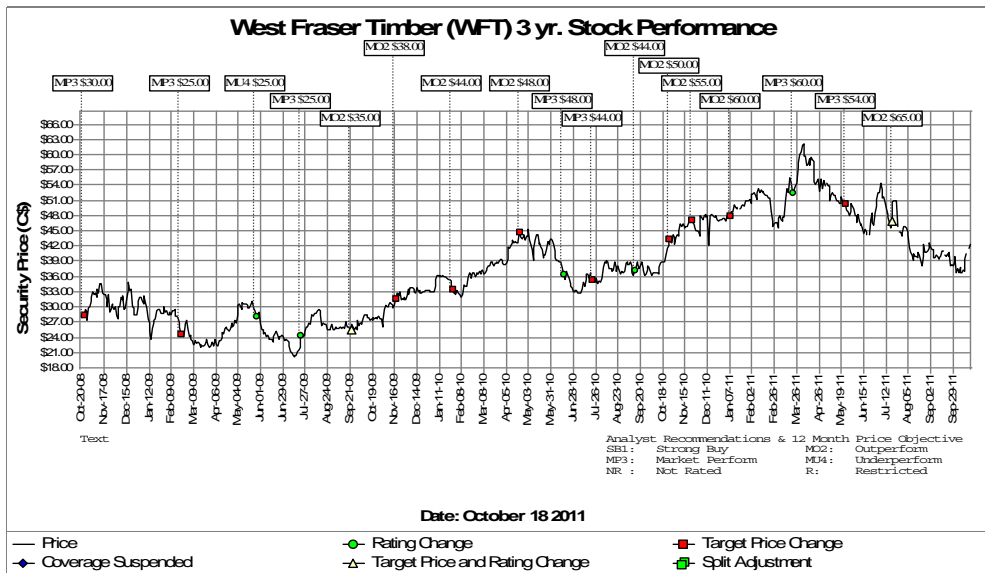
Update Date	Closing Price	Target Price	Rating
Jul-19-11	10.74	16.00	2
May-24-11	10.78	12.50	3
Mar-22-11	13.52	14.00	3
Jan-07-11	11.52	14.00	2
Nov-22-10	10.45	12.50	2
Oct-29-10	9.63	11.25	2
Sep-13-10	8.07	10.50	2
Jul-21-10	8.54	10.50	3
Jun-15-10	8.53	11.50	3
Apr-21-10	10.31	11.50	2
Feb-11-10	7.98	10.50	2
Jan-27-10	7.50	10.00	2
Nov-17-09	7.18	9.00	2
Sep-22-09	5.96	7.50	2
Feb-20-09	5.51	6.00	3
Jan-27-09	6.85	7.00	3
Oct-22-08	6.25	8.00	3

**Valuation Methodology:** We value Canfor on a comparative basis to historical multiples.



Update Date	Closing Price	Target Price	Rating
Jul-19-11	5.19	7.00	2
May-24-11	5.49	6.00	3
Apr-15-11	6.55	7.00	3
Jan-07-11	5.75	7.00	2
Jul-21-10	4.00	6.00	2
Apr-21-10	5.88	7.00	2
Jan-27-10	4.31	6.00	2
Nov-17-09	4.05	5.00	2
Sep-22-09	2.90	4.50	2
Jul-24-09	2.40	3.00	3
Feb-13-09	1.66	3.00	2
Feb-09-09	1.84	2.75	2
Dec-09-08	2.00	2.75	3
Oct-24-08	3.25	4.00	3
Oct-22-08	3.48	5.50	2

**Valuation Methodology:** We value Interfor on a comparative basis to historical multiples.



Update Date	Closing Price	Target Price	Rating
Jul-19-11	47.00	65.00	2
May-24-11	50.38	54.00	3
Mar-22-11	52.41	60.00	3
Jan-07-11	48.00	60.00	2
Nov-22-10	47.13	55.00	2
Oct-16-10	43.35	50.00	2
Sep-13-10	37.21	44.00	2
Jul-21-10	35.33	44.00	3
Jun-15-10	36.45	48.00	3
Apr-21-10	44.66	48.00	2
Jan-27-10	33.57	44.00	2
Nov-17-09	31.57	38.00	2
Sep-22-09	25.60	35.00	2
Jul-21-09	24.39	25.00	3
May-26-09	28.10	25.00	4
Feb-20-09	24.71	25.00	3
Oct-22-08	28.40	30.00	3

**Valuation Methodology:** We value West Fraser Timber on a comparative basis to historical multiples.

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**Risks - Conifex Timber Inc.**

- i) Lumber prices are cyclical, slower than expected economic growth or higher mortgage rates could reduce our price forecasts.
- ii) As sales are denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings.
- iii) Conifex’s logging operations are primarily on Crown land. Government policy changes could negatively affect operating margins.
- iv) Forest product markets are global in nature issues affecting transportation or market access could impact earnings.
- v) Conifex’s bio-energy project is yet to be completed and unforeseen delays in the implementation of the project could also negatively impact our earnings estimates.

**Risks - Canfor Corp.**

Forest product prices are cyclical, worse than expected economic conditions could reduce our price forecasts. ii) As sales are typically denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) Canfor operates on Crown land. Government policy changes could negatively affect operating margins. v) Forest product markets are global in nature issues affecting transportation or market access could impact earnings. vi) Extreme weather conditions or fires could impact harvesting plans and hence earnings.

**Risks - Interfor**

i) Lumber prices are cyclical, slower than expected economic growth or higher mortgage rates could reduce our price forecasts. ii) As sales are denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) Interfor's logging operations are primarily on Crown land. Government policy changes could negatively affect operating margins, iv) Forest product markets are global in nature issues affecting transportation or market access could impact earnings.

**Risks - West Fraser Timber**

Forest product prices are cyclical, worse than expected economic conditions could reduce our price forecasts. ii) As sales are typically denominated in U.S. dollars, a depreciation of the U.S. dollar could negatively affect earnings. iii) West Fraser operates on Crown land. Government policy changes could negatively affect operating margins. v) Forest product markets are global in nature issues affecting transportation or market access could impact earnings. vi) Extreme weather conditions or fires could impact harvesting plans and hence earnings.

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